INDEPENDENT EXPERT REPORT
OF PHILIP TIPPIN FIA
In the matters of

HISCOX INSURANCE COMPANY LIMITED
AND
HISCOX SA

AND IN THE MATTER OF PART VII OF THE FINANCIAL
SERVICES AND MARKETS
ACT 2000

IN THE HIGH COURT OF JUSTICE

DATED 27 JULY 2018

Contents

1. Introduction

The Proposed Transfer

1.1 On 23 June 2016, the UK electorate voted to leave the European Union ('EU'). The consequences of this decision - commonly referred to as 'Brexit' – remain uncertain. The UK formally served notice under Article 50 of the Lisbon Treaty on 29 March 2017 and has commenced a two-year period of staging negotiations regarding the terms of its exit from the EU.

1.2 A potential implication of Brexit for UK insurance companies is the loss of insurance passporting rights (the ability to underwrite on a Freedom of Services or Freedom of Establishment basis).

1.3 The Hiscox Group ('Hiscox') is engaged in a wide range of insurance and reinsurance business through its subsidiaries. Hiscox Ltd is the ultimate parent of Hiscox and is headquartered in Bermuda.

Hiscox currently underwrites business relating to risks in the EU under Freedom of Establishment and Freedom of Services arrangements through Hiscox Insurance Company Limited ('HIC', or 'the Transferor'), an insurance company which is a wholly owned subsidiary of Hiscox Insurance Holdings Limited. HIC is registered in England and Wales and is regulated by the Prudential Regulatory Authority ('PRA') and the Financial Conduct Authority ('FCA'). It also underwrites business in Europe through two Lloyd's Syndicates, which are out of the scope of this work.

Hiscox SA ('HSA', or 'the Transferee') is a subsidiary of Hiscox Ltd and a newly incorporated Luxembourg-based non-life insurer, which will underwrite business in the European Economic Area excluding the UK ('EEA') from 1 January 2019. Please note that references throughout this report to the EEA mean the EEA excluding the UK.

In addition to the above, there are three established intermediaries within Hiscox that introduce business to HIC through delegated authority agreements ('DAAs') whereby they act as agents for HIC: Hiscox Underwriting Limited ('HUL'), Hiscox Europe Underwriting Limited ('HEUL'), and Hiscox Underwriting Services Limited ('HUSL'). HUL, HEUL and HUSL are UK registered. Only HUL and HEUL are relevant for the rest of this report; HUSL is mentioned here only for completeness. HUL introduces business to the UK branch of HIC through regional offices in UK and Ireland, and HEUL introduces business to the EEA branches of HIC.

The proposed transfer ('the Transfer') involves moving all HIC's outstanding EEA customers' liabilities and obligations, as well as those from non-EEA customers with EEA exposures, to HSA – the precise definition of which contracts transfer is shown in section 1.8 below. This transfer will take place under the provision of Part VII of the Financial Services and Markets Act 2000 ('FSMA'), to be sanctioned by the High Court of Justice, England ('the Court').

In this report I refer to HIC and HSA as the 'Transfer Companies'.

The Transfer will move £421.5m of liabilities (and the corresponding assets) from HIC to HSA.

1.4 In addition to the transfer described above, which takes place under the jurisdiction of the law of England and Wales and as such needs to be sanctioned by the Court, a parallel transfer of the Jersey EEA risks within HIC to HSA is proposed in Jersey. The transfer of insurance business carried on in or from within Jersey must be approved by the Royal Court of Jersey. In the unlikely case of this transfer not being approved, the policies in question will remain within HIC until a further solution is agreed upon. For the avoidance of doubt, I have specifically considered the position of Jersey policyholders and my conclusions equally apply to those policyholders affected by the Jersey transfer. I will comment on further developments relating to these policies in a supplemental report, as further described in section 2.7 below.

1.5 In addition to the above, the following related transactions are expected to occur:

- A cross-border merger will occur between Hiscox Vertrieb AG ('HAG') and HEUL. HAG is a former intermediary company within the Hiscox Group and is registered in Germany. This is driven by the aim to establish a more effective and efficient legal structure for Hiscox. It is also part of a wider restructuring of Hiscox which is driven, in part, by the United Kingdom's impending departure from the European Union.

- A cross-border merger will occur between HEUL and HSA. The vast majority of the EEA risks underwritten by HIC are introduced by HEUL and the bulk of its operations are in offices in the EEA, so this cross-border merger transfers all renewal rights, staff contracts, broker arrangements, DAAs and staff from HEUL to HSA (though some of these rights and arrangements will move from HEUL before the Transfer where they are in respect of business transacted at Lloyd's). HSA legally remains Hiscox SA after these cross-border mergers.

The proposed deadline for the Transfer to become effective is 1 January 2019 (the 'Effective Date'). The first cross-border merger is anticipated to occur before the Transfer becomes effective. The second cross-border merger is intended to be effected one minute after the Transfer.

1.6 HSA has been established in Luxembourg in order to underwrite those risks that will not be able to be underwritten by HIC if passporting rights cease. It is also currently unclear whether existing 'passported' insurance contracts will be able to be serviced after Brexit within the law, which means that it could be illegal for HIC to pay some otherwise valid claims to these policyholders. It is therefore proposed that the policies underwritten by HIC for their European customers and any European risks be transferred to HSA through the proposed Transfer in order to protect policyholder rights under their existing policies.

1.7 HSA will underwrite business for European risks and European customers which is currently underwritten by HIC. HSA has been authorised by the Luxembourg Minister of Finance to provide regulated insurance products and services, and has notified the Commissariat aux Assurances de Luxembourg ('CAA') that it will not underwrite any business until the Effective Date.

1.8 HIC will use three main factors to determine which policies are to be transferred from HIC to HSA: the location in which the policy is underwritten, the risk location of the primary policyholder (either an individual or a corporate) and the location of risk.

- If the policy was underwritten in the EEA, or the customer is in the EEA, or the risk location was in the EEA then the policy will transfer.
- For other policies underwritten in the UK only, the EEA exposures within such a policy will transfer, creating a joint policy by adding HSA as additional insurer covering the EEA risks only. This is described in more detail in section 4.1.

Scope and Purpose of this Report

1.9 Under FSMA, a proposed transfer of (re)insurance business from one entity to another can only take place if it has been sanctioned by the Competent Authority for the appropriate jurisdiction, in this case the Court. As part of the approval process a report is required from an expert (the 'Independent Expert') to aid the Court in their deliberations.

1.10 As Independent Expert, it is my duty to the Court to consider the impact of the Transfer on the policyholders of the Transfer Companies, along with any other policyholders affected by the Transfer. In particular, it is my duty to consider the impact on their security and service levels for their benefits as set out in Appendix 2. In this instance, I have not identified any policyholders other than those of the Transfer Companies to be potentially affected.

I confirm that the comments and conclusions in this report apply to all existing policyholders of HIC as at the Effective Date and those to be transferred to HSA, irrespective of their place of residence and/or jurisdiction within which the business is said to be carried on or in which their policy was issued.

1.11 I have prepared this report to address the Part VII transfer of the EEA business of HIC into HSA. This report does not consider any possible alternative arrangements to that referred to in section 1.1. I am not aware of any other significant transaction relating to the Transfer Companies other than the cross-border mergers set out in section 1.1.

1.12 This report describes the proposed transfers and discusses their possible effects on the relevant policyholder groups, including effects on security and levels of service.

This report is organised into seven sections as follows:

Section 1 – The purpose of this report and the role of the Independent Expert

Section 2 – Executive summary and conclusions

Section 3 – Relevant background information on each of the Transfer Companies

Section 4 – Setting out the effect of the Transfer on the Transfer Companies

Section 5 – Discussion of the potential impact of the Transfer on stakeholders

Section 6 – Consideration of the appropriateness of the information provided to me which informs my opinion, including consideration of methodologies for calculations used in provision of data and scenarios following the Transfer taking effect that may affect policyholder security.

Section 7 – Summary of findings on the proposed Transfer.

The Independent Expert

1.13 I, Philip Tippin, am a partner in the actuarial practice of KPMG LLP (‘KPMG’). I have been a Fellow of the Institute and Faculty of Actuaries for 19 years. My detailed curriculum vitae is included in Appendix 1.

1.14 I have been appointed by HIC to act as the Independent Expert in connection with the Transfer. My appointment has subsequently been approved by the PRA on 21 December 2017, following consultation with the FCA.

1.15 To the best of my knowledge, information and belief, I have no conflicts of interest in connection with the parties involved in the proposed Transfer and I therefore consider myself able to act as an Independent Expert on this transaction.

1.16 I confirm that I have no financial interest in the Transfer Companies, nor do I work for any entity belonging to Hiscox. KPMG was auditor of Hiscox until the 2015 year-end, and I served on the audit team at that time. I have not performed client work for any of the entities in Hiscox since that audit, and neither have any of my immediate team assisting me in producing this report. I confirm that over each of the last 3 years, the contribution of Hiscox to KPMG’s global fee income has not exceeded 0.1%, nor has its contribution to KPMG’s UK fee income exceeded 0.5%.

1.17 The costs and expenses associated with my appointment as Independent Expert and the production of this report will be charged to HIC. For the avoidance of doubt, I note that no costs of the Scheme will be borne by policyholders.

1.18 In reporting to the Court on the proposed Transfer my overriding duty is to the Court. This duty applies irrespective of any person or firm from whom I have been instructed or paid.

Reliances

1.19 My role is to produce a report in a form approved by the PRA in consultation with the FCA for submission to the Court. Whilst I have been assisted by my team, the report is written in the first person singular and the opinions expressed are my own. Any review or analysis from my team has been carried out under my supervision.

1.20 My work has been based on the data and other information made available to me by the Transfer Companies. A list of data and other information that I have considered is shown in Appendix 4.

I have not sought independent verification of data and information provided to me by the Transfer Companies, nor does my work constitute an audit of the financial and other information provided to me. Where indicated, I have reviewed the information provided for reasonableness and consistency and with the benefit of my experience this has not raised any concerns. I note that the information has been provided to me by members of the senior management of the Transfer Companies or by responsible senior professionals from the Transfer Companies’ advisors. A representation letter has been provided by an officer of the Transfer Companies in respect of items that cannot otherwise be confirmed. This is shown in Appendix 3 to this report.

Where possible I have obtained audited financial information, and have received reports from independent third parties. In any case I have considered the sources of all data I have received before placing any reliance on it, and have sought representations where I consider it appropriate.

I have met in person or conducted conference calls with representatives of the Transfer Companies to discuss the information provided to me and specific matters arising out of the considerations and analysis conducted. This includes the legal advisers to the Transfer, with whom I have discussed the impact of the Transfer on policyholder protections. This is covered in detail in section 4.19 of this report.

Where significant pieces of information have been provided orally I have requested and received written confirmation.

There are no documents or other information that I have requested that have not been provided to me.

As far as I am aware, there are no matters which should be drawn to the attention of policyholders in their consideration of the terms of the proposed Transfer that I have not taken into account in undertaking my assessment of the proposed Transfer and in preparing my report.

Use and limitations

1.21 This report must be read in its entirety. Reading individual sections in isolation may be misleading.

1.22 Copies of this report will be sent to the relevant UK financial regulators: the PRA and the FCA. This report will be used in evidence in the applications submitted to the Court. It will also be made available to the CAA, policyholders, and other members of the public as required by the relevant legislation, and will be made available on a dedicated website.

This report has been prepared under section 109 of FSMA in a form approved by the PRA on 26 July 2018 in consultation with the FCA.

This report is prepared solely in connection with, and for the purposes of, informing the Court, the PRA, the FCA and policyholders of the Transfer Companies of my findings in respect of the impact of the Transfer on the security and service levels of policyholders (including, for the avoidance of doubt, those who benefit from the cover provided under the relevant insurance policies) and may only be relied on for this purpose. This report is subject to the terms and limitations, including limitation of liability, set out in my firm’s engagement letter of 8 November 2017. An extract from this letter describing the scope of my work is contained in Appendix 2.

This report should not be regarded as suitable to be used or relied on by any party wishing to acquire any right to bring action against KPMG in connection with any other use or reliance. To the fullest extent permitted by law, KPMG will accept no responsibility or liability in respect of this report to any other party, other than as defined in my firm’s engagement letter referenced above.

1.23 In the normal course of conducting my role as Independent Expert, I have been provided with a significant and appropriate amount of information and data about the Transfer Companies’ activities and performance. In forming my view as set out in this report, this information has served a necessary and vital contribution. Due to a combination of legal, regulatory and commercial sensitivities some of the information I have relied upon to reach my conclusions cannot be disclosed in a public report such as this. However I can confirm that appropriate detailed information has been provided to me to enable me to form the opinions I express to the Court in this report.

Professional guidance

1.24 This report has been prepared in accordance with the guidance set out in Part 35 of the Civil Procedure Rules and the accompanying practice direction, including the protocol/guidance for the instruction of experts to give evidence in civil claims (2014) issued by the Civil Justice Council.

This report also complies with the guidance for transfer reports set out in the Statement of Policy issued by the PRA in April 2015 entitled 'The Prudential Regulation Authority's Approach to Insurance Business Transfers' and in Chapter 18 of the Supervision Manual of the FCA Handbook, in particular, sections 18.2.31 to 18.2.41 inclusive, regarding the content and considerations of the report, along with the document 'The FCA's approach to the review of Part VII insurance business transfers' issued by the FCA in May 2018.

In preparing this report I have taken into account the requirements of the Technical Actuarial Standards ('TASs') issued by the Financial Reporting Council. The TAS Standards which apply to the work performed in preparing this report are Principles for Technical Actuarial Work ('TAS 100') and Insurance ('TAS 200'). In my opinion, there are no material departures from any of these TASs in my performance of this work and this report. I have also followed the guidance set out in 'APS X2: Review of Actuarial Work' and this report has been peer reviewed by the reviewer approved by the PRA and FCA in accordance with this guidance.

Terminology

1.25 In my discussion of the effects of the proposed Transfer on the Transfer Companies concerned, I use various technical terms. The definitions of these terms as used in this report are contained in the Glossary in Appendix 5.

In considering the proposed Transfer, the FCA's Treating Customers Fairly ('TCF') principles should be applied. To ensure that customers are treated fairly in the future, it is necessary to establish the ways in which customers have been treated in the past, which I have done by considering the times when policyholders interact with their insurer (which are primarily through the underwriting process, the claims process and any incidental policy administration) and considering how the systems, people and processes associated with these times changes as a consequence of the Transfer, if indeed they do. From the policyholders' perspective, the successful implementation of the Transfer must be on the basis that their benefits and fair treatment are not materially adversely affected.

1.26 I make reference throughout this report to financial items or events that are material or immaterial. I consider an event immaterial if 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 immaterial events. This could be because the event has a very low probability of occurring, a very low financial impact if it did occur, or a combination of these. Similarly a financial item (such as an insurance claim reserve for a particular line of business) is immaterial if its value is very small in the context of the whole, and the probability of significant variability in the value of that item in the context of the whole is similarly small. Conversely material items and events would be of such a size that they could influence the decisions of a reader of this report, and where I have identified these I have considered them specifically in my discussion of the effects of the proposed Transfer.

2. Executive Summary & Conclusions

Overview of the Transfer

2.1 This report considers the impact of the proposed Transfer on affected policyholders of the EEA insurance business of HIC to HSA.

In 1996, Hiscox acquired Economic Insurance Company Limited, changing its name to the Hiscox Insurance Company Limited. It underwrites non-life insurance business and personal and commercial lines in particular. Personal lines includes high-value household, fine art and collectibles, and luxury motor vehicles. Commercial lines are focused on small and medium-sized businesses, in particular professional indemnity and other liabilities including employment liability and property risk. It underwrites business in the UK and in the EEA.

HSA is a newly formed Luxembourg carrier, formed to underwrite and service EEA business following Brexit, including both new business and existing HIC business written in these countries.

2.2 The EEA policies of Jersey policyholders issued by HIC will not transfer to HSA unless the Jersey transfer is approved by the Royal Court of Jersey. In the unlikely case of this transfer not being approved, the policies in question will remain within HIC but will be 100% reinsured to HSA and will also be serviced by HSA. This arrangement will apply from the Effective Date of the Transfer until such time as the Jersey transfer is approved, providing approval is granted on or before 31 December 2019. If the Jersey transfer is not approved by this date, the above arrangement will become business as usual for the relevant policies. I will comment on further developments relating to these policies in a supplemental report, as further described in section 2.7 below.

2.3 The Transfer from HIC to HSA acts to mitigate the risk to policyholders of HIC losing the right to operate in the EEA as a result of the United Kingdom leaving the European Union without an agreement which allows passporting or the ability to underwrite on a Freedom of Services or Freedom of Establishment basis. Any such loss of the right to operate in the EEA could make it illegal to service existing policies or pay valid claims.

2.4 HIC intends to communicate details of the Transfer to their policyholders. HIC proposes to directly notify its policyholders (with the exclusion of specific groups listed below) and also plans to advertise the Transfer through publications in countries which reflect the policyholder population. The advertisements will contain details of a dedicated website from which documentation relating to the Transfer can be downloaded. Contact details for questions or requests will also be provided on the website.

Waivers are being sought in respect of the following groups of policyholders, meaning that they will not be notified of the Transfer individually:

- non-transferring policyholders remaining with HIC;
- property policyholders whose policies lapsed before 31 December 2016;
- joint policyholders and additional insureds under group policies;
- employees under an UK employer's liability policy;
- motor and employer's liability third party claimants whose contact details are unavailable;
- accidentally omitted policyholders;
- deceased policyholders;
- 'goneaway' policyholders for whom no up-to-date address record can be validated;
- Trustees in bankruptcy, receivers and administrative receivers; and
- policyholders for whom no contact details can be traced at all.

There are then further waivers being requested as to the manner of how certain groups of policyholders are being contacted. It is proposed that certain policyholders that only communicate with HIC by email be notified by email; policyholders where another insurer is the lead insurer be notified by the lead insurer or intermediary; and that certain identified intermediaries where HIC does not hold the policyholders' contact details notify their customers on HIC's behalf. New customers that apply for a policy after the Directions Hearing will be given a cover letter with their application that informs them of the Transfer and refers them to the Transfer website: https://www.hiscoxgroup.com/partvii.

2.5 Although it is not part of my scope as Independent Expert I have been asked to comment on the appropriateness of the communications waivers requested in connection with the Transfer. I consider these waiver requests in detail, including the estimated number of policyholders affected by each one, in Appendix 7. I note and accept though that the Court is the ultimate arbiter on the communication required and any waivers in respect of the same, and the PRA and FCA will also have their own opinions on these issues.

When considering the proposed approach to notifications, I have considered a number of factors, including the likelihood of a policyholder having a claim, whether the policyholder's policy is transferring and the impact of the Transfer on the security of the policyholders. I have also considered the practicality of notifying policyholders.

I consider the proposed approach to communicating the Transfer to be appropriate, reasonable and proportionate. I consider that the non-circularisation to the specific groups of policyholders of HIC (as set out above in summary and in Appendix 7 in detail) is appropriate, reasonable and proportionate given the circumstances of those policyholders.

Approach

2.6 My approach to assessing the likely effects of the Transfer on policyholders is to:

- Understand the business of the entities affected by the Transfer; and
- Understand both the financial and non-financial effects of the Transfer on the companies involved.

The above stages are contained in sections 3 and 4 of this report respectively.

Having identified the effects of the Transfer on the various companies and businesses, I then do the following in section 5:

- Identify the relevant groups of policyholders;
- Consider the impact of the Transfer on the security of each group of policyholders and other stakeholders; and
- Consider other non-financial aspects of the impact of the Transfer (for example, policyholder service and the claims handling process).

I then consider some stress and scenario tests in section 6 of this report to determine whether these would change my view of the impact of the Transfer on policyholder groups, and in section 7 present my conclusions.

2.7 Financial and economic information considered

In order to consider the effect of the proposed Transfer on each of the entities and groups of policyholders concerned, I have been provided with comparative information for each legal entity, including:

- Accounting (IFRS) and Solvency II balance sheet information based on the most recently audited financial information as at 31 December 2017 and as at 31 December 2016, and projected figures as at 1 January 2019, 31 December 2019 and 31 December 2020 for all entities;
- Actuarial reserve reports for HIC;

- 2017 Own Risk and Solvency Assessment ('ORSA') for HIC along with the draft 2018 ORSA for HIC;
- The regulatory capital required for each entity as at 31 December 2017 and as at 31 December 2016, and projected figures as at 1 January 2019, 31 December 2019 and 31 December 2020 for all entities; and
- Internal management information provided over the course of preparing this report.

I will issue a supplemental report containing the most up-to-date quarterly financial information prior to the final hearing, at which sanction to proceed with the Transfer will be sought from the Court. This will provide an update to the Court on my conclusions in respect of the effect of the proposed Transfer on the different groups of policyholders, in light of any significant events subsequent to the date of the finalisation of this main report.

In forming my opinion, I have conducted a number of interviews with key personnel responsible for core functions in the Transfer Companies (a complete list of interviewees is provided in Appendix 6), and I have placed reliance on, amongst other information, estimates of the capital required to be held by the Transfer Companies (such that the companies are able to fulfil their policyholder obligations in the event of an extreme event or scenario) provided by the Transfer Companies. I describe how I have used this information in performing my analysis in more detail in section 5.8. In order to satisfy myself that these estimates are an appropriate basis on which to form an opinion, I have considered:

- The appropriateness of the methods used by the Transfer Companies to calculate the estimates of capital requirements; and
- The impact of a set of specific severe adverse events on each of the Transfer Companies pre- and post-Transfer in order to gain comfort that, at a high level, the capital estimates are reasonable.

Key Assumptions

2.8 In conducting my analysis I have assumed the following:

- The Transfer is to be broadly tax neutral for all of the Transfer Companies, because any tax liability that does emerge will be indemnified by Hiscox. Details on the initial advice provided by Hiscox's specialist tax advisors is contained in section 4.6 and 4.7.
- In the unlikely event of the UK leaving the EU before the Effective Date, the UK will still follow the EU-wide prudential regulatory regime known as Solvency II, or an equivalent, going forward. I note though that the negotiations to lead to any exit of the EU can last up to two years from the point at which the UK Government formally gave notice to leave by triggering 'Article 50' on 29 March 2017, which most likely extends beyond the proposed Effective Date of this Transfer.
- HIC will continue to underwrite new business following the Transfer for non-EEA customers. Following the Transfer, HSA will start underwriting new business.

The above assumptions underlie the analysis and conclusions in my report. If these assumptions were to change my opinion may also change. At the time of writing my report the above assumptions are the current intentions for the Transfer and the Transfer Companies and I have received written representations from the Transfer Companies substantially similar to Appendix 3 confirming my understanding.

Findings

2.9 The findings of my report are summarised below. The detailed explanation behind these conclusions follows in the body of this report:

- I have identified three distinct policyholder groups. These are:

  i) transferring HIC policyholders currently protected by the Financial Services Compensation Scheme ('FSCS') (these are a subset of the transferring retail and small commercial policyholders);

  ii) transferring HIC policyholders not protected by the FSCS (being all transferring policyholders not included in (i) above); and

  iii) Non-transferring HIC policyholders.

  Note that there will be no policyholders in HSA before the Effective Date.

- The split of transferring to non-transferring policyholders is roughly 35%:65%. Given the eligibility criteria for FSCS protection it is not possible to determine precisely whether an individual policyholder is covered, but Hiscox estimates that the number of non-FSCS policyholders is under 5% of the total transferring and that the vast majority (greater than 95%) are protected.

With respect to non-transferring policyholders of HIC I conclude that:

Based on the analysis that I have carried out in sections 5 and 6 of this report I note that:

(a) The policies remain with HIC after the Transfer;

(b) The anticipated capital coverage of HIC is largely unchanged by the Transfer, and remains at a comfortable level of greater than 120% of the regulatory requirements. Reserving and other financial policies remain unchanged, and therefore the chance that HIC would not be able to meet its respective future obligations in full remains remote;

(c) Changes in claims handling, the ability to make new claims, the protection of policyholder data, and any changes in the overall treatment of customers as a result of the Transfer do not have any material impact on the existing HIC policyholders; and

(d) The potential impact of Brexit and its consequences does not have any effect on non-transferring HIC policyholders, as they are not exposed to EEA risks.

With respect to transferring policyholders of HIC I conclude that:

Based on the analysis that I have carried out in sections 5 and 6 of this report I note that:

(a) The policies move from HIC to HSA;

(b) The capital coverage of HSA is similar to that of HIC pre-Transfer from that of HIC pre-Transfer, and remains at a comfortable level of greater than 120% of the regulatory requirements. Reserving and other financial policies remain unchanged, and therefore the chance that HSA would not be able to meet its respective future obligations in full is remote;

(c) There are no material changes to the claims handling (and none at all except for customers in Ireland), ability to make new claims, protection of policyholder data, or any changes in the overall treatment of customers as a result of the Transfer. Furthermore, the contact points for customers will remain the same even though the insurance carrier supporting their policy has changed;

(d) With regard to whether transferring policyholders currently have access to the FSCS:

(i) Those policyholders that currently benefit from FSCS protection will retain that entitlement post-Transfer until the policy is renewed; and

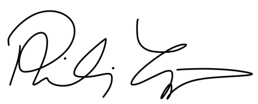
(ii) Those policyholders that do not currently benefit from FSCS protection will still have no protection from the FSCS post-Transfer, and their situation has not been adversely affected as a consequence of this.

(e) The potential impact of Brexit on transferring policyholders were the Transfer not to happen is that the transferring policies would not legally be able to be serviced, and consequently valid claims may not legally be able to be paid. The Transfer completely removes this risk, and therefore creates a benefit for this group of policyholders.

I have considered the Transfer and its likely effect on each of the policyholder groups. I have concluded that the risk of any policyholder being adversely affected by the proposed Transfer is sufficiently remote for it to be appropriate to proceed with the proposed Transfer as described in this report.

Expert's declaration

2.10 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.



Philip Tippin
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27 July 2018

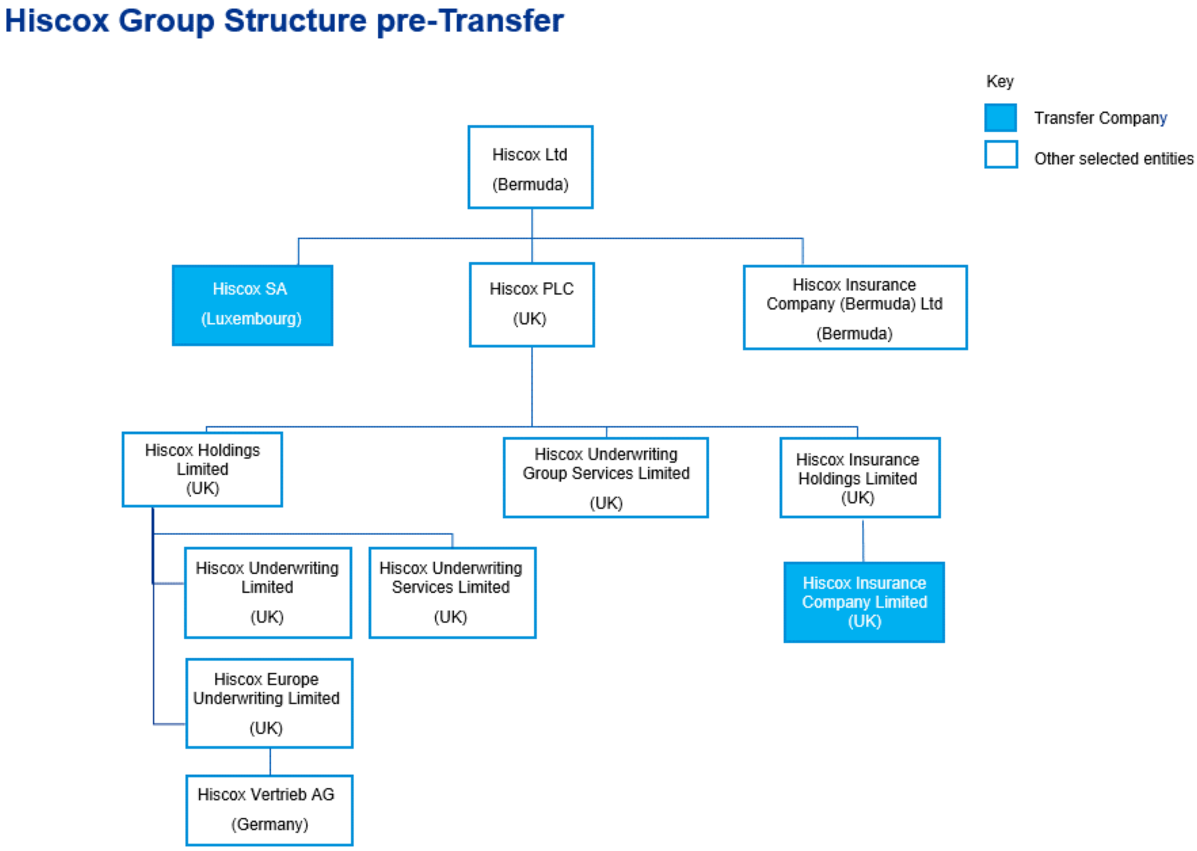
3. Background

Hiscox Insurance Company Limited ('HIC')

3.1 HIC is a UK authorised insurer and a wholly owned subsidiary of Hiscox Insurance Holding Limited and forms part of the Hiscox Group. The ultimate parent is Hiscox Ltd, a Bermudan based holding company which is listed on the FTSE 250 on the London Stock Exchange. In 1996, the Hiscox Group acquired the Economic Insurance Company, changing its name to the Hiscox Insurance Company, with the aim of widening activities outside of Lloyd's and to underwrite regional specialist risks. It underwrites non-life insurance business and personal and commercial lines in particular. Personal lines includes high-value household, fine art and collectibles, and luxury motor vehicles. Commercial lines are focused on small and medium-sized businesses, in particular professional indemnity and other liabilities including employment liability and property risk. It underwrites business in the UK, Ireland and all other EU member states, typically via two wholly-owned internal agency firms, HEUL and HUL.

Given Hiscox's capital position and its support for HIC, HIC has an A.M. Best credit rating of A (Excellent), an S&P rating of A (Strong) and a Fitch rating of A+ (Strong), with net assets of £244m at the end of 2017.

The chart below shows the simplified group structure of relevant entities in Hiscox immediately before the time of the Transfer.



3.2 HIC is authorised by the PRA, regulated by the PRA and the FCA, and as a consequence is a member of the FSCS.

The FSCS is a statutory scheme funded by members of the UK financial services industry. It provides compensation to individual holders of policies issued by UK insurers in the UK or another EEA state who are eligible for compensation under the FSCS in the event of the insurer's default.

Under current FSCS rules, liability claims which are subject to compulsory insurance or professional indemnity insurance or claims which arise from death or incapacity of a policyholder due to injury to sickness are 100% protected and other types of policies are 90% protected. Reinsurance contracts, as well as Goods in Transit, Marine, Aviation and Credit Insurance are not covered by the FSCS. As I note in section 2.9, Hiscox estimate that under 5% of policies transferring are not covered by the FSCS.

The table below provides an overview of the audited annual financial performance of HIC from 31 December 2013 to 2017 on an IFRS basis.

HIC (£'000)	2017	2016	2015	2014	2013
Net Earned Premium	337,411	294,457	287,761	281,305	270,208
Profit/(Loss) after tax	**8,411**	**25,732**	**25,136**	**13,412**	**23,980**
Gross Insurance Liabilities	902,245	812,804	719,535	656,413	633,291
Other Liabilities	221,041	228,966	145,675	185,912	165,031
Total Liabilities	**1,123,286**	**1,041,770**	**865,210**	**842,325**	**798,322**
Reinsurance Assets	456,467	412,300	346,211	302,226	276,833
Other Assets	910,260	904,500	788,297	784,261	772,239
Total Assets	**1,366,727**	**1,316,800**	**1,134,508**	**1,086,487**	**1,049,072**
Net Assets	**243,441**	**275,030**	**269,298**	**244,162**	**250,750**

Source: Financial Statements; IFRS; Management Accounts

The table below provides an overview of the Solvency II balance sheet as at 31 December 2016 and 31 December 2017. The Solvency II balance sheet values assets and liabilities on a different basis to IFRS. This is discussed further in section 3.12.

HIC (£'000)	2017	2016
Gross Solvency II Technical Provisions	532,595	520,218
Risk Margin	17,017	16,164
Other Liabilities	71,956	78,927
Total Liabilities	**621,568**	**615,308**
Reinsurance Assets	240,648	242,906
Other Assets	651,262	660,009
Total Assets	**891,910**	**902,914**
Net Assets	**270,342**	**287,606**
Own Funds	**270,342**	**247,606**
SCR	**193,323**	**184,737**
Capital Cover Ratio	**140%**	**134%**

Source: Financial Statements; SII Balance Sheets

The 31 December 2017 figures indicate that HIC is well capitalised and have excess of assets over liabilities, with a Capital Cover Ratio (the ratio of Own Funds to SCR, as defined in section 5.9) of 140%. The Own Funds for HIC as at 31 December 2016 were £40m less than the net assets – this is because of foreseeable dividends that were paid in two tranches in February and May 2017. A dividend of £35m is planned for the second quarter of 2018 – assuming no other material changes this will reduce the available Own Funds such that the Capital Cover Ratio (as defined in section 5.9) will be 122% by 30 June 2018.

Outwards reinsurance programmes

3.3 HIC has purchased reinsurance protections to mitigate their insurance risks. These protections are typical of those used by other insurance companies for the types of insurance business underwritten by the Transfer Companies.

This includes Excess of Loss ('XL') reinsurance on the Property and Liability portfolio, as well as Quota Share ('QS') arrangements on Employer's Liability, Professional Indemnity and Construction Bonds. This is not an exhaustive list of covers, but briefly describes the material covers that are available to protect against new claims and events. These reinsurance protections are purchased from companies outside the Hiscox group.

HIC has an internal 70% QS arrangement with Hiscox Insurance Company Bermuda ('HIB') in respect of its Liability business in addition to any of the other covers mentioned above. This helps to reduce peak exposures in the case of liability clash claims (where a single event can trigger claims on policies in multiple liability lines of business). In order to mitigate the counterparty credit risk associated with such a large reinsurance, ring-fenced collateral accounts have been established to support the liabilities associated with this contract.

Policy and claims administration

3.4 Business is currently placed with HIC primarily through HUL and HEUL, internal intermediaries that have DAAs with HIC for both underwriting and claims. Under the current operating model, HUL and HEUL establish contracts of insurance between customers and HIC, and HUL and HEUL are able to handle and settle claims on behalf of HIC for risks in the UK and EEA.

HEUL introduces business directly to the European branches of HIC from non-UK EEA countries. It provides operational and policy administration services from Lisbon and EU branches for HIC business.

HUL currently has a branch in Ireland with a team of underwriters and regional management; Irish business is currently managed as part of the UK operation. The back office team is based in Lisbon with 3 full time equivalents, whereas claims handling, finance and IT are all provided from the UK.

Employers' Liability Tracing Office ('ELTO') system

3.5 ELTO is set up to provide claimants, insurers, policyholders, and other interested parties with access to a database of Employers' Liability ('EL') policies through an online search engine. The system can be used, for example, to find the insurer of a previous employer where the claimant has suffered from injury/disease caused by previous employment. ELTO requires all insurers to upload the details on all new and renewed EL policies from April 2011 and any policies prior to that which have had new claims made against them after this date. HIC is a member of ELTO and HSA will register with ELTO with respect to UK exposure underwritten in Ireland.

Hiscox SA ('HSA')

3.6 HSA is a European subsidiary of Hiscox Ltd, established as a result of HIC's need to both continue underwriting insurance business and service pre-existing insurance business in the EEA after Brexit.

3.7 HSA is established and authorised in Luxembourg and regulated by the CAA. HSA is required to establish technical provisions for all the liabilities arising from the insurance contracts that have been concluded, for the entirety of its insurance activities. Such technical provisions must at all times be covered by equivalent and matching assets ("Segregated Assets") held with a custodian bank under a standard tri-partite agreement between the insurance company, the custodian bank and the CAA. The Segregated Assets constitute a separate pool of assets, which must be clearly segregated from the other assets and liabilities of the insurance company. The Segregated Assets are allocated, in absolute preference and priority, to the guarantee of the payment of insurance claims payable by the insurance undertaking to its insurance creditors. If the insurance undertaking becomes insolvent, the insurance creditors are paid out of Segregated Assets preferentially and in priority to other creditors.

Policyholders have access to an Insurance Ombudsman run by the ACA and the ULC and can address complaints directly to the CAA.

For any complaints regarding the UK branch of HSA, policyholders will have access to the FOS; The FOS is an independent public body that aims to resolve disputes between individuals and

UK financial services companies. It may make compensation awards in favour of policyholders. Only holders of policies that constitute business carried out in the UK are permitted to bring complaints to the FOS.

The Insurance Ombudsman described here is the Luxembourg equivalent of the FOS with regard to insurance companies.

I discuss in more detail the differences in policyholder protections between Luxembourg and the UK in section 4.19.

3.8 At the date of this report HSA has not underwritten any policies. It is intended that HSA will begin underwriting EU renewals from the HIC portfolio and new business from the Effective Date of the Transfer.

Insurance business of the Transfer Companies

3.9 As a consequence of the Transfer, all insurance, obligations and outstanding claims liabilities relating to EEA policies, along with EEA risks currently covered under non-EEA policies, as well as certain other assets and liabilities of HIC will transfer to HSA.

The table below shows comparative metrics for the Transfer Companies at the last audited date available. Open claims information is provided for HIC in order to give an indication of the outstanding claim volumes transferring to HSA. Reserve information is provided for all Transfer Companies in order to give perspective on the size of the entities involved.

€1 = £0.88 (£'000)	Current				Transferring			
	Open Claim Numbers as at 31 Jan 2018	Gross Outstanding Claims as at 31 Jan 2018	Q4 2017 Gross TPs as at 31 Dec 2017	Q4 2017 Net (of RI) TPs as at 31 Dec 2017	Open Claim Numbers as at 31 Jan 2018	Gross Outstanding Claims as at 31 Jan 2018	Q4 2017 Gross TPs as at 31 Dec 2017	Q4 2017 Net (of RI) TPs as at 31 Dec 2017
HIC UK	284,157	180,198	347,726	163,661	12,755	24,940	42,325	11,157
HIC Europe			184,869	128,286			176,603	128,286
Total	**284,157**	**180,198**	**532,595**	**291,947**	**12,755**	**24,940**	**218,928**	**139,443**

Source: Management information

The table below shows the number of policies transferring from HIC to HSA, split into lines of businesses, and identified based on underwriting regions and whether the policies are live, or have already expired ('tail' policies). Please note that one policy is able to have multiple lines of business on it, therefore the total number of lines of business transferring will exceed the total number of policies transferring. For example, a policy which has the lines of business *HIC EU General Liability* and *HIC EU PI* would be counted twice in the table below, but only once in the policy calculations elsewhere in this document.

Line of Business (UK & Ireland)	UK Live	UK Tail	Ireland Live	Ireland Tail	Block Booked	No. Transferring
HIC UK&I Business Interruption	0	0	0	0	754	**754**
HIC UK&I Commercial Property	905	898	5,641	6,064	3,801	**17,309**
HIC UK&I Cyber	26,848	0	945	0	0	**27,793**
HIC UK&I Employers Liability	2,888	1,065	8,469	8,607	3,059	**24,088**
HIC UK&I Fine Art	38	82	17	22	0	**159**
HIC UK&I Household	3,361	25,366	1,883	4,471	0	**35,081**
HIC UK&I Management Liability	22,009	114	1,213	2	754	**24,092**
HIC UK&I Motor Liability	27	0	7	0	0	**34**
HIC UK&I Motor Property	27	0	7	0	0	**34**
HIC UK&I Legal Protection	0	0	0	0	1,502	**1,502**
HIC UK&I Personal Accident	0	0	0	0	1,506	**1,506**
HIC UK&I PI	4,444	0	6,247	0	6,448	**17,139**
HIC UK&I Public Liability	1,255	4,334	10,137	10,070	6,407	**32,203**
HIC UK&I Surety	0	0	35	129	13,243	**13,407**
HIC UK&I TMT	59,764	0	1,312	0	0	**61,076**
HIC UK&I Travel	0	0	0	0	2	**2**
Total (UK & Ireland)	**121,566**	**31,859**	**35,913**	**29,365**	**37,476**	**256,179**

Line of Business (EEA)	EU Live	EU Tail	Block Booked	No. Transferring
HIC EEA Commercial Property	10,968	6,991	1,447	**19,406**
HIC EEA Cyber	5,488	739	0	**6,227**
HIC EEA Fine Art	6,135	10,172	68	**16,375**
HIC EEA General Liability	68,916	29,979	0	**98,895**
HIC EEA Household	31,295	48,990	10,042	**90,327**
HIC EEA Management Liability	27,033	13,481	4,142	**44,656**
HIC EEA Motor Liability & Property	0	0	41,521	**41,521**
HIC EEA Motor Property	3,693	4,097	1,251	**9,041**
HIC EEA Personal Accident	0	0	686	**686**
HIC EEA PI	55,130	29,401	12,424	**96,955**
HIC EEA Surety	100	5,196	0	**5,296**
HIC EEA TMT	33,662	19,281	3,401	**56,344**
Total (EEA)	**242,420**	**168,327**	**74,982**	**485,729**

Source: Management information

I also note that Jersey policy numbers are as follows:

- 378 live Jersey policies of which 350 have EU exposure, with the 350 policies included in the 'UK Live' column in the table above;
- 302 lapsed Jersey polices of which 244 have EU exposure, with the 244 policies included in the 'UK Tail' column in the table above; and
- 403 cancelled Jersey policies of which 370 have EU exposure, with the 370 policies included in the 'UK Tail' column in the table above.

3.10 Business underwritten by HIC

HIC underwrites non-life insurance business and, in particular, personal and commercial lines. Personal lines include high-value household, fine art and collectibles, and luxury motor vehicles. Commercial lines are focused on small and medium-sized businesses, in particular professional indemnity and other liabilities including employment liability and property risk. It writes these lines across Europe.

3.11 Policyholder mix

As can be seen from the tables in 3.9 above, there are a substantial number of policies transferring where the policyholders would be individual customers rather than companies. A subset of these policyholders, together with certain of the smaller commercial customers, will qualify to be protected by the FSCS currently. Given the numbers of such policyholders in HIC I will consider the interests of the FSCS protected policyholders separately from those without protection in my analysis in Section 5 of this report.

Prudential capital requirements

3.12 The Transfer Companies are currently subject to a prudential capital regime which requires them to meet a solvency capital requirement calibrated to ensure that policyholders are secure at the 99.5% confidence level of potential future liability outcomes over a single year.

This is part of the EU wide regulatory regime for insurance companies known as 'Solvency II', which was introduced with effect from 1 January 2016.

Other key requirements of this regime are as follows:

- Insurance entities must calculate their Solvency II capital requirement ('Solvency Capital Requirement' or 'SCR') either using a set of rules specified in EU legislation (the 'Standard Formula'), or, subject to the approval of their regulator, using an internally developed Economic Capital model (an 'Internal Model'). In either case, the determinants of the solvency capital requirement relate to the nature of the risks within the regulated entity, including market related investment risk, insurance risk arising from new business or existing liabilities, and other business risks including credit risk and operational risk.

- Both HIC and HSA calculate their SCR using the Standard Formula approach. There are no current plans for either company to apply for Internal Model approval in the near future, so the SCRs for each company will continue to be based on the Standard Formula for the foreseeable future.

- Regulatory capital requirements are defined in terms of an SCR and a Minimum Capital Requirement (‘MCR’). The requirements are calculated based on a complex formula based on items including the technical provisions, written premiums, reinsurance, deferred tax and administrative expenses.

- The method with which insurance entity balance sheets and the definition of capital are calculated for regulatory purposes is now based on largely economic measures of assets and liabilities, rather than accounting based measures.

- A range of minimum standards relating to insurance entity governance and disclosure have been introduced (known as ‘Pillar II’ and ‘Pillar III’), including a requirement to perform and document an ORSA.

- If an insurer's available resources fall below the SCR, then supervisors are required to take action with the aim of restoring the insurer’s finances back to the level of the SCR as soon as possible. If, however, the financial situation of the insurer continues to deteriorate, then the level of supervisory intervention will be progressively intensified. The aim of this 'supervisory ladder' of intervention is to identify any ailing insurers before a serious threat to policyholders' interests is realised. If, despite supervisory intervention, the available resources of the insurer fall below the MCR, then 'ultimate supervisory action' will be triggered. This means that the insurer's liabilities could be transferred to another insurer, the licence of the insurer withdrawn, the insurer closed to new business and its in-force business liquidated.

I note that:

- Luxembourg is also subject to Solvency II regulation.

- I have reviewed the Solvency II Standard Formula calculations of the Transfer Companies to compare the relative difference in policyholder positions before and after the transfer of liabilities. The appropriateness of this approach and more detailed description of this analysis can be found in section 5.9 below.

- I have considered the stress tests included within the ORSA produced by HIC on each of the Transfer Companies in determining the stress tests to apply when considering the policyholder security for each policyholder group in section 6 below.

Capital management policy

3.13 HIC targets a Capital Cover Ratio of above 120% of SII available capital to SII SCR in normal trading conditions. Upon inception, HSA is expected to follow the same capital management policy.

3.14 HIC has no specific dividend policy, however dividend payments are calculated on the surplus funds over and above the agreed HIC minimum requirement with allowance made for SCR compliance. HSA is expected to follow the same policy.

3.15 The minimum regulatory capital cover levels implied by the risk appetites within the intended capital management policies for both Transfer Companies are sufficiently in excess of the regulatory minimum such that the probability of policyholder default remains a remote possibility.

Guarantees / risk sharing arrangements

3.16 HIC and HSA have confirmed that there are no guarantees or risk sharing arrangements currently in place other than the reinsurance arrangements described in section 3.3.

Pension Scheme Obligations

3.17 The statutory employer of the defined benefit pension scheme for the people who perform services for the Transfer Companies is the service company Hiscox Underwriting Group Services Limited ('HUGS'), and not HIC or HSA. The statutory employer sponsors the scheme and is legally responsible for its funding. Hiscox management have informed me that HIC has not employed any of the staff eligible for the pension scheme since 1 April 2001, and HSA never has. The scheme has been closed to new members since 31 December 2000 and to future accrual of benefits since 31 December 2006.

Hiscox PLC, the parent of HUGS, has provided a guarantee to HUGS, which I have reviewed, and this provides that if HUGS were to fail to meet its obligations to the Scheme, then Hiscox PLC would meet the first £50m of any resulting liability.

Historically 37.1% of any movements in surplus or deficit had been recharged to HIC as an operating expense, however I understand from the external legal advice to HIC (which I have seen) that this does not create a legal recourse to this entity. Going forward I have been advised by Hiscox management that there will be no recharge to HIC, so policyholder security within HIC and HSA should not be affected by any future potential from the pension scheme.

Despite this, I have been advised by pensions specialists within my team that The Pensions Regulator has wide-ranging powers in the event of a default, and would be able to look to other members of Hiscox Group in order to collect funds, so I have considered further the impact of an extreme event on the pension scheme. I discuss this further in section 5.7.

4. Effects of the Transfer

How does the Transfer work?

Which policies will transfer to HSA?

4.1 HIC will use three main factors to determine which policies are to be transferred from HIC to HSA.

- The first consideration is the location in which the policy is underwritten; if the policy was underwritten in one of HIC's EEA branches initially, it will be transferred to HSA.
- HIC then considers the risk location of the primary policyholder/head office; if the location of the primary policyholder is the EEA, then the policy will be transferred to HSA. Primary policyholder is defined in Appendix 5 of this report.
- The final consideration is the location of risk. Here the Solvency II definition of risk location is followed e.g. if a policy covers a French property, then the property risk and any related covers are deemed to be French risk. Policies with only EEA risks will be transferred to HSA. For policies which cover risks in multiple locations (hereafter referred to as split risks), the EEA component of the policy will be transferred to HSA, with UK and Rest of World covers remaining with HIC.

For avoidance of doubt, a policy will transfer if it falls into just one of the above categories; it does not have to satisfy all of them.

Collectively I refer to the policies that transfer to HSA from HIC as the transferring policies. Those that will remain with HIC I refer to as non-transferring policies.

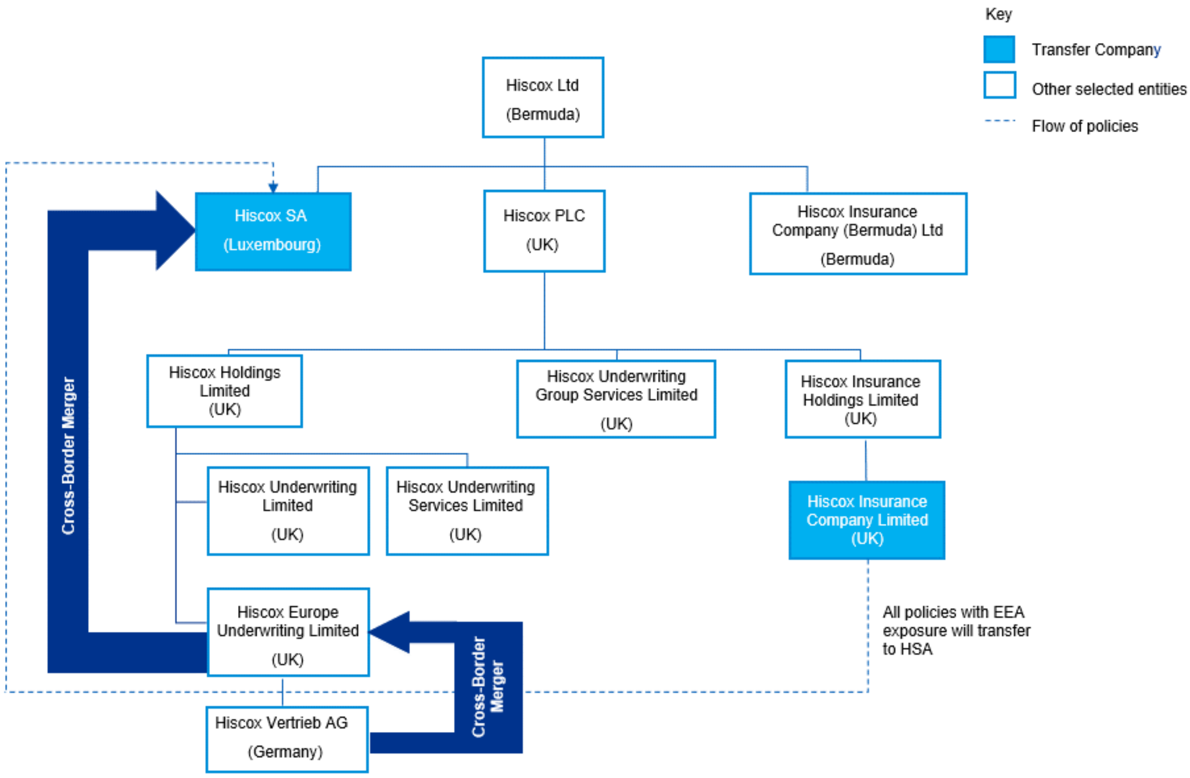
Financial effects of the Transfer

Effect of the Transfer on the Hiscox Group structure

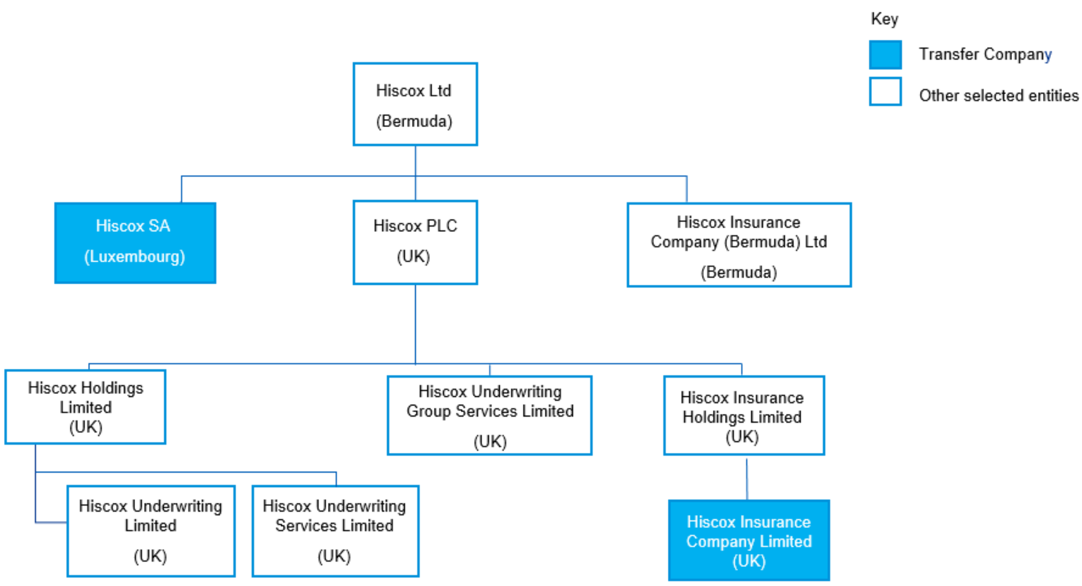
4.2 As a consequence of the Transfer the insurance obligations relating to transferring policies and certain other assets and liabilities of HIC will transfer to HSA.

The simplified group structure chart after the Transfer shows the Hiscox structure highlighting which entities will retain insurance liabilities after the Transfer.

Hiscox Group Structure with Mergers and Transfer Shown



Hiscox Group Structure post-Transfer



Please note that prior to the above Transfer, two cross-border mergers will occur merging HAG into HEUL, and then HEUL into HSA.

The impact of the cross-border mergers (that of HAG and HEUL, and of HEUL and HSA seen in the structure charts above) is twofold. The merger of HAG into HEUL is a streamlining exercise; HAG is a former intermediary company within Hiscox that introduced business in Germany. It has been in run off for some time. HEUL is currently the intermediary that introduces business to the European branches of HIC. By merging into HSA this effectively transfers the renewal rights for the HEUL introduced policies to HSA. There are no known mis-selling or similar risks being transferred as part of the cross-border mergers into HSA. Whilst there are hypothetical risks that could crystallise in future time periods, there are none that have been identified by Hiscox. As these risks are hypothetical at this point in time and no specific instance has been identified, I have not explicitly considered these risks further in my analysis. I note though that under Solvency II there is a consideration of operational risk in the calculation of the SCR for a business, so there is some allowance for as yet unidentified future risks to be covered.

For avoidance of doubt, HSA will retain the same company name and legal status post-Transfer and cross-border mergers. The starting balance sheets for HSA that I refer to in this report all include the impact of the cross-border mergers already.

Effect of the Transfer on Transfer Company balance sheets

4.3 I have carried out my analyses based on figures as at 31 December 2016 and 31 December 2017, as well as projected figures as at 1 January 2019, 31 December 2019 and 31 December 2020, for the purposes of this report. I will update the analyses to reflect the most recent quarterly financial information in a supplemental report when these updated figures are available.

4.4 The tables below illustrate the projected IFRS financial position of the Transfer Companies following the Transfer based on the financial position of the Transfer Companies at 01 January 2019, 31 December 2019 and 31 December 2020 assuming that all related assets and liabilities at each date were to transfer to HSA:

All figures in £

€1 = £0.88	As At 01 January 2019				As At 31 December 2019		As At 31 December 2020	
IFRS Balance Sheet (£'000)	HIC (pre-Transfer)	HSA (pre-Transfer)	HIC (post-Transfer)	HSA (post-Transfer)	HIC (post-Transfer)	HSA (post-Transfer)	HIC (post-Transfer)	HSA (post-Transfer)
Assets								
Financial Investments & Cash	588,310	47,673	367,804	130,014	409,355	122,011	465,431	130,961
Unearned Reinsurance Premiums	165,639	-	115,188	82,764	137,763	91,143	163,471	103,930
Reinsurance Claims Outstanding	343,734	-	232,480	220,593	258,178	240,087	290,002	262,768
Insurance Debtors	200,021	76,614	162,172	51,469	186,949	58,431	215,493	66,877
Reinsurance Debtors	21,260	-	13,731	6,705	15,952	7,658	19,594	8,679
Other Debtors	6,949	3,831	2,385	8,394	2,741	9,530	3,163	10,888
Prepayments and Accrued Income	136,357	-	83,428	37,384	88,220	42,441	95,796	48,186
Total Assets	1,462,270	128,118	977,189	537,325	1,099,158	571,301	1,252,950	632,290
Liabilities								
Unearned Premium Reserve	356,840	-	241,194	115,646	277,547	127,674	320,217	146,195
Claims Outstanding	640,909	-	397,716	243,193	439,243	264,940	489,462	290,163
Insurance Creditors	28,531	61,465	21,250	7,281	24,653	8,316	28,778	9,407
Reinsurance Creditors	71,421	-	50,538	48,972	59,165	35,613	69,979	40,624
Other Creditors	67,828	25,396	56,074	24,068	58,569	27,323	62,616	29,690
RI DAC	73,523	-	52,027	31,661	61,006	35,944	72,540	40,438
Other Liabilities	9,691	-	8,407	1,283	-	3,386	9,388	3,679
Total Liabilities	1,248,744	86,861	827,206	472,104	920,184	503,197	1,052,982	560,196
Net Assets	213,526	41,256	149,983	65,221	178,974	68,104	199,968	72,093

Source: Financial statements; IFRS; Management Information.

HIC's net assets reduce from £213.5m to £150.0m after the Transfer, though it is anticipated that not all of the dividend that effects this change will have been made by 31 December 2018. The balance, though expected to be paid, would be available to cover events that happen between the date of this report and the Effective Date. I will revisit this point in my supplemental report before the final Sanctions Hearing. The HSA balance sheet pre-Transfer reflects the assets and liabilities of HAG and HEUL that have merged in; it has underwritten no insurance business at this stage. HSA's increase, and the balance of the assets are transferred to HIB under the enlarged reinsurance arrangement discussed in section 4.8. The reinsurance items change in aggregate because of the increased cession to HIB (discussed in section 4.8 below).

4.5 The tables below illustrate the projected Solvency II financial position of the Transfer Companies as at 1 January 2019, 31 December 2019 and 31 December 2020, following the Transfer.

All figures in £000s

£1=€0.88	As At 01 January 2019				As At 31 December 2019		As At 31 December 2020	
Solvency II Balance Sheet	**HIC (pre-Transfer)**	**HSA (pre-Transfer)****	**HIC (post-Transfer)**	**HSA (post-Transfer)**	**HIC (post-Transfer)**	**HSA (post-Transfer)**	**HIC (post-Transfer)**	**HSA (post-Transfer)**
Assets								
Investment and Cash	635.0	29.3	410.5	121.7	451.3	116.9	507.6	131.4
Reinsurer's Share of Technical Provisions	308.7		215.2	225.2	243.4	266.7	276.1	293.1
Receivables	19.6	12.9	12.6	17.9	14.5	20.3	16.7	23.2
Other	0.0		-	-	-	-	-	-
Total Assets	963.2	42.2	638.3	364.8	709.3	403.9	800.5	447.7
Liabilities								
Technical Provisions (excl. Risk Margin)	615.4		384.4	280.5	428.7	304.7	480.5	336.8
Risk Margin	17.9		9.9	3.2	10.8	2.2	11.9	2.5
Insurance and Reinsurance Payables			-	-	-	-	-	-
Payables (trade, not insurance)	67.8	25.4	56.1	27.4	58.6	31.1	62.6	33.8
Solvency II DTL Adjustment	7.4		5.6	(5.8)	6.1	(4.1)	6.8	(3.1)
Other	9.7		8.4	1.5	8.8	3.9	9.4	4.2
Total Liabilities	718.2	25.4	464.4	306.9	513.0	337.8	571.3	374.3
Net Assets	**245.0**	**16.8**	**174.0**	**57.9**	**196.3**	**66.0**	**229.2**	**73.4**
Eligible Own Funds	**245.0**		**174.0**	**57.9**	**196.3**	**66.0**	**229.2**	**73.4**
SCR 2019 *	**215.9**		**143.6**	**48.4**	**163.7**	**54.9**	**189.1**	**59.5**
Capital Cover Ratio 2019 *	**113%**		**121%**	**120%**	**120%**	**120%**	**121%**	**123%**
Capital Cover Ratio (HIC 2018 SCR)	**127%**							

** HIC pre-Transfer 2019 ratios calculated as though Brexit were not happening and the business could continue to underwrite as now for comparison with the sum of the parts*

*** HSA does not have a pre-Transfer Solvency II balance sheet as it has not underwritten insurance business. These numbers reflect the balance sheet after the cross-border mergers re-expressed in Solvency II terms*

Source: SII Balance Sheet

The table also shows the eligible Own Funds of each entity (i.e. the available capital that is used for calculating the capital coverage under Solvency II regulatory purposes). In this particular instance, HIC and HSA do not have any ring-fenced funds that restrict how much of their net assets can contribute to their capital position. Again, the HSA position pre-Transfer is made up of the assets and liabilities merged in from HAG and HEUL and expressed in Solvency II terms – it does not strictly have a Solvency II balance sheet pre-Transfer.

HIC and HSA are projected to hold capital equivalent to a Capital Cover Ratio of 120% to 123% post-Transfer throughout the period from 1 January 2019 to 31 December 2020. Pre-Transfer HIC is anticipated to have a 127% Capital Cover Ratio by 31 December 2018 based on the 2018 SCR calculation. I have also shown the Capital Cover Ratio for HIC if the 2019 SCR were to be calculated on the same basis as the 2018 SCR. This assumes that HIC can continue to underwrite EEA business after 29 March 2019 – this currently is not the case, but provides the natural comparison to the post-Transfer split of business capital requirements. This ratio is 113%, but this takes into account a dividend paid in June 2018 which anticipates this Transfer (on the basis that HIC will not be able to underwrite EEA business after 29 March 2019).

The Solvency II balance sheets above do not match if you sum each line before and after the Transfer. The primary reasons for this are:

- Capital position changes – HIC's capital requirement will drop materially because of the loss of EEA underwriting, and HSA will be additionally capitalised. Therefore, due to the reduced capital needs of HIC, it will pay a dividend to Hiscox Group. The net impact of this is a reduction in the overall cash and investments of £41.7m.
- Reinsurance arrangement changes – cancellation of the existing 70% commercial quota share arrangement between HIB and HIC for transferring policies; this will still remain in place for non-transferring HIC policies). This will be replaced with a 90% loss portfolio transfer on all (not just commercial) existing risks. There will also be a new 90% quota share arrangement put in place for new risks written in HSA. These changes are discussed further in section 4.8 below).These changes affect most of the lines above on the asset side.
- Other minor adjustments (largely intragroup cancellations).

The risk margin is an amount required under Solvency II to be included in the technical provisions. It is intended to provide for the risk that claims liabilities deteriorate further than allowed for in the capital requirement which only considers the risks of deterioration over a one-year period rather than until the expiry of the liabilities. As part of my work I have reviewed the documents which contain the calculation of, and the methodology for the calculation of, the HIC risk margin, as the basis of the risk margin numbers included in the Solvency II balance sheets I have been provided for use in my Report. I am satisfied that the calculations are in line with the Solvency II rules an note that the calculations for HIC have been subject to audit at 31 December 2016 and 31 December 2017.

Cost and tax impact of the Transfer

4.6 I have received the internal analysis completed by HIC regarding potential tax outcomes of the Transfer. While HIC is unable to confirm the quantum of tax liabilities which may arise from the Transfer, I understand that Hiscox are committed to inject capital into both HIC and HSA so that any tax liabilities that may arise will not have a material adverse impact on policyholders. I have been presented with an analysis by Hiscox' specialist tax advisors that shows the worst case estimate of potential tax liabilities triggered by the Transfer to be a little over £13m, and that there are potential mitigating actions that would reduce this amount. This is a very small portion of the available assets of the Hiscox group, so I am comfortable that even in the worst case scenario there is only a remote risk to the HIC and HSA balance sheets from tax liabilities crystallising as a result of the Transfer.

4.7 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 sanction hearing (for example, with respect to legal fees and policyholder communications). Therefore I identify no significant additional costs arising from the implementation of the Transfer. HIC will meet these costs.

Outward reinsurance

4.8 In a Part VII transfer where outwards reinsurance is being transferred, there is a risk that non-group reinsurers of the Transfer Companies whose contracts are not governed by English Law may not recognise the Transfer and decline payment of future reinsurance recoveries. However, all outwards reinsurance contracts that are relevant to this Transfer are governed by English law, so this is not a risk here.

Reinsurance contracts purchased in 2018 (including all contracts covering European risks) currently cover HSA as well as HIC; on these contracts HSA is included as a named and covered Hiscox Group company, and as a consequence of this when it receives policies through the Transfer, they will be automatically covered by the contracts. As some placements incept during the year, some cover is also provided for business written during 2019. Reinsurance contracts agreed in 2017 and prior do not cover HSA, as these were purchased before the date at which the Transfer was first proposed.

For those placements where only HIC is covered, HSA will be added as an endorsement to the existing reinsurance contract as part of the Transfer.

As a result of the Transfer, there will also be some amendments to the internal QS arrangements, which are listed below:

- Whilst the HIC business will continue to be covered by the 70% liability QS to HIB, a new contract will be underwritten from HSA to HIB effective from the point that HSA begins underwriting.
- The proportion ceded to HIB under the new HSA contract will be 90%, and will cover all lines of business and not just liability – this will help to reduce peak aggregate property exposures to catastrophe risk.
- There will also be a change in the chain of security; whereas the HIC QS is protected by ring-fenced collateral accounts, the new HSA QS will operate on a 'funds-withheld' basis whereby no premium will be paid to HIB until after 36 months, at which point the balance of premium less expected claims will be payable. This ensures that HSA has the money to pay gross claims as they come due until the losses to the contract become large enough to make it loss-making. As at 31 December 2017 the net assets of HIB are $865m.

- In addition there will be a loss portfolio transfer from HSA to HIB that covers the transferring risks from HIC. This will QS to HIB 90% of the existing liabilities that are transferring from HIC to HSA, i.e. £379.4m. This contract will also be on a ‘funds withheld’ basis, and so by mirroring the HSA QS will mitigate the potential counterparty credit risks to HIB. There will also be a new 90% quota share agreement put in place for new business written in HSA.

Dividends and capital structure

4.9 There will be no changes to the capital management policy of either Transfer Company as a consequence of the Transfer.

Non-financial effects of the Transfer

4.10 I consider here the areas that a policyholder may have considered in their decision to buy their original policy and would therefore have reasonable expectations regarding throughout the lifecycle of their policy and any claims. In particular I have considered the quality and culture of the executive management of the Transfer Companies (in that it sets the tone and culture for the company), claims handling, the ease of access to the company for complaints or policy administration, cyber security insofar as it protects the customer’s data, and the regulatory protections that the policyholder benefits from.

Future intentions of HIC and HSA

4.11 The Transfer of EEA policies from HIC to HSA will ensure that Hiscox continue to be able to write European business, regardless of the final outcome of the Brexit negotiations and the final deal which is struck, if any. There is no current intention to discontinue or deregister the operation of HIC or HSA.

Policy and Claims Administration

4.12 Following the Transfer, Hiscox have informed me that they intend to establish an operating model for policy and claims administration that adheres to the following standards:

- Consistency with current operating model
- Maintain ability to provide customers with one policy that covers UK and EEA risks
- Compliance with expected changes in regulation as a result of Brexit
- Continue to pay claims to all existing policyholders after Brexit

I summarise the effect of the proposed operating model on different types of customers below:

- **EEA customer:** EEA customer risks are currently primarily underwritten through HEUL currently. After the cross-border merger between HSA and HEUL these risks will instead be written directly into HSA, and the renewal rights for such policies will be moved to HSA before the Transfer occurs. For any EEA customer risks currently underwritten through HUL, following the Transfer, the policyholder will be referred to and underwritten directly into HSA.
- **Non-EEA customer with EEA risks:** Currently, EEA risks are written via HUL into HIC. Going forward, HUL will still be the first point of contact for the customer in the UK, but HUL will write this risk onto HSA through a DAA.

  In terms of claims handling, following Brexit HUL will not have authority to make any decisions or payments with respect to claims relating to EEA risks. When a notification is received, HUL will pass on HSA claims to the appropriate HSA EEA branch to be settled and paid.
- **Non-EEA customer with EEA and non-EEA risks:** Currently, EEA and non-EEA risks are written by HUL (through regional offices in UK and Ireland) onto HIC through the DAA. HUL administers the claim process and pays claims on behalf of HIC. Following Brexit, HUL will use its revised DAAs to write EEA risks to HSA and non-EEA risks to HIC. In this way HUL remains the primary point of contact for the customer. These type of policies represent 22-24% of all transferring policies.

In terms of claims handling, following Brexit HUL will not have authority to make any decisions or payments with respect to claims relating to EEA risks, but are able to liaise with the UK broker/customer. When a notification is received, HUL will pass on HSA claims to the appropriate HSA EEA branch to be settled and paid.

As a result of the Transfer, there will also be some changes to the operating model for HUL's Ireland branch, which currently has some functions in the UK and some in other countries of the EEA. These changes are summarised below:

- **Sales and Underwriting:** there will be a change in reporting lines. The Managing Director and Underwriting Manager will now report into the CEO and CUO of Europe respectively rather than the UK Sales Director and Deputy CUO of the UK respectively.
- **Operations and Service Delivery:** This team will continue to operate from Lisbon, but will report to the Managing Director of HSA's Ireland branch.
- **Claims handling:** A claims handling team will be established in Ireland, which will comprise of one claims manager and three claims handlers (the current state has 3.7 full time equivalent staff), reporting into the Head of Claims for Europe. This will take the form of a new team, but the handover will be managed gradually with support as required from the current UK team to ensure that there are no changes to policy or procedures.

The customer journey is largely unchanged by this new operating model. All of the customers involved in this Transfer are currently introduced to HIC either directly through their relationships with HUL or HEUL (though this is extremely rare), or through a third-party intermediary or broker. However, all customers have a right to contact Hiscox directly (e.g. to make a claim) and so I have considered how direct contact with Hiscox would change:

- Customers of HEUL will maintain the same point of contact they always had, though they will now be in HSA following the merger.
- Customers of HUL will largely maintain the same point of contact that they always had, and HUL will manage any splitting and placing of risks and refer claims to HSA as appropriate. HUL will remain their customers' direct point of contact throughout the lifecycle of their policy.
- The exception to this is for customers of the Irish branch of HUL. In this case the staff and operations of this branch will transfer to the Irish branch of HSA. In this instance the customer will contact a different company from before for claims and underwriting activity, but they will be dealing, at least initially, with the same people that they used to deal with in HUL.
- Any customer that transacts with HIC through a third-party intermediary will see no change – the intermediary will deal with HUL or HEUL as appropriate in exactly the same way that they used to.

Hence the policyholder does not need to navigate any new or unfamiliar processes as a consequence of the change in operating model – all the change is managed with HUL, HIC and HSA.

Impact of the Transfer on competition

4.13 I am only concerned about the impact of changes on existing policyholders, unless the Transfer results in a material reduction in the size of the wider market for certain types of policy that could meet a policyholder's requirements. This is because a future potential policyholder that is unhappy with the product, service, or any other aspect of the service they experience post-Transfer has the opportunity to buy their next policy elsewhere. As this Transfer is a re-organisation of policies between entities I see no impact on the competitive environment that would affect the different policyholder groups as a consequence of this Transfer.

Executive management

4.14 The HIC executive management teams will not change. The Board members of HSA are the Group CEO, Group CFO, the CEO of Europe, the CEO of UK and EU (all of whom are based in the UK), the Appointed Director, a Non-Executive Director ('NED') based in Belgium, and a Group NED based in Switzerland. The HSA European executive management team is proposed to include both UK and European staff that currently work with HIC (though are employed by HUGS or HEUL) as well as the Appointed Director in Luxembourg. Each branch will have country management teams, and some back-office services will continue to be provided on a group basis – IT; actuarial; risk management; internal audit; capital modelling and capital management; outwards reinsurance support; and investment management.

4.15 Many of the continental European staff are currently employed by HEUL. Those not moved before the Transfer will transfer to HSA as a consequence of the cross-border merger between HEUL and HSA.

ELTO

4.16 HIC have requested ELTO to publish details of the proposed Transfer on their website and have committed to inform ELTO of any Employers' Liability ('EL') policies which change insurer as a consequence of the Transfer. At their last audits, HIC was found to be compliant with ELTO requirements. Any third-party claimant that would have an EL claim to make for which HIC was liable would still be able to trace the appropriate insurer post-Transfer through ELTO.

Administration of the business

4.17 The IT systems will be updated to accommodate HSA, so policies will be administered on the same IT systems irrespective of whether they transfer or not.

This will be achieved as follows:

Currently, all UK and EEA exposure is allocated in the systems to the HIC carrier. Going forward, all HIC policies written from the Hiscox's European branches will be switched into HSA. For business written from the UK, rules will be put in place based on the risk addresses within each policy. If the risk is based in the UK, it will continue to be allocated to HIC; if based in the EEA then it will be allocated to HSA.

A script will be run to identify the addresses and risk locations. Following this, in an update which will be set up to take place automatically on the Effective Date, those policies that need to move to HSA will be switched. This will ensure policyholders see the correct carrier on all their documentation going forward.

Where there are split risks, the relevant components of the policy will need to be allocated to HIC and HSA as appropriate; at present the system can identify the appropriate allocation automatically for some policies but for others a manual intervention at renewal is required. In the meantime, the split risk will be allocated to a new mixed carrier on the system so that the carrier is disclosed correctly on policy documentation as "Hiscox Insurance Company Ltd for your insured companies registered outside the EEA; Hiscox Societe Anonyme for your insured companies registered in the EEA".

The wider administration of policies and claims is already addressed in more detail in section 4.12 above.

There will be no major changes to IT processes as a result of the Transfer.

Contractual arrangements

4.18 The Transfer is to have no impact on contractual terms of transferring insurance policies, other than changing the party to the contract from HIC to HSA.

For non-transferring policyholders of HIC, there should not be any additional issues bringing claims as a result of the Transfer.

Regulatory arrangements

4.19 HIC'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 HSA's primary regulator will be the CAA, the Luxembourg regulator. EEA policyholders already underwritten through HIC's EEA branches will already be subject to the conduct regime in their local country, and this does not change.

In addition, HSA will have a UK branch, which will be established by the exercise of passporting rights. The UK branch of HSA will underwrite incidental EU risks based on a DAA with HUL. HSA will also apply to the PRA for direct authorisation of the UK branch as third country branch, so that (even if that passporting rights do cease to apply after the UK leaves the EU) the PRA and FCA will directly regulate HSA's UK branch. The UK branch of HSA is expected to be established and the notification procedure under the Freedom of Establishment regime finalised by the end of October 2018. Whilst transferring policyholders that are not considered to be underwritten through the UK branch of HSA will cease to be subject to the over-arching principles that the FCA requires its regulated businesses to follow, the fact that the UK branch of HSA will need to follow those principles means that HSA will continue to consider the conduct guidelines currently followed by HIC insofar as they do not conflict with the Luxembourg regime.

The non-transferring policyholders of HIC that are eligible for protection under the FSCS will retain this protection in the event that claims cannot be paid in full out of current reserves, capital and reinsurance.

FSCS protection will also continue to apply to claims under transferring policies that were eligible for such protection arising before or after the effective date of the Transfer, as HSA is a participant firm within the scope of the FSCS regime (initially, as an incoming EEA firm exercising passport rights and in future as an authorised UK branch). FSCS protection will then end on renewal for transferring policies that renew with HSA in the future, who will instead be protected by the Luxembourg system, as described in section 3.7. I have discussed this matter with two different lawyers to confirm how this FSCS protection continues. Transferring policyholders who were not eligible for protection under FSCS will be eligible under the Luxembourg system.

While the FSCS offers protection for individuals and small businesses, as I discuss in section 3.7, the Luxembourg system offers protection for all policyholders. Therefore, there will be an increase in the level of protections for policyholders who did not have access to FSCS pre-Transfer. It is otherwise not straightforward to compare the FSCS and the Luxembourg system; the FSCS covers at least 90% of eligible claims with no upper limit (certain types of business are covered 100%), and is funded by a levy on eligible businesses (i.e. businesses where customers of that business may call on the protection of the FSCS). The Luxembourg system, as discussed in section 3.7, will cover all claims in a preferential order, though prioritising insurance creditors before all other creditors. The FSCS is an independent body and as such the funds it holds are not accessible by insurers in the case of their default; similarly, the Luxembourg system uses legally protected capital held under a tripartite agreement to protect policyholder security. I do not consider there to be a material difference in security of protection between the FSCS and the Luxembourg system, though as FSCS protection continues for eligible transferring policies (i.e. those that previously had access to the FSCS) until renewal there will be no impact from what differences there are for these policies.

Post-Transfer, the non-transferring policyholders of HIC will continue to have access to the FOS, if they previously had access to the FOS pre-Transfer. This is because the activities of HIC will continue to fall under the compulsory jurisdiction of the FOS. Any transferring policyholders of HIC that currently have access to FOS will continue to be able to complain to the FOS about the regulated activities of HIC or the UK branch of HSA; i.e. regarding regulated activities that are carried out in the UK. For other complaints they will have access to an Insurance Ombudsman run by the ACA, and the ULC. They can also address complaints directly to the CAA. In any event, these customers will not lose their right to complain to an independent ombudsman should they feel the need to do so.

Luxembourg and the UK are both currently members of the EU, and follow the Solvency II regime for prudential regulation. Whilst there are minor differences between precisely how Solvency II has been implemented in each EU territory (for example the UK requires an external audit of the SCR for Standard Formula firms and has enshrined some of the key functional roles from Solvency II in the Senior Insurance Managers Regime, whereas Luxembourg has a less formalised process than the UK, key functional roles are usually specified in a narrative report written on the system of governance and the ORSA), the overall target level of capital that insurance undertakings should hold and the commitments to risk management required by the Solvency II legislation do not change. The Standard Formula calculation in particular does not vary between EU member states, so there is no real risk of material differences in policyholder security resulting from changing from one EU regulator to another.

Cyber security risk

4.20 Cyber security risk is a relatively new and increasing threat to businesses today. Cyber-attacks on companies are becoming more frequent. These attacks can take forms such as gaining access to and selling or publicising customers' data, or preventing the business from operating as usual. Cyber security is therefore becoming ever more paramount. It is a reasonable expectation of a customer that their insurer should take appropriate steps to protect their confidential data.

The majority of HIC's data is held electronically at a primary Data Centre in the UK, which is replicated to the secondary Data Centre in France. The remaining data is held at Microsoft Azure locations or with Third Parties. Consideration is given to data protection acts, and all internal staff have to complete periodical cyber and data security training periodically. PwC perform the external audits which also cover information security.

HSA is expected to follow the same operating model.

Conduct risk

4.21 The primary areas in which conduct risk can materialise for HIC and HSA are the policy origination and underwriting process, and claims handling. It is intended that changes are kept to a minimum in each of these, as described in more detail above. For HIC and HSA the Boards are ultimately responsible for conduct risk. Monitoring of regulatory compliance will be performed by different individuals before and after the Transfer for transferring policyholders as the compliance function of HSA is one of the key functions that has been established in Luxembourg. The Compliance team of HSA will be composed of the Head of Legal & Compliance, the Compliance Manager and a Compliance Analyst. The Compliance function within HSA will be performed with additional support from the Hiscox Group Compliance function.

Front line distribution, underwriting and claims processes will not change as a result of Brexit (with a few exceptions, e.g. European claims of the UK branch will be dealt with by the European Claims team). The current governance of conduct risk in Europe is managed through "Europe Customer and Conduct Group" ("EUCC"), which in turn has oversight of local product oversight groups ("POG"), one for Germany, France, Benelux and Iberia. The UK Customer and Conduct Group ("UKCC") manages conduct risk for the UK and Ireland business unit. This structure helps to ensure that the regulatory requirements are appropriately considered for each country, while maintaining a consistent approach. The EUCC chair reports to the HEUL Board, and ultimately the HIC Board on conduct matters. The UKCC reports to the HUL Board and ultimately the HIC Board.

Post-Transfer, the new Ireland POG will fall under the remit of the EUCC which will report into the HSA Board. The UKCC will continue to report to the HUL Board. Monitoring of compliance of the distribution and underwriting activities in the UK through HUL will be based on regular reports from HUL to the EUCC.

The EUCC is chaired by the CEO Europe (and HSA Director), and includes the Europe CUO, Head of Europe Claims, and the Chair of each of the local POGs, the HSA Compliance Manager and the Group Compliance Manager. This will remain unchanged with the exception of the Group Compliance Manager who will only attend by exception post-Transfer. The UKCC is chaired by the MD of the UK Broker Channel and includes the MD of the UK Direct Channel, the Head of Claims, the UK Head of Alternative Distribution, the deputy UK CUO, the UK Conduct and Complaints Manager and the UK Compliance Manager. Post-Transfer the HSA Compliance Manager will attend the UKCC when matters impacting HSA are on the agenda.

The processes followed for monitoring conduct risk are not intended to materially change however between HIC and HSA.

Implications of Brexit

4.22 The whole purpose of the proposed Transfer is to mitigate the risks arising from Brexit. By transferring policies from HIC to HSA, the Transfer Companies guarantee that they will be able to continue to service those policies in the future. So for transferring policyholders the risk that valid claims cannot legally be paid post-Brexit will be removed once the Transfer has occurred. If the Transfer does not take place then as there is no agreement on the continuation or otherwise of passporting rights at the date of writing this report it could become illegal for HIC to service contracts or pay claims to EEA policyholders.

The rights of non-transferring policyholders of HIC are not affected by Brexit. There will be no HSA policyholders as at the Effective Date.

5. Potential impact of Transfer on stakeholders

Overview of analysis performed

5.1 In considering the impact of the proposed Transfer on the security of policyholders, I have considered both the impact of the Transfer of the financial resources available to support policyholders and also a number of non-financial impacts on how a customer's experience may change as a result of the Transfer. I have followed the following steps:

(i) I have considered the specific circumstances of different types of policyholder and divided them into distinct groups with similar characteristics.

(ii) I have considered the management and governance framework in place and the future intentions and strategies adopted by the Transfer Companies.

(iii) I have compared the position of each policyholder group in the event the Transfer proceeds with the position that they would be in if the Transfer does not proceed. I have considered the position of policyholders under the following headings:

(a) Financial resources available to pay future policyholder claims;

(b) TCF (with a particular focus on handling of claims);

(c) The ease of presenting a new claim;

(d) Protection of customer data;

(e) The impact of Brexit; and

(f) Other considerations.

(iv) I have further compared the position of policyholders before and after the Transfer under a variety of stressed scenarios to consider the ability of the Transfer Companies to deal with adverse scenarios.

(v) Having considered the change for each policyholder group under each of these categories, and considering the results of the stress scenarios, I have formed an opinion on the impact of the Transfer on each of the policyholder groups.

Bullets (i) to (iii) of the above follow here in section 5 of the report. The stress testing (bullet (iv)) is in section 6, and my conclusions (bullet (v)) are presented in section 7.

Identification of policyholder groups

5.2 Consideration of Policyholder groupings

5.2.1 Policyholder characteristics

I have identified a number of policyholder characteristics that could influence the impact of the Transfer on customers. The policyholder characteristics that I have considered include:

- The Transfer Company that will provide the cover after the Transfer.
- The nature of the regulatory regime and other policyholder protections which apply before and after the Transfer to different groups of policyholders.
- The nature of the type of business written and whether policyholders are:
    - i) Insurance or Reinsurance policyholders;
    - ii) Policyholders of compulsory or non-compulsory insurance; or

iii) Policyholders related to legacy risks or those with products that continue to be underwritten

- The length of time that policyholders are likely to continue to receive benefits under the terms of their policies.

- The ability of policyholders to access the financial resources of each Transfer Company in the event of them entering administration, rehabilitation or insolvency and how this changes as a result of the Transfer.

5.2.2 Reasoning for policyholder groupings

In selecting appropriate groupings of policyholders for my analysis I have considered the following:

- Under title IV of the Solvency II Directive reinsurance policyholders rank behind insurance policyholders in the event of the insolvency of an insurance business. The distinction then between reinsurance and insurance policyholders becomes important if there is a significant risk that one or both of the Transfer Companies could become insolvent in the short term. Given the levels of regulatory capital coverage that HIC enjoys I consider such a possibility to be remote. I also note that the number of reinsurance policyholders is not material; HIC primarily insures the risks of retail customers, predominantly high net worth individuals and SME companies. HIC does not have a strategy to write reinsurance, but there may however be circumstances in which they provide a reinsurance policy to cover the same type of underlying exposures to these small-medium enterprises and high net worth individuals. An example of this would be where a professional association provides professional indemnity cover for its members via a mutual but that mutual purchases excess of loss reinsurance from HIC. These arrangements are very unusual and require referral to senior underwriting management. As such, whilst it is impossible to distinguish reinsurance policies from insurance policies in the data I have been provided with, these reinsurance arrangements are normally well known to underwriting management and are few in number. HIC are not aware of any Transferring Policies that are reinsurance policies. Given the above, I do not distinguish between reinsurance and insurance policyholders in my analysis.

- Given that number of transferring policyholders that will be currently entitled to FSCS protection, I have specifically considered the interests of those policyholders separately from those that are not currently entitled to FSCS protection (under 5% of the total transferring). To avoid repetition in the analysis that follows I consider the two groups of transferring policyholders together for everything except consideration of how this entitlement may change.

5.2.3 Policyholder groupings chosen

Based on my analysis of policyholder characteristics and the fact that there is no practical change in regulation as a result of the Transfer I have identified the following three policyholder groups. These are:

- transferring HIC policyholders that currently benefit from FSCS protection;

- transferring HIC policyholders that currently do not benefit from FSCS protection; and

- HIC policyholders who will not be transferring

There will be no HSA policyholders before the Effective Date of the Transfer.

Financial resources available to pay policyholder claims

5.3 Approach to assessing the impact of the Transfer on available financial resources

In the sections that follow I consider a number of items that contribute to the change in financial resources for the different policyholder groups as a consequence of the Transfer. First of all I consider in detail the changes to the assets and liabilities (in the form of asset mix, claims reserving, reinsurance arrangements and pension liabilities) that will affect the IFRS and Solvency II balance sheets of the Transfer Companies. Then I consider the changes to the capital requirements of the Transfer Companies as a consequence of the Transfer and consider how easily they are met.

5.4 Consideration of the nature of assets available to meet policyholder obligations

In assessing the impact of the Transfer, I have considered the nature of assets within each Transfer Company before and after the Transfer occurs. The assets of each Transfer Company can be classified into four broad categories.

- Equities – HSA and HIC both hold no direct equities, but are exposed to equities through holding funds, which are shown as 'risk assets' in the table below.
- Investments and cash – Financial investments held by the Transfer Companies are mainly held in bonds. HSA hold a fairly limited amount of cash and HIC holds a fairly significant amount.
- Reinsurance share of provisions – Subject to the specific terms of the relevant reinsurance contracts, reinsurance assets have the capacity to absorb losses arising from the underlying reinsured insurance liabilities, thereby reducing financial risk. The nature and level of utilisation of such arrangements is in line with my expectations for the Transfer Companies.
- Other assets – Other balance sheet assets include mortgages and loans, sundry assets arising in the normal course of business such as accounts receivable, accrued interest and rent and intercompany balances due from other members of Hiscox largely arising as a consequence of recharges of expenses between group companies. HSA holds a lot of these pre-Transfer as it has not written any insurance business at that point, and therefore has not established insurance reserves (which would normally be held predominantly in investments and cash) to pay claims. These balances are in line with my expectations for a business of this nature.

The table below shows each asset group as a percentage of the total assets for HIC and HSA as at 1 January 2019, pre- and post-Transfer. This is based on projections performed by HIC.

Nature of assets as % of balance sheet	Pre-Transfer		Post-Transfer	
	HIC	HSA	HIC	HSA
Equities and UT share	0%	0%	0%	0%
Investments - other (excl. direct equities)	31%	0%	30%	0%
Risk assets (equities funds)	4%	0%	4%	0%
Cash	6%	23%	3%	20%
Reinsurance share of provisions	34%	0%	36%	56%
Other assets	24%	77%	27%	24%

Source: Financial Statements; IFRS; and Management Information

Overall the asset mix for HIC is projected to change only slightly. Investment and cash are reduced through the Transfer to HSA.

The overall asset mix for HSA is projected to change as a result of the Transfer. This is primarily driven by an increase of 56% in the reinsurance share of provisions coming in most part from the arrangements with HIB; as HSA has no insurance liabilities prior to the Transfer it cannot have reinsurance assets beforehand either.

In HSA there will be a significant reinsurance arrangement with HIB after the Transfer, on a funds withheld basis, so HSA keeps the funds until there is more certainty as to the liabilities protected by the reinsurance cover. The investment assets for HSA will all be held in cash. The ‘other asset’ proportion of the total assets for HSA is the same as it was before the Transfer in HIC. I also note that both HIC and HSA will have to follow (at least to begin with in the case of HIC) the Solvency II rules which restrict the amount of certain assets that can contribute to a company’s Own Funds available to meet their regulatory capital requirements.

I do not therefore identify any matter arising from balance sheet assets held by the Transfer Companies that would cause me to perform specific further additional analysis or conclude that there was any adverse effect on policyholders of either HIC or HSA as a consequence of it. I note that no change in the overall asset mix of the Transfer Companies is planned as a direct consequence of the Transfer.

I also understand that HIC have explored with the PRA the possibility of introducing some Tier 2 capital into their balance sheet. The Solvency II regime distinguishes between different tiers of capital (Tiers 1 to 3) based on how accessible they are perceived to be in times of stress (with Tier 1 the highest standard). Currently, 100% of HIC’s Own Funds are Tier 1 capital, as are the proposed Own Funds for HSA. HIC have applied to the PRA to introduce some Tier 2 capital into their balance sheet, within the limits allowed by the Solvency II rules. There has not been a decision to go ahead with an application and the decision as to whether to allow this is a regulatory one, and the Transfer is in no way contingent on it. I understand from the Transfer Companies that there is no intention to vary the capital structure of HSA in the near future, but in any case future changes would have to comply with Solvency II rules about admissibility of assets for meeting capital requirements. As this potential change would be subject to future regulatory approval and is part of business as usual activity for HIC and HSA rather than related to the Transfer I do not consider this further here.

5.5 Valuation of insurance liabilities

I have considered the valuation of insurance liabilities included in each Transfer Company balance sheet. The process of estimating insurance liabilities is inherently uncertain due to unknown future events or circumstances and the effect these may have on the frequency and cost of claims. For example, future legal changes may increase the number of claims to which insurers are exposed, inflation may change the costs of remediation of insured events and new types of claim may emerge which are not currently anticipated. Recent examples of this uncertainty include the market-observed significant increases (and subsequent decrease) in the number of claims reported to EL policies for noise-induced hearing loss, or the increasing costs to the market of periodic payment order claims for catastrophic injuries.

In performing my analysis of the relative impact of the Transfer on different policyholder groups I have considered the appropriateness of the methods and assumptions used by the Transfer Companies to value their insurance liabilities.

The Reserving Team performs full actuarial reserve reviews quarterly, using a variety of standard actuarial techniques such as Chain Ladder, Bornhuetter Ferguson and Loss Ratio methods. The reserving process will continue on in its current format and will be completed by the same teams and staff following the Transfer.

Draft results are discussed at the HIC Pre-Reserving Committee, any necessary amendments are made and the figures are finalised. Governance includes validation of methods and assumptions and peer reviews within the Group Actuarial department. Meetings are held with divisional underwriters to discuss changes to underlying exposures, rate changes and underwriting strategy; the claims team to discuss uncertainty around significant claims; the reinsurance team to ensure the programs are taken into consideration and management and finance teams to resolve areas of uncertainty.

For Solvency II, HIC has to produce an economic balance sheet, for which the appropriate actuarial best estimate is used as the base point.

As the overall reserving philosophies of the Transfer Companies are the same, there will not be any impact on the security of the transferring policyholders.

I have performed an analysis to satisfy myself that the insurance liabilities are consistent with my expectations for insurance business of this nature. This analysis involved:

- A review of both internal reserve reports on the business prepared by qualified actuaries;
- A review of the methods used to estimate reserves compared with industry best practice;
- A specific review of the calculation of the Solvency II risk margin as part of the Solvency II technical provisions;
- A number of interviews with key personnel responsible for estimating the value of insurance liabilities within the actuarial and claims management functions discussing the analyses performed and results of these analyses; and
- Consideration of the actual run-off profit or loss on prior underwriting years exhibited by each of the Transfer Companies.

Impact on the different policyholder groups

As the reserving for both HSA and HIC will be carried out by the same actuarial team, with the same processes around reserving philosophy and governance, I do not consider there to be any change to the way policyholder liabilities will be quantified as a consequence of the Transfer. Therefore I see no material impact on any policyholder group from any changes in the provisioning process related to the proposed Transfer.

Impact on existing reinsurers

5.6 Outwards reinsurance arrangements

Outwards reinsurance policies that have been purchased in 2018 cover both HIC and HSA explicitly. For legacy placements which currently cover only HIC, HSA will be added as part of the Transfer so as to become a reinsured under the policy. Reinsurance assets along with the liabilities associated with them will transfer under the Transfer with the reinsured party's name changing from HIC to HSA.

HIC have confirmed that all of the external reinsurance arrangements which relate to HIC currently are governed by UK law, so there should be no contracts where the recognition of the Transfer could be challenged under the law of another jurisdiction.

The Transfer is expected to have no effect on the reinsurance assets and liabilities associated with non-transferring policies.

Given the above, I identify no material adverse impact to any policyholders of the Transfer Companies from the Transfer due to reinsurance arrangements.

Pension Scheme Obligations

5.7 Pension Scheme Obligations

As discussed in 3.17, Hiscox management have informed me that HIC has not employed any of the staff eligible for the pension scheme since 1 April 2001, and HSA never has. Despite this, I have been advised by pensions specialists within my team that The Pensions Regulator has wide-ranging powers in the event of a default, and would be able to look to other members of Hiscox Group in order to collect funds. Therefore, I have considered further the impact of an extreme event on the pension scheme.

The Hiscox Group has modelled the impact of deterioration of the pension scheme liabilities on its group capital requirement, and holds additional capital at the 1 in 200 year event level in respect of that risk. The additional capital requirement that it generates after diversification benefits is substantially below the level of the guarantee (£50m) provided to HUGS by Hiscox Group, so the risk to the balance sheet of HIC (or HSA) is remote as this would require the guarantee to be exhausted and HUGS to be unable to meet the liability through other capital resources in order for The Pensions Regulator to consider exercising their broader powers). In any case, these potential liabilities exist both pre- and post-Transfer, so the situation does not really change for the Transfer Companies.

As such I conclude that the possibility of future pension scheme risk impacting the HIC balance sheet is remote.

Consideration of capital and risk

5.8 Measures of capital

I have considered the value of each Transfer Company's net assets compared with the risk that each Transfer Company is exposed to by reference to the Standard Formula SCR for each company. This is a regulatory measure which is available for HIC (and will be available in future for HSA; they have not published an SCR yet due to the company being recently established) and as both use the Standard Formula to calculate their SCR is a consistent comparison. I have reviewed the Standard Formula estimates as at 31 December 2016 and 31 December 2017, as well as projected figures at 1 January 2019, 31 December 2019 and 31 December 2020 for HSA and HIC, for comparison purposes.

These estimates compare in principle to the value of each legal entity's economic resources with the Transfer Companies' estimates of the amount of capital required to ensure that policyholders are secure at the 99.5% confidence level over a one year time horizon under the Solvency II regime. The risks considered in these estimates include:

- The potential deteriorations in insurance liabilities;
- Potential losses from investments;
- Potential losses arising from the failure of third parties to which each legal entity has exposure; and
- Potential losses arising from operational risks.

I note that these Standard Formula estimates:

- Have been produced by suitably qualified individuals from within the Transfer Companies;
- Have been reviewed and agreed by the Boards of the Transfer Companies; and
- Are consistent with the estimates submitted to the PRA, where relevant

Whilst I have not performed any detailed verification of the calculations performed by the Transfer Companies using the Standard Formula, I note that the results of these calculations as at 31 December 2016 and 31 December 2017 for HIC have been audited as part of the audit of the Solvency and Financial Condition Report ('SFCR').

With the Standard Formula being based on the insurance risks within the 'average' insurance company, it will not reflect the risk profile of either Transfer Company perfectly.

HIC currently utilises an internal Economic Capital Model ('ECM') for considering business decisions in addition to calculating the Standard Formula for regulatory capital purposes. It is proposed that HSA will use the same model after the Transfer.

I have therefore considered the methodology and key differences between the Standard Formula and the Transfer Companies' ECM, as this allows for additional insight into the capital requirements of the Transfer Companies. For this purpose I have reviewed HIC's assessment of the appropriateness of the Standard Formula for regulatory capital purposes, together with HIC's ORSA for 2017 and their draft ORSA for 2018. In considering their capital requirements HIC calculate their capital requirement using the ECM on both a one-year basis for consistency with the Standard Formula calculation, and on an ultimate basis, where liabilities are modelled to their expiry and a corresponding longer term view of the asset risks are taken as well.

The HIC Standard Formula calculation results in a higher capital requirement than the ECM does on both the one-year and ultimate basis.

This is due primarily to the Standard Formula calculation of insurance risk currently being higher than for the ECM on both bases because the Standard Formula is not tailored to HIC's risk portfolio, nor able to take account of HIC's bespoke analysis of catastrophe risk. The Standard Formula uses a method of applying fixed factors to sum insureds dependant on high-level risk location, meaning that it does not capture the same risks or allow as fully for the spread of exposure as the ECM. HIC also believe that their property insurance portfolio is more weighted to consumer risks than the average portfolio backing the Standard Formula assumptions – these risks exhibit lower volatility of insurance claims than larger commercial risks.

In HIC's ORSA calculation of reserving risk (the risk that the technical provisions established turn out to be inadequate to pay claims as they become due) is carried out to ultimate expiry of the liability rather than just calculating the risk over the next twelve months (as is performed under the Standard Formula). This is more prudent and reflects the reality that the company is liable for the ultimate cost of claims. In the Solvency II regime an allowance for this risk is incorporated into the technical provisions through calculation of the risk margin. I have reviewed the calculation of the risk margin for the Transfer Companies and am satisfied that it complies with the Solvency II rules, and is appropriate for its purpose. This, coupled with the fact that the ORSA calculation of required capital (including an allowance for this ultimate reserving risk), is lower than the Standard Formula capital requirement, gives me comfort that the Standard Formula capital requirement in conjunction with the risk margin established in the technical provisions provide appropriate protection for longer tailed policyholders for the run-off of their claims to expiry in the event that either Transfer Company was to cease trading.

Notwithstanding that the HIC's ECM view of the capital required to support its business is lower than that calculated using the Standard Formula, HIC has determined that it is appropriate to use the Standard Formula to derive its regulatory capital requirements.

I have not performed a detailed verification of the calculations performed by the Transfer Companies. However, in order to satisfy myself that the estimates are reasonable, I have reviewed stress tests on the areas I consider material to the Transfer Companies' assessment of available and required capital, or where other market participants have to my knowledge experienced deteriorations recently and to which one or several of the Transfer Companies are exposed. These stresses are intended to describe real life scenarios that are conceptually easier to understand than, for example, a 1 in 200 year event, but are expected to relate to that level of probability. I have determined these stress tests through reference to the ORSA reports of HIC, which pre-Transfer is exposed to all of the risks that are shared between the Transfer Companies as a consequence of the Transfer.

In each case the available capital post-Transfer more than meets the scenario tested. Whilst this does not constitute a formal re-estimation of the capital required for each of these scenarios, the fact that each scenario is contained within the capital amounts estimated under the Standard Formula approach reassures me that these estimates are capturing and covering the appropriate risks. I discuss the results of this analysis in sections 6.4-6.7.

Based on the ECM calculations shown in the ORSA, the Standard Formula capital requirement is higher than the ECM modelled risk at the 1 in 500 year level. As some of HIC's existing customers will be purchasing insurance from them in the expectation of a higher level of security than an average insurance company, this information provides me with comfort that using the Standard Formula capital requirement in my report to assess relative security is appropriate from a policyholder perspective. As stated in section 3.13, HIC target at least 120% coverage of their Standard Formula capital requirement – this ensures that they can manage the business on a day-to-day basis without fear of triggering regulatory intervention thresholds because of one-off large events or circumstances.

Therefore, notwithstanding that the risk profiles of the Transfer Companies are not going to be perfectly captured through use of the Standard Formula, I conclude that it provides a reasonable estimate of the capital required to support the ongoing business operations of the Transfer Companies, and appropriately demonstrates the relative change in policyholder security before and after the Transfer to support my opinion within this report. Furthermore it does so consistently across the Transfer Companies, which both calculate the Standard Formula in the same way. I therefore use the Standard Formula SCR and its coverage as metrics to determine whether policyholder security is affected by the Transfer.

Impact of Transfer on capital available to policyholders

5.9 Change in Solvency II Capital Cover Ratios

The tables below summarise the Solvency II balance sheet assets and liabilities for the Transfer Companies before and after the Transfer as shown in section 4.4.

Reinsurance assets are included within total assets. The most important measure to consider is how the eligible Own Funds compare to the SCR and I show this for HIC and HSA below.

I consider the impact of the Transfer in terms of the projected ratio of available capital to the capital requirement ('Capital Cover Ratio') calculated by reference to the Standard Formula as at 1 January 2019, 31 December 2019 and 31 December 2020, in the tables below:

€1 = £0.88	As At 01 January 2019			As At 31 December 2019		As At 31 December 2020	
Solvency II Balance Sheet (£'000)	HIC (pre-transfer)	HIC (post-Transfer)	HSA (post-Transfer)	HIC (post-Transfer)	HSA (post-Transfer)	HIC (post-Transfer)	HSA (post-Transfer)
Own Funds	245,011	173,966	50,783	196,280	57,912	229,165	64,428
Total Assets	**963,218**	**638,321**	**319,985**	**709,291**	**354,262**	**800,459**	**392,752**
Insurance Liabilities	633,279	394,248	248,924	439,541	269,221	492,440	297,648
Other Liabilities	84,928	70,107	20,278	73,470	27,129	78,853	30,676
Total Liabilities	**718,207**	**464,355**	**269,202**	**513,011**	**296,350**	**571,293**	**328,325**
SCR	215,914	143,643	42,429	163,728	48,171	189,108	52,190
Capital Cover Ratio 2019 *	113%	121%	120%	120%	120%	121%	123%
Capital Cover Ratio (HIC 2018 SCR)	127%						

Source: SII Balance Sheet and Management Information

I observe the following:

- Pre-Transfer, at 1 January 2019, and on the assumption that HIC is able to continue writing European business through 2019, the Capital Cover Ratio would be 113%. This is lower than the targeted Capital Cover Ratios for HIC, but reflects the fact that it is already anticipated that HIC will not be able to continue writing European business after 29 March 2019, and therefore a dividend has been paid by HIC, in part to be used to capitalise HSA. The comparable Capital Cover Ratio based on HIC's 2018 SCR is 127%, which is more in line with historical levels.

- Following the Transfer, Capital Cover Ratio is projected to be in the range of 120% to 123% for HIC and HSA, in line with management's target in excess of 120%. Splitting the business produces a reduction in diversification which I would expect (absent other factors) to reduce the overall Capital Cover Ratio, though the increased reinsurance to HIB offsets this.

- Hence the Capital Cover Ratio after the Transfer remains substantially unchanged in the range of 120%-125%, in excess of 100% and within HIC's and HSA's stated target range after the Transfer. The increase from the forecast HIC position against its hypothetical 2019 SCR is artificial as indicated above.

- I note that the numbers above are based on forecasts, and these have lessening credibility the further out into the future they are projected. However, I have considered the movements between HIC financial statements and Solvency II balance sheets as at 31

December 2017 and those in the forecasts, and I consider the assumptions made to produce these forecasts to be reasonable. The forecasts are also consistent with the three-year business plan that was submitted to the Luxembourg regulator as part of the authorisation process for HSA.

Given the above, I identify no material change in the economic position of, or capital protection available to, any of the identified groups of policyholders.

Guarantees/risk sharing arrangements

5.10 As discussed in section 3.16, HIC and HSA have confirmed that there are no non-reinsurance intragroup guarantees or risk sharing arrangements currently in place. Therefore, I identify no effect on the HSA or HIC policyholders as a result of the Transfer from changes in these.

Treating Customers Fairly

Claims and policy administration

5.11 HIC and HSA's proposed operating model for claims and policy administration were summarised in section 4.12. The changes in operating model are dealing with the issues that would arise after Brexit if passporting rights were to cease, whilst trying to minimise changes to customer interface and experience. The most material changes in the operating model are to do with business originated through Ireland, but the new operating model design is such that points of customer interaction remain unchanged as the renewal rights for the policies will be transferred to the Irish branch of HSA. Whilst the individuals responsible for claims handling may ultimately change, the Transfer Companies have committed to a period of handover and support that means a policyholder's experience should not change.

I therefore identify no material adverse impact upon any group of HIC policyholders as a result of the change in operating model.

Policy origination and underwriting process

5.12 The policy origination and underwriting process is intended to remain the same both before and after the Transfer. As described in section 4.12, the customer will still engage (usually through a broker) with HUL or HEUL (which will have merged with HSA post-Transfer) in respect of approaches made in the UK or EEA respectively. Whilst the carrier that the policy is placed with may vary depending on the location of the policyholder and the risk being insured, the policyholder experience should not change.

I conclude that there will be no adverse impact upon any group of HIC policyholders from these changes as a result of the Transfer.

Conduct Risk

5.13 The monitoring of conduct risk and compliance with the relevant regulation does not materially change as the HIC and HSA processes are the same, albeit with different individuals responsible for monitoring compliance. I do not consider that this causes any material adverse impact on any group of HIC policyholders.

The ease of presenting a new claim

5.14 As described in section 4.12, there will need to be changes to the claims handling processes to ensure that claims are handled in the correct legal entity with the correct permissions after Brexit. However, whilst a claim may be handled through different processes from the position pre-Transfer depending on whether the risk is an EEA one or not, the policyholders' interaction with HUL or HEUL (merged into HSA) remains unchanged. I note that currently a proportion of EEA claims are handled within the EEA to leverage local claims handling expertise, and for these claims there would not be any effective change in claims handling process in any case. As such I identify no impact on any group of policyholders as a result of the Transfer.

Protection of customer data

5.15 There is no expectation that the protection of customers' data will diminish as a result of the Transfer and I conclude that there is no risk of any material adverse impact on policyholders resulting from the Transfer. Cyber-attacks are attempted on businesses on a regular basis, so there is always the risk that one may be successful, but the Transfer does not appear to increase that risk in any way. I therefore identify no impact on any group of policyholders as a result of the Transfer.

The impact of Brexit

5.16 As discussed in section 4.22**,** the primary purpose of the Transfer is to remove uncertainties around the servicing of policies following Brexit for the transferring policyholders. Non-transferring policyholders are not moving and their circumstances and risk profile with regard to Brexit uncertainties do not change. There is therefore no adverse impact on any of the policyholders with regard to Brexit uncertainties as a result of the Transfer, and in fact the situation improves for the transferring policyholders, as without the Transfer it could be illegal for HIC to service their policies or pay any claims after Brexit.

Other considerations

5.17 Regulatory framework, executive management and governance

HIC is incorporated in England and Wales and regulated by the PRA and FCA. As such the same regulatory framework applies to it both before and after the Transfer. There is no change in entitlement to protection under the FSCS for the non-transferring policyholders, and there is no change in access to the FOS. In both cases eligible policyholders will retain their entitlements, and ineligible policyholders will remain ineligible.

HSA is regulated by the CAA, so there will be a regulatory change for transferring policyholders. As discussed in section 4.19, the UK branch of HSA will, once authorised, continue to be regulated by the PRA and FCA, so many of the standards required by the PRA and FCA will continue to be applied for HSA in any case. For policyholders of European branches their conduct regulation already follows their local regulatory regime, so the conduct situation will not materially change for them.

With regard to prudential regulation I also noted in section 4.19 that both the UK and Luxembourg follow Solvency II, so there is no risk of material change in the regime that protects transferring policyholders. Local interpretations of some of the rules may differ but I do not expect this to represent a material shift in the regulatory protections for policyholders.

As discussed in detail in section 4.19, transferring policyholders that currently benefit from protection by the FSCS will retain that protection following the Transfer, until the policies are renewed. They will retain access to the FOS, if they have it currently, in respect of activities of HIC or HSA's UK branch and gain access to the CAA for all other complaints. The protections for this group of policyholders are therefore the same until renewal. On renewal a policyholder has the right to look for alternate cover if they wish, though as I note in section 4.19, I do not consider there to be a material difference in security of protection between the FSCS and the Luxembourg system. As a consequence of this I do not identify any adverse impact of the Transfer on this group of policyholders caused by changes in regulatory environment.

Transferring policyholders that do not currently benefit from protection by the FSCS do not have any protection to lose. In fact they will gain as the Luxembourg policyholder protection system will apply to them after the Transfer. If they have access to the FOS currently they will also retain it in respect of activities of HIC and HSA's UK branch as for the group above, and will be able to refer to the CAA for all other complaints. The protections for this group of policyholders are therefore increased by the Transfer. As a consequence of this I do not identify any adverse impact of the Transfer on this group of policyholders caused by changes in regulatory environment.

There will be no other changes to the circumstances of HIC or HSA as part of the Transfer that I am aware of.

5.18 Viability of future business models

I note that both HIC and HSA have smaller income streams after the Transfer than HIC does before it, as a material amount of premium and risk is transferring. This Transfer introduces capital and expense inefficiencies, as the two businesses lose some of the benefits of risk diversification by splitting apart, certain procedures have to be carried out twice instead of once (for instance the production of regulatory returns), and there are certain management roles and key function holders that effectively need to be replicated into HSA rather than shared with HIC. However, the potential amount of expense duplication will be reduced by the common use of group services provided by HUGS to HIC and HSA under outsourcing arrangements.

The inefficiencies introduced by the Transfer re-emphasise the point that the motivation for it is purely to ensure that policyholder rights are maintained after Brexit. The Transfer has been designed in such a way as to minimise the inefficiencies introduced by it so that neither HIC nor HSA is reduced to a size that makes their future business model unviable, and reinsurance protections have been extended for HSA in order to ensure that its capital is not over-exposed. I conclude therefore that the Transfer does not materially change the ongoing viability of either HIC or HSA in the immediate future.

6. Methodology, stress and scenario analysis

Overview

6.1 In performing my analysis of the impact of the proposed Transfer, I have considered estimates prepared by the Transfer Companies of the maximum losses each of the Transfer Companies would face under a number of stress scenarios. In order to satisfy myself that these estimates are an appropriate basis on which to form an opinion, I have performed further analysis in three main areas:

- Modelling approach – I have considered the methods used by the Transfer Companies to calculate the estimate of insured losses at differing levels of confidence, allowing me to have confidence that the results of the model prepared by the Transfer Companies are based on appropriate assumptions and capture the relevant aspects of each Transfer Company's risk.

- Analysis of sensitivity of the model estimates to alternative assumptions – I have considered how sensitive my opinion is to variations in the underlying assumptions used by the Transfer Companies, and whether the reasoning behind my opinion would be different using alternative assumptions. Given that the dominant risks for both Transfer Companies are insurance risks, the modelled capital requirements are only particularly sensitive to changes in assumptions around premium volumes. Sensitivities to other risk types do not produce material capital requirement changes because the risk diversifies away between different risk types.

- Stress test analysis – I have considered the impact of a set of specific severe adverse events on each of the Transfer Companies, allowing me to gain comfort at a high level that the economic loss estimates used in my analysis are meaningful when compared with real world loss assumptions.

Loss modelling approach

6.2 Modelling approach

In finding the most suitable metric for assessing and comparing the capital required for each entity, I had to consider the methods that each entity used to calculate its capital required.

The Transfer Companies both use the Standard Formula to calculate their respective SCR (the required regulatory capital amount) and use an (unapproved) ECM internally to manage their respective businesses.

Given both of the Transfer Companies have calculated their capital required using the Standard Formula guidelines, and this is a common metric, I have used as my consideration of capital requirements the Standard Formula calculation for each entity.

A broad spectrum of risks is considered within this Standard Formula calculation including:

- Risk arising from insurance business, for example, the risk of losses from natural catastrophes or deterioration in the valuation of insurance liabilities.

- Market risk, for example, the risk that investment returns are not as high as anticipated.

- Counterparty default risk, for example, the risk that a reinsurance counterparty becomes insolvent and cannot honour its obligations.

- Operational risk, for example, the risk that there is a failure in underwriting controls.

The range of risks considered by each Transfer Company is prescribed by the Solvency II guidelines and is intended to reflect the inherent risk within the activities of each entity. In each case senior management is closely involved in the calculation of required capital. For each entity, the results require approval from the respective board.

I consider the processes which have been adopted in calculating this Standard Formula calculation to be consistent with industry practice for insurance businesses of the size and complexity of HSA and HIC. I am therefore comfortable that these processes are appropriate in nature and scope.

6.3 Findings of review of the modelling approach

I have discussed the results of the Standard Formula approach with the Transfer Companies' management and been provided with a range of related material including required capital estimates using alternative methods and descriptions of the methodology used. The Transfer Companies have applied standard actuarial methods to generate their estimates of potential losses for each entity. The calculations of required capital that have been provided to me as at 31 December 2017 have been subject to full internal review and governance processes. The Standard Formula calculations at 31 December 2017 have been subject to audit by HIC's external auditors.

The most significant risks contributing to HSA and HIC's required capital relate to the underlying general insurance business and associated uncertainties relating to the value of existing insurance liabilities and potential for adverse outcomes to that expected in the reserves currently set, and the counterparty credit risk from the intragroup reinsurance arrangements.

The relative contribution of different risk types to the required capital calculations for HSA and HIC are consistent with my understanding of the underlying business and in line with my expectations.

Whilst I have not performed a detailed validation of model results, the assumptions, methodology and outputs from the model are consistent with my expectations for business of this nature and I am satisfied that they are informative as to the change in risk which could occur following the Transfer compared with the position assuming no Transfer occurs.

Stress test analysis

6.4 I have considered a variety of severe adverse scenarios that could have a material impact on the financial security of policyholders. I have performed this analysis in order to:

- Quantify the impact of a stress event on the capital positions of the Transfer Companies and hence policyholder security; and
- Satisfy myself that the required capital calculations produced by the respective entities on the basis of their Solvency II Standard Formula calculations, together with the resulting Capital Cover Ratios, are reasonable when compared with the impact of a combination of specific adverse events.

The levels of capital required from the Standard Formula calculation prepared by the Transfer Companies are intended to represent the full range of realistic economic risks that each Transfer Company could experience, and represents a more complete consideration of business risk than an analysis of specific stress events. However, such calculations are based on multiple modelling assumptions which rely on expert judgement. By contrast my consideration of specific adverse stresses provides qualitative information on the security of policyholders in a single defined scenario. Such specific severe adverse scenario testing does not rely on expert judgements regarding the frequency and range of uncertainty, and provides an alternative source of information from which I can gain insight into the levels of security of policyholders.

6.5 I have considered a variety of potential severe adverse circumstances or extreme events that could affect the Transfer Companies, all of which represent stresses that fall outside the normal course of business. In selecting the scenarios to model, I have considered:

- Current developments occurring in the insurance markets in which each Transfer Company operates.
- The typical risks faced by an insurance business.
- My overall understanding of each Transfer Company including its portfolio mix, structure and business model.
- The key risks identified by each Transfer Company in its estimates of required economic capital from its ORSA.
- The scenarios identified by each Transfer Company as part of its normal risk management processes.

I have considered each stress by assuming the outcomes of what might happen given each scenario, looking at how this would affect the entities both individually and post-Transfer based on their business and coverage, and consequently how this would affect each of their capital. I have then compared the lower capital position that would be in effect should each scenario (in isolation) happen to the capital requirements of each Transfer Company.

As discussed in sections 3.12 and 5.9, the capital requirements under the Solvency II regime are based on policyholders being secure at the 99.5% confidence level. For an even more rigorous check on the level of security, I further consider the capital levels against a capital requirement based on a 99.8% confidence level. I note that at this extreme level, under the ECM, the required capital is still less than that at the 99.5% level under the Standard Formula, giving more comfort on the prudent nature of the Standard Formula in this case.

Whilst these stresses do not represent an exhaustive list of all adverse events that could impact the Transfer Companies, they include those risks I consider most material and relevant to my analysis. I note that the Transfer Companies perform such stress testing as part of their business as usual risk management processes as expected under Solvency II. I am satisfied that the standard stress tests considered in the HIC ORSA are appropriate in terms of the risk profile of the company. I note further that under these scenarios, HIC has readily enough available assets to cover the resulting financial impact. The stress tests in question cover the following:

- Cyber attack: A large scale ransomware cyber attack, locking companies' systems as well as Hiscox, and causing an industry loss in the tens of millions.
- Economic downturn: An economic collapse more severe than the 2008 financial crisis (based on the output of HIC's stochastic model for market risk).
- Global inflation: Global inflation increases and this higher inflation environment persists for a number of years.
- European windstorms: Catastrophe scenario where windstorms across Europe (including the UK) combined with UK floods occur, also leading to default of the top two external reinsurers.

I focus my additional analysis on the stress tests that could materially change as a consequence of the Transfer.

The impact of the Transfer is to split the business currently in HIC into two parts. There are no policies in HSA before the Transfer, so the total exposure to underwriting risk across both HIC and HSA is unchanged as a consequence of the Transfer, though there will be less geographic diversification between risks.

The key concern then for selecting stress tests is not that HIC can withstand them before the Transfer (as policyholders are already exposed to these risks), but that splitting the business through the Transfer does not over-expose either HIC (post-Transfer) or HSA to risks relative to their lower capital bases to such an extent that it would be considered a material adverse effect of policyholder security.

I have therefore considered stress tests relating to aggregation that could occur as a consequence of splitting the business between the EEA and the rest of the world or from the way in which HIC's assets are split between HIC and HSA.

From the stresses noted above:

- the cyber attack stress would still hit both HIC and HSA following the Transfer, and there is no reason why either would be over exposed compared to the pre-Transfer state given the diverse group of policyholders of the two companies.

- the economic downturn may at first seem to hit HIC harder due to the higher level of investments compared to cash held compared to HSA (as seen in the table in section 5.4), however if looking solely at HIC pre- and post-Transfer, the proportions of assets held are very similar, so the effect post-Transfer to HIC would not be dissimilar to pre-Transfer.

- the global inflation scenario increases claims costs across the board. Given the claims reserves split between HIC and HSA as a result of the Transfer the impact of this scenario is similarly split, but less for HSA. HSA has the smaller capital base but benefits from the higher 90% reinsurance to HIB and can withstand the scenario independently. HIC post-Transfer similarly can withstand the scenario similarly to its situation pre-Transfer.

- The European Windstorms may also cause aggregation that was not there as a result of splitting the business in the EEA and the rest of the world. I discuss this further below.

6.6 This potential aggregation indicates two such areas of risk, both of which emerge from catastrophe exposures. The results of the stress tests are not available in this report as they are of a commercially sensitive nature, however I include my analysis and conclusions below.

1) Catastrophe exposures are a source of risk for HIC. As all of the European risks are transferring to HSA, there is a potential for the European windstorm exposure after the Transfer to reach a more material level compared to the capital base of HSA than was the case before the Transfer on the larger capital base of HIC. I have analysed the impact of a material European catastrophe loss (estimated to a 1 in 200 year event level) on HIC before the Transfer and HSA after it.

   There is an aggregation of risk in respect of EU catastrophes to HSA. The gross of reinsurance loss to HSA would be the same as the gross of reinsurance loss to HIC would have been before the Transfer. However, HSA will have the benefit of a new 90% QS reinsurance arrangement with HIB in place to protect HSA from this proportionally higher aggregate risk, over and above its existing catastrophe reinsurance programme. The proportion of HSA's capital eroded by a 1 in 200 year European catastrophe is not materially larger than the equivalent proportion of HIC's would have been eroded before the Transfer.

2) Conversely there is the potential for catastrophe exposures in the rest of the world to represent a larger proportion of HIC's capital base post-Transfer. I have analysed the impact of a material UK catastrophe loss (estimated to a 1 in 200 year event level) on HIC before the Transfer and HIC after it. Once again the proportion of capital eroded after the Transfer is not materially larger than the proportion that would have eroded before it.

6.7 Findings of stress test analysis

Having analysed the results of the stress tests outlined above, I find that only those extreme scenarios well in excess of the Solvency II requirement of 1 in 200 year events would result in one or both of the Transfer Companies falling short of their capital requirements.

7. Summary of findings

Summary of changes in circumstances of the non-transferring HIC policyholders

7.1 Based on the analysis that I have carried out in sections 5 and 6 of this report I note that:

(a) The policies remain with HIC after the Transfer;

(b) The anticipated capital coverage of HIC is largely unchanged by the Transfer, and remains at a comfortable level of greater than 120% of the regulatory requirements. Reserving and other financial policies remain unchanged, and therefore the chance that HIC would not be able to meet its respective future obligations in full remains remote;

(c) Changes in claims handling, the ability to make new claims, the protection of policyholder data, and any changes in the overall treatment of customers as a result of the Transfer do not have any material impact on the existing HIC policyholders; and

(d) The potential impact of Brexit and its consequences does not have any effect on non-transferring HIC policyholders, as they are not exposed to EEA risks.

As a result I consider there to be no material adverse impact on the non-transferring HIC policyholders as a consequence of the Transfer.

Summary of changes in circumstances of transferring HIC policyholders

7.2 Based on the analysis that I have carried out in sections 5 and 6 of this report I note that:

(a) The policies move from HIC to HSA;

(b) The capital coverage of HSA is similar to that of HIC pre-Transfer from that of HIC pre-Transfer, and remains at a comfortable level of greater than 120% of the regulatory requirements. Reserving and other financial policies remain unchanged, and therefore the chance that HSA would not be able to meet its respective future obligations in full is remote;

(c) There are no changes to the claims handling, ability to make new claims, protection of policyholder data, or any changes in the overall treatment of customers as a result of the Transfer. Furthermore, the contact points for customers will remain the same even though the insurance carrier supporting their policy has changed;

(d) With regard to whether transferring policyholders currently have access to the FSCS:

(i) Those policyholders that currently benefit from FSCS protection will retain that entitlement post-Transfer until the policy is renewed; and

(ii) Those policyholders that do not currently benefit from FSCS protection will still have no protection from the FSCS post-Transfer, and their situation has not been adversely affected as a consequence of this.

(e) The potential impact of Brexit on transferring policyholders were the Transfer not to happen is that the transferring policies would not legally be able to be serviced, and consequently valid claims may not legally be able to be paid. The Transfer completely removes this risk, and therefore creates a benefit for this group of policyholders.

As a result I consider there to be no material adverse impact on transferring HIC policyholders as a consequence of the Transfer.

Appendix 1 Curriculum Vitae of the Independent Expert

Philip Tippin is a non-life actuarial partner in KPMG.

Philip Tippin has been an actuarial services partner since 2004. He joined in 2001 and has led KPMG's general insurance actuarial business for much of his time with the firm. He has worked on a number of previous Part VII transactions over this period. Philip qualified as a Fellow of the Institute of Actuaries in 1998 with Watson Wyatt, having specialised in general insurance actuarial work since the start of his career.

Prior to joining KPMG Philip also worked as a consultant with Deloitte, and spent several years as a syndicate actuary in the Lloyd's Market with Venton (latterly Alleghany) Underwriting.

Experience

Philip has a wide range of experience in finance, insurance and reinsurance, covering both retail and wholesale markets, as well as having performed engagements looking at financial guarantee products. He has assisted clients in reserving, pricing, risk management, underwriting control, capital management and strategic consulting projects. His experience includes substantial exposure to UK and US law and regulation as they apply to insurance. Examples of recent assignments include:

- Acting as Independent Expert in general insurance Part VII business transfers.
- Undertaking the formal role of Scheme Actuary for a large number of Schemes of Arrangement, for both insolvent and solvent companies.
- Negotiation of commutations with policyholders and cedants on behalf of businesses in run-off.
- Expert witness appointment in the United States, covering reinsurance, reserving and pricing of specialist products, providing advice through the lifecycle of the case.
- Acting as independent expert for complex liability valuation determinations.
- Estimation of claim emergence and quantification of liabilities from environmental disasters in the United States.
- Gap analyses and development of implementation plans for Solvency II for large insurance groups.
- Review of credit risk liability models.
- Capital model design and review.
- Providing actuarial due diligence reporting for a number of major London Market acquisitions.
- Strategic reviews of business models for insurance risk management for providers and buyers of insurance.
- Providing statements of actuarial opinion for Lloyd's syndicates, including provision of opinions for US trust funds.
- Technical pricing of retail and commercial insurance products.
- Providing support to the audit of major UK and international insurance groups.

Professional & Educational

Philip is a Fellow of the Institute and Faculty of Actuaries (FIA). He holds a Practising Certificate to act as a Syndicate Actuary at Lloyd's, and has previously held a similar certificate to act for insurance and reinsurance entities in Ireland. He acted as an examiner and senior examiner for the general insurance papers of the Institute and Faculty of Actuaries exams for six years until 2005.

He holds an MA in Mathematics and Philosophy from the University of Oxford.

Appendix 2 Extract from Letter of Engagement

Scope of the Independent Expert's work

My role as Independent Expert will be to consider and to report to the Court on the proposed Transfer from the perspectives of the policyholders of the Transferor, and to give a reasoned opinion on the likely effects of the Transfer on the policyholders of the Transferor including whether any of their interests could be in any way (either directly or indirectly) adversely affected by any of the Transfer. Under the regulators' guidance, the Report must comply "with the applicable rules on expert evidence". My understanding therefore is that the PRA expects an independent expert to prepare a report in accordance with Part 35 of the Civil Procedure Rules 1998 ('CPR'), the relevant Practice Direction and the protocol for the Instruction of Experts to give evidence in Civil Claims, to the extent relevant ('the Requirements'). I will therefore conduct my work as if the Requirements apply. In particular, I will owe an overriding duty to the Court to assist the Court and to give the Court independent expert evidence on the Transfer.

I expect that my work will include the following tasks in order for me to form my opinion:

- reviewing existing company documentation, as set out in Appendix 1 to this letter;
- reviewing the documentation for the Scheme and, if necessary, suggesting amended drafting in order to eliminate any concerns;
- reviewing the Transfer, considering the effect on policyholders of the Transferor, covering their contractual rights, benefit security, and benefit expectations;
- reviewing any changes to reinsurance arrangements in connection with the Transfer;
- reviewing the effects of the Transfer on the risks and policyholders remaining within the Transferor and the resources of that company to meet those risks;
- reviewing the effects of the Transfer on the risks within both Transferee and the resources of each entity to meet those risks;
- reviewing comparative solvency levels before and after the proposed transfer;
- liaising and raising issues and questions as necessary with the appropriate persons at the Transferor and Transferee;
- liaising and raising issues and questions as necessary with your advisers, including tax and legal advisers;
- considering any potential competition issues arising in connection with the Transfer (as expected by the FCA);
- such other tasks as you, I or the PRA and/or FCA consider reasonably necessary for the proper discharge of my role as independent expert.

Appendix 3 Letter of Representation

HISCOX

Philip Tippin
KPMG LLP
15 Canada Square
London
E14 5GL

Dear Mr Tippin,

I, Christian Nielsen, am the Chief Financial Officer of Hiscox Insurance Company Limited ("**HIC**"). This letter relates to the proposed transfer of general insurance business as described in the Scheme involving HIC and Hiscox SA ("**HSA**") (hereinafter collectively referred to as the "**Scheme Companies**"). I have been authorised by the board of directors of each of the Scheme Companies to give representations set out in this letter on behalf of each of the Scheme Companies, which are given to the extent that each of the Scheme Companies exercise control over the general insurance business which is the subject of the Scheme both before and after the Scheme comes into effect. In this capacity I have reviewed the final copy of the report produced by the Independent Expert (the "**Report**") in connection with and for the purposes of the proposed Scheme.

In respect of the Scheme, I can confirm that:

1. I have disclosed all the information that in my opinion is relevant to the Independent Expert when forming a view as to whether policyholders are adversely affected by the proposed Scheme.
2. I can confirm that the Report accurately and fairly reflects my understanding of the details of the proposed Scheme and the facts relied upon in the Report are true and accurate to the best of my knowledge and belief.
3. I will keep the Independent Expert apprised of all matters and issues, up to the date of the Court hearings, which, in my opinion, may be relevant to the Independent Expert in opining on the proposed Scheme.
4. In particular, the facts stated below are true and accurate to the best of my knowledge and belief:
   a. The financial position as stated in the HIC audited accounts for the year ended 2017 gives a true and fair view of HIC's affairs at that date.
   b. Other financial projections you have used to prepare the Report have been prepared in good faith by persons with appropriate knowledge and experience and based on reasonable assumptions.
   c. The management and administration of the business affected by the Scheme will remain substantially unchanged following the implementation of the Scheme.
   d. The Scheme Companies will continue to target a regulatory solvency ratio above 120% of the Solvency II Standard Formula SCR in normal trading conditions after the implementation of the Scheme, in line with their respective risk appetite

Yours sincerely

Christian L Nielsen

Chief Financial Officer

For and on behalf of Hiscox Insurance Company Limited

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Appendix 4 List of Information provided

Financial Information

HSA and HIC business plan containing forecast for 3 years of IFRS and SII balance sheets

HIC PRA Insurance Returns and Solvency II successor NST forms for 2015 and 2016

Analysis of open claims and policy counts transferring by line of business

HIC financial statements 2014-7

HIC Statutory Accounts 2014-6

Unaudited HIB 31 December 2017 financial statements

Worst case scenario analysis of tax liability from the Transfer

Structure and Company Information

Hiscox group structure chart

HSA organisation chart

HIC governance structure post-Transfer

Claims and underwriting guides for UK casualty, UK property and Europe

Operating models pre- and post-Transfer

Legal analysis of policyholder protection changes

Legal advice on pension scheme risks

HSA investment guidelines

Analysis of tax consequences of Transfer

Significant Risk Sharing Arrangements & Material Counterparties

HIC 2018 outwards reinsurance contracts

Other relevant HIC outwards reinsurance contracts

- 2016 EL QS and LPT
- 2016-8 European Property Risk XL
- 2017-8 Motor XL
- Stop loss for Economic Insurance Company liabilities

HSA QS with HIB for ongoing business

Scheme Information

Part VII Transfer timetable

Draft Transfer scheme document

Brexit programme Part VII meeting with PRA and FCA minutes

List of policy numbers transferring

Part VII overview for regulators

Draft First Witness Statements

Capital and Risk Management

HIC Regular Supervisory Report 2016

2017 ORSA for HIC and draft 2018 ORSA for HIC

HIC Reserving Committee papers Q3 and Q4 2017, and HIC Audit Committee papers Q4 2017

HIC Standard Formula appropriateness paper

HIC Board meeting pack 30 November 2017

HIC SFCR 31 December 2017

HIC QRTs 31 December 2017

HIC CFO update for March 2018 Board

Other information considered

Discussions with key staff within executive team. Numerous e-mails and documents confirming statements and information provided verbally during these meetings

Appendix 5 Glossary of terms and definitions

Adverse impact – A negative change of any size.

Asset – Generally, any item of property whether tangible or intangible, that has financial or monetary value.

Brexit – The process of the United Kingdom of Great Britain and Northern Island leaving the European Union, set in motion by the 'Leave' result of the referendum on 23 June 2016.

Capital – Defined as total assets less total liabilities as measured using either an economic method of valuation, PRA mandated valuation rules or Statutory Accounting principles, as indicated by the accompanying text.

Capital Cover Ratio – The ratio of the amount of capital available (Own Funds) to the selected capital requirement. A ratio of more than 100% implies that the company more than meets the capital requirement.

Claims Reserves – Funds to be set aside for the future payment of incurred claims that have not yet been settled, and hence are classified as liabilities on the company's balance sheet.

Communication Pack – The pack that will be sent to policyholders and other stakeholders as set out in Appendix 7 to inform them of the proposed Transfer, comprised of a cover letter and accompanying information leaflets, including a summary of this Report.

Competent Authority - Any person or organisation that has the legally delegated or invested authority, capacity, or power to perform a designated function.

The Court – The High Court of Justice of England and Wales.

CPR – Civil Procedure Rules 1998.

Credit risk - The risk of financial loss resulting from changes in the value of assets due to actual default or perception of the risk of default in the future. The term is commonly used to describe the risk that the market value of a financial investment such as a bond will fall due to an increase in the perceived likelihood of default, for example, due to an opinion issued by a credit rating agency, but would also cover the risk of non-payment of reinsurance recoveries or broker balances.

Delegated Authority Agreement – an agreement between an insurer and an intermediary by which the authority to underwrite insurance policies is passed to the intermediary.

Economic basis – A method of measuring the value of assets and liabilities using market consistent valuation techniques including reflecting the time value of money on cashflows occurring in the future, and excluding 'prudent' valuation margins included in estimates of the valuation of insurance liabilities. In this report the word 'economic' is used to represent the closest representation to the real value of the assets or liabilities in question, disregarding the effect of accounting or regulatory measurement rules.

Economic capital – Capital calculated using an economic basis.

Effective Date – The date and time on which the Transfer takes effect.

Employers' Liability Tracing Office ('ELTO') – ELTO is a system set up to provide claimants with access to a database of EL policies through an online search engine. The system can be used, for example, to find the insurer of a previous employer where the claimant has suffered from injury/disease caused by previous employment. ELTO requires all insurers to upload the details on all new and renewed EL policies post 2011 and any policies prior to that which have had new claims made against them.

The EU – The European Union

EEA – the European Economic Area made up of the EU nations plus Iceland, Liechtenstein and Norway. Throughout this report the EEA is used to refer to the current EEA members absent the United Kingdom, which is expected to lose its membership following Brexit.

FIA – Fellow of the Institute and Faculty of Actuaries.

Financial Conduct Authority ('FCA') – The Financial Services Authority was reorganised into two separate regulatory agencies during 2013. The successor organisations are the Prudential Regulation Authority and the Financial Conduct Authority. The Financial Conduct Authority focuses on the regulation of conduct by retail and wholesale financial services firms.

The Financial Ombudsman Service ('FOS') – An independent public body that aims to resolve disputes between individuals and UK financial services companies. It may make compensation awards in favour of policyholders. Only holders of policies that constitute business carried on in the UK are permitted to bring complaints to the FOS.

The Financial Services Compensation Scheme ('FSCS') – A statutory scheme funded by members of the UK financial services industry. It provides compensation to individual holders of policies issued by UK insurers in the UK or another EEA state who are eligible for compensation under the FSCS in the event of the insurer's default.

The Financial Services and Markets Act 2000 ('FSMA') – An Act where Part VII of which governs the transfers of insurance business between insurance undertakings.

Gross – Excluding the effect of reinsurance arrangements. For example, 'gross insurance liabilities' refers to insurance liabilities before taking into account any offsetting of reinsurance assets.

Hiscox Group – A group of international entities conducting business under the Hiscox brand including Hiscox Insurance Company Limited ('HIC') and Hiscox SA ('HSA')

Hiscox Insurance Company Limited ('HIC') – A UK-regulated non-life insurance company which is part of the Hiscox Group and is the Transferor in this Transfer.

Hiscox SA ('HSA') – A Luxembourg non-life insurance carrier which is a part of the Hiscox group which has been setup to write EEA business after Brexit. As part of the Transfer, existing EEA policies from HIC will transfer to HSA.

Holding company – A holding company is a company established for the sole or main purpose of holding shares in subsidiary companies.

Independent Expert – The person appointed to report on the terms of the Transfer pursuant to section 109 of FSMA, or any successor appointed to report on this and whose appointment is approved by the PRA. The Independent Expert's primary duty lies with the Court, and the opinions of the expert are developed independently of the sponsoring Transfer Companies and the PRA.

Insolvency – The condition of having more liabilities than assets which might be available to pay them, even if the assets were mortgaged or sold.

Insurance reserves – The estimated value of future claims costs recorded in the balance sheet of an insurance company, also referred to as the 'value of insurance liabilities'.

Jurisdiction – The concept that a court or government authority or regulator may exercise control over a person or property because of the location of the property, the activities of a person within a geographic area, or a person's request for assistance from that authority, thereby voluntarily subjecting themselves to jurisdiction.

KPMG – KPMG LLP, a UK limited liability partnership, is a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative, a Swiss entity.

Liability – A claim against the assets, or legal obligations of a person or organisation, arising out of past or current transactions or actions.

Managing General Agent – An individual or business acting as an insurance agent to provide underwriting services to an insurer, having being granted the authority to do so by that insurer.

Material adverse impact – A negative change that is considered to have a material impact on policyholders. A material impact is one that could cause a policyholder to take a different view on the future performance of their policy. When considering policyholder security these would include changes to the assets or liabilities of a Transfer Company such that there was a shift in the probability of a policyholder's claim being paid which is substantially larger than that which would be observed through the day-to-day fluctuation of the value of assets in a Transfer Company's investment portfolio, or from the reporting of a particularly large but not extreme claim to the Transfer Company's liabilities. In terms of non-financial impacts, an assessment of materiality is more subjective, but as an example a change in claims handling process that added a few hours to the customer response time is probably not material, but if it added a few days then it could be, depending on the type of claim.

Minimum Capital Requirement ('MCR') – The level above which an insurer's available resources must stay above to avoid severe supervisory action, such as the insurer's liabilities being transferred to another insurer, the licence of the insurer being withdrawn, the insurer being closed to new business and its in-force business being liquidated.

Net – Including the effect of reinsurance arrangements. For example, 'net insurance liabilities' refers to insurance liabilities after deducting any offsetting reinsurance assets from the gross insurance liabilities.

Own Funds – The assets held in excess of the technical provisions, available to an insurance entity to meet its SCR under the Solvency II rules.

Own Risk and Solvency Assessment ('ORSA') – A requirement under Solvency II for an assessment and documentation of the entirety of the processes and procedures employed to identify, assess, monitor, manage, and report the short and long term risks a firm faces or may face and to determine the funds necessary to ensure that overall solvency needs are met at all times.

Parameter / Parameterised – A numerical input which affects the result of a calculation.

Part VII Transfer – A court process for transferring insurance business, ranging from single contracts to an entire portfolio, to another insurer. The insurers involved can either be in the same insurance/reinsurance group or from different corporate groups. FSMA requires that the transferor and transferee company appoint an Independent Expert who considers the impact of the proposed transfer on the various groups of affected policyholders and submits a report to the Court.

Passporting – Exercising the right to do business in any European Economic Area state by an entity registered in any other European Economic Area state without needing to apply for further authorisation. It is unknown whether this will remain a right after Brexit.

Periodic Payment Orders ('PPOs') – A method of settling catastrophic injury claims where compensation is paid to claimants at regular intervals rather than in a single lump sum.

Policyholder obligation – The contractual obligation of an insurer to its policyholders.

Policyholder security – The degree of certainty that policyholders have that an insurer will have the financial resources available to meet its policyholder obligations.

Premium – The amount of money received by an insurer in return for providing an insurance policy providing protection to an insured against the financial consequences of a specified set of potential events. Premium can be measured gross or net of reinsurance, meaning before or after the deduction of any associated reinsurance premiums paid by the insurer. Premium is measured on a 'written' basis, meaning all premiums receivable on policies commencing within a given period, or is measured on an 'earned basis', meaning the amount of premium attributable to the accounting period based on some allocation of the premium across the period during which the underlying policy is exposed to risk.

Primary policyholder – The individual or corporate that is the over-arching named policyholder on a policy. For corporates buying insurance for their group this will usually be the head office of the business, but if a subsidiary purchased insurance under its own name then it would be the subsidiary.

Prudential Regulation Authority ('PRA') – The Financial Services Authority was reorganised into two separate regulatory agencies during 2013. The successor organisations are the Prudential Regulation Authority and the Financial Conduct Authority. The Prudential Regulation Authority is part of the Bank of England and carries out the prudential regulation of financial firms, including banks, investment banks, building societies and insurance companies.

Reinsurance – An insurance contract between one insurer (the reinsurer) and another insurer (the cedant) to indemnify against losses of the cedant on one or more contracts issued by the cedant in exchange for a consideration (the premium). Reinsurance is 'insurance for insurers', allowing insurers to share potential insurance losses with a reinsurer and hence reduce their own risk. Similar to insurance policies, reinsurance policies are written to cover specific pre-agreed risks and eventualities, as detailed in the reinsurance contract.

The Report – The report produced by the Independent Expert.

Retrocession – Reinsurance purchased by a reinsurer in relation to its liabilities. The reinsurers' liabilities are said to be retroceded.

Reserves – See 'Claims Reserves''.

Sanction – To receive approval from the Court to proceed (with the Transfer).

Solvency II – The EU's revision of insurance regulation designed to improve consumer protection, modernise supervision, deepen market integration and increase the international competitiveness of European insurers, which came into effect from 1 January 2016. Under this new system insurers are required to take into account a wide variety of different types of risk to which they are exposed and to demonstrate they manage those risks effectively. The new system has introduced more sophisticated solvency requirements for all EU insurers, in order to guarantee that they have sufficient capital to withstand adverse events (for example, floods or investment market crises).

Solvency Capital Requirement ('SCR') – An insurance entity's Solvency II capital requirement.

Stressed scenario – Consideration of the impact (current and prospective) of a particular defined set of alternative assumptions or outcomes that are adverse. Consideration is given to the effect on the insurance company assets, liabilities and operations of a defined adverse scenario.

Subsidiary – An enterprise controlled by another (called the parent) through the ownership of greater than 50 percent of its voting stock.

Surplus – An insurance undertaking typically holds assets of greater value than its contractual liabilities. The difference between these two amounts is often described as the surplus assets, and is usually compared against the amounts of regulatory capital that the undertaking is required to hold.

TASs – Technical Actuarial Standards issued by the Financial Reporting Council.

The Transfer – In the context of this report, I mean the proposal that HIC will transfer its EEA insurance business to HSA through English transfers under the provisions of Part VII of the Financial Services and Markets Act 2000.

The Transfer Companies – Hiscox SA ('HSA') and Hiscox Insurance Company Limited ('HIC').

Treating Customers Fairly ('TCF') – A set of principles set out by the FCA to ensure customers are being treated fairly

Underwriting – In general insurance, this is the process of consideration of an insurance risk. This includes assessing the appropriate premium, together with the terms and conditions of the cover as well as assessing the risk in the context of the other risks in the portfolio.

Well capitalised – Having capital resources comfortably in excess of the regulatory requirement; in this case I use it when the ratio is over 125%.

Written premium – See 'Premium'.

Very well capitalised – Having capital resources comfortably in excess of the regulatory requirement, in this case I use it when the ratio is over 200%.

Appendix 6 List of interviews carried out

Name	Business Unit	Position
Catherine Braum	HIC	Compliance Manager
Helen Cooper	HIC	Chief Actuary
James Pilgrim-Morris	HIC	Head of UK Claims
Andy Stevenson	HIC	Head of Europe Claims
Christian Nielsen	HIC	Chief Financial Officer
Juan de Castro	HIC	Chief Operations Officer
Stuart Shepley	HIC	Interim Chief Actuary
Andrea Schmid	HSA	Head of Risk, Legal & Compliance

Appendix 7 Details of proposed policyholder communication (summarised from Witness Statements)

Subject to the approval of the Court, it is proposed that a cover letter and accompanying information leaflets, including a summary of this Report (together, the 'Communication Pack'), will be dispatched to:

(a) policyholders of HIC for whom HIC (or its Third Party Administrators) holds a current valid address; and

(b) reinsurers,

Waivers are being sought in respect of certain groups of policyholders meaning that certain policyholders will not (subject to the Court's approval) be notified of the Transfers individually and I have considered the reasoning for each in turn. I believe the waivers still to be fair to each policyholder group given that the nature of the Transfers, the nature of some of the policies affected and given the substantial advertising campaign that will be in place for the Transfers will still inform these policyholders. The below lists these groups and the reasoning presented by the Transfer Companies for each:

- Policyholders remaining with HIC after the Transfer. For these policyholders there is no change to their insurer and I have concluded that there is no material adverse effect on their circumstances. HIC estimate that there are 994,082 such policyholders, and the administrative burden of notifying them could compromise ongoing customer service given that they do not need to do anything and are not materially affected by the Transfer;
- Property policyholders whose policy lapsed before 31 December 2016. HIC has performed analysis to demonstrate that there are less than 0.2% of property claims that are first notified after two years. HIC estimate that there are 167,630 such policyholders. I believe it is practical to restrict notification for expired policyholders to those for whom there is a realistic prospect of a future claim;
- Additional insureds under joint policies and group policies: Where a company has purchased an insurance product that covers multiple group companies HIC propose to only notify the primary policyholder, and request that they notify any other group or former group companies that are also beneficiaries of the (re)insurance policy. Similarly for joint personal policyholders HIC propose to only notify the main policyholder on the contract. I believe this is reasonable as HIC are still proposing to notify the principal policyholder. HIC estimate that there are 38,000 such policyholders;
- Employees under an employer's liability policy: HIC do not hold individual contact information for all of these parties, and therefore cannot notify them directly. HIC have identified 20,734 employer's liability policyholders covering an estimated 400,000 employees;
- Motor and employer's liability third party claimants whose contact details are unavailable: HIC do not have the contact details for these claimants and as such it is impossible to contact them. HIC have identified 1,179 such policyholders;
- Policyholders who are omitted from the communication through accidental omission: If a policyholder is accidentally omitted from the communication then they will not receive the communications pack. If accidental omission is identified prior to the final Court hearing steps would be taken by HIC to remedy this immediately. The number of these policyholders cannot be known;
- Deceased policyholders: Where HIC has been able to identify that a policyholder is deceased they will not be written to. This is practical and considerate. The number of deceased policyholders is currently unknown and an exercise to identify these is being carried out in the four weeks from 9 July 2018;
- Policyholders of HIC for which it is determined that the address is out of date and cannot be updated ('goneaways'). Efforts have been made to validate addresses for all policyholders whose policy was underwritten during the period 1995-2017. HIC has no way of contacting these policyholders. The number of such policyholders is unknown and an

exercise to identify and trace as many as possible is being carried out in the four weeks from 9 July 2018; and

Trustees in bankruptcy, receivers and administrative receivers: Where an individual or company's affairs are being managed by trustees in bankruptcy, receivers or administrative receivers, HIC will usually only have a record of the original policyholder. HIC propose to remove any policyholders identified as insolvent from the notification process as it is considered impractical to individually trace the other parties with the interest in the policies in question. The number of such policyholders is currently unknown and an exercise to identify them is being carried out in the four weeks from 9 July 2018.In addition waivers are being sort to change the method of communication to the following groups of policyholders:

- Policyholders of HIC that purchase their insurance online through one of BBVA, Norwegian Brokers AS, Germany Direct and France Direct, and O'Driscoll O'Neill DAC. For these policyholders the only means of communication is through email, and it is the email addresses of these policyholders that are most likely to be up-to-date. It is proposed to send these policyholders a copy of the communications pack via email. Excluding lapsed policies there are estimated to be 64,000 such policyholders;
- Policyholders of HIC where HIC is acting as a co-insurer rather than the lead insurer. These policyholders may not be aware that HIC are one of their insurers and will never have had any direct communication with HIC about their policy. It is proposed that HIC requests that the lead insurer or intermediary for the policy informs their policyholders of the Transfer and refers them to the Hiscox website where the communications pack can be accessed. It is estimated that there are 30,000 such policyholders;
- Intermediated policyholders, where the broker or intermediary holds the record of the policyholder's contact details. This is restricted to specific intermediaries in the UK & Ireland, Belgium and the Netherlands. The intermediary will be instructed to pass on the same policyholder communications pack to the policyholders as HIC would send direct. This is because it is not practically possible for HIC to contact these policyholders directly given they do not have the contact details and/or the intermediary wishes to do the communication; and
- New customers post Directions Hearing: Following the Directions Hearing new customers will receive a cover letter with their applications alerting them to the Transfer and directing them to the Hiscox website where the communications documents can be found, but they will not be mailed a copy of the communications pack. This means that they have the ability to make the decision to become a new customer in the full knowledge of the Transfer that is planned.

In addition a waiver is being applied for to not notify policyholders for whom no contact records can be traced. HIC have yet to identify any such policyholders but are requesting the waiver as a precaution.

I have considered the list of waivers requested above and the rationales provided for each of them. I consider the waiver requests to be reasonable.

I note each of the groups of policyholders not being communicated with can still submit claims following the Transfer and the means to do so will be appropriately accessible to them.

Wider communication

The Transfer will be published in the following publications: the London Gazette, the Edinburgh Gazette and the Belfast Gazette; the Times newspaper in the UK; the Daily Telegraph newspaper in the UK; and the European edition of the Financial Times.

As there are insurance risks situated outside of the UK, notice of the proposed Transfer will be advertised in the following publications and national newspapers: Der Standar (Austria); Le Soir (Wallonia – Belgium); De Standaard (Flanders – Belgium); Politiken (Denmark); Les Echos (France); Suddeutsche Zeitung (Germany); Kathimerini (Greece); Irish Independent (Ireland); Il Sole 24 Ore (Italy); Luxembourger Wort (Luxembourg); NRC (Netherlands); Dagens Naeringsliv (Norway); Expressao (Economia supplement) (Portugal); El Pais (Spain); and Dagens Nyheter (Sweden).

A website will also be operated on which the Communication Pack and a full copy/summary of this Report will be posted.

The Transfer will not, subject to the approval of the Court, be published in national newspapers in the remaining EEA states as these are not considered to have a significant number of policyholders (less than 150 in each case). The policyholders of the remaining EEA states will receive the individual notifications (subject to the above exemptions), have access to the European edition of the Financial Times, and/or be able to access the information on the dedicated website.