MILLIMAN REPORT

Report of the Independent Expert to the High Court of Justice in England & Wales on the proposed transfer of business from FM Insurance Company Limited to the UK branch of FM Insurance Europe S.A.

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Milliman

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1. Purpose and Scope

PURPOSE OF THIS REPORT

1.1 It is proposed that the business of FM Insurance Company Limited (“**FMI**” or the "**Transferor**") be transferred to FM Insurance Europe S.A. (“**FMIE**” or the "**Transferee**"), specifically to the UK branch of FMIE (“**FMIE UK Branch**”), by an insurance business transfer scheme (the “**Scheme**"), as defined in Section 105 of the Financial Services and Markets Act 2000 ("**FSMA**"). In this report (the "**Report**"), I refer to any insurance business transfer scheme that meets with the definition in Section 105 of FSMA as a "**Part VII Transfer**".

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

1.3 I refer to FMI and FMIE collectively as "**the Companies**". The Companies have nominated me to act as the Independent Expert to provide the FSMA Report in respect of the Scheme, and the PRA, in consultation with the FCA, has approved my appointment (see paragraph 1.14, below).

1.4 This Report, which I have prepared for the benefit of the Court, describes the Scheme, as proposed, and discusses its possible effects on the policyholders of FMIE and FMI, including its effects on the security of policyholder benefits and levels of service. As such, this Report fulfils the requirements of the FSMA Report.

1.5 FMI is domiciled in the UK, where it is authorised by the PRA and regulated by the PRA and the FCA. FMIE is domiciled in the Grand Duchy of Luxembourg (which I refer to throughout this Report simply as “Luxembourg”), where it is authorised and regulated by the Commissariat aux Assurances (“**CAA**”). The FMIE UK Branch is authorised by the PRA and regulated by the PRA and the FCA. Both FMI and FMIE are part of the FM Global group (“**FM**”) consisting of Factory Mutual Insurance Company (“**FMIC**”), a mutual commercial property insurance company incorporated in 1835 in the State of Rhode Island[1], USA, together with its worldwide subsidiaries and branches.

1.6 A list of terms defined in this Report is shown in Appendix A.

THE SCHEME

1.7 Prior to the UK’s decision in June 2016 to withdraw from the European Union (“**EU**”), FMI operated as hub for FM’s insurance business across the EEA, using the passporting rights enshrined in EU rules. FMIE was established in December 2016, and granted its insurance licence by the CAA in May 2017, with the intention that, ahead of the UK leaving the EU (“**Brexit**”), it would take over as FM’s hub for insurance business in the EEA and Switzerland, it being anticipated that, post-Brexit, FMI would lose passporting rights. FMI now only writes UK business and the liabilities in respect of the business that it wrote in EEA member states and in Switzerland prior to FMIE starting to write that business have now fully run-off.

[1] Prior to November 2020, the official name of the State of Rhode Island was the State of Rhode Island and Providence Plantations.

1.8 FMI and FMIE are very similar in structure, processes, procedures and management. FM has determined that it would be managerially more efficient to operate across the UK, the EEA and Switzerland via a single entity, as it did prior to Brexit, which could be achieved by:

- FMIE seeking and gaining authorisation for a UK Branch into which all future UK business would then be written (rather than into FMI) and
- the remaining business in FMI being transferred to FMIE, specifically to the FMIE UK Branch, FMI and FMIE seek to achieve this via the Scheme.

It is intended that, once all remaining business within FMI has been transferred out of FMI, FMI will apply for its permissions to conduct insurance business to be cancelled, following which it will be wound up.

1.9 Under the provisions of the Scheme, all of FMI's liabilities (the "**Transferring Liabilities**") will be transferred to the FMIE UK Branch. I understand that, although in prior years FMI wrote business in Switzerland and in EEA member states, no liabilities remain in respect of that business. The Scheme also provides for the transfer to the FMIE UK Branch of part of FMI's assets, including the outwards reinsurance contracts associated with the Transferring Business, that in value are more than sufficient to cover both the value of the Transferring Liabilities and the solvency requirements of the FMIE UK Branch relative to its risk appetite; I refer to the assets to be transferred from FMI to FMIE as the "**Transferring Assets**".

1.10 Under a separate intragroup agreement (the "**Intragroup Asset Transfer Agreement**") and therefore not as part of the Scheme, all but £5 million of the remaining assets of FMI will be transferred to FMIE (not to the FMIE UK Branch) on the Effective Date. The £5 million of assets that, post the Effective Date, remain within FMI are expected to be more than sufficient to meet FMI's residual liabilities and to satisfy both its regulatory requirements and risk appetite pending its winding-up.

1.11 In this Report, I refer to the (re)insurance policies that give rise to the Transferring Liabilities as the "**Transferring Policies**".

1.12 The date on which the Scheme becomes effective (the "**Effective Date**") is expected to be 30 November 2024.

1.13 The business involved in the Scheme, the arrangements for the Scheme and the effect of the Scheme are discussed in more detail in Sections 4 to 9 of this Report.

THE INDEPENDENT EXPERT

1.14 I, Derek Newton, have been appointed jointly by FMI and FMIE as the Independent Expert to consider the Scheme under Section 109 of FSMA. My appointment has been approved by the PRA, in consultation with the FCA; this was confirmed in a letter dated 16 January 2024.

1.15 I am a Principal of Milliman LLP ("**Milliman**"), based in its UK General Insurance practice in London. I am a Fellow of the Institute and Faculty of Actuaries ("**IFoA**"), which was established in 2010 by the merger of the Institute of Actuaries and the Faculty of Actuaries. I became a Fellow of the Institute of Actuaries in 1988. My experience of general insurance includes (reserved) roles such as Signing Actuary to Lloyd's syndicates and to Irish non-life insurance companies, as well as acting as the Independent Expert in eleven insurance business transfer schemes that were sanctioned between 2014 and 2023. I have included my Curriculum Vitae in Appendix C in which I explicitly note the insurance business transfer schemes for which I have acted as the Independent Expert, as well as those for which I have provided peer review support to the Independent Expert.

1.16 I do not have, and, to the best of my knowledge, never have had, any direct or indirect interest in any of the parties involved in the proposed Scheme. I have never had any insurance policies with the Companies or with any entity related to the Companies, and I am not a shareholder or member of any entity related to the Companies. I have not previously acted in an advisory role to either of the Companies or to any entity related to the Companies.

1.17 As explained in paragraph 1.5, above, both FMI and FMIE are members of FM. Milliman is a global firm and some of its many offices might, from time to time, have been engaged by members of FM to provide consultancy services. I have checked Milliman's records since January 2016 (complete information regarding prior periods no longer exists) and have found that, over that period, there has been just one such engagement: starting in 2022, a consultant in Milliman's Zurich office was appointed the Responsible Actuary for (and solely for) FMIE's branch in Switzerland (the "**FMIE Swiss Branch**"). As such, he has undertaken, as at the 2021, 2022 and 2023 year-ends, a high-level review of the calculations performed by FMIE in respect of the booked claims reserves relating to its branch in Switzerland. He has performed neither an independent assessment of those claims reserves nor a review of the premium provisions of FMIE's branch in Switzerland. He has undertaken no other work on behalf of any part of FM. This work as at the 2021 and 2022 year-ends constituted 0.0013% of Milliman's total client charges in calendar years 2022 and 2023. I note that, as at 31 December 2022, FMIE's Swiss branch contributed 4.9% of FMIE's total GAAP claims reserves, gross of reinsurance, and 4.5% net of reinsurance. I also note that, as at 31 December 2023, FMIE's Swiss branch contributed 6.0% of FMIE's total GAAP claims reserves, gross of reinsurance, and 5.7% net of reinsurance.

1.18 I note that the Responsible Actuary expects to remain in post for the foreseeable future and to perform similar reviews of the claims reserves of FMIE's Swiss branch as at future year-ends. However, neither I nor anyone supporting me as the Independent Expert have been or will be involved in his review. Likewise, neither the Responsible Actuary nor anyone supporting him in his work for the Swiss branch of FMIE, has had, or will have, any involvement in my review of the Scheme and of its expected impact on the policyholders of FMIE and FMI. Therefore, I believe that, for all practical purposes, I am independent for the purposes of assessing the proposed Scheme.

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

1.20 FMIE will meet the cost of my work as Independent Expert. No costs of the Scheme will be borne directly by any of the policyholders of either FMI or FMIE.

THE SCOPE OF MY REPORT

1.21 My terms of reference have been reviewed by the PRA and by the FCA and are set out in Appendix D.

1.22 I have considered the terms of the Scheme only and have not considered whether any other scheme or schemes or alternative arrangement might provide a more efficient or effective outcome.

1.23 The Report describes the Scheme and its likely effects on policyholders of FMI and FMIE, including effects on the security of policyholders' benefits and levels of service.

1.24 The Report should be read in conjunction with the full terms of the Scheme.

1.25 My work has required an assessment of the liabilities of FMI and FMIE for the purposes of describing the effect of the Scheme. My review of the liabilities was based on the actuarial reserve assessments conducted by actuaries employed or engaged by FMI or by FMIE. I have reviewed the methodology and assumptions used in their work and assessed the key areas of uncertainty in relation to these liabilities. I have not attempted to review in detail the calculations performed by the actuaries on behalf of FMI and FMIE or to produce independent estimates of the liabilities, although I would have done had I considered their work to be inadequate.

1.26 In addition to the liabilities, I have assessed the appropriateness in nature and amount of any assets to be transferred under the Scheme, and the capital position of FMI and FMIE, both pre- and post-Scheme. Again, I have not attempted to review in detail the calculations of the capital position performed on behalf of FMIE and of FMI, and I have not attempted to produce independently my own estimates, although I would have done had I considered the capital calculations to be inadequate.

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

1.28 In reporting on the Scheme as the Independent Expert, I recognise that I owe a duty to the Court to assist the Court on matters within my expertise. This duty overrides any obligation to FMI and / or to FMIE. I confirm that I have complied with this duty.

1.29 I have taken account of the requirements regarding experts set out in Part 35 of the Civil Procedure Rules, in Practice Direction 35 (Experts and Assessors), and in the Guidance for the Instruction of Experts in Civil Claims.

1.30 I confirm that I have made clear which facts and matters referred to in this Report are within my own knowledge and which are not. Those that are within my own knowledge I confirm to be true. The opinions I have expressed represent my true and complete professional opinions on the matters to which they refer.

1.31 Shortly before the date of the Court hearing at which an order sanctioning the Scheme will be sought, I will prepare a supplemental report ("**Supplemental Report**") that will cover any relevant matters that might have arisen since the date of this Report.

Materiality

1.32 After considering the effects of the Scheme on each of the different groups of policyholders affected by the Scheme (as identified in paragraph 5.13, below), I have drawn conclusions as to whether I believe the Scheme will materially adversely affect that group of policyholders. It should be recognised that the Scheme will affect different policyholders in different ways, and that, for any one group of policyholders, there may be some effects of the Scheme that are positive and others that are adverse. If some effects of the Scheme are adverse, that does not necessarily mean that the Scheme is unreasonable or unfair, as those adverse effects may be insignificant, or they may be outweighed by positive effects.

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

1.34 When assessing the financial security of policyholders, I have looked at the solvency position of the Companies, both pre- and post-Scheme, relative to regulatory solvency requirements, and also at the nature of the assets that constitute each company's capital and surplus. It should be noted that a company may have capital considerably in excess of its regulatory requirements, but that the directors of a company could legitimately reduce that level of capital (for example, through the payment of dividends) and still leave the company appropriately capitalised. In circumstances where the Scheme would adversely affect the financial security of a group of policyholders, in order to determine whether that impact is material, I have considered whether the level of financial security projected to be in place after implementation of the Scheme remains appropriate, taking into account both applicable regulatory requirements and how implementation of the Scheme would alter the risk profile to which that group of policyholders was exposed. I would consider the impact of the Scheme on a particular group of policyholders to be materially adverse if the level of financial security expected to be afforded to them after implementation of the Scheme were no longer appropriate.

THE STRUCTURE OF MY REPORT

1.35 The remainder of this Report is set out as follows:

- Section 2: I provide an executive summary of this Report (I have also provided a separate summary of this Report, as described in paragraph 1.42, below).
- Section 3: I provide some background information regarding the regulatory environments in which FMI and FMIE operate respectively.
- Section 4: I provide some background information regarding FMI and FMIE.
- Section 5: I summarise the key provisions of the Scheme.
- Section 6: I consider the likely impact of the Scheme on the holders of policies that comprise the Transferring Business ("**Transferring Policyholders**").
- Section 7: I consider the likely impact of the Scheme on the policyholders who will remain within FMI after the transfer has taken place ("**FMI Non-Transferring Policyholders**").
- Section 8: I consider the likely impact of the Scheme on the current policyholders of FMIE ("**Current FMIE Policyholders**").
- Section 9: I cover more general issues relating to the Scheme and the management of FMI and FMIE.

1.36 I summarise my conclusions in Section 10.

RELIANCES AND LIMITATIONS

1.37 In carrying out my review and producing this Report, I have relied, without detailed verification, upon the accuracy and completeness of the data and information provided to me, in both written and oral form, by the Companies. Reliance has been placed upon, but not limited to, the information detailed in Appendix B. My opinions depend on the substantial accuracy of this data, information and the underlying calculations. I am unaware of any issue that might cause me to doubt the accuracy of the data and other information provided to me. All information that I have requested in relation to my review has been provided. I have been assisted in my review of the information and my analyses by colleagues of mine at Milliman, but I have not relied on their work or their advice.

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

1.39 The Report must be considered in its entirety as individual sections, if considered in isolation, may be misconstrued.

1.40 Neither this Report, nor any extract from it, may be published without me having provided my specific written consent, save that:

- copies of this Report may be made available for inspection by policyholders who might be affected by the Scheme, and
- copies may be provided to any person requesting the same in accordance with legal requirements.

1.41 I explain in paragraph 5.42, below, that a web page dedicated to the Scheme will be set up on FM's UK website (www.fm.com/uk/) (the FM website covers all FM operations – neither FMI nor FMIE has its own specific website). I consent to this Report being made available on the website dedicated to the Scheme.

1.42 No summary of this Report may be made without my express consent. I will provide a summary of this Report (the "**Report Summary**") for inclusion in a document that will be made available to the affected policyholders of FMI and of FMIE, and to anyone who has been identified as having an interest in the policies being transferred or who has notified FMI or FMIE of their interest (further details are provided in paragraphs 5.36-5.38, below). That document will be sent to the FCA and PRA, will accompany the Scheme application to the Court, and will be available on the aforementioned website dedicated to the Scheme.

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

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

1.45 This review does not comprise an audit of the financial resources and liabilities of FMI or FMIE.

1.46 The Report should not be construed as investment advice.

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

1.48 In considering the background to the Companies, and in considering the likely impact of the Scheme, I have made extensive use of the most recent audited financial information that is available. I have also taken into account updated financial information insofar that has been made available to me, although I note that such updated information will have been neither audited nor, in general, publicly disclosed. I have asked the managements of the Companies for information regarding any developments between the dates of their respective most recent audited financial statements and the date of this Report that would have affected the Companies, in particular any development that might have affected the security of their policyholders and the standards of service provided to them, both now and in future. I have referred in this Report to the developments that they have reported to me. The managements of FMI and FMIE have confirmed to me that there have been no other such developments. I have also searched using on-line resources for information regarding any such developments. At the date of this Report, I am not aware of any material changes in circumstances since the dates of the Companies' respective most recent audited financial statements other than those referred to in this Report. The Report also takes no account of any information that I have not received, or of any inaccuracies in the information provided to me. I will review any further financial statements of FMI and FMIE, whether audited or unaudited, as and when they become available, and will comment on this information in the Supplemental Report.

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

PROFESSIONAL AND REGULATORY GUIDANCE

1.50 I am required to comply with relevant professional standards and guidance maintained by the Financial Reporting Council and by the IFoA, including *TAS 100: Principles for Technical Actuarial Work* (as issued in 2023) and *TAS 200: Insurance* (as published in 2016). I have complied with such standards, subject to the principles of proportionality and materiality. I have also been mindful of the exposure draft, published in February 2024, of version 2.0 of *TAS 200: Insurance*.

1.51 In accordance with *Actuarial Profession Standard X2*, as issued by the IFoA, I have considered whether this Report should be subject to review ("**Work Review**"). I concluded that it should, and I have also decided that the Work Review should be conducted by an individual who has not otherwise been involved in the analysis underlying this Report or in the preparation of this Report, but who would have had the appropriate experience and expertise to take responsibility for the work himself. In other words, I have decided that this Report should be subject to Independent Peer Review. I confirm that this Report has been subject to Independent Peer Review prior to its publication.

1.52 This Report has been prepared under the terms of the guidance set out in the Statement of Policy entitled *Insurance business transfers* (the "**Policy Statement**"), issued by the PRA in January 2022 (see Appendix H, where I cross-reference the relevant paragraphs in this Report to each reference in the Policy Statement), and in Section 18 of the FCA Supervision Manual ("**SUP18**") contained in the Handbook of Rules and Guidance to cover scheme reports on the transfer of insurance business. I have also followed the guidance contained within the FCA's February 2022 paper on Part VII Transfers ("**FG22/1**").

2. Executive Summary

CONCLUSION

2.1 In my opinion, provided the proposed Scheme operates as intended (I note that I have no grounds for believing that it will not do so):

- the Scheme will not materially adversely affect the security of benefits to policyholders of either FMI (both the Transferring Policyholders and the FMI Non-Transferring Policyholders, as defined in paragraph 5.13, below) or FMIE; and
- the Scheme will not affect the service standards experienced by the policyholders of either FMI (both the Transferring Policyholders and the FMI Non-Transferring Policyholders) or FMIE.

2.2 I summarise below the key aspects of the Scheme, the aspects of the Scheme that I considered, and the conclusions that I reached in respect of those aspects.

2.3 I will review my analyses and conclusions in the light of any relevant information of which I become aware prior to the Court hearing to sanction the Scheme, and I will summarise my additional review and conclusions, explaining any revisions to those contained within this Report, in the Supplemental Report.

THE SCHEME

2.4 The Transferring Business comprises all liabilities of FMI and the assets (including the associated reinsurance assets, rights of salvage and subrogation) of FMI that support those liabilities. These assets and liabilities relate to the (re)insurance policies written by FMI in the UK (up to 2024). Under the Scheme, the Transferring Business will be transferred from FMI to the FMIE UK Branch, which has been authorised by the PRA and FCA to conduct business in the UK.

2.5 Under the Intragroup Asset Transfer Agreement, which will run separate to but simultaneously with the Scheme, all but £5 million of the remaining assets of FMI will be transferred to FMIE (not to the FMIE UK Branch) on the Effective Date.

2.6 There will be no changes to the terms and conditions of any policy included within the Transferring Business as a result of the Scheme. Similarly, it is intended that there will be no change in how the Transferring Business is administered as a result of the Scheme.

2.7 FMI's records indicate that, as at 31 December 2023, there were 110 Transferring Policies that had open claims relating to all risks commercial property policies and a further 974 claims relating to a portfolio of casualty business that has been in run-off for over fifty years and which is fully reinsured by FMIC. FMI's records also show that, as at 31 December 2023, 791 Transferring Policies were unexpired, and a further 71 policies had been bound but had not incepted as at that date. Aside from the casualty business in long-term run-off, the nature of the business written by FMI is such that claims tend to be reported very soon after they have been incurred, usually within a week, so the numbers of incurred but not yet reported claims at any particular time is likely to be small.

2.8 It is possible, although unlikely, that, for some reason, one or more policies within the Transferring Business are not transferred to FMIE under the Scheme. I refer in this Report to any such policy as an "**Excluded Policy**".

2.9 As at 31 December 2023, on a UK GAAP basis, FMI held gross reserves totalling £183.0 million and net reserves totalling £45.8 million in respect of the Transferring Business. As at 31 December 2023, on a Luxembourg GAAP ("**LuxGAAP**") basis (which is broadly the same as a UK GAAP basis), FMIE held gross reserves totalling €772.5 million and net reserves totalling €205.0 million. Based on an exchange rate of £1.00 = €1.16 (which was roughly the rate as at 31 December 2023), the Transferring Liabilities were the equivalent of 27.5% of FMIE's gross reserves and 25.8% of its net reserves.

2.10 I have provided a schematic representation of the proposed Scheme in Figure 5.1, below.

Motivation for the Scheme

2.11 The motivation for the Scheme is to streamline the structure, management and operations relating to FM's European business. Currently, FM's business in Europe is split between two companies (FMI and FMIE) that have very similar processes, procedures and management. The Scheme is intended to result in all of FM's European business being within a single company (FMIE), and FMI having no remaining insurance liabilities. FMI would then be able to apply to the PRA for the cancellation of its permissions and, in due course, would be wound up. Thus, FM would eliminate the existing duplication across FMI and FMIE in governance and management structures and in reporting obligations, which would facilitate both greater management efficiency and expense savings.

Policyholders Affected

2.12 I have considered the effects of the Scheme on the following groups of policyholders:

- the Transferring Policyholders;
- the Current FMIE Policyholders; and
- the FMI Non-Transferring Policyholders (although none are expected, it is possible that there may be some Excluded Policies, as noted in paragraph 2.8, above).

2.13 I have summarised the numbers of policies that could have been affected by the Scheme, had the Effective Date been 31 December 2023, in Figure 5.2, below.

Administration

2.14 The approach and standards of FMI and of FMIE to policy servicing are virtually identical. As it is intended that all members bar one[2] of FMI staff will be transferred to the FMIE UK Branch as soon as the FMIE UK Branch becomes operational and that they continue to operate in accordance with the current FMI conduct rules (subject to any subsequent revision), the Transferring Business will be managed and serviced, post-Scheme, by the same people, using the same IT and other systems, using the same processes and to the same standards as it was pre-Scheme.

THE IMPACT OF THE SCHEME UPON THE TRANSFERRING POLICYHOLDERS

2.15 Based on their balance sheets as at 31 December 2023, I consider FMI (pre-Scheme) to be very well-capitalised and FMIE (both pre-Scheme and post-Scheme, had the Scheme been effective as at 31 December 2023) to be well-capitalised (I have defined these terms in paragraph 6.4, below). I note that FMIE (post-Scheme) is projected to remain well-capitalised as at the year ends 2024-2026.

2.16 In reviewing the extent to which changes induced by the Scheme would materially affect the Transferring Policyholders, I have considered the following:

- the reserves of FMI and FMIE as at 31 December 2023 (and subsequently where available);

[2] The member of FMI staff who will not be transferred to the FMIE UK Branch is an engineer who it is intended will instead be transferring to an engineering company that, as at the date of this Report, FM is in the process of establishing.

- the excess assets of FMI and FMIE as at 31 December 2023 (and subsequently where available);
- the risk exposures in the Companies and the impact that the Scheme might have on those; and
- the standards of policy servicing that will apply to the Transferring Policies both pre- and post-Scheme.

2.17 I concluded that:

- the reserves of FMI and FMIE appear reasonable as at 31 December 2023;
- there is no reason to think that the reserve strength of FMI or FMIE will be impacted by the Scheme;
- pre-Scheme, FMI was a very well-capitalised company and FMIE a well-capitalised company. Post-Scheme, FMIE is expected to be a well-capitalised company, and is projected to remain a well-capitalised company for the planning period 2024-2026. Therefore, the likelihood of the Transferring Policyholders not receiving their full contractual benefits under the terms of their Transferring Polices will not be materially increased by the Scheme;
- although the proposed Scheme will lead to some change to the risk exposures of the Transferring Business, this will not have a materially adverse impact on the security of policyholder benefits; and
- the proposed Scheme will have no impact on the standards of policy servicing experienced by the Transferring Policyholders compared to their current position.

2.18 In summary, I am satisfied that the proposed Scheme does not affect in a materially adverse way either the security or the policy servicing levels of the Transferring Policyholders.

THE IMPACT OF THE SCHEME UPON THOSE POLICYHOLDERS REMAINING WITHIN FMI

2.19 The FMI Non-Transferring Policyholders will comprise only holders of policies that become Excluded Policies (if there are any). I note that no Excluded Policies are expected. I am satisfied that the security of the contractual rights and the standards of policy servicing currently enjoyed by the FMI Non-Transferring Policyholders will not be adversely affected by the Scheme.

2.20 In reaching this conclusion I have noted that:

- post-Scheme, FMI will remain a very well-capitalised company; and
- the policy service standards within FMI will be maintained, post-Scheme, with servicing provided by the same people as currently perform the tasks, who would be seconded from the FMIE UK Branch to FMI as needed.

THE IMPACT OF THE SCHEME UPON THE CURRENT FMIE POLICYHOLDERS

2.21 I have concluded that the Scheme would not have a materially adverse impact on the Current FMIE Policyholders.

2.22 In reaching this conclusion I have noted that:

- the post-Scheme financial strength of FMIE, and hence the level of financial security offered to the Current FMIE Policyholders, will, if anything, be greater than it was pre-Scheme; and
- the Scheme will make no difference to the terms or the servicing of the policies held by the Current FMIE Policyholders.

OTHER MATTERS

2.23 I have considered the likely effects of the Scheme on the reinsurers whose reinsurance contracts relate to the Transferring Business. FMI's rights in relation to such contracts will transfer to FMIE. The Scheme will have no impact upon the magnitude of the claims within the Transferring Business. The administration of the Transferring Business, including the management and handling of claims and of recoveries against outwards reinsurers, will be performed post-Scheme using the same processes and staff, and to the same standards, as it had been pre-Scheme. Therefore, the magnitude and timing of recoveries claimed against reinsurance contracts relating to the Transferred Business will be unaffected by the Scheme.

2.24 I have been informed that the Scheme is not expected to have any material tax implications that would affect either of the Companies or any of the groups of policyholders identified in paragraph 2.12, above.

2.25 I have been provided with an estimate of the external costs of the Scheme. I consider that the costs of the Scheme will not be such as to jeopardise the security of any of the groups of policyholders.

2.26 The COVID-19 pandemic had only a small and largely temporary impact on FMI and FMIE. It had only a limited effect on the claims experience of the Companies, as the terms and conditions had specific limits in place in respect of communicable diseases, which were limiting the cover to cleaning the facilities. Those few claims that the Companies incurred that were related to the COVID-19 pandemic were covered and aggregated at group level as a catastrophe event, further limiting the impact on both Companies. The Companies activated their respective business continuity plans and were able to maintain continuous support to their clients throughout the pandemic. They both suffered immediate and sharp drops in the value of the equities that they held, but these were reversed over the following two months.

2.27 The ongoing conflict in Ukraine has led to significant sanctions against Russia and Belarus, as well as disturbing the economies of countries that have material dealings with Ukraine, Russia or Belarus. There has been, and is expected to be, no claims impact on either FMI or FMIE due to this conflict: the standard FM policy contract terms specifically exclude cover following act of war, moreover, neither FMI nor FMIE have covered any risks located in any of those three territories. FM is not a licensed insurer in Russia and stopped renewing any reinsurance business or underwriting new reinsurance business with Russian insurers in 2022. FM Engineering International Limited ("**FME**"), a wholly owned subsidiary of FMI, had engineers located in Russia providing engineering services to FM clients, but those employees have now been relocated to other countries. FME is in the process of closing its Russian branch. The Companies have confirmed to me that any exposures to interests relating to, or investments in, Russia or Belarus that they may have had in the past were all settled prior to 2022 and that none are ongoing.

2.28 The ongoing conflict in Israel and the Gaza Strip is expected to have only a limited impact upon FMI and FMIE. As noted above, the standard FM policy contract terms specifically exclude cover following act of war and FMIE covers no risks in either Israel or the Gaza strip. FMI also has no exposure to the Gaza strip but has a limited exposure to risks located in Israel through reinsurance agreements, although no losses have been reported so far. FME has engineers located in Israel and servicing FM clients. The Companies are monitoring the situation closely.

2.29 The Ukraine conflict has also been instrumental in fuelling market instability, including rising levels of inflation, in many countries, which drove up interest rates and drove down bond values across the world. Inflation and interest rates appear to have peaked across most of the developed world and inflation rates have recently reduced markedly, although UK interest rates have yet to follow. Likewise, bond values are rising slowly. The impact of these movements on the Companies, via claim costs and expenses, has been mitigated by increased premiums, which have been driven by rate increases, by increases in insured values and by new business.

2.30 There is a risk of escalation in the above conflicts and of other geopolitical tensions leading to further hostilities, which would likely affect the value and returns on investment assets and could lead to higher inflation and rising claim costs. In such circumstances, both Companies would be affected. I have considered the possible impact of a sudden fall in asset values and of a sharp increase in inflation as part of my evaluation of the capital robustness of FMIE, post-Scheme.

2.31 I discuss these matters in more detail in Section 9.

APPROACH TO COMMUNICATION WITH POLICYHOLDERS

2.32 The Companies' approach to communicating the Scheme to affected policyholders and their brokers is outlined in paragraphs 5.34-5.45, below.

2.33 I consider the approach being taken to be reasonable.

2.34 The Companies will communicate, directly or indirectly, with all Transferring Policyholders. The Companies will apply to the Court for waivers of the notification requirements in respect of all FMIE policyholders.

2.35 In addition to direct, written correspondence with policyholders, the Companies also plan indirect notification via advertisements in appropriate publications.

2.36 The letters, notices and advertisements will refer all queries to a postal address, telephone number and email address, all of which are intended to respond promptly to any such queries. Both this Report and the Supplemental Report will be published on a clearly labelled and sign-posted page on the FM website.

2.37 In the circumstances, I regard the proposed approach to communications to be reasonable and proportionate, and the draft communications to be clear, fair and appropriate for their intended audiences.

3. Background regarding the regulatory environments

INTRODUCTION

3.1 The Scheme proposes the transfer of the insurance and reinsurance business that is currently within FMI to the FMIE UK Branch. FMI is a company domiciled and regulated in the UK; FMIE is a company domiciled and regulated in Luxembourg; and the FMIE UK Branch is established and regulated in the UK.

3.2 Although the FMIE UK Branch is subject to regulation in the UK, it is not a distinct legal entity, and it is therefore necessary for me to consider FMIE as a whole, as well as the FMIE UK Branch in isolation.

3.3 In this Section, I describe the general insurance markets of the UK and of Luxembourg, and the regulatory environments therein. I also comment here on consumer protection schemes in the UK and in Luxembourg. I then comment on the respective winding-up arrangements for companies in the UK and in Luxembourg.

OVERVIEW OF UK INSURANCE REGULATION

Background

3.4 UK insurers are regulated by both the PRA and the FCA using a system of dual regulation. The PRA and the FCA are statutory bodies set up under FSMA and the Financial Services Act 2012; their roles and objectives are defined by FSMA (as amended).

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

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

3.6 The FCA is a separate institution and is responsible for:

- ensuring the efficient functioning of markets that it regulates;
- the conduct regulation of all financial firms; and
- prudential regulation of those financial services firms that are not supervised by the PRA.

3.7 A Memorandum of Understanding has been established between the PRA and the FCA, which sets out the high-level framework by which these two regulatory bodies will co-ordinate. In particular, the Memorandum of Understanding requires the PRA and FCA to co-ordinate with each other in respect of Part VII Transfers.

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

3.9 The FCA is concerned with achieving fair outcomes for consumers and seeks to ensure that firms that it regulates adhere to its conduct principles. Its strategic objective is to ensure that the relevant markets function well. To support this, it has three operational objectives, which are:

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

Taxation

3.10 In the UK, proprietary general insurance companies are taxed on profits achieved at the main rate of corporation tax (currently 25% for the financial year ending 5 April 2025[3]). Mutual general insurance companies are taxed only on their investment income and, to the extent that they conduct some business not on a mutual basis, on the proceeds of that non-mutualised business.

Financial Services Compensation Scheme

3.11 As well as through the PRA and FCA regulations, consumer protection is also provided by the Financial Services Compensation Scheme ("**FSCS**"). This is a statutory "fund of last resort", which compensates customers in the event of the insolvency (or other defined default) of a financial services firm authorised by the PRA or FCA, subject to certain eligibility rules. Insurance protection exists for private policyholders and small businesses[4] that hold eligible policies in the situation when an insurer is unable to meet fully its liabilities. For general insurance business, the FSCS will pay 100% of any claim incurred before the default:

- in respect of a liability subject to compulsory insurance (such as employers' liability cover); or
- that arises in respect of a liability subject to professional indemnity insurance; or
- that arises from the death or incapacity of the policyholder due to injury, sickness, or infirmity

and 90% of any claim incurred before the default for other eligible types of insurance (such as home insurance).

3.12 These limits have been effective since 3 July 2015; prior to that date, for general insurance business, only claims in respect of compulsory insurance were eligible for 100% payment by the FSCS in the event of the default of an authorised firm.

3.13 No protection is available for Goods in Transit, Marine, Aviation and Credit Insurance. Contracts of reinsurance are also not protected. The FSCS is funded by annual levies on all firms regulated by the PRA and by the FCA, with separate tariffs for each of five broad classes of activity (deposits, life and pensions, general insurance, investments and home finance).

3.14 I note that FMI has written exclusively commercial lines business. I have been told by FMI that, to the best of its knowledge, none of its policyholders would be eligible for compensation under the FSCS.

Financial Ombudsman Service

3.15 The Financial Ombudsman Service ("**FOS**") provides eligible complainants with a free, independent service for resolving disputes with financial companies. An eligible complainant must be a person that is one of the following:

- a consumer (essentially, a private individual);
- a micro-enterprise[5];
- a charity that has an annual income of less than £6.5 million at the time that the complaint is made;
- a trustee of a trust that has a net asset value of less than £5 million at the time that the complaint is made;

[3] This rate applies to companies with profits over £250,000. For companies with profits under £50,000 the Corporation Tax rate is 19%. Companies with profits between £50,000 and £250,000 pay tax at the 25% rate reduced by a marginal relief such that, overall, they pay on a sliding scale between 19% and 25%.

[4] In accordance with Section 382 of the Companies Act 2006, a small business is defined as one for which two of the following three conditions apply over the preceding financial year: turnover not more than £10.2 million; balance sheet not more than £5.1 million; and not more than 50 employees.

[5] An entity is considered to be a micro-enterprise if it has an annual turnover of less than €2 million and fewer than ten employees.

- in relation to consumer buy-to-let business, a buy-to-let consumer;
- a small business[6] at the time the complainant refers the complaint to the respondent;
- a guarantor.

3.16 For a complaint regarding an insurance policy to be dealt with by the FOS, it is not necessary for the complainant to live or be based in the UK, but it is necessary for the insurance policy concerned to be, or have been, administered from within the UK.

3.17 As I noted in paragraph 3.14, above, FMI has written exclusively commercial lines business. I have been told by FMI that, to the best of its knowledge, none of its policyholders would be eligible to access the FOS.

FCA Conduct Principles

3.18 Within its document "*Fair treatment of customers*", the FCA sets out six consumer outcomes that firms (and the UK branches of insurers not domiciled in the UK) should strive to achieve to ensure fair treatment of customers. These remain core to what the FCA expects of firms. These are as follows:

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

3.19 These outcomes, which are often summarised as "Treating Customers Fairly" ("**TCF**"), apply even for firms that do not have direct contact with retail customers. The FCA's rationale is that risks and poor conduct can be carried from wholesale to retail markets.

3.20 In its Handbook, the FCA sets out the twelve principles to which it expects all firms that it regulates to adhere. These are:

- **Principle 1** Integrity: A firm must conduct its business with integrity.
- **Principle 2** Skill, care and diligence: A firm must conduct its business with due skill, care and diligence.
- **Principle 3** Management and control: A firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems.
- **Principle 4** Financial prudence: A firm must maintain adequate financial resources.
- **Principle 5** Market conduct: A firm must observe proper standards of market conduct.
- **Principle 6** Customers' interests: A firm must pay due regard to the interests of its customers and treat them fairly.

[6] According to FOS eligibility rules, a small business is a business that is not a micro-enterprise but which has an annual turnover of less than £6.5 million and either has a balance sheet total of less than £5 million or employs fewer than 50 people.

- **Principle 7** Communications with clients: A firm must pay due regard to the information needs of its clients and communicate information to them in a way which is clear, fair and not misleading.
- **Principle 8** Conflicts of interest: A firm must manage conflicts of interest fairly, both between itself and its customers and between a customer and another client.
- **Principle 9** Customers: relationships of trust: A firm must take reasonable care to ensure the suitability of its advice and discretionary decisions for any customer who is entitled to rely upon its judgment.
- **Principle 10** Clients' assets: A firm must arrange adequate protection for clients' assets when it is responsible for them.
- **Principle 11** Relations with regulators: A firm must deal with its regulators in an open and cooperative way and must disclose to the FCA appropriately anything relating to the firm of which that regulator would reasonably expect notice.
- **Principle 12** Consumer Duty: A firm must act to deliver good outcomes for retail customers.

3.21 The FCA has provided supplementary guidance, entitled *The Responsibilities of Providers and Distributors for the Fair Treatment of Customers* ("**RPPD**") and most recently published in March 2019, which provides the FCA's view on what the combination of Principles for Businesses and detailed rules require respectively of providers and distributors in certain circumstances to treat customers fairly. The RPPD looks particularly to Principles 2, 3, 6 and 7, as listed in paragraph 3.20, above.

3.22 Principle 12 (the Consumer Duty Principle) is supported by the "Four Outcomes," which are a suite of rules and guidance setting more detailed expectations for firm conduct in four areas that represent key elements of the firm-consumer relationship:

- the governance of products and services;
- price and value;
- consumer understanding; and
- consumer support.

3.23 The key behaviours required by the Consumer Duty Principle are set out by "Cross-cutting Rules," and make clear that the Consumer Duty Principle requires firms to:

- act in good faith;
- avoid foreseeable harm to retail customers; and
- enable and support retail customers to pursue their financial objectives.

3.24 The Consumer Duty Principle is underpinned by the concept of reasonableness. This is an objective test and means the rules and this guidance must be interpreted in line with the standard that could reasonably be expected.

3.25 Firms must monitor the outcomes of their retail customers. At least annually, the governing body of each FCA-regulated firm must:

- review and approve a report provided by the firm on the outcomes being received by the retail customers with which it deals;
- confirm whether it is satisfied that the firm is complying with its obligations under the Consumer Duty Principle; and
- assess whether the firm's future business strategy is consistent with its obligations under the Consumer Duty Principle.

3.26 The governing body must also agree:

- any action required to address any identified risk that retail customers may not receive good outcomes;

- any action required to address any identified instance where retail customers have not received good outcomes; and
- any amendments to the firm's business strategy to ensure that it remains consistent with meeting the firm's obligations under the Consumer Duty Principle.

3.27 Prior to the Consumer Duty Principle being introduced to its Handbook, the FCA helpfully summarised its expectations that, under the (then proposed) Consumer Duty Principle, firms should:

- put consumers at the heart of their business;
- provide products and services that are fit for purpose, that they know provide fair value, that help consumers achieve their financial objectives and which do not cause them harm;
- communicate and engage with consumers so that they can make effective, timely and properly informed decisions about financial products and services and take responsibility for their actions and decisions;
- not seek to exploit customers' behavioural biases, lack of knowledge or characteristics of vulnerability;
- support their customers in realising the benefits of the products and services they buy and acting in their interests without unreasonable barriers;
- consistently consider the needs of their customers, and how they behave, at every stage of the product/service lifecycle;
- continuously learn from their growing focus and awareness of real customer outcomes;
- embed a culture of acting to deliver good outcomes in each of their business functions and related policies, from high-level strategic planning to individual customer interactions;
- monitor and regularly review the outcomes that their customers are experiencing in practice and take action to address any risks to good customer outcomes; and
- ensure that their management and executive body takes full responsibility for the outcomes their customers are experiencing, in line with their accountability under the Senior Managers and Certification Regime.

3.28 I note that the Consumer Duty Principle applies in respect of retail customers and not in respect of all customers. The definition of "retail customers" includes personal lines policyholders and small commercial businesses but does not include large corporate entities. As I noted in paragraphs 3.14 and 3.16, above, FMI has written exclusively commercial lines business and believes that its policyholder base falls outside the definition of "retail customer".

The Insurance Distribution Directive

3.29 The Insurance Distribution Directive ("**IDD**") has applied in the UK (and in all EU Member States) since 1 October 2018. The key requirements of the IDD are:

- Product oversight and governance arrangements aimed at ensuring that customers' interests are taken into consideration throughout the whole life cycle of an insurance product;
- Transparency of inducement schemes to ensure respect of customers' interests;
- The insurance undertaking (or insurance intermediary) providing advice to a customer is responsible for the assessment as to whether the insurance product(s) is/are suitable and appropriate, having regard to the customer's profile; and
- A conflict-of-interest policy to facilitate customers' understanding of an insurance undertaking's actions taken on their behalf.

The Insurers (Reorganisation and Winding-Up) Regulations 2004

3.30 Under UK law, the winding-up of an insurance undertaking is governed by the *Insurers (Reorganisation and Winding-Up) Regulations 2004* (as amended, including under the Solvency II Regulations 2015). Under these regulations, direct insurance claims have precedence over any claim on the insurance undertaking with the exception of certain preferential claims (e.g. claims by employees, etc.) with respect to the whole of the insurance undertaking's assets. Therefore, direct policyholders rank equally and above inwards reinsurance policyholders and all other unsecured/non preferential creditors in the event that an insurer is wound up.

Solvency Capital Framework (Solvency II and Solvency UK)

3.31 With effect from 1 January 2016, the regulatory solvency and reporting framework for (re)insurers regulated within the EU (commonly referred to as **Solvency II**) introduced, consistently across the EU, solvency requirements intended to reflect the risks that individual (re)insurers actually face.

3.32 Although the UK left the EU with effect from 31 January 2020, in effect it continued to apply Solvency II, having transcribed an identical regime into UK regulations. Towards the end of 2023, the UK Government approved specific changes to the UK regulations, which are now starting to diverge from Solvency II. I refer in this Report to the UK's regulatory regime as **Solvency UK**.

3.33 Under Solvency II (and Solvency UK), those (re)insurers regulated within the EU (and the UK) are required to adhere to a set of risk-based capital requirements.

3.34 Solvency II (and Solvency UK) is a principles-based regime, based on three so-called pillars:

- Under Pillar I, quantitative requirements define a market consistent framework for valuing the company's assets and liabilities and determining both the Solvency Capital Requirement ("**SCR**") and the Minimum Capital Requirement ("**MCR**").
- Under Pillar II, insurers must meet minimum standards for their corporate governance, and also for their risk and capital management. There is a requirement for internal audit and actuarial functions. Insurers must regularly complete an Own Risk and Solvency Assessment ("**ORSA**").
- Under Pillar III, there are explicit requirements governing disclosures to supervisors and policyholders. Insurers must publicly disclose their solvency and financial condition in an annual Solvency and Financial Condition Report ("**SFCR**").

3.35 Under Solvency II (and Solvency UK), both the assets and liabilities of insurers are valued on a market consistent basis. Therefore, under Solvency II (and Solvency UK), the technical provisions in respect of claims incurred and losses arising from unexpired exposures (which, together, are typically the largest item on the liability side of an insurer's balance sheet) are often substantially different from those calculated under the current requirements for GAAP.

3.36 I set out in Appendix F a summary of the components of the balance sheet, and of the calculation of technical provisions (in respect of claims incurred and losses arising from unexpired exposures), for an insurer under Solvency II (and Solvency UK). In this Report, I denote technical provisions under Solvency II (and Solvency UK) as "**TPs**".

3.37 TPs as relating to general insurance business are:

- The premium provision: the expected present value (with no allowance for optimism or prudence) of all future cashflows (claim payments, expenses and future premiums due) relating to future exposures arising from policies for which the insurer is obligated as at the valuation date;
- The claims provision: the expected present value (with no allowance for optimism or prudence) of all future cashflows (claim payments, expenses and future premiums due) relating to claim events prior to the valuation date; and

- The risk margin: the risk margin is intended to be the balance that another (re)insurer would require over and above the sum of the premium provision and claims provision for taking on the liabilities at the valuation date. Under Solvency II (and Solvency UK), the risk margin is calculated using a cost-of-capital approach[7].

3.38 TPs in respect of claims and premiums differ from the GAAP reserves in several ways, including the following:

- The TPs contain no element of conservatism (aside an explicit risk margin - see below) above a best estimate;
- The TPs include an allowance for events not in data ("**ENID**"), which are events or future developments that might occur, but which are not represented in the historical data upon which the actuarial projections are based;
- The TPs include a discount to account for the time value of money in the future cashflows; and
- The TPs include an explicit risk margin.

I have set out the differences and their balance sheet implications in Appendix G.

3.39 The SCR under Solvency II (and Solvency UK) is the amount of capital required to ensure continued solvency over a one-year time horizon with a probability of 99.5%. There are two main approaches to calculating the SCR:

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

3.40 The MCR defines the point of intensive regulatory intervention. The MCR calculation is less risk sensitive than the SCR calculation and is calibrated to a confidence level of 85% over a one-year time horizon (compared to 99.5% for the SCR). The MCR is calculated as a linear function of the TPs and written premium but must be between 25% and 45% of the firm's SCR, subject to an absolute floor of €2.5 million (or €3.7 million for (re)insurers writing liability, credit or suretyship classes).

3.41 It is possible that, for some small insurers, the calculated SCR is less than the absolute floor of the MCR. In such cases, the reported SCR is set equal to the MCR.

[7] The cost-of-capital parameter under Solvency II has been 6% since the regime was implemented in 2016. However, under Solvency UK, the cost-of-capital parameter was reset to 4% at the end of 2023. Under Solvency II, the equivalent parameter remains at 6%, although, during 2023, the European Parliament proposed that the standard capital rate under Solvency II be reduced to 4.5%. As at the date of this Report, this change had not been implemented within Solvency II.

3.42 If an insurer's available resources eligible for solvency purposes (known as Eligible Own Funds ("**EOFs**")) fall below the SCR, then the relevant supervisor is 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 capture any ailing insurer before its situation becomes a serious threat to its policyholders' interests. If the available resources of the insurer were to fall below the level of the MCR, then "ultimate supervisory action" would be triggered, e.g. the insurer's liabilities would be transferred to another insurer and the licence of the insurer would be withdrawn, or the insurer would be closed to new business and its in-force business placed into run-off. In practice, a supervisor would be expected to have determined earlier whether or not the insurer's finances could be restored to above the level of the SCR – an insurer whose supervisor determined that it would not be able to restore its solvency position would be placed into run-off before it breached its MCR.

Brexit

3.43 As mentioned above in paragraph 3.32, the UK withdrew from membership of the EU on 31 January 2020, and the formal transition period concluded on 31 December 2020. The EU and UK have signed a Trade and Cooperation Agreement, which reaffirmed the commitment of both the UK and the EU to ensure financial stability, market integrity and the protection of investors and consumers of financial services. It further noted agreement for enhanced regulatory cooperation between the UK and the EU and also the integrity of the respective, autonomous equivalence financial services frameworks. As also mentioned in paragraph 3.32, the UK government initially (post-Brexit) adopted the Solvency II framework wholly within UK regulations, but has since implemented some changes that it considers appropriate for the UK insurance market but which have caused Solvency UK to diverge slightly from the Solvency II framework that continues to apply across the EU.

3.44 Notwithstanding these changes, Solvency II and Solvency UK are still substantially the same.

3.45 While I note the possibility of further changes to both Solvency II and Solvency UK, I would be surprised were any such changes to affect materially over the next few years the matters that I have considered in this Report or my conclusions. Therefore, I have not considered any further in this Report the possibility of more changes to either Solvency II or Solvency UK.

OVERVIEW OF LUXEMBOURG INSURANCE REGULATION

Background

3.46 Luxembourg is one of Europe's smallest countries but is highly developed and with an advanced economy. Its eponymous capital is (along with Brussels, Strasbourg and Frankfurt) one of the key organisational centres of the EU. The country has a reputation for being business-friendly and it hosts the headquarters of many multinational businesses.

3.47 Luxembourg has a strong financial services sector, particularly in respect of investment funds, banking and insurance. Luxembourg's insurance market developed particularly strongly in the 1990s, and there was a further boost due to Brexit, as, following the Brexit referendum result, UK-based insurers that were writing business elsewhere in the EEA set up sister companies elsewhere in the EU from which to write EEA business post-Brexit. Several insurers have established bases in Luxembourg from which to sell insurance products throughout Europe under the EU freedom of services provision. Between them, the 70 insurers and 194 reinsurers authorised in Luxembourg[8] wrote €56 billion of premiums in 2022. This covered direct life business, direct non-life business and inwards reinsurance business.

[8] As reported by the CAA in June 2023.

The regulatory regime in Luxembourg

3.48 The insurance market in Luxembourg operates in accordance with two laws:

- the Law of 8 December 1994, which covers the annual accounting obligations for insurance and reinsurance companies. This makes clear that local GAAP provisions should be sufficient to cover all present and future obligations and that (other than for pure reinsurers) discounting of the provisions for the time value of money is not permitted; and
- the Law of 7 December 2015 ("**Luxemburg Insurance Law**") (including subsequent amendments), the first part of which focuses on the supervision of the insurance sector by the CAA, with the second part focusing on the activity of the insurance sector. This sets out the requirement for insurers under the CAA's supervision to comply with all aspects of Solvency II (see paragraphs 3.31-3.42, above).

3.49 The CAA is the national supervisory authority of insurance and reinsurance undertakings in Luxembourg. It is charged with promoting transparency, simplicity and equity on insurance products and services markets.

3.50 The key tasks of the CAA include the following:

- to receive, examine and decide on applications for authorisation or registration to carry out one or more activities covered by the Luxemburg Insurance Law;
- to perform a supervisory role, including financial supervision, over those that it has authorised or registered, and over insurance products that are marketed, distributed or sold within or from Luxembourg;
- to pass regulations relating to the insurance market in Luxembourg;
- to oversee compliance by all those under its supervision with the obligations relating to the fight against money laundering and the financing of terrorism;
- to ensure the application of laws and regulations relating to:
    - the relations between parties to insurance contracts and insurance operations, and in particular compliance with legal provisions governing insurance contracts;
    - reinsurance and reinsurance securitisation operations; and,
    - relations between policyholders and insurance intermediaries;
- to ensure that those in positions of control of entities under its supervision are fit and proper, which includes an assessment of their expertise and integrity;
- to receive and examine any claim made against an entity under its supervision;
- to monitor requests, and participate in negotiations, pertaining to insurance and reinsurance issues at EU and international levels;
- to present to the Luxembourg Government any suggestion likely to improve the legislative and regulatory environment relative to the business of insurance and reinsurance in Luxembourg.

3.51 Insurances activities in Luxembourg can be carried out either by Luxembourg companies or by foreign companies, either through a branch office or directly without any establishment in Luxembourg (through relevant passporting rights), provided that they have been duly approved by or, as the case may be, the exercise of their activities has been duly notified to, the CAA.

3.52 Authorisation is granted for each specific insurance field provided certain conditions are met, *inter alia*:

- The company must be effectively managed in and from Luxembourg. This means that the effective management and central administration must be carried out in Luxembourg;
- The direct and indirect shareholding of the company structure must be transparent, and the shareholders' identities must be disclosed to the CAA;

- The company must be effectively managed by one or more persons meeting the required conditions for integrity, qualifications and professional experience;
- Any natural or legal person wishing to take over, directly or indirectly, a qualifying holding (10% or more of the capital or of the voting rights, or a holding that makes it possible to exercise a significant influence over the management of the undertaking) or to further increase their qualifying holding in an insurance company will be required to seek the CAA's prior approval. In this context, the CAA will assess whether the sound and prudent management of the insurance company is ensured;
- The company must appoint an approved independent auditor;
- The company must comply with specific rules regarding solvency margins, assets and accounting principles.

3.53 In principle, it is not permitted for a Luxembourg insurance company to carry out both life insurance and non-life insurance activities, although certain exemptions do exist for specific insurance classes.

3.54 Luxembourg insurance undertakings are permitted to establish a branch in the territory of a third country but must notify the CAA beforehand. The CAA may object to the establishment of such a branch if:

- there are reasons to doubt the adequacy of the system of governance or the financial situation of the insurance undertaking or the fit and proper requirements of the legal representative;
- if the establishment or the business planned by the branch breach the rules of the host third country;
- if the host third country is subject to international sanctions or does not apply the international standards on combatting money laundering and terrorism financing or does not allow the CAA to carry out its supervisory missions.

Policyholder protection

3.55 In the event that a motor insurer becomes insolvent and hence unable to meet fully its insurance obligations, victims of road traffic accidents in Luxembourg who are affected by the insolvency can receive compensation from the *Fonds d'insolvabilité en assurance automobile* ("FIAA"). The *Fonds Commun de garantie automobile* ("FCGA") is a mutual fund established to compensate victims of road traffic accidents involving uninsured drivers or where the vehicle involved cannot be traced (akin to the Motor Insurance Bureau in the UK). There are no other compensation schemes that applies to insurance products in Luxembourg.

Triangle of Security

3.56 Luxembourg law requires that insurance undertakings treat the assets representing their insurance liabilities as distinct, and managed separately, from their own assets. These representative assets must be deposited with a custodian bank. A custody agreement between the insurance undertaking and the custodian bank must be concluded. Prior to the deposit of the representative assets, the CAA must approve the custody agreement. This system for the protection of insurance claims is commonly referred to as the "Triangle of Security" because it is based on the involvement of three stakeholders: the insurance company, a custodian bank and the CAA. The Triangle of Security thus provides a form of legal protection for insurance creditors (policyholders or their beneficiaries).

Ombudsman service

3.57 The Insurance Ombudsman service in Luxembourg was set up in 1995, jointly by the Association of Insurance and Reinsurance Companies and by the Luxembourg Union of Consumers, with the objective of finding extrajudicial solutions (through mediation) in insurance litigation that involves Luxembourg-based insurance companies and consumers who reside in an EU member state. The service covers disputes involving both life and non-life insurance. In 2022, it dealt with 37 non-life insurance cases (36 in 2021).

Winding-up

3.58 In the event of the winding-up of an insurance undertaking under Luxembourg law, all policyholders (direct and reinsurance, regardless of whether the business is written via a branch or directly into the Luxembourg entity) rank with general creditors (behind creditors with the right of a pledge/mortgage, claims by employees and tax) with respect to the whole of the insurance undertaking's assets.

4. Background regarding the entities concerned in the Scheme

4.1 In this section of the Report, I set out some background information and key metrics relating to the entities that are involved in the Scheme, specifically FMI and FMIE.

FM

4.2 FM is one of the world's largest insurance underwriting groups within the commercial property market. Its covers include all-risk policies and policies providing fire and extended coverage, boiler and machinery, difference in conditions, ocean cargo, business interruption insurance or any combination of these lines of coverage. It also offers risk mitigation expertise, inspection and loss prevention services, training and research to provide holistic risk solutions to its customers, which comprise principally Global 1000 companies.

4.3 FM's insurance activities are conducted in Canada, Asia-Pacific and the USA primarily through FMIC, which is a mutual company and the ultimate parent company within FM. FM's UK exposures are covered by FMI; its EEA and Swiss exposures, which pre-Brexit were covered by FMI, are now covered by FMIE.

4.4 The financial year of the companies within FM runs 1 January - 31 December.

FMI

4.5 FMI is an insurance company incorporated in the UK in 1963, with registration number 0755780. It writes commercial property insurance for multinational companies. FMI is a wholly owned subsidiary of FMIC and is authorised by the PRA and regulated by both the PRA and FCA. It originally operated as the international headquarters for FM and, in more recent years, prior to the UK's decision to withdraw from the European Union, it operated as FM's European hub in respect of its insurance business across the EEA. Since before the implementation of Brexit, its non-UK business has been in run-off.

4.6 FMI is permitted under Part 4A of FSMA to carry out contracts of non-life insurance in respect of the following classes: 4 (Railway rolling stock), 5 (Aircraft), 6 (Ships), 7 (Goods in transit), 8 (Fire and natural forces), 9 (Damage to property), 11 (Aircraft liability), 12 (Liability of ships), 13 (General liability), 14 (Credit), 15 (Suretyship), 16 (Miscellaneous loss insurance), and 17 (Legal expenses).

4.7 Aside from a small book of casualty business that has been in run-off for over fifty years (see paragraph 4.11, below), FMI's business comprises all risks commercial property policies, both comprise master policies issued to policyholders domiciled in the UK and underlyer policies issued to policyholders domiciled overseas but with insured risks located in the UK.

4.8 FMI has a wholly owned subsidiary, FME, which provides the services noted above in the last sentence of paragraph 4.2 in support of the (re)insurance provided by FM. These services are complementary to the insurance services, in that helping clients to improve risk mitigation and loss prevention within their properties would be expected to reduce the cost and frequency of claims. A key philosophy within FM is that 'the majority of loss is preventable' and, by employing and utilising engineers and loss prevention specialists, the entities within FM aim to minimise the losses to their clients and the impact of those losses should they occur.

4.9 While it continues to provide insurance under the current model, FM is constantly looking to improve and develop the overall service offering provided to its customers and maintain a high level of client retention. However, FMI has a stable book of business and has no plans to expand into new lines of business.

4.10 FMI is currently rated:

- A+ (Strong) (Outlook: Positive) by Standard and Poor's (as updated 10 April 2024);

- A+ (Superior) (Outlook: Stable) by AM Best (as updated 26 January 2024 – this rating pertains to FM, rather than to individual parts of the group); and
- AA (Very Strong) (Outlook: Stable) by Fitch (as updated 27 October 2023).

4.11 I note that, in its early days (primarily 1963-67), FMI wrote a portfolio of casualty business, referred to internally as "**Category C**" business. This comprised small[9] following lines on business written in the London Market, both direct excess policies and assumed reinsurance / retrocessional treaties (on both Excess of Loss ("**XoL**") and proportional bases). Although in run-off for over fifty years, there remain open a number of Category C claims (relating to asbestos and environmental hazards). As discussed in paragraphs 4.28-4.29, below, the economic liability for this business is now carried, through reinsurance, by FMIC, so that FMI retains no net liability for Category C business.

Key financial information

4.12 In the year ending 31 December 2023, FMI wrote gross premiums totalling £208.0 million, of which it ceded to reinsurers £156.9 million, resulting in net written premiums of £51.1 million. 93% of the gross written premiums were attributable to "Fire and Other" business, 3% to "Marine Aviation & Transport" business (most of which is "Goods in Transit" cover), and a further 4% to inwards reinsurance business accepted.

4.13 As at 31 December 2023, on a UK GAAP basis, it had total assets of £1,136.8 million and the total liabilities amounted to £288.3 million, giving net assets of £848.5 million. I have shown the full UK GAAP balance sheet for FMI as at 31 December 2023 in the first column of Figure 5.3, below.

4.14 As at 31 December 2023, FMI's insurance liabilities on a UK GAAP basis were as set out in Figure 4.1, below.

FIGURE 4.1. FMI'S INSURANCE LIABILITIES ON A UK GAAP BASIS AS AT 31 DECEMBER 2023 (£ MILLION)

	Claims Outstanding	UPR	TOTAL
Gross	81.1	101.9	183.0
Ceded	-61.1	-76.1	-137.2
Net	20.0	25.8	45.8

4.15 Aside from the Category C business, the outstanding claims provisions as at 31 December 2023 relate to 110 claims (across 108 accounts), the oldest of which was incurred in 2006 but most of which are more recent (85% are from the period 2018-2023). 48 (39%) of the claims outstanding as at 31 December 2022 were settled during 2023; 12 (11%) of the claims outstanding as at 31 December 2023 were settled during the first 15 weeks of 2024.

4.16 As at 31 December 2023, there were 974 open Category C claims, relating to 146 separate policies. The claims provisions in respect of this business were £1.57 million, gross of reinsurance, and nil net of reinsurance. Therefore, as at 31 December 2023, 0.9% of FMI's gross insurance liabilities, 1.9% of FMI's gross claims liabilities and 0.0% of FMI's net liabilities were attributable to the Category C business.

4.17 The Unearned Premium Reserve ("**UPR**") relates to 791 policies that had not been fully earned by 31 December 2023, i.e. that had some unexpired exposure as at that date. There was no UPR in respect of the Category C business.

[9] The line sizes were typically between less than 1% and 3% (up to 7% in a limited number of cases) for insurance business, and between 2% and 7% (up to 10% in a limited number of cases) for reinsurance or retrocession business.

4.18 As at 31 December 2023, on a Solvency UK basis, FMI had total assets of £1,032.0 million and the total liabilities amounted to £187.1 million, giving net assets of £844.9 million. I have shown the full Solvency UK balance sheet for FMI as at 31 December 2023 in the first column of Figure 5.4, below.

4.19 As at 31 December 2023, FMI's insurance liabilities on a Solvency UK basis were as set out in Figure 4.2, below.

FIGURE 4.2. FMI'S INSURANCE LIABILITIES ON ASOLVENCY UK BASIS AS AT 31 DECEMBER 2023 (£ MILLION)

	Claims Provisions	Premiums Provisions	Risk Margin	TOTAL
Gross	75.7	29.8	4.9	**110.3**
Ceded	-93.1	-24.8	0.0	**-117.9**
Net	-17.4	4.9	4.9	**-7.6**

4.20 I note that the premium provisions relate both to the 791 policies that had yet to be fully earned as at 31 December 2023 and to a further 71 policies that had, as at that date, been bound but not incepted ("**BBNI**").

4.21 I further note that the ceded claims TP exceed the gross of reinsurance claims TP as at 31 December 2023 on a Solvency II basis. This is because the portions of creditors and debtors in the GAAP balance sheet that are not yet due for collection are reclassified into the TPs. As at 31 December 2023, there was a large balance of debtors arising from reinsurance, totalling roughly £41 million. This reflects timing differences between FMI paying gross claim amounts and then recovering amounts from its reinsurers in accordance with the reinsurance programme.

4.22 As at 31 December 2023, FMI's SCRs and the EOFs available within FMI to meet those requirements were as set out in Figure 4.3, below. I also show the ratios of the EOFs over the reported capital requirements (the "**Capital Cover Ratios**").

FIGURE 4.3. FMI'S AVAILABLE ASSETS AND SOLVENCY REQUIREMENTS AS AT 31 DECEMBER 2023 (£ MILLION)

	SCR	MCR
Eligible own funds	844.9	844.9
Solvency Requirements	365.2	91.3
Capital Cover Ratio	231%	925%

Reinsurance

4.23 FMI seeks to mitigate its insurance risk through reinsurance, while maintaining a balance between limiting the potential risk and increasing costs. In order to achieve this, for all except its Category C business, FMI utilises a number of reinsurance packages including facultative, captive, treaty and group reinsurance. Each client account is assessed individually, and reinsurance cover is put in place, as needed, based on the risk assessment or guidelines. In addition, a proportion of the remaining risk is ceded to FMIC through an intragroup reinsurance agreement, whereby FMIC provides:

- 75% reinsurance coverage for losses exceeding the stated retention amount, which as at the date of this Report was £650k; and
- 100% reinsurance coverage once FMI's combined ratio exceeds 125%.

4.24 FMI cedes to FMIC a percentage of its net earned premium in return for this intragroup reinsurance coverage. The experience and cession rate are reviewed annually by FMI and FMIC, and a review of the experience under the reinsurance agreement is performed on an annual basis, to ensure that the cession rate and terms of the agreement remain appropriate. As at the date of this Report, the cession rate is 60%.

4.25 In addition to the above intragroup reinsurance arrangement, FMI also has access to corporately placed external reinsurance treaties, as well as the authority to purchase local facultative reinsurance from third party reinsurers in respect of individual accounts, certain portions of an account, certain locations of an account or in respect of certain perils only. This authority is exercised only in accordance with the FM underwriting standards. Confirmation of reinsurance cover is obtained prior to the binding / renewal of an account. FMI's authorised underwriters have the authority to place any locally purchased facultative reinsurance with any reinsurance carrier that has received prior approval by the FM Reinsurance Security Committee (the "**Reinsurance Security Committee**"). Reinsurers that partner with FM, must be approved by the Reinsurance Security Committee. I note that only those reinsurers with a surplus of at least $500 million and an AM Best rating of A- and better (or the equivalent from other recognised rating agencies) would be approved (unless a specific exception has been granted by the Reinsurance Security Committee).

4.26 The list of approved reinsurers is provided to all authorised underwriters and is reviewed regularly and updated by the Reinsurance Security Committee. I have been told that the Reinsurance Security Committee undertakes a rigorous process to evaluate the financial security of the reinsurers that it is asked to approve, analysing (at least annually) their financial accounts, claims paying ability, claims paying track record and any potential new capacity. In practice, FM's external reinsurance is provided by a panel of traditional reinsurer partners, who are stable companies that have supported FM for many years and have a proven track record of paying losses in a timely fashion.

4.27 Most of FMI's reinsurance agreements are under the Law of the State of Rhode Island as they have been negotiated at a group level.

Category C business

4.28 For the Category C business, FMI is protected primarily via two reinsurance contracts underwritten by FMIC:

- A per claim XoL contract, that currently provides FMI with cover of £1,000,000 xs £5,000 for each and every Category C loss, net of all other outwards reinsurance contracts pertaining to Category C business; and
- An aggregate XoL contract (also known as a stop-loss contract), that currently provides FMI with cover of £15,000,000 xs £900,000 for aggregate Category C losses, net of all other outwards reinsurance contracts pertaining to Category C business (including the above per claim XoL contract).

4.29 Although there are some outwards reinsurance contracts on the Category C business that have been provided by third parties, I have been told by FMI that it no longer cedes any liability to them, as the amounts involved are nominal and do not justify the expense involved in effecting cession and collection. In addition, several of these third-party reinsurers are, for various reasons, no longer operating.

Guarantees

4.30 FMI has a performance guarantee whereby FMIC guarantees the full, prompt and complete performance by FMI of its lawful obligations with respect to contracts of insurance or reinsurance issued by FMI. It has no further guarantees and has provided no guarantees to other parts of FM.

Governance

4.31 In the following paragraphs, I discuss governance, risk management strategy and capital policy as it pertains to FMI. I note that the same approaches apply to FMIE.

4.32 FMI is governed by a Board, which includes executive directors, non-executive directors ("**NEDs**") from the parent company and independent non-executive directors ("**INEDs**"). The Board has control of all business, strategic and risk decisions within FMI and meets three times a year. Two committees report to it: the Audit and Risk Committee ("**ARC**"); and the Risk Management Committee ("**RMC**").

- The FMI ARC consists of no fewer than three members, who are not officers of FMI, and they meet at least three times a year. The ARC's responsibilities include overseeing the Internal Audit function, approving the external audit plan and reviewing both internal and external audit reports, in addition to ensuring that FMI's risk management framework and controls comply with all relevant requirements, and reporting any identified gaps or breaches to the FMI Board. The FMI ARC receives reports and consults with the RMC members, as needed, on any material breaches of risk limits and the adequacy of proposed risk mitigation, taking into account the regulatory environment. I note that the FMI ARC was formed during the course of 2022 by merging the then separate Audit Committee and Risk & Compliance Committee.
- The FMI RMC has been established to implement and manage FMI's risks and risk management framework, to oversee the risk function on a day-to-day basis and to monitor the ongoing efforts of FMI to remain within the risk appetite and tolerance levels. It is an executive committee, made up of two executive directors and members of senior management from the key functions in the business, that has the power to make decisions regarding FMI's risk management policies and practices. It also provides recommendations to the Board, the FMI ARC and to FM's Business Risk Management Committee. The FMI RMC meets no less than four times per year.

4.33 All of FMI's Senior Managers must satisfy the FCA's fit and proper requirements by possessing appropriate qualifications, knowledge, and experience, and through being persons of good repute and integrity.

Risk management policy

4.34 As noted above, the FMI RMC is responsible for maintaining FMI's risk management policy and ensuring it is applied consistently across FMI. It is also responsible for the risk appetite framework, which details the limits and tolerances that FMI will accept in each of the key risk areas.

4.35 Subject matter experts contribute to the identification of risks faced by FMI, which are then evaluated and reviewed by the FMI RMC. Risks that have the greatest potential for adverse impact are held in FMI's risk register, which is monitored and regularly reviewed by the FMI RMC. These risks cover market, underwriting, credit, group, liquidity, compliance and operational risk. The criteria for risks to be included on FMI's risk register are based on a combination of their likelihood and their potential impact, along with the judgement of the FMI RMC. Each risk on the register must be reviewed by the risk owner at least annually. However, risks with a high rating are reviewed either quarterly or monthly, and the results discussed with the FMI ARC as well as with the FMI RMC.

4.36 The risk appetite monitoring system is based on the tolerances and limits laid out in the risk appetite framework. The risk appetite of FMI is focused on the key risks; therefore, the majority of tolerances and limits are focused around underwriting risk. These include targets for the combined ratio, premium retention and new business, as well as policy limits. The framework is regularly reviewed and the discussions arising from these reviews may prompt changes to some of the framework narrative or lead to limits being adapted to ensure ongoing alignment with the business and its exposures. The risk management framework is a working document and as such is expected to evolve with the business.

4.37 The FMI RMC reviews, monitors and documents significant risks. Strategies and operational controls are considered and evaluated to ensure the minimisation and effective management of each risk. There is also a standing item on the FMI RMC agenda to consider any operational changes that are occurring and the resulting potential for any new risks arising, together with emerging risk (that has climate risk as a component part). Depending on the operational change being considered, a discussion is held regarding re-running the ORSA process to quantify the effect on capital. To assist with the identification of new risks, there are policies in place for each of the risk categories, which define that risk area and give examples of the types of risks that could be included in that risk area. They also cover the possible controls in place to mitigate a risk. These risk-specific policies are reviewed at least annually.

4.38 The materiality of risks is determined during the process of development of the risk profile by considering the consequences, likelihood and controllability of each risk. The assessment of risk is based on quantitative and/or qualitative factors.

4.39 The risks from the risk register are a key input into the solvency capital model. The FMI RMC is involved in the review of the ORSA and its familiarity with the risks involved gives it a good understanding of the expected capital charge and coverage.

4.40 In addition to risks identified in the risk register, FMI's approach is to minimise risk, which is demonstrated by the levels of review and audit within FMI and is consistent with the aforementioned FM ethos that "the majority of all property loss is preventable". Consistent with the other insurers within FM, FMI creates a partnership with its policyholders and only those policyholders that share FMI's commitment to loss prevention are retained over the longer term. Regular audits of engineering, claims, and underwriting processes and procedures take place in order to ensure that the systems and controls in place are adequate and are being followed. In addition, whenever a significant claim occurs, an additional review takes place, including the underwriting and engineering assessments for that location, to see if any lessons can be learnt to avoid similar future claims.

4.41 FMI's risk management is an integral part of strategic planning processes of the FMI Board, individual operations within FMI, and FM's planning committee.

Risks

4.42 For the purposes of managing its risk, FMI classifies risk into the following categories:

- non-life underwriting risk (which covers reserving risk, premium risk, and catastrophe risk, plus a minimal level of lapse risk);
- market risk;
- credit risk;
- liquidity risk;
- group risk;
- operational risk;
- compliance risk; and
- emerging risks.

Non-life underwriting risk

4.43 This is the risk of insurance payments differing from expectations, in magnitude and/or in timing. The underlying risks typically include:

- Inaccurate pricing of risk when underwritten;
- Inadequate reinsurance protection;
- Fluctuations in the timing, frequency and severity of claims and claims settlements relative to expectations (which is occasionally referred to as "claims management risk"); and

- Inadequate claims reserves.

4.44 As at 31 December 2023, insurance risk was a relatively small component of FMI's SCR (5% of the SCR prior to allowance for the diversification benefit between the risk modules).

4.45 FMI manages its non-life underwriting risk through careful monitoring of its:

- combined ratio, with a tolerance limited to, at most, 100% over a rolling five-year period (the reinsurance arrangement with FMIC caps the combined ratio in any single year to 125%);
- claim costs (including loss adjustment expenses), with a tolerance limited to, at most, 125% in any one financial year;
- client retention, with a tolerance of no less than 90% of premiums retained each year;
- new business growth, not to exceed 10% of the prior year end in-force premium, other than in exceptional circumstances;
- policy limits and the (perceived) underlying riskiness of each individual risk underwritten – FM is a preferred risk underwriter and, as such, FMI aims only to underwrite polices that are considered to be lower risk than standard.

Market risk

4.46 Market risk is defined as the risk that arises from fluctuations in the values of, or income from, assets driven by interest rates, market valuations or exchange rates. Sources of general market risk include movements in interest rates, equities, exchange rates, etc. It is important to note that none of these sources of risk is independent of the others. Such movements will affect not only an insurer's investments, but also the value of other assets and liabilities such as premium income, claims payments and reinsurance recoveries. As at 31 December 2023, market risk was the largest by far of FMI's risk modules (84% of the SCR prior to allowance for the diversification benefit between the risk modules).

4.47 FMI's market risk comprises several elements, most notably equity risk (I note that equities comprised nearly 60% of FMI's investments in its UK GAAP balance sheet as at 31 December 2023) and currency risk. Together, as at 31 December 2023, those two elements comprise 85% of the pre-diversification market risk module.

4.48 FMI manages its market risk through:

- Careful matching of assets and liabilities, by currency and duration;
- Segmentation of assets held for solvency purposes long-term and short-term holdings. Short-term assets are held for working capital purposes (based on a rolling 12-month cashflow forecast) and with a policy of neutrality on foreign currency;
- Holding all cash deposits and short-term investments in US dollars, unless required for a specific liability;
- Holding a mix of asset types within FMI's long-term assets so as to maximise returns while also maintaining an acceptable level of risk. The long-term assets are managed on behalf of FMI by the FMIC Investment team.

4.49 Investment activity is in compliance with FMI's investment policy, which covers target returns, counterparty risk limits and credit ratings.

Credit risk

4.50 Credit risk is defined as the risk relating to an insurer's ability to recover money owed by third parties. Counterparties include reinsurance providers, intermediaries, policyholders, banks and issuers of investments with which the insurer has dealings. As at 31 December 2023, credit risk was the second largest of FMI's risk modules, albeit dwarfed in size by its market risk (9% of the SCR prior to allowance for the diversification benefit between the risk modules).

4.51 FMI has a low tolerance of credit risk, as shown by the following measures:

- FMI aims to restrict the amount of intermediary debt overdue by more than 60 days to less than 20% of total premium income;
- Other than certain specifically approved counterparties, no single counterparty may hold in excess of 5% of the total assets held for solvency calculations;
- No more than 5% of total cash (subject to a maximum total value of £10 million) may be held in entities with a credit rating less than A-;
- All reinsurance counterparties must each have a minimum surplus of $500 million, must have an AM Best (or equivalent) rating of A- (or better) and must be approved by the Reinsurance Security Committee (unless a specific exception has been granted at group level).
- There are further firm limits for the size of risk accepted by FMI when fronting for another entity, or vice versa.

Liquidity risk

4.52 Liquidity risk is the risk that cash may not be available (other than at a prohibitive cost) to pay obligations when due at a reasonable cost.

4.53 FMI has a low tolerance of liquidity risk. It requires that sufficient cash be held to cover known short term liabilities, and that investments must be marketable and thus able to be sold immediately if so required.

4.54 The residual liquidity risk within FMI (as shown in its SCR) was negligible as at 31 December 2023.

Group risk

4.55 For FMI, group risk refers to the risks to which it is exposed to as a member of a group, in this case FM, e.g. group liabilities that cause the depletion or diversion of FMI's financial resources.

4.56 FMI's main exposure to group risk is via its reinsurance arrangements with FMIC. These are not to exceed 85% of capital resources and are to be reported and acted upon by FMI management when they exceed 70%.

4.57 FMI has a medium appetite for group risk. Nevertheless, the residual group risk within FMI (as shown in its SCR) was negligible as at 31 December 2023.

Operational risk

4.58 Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. In particular, this includes the risk of business interruption, of compliance or regulatory breaches, or of poor service delivery, any of which could result in damage to FMI's reputation and could adversely affect its ability to meet its stated objectives.

4.59 As at 31 December 2023, operational risk was a relatively small component of FMI's SCR (1% of the SCR prior to allowance for the diversification benefit between the risk modules).

4.60 FMI has a low tolerance of operational risk. It is managed by a programme of staff training and authority limits, by succession planning, and by having a comprehensive business continuity plan that is subject to annual testing. All complaints, disputes and suspected fraud incidents are identified, assessed and addressed promptly.

Compliance risk

4.61 Compliance risk is defined as the risk that an entity faces in ensuring that it remains compliant with applicable laws and regulations.

4.62 FMI has a low tolerance of compliance risk, with no tolerance of bribery or corruption, no tolerance of regulatory filings being submitted outside the agreed timelines, and no tolerance of staff not completing their compliance training.

4.63 The residual compliance risk within FMI (as shown in its SCR) was negligible as at 31 December 2023.

Emerging risks

4.64 Emerging risk is defined as a risk that an entity could face in the foreseeable future based on current events. These may not yet be fully declared risks but are monitored by senior management to ensure they are included on the risk register should they reach the appropriate risk level. Emerging risks are also a standing item on the RMC agenda.

Capital Management Policy

4.65 FMI's Capital Management Policy is reviewed annually and was most recently revised in February 2022 (subsequent reviews have resulted in no changes). It is intended to ensure that FMI has sufficient own funds to cover the regulatory capital required over the three-year period of the strategic plan.

4.66 Aside from deferred tax assets, FMI's own funds are all classified as Type 1 under the Solvency UK regulations, which mean they are fully available for matching against the regulatory capital requirement. FMI has no plans to change the nature of its own funds or issue new own fund items.

4.67 A key element of the capital management strategy is the intra-group stop-loss reinsurance agreement with FMIC, which effectively caps FMI's combined ratio for any one calendar year at 125%. I have already shown, above in Figure 4.3, that FMI's Capital Cover Ratio relative to its SCR was 231% as at 31 December 2023 (relative to the SCR) – the maximum 125% combined ratio would have to be reached for several consecutive years for that Capital Cover Ratio to be eroded to 100%.

4.68 FMI recognises the additional risk of losses arising from investments (such losses not being covered by the stop loss arrangement with FMIC) and so closely monitors the investment portfolio as part of the Risk Appetite Framework.

4.69 The Capital Management Policy states that a Capital Cover Ratio (relative to the SCR) below 125% is outside of FMI's Risk Appetite.

Policy servicing

4.70 FM has a Code of Conduct that describes the standard of conduct expected of all FM staff, including those employed by FMI. The Code of Conduct is set out under the following headings:

- General conduct
- Conflicts of interest
- Political activities
- Confidentiality and information security
- Electronic privacy and usage
- Antitrust guidelines
- Anti-bribery and corruption:
- Anti-money laundering
- Fraud prevention
- Diversity, equity and inclusion
- Whistleblowing.

4.71 Aside from the items requiring FM staff to comply with relevant laws and regulations, the requirements of the Code of Conduct that I consider of most relevance to policy servicing are the following:

- FM staff should strive to always serve FM policyholders honestly and fairly;

- FM staff should strive to always fulfil FM's contractual commitments and other promises;
- FM staff should strive to always Promote and sell FM's product(s) in a responsible and lawful manner.

4.72 This Code of Conduct is accompanied by ongoing staff training.

4.73 FMI employees are also governed by a set of five Individual Conduct Rules that state that all FMI employees must:

- act with integrity;
- act with due skill, care and diligence;
- be open and cooperative with the FCA, the PRA and other regulators;
- pay due regard to the interests of customers and treat them fairly; and
- observe proper standards of market conduct.

4.74 These Individual Conduct Rules are distributed to FMI employees annually. Senior manager and certification function holders are subject to annual fit and proper declaration, which includes confirmation that the individual has not breached the Code of Conduct.

4.75 FMI policyholders are categorised as "large risks" by the FCA. Therefore, many of the FCA's conduct requirements, as set out in paragraphs 3.18-3.27, above, do not apply to its business. However, the principles embedded within FM's business model are largely consistent with the FCA's conduct principles. As a mutual group, FM's products and services are based on policyholders' needs and input.

4.76 FM applies an onboarding process consistently throughout its entities. The information contained within the quote, policy and supporting documentation is reviewed in detail with the policyholder at outset to ensure complete and mutual understanding. FM entities also provide policy workshops to their policyholders and brokers to ensure they understand how the policy applies. Contract certainty ensures that FM delivers 99% of policies within 30 days of inception.

4.77 FMI has a set of complaints standards that is subject to annual review by the FMI RMC (I have reviewed, as a random sample, the document dated September 2023). These set out the procedure, process and staff responsibilities in the event that a complaint is received by FMI. They also set out FMI's ethos regarding complaints, which is a commitment to treating complainants fairly, ensuring that a positive complaints culture and philosophy exists that meets regulatory standards for complaint handling.

4.78 FMI aims to resolve complaints at the earliest possible stage. However, under the terms of this complaints policy and procedure document, the following time limits will usually apply:

- a written acknowledgement must be sent to the complainant within five business days of receipt; and
- a written response following investigation must be sent to the complainant within four weeks of receipt (unless a "holding response", which advises the complainant what action is being taken together with an indication of the timeframes, has been given to the complainant – indeed, if a complaint remains unresolved, FMI must provide an update to the complainant at least once every four weeks).

4.79 I have been told that, as at the date of this Report, the complaints standards for FMI (and for FMIE) are being reviewed with the intention of implementing (later in 2024) an EMEA-wide set of standards.

4.80 I note that all loss adjusting in respect of the Category C business is conducted on FMI's behalf by a dedicated run-off operations team within FMIC. That team notifies FMI of all claim payments that it has approved, and FMI then processes the payments.

FMIE

Background

4.81 FMIE is a public limited company incorporated in Luxembourg with registered number B211309. It was incorporated in December 2016. It is authorised by the CAA to underwrite policies throughout the European Economic Area (EEA), via branches established in Belgium, France, Germany, Italy, the Netherlands, Spain and Sweden and on a freedom of services basis in the remaining EEA Member states. FMIE is also authorised by the Swiss Financial Market Supervisory Authority ("**FINMA**") to establish insurance activities and underwrite policies in Switzerland via the FMIE Swiss Branch. It has been writing business with effect from 1 January 2018, since when it has been the only member of FM to have been conducting insurance business within the EEA (excluding the UK), such business having previously been written by FMI, using "passporting rights". From 1 January 2020, it has been the only member of FM to have been conducting insurance within Switzerland, such business having previously been written by FMI.

4.82 The FMIE UK Branch has been established with registered branch number BR024525 and was authorised by the PRA on 5 January 2024, with reference number 782276. The CAA gave its approval for the FMIE UK Branch on 23 April 2024.

4.83 It is intended that the FMIE UK Branch will write all UK business on behalf of FM with effect from the date of the Court hearing at which the Scheme might be sanctioned. It is also intended that the Transferring Business will be transferred under the Scheme to the FMIE UK Branch.

4.84 FMIE has permission from the CAA to effect and carry out contracts of insurance falling within the following classes: 4 (Railway rolling stock), 5 (Aircraft), 6 (Ships), 7 (Goods in transit), 8 (Fire and natural forces), 9 (Damage to property), 13 (General liability) and 16 (Miscellaneous loss insurance). These permissions have been mirrored by the PRA in respect of the FMIE UK Branch, although the PRA has stipulated that the FMIE UK Branch must not write any business until after the date on which the Court sanctions the Scheme (assuming that it does do so).

4.85 I note that FMIE's permissions do not wholly mirror those of FMI, which also has permission from the PRA and FCA to effect and carry out contracts of insurance falling within the classes 11 (Aircraft liability), 12 (Liability of ships), 14 (Credit), 15 (Suretyship), and 17 (Legal expenses). However, I understand that FMI has never exercised these additional permissions and so business within these classes forms no part of the Transferring Business. Moreover, FMIE currently has no appetite to write business that could be categorised within these five classes.

4.86 FMIE is currently rated:

- A+ (Strong) (Outlook: Positive) by Standard and Poor's (as updated 10 April 2024);
- A+ (Superior) (Outlook: Stable) by AM Best (as updated 26 January 2024 - this rating pertains to FM, rather than to individual parts of the group); and
- AA (Very Strong) (Outlook: Stable) by Fitch (as updated 27 October 2023).

I note that these ratings are the same as have been awarded to FMI.

Key financial information

4.87 In the year ending 31 December 2023, FMIE wrote gross premiums totalling €1,149.7 million, of which it ceded to reinsurers €845.3 million, resulting in net written premiums of €304.4 million. 64% of the gross written premiums were attributable to "Fire and Other Damage to Property" business and 35% to "Miscellaneous Financial Loss" business. Most of the remainder comprised inwards reinsurance business accepted. While this profile of the FMIE portfolio appears to be materially different from that of FMI, I understand this is due primarily to the CAA requiring insurers that it regulates to classify premiums relating to business interruption cover as "Miscellaneous Financial Loss" whereas the PRA is content for such premiums to be classified in accordance with the primary peril covered by the relevant policies.

4.88 As at 31 December 2023, on a LuxGAAP basis, FMIE had total assets €1,999.7 million and the total liabilities amounted to €1,262.2 million, giving net assets of €737.5 million. I have shown the full LuxGAAP balance sheet for FMIE as at 31 December 2023 in the first column of Figure 5.5, below.

4.89 As at 31 December 2023, FMIE's insurance liabilities on a LuxGAAP basis were as set out in Figure 4.4, below.

FIGURE 4.4. FMIE'S INSURANCE LIABILITIES ON A LUXEMBOURG GAAP BASIS AS AT 31 DECEMBER 2023 (€ MILLION)

	Claims Outstanding	UPR	TOTAL
Gross	337.8	434.7	**772.5**
Ceded	-246.1	-321.4	**-567.5**
Net	91.7	113.2	**205.0**

4.90 The outstanding claims provisions as at 31 December 2023 relate to 355 claims (across 329 accounts), the oldest five of which were incurred in 2018 (the first year in which FMIE wrote business) but most of which are more recent (85% are from the period 2022-2023). 188 (59%) of the claims outstanding as at 31 December 2022 were settled during 2023; 92 (26%) of the claims outstanding as at 31 December 2023 were settled during the first 15 weeks of 2024.

4.91 The UPR relates to 1,559 policies that has not been fully earned by 31 December 2023, i.e. that had some unexpired exposure as at that date.

4.92 As at 31 December 2023, on a Solvency II basis, FMIE had total assets €1,547.9 million and the total liabilities amounted to €781.3 million, giving net assets of €766.7 million. I have shown the full Solvency II balance sheet for FMIE as at 31 December 2023 in the first column of Figure 5.4, below.

4.93 As at 31 December 2023, FMIE's insurance liabilities on a Solvency II basis were as set out in Figure 4.5, below.

FIGURE 4.5. FMIE'S INSURANCE LIABILITIES ON A SOLVENCY II BASIS AS AT 31 DECEMBER 2023 (€ MILLION)

	Claims Provisions	Premiums Provisions	Risk Margin	TOTAL
Gross	317.8	87.0	25.3	**430.1**
Ceded	-304.4	-63.5	0.0	**-367.9**
Net	13.4	23.6	25.3	**62.2**

4.94 I note that the premium provisions relate both to the 1,559 policies that had yet to be fully earned as at 31 December 2023 and to a further 471 policies that, as at that date, were BBNI.

4.95 As at 31 December 2023, FMIE's SCRs and the EOFs available within FMIE to meet those requirements were as set out in Figure 4.6, below.

FIGURE 4.6. FMIE'S AVAILABLE ASSETS AND SOLVENCY REQUIREMENTS AS AT 31 DECEMBER 2023 (€ MILLION)

	SCR	MCR
Eligible own funds	766.7	766.7
Solvency Requirements	493.5	123.4
Capital Cover Ratio	155%	621%

Reinsurance

4.96 FMIE deploys the same reinsurance philosophy and reinsurance structure as FMI (details of which are shown above in paragraphs 4.23-4.26) and has no plans to deviate from that policy and structure, either overall or for the FMIE UK Branch. Within that structure, there are differences in some of the details relating to the intergroup reinsurance agreement (which are all subject to review at least annually), specifically:

- As at the date of this Report, the loss amount retained by FMIE before application of the proportional reinsurance is higher, at €1 million, than that applying to FMI (£650k); and
- As at the date of this Report, the proportion of its net earned premium that FMIE ceded to FMIC in return for the intragroup reinsurance coverage is lower, at 55%, than the proportion ceded by FMI (60%).

4.97 As with FMI, FMIE authorised underwriters have the authority to place any locally purchased facultative reinsurance with any reinsurance carrier that has received prior approval by the Reinsurance Security Committee. It is anticipated that the FMIE UK Branch Manager will have similar authority.

4.98 Most of FMIE's outwards reinsurance agreements are under the Laws of the State of Rhode Island, except for the intergroup reinsurance agreement, which (as required by the CAA) is under the Law of Luxembourg.

4.99 There are no special arrangements, e.g. collateralisation, in respect of specific reinsurance contracts involving FMIE.

Guarantees

4.100 As per FMI (see paragraph 4.30, above), FMIE has a performance guarantee whereby FMIC guarantees the full, prompt and complete performance by FMIE of its lawful obligations with respect to contracts of insurance or reinsurance issued by FMIE. FMIE has no further guarantees and has provided no guarantees to other parts of FM.

Governance

4.101 In the following paragraphs, I discuss governance, risk management strategy and capital policy as it pertains to FMIE. As noted in paragraph 4.31, above, FMIE's approaches to governance, risk management strategy and capital policy are largely the same as those of FMI. To avoid needless repetition, I do not replicate the material that I set out in respect of FMI in paragraphs 4.32-4.69, above, but instead highlight the differences in governance, risk management strategy and capital policy between FMI and FMIE.

4.102 As with FMI, an RMC reports to the FMIE Board, with much the same responsibilities (in respect of FMIE) as the FMI RMC has (in respect of FMI), save that it also oversees risk (which in FMI falls under the FMI ARC). The reason for the difference is that, to comply with CAA requirements, FMIE has a designated Risk Manager (approved by the CAA) who is also the actuarial function holder and a member of the FMIE RMC, who reports to the FMIE Board. FMIE has an Audit Committee (as a Board sub-committee) rather than an ARC. While the need under CAA regulations for an approved Risk Manager mean that reporting lines and committee structures differ slightly between FMI and FMIE, in all other respects the governance structures of the two companies are identical.

4.103 All FMIE's Senior Managers must satisfy the fit and proper requirements set out in the Luxemburg Insurance Law by possessing appropriate qualifications, knowledge, and experience, and through being persons of good repute and integrity. This is very similar to the "fit and proper" criteria operated by the FCA.

4.104 I note that, by the time that the FMIE UK Branch becomes operational, its legal representative will have become a member of the FMIE RMC. The Risk Manager of FMIE will also be the Risk Manager of the FMIE UK Branch (i.e. the Risk Manager will retain and not delegate this responsibility in respect of the FMIE UK Branch).

Risk management policy

4.105 FMIE's risk management policy is immaterially different from that of FMI (the differences are mainly in respect of the functional owners of the particular aspects of the risk management framework). I refer readers of this Report to paragraphs 4.34-4.41, above, for further information.

Risks

4.106 For the purposes of managing its risk, FMIE classifies risk into the following categories (the same as per FMI):

- non-life underwriting risk (which covers reserving risk, premium risk, and catastrophe risk, plus a minimal level of lapse risk);
- market risk;
- credit risk;
- liquidity risk;
- group risk;
- operational risk;
- compliance risk; and
- emerging risks.

Non-life underwriting risk

4.107 As at 31 December 2023, insurance risk was the third largest component of FMIE's SCR (17% of the SCR prior to allowance for the diversification benefit between the risk modules).

4.108 FMIE manages its non-life underwriting risk through limiting the same measures as does FMI (see paragraph 4.45, above) save that, other than in exceptional circumstances, new business growth is not to exceed 50% of the new business objective of the year (FMI: 10%) of the prior year end in-force premium. This higher percentage has been appropriate due to the larger geographical diversification of the underlying risks and the higher level of premiums within FMIE compared with FMI.

Market risk

4.109 As at 31 December 2023, market risk was the largest of FMIE's risk modules (58% of the SCR prior to allowance for the diversification benefit between the risk modules).

4.110 FMIE's market risk comprises several elements, most notably equity risk (as at 31 December 2023, equities comprised 51% of FMIE's investments in its LuxGAAP balance sheet) and currency risk. Together, those two elements comprise 78% of the pre-diversification market risk module.

4.111 FMIE and FMI manage their respective market risks identically (see paragraph 4.48, above).

Credit risk

4.112 As at 31 December 2023, credit risk was the third largest component of FMIE's SCR, albeit much less significant than market risk (20% of the SCR prior to allowance for the diversification benefit between the risk modules).

4.113 Like FMI, FMIE has a low tolerance of credit risk, and operates the same management measures, as set out in paragraph 4.51, above.

Liquidity risk

4.114 Like FMI, FMIE has a low tolerance of liquidity risk, and operates the same management measures, as set out in paragraph 4.53, above. The residual liquidity risk within FMIE (as shown in its SCR) was negligible as at 31 December 2023.

Group risk

4.115 FMIE's main exposure to group risk is via its reinsurance arrangements with FMIC. It manages this risk in a similar fashion to FMI (see paragraph 4.56, above).

4.116 While FMI has a medium appetite for such risk, FMIE's appetite is high. Nevertheless, the residual group risk within FMIE (as shown in its SCR) was negligible as at 31 December 2023.

Operational risk

4.117 As at 31 December 2023, operational risk was a relatively small component of FMIE's SCR (5% of the SCR prior to allowance for the diversification benefit between the risk modules.

4.118 Like FMI, FMIE has a low tolerance of operational risk. It manages its operational risk using the same measures as does FMI (see paragraph 4.60, above).

Compliance risk

4.119 The measures by which FMIE manages its compliance risk are more extensive than those for FMI, simply to reflect the specific regulatory requirements in Luxembourg and in Switzerland (where FMIE has a branch). Aside from that detail, FMI and FMIE manage their respective compliance risks identically.

4.120 The residual compliance risk within FMIE (as shown in its SCR) was negligible as at 31 December 2023.

Emerging risks

4.121 FMI and FMIE manage their respective emerging risks identically.

Capital Management Policy

4.122 FMIE's Capital Management Policy is reviewed annually and was most recently revised in February 2024. It is essentially identical to FMI's Capital Management Policy (see paragraphs 4.65-4.69, above). In particular, a Capital Cover Ratio (relative to the SCR) below 125% is outside of FMIE's Risk Appetite.

Policy servicing

4.123 I have explained in some detail in paragraphs 4.70-4.79, above, FMI's approach to policy servicing, in particular the FM Code of Conduct, FMI's Individual Conduct Rules, FM's onboarding process and FMI's complaints standards. I note that:

- FMIE is similarly subject to FM's Code of Conduct and onboarding, and, rather than repeat myself, I refer readers to paragraphs 4.70-4.72 and 4.76, above, for summaries of those; and

- FMIE also has a set of complaints standards, subject to annual review by the FMIE RMC. These standards are worded differently from FMI's complaints standards, but the two sets of standards cover the same material and impose the same time limits. I refer readers to paragraphs 4.77-4.78, above, for further information on the complaints standards. As explained above in paragraph 4.79, as at the date of this Report, the complaints standards for FMIE (and for FMI) are being reviewed with the intention of implementing (later in 2024) an EMEA-wide set of standards.

4.124 FMIE has not adopted a formalised additional set of conduct rules equivalent to FMI's Individual Conduct Rules. In this respect, FMIE might be thought to have a weaker set of conduct standard than has FMI. However, I consider that the five requirements in FMI's Individual Conduct Rules are covered (in more general terms) by the FM Code of Conduct and that, therefore, there is in effect minimal difference between FMI and FMIE in their approaches and standards of policy servicing.

4.125 I further note that FMIE intends that the FMIE UK Branch will introduce individual conduct rules, the content of which will be the same as FMI's Individual Conduct Rules. Therefore, on and after their transfer to the FMIE UK Branch, the staff currently employed by FMI will be governed by individual conduct rules that are no different from those that currently govern them, ensuring post-Scheme continuity of servicing standards for the Transferring Policyholders.

5. The proposed Scheme

SUMMARY OF THE SCHEME

5.1 In this section of the Report, I summarise the terms of the Scheme, as set out in the document that sets out the terms of the Scheme (the "**Scheme Document**"). For the avoidance of doubt, the terms of the Scheme as set out in the Scheme Document are definitive. I note that I also detail a number of additional implications of the Scheme that in accordance with the Framework Agreement, will take effect as a result of the Scheme.

5.2 Assuming that the Court approves the Scheme as proposed, the Scheme shall be effected at and with effect from 22:59 hours GMT (23:59 hours CET) on the Effective Date (expected to be 30 November 2024).

5.3 The Scheme provides for the transfer of Transferring Liabilities and Transferring Assets from FMI to FMIE. The Transferring Liabilities comprise all obligations and liabilities (whether current or future, certain or contingent) of FMI as at the Effective Date under or by virtue of the Transferring Policies or the outwards reinsurance contracts that protect the Transferring Policies for the benefit of FMI. The Transferring Assets comprise all rights, benefits and powers of FMI as at the Effective Date under or by virtue of the Transferring Policies, including the insurance provisions and reserves associated with the Transferring Policies. The Transferring Assets also include all documents, files and other records (held in whatever medium) referable to the Transferring Business, as well as supporting IT and other systems.

5.4 In essence, all of the liabilities of FMI will be transferred by the Scheme to the FMIE UK Branch and those assets supporting those liabilities, plus assets more than sufficient in value to satisfy the solvency requirements and risk appetite of the FMIE UK Branch will also be transferred by the Scheme to the FMIE UK Branch. Under the terms of the Intragroup Asset Transfer Agreement, most of the other assets within FMI will also be transferred to FMIE but not to the FMIE UK Branch. However, cash totalling £5 million will be retained within FMI (on a temporary basis), which will be more than sufficient for FMI to be able to continue fulfilling its regulatory reporting obligations, including maintaining an adequate solvency margin, up until the time when the (by then) otherwise empty FMI can be wound-up and the remaining assets within FMI transferred to FMIE.

5.5 There will be no changes to the terms and conditions of any policy included within the Transferring Business as a result of the Scheme. The rights and obligations of FMI under the policies that comprise the Transferring Business will be transferred, without alteration, to FMIE. Similarly, it is intended that there will be no change in how the Transferring Business is administered as a result of the Scheme. All holders of policies included within the Transferring Business will be entitled to the same rights against FMIE as were available to them against FMI under such policies and will be accountable to FMIE for any further or additional premiums or other amounts attributable or referable thereto as and when the same become due and payable.

5.6 Any pending or current proceedings or complaints issued or served before the Effective Date by or against FMI in connection with the Transferring Business shall be continued by or against FMIE in place of FMI, and FMI shall cease to have any direct legal liability under those proceedings following the Effective Date. Any proceedings or complaints issued or served on or after the Effective Date that would hitherto have been by or against FMI will instead be by or against FMIE. FMIE shall be entitled to all defences, claims, counterclaims and rights of set-off that would have been available to FMI before the Effective Date in respect of the Transferring Business.

5.7 Any judgment, order or award in respect of the Transferring Business that is not fully satisfied before the Effective Date will become enforceable by or against FMIE in the place of FMI.

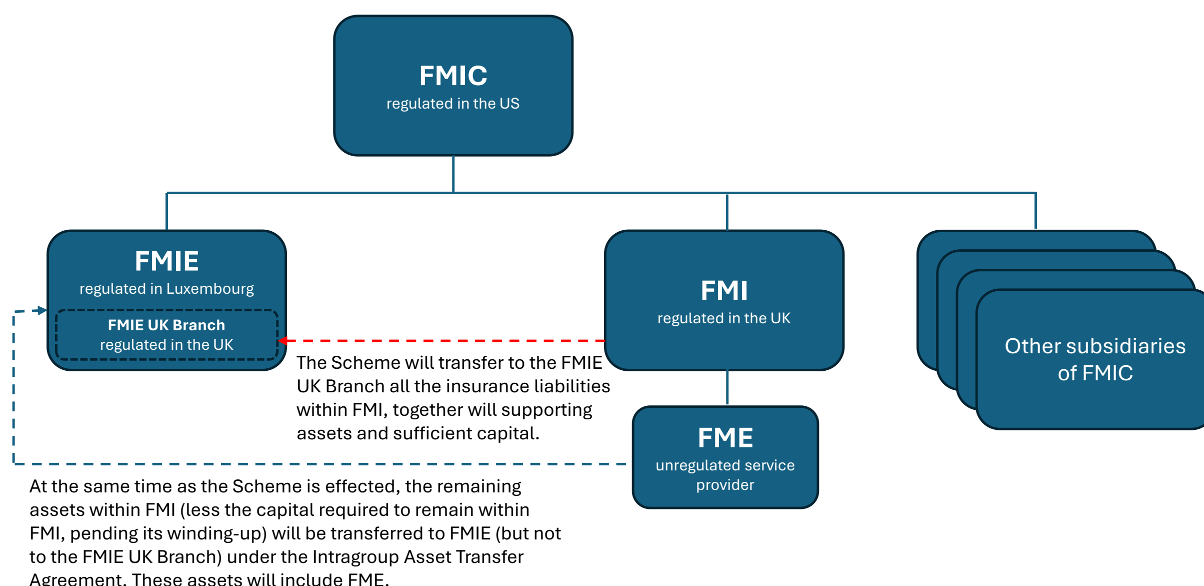
5.8 FMIE shall indemnify FMI against any loss or expense incurred by FMI, whether before or after the Effective Date, that is attributable to the Transferring Business.

5.9 All but one[10] of the employees of FMI as at the Effective Date shall have their contracts of employment reassigned to FMIE as a result of the Scheme. This will be performed in accordance with the Transfer of Undertakings (Protection of Employment) regulations ("**TUPE**").

5.10 All costs and expenses, including, without limitation, fees and disbursements of legal and financial advisers and accountants, incurred in connection with the Scheme and the transactions contemplated by the Scheme shall be borne wholly by FMIE (and not by the Transferring Policyholders). I discuss this further in paragraph 9.37, below.

5.11 Figure 5.1, below, provides an illustrative representation of the Scheme, and of the simultaneous transfer that is proposed under the terms of the Intragroup Asset Transfer Agreement.

FIGURE 5.1. SCHEMATIC REPRESENTATION OF THE PROPOSED SCHEME



MOTIVATION FOR THE SCHEME

5.12 FM has decided to streamline the company structure and operations relating to its European business. By transferring to the FMIE UK Branch the liabilities (and supporting assets) of FMI, FM would then have all its European business within a single company (FMIE), with the permissions required for it to continue to write and to conduct the business currently in FMI. FMI would then be able to apply to the PRA for the cancellation of its permissions and, in due course, could be wound up. Thus, FM would be able to avoid duplication across FMI and FMIE in Board and management structures, and in reporting obligations, which would facilitate both greater management effectiveness and some expense savings, without compromising its ability to meet its contractual obligations to, and the established services standards enjoyed by, its UK, EEA and Swiss policyholders.

POLICYHOLDERS AFFECTED

5.13 I have considered the effects of the Scheme on the following groups of policyholders:

- the Transferring Policyholders;

[10] As mentioned in an earlier footnote, the member of FMI staff who will not be transferred to the FMIE UK Branch is an engineer who FM intends will instead transfer to an engineering company that it is in the process of establishing.

- the FMI Non-Transferring Policyholders (although none are expected – see paragraphs 5.16-5.19, below);
- the Current FMIE Policyholders.

5.14 I do not consider that the policyholders of any other insurance companies are affected by the Scheme.

5.15 In Figure 5.2, below, I provide a table setting out the numbers of policies that could have been affected by the Scheme had it taken place as at 31 December 2023. This table summarises the numbers set out and explained above in paragraphs 4.15-4.17, 4.20, 4.90-4.91 and 4.94. It should be noted that the numbers under FMIE include the numbers under FMIE UK Branch.

FIGURE 5.2. NUMBERS OF POLICIES INVOLVED IN THE SCHEME, HAD THE EFFECTIVE DATE BEEN 31 DECEMBER 2023

	Pre-Scheme			Post-Scheme		
	FMI	FMIE	FMIE UK Branch	FMI	FMIE	FMIE UK Branch
Policies with open claims (excluding Category C)	108	329	0	0	437	108
Policies with open claims (Category C only)	146	0	0	0	146	146
Policies that are not yet unexpired	791	1,559	0	0	2,350	791
Policies that have been bound but not yet incepted	71	471	0	0	542	71
Total	**1,116**	**2,359**	**0**	**0**	**3,475**	**1,116**

EXCLUDED POLICIES

5.16 While it is possible that there will be some Excluded Policies, none are currently expected.

5.17 If there were any Excluded Policies post the Effective Date then they would remain within FMI. As mentioned above in paragraph 5.4, FMI will retain post the Effective Date, cash equal to £5 million. The Scheme provides that, post the Effective Date, FMIE will observe and perform FMI's obligations under the Excluded Policies and shall indemnify and keep indemnified FMI against and in respect of any liability, loss or expense incurred by FMI that is attributable to the Excluded Policies. This effectively means that the Scheme would transfer from FMI to FMIE the economic liability in respect of the Excluded Policies, even though the legal liability would remain with FMI.

5.18 If necessary, FMI would also hold back from the transfer under the Scheme sufficient additional assets that it would remain able to meet both its obligations in respect of any Excluded Policies, its ongoing reporting/operational requirements and its solvency requirements under Solvency UK. These assets would include any reinsurance contracts that pertained specifically to those Excluded Policies. The intragroup reinsurance arrangements between FMI and FMIC would remain in place.

5.19 Subsequent to the Scheme, the Companies would work towards transferring any such Excluded Policy from FMI to FMIE by other means, such as novation, as soon as could be achieved at reasonable cost.

GOVERNANCE

5.20 The governance structure of FMIE will remain unaltered post-Scheme. So too, immediately post-Scheme, will the governance structure of FMI. However, that will be dismantled as part of the winding-up of FMI, which will follow the PRA withdrawing FMI's permissions.

POLICY ADMINISTRATION

5.21 The Scheme does not foresee any change in the administration of the Transferring Business. As noted above in Section 4, the approach and standards of FMI and of FMIE to policy servicing are virtually identical. Moreover, as it is intended that all members bar one of FMI staff will be transferred to the FMIE UK Branch as soon as that becomes operational and that they continue to operate in accordance with the current FMI Individual Conduct Rules (subject to any subsequent revision), the Transferring Business will be managed and serviced, post-Scheme, by the same people, using the same IT and other systems, using the same processes and to the same standards as it was pre-Scheme.

5.22 As at the date of this Report, an operational readiness plan was being developed, which was intended to address any data migration concerns, in particular any changes to the FM IT systems that would be required to enable the Scheme to be fulfilled. I shall comment on this matter, and any implications for the Scheme, in the Supplemental Report.

REINSURANCE

5.23 As explained in paragraphs 5.3 and 5.9, above, the Scheme will transfer to FMIE the rights of FMI in respect of all outwards reinsurance policies underwritten or issued by FMI that provide reinsurance in respect of the Transferring Policies.

EFFECT OF THE SCHEME ON THE BALANCE SHEETS OF FMI AND FMIE

5.24 In the following balance sheets (all expressed as at 31 December 2023), I have assumed a currency exchange rate of £1.00 = €1.16, which was the rate pertaining as at 31 December 2023.

5.25 The effect of the Scheme on the balance sheets of FMI will be extreme. It is intended that almost all of FMI's balance sheet will be transferred to FMIE, leaving only a relatively small amount of cash (that will be more than sufficient to meet the MCR, to satisfy its risk appetite under its Capital Policy and to fulfil its ongoing reporting/operational obligations). This is illustrated, below, both in Figure 5.3, which shows, on a UK GAAP basis, how FMI's balance sheet as at 31 December 2023 (i.e. the date as at the most recent published, audited accounts are available) would have changed had the Scheme and the Intragroup As set Transfer taken place on that date, and in Figure 5.4, which shows the same thing but on a Solvency UK basis. Unless there were a material amount of liabilities relating to Excluded Policies, the MCR would be the sterling equivalent of €2.5 million, which is £2.16 million.

FIGURE 5.3. **SIMPLIFIED UK GAAP SHEETS FOR FMI AS AT 31 DECEMBER 2023 (IN £ MILLION)**

	Actual	Effect of Scheme and Intragroup Asset Transfer	Post-Scheme and post-transfer
Assets			
Investments	732.2	-732.2	0.0
Debtors	106.8	-106.8	0.0
Reinsurers' share of technical provisions	137.2	-137.2	0.0
Net pension asset	73.9	-73.9	0.0
Other assets	86.6	-81.6	5.0
Total Assets	**1,136.8**	**-1,131.8**	**5.0**
Liabilities			
Capital and reserves	848.5	-843.5	5.0
Gross technical provisions	183.0	-183.0	0.0
Creditors	59.7	-59.7	0.0
Net pension liability	10.4	-10.4	0.0
Other liabilities	35.2	-35.2	0.0
Total Liabilities	**1,136.8**	**-1,131.8**	**5.0**

FIGURE 5.4. **SIMPLIFIED SOLVENCY UK BALANCE SHEETS FOR FMI AS AT 31 DECEMBER 2023 (£ MILLION)**

	Actual	Effect of Scheme and Intragroup Asset Transfer	Post-Scheme and post-transfer
Assets			
Investments	754.3	-754.3	0.0
Debtors	14.4	-14.4	0.0
Reinsurers' share of technical provisions	117.9	-117.9	0.0
Net pension asset	73.9	-73.9	0.0
Other assets	71.4	-66.4	5.0
Total Assets	**1,032.0**	**-1,027.0**	**5.0**
Liabilities			
Capital and reserves	844.9	-839.9	5.0
Gross technical provisions	110.3	-110.3	0.0
Creditors	38.7	-38.7	0.0
Net pension liability	10.4	-10.4	0.0
Other liabilities	27.6	-27.6	0.0
Total Liabilities	**1,032.0**	**-1,027.0**	**5.0**

5.26 I note that Figure 5.3 and Figure 5.4, above, assume that, post-Scheme, there are no Excluded Policies. If there were Excluded Policies, then the post-Scheme assets and liabilities would both have to be increased by the magnitude of the gross technical provisions (on the respective bases) relating to those Excluded Policies. Depending on the magnitude of those gross technical provisions and the mixture of the assets supporting them, it is possible that the resultant SCR would exceed the MCR, necessitating an increase in the capital and reserves and a corresponding increase in the assets. However, as I understand the likelihood of there being any Excluded Policies to be remote, I have not considered further the impact that they might have upon FMI’s post-Scheme post-Intragroup Asset Transfer balance sheets.

5.27 In Figure 5.5, below, I illustrate the impact of the Scheme on the statutory balance sheet of FMIE. Figure 5.5 shows the actual balance sheet as at 31 December 2023, the value of the assets and liabilities that are expected to transfer to FMIE under the Scheme, and the resulting expected post-Scheme and post-Intragroup Asset Transfer balance sheet. I show the same in Figure 5.6, below, but on a Solvency II basis. I have also shown (in italics) the post-Scheme balance sheets for the FMIE UK Branch – these balance sheet amounts are included in the post-Scheme and post-Intragroup Asset Transfer balance sheets for FMIE.

FIGURE 5.5. SIMPLIFIED LUXEMBOURG GAAP BALANCE SHEETS FOR FMIE AS AT 31 DECEMBER 2023 (€ MILLION)

	Actual	Effect of Scheme and Intragroup Asset Transfer	Post-Scheme and post-transfer	*Post-Scheme UK Branch*
Assets				
Investments	751.5	849.2	1,600.7	163.4
Reinsurers' share of technical provisions	567.5	159.2	726.7	*159.2*
Debtors and salvage	425.1	123.9	549.0	*123.9*
Net pension asset	0.0	85.7	85.7	*85.7*
Cash or cash equivalent	249.4	94.6	344.0	*94.6*
Prepayments and accrued income	6.3	0.0	6.3	*0.0*
Total Assets	**1,999.7**	**1,312.8**	**3,312.5**	***626.8***
Liabilities				
Capital and reserves	737.5	978.5	1,716.0	292.5
Gross technical provisions	772.5	212.2	984.7	*212.2*
Creditors	232.1	69.2	301.3	*69.2*
Net pension liability	0.0	12.1	12.1	*12.1*
Provision for other risks and charges	206.1	40.8	247.0	*40.8*
Accruals and deferred income	51.5	0.0	51.5	*0.0*
Total Liabilities	**1,999.7**	**1,312.8**	**3,312.5**	***626.8***

FIGURE 5.6. SIMPLIFIED SOLVENCY II BALANCE SHEETS FOR FMIE AS AT 31 DECEMBER 2023 (€ MILLION)

	Actual	Effect of Scheme and Intragroup Asset Transfer	Post-Scheme and post-transfer	*Post-Scheme UK Branch*
Assets				
Investments	869.8	875.0	1,744.5	182.0
Reinsurers' share of technical provisions	367.9	136.8	504.6	*136.8*
Debtors and salvage	91.7	16.7	228.5	*16.7*
Net pension asset	0.0	85.7	85.7	*85.7*
Cash or cash equivalent	146.8	77.1	223.8	*77.0*
Other assets	71.8	0.0	71.8	*0.0*
Total Assets	**1,547.9**	**1,191.2**	**2,859.0**	***497.8***
Liabilities				
Capital and reserves	766.7	974.3	1,740.7	280.9
Gross technical provisions	430.1	127.9	558.1	*127.9*
Creditors	70.5	44.9	115.4	*44.9*
Net pension liability	91.9	12.1	104.0	*12.1*
Other provisions	119.0	32.0	151.1	*32.0*
Other liabilities	69.7	0.0	69.7	*0.0*
Total Liabilities	**1,547.9**	**1,191.2**	**2,739.0**	***497.8***

5.28 As can be seen from Figure 5.5, above, the Scheme is expected to have a significant impact on FMIE's GAAP balance sheet, with increases of 26% in liabilities, 66% in assets (excluding capital and reserves) and 133% in net assets had the Scheme taken place as at 31 December 2023.

5.29 As can be seen from Figure 5.6, above, the Scheme is also expected to have a significant impact on FMIE's Solvency II balance sheet.

5.30 I note that:

- Figure 5.5 and Figure 5.6 make no allowance for any leakage from the FMIE balance sheets due to the costs of the Scheme (which will largely be incurred whether or not the Scheme proceeds);
- Figure 5.5 and Figure 5.6 also assume that there will be no Excluded Policies, which, should there be any, would reduce the value of the assets and liabilities being transferred to FMIE (I have discussed this further in paragraph 5.26, above);
- following the changes in Solvency UK as at the end of 2023, the value of TPs under Solvency UK would be slightly less for the same block of business, as at 31 December 2023, than those under Solvency II due to the difference in the capital charge rate in the calculation of the risk margin. This has not been allowed for in the above pro-forma balance sheets, but I do not believe that this misstatement is material in the context of this Report.

5.31 I further note that the pre-Scheme FMI liabilities are equal in value (after allowing for the currency exchange rate) to those in the FMIE UK Branch post-Scheme, i.e. all of FMI's pre-Scheme liabilities are being transferred by the Scheme to the FMIE UK Branch. However, not all of the pre-Scheme FMI assets are being placed, post-Scheme, into the FMIE UK Branch. Some are being retained, post-Scheme, in FMI (to meet FMI's remaining post-Scheme liabilities, solvency requirements and ongoing operational costs) and the remainder will be transferred to FMIE (but not to the FMIE UK Branch) by the Intragroup Asset Transfer Agreement.

5.32 I discuss the reserving strength of FMI and FMIE in more detail in Section 6, below.

5.33 In Figure 5.7, below, I show the SCRs, MCRs and EOFs for FMI as at 31 December 2023, both as they actually were and as they would have been had the Scheme and the Intragroup Asset Transfer been enacted at that date. The pre-Scheme figures are also shown above in Figure 4.3. Immediately below that, in Figure 5.8, I show the same measures for FMIE (the pre-Scheme figures are also shown above in Figure 4.6), and also, post-Scheme, for the FMIE UK Branch.

FIGURE 5.7. **FMI'S SOLVENCY CAPITAL RATIOS AND ELIGIBLE OWN FUNDS AS T 31 DECEMBER 2023, BOTH PRE AND POST SCHEME (€ MILLION)**

	Pre-Scheme		Post-Scheme and post-Intragroup Asset Transfer	
	SCR	**MCR**	**SCR**	**MCR**
Eligible own funds	844.9	844.9	5.0	5.0
Solvency Requirements	365.2	91.3	2.2	2.2
Capital Cover Ratio	231%	925%	232%	232%

FIGURE 5.8. **FMIE'S SOLVENCY CAPITAL RATIOS AND ELIGIBLE OWN FUNDS AS T 31 DECEMBER 2023, BOTH PRE AND POST SCHEME (€ MILLION)**

	Pre-Scheme		Post-Scheme and post-Intragroup Asset Transfer		UK Branch Post-Scheme	
	SCR	**MCR**	**SCR**	**MCR**	**SCR**	**MCR**
Eligible own funds	766.7	766.7	1,740.7	1,740.7	280.9	280.9
Solvency Requirements	493.5	123.4	923.5	230.9	216.6	50.6
Capital Cover Ratio	155%	621%	188%	754%	130%	555%

APPROACH TO COMMUNICATION WITH POLICYHOLDERS

5.34 The Companies have set out the approach that they intend to take in communicating information about the proposed Scheme to those policyholders who might be affected and to other relevant parties. Their plans will be subject to approval by the Regulators and by the Court before the Companies can implement them.

5.35 The main objectives of the communications are to:

- Provide those policyholders and others who might be affected by the Scheme with the information that they need to understand the proposed changes;
- Inform those policyholders and others who might be affected by the Scheme about the implications for them of the proposed changes;
- Provide to those policyholders and others who might be affected by the Scheme access to further relevant information (beyond that in the communications pack);
- Let those policyholders and others who might be affected by the Scheme know what steps they should take if they object to any of the proposed changes;
- Maintain customers' confidence in FMIE's willingness and ability (post-Scheme) to continue to meet its obligations in respect of the Transferring Business; and
- Meet legal and regulatory requirements.

5.36 It is intended that the Companies will communicate with the following groups about the Scheme:

- subject to the first bullet point of paragraph 5.37, below, the Transferring Policyholders (who comprise FMI policyholders with open claims, with unexpired policies, with policies that have been bound but not yet incepted and with policies that have expired but who would not yet be time-barred from making a claim);
- persons named under Transferring Policies as co-insureds, interested parties or beneficiaries;
- brokers to those outwards reinsurers whose contracts of reinsurance are to be transferred by the Scheme and whose contacts cover Transferring Business;
- brokers with whom FMI has had correspondence in relation to the Transferring Policies in the last five years and who remain in contact with FMI in relation to such business;
- third parties who provide ancillary and non-insurance services to FMI's business and operations.

5.37 The Companies will be applying to the Court for waivers in respect of the requirement to make similar direct notification to the following groups:

- Transferring Policyholders with whom, in the normal course of business, contact is made by FMI via an intermediate party and/or for whom FMI would not hold contact details in the normal course of business, being:
    - any Transferring Policyholder who holds a policy that has been issued as an "underlyer" policy to a master policy held by another member of that Transferring Policyholder's group and who acts as the primary point of contact with FMI for the underlyer. In such cases, the Companies will write to the master policyholder and request that the master policyholder shares a communication pack with each and every holder of an underlyer policy, or introduces FMI to each and every holder of an underlyer policy in order for the Companies to send communications directly; and

- Category C Transferring Policyholders. All contact by FMI in respect of such policies has historically been conducted via the lead insurer or the relevant broker or third-party administrator. In such cases, the Companies will write to the relevant contact and request that the contact shares the communication pack with the Transferring Policyholder or that it provides to the Companies contact details in order for the Companies to send a communication pack directly to the Transferring Policyholder.

In each of the cases outlined above, the Companies are of the view that notification to the relevant representatives of the Transferring Policyholders is more likely to be effective than direct communication, if indeed it would be possible for the Companies to notify the Transferring Policyholders directly; and

- the Current FMIE Policyholders.

5.38 The intended communication packs shall comprise:

- a letter that will be tailored for the different audiences and that will:
  - explain why the recipient has been notified;
  - outline the Scheme process;
  - explain briefly the other documents in the pack, highlighting those parts considered most relevant to the recipient;
  - provide instructions for any persons as to how to make further enquiries;
- a frequently asked questions and answers document in respect of the Scheme;
- a document summarising the terms of the Scheme and this Report;
- notice of the application, which will also set out the date of the hearing of the application for sanction of the Scheme.

5.39 The communication packs will be distributed by email (although they will be made available in hard copy if it proves impossible to send them electronically). The contents of the communication packs will be made available in large print or Braille if requested.

5.40 If the emailing of a communication pack were to result in a "delivery failure" notification, then FMI would initially check that the email address used contained no obvious error.

- Should such error be identified then the pack would be resent, this time to the corrected address.
- Should no such errors be identified, or if a resent pack generates a further "delivery failure" notification, then FMI would attempt to contact the intended recipient using whatever alternate contact details it holds (for example policyholder address or telephone number or those of a relevant broker or agent). If the intended recipient is a corporate entity, then FMI would check the relevant public register (if any) for its registered address. FMI would systematically use each of the contact details held or obtained until the earlier of it establishing contact with the intended recipient of the communications pack or it exhausting, without establishing contact, the list of contact details held or obtained.

5.41 In addition to direct, written correspondence, the Companies also plan to make indirect notification. In accordance with FSMA requirements, notices will be placed in two UK national newspapers, and in each of the *London Gazette*, the *Edinburgh Gazette* and the *Belfast Gazette*. Notices will also be placed in the *Luxemburger Wort*, the daily newspaper with the highest circulation figures[11] in Luxembourg.

[11] https://www.statista.com/statistics/1235948/daily-newspaper-reach-in-luxembourg/ (as published in March 2022).

5.42 The letters, notices and advertisements will refer all queries to a postal address, telephone number and email address, all of which will respond promptly to any such queries. It is intended that all relevant documentation, including both this Report and the Supplemental Report, will be published on a webpage to be set up and administered by FMI, links to which will be included on the websites of both FMI and FMIE. Copies of this Report will be sent to any policyholders who request them. The Report will be made available in this way immediately following the directions hearing relating to the Scheme and it is intended that the Supplemental Report will likewise be made available at least two weeks before the date of the Court hearing at which the Scheme might be sanctioned.

5.43 I note that the communications pack will also be provided to anyone that becomes a new policyholder of FMI before the date of the meeting at which the Court decides whether to sanction the Scheme.

5.44 FMI will manage the communications process and will handle any enquiries or other responses regarding the Scheme.

5.45 I comment on this proposed approach to communications with policyholders in Section 9, below.

6. The impact of the Scheme on the Transferring Policyholders

INTRODUCTION

6.1 Under the Scheme, the Transferring Business will be transferred to FMIE.

6.2 The main issues affecting the Transferring Policyholders as a result of the Scheme are likely to arise from relative differences in:

- the financial strength of FMIE post-Scheme compared with that of FMI pre-Scheme. Financial strength is derived from:
  - the strength of the reserves held, relative to a best estimate of the outstanding liabilities;
  - excess assets or capital; and
  - specific financial support arrangements;
- the risk exposures in FMIE compared with those in FMI; and
- the policy servicing levels provided by FMIE post the Effective Date compared with those currently enjoyed by the Transferring Policyholders.

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

6.3 I note that the reserves held on a statutory basis differ from the TPs that are used to determine an insurer's funds available to meet its solvency capital requirements under both Solvency II and the Solvency UK (which, as noted in paragraph 3.32, above, are essentially synonymous with each other). However, the best estimate of the claims liabilities that underlie those shown in the statutory accounts is used as the base for the best estimate of the claims provision, which then forms a key part of the Solvency II/Solvency UK TPs.

6.4 Key metrics under both Solvency II and Solvency UK, such as the SCR, MCR and EOFs, are intended to be made public as part of each insurer's annual SFCR. However, other relevant metrics (for example, projected values of own funds and of solvency capital requirements as set out in insurers' ORSAs or in their quarterly Quantitative Reporting Templates ("**QRTs**")) are private matters between the entities and the relevant regulators, and entities might consider some of those metrics to be commercially sensitive and thus not to be disclosed in public documents. In this Report, I have considered the extent to which FMI and FMIE each hold capital in excess of various solvency capital measures. Each entity will have different Capital Cover Ratios for different solvency measures. Where permitted by each of the Companies (e.g. when dealing with publicly available information or information that is not considered to be commercially sensitive), I have expressed Capital Cover Ratios in numeric terms. In other instances in this Report, either to preserve the Companies' confidentiality or to provide broad comparators, I have expressed Capital Cover Ratios in more general terms, as follows:

- "sufficiently capitalised" refers to a Capital Cover Ratio between 100% and 119%;
- "more than sufficiently capitalised" refers to a Capital Cover Ratio between 120% and 149%;
- "well-capitalised" refers to a Capital Cover Ratio between 150% and 199%, and
- "very well-capitalised" refers to a Capital Cover Ratio in excess of 200%.

STRENGTH OF FMI'S TECHNICAL PROVISIONS (PRE-SCHEME)

6.5 Aside from the provisions for the Category C business, which I discuss separately below, FMI has predominately short-tailed liabilities (99% of its insurance liabilities are paid out within three years of claim incidents occurring). As shown above, in Figure 4.1, FMI's UK GAAP provision for outstanding claims, gross of reinsurance, was £81.1 million as at 31 December 2023. FMI has in place a significant reinsurance programme that reduces the UK GAAP provision for outstanding claims as at 31 December 2023 to £20.0 million, net of reinsurance.

6.6 The UK GAAP provisions for outstanding claims comprise mostly the case reserves for open claims, with a relatively small additional provision for IBNR claims (and for further development of open claims).

Case reserves

6.7 The case reserves are set on a claim-by-claim basis by FMI's claims adjusters (with input if appropriate from third parties). Initial case estimates (i.e. those posted on claim notification, before the claims adjusters have been able to examine the loss in any detail) are largely based upon the underwriting file for the specific risk. Case estimates are then revised as and when the claims adjusters have more detailed information regarding the specifics of the loss. Case reserves typically have two areas of uncertainty: one relates to the ultimate cost of the property damage; and the other element is a "time element", which relates to the speed with which the property damage can be (sufficiently) resolved to allow the policyholder to return to normal operations. Claims for losses incurred due to business interruption are atypical part of the "time element".

6.8 Claims are typically reported very soon after the related claims incident has occurred, usually within a week.

6.9 Case estimates on individual claims are reviewed periodically. Significant claims are reviewed at least every three months; less significant ones every six months. Any movements greater than US$10 million are further reviewed by senior management.

6.10 FMI aims to settle claims as quickly as reasonably possible, which minimises the time element of the claim costs. However, some claims can take a long time to settle due to their complexity. Such claims are not necessarily the largest claims experienced by FMI. Where settlement of claims is slow, FMI would typically be making advance payments.

6.11 FMI makes no allowance in its reserving for salvage or subrogation. Such recoveries are only reflected in the data when they have been received.

IBNR

6.12 The IBNR reserve and the provision for loss adjustment expenses ("**LAE**") are estimated by a team based in the UK for both FMI and FMIE. The methodology is based on an incurred loss development factor ("**LDF**") approach (which is a standard actuarial technique for estimating IBNR reserves), applied using ten years' worth of data. The future LDFs are selected, based on a weighted average of the last five years' LDFs, subject to the occasional adjustment and to a minimum value for future LDFs of 1.000. I note that, in recent years, there has been some saving on incurred claim amounts, as claims mitigation actions have proved effective.

6.13 The data used to select the LDFs is adjusted to remove subrogation recoveries and business that is no longer within the outstanding claims, and to adjust for other material changes over time in the mix of the business. Other adjustments are applied in respect of:

- significant claims (which are considered in isolation);
- those claims that have (nearly) reached their policy limits; and
- movements in case reserves that are anticipated for the next accounting period.

6.14 The reserves booked under UK GAAP are those estimated as above, with no additional margins. However, there are implicit margins within these reserves above a true "best estimate" in that there is no allowance for future salvage or subrogation and in that future LDFs cannot be less than unity.

Outstanding Claims Reserve Validation

6.15 The case reserves are subject to both a technical audit and an operation audit. Technical audits are carried out every two years and check that the claims team is complying with the Claims Policy. Operational audits take place twice per annum and check that the claims team is following operational processes. I have seen evidence in the form of reports that these audits are being conducted.

6.16 The reserves (including the IBNR element) are also subject an annual in-depth review by the auditors for FM (the auditors being a large and reputable international firm, with significant insurance-related experience, including actuarial skills). This review is conducted centrally in respect of all the FM entities and includes independent projections for a sample of classes, and the independent calculation of a range of reasonable best estimates. As at 31 December 2023, the auditors concluded that FMI's booked reserves were well within the auditors' range of reasonable best estimates. I have discussed with the actuaries responsible for this work the steps that they have taken in reaching this conclusion and consider them to be reasonable. I understand that further review work is conducted locally, by the relevant local audit teams.

6.17 FMI's reserves as at each year-end are discussed by FM's Financial Controller and by its Finance Team. They consider the extent to which trends seen in FMI's reserves are consistent with trends seen across FM, and whether further adjustments are required.

6.18 FMI's reserves have been broadly consistent for several years, with no changes in recent years to the Claims Policy and very low levels of staff turnover within the claims team. FMI has, for several years, conducted a back-testing exercise in respect of its UK GAAP outstanding claim reserves, which has confirmed this broad consistency.

Category C business

6.19 As explained in paragraph 4.11, above, FMI wrote a small portfolio of business in the late 1960s that has since been in run-off but which has given rise to industrial disease claims. These claims have been handled by a team in the US and the losses are effectively 100% reinsured by FMIC, with roughly a third (or £5 million) of the capacity of the aggregate XoL contract remaining. Therefore, the net liability to FMI is zero. However, the legal liability for this business remains with FMI.

6.20 In 1996, based on advice provided by KPMG, FMI booked a gross reserve in respect of this business, based upon KPMG's estimate of the ultimate cost of the claims, gross of reinsurance. Since then, the reserve has been updated quarterly by reducing the amount for payments made in the quarter and for reductions in the incurred amounts on settlement. As noted above in paragraph 4.16, as at 31 December 2023, there were 974 open Category C claims, relating to 146 separate policies, and FMI carried gross provisions in respect of this business totalling £1.57 million.

6.21 Reserving for business such as that included with Category C is not straightforward and any estimate of the ultimate cost of the claims is very uncertain. However, I am reassured in respect of the impact of this business on FMI's balance sheet by the following:

- the business is wholly reinsured by FMIC;
- the gross reserves relating to Category C business are small relative to FMI's overall reserves, gross of reinsurance;
- although claims can still be reported, just eight were made in 2022 and none in 2023;

- payments relating to Category C business over the past 10 years have amount to the equivalent of just under £1 million – at that rate of payment, the gross reserves should be sufficient to meet payments for the next 17 years (and about 85 years to exhaust the aggregate XoL contract). However, most of the recent payments were made in 2016 and 2017. Over the last five years, claim payments totalling just £72k have been made and at that rate the gross reserves would be sufficient to meet payments for the next 108 years.

Solvency II

6.22 FMI's Actuarial Function is fulfilled by both internal resources and, on an outsourced basis, an external actuarial firm. Both sub functions report into the Head of the Actuarial Function who is the FMI Finance Manager. FMI has an Actuarial Function policy, which is subject to annual review by the FMI RMC and which defines the division of tasks between the Internal Actuarial Function and the External Actuarial Function. The Internal Actuarial Function carries out the annual calculation of the TPs in accordance with the Technical Provisions policy (see below), including back-testing. The External Actuarial Function then provides a review of the TPs. This comprises a detailed review every two years and a high-level review in intervening years, unless there have been any changes to requirements, practices or procedures.

6.23 The Technical Provisions policy outlines the requirements under Solvency UK and requires input from multiple teams into the process and that changes in practice are discussed. The Technical Provisions policy is reviewed at least annually, with the last review completed on 26 February 2024.

6.24 The key differences in the calculation of the TPs compared with the calculations of UK GAAP reserves are outlined below.

- The UPR allowed for under UK GAAP is replaced with a premium provision, which reflects the future cashflows arising on the unearned premium reserve and on bound but not incepted policies. It is possible for the premium provision to be negative if the future cashflows are to be profitable to the insurer (allowing for the adjustments below). FMI's premium provision as at 31 December 2023 (see Figure 4.5, above) is positive but much smaller than the UPR.
- The TPs include allowance for Events Not In Data (ENIDs). The ENID allowance is calculated based on specific catastrophe events as modelled by FMIC. The scenarios with the greatest potential impact are included within the TPs each period. The approach here only covers catastrophe events but, based on my experience, does not appear unreasonable for a portfolio of this nature. I also note that there is no ENID adjustment within the claims provision. This is reasonable because all catastrophic events affecting the claim provisions would be known by the time that the provisions were finalised.
- The ceded TPs also include allowance for the risk of counterparty default.
- The TPs allow for the time value of money based on the expected run-off pattern and discounting using risk-free yields published by the PRA.
- The TPs include a risk margin, based on the standard approach of calculating the cost of capital associated with holding the SCR for the portfolio through to run-off. I have considered this approach in the context of the nature and size of FMI's business and have concluded that it is reasonable.
- The TPs include adjustments for all recoverable balances within debtors and creditors from direct and reinsurance operations. These balances are reclassified out of their respective UK GAAP accounts and included within the provisions for the calculation of future discounted cash flows.
- The ceded TPs as at 31 December 2023 were also adjusted to take account of expected losses due to the default of a counterparty.

This approach to calculating the TPs is in line with market practice.

6.25 The External Actuarial Function carried out a formal review of the TPs as at 30 June 2022 during the second half of 2022, including back-testing of results. This review included back-testing, a comparison of actual development over the preceding period against that expected based on the previous reserving exercise ("**AvE**") and stress and scenario testing of the key assumptions. While it included some recommendations for enhancing FMI's processes, the review concluded that, overall, FMI's TPs met the validation requirements as set out in Article 264 of the Delegated Act. The External Actuarial Function did not repeat this analysis as at 31 December 2022 due to the stability within the requirements and within FMI's processes and procedures, but it intended to perform a detailed analysis again as at 30 June 2024. If this has been undertaken by the time that I prepare the Supplemental Report, I will comment upon it in that.

Conclusion with regard to the strength of FMI's technical provisions, pre-Scheme

6.26 I have reviewed the approaches taken by FMI to calculating its technical provisions on both a UK GAAP and a Solvency UK basis and consider them appropriate. I have also reviewed the measures taken by FMI (including the actions of its auditors and its External Actuarial Function) to satisfy itself regarding the adequacy of its technical provisions on both a UK GAAP and a Solvency UK basis and consider them appropriate. Finally, I have reviewed, at a high level, the documentation supporting these calculations and checks, and consider them sufficient.

6.27 Based on this review, I am satisfied that:

- the UK GAAP reserves held overall by FMI as at 31 December 2023 appear reasonable; and
- the TPs held by FMI as at 31 December 2023 appear reasonable.

STRENGTH OF FMIE'S TECHNICAL PROVISIONS (PRE-SCHEME)

6.28 Like FMI, FMIE's insurance liabilities are predominately short-tailed liabilities and its outstanding claim reserves comprise mostly case estimates, with only small amounts of IBNR reserves, reflecting the speed at which claims are reported. As shown above, in Figure 4.4, FMIE's LuxGAAP provision for outstanding claims, gross of reinsurance, was €337.8 million as at 31 December 2023. FMIE has in place a significant reinsurance programme that reduces the LuxGAAP provision for outstanding claims as at 31 December 2023 to €91.7 million, net of reinsurance.

6.29 The approaches taken to reserving by FMIE – both for local GAAP reporting and for Solvency II reporting – are virtually identical to those taken by FMI. This includes both the case reserving and the calculation of IBNR reserves (I note that the same UK-based team performs the IBNR reserve estimation for both FMI and FMIE), and the validation of the reserves. Rather than repeat prior material, I refer readers who wish to understand FMIE's approach to reserving to the paragraphs above, starting at paragraph 6.7.

6.30 I note three areas of difference in the estimation of technical provisions between FMI and FMIE.

- FMIE has no exposure to business similar to FMI's Category C portfolio;
- under LuxGAAP, insurers are required to include within their technical provisions an allowance for <u>all</u> future LAE whereas, under UK GAAP, there is only a requirement to reserve for allocated LAE and no requirement to reserve for unallocated LAE (e.g. the overhead costs of running a claims team);
- FMIE's business covers risks (and supporting assets) denominated in many more currencies than FMI. This introduces an additional layer of complexity when setting the TPs, in particular in respect of the discounting for the time value of money.

6.31 To comply with local regulatory requirements, FMIE also outsources to a Luxembourg qualified actuary the preparation of a regulatory return (which includes an independent valuation of the TPs). The work is performed by a large international financial services firm that is neither FMIE's auditor nor its External Actuarial Function.

Conclusion with regard to the strength of FMIE’s technical provisions, pre-Scheme

6.32 I have reviewed the approaches taken by FMIE to calculating its technical provisions on both a LuxGAAP and a Solvency II basis and consider them appropriate. I have also reviewed the measures taken by FMIE (including, indirectly, the actions of its auditors and its External Actuarial Function) to satisfy itself regarding the adequacy of its technical provisions on both a LuxGAAP and a Solvency II basis and consider them appropriate. Finally, I have reviewed, at a high level, the documentation supporting these calculations and checks, and have both documentation and calculations to be satisfactory.

6.33 Based on this review, the technical provisions of FMIE (on both statutory and Solvency II bases) as at 31 December 2023 appear reasonable.

STRENGTH OF FMI’S TECHNICAL PROVISIONS (POST-SCHEME)

6.34 As discussed in Section 5, above, it is intended that the Scheme will transfer to FMIE all of FMI’s insurance liabilities. Therefore, it is intended that, post-Scheme, FMI will have no need to hold technical provisions. However, if there were to be any Excluded Policies, the calculation of the technical provisions for those Excluded Policies would follow the same processes, practices and procedures as outlined above, without any intended changes.

Conclusion with regard to the strength of FMI’s technical provisions, post-Scheme

6.35 I therefore conclude that implementation of the Scheme will cause no material change in the strength of FMI's reserves in respect of any business that remains with FMI post-Scheme.

STRENGTH OF FMIE’S TECHNICAL PROVISIONS (POST-SCHEME)

6.36 FMIE is not intending to change its approach to reserving for its existing business. The reserving approach currently operated by FMI in respect of the Transferring Business is essentially identical to that of FMIE and FMIE intends no changes to that approach post-Scheme (save the requirement to include in LuxGAAP reserves a provision for the unallocated LAE – such a provision will not be required in the FMIE UK Branch accounts) nor in the personnel who will be conducting it.

6.37 On a Solvency II basis, the TPs in respect of the Transferring Business will be slightly stronger than they were under Solvency UK, simply because of the lower cost of capital rate assumed under Solvency UK compared with Solvency II, which would make a small difference to the risk margin.

Conclusion with regard to the strength of FMIE’s technical provisions, post-Scheme

6.38 I therefore conclude that implementation of the Scheme will cause no material change in the strength of FMIE’s technical provisions on either a GAAP or Solvency II basis.

EXCESS ASSETS OF FMI

6.39 In assessing the level of security afforded by FMI to its policyholders, I have taken account of the balance sheet strength of FMI, as set out in its audited financial accounts as at 31 December 2023, its regulatory solvency margin and its credit rating.

6.40 As set out in Figure 4.3, above, as at 31 December 2023, FMI had EOFs of £844.9 million and an SCR of £365.2 million. This can be expressed as a Capital Cover Ratio of 231%. This would make FMI a “very well-capitalised” company according to the definitions in paragraph 6.4, above.

6.41 The SCR for FMI has been calculated using the Standard Formula. For the purposes of its ORSA, FMI also assesses its capital requirements using a model that considers the same main risk areas as does the Standard Formula, but which is more representative than the Standard Formula of how FMI actually conducts its business. In particular, the ORSA model makes appropriate allowance for FMI's stop-loss arrangement with FMIC (as described in paragraph 4.23, above – the Standard Formula allows only limited credit to be taken for outwards non-proportional reinsurance contracts). The ORSA model also ignores equity risk within the assessment of market risk, as only free assets (i.e. those in excess of the SCR) are invested in equities. As noted above in paragraph 4.47, equity risk made up a significant proportion of FMI's SCR, pre-diversification benefit, as at 31 December 2023, and its removal in the ORSA SCR has a material impact upon the calculated SCR. Having said that, when considering an entity's Capital Cover Ratio, one would typically consider the inherent riskiness of the assets that constitute that part of the ratio above 100% as well as those that meet the SCR. However, I consider FMI's SCR (as calculated using the Standard Formula) to be a conservative assessment of FMI's capital requirement.

6.42 I note that neither the Standard Formula nor the ORSA model include any allowance for the parental guarantee provided to FMI by FMIC, as explained above in paragraph 4.30.

6.43 FMI is also strongly rated by Standard & Poor's, A.M. Best and Fitch, as noted in paragraph 4.10, above.

Conclusion regarding the excess assets of FMI

6.44 Based on my review of the financial statements, regulatory solvency margin and credit ratings of FMI, as outlined above, my view is that FMI is (as at 31 December 2023) a very well-capitalised company.

EXCESS ASSETS OF FMIE PRE-SCHEME

6.45 As set out in Figure 4.6, above, as at 31 December 2023, FMIE had EOFs of €766.7 million and an SCR of €493.5 million. This can be expressed as a Capital Cover Ratio of 155%. This would make FMIE a "well-capitalised" company according to the definitions in paragraph 6.4, above.

6.46 In assessing its SCR for regulatory purposes, FMIE uses the Standard Formula. The limitations of the Standard Formula in calculating the SCR for FMIE are the same as they are for FMI, as set out in paragraph 6.41, above. In its ORSA, FMIE uses a model to calculate its solvency requirements that is similar to that used by FMI in its ORSA, which has been constructed using the same modelling software (which is a capital modelling tool commonly used throughout the European non-life insurance market) as that used by the FMI ORSA model, and which better reflects how FMIE actually conducts its business. In particular, the ORSA model makes appropriate allowance for FMIE's stop-loss arrangement with FMIC and ignores equity risk that relates to free assets. On this basis, I consider FMIE's SCR (as calculated using the Standard Formula) to be a conservative assessment of FMIE's capital requirement.

Conclusion regarding the excess assets of FMIE pre-Scheme

6.47 I have explained above why I consider that FMIE's calculations and projections of its solvency requirements and available capital, and hence of its excess assets, are reasonable. Overall, these lead me to conclude that the policyholders of FMIE currently benefit from the financial strength provided by a well-capitalised company.

EXCESS ASSETS OF FMIE POST-SCHEME

6.48 I note that, as shown in Figure 5.8, above, had the Scheme taken place as at 31 December 2023, on a standalone basis the FMIE UK Branch would have had a Capital Cover Ratio of 130%. As such, the FMIE UK Branch would be considered more than sufficiently capitalised, which represents a material decline from the Capital Cover Ratio afforded to the Transferring Policyholders, pre-Scheme. However, although the FMIE UK Branch must maintain capital to meet UK regulatory solvency capital requirements, it is not a distinct legal entity, rather it is a part of FMIE. Therefore, post-Scheme, the Transferring Policyholders can expect the assets of all of FMIE to meet their liabilities, not just the assets of the FMIE UK Branch. Therefore, when considering the post-Scheme security of the benefits of the Transferring Policyholders, I have focused my attention on the financial strength of FMIE in general and not on the FMIE UK Branch in isolation.

6.49 As is shown in Figure 5.6, above, FMIE's Solvency II balance sheet will increase as a result of the Scheme, as will its EOFs and its SCR. As shown in Figure 5.8, above, had the transfer taken place as at 31 December 2023, the post-Scheme Capital Cover Ratio would have been 188%, which would have made FMIE, post-Scheme, a well-capitalised insurer.

6.50 FMIE has provided me with projections of its post-Scheme LuxGAAP balance sheet and of its post-Scheme EOFs and SCR, all as at 31 December 2024 (which is a month after the expected Effective Date) and as at the subsequent two year-ends. These show that, throughout that period, FMIE's post-Scheme Capital Cover Ratio is expected to be just above the level that would mark FMIE as a very well-capitalised insurer.

6.51 I have been informed that these projections have been based on expected cashflows into and out from FMIE (post-Scheme), with no allowance for any dividend payments to the parent company (FMIC) or additional capital support being provided by FMIC at any time throughout the projection period.

6.52 I note that, as stated above in paragraph 4.122, FMIE's Capital Management Policy states that a Capital Cover Ratio (relative to the SCR) below 125% is outside of FMIE's risk appetite. FMIE's current (pre-Scheme) and projected (post-Scheme) Capital Cover Ratios are well in excess of this stated risk appetite. Although FMIE could utilise or release capital post-Scheme so as to reduce materially its Capital Cover Ratio while still remaining within its own risk appetite, I have been told by FMIE that it has no plans to do so. I further note that FMI's risk appetite in terms of its Capital Cover Ratio is identical to that of FMIE and therefore it too could release capital (subject to regulatory approval) so as to reduce materially its Capital Cover Ratio while still remaining within its own risk appetite.

6.53 I set out below in Figure 6.1 the history of FMIE's EOFs, SCRs and Capital Cover Ratios as at year-ends 2017-2022.

FIGURE 6.1. HISTORY OF FMIE'S SCR, ELIGIBLE OWN FUNDS AND CAPITAL COVER RATIOS 2017-2022

	2017	2018	2019	2020	2021	2022
SCR (€ million)	85.0	148.5	297.3	280.7	355.9	350.6
EOFs (€ million)	230.5	208.5	494.5	507.7	602.8	636.3
Capital Cover Ratio	271%	140%	166%	181%	169%	182%

Conclusion regarding the excess assets of FMIE post-Scheme

6.54 I have explained above why I consider that FMIE's calculations and projections of its solvency requirements and available capital, and hence of its excess assets, on a post-Scheme basis are reasonable. Overall, these lead me to conclude that the policyholders of FMIE, including those that will transfer from FMI under the Scheme, will benefit from the financial strength provided by a company that is well-capitalised and is projected shortly to become very well-capitalised.

RELATIVE FINANCIAL STRENGTH ENJOYED BY TRANSFERRING POLICYHOLDERS PRE- AND POST-SCHEME

6.55 I have concluded, above, that the Transferring Policyholders currently benefit from the financial strength provided by a very well-capitalised company. I have also concluded that, assuming the Scheme is implemented, the Transferring Policyholders will become policyholders of a company that would be, post-Scheme, well-capitalised, and which would be expected to remain well-capitalised throughout the 2024-2026 planning period. Therefore, relative to the solvency capital requirements of the respective entities, the Transferring Policyholders will see only a marginal reduction in the financial security afforded to them.

6.56 Nevertheless, in order to assess FMIE's ability to withstand adverse circumstances and, therefore, whether the Transferring Policyholders might be materially worse off as a result of the Scheme, I have considered the results of a series of stress tests that look at the likely impact on FMIE's post-Scheme balance sheet of severely adverse potential scenarios. I have applied these simplified stress tests to the pro-forma post-Scheme Solvency II balance sheet as at 31 December 2023, which I have shown in Figure 5.6, above. For comparison purposes, I have also applied the same stresses to the pre-Scheme balance sheets of both FMI and FMIE. I have applied one stress to the liabilities and three stresses to the assets (to the reinsurance recoverables, to the bond holdings and to the equity holdings), as these four elements dominate the balance sheets of both FMI and FMIE. As such, the results of these stress tests should be considered illustrative. Nevertheless, in the circumstances, I consider the results of the tests to be strong indicators of the robustness of FMIE's post-Scheme balance sheet.

Stress tests

Stress Test 1

6.57 This test shows the impact of the equities within the investments of FMI and FMIE losing 50% of their value. This would cause the EOFs in the entities to reduce by the loss of equity value, although the corresponding SCRs would also reduce somewhat, as a result of reduced market risk.

6.58 In considering the likelihood of this, I have focused on the historic performance of the S&P 500 index (as most of the equities within FM are invested in US stocks) between July 1924 and July 2024. I have considered movements in the S&P 500 index on a rolling basis, over one year, three years and five years. I did not consider a longer period to be relevant in the context of the predominantly short-tailed nature of the insurance business of FMI and FMIE.

6.59 Over both a one-year period and a three-year period, the S&P 500 index has only fallen by more than 50% once: between February and July 1932, the index was less than 50% of the corresponding value one year earlier; between October 1931 and June 1933, the index was less than 50% of the corresponding value three years earlier. Over a rolling five-year period, the index also fell by more than 50% for a brief period following the entry of the US into the Second World War. Otherwise, the S&P 500 index has not fallen by over 50% over the last 100 years. As the underlying economic and political conditions are currently more positive than they were during the Second World War or prior to the Great Depression, I conclude that a sudden 50% fall in equity values would appear to be very unlikely.

Stress Test 2

6.60 This test shows the impact of the bonds within the investments of FMI and FMIE losing 25% of their value. The EOFs in the entities would reduce by the amount of the reduction in the bond values, although the corresponding SCRs would also reduce somewhat, as a result of reduced market risk.

6.61 As the bond portfolio within both entities was relatively short dated as at 31 December 2023, I would regard such an outcome as being very unlikely. I note that the FMIE bond portfolio is split evenly between mortgage-backed securities (mostly through FNMA), US Treasury bonds and investment quality corporate bonds.

Stress Test 3

6.62 Under this stress, I have increased the technical provisions held as at 31 December 2023 by the Companies as if the gross incurred loss ratio experienced during 2023 was equal to the sum of those incurred over the period 2018-2023, i.e. 256% instead of 30% (which it actually was in 2023). I have attempted to model the distribution of loss ratios for the combined business, based on the experience across 2016-2023. Assuming a lognormal distribution (which is typically used when modelling loss ratios), a gross loss ratio of 256% would be around the 99.75^{th} percentile of the distribution, i.e. losses of this magnitude would occur with a probability of about 0.25%. I note that this measure of likelihood is based upon only eight data points, but I believe that it is strongly indicative that a gross loss ratio of this magnitude is extremely unlikely. I have not used data relating to earlier periods as I understand that the business was extensively re-underwritten during the period 2018-2020 and that premium rates have been strengthened materially in recent years, so older experience is unlikely to be a good predictor of the likely distribution of loss ratios for current business.

6.63 As noted in paragraphs 4.23, 4.45 and 4.96, above, FMIC provides 100% reinsurance cover to both FMI and FMIE (pre-Scheme and post-Scheme) for losses exceeding a net combined ratio of 125%. Therefore, subject to FMIC fulfilling its reinsurance obligations (see paragraph 6.65, below), the net combined ratios of FMI and of FMIE cannot exceed 125%.

Stress Test 4

6.64 This stress assumes significant reinsurance non-performance. For ease of calculation, the effect of the stress has been calculated by writing-off all reinsurance recoveries relating to reinsurance provided by FMIC. As at 31 December 2023, this would equate to:

- 77% of the pre-Scheme reinsurance asset for FMI;
- 66% of the pre-Scheme reinsurance asset for FMIE; and
- 69% of the post-Scheme reinsurance asset for FMIE.

6.65 FM evaluates its capital robustness using an internal model that simulates results for defined assumptions including normal and stressed scenarios. The model considers reserve risk, large loss risk, investment risk, credit risk, operational risk and natural catastrophe risk, calibrated to a 1 in 500 return period event. FM includes the results from this model in its ORSA, which is provided to its US regulators annually (the "**US ORSA**"). The most recent US ORSA was finalised in October 2023 and was shared with the PRA in December 2023. This indicates that, in the event of the modelled 1 in 500 return period event (compared to a 1 in 200 period event in Solvency II models), the available capital within FMIC, which was $18.5 billion as at 31 December 2022, would have reduced by $6.6 billion (to $11.9 billion).

6.66 I have examined the US GAAP balance sheet of FMIC as at 31 December 2023 and note that, as at that date (with the equivalent figures as at 31 December 2022 in parenthesised italics) and on a consolidated basis, its assets totalled $34.5 billion *($30.7 billion)*, of which its equities were valued at $13.4 billion *($9.8 billion)*, debt securities at $9.2 billion *($8.3 billion)*, and real estate and other securities at $3.6 billion *($3.4 billion)*. As at the same date, its insurance liabilities totalled $10.0 billion *($10.4 billion)*, and its available capital was $22.5 billion *($18.5 billion)*.

6.67 In summary, I consider FMIC's balance sheet to be very strong (as befits that of a mutual insurer) and, therefore, the likelihood of FMIC being unable to meet its reinsurance liabilities in full appears to me to be remote. Hence, irrespective of the strength of the other reinsurers, I regard stress 4 as extreme.

Results of the Stress Tests

6.68 I summarise the results of these four stress tests (applied isolation from one another) in Figure 6.2-Figure 6.4, below.

FIGURE 6.2. THE IMPACT OF DIFFERENT STRESSES UPON THE ELIGIBLE OWN FUNDS OF FMI AND OF FMIE (BOTH PRE AND POST-SCHEME) AS AT 31 DECEMBER 2023

		FMI pre-Scheme (£ million)	FMIE pre-Scheme (€ million)	FMIE post-Scheme (€ million)
Base Case		844.9	766.7	1,741.7
Stress test 1	50% reduction in the value of the equity portfolio	629.4	527.0	1,257.8
Stress test 2	25% reduction in the value of the bond portfolio	769.5	681.5	1,569.6
Stress test 3	Increase gross incurred losses by five years	830.6	567.8	1,526.4
Stress test 4	Write-off of FMIC reinsurance asset	754.3	524.5	1,395.8

FIGURE 6.3. THE IMPACT OF DIFFERENT STRESSES UPON THE SCR OF FMI AND OF FMIE (BOTH PRE AND POST-SCHEME) AS AT 31 DECEMBER 2023

		FMI pre-Scheme (£ million)	FMIE pre-Scheme (€ million)	FMIE post-Scheme (€ million)
Base Case		365.2	493.5	923.5
Stress test 1	50% reduction in the value of the equity portfolio	255.3	383.3	681.8
Stress test 2	25% reduction in the value of the bond portfolio	350.8	475.1	888.3
Stress test 3	Increase gross incurred losses by five years	445.7	710.5	1,209.7
Stress test 4	Write-off of FMIC reinsurance asset	365.9	490.7	911.4

FIGURE 6.4. THE IMPACT OF DIFFERENT STRESSES UPON THE CAPITAL COVER RATIOS OF FMI AND OF FMIE (BOTH PRE AND POST-SCHEME) AS AT 31 DECEMBER 2023

		FMI pre-Scheme	FMIE pre-Scheme	FMIE post-Scheme
Base Case		231%	155%	189%
Stress test 1	50% reduction in the value of the equity portfolio	246%	137%	184%
Stress test 2	25% reduction in the value of the bond portfolio	219%	143%	177%
Stress test 3	Increase gross incurred losses by five years	186%	80%	126%
Stress test 4	Write-off of FMIC reinsurance asset	206%	107%	153%

6.69 I note that, based on the balance sheet as at 31 December 2023, FMI would remain a very well-capitalised insurer even in the extreme conditions of stresses 1-4. In the same extreme conditions, FMIE post-Scheme would remain a well-capitalised insurer, save in respect of stress 3, which would leave it more than sufficiently capitalised.

6.70 I note that in the above stress tests, I have ignored the parental guarantee because, according to the results of these tests, the guarantee should not need to be invoked as the stresses do not cause the financial failure of FMIE.

Reverse stress test

6.71 I have also considered what combination of stresses would result in FMIE, post-Scheme, becoming insolvent, i.e. for its capital to be exhausted. For ease, I have combined stresses 1, 2 and 4 and have then flexed the stress on the gross loss experience of FMIE, post-Scheme, until its EOFs fall to zero.

6.72 Had FMIE, post-Scheme, incurred loss ratios during 2023 equal to those of FMI and FMIE combined over the period mid-2020 to end 2023 then, in conjunction with stresses 1, 2 and 4, FMIE's EOFs would be totally eroded and its Capital Cover Ratio would be zero. At this point, the post-Scheme FMIE would just be able to pay in full its insurance obligations to its policyholders, including the Transferring Policyholders, but higher losses would mean that policyholders would not be paid in full.

6.73 The gross loss ratio of FMIE, post-Scheme, under this reverse stress would be 136%, which I have estimated to be about the 96th percentile in the range of loss ratios. While this might not be considered in isolation to be an extreme outcome, I believe that the likelihood of it occurring at the same time as the outcomes under the other three stresses, is extremely remote, notwithstanding that, at the extremes, there is likely to be some correlation between stressed outcomes.

6.74 Based on my assessment of the impact on FMIE's balance sheet of the various stress tests outlined above, I believe that the expected EOFs would be sufficiently robust that, post-Scheme, FMIE would be able to continue to meet all of its liabilities, even in very extreme adverse circumstances. Furthermore, it should be able to meet its regulatory capital requirements in all but the most extreme circumstances.

Conclusion regarding the relative financial strength enjoyed by Transferring Policyholders pre- and post-Scheme

6.75 I consider that FMI is currently a very well-capitalised company and that, post-Scheme, FMIE will be well-capitalised (and projected shortly to become very well-capitalised), and that the likelihood of either FMI (pre-Scheme) or FMIE (post-Scheme) becoming insolvent and hence unable to meet their contractual obligations to be remote. The difference in the relative probabilities of FMI (pre-Scheme) or FMIE (post-Scheme) becoming insolvent is negligible. Therefore, I am satisfied that the Transferring Policyholders will not be materially adversely affected due to any differences in the financial strength of FMIE post-Scheme to those of FMI pre-Scheme.

CHANGES IN RISK EXPOSURES

6.76 If the Scheme is sanctioned, the Transferring Policyholders will be exposed to the risks within FMIE and will no longer have any exposure to risks within FMI. I note that, although FMI (pre-Scheme) and FMIE (both pre-Scheme and post-Scheme) are subject to broadly similar types of risk, due to significant overlap in their governance processes and practices, in the types of business that they write and in the investment of their assets, there are differences in their profile:

- FMI (pre-Scheme) is smaller than FMIE (both pre-Scheme and post-Scheme).
- FMIE (both pre-Scheme and post-Scheme) is exposed to wider geographical range of risk spread than is FMI (pre-Scheme). This also provides greater diversification of risk.
- The risks of FMI (pre-Scheme), as measured by its pre-diversification SCR, are dominated by market risk. In FMIE (both pre-Scheme and post-Scheme), market risk is the pre-eminent risk, but other risk types (insurance risk, credit risk and operational risk) are more significant than they are in FMI (pre-Scheme). This is illustrated in Figure 6.5, below.

FIGURE 6.5. THE PROPORTIONS OF THE PRE-DIVERSIFICATION SCRS BY RISK TYPE FOR FMI AND FMIE AS AT 31 DECEMBER 2023

	FMI pre-Scheme	FMIE pre-Scheme	FMIE post-Scheme
Non Life	5.2%	17.5%	11.8%
Market	84.5%	57.7%	69.8%
Counterpart Risk	8.9%	19.6%	14.9%
Operational Risk	1.4%	5.2%	3.5%

6.77 While the above demonstrates changes from pre-Scheme to post-Scheme in the profile of risks to which the Transferring Policyholders will be exposed, I do not see reason why these changes might be adverse for the Transferring Policyholders. Indeed, I feel that the wider spread of the risks to which the Transferring Policyholders are exposed are more likely than not to be to their benefit.

6.78 However, I note that the Solvency II / Solvency UK regimes have been designed to reflect the underlying riskiness of insurers. Therefore, different risk profiles, insofar as they might affect the future financial security of policyholders, should be adequately reflected in the capital requirements of both FMI and FMIE. As I have already concluded, pre-Scheme, FMI is currently very well-capitalised and FMIE is expected, post-Scheme, to be (and to remain) well-capitalised. I consider the difference in the relative probabilities of two insurers with these levels of capitalisation becoming insolvent to be negligible. I have further checked in the stress tests whether, post-Scheme, (very unlikely but not wholly implausible) extreme movements in the claims experience and in the asset values could compromise FMIE's solvency. I have concluded in paragraph 6.74, above, that they would not. Therefore, I am satisfied that, even though the Scheme is likely to result in some changes to the Transferring Policyholders' risk exposures, the capital protection available to them post-Scheme will not be materially different to that which they enjoyed pre-Scheme. Therefore, I conclude that any change in their risk exposure will not have a materially adverse impact on the security of the Transferring Policyholders.

Conclusion regarding the effect of the Scheme on the Transferring Policyholders' exposure to risk

6.79 I am satisfied that, although the proposed Scheme will lead to some change to the risk exposures of the Transferring Business, this will not have a materially adverse impact on the security of the Transferring Policyholders' benefits.

IN THE EVENT OF INSOLVENCY

6.80 In the event that FMIE became insolvent post-Scheme, under Luxembourg law Transferring Policyholders who are not reinsureds would rank alongside Transferring Policyholders who are reinsureds (as well as alongside the Current FMIE Policyholders), whereas in the event of the pre-Scheme insolvency of FMI they would have ranked ahead of those Transferring Policyholders.

6.81 However, as has been discussed above, post-Scheme, FMIE will be a well-capitalised company and, as illustrated through the scenario tests, would be able to continue to meet its obligations to policyholders even in some very adverse circumstances. Therefore, the insolvency of FMIE, post-Scheme, is such a remote possibility that any change in ranking would not be sufficiently material to affect my conclusions, and so I have not investigated the matter in detail.

Conclusion regarding the effect of the Scheme on the Transferring Policyholders in the event of the post-Scheme insolvency of FMIE

6.82 I am satisfied that the Transferring Policyholders will not be materially adversely affected due to relative differences in their rights pre- and post-Scheme in the event of the insolvency of FMIE.

POLICY SERVICING

6.83 As explained in paragraph 5.21, above, it is intended that the Scheme will result in no change to the management and administration of the Transferring Business. In my opinion, this will be achieved because:

- The conduct standards and rules and the policy servicing processes and practices within FMI and FMIE are essentially the same; and

- All members bar one of FMI staff will be transferred to the FMIE UK Branch as soon as the FMIE UK Branch becomes operational and that they will continue to operate in accordance with the current FMI Individual Conduct Rules (subject to any subsequent revision)

Conclusion regarding the effect of the Scheme on the policy servicing of the Transferring Business

6.84 I believe that the Scheme will have no effect on the standards of policy servicing experienced by the Transferring Policyholders compared to their current position.

COMPENSATION AND COMPLAINTS

6.85 I have explained in paragraphs 3.11-3.13, above, that in the event that a UK-authorised financial firm had insufficient assets to meet its liabilities, the FSCS would compensate eligible customers of the firm in question. I have also explained, in paragraphs 3.15-3.16, above, that the FOS provides eligible customers with a free, independent service to help settle disputes with financial firms (including insurers). The FOS has compulsory jurisdiction in respect of complaints raised by eligible policyholders. I further explained, in paragraph 3.55, above, that, aside from the FIAA and the FCGA, which operate in respect solely of victims of road traffic accidents, there are no policyholder protection schemes that apply to insurers regulated in Luxembourg. I also explained, in paragraph 3.57, above, that there is an Insurance Ombudsman service in Luxembourg whose objective is to find extrajudicial solutions to disputes that involves Luxembourg-based insurance companies and consumers who reside in an EU member state (which would therefore not include UK consumers).

6.86 The Transferring Business comprises wholly commercial risks. Even those Transferring Policyholders whose risks relate to an EU member state would be unable to access, post-Scheme, the Insurance Ombudsman service in Luxembourg. As I explained in paragraph 3.17, above, because of the nature of its insurance business, FMI believes that none of its policyholders would be eligible to access the FOS. Were there any Transferring Policyholders who, pre-Scheme, were eligible to access the FOS, they would remain eligible to access the FOS post-Scheme.

6.87 As I explained in paragraph 3.14, above, FMI believes that none of its policyholders would be eligible for compensation under the FSCS. However, were there any Transferring Policyholders who, pre-Scheme, were eligible to seek compensation from the FSCS, they would remain eligible to seek compensation from the FSCS post-Scheme, by dint of being transferred into the FMIE UK Branch, which is authorised by the PRA.

6.88 I conclude that, in respect of access to compensation schemes and ombudsman services, the Transferring Policyholders will not be adversely affected by the Scheme.

CONCLUSION FOR THE TRANSFERRING POLICYHOLDERS

6.89 I am satisfied that the Scheme will not affect in a materially adverse way the security or the policy servicing levels or the access to compensation or ombudsman services of the Transferring Policyholders.

7. The impact of the Scheme on the FMI Non-Transferring Policyholders

7.1 In this section of the Report, I consider the impact of the Scheme on the FMI Non-Transferring Policyholders (i.e. those holders of policies that become Excluded Policies). There will be no other policyholders of FMI whose policies are not transferred by the Scheme to FMIE.

7.2 I note that no Excluded Policies are expected. As described in paragraph 5.19, above, if there were any Excluded Policies post the Effective Date then FM would work towards subsequently transferring each and every such Excluded Policy to FMIE, by novation or other means. Furthermore, post the Effective Date, FMIE will assume all of FMI's obligations in respect of the Excluded Policies.

7.3 While they remain direct policyholders of FMI, the holders of any such Excluded Policies would be treated the same as they had been pre-Scheme, with the same standards applied as before and as set out above in paragraphs 4.70-4.79. Although it is intended that the contracts of employment of all members (bar one) of FMI staff will be transferred to FMIE once the FMIE UK Branch becomes operational, should there be any Excluded Policies then FMI and FMIE would put in place a mutual service agreement whereby former FMI employees would be seconded from the FMIE UK Branch to FMI, as necessary, to provide the services required by FMI.

7.4 I would expect that FMI policyholders with Excluded Policies (if any) would continue to benefit from the financial security offered by an insurer that would be at least more than sufficiently capitalised (which, according to its Capital Policy, FMI aims to be). Indeed, Figure 5.7, above, indicates that, immediately post-Scheme, FMI would remain a very well-capitalised insurer (although that the Capital Cover Ratio might vary if there were material liabilities relating to Excluded Policies). As such, I believe that the Scheme will have no impact upon the financial security of holders of Excluded Policies (if any).

CONCLUSION FOR THE FMI NON-TRANSFERRING POLICYHOLDERS

7.5 I am satisfied that the security of the contractual rights or the standards of policy servicing currently enjoyed by the FMI Non-Transferring Policyholders, who will comprise solely any holders of policies that become Excluded Policies, should there be any, will not be adversely affected by the Scheme.

8. The impact of the Scheme on the Current FMIE Policyholders

8.1 In this Section, I consider the impact of the Scheme on the Current FMIE Policyholders.

RELATIVE FINANCIAL STRENGTH ENJOYED BY THE CURRENT FMIE POLICYHOLDERS PRE-AND POST-SCHEME

8.2 I have concluded, in paragraph 6.47, above, that the Current FMIE Policyholders currently benefit from the financial strength provided by a well-capitalised company. I have shown in Figure 5.5 and Figure 5.6, above, that the Scheme would have a material impact on FMIE's balance sheets and would affect its calculated SCR. I have concluded in paragraph 6.54, above, that, post-Scheme, FMIE will be well-capitalised, and that, according to projections provided to me by FMIE, it will remain well-capitalised for at least the next three years.

8.3 I have shown in the stress tests, shown in tabular form in Figure 6.2-Figure 6.4, above, that, post-Scheme, FMIE's Solvency II balance sheet would be more robust in the face of extreme stresses than it would be pre-Scheme. Therefore, in my view, the financial strength afforded to the Current FMIE Policyholders will, if anything, be enhanced if the Scheme is implemented.

Conclusion regarding the impact of the Scheme on the financial security of Current FMIE Policyholders

8.4 I am therefore satisfied that the Current FMIE Policyholders will not be materially adversely affected due to relative differences in the financial strength of FMIE pre-Scheme and post-Scheme.

CHANGES IN RISK EXPOSURES

8.5 If the Scheme is sanctioned, the Current FMIE Policyholders will be exposed to the risks of the Transferring Business as well as those within FMIE pre-Scheme. I note that, although FMIE (pre-Scheme) and FMIE (post-Scheme) are subject to broadly similar types of risk, due to significant overlap in the governance processes and practices of FMI and of FMIE, in the types of business that they write and in the investment of their assets, there are differences in these profiles. These have been illustrated in Figure 6.5, above. I also note that FMIE (post-Scheme) will be exposed to a wider geographical range of risks than it is pre-Scheme. This also provides greater diversification of risk.

8.6 While the above demonstrates changes from pre-Scheme to post-Scheme in the profile of risks to which the Current FMIE Policyholders will be exposed, I do not believe that these changes will be materially adverse for the Current FMIE Policyholders.

8.7 I have concluded in paragraph 6.74, above, that (unlikely but not implausible) extreme movements in the cost of claims and in the asset values would not compromise FMIE's post-Scheme solvency. Therefore, I am satisfied that, even though the Scheme is likely to result in some change to the Current FMIE Policyholders' risk exposures, the capital protection available to them post-Scheme will be stronger in relative terms to that which they enjoyed pre-Scheme. Therefore, I conclude that any change in their risk exposure will not have a materially adverse impact on the security of the Current FMIE Policyholders.

Conclusion regarding the effect of the Scheme on the Current FMIE Policyholders' exposure to risk

8.8 I am satisfied that the Scheme will not lead to any material change in the risk exposures of the Current FMIE Policyholders.

POLICY SERVICING

8.9 I have described in paragraphs 4.123-4.125, above, the current arrangements for the servicing of FMIE's existing business. It intends that, post-Scheme, these arrangements remain in place. Therefore, the Current FMIE Policyholders should experience no change in the servicing of their business.

Conclusion regarding the effect of the Scheme on the policy serving for Current FMIE Policyholders

8.10 I believe that the Scheme will have no adverse impact on the standards of policy servicing experienced by the Current FMIE Policyholders compared to their current position.

IN THE EVENT OF INSOLVENCY

8.11 Pre-Scheme, in the unlikely event that FMIE were to become insolvent, the claims of Current FMIE Policyholders to access the remaining assets of FMIE would rank equally, irrespective of whether they were insureds or reinsureds or whether or not their business had been written via FMIE's branch structure.

8.12 Post-Scheme, the Transferring Policyholders would rank alongside the Current FMIE Policyholders. As such, the Current FMIE Policyholders would face more "competition" for the remaining assets of FMIE. Although the remaining assets would probably be proportionately larger post-Scheme than they would have been pre-Scheme, it is possible that the Current FMIE Policyholders would be (or feel that they were) in a worse situation post-Scheme than they had been pre-Scheme. However, as discussed in paragraph 6.54, above, post-Scheme, FMIE will be a well-capitalised company and would be able to continue to meet its obligations to policyholders even in some very adverse circumstances. Therefore, the insolvency of FMIE, post-Scheme, would presently appear to be only a remote possibility.

Conclusion regarding the effect of the Scheme on the Current FMIE Policyholders in the event of the insolvency of FMIE

8.13 Although it is possible that the Current FMIE Policyholders would be in a worse position post-Scheme than they would have been pre-Scheme in the event of the insolvency of FMIE, the very small likelihood of FMIE becoming insolvent post-Scheme satisfies me that the Current FMIE Policyholders will not be materially adversely affected due to relative differences in their rights pre- and post-Scheme in the event of the insolvency of FMIE.

CONCLUSION FOR THE CURRENT FMIE POLICYHOLDERS

8.14 I am satisfied that the Scheme will not affect in a materially adverse way either the security or the policy servicing levels of the Current FMIE Policyholders.

9. Other considerations

ASSETS OF FMI AND FMIE

9.1 The Transferring Assets are as described in paragraph 1.9, above.

9.2 The Court has the power to order (and the Scheme provides for) the transfer to FMIE of the relevant outwards reinsurance contracts and all other assets in respect of the Transferring Business.

9.3 I have reviewed the investment policies of both FMI and FMIE. Short term assets are managed by the respective entities; long term assets are managed by FMIC on behalf of the entities. The two policies are virtually identical. Each entity's investments are managed with the objective of strengthening the respective entity's financial position and thereby, the capacity to provide for the insurance needs of its policyholders. These needs include stability and growth of policyholder surplus as well as liquidity to cover losses. Assets are held to cover the technical provisions and invested in a manner appropriate to the nature and duration of the insurance and reinsurance liabilities.

9.4 I have no reason to believe that the Transferring Assets are inappropriate in the context of either FMIE or the Transferring Liabilities. Post-Scheme (and post implementation of the Intragroup Asset Transfer Agreement), the asset mix within the FMIE UK Branch will be much lighter in respect of equities than was the pre-Scheme mix within FMI, with surplus capital above that needed to satisfy the capital risk appetite of the FMIE UK Branch not being included within the FMIE UK Branch balance sheet. It is intended that the Transferring Assets and Transferring Liabilities will be as well matched, in terms of duration and currency, post-Scheme as they were pre-Scheme, and, because of the general commonality of the investment policies of FMI and of FMIE, I see no reason (other than unforeseeable external circumstances) why this might change in future.

OPERATIONAL PLANS AND CHANGES IN ASSETS AND LIABILITIES UP TO THE EFFECTIVE DATE

COVID-19 pandemic

9.5 Both FMI and FMIE coped well with the COVID-19 pandemic:

- It had only a limited effect on the claims experience of the Companies, as the terms and conditions had specific limits in place in respect of communicable diseases, which limited the cover to cleaning the facilities. Those few claims that the Companies incurred that were related to the COVID-19 pandemic were covered and aggregated at group level as a catastrophe event, further limiting the impact on both Companies.
- Both FMI and FMIE have business continuity plans that are in-line with FM guidelines, and those plans were activated as the pandemic became apparent. Staff began to work remotely, and the Companies were able to provide continuous support to their clients leveraging technologies. Overall, they consider that the COVID-19 pandemic had very little impact on the operational aspects of their business.
- The Companies experienced an immediate and sharp drop in the value of the equities that they held, but this was largely reversed over the following few weeks.
- Both companies have achieved and outperformed their objectives in terms of new business since the COVID-19 pandemic.

9.6 Both Companies appear to have operated seamlessly throughout the COVID-19 pandemic, and both are confident that they would continue to operate with minimal disruption should there be any future COVID-19 variants, or indeed other events, that led to similar social and business restrictions. As the COVID-19 pandemic has been taken into account (insofar as there has been an impact) within the Companies' most recent respective financial statements and as it is expected to have minimal future impact on the Companies or the Transferring Business, I have concluded that I do not need to consider it further in my review of the likely effect of the Scheme upon the groups of policyholders identified in paragraph 5.13, above.

Ukraine conflict

9.7 The ongoing conflict in Ukraine has led to significant sanctions against Russia and Belarus, as well as disturbing the economies of countries that have material dealings with Ukraine, Russia or Belarus. There has been, and is expected to be, no claims impact on either FMI or FMIE due to this conflict: the standard FM policy contract terms specifically exclude cover following act of war; moreover, neither FMI nor FMIE have covered any risks located in any of those three territories. FM is not a licensed insurer in Russia and stopped renewing any reinsurance business or underwriting new reinsurance business with Russian insurers in 2022. FME had engineers located in Russia providing engineering services to FM clients, but those employees have now been relocated to other countries. FME is in the process of closing its Russian branch. The Companies have confirmed to me that any exposures to interests relating to, or investments in, Russia or Belarus that they may have had in the past were all settled prior to 2022 and that none are ongoing.

9.8 As the Companies have negligible and only indirect involvement with the affected countries, I have concluded that I do not need to consider further the conflict in Ukraine in my review of the likely effect of the Scheme upon the groups of policyholders identified in paragraph 5.13, above.

Conflict in Israel/Gaza

9.9 The ongoing conflict in Israel and the Gaza Strip is expected to have only limited impact upon either FMI or FMIE. As noted above, the standard FM policy contract terms specifically exclude cover following act of war and FMIE covers no risks in either Israel or the Gaza strip. FMI also has no exposure to the Gaza strip but has exposure to four policyholders with risks located in Israel through reinsurance agreements (gross written premium amounting to $10 million, which is less than 4% of FMI's gross written premium for 2023), although no losses have been reported so far. It has further indirect exposure through its subsidiary, FME, which has engineers located in Israel and servicing FM clients. The Companies are monitoring the situation closely.

9.10 As the Companies have negligible and only indirect involvement with the affected countries, I have concluded that I do not need to consider further the conflict in Israel/Gaza in my review of the likely effect of the Scheme upon the groups of policyholders identified in paragraph 5.13, above.

Inflation/interest rates

9.11 The Ukraine conflict was also instrumental in fuelling inflation in many countries, which drove up interest rates and drove down bond values across the world. Inflation appears to have peaked across most of the developed world and interest rates are expected to reduce (even if they have not yet done so everywhere). Likewise, bond values are rising slowly.

9.12 The impact of these movements on the Companies, via claim costs and expenses, has been mitigated by increased premiums, which have been driven by rate increases, by increases in insured values and by new business.

9.13 I note that there is a risk of the above conflicts (especially that in Israel/Gaza) spreading, through external groups or countries becoming involved on both sides, even to the extent that it extends to other regions of the world. Indeed, that is already being seen through attacks on shipping in the Red Sea (and through counterattacks against the attackers). Further hostilities would affect the value and returns on investment assets and could lead to higher inflation, affecting claim costs. In such a scenario, both Companies would be affected, probably to a similar extent. A sharp hike in inflation would be expected to result in a sudden fall in asset values and a rise in claims costs, which were both implicitly part of my scenario testing in paragraphs 6.57-6.74, above.

General

9.14 I expect that the current activities of both FMIE and FMI have continued, and will continue, between the date as at which I have based most of my analyses (31 December 2023) and the Effective Date. Both FMI and FMIE have continued, and will continue until the Effective Date (and beyond in the case of FMIE), to write new business, and both FMI and FMIE have continued, and will continue until the Effective Date (and beyond in the case of FMIE), to settle claims and reassess reserves in the light of experience. I do not consider that any material additional risk to any group of affected policyholders will emerge as a result of the continuation of normal business.

9.15 I believe that it is unlikely that any events occurring between the date as at which I have based most of my analyses (31 December 2023) and the Effective Date would affect any conclusion that I have reached based on my review of the data as at these dates.

9.16 A short time before the final Court hearing, I will consider the extent to which actual changes in assets and liabilities have been in line with expectations (relative to the position as at 31 December 2023), whether internal forecast and projection have been updated, and hence whether there have been any changes (including those associated with current economic conditions) that would affect my overall opinion. I will include in my consideration further developments in respect of the COVID-19 pandemic, the conflicts in Ukraine and Israel/Gaza (and elsewhere if relevant), and the movements in inflation and interest rates. I will report on these matters (insofar as there are developments to report) in the Supplemental Report.

MIS-SELLING LIABILITIES

9.17 In her judgement regarding the case of PA(GI) Limited v (1) GICL 2013 Limited (2) Cigna Insurance Services (Europe) Limited (2015), Mrs Justice Andrews DBE said that *"...an intention to make provision for the transfer of mis-selling liabilities would qualify as an unusual feature which might have a material financial impact on the scheme, and which one would therefore expect to be expressly disclosed in the context of an application for a transfer under a Part VII scheme."* The Transferring Business comprises only commercial insurance business and no personal lines direct business. While it is possible for commercial insurance to be mis-sold, it is, in general, considered much less likely to occur than in respect of personal lines policies, especially on a systemic basis. Therefore, I consider the likelihood of any mis-selling liabilities emerging in relation to the Transferring Business to be very small and it would be reasonable to assume the expected cost of such liabilities to be at most negligible. I have been told by FMI and FMIE that it is intended that the Scheme will transfer such liabilities to FMIE, should they arise in relation to any part of the Transferring Business. I have not considered it necessary to comment further on this matter in this Report.

THE LIKELY EFFECTS OF THE SCHEME UPON REINSURERS OF THE TRANSFERRING BUSINESS

9.18 In accordance with the PRA Statement of Policy and SUP18, I have considered the likely effects of the Scheme on the reinsurers whose reinsurance contracts cover the Transferring Business.

9.19 All reinsurance contracts relating to the Transferring Business will remain in place, albeit with FMI replaced as cedant by FMIE. As shown above in Figure 4.1, as at 31 December 2023, the reinsurers' share of the technical provisions held by FMI on a UK GAAP basis amounted to £137.2 million (and was all in respect of the Transferring Business). The reinsurers' share of the outstanding claims provisions held as at 31 December 2023 by FMI on a UK GAAP basis amounted to £61.1 million.

9.20 The amount of the liabilities of each external reinsurer of the Transferring Business will not change as a result of the Scheme.

9.21 The Scheme will not result in a change in the way in which recoveries are managed in respect of the reinsurance protecting the Transferring Business. As explained in paragraph 5.9 above, and in other places, all FMI employees will become FMIE employees with effect from the date on which the FMIE UK Branch becomes operational, and will henceforth perform for the FMIE UK Branch exactly the same roles in respect of the Transferring Business as they are pre-Scheme for FMI. In so doing, those employees will continue to use the same policies, processes, practices and procedures regarding the Transferring Business (including its outwards reinsurance programme and hence it their dealing with the reinsurers within that programme) as it did pre-Scheme.

9.22 Therefore, I have no reason to expect the Scheme to result in any change in the standards of service provided to the reinsurers of the Transferring Business, or to the magnitude and timing of recoveries claimed against reinsurance contracts relating to the Transferring Business.

9.23 I have considered whether the Scheme is likely to lead to any changes in the rights of "set-off"[12] for creditors or debtors of FMI or FMIE. I understand that there is no legal right of set-off outside of insolvency, but that many (re)insurers take advantage of the opportunity for (non-contractual) set-off as and when it presents itself. In my opinion, it is very unlikely that a reinsurer that anticipated setting-off credits/debits in respect of the Transferring Business with debits/credits from other of its business with FMI would not be able to find such offsets post-Scheme within FMIE. As such, in respect of the right of set-off, I do not foresee any reinsurer being inconvenienced by the Scheme.

Conclusion regarding the impact of the Scheme on the reinsurers of the Transferring Business

9.24 For the reasons discussed above, I am satisfied that the Scheme will have negligible effect on those reinsurers whose contracts of reinsurance cover the Transferring Business.

THE APPROACH TO COMMUNICATION WITH POLICYHOLDERS

9.25 FSMA requires a communication regarding the proposed Scheme to be sent to every policyholder of the Companies. However, consideration may be given to the practicality and costs of sending notices against the likely benefits for policyholders of receiving such communications. In order to comply with paragraph 2.53 of the Policy Statement, paragraph 2.46G of SUP18 and Sections 7 and 8 of FG22/1, the Companies would be expected to notify the policyholders, or interested persons (which would include all reinsurers of the business to be transferred), at least six weeks before the date of the Court hearing at which the application to sanction the Scheme will be heard.

9.26 The Companies' approach to communicating the Scheme to affected policyholders is outlined in paragraphs 5.34-5.45, above.

9.27 I consider the approach being taken to be reasonable.

[12] "Set-off" allows parties to cancel or offset mutual debts with each other by subtracting one from the other and paying only the balance.

9.28 The Companies will be applying to the Court for waivers in respect of the requirement to make direct notification to the following groups:

- Transferring Policyholders who hold policies that are "underlyers" and where the holder of the master policy acts as the primary point of contact with FMI for the underlyer. Instead, the Companies intend to communicate with each underlyer policyholder via its respective master policyholder or for FMI to be introduced by the master policyholder to the underlyer policyholder and the Companies then to send the communications pack directly;
- Transferring Policyholders who hold Category C policies. As FMI only wrote such business on a following basis, it has no contact details for the policyholders and hence direct communication is not practical. Instead, the Companies intend informing such policyholders via the lead insurer or the relevant broker or third-party administrator, through whom FMI has historically worked in respect of this business. Again, the Companies will request that the contact shares the communication pack with the Transferring Policyholder or that it provides to FMI contact details and the Companies then send a communication pack directly to the Transferring Policyholder;
- the Current FMIE Policyholders.

9.29 I consider the proposed waivers in respect of the Transferring Policyholders to be reasonable for the following reasons.

- the Scheme will not result in any changes to the terms and conditions of any of the policies underwritten by either FMI or FMIE;
- in the case of Transferring Policyholders who hold policies that are either "underlyers" or Category C business, the Companies intend that they are properly informed but are proposing pragmatic solutions to problems such as the lack of direct contact information;
- the Companies expect that the Scheme will have little if any impact upon any of the groups identified in paragraph 5.13, above. As I have explained in this Report, I concur with that view; and
- the Companies consider that communication with the Current FMIE Policyholders, on a subject expected to have little if any impact upon them, is likely to be of only marginal interest to them and could create unnecessary concern and/or confusion. I also concur with that view.

9.30 I have reviewed draft copies of the proposed notices and letters, including the draft summary of the Scheme and of the Report. I am not an expert in such communications. However, I consider the draft notices and letters to be clear and concise, to contain all of the information that I would expect them to contain, to be fair, and to be appropriate for their intended audiences.

Conclusion regarding communication with policyholders

9.31 I am satisfied that the proposed approach to communication with policyholders in respect of the Scheme is both proportionate and reasonable.

POLICYHOLDER EXPECTATIONS

9.32 I have not considered the expectations of policyholders other than whether their policies will continue to be serviced post-Scheme to the same service levels as they were pre-Scheme and the relative likelihood pre- and post-Scheme that they will receive whatever benefits to which they are contractually entitled. I note that the Transferring Policyholders comprise entirely commercial businesses and that liability for their cover and/or outstanding claims will remain within the same insurance group post-Scheme as it was pre-Scheme.

WHAT WOULD HAPPEN WERE THE SCHEME NOT TO PROCEED?

9.33 If the Scheme were not to proceed then

- the Transferring Business would remain with FMI;

- all renewals of that business would be into the FMIE UK Branch, once it became operational;
- all FMI employees would transfer to the FMIE UK Branch, once it became operational;
- FMIE would agree to second former FMI employees from the FMIE UK Branch to FMI, as necessary, to provide the services required by FMI (e.g. policy servicing, finance, regulatory reporting, etc.);
- FMI would then be in run-off. It could take many years for that run-off to be completed and for it then to be possible to obtain the PRA's agreement for the cancellation of FMI's permissions and for FMI to be wound-up.

LEGAL JURISDICTION

9.34 I understand that an insurance business transfer scheme as defined in Section 105 of FSMA would be effective as a result of the Court Order sanctioning the business transfers for all policies governed by English law. For cases where such an insurance business transfer scheme aimed to transfer policies that were governed under laws other than English law, it might be possible for holders with such policies to challenge the effectiveness of the sanctioned Part VII Transfer under the applicable law of the policy.

9.35 I have been told by FMI that it has reviewed the laws under which the Transferring Policies have been written. It has been able to establish that, for all of the Transferring Policies, the governing law is that of England and Wales. Therefore, there should be no grounds on which a challenge to the Scheme could be made in a non-UK court, assuming that the Scheme is sanctioned by the Court.

TAX

9.36 The tax implications of the Scheme are expected to be nil in respect of all of FMI, FMIE and the policyholders of either of the Companies. The assets should transfer on a no gain / no loss basis and no chargeable gain should arise in the UK. Likewise in Luxembourg, there should be no direct tax implications. Underwriting profits will attract corporation tax in the normal course. I have been told that the Scheme has been structured as a Transfer of a Going Concern and, as such, the Companies expect that no VAT will be levied on the transaction.

COSTS OF THE SCHEME

9.37 All the external costs of the Scheme (e.g. those of the legal advisors and me/Milliman as independent expert) will be borne by FMIE. These costs have been estimated by the Companies to represent less than 0.1% of the projected Combined Ratio of FMIE. As such, they would not affect the post-Scheme solvency of FMIE or the security of any group of policyholders.

10. Final conclusions

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

- the Scheme will not materially adversely affect the security of benefits to policyholders of either FMI (both those policyholders being transferred under the Scheme and those who will remain, post-Scheme, policyholders of FMI) or FMIE; and
- the Scheme will not have any impact on service standards experienced by the policyholders of either FMI (both those policyholders being transferred under the Scheme and those who will remain, post-Scheme, policyholders of FMI) or FMIE.

10.2 In reaching this opinion I have applied the following principles:

- I have considered which parties might be affected by the Scheme and in what way. I have documented my findings.
- I have not performed my own modelling, rather I have relied on the results of models developed and operated by or on behalf of FMI and FMIE. I have reviewed documentation describing the models, describing and justifying the assumptions underlying those models, and explaining the derivation of the data underlying the models and assumptions, in particular explaining how its accuracy, completeness and relevance has been verified.
- To the best of my knowledge, there are no beneficiaries for whom the impact of the Scheme has not been considered.
- I have considered how the Scheme might lead to any changes in the material risks to the benefits of the different interested parties.
- I have considered the impact on the actuarial information provided to me of FMI and FMIE having adopted alternative plausible assumptions.
- I have not considered alternative arrangements, other than what would happen were the Scheme not to proceed.

Derek Newton / 29 July 2024

Fellow of the Institute and Faculty of Actuaries

Appendix A Definitions

TERM	DEFINITION
Act	The Financial Services Act 2021.
ARC	Audit and Risk Committee, which is an executive committee reporting directly to the Board of Directors.
Available Capital	Capital available to meet solvency capital requirements.
AvE	"Actual vs Expected", an exercise whereby the actual movement over a period in, say, claim incurred amounts are compared with movements that would have been expected, based on an earlier reserving review.
BBNI	Bound But Not Incepted.
Best estimate	This term is used in this Report in reference to an estimate of outstanding claim amounts and is intended to represent an expected value over a reasonable range of estimates. As such, a "best estimate" is not deliberately biased upwards or downwards, and does not include any margins. However, the limitations of actuarial projection methods mean that a "best estimate" is not a statistically rigorous estimate of the mean of the underlying distribution of all possible outcomes.
CAA	Commissariat aux Assurances, the regulator of insurers in Luxembourg.
Capital Cover Ratio	The ratio of Available Capital to Required Capital. This is a measure of the capital strength of the insurer – the higher the ratio, the stronger the company.
Category C business	A portfolio of casualty business, comprising both direct and inwards reinsurance covers, written by FMI primarily between 1963 and 1967.
CET	Central European Time, which is one hour ahead of GMT.
The Companies	The collective term for FMI and FMIE.
Correlation	Correlation (in the context of this Report) is a number that describes the statistical relationship between two variables (e.g. equity prices and interest rates).
The Court	The High Court of Justice of England and Wales.
Current FMIE Policyholders	The policyholders of FMIE immediately pre-Scheme.
EEA	The European Economic Area (which comprises the member states of the EU plus Iceland, Liechtenstein and Norway).
Effective Date	The date on and from which the Scheme shall become effective.
ENID	In estimating the technical provisions under Solvency II, insurers must make allowance for events not in data ("ENID"), i.e. those possible future events or developments that have not been seen in the historic claims experience of the insurer.
EOFs	Eligible Own Funds, i.e. the funds available in an insurer to meet its regulatory SCR.
EU	The European Union.

Excluded Policy	A contract of insurance written or assumed by FMI under which any liability remains unsatisfied or outstanding as at the Effective Date and which would have formed part of the Transferring Business but which, for any reason, is not transferred by order of the Court pursuant to Part VII of FSMA on the Effective Date.
FCA	The Financial Conduct Authority, which is the UK regulatory agency that focuses on the regulation of conduct by retail and wholesale financial services firms. The FCA operates as part of the regulatory framework implemented under the Financial Services Act 2012.
FG22/1	Guidance published by the FCA in February 2022 relating to Part VII insurance business transfers.
FME	FM Engineering International Limited, a subsidiary of FMI.
FM	The FM Global group of companies, comprising Factory Mutual Insurance Company and its worldwide subsidiaries and branches.
FMIC	Factory Mutual Insurance Company, the parent company in FM.
FMI	FM Insurance Company Limited.
FMI Non-Transferring Policyholders	Those holders of FMI policies that are not being transferred to FMIE.
FMIE	FM Insurance Europe S.A.
FMIE Swiss Branch	The branch office of FMIE in Switzerland.
FMIE UK Branch	The branch office of FMIE in the UK.
FOS	Set up by the UK Parliament, the Financial Ombudsman Service (“FOS”) is a service that settles complaints and resolves disputes between consumers and businesses that provide financial services.
FSCS	The Financial Services Compensation Scheme (“FSCS”) is the compensation fund of last resort for customers of UK authorised financial services firms.
FSMA	Financial Services and Markets Act 2000, the legislation under which Part VII governs the transfer of (re)insurance business between (re)insurance undertakings.
FSMA Report	A report on the terms of a transfer under Part VII of FSMA, to be prepared by an independent person. The FSMA Report is required in order that the Court may properly assess the impact of the proposed transfer, including the effect on the policyholders of the insurance companies in question.
GAAP	Generally accepted accounting principles (“GAAP”) form the standard framework of guidelines for financial accounting used in any given jurisdiction.
GMT	Greenwich Mean Time.
IBNR	Incurred but not reported.
IBNR reserves	These are reserves in respect of claims that relate to claim events that have occurred before the valuation date but which were still to be reported to the insurer as at that date. For the purposes of this Report, they also include reserves in respect of any perceived shortfall between the projected ultimate costs and the case estimates for claims already notified, occasionally referred to as **IBNER** reserves. Reserves that are in respect of pure IBNR claims are referred to as **IBNYR** reserves.

IDD	The Insurance Distribution Directive, which has applied in the UK and Gibraltar with effect from 1 October 2018.
IFoA	The Institute and Faculty of Actuaries, the professional body for actuaries in the UK.
Independent Expert	The Independent Expert prepares the FSMA Report and provides it to the Court in order that it may properly assess the impact of the proposed transfer, including the effect on the policyholders of the insurance companies in question. In the case of the Scheme, I have been appointed as the Independent Expert.
Independent Peer Review	Work Review undertaken by one or more individual(s) who is, or are, not otherwise involved in the work in question and who would have had the appropriate experience and expertise to take responsibility for the work themselves.
INED	Independent non- executive director.
LoB	Line of business.
Luxemburg Insurance Law	The Law of 7 December 2015 that forms the laws governing insurance operations in Luxembourg.
MCR	The Solvency II Minimum Capital Requirement ("MCR"), which defines the point of intensive regulatory intervention. The MCR calculation is less risk sensitive than the SCR calculation and is calibrated to a confidence level of 85% over one year (compared to 99.5% for the SCR). However, there is a minimum amount of MCR that applies to all (re)insurers that are regulated in accordance with the Solvency II framework.
Milliman	Milliman LLP, a member of the Milliman Group.
The Milliman Group	The group of entities whose ultimate parent is Milliman, Inc.
NED	Non-executive director.
ORSA	Own Risk Solvency Assessment, which is a fundamental set of processes under Solvency II constituting a tool for decision-making and strategic analysis. It aims to assess, in a continuous and prospective way, the overall solvency needs related to the specific risk profile of the insurance company.
Own Funds	In Solvency II terminology, the amount of capital or excess assets of an insurance company. Own funds are divided into basic own funds and AOFs (e.g. additional premiums from members), which require regulatory approval.
Part VII Transfer	An insurance business transfer scheme performed in accordance with the requirements set out in Part VII of FSMA.
The Policy Statement	The Statement of Policy issued by the PRA entitled *Insurance business transfers*, issued in January 2022.
PRA	The Prudential Regulation Authority, which is part of the Bank of England and carries out the prudential regulation of financial firms in the UK, including banks, investment banks, building societies and insurance companies. The PRA operates as part of the regulatory framework implemented under the Financial Services Act 2012.

QRTs	Quantitative Reporting Templates, which must be completed by insurers and submitted to the regulator on a regular basis in accordance with Solvency II. The QRTs cover a wide range of quantitative financial information about the insurer including details of its balance sheet, capital requirements and reserves.
Reinsurance	An arrangement with another insurer whereby risks are shared (or passed on). If reinsurance is termed as being "inwards" then the reinsurer in question has accepted risk from an(other) (re)insurer; if reinsurance is termed as being "outwards" then the (re)insurer in question has passed risk to a(nother) reinsurer.
Reinsurance Security Committee	An FM committee that oversees, among other things, approval of the list of reinsurers to which FM entities may cede risk.
Report	References to the "Report" refer to this report.
Report Summary	The summary of this Report, prepared specifically to be included in a document that also summarises the Scheme and which will be made available to policyholders of the Companies and to others who might be affected by the Scheme.
Required Capital	The amount of capital an insurer must hold in order to meet its regulatory capital requirements (for example the SCR).
RMC	Risk Management Committee, which is an executive committee reporting directly to the Board of Directors.
RPPD	The Responsibilities of Providers and Distributors for the Fair Treatment of Customers, a guidance document published by the FCA in January 2018.
The Scheme	In the context of this Report, the proposal that the Transferring Business be transferred from FMI to FMIE under the provisions of Part VII of FSMA.
Scheme Document	The document that sets out the terms of the Scheme.
SCR	Solvency Capital Requirement, which, under Solvency II, is the amount of capital required to ensure continued solvency over a one-year trading time frame with a likelihood of 99.5%.
SFCR	Solvency and Financial Condition Report, which, under Solvency II, each insurer is expected to publish annually, and which will contain certain qualitative and quantitative information, the quantitative information being in the format of certain prescribed QRTs.
Solvency II	The system for establishing (among other things) minimum capital requirements for EU (re)insurers under the Solvency II Directive 2009/138/EC.
Standard Formula	The standard formula for calculating an insurer's SCR, as specified in detail in the Solvency II legislation to be used by all insurers other than those who have an approved internal model.
SUP18	Section 18 of the FCA Supervision Manual.
Supplemental Report	A report I will prepare in advance of the Court hearing to sanction the Scheme covering any relevant matters that might have arisen since the date of this Report.

TCF	The TCF ("treating customers fairly") principles aim to raise standards in the way firms carry on their business by introducing changes that will benefit consumers and increase their confidence in the financial services industry. Specifically, TCF aims to: help customers fully understand the features, benefits, risks and costs of the financial products they buy; and minimise the sale of unsuitable products by encouraging best practice before, during and after a sale.
Technical Provisions	Liabilities determined for regulatory purposes. In particular, the provisions for the ultimate costs of settling all claims arising from events that have occurred up to the balance sheet date, including provision for claims incurred but not yet reported, less any amounts paid in respect of these claims; plus the provisions for future claims (and premiums) arising on unexpired periods of risk (see Appendix G for further details).
TPs	Technical provisions as calculated for Solvency II purposes. As such, they differ from technical provisions calculated on a GAAP basis.
Transferee	The entity to which business is being transferred – in the case of the Scheme, this is FMIE.
Transferor	The entity from which business is being transferred – in the case of the Scheme, this is FMI.
Transferring Assets	The assets within the Transferring Business.
Transferring Business	The business of FMI that is to be transferred to FMIE under the Scheme.
Transferring Liabilities	The liabilities within the Transferring Business.
Transferring Policies	The (re)insurance policies that give rise to the Transferring Liabilities.
Transferring Policyholders	The policyholders of the Transferring Business.
TUPE	The Transfer of Undertakings (Protection of Employment) regulations.
UPR	Unearned premium reserve.
US ORSA	ORSA prepared annually by FM in respect of FMIC and in accordance with US regulatory and reporting requirements.
Work Review	Process by which a piece of actuarial work is considered by at least one other individual for the purpose of providing assurance as to the quality of the work in question.
XoL	Excess of Loss, a type of reinsurance.

Appendix B Key sources of information

B.1. In writing this Report, I relied upon the accuracy of certain documents provided by FMI and FMIE. These included, but were not limited to, the following:

Background

- Financial statements for
  - FMI as at 31 December 2022 and 31 December 2023
  - FMIE as at 31 December 2022 and 31 December 2023
  - FMIE (Bern Branch) as at 31 December 2022 and 31 December 2023
- FM Annual Report 2022
- FM Annual Report 2023
- FMI QRTs as at 31 December 2022 and as at 30 June 2023
- FMIE QRTs as at 31 December 2022 and as at 30 September 2023
- FMI SFCR as at 31 December 2022 and as at 31 December 2023
- FMIE SFCR as at 31 December 2022 and as at 31 December 2023

Scheme and related documents

- Draft Scheme document (dated 24 April 2024)

Reserving

- Extract from the year-end Audit Report relating specifically to the reserves, separately for FMI and for FMIE, as at year ends 2022 and 2023
- Report of FMIE's External Actuarial Function as at 31 December 2022
- Report of the Head of Actuarial Function for FMIE as at 31 December 2022
- Report of the Head of Actuarial Function for FMI as at 31 December 2023
- Report on the Solvency II Technical Provisions Validation as at 30 June 2022, separately for FMI and for FMIE

Risks and Solvency Capital

- Sample file monitoring compliance, by risk, with risk appetite statement for FMI (this was as at the end of December 2023 and also showed compliance for each of the preceding twelve months (noting that some risks are monitored quarterly or annually rather than monthly)
- Sample file monitoring compliance, by risk, with risk appetite statement for FMIE (this was as at the end of November 2023 and also showed compliance for each of the preceding twelve months (noting that some risks are monitored quarterly or annually rather than monthly)
- Summary GAAP balance sheets and profit & loss accounts as at year-ends 2022-2023 (actual), and as at year-ends 2024-2026 (projected), for FMI and for FMIE. The projected balance sheets are on a pro forma basis, assuming that the Scheme and the Intragroup Asset Transfer Agreement are implemented as at year-end 2024. They also show separately the balance sheet for the FMIE UK Branch
- Projected SCR and EOFs for FMIE as at year-ends 2024-2026, on the assumption that the Scheme and the Intragroup Asset Transfer Agreement have been implemented prior to the 2024 year-end.
- Pro forma calculation of what would have been the SCR and EOFs for FMIE as at 31 December 2023 had the Scheme and the Intragroup Asset Transfer Agreement been implemented as at that date. This also shows the SCR by component risk module
- FMI's ORSA 2023, including Appendices 1-7
- Extracted pages from FMIE's ORSA 2023, plus a copy of Appendix 3

- Calculations of the EOFs and SCRs as at 31 December 2023 for FMI (pre-Scheme), FMIE (pre-Scheme) and FMIE (post-Scheme), under each of four stressed conditions, and under combined stresses
- Calculations of the effects of the same stresses applied at a group level on FMIC as at 31 December 2023

Governance and related policies

FMI

- Technical Provisions Policy
- Capital Management Policy
- Investment Management Policy
- Risk Management Policy
- Risk Management Function Overview
- Insurance Risk Policy
- Market Risk Policy
- Credit Risk Policy
- Operational Risk Policy
- Group Risk Policy
- Liquidity Risk Policy
- Emerging Risk Policy
- Compliance Risk Policy
- Actuarial Function Policy
- Risk Management Framework
- RMC Terms of Reference
- ARC Terms of Reference

FMIE

- Technical Provisions Policy
- Capital Management Policy
- Investment Management Policy
- Risk Management Policy
- Risk Management Function Overview
- Insurance Risk Policy
- Market Risk Policy
- Credit Risk Policy
- Operational Risk Policy
- Group Risk Policy
- Liquidity Risk and Asset-Liability Risk Management Policy
- Emerging Risk Policy
- Compliance Risk Policy
- Reinsurance Policy
- Actuarial Function Policy
- Risk Management Framework
- Audit Committee Terms of Reference
- RMC Terms of Reference

Communications

- Version 5 of a document entitled *Communications Strategy*
- Copies of the draft covering letter, separately for:
  - Transferring Policyholders
  - Transferring Policyholders who hold master policies
  - brokers
  - reinsurance brokers
  - representatives in respect of Category C business

Policy serving

- FMI Complaints Standard (dated September 2023)
- FMIE Complaints Standard (dated September 2022)
- FMI Conduct Rules
- FM Code of Conduct 2024
- London Operations Claims Operations Audit Report (dated November 2022)
- London Operations Claims Operations Audit Report (dated November 2023)
- FMI Annual Fit and Proper Declaration (blank)
- FMI Annual Competency Declaration (blank)

Other

- Legal opinion regarding the applicability under English Law of the limitation clause in the policy wording for the commercial property all risks contracts
- First witness statement of William Kenneth Bradshaw and of Christopher Michael Dempsey.

B.2. Information relating to the items listed above was also gathered during discussions with staff of FMIE and FMI.

Appendix C CV for Derek Newton

C.1. Derek Newton is a principal and actuarial consultant in Milliman's London office. He joined the firm in 2003 and led its UK General Insurance practice from 2010 until the end of 2023.

C.2. Derek started his actuarial career in 1983. Since 1994 he has worked exclusively within General Insurance, where he has experience with reserving, mergers and acquisitions (M&A) activity, portfolio transfers, Solvency II, the underwriting process, management reporting, designing and evaluating risk transfer mechanisms, premium rating, risk modelling, and capital and solvency evaluation. His experience includes:

- Leading teams reviewing reserves (and the internal reserving processes) for various insurers and reinsurers, including, where relevant providing statements of actuarial opinion for Lloyd's, for the Central Bank of Ireland, for the Bermudan Monetary Authority and for the relevant US insurance departments.
- Assisting insurers with the preparation of solvency capital assessments, both internal and in accordance with prevailing regulatory requirements.
- Leading assignments to review the underwriting effectiveness of several insurance operations, both commercial and personal lines, resulting in improved efficiency and additional profits to the insurers.
- Providing independent expert support to insurers arranging transfers of business between themselves (see below).
- Providing Chief Actuary / Actuarial Function support to several insurers.
- Leading the evaluation of the reinsurance strategy and reinsurance programme for a major insurer.
- Leading the review of various European insurers as part of due diligence assignments.

C.3. Of particular relevance in this context, Derek acted as the independent expert in respect of the following Part VII transfers:

- The transfer of the general insurance business of RL(CIS) Limited to CIS General Insurance Limited, a transfer that was sanctioned in 2014;
- The transfer of general insurance business relating to the Tower pool from Royal & Sun Alliance Insurance PLC to Knapton Insurance Limited, a transfer that was sanctioned in 2015;
- The transfer of the general insurance business of Dowa Insurance Company (Europe) Limited to Aioi Nissay Dowa Insurance Company of Europe Limited, a transfer that was sanctioned in 2016;
- The transfer of general insurance business relating to the Ridgwell, Fox & Partners pool from QBE Insurance (Europe) Limited and from Moorgate Insurance Company Limited to Bothnia International Insurance Company Limited, a transfer that was sanctioned in 2017;
- The transfer of general insurance business from Royal & Sun Alliance Insurance PLC and from The Marine Insurance Company Limited to Mercantile Indemnity Company Limited, a transfer that was sanctioned in 2019;
- The transfer of EEA general insurance business from Assurant General Insurance Limited and from London General Insurance Company Limited to Assurant Europe Insurance N.V., a transfer that was sanctioned in 2020;
- The transfer of general insurance business from Sunderland Marine Insurance Company Limited to The North of England Protecting and Indemnity Association Limited, a transfer that was sanctioned in 2020;
- The transfer of general insurance business from TTI to UKNV, a transfer that was sanctioned in 2021;

- The transfer of business from QBE UK Limited, from The World Marine & General Insurance PLC and from R&Q Eta Company Limited to Inceptum Insurance Company Limited, a transfer that was sanctioned in 2022;
- The transfer of Gibbon Pool business from Allianz Suisse Versicherungs-Gesellschaft AG to British Reserve Insurance Company Limited, a transfer that was sanctioned in 2023.
- The transfer of general insurance business in run-off business from the UK branch of Aioi Nissay Dowa Insurance Company Ltd. to Beacon Insurance Company Limited, a transfer that was sanctioned in 2023.

C.4. In addition, Derek has been peer reviewer to the Independent Expert in the following transfers:

- The general insurance business of various UK-regulated subsidiaries of the Royal Sun Alliance Insurance Group to a smaller number of UK-regulated subsidiaries of Royal Sun Alliance Insurance Group. The transfers were approved by the Court on 12 December 2011;
- The general insurance business of PA(GI) Limited to Royal Sun Alliance Insurance and to Marine Insurance Company Limited. The transfers were approved by the Court on 12 December 2011;
- Certain general insurance business of the Italian branch of Sompo Luxembourg Insurance Company of Europe Limited to Berkshire Hathaway International Insurance Limited. The transfer was effective 31 December 2013;
- The general insurance business of Chevanstell Limited to R&Q Insurance (Malta) Limited. The transfer was effective 31 December 2013;
- The European branch general insurance business of Mitsui Sumitomo Insurance Company (Europe) Limited to MSIG Insurance Europe AG. The transfer was effective 31 December 2013;
- The EEA general insurance businesses of Sompo Luxembourg Nipponkoa Insurance Company of Europe Limited and Endurance Worldwide Insurance Limited to SI Insurance (Europe), SA and the non-EEA business of Sompo Luxembourg Nipponkoa Insurance Company of Europe Limited to Endurance Worldwide Insurance Limited. The transfer was effective 31 December 2018;
- The business of the Irish, Dutch, French and German branches of Travelers Insurance Company Limited to Travelers Insurance DAC. The transfer was effective 1 October 2019;
- The business of the UK branch of Basler Versicherung AG to Bothnia International Insurance Company Limited. The transfer was effective 2 July 2021;
- The business of the UK Branch of Tokio Marine & Nichido Fire Insurance Company Limited to NRG Victory Reinsurance Limited. The transfer was effective 20 July 2022.

C.5. Before joining Milliman, Derek was:

- A director of Heath Lambert's ART division (2002-2003)
- A partner within Ernst & Young's UK property & casualty consulting practice (1998-2001)
- In a variety of roles within Prudential plc (1983-1998), culminating in finance director and actuary for Prudential's UK general insurance operation.

C.6. Derek was awarded Fellowship of the Institute of Actuaries in 1988. He was a member of the General Insurance Board of the Institute & Faculty of Actuaries (2002-2014) and chaired the Board 2005-2007. He also served on the Council of the Institute of Actuaries (2005-2010). He has chaired various actuarial working parties and authored or co-authored several papers. In 2013, Derek received a special award from the profession to mark his Outstanding Contribution to General Insurance Research.

Appendix D Scope of the Work of the Independent Expert in relation to the Scheme

The following was included within the letter of engagement that was agreed between the Companies, Milliman and me, and which was shown to the PRA prior to the approval by the PRA and FCA of my appointment as the Independent Expert in respect of the Scheme. As such, the following constitutes my terms of reference in respect of this assignment.

> *"The Independent Expert's report (the Scheme Report) will consider the terms of the Scheme generally and the effect that the Scheme will have on the holders of (re)insurance policies of the Companies.*
>
> *His review and Scheme Report will address generally the way in which the Companies have conducted their (re)insurance business but taking into account the particular circumstances of each of the different groups of policyholders of the Companies involved in the Scheme. It will deal inter alia with the following aspects:*
>
> - *The likely scope for deteriorations in each of the Companies' claims reserves (i.e. the likelihood and extent to which each of the Companies' reserves may prove inadequate);*
> - *The impact of the Scheme on the security of / financial strength afforded to the different groups of policyholders of the Companies involved in the Scheme;*
> - *The corporate governance structures operating in the Companies involved in the Scheme and the impact on the different groups of policyholders in the Companies involved in the Scheme;*
> - *The impact of the Scheme on the levels of service provided to the different groups of policyholders of the Companies involved in the Scheme;*
> - *The relative solvency margins of the Companies;*
> - *The future business plans and the capital management policy to be adopted by the Companies following implementation of the Scheme;*
> - *The existing and proposed agreements between the Companies and their reinsurers;*
> - *Guarantees and/or agreements (if any) between the Companies;*
> - *Guarantees and/or agreements (if any) between each of the Companies and their respective parent company;*
> - *Transactions (outside the Scheme) that impact upon one or both of the Companies;*
> - *The terms and conditions (if any) expected to be imposed by the Scheme to be presented to the Court;*
> - *The matters required by applicable provisions of the PRA's January 2022 Statement of Policy on its approach to insurance business transfers (and subsequent amendments) and of Chapter 18 of the supervision manual in the FCA's Handbook (including the guidance contained within the FCA's February 2022 paper on Part VII Transfers (FG22/1) and all relevant subsequent guidance issued by the FCA;*
> - *A review of the communications made to policyholders and the categories of any policyholders to be excluded from any direct communications;*
> - *Any other matters drawn to my attention by the Regulators or which are required by the Regulators to be addressed within the report.*
>
> *The above list is not intended to be exclusive to any other aspects that may be identified during the completion of the project and which are considered to be relevant.*
>
> *The Independent Expert shall not be directly involved in the formulation of the proposed transfers although he should expect to give guidance during the evolution of the detailed proposals on those issues that concern him, or that he considers unsatisfactory.*
>
> *The Independent Expert will meet with the Companies at an early stage to identify key issues and will also discuss the initial findings in respect of the Scheme with the Companies.*

The Independent Expert will support the Companies in their liaison with and provision of information to the Regulators and will also participate in discussions with the Regulators as required.

The Independent Expert will produce (i) the Scheme Report for submission to the Court; (ii) a supplemental report to the Scheme Report for submission to the Court at the final court hearing; and (iii) a summary of the Scheme Report that forms part of the Scheme summary for inclusion within letters to policyholders (or approve such a summary if prepared by the Companies). He will share the Scheme Report (and drafts) and any supplemental report with those noted at paragraph 7 of the engagement letter.

If required, the Independent Expert will attend the Court hearings. For the avoidance of doubt, Milliman's fee estimates included in this agreement include its attendance at the directions court hearing and final court hearing for the Scheme.

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

Appendix E General considerations of the Independent Expert in relation to the Scheme

INTRODUCTION

E.1. I have compiled my Report in accordance with the Policy Statement, with SUP18 and with FG22/1.

E.2. Under FSMA, the concept of TCF must be applied. To help ensure that customers are treated fairly in the future it is necessary to understand how they have been treated in the past. From the policyholders' perspective, the acceptability of the Scheme must be on the basis that it will not have a materially adverse effect on their benefits or fair treatment.

E.3. In order to fulfil my obligations as Independent Expert I have considered the terms of the Scheme generally and how the different groups of policyholders are likely to be affected by the Scheme. In particular, I have considered:

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

MATERIALITY

E.4. After considering the effects of the Scheme on each of the different groups of policyholders affected by the Scheme (as identified in paragraph 5.13, above), I have drawn conclusions as to whether I believe the Scheme will materially adversely affect that group of policyholders. It should be recognised that the Scheme will affect different policyholders in different ways, and, for any one group of policyholders, there may be some effects of the Scheme that are positive, and others that are adverse. If some effects of the Scheme are adverse, that does not necessarily mean that the Scheme is unreasonable or unfair, as those adverse effects may be insignificant or they may be outweighed by positive effects.

E.5. In order to determine whether any effects of the Scheme on any group of policyholders are materially adverse it has been necessary for me to exercise my professional judgement in the light of the information that I have reviewed.

E.6. When assessing the financial security of policyholders, I have looked at the solvency position of the companies involved in the Scheme, on both pre- and post-transfer bases, relative to regulatory solvency requirements, and also at the nature of the assets that constitute each company's capital and surplus. It should be noted that a company may have capital considerably in excess of its regulatory requirements, but that the directors of a company could legitimately reduce that level of capital (for example through the payment of dividends, and subject to regulatory approval) and still leave the company appropriately capitalised. In circumstances where the Scheme has adversely affected the financial security of a group of policyholders, in order to determine whether that impact is material, I have considered whether the level of financial security projected to be in place after the transfer would have been acceptable and permissible before the transfer had taken place. I would determine that any adverse impact to a particular group of policyholders is material if the level of financial security afforded to them after the transfer would not have been acceptable under the normal constraints under which the company's capital position was managed before the transfer

SECURITY OF POLICYHOLDER BENEFITS

E.7. As noted above, I need to consider the security of policyholder benefits, i.e. the likelihood that policyholders will receive their benefits when due.

E.8. In considering and commenting upon policyholder security, I shall consider the financial strength of each entity. Financial strength is provided by the margins for prudence in the assumptions used to calculate the technical provisions, by the shareholder capital and by any specific arrangements for the provision of financial support. In considering policyholder security, it is also necessary to take into account the potential variability of future experience (including claim frequency and severity). Security is also affected by the nature and volume of future new business.

E.9. The main factors that determine the risks to which a policyholder is exposed are:

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

E.10. I also need to consider the impact on policyholders' security in the event of the default of an insurer (e.g. the role of the FSCS).

TREATING CUSTOMERS FAIRLY

E.11. As Independent Expert I also need to consider the impact of the Scheme on levels of service provided to policyholders, including those resulting from changes in administration, claims handling, expense levels and regulation.

E.12. Further, I have considered the proposals in the context of applicable conduct rules/regulation, e.g. the fair resolution of complaints between an insurer and its customers (policyholders).

OTHER CONSIDERATIONS

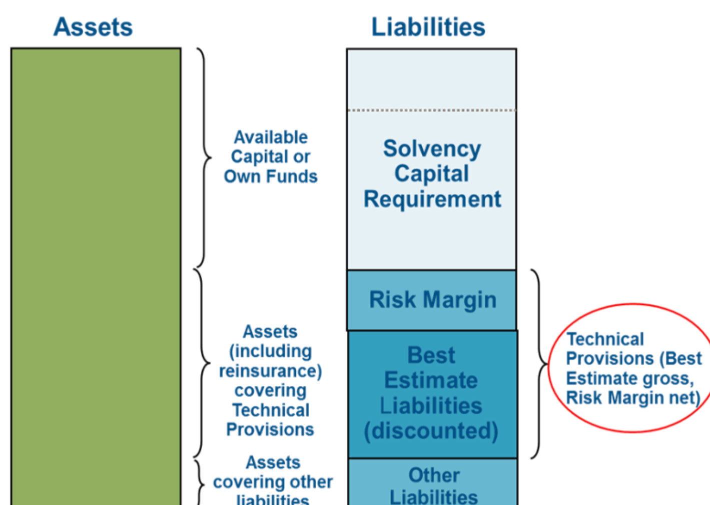
E.13. Paragraph 2.34(4)(b) of the Policy Statement and paragraph 2.36 of SUP18 both require me, as Independent Expert, to consider the likely effects of the Scheme on matters such as investment management, new business, administration, expense levels and valuation bases insofar as they might impact on levels of service to policyholders or on the security of policyholders' benefits.

E.14. I am also required to consider the cost of the Scheme and the tax effects of the Scheme insofar as they might impact on the security of policyholders' benefits.

Appendix F Solvency II / Solvency UK balance sheet

F.1. A simplified illustration of a Solvency II balance sheet is shown in Figure F.1, below. I would use the same diagram to illustrate a Solvency UK balance sheet.

FIGURE F.1. SOLVENCY II BALANCE SHEET



F.2. The Solvency II / Solvency UK balance sheet is intended to be a tool for management to assess an entity's solvency and hence an important consideration for significant decisions. It is also a tool for regulators to assess the solvency of an insurer.

F.3. A key consideration for management in making significant decisions will be the excess of assets over TPs, other liabilities, and the Solvency Capital Requirement (SCR). This excess of Own Funds over the SCR will determine whether the entity can expand existing business, move into new areas, undertake mergers/acquisitions, etc. or whether it needs to consider reducing business volumes, moving out of capital-intensive LoBs, purchasing additional reinsurance and so on. The level of Own Funds will also likely impact the credit rating of an entity.

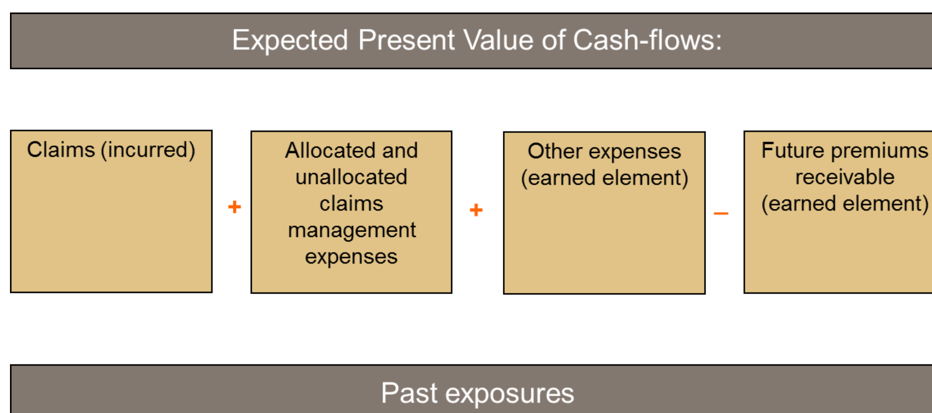
F.4. The TPs are a direct input to the balance sheet. Therefore, they are a fundamental input into the SCR calculation that models the potential movement in the balance sheet over a one-year time horizon.

F.5. Solvency II and Solvency UK both require the TPs (as at the valuation date) to be determined using a market consistent valuation of the liabilities relating to insurance contracts. In practice, a market consistent liability valuation cannot be calculated by reference to market prices, because such prices are not (for practical purposes) available. Therefore, TPs are presently estimated on a proxy to a market value basis, i.e. a 'best estimate' of the liabilities relating to insurance contracts, allowing (i.e. discounting) for the time value of money, supplemented by a risk margin. More specifically, the TPs are made up as follows:

Claims provision + Premium provision + Risk margin

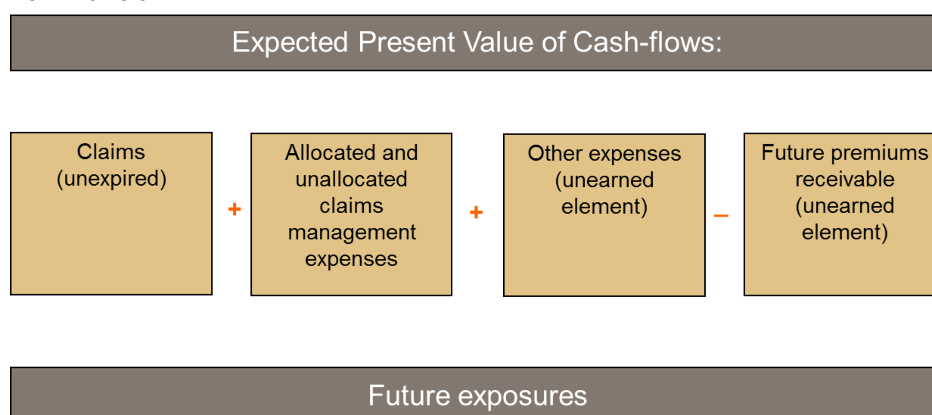
F.6. The claims provision is the expected present value/discounted 'best estimate' of all future cashflows (claim payments, expenses, and future premiums due) relating to claim events prior to the valuation date (i.e. to past exposures). Figure F.2, below, illustrates the components of the claims provision calculation.

FIGURE F.2. CLAIMS PROVISION



F.7. The premium provision is the expected present value/discounted 'best estimate' of all future cashflows (claim payments, expenses, and future premiums due) relating to future exposures arising from policies for which the insurer is obligated as at the valuation date. Figure F.3, below, illustrates the components of the premium provision calculation.

FIGURE F.3. PREMIUM PROVISION



F.8. The risk margin is intended to be equivalent to the balance that another (re)insurer taking on the liabilities as at the valuation date would require over and above the discounted 'best estimate'. Under both Solvency II and Solvency UK, the risk margin is calculated using a cost-of-capital ("**CoC**") approach[13]. More specifically, the calculation is as follows:

$$RM = CoC \times \sum_{t \geq 0} \frac{SCR(t)}{(1 + r_{t+1})^{t+1}}$$

where:

- SCR(t) as employed for the RM formula consists of underwriting risk (with respect to existing business); counterparty risk (e.g. reinsurance); operational risk; and market risk (if unavoidable, i.e. not hedge-able); and
- r_t is the risk-free discount rate(s) at time t, as provided by EIOPA (for Solvency II) or the PRA (for Solvency UK) for all major currencies.

[13] It is here that, for non-life (re)insurers, the differences between Solvency II and Solvency UK are most pronounced. Under Solvency UK, the cost-of-capital parameter was reset to 4% at the end of 2023. Under Solvency II, the equivalent parameter remains at 6%, although, during 2023, the European Parliament proposed that the standard capital rate under Solvency II be reduced to 4.5%. As at the date of this Report, this change had not been implemented within Solvency II.

Appendix G Key differences between GAAP and Solvency II / Solvency UK Technical Provisions

A summary of the key differences between GAAP reserves and TPs is set out in the table below:

Area of change	UK GAAP Reserves	Technical Provisions under both Solvency II and Solvency UK	Balance sheet impact
Earned business	Claims reserve = point estimate within a reasonable range (“not insufficient”)	Claims provision = probability weighted average of future cashflows	Reduces liabilities (removes margins)
Unearned business	UPR, net of Deferred Acquisition Costs	Premium provision = probability weighted average of future cashflows	Reduces liability (expected profit)
Risk Margin	n/a	Explicit item, based on cost of capital approach (note parameter difference between Solvency II and Solvency UK)	Increases liabilities
Discounting	Undiscounted	Discounted cashflows	May reduce or increase liabilities depending on currency and duration.
Contract recognition	Policies written	Policies written and legally bound BBNI policies	Reduces liabilities (due to expected profit on BBNI policies)
Expenses	Claims handling expense reserve	More explicit treatment of expenses (including those not relating to claims handling)	Increases liabilities
ENIDs	Limited allowance for contingent liabilities	Allowance for possible outcomes that have not historically occurred (and hence are not in the data used for reserving)	Increase liabilities
Reinsurance Bad Debt Provision	n/a	Explicit provision required for possibility of reinsurer default	Decreases assets

Appendix H Compliance with the PRA Policy Statement

The table below indicates how I have complied with the provisions of the PRA Policy Statement ("*Insurance business transfers*", dated January 2022) that pertain to the form of the Report. I have not included references to paragraphs in the Executive Summary of this Report; there should be nothing in the Executive Summary that has not been stated or explained in other parts of the Report.

I note that, in preparing this Report, I have also been mindful of the contents of SUP18 and FG22/1.

PRA Policy Statement Reference	Requirement	Scheme Report paragraph reference
2.30 (1)	Who appointed the Independent Expert and who is bearing the costs of that appointment	1.3, 1.14, 1.20, 5.10, and 9.37
2.30 (2)	Confirmation that the independent expert has been approved or nominated by the appropriate regulator	1.3 and 1.14
2.30 (3)	A statement of the independent expert's professional qualifications and (where appropriate) descriptions of the experience that fits him for the role	1.15 and Appendix C
2.30 (4)	Whether the independent expert, or his employer, has, or has had, direct or indirect interest in any of the parties that might be thought to influence his independence, and details of any such interest	1.16-1.18
2.30 (5)	The scope of the report	1.21-1.34
2.30 (6)	The purpose of the Scheme(s)	5.12
2.30 (7)	A summary of the terms of the scheme in so far as they are relevant to the report	5.1-5.10
2.30 (8)	What documents, reports and other material information the independent expert has considered in preparing his report and whether any information that he requested has not been provided	1.37, 1.48, and Appendix B
2.30 (9)	The extent to which the independent expert has relied on: (a) information provided by others; and (b) the judgment of others	1.37 and 10.2
2.30 (10)	The people on whom the independent expert has relied, and why, in his opinion, such reliance is reasonable	1.37
2.30 (11)	His opinion of the likely effects of the scheme on policyholders (this term is defined to include persons with certain rights and contingent rights under the policies), distinguishing between: (a) transferring policyholders; (b) policyholders of the transferor whose contracts will not be transferred; and (c) policyholders of the transferee	 Section 6 Section 7 Section 8
2.30 (12)	His opinion on the likely effects of the scheme on any reinsurer of a transferor, any of whose contracts of reinsurance are to be transferred by the scheme	9.18-9.24
2.30 (13)	What matters (if any) that the independent expert has not taken into account or evaluated in the report that might, in his opinion, be relevant to policyholders' consideration of the scheme	None of which I am aware.

2.30 (14)	For each opinion that the independent expert expresses in the report, an outline of his reasons	2.1, 2.15-2.25, 2.37, 6.32, 6.35, 6.38, 6.68-6.75, 6.79, 6.82, 6.84, 6.85-6.89, 7.4-7.5, 8.2- 8.4, 8.8, 8.10, 8.13, 8.14, 9.18-9.24, 9.25-9.31, and Section 10
2.32 (1)	The summary of the terms of the scheme should include a description of any reinsurance agreements that it is proposed should pass to the transferee under the scheme	1.9, 2.4, 5.3, 5.9
2.32 (2)	The summary of the terms of the scheme should include a description of any guarantees or additional reinsurance that will cover the transferred business or the business of the transferor that will not be transferred	Not applicable
2.33 (1)	The independent expert's opinion of the likely effects of the scheme on policyholders should include a comparison of the likely effects if it is or is not implemented	9.33
2.33 (2)	The independent expert's opinion of the likely effects of the scheme on policyholders should state whether he considered alternative arrangements and, if so, what	1.22
2.33 (3)	The independent expert's opinion of the likely effects of the scheme on policyholders should, where different groups of policyholders are likely to be affected differently by the scheme, include comment on those differences he considers may be material to the policyholders	5.13, Section 6, Section 7, and Section 8
2.33 (4)	The independent expert's opinion of the likely effects of the scheme on policyholders should include his views on: (a) the effect of the scheme on the security of policyholders' contractual rights, including the likelihood and potential effects of the insolvency of the insurer; (b) the likely effects of the scheme on matters such as investment management, new business strategy, administration, expense levels and valuation bases in so far as they may affect: (i) the security of policyholders' contractual rights; (ii) levels of service provided to policyholders; or (iii) for long-term insurance business, the reasonable expectations of policyholders; and (c) the cost and tax effects of the scheme, in so far as they may affect the security of policyholders' contractual rights, or for long-term insurance business, their reasonable expectations	 (a) 6.75, 6.82, 6.89, 7.5, 8.14 (i) 6.55-6.75, 7.5, 8.4, 8.14 (ii) 6.83-6.84, 6.89, 7.5, 8.10, 8.14, 8.10 (iii) Not applicable (c) 9.36, 9.37

2.35 (1)	For any mutual company involved in the scheme, the report should describe the effect of the scheme on the proprietary rights of members of the company, including the significance of any loss or dilution of the rights of those members to secure or prevent further changes that could affect their entitlements as policyholders	Not applicable
2.35 (2)	For any mutual company involved in the scheme, the report should state whether, and to what extent, members will receive compensation under the scheme for any diminution of proprietary rights	Not applicable
2.35 (3)	For any mutual company involved in the scheme, the report should comment on the appropriateness of any compensation, paying particular attention to any differences in treatment between members with voting rights and those without	Not applicable
2.36 (1)	For a scheme involving long-term insurance business, the report should describe the effect of the scheme on the nature and value of any rights of policyholders to participate in profits	Not applicable
2.36 (2)	For a scheme involving long-term insurance business, the report should, if any such rights will be diluted by the scheme, how any compensation offered to policyholders as a group (such as the injection of funds, allocation of shares, or cash payments) compares with the value of that dilution, and whether the extent and method of its proposed division is equitable as between different classes and generations of policyholders	Not applicable
2.36 (3)	For a scheme involving long-term insurance business, the report should describe the likely effect of the scheme on the approach used to determine: (a) the amounts of any non-guaranteed benefits such as bonuses and surrender values; and (b) the levels of any discretionary charges	Not applicable
2.36 (4)	For a scheme involving long-term insurance business, the report should describe what safeguards are provided by the scheme against a subsequent change of approach to these matters that could act to the detriment of existing policyholders of either firm	Not applicable
2.36 (5)	For a scheme involving long-term insurance business, the report should include the independent expert's overall assessment of the likely effects of the scheme on the reasonable expectations of long-term insurance business policyholders	Not applicable
2.36 (6)	For a scheme involving long-term insurance business, the report should state whether the independent expert is satisfied that for each firm the scheme is equitable to all classes and generations of its policyholders	Not applicable

2.36 (7)	For a scheme involving long-term insurance business, the report should state whether, in the independent expert's opinion, for each relevant firm the scheme has sufficient safeguards (such as principles of financial management or certification by a with-profits actuary or actuarial function holder) to ensure that the scheme operates as presented	Not applicable

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