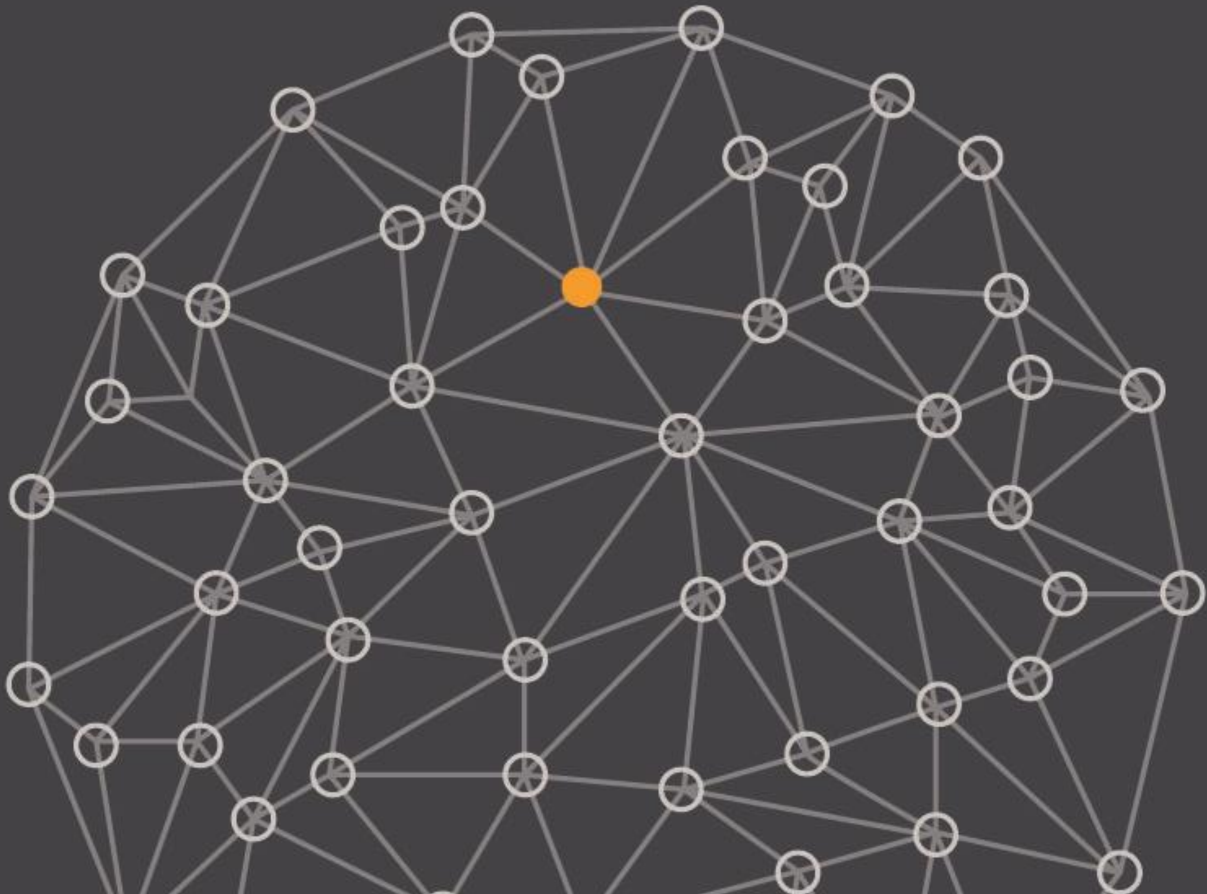
MILLIMAN REPORT

Report of the Independent Expert on the proposed transfer of business from the London Branch of Tokio Marine & Nichido Fire Insurance Co., Ltd. to NRG Victory Reinsurance Limited for the High Court of England and Wales

04 April 2022

Christopher Clarke, FIA



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1. Purpose and Scope

PURPOSE OF THIS REPORT

1.1 It is proposed that all of the insurance and reinsurance business of the London Branch of Tokio Marine & Nichido Fire Insurance Co., Ltd. ("**TMNF**" or the "**Transferor**") be transferred to NRG Victory Reinsurance Limited ("**NRG**" or the "**Transferee**") 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 such business transfer scheme 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 TMNF and NRG collectively as "**the Companies**". The Companies have nominated me to act as 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 1.13, below).

1.4 This Report, which is addressed to the Court, describes the proposed transfer and discusses its possible effects on the policyholders of TMNF and NRG, 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 TMNF is domiciled in Japan and is regulated by Japan's Financial Services Agency (**"JFSA"**). In December 2020, the PRA granted TMNF permission to establish a branch in the UK (the "**London Branch**"). TMNF opened the London Branch on 1 March 2021 and relocated a portfolio of legacy insurance and reinsurance business into the London Branch on that date. TMNF is a subsidiary of Tokio Marine Holdings, Inc. (**"Tokio Marine"**), a company domiciled in Japan.

1.6 NRG is domiciled and authorised in the UK, where it is regulated by both the PRA and FCA. NRG's ultimate parent company is Berkshire Hathaway, Inc. (**"Berkshire Hathaway"**), a conglomerate holding company domiciled in the US state of Nebraska.

1.7 A list of terms defined in this Report is shown in Appendix A. Otherwise, I use the same defined terms (which are capitalised in this Report) as are in the document that sets out the terms of the Scheme (the "**Scheme Document**").

THE SCHEME

1.8 Under the Scheme, it is intended that the business to be transferred to NRG (the "**Transferring Business**") comprises all of the business of the London Branch of TMNF.

1.9 On 31 December 2014, TMNF entered into a reinsurance agreement (the **"Reinsurance Agreement"**) with National Indemnity Company (**"NICO"**) pursuant to which NICO agreed to cover, inter alia, all claim payments made by TMNF in respect of the Transferring Business, up to an agreed aggregate limit, as well as certain overhead expenses relating to the business. It is intended that the Reinsurance Agreement will transfer as part of the Scheme and continue to cover the Transferring Business for the benefit of NRG. Like NRG, NICO is also a subsidiary of Berkshire Hathaway.

1.10 The Effective Date of the Scheme is expected to be 31 August 2022.

1.11 Pursuant to the Reinsurance Agreement and a subsequent framework agreement entered into between TMNF, NICO, NRG and Resolute Management Limited (**"RML"**) in 2018 (the **"Framework Agreement"**), the administration of the Transferring Business is currently undertaken by Resolute Management, Inc. (**"RMI"**) and Resolute Management Services Limited (**"RMSL"**), with RML providing additional support services to the London Branch of TMNF. RML and RMSL are UK domiciled companies, whereas RMI is domiciled in the US. RML, RMI and RMSL are all subsidiaries of Berkshire Hathaway. It is intended that RMI and RMSL will continue to administer the business once the Scheme is effected.

1.12 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

1.13 I, Christopher Clarke, have been appointed by TMNF and NRG 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 July 2021.

Professional Experience

1.14 I am a Principal of Milliman, Inc. ("**Milliman**") and I am 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 2009.

1.15 I have been employed by Milliman since 2010. Since 2011, I have worked on over a dozen Part VII transfers, of varying size and complexity, providing support to the Independent Expert. I have also supported the Independent Actuary in relation to a number of insurance business transfers in Ireland, and I also provided support to the Independent Expert in the first insurance business transfer in the US state of Oklahoma.

1.16 Aside from my work on Part VII transfers, I also have extensive experience with run-off insurance portfolios, gained through undertaking reserve reviews, as well as through working on transactions involving the sale of run-off business.

1.17 In addition, I also have experience undertaking reserve reviews for “live” insurance business, including reserving for Lloyd’s syndicates and for UK, Irish and Bermudian insurers across a broad range of lines of business. I have also provided advice to insurance clients in relation to their solvency capital requirements, in particular in relation to Solvency II.

1.18 For several years I have led a quarterly valuation exercise for an Insurance Linked Securities manager that invests, primarily, in collateralised reinsurance contracts exposed to property catastrophe risks.

1.19 From 2003 to 2007 I was employed by Equitas Management Services Limited, where I was primarily responsible for reserving for asbestos-related reinsurance claims. Following the acquisition of Equitas Management Services Limited by the Berkshire Hathaway group, the company was renamed Resolute Management Services Limited. From 2007 to 2010 I was employed by RMSL where I continued to undertake reserving for the Equitas business (which by that time had been reinsured by NICO), as well as in relation to other run-off portfolios managed by RMSL.

1.20 I am currently a member of the IFoA’s UK Asbestos Working Party (**“AWP”**).

Independence

1.21 To the best of my knowledge, I, and my immediate family, do not have and have never had, any direct or indirect interest in any of the parties involved in the proposed Scheme. We have never had any insurance policies with the Companies or with any entity related to the Companies, and we are not shareholders or members of any entity related to the Companies.

1.22 I have not undertaken any work for TMNF or for NRG in the past 5 years.

1.23 I have previously undertaken reserve reviews (most recently as at 30 June 2015) for TMNF in respect of certain contracts representing TMNF’s participation in the Excess Insurance Company Limited’s reinsurance programme. The reviewed portfolio forms part (circa 30%) of the Transferring Business under the Scheme. The reserve reviews undertaken were in support of a potential (but ultimately unrealised) commutation of the portfolio. Given that these reviews were undertaken more than 5 years ago and that TMNF is no longer using the results of this work, I do not believe that me having undertaken this work adversely affects my ability to act independently in my assessment of the proposed Scheme.

1.24 As noted in paragraph 1.19 above, between 2007 and 2010 I was employed by the actuarial department of RMSL. The remit of the team I worked for included reviewing the technical provisions of a number of Berkshire Hathaway group companies, including that of NRG. Given that I have not worked for RMSL for over 10 years, I do not believe this adversely affects my ability to act independently in my assessment of the proposed Scheme.

1.25 Both TMNF and NRG are members of large multinational insurance groups and, as with the majority of professional services firms in a position to offer suitably experienced expert opinion, Milliman has an existing business relationship with both the Tokio Marine and Berkshire Hathaway groups.

1.26 With regard to the Tokio Marine group, the overall fee income that Milliman has received from companies within the Tokio Marine Group, including any of its subsidiaries, in any of the last 5 calendar years (2016 to 2020) has not exceeded 0.2% of Milliman's corresponding annual global revenue. A summary of the main assignments carried out for the Tokio Marine Group over the last five years are listed below:

- Gary Wells, a (now retired) Principal of Milliman, was the Independent Expert for the transfer of the UK branch business of Nisshin Fire & Marine Insurance Co., Ltd (a Tokio Marine Group company) to Rombalds Limited. I had limited involvement in this project. The transfer was approved by the Court with effect from 31 December 2017.
- Milliman performs the role of actuarial function for Tokio Marine Europe SA, a Luxembourg domiciled company. This work is principally undertaken by Milliman personnel in Luxembourg, although a Milliman consultant in the London office (who has not been, and will continue not to be, involved in the work in relation to the Scheme) acts as peer reviewer.
- Milliman has recently been engaged to provide consulting advice to Tokio Marine HCC. Employees of Milliman's London office are working on this assignment, but none of them have worked, or will work, with me in my role as Independent Expert in assessing the Scheme.
- Milliman has provided casualty and life consulting advice to companies in the Tokio Marine Group, primarily through the firm's offices in the US and Japan, as well as through other offices in Asia and the Middle East.

1.27 As all of the above engagements relate to parts of the Tokio Marine group that operate separately from the London Branch of TMNF, and are entirely unrelated to the Transferring Business, I do not believe that Milliman's involvement in any of these engagements adversely affects my ability to act independently in my assessment of the proposed Scheme. Nevertheless, I note that, in relation to other ongoing engagements with the Tokio Marine group, ethical walls have been, and will continue to be, maintained.

1.28 With regard to the Berkshire Hathaway group, the overall fee income that Milliman has received from companies within the Berkshire Hathaway group, including any of its subsidiaries, in any of the last 5 calendar years (2016 to 2020) has not exceeded 0.1% of Milliman's corresponding annual global revenue. A summary of the main assignments carried out for the Berkshire Hathaway group over the last five years are listed below:

- Gary Wells was the Independent Expert for the transfer of the UK branch business of Sompo Japan Nipponkoa Insurance Company to Transfercom Limited (a Berkshire Hathaway company). I assisted the Independent Expert in this project. The transfer was approved by the Court with effect from 28 February 2016.
- Gary Wells was the Independent Expert/Actuary for the (parallel) transfers of Cardrow Insurance Limited and Beech Hill Insurance Limited to Tenecom Limited (a Berkshire Hathaway company). I assisted the Independent Expert/Actuary in this project. The transfers were approved by the relevant Courts with effect from 7 March 2016.
- A consultant in Milliman's Zurich office performs the role of Appointed Actuary for BHIIL's Swiss branch. A consultant in Milliman's London office (who will not be involved in the work in relation to the Scheme) acts as peer reviewer.
- The other main assignments (i.e. excluding the Independent Expert work discussed above) carried out for the Berkshire Hathaway Group worldwide over the last five years (2016 to 2020) were primarily Casualty exercises undertaken by the Milliman office in Milwaukee (mainly in relation to the Global Aerospace pool on which the Berkshire Hathaway Group participates with a share of circa 18% for risks written).
- Although not direct engagements with the Berkshire Hathaway group and not involving entities that are involved in the Scheme, I note that Milliman offices in Ireland and Italy were engaged by regulators in those countries in separate projects that involved Berkshire Hathaway group companies. In relation to the Italian engagement, a member of Milliman's London office (who is assisting in work in relation to the Scheme) previously acted as peer reviewer, through which he had no direct interaction either with the Italian regulator or Berkshire Hathaway personnel.

1.29 As all of the above engagements relate to entities within the Berkshire Hathaway group that are not involved in the Scheme, and the projects were unrelated to the Scheme, I do not believe that Milliman's involvement in any of these engagements adversely affects my ability to act independently in my assessment of the proposed Scheme. Nevertheless, I note that, in relation to other ongoing engagements with the Berkshire Hathaway group, ethical walls have been and will be maintained.

1.30 In summary, I believe that, for all practical purposes, none of the aforementioned adversely affects my ability to act independently in my assessment of the proposed Scheme.

1.31 I note that all of the aforementioned was disclosed to the PRA prior to its approval of me as Independent Expert.

1.32 TMNF will meet the cost of my work as Independent Expert. No costs relating to the Scheme will be borne directly by any of the policyholders of either TMNF or NRG.

THE SCOPE OF MY REPORT

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

1.34 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. TMNF has confirmed to me that it has not considered any alternative arrangements other than maintaining the situation that existed before relocating the Transferring Business to the London Branch (i.e. with the Transferring Business continuing to be reinsured by NICO). As described in paragraph 9.24 below, were the Scheme not to proceed for any reason, then TMNF would revert to that situation.

1.35 The Report describes the Scheme and its likely effects on policyholders of TMNF and NRG, including effects on the security of policyholders' benefits and levels of service.

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

1.37 My work has required an assessment of the liabilities of the London Branch of TMNF and of NRG for the purposes of describing the effect of the Scheme. My review of the liabilities of the London Branch of TMNF was based on the actuarial reserve assessments conducted by third party actuarial consultants, on behalf of TMNF. My review of the liabilities of NRG was based on the actuarial reserve assessments conducted by actuaries employed by RMSL, on behalf of NRG. I note that, in both cases, the actuarial reserve assessments were conducted by suitably qualified professionals with experience in undertaking reserve reviews for the types of business concerned. I have not attempted to produce independent estimates of the liabilities for either entity, but I have reviewed the methodology and assumptions used by the respective actuaries in order to satisfy myself that their results appear reasonable, and to assess the key areas of uncertainty in relation to these liabilities.

1.38 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 TMNF and NRG both pre- and post-Scheme. As explained further in Section 6 below (in particular in paragraph 6.85), I have not attempted to review in detail the calculations of the capital position of TMNF as I do not believe that undertaking such a review would alter my conclusions about the impact of the Scheme. My conclusions concerning TMNF's capital position have been based on a review of public disclosures concerning its regulatory capital requirements in Japan, as well as its audited financial statements and credit ratings from the major rating agencies. With regard to the capital position of NRG, my conclusions have been based on a review of capital calculations (both pre- and post-Scheme) made by the RMSL actuaries on behalf of NRG. I have not attempted to produce independently my own estimates of capital requirements for NRG, but have undertaken sufficient review of the RMSL actuaries' calculations to satisfy myself that their results appear reasonable.

1.39 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.

1.40 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 TMNF and/or to NRG. I confirm that I have complied with this duty.

1.41 I have taken account of the requirements regarding experts set out in Part 35 of the Civil Procedure Rules, Practice Direction 35 and the Protocol for Instruction of Experts to give Evidence in Civil Claims.

1.42 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.

1.43 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

1.44 After considering the effects of the Scheme on each of the different groups of policyholders affected by the Scheme (as identified in paragraph 5.9 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.

1.45 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.

1.46 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 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 relative to the normal constraints under which the company's capital position was managed before the transfer.

THE STRUCTURE OF MY REPORT

1.47 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 1.53, below).
- Section 3: I provide some background information regarding the two regulatory environments in which TMNF and NRG operate.
- Section 4: I provide some background information regarding TMNF and NRG.
- 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 included within the Transferring Business (“**Transferring Policyholders**”).
- Section 7: I consider the likely impact of the Scheme on the policyholders who would remain within TMNF after the transfer has taken place (“**TMNF Non-Transferring Policyholders**”).
- Section 8: I consider the likely impact of the Scheme on the current policyholders of NRG.
- Section 9: I cover more general issues relating to the Scheme and the management of TMNF and NRG.

1.48 I summarise my conclusions in Section 10.

RELIANCES AND LIMITATIONS

1.49 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 D. 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.

1.50 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 the PRA, and will accompany the Scheme application to the Court.

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

1.52 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.

TMNF, will host a standalone webpage on its website dedicated to the Scheme. I consent to this Report being made available on the webpage dedicated to the Scheme.

1.53 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 package of documents that will be sent to certain affected policyholders, reinsurers and brokers in accordance with the communications policy that I discuss from paragraph 9.12 below. That document will also be sent to the FCA and PRA, will accompany the Scheme application to the Court, and will also be available on the webpage dedicated to the Scheme that will be hosted by TMNF on its website.

1.54 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.

1.55 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.

1.56 This review does not comprise an audit of the financial resources and liabilities of TMNF or NRG.

1.57 The Report should not be construed as investment advice.

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

1.59 As explained from paragraph 9.3 below, as 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 TMNF and NRG, whether audited or unaudited, as and when they become available, and will comment on this information in my Supplemental Report.

1.60 The financial information with which I have been provided has been expressed in a variety of currencies. NRG reports in British pounds, TMNF reports in Japanese yen, and TMNF's London Branch reports in US dollars (the liabilities of the Transferring Business being predominantly in US dollars). I have generally quoted figures in this Report in the currency relevant to the entity in question. Note that any reference to dollars ("$") refers to US dollars unless otherwise stated. Amounts underlying any figures quoted may include amounts converted from other currencies. I presume that, throughout the financial information, data in other currencies has been converted to the relevant reporting currency at appropriate and mutually consistent currency exchange rates.

1.61 The Report has been seen by the Companies (i.e. by members of the senior management of the Companies and by responsible professionals from the Companies' advisors) and each entity has agreed it is correct in terms of all factual elements of the Scheme.

1.62 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

1.63 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* and *TAS 200: Insurance*. I have complied with such standards, subject to the principles of proportionality and materiality.

1.64 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.

1.65 This Report has been prepared under the terms of the guidance set out in the Statement of Policy entitled *The PRA's approach to insurance business transfers* ("**the Policy Statement**"), issued in January 2022 (see Appendix C), 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 guidance published by the FCA in February 2022 entitled *The FCA's approach to the review of Part VII insurance business transfers* (FG22/1).

2. Executive Summary

CONCLUSION

2.1 In my opinion, provided the proposed Scheme operates 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 TMNF (both the Transferring Policyholders and the TMNF Non-Transferring Policyholders, as defined in paragraph 5.9, below) or NRG; and
- the Scheme will not have an impact on service standards experienced by either the policyholders of TMNF or the existing policyholders of NRG.

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 a Supplemental Report.

THE SCHEME

2.4 The Transferring Business consists of a portfolio of, predominantly, reinsurance business that was written between the 1950s and 2003, although, as outlined in paragraph 4.20 below, it also includes 17 direct insurance policies. The outstanding liabilities of the portfolio now consist primarily of latent claims, in particular Asbestos, Pollution and Health Hazard (**"APH"**) claims. Under the Scheme, the Transferring Business will be transferred from TMNF to NRG. Reinsurance assets, principally the Reinsurance Agreement, will transfer under the Scheme. There are no other transferring assets, although the parties have agreed in the Framework Agreement that a $10 million fee will be payable by TMNF to NRG on completion of the Scheme.

Motivation for the Scheme

2.5 TMNF no longer writes any international commercial reinsurance business and the Transferring Business does not align with its future strategic business plan. Therefore, TMNF intends to transfer the business of its London Branch to NRG under the Scheme.

Policyholders Affected

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

- the Transferring Policyholders;
- the current policyholders of TMNF whose policies will not be transferred under the Scheme (including any Excluded Policies); and
- the current policyholders of NRG.

2.7 I do not consider any other group of policyholders to be affected by the Scheme.

Administration

2.8 Post-Scheme, the Transferring Business will continue to be serviced by RMSL and RMI in the same way that it has been since the inception of the Reinsurance Agreement. Other than that TMNF will no longer have any oversight over the settlement of large claims, commutation and ex-gratia payments, there will be no changes to the administration of the Transferring Business post-Scheme.

THE IMPACT OF THE SCHEME UPON THE TRANSFERRING POLICYHOLDERS

2.9 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. I have reached this conclusion by considering:

- The reserves of the London Branch of TMNF, based on an external actuarial report as at 31 December 2020 and reserves subsequently booked as at 31 March 2021;
- The reserves of NRG as per its management accounts as at 30 June 2021 as well as Solvency II basis technical provisions as at the same date based on the results of an internal actuarial review as at 31 May 2021;

- The excess assets of TMNF as at 31 March 2021, and the excess assets of NRG as at 30 June 2021;
- the risk exposures in the Companies and the impact that the Scheme might have on those; and
- the standards of policy servicing in each of the Companies.

2.10 I concluded that:

- the reserves of TMNF and NRG appeared reasonable as at 31 March 2021 and 30 June 2021 respectively;
- there is no reason to think that the reserve strength of TMNF or NRG will be impacted by the Scheme;
- as at 31 March 2021 and 30 June 2021 respectively, TMNF and NRG were both very well-capitalised companies and will continue to be so post-Scheme (I have defined the term very well-capitalised in paragraph 6.5 below);
- the policyholders of the Transferring Business will not be materially adversely affected due to relative differences in the financial strength of TMNF post-Scheme to those of NRG pre-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 the Transferring Policyholders' benefits; and
- the proposed Scheme will not have a materially adverse impact on the standards of policy servicing experienced by the Transferring Policyholders compared to their current position.

THE IMPACT OF THE SCHEME UPON THOSE POLICYHOLDERS REMAINING WITHIN TMNF

2.11 I concluded that the Scheme will not affect in a materially adverse way either the security or the standards of policy servicing currently enjoyed by the policyholders of TMNF who will remain in TMNF post-Scheme.

2.12 My conclusion was based on the fact that the Transferring Business represents only a very small proportion (less than 0.3% on a consolidated basis) of the reserves of TMNF and that there are no changes intended to the policy administration of the policyholders of TMNF who will remain in TMNF post-Scheme.

THE IMPACT OF THE SCHEME UPON THE EXISTING POLICYHOLDERS OF NRG

2.13 I have concluded that the Scheme will not affect in a materially adverse way either the financial security or the policy servicing levels of the existing NRG policyholders.

2.14 In reaching this conclusion I have noted that:

- NRG will continue to be a very well-capitalised company post-Scheme and scenario tests have shown it will be able to withstand remote outcomes and continue to meet its solvency capital requirements;
- any changes in risk exposures resulting from the Scheme will not materially adversely affect the existing policyholders of NRG; and
- there will be no changes to the policy administration arrangements of either the existing NRG business or the Transferring Business as a result of the Scheme.

THE IMPACT OF THE SCHEME IN RESPECT OF OTHER MATTERS

2.15 I have considered the likely effects of the Scheme on the reinsurers whose reinsurance contracts relate to the Transferring Business. I have concluded that the Scheme will have negligible effect on these reinsurers as the reinsurance contracts will provide the same benefits post-Scheme as pre-Scheme, and there will be no change to the administration of the outwards reinsurance contracts as a result of the Scheme.

2.16 There are not expected to be material tax implications of the Scheme. As the Scheme has been structured as a Transfer of a Going Concern, no VAT will be levied on the transaction. NRG has provided me with correspondence from HM Customs and Revenue indicating that NRG has demonstrated that the relevant conditions for the Transfer of a Going Concern have been met.

2.17 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.

APPROACH TO COMMUNICATION WITH POLICYHOLDERS

2.18 The Companies' approach to communicating the Scheme to affected policyholders, reinsurers and their brokers is outlined in paragraphs 9.12 to 9.20, below.

2.19 I consider the approach being taken in relation to the affected policyholders to be reasonable.

2.20 The Companies will apply to the Court for a waiver of the requirement to notify the policyholders of TMNF who will not transfer under the Scheme, as well as a small number of inactive Transferring Policyholders whose addresses could not be found, and certain Transferring Policyholders whose policy is only recorded under the name of a pool manager or underwriting agent. They will also seek a waiver to notify the policyholders of NRG.

2.21 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 from the London Branch of TMNF to NRG. TMNF is a Japanese domiciled company that is authorised and regulated in Japan. Although its London Branch is subject to regulation in the UK (as is NRG, which is a UK domiciled company), the London Branch is not a distinct legal entity, and it is therefore necessary for me to consider TMNF as a whole, rather than its London Branch in isolation. In this Section, I therefore describe the general insurance markets of both the UK and Japan and the regulatory environments therein.

3.2 I also comment here on consumer protections schemes in the UK and Japan and on the respective winding-up arrangements for companies in the UK and in Japan.

OVERVIEW OF UK INSURANCE REGULATION

Background

3.3 UK insurers, as well as other financial services organisations, 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).

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

- Prudential regulation and supervision 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.

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

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

3.6 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 consult. In particular, the Memorandum of Understanding requires the PRA and FCA to co-ordinate with each other in advance of Part VII transfers.

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

3.8 The FCA is concerned with achieving fair outcomes for consumers and seeks to ensure that firms 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.

Financial Services Compensation Scheme

3.9 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[1] 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:

[1] *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.*

- 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).

3.10 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.

3.11 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).

3.12 My conclusion regarding the impact of the Scheme on the Transferring Policyholders' access to the FSCS is set out in paragraph 6.143 below.

Financial Ombudsman Service

3.13 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[2];
- 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;
- in relation to consumer buy-to-let business, a consumer buy-to-let consumer;
- a small business[3] at the time the complainant refers the complaint to the respondent;
- a guarantor.

3.14 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.

3.15 My conclusion regarding the impact of the Scheme on the Transferring Policyholders' access to the FOS is set out in paragraph 6.143 below.

FCA Conduct Principles

3.16 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

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[2] *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.*

[3] *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.*

- 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.

3.17 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.

3.18 The FCA has supplemented its *Fair Treatment of Customers* document with guidance, published in January 2018, entitled *The Responsibilities of Providers and Distributors for the Fair Treatment of Customers* ("**RPPD**"). This 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 the following Principles:

- Principle 2: A firm must conduct its business with due skill, care and diligence;
- Principle 3: A firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems;
- Principle 6: A firm must pay due regard to the interests of its customers and treat them fairly; and
- Principle 7: A firm must pay due regard to the information needs of its clients, and communicate information to them in a way that is clear, fair and not misleading.

The Insurance Distribution Directive

3.19 The UK transposed the Insurance Distribution Directive ("**IDD**") into UK law with the regime coming into force from 1 October 2018. The IDD regime was then retained following the UK's withdrawal from the EU with further changes being made to amend any deficiencies within UK legislation. 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

3.20 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, 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)

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

3.22 The UK left the EU with effect from 31 January 2020. Effectively, the UK continues to apply Solvency II, having transcribed an identical regime into UK regulations. I therefore refer in this Report to the UK's regulatory regime as Solvency II.

3.23 Under Solvency II, those (re)insurers regulated within the EU (and the UK) are required to adhere to a set of risk-based capital requirements, the results of some of which are shared with the public.

3.24 Solvency II 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 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.

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

3.26 I set out, in Appendix E, simplified details for the balance sheet and the calculation of technical provisions (in respect of claims incurred and losses arising from unexpired exposures) for an insurer under Solvency II. In this Report I denote technical provisions under Solvency II as "**TPs**".

3.27 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 cash-flows (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 cash-flows (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, the risk margin is calculated using a cost-of-capital approach (presently employing a 6% cost of capital parameter as set out in EU regulation[4]).

3.28 TPs in respect of claims required under Solvency II differ from the GAAP/IFRS reserves in several ways, including the following:

- The TPs contain no element of conservatism above a best estimate that may be held in the undiscounted GAAP reserves;
- 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 a risk margin.

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

3.29 The SCR under Solvency II 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 legislation (the “**Standard Formula**”): the Standard Formula is designed to be applicable to all insurers and is not therefore tailored to the circumstances of an individual insurer. In summary, the basic SCR consists of five risk modules (non-life, life, health, market and counterparty default) 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.

[4] *Commission Delegated Regulation (EU) 2015/35 dated 10 October 2014.*

3.30 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).

3.31 If an insurer's available resources fall below the SCR, then supervisors are required to take action with the aim of restoring the insurer's finances back to the level of the SCR as soon as possible. If, however, the financial situation of the insurer continues to deteriorate, then the level of supervisory intervention will be progressively intensified. The aim of this "supervisory ladder" of intervention is to capture any ailing insurers before their situation becomes a serious threat to 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, i.e. 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, supervisors 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

3.32 The UK formally withdrew from membership of the EU on 31 January 2020, whereupon a transition period ("**Transition Period**") commenced, during which almost all existing arrangements between the UK and EU continued to apply and during which the UK Government and the EU negotiated the terms under which the UK and EU (and EU member states) would trade with each other post the Transition Period (the **"Trade and Cooperation Agreement"**). The Transition Period concluded on 31 December 2020.

3.33 The Trade and Cooperation Agreement 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, and noted agreement for enhanced regulatory cooperation between the UK and the EU and the integrity of the respective, autonomous equivalence financial services frameworks. This suggests that it is unlikely that the UK Government will, in the foreseeable future, seek to cancel or materially alter its existing solvency regime for insurers such that it deviates materially from the Solvency II regime that applies throughout the EU. I have therefore not considered further this possibility in this Report, although I note that, in both the UK and EU, consultation exercises are currently being conducted that are expected to result in some adjustments to the respective regulatory regimes.

3.34 While it appears likely, from the terms of the Trade and Cooperation Agreement, that there will continue to be considerable commonality between the UK and the EU in their respective regulation of their insurance markets, the Trade and Cooperation Agreement did not extend the so-called passporting regime that had applied up to the end of the Transition Arrangements, whereby UK insurers could operate and perform regulated activities across UK/EEA borders (and EU insurers could likewise operate in the UK). Therefore, with effect from 1 January 2021, insurers authorised and regulated in the UK are unable to write direct business relating to risks located in the EEA and, with a few exceptions[5], are not authorised to service policies that they have previously written that relate to risks located in the EEA.

OVERVIEW OF JAPANESE INSURANCE REGULATION

Background

3.35 Japan is the world's third largest economy and also has the world's third largest insurance market with total life and non-life direct insurance premium income in 2020 estimated at more than $400 billion[6]. Approximately 70% of this amount related to life insurance business and 30% to non-life insurance. As at 1 September 2021, there were a total of 55 companies operating in the non-life market in Japan (including 22 branches of foreign companies)[7] and 42 life insurance companies[8].

[5] *Some, but far from all, EU member states have enacted legislation that permits UK insurers of risks located in their respective states to continue to service them for a period after the conclusion of the Transition Period. This is intended to allow the orderly run-off of those contracts or for the orderly transfer of the UK insurers' obligations to suitably qualified entities within the EU, whom the local regulators would permit to undertake those services.*

[6] *https://www.swissre.com/institute/research/sigma-research/World-insurance-series.html*

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

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

The Current Regulatory Regime in Japan

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

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

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

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

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

Role of the JFSA

3.40 The JFSA has three major policy objectives: (1) to ensure the stability of the financial system; (2) to enhance user protection and user convenience; and (3) to establish fair and transparent markets. In the context of insurance business, these objectives are achieved by various policy makings, off-site monitoring including the solvency margin ratio and on-site monitoring including periodical inspections.

Reserving

3.41 Technical reserves of Japanese insurance companies consist of underwriting reserves and outstanding loss reserves.

3.42 There are two types of the underwriting reserves – the ordinary policy reserves and the catastrophe reserves:

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

3.43 Outstanding loss reserves are comprised of case reserves and incurred but not reported (**"IBNR"**) reserves[9]. Usually, the indemnity and allocated loss adjustment expense amounts are not separate in calculating the loss reserves. Unallocated loss adjustment expense reserves are not established. The IBNR reserves are calculated using actuarial methods for long-tail and material lines of business or on a formula basis for short-tail or immaterial lines.

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

Regulatory Solvency Margin

3.45 The solvency margin ratio ("**SMR**") is calculated as SMR = "Solvency Margin" ÷ "Risk × ½", where "Solvency Margin" and "Risk" are defined below in paragraphs 3.47 and 3.48 respectively.

[9] *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.*

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

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

3.48 "Risk" is calculated on a VaR[10] basis over on a one-year time horizon. From 2012 and for most lines, a 95% VaR measure is generally used. "Risk" for Fire insurance is calculated as the maximum of a 99.5% (i.e. a 200 year return period) VaR for earthquake and a 98.57% (i.e. a 70 year return period) VaR for wind (or typhoon). See Appendix G for further details of the components of the Risk measure.

3.49 Most Japanese non-life companies have relatively high SMRs. As discussed below in paragraph 4.10, as at 31 March 2021, TMNF reported a SMR of 762%.

Policyholder Protection

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

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

3.51 In the event of the winding-up of an insurance undertaking under Japanese law, all policyholders (direct and reinsurance) rank with general creditors (behind creditors with the right of a pledge/mortgage, claims by employees and tax) with respect to the whole of the insurance undertaking's assets. There is, however, a safety net for personal (or private) policyholders in the case where the residual assets do not support the prescribed coverage (in most cases, 80% of the original insured amount) – the difference is provided by the relevant Policyholders Protection Corporation as outlined in paragraph 3.50 above. (I note that contracts of reinsurance are not protected under the schemes provided by either Policyholder Protection Corporation.)

3.52 My conclusion regarding the impact of the Scheme on the Transferring Policyholders' access to the policyholder protection in Japan is set out in paragraph 6.143 below.

General Insurance ADR Center

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

3.54 My conclusion regarding the impact of the Scheme on the Transferring Policyholders' access to the General Insurance ADR Center is set out in paragraph 6.143 below.

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

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 TMNF and NRG. I also provide some background information on NICO, as it plays an important role in the Scheme as reinsurer of the Transferring Business.

TMNF

4.2 TMNF was formed in October 2004 by the merger of Tokio Marine & Fire Insurance Co., Ltd (**"TMF"**) and Nichido Fire & Marine Insurance Co., Ltd (**"NFM"**), both companies domiciled in Japan.

4.3 TMNF is a large non-life insurance company writing business both domestically in Japan and worldwide through its network of subsidiary companies. Subsidiary groups include Tokio Marine Kiln, which operates in the UK and continental Europe, including via a Lloyd's syndicate, and Tokio Marine HCC, which has operations in the US and UK. TMNF also has subsidiary holdings elsewhere in the Asia Pacific region, in the Middle East, Brazil and Mexico.

4.4 In the year to 31 March 2021, TMNF reported net underwriting income, on a consolidated basis, of ¥3.9 trillion (approximately $33 billion, based on the prevailing exchange rate at the time of writing of $1=¥119). Non-life premiums written accounted for ¥3.4 trillion ($29 billion) and life insurance premiums ¥0.4 trillion ($3 billion). The balance related, primarily, to deposit premiums and investment income thereon.

4.5 Of the ¥3.4 trillion of non-life premiums written, around two thirds, or ¥2.3 trillion ($19 billion), was written directly by TMNF, domestically in Japan. Just under 60% of this was in respect of automobile insurance (both compulsory and voluntary), around 16% fire and allied lines, 7% personal accident insurance, 3% hull and cargo, and the remaining 15% a variety of other, smaller lines.

4.6 Of the business written by subsidiaries outside Japan, almost three quarters was written in the US, just under 10% in each of the UK and Brazil and the remainder mainly elsewhere in the Asia-Pacific region. Most of this business was commercial property and casualty business across a variety of lines, with about 20% relating to automobile risk and 20% fire and allied lines.

4.7 In its consolidated accounts as at 31 March 2021, TMNF recorded total assets of ¥15.8 trillion ($133 billion), total liabilities of ¥12.5 trillion ($105 billion) and net assets of ¥3.3 trillion ($28 billion).

4.8 TMNF's liabilities included ¥10.3 trillion ($87 billion) of insurance liabilities (on a consolidated basis), of which ¥3.0 trillion ($25 billion) were outstanding claims reserves and ¥7.3 trillion ($61 billion) underwriting reserves. Only 36% of TMNF's outstanding claims reserves related to domestic Japanese business, whereas 55% related to business written in the US. This reflects the longer tailed nature of the business written internationally. On the other hand, around 60% of the underwriting reserves related to the domestic Japanese business, i.e. reflecting where most business is written.

4.9 TMNF has been rated by a number of credit rating agencies. As at July 2021, it had ratings from Standard & Poor's of A+, Moody's of Aa3 and A.M. Best of A++.

4.10 As at 31 March 2021, TMNF reported, on a consolidated basis, a Solvency Margin ratio of 762.3%. This figure is based on a solvency margin of ¥4.8 trillion and a total Risks amount of ¥1.2 trillion.

4.11 As noted above, TMNF is a member of the group of companies ultimately owned by Tokio Marine. Other major constituent members of the group include Nisshin Fire & Marine Insurance Co., Ltd., a non-life insurance company focusing on the Japanese domestic retail market and business activities rooted in local communities, and Tokio Marine & Nichido Life Insurance Co., Ltd., a life insurance company playing a major role in the domestic life insurance market in Japan.

4.12 Tokio Marine is listed on the Tokyo Stock Exchange.

The London Branch of TMNF and the Transferring Business

Background

4.13 The Transferring Business (i.e. the business that has been relocated to the London Branch of TMNF), relates to a portfolio of business that was originally written by TMF's International Reinsurance Department, or by the Reinsurance Department or the Marine Department of NFM (the **"Legacy Portfolio"**).

4.14 TMF's International Reinsurance Department's involvement in international reinsurance business commenced in the 1950s and continued until the end of 2000 when it ceased its underwriting and the group established overseas subsidiaries to write such business instead.

4.15 The Reinsurance Department and the Marine Department of NFM commenced their operations in the 1960s and continued until shortly before the merger with TMF in 2004.

4.16 The Legacy Portfolio comprises non-life, marine and non-marine international business:

- directly written by the former International Reinsurance Department of TMF for 2000 and prior years; and
- written by the former Reinsurance Department and Marine Department of NFM for 2003 and prior years,

which was classified as reinsurance business when written and which excludes any aviation business unless incidentally written.

4.17 Note that, with the exception of certain contracts in respect of a small number of cedants that are located in jurisdictions that are subject to sanctions by the US and/or UK governments (namely Cuba, Iran, North Korea, Syria and Venezuela), all of the Legacy Portfolio was relocated to the London Branch as of 1 March 2021. TMNF decided not to relocate these policies to the London Branch when it was established and they will not be transferred under the Scheme. These policies will therefore remain with TMNF in Japan. In addition, following Russia's military invasion of Ukraine in February 2022, various countries began imposing sanctions against Russia. TMNF identified 113 policies within the Legacy Portfolio in respect of one Russian cedant. While not listed as an expressly sanctioned party by the US or the UK government at the time, TMNF took the decision to relocate these policies out of the London Branch, back to Japan, as of 14 March 2022. All of the remaining policies of the London Branch form the Transferring Business.

4.18 Responsibility for the administration of the policies of the Legacy Portfolio that have not been relocated to the London Branch (including those of the Russian cedant) lies with TMNF in Japan. These policies date back to between 1955 and 1999 and have been inactive for a number of years, with the last paid loss transaction booked in 2009 and no claims reported since. Remaining case reserves were subsequently reduced. The last time that TMNF booked case reserves in its accounts for any of these policies was as at 31 March 2012, with those reserves having all been removed (without payment) by the next set of accounts as at 31 March 2013. TMNF does not expect these policies will give rise to any claims in the future. It should be noted that, if any future claims were to emerge on these policies after the Scheme is effected, then they would no longer be covered by the Reinsurance Agreement with NICO; however, they would be covered by an indemnity given by NRG to TMNF under the Framework Agreement, which provides that NRG will indemnify TMNF for all losses, damages, costs and/or expenses that may be incurred by TMNF following completion of the Scheme in respect of the contracts in the Legacy Portfolio (see paragraph 4.47 below).

4.19 TMNF is permitted to carry out contracts of non-life insurance and reinsurance in the UK through its London Branch. TMNF's permissions include the following business classes: accident; aircraft; aircraft liability; credit; damage to property; fire and natural forces; general liability; goods in transit; liability for ships; motor vehicle liability; ships; and suretyship.

Business Profile

4.20 All forms of reinsurance contract, namely proportional and non-proportional reinsurance treaties, as well as facultative reinsurance contracts, are included within the Transferring Business. As far as TMNF is aware, the Transferring Business comprises only reinsurance business, with the exception of a very small number of direct policies (17 in total) that appear to have been incidentally written as part of its facultative underwriting operations during the 1970s. The insureds for those policies are all believed to be US domiciled companies.

4.21 As at 31 December 2020, the cost of settling the unpaid claims of the Transferring Business was estimated by third party actuarial consultants to be $77.1 million, gross of any outwards reinsurance. The vast majority (approximately 99%) of the cost stems from TMF's 2000 and prior years' business, with NFM's share for its 2003 and prior years' business amounting to approximately 1%.

4.22 Approximately 98% of the estimated gross unpaid claims costs stem from US and UK cedants that are known to have exposures to APH claims, with the remaining 2% arising mostly from workers' compensation and other essentially long-tail claims elsewhere in the world.

4.23 When split into underwriting years, approximately 98% of the estimated gross unpaid claim costs emanated from 1985 and prior years that are heavily exposed to the APH claims, and the remaining 2% from the later underwriting years 1986 to 2003.

4.24 TMNF has identified approximately 947 "active" policies as at 31 December 2020 in respect of which there is an actual claim reported or a claim could still potentially be reported by the policyholder. The active policies include 926 reinsurance treaty policies, 19 facultative reinsurance policies and two out of the 17 direct policies.

4.25 The reinsurance treaty and facultative contracts that TMNF entered into with cedants were typically renewed on an annual basis for each underwriting year. TMNF treats each such renewal as a separate policy, but refers to each set of policies (i.e. the original policy plus its renewal(s)) as "**Subject Contracts**".

4.26 The 926 active reinsurance treaty policies include: (i) 231 Subject Contracts and (ii) 695 renewals of those contracts. The 19 active facultative reinsurance contracts have 15 Subject Contracts with four renewals, and the two active direct policies represent two Subject Contracts with no renewals, The total number of cedants for the 231 Subject Contracts ("**Active Cedants**") was identified by TMNF to be 154 as at 31 December 2020.

4.27 Based on the records of the location of the cedants held by TMNF, the geographical spread of the Active Cedants is estimated to be as follows:

Location of cedant	Number of Active Cedants	Total Estimated Gross Reserve as at 31/12/2020 ($ million)
UK	44	32.5
US	55	43.0
France	10	0.5
Bahrain	1	0.3
Japan	1	0.2
Singapore	1	0.2
Italy	2	0.1
Belgium	3	0.1
Morocco	1	0.1
Philippines	2	0.1
Germany	3	0.0
Pakistan	4	0.0
Sweden	1	0.0
Indonesia	1	0.0
India	2	0.0
Greece	2	0.0
Bermuda	1	0.0
Taiwan	5	0.0
Korea	1	0.0
China	3	0.0
Israel	1	0.0
Trinidad And Tobago	1	0.0
Egypt	1	0.0
Malaysia	2	0.0
Canada	2	0.0
Kenya	1	0.0
Hong Kong	1	0.0
Australia	1	0.0
Brazil	1	0.0
Total	**154**	**77.09**

4.28 With regard to the direct policies (of which there are 17 in total), there are only two active policies for which the reserves are estimated to be approximately $0.7 million.

4.29 The Transferring Business includes a far greater number of "inactive" contracts of which there are no outstanding claims currently reported and in respect of which TMNF considers that there is only a minimal prospect of any new claim being reported in the future. This view was reached based on the stability of the book according to the records maintained by TMNF, the short-tail nature of a significant proportion of the exposures and the TMNF's London Branch Manager's experience in managing the run-off of the business since 2006.

4.30 The total numbers of all the active and inactive contracts and cedants identified by TMNF in its electronic records as at 31 December 2020 were as shown in the table below. There are, therefore, a total of 37,028 policies that are intended to transfer under the Scheme, made up of 37,011 policies of inwards reinsurance business and 17 direct insurance policies.

	Active	Inactive	Total
Cedants*	154	1,000	1,154
Subject Contracts	248	4,926	5,174
All Policies	947	36,081	37,028

**This includes 5 direct policyholders, two of which are active*

Outwards Reinsurance

<u>The Reinsurance Agreement</u>

4.31 As referred to in paragraph 1.9 above, effective from 31 December 2014, TMNF entered into the Reinsurance Agreement with NICO, pursuant to which NICO agreed to cover, inter alia, all claim payments made by TMNF in respect of the Legacy Portfolio from the effective date, up to an aggregate limit of $168,292,084, as well as certain overhead expenses relating to the Legacy Portfolio. As at 31 December 2020, the remaining cover was $145,203,092.

4.32 As discussed in more detail from paragraph 4.38 below, the Reinsurance Agreement specifies that from its effective date, NICO, or its affiliate, will assume all responsibility for administering the Legacy Portfolio (as well as third party reinsurance), on behalf of TMNF.

4.33 Note that the definition of ultimate net loss under the reinsurance contract does not include overhead expenses; the overhead expenses associated with administering the business will therefore not erode the aggregate limit of the contract.

4.34 The contract specifies that it will terminate either when the liabilities under the contract are terminated (either as a result of the underlying liabilities being terminated and all amounts due under the contract paid, or as a result of the full aggregate limit being paid), or by mutual written consent of the parties.

<u>Existing Outwards Reinsurance</u>

4.35 Other than the Reinsurance Agreement, there is a small amount of existing outwards reinsurance asset relating to the Legacy Portfolio, all of which is in respect of business originally ceded to TMNF from the Excess Insurance Company Limited (UK) ("**ExCo**").

4.36 ExCo is the single largest cedant of the Legacy Portfolio, comprising 31% (or $24.2 million) of gross reserves of $77.1 million as at 31 December 2020. A portion of those liabilities (circa 6% or $1.4 million) are retroceded on a quota share basis to three retrocessionaires.

4.37 It is intended that the existing outwards reinsurance (as well as the Reinsurance Agreement) will transfer to NRG as part of the Scheme.

Administration

4.38 Pursuant to the Reinsurance Agreement, the parties also agreed that NICO (or an affiliate of NICO) would assume, undertake and perform all administrative services with respect to the Legacy Portfolio, including all matters relating to the administration of claims arising under the Legacy Portfolio (the **"Administrative Services"**). However, the prior mutual agreement of the parties is required to, among other things, (i) commute any reinsured contract or third party reinsurance agreement, (ii) make any *ex gratia* payments and (iii) effect settlements involving payments in excess of $500,000 on a gross basis. NICO agreed that it would perform the Administrative Services with respect to the Legacy Portfolio at its own expense and without any rights of reimbursement from TMNF in consideration for TMNF having entered into the Reinsurance Agreement.

4.39 In April 2015, in accordance with the Reinsurance Agreement, NICO appointed a US-based affiliate, RMI, to provide the Administrative Services in respect of the Legacy Portfolio. RMI subsequently delegated the management of any non-US cedant accounts to another affiliate of NICO, UK-based RMSL. As such, a substantial portion of the administration of claims arising under the Legacy Portfolio is currently being conducted in the UK.

4.40 RMSL has also been managing the administration of the existing outwards reinsurance on ExCo, including collection of recoveries from the three retrocessionaires, since 2017.

4.41 At the time of entering into the Reinsurance Agreement, TMNF was party to a number of existing administrative service agreements in respect of the Legacy Portfolio. However, those agreements have since been terminated and RMI and RMSL are currently the only third parties providing administration services in respect of the Legacy Portfolio.

4.42 On 9 October 2018, TMNF entered into the Framework Agreement with NICO, NRG and RML. Pursuant to the Framework Agreement, the parties agreed that the administration of the Legacy Portfolio will continue to be conducted in accordance with the Reinsurance Agreement, and the protocols and practices developed in connection with that agreement, until such time as the Scheme has completed. Therefore, the existing arrangements with NICO, RMI and RMSL will remain in place until the Transfer has been effected.

4.43 The Framework Agreement also specified certain additional support services that would be provided by RML to TMNF in order to help it establish a branch in the UK and, following the authorisation of the branch, with the ongoing operations of the branch. These services, for which specified ongoing fees are payable by TMNF to RML, include: provision of office space, procurement of banking services, preparation of accounts and regulatory solvency returns, preparation of an ORSA and performance of all risk management, compliance and internal audit functions.

4.44 The Framework Agreement specifies that, upon the Scheme being effected, a sum of $10 million will be paid by TMNF to NRG.

4.45 The Framework Agreement's completion is subject to two conditions precedent: that the High Court sanctions the Scheme; and that written non-objection is obtained from HM Revenue and Customs that no VAT is chargeable in respect of the transfer of the Transferring Business to NRG. With regard to the latter, I have been provided with a copy of an email from HM Revenue and Customs regarding the matter (refer to paragraph 9.33 below) and I am informed that the parties all agreed that this satisfies the condition.

4.46 The Framework Agreement originally specified that the transfer of the Transferring Business to NRG must be sanctioned by 31 March 2021 or else the Framework Agreement would terminate. As the establishment of TMNF's London Branch took longer than expected, as at 30 September 2019, the parties to the Framework Agreement executed an amendment to the agreement that changed the deadline for the Scheme being sanctioned to 31 March 2022. This was further amended as at 13 October 2021 to change the deadline for the Scheme being sanctioned to 31 December 2022.

4.47 The Framework Agreement provides for the indemnification of TMNF by NRG in respect to any claims brought against it in relation to the Legacy Portfolio after the Scheme becomes effective. The Framework Agreement specifies no limit to the indemnification. Furthermore, this indemnification is guaranteed by NICO.

Strategy

4.48 The London Branch of TMNF was established with the express purpose of relocating the Transferring Business into the UK such that it can be transferred, via the Scheme, to NRG. As such, the management of the London Branch of TMNF is focused on ensuring the orderly run-off of the Transferring Business until it has been transferred. TMNF has no intention to write any new business into the London Branch.

4.49 Once the Scheme has become effective, TMNF intends to seek the de-authorisation of the London Branch.

Financial Position of the London Branch

4.50 TMNF has provided me with a spreadsheet showing the (unaudited) accounts of the London Branch as at 31 March 2021, prepared on a GAAP basis. The balance sheet included shows nil net technical reserves (i.e. owing to its insurance liabilities all being reinsured to NICO). The only other material items on the balance sheet are assets totalling $30.7 million, with $30 million of this relating to a short term deposit (held in US dollars) and the remainder being cash held in British pounds.

4.51 The London Branch is required to calculate its solvency capital requirements in accordance with Solvency II requirements, and it also must file QRTs with the PRA. I have been provided with the London Branch's SCR calculations (which use the standard formula approach), as well as its QRTs as at 31 March 2021.

4.52 The Solvency II balance sheet shows that, as at 31 March 2021, it had Eligible Own Funds (**"EOF"**), i.e. the funds available in an insurer to meet its regulatory SCR, of $16.8 million. Note that the Solvency II balance sheet includes provisions for the expenses associated with running-off the business (including some ongoing expenses that are not recoverable from NICO but which are included within the technical provisions, as well as for the costs associated with the Scheme, which are treated as non-technical provisions), as well as a risk margin. None of these liabilities are allowed for in the GAAP basis accounts, resulting in materially lower net assets.

4.53 As at 31 March 2021, the London Branch's SCR was calculated to be $6.4 million. The ratio of EOF to the SCR was about 260%.

NRG

Background

4.54 NRG is a non-life insurance and reinsurance company registered in England. NRG wrote business from 1920 until it ceased underwriting in 1993. It is part of Nederlandse Reassurantie Groep NV ("**NRG NV**"), a Dutch registered insurance group with interests in the UK and US, all of which are in run-off. NRG NV was acquired by the Berkshire Hathaway group in 2008 and is wholly owned by Columbia Insurance Company ("**Columbia**").

4.55 NRG has permissions (a) to carry out contracts of general insurance and reinsurance in the UK for 18 separate classes of business and (b) to effect contracts in 13 classes of business (I note that the permission to effect contracts is subject to a qualification, known technically as a "limitation", to the effect that before effecting any contract of insurance in the course of its business, NRG is required to seek and obtain from both the PRA and FCA confirmation that the regulator does not object to the firm effecting the contract of insurance and reinsurance). NRG's current permissions to *carry out* contracts of insurance and reinsurance include all the classes for which TMNF currently has permission (as listed in paragraph 4.19 above). NRG's current permissions to *effect* contracts includes all of the classes listed in paragraph 4.19 above, save for the permission to effect accident business. NRG intends to obtain, ahead of the Sanctions Hearing for the Scheme, permission from the PRA and the FCA to be able to effect accident business.

4.56 Since its acquisition in 2008, NRG has accepted the transfer of two additional portfolios:

- With effect from 28 December 2016, NRG received the transfer, under Swedish law, of a portfolio of insurance business related to building construction from Swedish insurance company, Försäkringsaktiebolaget Bostadsgaranti ("**FABO"**).
- Effective 31 July 2017, the Company received, by means of a Part VII Transfer, the transfer of a portfolio of reinsurance liabilities from Colbourne Insurance Company Limited ("**Colbourne**").

Outstanding Liabilities

4.57 The outstanding liabilities relating to the business originally written by NRG predominantly relate to asbestos claims from the US, UK and Australia, with other Australian liability and US pollution claims representing the bulk of the balance of the reserves. NRG's liabilities arise from both direct and reinsurance business. NRG has most recently undertaken an actuarial review of its claims liabilities as at 31 May 2021. As per that review, NRG's best estimate of the cost of settling these claims was $90.6 million, gross of outwards reinsurance. The largest component of that amount was in respect of UK asbestos claims, all of which arise from inwards reinsurance contracts. These reserves amounted to $40.2 million. US asbestos (direct and reinsurance) accounted for $16.9 million, other US liabilities $7.0 million and Australian liabilities $17.8 million ($3.6 million, of which are in respect of asbestos claims).

4.58 Best estimate reserves in respect of the FABO business amounted to $22.4 million, gross of reinsurance, and $14.0 million, net of reinsurance. Note that FABO is the only component of NRG's portfolio for which future reinsurance recoveries are expected. FABO's business related to Swedish construction risks and it operated from 2000 until it went into run-off at the end of 2015. The main product types written were cover for defects emerging after a building's completion (Buildings Defect Insurance, or **"BDI"**) and protection from the failure of builders due to financial distress (Completion Warranty Insurance or **"CWI"**). Note that, while the FABO business has been in run-off since 2015, as the discovery period of some of the policies is up to 10 years, not all of the business is fully earned and thus NRG holds an unearned premium provision.

4.59 The Colbourne business was written between 1981 and 1991 via the Lennox Agency. It wrote mainly marine hull, cargo and excess of loss reinsurance lines. The remaining liabilities include familiar catastrophe losses from that period. NRG's best estimate of reserves required for the Colborne portfolio as at 31 May 2021 was $1.6 million.

Reinsurance

4.60 As noted above, the only component of NRG's portfolio that has a material remaining reinsurance asset is that of FABO. The FABO book benefits from proportional and non-proportional reinsurance provided by five highly rated carriers (Hannover Re, HDI Global, Liberty Mutual, Swiss and SCOR).

4.61 Effective 1 January 2021, NRG entered into a loss portfolio transfer agreement with Columbia in relation to the FABO business (**"the Columbia Reinsurance"**). Under the agreement, NRG has ceded to Columbia all remaining net of reinsurance liabilities, including all external claims-related costs up to an aggregate limit of SEK 600m (approximately $68 million). I am informed by NRG that the motivation for entering into the agreement was that the Swedish Krona funds held by NRG to support the book were attracting significant negative interest rates, an expense that NRG wanted to avoid.

Key financial information

4.62 The last set of audited statutory accounts for NRG were produced as at 31 December 2020. A simplified version of NRG's balance sheet from those accounts is shown in Table 4.1 below. Since that time NRG has entered into the loss portfolio transfer agreement with Columbia in respect of the FABO business. In order to show the impact of this development I have also shown in Table 4.1 NRG's balance sheet as at 30 June 2021, as per NRG's (unaudited) management accounts. As can be seen, the amount of reinsurance assets has increased, whereas the amount of cash has reduced, reflecting the payment of premium to Columbia. I note that the results of the new actuarial reserve review as at 31 May 2021 were not available at the time of producing the 30 June 2021 management accounts and the insurance liabilities included in those accounts had been rolled forward from those assessed as at 31 December 2020.

TABLE 4.1 NRG SIMPLIFIED BALANCE SHEETS AS AT 31 DECEMBER 2020 AND 30 JUNE 2021 (£'000)

	31/12/2020	30/06/2021
Assets		
Investments	285,352	280,372
Reinsurance Assets	14,199	29,860
Receivables	2,231	3,696
Cash and equivalents	34,181	15,819
Total Assets	**335,963**	**329,747**
Liabilities		
Equity	207,388	206,250
Insurance Liabilities	126,998	120,752
Payables	1,569	2,784
Other	8	-39
Total Liabilities	**335,963**	**329,747**

4.63 As can be seen from Table 4.1 above, as at 31 December 2020, NRG had net assets (equity) of approximately £207 million and that has not changed materially as at 30 June 2021. As a result of the 31 May 2021 actuarial review, NRG will reassess its booked insurance provisions by year-end 2021. Given the reduction in the actuarial best estimate, it is likely that NRG will reduce its booked reserves, leading to an increase in its net assets.

4.64 I note that the investment assets shown on NRG's balance sheet relate to holdings in UK, US and Australian treasury bonds, all of which mature within a 12 month period.

4.65 The make-up of the insurance liabilities (gross and net of reinsurance) is shown in Table 4.2 below. As can be seen, reserves for IBNR made up the bulk of the reserves. The unearned premium reserves (**"UPR"**) relates to the FABO portfolio.

TABLE 4.2 INSURANCE LIABILITIES GROSS AND NET OF REINSURANCE AS AT 31 DECEMBER 2020 AND 30 JUNE 2021 (£'000)

	31/12/2020		30/06/2021	
	Gross	Net	Gross	Net
Claims Outstanding	28,330	22,673	21,538	15,501
IBNR	85,380	81,783	88,861	75,391
ULAE	2,108	2,108	1,998	0
UPR	11,180	6,235	8,355	0
Total	**126,998**	**112,799**	**120,752**	**90,892**

4.66 NRG has also provided me with copies of its year-end QRTs as at 31 December 2020, as well as quarterly QRTs as at 31 March 2021 and 30 June 2021. I note that NRG is not required to recalculate its SCR more frequently than annually; however, it has provided me with a recalculation of its SCR as at 30 June 2021, which allows for both Columbia's reinsurance of the FABO portfolio and the revised best estimate technical provisions. I note that these figures were not filed as part of its 30 June 2021 QRT submission. Table 4.3 below summarises the Solvency II balance sheets and the SCRs and MCRs for NRG as at 31 December 2020 and 30 June 2021.

TABLE 4.3 NRG'S SOLVENCY II BALANCE SHEETS AND CAPTIAL REQUIREMENTS AS AT 31 DECEMBER 2020 AND 30 JUNE 2021 (£'000)

	31/12/2020	30/06/2021
Assets		
Investments	293,449	286,894
Reinsurance Assets	11,463	15,899
Receivables & other	483	1,549
Cash and equivalents	27,820	11,445
Total Assets	**333,216**	**315,786**
Liabilities		
Technical Provisions	140,531	108,519
Payables & other	1,578	2,745
Total Liabilities	**142,109**	**111,264**
Excess assets (own funds)	**191,107**	**204,522**
SCR	**56,964**	**48,153**
Ratio of own funds to SCR	**335%**	**425%**
MCR	**16,227**	**12,038**
Ratio of own funds to MCR	**1178%**	**1699%**

4.67 As can be seen from Table 4.3 above, NRG's own funds (all of which are eligible for the purposes of meeting its SCR) as at 31 December 2020 amounted to £191.1 million and its SCR was £57.0 million, giving a ratio of EOF to capital requirements ("**Capital Cover Ratio**") of 335%. By 30 June 2021, NRG's SCR had reduced to $48.2 million whilst its EOF had increased to $204.5 million. These movements reflect both the Columbia Reinsurance of the FABO portfolio and the results of the 31 May 2021 actuarial review.

4.68 Table 4.4 below shows the split of NRG's technical provisions (gross and net of reinsurance) between claims and premium provision, the expense provision, as well as the risk margin.

TABLE 4.4 MAKE-UP OF NRG'S SOLVENCY II TECHNICAL PROVISIONS AS AT 31 DECEMBER 2020 AND 30 JUNE 2021 (£'000)

	31/12/2020		30/06/2021	
	Gross	Net	Gross	Net
Claims & Premium Provision	99,082	87,619	73,555	57,655
Expenses	11,893	11,893	7,730	7,730
Risk Margin	29,557	29,557	27,234	27,234
Total	**140,531**	**129,068**	**108,519**	**92,620**

Governance and Operations

4.69 NRG is run by a board of 5 directors (2 executive and 3 non-executive). The board is supported by 3 committees: the Audit and Risk Committee, the Operations Committee and the Investment Committee.

4.70 NRG does not employ any staff; its activities are mainly undertaken on an outsourced basis by RML and RMSL under a shared services agreement. With regard to claims handling, US direct APH claims are outsourced to RMI, and the FABO business is handled by third party sub-contractors. Investment management services are provided by NICO. NRG has an outsourcing policy to ensure that appropriate legal contracts exist for all outsourced activity, that risks around the activity are managed, that there is a clear allocation of responsibility of outsourced arrangement and that the arrangements are reviewed on an annual basis.

Business Strategy

4.71 The following paragraphs summarise NRG's stated business strategy with regard to underwriting, claims, reinsurance, investment and capital.

4.72 **Underwriting**: NRG has no specific strategy to seek new underwriting opportunities, but is willing to consider acquiring additional run-off books of business on a case by case basis, having regard to available capital and licenses. No underwriters are employed and the Board of Directors is therefore required to review and approve all underwriting.

4.73 **Claims**: NRG aims to run-off the claims efficiently, in accordance with its claims philosophy of paying valid claims in a timely fashion and with the additional objective of controlling total claims costs. Compliance with TCF principles is an important element of this strategy. All valid subrogation is identified and recovery sought in a cost-effective manner. Inwards commutations may be negotiated when this is deemed cost effective.

4.74 **Reinsurance**: reinsurance purchase strategy is aligned with the underwriting strategy. Any new underwriting prompts the consideration of any existing reinsurance within the business to be acquired, and any requirement for additional outwards reinsurance to be purchased. If required, reinsurance would be expected to be placed with a Berkshire Hathaway group company, as has been the case with related companies. All valid recoverable third party reinsurance is identified and recovery sought in a cost-effective manner.

4.75 **Investment**: NRG adopts a conservative investment strategy to ensure that there is no material exposure to market, liquidity or cash-flow risks to the funds held that support its solvency requirement, or own economic capital requirement.

4.76 **Expenses**: NRG manages expenses with the objective of maintaining the appropriate balance with regard to efficiently and effectively carrying out required corporate and operational activities on the one hand, and minimising the risk to policyholder security on the other.

4.77 **Capital**: the capital available to the business is efficiently managed with the intention of meeting sufficient regulatory solvency requirements. Solvency is monitored, and any potential shortfalls in solvency are reported to and discussed with the regulator. Further capital is only anticipated to be available in response to material additional underwriting (e.g. taking on a new run-off book of business). Capital distribution through capital repayment or dividend is not planned at present, and would need to be discussed in advance with the PRA before implementation.

Risks and Risk Appetite

4.78 Like all insurance companies, NRG is exposed to a variety of risks as it carries out its business. NRG has in place a risk management framework that is designed to ensure that risks are appropriately identified, monitored and controlled, with clear responsibilities and reporting lines.

4.79 NRG has in place risk appetite statements relating to each of the major risks to which it is exposed. Each statement is supported by risk appetite measures, which define the extent to which NRG is prepared to tolerate exposure to different types of risk in order to meet its strategic objectives. The risk appetite metrics are updated on a six monthly basis and are presented to the Risk Committee and Operations Committee for review. Red, Amber and Green ("RAG") ratings are used to define whether NRG is in breach of the risk tolerance, is approaching the risk tolerance, or is within the risk appetite, respectively.

4.80 As NRG is entirely in run-off, there is little scope for management to take corrective action in the event of a material deterioration of NRG's balance sheet. In such an event, NRG would be required to request a capital injection from a parent entity. However, there is no guarantee that such a capital injection would be provided.

4.81 I discuss below the major areas of risk to which NRG has identified an exposure, as well as its risk appetite in relation to each.

Insurance Risk

4.82 Insurance risk relates to the inherent uncertainty in the company's claims liabilities and the risk that the booked reserves prove to be inadequate. This risk is heightened for NRG given the long tailed nature of its claims liabilities.

4.83 According to its risk appetite statement, NRG aims to book reserves prudently at an 80% confidence level.

Market risk

4.84 Market Risk is the risk of an adverse financial impact due to changes in future cash flows of financial instruments resulting from fluctuations in interest rates and market prices. NRG's investment strategy is conservative and investment guidelines require funds held that support NRG's solvency requirement to be invested in fixed interest securities with a credit rating of A and above, held to maturity. Investments are held in government securities with short maturity dates. Through matching of the foreign currency liabilities with assets in the same currencies, NRG mitigates the impact of volatility in exchange rates.

4.85 According to NRG's risk appetite statements, NRG will invest 100% of its total investment portfolio within government securities or fixed income instruments unless approved by the Investment Committee. It also specifies that it should hold assets in each currency greater than 90% of the liabilities in the same currency.

Credit risk

4.86 Credit Risk is the risk of loss in the assets due to counterparties failing to meet all or part of their obligations. This includes counterparties that issue financial securities or hold cash deposits, as well as reinsurers. NRG mitigates credit risk in relation to financial investments and cash by only investing with highly rated institutions.

4.87 NRG's risk appetite statements define its tolerance for delays in billing reinsurers for claims that have been paid and in collecting outstanding balances from reinsurers once bills have been issued.

Liquidity Risk

4.88 Liquidity risk is the risk that a company cannot meet its obligations associated with financial liabilities as they fall due. NRG mitigates this risk by retaining significant liquid balances and the investment portfolio is such that it may be converted to liquid assets at short notice. NRG does not, therefore, consider liquidity to be a material risk. The risk appetite requires cash and short term investments to cover at least 3 months of expected cash flows.

Operational risk

4.89 Operational risk is the risk of an adverse financial impact due to being in business, and can arise from the operation's people, processes, and systems. NRG manages these risks through controls that are aligned with the Board's risk appetite and monitored via an early warning indicator system based on risk appetite statements that are reported bi-annually to the Audit & Risk Committee and the Operations Committee. Key risks, controls and risk appetite are reviewed at least annually.

4.90 There are a series of risk appetite statements relating to operational risks. These include those in relation to staff retention and absence, outsourced services, IT system availability and outages, and conduct standard.

4.91 With regard to conduct standards, NRG's risk appetite statements specify:

- Claims should be managed efficiently in accordance with its documented Claims Philosophy, Principles and Guidelines. It will not tolerate more than 60% of claims to be outside of the claims service standards (45 day turn around), unless there is a dispute with reinsurer.
- No more than 10% of complaints referred to an external adjudicator (i.e. the FOS) should be upheld as this would indicate failings within the first line (either internal or external) and complaints handling team.
- It has no appetite for regulatory censure or customer detriment arising from TCF failings.

Strategic risk

4.92 Strategic risk is the risk of lower than expected profits, or impact to a company's long-term positioning and performance due to inadequate strategy, failed business decisions, or lack thereof. NRG's strategic risk is explicitly monitored via risk and control reporting.

Capital Policy

4.93 NRG's risk appetite in relation solvency capital states that it will maintain capital of at least 150% of the standard formula SCR and 120% of its Own Economic Capital Requirement (**"OECR"**). However, I note that a "green" rating within its RAG framework (i.e. specifying that NRG is within its risk tolerance) requires the Capital Cover Ratio relative to the SCR to be over 175%.

4.94 As detailed above, NRG's Capital Cover Ratio is currently significantly above 175% and it currently does not intend to make any capital distributions, which in any case would be discussed with and agreed by the PRA prior to being made.

Recent significant market events that might affect NRG

COVID-19 pandemic

4.95 The COVID-19 pandemic and the responses to it of various national governments have had far-reaching consequences across society and business, worldwide. Impacts on insurance companies have included claims specifically relating to the pandemic (such as business interruption claims), disruption to financial markets and operational issues.

4.96 As an insurer long in run-off, NRG does not have any exposure to claims relating to the pandemic. It is exposed to movements in foreign exchange rates, investment markets and interest rates, which were seen during 2020 as a result of the COVID-19 pandemic. Through matching of the foreign currency liabilities with assets in the same currencies, NRG mitigates the impact of volatility in exchange rates. Investments are held in government securities with short maturity dates, whose values were impacted by the pandemic, but not significantly enough to reduce materially solvency surplus. From an operational risk perspective, I understand that NRG has continued to operate satisfactorily during the "lock down" periods, by way of staff working remotely from home, and the directors of NRG have no reason to believe this cannot continue for the foreseeable future.

NICO

Background

4.97 NICO is a large insurance and reinsurance company based in Nebraska, US, and is one of the leading non-life insurance companies in the Berkshire Hathaway group. In 2020, its total written premiums amounted to over $30 billion. Of this, over $17 billion related to automobile insurance lines, $6.8 billion to reinsurance business, and the remainder to a variety of other lines of business.

Outstanding Liabilities

4.98 The gross carried loss and loss expense reserves of NICO as at 31 December 2020 totalled $81.9 billion ($80.5 billion net of reinsurance). These consist of reserves, under Schedule P of its return to the US National Association of Insurance Commissioners ("**NAIC**"), for unpaid losses and loss adjustment expenses of $40.6 billion ($39.2 billion net), retroactive reinsurance reserves of $39.6 billion (gross and net) and deposit liabilities of $1.7 billion (gross and net).

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

4.100 There are also some asbestos and environmental exposure amongst the unpaid losses and loss adjustment expenses that NICO reports in its Schedule P return, although these are less significant than those under the retroactive reinsurance contracts. Asbestos and environmental related claims accounted for $2.3 billion (net of reinsurance) as at 31 December 2020, or around 6% of the overall Schedule P carried reserves.

Key Financial Information

4.101 NICO has been rated by a number of credit rating agencies. As at the time of writing, it had financial strength ratings from Standard & Poor's of AA+, and A.M. Best of A++.

4.102 As at 31 December 2020, the admitted assets (excluding protected cell business) of NICO amounted to $317.4 billion, made up of cash and bonds (5%), common and preferred stocks (68%) and investments in its parent, subsidiaries and affiliates (24%).

4.103 NICO is required to hold capital in accordance with the Risk-Based Capital (**"RBC"**) formula developed by the NAIC (see Appendix G for further details). As at 31 December 2020, NICO's total adjusted capital (i.e. its available capital under the regime) amounted to $189.4 billion. Its risk-based capital requirement amounted to $88.6 billion. The ratio of its adjusted capital to required RBC was therefore 214% and the free assets were $100.8 billion (i.e. adjusted capital – required RBC). The ratio of free assets to carried loss reserves net of reinsurance (of $80.5 billion) was approximately 125%, i.e. claim reserves net of reinsurance could deteriorate by 125% before NICO's free assets were exhausted. The ratio of adjusted capital to carried loss reserves was 234%, meaning that claim reserves net of reinsurance could deteriorate by 234% before NICO would become insolvent.

4.104 The admitted assets held by NICO as at 31 December 2020 are dominated by common and preferred stocks, and by investments in its parent, subsidiaries and affiliates. As such, they are not managed to a target duration that is based on the expected cash-flows of the underlying liabilities. The common and preferred stocks held by NICO are subject to significant market variability. Nonetheless, the ratio of free assets (of $100.8 billion) to admitted assets (of $317 billion) is 32%, i.e. the value of admitted assets could fall by up to 32% before NICO's free assets would be exhausted.

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 Scheme Document. For the avoidance of doubt, the terms of the Scheme as set out in the Scheme Document are definitive.

5.2 Assuming that the Court approves the Scheme as proposed, all the insurance business of the London Branch of TMNF will transfer to NRG on the Effective Date. This will include all of the assets and liabilities arising from the policies that have been relocated to TMNF's London Branch, as well those relating to the Reinsurance Agreement with NICO, and other third party outwards reinsurance policies in respect of the Transferring Business.

5.3 There will be no changes to the terms and conditions of any policy included within the Transferring Business as a result of the Scheme. TMNF's rights and obligations under the policies that comprise the Transferring Business will be transferred, without alteration, to NRG. Similarly, it is intended that there will be no change in how the Transferring Business is administered as a result of the Scheme (as discussed in more detail in paragraphs 5.13-5.16 below). All holders of policies included within the Transferring Business will be entitled to the same rights against NRG as were available to them against TMNF under such policies and will be accountable to NRG for any further or additional premiums or other amounts attributable or referable thereto as and when the same become due and payable.

5.4 Any pending or current proceedings or complaints issued or served before the Effective Date by or against TMNF in connection with the Transferring Business shall be continued by or against NRG in place of TMNF, and TMNF 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 TMNF will instead be by or against NRG. NRG shall be entitled to all defences, claims, counterclaims and rights of set-off that would have been available to TMNF before the Effective Date in respect of the Transferring Business.

5.5 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 NRG in the place of TMNF.

5.6 No members of staff of TMNF will be transferred from their current employer to a new employer as a result of the Scheme.

5.7 The terms of the Scheme are governed by English law.

MOTIVATION FOR THE SCHEME

5.8 TMNF no longer writes any international commercial reinsurance business and the Legacy Portfolio does not align with its future strategic business plan. Therefore, TMNF intends to transfer the business of its London Branch (which comprises the vast majority of the Legacy Portfolio) to NRG under the Scheme.

POLICYHOLDERS AFFECTED

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

- the Transferring Policyholders;
- the TMNF Non-Transferring Policyholders;
- the current policyholders of NRG.

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

EXCLUDED POLICIES

5.11 While it is possible that there will be some Excluded Policies (i.e. policies that the Court determines shall not be transferred under the Scheme), none are currently expected.

5.12 From the Effective Date, in accordance with the Framework Agreement, NRG shall observe and perform TMNF’s obligations under the Excluded Policies to the greatest extent permitted thereunder and shall indemnify TMNF from any liability, loss, cost or expense incurred by, or demand or claim made against, TMNF in respect of any Excluded Policy.

POLICY ADMINISTRATION

5.13 As discussed from paragraph 4.38 above, the policy administration of the Transferring Business is currently undertaken by RMSL and RMI on behalf of TMNF, in accordance with the Reinsurance Agreement. After the Scheme has become effective, RMSL and RMI will continue to administer the business, on behalf of NRG. I note that the latter point is confirmed in a draft letter from NICO to TMNF and NRG (which I have been informed NICO has agreed to sign).

5.14 There will be no need for claims records to be migrated, as copies of such records have already been provided to RMSL and RMI under the Reinsurance Agreement. No material IT developments will be required as a result of the Scheme.

5.15 It is intended and expected that the Transferring Policyholders will experience no difference in the administration and servicing of their policies and claims between the periods before and after the Effective Date, and it is intended that those operations are undertaken pursuant to substantially the same arrangements as currently exist. I note that RMSL and RMI are responsible for managing NRG's existing book of business. I also note that RML is also engaged by the London Branch of TMNF to provide administrative services, as it does for NRG.

5.16 On and with effect from the Effective Date, NRG shall:

- succeed to any rights, liabilities and obligations of TMNF in respect of any personal data that relates to the Transferring Business and which is subject to **Data Protection Laws** (meaning the EU General Data Protection Regulation 2016/679 (**"GDPR"**) as it forms part of the laws of England and Wales, the UK Data Protection Act 2018 and, to the extent applicable, the data protection or privacy laws of any other country including GDPR, as implemented or supplemented into domestic legislation of each EEA member state);
- shall be substituted for TMNF as the controller of any personal data that relates to the Transferring Business and which is subject to Data Protection Laws to the extent that, on the Effective Date, TMNF is the controller of such personal data;
- in respect of any personal data relating to the Transferring Business, be under the same duty by virtue of any law that was applicable to TMNF in relation to the confidentiality and privacy of any person in relation to that data and shall be bound by any specific notice given or request made by any data subject that was binding upon TMNF and that required that TMNF not use the data for marketing purposes; and
- in any consents provided by a data subject be substituted for any references to TMNF.

EFFECT OF THE SCHEME ON THE BALANCE SHEETS OF TMNF AND NRG

5.17 The effect of the Scheme on the balance sheet of TMNF will be minimal. As mentioned in paragraph 4.8 above, on a consolidated basis as at 31 March 2021, TMNF held reserves for outstanding claims of approximately ¥3 trillion or around $28 billion (these figures are presented in its accounts net of reinsurance). The gross reserves of the Transferring Business represent less than 0.3% of this amount; and the net reserves are nil, so, on a net basis, there will be no change. As noted in paragraph 4.7 above, as at 31 March 2021, TMNF recorded net assets of approximately ¥3.3 trillion ($30 billion). If the Scheme is implemented, TMNF will, pursuant to the Framework Agreement, need to pay $10 million to NRG. This will reduce TMNF's net assets by less than 0.1%. This is illustrated in Table 5.1 below, which shows how TMNF's consolidated balance sheet as at 31 March 2021 would have changed had the transfer taken place on that date.

TABLE 5.1 SIMPLIFIED CONSOLIDATED BALANCE SHEET OF TMNF AS AT 31 MARCH 2021 (¥ BILLIONS)

	Pre-Scheme	Transferring Business	Post-Scheme
Assets			
Cash and Bank Deposits	557	1	556
Receivables	1,379		1,379
Investments	10,960		10,960
Tangilble Fixed Assets	306		306
Intangible Fixed Assets	1,038		1,038
Other assets	1,595		1,595
Total Assets	**15,834**	**1**	**15,833**
Liabilities			
Net Insurance Liabilities*			
Outstanding Claims	3,027	0	3,027
Underwriting Reserves	7,283		7,283
Corporate Bonds	231		231
Other Liabilities	2,004		2,004
Total Liabilities	**12,544**	**0**	**12,544**
Net Assets	**3,290**	**1**	**3,289**

* TMNF presents the insurance liabilities in its consolidated accounts on a net of reinsurance basis only. Note that the gross of reinsurance reserves for outstanding claims in relation to the Transferring Business as shown in the accounts of the London Branch as at 31 March 2021 amounted to $77 million, or approximately ¥8.5 billion (and nil on a net of reinsurance basis).

5.18 With regard to the balance sheet of the London Branch of TMNF, the Scheme will cause its gross claims reserves to reduce to nil. Payment of the $10 million to NRG will cause its financial assets to fall from approximately $30 million to $20 million. This is illustrated in Table 5.2 below, which shows how the London Branch's balance sheet as at 31 March 2021 would have changed had the transfer taken place on that date. Note that the London Branch produces accounts in US dollars, reflecting the principal currency of its liabilities. Note also that, as at 31 March 2021, it booked reserves of $77.0 million, i.e. slightly less than the $77.1 million estimate of its unpaid claim liabilities made by the external actuaries as at 31 December 2020, having allowed for payments and currency movements between the two dates.

TABLE 5.2 SIMPLIFIED GAAP BALANCE SHEET OF THE LONDON BRANCH OF TMNF AS AT 31 MARCH 2021 ($ MILLIONS)

	Pre-Scheme	Transferring Business	Post-Scheme
Assets			
Reinsurance Assets	77.0	77.0	0.0
Short Term Deposit	30.0	10.0	20.0
Cash and Equivalents	0.7		0.7
Total Assets	**107.6**	**87.0**	**20.7**
Liabilities			
Insurance Liabilities	77.0	77.0	0.0
Other Liabilities	0.0		0.0
Total Liabilities	**77.0**	**77.0**	**0.0**
Net Assets	**30.7**	**10.0**	**20.7**

5.19 Table 5.3, below, shows the impact of the Scheme on NRG's GAAP balance sheet as at 30 June 2021, on the basis that the Scheme had been implemented as at that date.

TABLE 5.3 SIMPLIFIED GAAP BALANCE SHEETS FOR NRG AS AT 30 JUNE 2021 (IN £'000)

	Pre-Scheme	Transferring Business	Post-Scheme
Assets			
Investments	280,372	7,227	287,599
Reinsurance Assets	29,860	70,826	100,686
Receviables	3,696		3,696
Cash and equivalents	15,819		15,819
Total Assets	**329,747**	**78,053**	**407,800**
Liabilities & Equity			
Equity	206,250	3,614	209,863
Insurance Liabilities	120,752	74,440	195,192
Payables	2,784		2,784
Other	-39		-39
Total Liabilities & Equity	**329,747**	**78,053**	**407,800**

5.20 Table 5.4, below, shows NRG's balance sheet as at 30 June 2021 under the same actual and post-Scheme situations as per Table 5.3, but on a Solvency II basis. NRG's Solvency II SCR and MCR are also shown for comparison purposes.

TABLE 5.4 SIMPLIFIED SOLVENCY II BALANCE SHEETS FOR NRG AS AT 30 JUNE 2021 (IN £'000)

	Pre-Scheme	Transferring Business	Post-Scheme
Assets			
Investments	284,332		284,332
Reinsurance Assets	15,899	44,155	60,055
Receviables & other	3,696		3,696
Cash and equivalents	11,860	7,227	19,087
Total Assets	**315,787**	**51,383**	**367,169**
Liabilities			
Technical Provisions	108,581	47,904	156,485
Payables & other	2,745	0	2,745
Total Liabilities	**111,326**	**47,904**	**159,230**
Excess assets (own funds)	**204,461**	**3,478**	**207,939**
SCR	**48,153**		**51,753**
Ratio of own funds to SCR	**425%**		**402%**
MCR	**12,038**		**12,938**
Ratio of own funds to MCR	**1698%**		**1607%**

5.21 The figures that underlie Table 5.3 and Table 5.4, above, have been produced by NRG. The GAAP balance sheet is based on NRG's unaudited management accounts as at 30 June 2021. I note that the technical provisions included within the GAAP balance sheet are based on actuarial indications as at 31 December 2020, plus a margin, that have been rolled forward to 30 June 2021. In contrast, the Solvency II technical provisions have been based on an updated actuarial review as at 31 May 2021. As the level of the margin for the GAAP accounts has not yet been reassessed, they have not been updated post the 31 May 2021 actuarial review.

5.22 If the Scheme had been effected as at 30 June 2021, then I would expect NRG's gross technical provisions on a GAAP basis to have increased by about £74.4 million. NRG's reserving policy is to book reserves at an 80% confidence level; according to its modelling of the Transferring Business, as at 30 June 2021, reserve requirements at the 80% confidence level would amount to about $98 million (£70.8 million). Once the Scheme is sanctioned, NRG will, under the terms of the Framework Agreement, receive a $10 million (£7.2 million) fee from TMNF. According to NRG's business plan, it will hold back half of this (£3.6 million) to cover any unforeseen expenses that may be incurred by the company directly in relation to the Transferring Business that are not covered by the NICO Agreement (NRG has informed me that holding back part of any transfer fee and then releasing it over the subsequent few years is its standard practice). Hence, Table 5.3 above shows an increase in gross provisions of about £74.4 million (i.e. £70.8 million in respect of the reserves of the Transferring Business plus an additional £3.6 million provision relating to any expenses incurred by NRG that are not recoverable under the Reinsurance Agreement), an increase in reinsurance recoveries of £70.8 million (i.e. equal to the increase in gross provisions excluding the expense reserve), an increase in cash of £7.2 million and a resulting increase in equity of about £3.6 million. Note that this ignores any impact of tax.

5.23 On a Solvency II basis, the increase in the gross technical provisions, as shown in Table 5.4 above, is smaller than on a GAAP basis (at £47.9 million). This is because these figures are booked at a best estimate level, rather than 80% confidence level (although a risk margin is included in addition), and are also discounted for the time value of money. The impact on net assets (EOF) is expected to be similar. The SCR will increase as a result of the Scheme, relatively more so than the EOF, resulting in a slight reduction in the ratio of EOF to SCR.

5.24 I discuss the impact of the Scheme on the reserving strength and excess assets of TMNF and NRG in more detail in Section 6, below.

APPROACH TO COMMUNICATION WITH POLICYHOLDERS

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

5.26 The main objectives of the communications are to:

- Give those policyholders and others who might be affected by the Scheme 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;
- Give 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 NRG's willingness and ability to continue to meet its obligations in respect of the Transferring Business; and
- Meet legal and regulatory requirements.

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

COSTS

5.28 Any costs and expenses incurred in relation to the preparation and effecting of the Scheme between the date of the Framework Agreement and the Effective Date shall be borne by whichever party incurred the costs and expenses unless otherwise agreed between the parties.

6. The impact of the Scheme on the Transferring Policyholders

INTRODUCTION

6.1 Under the Scheme, the Transferring Business will be transferred from the London Branch of TMNF to NRG, and will continue to be 100% reinsured to NICO (up to the limits of the Reinsurance Agreement).

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 NRG post the Effective Date compared with that of TMNF pre the Effective Date. 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
  - the risk exposures in NRG compared with those in TMNF.
- the policy servicing levels provided by NRG 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 As is discussed further below, as the London Branch of TMNF is not a distinct entity from TMNF as a whole, I have considered the financial strength of TMNF generally rather than the London Branch in isolation.

6.4 I note that the reserves held on a GAAP basis differ from the TPs that are used to determine an insurer's funds available to meet its solvency capital requirements under the UK solvency regime (which, as noted in paragraph 3.22, above, is essentially synonymous with Solvency II). However, the best estimate of the claims liabilities that underlie those shown in the GAAP Accounts is used as the base for the best estimate of the claims provision under the UK solvency regime, which then forms a key part of the TPs.

6.5 Key metrics under Solvency II and the UK solvency regime, such as the SCR, MCR and EOF, are intended to be made public as part of each insurer's annual SFCR. However, other relevant metrics (for example, projected values of EOF 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. Therefore, I am not at liberty to disclose in this Report the actual values of those private metrics, or figures by which those values could be calculated, other than where consented to by the company concerned. In this Report, I have considered the extent to which TMNF and NRG each hold capital in excess of various solvency capital measures. Each entity will have different Capital Cover Ratios for different solvency measures. Where permitted (e.g. when dealing with publicly available information), I have expressed Capital Cover Ratios in numeric terms. In other instances, for comparative purposes in this Report, I have defined the following terms:

- "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%.

RESERVE STRENGTH OF TMNF (PRE-SCHEME)

6.6 As detailed in paragraph 4.8 above, TMNF is a very large insurance company with reserves for outstanding claims (as at 31 March 2021) totalling approximately $25 billion. The reserves of its London Branch amount to $77 million, i.e. just 0.3% of the total outstanding claims reserves of TMNF (and nil on a net of reinsurance basis). As such, the Scheme will not materially impact the strength of TMNF's reserves as a whole. I have not attempted to review in detail the claims reserves held generally by TMNF, although TMNF has provided me with details of the Tokio Marine group actuarial policy for property and casualty loss reserving, which sets out the framework within which loss reserves are reviewed within the group. This suggests that the Tokio Marine group has appropriate policies and procedures in place to ensure that reserve are calculated, both in TMNF itself and its subsidiaries, by appropriately experienced personnel using suitable actuarial techniques and that there exists appropriate oversight of the reserves, both at subsidiary and group level.

6.7 On a gross of reinsurance basis, the reserves of the Transferring Business will represent a significant portion of the reserves of NRG post-Scheme and the strength and uncertainty inherent within those reserves could materially affect the financial security of NRG's policyholders post-Scheme (including those of the Transferring Business). My review of TMNF's reserves has therefore concentrated on reviewing TMNF's reserves for the London Branch business (i.e. the business that will transfer under the Scheme).

London Branch Business

6.8 I have been provided with an actuarial report prepared by external actuarial consultants on the unpaid claims reserves of the Transferring Business as at 31 December 2020. TMNF has used the results of this analysis as the basis for setting reserves in the London Branch. As noted in paragraph 4.21 above, the external actuaries estimated the cost of unpaid claims to be $77.1 million. TMNF used this figure as the basis of the reserves booked in the accounts for the London Branch as at 31 March 2021. Rolled forward for payments, the reserves totalled $77.0 million as at 31 March 2021.

6.9 The external actuaries have split the Transferring Business into 14 reserving segments and within each have reviewed APH and non-APH claims separately.

6.10 The most material of the reserving segments relates to the reinsurance of ExCo. In total, the reserves for this segment amount to $24.2 million. $24 million of this relates to APH claims and $0.2 million to non-APH claims.

6.11 Two further segments are particularly material, both of them in respect of US cedants: proportional contracts relating to large cedants (for which unpaid claims estimates amount to $19.9 million, $18.8 million of which is APH); and excess of loss and facultative contracts (for which reserves amount to $18.4 million, $18.2 million of which is APH). There is a further class in respect of US cedants that relates to proportional contracts from small cedants. Reserves for that class total $4.7 million ($4.6 million of which is in respect of APH claims).

6.12 There are four segments relating to non-US cedants. In total, reserves for these segments total $8.3 million, almost all of which is in respect of APH claims.

6.13 There are six further segments that relate purely to classes of business that are not exposed to APH claims (including hull, cargo, fire and bond and credit classes). The external actuaries have used traditional actuarial development methods for projecting these claims. The non-APH claims remaining on these segments account, in total, for $1.6 million of the total estimated unpaid claims across all segments of $77.1 million, and are therefore relatively immaterial.

6.14 I provide below some commentary on each of the main segments.

<u>ExCo</u>

6.15 TMNF underwrote a number of different treaties in respect of ExCo from the 1960s through to 1990. The approach taken by the external actuaries across all contracts has been to apply multipliers to the outstanding case reserves. This type of benchmarking approach is typically used for portfolios with APH exposures where a more detailed, exposure-based, analysis is not feasible.

6.16 Multipliers have been selected according to claim type (i.e. asbestos, pollution, health hazard) and whether they are US or non-US contracts. For asbestos claims, higher multipliers have been applied for "small treaties".

6.17 I have compared the multipliers used (both on this segment and other reserving segments) to benchmarks to which I have access, derived from industry sources (in particular the statutory filings of US insurers, which are required to disclose details of their reserves relating to asbestos and pollution exposures) and from my experience with other projects involving asbestos liabilities. The external actuaries have also shown, in their report, paid survival ratios implied by their multiplier selections. Paid survival ratios are the ratio of the estimate of unpaid claims to the observed annual rate of claims payments (which can be calculated as the average of actual paid amounts over recent years). I have also compared the paid survival ratios implied by the external actuaries' unpaid claims estimates with other benchmarks to which I have access. No two portfolios have exactly the same exposures and reserve requirements, so a degree of caution is required when applying benchmark multipliers. However, in order to ensure that the benchmarks against which I have compared the multipliers are as relevant as possible, I have sought to undertake the comparison at a granular level, e.g. accounting for the type of contract (direct insurance, proportional reinsurance, excess of loss reinsurance, etc.), for the underwriting year of exposure and for the type of underlying insured (e.g. major insured or peripheral insured). The most granular, and therefore most easily comparable, benchmarks have been those available to me from other projects on which I have worked, rather than from public disclosures. In forming an opinion on the reserves estimated by the external actuaries, I have considered both the multipliers used and the paid survival ratios and have compared these to relevant benchmarks. In some cases, I have also raised queries directly with the external actuaries to understand better the reasoning behind their multiplier selections and resulting loss estimates. In relation specifically to the ExCo APH exposures, based on benchmark comparisons and dialogue with the external actuaries, I have concluded that the resulting reserves are reasonable.

6.18 As noted above, there are very small amounts of non-APH reserves on these contracts. The non-APH reserves held are all in respect of outstanding claims, with no IBNR reserves having been allowed for.

<u>US Cedants</u>

6.19 There are three segments for US cedants: proportional large; proportional small; and excess of loss and facultative. As above, the proportional large and excess of loss and facultative segments are most material. For these two segments, the external actuaries have been able to use exposure based modelling to estimate the unpaid claims in respect of asbestos claims for these cedants. For pollution and health hazard claims, multipliers have been applied to outstanding amounts.

6.20 The proportional large segment is comprised of six different cedants. The exposure based modelling of asbestos claims involves projecting the ultimate cost of asbestos claims to each of the underlying companies insured by each cedant. Their projected liabilities are then allocated to their insurance coverage and the amounts falling to the cedant concerned are calculated. The cedant's liabilities are then applied to their reinsurance coverage to calculate TMNF's share of the loss. This is a detailed exercise that requires granular claims and coverage data. The external actuaries have their own proprietary model for undertaking these projections that has not been made available to me, although I have been provided with summaries of the outputs. However, based on their descriptions of how the model works, it appears to me to be consistent with both market practice and my own experience and expectations for modelling asbestos claims. I have again also been able to use market benchmarks (as discussed in paragraph 6.17 above) as a means of checking the reasonableness of the results.

6.21 For the excess of loss and facultative contracts, there are a larger number of cedants, but the external actuaries have been able to use their model to project future asbestos claims. For pollution and health hazard claims, on both segments, outstanding multipliers have been applied.

6.22 For the smaller proportional cedants, the external actuaries have not used the exposure based model, but have applied multipliers to outstanding amounts for all claims. For this segment they noted that it was not always apparent to which claim type outstanding amounts related. However, they have assumed that the vast majority relate to asbestos, which attracts the highest multiplier.

6.23 As noted above, there are very small amounts of non-APH reserves on these contracts. Most of the non-APH reserves are held in respect of outstanding claims, with an immaterial amount of IBNR claims having been allowed for.

6.24 Overall, I conclude that the reserves estimated for the US cedants appear reasonable.

Non-US Cedants

6.25 The non-US cedants are divided into four segments: proportional; excess of loss and facultative; retrocession of Japanese reinsurers; and reinsurance of the HS Weavers underwriting pool. Proportional and excess of loss and facultative make up over 90% of the reserves for the non-US cedants. Whilst the cedants are not US companies, the majority of the underlying exposures are from the US, although there are also some material UK asbestos exposures in the excess of loss and facultative segment.

6.26 For all of the segments the external actuaries have used multipliers of outstanding amounts to derive estimates of IBNR amounts for APH claims. These have been selected taking regard of the claim types, in some cases year of exposure, as well as the source of the exposure (i.e. different factors have been selected for UK claims). The survival ratios implied by the external actuaries' selections are high, particularly for the proportional and excess of loss and facultative segments. This reflects relatively benign payment activity in recent years resulting, in part, from disputes with cedants. Overall, based on my experience and relative to market benchmarks, the external actuaries' reserve selections for the APH exposure associated with these segments look reasonable.

6.27 As noted above, there are very small amounts of non-APH reserves on these contracts. The non-APH reserves held are all in respect of outstanding claims, with no IBNR reserves having been allowed for.

Uncertainty

6.28 Whilst all estimates of unpaid claims amounts are inherently uncertain, estimates of unpaid APH loss amounts are subject to particular uncertainty due to the very long period over which these claims are expected to emerge, as well as due to the potential for claims to be impacted by the outcome of litigation.

6.29 The external actuaries have also noted that limitations in the data provided have given rise to further uncertainty. In particular, a lack of detailed policy and claims information prevented them from undertaking an exposure based approach on all segments, and, for some segments, lack of detail around the type of claim necessitated the external actuaries to make assumptions as to which claim type was appropriate.

6.30 The external actuaries have also noted that the COVID-19 pandemic could affect claims, for example through delays in the claims handling and court processes, or through increased mortality of people who would have otherwise suffered from asbestos-related diseases. It remains unclear whether COVID-19 will actually have any material impact on the claims within the London Branch business and, if it does, whether it will be adverse or beneficial to TMNF's reserve requirements.

Solvency II Technical Provisions

6.31 The external actuaries were separately engaged by TMNF to calculate its Solvency II TPs, as well as its SCR using the standard formula approach. These were all calculated as at 31 March 2021 to coincide with TMNF's year-end.

6.32 The starting point for calculating the TPs was the unpaid claims estimates as per the external actuaries' 31 December 2020 report, which were rolled forward for payments to 31 March 2021. There were a number of adjustments made to the rolled forward unpaid claims estimates to bring them into line with requirements for TPs. On a gross of reinsurance basis:

- A 5% loading has been applied to allow for ENIDs. This has been set judgementally but, based on my experience, does not appear unreasonable for a portfolio of this nature.
- A provision for administrative and claims handling expenses has been added.
- A payment profile for the liabilities has been estimated and, using this, the estimates have been discounted for the time value of money. I note that it has been assumed that payments will continue to be made for a further 45 years on the London Branch portfolio before the business is finally run-off.

6.33 As the best estimate TPs should be calculated as the average of all possible outcomes, weighted by the probabilities of those outcomes, and there are some potential outcomes where the gross liabilities will exceed the limit of the Reinsurance Agreement, the external actuaries have undertaken some stochastic modelling to assess the loading that is required to the net TPs to allow for scenarios where the limit is breached (referred to by the external actuaries as the "excess loading"). In doing so, the external actuaries have assumed that the liabilities follow a lognormal distribution with a coefficient of variation of 50%. It should be noted that these are highly judgemental assumptions, and the resulting excess loading is quite sensitive to the choice of coefficient of variation. The excess loading calculated amounted to approximately $2 million, before discounting for the time value of money.

6.34 The net TPs also allow for the expected cost of reinsurer default.

6.35 I further note that, whilst some of the expenses are assumed to be recoverable from NICO under the Reinsurance Agreement, some of the administrative expenses of the London Branch are not (including those discussed in paragraph 4.43 above) and these are also allowed for in the net TPs.

6.36 Finally, I note that, in accordance with Solvency II requirements, the TPs include a risk margin. This has been calculated according to a standard approach of calculating the cost of capital of holding the SCR over the course of the expected run-off of the business. The risk margin has been calculated to be $4.6 million as at 31 March 2021.

6.37 Table 6.1 below shows the estimated unpaid claim amounts (both gross and net of reinsurance) from the external actuaries' 31 December 2020 review, together with the Solvency II TPs as at 31 March 2021, allowing for the adjustments discussed above.

TABLE 6.1 TMNF LONDON BRANCH UNPAID CLAIM ESTIMATES AS AT 31 DECEMBER 2020 AND TECHNICAL PROVISIONS AS AT 31 MARCH 2021 ($ MILLIONS)

	GROSS	NET
Estimated unpaid claims 31/12/20	77.1	0.0
Estimate rolled forward to 31/3/21	**77.0**	**0.0**
Best estimate TPs	68.7	4.3
Risk Margin	4.6	4.6
Total TPs	**73.4**	**8.9**

Conclusion with regard to the strength of the London Branch of TMNF's technical provisions pre-Scheme

6.38 **Based on my review of the technical provisions of the London Branch of TMNF, as described above, I have concluded that:**

- **the methodologies and major assumptions underlying the reserve analyses as performed by the external actuaries as at 31 December 2020 are reasonable;**
- **the resulting actuarial indications of unpaid claim amounts as 31 December 2020 also appear reasonable; and**
- **the TPs booked by TMNF as at 31 March 2021 include appropriate margins and other adjustments over those actuarial indications.**

I therefore conclude that the London Branch of TMNF's TPs appear reasonable as at 31 March 2021, notwithstanding the uncertainty present.

RESERVE STRENGTH OF NRG (PRE-SCHEME)

6.39 NRG has most recently performed an actuarial review of its reserves as at 31 May 2021 and I have been provided with a copy of the report that details the results of that review, as prepared by the RMSL actuarial team. As noted in Section 4 above, NRG's statutory reserves were last set as at 31 December 2020 and contained a margin over and above the central estimates made by the RMSL actuaries. NRG is yet to update its reserves in the light of the 31 May 2021 review, but it has prepared TPs and an SCR calculation, as at 30 June 2021, based on the central estimates in the 31 May 2021 review. As noted in paragraph 4.63 above, I would expect NRG to reduce its reserves for the purpose of preparing its GAAP accounts as at 31 December 2021, in the light of the 31 May 2021 actuarial review.

6.40 The RMSL actuaries have split the business into 10 main reserving classes. Eight of these relate to the business as was present in NRG at the time of its acquisition by Columbia. The subsequently acquired Colbourne and FABO portfolios make up two distinct reserving classes.

6.41 The eight reserving classes that make up the NRG business that was present at the time of acquisition have been formed based on a combination of domicile and claim type. A further non-segment specific IBNR estimate has also been added within the central estimate reserve.

6.42 A summary of the gross unpaid claims estimates by reserving class is shown in Table 6.2 below. I note that there is no outwards reinsurance allowed for on any class other than FABO, for which net unpaid claims have been assessed as nil given the presence of the Columbia Reinsurance.

TABLE 6.2 NRG GROSS UNPAID CLAIMS ESTIMATES AS PER 31 MAY 2021 ACTUARIAL REVIEW ($ MILLIONS)

RESERVING CLASS	OUTSTANDING	IBNR	UNPAID
UK Asbestos	1.6	38.6	40.2
FABO	8.4	14.0	22.4
AUD Non-Asbestos	8.2	6.0	14.2
US Asbestos Reinsurance	3.0	6.4	9.4
US Asbestos Direct	1.3	6.2	7.5
US Pollution/Health Hazard/Other	3.2	3.7	7.0
Balance of Account	1.4	2.9	4.3
AUD Asbestos	0.6	3.0	3.6
Colbourne	0.7	0.8	1.6
Cat XOL	1.4	-1.0	0.4
Non Class Specific IBNR	0.0	4.0	4.0
Grand Total	**29.8**	**84.7**	**114.5**

6.43 I provide below some commentary on the methodology and assumptions used by the RMSL actuaries for each of the main reserving classes.

UK Asbestos

6.44 UK Asbestos is the largest of the reserving classes, making up around a third of NRG's total gross reserves.

6.45 The exposures within the UK Asbestos class all relate to inwards reinsurance contracts, with the reserves being dominated by contracts relating to one cedant in particular, and much of the other reserves relating to a small number of other cedants.

6.46 The standard industry approach to projecting UK asbestos claims is to use a frequency-severity model whereby the numbers of future claims reported in each future year (frequency) are projected together with the average costs of those claims in each future year (severity). The product of the frequency and severity gives the total cost in each future year. Summing across all future years until the claims have all run off gives the total expected future cost. The IFoA's AWP has produced models that project total numbers of claims for the insurance industry as a whole. Insurance companies and third party actuarial consultants typically use these models as the basis for projecting claims for individual portfolios or companies.

6.47 Much of the liability faced by insurers in relation to asbestos claims results from compensation paid to claimants with (or who have already died from) mesothelioma. Mesothelioma is a non-curable cancer that is usually caused by exposure to asbestos. The AWP has constructed a detailed model to project the cost to insurers of settling future mesothelioma claims.

6.48 There are a number of other disease types that can result from exposure to asbestos, in particular other lung cancers, asbestosis and pleural thickening. These tend to be less costly to insurers than mesothelioma claims as compensation amounts and/or claims numbers are smaller. The AWP has also produced models to project these claims types, although they are less sophisticated.

6.49 In the case of NRG, its UK asbestos exposures relate to inwards reinsurance contracts only. This makes it more difficult to project future claims as NRG normally only has visibility of the claims that attach to its reinsurance treaties (which only cover a limited number of years), rather than the full spectrum of claims advised to the cedant. However, prior to NRG's actuarial review as at 31 May 2016, it was provided with access to a wider set of claims data from its main cedant, as well as the second largest cedant. This enabled the RMSL actuaries to project each cedant's ultimate future liability and, using a simulation approach based on the profile of claims received by the cedant and assumptions around how that profile will change over time (in particular with regard to exposure dates), projected the share of the cedant's claims that will be payable under NRG's reinsurance treaties.

6.50 NRG has not been able to update the results of that analysis undertaken as at 31 May 2016, due to the cedants not routinely providing such detailed claims data, and it has essentially been rolling forward the reserves set as part of its 31 May 2016 review ever since. In its most recent review as at 31 May 2021, in light of a newly released version of the AWP model, the RMSL actuaries made a reduction of 15% to NRG's reserves for UK asbestos claims. This was made judgementally, but reflected some material changes to the AWP model (from the version that underlay the 31 May 2016 review) that resulted in a material reduction in the AWP's estimate of future industry costs.

6.51 I have discussed with the RMSL actuaries the approach taken for this reserving class and they have made available to me the spreadsheet models used in their 31 May 2016 review. There is a high degree of uncertainty associated with any projection of UK asbestos claims and that is magnified here due to the reinsurance nature of the exposures. I also note that, recently, there has been a lack of updates provided by the major cedants due to a dispute regarding the allocation of a subrogation amount. This further adds to the uncertainty. Nevertheless, notwithstanding the considerable uncertainty, based on my review of the methodologies and major assumptions use by the RMSL actuaries, I believe that their unpaid claims estimates as at 31 May 2021 for the UK asbestos claims are reasonable.

FABO

6.52 As noted above, the FABO portfolio relates to Swedish construction risks. The RMSL actuaries have split the business into three main reserving classes: BDI – Multi, BDI – Single, and Other. BDI – Multi refers to buildings defect insurance for multi-dwelling projects, whereas BDI – Single is for single dwellings. Other includes a number of smaller classes, mainly CWI.

6.53 For all lines, the actuaries have used traditional actuarial development methods such as the chain ladder and Bornhuetter-Ferguson techniques. These methods project the future development of claims based on the historical experience in prior years. In the case of the Bornhuetter-Ferguson method, some weight is applied to a prior expectation of the level of claims activity that is likely to occur.

6.54 The methodology employed by the RMSL actuaries for this class appears reasonable. I have reviewed the amount of future development projected relative to historical experience and I believe that the selected IBNR reserves appear reasonable.

6.55 As noted above, this class benefits from both third party reinsurance (the value of which is approximately 40% of the gross unpaid claims estimates), and also by the Columbia Reinsurance. The amount of limit provided by the Columbia Reinsurance is extensive (more than three times current reserves, gross of third party reinsurance). Whilst there is material uncertainty in the gross reserves for the FABO business, the Columbia Reinsurance largely removes that uncertainty on a net basis.

US APH

6.56 The US APH classes comprise US Asbestos Reinsurance, US Asbestos Direct and US Pollution/Health Hazard/Other.

6.57 In terms of unpaid claims estimates, US Asbestos Reinsurance is the most significant of these classes. The RMSL actuaries' approach to projecting these claims, as well as the US Asbestos Direct claims, has been to use paid survival ratios and IBNR-to-outstanding multipliers that have been benchmarked relative to other portfolios within the Berkshire Hathaway group. As with the TMNF London Branch portfolio, I have compared the selected ratios to industry benchmarks to which I have access and I believe the selections to be reasonable.

6.58 The US Pollution/Health Hazard/Other estimates are noted by the RMSL actuaries to have been set judgementally (i.e. in the absence of specific applicable benchmarks or other approaches, the RMSL actuaries have set their estimate of IBNR amounts at a level they deem appropriate, based on their experience). Given the level of paid and incurred development in recent years, the selected IBNR amount would appear adequate.

Australian Liabilities

6.59 There are two reserving classes in respect of Australian liabilities: Asbestos and Non-Asbestos. The Non-Asbestos class is the larger of the two with an unpaid claims estimate of $14.2 million. $8.2 million of this is in respect of outstanding claims, with much of this relating to just two personal injury claims that have been reserved to ultimate based on actuarial modelling.

6.60 The $6 million IBNR estimate is noted to have been set judgementally and is intended to allow for a number of small claims to emerge over time.

6.61 The Australian asbestos claims are a relatively smaller component of the unpaid claims estimates, amounting to $3.6 million. Of this amount, $0.6 million relates to claims outstanding (all in respect of inwards reinsurance business) and $3 million is IBNR. There has been minimal incurred claims development in the last few years and, as such, the IBNR estimate made would appear to be adequate.

Other classes

6.62 The remaining classes are Balance of Account, Colbourne and Catastrophe XoL.

6.63 Balance of Account covers any claims that are not included within any of the specific reserving groups. For this class, outstanding claims amount to $1.4 million and the IBNR has been judgementally set at twice this amount. Incurred movements on this account have been minimal for over a decade and it would appear unlikely that this IBNR amount would prove inadequate.

6.64 The Catastrophe XoL class relates to historical catastrophe claims that have gone into the London Market excess of loss reinsurance spiral[11]. Much of the outstanding reserve for these claims is thought to be redundant and so negative IBNR amounts have been allowed for.

6.65 Colborne relates to a portfolio written via the Lennox Agency between 1981 and 1991 that was transferred into NRG in 2017. Reserves for this business, which are in respect of a mixture of APH and non-APH (mainly catastrophe) claims, are now small relative to other classes, and have grown smaller since acquisition due to commutations.

6.66 In addition to estimates for the specific reserving classes, the RMSL actuaries have also included a non-specific IBNR load of $4 million. This is intended to allow for any unknown coverages and claim types that could occur. The selection of this amount is entirely judgemental.

Solvency II TPs

6.67 I have also reviewed the adjustments that the RMSL actuaries have made to their unpaid claims estimates as at 31 May 2021 in order to estimate their TPs as at 30 June 2021, as used in their revised standard formula SCR calculations as at that date. I note the following:

- The estimates have not been rolled-forward for payments made in June 2021, although these are not expected to be material.
- An explicit ENID loading has not been added. However, this is offset by the existence of a non-class specific IBNR load of $4 million (which equates to about 4.5% of net reserves), as explained in paragraph 6.66.
- Cash flow patterns have been estimated for each major class/currency to facilitate discounting. These patterns extend out to 2065 for asbestos classes.
- Provisions have been added to cover the expenses involved in running-off the business.
- In order to assess the likelihood of the FABO claims exceeding the limit of the Columbia Reinsurance contract, stochastic modelling has been undertaken (similar to that of TMNF in relation to the Reinsurance Agreement as discussed in paragraph 6.33 above). Given the extensive limit afforded by the Columbia Reinsurance, very few simulations show a loss above the limit, meaning that the addition to the net reserve to allow for the very low probability of the Columbia Reinsurance being exhausted is relatively small.
- The risk margin that has been added to the TPs has been calculated according to a standard approach of calculating the cost of capital of holding the SCR over the course of the expected run-off of the business.

6.68 Table 6.3 below summarises both the unpaid claims estimates from the 31 May 2021 actuarial report and the TPs, calculated as at 30 June 2021. Note that figures in NRG's 31 May 2021 actuarial report are presented in US dollars, whereas it reports in British pounds. I have therefore converted the figures from its actuarial report to British pounds for comparison purposes with the TPs.

[11] *The London Market excess of loss reinsurance spiral was a phenomenon that occurred in the London reinsurance market in the 1980s whereby reinsurers reinsured the same risks between themselves. It eventually collapsed as a results of a series of catastrophe claims in the late 1980s.*

TABLE 6.3 ACTUARIAL UNPAID CLAIMS ESTIMATES AND TPS AS AT 30 JUNE 2021 ($'000)

	GROSS	NET
Estimated unpaid claims 31/5/21 $	114,527	92,159
Estimate rolled forward to 30/6/21 $	114,527	92,159
Estimate rolled forward to 30/6/21 £	**82,770**	**66,605**
Best estimate TPs £	81,285	65,386
Risk Margin £	27,234	27,234
Total TPs £	**108,519**	**92,620**

Converted using exchange rate of £1 = $1.384

Conclusion with regard to the reserve strength of NRG pre-Scheme

6.69 **Based on my review, as described above, of the actuarial unpaid claims estimates of NRG as at 31 May 2021, I have concluded that**

- **the methodologies and major assumptions underlying the reserve analyses as performed by the RMSL actuarial team on behalf of NRG as at 31 May 2021 are reasonable; and**
- **the resulting best estimates of unpaid claim amounts also appear reasonable.**

6.70 **I also conclude that the provisions currently shown in NRG's management account as at 30 June 2021, which include a margin over and above the actuarial best estimates when rolled forward to 30 June 2021, are reasonable, although I note that the reserves held are likely to be reduced when NRG produces its GAAP accounts for the 2021 year-end, in the light of the result of the 31 May 2021 actuarial review.**

6.71 **I have further concluded that the revised TPs for NRG as at 30 June 2021 that have been shared with me (based on the 31 May 2021 actuarial review) appear reasonable.**

RESERVE STRENGTH OF TMNF (POST-SCHEME)

6.72 The proposed Scheme will result in a very small decrease to the gross liabilities of TMNF, as the transferring liabilities representing less than 0.3% of the TMNF's reserves for outstanding losses and claims, and no change to the net liabilities of TMNF. Therefore, in my opinion the financial effect of the proposed Scheme on the reserve strength enjoyed by the policyholders of TMNF will be *de minimis* and their reserve strength is effectively unchanged on both pre- and post-Scheme positions.

6.73 If the Scheme is effected (and subject to there being no Excluded Policies), there will be no remaining insurance business within the London Branch of TMNF and therefore, post-Scheme, claims reserves on both a gross and net basis will be nil.

Conclusion with regard to the strength of TMNF's technical provisions post-Scheme

6.74 **I therefore conclude that implementation of the Scheme will cause no material change in the strength of TMNF's reserves.**

RESERVE STRENGTH OF NRG (POST-SCHEME)

6.75 In relation to its existing business, there is no reason to think that the Scheme would have any impact on the strength of the reserves assessed by the actuarial team, or those booked by the NRG.

6.76 NRG has used the unpaid claims estimates made by the external actuaries for TMNF, which I have commented upon above, as the basis for its financial projections post-Scheme on a gross of reinsurance basis. Where these have been used to derive TPs on a Solvency II basis, these are essentially the same as used by TMNF, albeit that they have been rolled-forward for payments, and for the reasons discussed above, I believe that these are reasonable for the purpose of use in NRG's Solvency II reporting.

6.77 Post the implementation of the Scheme, NRG will continue with its policy of reserving at an 80% confidence level, for the purpose of preparing its GAAP accounts. NRG has provided me with some projections of its GAAP accounts into the future that incorporate the TMNF business. For the purpose of these projections, the basis of the TMNF reserves are figures booked by NICO. I also note that these amounts are broadly consistent with the 80th percentile of reserves for the Transferring Business as per separate projections made by NRG for the purpose of estimating its Own Economic Capital Requirement (**"OECR"**) (as discussed below).

Conclusion with regard to the strength of NRG's technical provisions post-Scheme

6.78 **I therefore conclude that, although the implementation of the Scheme will cause the gross of reinsurance reserves of NRG to increase significantly, it should cause no change in the strength of either NRG's reserves on a GAAP basis or NRG's TPs.**

EXCESS ASSETS OF TMNF

6.79 Prior to the Scheme, although the London Branch must maintain capital to meet regulatory solvency capital requirements in the UK, the London Branch is not a distinct legal entity, rather it is a part of TMNF and so the Transferring Policyholders are subject to the security levels of TMNF (generally), and not to the security of the London Branch in isolation.

6.80 In assessing the level of security afforded by TMNF to its policyholders, I have taken account of the balance sheet strength of TMNF, as set out in its audited financial accounts as at 31 March 2021, its regulatory solvency margin and its credit rating.

6.81 As noted in paragraph 4.10 above, on a consolidated basis as at 31 March 2021, TMNF had a Solvency Margin of ¥4.8 trillion and a total Risks amount of ¥1.2 trillion. This can be expressed as a Capital Cover Ratio of about 380%. This would make TMNF a "very well-capitalised" company according to the definitions in paragraph 6.5 above.

6.82 I note that regulatory capital requirements in Japan are not directly comparable to those in the UK under the Solvency II regime. In particular, whereas the Solvency II SCR is calibrated to a 99.5% confidence level over a one-year time horizon, the individual component charges of the "risk amount" under the Japanese regime are calibrated to confidence levels that vary between 95% and 99.5% (also over a one-year time horizon). Therefore, the calibration is, in general and overall, at a lower confidence level than under Solvency II.

6.83 TMNF has provided me with extracts from the Tokio Marine group 2020 ORSA report. This includes its own economic solvency assessments for the group and constituent companies. The economic solvency assessments are made at a very high confidence level of 99.95% over a one-year time horizon. Relative to these assessments, the group would be categorised as well-capitalised. However, based on indicative figures provided to me by TMNF at a confidence level of 99.5%, it would be categorised as a very well capitalised company.

6.84 I note that TMNF is the largest component of the Tokio Marine group. On a consolidated basis, as at 31 March 2021 the Tokio Marine group's Solvency Margin amounted to ¥6.0 trillion (compared to ¥4.8 trillion for TMNF alone) and its Risk amount under the Japanese solvency regime ¥1.3 trillion (compared to ¥1.2 trillion for TMNF alone). TMNF therefore accounts for much of the risk exposure of the group as a whole, but Tokio Marine has more assets relative to its risk exposure resulting in a stronger Capital Cover Ratio than for TMNF.

6.85 For the purpose of undertaking a comparative analysis of the solvency position enjoyed by policyholders of TMNF pre- and post-Scheme, I have assumed that TMNF's financial strength can be considered to be equivalent to that of a very well-capitalised company on a Solvency II basis. If TMNF were to undertake solvency capital calculations on a strict Solvency II basis, it may be that the resulting Capital Cover Ratio would be less than the threshold for meeting the definition of very well-capitalised. However, if that were the case, it would only strengthen the conclusions I have made herein with regard to the impact of the Scheme on Transferring Policyholders (given that I conclude below that NRG is a very well-capitalised company and will continue to be after the Effective Date). As such, I do not believe any benefit would be gained from a more detailed review of the capital calculations of TMNF, or from attempting to calculate a Solvency II basis SCR for TMNF.

6.86 TMNF is also strongly rated by both Standard & Poor's and A.M. Best, which, as at July 2021 had given TMNF financial strength ratings or A+ and A++ respectively.

6.87 As is detailed in paragraph 4.53 above, as at 31 March 2021, the London Branch of TMNF calculated a Capital Cover Ratio relative to its Solvency II SCR of about 260%. Therefore, on this measure, the London Branch can be described as very well-capitalised. However, as noted above, the London Branch is not a distinct legal entity and its policyholders are subject to the security levels of TMNF (generally), and not to the security of the London Branch in isolation.

Conclusion regarding the excess assets of TMNF

6.88 **Based on my review of the financial statements, regulatory solvency margin and credit ratings of TMNF, as outlined above, my view is that TMNF is a large, very well-capitalised and diversified company.**

EXCESS ASSETS OF NRG PRE-SCHEME

6.89 In assessing its SCR for regulatory purposes, NRG uses the Standard Formula. As noted in paragraph 3.29 above, the Standard Formula SCR is an estimate of the amount of capital required to ensure continued solvency over a one-year time horizon with a probability of 99.5%. The Standard Formula considers the following risks which are relevant to NRG and calculates a capital requirement for each. These capital requirements are then aggregated using an approach that allows for diversification between some of the risks.

- Non-life reserve risk;
- Market risk, including currency risk;
- Counterparty default risk; and
- Operational risk.

6.90 To measure solvency under Solvency II, the SCR is compared against the EOF to cover the SCR of an insurer. In the case of NRG, its EOF is equal to its excess of assets over liabilities in its Solvency II balance sheet. NRG does not make use of any ancillary own funds items, or other non-Tier 1 capital, to cover its SCR. The ratio of EOF to SCR is an example of a Capital Cover Ratio.

6.91 NRG most recently published publicly its Standard Formula SCR and EOF within its 2020 SFCR, published in early 2021. This shows that, as at 31 December 2020, NRG was a very well-capitalised insurer relative to its regulatory SCR, with a Capital Cover Ratio of 335%.

6.92 NRG has provided me with an updated version of its Standard Formula SCR calculation as at 30 June 2021, which considers both the actuarial review of its reserves as at 31 May 2021, and the Columbia Reinsurance. I note that this is different from the Standard Formula SCR as submitted within NRG's QRTs as at 30 June 2021. This indicates that NRG remained very well-capitalised as at 30 June 2021, with an increased Capital Cover Ratio of 425%. This reflects an increase in EOF due to the reserve release resulting from the actuarial review, and a decrease in SCR due to the introduction of the Columbia Reinsurance. Compared to the position as at 31 December 2020, underwriting risk has reduced due to the aforementioned Columbia Reinsurance and reserve release.

6.93 The most significant component of NRG's Solvency II SCR as at 30 June 2021 is reserve risk, being 62% of the SCR, prior to application of diversification benefits. As at the same date, market risk, counterparty default risk, and operational risk were 33%, 1% and 4% respectively of the Standard Formula SCR prior to application of diversification benefits.

6.94 Non-life reserve risk relates to the risk that NRG's best estimate claims provision (see paragraph 3.27, above) on a Solvency II basis proves to be inadequate over a one-year time horizon. NRG's second largest risk, currency risk, relates to the risk that an adverse movement in rates of foreign exchange reduces the capital resources of NRG.

6.95 Within the report entitled *"ORSA Report Own Risk and Solvency Assessment NRG Victory Reinsurance Limited",* dated 22 October 2020 ("**NRG 2020 ORSA**"), NRG management confirms that it believes the use of the Standard Formula is appropriate for the regulatory capital purposes, but that it also monitors solvency on an OECR basis that includes a number of adjustments to the Standard Formula that are intended to address deviations in its own risk profile from that of the Standard Formula.

6.96 NRG has identified the following as the key deviations between its own risk profile and the Standard Formula:

- The Standard Formula SCR is calibrated at a 99.5% confidence level (i.e. 1 in 200) over a one-year time horizon basis. As NRG's liabilities are long-tailed in nature, a one-year view of reserve risk will underestimate the full extent of the uncertainty present in its estimates of unpaid claim liabilities. NRG believes that an "ultimate" time horizon view, based on settling all unpaid claim liabilities over whatever time horizon is necessary, is more appropriate for understanding NRG's underwriting risk.

- NRG's currency risk strategy is to retain excess assets over its liabilities in each of the currencies in which it operates. As such, NRG does not believe that movements in foreign exchange rates will have an adverse impact on NRG's ability to pay claims, and so believes that no capital requirement for currency risk is required. I note that, as at 31 December 2020, this was achieved for all currencies other than for Australian Dollars, for which NRG had a small shortfall in its excess assets.

6.97 NRG has described its OECR in the NRG 2020 ORSA. When calculating its OECR, NRG has made the following adjustments to the Standard Formula.

- NRG has calculated its underwriting risk based on an internally modelled assessment of the cost of settling its unpaid liabilities such that there is only a 1 in 40 chance (i.e. 97.5%) of the estimate being insufficient to pay all claims on an ultimate time-horizon basis. This leads to a capital requirement which is greater than the capital requirement for underwriting risk under the Standard Formula. The change in the confidence level used from 1 in 200 to 1 in 40 is more than offset by the increase in uncertainty over an ultimate time horizon compared to a one-year time horizon basis.
- NRG has eliminated currency risk. In respect of other market risks, NRG retains the Standard Formula approach.

6.98 NRG has considered which parts of its risk profile are not captured by the Standard Formula. It has identified reputation risk, legal and environmental risk, and strategy risk. NRG considers these risks to be explicitly monitored via the risk management and control reporting, and considers these risks are appropriately managed. NRG has not added any additional capital requirements within its OECR in respect of these risks.

6.99 As at 30 June 2021, NRG has calculated its OECR to be £56.4 million (as compared to its Standard Formula SCR of £48.2 million). For OECR purposes, NRG has calculated its net assets on the same basis as its EOFs, except that it has not included a risk margin. This means that net assets on an OECR basis amounted to £175.4 million, giving a Capital Cover Ratio of 411%. On this measure, NRG can therefore also be considered a very well-capitalised company.

6.100 I believe that, overall, NRG's approach to its OECR is reasonable, for the following reasons:

- For a company with long-tailed liabilities, looking at risk on an ultimate basis is sensible.
- The choice of using a 97.5% confidence level is typical of run-off firms with longer tailed liabilities and was, in fact, the standard approach in the UK for assessing regulatory capital for such firms prior to the introduction of Solvency II.
- Its use of the SCR outputs for most of the other risk charges is a pragmatic one and, as these appear to be reasonable for their purpose, an alternative approach would likely be of limited benefit.
- Discarding the currency risk charge is questionable, although the SCR approach does lead to higher risk charges if all of the company's surplus capital is not held in the home currency. In the case of NRG, it holds surplus capital across the main currencies in which its liabilities are denominated. This means that, were liabilities in a particular currency to increase beyond existing reserve levels, a buffer of assets in that currency would be available to meet the excess liabilities and NRG would be less exposed to the risk of a reserve deterioration that occurred at the same time as an unfavourable exchange rate movement.
- Where reserve risk is considered on an ultimate basis, it is reasonable not to allow for a risk margin within the technical provisions.

6.101 I note that NRG uses a spreadsheet-based tool produced by the Corporation of Lloyd's for calculating the SCR and a separate spreadsheet-based stochastic model for estimating the reserve risk component of the OECR. I have not sought to independently replicate the results of these files or review all the individual calculations in detail, but I have reviewed the inputs, methodologies, major assumptions and outputs to satisfy myself that the results are reliable and not materially misstated.

Conclusion regarding the excess assets of NRG pre-Scheme

6.102 **I have explained above why I consider that NRG'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 NRG currently benefit from the financial strength provided by a very well-capitalised company.**

EXCESS ASSETS OF NRG POST-SCHEME

6.103 NRG has also provided me with a further version of its SCR and OECR calculations as at 30 June 2021 that allows for the Transferring Business on the basis that it had been transferred to NRG as at that date. In undertaking these calculations, NRG has assumed that the value of the liabilities of the Transferring Business is consistent with the reserves held by TMNF, as assessed by the external actuaries as at 31 December 2020, rolled-forward for payments to 30 June 2021.

6.104 The main impacts on the EOF and SCR of adding in the Transferring Business are as follows:

- Whilst fully reinsured, the Transferring Business gives rise to a small increase to the net technical provisions due to allowing in the best estimate calculation for scenarios where the losses exceed the limit of Reinsurance Agreement. NRG has used stochastic modelling techniques to estimate this increase. This causes a small reduction in EOF. It also leads to a small increase in the reserve risk charge in the SCR.
- Pursuant to the Framework Agreement, TMNF has committed to paying a fee of $10 million to NRG on completion of the Scheme. This more than offsets the increase in net technical provisions and, overall, the EOF therefore increase as a result of the completion of the Scheme.
- There are some relatively small increases to the interest rate and currency risk components of the market risk charge in the SCR, resulting from both the technical provision increase and receipt of the $10 million fee.
- There is a more material increase to the counterparty default risk charge in the SCR, resulting mainly as a result of the increased amount of reinsurance asset (i.e. through the Reinsurance Agreement), as well as increased counterparty default risk relating to additional cash held as a result of receipt of the $10 million fee.
- Operational risk increases quite significantly as this is calculated as a function of gross technical provisions, which increase materially due to the Transferring Business.
- Overall, the SCR increases by around 7.5%. The increase in EOF is smaller, at around 2%. This leads to a small reduction in the Capital Cover Ratio, but it is still estimated to be in excess of 400%. Note that the Solvency II Balance Sheets and SCRs pre- and post-Scheme for NRG are summarised in Table 5.4 above.

6.105 I have reviewed the changes to NRG's SCR calculation resulting from the Scheme and, although some simplifying assumptions have been made, I do not believe these to be material and I believe the SCR, as calculated, is a fair representation of what the SCR of NRG post-Scheme would have been, had the Scheme taken effect as at 30 June 2021.

6.106 NRG has also provided me with a version of its OECR, as at 30 June 2021, on the basis that the Transferring Business was transferred as at that date. As noted in paragraph 6.97 above, the main area of deviation between the OECR and SCR relates to looking at reserve risk on an ultimate basis. In the version of the OECR calculations that includes the Transferring Business, NRG has modelled the TMNF portfolio assuming that it will follow a lognormal distribution. Using this approach, it has evaluated that, at a 97.5% confidence interval, the liabilities of the Transferring Business would exceed the limit of the Reinsurance Agreement by about $23 million (£17 million), on an undiscounted basis. Allowing for diversification between lines of business and discounting for the time value of money, NRG's reserving risk charge increases by about £6 million as a result of including the Transferring Business.

6.107 I note that there is a considerable degree of judgement involved in parameterising[12] models of long-tailed liability classes, as well as in setting correlation factors between the classes that determine the extent of any diversification benefit. The approach taken by NRG in setting the reserve risk charge in its OECR is, in my experience, fairly typical of the approach taken by firms in such circumstances, and I note the approach taken to model the Transferring Business is essentially identical to that used by the external actuaries on behalf of TMNF. Notwithstanding the subjectivity involved, the reserve risk charge calculated appears reasonable.

[12] *The parameterisation of a model is the process of choosing the numerical inputs to the model such that the model best represents the real-life process that it is simulating.*

6.108 NRG does not consider that those parts of its risk profile that are not captured by the Standard Formula (reputation risk, legal and environmental risk, and strategy risk) are materially changed by the Scheme and has therefore continued to not add any additional capital requirements within its post-Scheme OECR in respect of these risks (as was the case pre-Scheme as described in paragraph 6.98 above).This does not appear unreasonable.

6.109 In paragraph 6.100 above, I explained the reasons why I believe NRG's approach to its OECR is reasonable pre-Scheme. I also believe that the modifications made to the model to allow for the Transferring Business are reasonable. Therefore, I am comfortable overall that NRG's OECR model will remain an appropriate capital model following the Scheme.

6.110 Overall, NRG's OECR increases by around 14% as a result of including the Transferring Business, and its EOF increase by just under 3%. NRG's Capital Cover Ratio on the OECR basis therefore reduces from 411% to 370%. On both the OECR and SCR bases, the effect of the Scheme on NRG's Capital Cover Ratios is relatively modest, and it comfortably remains a very well-capitalised company.

6.111 NRG has also prepared some projections of its GAAP accounts, its SCR and its OECR over the period 2021-23. This illustrates the expected movements over the period, including the developments since year-end 2020, the effect of the Scheme (which it is assumed will be effected in 2022), and general developments in the portfolio. NRG does not have any current plans to take on any other new business. As time goes on, assuming that the liabilities run-off as planned and that reserves can therefore be released, one would expect the capital requirements for the business to decrease. Absent any distribution of capital, the shareholders' funds should remain constant and the Capital Cover Ratio, on both SCR and OECR bases would increase.

6.112 **Based on my review of NRG's SCR and OECR calculations, as described above, I have concluded that NRG will continue to be a very well-capitalised company after the implementation of the Scheme.**

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

6.113 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, if the Scheme is implemented, the Transferring Policyholders will become policyholders of a company that is also expected to be very well-capitalised. Therefore, relative to the solvency capital requirements of the respective entities, the Transferring Policyholders will see no material change in the financial security afforded to them.

6.114 Post-Scheme, the payment of the Transferring Policyholders' claims will still be funded by NICO, via the transfer of the Reinsurance Agreement from TMNF to NRG. However, the security of the Transferring Policyholders' benefits will depend more significantly on NICO if the Scheme is implemented. Prior to the Scheme, even if NICO were no longer able to meet its obligations under the Scheme, as the liabilities of the Transferring Business represent only a very small part of the overall liabilities of TMNF, and are small relative to the net assets of TMNF, TMNF would comfortably be able to fund the liabilities of the Transferring Business with little detriment to its financial strength. Post the Scheme, if NICO were unable to meet its obligations then, all else being unchanged, NRG would be able to use its excess assets to fund the claims of the Transferring Business, although they would be significantly reduced, but based on calculations I have performed, I would still expect NRG to be a well-capitalised company. In any case, the likelihood of NICO being unable to meet its liabilities under the Reinsurance Agreement would appear to be remote given its very significant financial strength, as detailed from paragraph 4.101 above.

6.115 Were the liabilities of the Transferring Business to increase significantly above expectations, to the extent that the limit of the Reinsurance Agreement were breached, then that could also put financial strain on NRG, particularly as the existing liabilities of NRG include some claims of a similar nature (such as those in respect of US asbestos). Such a situation would be less likely to cause TMNF difficulties pre-Scheme as it is a relatively larger company than NRG, and its other liabilities are largely of a different, uncorrelated nature. To this extent, the Transferring Policyholders could be worse off as a result of the Scheme. However, in order to assess NRG'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 scenario tests undertaken by NRG that look at the impact on NRG's solvency position in the event of some adverse scenarios.

6.116 I do not believe that any differences in the Transferor's and Transferee's respective abilities to measure, monitor, and manage risk and to conduct their business prudently will have a materially adverse effect on the Transferring Business. As noted in paragraph 4.80 above, in the event of a material deterioration of the balance sheet of NRG, there is little scope for corrective action as NRG is entirely in run-off. A capital injection could be requested from a parent company, but there are no guarantees in place to ensure that such requests would be met. However, the likelihood of NRG needing such an injection appears to me to be very unlikely.

6.117 The NRG 2020 ORSA (carried out on data as at 31 December 2019) included a number of scenario tests. All scenario tests relate to the valuation of the unpaid claim liabilities as this represents NRG's main source of uncertainty and capital requirements. These scenarios range from scenarios that are not unlikely, such as changes in interest rate term structures, to severe and remote scenarios such as doubling reserves for asbestos claims. Under all scenarios, NRG was expected to be a well-capitalised insurer with respect to its regulatory SCR, and in all scenarios other than the aforementioned doubling of asbestos reserves, NRG was expected to be a very well-capitalised insurer. In addition, under all scenarios, NRG was expected to be sufficiently capitalised relative to its OECR.

6.118 At the time of writing, NRG's 2021 ORSA report was not available, but NRG has provided me with updates of the three most severe scenario tests, using its revised capital calculations as at 30 June 2021 as a base scenario, and on the basis that the Transferring Business had already transferred. I discuss the results of each of these scenarios below.

Scenario tests

Test 1: Claims inflation

6.119 Under this scenario, claims inflation is assumed to be 5% higher than already allowed for within the claims provisions, in each of the next 5 years, before returning to anticipated levels for the remainder of the run-off period for the claims. Inflation is clearly a significant risk for NRG. NRG's investment strategy (invested primarily in short-dated government bonds) is risk-adverse and the value of the investments should not change materially in nominal terms, but the value of these investments will not increase with inflation. Further, the limits of the reinsurance contracts benefiting NRG (in particular the Reinsurance Agreement post-Scheme) are set in nominal terms and inflation could lead to the limits being exhausted.

6.120 The scenario considered here, i.e. several years of consistently high inflation rates, is one that has not been seen in practice for around 40 years. It is impossible to predict how inflation rates will change in the future, and, although inflation rates have increased in both the US and UK recently, based on the experience seen in recent history, a sustained period of high inflation of the sort implied by this scenario would appear to be an unlikely outcome, at least in the next few years.

6.121 NRG has calculated that this scenario would increase its Solvency II TPs by around 25%, leading to a reduction in EOF of around 12%, and also an increase in its SCR of around 17%, owing, primarily, to an increase in the reserve risk charge. Overall, this scenario would reduce NRG's Capital Cover Ratio relative to its SCR from around 400% to around 300% and relative to its OECR from 370% to around 240%, but it would remain very well-capitalised on both bases.

Test 2: New liability class

6.122 This scenario considers the emergence of a class of new latent claims that would impact the policy years in question. Such a possibility cannot be ruled out, although it becomes less likely the further the portfolio moves into run-off. Any estimate of the size of such a loss is purely judgemental. For the purposes of this scenario test, NRG has assumed that the new liability class would give rise to losses of half the current size of its asbestos reserves across all its business, including the Transferring Business. I note that it has not allowed for any reinsurance recoveries on this new class of claims, although any claims associated with the Transferring Business would be covered, up to the limit, by the Reinsurance Agreement. This scenario results in the gross (and net) undiscounted best estimate reserves of NRG increasing by $58 million, which is over 30% gross and over 60% net of reinsurance. This would therefore be very material to NRG's balance sheet.

6.123 For the purpose of this test, NRG has assumed that the new liability class emerged immediately and it has calculated the impact on its capital requirements on this basis. In practice, a new liability class will not emerge immediately and this therefore adds to the extreme nature of the scenario.

6.124 NRG has calculated that this scenario would lead to a reduction in EOF of around 22%, and also an increase in its SCR of around 32% owing, primarily, to an increase in the reserve risk charge. Overall, this scenario would reduce NRG's Capital Cover Ratio relative to its SCR from around 400% to 236% and relative to its OECR from 370% to 202%, but it would remain very well-capitalised on both bases.

Test 3: Doubling of asbestos reserves

6.125 This test considers a scenario in which very material deterioration occurs on the reserves for the asbestos claims. NRG has chosen to double the existing reserves. I would regard this scenario as being very remote. Further, NRG has chosen to assume that the reserve deterioration occurs immediately. In practice, it is not conceivable that reserves would need to be doubled overnight. Rather, the reasons that would cause the unpaid liabilities to double would emerge over time. Were such a scenario to occur, it would likely be caused by a combination of factors, such as materially higher than expected claims inflation over a period of many years, unfavourable judicial or legislative developments, or medical advances leading to expensive new treatments for asbestos-related diseases.

6.126 Were this scenario to occur, the limit of the Reinsurance Agreement would be breached, and, as such, the proportionate increase in the net reserves would be greater than on the gross reserves. The calculations undertaken by NRG show that its Solvency II EOF would reduce by around 28%, whilst its SCR would increase by 50%. The Capital Cover Ratio on a Solvency II basis would reduce to under 200%, but it would still be a well-capitalised company on this basis. NRG has calculated that its OECR would increase more significantly, owing to a greater impact on the reserve risk charge, by around 140%. The Capital Cover Ratio on this basis would fall to just over 120%, meaning that NRG would then be a "more than sufficiently capitalised" company.

6.127 I note that, in the event that asbestos reserves needed to be doubled, this would also lead to a significant impact on the balance sheet of NICO. However, I do not believe that this would, in itself, lead to NICO's inability to make payments under the Reinsurance Agreement, given that, as discussed from paragraph 4.99 above, the asbestos reserves, whilst significant, are a minority of the reserves held by NICO, the retrospective reinsurance contract have been written with aggregate limits thus limiting the potential impact from reserve reductions, and the fact that NICO has very significant excess assets, to the extent that its total net carried reserves as at 31 December 2020 could more than treble before it became insolvent.

Conclusion of Scenario Tests

6.128 The scenario tests set out above describe the effect of a range of adverse outcomes impacting the reserves of NRG. As commented on above, the scenarios range in their extremity. Scenario 3 (doubling of asbestos reserves) has the most extreme impact on the reserves of NRG. It is a scenario that I would regard as very remote, more so because it is assumed to occur immediately. Nevertheless, under this scenario (as well as the other scenarios considered), NRG would not only remain solvent, but would also continue to be able to meet comfortably both its regulatory capital requirements and OECR.

6.129 As I believe the scenario tests undertaken by NRG, as described above, consider a suitable range of scenarios that cover the most material sources of uncertainty to which it is exposed, I have not undertaken any stress or scenario testing of my own, nor have I asked NRG to undertake any further tests. The scenario tests have shown that, although NRG is a considerably smaller, less diversified company than TMNF, its financial strength is nevertheless sufficient to withstand extremely adverse outcomes. I therefore believe this illustrates that there will not be any materially adverse impact in the financial security enjoyed by the Transferring Policyholders as a result of the Scheme.

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

6.130 **I am therefore satisfied that the Transferring Policyholders will not be materially adversely affected due to relative differences in the financial strength of NRG post-Scheme and of TMNF pre-Scheme.**

CHANGES IN RISK EXPOSURES

6.131 If the Scheme is sanctioned, the Transferring Policyholders will move from a large, well-diversified insurer whose liabilities are mainly quite different to those of the Transferring Business to a smaller insurer whose portfolio is more concentrated and includes a significant amount of business that is of a similar type to the Transferring Business. As a result of this reduction in risk diversification, the Transferring Policyholders will be adversely impacted as a result of the Scheme; however, I do not believe this to be material for the following reasons:

- In practice, both pre- and post-Scheme, the liabilities of the Transferring Business are paid by NICO, which is a very large and financially strong insurer, as has been described above. The Transferring Policyholders' exposure to the risks of NICO will not change as a result of the Scheme.
- In the event that the NICO reinsurance fails, or is exhausted, the Transferring Policyholders would become more materially exposed to the other risks of NRG. However, as discussed above (in paragraph 6.114 in relation to the failure of NICO, as well as the 3 scenario tests), although the Transferring Policyholders would be adversely affected in those scenarios, even in the most extreme of the scenario tests considered above (which would lead to the Reinsurance Agreement being exhausted), I would expect NRG to still be able to comfortably meet its obligations to its policyholders, including the Transferring Policyholders.
- As discussed from paragraph 6.140 below, the claims will continue to be handled by the same staff post-Scheme as pre-Scheme, so there is no reason to think that any change in risk exposures would adversely affect service levels.

6.132 I also note that, if the Scheme is sanctioned, the Transferring Policyholders will become more exposed to Berkshire Hathaway. Currently, the Transferring Policyholders are exposed to Berkshire Hathaway only through its subsidiary NICO's reinsurance of the Transferring Business. If the Scheme is sanctioned then they will continue to be exposed to Berkshire Hathaway, as before, through the reinsurance with NICO, but also directly as policyholders of NRG, which is another subsidiary of Berkshire Hathaway. I do not believe that this increased exposure to the risks of Berkshire Hathaway (and the group of companies that it owns) will materially adversely affect the Transferring Policyholders. This is because Berkshire Hathaway is a very large, diversified and financially strong conglomerate holding company (it has a credit rating of AA with Standard and Poor's), and also because NRG (like NICO), whilst being ultimately owned by Berkshire Hathaway, is a distinct legal entity that must satisfy its own regulatory capital requirements. If Berkshire Hathaway wanted to extract capital from NRG, as a firm in run-off, the directors of NRG would need to make a request to the PRA for its non-objection. They would also need to comply with specific guidance regarding such extractions, as issued by the PRA, that aims to ensure that, after such capital extraction, run-off companies maintain an adequate financial position for the full run-off of the business. Therefore, even if there were difficulties in another part of the Berkshire Hathaway group, it would not necessarily directly affect NRG.

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

6.133 **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

6.134 In this subsection of the Report, I consider the effect on the Transferring Policyholders of either TMNF or NRG becoming insolvent, pre-Scheme and post-Scheme. I then compare the effects pre- and post-Scheme to determine the effect of the Scheme on the Transferring Policyholders in the event of insolvency.

6.135 As described in paragraph 3.51 above, under Japanese law, direct and reinsurance policyholders have equal priority in the event that a firm is subject to insolvency. Based on advice set out by TMNF's legal advisers in relation to the Scheme, I understand that, as a matter of Japanese law, if TMNF were to enter into insolvency proceedings in Japan then the policyholders of the London Branch would be treated the same as other policyholders of TMNF. On this basis, pre-Scheme, all Transferring Policyholders (the vast majority of which are reinsurance policyholders) would rank alongside all other policyholders of TMNF (the vast majority of which are direct policyholders).

6.136 However, if formal insolvency proceedings were opened in respect of TMNF in Japan, TMNF's legal advisers have advised that the English courts would likely recognise and assist those proceedings. In doing so, the court may order the transfer of TMNF's English assets to the insolvency officeholders appointed in Japan. TMNF's legal advisers have advised that it is possible that, as a condition of any transfer to the Japanese insolvency officeholder, the English court could require the small number of direct policyholders of the Transferring Business to be afforded an equivalent level of priority in the Japanese insolvency process as they would be in an English insolvency (in which insurance debts are given priority over general unsecured debts, including reinsurance debts). The legal advisers also noted that, if there were an ancillary liquidation in England, it would be possible that the English liquidator's role could extend to collecting the English assets, settling English creditors and transferring the balance to the Japanese liquidation. In this case, the starting point would be that the English insurance debts would have priority over general debts, including reinsurance debts, which would lead to the small number of direct policyholders having priority over the reinsurance policyholders. It is therefore unclear whether or not the direct policyholders of the Transferring Business would get priority over the reinsurance policyholders in the event of the insolvency of TMNF pre-Scheme.

6.137 Post-Scheme, were NRG to become insolvent, under English law, the direct policyholders would receive priority over reinsurance policyholders. Therefore, the vast majority of the Transferring Policyholders would rank behind the existing direct policyholders of NRG. It follows that were NRG to become insolvent post-Scheme, the reinsurance policyholders of the Transferring Business may be in a less favourable position than pre-Scheme, were TMNF to become insolvent.

6.138 However, as has been discussed above, post-Scheme NRG will continue to be a very well-capitalised company and, as illustrated through the scenario tests, will be able to continue to meet its obligations to policyholders even in some very adverse circumstances. Therefore, the insolvency of NRG post-Scheme would presently appear to be a remote possibility.

Conclusion regarding the effect of the Scheme on the Transferring Policyholders in the event of the insolvency of either TMNF or NRG

6.139 **I am therefore 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 either TMNF or NRG.**

POLICY SERVICING

6.140 As explained from paragraph 5.13 above, the administration of the Transferring Business will be essentially unchanged as a result of the Scheme. Claims will continue to be handled by RMI and RMSL and there will be no change to claims systems or processes. The management of NRG has confirmed to me that there is no intention to change the approach to claims handling after the implementation of the Scheme. The only material difference will be that the involvement of TMNF, whose agreement had been required prior to making commutations, *ex gratia* payments and settlements over $500,000, will fall away.

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

6.141 **Because there are no material intended post-Scheme changes to the policy administration arrangements, the policy administration systems or policy administration personnel, I believe that the Scheme will not have a materially adverse impact on the standards of policy servicing experienced by the Transferring Policyholders compared to their current position.**

COMPENSATION AND COMPLAINTS

6.142 I have explained in Section 3 above, that certain UK policyholders would qualify for compensation from the FSCS in the event of the insolvency of their insurer, and I also explained that certain UK policyholders would be able to access the FOS in the event of a dispute with their insurer. I further explained that policyholder protection corporations exist in Japan and that the General Insurance ADR Center exists to provide mediation services for certain policyholders with complaints against their insurer.

6.143 As the Transferring Policyholders are mainly reinsurance policyholders, and the remaining direct insurance policyholders are large corporations, none of the Transferring Policyholders currently qualify for access to any of the compensation or complaints schemes in either the UK or Japan, and will not qualify for access if the Scheme is implemented. As such, there will be no change in this regard as a result of the Scheme.

CONCLUSION FOR THE TRANSFERRING POLICYHOLDERS

6.144 **I am satisfied that the Scheme will not affect in a materially adverse way either the security or the policy servicing levels of the Transferring Policyholders.**

7. The impact of the Scheme on the policyholders of TMNF not transferring to NRG under the Scheme

7.1 In this section of the Report, I consider the impact of the Scheme on the TMNF Non-Transferring Policyholders. This group of policyholders consists of the existing policyholders of TMNF, excluding those of the London Branch. I also consider in this section the position of holders of Excluded Policies, should there be any.

7.2 Post the Effective Date, the position of the TMNF Non-Transferring Policyholders will be very little changed from that before the Effective Date. As has been discussed above, the Transferring Business represents only a very small part of the existing gross reserves of TMNF, and nil on a net of reinsurance basis. The implementation of the Scheme will lead to TMNF paying a $10 million fee to NRG, but this amount is very small in relation to the overall assets of TMNF. The TMNF Non-Transferring Policyholders will therefore experience essentially no change in the financial security to their benefits provided by TMNF as a result of the Scheme.

7.3 There will be no changes to the policy administration of the TMNF Non-Transferring Policyholders as a result of the Scheme.

7.4 If there are any Excluded Policies post the Effective Date then these will remain in TMNF. Although they will no longer be reinsured under the Reinsurance Agreement (as the benefit of that would have transferred to NRG), as described in paragraph 5.11, above, they will, pursuant to the Framework Agreement, benefit from an indemnity provided by NRG (and guaranteed by NICO), and the administration of those policies will continue to be undertaken by RMI or RMSL. As such, the position of any Excluded Policies would be very similar to that before the Scheme.

CONCLUSION FOR THE POLICYHOLDERS OF TMNF NOT TRANSFERRING UNDER THE SCHEME

7.5 **I am satisfied that the Scheme will not affect in a materially adverse way either the security or the standards of policy servicing currently enjoyed by the TMNF Non-Transferring Policyholders, and by any holders of policies that become Excluded Policies.**

8. The impact of the Scheme on the existing NRG policyholders

8.1 In this Section, I consider the impact of the Scheme on the existing policyholders of NRG.

RELATIVE FINANCIAL STRENGTH ENJOYED BY THE EXISTING NRG POLICYHOLDERS PRE- AND POST-SCHEME

8.2 I have concluded in paragraph 6.102 above that the existing NRG policyholders currently benefit from the financial strength provided by a very well-capitalised company. NRG's estimates of its Capital Cover Ratios, assuming the successful completion of the Scheme, suggest that NRG will continue to be a very well-capitalised company after the Scheme Effective Date, although its Capital Cover Ratios (relative to both SCR and OECR) will be slightly reduced. Given that the reduction in Capital Cover Ratios is only slight, and that they will still be very high (i.e. significantly above the threshold for a very well-capitalised company), I do not regard this reduction in Capital Cover Ratios to be materially adverse to the existing NRG policyholders. Furthermore, the scenario tests undertaken, as described in Section 6 above, have illustrated that, even with the additional risks associated with the Transferring Business, NRG's financial position is robust enough to withstand remote outcomes and still meet its SCR and OECR.

Conclusion regarding the impact of the Scheme on the financial security of existing NRG policyholders

8.3 **I am therefore satisfied that the existing policyholders of NRG will not be materially adversely affected due to relative differences in the financial strength of NRG pre-Scheme and post-Scheme.**

CHANGES IN RISK EXPOSURES

8.4 Post-Scheme, the existing policyholders of NRG will become exposed to the risks of the Transferring Business. The gross liabilities of the Transferring Business are predominantly US APH claims. US APH claims already make-up around 20% of the existing NRG portfolio, and APH claims more generally about 60% of the portfolio. After the Scheme is implemented, NRG's gross liabilities will be more concentrated in APH claims, with claims from the US becoming predominant.

8.5 As the Transferring Business is reinsured into NICO, the existing policyholders will become exposed to counterparty default risk with NICO. However, as I have described in more detail from paragraph 4.97 above, NICO is both large and financially strong. As at 31 December 2020, it had total assets of $317.4 billion, with assets available to meet its capital requirements under the RBC regime of $189.4 billion. Its Capital Cover Ratio relative to its RBC capital requirements was 214%, making it a very well-capitalised company. Furthermore, NICO had financial strength ratings from Standard & Poor's of AA+, and A.M. Best of A++. I therefore regard the counterparty default risk associated with the NICO reinsurance as being slight.

8.6 The Scheme will make the liabilities of NRG more concentrated in APH exposures, albeit that NRG is currently already heavily exposed to APH claims. This reduced diversification does potentially leave the NRG policyholders more exposed to the risk of a material increase in APH claim costs. However, as has been shown in the scenario tests in Section 6, even in the event that the reserves for asbestos claims were doubled, the financial resources of NRG are such that it should be still be a well-capitalised company relative to its SCR. As such, I do not believe that the changes in risk exposures resulting from the Scheme will materially adversely affect the existing policyholders of NRG.

Conclusion regarding the effect of the Scheme on the existing NRG policyholders' exposure to risk

8.7 **I am satisfied that any changes in risk exposures resulting from the Scheme will not materially adversely affect the existing policyholders of NRG.**

POLICY SERVICING

8.8 There will be no changes to the policy administration arrangements of either the existing NRG business or the Transferring Business as a result of the Scheme.

Conclusion regarding the effect of the Scheme on the policy serving for existing NRG policyholders

8.9 **I believe that the Scheme will not have a materially adverse impact on the standards of policy servicing experienced by the existing NRG policyholders compared to their current position.**

IN THE EVENT OF INSOLVENCY

8.10 Pre-Scheme, in the unlikely event that NRG were to become insolvent, then the existing direct policyholders of NRG would take priority over reinsurance policyholders for the payment of their claims. Post-Scheme, the existing direct policyholders of NRG would continue to take priority over reinsurance policyholders. They would be joined by a relatively small number of direct policyholders from the Transferring Business, with whom they would have to share assets, but the Transferring Policyholders are mainly reinsurance policyholders, who would rank alongside the existing reinsurance policyholders of NRG.

8.11 In any case, as has been discussed above in Section 6, NRG is a very well-capitalised company and is expected to continue to be so post the Effective Date of the Scheme. As such, the event of the insolvency of NRG would appear to be a very remote possibility.

Conclusion regarding the effect of the Scheme on the existing NRG policyholders in the event of the insolvency of NRG

8.12 **The very small likelihood of NRG becoming insolvent post-Scheme satisfies me that the existing NRG 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 NRG.**

CONCLUSION FOR THE EXISTING NRG POLICYHOLDERS

8.13 **I am satisfied that the Scheme will not affect in a materially adverse way either the financial security or the policy servicing levels of the existing NRG policyholders.**

9. Other considerations

ASSETS OF TMNF AND NRG

9.1 In addition to any rights and powers associated with the Transferring Business, the only assets that will transfer under the Scheme will be those of the outwards reinsurance contracts protecting the Transferring Business: both the Reinsurance Agreement with NICO and the third party reinsurance contracts. On the basis that the outwards reinsurance contracts are transferred as part of the Scheme, the net (of reinsurance) position of NRG should not be adversely impacted as a result of the Scheme.

9.2 As noted in paragraph 4.44 above, the Framework Agreement specifies that, upon the Scheme being effected, a fee of $10 million in cash will be paid by TMNF to NRG.

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

9.3 In this Report, I have provided details of balance sheet data for TMNF as at 31 March 2021, this being the most recent date for which audited financial information is available. With regard to NRG, the most recent date at which audited balance sheet information is available was as at 31 December 2020, and I have accordingly provided details of these figures above. However, as there have been some material developments for NRG since that time, I have chosen to use unaudited figures prepared by NRG as at 30 June 2021 as the focus of my analysis of the financial position of NRG both pre- and post-Scheme.

9.4 I expect that the current activities of both NRG and TMNF have continued, and will continue, between the dates mentioned in paragraph 9.3 and the Effective Date. TMNF has continued, and will continue until the Effective Date and beyond, to write new business, and both TMNF and NRG have continued, and will continue until the Effective Date, 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 is likely to emerge as a result of the continuation of normal business. I note that NRG has confirmed to me that it currently has no plans to write any new business or to take on any additional run-off portfolios.

9.5 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 the dates mentioned in paragraph 9.3) and hence whether there have been any developments (including those associated with current economic conditions) that would affect my overall opinion. I will report on these separately in the Supplemental Report.

MIS-SELLING LIABILITIES

9.6 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."* TMNF is unaware of any actual or potential mis-selling liabilities within its business. The Transferring Business comprises mainly reinsurance business and some direct 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 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. In any event, any liabilities relating to mis-selling have been excluded from the scope of the Scheme and will not transfer from TMNF to NRG as part of the Scheme. 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

9.7 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.

9.8 All reinsurance contracts benefiting the Transferring Business will continue to provide the same benefit post-Scheme as pre-Scheme, albeit as reinsurers of NRG rather than TMNF. The amount of the liabilities of each external reinsurer of the Transferring Business will not change as a result of the Scheme.

9.9 The Scheme will not result in any changes to the way in which recoveries under TMNF’s reinsurance programmes are administered, as these are already administered by RMSL and will continue to be so post-Scheme. I therefore have no reason to expect the Scheme to result in any change in the standards of claims handling or management.

9.10 I have considered whether the Scheme is likely to lead to any changes in the rights of "set-off"[13] for creditors or debtors of TMNF or NRG. The existing business of NRG and the Transferring Business include inwards reinsurance contracts with liability mitigated by outwards reinsurance contracts. Any mutual debits or mutual credits would be available, post-Scheme, to be set off by NRG, as if the mutual relationship always existed (this also means that any offsets that previously existed within TMNF would be lost). While NRG remains a solvent company, paying and receiving recoveries in respect of valid claims, this would not be an issue, but there is a possibility of changes in the right of set-off on the insolvency of NRG post-Scheme. However, as the likelihood of insolvency of NRG is remote (particularly in the short-term), I do not believe the right of set-off affects my conclusions on the impact of the Scheme on reinsurers.

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

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

THE APPROACH TO COMMUNICATION WITH POLICYHOLDERS

9.12 Regulation 3 of the Financial Services and Markets Act 2000 (Control of Business Transfers) (Requirements on Applicants) Regulations 2001 (as amended) (the **“2001 Regulations”**), sets out requirements for applicants to both advertise the proposed insurance business transfer and to communicate directly with policyholders and reinsurers.

9.13 With regard to advertising, under the 2001 Regulations, TMNF will need to advertise the proposed Scheme in the London, Edinburgh and Belfast Gazettes and in two national newspapers in the United Kingdom. TMNF intends to comply with this requirement. TMNF is also proposing to advertise the proposed Scheme in the Financial Times in the US.

9.14 The starting point under the 2001 Regulations with regard to direct communications is that a notice should be sent:

- to every policyholder of the parties;
- to every reinsurer whose contracts of reinsurance are to be transferred; and
- in each case where a contract has been placed through a person authorised to act on behalf of the reinsurer, or with more than one reinsurer, to the person or persons authorised to act on behalf of the reinsurer(s).

9.15 These requirements may be waived by the court in such circumstances and subject to such conditions as the court considers appropriate.

9.16 TMNF has recently undertaken a detailed review of its records relating to the Legacy Portfolio (i.e. the portfolio of business comprising the Transferring Business and a small number of policies that were not relocated to the London Branch due to the imposition, or potential imposition, of international sanctions) to ensure, as far as possible, that it has identified all policyholders associated with the Legacy Portfolio and that it has up-to-date contact details for those policyholders. It has identified a total of 1,182 distinct policyholders, 1,177 in respect of cedants and 5 in respect of direct policyholders. TMNF intends to notify 1,092 policyholders about the Scheme, leaving 90 for which it intends to apply for a waiver of the requirement to do so. These 90 include:

[13] *“Set-off” allows parties to cancel or offset mutual debts with each other by subtracting one from the other, and paying only the balance.*

- 41 for which no addresses could be found. All these cedants are inactive. In respect of 31, TMNF has found no record of any transaction in its settlement records, which go back to 1990. For the remaining 10, the majority of transactions found relate to the 1990s, with the very latest recorded in August 2005 (i.e. more than 16 years ago). Given this, and that it could find no trace of these cedants online, TMNF considers that there is a good prospect that these cedants are no longer in operation. However, as the Transferring Business was largely a broker-led business that was written through the London Market, TMNF intends to write to all of the brokers it has identified from its records. Therefore, in the unlikely event that any of the 41 cedants are still in operation, TMNF considers there to be a reasonable prospect that they may receive notice of the transfer in any event through the relevant brokers.
- 21 that relate to pool managers or underwriting agents rather than individual cedants, most of whom are no longer in operation. TMNF believes that there is a very good prospect that any individual policyholders relating to these 22 entries are duplicated in the above 1,089 company entries for whom addresses are available.
- 28 cedants with policies in Legacy Portfolio that have not been relocated to the London Branch due to the imposition, or potential imposition, of international sanctions. As noted in paragraph 4.17 above, these policies have not been relocated to the London Branch and will not be transferred under the Scheme in any case.

Given the circumstances, it appears reasonable to me for TMNF to apply for waivers in relation to these policyholders.

9.17 TMNF does not intend to notify any of its policyholders that will not transfer under the Scheme. Given the large number of non-transferring policyholders, and the relatively immaterial nature of the Transferring Business in the context of TMNF's business as a whole, I believe that this is appropriate.

9.18 NRG also does not intend to notify any of its policyholders of the Scheme. Although the Scheme will increase NRG's gross liabilities considerably, as the Transferring Business will be protected by the Reinsurance Agreement, it is NRG's view that the existing policyholders of NRG are unlikely to be materially impacted by the Scheme. Furthermore, NRG is of the view that it would not be practical or proportionate to write to all of its approximately 48,500 policyholders (located in a number of territories including significant numbers in Sweden and Norway) notifying them of the proposed transfer. As I have concluded in Section 8 above that the existing policyholders of NRG will not be materially adversely affected by the Scheme, and given the practical difficulties of communicating with large numbers of policyholders, as well as the fact that the Scheme will not cause any changes to the terms and conditions of the policies held by the existing NRG policyholders, I believe that seeking a waiver to notify the NRG policyholders is not unreasonable.

9.19 TMNF will notify all of the reinsurers of the Transferring Business, including, for completeness, NICO.

9.20 In addition, TMNF will notify 14 brokers that it has identified as being intermediaries of its policyholders as a result of its recent review of its policyholder records.

9.21 I have been provided with drafts of the communications to be sent to policyholders and brokers. I am of the view that the draft communications are clear, fair and appropriate for their intended audiences.

Conclusion regarding communication with policyholders

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

POLICYHOLDER EXPECTATIONS

9.23 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. For example, I have not considered the possible reasons that TMNF policyholders might have had in selecting TMNF as their insurance provider and whether the Scheme would invalidate those reasons. However, I note that the Transferring Business comprises wholly commercial risks. I have no reason to suspect that policyholders' expectations would (reasonably) be adversely affected to a material extent.

WHAT WOULD HAPPEN WERE THE SCHEME NOT TO PROCEED?

9.24 It is conceivable that the Scheme will not proceed. As all parties to the Scheme are committed to it proceeding, it would appear that this scenario would only occur if the Court refused to sanction the Scheme. This could, for example, arise as a result of a policyholder objecting to the Scheme. I note that, if there are any objections to the Scheme, I will comment on these in my Supplemental report.

9.25 If, for any reason, the Scheme cannot be completed, then, as soon as practicable, TMNF will repatriate its liabilities to its head office in Japan and apply to have its London Branch de-authorised. The Transferring Business would continue to be reinsured under the Reinsurance Agreement and its claims administered by RMSL and RMI as currently.

LEGAL JURISDICTION

9.26 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 of such policies to challenge the validity of the sanctioned transfer, subsequent to its effective date. TMNF has informed me that 25% of the active policies of the Transferring Business are considered likely to be governed by English law and that 41% of reserves are allocated to these policies, whereas 34% of active policies are considered likely to be governed by the law of a US state and that 54% of reserves are allocated to these policies.

9.27 Given the predominance of US business amongst the Transferring Business, TMNF has sought the opinion of US counsel on whether the Scheme will be recognised and enforced by the US Courts. The attorney providing the opinion has concluded that, if the Order to sanction the Scheme were to be challenged in a US Court, there are good grounds to believe and it is reasonable to conclude that the Order would be recognised by the US Courts on the basis of comity (i.e. the legal principle that political entities, such as states, nations, or courts from different jurisdictions, will mutually recognise each other's legislative, executive, and judicial acts).

9.28 Ultimately, so long as NRG is willing and able to pay valid claims arising from the Transferring Business after the Effective Date, it is difficult to see why any policyholder would have any incentive to challenge the Order to sanction the Scheme. As I have concluded above, the likelihood of NRG being unable to pay claims after the Scheme is very remote and there will be no change to claims handling post-Scheme, so it would appear unlikely that such circumstances would arise.

9.29 As is noted in paragraph 4.47 above, the Framework Agreement provides for the indemnification of TMNF by NRG in respect of any claims brought against TMNF in relation to the Legacy Portfolio after the Scheme becomes effective and this indemnification is guaranteed by NICO.

9.30 With regard to outward reinsurance contracts, TMNF has outwards contracts with three external reinsurers (as noted in paragraph 4.36 above) that protect the ExCo business, in addition to the Reinsurance Agreement with NICO.

9.31 With regard to the Reinsurance Agreement (which is governed by the laws of New York), as NICO is bound by the terms of the Framework Agreement, it is very difficult to envision circumstances under which NICO would challenge the Order to sanction the Scheme. Furthermore, I have been provided with a draft of a letter from NICO to TMNF and NRG (which I have been informed NICO has agreed to sign), in which it undertakes to be bound by the terms of the Scheme.

9.32 With regard to the external reinsurance contracts, I am informed by TMNF that no physical copies of the original contracts have been kept by TMNF, but these contracts are regarded as, in practice, being governed by English law. While I am informed that some of the underlying reinsurance contracts written by ExCo in the 1960s and 1970s are expressly stated to be governed by English law, others do not have an express governing law clause. However, those policies do have an arbitration clause that states that the seat of arbitration is London. Therefore, those policies would also likely be considered by an English court to be governed by English law. Given the proportional nature of the retrocession contracts, it is likely that they would have followed the original terms. Even in the, apparently unlikely, event of the external reinsurance contracts not being successfully transferred under the Scheme, and the expected recoveries under them being lost, as the expected recoveries are not expected to be significant relative to the gross liabilities (i.e. less than 2%) and the fact that any loss would be covered by the Reinsurance Agreement, this would not have a materially adverse impact on the financial position of NRG post-Scheme.

TAX

9.33 There are not expected to be material tax implications arising from the Scheme. As the Scheme has been structured as a Transfer of a Going Concern, no VAT will be levied on the transaction. NRG has provided me with correspondence from HM Customs and Revenue indicating that NRG has demonstrated that the relevant conditions for the Transfer of a Going Concern have been met.

IMPACT OF THE COVID-19 PANDEMIC

9.34 As noted in paragraph 4.95 above, from an operational perspective, NRG has been able to operate satisfactorily during the COVID-19 pandemic and I have no reason to believe that the existence of the pandemic alters materially the impact of the Scheme on any affected policyholders in this regard.

9.35 Although neither the Transferring Business nor the existing business of NRG has any direct exposure to claims resulting from the pandemic, the pandemic does give rise to some uncertainty in the claims amounts, as is noted in paragraph 6.30 in the context of the reserves for the Transferring Business, through changes in reporting patterns and through higher mortality in potential claimants. However, in the context of claims with reporting patterns that are very long tailed, I do not believe that any changes in reporting patterns in the short term are likely to lead to material additional uncertainty, and, in my view, any mortality changes could be beneficial to reserving. As such, I do not believe that the uncertainty created by the pandemic on reserves alters materially the impact of the Scheme on any affected policyholders. Nevertheless, the implications of the pandemic remain uncertain and, to the extent that there is any change to the position set out above prior to the completion of the Scheme, I will address this in my supplemental report.

COSTS OF THE SCHEME

9.36 TMNF has provided me with an estimate of the external costs of the Scheme, including the costs of establishing the London Branch, all of which will be met by TMNF. These costs are not such as to affect the solvency of TMNF or the security of any group of policyholders.

10. Final conclusions

10.1 In summary, in my opinion, provided the proposed Scheme operates 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 TMNF (both those policyholders being transferred under the Scheme and those who will remain, post-Scheme, policyholders of TMNF) or NRG; and
- the Scheme will not have any impact on service standards experienced by the policyholders of either TMNF (both those policyholders being transferred under the Scheme and those who will remain, post-Scheme, policyholders of TMNF) or NRG.

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 on behalf of TMNF and NRG, which I have reviewed based on my own experience and judgement. 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 TMNF and NRG having adopted alternative plausible assumptions.
- I have not considered alternative arrangements, other than what would happen were the Scheme not to proceed.

Christopher Clarke
Fellow of the Institute and Faculty of Actuaries

4 April 2022

Appendix A Definitions

TERM	DEFINITION
2001 Regulations	Financial Services and Markets Act 2000 (Control of Business Transfers) (Requirements on Applicants) Regulations 2001 (as amended).
Active Cedants	Cedants of TMNF in respect of which, as at 31 December 2020, policies has been identified on which there was an actual claim reported or a claim could still potentially be reported by the cedant.
Administrative Services	A term used in the Reinsurance Agreement to define the scope of the administration services NICO must perform.
APH	Asbestos, pollution, health hazard.
AWP	The UK Asbestos Working Party, a working party of the Institute and Faculty of Actuaries.
BDI	Buildings Defect Insurance.
Berkshire Hathaway	Berkshire Hathaway, Inc
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.
Capital Cover Ratio	The ratio of available capital to required capital under a particular solvency capital regime.
Colbourne	Colbourne Insurance Company Limited.
Columbia	Columbia Insurance Company.
Columbia Reinsurance	A loss portfolio transfer agreement effected as at 1 January 2021, between NRG and Columbia in relation to the FABO business.
Companies	The collective term for TMNF and NRG.
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).
Court	The High Court of Justice of England and Wales.
CWI	Completion Warranty Insurance.
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.
EOF	Eligible Own Funds, i.e. the funds available in an insurer to meet its regulatory SCR.
EU	European Union.
Excluded Policy	A contract of insurance written or assumed by TMNF 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.
ExCo	Excess Insurance Company Limited (UK).
FABO	Swedish insurance company Försäkringsaktiebolaget Bostadsgaranti.
FCA	The Financial Conduct Authority ("FCA") 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.
FOS	The Financial Ombudsman Service. Established in 2000, and given statutory powers in 2001 by FSMA, it helps settle disputes between consumers and UK-based businesses providing financial services, such as banks, building societies, insurance companies, investment firms, financial advisers and finance companies.

Framework Agreement	An agreement entered into between TMNF, NICO, NRG and RML in 2018.
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, which form the standard framework of guidelines for financial accounting used in any given jurisdiction.
IBA	Insurance Business Act (1995). Japanese legislation that is the main pillar of Japanese insurance supervisory laws.
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.
IDD	The Insurance Distribution Directive, which has applied in the UK (and in all EU Member States) 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.
JFSA	Japan's Financial Services Agency.
Legacy Portfolio	A portfolio of business that was originally written by TMF's International Reinsurance Department, or by the Reinsurance Department or Marine Department of NFM.
London Branch	A UK branch of TMNF that was opened on 1 March 2021.
MCR	The Solvency II Minimum Capital Requirement – this measure is lower than the SCR, and 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).
Milliman	Milliman, Inc.
NAIC	National Association of Insurance Commissioners.
NFM	Nichido Fire & Marine Insurance Co., Ltd.
NICO	National Indemnity Company.
NRG	NRG Victory Reinsurance Limited
NRG 2020 ORSA	NRG's 2020 ORSA Report, dated 22 October 2020.
NRG NV	Nederlandse Reassurantie Groep N.V.
OECR	Own Economic Capital Requirement. NRG's term for describing its internally assessed capital requirements.
ORSA	Own Risk Solvency Assessment, 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.
Part VII Transfer	An insurance business transfer scheme performed in accordance with the requirements set out in Part VII of FSMA.
Policy Statement	The Statement of Policy issued by the PRA entitled The Prudential Regulation Authority's approach to insurance business transfers, as updated in November 2021.

PRA	The Prudential Regulation Authority ("PRA") 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.
RBC	Risk-Based Capital, which is the basis of the solvency regime in both Japan and the US.
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 Agreement	A reinsurance agreement entered into on 31 December 2014, pursuant to which NICO agreed to cover, inter alia, all claim payments made by TMNF in respect of the Transferring Business, up to an agreed aggregate limit, as well as certain overhead expenses relating to the business.
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.
RMI	Resolute Management, Inc.
RML	Resolute Management Limited.
RMSL	Resolute Management Services Limited.
RPPD	The Responsibilities of Providers and Distributors for the Fair Treatment of Customers, a guidance document published by the FCA in January 2018.
Scheme	In the context of this Report, the proposal that the Transferring Business of TMNF be transferred to NRG 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.
Subject Contracts	The contracts TMNF has entered into with its cedants. For the purposes of the statistics shown in Section 4, no matter if contract has been renewed (possibly multiple times), this is counted as one Subject Contract.
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.
TMF	Tokio Marine & Fire Insurance Co., Ltd.

TMNF	Tokio Marine & Nichido Fire Insurance Co., Ltd.
TMNF Non-Transferring Policyholders	Those holders of TMNF policies that are not being transferred to NRG. Essentially, this comprises all TMNF policyholders other than those of the London Branch.
Tokio Marine	Tokio Marine Holdings, Inc.
TPs	Technical provisions as calculated for Solvency II purposes. As such, they differ from technical provisions calculated on an IFRS basis.
Transferee	The entity to which business is being transferred – in the case of the Scheme, this is NRG.
Transferor	The entity from which business is being transferred – in the case of the Scheme, this is TMNF.
Transferring Business	The business of TMNF that is to be transferred to NRG under the Scheme.
Transferring Policyholders	The policyholders of the Transferring Business.
Transition Period	The period between the UK leaving the EU (31 January 2020) and the UK subsequently leaving the single market (31 December 2020) during which almost all existing trading arrangements between the UK and EU continued to apply.
UPR	Unearned premium reserve.
US	United States of America.
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 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 April 2015 Statement of Policy on its approach to insurance business transfers and of Chapter 18 of the supervision manual in the FCA's Handbook (including the guidance contained within the FCA's May 2018 paper on Part VII Transfers (FG18/4));*
> - *A review of the communications made to policyholders;*
> - *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(b) 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 C Compliance with the PRA Policy Statement

The table below indicates how I have complied with the provisions of the PRA Policy Statement ("*The PRA's approach to 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 the FCA's guidance paper 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, 1.32
2.30 (2)	Confirmation that the independent expert has been approved or nominated by the appropriate regulator	1.13
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	1.14 - 1.20
2.30 (4)	Whether the independent expert, or their employer, has, or has had, direct or indirect interest in any of the parties that might be thought to influence their independence, and details of any such interest	1.21 - 1.31
2.30 (5)	The scope of the report	1.33 - 1.46
2.30 (6)	The purpose of the Scheme(s)	5.8
2.30 (7)	A summary of the terms of the scheme in so far as they are relevant to the report	5.1-5.7
2.30 (8)	What documents, reports and other material information the independent expert has considered in preparing his report, whether they have identified any material issues with the information provided and whether any information that he requested has not been provided	Appendix D
2.30 (8A)	Any firm-specific information the independent expert considers should be included. Where the applicant(s) consider(s) it inappropriate to disclose such information, then the independent expert should explain this and the reasons why disclosure has not been possible;	At various points in the Report I have provided firm-specific information. The applicants have not requested me not to disclose any information that I would otherwise consider necessary to include in the Report.
2.30 (9)	The extent to which the independent expert has relied on: (a) information provided by others; and (b) the judgment of others	1.49, 1.61, 10.2
2.30 (10)	The people on whom the independent expert has relied and why, in his opinion, such reliance is reasonable	1.49, 1.61
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; (c) policyholders of the transferee; and (d) any other relevant policyholder groupings within the above that the independent expert has identified.	Section 6 Section 7 Section 8 Not applicable.

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	9.11
2.30 (12A)	Their definition of 'material adverse' effect	1.46
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 and conclusion that the independent expert expresses in the report, an outline of his reasons	Sections 6, 7 and 8 in relation to the conclusions given in paragraphs 6.144, 7.5 and 8.13.
2.30 (15)	An outline of permutations if a scheme has concurrent or linked schemes, and analysis of the likely effects of the permutations on policyholders.	Not applicable.
2.31A	The independent expert is ultimately responsible and accountable for the opinions and conclusions expressed in the scheme report, including where reliance has been placed on others. Therefore, where the independent expert has placed reliance on others, they must make clear in the scheme report why they are content to do so.	1.49
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	4.31 to 4.37
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 as there are no guarantees or additional reinsurance.
2.33 (1)	The independent expert's opinion of the likely effects of the scheme on policyholders should be assessed at both firm and policyholder level and should include a comparison of the likely effects if it is or is not implemented	9.24
2.33 (2)	The independent expert's opinion of the likely effects of the scheme on policyholders should be assessed at both firm and policyholder level and should state whether the firm(s) considered alternative arrangements and, if so, what were the arrangements and why were they not proceeded with	1.34
2.33 (2A)	The independent expert's opinion of the likely effects of the scheme on policyholders should be assessed at both firm and policyholder level and should analyse and conclude on how groups of policyholders are affected differently by the scheme, and whether such effects are material in the independent expert's opinion. Where the independent expert considers such effects to be material, they should explain how this affects their overall opinion	Section 6, Section 7, Section 8
2.33 (3)	The independent expert's opinion of the likely effects of the scheme on policyholders should be assessed at both firm and policyholder level and should include his views on:	

	(a) the effect of the scheme at firm and policyholder level on the security of policyholders' contractual rights, including an assessment of the stress and scenario testing carried out by the firm(s) and of the potentially available management actions that have been considered by the board of the firm(s) and the likelihood and potential effects of the insolvency of the transferor(s) and transferee(s). The independent expert should also consider whether it is necessary to conduct their own stress and scenario testing or to request the firm(s) to conduct further stress and scenario testing;	6.117 to 6.130, 6.134 to 6.139, 8.10 to 8.12
	(aa) the transferor's and transferee's respective abilities to measure, monitor, and manage risk and to conduct their business prudently. This includes their ability to take corrective action in the event there is a material deterioration of their balance sheets;	6.116
	(aaa) the likely effects of the scheme, in relation to the likelihood of future claims being paid, with consideration of not only the regulatory capital regime, but also any other risks not falling within the regime. This would include those likely to emerge after the first year or that are not fully captured by the regulatory capital requirements;	Risks likely to emerge after the first year are discussed in 6.97 (pre-Scheme) and 6.106 (post-Scheme). Risks not fully captured by the regulatory capital requirements are discussed in 6.98 (pre-Scheme) and 6.108 (post-Scheme).
	(aaaa) whether the transferee'(s') existing capital model (or proposed, where applicable)would remain appropriate following the scheme;	6.109
	(b) the likely effects of the scheme on matters such as investment management, capital management, new business strategy, claims reserving, administration, expense levels and valuation bases for both transferor(s) and transferee(s) in relation to:	
	(i) the security of policyholders' contractual rights;	5.13-5.16, 6.140-6.141 , 7.3, 8.8
	(ii) levels of service provided to policyholders,	
	(iii) for long-term insurance business, the reasonable expectations of policyholders;	Not applicable
	(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	9.33, 9.36
	(d) the likely effects at firm and policyholder level due to any change in risk profiles and/or exposures resulting from the scheme or related transactions; and	6.131-6.133, 8.4-8.7
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 as there are no mutual companies involved in the Scheme.
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 as there are no mutual companies involved in the Scheme.

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 as there are no mutual companies involved in the Scheme.
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 as no long-term insurance business.
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 as no long-term insurance business.
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 as no long-term insurance business.
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 (in 2.36(1)–(3)) that could act to the detriment of existing policyholders of either firm	Not applicable as no long-term insurance business.
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 as no long-term insurance business.
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 as no long-term insurance business.
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 as no long-term insurance business.

2.37	Where the transfer forms part of a wider chain of events or corporate restructuring, it may not be appropriate to consider the transfer in isolation and the independent expert should seek sufficient explanations on corporate plans to enable them to understand the wider picture. Likewise, the independent expert will also need information on the operational plans of the transferee and, if only part of the business of the transferor is transferred, of the transferor. These will need to have sufficient detail to allow them to understand in broad terms how the business will be run. The PRA expects the independent expert to comment on how any such plans (including other insurance business transfers involving the parties to the scheme) would impact the likely effects of the scheme at firm and policyholder level.	Not applicable.

Appendix D Key Sources of Data

D.1 In writing this Report, I relied upon the accuracy of certain documents provided by TMNF and NRG. These included, but were not limited to, those listed below. I note that I have not identified any material issues with the information provided and there is no information that I have requested that has not been provided.

Background

- TMNF Legacy Portfolio description
- English translation of TMNF Consolidated Financial Statements as at 31 March 2021
- London Branch of TMNF accounts spreadsheet as at 31 March 2021
- Letter from the PRA confirming the authorisation of the London Branch
- NRG Report and Accounts as at 31 December 2020
- NRG Management Accounts spreadsheets as at 31 March 2021, 30 June 2021 and 30 September 2021
- Annual statement of NICO as at 31 December 2020

Scheme and Restructuring

- Draft of the Scheme Document (most recently as of 15 March 2022)
- Framework Agreement and subsequent amendments
- Email correspondence with HMRC regarding with the Scheme can be treated as the transfer of a going concern
- Legal opinion from US counsel on whether the Scheme would be recognised by US courts
- Draft letter from NICO to TMNF and NRG in which it undertakes to be bound by the terms of the Scheme and confirms that RMSL and RMI will continue to provide administrative services in respect of the Transferring Business following the implementation of the Scheme

Reserving

- Actuarial review of the claims reserves of the Legacy Portfolio of TMNF as at 31 December 2020, prepared by external actuarial consultants
- Actuarial reports of the claims reserves for NRG, as prepared by the internal actuaries, as at 31 May 2021 and 31 May 2019
- Reports on the year-end best estimate reserves of NRG, as prepared by the internal actuaries, as at year-ends 2020 and 2019
- Reports on the UK asbestos reserves of NRG, as prepared by the internal actuaries, as at 31 May 2019 and 31 May 2016
- Actuarial function report covering various London-based Berkshire Hathaway group companies including NRG (redacted for other companies) as at 31 December 2020
- NICO Actuarial Opinion Summary and Actuarial Report as at 31 December 2020

Risks and Solvency Capital

- TMNF Solvency Margin Ratio disclosure as at 31 March 2021
- TMNF London Branch 2021 ORSA
- External actuarial report providing financial projections for TMNF London Branch ORSA and detailing the calculations of its SCR as at 31 March 2021
- Correspondence between the PRA and TMNF relating to the 31 March 2021 London Branch ORSA
- English translations of extracts from 2020 Tokio Marine group ORSA
- NRG 2020 ORSA
- NRG SCR and OECR calculations and accompanying report as at 31 December 2020
- Updated NRG SCR and OECR calculations as at 30 June 20
- Updated NRG SCR and OECR calculations as at 30 June 20 including the Transferring Business and including the results of scenario tests
- NRG SFCR as at 31 December 2020
- NRG business plan 2021-25

Reinsurance

- Reinsurance Agreement
- Columbia Reinsurance agreement

Governance and related policies

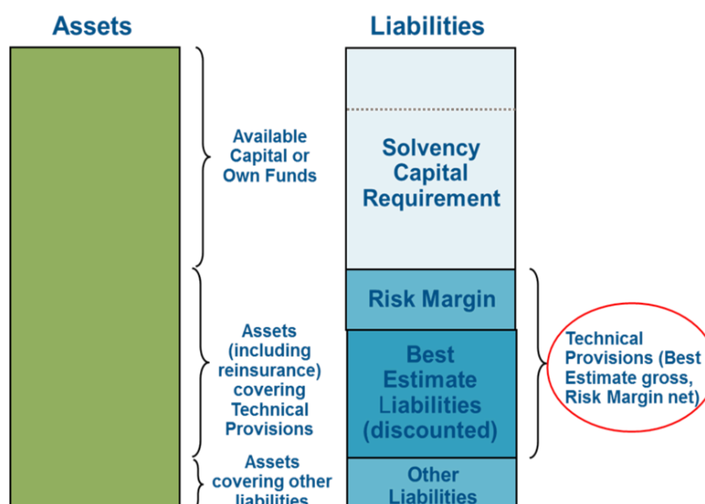
- Tokio Marine group actuarial policy for non-life loss reserving
- Risk management framework document for Berkshire Hathaway run-off companies (including NRG)
- RMSL and RML Claims-Handling Philosophy, Principles and Conduct Document
- Shared services agreement between for Berkshire Hathaway run-off companies (including NRG)

D.2 Information relating to the items listed above was also gathered during discussions with staff of NRG and TMNF.

Appendix E Solvency II Balance Sheet

E.1 A simplified illustration of a Solvency II balance sheet is shown in Figure E.1, below.

FIGURE E.1 SOLVENCY II BALANCE SHEET



E.2 The Solvency II 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.

E.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 EOF over the SCR will determine whether the entity can expand existing business, move in to new areas, undertake mergers/acquisitions (with less capital rich entities) etc. or whether they need to consider reducing business volumes, moving out of capital intensive lines of business, purchasing additional reinsurance and so on. The level of EOF will also likely impact the credit rating of an entity.

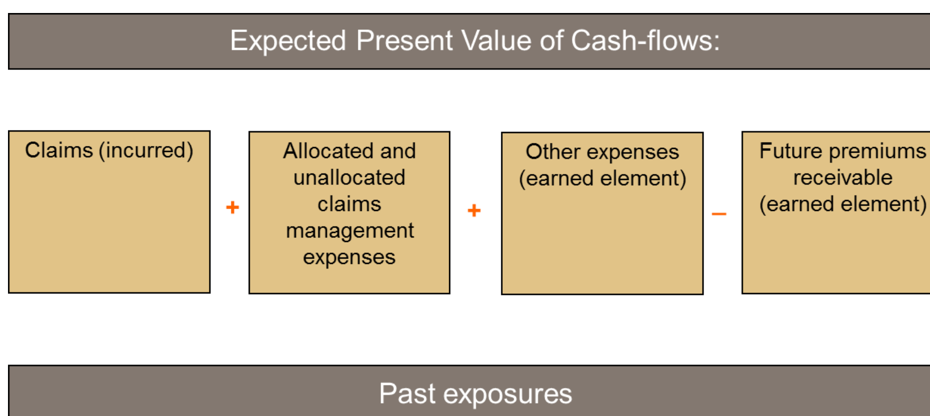
E.4 The TPs are a direct input to the balance sheet, and are therefore a fundamental input in to the SCR calculation that models the potential movement in the balance sheet over a one-year time horizon.

E.5 Solvency II requires 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

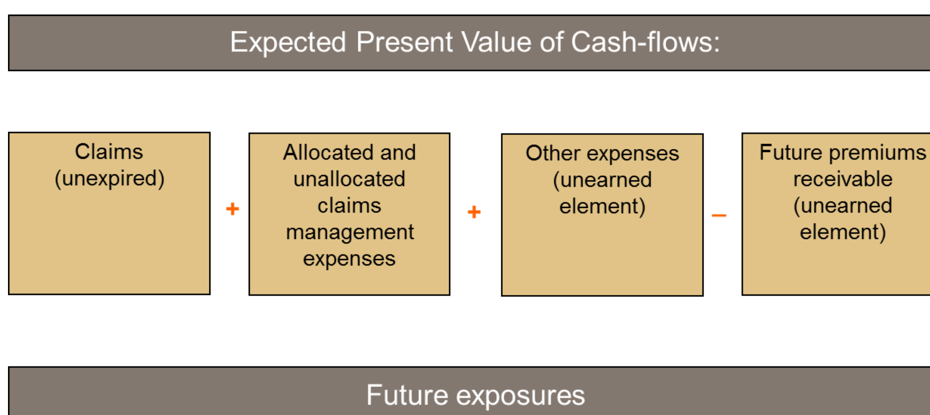
E.6 The claims provision is the expected present value/discounted 'best estimate' of all future cash-flows (claim payments, expenses and future premiums due) relating to claim events prior to the valuation date. E.2, below, illustrates the components of the claims provision calculation.

FIGURE E.2 CLAIM PROVISION



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

FIGURE E.3 PREMIUM PROVISION



E.8 The risk margin ("'RM") is intended to be the balance that another (re)insurer taking on the liabilities at the valuation date would require over and above the discounted 'best estimate'. Under Solvency II, the RM is calculated using a cost-of-capital ("CoC") approach (presently employing a 6% CoC parameter as provided by EIOPA). 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 default risk (e.g. reinsurance); operational risk; and market risk (if unavoidable, i.e. not hedge-able); and
- rt is the risk-free discount rate(s) at time t, as provided by EIOPA for all major currencies.

Appendix F Key Differences Between GAAP and Solvency II Technical Provisions

F.1 A summary of the key differences between GAAP reserves and Solvency II TPs is set out in the table below:

Area of change	UK GAAP Reserves	Solvency II Technical Provisions	Balance sheet impact
Earned business	Claims reserve = point estimate within a reasonable range ("not insufficient")	Claims provision = probability weighted average of future cash flows	Reduces liabilities (removes margins)
Unearned business	UPR, net of Deferred Acquisition Costs	Premium provision = probability weighted average of future cash flows	Reduces liability (expected profit)
Risk Margin	n/a	Explicit item, based on cost of capital approach	Increases liabilities
Discounting	Undiscounted	Discounted cash flows	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	Increases liabilities
Events Not In Data ("ENIDs")	Limited allowance for contingent liabilities	New concept allowance for extreme outcomes (which are "not in the data" used for reserving)	Increase liabilities
Reinsurance Bad Debt Provision	n/a	Explicit provision required for reinsurer bad debt	Decreases assets

Appendix G Minimum Capital Requirements in Japan and the US

US

G.1 In the US, the minimum solvency margin is calculated using a RBC methodology based on the various risks of an insurer. The RBC methodology defines six categories of risk, labelled R0 to R5 as follows:

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

G.2 The quantification of R_0 to R_5 is determined by applying a series of pre-determined percentages to specific items provided in the annual statement, filed by the entity to the NAIC.

G.3 The RBC amount (for regulatory purposes) is determined as the sum of R_0 to R_5 together with a covariance adjustment (as it is unlikely that all types of catastrophic events will occur simultaneously). The authorised control level RBC (c.f. the minimum solvency margin) is set at 50% of the calculated RBC amount.

JAPAN

G.4 In Japan the total amount of "Risks" is calculated using a RBC methodology based on the various risks of an insurer. The RBC methodology defines six categories of risk, labelled R1 to R6 as follows:

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

G.5 The quantification of R_1 to R_6 is determined by applying a different formulae to specific items provided in the annual statement, filed by the entity to the JFSA.

G.6 The RBC amount (for regulatory purposes) is determined as:

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

G.7 This is essentially the sum of R_1 to R_6 together with a covariance adjustment for underwriting and investment risks (as it is unlikely that all types of catastrophic underwriting events will occur simultaneously, and likewise it is unlikely that all types of catastrophic investment and interest rate events will occur simultaneously).