Scheme Report of the Independent Expert on the proposed transfer of insurance business from EC Insurance Company Limited to Markel International Insurance Company Limited in accordance with Part VII of the Financial Services and Markets Act 2000

For the High Court of Justice of England and Wales

21 October 2019

Prepared by:

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LCP

Table of Contents

Appendices

1. Executive summary

1.1. The Proposed Transfer

EC Insurance Company Limited (ECICL) is a specialist UK insurer providing insurance for contractors and trade associations in the construction industry. It also provides insurance schemes for self-build residential property, mobility products and let property.

ECICL was placed into run-off on 1 October 2018.

ECICL benefits from third party reinsurance and cedes all remaining liabilities to Markel International Insurance Company Limited (MIICL), such that ECICL retains no liabilities on a net of reinsurance basis.

ECICL and MIICL are both wholly owned subsidiaries of Markel Capital Holdings Limited (MCH).

Proposed Transfer: it is proposed that all of ECICL's business will transfer from ECICL into MIICL.

There will be no change in the immediate parent company, MCH or ultimate parent company, Markel Corporation (Markel).

The transferring reserves for ECICL, net of external reinsurance and before the 100% internal reinsurance to MIICL, represent 2.7% of MIICL's reserves as at 31 December 2018.

Jersey policies

Within the business written by ECICL, 63 insurance policies and/or certificates issued under master policies for 12 unique policyholders in Jersey have been identified. The liabilities for this business represent less than 1% of the total liabilities involved in the transfer. The transfer of these Jersey policies (the Jersey Transfer) is subject to approval by the Royal Court of Jersey under the Insurance Business (Jersey) Law 1996 and will take effect on the Jersey Effective Date. These policyholders will be treated the same as the UK policyholders upon transfer. It is expected that this report will be made available to the Royal Court of Jersey by ECICL and MIICL when seeking approval for the transfer of these policies.

1.2. My role as Independent Expert

MIICL has appointed me to act as the Independent Expert (IE) for the Proposed Transfer. The Prudential Regulation Authority (PRA), in consultation with the Financial Conduct Authority (FCA), has approved my appointment.

As IE, my overall role is to assess whether:

- The security provided to policyholders of ECICL or MIICL will be materially adversely affected by the Proposed Transfer.
- The Proposed Transfer will have any adverse impact on service standards to policyholders.
- Any reinsurer of ECICL covering the transferring business will be materially adversely affected.

This report is my Scheme Report for the Proposed Transfer. I will also prepare a Supplementary Report ahead of the Sanctions Hearing for the Proposed Transfer. The purpose of the Supplementary Report is to confirm and/or update the conclusions of the Scheme Report, based on any material new developments in the intervening period.

1.3. Summary of my conclusions

I set out below my summary conclusions, considering the effect of the Proposed Transfer from the perspective of the following three parties:

- A: "Transferring Policyholders", who will transfer from ECICL to MIICL as a result of the Proposed Transfer.
- B: "MIICL Policyholders", ie existing policyholders of MIICL who will remain with MIICL after the Proposed Transfer.
- C: Reinsurers whose contracts with ECICL will transfer to MIICL.

A: Transferring Policyholders

In my opinion, the security provided to Transferring Policyholders will not be materially adversely affected by the Proposed Transfer.

Summary of rationale:

- ECICL policyholders are currently protected by 100% reinsurance from MIICL, net of ECICL's external reinsurance. MIICL's financial strength provides the ultimate security for the Transferring Policyholders both before the Proposed Transfer (through the 100% reinsurance) and afterwards (directly to the Transferring Policyholders).
- MIICL is well-capitalised relative to statutory requirements, meaning that it has a very low probability of insolvency.
- MIICL's capital base is also significantly larger than that of ECICL.
- The expected capital coverage ratio of MIICL just after the Proposed Transfer (258% of the Solvency Capital Requirement (SCR)) is higher than the expected capital coverage ratio of ECICL just before the Proposed Transfer of (254% of the Minimum Capital Requirement (MCR)).
- After the Proposed Transfer, in the unlikely event of MIICL's insolvency and winding-up, the Transferring Policyholders would rank alongside other policyholders of MIICL. Before the Proposed Transfer, in the event of MIICL's insolvency and winding-up, ECICL policyholders would rank below MIICL Policyholders, because ECICL is reinsured by MIICL.
- Transferring Policyholders will retain their current access to the Financial Services Compensation Scheme and Financial Ombudsman Service, if eligible.

In my opinion, there will be no material impact on service standards to Transferring Policyholders following the Proposed Transfer.

Summary of rationale:

- Transferring Policyholders will continue to be administered by the same team within Markel as before the Proposed Transfer.
- The Transferring Policyholders will remain within the Markel group. MIICL is subject to the same group-wide policies as ECICL.
- Customer communication channels are already hosted on Markel systems and any communication through ECICL's previous phone numbers and address are routed to the current ones.

B: MIICL Policyholders

In my opinion the security provided to MIICL Policyholders will not be materially adversely affected by the Proposed Transfer.

Summary of rationale:

- MIICL Policyholders will remain with MIICL, ie there will be no change in their policies as a result of the Proposed Transfer.
- MIICL has no plans to change the approaches for providing policyholder security including how insurance provisions and capital requirements are set.
- MIICL already 100% reinsures the liabilities of ECICL. MIICL will remain responsible for these liabilities following the Proposed Transfer. Therefore, the MIICL Policyholders' exposure to ECICL's risks are materially the same before and after the Proposed Transfer.
- The Proposed Transfer is small in relation to MIICL and will not materially affect MIICL's capital coverage ratio. MIICL will remain very well-capitalised following the Proposed Transfer.

In my opinion, there will be no material impact on service standards for MIICL Policyholders following the Proposed Transfer.

Summary of rationale: MIICL has informed me that there are no plans to change how MIICL Policyholders are serviced. Resources are already in place to service ECICL policyholders both before and after the Proposed Transfer and, therefore, no impact on the servicing of existing MIICL Policyholders is expected.

C: Reinsurers whose contracts with ECICL are transferring to MIICL

In my opinion, reinsurers of ECICL who provide cover for the transferring business will not be materially affected by the Proposed Transfer.

Summary of rationale:

- The reinsurers' exposure to ECICL claims will not change following the Proposed Transfer. Reinsurers will continue to be required to pay out the same claim amounts in respect of the same events as before the Proposed Transfer.
- Reinsurers will still have the same visibility of the liabilities as before, and there are no planned changes to the reporting provided to them.
- As at 1 November 2017, MIICL provided a loss portfolio transfer (LPT) and quota share reinsurance which reinsured all ECICL remaining liabilities, net of the external reinsurance described above, including any bad debt from the external reinsurance. This reinsurance will cease upon the Proposed Transfer.
- ECICL will directly notify all reinsurers with whom ECICL either (i) has a live reinsurance contract i.e. the reinsurance period has not expired (ii) has a reinsurance contract under which ECICL has made a claim and such claim remains unpaid or outstanding (iii) has a reinsurance contract in respect of which ECICL holds 'Incurred But Not Reported' reserves ("IBNR Reserves") (as it expects to make a future claim) or (iv) participates in any reinsurance scheme. ECICL proposes to notify all reinsurers with whom ECICL has placed reinsurance from 31 December 2010 onwards.

Confirmation of factual correctness

This report has been reviewed by ECICL and MIICL and each has agreed the report is correct in terms of all factual elements of the transfer.

2. Introduction

2.1. Background

Part VII - Section 109 of the Financial Services and Markets Act 2000 (FSMA) requires that a scheme report (the Scheme Report) must accompany an application to the High Court of Justice of England and Wales (the Court) to approve an insurance business transfer scheme (Part VII transfer).

The Scheme Report should be produced by a suitably qualified independent person, known as the Independent Expert (IE), who has been nominated or approved by the Prudential Regulation Authority (PRA) having consulted with the Financial Conduct Authority (FCA).

The Scheme Report should address the question of whether any policyholders or reinsurers impacted by the insurance business transfer are adversely affected to a material extent.

MIICL has nominated Charl Cronje ("I", "me") of Lane Clark & Peacock LLP ("LCP", "we", "us") to act as the Independent Expert for the proposed insurance business transfer scheme (the Proposed Transfer) of the insurance business of ECICL to MIICL under Section 105 of the FSMA.

The Directions Hearing is expected to be on 30 October 2019 (Jersey on 31 October 2019) and the Sanctions Hearing on 5 March 2020 (Jersey on 6 March 2020). The Proposed Transfer is expected to be effected on 20 March 2020 (the Effective Date).

This report is the Scheme Report for the Proposed Transfer. I will also prepare a Supplementary Report ahead of the Sanctions Hearing for the Proposed Transfer. The purpose of the Supplementary Report is to confirm and/or update the conclusions of the Scheme Report, based on any material new developments in the intervening period.

2.2. The Proposed Transfer

ECICL benefits from third party reinsurance and cedes all remaining liabilities to Markel International Insurance Company Limited (MIICL), such that ECICL retains no liabilities on a net of reinsurance basis.

The Proposed Transfer will transfer all of ECICL's business into MIICL. The reinsurance cover from MIICL to ECICL will cease.

Jersey policies

Within the business written by ECICL, 63 insurance policies and/or certificates issued under master policies for 12 unique policyholders in Jersey have been identified. The liabilities for this business represent less than 1% of the total liabilities involved in the transfer. The transfer of these Jersey policies (the Jersey Transfer) is subject to approval by the Royal Court of Jersey under the Insurance Business (Jersey) Law 1996 and will take effect on the Jersey Effective Date. These policyholders will be treated the same as the UK policyholders upon transfer. It is expected that this report will be made available to the Royal Court of Jersey by ECICL and MIICL when seeking approval for the transfer of these policies.

2.3. Independent Expert appointment

My appointment

MIICL has appointed me to act as the IE for the Proposed Transfer. The PRA, in consultation with the FCA, has approved my appointment.

MIICL will bear the costs associated with the production of my report. I note that no costs or expenses of the scheme will be borne by policyholders.

My experience

I am a Fellow of the Institute and Faculty of Actuaries (IFoA). I am a Partner in the Insurance Consulting practice at LCP and have over 25 years' experience.

I have skills and experience in all areas of general insurance actuarial work including reserving, capital, pricing and transactions.

I am currently the IE on another Part VII transfer and peer reviewer for a further two Part VII transfers.

Appendix 3 contains my CV with further details of my experience.

Independence statement

I confirm that I have no direct or indirect interests in any company in the Markel group, either personally or via LCP. In particular:

- I am not, directly or indirectly, a shareholder of any such company;
- I am not a member of any pension scheme under the management of any such company; and
- I do not hold any insurance policies issued by any such company.

LCP has not previously provided professional services or advice to Markel or its subsidiaries, other than providing actuarial advice to Alterra until 2011, ie before Alterra became a subsidiary of Markel.

MIICL is on the panel of insurers that provide LCP's professional indemnity insurance. This is arranged on commercial, arms-length terms and, in my opinion, does not affect my independence.

I also confirm that LCP does not hold any direct or indirect shareholding in any company in the Markel Group.

2.4. Scope of this Scheme Report

Appendix 2 contains an extract from my terms of reference, which defines the scope of my work in relation to the Proposed Transfer. The actual work performed is in line with this agreed scope.

This Scheme Report considers the effect of the Proposed Transfer upon the policyholders of ECICL and MIICL, and reinsurers whose contracts with ECICL are transferring to MIICL. It contains a description of the Proposed Transfer, the methodology I have used to analyse the Proposed Transfer, the opinions I have formed, and reasons why I have formed those opinions.

The use of “I”, “me” and “my” in this report generally refers to work carried out by me or by the team operating under my supervision. However, when it is used in reference to a formal opinion that the IE is required to give, it is mine alone.

For presentational purposes some GBP amounts in this report have been converted to USD at an exchange rate of £1 = USD1.28.

2.5. Use of this Scheme Report

This Scheme Report has been produced by Charl Cronje FIA of LCP under the terms of our written agreement with MIICL. It is subject to any stated limitations (eg regarding accuracy or completeness).

This Scheme Report has been prepared for the purpose of accompanying the application to the Court in respect of the Proposed Transfer, in accordance with Section 109 of the Financial Services and Markets Act 2000.

A copy of the Scheme Report will be sent to the PRA and the FCA and will accompany the Scheme application to the Court.

This report is only appropriate for the purpose described above and should not be used for anything else. No liability is accepted or assumed for any use of the Scheme Report for any other purpose other than that set out above.

2.6. Reliances

I have based my work on the data and other information made available to me by ECICL and MIICL. Appendix 4 contains a list of key data and other information that I have considered. I have also held discussions with the relevant staff of ECICL, MIICL and their advisors.

I have generally used data as at 31 December 2018 for my analysis. Prior to the Sanctions Hearing for the Proposed Transfer, I will prepare a Supplementary Report to confirm and/or update the conclusions of the Scheme Report, based on any material new developments in the intervening period.

I have received all of the information that I have requested for the purposes of the production of my report. In this respect:

- ECICL and MIICL will submit witness statements to the Court stating that all information provided to me by ECICL and MIICL is correct and complete in all material aspects, and that there have been no material adverse changes to the financial position of ECICL or MIICL since that information was provided to me.
- I have conducted checks on the data provided to me for general consistency and reasonableness.
- My checks of the data have not revealed any cause for me to doubt that it is materially appropriate for me to rely upon for the purpose of this report.

The conclusions in my report take no account of any information that I have not received, or of any inaccuracies in the information provided to me.

I have not needed to take any third party legal advice on any aspects of the Proposed Transfer. ECICL and MIICL have confirmed that they have received no other specific legal advice relevant to my role as IE for the Proposed Transfer.

ECICL and MIICL have provided a Data Accuracy Statement confirming that the data provided to me regarding the Proposed Transfer are accurate and complete.

Figures in this report may be subject to small rounding differences and so totals within the tables may not equal the sum of the rounded components.

2.7. Professional standards

This report complies with the applicable rules on expert evidence and with the guidance for Scheme Reports set out by the PRA in their Statement of Policy, the FCA guidance to their approach to review of Part VII transfers issued in May 2018 and by the PRA Rulebook and the FCA Handbook.

This report complies with Technical Actuarial Standard 100: Principles for Technical Actuarial Work (TAS 100) and Technical Actuarial Standard 200: Insurance (TAS 200) issued by the Financial Reporting Council (FRC). The FRC is responsible for setting technical actuarial standards in the UK.

In producing this report, I have also considered The Actuaries' Code as issued by the IFoA.

This report has been subject to peer review prior to its publication, in line with Actuarial Professional Standard X2: Review of Actuarial Work (APS X2) as issued by the IFoA. This peer review has been undertaken by Stewart Mitchell. Stewart is a Partner at LCP. He has appropriate experience and expertise to act as peer reviewer of this report. He has been the IE on several other Part VII transfers.

2.8. Materiality

The FRC considers that matters are material if they could, individually or collectively, influence the decisions to be taken by users of the actuarial information. It accepts that an assessment of the materiality is a matter of reasonable judgement that requires consideration of the users and the context.

I have applied this concept of materiality in planning, performing and reporting the work described in this Scheme Report. In particular, I have applied this concept of materiality when using my professional judgement to determine the risks of material misstatement or omission and to determine the nature and extent of my work.

In complying with the reporting requirements of TAS 100, I have made judgements on the level of information to include in this Scheme Report. For example, to make the report easier to read, I have not included all the details that would normally be included in a formal actuarial report, such as details of the methodologies and assumptions underlying the reserve and capital assessments.

2.9. Definition of "materially adverse"

In order to determine whether the Proposed Transfer will have a "materially adverse" impact on any group of policyholders or on any reinsurers covering transferring business, it has been necessary for me to exercise my judgement in the light of the information that I have reviewed.

The Proposed Transfer will affect different policyholders in different ways and, for any one group of policyholders, there may be some effects of the Proposed Transfer that are positive, and others that are adverse. When assessing whether the Proposed Transfer will have a "materially adverse" impact, I have considered the aggregate impact of these different effects on each group of policyholders and on reinsurers.

In this report, I have provided the rationale for my judgements and conclusions. These explain why, in each case, I have concluded whether policyholders and reinsurers are materially adversely affected or otherwise.

3. Outline of Proposed Transfer

3.1. The companies involved in the Proposed Transfer

EC Insurance Company Limited (ECICL)

ECICL is an insurance company incorporated in England and Wales on 30 June 1976, authorised by the PRA and regulated by the PRA and FCA. ECICL is 100% owned by MCH. The ultimate holding company is Markel, which is incorporated in Virginia in the United States of America.

Up until 19 December 2018, ECICL had a financial strength rating of “A” (Excellent) by A.M. Best. ECICL no longer carries a stand-alone credit rating since it entered into run-off and all new business and renewal rights were transferred to MIICL.

ECICL effected and carried out contracts of general insurance in the UK, Isle of Man, Jersey and Guernsey. ECICL was placed into run-off on 1 October 2018. New business was written by MIICL from that date.

ECICL wrote a portfolio of policies for contractors in the electrical, heating, ventilation, air-conditioning, lift and escalator, roofing, and building services sector. It also provided insurance schemes for the self-build residential property, mobility products and landlords and tenants of let property. The contracts fall under classes of business accident, credit, damage to property, fire and natural forces, general liability, goods in transit, legal expenses, miscellaneous financial loss, sickness and suretyship.

The Proposed Transfer involves all ECICL’s policyholders transferring to MIICL.

Markel international Insurance Company Limited (MIICL)

MIICL is an insurance company incorporated in England and Wales on 20 November 1969, authorised by the PRA and regulated by the PRA and FCA. MIICL is a subsidiary of MCH and the ultimate holding company is Markel.

MIICL has a financial strength rating of “A” (Excellent) by A. M. Best and “A” (Strong) by Standard & Poor’s as of 18 June 2019.

MIICL effects and carries out contracts of general insurance from its office in London, in addition to overseas operations in Latin America and Dubai. MIICL holds US Surplus Lines Licences and is an accredited reinsurer in most US States. It is also able to underwrite general insurance and reinsurance in a number of overseas territories.

MIICL operates seven underwriting units; Marine, Energy, Speciality & Financial Lines, Reinsurance, Markel Assurance, National Markets and Latin America. MIICL writes a portfolio of marine, energy, personal accident, contingency and entertainment, equine and livestock, professional and financial risks, trade credit and political risks, amongst other product lines.

MIICL have confirmed there are no other insurance business transfers currently expected into MIICL.

MIICL completed the transfer of their European insurance business to Markel Insurance SE (MISE) on 29 March 2019 through a Part VII transfer. MISE is based in Germany and is the insurer covering European Union business.

MIICL have confirmed there are no other insurance business transfers currently expected out of MIICL.

3.2. Description of the Proposed Transfer

Transferring policies

If sanctioned by the Court, the Proposed Transfer will include all polices written by ECICL up to 1 October 2018, when ECICL ceased writing business.

All rights and obligations of ECICL relating to the transferring policies will also be transferred to MIICL. There will be continuity in terms of service as the same team will continue to administer the transferring policies.

The booked GAAP provisions are $58.7m on a gross basis, $26.7m on a net of external reinsurance basis, and zero on a net of all reinsurance basis as at 31 December 2018. ECICL has purchased a loss portfolio transfer (LPT) and reinsurance from MIICL such that it retains no insurance risk on a net basis.

The number of transferring policies is c. 421k as at 31 December 2018, of which 63 are policies written in Jersey which will be subject to the Jersey Transfer.

Following the transfer, it is expected that ECICL will be wound up.

ECICL expects that all policies will be able to transfer at the Effective Date. Should this not be possible for any reason, there are provisions in the Scheme Document to allow for the transfer of such policies at a later date.

Reinsurance

Reinsurance is an arrangement with another insurer (the "reinsurer") to share or pass on risks. Reinsurance contracts may be underwritten by an external reinsurer or by a reinsurance entity in the same group.

ECICL has the following reinsurance from third party reinsurers:

- Excess of loss ("XoL") programmes to reinsure its liability and property exposures.
- Quota share programmes to reinsure its liability and property exposures. These were cancelled as at 1 January 2018.
- Catastrophe XoL programmes to reinsure its property exposures, up until 30 April 2018.
- Terrorism exposures were reinsured to Pool Re.

The third party reinsurance will transfer to MIICL as part of the Proposed Transfer. There will be no change to the protection provided by the third party reinsurance.

ECICL does not purchase third party reinsurance for its Benefits Lines, Bond/Warranty/Guarantee or First Senior DUA Warranty/Property book.

ECICL has also entered in to the following reinsurance arrangements with MIICL:

- A Loss Portfolio Transfer (LPT) such that outstanding insurance balances at 31 October 2017, net of third party reinsurance balances, were transferred to MIICL at their book value;
- Quota share arrangement such that claims arising from all policies written by ECICL between 1 November 2017 and 1 October 2018, net of any third party reinsurance, are ceded to MIICL; and
- All costs incurred by ECICL from 1 November 2017 are fully reinsured and recoverable from MIICL.

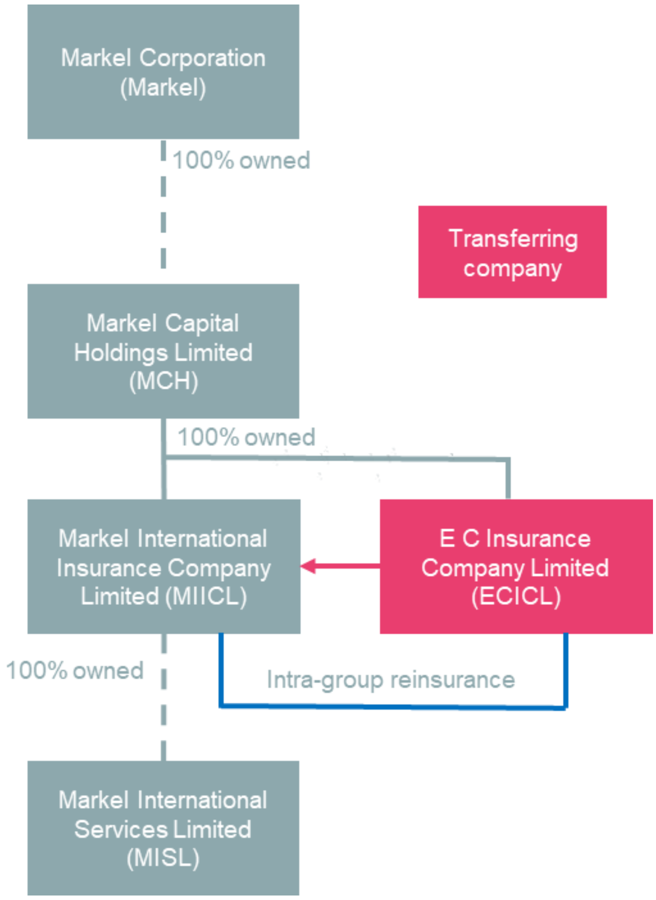
The MIICL reinsurance will cease upon the Proposed Transfer.

Corporate structure and operation of Proposed Transfer

ECICL and MIICL are both wholly owned subsidiaries of Markel Capital Holdings Limited (MCH), a holding company registered in England & Wales.

There will be no change in the immediate parent company, MCH or ultimate parent company, Markel Corporation (Markel).

The following diagram shows, in simplified form, the structure of the relevant parts of the Markel Group pre- and post- the Proposed Transfer.



3.3. Purpose of the Proposed Transfer

ECICL was purchased by MCH on 28 November 2017.

The purchase led to duplication of underwriting capabilities, with both ECICL and MIICL incurring operational and capital costs to support two underwriting platforms.

On 1 October 2018 ECICL was placed into run-off. ECICL employees were transferred to MISL under the Transfer of Undertakings (Protection of Employment) Regulations 2006 (TUPE) on 1 April 2018. MISL is also the employer of MIICL staff.

The Proposed Transfer will allow benefits to be realised in terms of operational costs and capital requirements.

3.4. Alternative options considered

The strategy for the run-off of ECICL was developed by considering the requirements to administer and manage the business.

In particular, the potential economies of scale and synergies from existing functions, processes and controls were a key consideration.

ECICL and MIICL concluded that the Proposed Transfer was the best way of achieving such economies.

3.5. Contingency plans

In the event of the Proposed Transfer not going ahead, policies would remain with ECICL and the ECICL business would continue to be reinsured by MIICL as at present.

4. My approach as IE

As IE, my overall role is to assess whether:

- The security provided to policyholders of ECICL and MIICL will be materially adversely affected by the implementation of the Proposed Transfer.
- The Proposed Transfer will have any adverse impact on service standards experienced by policyholders.
- Any reinsurer of ECICL covering the transferring business will be materially adversely affected.

To make these assessments, I have considered the effect of the Proposed Transfer from the perspectives of each of:

- Transferring Policyholders, who will transfer from ECICL to MIICL as a result of the Proposed Transfer.
- MIICL Policyholders, who will remain with MIICL after the Proposed Transfer.
- Reinsurers whose contracts with ECICL are transferring to MIICL.

My approach to assessing the Proposed Transfer has been to perform the following five steps analysing evidence provided by ECICL and MIICL to support the Proposed Transfer:

Step 1: Assessing the provisions of ECICL and MIICL

The first important form of security that an insurer provides to policyholders is the level of provisions. Provisions are based on an estimate of the amount of money the insurer will need to pay policyholders' claims and to cover the other costs associated with running the insurer.

Therefore, I have assessed the appropriateness of the provisions included on ECICL's balance sheet and the approach to be used for the calculation of provisions (also known as "reserving") for both ECICL and MIICL pre- and post-transfer. Details of this step are set out in section 5.

Step 2: Assessing the capital positions of ECICL and MIICL

In addition to the level of provisions, insurers hold capital designed to withstand more extreme levels of claims. The level of capital held is the second important form of security provided to policyholders.

For both ECICL and MIICL, the level of capital required is set under the European Solvency II standard. A key metric under Solvency II is the Solvency Capital Requirement (SCR). This is an estimate of capital required to ensure that an insurer is able to meet its obligations over the next 12 months with a probability of at least 99.5%.

I have assessed the appropriateness of the projected capital requirements of ECICL and MIICL. Details of this step are set out in section 6.

Step 3: Assessing overall policyholder security

Under this step, I have considered the level of provisions and capital (from steps 1 and 2) in the context of the assets held by each of ECICL and MIICL and other forms of security such as reinsurance.

For this analysis, I have considered the current balance sheet of ECICL and the post-transfer pro-forma balance sheets for each of ECICL and MIICL. Details of this step are set out in section 7.

Step 4: Assessing policyholder communications

I have assessed the appropriateness of ECICL's communication strategy to inform policyholders and other stakeholders of the Proposed Transfer.

The key focus of my assessment was whether the policyholders and other stakeholders are to be provided with appropriate information so that they can understand how the Proposed Transfer may affect them. Details of this step are set out in section 8.

Step 5: Assessing potential impact on customer service and other considerations that might affect policyholders

I have considered how the level of customer service including claims handling provided to policyholders could change following the Proposed Transfer. I have also considered a range of other factors that might affect policyholders, such as ongoing expense levels and tax implications. Details of this step are set out in section 9.

5. Reserving considerations

5.1. Introduction to insurance reserving

For an insurance company, the primary purpose of reserving is to assess the provisions for policyholders' claims and other costs associated with running the insurer.

Depending on how they are set, the provisions may be on a "best estimate" basis (ie with no deliberate optimism or pessimism) or include a "margin for prudence" (ie additional provisions to cover higher than expected claims). Where the provisions include a margin for prudence, this is typically designed to cover the possibility that claims are moderately higher than expected rather than more extreme levels of claims.

In addition to the provisions and any margin for prudence, the insurer would be expected to hold additional capital designed to withstand more extreme levels of claims. My considerations related to capital for the Proposed Transfer are set out in section 6.

5.2. Introduction to reserving bases

Insurers use different reserving bases (ie different measures of the provisions) for different purposes.

For example, accounting standards require the provisions to be calculated in particular ways, and an insurer may use a different basis for internal management accounts. Solvency II requirements involve calculating the provisions in yet another way.

For the Proposed Transfer, I have considered the provisions under two reserving bases, each of which is relevant for different purposes, namely:

- UK Generally Accepted Accounting Principles (GAAP)/International Financial Reporting Standards (IFRS) – these are the accounting standards used to set the provisions underlying the published financial accounts of ECICL and MIICL. GAAP/IFRS provisions are relevant for policyholders as they are used as a reference point when setting provisions to cover future claims and other costs.
- Solvency II technical provisions – these are calculated in line with the European Solvency II regulations that came into effect in both UK and Ireland from 1 January 2016. These provisions are relevant for policyholders as they are the basis for calculating the capital required and assessing solvency, for both ECICL and MIICL.

5.3. My considerations relating to reserving

As IE, my overall assessments related to reserving are:

- whether an appropriate level of provisions is maintained for both MIICL Policyholders and Transferring Policyholders; and
- whether any aspects of the reserving may lead to policyholders being materially adversely affected by the Proposed Transfer.

To make these assessments, I have considered the following areas:

- Appropriateness of provisions (section 5.5);
- Key uncertainties when setting the provisions (section 5.6);
- Current ECICL and MIICL reserving process and governance (section 5.7);
- Future reserving approach and governance (section 5.8); and
- Setting of case estimates (section 5.9).

Within these areas, I have also considered any expected differences in the reserving approach between ECICL and MIICL, to understand how this may affect policyholders.

Further details on each of these considerations are set out below, and I have stated my overall conclusion related to reserving in section 5.10.

5.4. Approach to my review

I have reviewed documents provided by ECICL and MIICL relating to the setting of provisions, including the reserving process and governance. In addition, I have had meetings with MIICL and ECICL to discuss the information provided and any questions I have had on the approach. A list of the key data and documentation is provided in Appendix 4.

5.5. Appropriateness of provisions

The following table shows the level of booked provisions as at 31 December 2018 for ECICL and MIICL.

Summary of GAAP booked provisions at 31 December 2018

	Gross of reinsurance $m	Net of external ECICL reinsurance $m	Net of all reinsurance $m
ECICL	58.7	26.7	0.0
MIICL	1,611.1	1,005.5	1,005.5

Source: ECICL, MIICL (figures include ULAE, UPR and bad debt)

The ECICL net of external reinsurance provisions are reinsured 100% by MIICL and represent 2.7% of MIICL's reserves, net of reinsurance.

My assessment of the appropriateness of provisions

I have considered the appropriateness of the following:

- Booked provisions for ECICL as at 31 December 2018;
- Booked provisions for MIICL as at 31 December 2018;
- Calculation approach for the transferring provisions;
- Solvency II technical provisions for ECICL; and
- Solvency II technical provisions for MIICL.

Booked provisions for ECICL

Previously an external actuarial consultancy were engaged to estimate ECICL's reserves – their most recent review was as at 31 December 2017. Since then, the reserve review has been performed internally by the MINT (Markel International) actuarial team.

Standard actuarial techniques are used including the chain ladder and Bornhuetter-Ferguson (BF) methods. Separate analysis is performed for "attritional" claims (which MINT defines as claims with a value of less than £300,000) and "large" claims (claims of £300,000 or more). Analysing attritional and large claims separately is a standard actuarial practice.

During 2018, claims experience was worse than expected, due to deterioration in specific large losses. However, this adverse experience is fully covered by reinsurance.

MINT estimates that 50% of ECICL's reserves will have been paid out in 2 to 3 years.

For reserving purposes, MINT splits the Specialist Contractor business into four classes: Employers' Liability, Public & Products Liability, Property and Professional Indemnity. The first two classes are each split further into five subclasses and Property is split into three subclasses. Professional Indemnity, which represents less than 5% of gross written premium, is reserved in aggregate.

ECICL has exposure to "long-tail" liabilities such as asbestos-related disease including mesothelioma claims. ECICL continue to use the external actuarial consultancy's approach for reserving this business. This involves a claims projection model based on research by the Health and Safety Executive (HSE) and other studies for asbestos. This approach is similar to that used by other insurers with exposure to asbestos. The asbestos reserves are discounted for the time value of money which is in line with common market practice.

In using the asbestos claims projection model mentioned above, ECICL has used assumptions in line with benchmarks based on external actuarial advice, and then updated these assumptions in line with ECICL's own emerging claims experience.

A number of scenarios have been considered to illustrate the uncertainty in the asbestos and non-asbestos reserves. It is important to note that, the reinsurance provided by MIICL will absorb the impact of this uncertainty.

In my opinion, ECICL's approach and assumptions are reasonable in the context of the Proposed Transfer.

The gross of reinsurance provisions actually held by ECICL in its financial statements are higher than those recommended by the MINT actuarial team. On a net of reinsurance basis, the provisions are zero.

Overall, the reserving approach taken for the ECICL reserves is reasonable and in line with market practice. This is true on a gross of reinsurance basis, on a net of external reinsurance basis and on a net of all reinsurance basis.

The ECICL reserving will continue to be performed by the MINT actuarial team post-transfer.

Booked provisions for MIICL

The booked provisions for MIICL were of the order of $1bn net of reinsurance as at 31 December 2018. By comparison, the size of the transferring reserves under the Proposed Transfer is not material.

The reserving process and governance for MIICL will not change as a result of the Proposed Transfer.

 A quarterly reserve review is performed by the MINT actuarial team.

 MIICL uses standard actuarial techniques such as the chain ladder and BF methods on both a paid and incurred (ie including case estimates) basis. The analysis is performed separately for attritional claims and large/catastrophe claims.

For large losses, separate projections are performed for the number of claims and the average cost of claims.

Where historical claims development data are sparse, these are supplemented by using London Market Association market level data to derive benchmark claims development assumptions.

The provisions are calculated on two bases: (a) a best estimate basis and (b) a basis which includes an element of prudence such that the provisions are more likely to prove redundant than deficient. The actual provisions held are higher than basis (b).

MIICL stated aim is to hold a consistent monetary margin above (b) which results in held provisions consistently in excess of a 90% confidence level, based on MIICL's internal capital model. In my experience, this is higher than for many other insurers.

Note that the holding of reserves at the 90% confidence level, whilst relevant as background, is not pivotal to my opinion as IE.

Overall, the reserving approach taken for the MIICL reserves is reasonable and in line with market practice and the reserves held are prudent.

Solvency II technical provisions for ECICL and MIICL

I have reviewed the approach taken by MIICL to convert the booked GAAP provisions into Solvency II technical provisions (TPs). This includes the provisions for ECICL.

I have not sought to re-perform the calculation of the TPs or verify the calculations performed by MIICL.

I have focused my review on the areas which, in my experience, are of greatest relevance to an independent reviewer. This included the treatment of contract boundaries, Events Not in the Data (ENIDs) and the Risk Margin.

- The treatment of contract boundaries, ie allowing only for business that MIICL is legally committed to, is reasonable and in line with the TPs regulations.
- Typically, insurers allow for extreme events (ENIDs) in their TPs by adding a loading to their best estimate provisions. MIICL take a different approach by

incorporating a loading within their planning loss ratios. This is a reasonable alternative approach.

- The Risk Margin is intended to represent the premium that a third party would require to take on the liabilities of an insurer. There are a number of ways of calculating the Risk Margin. MIICL have considered alternative approaches at their Internal Model Governance and Validation meeting and justified their approach, taking into account the catastrophe-exposed nature of the business written. They also continue to monitor the impact of different methods.

My conclusion is that the approach used by MIICL to calculate the TPs is appropriate.

5.6. Key uncertainties when setting provisions

The ultimate costs of settling general insurance claims are subject to uncertainty in terms of both the frequency (ie how many valid claims there will be) and severity (ie the cost of settling each claim) including exposure to inflation in claim amounts over time. Therefore, there are uncertainties when setting the corresponding provisions.

Key uncertainties, specific to ECICL, are as follows:

- Most of ECICL’s business is Employers’ Liability and Public Liability where the claims development is volatile and claims can take a long time to settle;
- Some earlier policy years have been affected by a higher than expected severity of losses and late reporting of claims;
- The impact of recent underwriting changes is not yet clear; and
- There is exposure to asbestos which is very long-tail.

Key uncertainties within the provisions, specific to MIICL, include the following:

- Professional and Financial Risks:
    - Given the long-tailed nature of the classes of business written, there is considerable uncertainty around the tail of the claims development and the reserves are particularly sensitive to changes in claims inflation and the impact of the reserving cycle.
    - Construction Professional Indemnity: MIICL has exposure to Grenfell and defective cladding-related claims, for which there is uncertainty over the size and number of claims.
    - Pension transfers: the Financial Services business is exposed to claims arising from pension transfer advice, particularly since the introduction of the pension reform of April 2015, allowing people greater access and choice in relation to their pension arrangements.

- Casualty Treaty: MIICL has exposure to claims which may settle as Periodical Payment Orders, which are highly uncertain in terms of the size and duration of the payments.

These uncertainties are not unusual compared to other similar insurers. I am satisfied that the reserving work performed by MINT appropriately acknowledges these uncertainties.

5.7. Current reserving process and governance

ECICL and MIICL reserving process

The ECICL and MIICL reserves are calculated by the MINT actuarial team. This will be unchanged after the Proposed Transfer.

Wider stakeholder involvement in the reserving process

The MIICL and ECICL reserves are discussed and signed-off at the MINT Reserving Committee which is made up of representatives of the actuarial, finance, underwriting, risk and the claims functions.

The MINT Reserving Committee Report provides a record of the proposed reserves, key movements and issues to discuss and a record of the minutes together with any agreed actions arising from the meeting. I have reviewed an example of the MINT Reserving Committee report and have concluded they provide a detailed record of the key reserving considerations.

Actions from the Reserving Committee and any changes recommended are recorded in the minutes and circulated to attendees.

Reserving process governance

I have seen evidence of minutes from the Reserving Committee, including the capture of action points. There are also terms of reference in place for the Reserving Committee.

5.8. Future reserving approach and governance

The MINT actuarial team produce actuarial reserve studies to support the ECICL Board. The ECICL actuarial function role is performed by the MINT Chief Actuary.

Post-transfer, there will be no change to the current reserving approach and governance for MIICL, which includes the ECICL transferring business as this is part of the current MIICL process.

5.9. Setting of case estimates

Claims handlers assess claims as they are notified to an insurer and use their judgement and experience to estimate the likely cost of each claim. This is known as setting a "case estimate".

These case estimates are a key input into the reserving process as a basis for projecting the estimated costs of future claims, ie those that have not yet been reported and the additional cost of settling those that have been reported. The provision for these future claims is known as IBNR (incurred but not reported).

The IBNR also includes any expected developments on existing open claims, ie those that have been reported but not fully settled. The provision for these developments on open claims is called IBNER (incurred but not enough reported).

Depending on the type of insurance being considered, and the claims handling approach, both the IBNR and IBNER can be either positive or negative.

Markel's reserving philosophy (MINT Claims Handling Manual v.4 dated 20 May 2019):

"…is to favour redundancy over deficiency. Each reserve, whether for indemnity or costs, should reflect the Claims Adjuster's best estimate, at that time, of the ultimate cost of claim resolution given the information available and the claim adjuster's strategy for resolving the claim."

As such, initial case estimates are on average expected to reduce rather than increase over time as claims settle.

ECICL has adopted the MINT claims handling guidelines and so there will be no change to the case estimate approach post-transfer.

5.10. Overall conclusion: Reserving considerations

I have set out below my overall conclusions related to reserving. These reserving considerations should not be considered in isolation. For example, the overall level of protection for policyholders also depends on the level of capital held, and a range of other considerations. My overall conclusions on the Proposed Transfer are set out in section 10.

MIICL Policyholders

Based on the work described above, I have concluded that an appropriate level of provisions will be maintained for the MIICL Policyholders and that they will not be materially adversely affected by the reserving aspects of the Proposed Transfer.

Summary of rationale:

- The ECICL provisions, net of external reinsurance, are already reflected in the MIICL provisions, given that MIICL reinsures these liabilities.
- The transferring provisions are small compared to the MIICL provisions and so the Proposed Transfer will have a limited impact.
- MIICL has confirmed that there is no change expected to the reserving process and governance post-transfer.

Transferring Policyholders

Based on the work described above, I have concluded that an appropriate level of provisions will be maintained for the Transferring Policyholders and that they will not be materially adversely affected by the reserving aspects of the Proposed Transfer.

Summary of rationale:

- The ECICL provisions, net of external reinsurance, are already reflected in the MIICL provisions, given that MIICL reinsures these liabilities.
- ECICL have confirmed that the MIICL reserving process will be subject to the current MIICL and Group governance structure and have provided sufficient evidence to support this statement.
- The calculation of the transferring provisions has been performed using an appropriate methodology.

6. Capital considerations

6.1. Introduction to insurance capital setting

A key reason why insurers hold capital is to withstand adverse or extreme levels of claims and other losses. The capital is held in excess of the provisions for policyholders' claims and other costs associated with running an insurer.

Under Solvency II, the level of available capital is referred to as "own funds".

Definition: in this report, when I refer to the "capital coverage ratio" for an insurer, this means the available capital in excess of provisions divided by the capital required under regulations.

The coverage ratio is a measure of capital strength and, whilst it does not capture all aspects of policyholder protection, all else being equal, a higher coverage ratio provides more protection. A higher ratio indicates there is more capital available per $ of capital required.

Definition: For the purposes of this report, I describe a company as having "sufficient capital" (relative to the regulatory capital requirement under consideration) if the capital coverage ratio is above 100%. I describe a company as "well-capitalised" if the capital coverage ratio is between 150% and 200% and "very well-capitalised" if the capital coverage ratio is in excess of 200%.

6.2. Calculating capital requirements

For both ECICL and MIICL, the level of capital required is set under the European Solvency II standards.

A key metric under Solvency II is the Solvency Capital Requirement (SCR). This is an estimate of capital required to ensure that an insurer is able to meet its obligations over the next 12 months with a probability of at least 99.5%. Firms are required to hold capital equal to at least 100% of the SCR.

Under Solvency II, there are three ways in which the SCR can be calculated:

- Standard formula: under this approach, the SCR is set using a prescribed calculation and parameters, as specified in the Solvency II regulations. Within the standard formula framework, insurers can use undertaking-specific parameters (USPs) to help improve the parameterisation of the calculation for their specific business.
- Internal model: under this approach, the SCR is set using the insurer's own internal capital model. The internal model is developed and parameterised by the insurer to reflect their specific business.

- Partial internal model: under this approach, the SCR is set using a combination of the standard formula and the insurer's own internal capital model. Under this approach, some aspects of the SCR are calculated using the internal model, and the remainder is calculated using the standard formula.

The choice of approach is made by the insurer. However, an insurer needs to obtain regulatory approval in order to use USPs, an internal model or a partial internal model to calculate their SCR. An insurer does not need approval to calculate their SCR using the standard formula without USPs but does need to complete their own assessment of the appropriateness of the standard formula for this purpose.

ECICL uses the standard formula without USPs to calculate their SCR.

MIICL uses an internal model to calculate their SCR.

Capital requirements beyond a "one-year" view

The SCR is a "one-year" view of risk as it focuses on risks that an insurer faces over the next 12 months.

As part of their overall capital management, insurers typically also consider an "ultimate" view of risk that considers the risks faced over the period until the business is fully run-off.

MIICL's projected ultimate SCR is $205m. This is slightly less than the one-year SCR of $239m. The key reason is that the ultimate SCR allows for the release of the "Risk Margin" required by regulation in the opening balance sheet. This release of Risk Margin does not occur to the same extent in the one-year SCR calculation. This impact is approximately $56m. It is partially offset by the fact that some risks have a greater value on an ultimate basis than on a one-year basis. Therefore, overall, the ultimate SCR is $34m less than the one-year SCR.

ECICL uses the standard formula, which does not give an estimate of the SCR on an ultimate view. However, ECICL undertook a forward-looking assessment of capital requirements using the standard formula SCR in their 31 December 2018 Own Risk and Solvency Assessment (ORSA) and updated this analysis in July 2019. This shows that the SCR coverage ratio is expected to stay above 340% until 2023 and the Minimum Coverage Ratio (see below) is expected to stay above 200% until 2023 ie very well-capitalised on both measures. These projections do not take in to account the Proposed Transfer or any other changes in the structure of the business.

Minimum Capital Requirement

Other than the SCR, another key measure of capital under Solvency II is the Minimum Capital Requirement (MCR). This is a simpler calculation than the SCR, using a formula based partly on volumes of premiums and technical provisions. The MCR is normally lower than the SCR although it can be greater in certain circumstances, eg where an insurer is relatively small.

Firms need to hold capital equal to at least 100% of the greater of the SCR and the MCR. The purpose of the MCR is to ensure that firms are holding at least a minimum level of capital. Breaching the MCR will result in more intensive regulatory intervention than would be the case for a breach of the SCR.

Both ECICL and MIICL are projected to be very well-capitalised on this measure (with MCR coverage ratios of 268% and 532% respectively) as at 31 December 2018.

ECICL's size and, therefore, its SCR, have reduced in recent years. The SCR is now lower than the MCR. This is because, under regulation, the MCR is subject to an absolute floor of $4.2m (€3.7m).

Therefore, for ECICL, the key regulatory capital measure is the MCR.

6.3. Components of capital requirements

The key components of the MIICL's SCR are as follows:

- *Insurance risk*, which is made up of:
  - *Underwriting ri*sk: the risk that may arise from an inaccurate assessment of the risks associated with writing an insurance policy or from uncontrollable factors. As a result, the insurer's costs may significantly exceed premiums.
  - *Reserving risk*: the risk that the value of insurance claims proves to be higher than expected. For example, this covers the risk of deterioration in reserves or other catastrophe events, and uncertainties related to existing liabilities.
- *Market risk*: the risk of changes in the market value of assets, liabilities and financial instruments. For example, this covers the risk of falls in the value of assets that are being held to make future claims payments.
- *Counterparty default risk*: the risk of defaults or downgrades by counterparties that either owe the insurer money or hold money on its behalf. For example, this covers the risk of the failure of a reinsurer or a broker.
- *Other - Operational risk, Pension risk*: the risk of losses caused by failures in an insurer's operational processes, people and systems, or from events that are external to the insurer. For example, this would cover the risk of fraud or IT failure. The pensions risk relates to a defined benefit scheme. The scheme was closed to new entrants 10 years ago.

The most material component of the SCR for MIICL is insurance risk, which represents 62% of the SCR, as reported in MIICL's Solvency and Financial Condition Report

(SFCR) as at 31 December 2018. This is as expected given that insurance is the core business of MIICL.

ECICL's SCR is comprised of counterparty default risk and operational risk only, which represent 77% and 23% of the SCR respectively, as reported in ECICL's SFCR as at 31 December 2018. Counterparty default risk represents a large proportion of the SCR because of the high level of reinsurance ECICL have purchased. ECICL's SCR is below that of the MCR and so ECICL holds capital based on the MCR.

ECICL's underwriting risk charge is zero as all claims are fully reinsured.

ECICL's market risk is zero because:

- The fixed income investment portfolio has been sold, meaning that exposure to movements in interest rates is negligible.
- ECICL operates in the United Kingdom and all of its business is transacted in pounds sterling, meaning that ECICL has no direct exposure to movements in exchange rates.

6.4. My considerations related to capital

As IE, my overall assessments related to capital are:

- whether the projected capital requirements have been calculated appropriately for both MIICL and the Transferring Policyholders;
- whether there are expected to be any material adverse changes in the strength of capital protection for either group of policyholders (I have assessed this by comparing the projected SCR coverage ratios pre- and post- the Proposed Transfer); and
- whether any other aspects of the capital considerations may lead to policyholders being materially adversely affected by the Proposed Transfer.

To make these assessments, I have considered the following areas:

- The capital policy for MIICL (section 6.6);
- SCR appropriateness for ECICL and MIICL (section 6.7);
- The SCR under stressed scenarios for MIICL (section 6.8);
- The planned capital structure for MIICL (section 6.9); and
- Projected SCR coverage ratios (section 6.10).

6.5. Approach to my review

I have reviewed a number of documents provided by ECICL relating to the calculation of capital requirements and projected coverage ratios. A list of the key data and documentation reviewed is provided in Appendix 4.

I have also independently calculated selected aspects of the standard formula SCR calculation for ECICL using LCP's standard formula model and compared my results to those produced by ECICL.

6.6. The capital policy for MIICL

I have reviewed the MIICL Economic Capital & Dividend Threshold Policy. MIICL's policy is to hold a minimum economic capital requirement of 135% of the SCR, which I would consider to be sufficient capital as described in section 6.1.

As at 31 December 2018, ECICL calculated its economic capital requirement to be £3.4m ie 135% of the SCR at that date.

The MIICL Board may consider paying a dividend if capital increases above the 150% level. However, the Board will consider a number of items when deciding whether to pay a dividend or not, including a minimum level of net assets held.

6.7. SCR appropriateness for ECICL and MIICL

I have considered the SCR appropriateness for ECICL considering two aspects: the appropriateness of using the standard formula; and calculating my own independent estimates of the SCR.

I have considered the SCR appropriateness for MIICL by considering the robustness of the internal model validation that has been performed.

Appropriateness of the standard formula for ECICL

ECICL has reviewed the appropriateness of the standard formula for the purpose of calculating the SCR.

ECICL commissioned a report from an external actuarial consultancy in 2017 to assess the appropriateness of the standard formula for ECICL. The conclusion of that report was that the standard formula is appropriate for ECICL's risk profile.

ECICL has also confirmed that, given that the risk profile is now mainly counterparty default risk, followed by operational risk (with the reinsurance with MIICL having removed insurance risk) they continue to consider the standard formula as appropriate for ECICL.

Having reviewed the external report on the assessment of the standard formula appropriateness provided by ECICL, I have concluded that the standard formula is an appropriate basis for calculating the SCR for ECICL.

Independent calculation of the SCR for ECICL

I have also performed an independent calculation, on an approximate basis, of the standard formula SCR for ECICL and compared my results to those produced by ECICL.

My independent estimates provide me with the evidence required to support my conclusion that the standard formula SCR for ECICL has been calculated appropriately.

Appropriateness of MIICL's internal model

MIICL has performed validation tests on their internal model to give assurance that the internal model is appropriate for MIICL's risk profile and is sufficiently reliable that it can be used to inform decision-making within the business. I have reviewed the validation carried out to ensure it is sufficiently robust.

As of February 2019, based on the testing carried out, MIICL concluded that the internal model continues to:

- cover all material risks;
- be reliable and its results appropriate; and
- calculate the SCR and ultimate SCR in line with applicable regulations / franchisor guidance and is not materially misstated.

MIICL's internal audit carry out a review of the validation each year and all recommendations from the previous year have been addressed.

I have reviewed the internal model validation carried out. I have concluded that the internal model provides an appropriate basis for calculating the SCR for MIICL.

Given that MIICL reinsures all the ECICL business, their SCR already reflects the risks in respect of ECICL.

6.8. Scenario analysis

In addition to the SCR and MCR, it is relevant for an insurer to consider plausible adverse scenarios and how these would affect its financial position.

ECICL and MIICL have considered a number of scenarios in their ORSAs. I have summarised these below and provided my opinions on the appropriateness and likelihood of these scenarios.

ECICL scenarios

The key scenarios considered by ECICL are:

1. Reserves deteriorate above current levels: nil impact on reserving risk. Increase in counterparty default risk.
2. Expenses above plan: nil impact on underwriting risk. Increase in counterparty default risk.
3. External reinsurer fails, owing ECICL money: reduction in counterparty default risk. Shortfall in recoveries will be paid by MIICL.

Scenarios 1 and 2 result in an increase in counterparty default risk. A £5m increase in the expected recovery would increase ECICL's capital charge, before diversification by £0.5m. ECICL's expected recoveries would need to increase by ~£63m before ECICL would breach its regulatory capital. ECICL consider this to be an extremely unlikely event.

In order for ECICL's business to become unviable, it would have to be unable to make recoveries from MIICL under the terms of the LPT and reinsurance agreements entered in to in December 2017. Although this scenario is not explicitly considered within ECICL's ORSA, the ECICL Board consider this a very remote possibility given the financial strength of MIICL and Markel. In addition, as I have noted in this report, in the event of MIICL's insolvency, ECICL policyholders would rank more highly in the winding-up priority order after the Proposed Transfer than before the Proposed Transfer. In this respect, the ECICL policyholders would be better-off after the Proposed Transfer.

MIICL has a financial strength rating of "A" (Excellent) by A. M. Best and "A" (Strong) by Standard & Poor's as of 18 June 2019.

Markel Corporation is financially strong. As at 31 December 2018, it had:

- $19.2bn of assets in their investment portfolio;
- Shareholders' equity of $9.1bn; and
- Total assets of $33.3bn.

Given that ECICL holds significantly more capital than required by the MCR (which is higher than the SCR), the return period for an insolvency event would be considerably greater than 1 in 200 years.

MIICL scenarios

The key scenarios considered by MIICL are:

1. Natural catastrophe losses at various levels of loss (eg 1 in 10 year event, 1 in 250 year event).
2. A reserve deterioration equivalent to the worst 1 in 200 scenario for a single class of business.
3. A five-year global recession.
4. A "climate change" scenario involving five consecutive years of 1 in 10 year natural catastrophe losses.

In addition, MIICL has considered some combined scenarios, such as:

5. 1 in 250 net natural catastrophe losses plus a reserve deterioration equivalent to the worst 1 in 200 scenario for a single class of business.
6. A five-year global recession plus four major trade credit losses.

None of the scenarios, or combined scenarios, result in MIICL requiring additional capital from Markel Corporation for 2020.

Several of the scenarios result in a drop in profitability below MIICL's minimum target and would trigger management actions to improve returns. However, these scenarios are very unlikely.

MIICL reverse stress tests

Reverse stress tests have also been considered. These consider what it would take to make the business unviable. This could include scenarios involving the exhaustion of capital. The events required to trigger these losses are then evaluated, eg a combined ratio of c.143% would be required to exhaust total capital on one-year and ultimate bases respectively.

In our view, the reverse stress test scenarios described are all unlikely. This assessment is consistent with the results from scenario testing that show that even in the event of a 1 in 250 event or worse, no additional capital would be required by MIICL.

Conclusions

Based on my assessment, I are satisfied that MIICL has considered a reasonable set of scenarios, given the nature of the business considered. The scenarios are focused on natural catastrophe losses, which are the single most important driver of volatility for MIICL, but with a range of other types of scenario considered.

Given the substantial level of additional capital held by MIICL, I do not believe it would be necessary to conduct additional scenarios as I am comfortable, based on the evidence provided, that MIICL will remain solvent in reasonably foreseeable circumstances.

MIICL currently holds capital well in excess of its calculated SCR, to help support its business objective of maintaining its credit rating. In our view, the Proposed Transfer is unlikely to alter these objectives or MIICL's approach to holding capital. The transfer will also have limited impact on the amount of free capital held above the required level, given the small volume of business being transferred.

6.9. The planned capital structures for MIICL and ECICL

MIICL's SCR coverage ratio as at 31 December 2018 was 239% (Own Funds of $621.8m and SCR of $259.7m).

Since then, there have been two sets of changes to the internal model:

- Changes to reflect the Brexit-related Part VII transfer to MISE on 29 March 2019
- Other changes to the internal model relating mainly to catastrophe modelling and risk margin methodologies.

Following these two sets of changes, MIICL has projected the 31 December 2019 SCR and Solvency II Own Funds, giving a projected SCR coverage ratio of 256% (Own Funds of $611.4m and SCR of $238.9m).

Note that the other changes referred to in the second bullet above are subject to a major model change approval by the PRA which is not expected to be provided until near the end of 2019. I will comment on any updates to this in my Supplementary Report.

MIICL has projected the Solvency II Own Funds as at 31 December 2019 based on the ratio of Solvency II Own funds to GAAP Total Equity as at 30 June 2019 (117.6%).

MIICL has confirmed to me that this represents its best estimate of the projected year-end 2019 financial position.

Within MIICL's January 2019 ORSA, MIICL calculated its economic capital requirement for the 2019 underwriting year to be $447m ie 135% of the SCR for the year (including a pension provision).

Definition: In this section I describe Day 0 as the day before the Proposed Transfer and Day 1 as the Day after the Proposed Transfer which is expected in March 2020.

MIICL has confirmed to me that it is not aware of any known, or currently anticipated, events that would materially reduce the net asset position of MIICL between 31 December 2019 and Day 0.

Therefore, the Day 0 projections are based on the expected position as at 31 December 2019.

The MIICL projected SCR on Day 0 is based on the SCR figure submitted to the PRA on 26 June 2019. This is the latest Internal Model capital assessment, supporting the 2019 underwriting year based on data as at 31 December 2018, adjusted for the Brexit Part VII transfer.

The Proposed Transfer results in a “Day 1” capital coverage ratio for MIICL of 258% (as shown in the second table of the following section).

ECICL’s SCR coverage ratio at 31 December 2018 was 349% and the MCR coverage ratio was 268% (Own Funds of $11.3m, SCR of $3.2m, MCR of $4.2m). ECICL’s SCR coverage ratio at Day 0 is projected to be 350% and the MCR coverage ratio 254% (Own Funds of $10.7m, SCR of $3.1m, MCR of $4.2m).

The reason why ECICL’s Own Funds are projected to decrease slightly over 2019 is that there are accruals at 31 December 2018 that will be released during 2019 as expenses are settled by MIICL.

ECICL will have no remaining liabilities post-transfer.

6.10. Projected capital coverage ratios

The following tables set out the projected capital coverage ratios, prepared by ECICL and MIICL, for ECICL and MIICL pre- and post- the Proposed Transfer. These figures are current projections and I will comment on any updates to the figures in my Supplementary Report.

ECICL – coverage ratio pre- the Proposed Transfer

$m	Pre-Transfer Day 0
Total own funds eligible to meet SCR	10.7
SCR	3.1
SCR coverage ratio	350%
MCR	4.2
MCR coverage ratio (this is the most relevant measure for ECICL)	**254%**

Source: ECICL

MIICL – SCR and coverage ratio pre- and post- the Proposed Transfer

$m	Pre-Transfer Day 0	Post-Transfer Day 1
Total own funds eligible to meet SCR	611.4	617.5
SCR	238.9	238.9
SCR coverage ratio	**256%**	**258%**

Source: MIICL

On Day 1 post-transfer, MIICL is projected to be very well-capitalised (as defined in section 6.1). MIICL has projected that the transfer will increase the SCR coverage ratio from 256% to 258%. The movement is not material as MIICL already reinsures ECICL 100% and, as such, the inputs into MIICL's internal model which calculates the SCR are unchanged. In the years following the transfer, the SCR coverage will be maintained in line with MIICL's capital policy (see section 6.6).

In summary, following the Proposed Transfer:

- The capital coverage ratio for transferring ECICL policyholders is projected to increase from 254% (based on MCR) on Day 0 to 258% as part of MIICL (based on SCR) on Day 1. Therefore, Transferring Policyholders will not be materially adversely affected by this aspect of the capital considerations.
- The capital coverage ratio for MIICL Policyholders is projected to increase slightly on Day 1 post-transfer as a result of a portion of ECICL's Own Funds transferring

to MIICL. Therefore, MIICL Policyholders will not be materially adversely affected by this aspect of the capital considerations.

Therefore, I do not expect there to be any material adverse changes in the strength of capital protection for either group of policyholders.

The balance of ECICL's net assets ($4.7m at Day 1) comprising mainly bank accounts and non-technical liabilities, will be paid as a dividend to MCH at some point in the future.

6.11. Overall conclusion: Capital considerations

I have set out below my overall conclusions related to capital. These capital considerations should not be considered in isolation. For example, the overall level of protection for policyholders also depends on a range of other considerations. My overall conclusions on the Proposed Transfer are set out in section 10.

Based on the work and rationale described above I have concluded that:

- **The projected capital requirements for ECICL and MIICL have been calculated appropriately for both MIICL and Transferring Policyholders.**
- **Following the Proposed Transfer, I do not expect there to be any materially adverse changes in the strength of capital protection for either group of policyholders.**

7. Policyholder security

7.1. My considerations relating to policyholder security

As IE, my overall assessments related to policyholder security are:

- whether the likelihood of valid policyholder claims being paid is maintained following the Proposed Transfer for both the MIICL and Transferring Policyholders.
- whether any change in policyholder security results in policyholders being materially adversely affected by the Proposed Transfer.

To make these assessments, I have considered the following areas:

- The GAAP balance sheets of ECICL and MIICL (section 7.2)
- The solvency positions of ECICL and MIICL (section 7.3)
- Access to the Financial Services Compensation Scheme (section 7.4)
- Access to the Financial Ombudsman Service (section 7.5)
- Reinsurance arrangements with external reinsurers (section 7.6)
- Insurance regulation (section 7.7)

Further details on each of these considerations are set out below, and my overall conclusion related to policyholder security is set out in section 7.8.

7.2. Impact on the balance sheets of ECICL and MIICL

My analysis relies upon projected 31 December 2019 balance sheets, which are based on data as at 31 December 2018 and mid-year 2019 accounts. The actual balance sheets immediately pre- and post- the Proposed Transfer will be different from those below.

I will also prepare a Supplementary Report ahead of the Sanctions Hearing for the Proposed Transfer, which will include updated projected balance sheets and an update of my conclusions in this report.

GAAP balance sheets of ECICL and MIICL

	ECICL $m Day 0 Pre-Transfer	MIICL $m Day 0 Pre-Transfer	MIICL $m Day 1 Post-Transfer
Reinsurers' share of Technical Provisions	39.4	748.3	770.0
Deferred acquisition costs	0	33.5	33.5
Insurance debtors	7.0	31.2	38.2
Investments	0.0	864.7	864.7
Other assets	5.1	301.1	301.1
Total Assets	**51.5**	**1,978.8**	**2,007.5**
Technical provisions	39.4	1,386.0	1,407.7
Insurance creditors	0.6	61.3	61.9
Other liabilities	0.5	11.4	11.4
Total Liabilities	**40.5**	**1,458.7**	**1,481.0**
Total Equity	**11.0**	**520.1**	**526.5**

Source: ECICL, MIICL

The table above shows simplified balance sheets for MIICL pre- and post- the Proposed Transfer and the simplified balance sheet for ECICL before the Proposed Transfer.

The increase in MIICL equity is as a result of all debtors and creditors between ECICL and MIICL being settled on Day 1.

7.3. Impact on the solvency positions of ECICL and MIICL

The solvency positions of ECICL and MIICL pre- and post-transfer are summarised in the following table.

Solvency positions of ECICL and MIICL

	ECICL $m Day 0 Pre-Transfer	MIICL $m Day 0 Pre-Transfer	MIICL $m Day 1 Post-Transfer
Total own funds eligible to meet SCR	10.7	611.4	617.5
MCR (ECICL) or SCR (MIICL)	4.2	238.9	238.9
Coverage ratio	**254%***	**256%^**	**258%^**

Source: ECICL, MIICL.

* *Based on* MCR

^ Based on SCR

Based on information provided by MIICL and ECICL, the key drivers of differences between the projected GAAP Total Equity and Solvency II Own Funds at Day 0 are as follows:

- For ECICL, the Solvency II Own Funds ($10.7m) are lower than the GAAP Total Equity ($11.0m) due to inclusion of the Risk Margin under Solvency II. Other differences have a zero net impact because of MIICL reinsurance.
- For MIICL, the Solvency II Own Funds ($611.4m) are higher than the GAAP Total Equity ($520.1m). This is largely due to removal of the margin for prudence within the GAAP provisions, recognition of profit on unearned premium and inclusion of the fair value of bonds. These are partially offset by the Risk Margin under Solvency II and other technical valuation differences between the GAAP and Solvency II balance sheets.

ECICL is very well-capitalised (based on the MCR coverage ratio) immediately before the Proposed Transfer and MIICL is very well-capitalised immediately before and after the Proposed Transfer (as described in sections 6.1 and 6.10).

7.4. Access to the Financial Services Compensation Scheme

The Financial Services Compensation Scheme (FSCS) in the UK provides consumer protection. This statutory “fund of last resort” compensates customers in the event of the insolvency of a financial services firm.

Insurance protection exists for individuals and small businesses in the situation where an insurer is unable to meet its liabilities for direct policyholders only (ie reinsured policyholders are not covered). For certain insurance that is compulsory in the UK (eg motor third party liability insurance), insurance protection also exists for direct policyholders whether or not they are individuals or small businesses.

The FSCS will pay 100% of any claim incurred for compulsory insurance (eg motor third party liability insurance) and 90% of claims incurred for non-compulsory insurance (eg home insurance), without any limit on the amount payable. The PRA fund the FSCS through levies on authorised firms. No protection is available for Goods in Transit, Marine, Aviation and Credit Insurance

Transferring Policyholders who currently have access to the FSCS will retain access to the FSCS, if eligible, following the Proposed Transfer.

Therefore, there is no change to access to the FSCS.

7.5. Access to the Financial Ombudsman Service

The Financial Ombudsman Service (FOS) provides private individuals, and micro-enterprises with a free, independent service for resolving disputes with financial companies. Micro-enterprises are defined to be businesses with less than €2m annual turnover and fewer than ten employees.

The FOS was extended on 1 April 2019 to also cover small businesses. Small businesses are defined to be businesses with less than £6.5m turnover and either fewer than 50 employees or a balance sheet total of less than £5m.

It is not necessary for the private individual, micro enterprise or small business to live or be based in the UK for a complaint regarding an insurance policy to be dealt with by the FOS. However, it is necessary for the insurance policy concerned to be, or have been, administered from within the UK and/or issued from within the UK.

Transferring Policyholders who currently have access to the FOS will retain access to the FOS, if eligible, following the Proposed Transfer.

Therefore, there is no change to access to the FOS.

7.6. Reinsurance arrangements with external reinsurers

The transfer scheme provides for all of ECICL's reinsurance with external reinsurers that provide cover for the transferring business to transfer to MIICL.

Therefore, there is no material change to the external reinsurance protection provided for either group of policyholders.

7.7. Insurance regulation

Prudential regulation

Prudential regulation requires financial firms to control risks and hold adequate capital to ensure regulated firms are being run in a safe and sound way.

Both ECICL and MIICL are incorporated in the UK. The UK is currently regulated under Solvency II. Solvency II covers the prudential regulation of insurers, including risk management and capital requirements.

As ECICL and MIICL are both UK companies, any changes in insurance regulation due to Brexit would impact both ECICL and MIICL.

Therefore, there is no change to the prudential insurance regulation governing the transferring policies.

Conduct regulation

Conduct regulation of financial firms typically includes consumer protection, market conduct rules and ethical codes of conduct. Conduct is generally regulated by the insurance regulator in the country in which a risk is located and/or the location from which the business is carried out.

There is no change to the conduct regulation governing the transferring policies.

Other guarantees or policyholder benefits

ECICL and MIICL have confirmed that the Transferring Policyholders have no other guarantees or access to any other benefits that will be lost as a consequence of the Proposed Transfer.

Conclusions on regulation

Based on the above considerations, I do not expect any change in the insurance regulation governing the transferring policies.

7.8. Overall conclusion: Policyholder security

Based on the work and rationale described above, I have concluded that the Transferring Policyholders and MIICL Policyholders will not be materially adversely affected by the Proposed Transfer.

8. Policyholder communications

8.1. My considerations relating to policyholder communications

I have assessed the appropriateness of ECICL and MIICL's proposed communication strategy to inform policyholders and other stakeholders of the Proposed Transfer.

The key focus of my assessment was whether the policyholders and other stakeholders are to be provided with appropriate information so that they can understand how the Proposed Transfer may affect them.

8.2. Overview of communications strategy

ECICL and MIICL have developed a communication strategy to notify affected parties of the Proposed Transfer and allow time for affected parties to raise objections to the Court. I have summarised the main points of the communications strategy below:

Current policyholders

ECICL will notify Transferring Policyholders who comprise the following categories below:

- all Transferring Policyholders with either live policies (ie policies where the coverage period has not expired), or policies under which there are current unpaid and outstanding claims ("Active Policyholders"), except for Master Policies (see below)
- all Transferring Policyholders with policies where the period of insurance expired on or after 31 December 2015 ("Non-Active Policyholders"), except for Master Policies (see below) and policies issued through delegated underwriting agreements with Sennocke International Insurance Services Ltd, First Senior Insurance Services Ltd and Let Insurance Services Ltd (see below)
- for master policies ECICL will notify the master policyholder only. ECICL will not notify any underlying certificate holders but will request that master policyholders do so and will provide reasonable financial assistance where necessary to enable them to do so
- for Transferring Policyholders whose polices were written through delegated underwriting agreements ("DUAs") with Sennocke International Insurance Services Ltd (covering self-build residential properties); First Senior Insurance Services Ltd (covering mobility products insurance and warranty); and Let Insurance Services Ltd (covering residential landlords & tenants insurances), where ECICL has determined that the likelihood of a claim notification arising after 12 months is significantly reduced, ECICL will notify Non-Active Policyholders whose period of insurance expired on or after 1 March 2019.

Brokers, Reinsurance Brokers and Coverholders

ECICL will notify those brokers, agents and third party intermediaries ("Brokers") or coverholders through which ECICL has placed or written business, or who have placed or written business on behalf of ECICL since 30 April 2010.

ECICL will also notify those reinsurance brokers, agents or other third parties ("Reinsurance Brokers") who have placed on behalf of ECICL reinsurance contracts since 30 April 2010, which will transfer (in whole or in part) with the Transferring Business.

Other

ECICL will notify the Employers' Liability Tracing Office ("ELTO"), the centralised industry database for tracing employers' liability, which is most likely to be used by claimants when making a claim.

ECICL will notify the Electrical Contractors Association ("ECA"). As ECICL was historically a specialist insurer to the electrical industry, a large proportion of the Transferring Policyholders are expected to be active members of the ECA.

IE conclusion

I am satisfied that the communications strategy is appropriate. My rationale is as follows:

- The 31 December 2015 cut-off date for Non-Active Policyholders:

  ECICL have performed analysis which shows that over 99% of non-disease claims are notified within 4 years. In my opinion, this coverage is reasonable.

  Delays for notification of disease claims can be longer than this. However (a) any such claims can be notified in the same way post-Transfer as pre-Transfer (b) the ELTO is also able to assist claimants in finding their relevant insurer and (c) the number of such future disease claims, while unknown, is expected to be very small relative to the number of policyholders who would need to be contacted.

  I agree with ECICL's assessment that it would be disproportionate to go back earlier than the 31 December 2015 cut-off date.

- The 30 April 2010 cut-off date for Brokers, Reinsurance Brokers and Coverholders:

  In my view, this provides excellent coverage. Going back earlier would involve significant cost because it would involve IT systems which are no longer in current use, but most likely without providing any material benefit.

- The 1 March 2019 cut-off date for Transferring Policies falling under the DUAs:

  ECICL have performed analysis which shows that over 99% of claims for these three DUAs have historically been notified within 12 months.

  In addition, any claims can be notified in the same way post-Transfer as pre-Transfer.

  I agree with ECICL's assessment that an earlier cut-off date would entail disproportionate costs for little or no benefit.

8.3. Planned dispensations and rationale

ECICL and MIICL intend to request that the Court grant a dispensation from the need to directly notify the MIICL Policyholders.

ECICL and MIICL have provided a rationale to support their request for dispensation which included consideration of the judgement of Norris J in the Directions Hearing in Re Aviva International Insurance Limited [2011] EWCH 1901 (Ch.) (the Aviva Judgement). The Aviva Judgement summarised the following factors as a rationale for granting a dispensation:

- the impossibility of contacting policyholders;
- the practicality of contacting policyholders;
- the utility of contacting policyholders;
- the availability of other information channels through which notice of the application can be made available;
- the proportionality of strict compliance and the impact of collateral commercial concerns; and
- the likely impact of the Proposed Transfer on policyholders.

MIICL policyholders

ECICL's and MIICL's rationale for the dispensation sought for MIICL Policyholders is as follows (I have included in brackets the reference to the factors from the Aviva Judgement where applicable).

ECICL's and MIICL's view is that the MIICL Policyholders will have access to the information from the publications in the UK, Isle of Man, Jersey and Guernsey, so will have the opportunity to be made aware of the Proposed Scheme without direct notification (availability of other information channels).

ECICL and MIICL also believe the cost of direct notification of all MIICL Policyholders is disproportionate to the benefit received from direct notification, particularly given the MIICL Policyholders are not disadvantaged by the Proposed Transfer (proportionality and impact).

IE conclusion

I am satisfied with the rationale for the dispensation sought for MIICL Policyholders, as the information is available from other sources and my conclusions support that the MIICL Policyholders are not disadvantaged by the Proposed Transfer.

Markel have estimated the costs of contacting the 2m MIICL policyholders at £3.4m. Given that I have concluded that the MIICL policyholders are not materially disadvantaged by the transfer, these costs are, in my view, disproportionate.

8.4. Planned notices

ECICL and MIICL will comply with the regulation and place a notice of the Proposed Scheme in:

- the London Gazette, the Edinburgh Gazette, the Belfast Gazette; and
- once in each of two national newspapers in the UK, Isle of Man, Jersey and Guernsey.

ECICL and MIICL have confirmed that there are no requirements to publish notices in any non-UK EEA states.

IE conclusion

As ECICL will be notifying those Transferring Policyholders that are most likely to be affected by the Proposed Transfer, and I have concluded that MIICL Policyholders are not disadvantaged by the Proposed Transfer, I am satisfied with the proposal for planned notices.

8.5. Translation of key documents

All publication notices and major documents (including this report) will be provided in English and there are no plans to translate any documents into other languages.

Should any translations be required, the documents will be translated by ECICL and MIICL and I would rely on ECICL and MIICL to ensure that the translations into each language are accurate.

8.6. Clarity of communication

I have reviewed a draft of the proposed letter to policyholders and other stakeholders and the ‘Transferring to MIICL’ document which explains the background to the Proposed Transfer and the transfer process through a series of ‘frequently asked questions’ format.

IE conclusion

I am satisfied the communication to policyholders regarding the Proposed Transfer is clear, fair and not misleading.

8.7. Overall conclusion: Communication strategy

Based on my review of the communication strategy, I have concluded the planned communications strategy will ensure adequate coverage of affected parties. ECICL/MIICL are applying for a number of dispensations from communicating to some affected parties. I have concluded that these are appropriate.

I have also concluded that the planned communication is sufficiently clear for policyholders to understand the effects of the Proposed Transfer.

9. Customer service and other considerations

9.1. Customer service

ECICL and MIICL have confirmed that there will be no changes in claims handling and customer service and that there will be continuity in terms of service as the same team will continue to administer the transferring policies.

Customer communication channels are already hosted on Markel systems and any communication through ECICL previous phone numbers and address are routed to the current ones. The ECICL Sevenoaks office will move to Markel's Fenchurch Street office in Q4 2019 and communications will be forwarded.

As such, I do not expect that policyholders will receive a materially different level of customer service following the Proposed Transfer.

9.2. Tax implications

ECICL/MIICL have considered the tax implications of the Proposed Transfer in the draft 'Scheme' document which will be presented to the Court at the Directions Hearing.

This states that the Proposed Transfer will not become operative on the Effective Date until formal or informal confirmation from HM Revenue and Customs that the UK taxation consequences on any policy or contract will not be different to before the Proposed Transfer.

MIICL have confirmed that there are no transfer pricing implications of the Proposed Transfer.

Therefore, there are no tax implications of the Proposed Transfer on the Transferring or MIICL Policyholders.

9.3. Investment management implications

As part of the sale to Markel International in November 2017 ECICL sold the entirety of their investment portfolio to fund a loss portfolio reinsurance agreement and dividend payment to Markel.

Given that ECICL no longer hold investments there will be no change in terms of investment management for ECICL or MIICL post- transfer.

Therefore, I do not anticipate any materially adverse impact to the Transferring or MIICL Policyholders in terms of investment management as a consequence of the Proposed Transfer.

9.4. Implications on ongoing expense levels

All costs and expenses incurred relating to the Scheme will be borne by MIICL and will not be borne by policyholders.

Since June 2018, all ECICL invoices, expenses, and employee expenses have been processed or paid by Markel International Services Limited (MISL). MISL is also responsible for the payment and processing of invoices, expenses and personal expenses for MIICL and all other entities and employees within the Markel Group.

Post-transfer, there will be no change to the way that payments are processed. MISL will continue to pay all employee expenses.

Therefore, there are no impacts on the Transferring or MIICL Policyholders as a result of any changes to the ongoing expense levels.

9.5. Impact on liquidity position

ECICL has a UK GBP bank account with NatWest in which premiums are received and claims/commissions are paid out. As at March 2019, ECICL held a cash balance of £3.5m and held no investments.

Post-transfer, this bank account will close and the funds will be transferred to MIICL. As at March 2019, MIICL held cash and cash equivalent balances of $244.5m and investments of $1.14bn.

MIICL have confirmed that they have no liquidity concerns for ECICL or MIICL. All ECICL's assets are in cash and MIICL will have a small increase in liquidity post-transfer.

Therefore, I do not anticipate any materially adverse impact on the liquidity position for the Transferring or MIICL Policyholders as a consequence of the Proposed Transfer.

9.6. Set-off

I have considered whether the Proposed Transfer is likely to lead to any changes in the rights of set-off for creditors or debtors of ECICL or MIICL. "Set-off" is a right that allows parties to cancel or offset mutual debts with each other by subtracting one from the other and paying only the balance.

ECICL and MIICL have confirmed that there are no changes in set-off rights as a result of the Proposed Transfer. I have also not identified any material set-off rights as part of my review.

Therefore, I do not believe considerations around set-off impact my conclusions.

9.7. Overall conclusions: Customer service and other considerations

Based on the work and rationale described above, I have concluded that no material impact on service standards (or any other considerations within this section of the report) is expected following the Proposed Transfer.

10. Conclusions and Statement of Truth

I have considered the Proposed Transfer and its likely effects on the MIICL Policyholders, the Transferring Policyholders of ECICL and the transferring reinsurers.

In reaching the conclusions set out below, I have applied the principles as set out in relevant professional guidance, being the Technical Actuarial Standards (TASs) TAS 100: Principles for Technical Actuarial Work and TAS 200: Insurance.

I have concluded that:

- **The security provided to MIICL Policyholders will not be materially adversely affected by the Proposed Transfer. No material impact on service standards is expected for MIICL Policyholders following the Proposed Transfer.**
- **The security provided to Transferring Policyholders will not be materially adversely affected by the Proposed Transfer. No material impact on service standards is expected for Transferring Policyholders following the Proposed Transfer.**
- **Reinsurers of ECICL who provide cover for the transferring business will not be materially affected by the Proposed Transfer.**

10.1. Issues to highlight

I consider it necessary that I review the most recent information, up to the date of the Sanctions Hearing for the Proposed Transfer, when this becomes available later in the year, before confirming my opinion and conclusions.

Issues that I have highlighted in this report which require further review include:

- Any reinsurer and policyholder objections received.
- Update on the major model change application to the PRA.

I will consider these points further as part of my Supplementary Report.

10.2. IE duty and declaration

My duty to the Court overrides any obligation to those from whom I have received instructions or paid for this Report. I confirm that I understand my duty to the Court and I have complied with that duty.

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.

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

10.3. Sign-off

Charl Cronje FIA
Partner

21 October 2019

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The use of our work

This work has been produced by Lane Clark & Peacock LLP under the terms of our written agreement with Markel International Insurance Company Limited. It is subject to any stated limitations (eg regarding accuracy or completeness).

This Scheme Report, which is our work, has been prepared for the purpose of accompanying the application to the Court in respect of the insurance business transfer scheme described in this report, in accordance with Section 109 of the Financial Services and Markets Act 2000. The Scheme Report is not suitable for any other purpose.

A copy of the Scheme Report will be sent to the Prudential Regulatory Authority, the Financial Conduct Authority and will accompany the Scheme application to the relevant Courts.

This work is only appropriate for the purpose described above and should not be used for anything else. No liability is accepted or assumed for any use of the Scheme Report for any other purpose other than that set out above.

Professional Standards

Our work in preparing this document complies with Technical Actuarial Standard 100: Principles for Technical Actuarial Work, together with Technical Actuarial Standard 200: Insurance.

Appendix 1 – Glossary

Appendix 1

Term	Definition
Best estimate	An estimate prepared with no margin for either prudence or optimism included.
Bornhuetter-Ferguson (BF) method	A blend of the Chain Ladder Method and the Expected Loss Ratio Method (defined later in this glossary). The weighting given to each is dependent on how developed the claims are for a particular policy year.
Brexit	The expected exit of the UK from the EU following the referendum on continuing membership held in the UK in June 2016.
Capital Coverage Ratio	The Capital Coverage Ratio is the ratio of Available Capital to Required Capital. This is a measure of the capital strength of the insurer – the higher the ratio, the stronger the insurer.
Chain Ladder method	An actuarial method for estimating future payments or numbers by using the historical pattern of past payments or numbers to estimate a development profile, which can be used to extrapolate future payments or numbers.
Counterparty Default Risk	The risk of defaults or downgrades by counterparties that either owe an insurer money or hold money on its behalf. For example, this covers the risk of the failure of a reinsurer or a broker.
Court	The High Court of Justice of England and Wales.
Direct policyholders	Any policyholders that are not insurers or reinsurers.
European Economic Area (EEA)	The EEA Agreement established the EEA on 1 January 1994. The EEA unites the 28 EU member states with Iceland, Liechtenstein, and Norway into an internal market governed by the same basic rules. These rules aim to enable goods, services, capital, and persons to move freely about the EEA in an open and competitive environment, a concept referred to as the four freedoms.
Effective Date	The effective date of the Proposed Transfer, expected to be 2 weeks after the Sanctions Hearing in mid-March 2020.
Events not in data (ENIDs)	An estimate of possible future events or developments that are not in existing data. Insurers need to make allowance for ENIDs in their Solvency II technical provisions.
Expected Loss Ratio method	An actuarial method for estimating future payments or numbers based on combining an exposure measure and an assumed rate per unit of exposure (the “initial expected loss ratio”) for the written business.
Financial Conduct Authority (FCA)	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.

Appendix 1 (cont)

Term	Definition
Financial Ombudsman Service (FOS)	Set up by the UK Parliament, the FOS is the UK's official expert in sorting out problems with financial services. Parliament set up the FOS and has legal powers in the UK to address unresolved complaints between a business and a customer relating to financial services.
Financial Reporting Council (FRC)	The body responsible for setting actuarial standards in the UK. The FRC also regulates auditors and accountants and sets the UK's Corporate Governance and Stewardship Codes.
Financial Services Compensation Scheme (FSCS)	The FSCS is the compensation fund of last resort for customers of UK authorised financial services firms. This covers insurance for individuals and some insurance for small businesses.
Financial Services and Markets Act 2000 (FSMA)	The legislation under which Part VII governs the transfer of (re)insurance business between (re)insurance undertakings.
Generally accepted accounting principles (GAAP)	A collection of commonly-followed accounting rules and standards for financial reporting. GAAP specifications include definitions of concepts and principles, as well as industry-specific rules.
Incurred but not enough reported (IBNER)	See definition of IBNR
Incurred but not reported (IBNR)	The provision for claims that are reported in the future but relate to events that have already occurred. This includes provision for estimated developments to existing open claims, ie those that have been reported but not fully settled. The provision for these open claims is called IBNER (Incurred But Not Enough Reported). Depending on the type of insurance being considered and the claims handling approach, both the IBNR and IBNER can be either positive or negative.
Independent Expert	A suitably qualified person appointed by the Court to produce an independent report on an insurance business transfer scheme, in accordance with the FSMA. The Independent Expert's primary duty lies with the Court, and the opinion of the expert is independent of those of the sponsoring companies involved in the Transfer and the PRA.
Long-tail/short-tail	Classes of insurance business where claims typically take a long time (ie a number of years) to be reported and/or settled are often referred to as "long-tail" classes of business. Conversely, claims for "short-tail" classes of insurance business are normally reported and settled within a year or two.
Loss Portfolio Transfer (LPT)	A loss portfolio transfer is a reinsurance treaty in which an insurer cedes policies that have already incurred losses to a reinsurer. In a loss portfolio transfer, a reinsurer assumes and accepts an insurer's existing open and future claim liabilities through the transfer of the insurer's loss reserves

Appendix 1 (cont)

Term	Definition
Market risk	The risk of changes in an insurer's financial position due to changes in the market value of assets, liabilities and financial instruments. For example, this covers the risk of falls in the value of assets that are being held to make future claims payments.
Minimum Capital Requirement (MCR)	A formulaic calculation of the capital requirement as part of the existing European Solvency II regulations for insurers. Breaching the MCR defines the point of intensive regulatory intervention. The calibration of the MCR is to be the capital required to give an 85% confidence level of sufficient capital to last one year. The MCR is a simpler calculation than the SCR and is typically a less onerous requirement.
Operational risk	The risk of losses caused by failures in an insurer's operational processes, people and systems, or from events that are external to the insurer. For example, this would cover the risk of fraud or IT failure.
Own Funds	The capital in excess of provisions available to meet the SCR capital requirements under Solvency II.
Prudential Regulation Authority (PRA)	The part of the Bank of England that 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.
PRA's Statement of Policy	The Statement of Policy issued by the PRA entitled "Statement of Policy – The PRA's approach to insurance business transfers – April 2015"
Proposed Transfer	The proposed insurance business transfer of ECICL to MIICL under Section 105 of the FSMA.
Quota share reinsurance	A reinsurance contract in which the insurer and reinsurer share both claims and premiums in the same proportion. The reinsurer usually pays a commission to the insurer to allow for their costs of selling and administering the policy.
Required capital	The amount of capital an insurer must hold in order to meet its regulatory capital requirements (ie the SCR).
Reinsurance	An arrangement with another insurer to share or pass on risks.
Reinsurance bad debt	Reinsurance bad debt is a provision for amounts that are owed by reinsurers but which may not be paid, eg due to the insolvency of the reinsurer.
Reserving risk	The risk that reserves for claims prove to be insufficient.
Scheme Document	A document submitted to the Court setting out details of the Scheme or Proposed Transfer.

Appendix 1 (cont)

Term	Definition
Scheme Report	This report prepared by me, as the Independent Expert, for submission to the Court.
Solvency Capital Requirement (SCR)	The amount of capital insurers are required to hold under Solvency II regulations. This is an estimate of capital required to ensure that an insurer is able to meet its obligations over the next 12 months with a probability of at least 99.5%. If an insurer's capital (ie the excess of its assets over its liabilities) falls below the SCR, it will trigger regulatory intervention, with the intention of remedying that position.
Solvency Financial Condition Report (SFCR)	Solvency II requires each insurer to publish an SFCR annually that contains certain qualitative and quantitative information.
Solvency II	The system for establishing (among other things) minimum capital requirements for EEA (re)insurers under the Solvency II Directive 2009/138/EC.
Standard Formula	A prescribed approach under Solvency II for the calculation of capital based on an insurer's financial information (eg premiums and claims provisions).
TAS 100	The FRC issued Technical Actuarial Standard 100: Principles for Technical Actuarial Work (TAS 100) which applies to all actuarial work produced after 1 July 2017.
TAS 200	The FRC issued Technical Actuarial Standard 200: Insurance (TAS 200) which applies to all actuarial work produced after 1 July 2017.
Technical provisions	Under Solvency II, the technical provisions cover the ultimate costs of settling all claims arising from events occurring up to the balance sheet date plus the provisions for future claims (and premiums) arising on unexpired periods of risk.
Transferee	The insurer to which the business is being transferred
Transferor	The insurer from which the business is being transferred
Unallocated Loss Adjustment Expenses (ULAE)	Unallocated Loss Adjustment Expenses are expenses relating to the handling of claims that are not allocated to specific claims, eg claim handlers' salaries and office space.
Underwriting risk	The risk that the value of insurance claims proves to be higher than expected.
Unearned Premium Reserve (UPR)	A provision for the unexpired portion of insurance policies and appears as a liability on the insurer's balance sheet, since the premium would be paid back upon cancellation of the policy.

Appendix 2 – Extract from Terms of Reference

Summary of agreed scope of work

I, Charl Cronje will act as IE to support your planned Part VII transfer of EC Insurance Company Limited (ECICL) business into Markel International Insurance Company Limited (MIICL).

Your primary requirement is for the IE to act in line with Section 109 of the Financial Services Markets Act 2000.

The key deliverables from the work will be:

- The main and supplementary IE reports;
- Input as required to address any issues arising;
- Presenting my findings as IE to the Court and responding to any queries and additional court requests; and
- A summary report to support policyholder communications.

Appendix 3 – CV of Charl Cronje FIA

Fellow of the Institute and Faculty of Actuaries (qualified 2000) and Fellow of the Society of Actuaries in Ireland. Holder of Lloyd's Syndicate Actuary practising certificate. Holder of Chief Actuary (non-Life with Lloyd's) practising certificate.

Work experience	
1997 – date	**Lane Clark & Peacock LLP – Partner** **Part VII transfers** • Appointed as the IE on another Part VII transfer. • Peer reviewer for a successful Part VII transfer. Peer review work included the underlying analysis and the supporting Independent Expert reports. • Peer reviewer for another Part VII transfer which is currently in progress. **Chief actuary appointments** Appointed Chief Actuary (SIMF20) on an outsourced basis for three insurers, providing formal opinions on technical provisions, underwriting policy and reinsurance and contributing to risk management. **Reserving** • Provides independent reserving review for a number of insurance companies, as well as public sector bodies with insurance liabilities. Experience covers all major classes of business. Significant expertise in reserving EL/PL business including asbestos and other industrial disease claims. • Acted as signing actuary on eight Lloyd's syndicates and as peer reviewer on a number of others. • Significant experience communicating with boards including presenting results, providing board training, assisting with presentations to regulators, reinsurers and capital providers and designing reserving governance structures. **Risk and capital** • Independent validation of internal models for more than twenty firms. • Has developed innovative methodologies for "top-down" model validation. • Closely involved in building two Solvency II internal models from scratch. • Significant experience writing and reviewing model documentation, risk management policies and processes and ORSA documentation. • Performing and reviewing standard formula capital calculations.
1994 – 1996	**NMG Risk Managers & Actuaries (Africa) Pty Ltd - Actuarial Consultant**
1992 – 1993	**JA Carson & Partners - Actuarial Trainee**

Appendix 4 – Summary of data provided

The following is a list of the key data items I have requested and received in assessing the Proposed Transfer. All data I have requested has been provided to me. ECICL has provided a Data Accuracy Statement confirming that the data and information provided to me regarding the Proposed Transfer are accurate and complete.

1. Draft Court and regulatory documents prepared by ECICL for the Proposed Transfer, including:

- Scheme Document, Scheme Summary and Q&A booklet (dated September 2019)
- Letter to policyholders (dated September 2019)
- ECICL First Witness Statement (dated September 2019)
- MIICL First Witness Statement (dated September 2019)
- Legal notice (dated September 2019)
- Order and Directions Order (dated September 2019)

2. Draft proposed communication plan and communication prepared by ECICL:

- Proposed communication plan (dated September 2019)
- Template letter to the Transferring Policyholders and other stakeholders (dated September 2019)
- Policyholder circular (dated September 2019)

3. Documents relating to provisions and reserving processes, including:

- Calculation of MIICL Technical Provisions (as at 31 December 2018)
- MINT Reserving Committee report and minutes (as at Q4 2018 and Q1 2019)
- MIICL SAO report (dated Jun 2019)
- Reserve Report ECIC (dated July 2019)

4. Documents relating to capital and related processes, including:

- Solvency and Financial Condition Report (SFCR) for ECICL and MIICL (as at 31 December 2018)
- ECICL and MIICL Own Risk and Solvency Assessment (ORSA) reports (as at 31 December 2018)
- MIICL Economic Capital and Dividend Policy (dated May 2019)
- ECICL Standard Formula calculations (as at 31 December 2018)

- ECICL Standard Formula appropriateness assessment (dated July 2017)
- Internal Model Governance and Validation meeting minutes and Risk Margin paper (Dated February 2018)
- MIICL Validation Report (dated January 2019)

5. Other evidence prepared by ECICL and MIICL to support the Proposed Transfer, including:

- Draft projections of future balance sheets and capital requirements at the point of the Proposed Transfer for ECICL and MIICL
- MIICL Board pack on impact of major model change (dated June 2019)
- Details of the impact of the Proposed Transfer on contact points and service standards (dated July 2019)
- Information regarding the tax, investment and liquidity implications of the Proposed Transfer (dated July 2019)
- ECICL run-off plan (dated August 2018)
- ECICL and MIICL Actuarial Function Reports

6. Data Accuracy Statement

- ECICL and MIICL have provided a Data Accuracy Statement confirming that the data provided to me regarding the Proposed Transfer are accurate and complete.

Appendix 5 – Mapping to requirements

The table below shows the relevant section references in the Scheme Report where I have addressed each point in the guidance from Chapter 18 of the Supervision Manual of the FCA Handbook and the PRA's "Statement of Policy - The PRA's approach to insurance business transfers – April 2015" with regards to the scheme report.

The guidance references for "PRA x.x" are taken from the PRA statement of policy and "FCA x.x" are taken from Chapter 18 of the Supervision Manual.

Guidance reference	Guidance	Scheme report reference
PRA 2.30 (1) FCA 18.2.33 (1)	Who appointed the independent expert and who is bearing the costs of that appointment	2.3 (page 10)
PRA 2.30 (2) FCA 18.2.33 (2)	Confirmation that the independent expert has been approved or nominated by the appropriate regulator (the PRA)	2.3 (page 10)
PRA 2.30 (3) FCA 18.2.33 (3)	A statement of the independent expert's professional qualifications and (where appropriate) descriptions of the experience that makes them appropriate for the role	2.3 (page 10) Appendix 3
PRA 2.30 (4) FCA 18.2.33 (4)	Whether the independent expert, or his employer, has, or has had, direct or indirect interest in any of the parties which might be thought to influence his independence, and details of any such interest	2.3 (page 10)
PRA 2.30 (5) FCA 18.2.33 (5)	The scope of the report	2.4 (page 11)
PRA 2.30 (6) FCA 18.2.33 (6)	The purpose of the scheme	3.3 (page 19)
PRA 2.30 (7) FCA 18.2.33 (7)	A summary of the terms of the scheme in so far as they are relevant to the report	3 (page 15)
PRA 2.30 (8) FCA 18.2.33 (8)	What documents, reports and other material information the independent expert has considered in preparing the report and whether any information that they requested has not been provided	Appendix 4

Appendix 5 (cont)

Guidance reference	Guidance	Scheme report reference
PRA 2.30 (9) FCA 18.2.33 (9)	The extent to which the independent expert has relied on: (a) information provided by others; and (b) the judgement of others	2.6 (page 12)
PRA 2.30 (10) FCA 18.2.33 (10)	The people the independent expert has relied on and why, in their opinion, such reliance is reasonable.	2.6 (page 12)
PRA 2.30 (11) FCA 18.2.33 (11)	Their opinion of the likely effects of the scheme on policyholders (this term is defined to include persons with certain rights and contingent rights under the policies), distinguishing between: (a) transferring policyholders; (b) policyholders of the transferor whose contracts will not be transferred; and (c) policyholders of the transferee	Executive summary (page 4) 10 (page 56)
PRA 2.30 (12) FCA 18.2.33 (11A)	Their 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.	Executive summary (page 4) 10 (page 56)
PRA 2.30 (13) FCA 18.2.33 (12)	What matters (if any) the independent expert has not taken into account or evaluated in the report that might, in their opinion, be relevant to policyholders' consideration of the scheme.	10 (page 56)
PRA 2.30 (14) FCA 18.2.33 (13)	For each opinion that the independent expert expresses in the report, an outline of their reasons	Reserving: 5.10 (page 30) Capital: 6.11 (page 42) Policyholder: 7.8 (page 47) Communication: 8.7 (page 52) Other: 9.7 (page 55)
PRA 2.32 (1) FCA 18.2.35 (1)	A description of any reinsurance arrangements that it is proposed should pass to the transferee under the scheme	3.2 (page 16)
PRA 2.32 (2) FCA 18.2.35 (2)	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	3.2 (page 16)
PRA 2.33 (1) FCA 18.2.36 (1)	Include a comparison of the likely effects if it is or is not implemented	3.4 (page 19)

Guidance reference	Guidance	Scheme report reference
PRA 2.33 (2) FCA 18.2.36 (2)	State whether they considered alternative arrangements and, if so, what	3.4 (page 19)
PRA 2.33 (3) FCA 18.2.36 (3)	Where different groups of policyholders are likely to be affected differently by the scheme, include comment on those differences they consider may be material to the policyholders	Executive summary (page 4)
PRA 2.33 (4) FCA 18.2.36 (4)	Include their views on: (a) the effect of the scheme on the security of policyholders' contractual rights, including the likelihood and potential effects of the insolvency of the insurer; (b) the likely effects of the scheme on matters such as investment management, new business strategy, administration, claims handling, expense levels and valuation bases in relation to how they may affect: (i) the security of policyholders' contractual rights; (ii) levels of service provided to policyholders; or (iii) for long-term insurance business, the reasonable expectations of policyholders; and (c) the cost and tax effects of the scheme, in relation to how they may affect the security of policyholders' contractual rights, or for long-term insurance business, their reasonable expectations	(a) Executive summary (page 4) 7.4 (page 45) (b) and (c) 9 (page 53)

The Proposed Transfer does not involve any mutual companies or long-term insurance business. As such, PRA 2.35 and PRA 2.36 (FCA 18.2.38 and FCA 18.2.39) do not apply.

At LCP, our experts provide clear, concise advice focused on your needs. We use innovative technology to give you real time insight & control. Our experts work in pensions, investment, insurance, energy and employee benefits.

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