



**INDEPENDENT EXPERT REPORT  
OF PHILIP TIPPIN FIA  
In the matters of**

AXA ART VERSICHERUNG AG, UK BRANCH  
AND  
AXA CORPORATE SOLUTIONS ASSURANCE, UK BRANCH  
AND  
XL INSURANCE COMPANY SE, UK BRANCH

AND IN THE MATTER OF AN APPLICATION PURSUANT TO ARTICLE 27  
OF AND

SCHEDULE 2 TO THE INSURANCE BUSINESS (JERSEY) LAW 1996

IN THE ROYAL COURT OF JERSEY

DATED 1 NOVEMBER 2019

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# 1. Introduction

## The Proposed Transfer

- 1.1 The AXA Group is one of the leading global insurance and asset management businesses; the ultimate parent of the AXA Group is AXA SA, which is headquartered in France. Following the acquisition of the XL Group by AXA SA in September 2018, the AXA Group created the AXA XL Division, which is a group of AXA Group subsidiaries focusing principally on insurance and reinsurance of large property and casualty commercial lines and speciality risks. The AXA Group plans to re-organise the AXA XL Division's European structure. This involves the merger of three AXA XL Division companies: AXA Art Versicherung AG ('AXA Art'), incorporated in Germany and regulated by the Federal Financial Supervisory Authority ('BaFIN'), AXA Corporate Solutions Assurance ('ACS'), incorporated in France and regulated by the Autorité de Contrôle Prudentiel et de Résolution ('ACPR'), and XL Insurance Company SE ('XLICSE'), incorporated in Ireland and regulated by the Central Bank of Ireland ('CBI'). All three write European non-life property and casualty commercial lines business.
- 1.2 AXA Art and ACS will be legally merged into XLICSE through two respective European Cross-Border Merger processes (the 'Mergers'). The Mergers are a particular type of merger that are available to companies registered under the laws of a member state of the European Union ('EU'). They are subject to the legislation detailed in Directive (EU) 2017/1132 of the European Parliament and of the Council of 14 June 2017 relating to certain aspects of company law as implemented in Germany and Ireland (in relation to the AXA Art merger) and France and Ireland (in relation to the ACS merger). The Mergers are currently set to take place on 31 December 2019, subject to regulatory approvals.

The Mergers involve transfers of insurance business (from ACS and AXA Art into XLICSE). As ACS, AXA Art and XLICSE are EU regulated entities, the responsibility for approving these business transfers is with their home state regulators ACPR and BaFIN, and the CBI (in addition to the relevant Court approvals).
- 1.3 On 23 June 2016, the UK electorate voted to leave the EU in a referendum. The UK formally served notice under Article 50 of the Lisbon Treaty on 29 March 2017 and then underwent a period of staging negotiations regarding the terms of its exit from the EU. At the time of writing this report the set date for the UK to leave the EU was 31 October 2019. Should terms satisfactory to both parties not have been agreed by that time, the UK may have left the EU without any agreement, in what is commonly referred to as a 'no deal Brexit'. As the UK government and the EU have since agreed to an extension of the set date to leave to 31 January 2020, this has not occurred.
- 1.4 AXA Art and ACS both write business in the UK through their own UK branches ('AXA Art UK' and 'ACS UK' respectively; together the 'UK Branches' or 'Transferors'). XLICSE also writes business in the UK through its own UK branch ('XLICSE UK' or the 'Transferee'). Following a no deal Brexit, the legal framework in the UK would have changed; under Chapter 5 of the Financial Services and Markets Act 2000 (Amendment) (EU Exit) Regulations 2019 published by HM Treasury on 21 December 2018 (the 'FSMA amendment'), and following confirmation from the Prudential Regulation Authority ('PRA'), an insurance business transfer scheme under Part VII of the Financial Services and Markets Act 2000 would be required to transfer the UK Branches to XLICSE UK in connection with the Mergers.
- 1.5 The proposed transfer ('the Transfer') would involve moving all the UK Branches' customers' outstanding liabilities and obligations to XLICSE UK. This transfer would have taken place under the provision of Part VII of the Financial Services and Markets Act 2000 ('FSMA') and the FSMA Amendment, together ('FSMA (amended)'), to be sanctioned by the High Court of Justice, England ('the Court'). **As there has not been a no deal Brexit, this has not occurred, and the proposed Transfer is no longer needed to transfer the UK Branches business. As such, the Transfer application has been terminated.**
- 1.6 In addition to the Transfer described above however, which would have taken place under the jurisdiction of the law of England and Wales and as such would have needed to be sanctioned by the Court, a parallel transfer of the Jersey risks within AXA Art UK and ACS UK to XLICSE

UK is proposed in Jersey. The transfer of insurance business carried on in or from within Jersey must be approved by the Royal Court of Jersey, regardless of whether a no deal Brexit was to occur. **As such, even though my report was originally prepared for the purposes of the Transfer, which is no longer going ahead, the report will be used instead for the purposes of the Jersey transfer. I note therefore that the structure and content of the report hereafter is necessarily predicated on the requirements of the Transfer.** The conclusions still stand however, and for the avoidance of doubt, I have specifically considered the position of Jersey policyholders and my conclusions equally apply to those policyholders affected by the Jersey transfer.

In this report I refer to AXA Art UK, ACS UK and XLICSE UK as the 'Transfer Companies'.

- 1.7 I note that the Transfer and the Mergers are each conditional upon the other; a conditional order is being requested from the Court as part of the Transfer, whereby in practice the effective date of the Transfer is to be the date the Mergers occur; so if the Mergers do not go ahead the Transfer will not. Similarly, if the Transfer is not sanctioned then the Mergers will not be permitted to occur. I also note that the AXA Art cross-border merger is contingent on the ACS cross-border merger. For the purposes of this report, I assume that the Mergers will go ahead, as if this does not happen then the conditional order would apply and there would be no change to policyholders of any of the Transfer Companies. With that in mind, I note for avoidance of doubt that the end state considered in this report is that of one combined entity comprising of all of the business of AXA Art, ACS and XLICSE. I also note that if the Transfer is not sanctioned then there would be no change at all - neither Transfer nor Mergers would occur and all policyholders would remain with the company that they currently have (re)insurance protection from.
- 1.8 The Transfer described in this report is of the UK branch business of each of ACS and AXA Art into the UK branch of XLICSE. However, these branches do not have genuine balance sheets of their own distinct from the businesses that they are branches of. Whilst there is a notional allocation of assets and capital made to each European branch of the Transfer Companies for the purpose of calculating local tax charges, these allocations are only notional. The reality is that the protection afforded to customers of the UK branch of one of the Transfer Companies is that of the company as a whole, with all of the assets and capital available for policyholder protection. As such, whilst I discuss the business of the UK branches of the three Transfer companies in section 3 of this report, the relevant financial metrics for the UK branches are those of the whole company of which they are a branch. Therefore, given that the Transfer and Mergers are conditional on each other (and the AXA Art cross-border merger is conditional on the ACS cross-border merger) and therefore either all business of ACS and AXA Art ultimately transfers or none does, I have conducted my financial analysis throughout this report as though the whole of ACS and AXA Art were subject to the Transfer rather than considering some small subset of their assets and liabilities.

The proposed deadline for the Transfer to become effective is 31 December 2019 (the 'Effective Date'), at the same time as the Mergers, subject to regulatory approvals.

## **Scope and Purpose of this Report**

- 1.9 Under FSMA (amended), a proposed transfer of (re)insurance business from one entity to another can only take place if it has been sanctioned by the Competent Authority for the appropriate jurisdiction, in this case the Court. As part of the approval process a report is required from an expert (the 'Independent Expert') to aid the Court in their deliberations.
- 1.10 As Independent Expert, it is my duty to the Court to consider the impact of the Transfer on the policyholders of the Transfer Companies, along with any other policyholders affected by the Transfer. In particular, it is my duty to consider the impact on their security and service levels for their benefits as set out in Appendix 2. In this instance, the policyholders of the wider AXA Art, ACS, and XLICSE entities will also be affected. As such, I have also considered them in my analysis.

I confirm that the comments and conclusions in this report apply to all existing policyholders of AXA Art, ACS and XLICSE as at the Effective Date, irrespective of their place of residence

and/or jurisdiction within which the business is said to be carried on or in which their policy was issued.

- 1.11 I have prepared this report to address the Part VII transfer of the AXA Art UK business and the ACS UK business into XLICSE UK. This report does not consider any possible alternative arrangements to those referred to in sections 1.1-1.8. I am not aware of any other significant transaction relating to the Transfer Companies other than the Mergers set out in section 1.2.
- 1.12 This report describes the proposed transfer and discusses their possible effects on the relevant policyholder groups, including effects on security and levels of service.

**This report is organised into eight sections as follows:**

- Section 1 – The purpose of this report and the role of the Independent Expert**
- Section 2 – Executive summary and conclusions**
- Section 3 – Relevant background information on each of the Transfer Companies**
- Section 4 – Setting out the effect of the Transfer on the Transfer Companies**
- Section 5 – Discussion of the potential impact of the Transfer on stakeholders**
- Section 6 – Consideration of the appropriateness of the information provided to me which informs my opinion, including consideration of methodologies for calculations used in provision of data and scenarios following the Transfer taking effect that may affect policyholder security**
- Section 7 – Summary of findings on the proposed Transfer**
- Section 8 – Details of proposed policyholder communication**

## **The Independent Expert**

- 1.13 I, Philip Tippin, am a partner in the actuarial practice of KPMG LLP ('KPMG'). I have been a Fellow of the Institute and Faculty of Actuaries for 21 years. My detailed curriculum vitae is included in Appendix 1.
- 1.14 I have been appointed by XLICSE to act as the Independent Expert in connection with the Transfer. As at the date of this report, my appointment has been approved in principle by the PRA, following consultation with the FCA.
- 1.15 To the best of my knowledge, information and belief, I have no conflicts of interest in connection with the parties involved in the proposed Transfer and I therefore consider myself able to act as an Independent Expert on this transaction.
- 1.16 I confirm that I have no financial interest in the Transfer Companies, nor do I work for any entity belonging to the AXA Group.

I have carried out no work for ACS or AXA Art.

I am currently assisting XLICSE on a historic legal matter. This work is based on information available to XLICSE as at 31 December 2011, 2012 and 2013. This does not overlap with the information under review in this Transfer. It does not involve any consideration of hindsight or the current financial position or operations of XLICSE. Furthermore, while I may be required to appear as an Expert Witness on this matter, the Court's expected timetable will not require me to appear before late 2020, well after the conclusion of this Transfer.

I have provided various services to other AXA Group companies, however I do not consider any of these to impair my independence.

I further confirm that over each of the last 3 years, the contribution of AXA Group to KPMG's global fee income has not exceeded 0.2%, nor has its contribution to KPMG's UK fee income exceeded 0.5%.

Based on my understanding of the past, current and future proposed work of KPMG UK, I do not identify any issues with my independence arising in connection with these matters.

- 1.17 The costs and expenses associated with my appointment as Independent Expert and the production of this report will be charged to XLICSE. For the avoidance of doubt, I note that no costs of the Transfer will be borne by policyholders.
- 1.18 In reporting to the Court on the proposed Transfer my overriding duty is to the Court. This duty applies irrespective of any person or firm from whom I have been instructed or paid.

## **Reliances**

- 1.19 My role is to produce a report in a form approved by the PRA in consultation with the FCA for submission to the Court. Whilst I have been assisted by my team, the report is written in the first person singular and the opinions expressed are my own. Any review or analysis from my team has been carried out under my supervision.
- 1.20 My work has been based on the data and other information made available to me by the Transfer Companies. A list of data and other information that I have considered is shown in Appendix 4.

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

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

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

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

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

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

## **Use and limitations**

- 1.21 This report must be read in its entirety. Reading individual sections in isolation may be misleading.
- 1.22 Copies of this report will be sent to the relevant UK financial regulators: the PRA and the Financial Conduct Authority ('FCA'). This report will be used in evidence in the applications submitted to the Court. It will also be made available to policyholders, and other members of the public as required by the relevant legislation, and will be made available on a dedicated website.

This report is prepared solely in connection with, and for the purposes of, informing the Court, the PRA, the FCA and policyholders of the Transfer Companies of my findings in respect of the impact of the Transfer on the security and service levels of policyholders (including, for the avoidance of doubt, those who benefit from the cover provided under the relevant insurance

policies) and may only be relied on for this purpose. This report is subject to the terms and limitations, including limitation of liability, set out in my firm's engagement letter of 1 August 2019. An extract from this letter describing the scope of my work is contained in Appendix 2.

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

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

## **Professional guidance**

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

This report also complies with the guidance for transfer reports set out in the Statement of Policy issued by the PRA in April 2015 entitled 'The Prudential Regulation Authority's Approach to Insurance Business Transfers' and in Chapter 18 of the Supervision Manual of the FCA Handbook, in particular, sections 18.2.31 to 18.2.41 inclusive, regarding the content and considerations of the report, along with the document 'The FCA's approach to the review of Part VII insurance business Transfers' issued by the FCA in May 2018. I include a cross reference between the PRA Statement of Policy and my report in Appendix 7.

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

## **Terminology**

- 1.25 In my discussion of the effects of the proposed Transfer on the Transfer Companies concerned, I use various technical terms. The definitions of these terms as used in this report are contained in the Glossary in Appendix 5.
- 1.26 In considering the proposed Transfer, the FCA's Treating Customers Fairly ('TCF') principles should be applied. To ensure that customers are treated fairly in the future, it is necessary to establish the ways in which customers have been treated in the past, which I have done by considering the times when policyholders interact with their insurer (which are primarily through the underwriting process, the claims process and any incidental policy administration) and considering how the systems, people and processes associated with these times changes as a consequence of the Transfer, if indeed they do. From the policyholders' perspective, the successful implementation of the Transfer must be on the basis that their benefits and fair treatment are not materially adversely affected.
- 1.27 I make reference throughout this report to financial items or events that are material or immaterial. I consider an event immaterial if the expected impact of the event is very small, such that it would not influence the decisions of a reader, either on its own or in conjunction with other immaterial events. This could be because the event has a very low probability of



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

## 2. Executive Summary & Conclusions

### Overview of the Transfer

- 2.1 This report considers the impact of the proposed Transfer of the UK Branches' business to XLICSE UK.

XLICSE is the largest European commercial lines business in the AXA XL Division and writes a range of property, casualty, financial lines and specialty products across a number of international branches, including one in the UK. The companies in the AXA XL Division include XLICSE, ACS and AXA Art. I include a full list of companies in the AXA XL Division in the Glossary in Appendix 5.

ACS carries out commercial lines property and casualty insurance and reinsurance business. It is domiciled in France and has branches in Austria, Germany, Italy, Spain, Switzerland, and the UK, as well as an insurance and a reinsurance subsidiary in Brazil. ACS also has Asia Pacific branches in Hong Kong, Singapore and Australia that are undergoing the process of deregistration as portfolio transfers have been completed that mean they have no remaining insurance business.

AXA Art is a specialist insurer which specialises in art and valuables as well as high value homes, listed buildings, collectibles and jewellery. It is domiciled in Germany and has branches in France, Belgium, Italy, the Netherlands, Spain, Switzerland and the UK.

XLICSE has the permissions to service all the classes of policy being transferred into it.

- 2.2 The Transfer is a necessary condition for the Mergers to go ahead. The Mergers are part of AXA Group's plans to consolidate its European property and casualty commercial lines carriers, following the acquisition of XL Group in September 2018. The Mergers aim to reduce administration costs and increase levels of diversification and the nominal capital base.
- 2.3 The Transfer theoretically provides for the possibility of there being a limited number of policies which may not be capable of being transferred by law under the Transfer ('Excluded Policies'). This may occur if the Court, or the Royal Court of Jersey with regard to the Jersey policyholders, for any reason determines not to transfer certain policies.

Even though the Transfer is required in order to transfer UK branch policies, business is also being transferred by virtue of the Mergers, as a matter of French, German and Irish law respectively. Therefore, if a policy were to be excluded from the Transfer by the Court, it would be still be transferred as a matter of French, German or Irish law to XLICSE, before the Transferors cease to exist. If a small number of UK branch policies were to be excluded, this would be unlikely to prevent the Mergers being approved, though if the Court were to not sanction the Transfer it is highly likely that the Irish Court would also refuse to sanction the Mergers.

Furthermore, the Transfer and the Mergers are intended to occur almost simultaneously (with ACS merging one second before AXA Art), the Transfer and Mergers are each conditional on the other, and the AXA Art UK cross-border merger is contingent on the ACS cross-border merger.

In practice therefore, any residual policies and associated assets would transfer to XLICSE UK under the Mergers as the UK Branches would no longer exist following the Mergers, but would actually be part of XLICSE.

For that reason, it is therefore currently expected that there will be no Excluded Policies and I assume in my report that this is the case.

- 2.4 The Transfer Companies propose to directly notify their policyholders (with the exclusion of specific groups listed below) and also plan to advertise the Transfer through various publications in the UK. The advertisements will contain details of a dedicated website from which documentation relating to the Transfer can be downloaded. Contact details for questions or requests will also be provided on the website and in the press notices.

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

- non-transferring policyholders remaining with XLICSE;
- non-UK branches policyholders of ACS and AXA Art, who will transfer under the Mergers
- policyholders of ACS UK whose policies lapsed 12 months before 1 November 2019;
- policyholders of AXA Art UK whose policies lapsed 6 months before 1 November 2019;
- beneficiaries of Motor Fleet policies written by ACS UK;
- beneficiaries of temporary insurance written by AXA Art UK;
- accidentally omitted policyholders;
- legacy Star Assurance Company Limited policyholders (excepting those with open claims); and,
- policyholders of the UK Branches for whom accurate and complete contact details cannot be traced.

Subject to the above waivers, it is also being proposed that the Transfer Companies use the customary form of communication with policyholders; that is, policyholders that communicate with their insurer by email be notified by email (rather than post). It is noted however that in practice most of the notifications will be sent by post. There will also be a small number of policyholders whose policies are administered through a third party that will be contacted via this third party. New customers that apply for a policy after the Directions Hearing will be given a summary document prior to inception of their policies that informs them of the Transfer and refers them to the AXA website, on which there has been information available from 15 October 2019: <https://www.axaxl.com/insurance/part-vii-planning-related-to-brexit-and-the-legal-merger>

I note that there will also be a slightly shortened notification period in which policyholders have the chance to consider whether they may be adversely affected. This is due to the shortened timeline of the Transfer which is driven externally by the Brexit timeline. The Transfer Companies have undertaken steps to mitigate any disadvantage from this shortened timeline.

More detail on the above is discussed in section 8 of this report.

- 2.5 Although it is not formally part of my scope as Independent Expert I have been asked to comment on the appropriateness of the communications waivers requested in connection with the Transfer. I consider these waiver requests in detail, including the estimated number of policyholders affected by each one, in section 8 of this report. I note and accept though that the Court is the ultimate arbiter on the communication required and any waivers in respect of the same, and the PRA and FCA will also have their own opinions on these issues.

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

I consider the proposed approach to communicating the Transfer to be appropriate, reasonable and proportionate. I consider that the non-circularisation to the policyholders of XLICSE and the specific groups of policyholders of ACS and AXA Art (as set out above in summary and in section 8 in detail) is appropriate, reasonable and proportionate given the circumstances of those policyholders.

## Approach

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

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

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

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

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

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

## 2.7 Financial and economic information considered

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

- Accounting (IFRS and GAAP) and Solvency II balance sheet information based on the most recently audited financial information as at 31 December 2018 for ACS and AXA Art;
- Accounting (UK GAAP) and Solvency II balance sheet information based on the most recently audited financial information as at 31 December 2018 for XLICSE, and projected figures as at 31 December 2018 for post Transfer XLICSE;
- Actuarial reports for ACS, AXA Art and XLICSE as at 31 December 2018;
- 2016, 2017 and 2018 Solvency and Financial Condition Reports ('SFCR's) for ACS, AXA Art and XLICSE;
- 2017 and 2018 Own Risk and Solvency Assessments ('ORSA's) for ACS, AXA Art and XLICSE along with the 2019 ORSA for XLICSE; and
- Internal management information provided over the course of preparing this report.

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

- The appropriateness of the methods used by AXA ART, ACS and XLICSE to calculate the estimates of capital requirements; and

- The impact of a set of specific severe adverse events on each of AXA ART, ACS and XLICSE pre and post Transfer in order to gain comfort that, at a high level, the capital estimates are reasonable.

## Key Assumptions

2.8 In conducting my analysis I have assumed the following:

- An ancillary own funds amount of €500 million will be provided to the post Transfer XLICSE as at the date of the Mergers, assuming the Mergers are sanctioned. This will be provided by means of a capital commitment deed from XL Bermuda Ltd ('XLB'), an AXA XL Division company domiciled in Bermuda, supported by a letter of credit issued by AXA SA. I discuss this further in sections 3.27 and 4.5.
- There will be no policyholders left in the UK Branches after the Transfer, as all existing policyholders of the UK Branches will become policyholders of XLICSE as a consequence of the Transfer. As discussed in 2.3, I assume there are no Excluded Policies.
- The Transfer is to be broadly tax neutral for all of the Transfer Companies. This has been confirmed by the management of the Transfer Companies and their advisers as discussed in 4.6.
- XLICSE will continue to operate and has no current intentions to cease underwriting or carry out a further restructuring of their business as a consequence of the Transfer, other than that of the planned Mergers and the potential future Part VII transfer of UK business described in section 4.12.
- The UK will still follow the EU-wide prudential regulatory regime known as Solvency II, or an equivalent, going forward post no deal Brexit.

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

## Findings

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

- I have identified 5 distinct policyholder groups. These are:
  - i) Existing XLICSE policyholders;*
  - ii) Transferring ACS policyholders (ACS UK policyholders);*
  - iii) Transferring AXA Art policyholders (AXA Art UK policyholders);*
  - iv) Non-UK Branches ACS policyholders; and*
  - v) Non-UK Branches AXA Art policyholders.*

I also note that the impact on the non-UK Branches policyholders from each entity will be near identical to that of the respective transferring policyholders. I discuss this further in section 5.2.2.

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

*With respect to policyholders of XLICSE I conclude that:*

- (a) The policies remain with XLICSE after the Transfer;
- (b) Even though policyholders of XLICSE would see a drop in their Capital Cover Ratio based on 31 December 2018 figures, at the time that the Transfer would actually be taking place, there would be an additional €90 million capital available in XLICSE pre Transfer and an additional €590 million capital available in XLICSE post Transfer and Mergers, which would lead to an increase in Capital Cover Ratio to 135% pre Transfer and to 145% post Transfer and Mergers. As discussed in the body of my Report, the €90 million capital contribution is made up of additional €30 and €60 million capital contributions in March and June 2019 respectively. As further referenced in the body of my report, given XLICSE's capital management policy aims for a Capital Cover Ratio of 130% and allows for dividends above 130%, I additionally consider a minimum Capital Cover Ratio of 130% for XLICSE pre and post Transfer. Based on this minimum level, XLICSE is consistently well capitalised. Reserving and other financial policies remain unchanged, and the chance that XLICSE would not be able to meet its respective future obligations in full remains remote; and
- (c) There are no changes to the ability to make new claims, claims handling, the protection of policyholder data, regulatory or management framework, or the overall treatment of customers as a result of the Transfer and as such no material impact on the existing XLICSE policyholders; the reasoning behind this is described in sections 5.12 to 5.16.

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

*With respect to policyholders of ACS UK I conclude that:*

- (a) The policies move from ACS to XLICSE;
- (b) The anticipated capital coverage that ACS policyholders will benefit from will decrease from 144% pre Transfer (as at 31 December 2018) to 116% post Transfer (though rising to 145% with the additional capitalisation post Mergers), though these figures are on different bases, with ACS using an Internal Model pre Transfer and post Transfer XLICSE using the Standard Formula. If comparing on the same basis (Standard Formula), the capital coverage would increase from 98% to 116%, rising to 145% with the additional capitalisation post Mergers. Even if assuming the 130% minimum for XLICSE post Transfer, I note that both ACS and XLICSE are well-diversified insurance businesses for which the Standard Formula provides an appropriate but conservative estimate of the capital required to support the risks in the business. I do not consider that the changes seen in reserving and other financial policies from ACS UK to post Transfer XLICSE cause any material adverse impact, as the impact of different levels of reserve margin under the Transfer Companies' accounting policies is stripped out in the Solvency II balance sheets that form the basis for my conclusions overall. Therefore, the chance that post Transfer XLICSE would not be able to meet its respective future obligations in full is remote;
- (c) There are no changes to the ability to make new claims, claims handling, protection of policyholder data, or any changes in the overall treatment of customers as a result of the Transfer. I do not consider the changes to the regulatory and management framework to cause any adverse material impact; the reasoning behind this is described in sections 5.12 to 5.16; and
- (d) With regard to regulatory supervision and the protections available:

- (i) Those policyholders that currently benefit from Financial Services Compensation Scheme ('FSCS') protection will retain that entitlement post Transfer;
- (ii) Those policyholders that do not currently benefit from FSCS protection will still have no protection from the FSCS post Transfer, and their situation has not been adversely affected as a consequence of this;
- (iii) Those policyholders that currently benefit from Financial Ombudsman Service ('FOS') protection will retain that entitlement post Transfer; and
- (iv) Those policyholders that do not currently benefit from FOS protection will still have no protection from the FOS post Transfer, and their situation has not been adversely affected as a consequence of this.

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

*With respect to policyholders of AXA Art UK I conclude that:*

- (a) The policies move from AXA Art UK to XLICSE UK;
- (b) The anticipated capital coverage that AXA Art policyholders will benefit from will drop from 185% pre Transfer (as at 31 December 2018) to 116% post Transfer on a Standard Formula basis, and rising to 145% with the additional capitalisation post Mergers. I note that even if assuming the 130% minimum for post Transfer XLICSE, it remains at a comfortable level of greater than 100% of the regulatory requirements. I also note that the nominal capital base is much larger post Transfer; plus AXA Art writes short tailed business, so the substantial increase in nominal capital base outweighs the reduction in proportionate coverage. I do not consider that the changes seen in reserving and other financial policies from AXA Art UK to post Transfer XLICSE cause any material adverse impact, as the impact of different levels of reserve margin under the Transfer Companies' accounting policies is stripped out in the Solvency II balance sheets that form the basis for my conclusions overall. Therefore, the chance that post Transfer XLICSE would not be able to meet its respective future obligations in full is remote;
- (c) There are no changes to the ability to make new claims, claims handling, protection of policyholder data, or any changes in the overall treatment of customers as a result of the Transfer. I do not consider the changes to the regulatory and management framework to cause any adverse material impact; the reasoning behind this is described in sections 5.12 to 5.16;
- (d) With regard to regulatory supervision and the protections available:
  - (i) Those policyholders that currently benefit from FSCS protection will retain that entitlement post Transfer;
  - (ii) Those policyholders that do not currently benefit from FSCS protection will still have no protection from the FSCS post Transfer, and their situation has not been adversely affected as a consequence of this;
  - (iii) Those policyholders that currently benefit from FOS protection will retain that entitlement post Transfer; and

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

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

*With respect to non-UK Branches policyholders of ACS I conclude that:*

- (a) The policies will move from ACS to XLICSE as a result of the Mergers. The sanction of the Transfer will enable the Mergers to take place;
- (b) The anticipated capital coverage that ACS policyholders will benefit from will decrease from 144% pre Transfer (as at 31 December 2018) to 116% post Transfer (and rising to 145% with the additional capitalisation post Mergers), though these figures are on different bases, with ACS using an Internal Model pre Transfer and post Transfer XLICSE using the Standard Formula. If comparing on the same basis (Standard Formula), the capital coverage would increase from 98% to 116% (and 145% as above). Even if assuming the 130% minimum for XLICSE post Transfer, I note that both ACS and XLICSE are well-diversified insurance businesses for which the Standard Formula provides an appropriate but conservative estimate of the capital required to support the risks in the business. I do not consider that the changes seen in reserving and other financial policies from ACS UK to post Transfer XLICSE cause any material adverse impact, as the impact of different levels of reserve margin under the Transfer Companies' accounting policies is stripped out in the Solvency II balance sheets that form the basis for my conclusions overall. Therefore, the chance that post Transfer XLICSE would not be able to meet its respective future obligations in full is remote;
- (c) There are no changes to the ability to make new claims, claims handling, protection of policyholder data, or any changes in the overall treatment of customers as a result of the Transfer. I do not consider the changes to the regulatory and management framework to cause any adverse material impact; the reasoning behind this is described in sections 5.12 to 5.16; and
- (d) Policyholders do not have access to the FSCS or FOS pre Transfer and will still have no protection post Transfer; and their situation has not been adversely affected as a consequence of this.

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

*With respect to non-UK Branches policyholders of AXA Art I conclude that:*

- (a) The policies will move from AXA Art to XLICSE as a result of the Mergers. The sanction of the Transfer will enable the Mergers to take place;
- (b) The anticipated capital coverage that AXA Art policyholders will benefit from will drop from 185% pre Transfer (as at 31 December 2018) to 116% post Transfer on a Standard Formula basis, rising to 145% with the additional capitalisation post Mergers. I note that even if assuming the 130% minimum for post Transfer XLICSE, it remains at a comfortable level of greater than 100% of the regulatory requirements. I also note that the nominal capital base is much larger post Transfer; plus AXA Art writes short



tailed business, so the substantial increase in nominal capital base outweighs the reduction in proportionate coverage. I do not consider that the changes seen in reserving and other financial policies from AXA Art to post Transfer XLICSE cause any material adverse impact, as the impact of different levels of reserve margin under the Transfer Companies' accounting policies is stripped out in the Solvency II balance sheets that form the basis for my conclusions overall. Therefore, the chance that post Transfer XLICSE would not be able to meet its respective future obligations in full is remote;

- (c) There are no changes to the ability to make new claims, claims handling, protection of policyholder data, or any changes in the overall treatment of customers as a result of the Transfer. I do not consider the changes to the regulatory and management framework to cause any adverse material impact; the reasoning behind this is described in sections 5.12 to 5.16; and
- (d) Policyholders do not have access to the FSCS or FOS pre Transfer and will still have no protection post Transfer; and their situation has not been adversely affected as a consequence of this.

As a result I consider there to be no material adverse impact on non-UK Branches AXA Art policyholders as a consequence of the Transfer.

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

### **Expert's declaration**

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



Philip Tippin  
Fellow of the Institute and Faculty of Actuaries  
Partner, KPMG LLP  
1 November 2019

### 3. Background

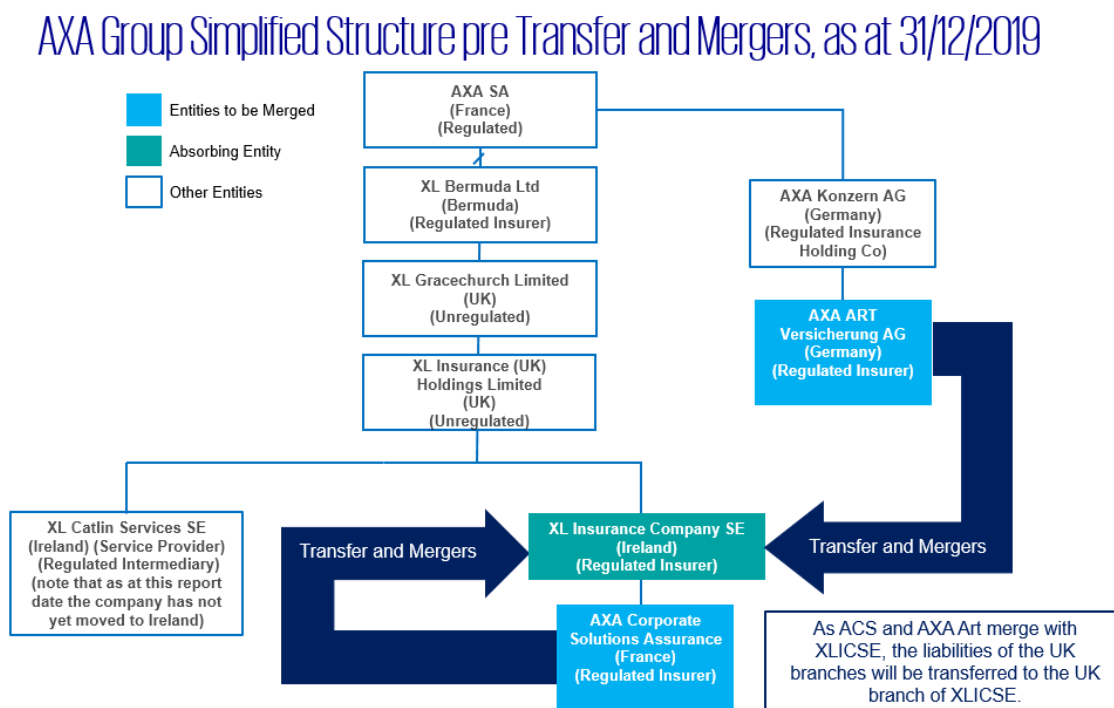
#### AXA Group

3.1 AXA Group is a worldwide insurance and asset management leader, with 171,000 employees serving 105 million clients in 61 countries. In 2018, the Group's IFRS revenues amounted to €102.9 billion and the underlying earnings to €6.2 billion. In addition, AXA had €1,424 billion in assets under management as at 31 December 2018.

The AXA Group has operations in Western Europe, North America, the Asia Pacific region and the Middle East, with a presence in Africa as well. The Group is a conglomerate of businesses run independently, operated according to the laws and regulations of the different underlying countries.

The AXA Group offers a wide range of Life and Savings, Property and Casualty, Health, Asset Management and Banking products and expertise. The AXA Group distributes its insurance products through exclusive and non-exclusive channels such as exclusive agents, salaried sales forces, direct sales, banks, as well as brokers, independent financial advisors, aligned distributors or wholesale distributors and partnerships.

3.2 The chart below shows the structure of the AXA Group pre Transfer along with the relevant entities involved in the proposed Mergers. In order for the Mergers to legally take place, ACS became a subsidiary of XLICSE on 1 October 2019.



Source: Management information

#### XL Insurance Company SE

3.3 XLICSE is the key European carrier of the legacy XL Group and is also the largest European commercial lines business within the AXA XL Division.

XLICSE's business is essentially comprised of commercial insurance, providing Property, Casualty, Financial Lines and Specialty products to industrial, commercial and professional firms across its network of branches and through fronting partners.

XLICSE writes business through offices in the UK and its branches worldwide.

XLICSE has no Europe-based employees, and services are provided by XL Catlin Services SE, which is expected to be based in Ireland by the time of the Transfer and Mergers.

- 3.4 XLICSE is authorised and regulated by the CBI and its UK branch is a member of the FSCS statutory scheme funded by members of the UK financial services industry that provides protection to policyholders. Under current FSCS rules, claims made by UK private individuals and compulsory commercial policyholders that are UK branch policyholders are protected in the event of a default of a covered insurer. However, most non-compulsory commercial policyholders are not covered by the FSCS.

The table below provides an overview of the annual financial performance of XLICSE from 31 December 2016 to 2018 on a UK GAAP basis. As noted in section 1.8 the liabilities for policies in the UK branch are backed by the entire balance sheet of the business, so this is the appropriate level of financial information to consider in my analysis.

GAAP Financial Performance (€ Millions)	XLICSE		
	2018	2017	2016
Net Earned Premium	594	576	532
<b>Profit/(Loss) after tax</b>	<b>(93)</b>	<b>(102)</b>	<b>(92)</b>
Gross Insurance Liabilities	6,598	5,569	5,119
<b>Total Liabilities</b>	<b>8,244</b>	<b>6,470</b>	<b>5,922</b>
Reinsurance Assets	5,523	4,168	3,737
Other Assets	3,529	3,110	2,906
<b>Total Assets</b>	<b>9,052</b>	<b>7,278</b>	<b>6,643</b>
<b>Net Assets</b>	<b>808</b>	<b>808</b>	<b>721</b>

Source: XLICSE Annual Reports

XLICSE's total liabilities have been growing significantly as have the entity's assets. I note that while the company has reported losses over the last three years, the 30 June 2019 results show a profit after tax of €26 million.

- 3.5 The table below provides an overview of the Solvency II balance sheet as at 31 December 2016 to 2018. The Solvency II balance sheet values assets and liabilities on a different basis to UK GAAP. This is discussed further in section 3.24.

I note that the Solvency II balance sheet is calculated at a legal entity level; as such, there is no equivalent at a branch level.

Solvency II Balance Sheet (€ Millions)	XLICSE		
	2018	2017	2016
Gross Solvency II Technical Provisions	5,363	4,518	4,138
Risk Margin	121	115	133
<b>Total Liabilities</b>	<b>6,204</b>	<b>4,834</b>	<b>4,407</b>
Reinsurance Assets	4,311	3,322	2,909
Other Assets	2,716	2,353	2,256
<b>Total Assets</b>	<b>7,027</b>	<b>5,675</b>	<b>5,165</b>
<b>Net Assets</b>	<b>823</b>	<b>840</b>	<b>758</b>
Eligible Own Funds	875	891	815
SCR	714	668	648
<b>Capital Cover Ratio</b>	<b>123%</b>	<b>133%</b>	<b>126%</b>

Source: XLICSE SFCRs

As can be seen, XLICSE is well capitalised as it has a material excess of assets over liabilities. Both assets and liabilities have increased over the three years, leading to a fairly stable level of net assets.

The Solvency II regulatory capital requirement ('SCR') and ratio of available capital to the capital requirement ('Capital Cover Ratio') for each entity are discussed further in section 5.10.

## AXA Corporate Solutions

3.6 ACS's main objective is to aid large companies (with revenues over €600 million) conduct their business, through insurance, loss prevention and claims handling. ACS is a French corporation headquartered in Paris and has a global network covering 150 countries.

ACS has no Europe-based employees, and services are also provided by XL Catlin Services SE. ACS is regulated by the ACPR. Its UK branch is also a member of the FSCS.

3.7 Note that while only the UK branch of ACS is subject to the Transfer, the policies of the branch are protected by the whole company balance sheet, so the discussion below focusses on the whole of the ACS business.

3.8 The table below provides an overview of the annual financial performance of ACS from 31 December 2016 to 2018 on an IFRS basis. Note that the published accounts are on a French GAAP basis, but the IFRS figures are considered here on the basis of consistency across the Transfer Companies. As noted in section 1.8 the liabilities for policies in the UK branch are backed by the entire balance sheet of the business, so this is the appropriate level of financial information to consider in my analysis.

IFRS Financial Performance (€ Millions)	ACS		
	2018	2017	2016
Net Earned Premium	1,262	1,307	1,285
<b>Profit/(Loss) after tax</b>	<b>125</b>	<b>33</b>	<b>156</b>
Gross Insurance Liabilities	6,118	5,973	6,570
<b>Total Liabilities</b>	<b>8,291</b>	<b>8,610</b>	<b>9,351</b>
Reinsurance Assets	1,784	1,760	2,245
Other Assets	7,440	7,773	8,149
<b>Total Assets</b>	<b>9,223</b>	<b>9,534</b>	<b>10,394</b>
<b>Net Assets</b>	<b>932</b>	<b>923</b>	<b>1,043</b>

Source: ACS management information

ACS's net assets have been fairly stable over the three years.

3.9 The table below provides an overview of the Solvency II balance sheet as at 31 December 2016 to 2018.

Solvency II Balance Sheet (€ Millions)	ACS		
	2018	2017	2016
Gross Solvency II Technical Provisions	5,689	5,446	5,885
Risk Margin	254	274	284
<b>Total Liabilities</b>	<b>8,189</b>	<b>8,262</b>	<b>8,711</b>
Reinsurance Assets	1,840	1,710	2,137
Other Assets	<b>7,882</b>	<b>8,152</b>	<b>8,514</b>
<b>Total Assets</b>	<b>9,722</b>	<b>9,862</b>	<b>10,651</b>
<b>Net Assets</b>	<b>1,533</b>	<b>1,600</b>	<b>1,940</b>
Eligible Own Funds	1,398	1,600	1,636
SCR	973	1,059	1,087
<b>Capital Cover Ratio</b>	<b>144%</b>	<b>151%</b>	<b>151%</b>

Source: ACS SFCRs

As can be seen, ACS is well capitalised as it has a material excess of assets over liabilities. The reduction in Capital Cover Ratio in 2018 was caused by the payment of a €135m dividend in line with ACS's dividend policy.

## AXA Art Versicherung AG

3.10 AXA Art is a specialist insurer headquartered in Cologne.

It specialises in the coverage of art, valuables, high value homes, listed buildings, collectibles and jewellery.

AXA Art has no Europe-based employees, and services are also provided by XL Catlin Services SE.

AXA Art's business is conducted in Germany and elsewhere in Europe. There are branches in Belgium, France, Italy, the Netherlands, Spain and Switzerland, and there is also a UK branch of AXA Art.

3.11 AXA Art is regulated by BaFIN. It is also a member of the FSCS.

3.12 Note that while only the UK branch of AXA Art is subject to the Transfer, the policies of the branch are protected by the whole company balance sheet, so the discussion below focusses on the whole of the AXA Art business.

3.13 The table below provides an overview of the annual financial performance of AXA Art from 31 December 2016 to 2018 on an IFRS basis. Note that the published accounts are on a German GAAP basis, but as above the IFRS figures are considered on the basis of consistency across the Transfer Companies. As noted in section 1.8 the liabilities for policies in the UK branch are backed by the entire balance sheet of the business, so this is the appropriate level of financial information to consider in my analysis.

IFRS Financial Performance (€ Millions)	AXA Art		
	2018	2017	2016
Gross Insurance Liabilities	130	78	71
<b>Total Liabilities</b>	<b>184</b>	<b>99</b>	<b>89</b>
Reinsurance Assets	19	1	0
Other Assets	252	202	180
<b>Total Assets</b>	<b>271</b>	<b>204</b>	<b>181</b>
<b>Net Assets</b>	<b>87</b>	<b>105</b>	<b>92</b>

Source: AXA Art management information

AXA Art has seen its liabilities and total assets increasing over the three years.

The table below provides an overview of the Solvency II balance sheet as at 31 December 2016 to 2018.

Solvency II Balance Sheet (€ Millions)	AXA Art		
	2018	2017	2016
Gross Solvency II Technical Provisions	86	43	37
Risk Margin	5	8	7
<b>Total Liabilities</b>	<b>147</b>	<b>111</b>	<b>90</b>
Reinsurance Assets	19	1	0
Other Assets	259	278	332
<b>Total Assets</b>	<b>279</b>	<b>280</b>	<b>332</b>
<b>Net Assets</b>	<b>132</b>	<b>169</b>	<b>243</b>
Eligible Own Funds	132	169	243
SCR	71	89	110
<b>Capital Cover Ratio</b>	<b>185%</b>	<b>191%</b>	<b>221%</b>

Source: AXA Art SFCRs

As can be seen, AXA Art is well capitalised as it has a material excess of assets over liabilities. Both assets and liabilities have decreased over the three years, though assets have fallen slightly more leading to a slightly decreasing level of net assets. This has been driven by the internal restructurings within AXA Art which has seen certain subsidiaries transformed into branches.

## Insurance business of the Transfer Companies

3.14 As a consequence of the Transfer, the insurance and reinsurance obligations of the Transferring Companies will transfer to XLICSE. The assets and all other liabilities will transfer as a consequence of the Mergers, which happen at the same time as the respective Transfer Company's Transfer, with the AXA Art cross-border merger occurring a second after the ACS cross-border merger.

The table below shows comparative metrics for the Transfer Companies. Open claims information is provided for the Transferring Companies in order to give an indication of the open claim volumes transferring to XLICSE. Reserve information is provided for all Transfer Companies in order to give perspective on the size of the entities involved.

Transfer Companies' Business Profile as at 31 December 2018 (€ Millions)			
	XLICSE	ACS	AXA Art
Gross Claims Outstanding - Whole entity	5,184	5,543	75
Net Claims Outstanding - Whole entity	782	3,889	56
Number of Open Claims - Whole entity	69,607	143,879	7,774
Gross Claims Outstanding - UK Branch	1,435	688	10
Net Claims Outstanding - UK Branch	0	490	8
Number of Open Claims - UK Branch	8,924	12,596	347

Sources: Management information; respective GAAP accounts

I note that the claims outstanding figures in the above table are based on figures in the published GAAP accounts rather than IFRS numbers.

### 3.15 Business written by XLICSE

XLICSE's business is mostly comprised of General Liability insurance business (45% of the Gross Written Premium ('GWP') as at 31 December 2018), of which the largest lines are International Casualty and Financial Lines, and Fire and Other Damage to Property insurance business (33% of the 2018 GWP), of which the main line of business is International Property.

Approximately 20% (by GWP) of XLICSE UK's business include policies which benefit from FSCS protection.

In 2018, around 21% of XLICSE's business had been written in the UK, 15% in Germany, 11% in France, 7.5% in Australia, 5% in Spain, 5% in Singapore, and more than a third of its total business (c. 36% remaining) relates to other geographies worldwide.

### 3.16 Transferring business written by ACS UK

ACS UK's business is only a small proportion (8% by number of policies) of total business carried out by ACS globally. ACS UK is an international commercial lines property and casualty insurer. It writes business in Marine, Property, Casualty, Liability, Financial Lines and Construction as well as Motor Fleet insurance for its clients, who are large corporates.

ACS UK writes relatively low volume (4,453 policies in total) but high value (£268.6m GWP) business, as at 31 December 2018.

Approximately 21% (by GWP) of ACS UK's business includes policies which benefit from FSCS protection.

The majority of ACS UK policies are direct policies, although it also writes Group Motor Fleet policies. The Motor Fleet policies are usually issued to a corporate, and there may be additional beneficiaries added temporarily to Motor Fleet policies. Such additional beneficiaries will have a limited portion of the insured interest under the policy.

ACS UK writes a small amount of inwards reinsurance business, mainly for local policies written by other AXA Group members globally and as captive for London Market business. The reinsurance covers the same underlying business lines as ACS underwrites above.

As at 31 December 2018, 90% of ACS UK policies (equivalent to 92% of GWP) were intermediated by third party distributors. Based on GWP, 36% of ACS UK policies' state of risk is situated in the UK, which comprises the largest location of risks. The remainder of ACS UK policies cover risks across 126 other countries, as well as worldwide policies which provide cover globally. Of the other countries covered, the largest are the US (6% of GWP) and worldwide policies (5% of GWP). EU (non-UK) risks comprise around 30% of the total.

The business transferring, irrespective of the location and governing law of the underlying risks, was underwritten and is being conducted in the UK, which is why it has to be transferred under a Part VII Transfer, and falls under the scope of the Part VII regulations. For policies not governed by either English law or any other EEA law the Transfer can still take place. Policies will also effectively transfer under the Mergers in any case as a cross-border merger necessitates a transfer of all of the business held in one entity to another; it is expected that the Mergers will be more widely recognised than the Transfer under other jurisdictions, including in the United States.

### 3.17 Transferring business written by AXA Art UK

AXA Art UK's business represents a small proportion (12% by number of policies) of the overall business carried out by AXA Art globally.

AXA Art UK is an international global specialist underwriter for art and collectors' items and insurance policies include Art, Contents, Buildings, Jewellery, Business Interruption and Liability insurance.

In addition, AXA Art UK has a legacy book of business constituting legacy Star Assurance Company Limited customers. Star Assurance Company was founded in 1977 and was designed to cover the UK subsidiaries of AXA Nordstern Art Versicherung AG's (now AXA Konzern AG) clients. It has been in run-off for over 25 years. The claims reserve held for this business is extremely low (£30,000 as at 31 December 2018) and the policies are managed through Capita plc.

99% of AXA Art UK's policies are distributed through third parties, and approximately 65% (based on GWP) of AXA Art UK's state of risk is situated in the UK. The remainder of AXA Art UK's policies cover risks located in 55 other countries. Only 21 (equal to £62,000 of GWP) of AXA Art UK's 6,489 policies (as at 31 December 2018) were direct business.

All insurance policies written by AXA Art UK benefit from FSCS coverage, provided that the policyholder is eligible as described in section 3.4. AXA Art estimates this to be around of 62% (by GWP as at 31 December 2018) of its UK branch policyholders.

AXA Art UK also has a small amount of inwards reinsurance business. The business is predominantly Asian and Middle Eastern art and high net worth business originally written by AXA Group entities in Hong Kong, Singapore, China and the United Arab Emirates.

The business transferring, irrespective of the location and governing law of the underlying risks, was underwritten and being conducted in the UK, which is why it has to be transferred under a Part VII Transfer, and falls under the scope of the Part VII regulations. For policies not governed by either English law or any other EEA law the Transfer can still take place. Policies will also effectively transfer under the Mergers in any case as a cross-border merger necessitates a transfer of all of the business held in one entity to another; it is expected that the Mergers will be more widely recognised than the Transfer under other jurisdictions, including in the US.

### 3.18 Noteworthy liability types in the entities

#### ACS:

A significant amount of ACS UK's business written is long tailed. ACS UK writes a large proportion of Liability business (43% of reserves as at 31 December 2018). The Liability line of business mainly provides General Liability and Employers' Liability coverages to clients with a turnover above €10 billion.

The French Liability business also has additional specific exposures to Alternative Risk Transfer contracts, asbestos related risks and annuities.

#### *Motor annuities:*

Annuities are paid as compensation to injury victims as a periodic payment for life rather than as a lump sum and originate from the Motor, and the Liability Directors & Officers French books. This creates the potential for very long term exposure (in excess of 20 years) and exposure to a range of risks including those arising from future investment returns and economic factors such as inflation and longevity risk. The UK branch of ACS has three open motor annuities (also known as Periodic Payment Orders or PPOs). The annuity reserves are calculated by AXA France on behalf of ACS given the additional expertise and tools it has available in AXA France to model annuities. Unlike life insurance or pensions-type annuities, the provider is not selected by the recipient of the annuity, as they are an injured party rather than the original policyholder, though they do acquire rights under the original insurance policies. As such the recipient of such an annuity cannot argue that they actively chose for it to be provided by ACS because of their reputation. I also note though that this Transfer is an intra-group Transfer, so the extent to which any policyholder takes comfort from the overall financial strength of the AXA Group should also not be changed by the Transfer.

#### *Asbestos:*

The nature of the health issues stemming from asbestos mean that previously unknown claims can develop from unexpired policies. Given the age of the liabilities it can be difficult for some companies to identify all of the potentially affected policyholders.

ACS are exposed to long tailed disease for several clients with exposures relating to the generation years (the year in which employment and hence exposure to disease began) between 1915 and 1995 through a range of Liability products offered. The UK branch of ACS has immaterial exposures to these risks.

#### AXA Art and XLICSE:

AXA Art UK reserves mostly relate to fine art and high net worth business underwritten for private policies and high-net worth individuals. Most of the exposure is in Hong Kong, Norway,



Switzerland, UK and US. It is short tail business with no exposure to annuities. It has very low exposure to asbestos related risks in its UK branch.

XLICSE has no exposure to asbestos related risks or annuities.

I discuss the annuity and asbestos liabilities further in the below section.

### 3.19 Business mix

The table below shows the ACS annuity and asbestos reserves as at 31 December 2018 and their relative sizes to the whole entities of pre Transfer ACS (on a GAAP basis) and the post Transfer XLICSE. I do not show AXA Art reserves as their exceedingly small size means they would show as null values; I note therefore that they are immaterial.

Annuity and Asbestos reserves (€ Millions)		
	Gross	Net
ACS Claims Reserves - Whole Entity	5,543	3,889
Post Transfer XLICSE Claims Reserves - Whole Entity	10,802	4,727
ACS Annuities Reserves - Whole Entity	73	73
ACS Asbestos Reserves - Whole Entity	60	55
<b>ACS Annuities and Asbestos Proportions:</b>		
Annuities as a % of ACS	1%	2%
Annuities as a % of Post Transfer XLICSE	1%	2%
Asbestos as a % of ACS	1%	1%
Asbestos as a % of Post Transfer XLICSE	1%	1%

Sources: Management information; respective GAAP accounts

As shown in the table above, ACS has asbestos and annuity liabilities though given the size of ACS and the post Transfer XLICSE, they are not material.

In addition, the asbestos reserves mostly sit on older years of business – €48 million of the reserves relate to incidents from 2003, €9 million to those in 2005, and the more recent years are various smaller amounts.

Furthermore, most of the annuity and asbestos reserves are in respect of France-underwritten exposures; as discussed in the previous section, there are an immaterial amount of known annuity and asbestos reserves in the UK branch. Gross outstanding claims reserves stand at €1.0 million for annuities and €0.1 million for asbestos.

I have considered the fact that annuities could grow as a proportion of the existing reserves if economic conditions or mortality assumptions were to change for the worse, but the relative immateriality of these reserves in the context of the combined post Transfer and Mergers balance sheet means that even an extreme deterioration in these reserves makes only a small impact on the capital level of XLICSE, and as a consequence none of my conclusions in this report would change.

Given the above, I do not consider either the asbestos or annuity reserves in ACS to pose a material adverse impact to the XLICSE and AXA Art groups of policyholders.

I also note that the people and systems used to manage the annuity and asbestos reserves will not change as a result of the Transfer, so there is no risk from loss of experience to the policyholders of the annuity and asbestos claims.

## **Outwards reinsurance programmes**

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

3.21 The key risk protections are as follows:

- XLICSE, ACS and AXA Art have two groups of reinsurance arrangements that they refer to by the relationship shared with each set of reinsurers. They hold External Risk Transfer arrangements with reinsurers that are external to the AXA Group and Internal Risk Transfer arrangements with reinsurers within the AXA XL Division. External Risk Transfer arrangements also extend to reinsurers that are within the AXA Group but are outside the AXA XL Division.
- External Risk Transfer arrangements:
  - These comprise of standard non-proportional and proportional reinsurance contracts i.e. Catastrophe Reinsurance, Excess of Loss Reinsurance and Quota Share ('QS') Reinsurance
- Internal Risk Transfer arrangements:
  - XLICSE arrangements are primarily on a QS basis whereby it shares a percentage of all premiums and claims with a reinsurer – XLB. This percentage is 60% for all classes of business except commercial bond where 95% of all premiums and claims are shared.
  - ACS has Catastrophe Reinsurance, Property Excess of Loss and Engineering Excess of Loss policies purchased from XL Re Europe SE, another AXA Group company.
  - AXA Art has an Excess of Loss Reinsurance protection for Personal, Property and Motor Damage with XLB.
  - There are also facultative reinsurance arrangements that XLICSE, ACS and AXA Art participate in. Facultative reinsurance is the reinsurance of one single direct insurance policy for a specific risk or several direct insurance policies formed around a shared common interest or activity (e.g. associations, clubs, trade groups, non-profits and professional organizations).
  - XLICSE UK also has a loss portfolio arrangement with XLB, covering all business from 2018 and prior that is exposed to UK risks. This means that all of the losses on this business from 2018 and prior are reinsured by XLB to a zero reserve net of reinsurance as at 31 December 2018.

## **Policy and claims administration**

3.22 Under the current operating model, XLICSE, ACS and AXA Art each have independent, in house claims administration systems. All of the workforce of the Transfer Companies are employed by the same service company XL Catlin Services SE, an AXA Group service company based in Ireland.

## **Employers' Liability Tracing Office ('ELTO') system**

3.23 ELTO is set up to provide claimants, insurers, policyholders, and other interested parties with access to a database of UK Employers' Liability ('EL') policies through an online search engine. The system can be used, for example, to find the insurer of a previous employer where the claimant has suffered from injury/disease caused by previous employment. ELTO requires all insurers to upload the details on all new and renewed EL policies from April 2011 and any policies prior to that which have had new claims made against them after this date. XLICSE and ACS are members of ELTO. AXA Art makes its UK EL records available via their website

rather than using ELTO. All three Transfer Companies are materially compliant for the Employers' Liability Register audit and Directors' certificate.

## **Prudential capital requirements**

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

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

Other key requirements of this regime are as follows:

- Insurance entities must calculate their Solvency II capital requirement ('Solvency Capital Requirement' or 'SCR') either using a set of rules specified in EU legislation (the 'Standard Formula'), or, subject to the approval of their regulator, using an internally developed economic capital model (an 'Internal Model'). In either case, the determinants of the solvency capital requirement relate to the nature of the risks within the regulated entity, including market related investment risk, insurance risk arising from new business or existing liabilities, and other business risks including credit risk and operational risk.
- Both XLICSE and AXA Art calculate their SCR using the Standard Formula approach while ACS calculates its SCR using a regulatory approved Internal Model. Post Transfer XLICSE will continue to calculate its SCR using the Standard Formula. There is a plan for the post Transfer XLICSE to apply for Internal Model approval in the future, though this is not in motion as of yet.
- Regulatory capital requirements are defined in terms of an SCR and a Minimum Capital Requirement ('MCR'). The requirements are calculated based on a complex formula based on items including the technical provisions, written premiums, reinsurance, deferred tax and administrative expenses.
- The method with which insurance entity balance sheets and the definition of capital are calculated for regulatory purposes is now based on largely economic measures of assets and liabilities, rather than accounting based measures.
- A range of minimum standards relating to insurance entity governance and disclosure have been introduced (known as 'Pillar II' and 'Pillar III'), including a requirement to perform and document an ORSA.
- If an insurer's available resources fall below the SCR, then supervisors are required to take action with the aim of restoring the insurer's finances back to the level of the SCR as soon as possible. If, however, the financial situation of the insurer continues to deteriorate, then the level of supervisory intervention will be progressively intensified. The aim of this 'supervisory ladder' of intervention is to identify any ailing insurers before a serious threat to policyholders' interests is realised. If, despite supervisory intervention, the available resources of the insurer fall below the MCR, then 'ultimate supervisory action' will be triggered. This means that the insurer's liabilities could be transferred to another insurer, the licence of the insurer withdrawn, the insurer closed to new business and its in-force business liquidated.

I note that:

- I have reviewed the Solvency II capital positions of the Transfer Companies' entities (Standard Formula for AXA Art and XLICSE and Internal Model for ACS) to compare the

relative difference in policyholder positions before and after the transfer of liabilities. The appropriateness of this approach and more detailed description of this analysis can be found in section 5.9.

- I have considered the stress tests included within the ORSAs produced by AXA ART, ACS, and XLICSE in determining the stress tests to apply when considering the policyholder security for each policyholder group in section 6 below.

## **Capital management policy**

3.25 ACS and AXA Art follow the overarching AXA Group capital management policy that allows each entity to take into account local specificities that better suit their risk profile. AXA Art uses a formula that targets a minimum Capital Cover Ratio of 130%. ACS uses a formula that gives a target between 140% and 145%.

There is an overarching capital management policy that is being implemented following the acquisition, regardless of the Transfer. The Board of XLICSE targets to maintain a capital buffer of 30% above the SCR, and capital is regularly monitored, forecasted and reported during a quarter, before formal submission to the regulator in the Quarterly Solvency Returns. If the capital falls below this buffer, XLICSE sets out a plan to increase it that takes into account the timing and nature of why it is below 130%. I note the capital coverage at 31 December 2018 was lower than 130%; I describe and comment on XLICSE's action plan in section 4.5.

3.26 XLICSE has a dividend policy whereby in cases where the Capital Cover Ratio is above 130%, dividends are considered for payment.

## **Guarantees / risk sharing arrangements**

3.27 In addition to the reinsurance arrangements described in sections 3.20 and 3.21, AXA Art has confirmed that it has a guarantee held on its reinsurance business in the form of a letter of credit from AXA Insurance Corporation, a US based AXA Group company. This was worth €2.6 million in 2018. ACS holds a guarantor position on one guarantee, and holds two letters of credit in respect of AXA Group subsidiaries.

XLICSE has a capital maintenance arrangement from XLB that enables XLICSE to draw down additional funds up to €400 million over and above any normal capital contributions that it requests from XLB. However, I note that these additional funds are not recognized as own funds under Solvency II.

In addition XLICSE has a floating charge arrangement with XLB, which provides some security for the reinsurance asset that XLICSE holds against XLB in the event of scenarios that reduce the financial strength of XLB. XLB grants XLICSE a floating charge over assets held in its Euro and Sterling accounts in an amount up to €1.25 billion (the "Charge"). In the event XLB's financial strength rating from S&P decreases to A-, the amount of the maximum amount of the Charge automatically increases to €1.7 billion. The Charge converts from a floating charge to a first ranking security interest upon certain events, including a downgrade of XLB's financial strength rating to S&P BBB+ and certain other actions relating to termination of XLB's existence, liquidation, solvency or winding up or satisfaction of its liabilities. At the date of this report collateral of €265 million (on a funds withheld basis) has been provided by XLB to support the Charge.

As mentioned in section 2.8, it is planned that a separate capital arrangement is agreed which will be recognized under Solvency II; this is in order to address the increase in capital required realised by ACS's effective move from Internal Model onto Standard Formula post Transfer. It is to be provided as an ancillary own funds capital commitment deed from XLB. This commitment will be to provide €500 million over one or more contributions on demand, and will last for five years. The commitment requires approval from the CBI before it can be considered as part of the solvency capital. The signed documents for that approval application have been provided to the CBI and approval was anticipated by 31 October 2019. To address XLB's counterparty risk under the capital commitment deed, XLICSE can call under a €500 million five year internal letter of credit issued by AXA SA, in the event XLB fails to pay under the capital commitment deed. The capital commitment deed has been approved by the XLB and XLICSE Board, and the issuance of the letter of credit has been approved by the Boards of both XLB and AXA SA. The letter of credit and the capital commitment deed will be effective from the date of the Mergers taking place, which is currently expected to be 31 December 2019.

There are no other intragroup guarantees in place supporting any insurance liabilities for any of the Transfer Companies.

## **Pension Scheme Obligations**

3.28 All three entities operate pension schemes. The schemes have each, at some point, had both defined benefit and defined contribution sections; the defined benefit sections are now all closed to future accrual and all current employees (within XL Catlin Services SE) are in defined contribution schemes; the costs of these are recharged from XL Catlin Services SE to the relevant entity.

XLICSE is the sponsoring employer for a German defined benefit, unfunded scheme. It only has 19 members. The total yearly costs for the scheme have been falling over the last three years, from €74.6k in 31 December 2016 to €47.4k at 31 December 2018.

AXA Art is the sponsoring employer for a small defined benefit scheme with only three remaining members. The vast majority of the remaining liability sits in respect of pensioners in payment. The size of obligations under this scheme is not material to XLICSE post Transfer and Mergers.

ACS is no longer liable for its defined benefit scheme; when the employees of ACS UK Branch transferred to XL Catlin Services SE (in February 2019) the defined benefit liabilities, legally transferred to AXA UK Plc, another AXA Group company. The deficit at these point was around £2 million.

I discuss this further in sections 4.9 and 5.7.

## **Litigation risk**

3.29 I note that the Transfer Companies are regularly involved in legal disputes as they defend third party claims. This is part of the usual business of insurance companies, and does not change any of the analysis in this report. However, I have been made aware of a confidential dispute involving a non UK branch of XLICSE which is outside the normal course of business. I have considered what I believe to be the worst case financial outcome for XLICSE in the event that they were to lose this dispute (an amount of around €60m), and am satisfied that this would not be so material as to change any of the conclusions reached in this report.

## 4. Effects of the Transfer

### Financial effects of the Transfer

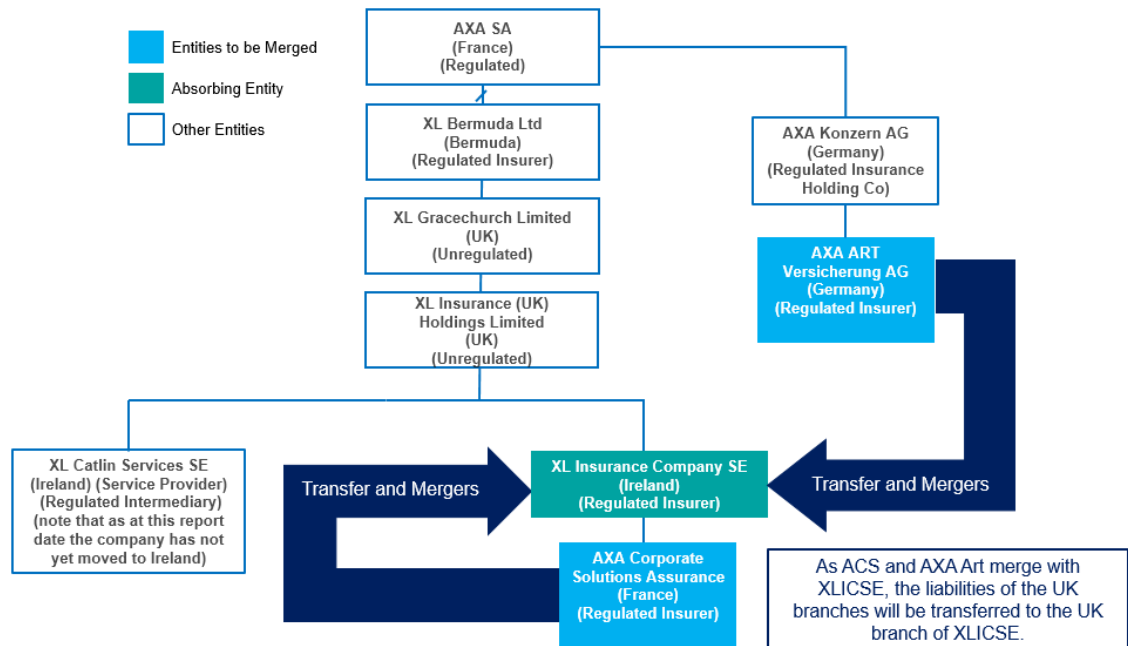
#### Effect of the Transfer on the AXA Group structure

- 4.1 As a consequence of the Transfer the insurance obligations relating to transferring policies of the UK Branches will transfer to XLICSE UK. As a consequence of the Mergers, all remaining assets and liabilities of ACS and AXA Art will merge with XLICSE.

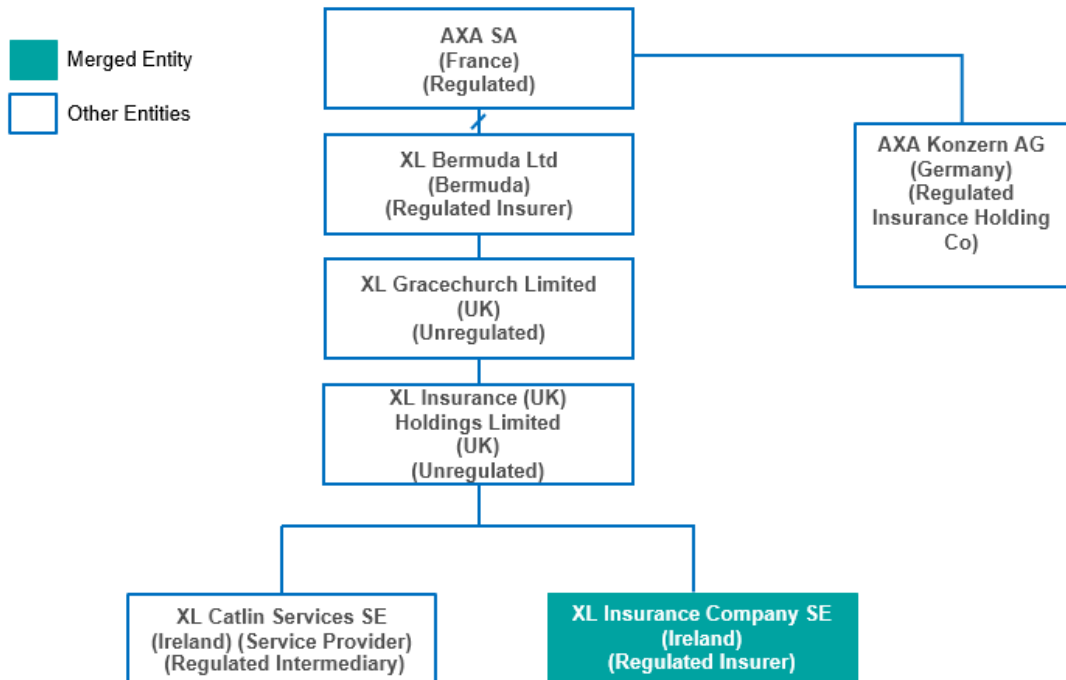
The first simplified group structure chart below is the same as that in section 3.1, showing the structure of the AXA Group just before the Transfer along with the relevant entities involved in the proposed Mergers. As mentioned in section 3.1, in order for the Mergers to legally take place, ACS became a subsidiary of XLICSE on 1 October 2019.

The second chart illustrates the simplified group structure after the Transfer and Mergers, highlighting which entities will remain after the Transfer and Mergers.

AXA Group Simplified Structure pre Transfer and Mergers, as at 31/12/2019



## AXA Group Simplified Structure post Transfer and Mergers



Sources: Management information

### Effect of the Transfer on Transfer Company balance sheets

- 4.2 I have carried out my analyses based on figures as at 31 December 2018 for the purposes of this Independent Expert report.
- 4.3 As presented in section 3, XLICSE figures are reported on a UK GAAP basis while ACS and AXA Art are reported on an IFRS basis. The difference in accounting treatments between these bases is immaterial.
- 4.4 The table below illustrates the financial position (on a UK GAAP basis) of the Transfer Companies' entities following the Transfer, based on the financial position as at 31 December 2018, assuming that all assets and liabilities at that date were to transfer from ACS and AXA Art to XLICSE.

In advance of the Transfer, the business of three Asia Pacific based branches of ACS have been portfolio transferred to XLICSE. The Hong Kong branch transferred on 1 July 2019, the Singapore branch on 1 August 2019, and the Australia branch on 1 September. The below figures show the state before these portfolio transfers occurred. However, the branches in question hold a total of €344 million in assets and €336 million in liabilities out of the below total ACS figures. These are individually less than 5% of the total ACS assets and liabilities respectively and the impact on net assets of their inclusion is less than 1%. As such, this does not invalidate the below 31 December 2018 position as a suitable metric on which to base my analysis.

Balance Sheet as at 31 Dec 2018 (€ Millions)	Pre Transfer			Post Transfer and Mergers
	XLICSE	ACS	AXA Art	XLICSE
<b>Assets</b>				
Investments	1,678	4,644	156	6,478
Cash	58	405	19	482
Reinsurer's Share of Provisions	5,523	1,784	19	7,326
Other Assets	1,794	2,390	77	4,261
<b>Total Assets</b>	<b>9,052</b>	<b>9,223</b>	<b>271</b>	<b>18,546</b>
<b>Liabilities</b>				
Technical provisions	6,598	6,067	124	12,788
Provisions for risk and charges	-	52	6	57
Other Liabilities	1,646	2,173	54	3,873
<b>Total Liabilities</b>	<b>8,244</b>	<b>8,291</b>	<b>184</b>	<b>16,718</b>
<b>Net Assets</b>	<b>808</b>	<b>932</b>	<b>87</b>	<b>1,828</b>

Source: Management information (UK GAAP basis for XLICSE, IFRS for ACS and AXA ART)

Under the proposed Transfer and Mergers, XLICSE will receive the insurance and reinsurance policies of ACS and AXA Art. Assuming the Transfer had occurred at 31 December 2018 the resulting balance sheet would therefore show €18.5 billion of assets, €16.7 billion of gross liabilities and a net assets position of €1.8 billion.

- 4.5 The tables below illustrate the Solvency II financial position of the Transfer Companies' entities following the Transfer and Mergers based on the Solvency II balance sheet as at 31 December 2018, assuming that all assets and liabilities at that date had transferred from AXA Art and ACS to XLICSE.

I note for avoidance of doubt that the SCR and Capital Cover Ratios under each entity's regulatory capital measure are Standard Formula for XLICSE and AXA Art and Internal Model for ACS. I therefore use these for comparison. I have also included the ACS Capital Cover Ratio information on Standard Formula, as that is the position that will be transferring into the post Transfer XLICSE. I consider the choice of metrics further in section 5.8.



SII Balance Sheet as at 31 Dec 2018 (€ Millions)	Pre Transfer				Post Transfer and Mergers	
					No Capital Injection or Ancillary Own Funds addition	After Capital Injections and Ancillary Own Funds addition
	XLICSE	ACS (IM)	ACS (SF)	AXA ART	XLICSE	XLICSE
<b>Assets</b>						
Investments and Cash	1,851	5,653		211	7,715	7,715
Reinsurer's Share of Provisions	4,311	1,840		19	6,170	6,170
Other Assets	866	2,229		48	3,124	3,124
<b>Total Assets</b>	<b>7,027</b>	<b>9,722</b>		<b>279</b>	<b>17,009</b>	<b>17,009</b>
<b>Liabilities</b>						
Best Estimate Liabilities	5,241	5,689		86	11,016	11,016
Risk Margin	122	254		5	382	382
Other Liabilities	841	2,246		56	3,156	3,156
<b>Total Liabilities</b>	<b>6,204</b>	<b>8,189</b>		<b>147</b>	<b>14,553</b>	<b>14,553</b>
<b>Net Assets</b>	<b>823</b>	<b>1,533</b>		<b>132</b>	<b>2,455</b>	<b>2,455</b>
	-	-		-	-	-
<b>Eligible Own Funds</b>	<b>875</b>	<b>1,398</b>	<b>1,367</b>	<b>132</b>	<b>2,373</b>	<b>2,963</b>
<b>SCR</b>	<b>714</b>	<b>973</b>	<b>1,389</b>	<b>71</b>	<b>2,049</b>	<b>2,049</b>
<b>Capital Cover Ratio</b>	<b>123%</b>	<b>144%</b>	<b>98%</b>	<b>185%</b>	<b>116%</b>	<b>145%</b>

Source: SFCRs and management information

Under the proposed Transfer and Mergers, XLICSE will receive the insurance and reinsurance policies of AXA Art and ACS. Assuming the Transfer and Mergers had occurred at 31 December 2018 the resulting Solvency II balance sheet would therefore show €17.0 billion of assets, €14.6 billion of gross liabilities and a net assets position of €2.5 billion. The table also highlights the Eligible Own Funds of each entity.

I note that for the Other Assets and Other Liabilities lines above, the sum of the pre Transfer figures do not equal the post Transfer figure in each case. This is due to deferred tax adjustments post Transfer.

The differences between the Solvency II Net Assets and the Eligible Own Funds that can be seen are as follows:

- XLICSE pre Transfer holds subordinated debt of €52 million which counts under Eligible Own Funds but not under Net Assets.
- ACS (on an Internal Model basis) has allowed for a foreseeable dividend of €135 million in its Eligible Own Funds that is not allowed for in its Net Assets. I note that this has subsequently been paid in May 2019.
- XLICSE post Transfer difference is due to the individual pre Transfer entity differences discussed above, and the difference due to ACS's capital being assessed on a Standard Formula basis rather than on Internal Model post Transfer and Mergers.

I note that there is a large difference between the Capital Cover Ratio for ACS when comparing its Internal Model basis with the Standard Formula calculation. This emerges from the fact that there are a number of risks that are modelled differently in the Internal Model from the way they are modelled in the Standard Formula. The actual liabilities and the assets and capital base backing them do not change between these two assessments. This relative shortfall on a Standard Formula basis is what drives the overall reduction in the Capital Cover Ratio for XLICSE as a consequence of the Transfer, before other actions are considered. The different approaches to risk modelling are discussed further in section 5.9.

As can be seen in the above table, XLICSE Capital Cover Ratio as at 31 December 2018 is below 130% both pre and post Transfer. In accordance with its capital management policy, as described in section 3.25, XLICSE is undertaking actions to bring this back above 130%.

There have been two additional capital contributions from XL Insurance (UK) Holdings Limited – the first for €30m which was paid in March 2019 and a further €60m that was agreed in June 2019 and has also been paid.

As discussed in section 3.27, XLICSE post Transfer will receive an additional amount of €500 million provided into ancillary own funds should the Mergers be sanctioned. As previously discussed, this is to be provided as an ancillary own funds capital commitment deed from XLB and AXA SA will issue a letter of credit to support this which will become effective upon the Effective Date. The issuance of the letter of credit has been approved by the Boards of both XLB and AXA SA, and regulatory approval was anticipated by 31 October 2019. I note for avoidance of doubt that any non-payment by XLB under the capital commitment deed would, under this arrangement, mean that XLICSE could ask AXA SA to pay such unpaid sum under the letter of credit. I note the following:

1. AXA SA, the ultimate parent of XLB, will guarantee this commitment through the letter of credit, thus showing a commitment from the AXA Group to uphold this agreement. As at 31 December 2018, AXA SA held assets of \$57 billion, with net assets of \$6 billion (under IFRS).
2. As at 31 December 2018, XLB held assets of \$62 billion, with net assets of \$11.6 billion (under US GAAP).
3. As part of the letter of credit arrangement, XLB's reimbursement obligations for any payments made to AXA SA under this will be spread out over one year to avoid any concentrated impact on XLB's liquidity.

I am therefore comfortable that the addition of €500 million should be considered.

These actions would bring the XLICSE Capital Cover Ratios to 135% pre Transfer and 145% post Transfer and Mergers. I note that prior to the ancillary own funds being included, the absolute level of capital available to support the (re)insurance business of the Transfer Companies is unchanged as a consequence of the Transfer and Mergers, and that all three Transfer Companies were individually considered to be appropriately capitalised before the Transfer was considered. These ancillary own funds represent an explicit increase (albeit one that can be drawn-down rather than directly owned) in the overall level of capital available to support the insurance liabilities of the Transfer Companies from the situation before the Transfer. In the event that the ancillary own funds could not be accessed in a stress scenario, that original level of capital pre Transfer still remains.

The SCR and Capital Cover Ratio for each entity are discussed further in section 5.10.

The risk margin is an amount required under Solvency II to be included in the Technical Provisions. It is intended to provide for the risk that claims liabilities deteriorate further than allowed for in the capital requirement which only considers the risks of deterioration over a one-year period rather than until the expiry of the liabilities; in other words, the risk margin allows for the risks on an ultimate basis. As part of my work I have reviewed the documents which contain the calculation of the XLICSE, AXA Art and ACS (Standard Formula) risk margins, as the basis of the risk margin numbers included in the Solvency II balance sheets I have been provided for use in my report. I am satisfied that the calculations are in line with the Solvency II rules and note that the calculations for XLICSE and AXA Art have been subject to audit.

## **Cost and tax impact of the Transfer**

- 4.6 I have received confirmation from the management of the Transfer Companies that no significant VAT liabilities will be realised as the result of the Transfer. I have received this information from XLICSE following advice from independent advisers, and ACS and AXA Art following advice from their in house tax team and independent legal advisers. To the extent that the Transfer creates an additional accounting profit in either Transfer Company this will incur a tax liability as in the normal course of business. As a result, I am satisfied that there should not be any unanticipated tax charge that would be material enough to change my conclusions in this report.
- 4.7 I understand that most costs associated with the Transfer will be incurred whether or not the Transfer proceeds, as the majority of these costs relate to activities occurring prior to the Sanctions Hearing (for example, with respect to legal fees and policyholder communications). Therefore I identify no significant additional costs arising from the implementation of the Transfer. XLICSE will meet these costs.

## **Outward reinsurance**

- 4.8 In a Part VII transfer where outwards reinsurance is being transferred, there is a risk that non-group reinsurers of the Transfer Companies whose contracts are not governed by English Law or EEA governing laws may not recognise the Transfer and decline payment of future reinsurance recoveries. However in this case, in addition to the outwards reinsurance contracts of ACS and AXA Art being included as transferring policies under the Transfer, all outwards reinsurance will also effectively transfer under the Mergers as a cross-border merger necessitates a transfer of all of the business held in one entity to another. It is expected that the Mergers will be more widely recognised than the Transfer in other jurisdictions, including in the US.

The External Risk Transfer programme will be unaffected by the proposed Transfer. Each of the Internal Risk Transfer ('IRT') arrangements are expected to continue as currently in force with the following exceptions:

- Post Transfer, the 60% IRT QS which XLICSE policyholders currently benefit from will also cover all newly attaching and renewing XLICSE business that used to sit within the ACS Asia Pacific branches of Australia, Hong Kong and Singapore before it was transferred to XLICSE in summer 2019, and all new and renewing AXA Art business, including new and renewing. I note that the business sitting within the European ACS branches will not be covered as the protections currently in place have been deemed adequate for post Transfer. Neither of these groups of policies constitute material changes to the reinsurance coverage.
- The IRT Excess of Loss Reinsurance for AXA Art will terminate at the Transfer for new (and renewing) business and new and renewing business across all lines will be covered by the 60% IRT QS.

The strategy for and use of facultative reinsurance covers will continue unchanged post Transfer.

## **Pension Scheme Obligations**

- 4.9 I understand that there will be no changes to the ACS, AXA Art and XLICSE pension scheme obligations as a result of the Transfer. There are no parental guarantees in place that affect the liabilities of the Transfer Companies, and no new ones are intended to support the Transfer.

## **Dividends and capital structure**

- 4.10 Assets in AXA Art and ACS will be passed to XLICSE as part of the Mergers. As a consequence of the Transfer and Mergers the capital of XLICSE will increase to reflect the combined capital resources of the Transfer Companies' legal entities. Management of XLICSE have confirmed to me that post Transfer, they will be adhering to the overarching capital management policy

that is being implemented following the acquisition, regardless of the Transfer. This policy ensures policyholder security is maintained above a minimum level of regulatory capital cover.

## **Non-financial effects of the Transfer**

4.11 I consider here the areas that a policyholder may have considered in their decision to buy their original policy and would therefore have reasonable expectations regarding throughout the lifecycle of their policy and any claims. In particular I have considered the executive management of the Transfer Companies, claims handling, the ease of access to the company for complaints or policy administration, cyber security insofar as it protects the customer's data, and the regulatory protections that the policyholder benefits from. I have also considered any tangible aspects of the likely reputation of the companies from the point of view of policyholders' likely reputation of the entities.

## **Future intentions of XLICSE**

4.12 As discussed in section 1.7 of this report, this Transfer is required for the Mergers to occur; AXA Group is undertaking the Mergers in order to streamline its European non-life business. The intention is to consolidate the operations of XLICSE, ACS and AXA Art into a single insurance carrier in order to deliver fully integrated property and casualty commercial lines products across the AXA XL Division.

The reduction of entities reduces administration costs and increases levels of diversification and the nominal capital base. Policyholders who hold policies across more than one of these entities currently will only have to deal with one company post Transfer and Mergers.

There is no current intention to discontinue or deregister the operation of XLICSE as an entity. However, certain types of business in XLICSE UK will be written into different entities on renewal, as will new policies. This covers policies with US surplus lines risks for which XLICSE UK does not have the permissions to write, and policies with UK risks, both of which AXA Group is aiming to consolidate in a UK domiciled AXA Group entity, XL Catlin Insurance Company UK Limited. For avoidance of doubt, XLICSE UK has the permissions to service these policies, but not to underwrite their renewals. Furthermore, in 2020, there is planned to be a portfolio transfer of the remaining policies with UK risks from XLICSE UK into XL Catlin Insurance Company UK Limited. AXA Group is undertaking the movement of the UK risks in line with its business strategy to manage UK risks within the UK for operational simplicity following Brexit.

As mentioned in section 3.21 I note that XLICSE UK already has a loss portfolio arrangement with XLB, covering all business from 2018 and prior that is exposed to UK risks.

The portfolio transfer of the remaining policies, should it go ahead, will be undertaken with another Part VII Transfer process. I note that this will not be considered further until after the Transfer and Mergers have gone ahead, and would be subject to the same Part VII process as this Transfer before it could be completed. As such, I do not consider this any further in this report, as the Court will have another opportunity to consider the impact of that proposed transfer in the future.

Given the above I identify no adverse impact on policyholders arising from the intentions or motives of XLICSE in proposing the Transfer.

## **Impact of the Transfer on competition**

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

## **Executive management**

4.14 As a result of the Transfer and Mergers, the Boards of ACS and AXA Art will be dissolved and governance roles and functions will be taken up by XLICSE. The ACS Board currently consists of four Executive Directors. The AXA Art Management Board currently consists of two Executive Directors, and the Supervisory Board of three Non-Executive Directors. The XLICSE Board consists of three independent Non-Executive Directors, one group Non-Executive Director and three Executive Directors. It is expected to have one additional group Non-Executive Director and one fewer Executive Director either prior to, or shortly following, the Transfer. There are no current planned changes to the governance of XLICSE's UK branch following the Transfer.

## **Policyholder perception**

4.15 Executive management often drive the tone and culture of a company so it is important to look at any changes in the area in this context as well; as noted above, the XLICSE Board post Transfer will consist of a number of Non-Executive and Executive Directors, such that ACS and AXA Art policyholders will have the same, or a larger sized, Board than pre Transfer. Credit ratings can also be a reason that customers choose to do business with a specific company. All three companies are rated AA- Stable by both Standard and Poors and Fitch ratings companies; AXA Group also has an overarching rating of AA- Stable from the same ratings companies. More broadly, the three entities are all part of the AXA Group, which is a worldwide and well-known brand, and all groups of policyholders will remain with the AXA Group post Transfer.

## **ELTO**

4.16 Currently, AXA Art are not registered with ELTO and only make their Employers' Liability Register available through their website. Post Transfer, there are plans for AXA Art to register with ELTO and upload their policies on the Catlin Underwriting website. There will also be change in the governance arrangements post Transfer where a centralised team in Poland will manage the ELTO processes for ACS and AXA Art. ELTO has been notified of these changes and of the Merger.

## **Administration of the business**

4.17 As mentioned in section 3.22, ACS, AXA Art and XLICSE have independent claims administration systems and claim handling procedures.

As part of the integration plans post acquisition, the administration and operational services used by the Transfer Companies will be aligned to XLICSE's business model. This process is not due to start until at least 1 April 2020 and would be happening regardless of the Transfer and Mergers. As part of this, ACS and AXA Art will also be moving to XLICSE's complaints process model. Previously ACS and AXA Art did not have a formal complaints process in place.

Further to this, I have received details of complaints metrics from the Transfer Companies. There were only 16 complaints in the year ended 31 December 2018; 10 relating to XLICSE UK, 5 for ACS UK and 1 for AXA Art UK. These complaints are negligible compared to the total number of claims processed, and do not suggest that any one Transfer Company has a significantly worse complaints record than any of the others

As mentioned in section 3.22 and several other times throughout my report, all employees of the Transfer Companies are employed by the service company XL Catlin Services SE. This will not change following the Transfer.

## **Contractual arrangements**

4.18 The Transfer is to have no impact on contractual terms of transferring insurance policies, other than changing the party to the contract from ACS and AXA Art respectively to XLICSE.

For policyholders of XLICSE, there are no contractual changes as a result of the Transfer.

## **Regulatory arrangements**

4.19 AXA Art is domiciled in Germany and regulated by BaFIN while ACS is domiciled in France and regulated by ACPR. XLICSE is domiciled in Ireland and its primary regulator is the CBI. The UK Branches of each entity are additionally overseen by the FCA for conduct purposes.

There will be supervisory changes for AXA Art and ACS to the CBI from BaFIN and ACPR respectively. Whilst there are minor differences between precisely how Solvency II has been implemented in each EU territory, the overall target level of capital that insurance undertakings should hold and the commitments to risk management required by the Solvency II legislation do not change. The Standard Formula calculation in particular does not vary between EU member states, so there is no real risk of material differences in policyholder security resulting from changing from one EU regulator to another. ACS will be moving from an Internal Model basis to a Standard Formula basis so there will be changes seen but these will not be due to a change in regulator.

There will be no supervisory change from FCA for the UK Branches. Under a no deal Brexit, the UK would count as a "third country" with respect to the European Union, and the UK Branches would operate under the Temporary Permissions Regime, which has been put in place to allow branches of EU insurers in the UK to continue to trade seamlessly following the Brexit date for a period of up to three years. Under this regime the UK Branches would also fall under the PRA's branch regulation regime. The PRA's branch regulation regime was designed to supervise UK branches of non-EEA insurance businesses (i.e. those in "third countries" with respect to the EU). Once the UK leaves the EU, the regime will also supervise UK branches of EEA insurance businesses, as is the case here. Under the branch regulation regime, the UK Branches will be required to be in compliance with the relevant rules in the PRA Rulebook (<http://www.prarulebook.co.uk>); for example, branches need to have a local branch manager, and to have sufficient assets attributed to their branch in order to meet branch liabilities. The legal entity as a whole is also required to have sufficient financial resources.

Responsibilities for the prudential supervision of branches under the regime are split between the supervisor where the business is domiciled and the PRA.

XLICSE management have confirmed that they will be seeking formal authorisation of the UK branch of XLICSE within the three year window under a timetable to be agreed with the PRA.

The policyholders of XLICSE, ACS and AXA Art that are eligible for protection under the FSCS will continue to be eligible for protection post Transfer in the event that claims cannot be paid in full out of current reserves, capital and reinsurance. The policyholders who are not currently eligible will also remain so.

In addition to this, the Transfer will also have no impact on the rights of the policyholders of XLICSE, ACS and AXA Art in relation to the FOS. The FOS is an independent public body that aims to resolve disputes between individuals and UK financial services companies. It may make compensation awards in favour of policyholders. Only holders of policies that constitute business carried on in the UK are permitted to bring complaints to the FOS.

As part of the integration following the Mergers, customer complaints handling will become more formalised for ACS UK and AXA Art UK policyholders and as complaints will now be handled by a single centralised specialist complaints team.

## **Cyber security risk**

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

All three companies have the Cyber Essentials certification. Consideration is given to data protection acts, and all internal staff have to complete periodical cyber and data security training.

As part of the integration following the acquisition, XLICSE, ACS and AXA Art are moving to comply with the AXA Group Information Security Policy and Standards to ensure uniformity

around the practices and process that protect information assets. This is happening regardless of the Transfer and Mergers. The standard will govern the security arrangements of the whole AXA Group. The policy also embodies concepts from ISO 27001 Information Security Management System, Information Security Forum – Standard of Good Practice and the National Institute of Standards and Technology.

## **Conduct risk**

4.21 The primary areas in which conduct risk can materialise for ACS, AXA Art and XLICSE are the policy origination and underwriting process, and claims handling. The majority of the changes in these areas are happening as a direct result of the integration following the acquisition, and will happen regardless of the Transfer.

For ACS, AXA Art and XLICSE, Boards are ultimately responsible for conduct risk. Following the Mergers, the Boards of ACS and AXA Art will dissolve and now conduct risk will be handled by the XLICSE Board. As discussed in section 4.14, the XLICSE Board consists of three independent Non-Executive Directors, one group Non-Executive Director and three Executive Directors. It is expected to have one additional group Non-Executive Director and one fewer Executive Director either prior to, or shortly following, the Transfer.

As I noted in section 4.19, there will be changes in overall supervisory compliance from BaFIN and ACPR to CBI for AXA Art and ACS respectively, though XLICSE UK will have additional oversight from the FCA as previously. I note however, that conduct standards apply based on the country in which the policy risk is located or transacted, so as the risks themselves do not change geography as a result of the Transfer or Mergers, the effective conduct regime does not change for any policyholder of a Transfer Company.

Furthermore, the processes followed for monitoring conduct risk are not intended to change materially for ACS, AXA Art and XLICSE as they are governed by the same Product Oversight Group ('POG') Terms of Reference framework which covers all companies under the AXA XL Division. The POG committee hold weekly meetings which comprise of various members including an underwriting manager, Head of Conduct and a senior member from the wider conduct risk team

## 5. Potential impact of Transfer on stakeholders

### Overview of analysis performed

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

- (i) I have considered the specific circumstances of different types of policyholder and divided them into distinct groups with similar characteristics.
- (ii) I have considered the management and governance framework in place and the future intentions and strategies adopted by the Transfer Companies.
- (iii) I have compared the position of each policyholder group in the event the Transfer proceeds with the position that they would be in if the Transfer does not proceed. As discussed in section 1.7, I note that if the Transfer does not proceed, due to the conditionality of the Transfer and Mergers, there would be no change for any of the policyholders' present positions.

I have considered the position of policyholders under the following headings:

- (a) Financial resources available to pay future policyholder claims;
  - (b) TCF (with a particular focus on handling of claims);
  - (c) The ease of presenting a new claim;
  - (d) Protection of customer data; and
  - (e) Other considerations.
- (iv) I have further compared the position of policyholders before and after the Transfer under a variety of stressed scenarios to consider the ability of the Transfer Companies' legal entities to deal with adverse scenarios.
  - (v) Having considered the change for each policyholder group under each of these categories, and considering the results of the stress scenarios, I have formed an opinion on the impact of the Transfer on each of the policyholder groups.

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

### Identification of policyholder groups

5.2 Consideration of Policyholder groupings

#### 5.2.1 Policyholder characteristics

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

- The Transfer Company that the (re)insurance policy was covered by before the Transfer, and separately after the Transfer Company that will provide the cover after the Transfer.
- The nature of the regulatory regime and other policyholder protections which apply before and after the Transfer to different groups of policyholders.
- Whether the new reinsurances could change the policyholders' customer experience.



- The nature of the type of business written and whether policyholders are:
  - i) Insurance or Reinsurance policyholders;
  - ii) Policyholders of compulsory or non-compulsory insurance; or
  - iii) Policyholders related to legacy risks or those with products that continue to be underwritten
- The length of time that policyholders are likely to continue to receive benefits under the terms of their policies.
- The ability of policyholders to access the financial resources of each Transfer Company's legal entity respectively in the event of them entering administration, rehabilitation or insolvency and how this changes as a result of the Transfer.

### 5.2.2 Reasoning for policyholder groupings

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

- Under title IV of the Solvency II Directive reinsurance policyholders rank behind insurance policyholders in the event of the insolvency of an insurance business. The distinction then between reinsurance and insurance policyholders becomes important if there is a significant risk that one or more of the Transfer Companies could become insolvent in the short term. Given the level of regulatory coverage that all the Transfer Companies enjoy, including the additional capital injection of €500 million post Transfer, I consider such a possibility to be remote. AXA Art UK reinsurance policyholders make up 19% of the total UK gross earned premium as at 31 December 2018. ACS UK writes a slightly higher proportion of inwards reinsurance business, mainly for local policies written by other AXA Group members internationally and as a captive for London market business. This reflects around 32% of gross earned premium (as at 31 December 2018) of its total UK business. Finally, XLICSE UK reinsurance policyholders make up around 20% of the XLICSE UK gross earned premium (as at 31 December 2018). After the Transfer, XLICSE UK reinsurance policyholders will make up around 24% of gross earned premium of the total XLICSE UK book. I note that these proportions are neither materially different between Transfer Companies, and nor do they materially change for any Transfer Company as a consequence of the Transfer. Furthermore the absolute aggregate amount of capital available increases by €500m as a result of the Ancillary Own Funds, and for each Transfer Company the total absolute level of capital available increases materially as a consequence of the Transfer. This additional aggregate capital reduces the risk of an already remote insolvency situation, which is the only event that would trigger the need to consider the reinsurance and insurance policyholders separately. Given that any change in policyholder mix would only matter under remote circumstances, and that the changes in proportions are not that large for any Transfer Company, I do not distinguish between reinsurance and insurance policyholders in my analysis.
- XLICSE UK, ACS UK and AXA Art UK policyholders are within authorised branches of European Union domiciled insurance companies, and as such are in an environment overseen by the PRA and FCA under their rules for branches. Policies protected by the FSCS (outlined in section 3.4 and sections 3.15 - 3.17) and with access to FOS (outlined in section 4.19) before the Transfer will continue to benefit from that protection after the Transfer as they will remain within a UK authorised branch. As such, there will be no change to any policyholder's FSCS protections or FOS access rights. Therefore I have not specifically considered the interests of those policyholders separately from those that are not currently entitled to FSCS protection or FOS access. Aside from this, I have decided not to distinguish any further between compulsory and non-compulsory product policyholders, nor between retail and commercial policyholders, within different policyholder groups in this report.

- ACS UK policyholders that are subject to the Transfer and ACS policyholders transferring under the Mergers experience almost identical impacts from the result of the Transfer as a consequence of the Transfer and Merger being each contingent on the other being sanctioned. It is expected that the Independent Expert considers the policyholders subject to Transfer separately from those remaining behind, so I have concluded on these groups separately, noting though that the conclusions in each case are effectively the same.
- The above is also true for AXA Art UK policyholders that are subject to the Transfer and AXA Art policyholders transferring under the Mergers. Therefore, I have similarly decided to conclude separately on these two groups.

### 5.2.3 Policyholder groupings chosen

Based on my above analysis I have identified the following 5 policyholder groups. These are:

- Existing XLICSE policyholders
- Transferring ACS policyholders (ACS UK policyholders)
- Transferring AXA Art policyholders (AXA Art UK policyholders)
- Non-UK Branches ACS policyholders
- Non-UK Branches AXA Art policyholders

## Financial resources available to pay policyholder claims

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

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

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

In assessing the impact of the Transfer, I have considered the nature of assets within each legal entity before and after the Transfer and Mergers occur as at 31 December 2018. The assets can be classified into four broad categories.

- Group Investments – These comprise of equity interests in other companies such as affiliates and subsidiaries, and related warrants, bonds, & receivables.
- Equities – None of the Transfer Companies hold a material amount in equities.
- Investments and cash – Financial investments held by the entities are mainly held in debt instruments for ACS, AXA Art and XLICSE. This is also expected after the Transfer as can be seen in the post Transfer balance sheet below. A limited amount of assets are also held as cash for all three entities. The “other” investment assets are, for ACS, investment funds and derivatives. The investment funds are mostly in real estate, with a smaller amount in credit and equities; its derivatives are mainly credit default swaps and exchange rate hedging. For XLICSE and AXA Art, the “other” investment assets are collective investment funds. The largest of the collective investment funds held by XLICSE is an exchange traded index fund; the rest of the funds are smaller liquidity funds. AXA Art’s collective investment funds are predominately fixed income funds, with the rest of the funds in equities and real estate.
- Reinsurance share of provisions - Subject to the specific terms of the relevant reinsurance contracts, reinsurance assets have the capacity to absorb losses arising from the

underlying reinsured insurance liabilities, thereby reducing financial risk. The nature and level of utilisation of such arrangements is in line with my expectations for the entities. XLICSE hold a large amount of assets as reinsurance assets. This is due to AXA Group reinsurers' share of the provision for claims outstanding. They include amounts under a net quota share reinsurance arrangement from XLB, amounts under a stop loss recovery policy and amounts under an adverse development cover contract. It also includes amounts under the loss portfolio reinsurance arrangement that XLICSE holds with XLB to cover the claims outstanding and unearned premium reserves of the 2018 and prior XLICSE UK Branch business, as discussed in section 3.21. As noted in section 3.27, XLICSE holds the Charge arrangement with XLB, to provide security for the reinsurance assets held with XLB. At the date of this report collateral of €265 million has been provided by XLB to support the Charge. The total intragroup reinsurance asset from XLB recognised by XLICSE as at 31 December 2018 is roughly €3 billion, so this represents just under 9% of the total intragroup reinsurance asset for XLICSE pre Transfer, and is broadly unchanged post Transfer. As noted in section 4.5, the net assets of XLB are \$11.6 billion as at 31 December 2018, and the Floating Charge arrangement discussed in section 3.27 provides additional protection (by converting to a first ranked security in the event of significant downgrade of XLB) over and above the actual collateral backing the Floating Charge. As such I do not believe that the significantly greater reliance on intragroup reinsurance that the post Transfer XLICSE has than either ACS or AXA Art beforehand creates any material risk of adverse impact on policyholder security for any Transfer Company as a consequence of the Transfer.

- Other assets – Other balance sheet assets include mortgages and loans, sundry assets arising in the normal course of business such as accounts receivable, accrued interest and rent and intercompany balances due from other members. These balances are in line with my expectations for a business of this nature.

The table below shows each asset group as a percentage of the total assets for of AXA Art, ACS, and XLICSE as at 31 December 2018, pre and "as if" post Transfer and Mergers.

Nature of Assets as a % of balance sheet as at 31 December 2018				
Type of Asset	Pre Transfer			Post Transfer
	XLICSE	ACS	AXA ART	XLICSE
<i>Group Investments</i>	0%	1%	18%	1%
<i>Equities</i>	0%	1%	0%	1%
<i>Investments (excl equities) and cash</i>	26%	56%	58%	43%
<i>Bonds</i>	23%	34%	39%	30%
<i>Cash</i>	1%	4%	7%	3%
<i>Other</i>	2%	17%	12%	11%
<i>Reinsurance Share of Provisions</i>	61%	19%	7%	36%
<i>Other Assets</i>	12%	23%	17%	18%
<b>Total Assets</b>	100%	100%	100%	100%

Source: SFCRs

The asset mix post Transfer and Mergers is an additive of the pre Transfer assets; there will be no specific changes upon Transfer or Mergers. AXA Art sees the largest shift as it is the smallest entity, with a reduction in proportion of Investments and Cash and an increase in reinsurance assets. This change would increase the relative risk of financial loss from creditor default but reduce the relative risk of financial loss arising from market volatility. These risks and the changes in them are explicitly reflected in the solvency capital requirement calculations under the Standard Formula (which applies to both AXA Art and XLICSE). I also note the extra

protections that exist against the relative risk of financial loss from XLB default in the form of the Charge.

I consider the post Transfer asset mix to be in line with my expectation for a business of the scale and nature of the combined business, so overall I do not consider that this would cause a material adverse effect to AXA Art policyholders.

I do not therefore identify any matter arising from balance sheet assets held by the Transfer Companies that would cause me to perform specific further additional analysis or conclude that there was any adverse effect on policyholders of either XLICSE, ACS or AXA Art as a consequence of it.

## 5.5 Valuation of insurance liabilities

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

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

### AXA Art

AXA Art calculates its reserves quarterly for all branches and subsidiaries. The reserves are calculated for each branch and subsidiary separately split by sub lines of business: Private, Commercial and Institutional. The exception to this is Spain where the calculation is performed in aggregate as the split into sub lines creates insignificant data. A reconciliation report is also produced and sent back to each branch to confirm. The results of the calculations are reviewed twice a year by the risk management team.

For claims worth less than 1 million in the local currency, standard actuarial techniques are used to produce the estimates. For losses above this, the claims team's reserve opinion for the individual claim is taken as best estimate. Over time this process will change to follow the XLICSE process, though this is occurring as part of the integration exercise rather than solely as a consequence of the Transfer.

### ACS

For ACS, reserving actuaries produce a first opinion on the reserves three times a year; in the second quarter, third quarter and fourth quarter of each year. An independent second opinion is given by the risk management team on the second and third quarter reserves. The differences between these opinions are discussed and analysed at two meetings between the actuarial and risk management functions. Differences between the two opinions are communicated to the CFO and CEO, and the final flash report (where the two opinions and related gaps are reported) is presented to the ACS Executive Committee, who ultimately confirm the level of booked reserves. It is then discussed with Group Risk Management and presented to the Board of Directors. The second opinion process is intended to be kept and extended post Transfer.

A variety of standard actuarial techniques are used as part of the reserving process. Over time this process will change to follow the XLICSE process, though this is occurring as part of the integration exercise rather than solely as a consequence of the Transfer.

### XLICSE

XLICSE's reserving teams perform a full valuation during the second and fourth quarters of the year. A review of Actual versus Expected development and of experience is carried out on a quarterly basis. Reserves are presented at the quarterly Technical Reserves Forum, which occur as part of the quarter end process. The reserves are reviewed and challenged by

management at these meetings. Internal review and challenge of the reserves is carried out by Business Group Actuaries, Legal Entity Actuaries, the Head of Actuarial Reporting and each Segment Reporting Team through individual review and Roundtable Forums that involve discussions and presentations across the teams. Results are discussed at Roundtable Forums before being passed to the Reserving Committee and then the Executive Committee. As at the third quarter of the year, the reserves are also peer reviewed externally, along with the Actual versus Expected analysis between the third and fourth quarters of the year.

A variety of standard actuarial techniques are used as part of the reserving process. The reserving process will continue on in its current format and will be completed by the same teams and staff following the Transfer.

#### *Reserving prudence*

XLICSE reserves are set on a best estimate basis, however ACS hold a “global safety margin” above the best estimate liability, amounting to about 10% of liabilities. AXA Art set their reserves to a prudent estimate; prudence is established by not allowing for potential recoveries and relying solely on expert judgements from claims specialists on major claims, that don't account for the likelihood of favourable developments. They also hold two additional margins in addition to the best estimate liability; a margin set at 8% of the best estimate liability and a safety margin of around €12 million.

Holding more prudent reserves means that there are more assets available in the booked reserves to fund any deterioration in claims experience beyond that anticipated in management's best estimate of the required amount. For a business that books reserves at best estimate deterioration in reserves moves quickly to a call on capital; for one that books stronger reserves the capital is effectively insulated for longer. As a consequence more prudent reserves can be considered to be another block of capital that provides protection to policyholders. It is appropriate that any additional protection provided by reserve margin should be reflected in my analysis of whether policyholder security is changing as a consequence of the Transfer.

There is no “correct” policy for where reserving prudence should be set. The requirements vary depending on the accounting regime followed, but most regimes require companies to book at least management's best estimate of the reserves, and many (but not all, with the US a notable exception here) allow a reasonable margin for risk to be booked on top. Prior to the acquisition by AXA the XL companies followed US GAAP, which is why they set reserves on a best estimate basis.

Even though AXA Art and ACS policyholders will be moving into an entity with a lower level of prudence in booked reserves as a policy, I note that this is only on an accounting (GAAP / IFRS) basis. The Solvency II balance sheet requires all margins to be stripped out of the reserves shown in any case, and these margins then effectively contribute to the Own Funds contributing to the Capital Coverage Ratios for each business. As I use the Solvency II balance sheet as the basis for much of my analysis throughout the report, the additional reserving prudence followed by ACS and AXA Art relative to XLICSE is therefore effectively converted into additional capital for the purposes of my analysis. As I do not find the change in Capital Coverage Ratios under Solvency II to have a materially adverse effect on any group of policyholders, neither do I find the level of prudence in accounting policies for reserves discussed above to cause any materially adverse effect on AXA Art or ACS policyholders.

#### *Reserving principles*

AXA Art, ACS and XLICSE (excepting the former Asia Pacific ACS branch business that now sits in XLICSE, which have some minor exceptions) all follow the same overarching global reserving principles, as set by AXA Group in their AXA XL Division Global Claims Handling Principles document. The Global Claim Handling Principles provide claims teams with a consistent operating framework for key procedures and controls across regions, entities and product lines.

There will be no change for any group of policyholders as a result of the Transfer or Mergers and I therefore do not anticipate any impact on the security of any group of policyholders.

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

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

#### *Impact on the different policyholder groups*

As discussed above, I do not consider any of the changes to the reserving philosophy and governance to have a material impact on the security of the policyholder liabilities. Therefore I see no material impact on any policyholder group from any changes in the provisioning process related to the proposed Transfer.

### **Impact on existing reinsurers**

5.6 Reinsurance assets along with the liabilities associated with them will transfer under the Transfer with the reinsured party's name changing from ACS and AXA Art to XLICSE.

As mentioned in section 4.8, any outwards reinsurance that does not transfer under the Transfer will do so under the Mergers in any case.

As also discussed in section 4.8, outwards reinsurance arrangements that were purchased in 2019 to cover XLICSE, ACS and AXA Art consist of External Risk Transfer arrangements and Internal Risk Transfer arrangements. External Risk Transfer arrangements will remain unchanged post Transfer and Internal Risk Transfer arrangements will undergo some minor changes as described in the same section. ACS business from the Asia Pacific branches and AXA Art business will now be covered by the XLICSE 60% IRT QS. The AXA Art Excess of Loss will be terminated, as the 60% IRT QS will be in place instead.

The Transfer has no further effect on the current coverage provided by current or historic reinsurers of the Transfer Companies, creating neither a material increase nor decrease in the exposure of reinsurers of the Transfer Companies.

The Transfer is expected to have no effect on the reinsurance assets and liabilities associated with XLICSE policies, nor the non-transferring AXA Art and ACS policies.

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

### **Pension Scheme Obligations**

5.7 As discussed in section 4.9, there will be no changes to pension scheme obligations as a result of the Transfer. Both XLICSE and AXA Art are liable for defined benefit schemes, so they are not going to be exposed to a new risk post Transfer. XLICSE's defined benefit reserves are not material, and have been decreasing, and the scale of the total pension liabilities in the combined entity post Transfer and Mergers is also immaterial to its capital position.

The majority of AXA Art's defined benefit reserves sit with pensioner members, which reduces the risk of the liability growing materially; furthermore, the size of obligations under this scheme is not material to XLICSE post Transfer and Mergers.

I also note that any pension scheme deficits are recognised on both the IFRS and Solvency II balance sheets that I reference in my report.

As discussed in section 3.28, ACS is no longer liable for its defined benefit scheme so there is no adverse impact for AXA Art or XLICSE policyholders post Transfer as a result of this.

Therefore, I identify no effect from pension scheme obligations on XLICSE, ACS or AXA Art policyholders as a result of the Transfer.

## Consideration of capital and risk

### 5.8 Measures of capital

I have considered the value of each Transfer Company's legal entity net assets compared with the risk that the legal entity is exposed to by reference to the Standard Formula SCR for each company. The Standard Formula is the measure which is used by XLICSE and AXA Art to assess their regulatory capital requirement, and its results are disclosed in their respective SFCR's. ACS use an Internal Model, of which these results are also disclosed in its SFCR, however the details behind the Internal Model are not public. A Standard Formula calculation as at 31 December 2018 has also been produced by ACS.

### 5.9 These estimates reflect the Transfer Companies' estimates of the amount of capital required to ensure that policyholders are secure at the 99.5% confidence level, over one year, under the Solvency II regime.

The risks considered in these estimates include:

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

I note that these estimates:

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

#### *Reasonableness of capital calculations*

Whilst I have not performed any detailed verification of the calculations performed by the Transfer Companies using the Standard Formula, I note that the results of these calculations as at 31 December 2018 for XLICSE have been audited as part of the audit of the SFCR. The available own funds of ACS have been audited, while the risk margin of AXA Art has been audited, in accordance with the requirements under each of the relevant jurisdictions.

In order to satisfy myself that each of the SCR estimates are reasonable, I have performed stress tests on the areas I consider material to the Transfer Companies' assessment of available and required capital, or where other market participants have to my knowledge experienced deteriorations recently and to which one or all of the Transfer Companies' entities

are exposed. These stresses are intended to describe real life scenarios that are conceptually easier to understand than, for example, a 1 in 200 year event. In each scenario, the Transfer Companies' entities would each be left with sufficient capital to ensure that their existing policyholder liabilities could be met in full. Whilst this does not constitute a formal re-estimation of the capital required for each of these scenarios, the fact that each scenario is contained within the capital amounts estimated under the Transfer Companies' SCR calculations reassures me that these estimates are capturing and covering the appropriate risks. I discuss the results of this analysis in sections 6.5-6.10.

#### *Different measures of capital*

ACS currently utilises an Internal Model to set its SCR under Solvency II while AXA Art and XLICSE use the Standard Formula. XLICSE do have an internal model which is used for Economic Capital and ORSA purposes (using different bases and probabilities in each case) which derives a lower capital requirement and as such, XLICSE believes that the use of the Standard Formula is not inappropriate given that it overstates what they believe to be the necessary capital for policyholder protection of the required level. I note that the XLICSE internal model has not completed the regulatory approval process. There are plans to submit this to the CBI for regulatory approval post Transfer, though these are not yet in place. XLICSE would be aiming to start this process by the end of 2020.

With the Standard Formula being based on the insurance risks within the 'average' insurance company, it will not reflect the risk profile of any company perfectly. As discussed throughout my report, ACS use an approved Internal Model and I consider below how it differs from the Standard Formula estimate of SCR.

#### *Differences between ACS IM and SF*

ACS's Standard Formula and Internal Model derive different results, with the Standard Formula calculating a higher, more prudent SCR.

The Internal Model provides for a more detailed and tailored set of risks than the Standard Formula, as would be expected. Due to the high number of risks and risk factors used in the Internal Model, the risks of different asset classes and the diversifications among them are captured more precisely. The following differences have been noted for the different risk modules;

- Market Risk – Interest rate implied volatility, equity implied volatility, government spreads and inflation are explicitly modelled in the Internal Model whereas they are not included in the Standard Formula calculation. The market risk module of the Standard Formula uses a simplified calculation that assumes the sensitivity of assets and liabilities to changes in the volatility of the market parameters is not material. Concentration risk is included in the corporate deficit calculation as opposed to the standard formula calculation that excludes assets covered by the counterparty default risk module in order to avoid any overlap between both elements.
- Credit Risk - The Internal Model addresses the default risk of corporate bonds separately whereas it is included implicitly as part of the calibration of spreads in the Standard Formula.
- Insurance Risks - Lapse risk is taken through the portfolio modelling, including lapses and new business evolution and through the volatility around the unearned premium reserve.
- Operational Risk – The Internal Model follows a forward looking and scenario based approach which relies on the identification and assessment of the most critical operational risks, while in the Standard Formula operational risk is a percentage of the gross written premiums or technical provisions, and is not risk sensitive.
- Diversification – Geographical diversification is allowed for in the Internal Model while this is not the case for the Standard Formula.



In summary of the above, I note that under its Internal Model ACS has a significantly lower SCR than under the Standard Formula. In my experience this is often the case for large commercial and corporate insurance businesses.

The Standard Formula is the SCR metric that will be used post Transfer, and sets a higher capital requirement for ACS than using the Internal Model (which will not be approved post-Transfer and Mergers), and also for XLICSE than under their unapproved internal model. The Standard Formula will be the prevailing regulatory measure of SCR post Transfer and it sets the highest bar (which provides for greater comfort over policyholder security) of the available metrics that I can use in my analysis.

Based on this I consider that the Standard Formula is an appropriate measure to base my analysis on, and will err on the side of providing for more security to policyholders than less. I have therefore used the Standard Formula SCR numbers as at 31 December 2018 throughout my analysis as the basis for my conclusions. This has the advantage also of allowing for a consistent comparison of the numbers as they are all calculated on the same basis. I have also considered ACS's Internal Model results by means of comparison, where applicable, as this is an approved model used for regulatory purposes; this is to be sure that the results of my analysis would not change if that approach were used.

## Impact of Transfer on capital available to policyholders

### 5.10 Change in Solvency II Capital Cover Ratios

The tables below summarise the Solvency II balance sheet assets and liabilities for the Transfer Companies' legal entities before and after the Transfer and Mergers as shown in section 4.5. I also consider here the ACS Capital Cover Ratio calculated on a Standard Formula basis.

Please note that net Solvency II Technical Provisions refers to Technical Provisions net of reinsurance. Reinsurance assets are included within total assets. The most important measure to consider is how the eligible own funds compare to the regulatory capital requirements (i.e. the 'SCR') and I show this for ACS, AXA Art and XLICSE below. As noted in section 4.5, in accordance with its capital management policy, XLICSE is undertaking actions to bring its Capital Cover Ratio pre and post back above 130% with additional €30 and €60 million capital contributions in March and June 2019 respectively, which increase the capital both pre and post Transfer, and the further post Mergers approval capital commitment of €500 million.

These actions would bring the Capital Cover Ratio pre Transfer to 135% and post Transfer and Mergers to 145%. The €500 million capital injection, as noted previously, is primarily in order to counteract the decrease caused by ACS moving from an Internal Model to Standard Formula post Transfer and Mergers.

As in previous tables, I have carried out my analyses based on figures as at 31 December 2018 for the purposes of this report.

Capital Cover Ratios as at 31 Dec 2018 (€ Millions)	Pre Transfer				Post Transfer and Mergers	
	XLICSE	ACS (IM)	ACS (SF)	AXA ART	No Capital Injection or Ancillary Own Funds addition	After Capital Injections and Ancillary Own Funds addition
					XLICSE	XLICSE
Eligible Own Funds	875	1,398	1,367	132	2,373	2,963
SCR	714	973	1,389	71	2,049	2,049
Capital Cover Ratio	123%	144%	98%	185%	116%	145%
MCR	192	438	561	18	768	768

Source: Solvency II accounts; Management information

I have considered the SCR for all companies, and the view of the Transfer Companies on how the combined SCR may have looked if the Transfer and Mergers had taken place at 31 December 2018. I also include the MCR for completeness.

Given XLICSE's capital management policy aims for a Capital Cover Ratio of 130% and allows for dividends above 130%, I additionally consider a minimum of a 130% Capital Cover Ratio for both pre and post Transfer XLICSE in my analysis below for prudence.

I observe the following:

- Before the Transfer, the ACS, AXA Art and XLICSE policyholders are all insured by companies that have a buffer over their regulatory requirement, such that they would be considered well capitalised;
- As a result of the Transfer and Mergers, as at 31 December 2018, policyholders of XLICSE would see a drop in their Capital Cover Ratio although the ratio is still comfortably in excess of one. As discussed above, however, at the time that the Transfer would actually be taking place, there would be an additional €90 million capital available in XLICSE pre Transfer and an additional amount of €590 million capital available in XLICSE post Transfer and Mergers, which would lead to an increase in the revised Capital Cover Ratios to 135% pre Transfer to 145% post Transfer and Mergers. Even at the minimum of 130% for pre and post Transfer, XLICSE is consistently well capitalised;
- Although policyholders of ACS will see a decrease in their Capital Cover Ratio on a regulatory basis post Transfer and Mergers, i.e. going from an Internal Model based Capital Cover Ratio of 144% to a Standard Formula based Capital Cover Ratio (116%), they see an improvement on a consistent Standard Formula basis from 98% to 116%. After the Mergers the additional capital inputs will increase this coverage to 145%, which is similar to the starting point even when assessed against the more prudent SCR produced by the Standard Formula. Even if taking the 130% minimum post Transfer, I note that both ACS and XLICSE are well-diversified insurance businesses for which the Standard Formula provides an appropriate but conservative estimate of the capital required to support the risks in the business. I also note that the total capital available to the Transfer companies remains identical after the Transfer to the situation before it – the drop in Capital Cover Ratio for ACS is caused by the change of SCR calculation and not the removal of any capital, and in fact the introduction of Ancillary Own Funds actually increases the amount of capital available to the Transfer Companies to protect policyholders; and
- As a result of the Transfer, policyholders of AXA Art will see a drop in their Capital Cover Ratio although the ratio is still comfortably in excess of 100%. AXA Art writes predominately short tailed business, and furthermore is a much smaller entity than ACS and XLICSE. In the event of any distress to post Transfer XLICSE, the substantial increase in nominal capital base would outweigh the reduction in proportionate coverage, as AXA Art policyholders claims are expected to be paid considerably more quickly than the other Transfer Companies business. In the event that the capital commitment deed that provides the Ancillary Own Funds did not pay out because of some severe stress scenario affecting both XLB and AXA SA, XLICSE would still be capitalised to 116% of its SCR after the Transfer. The capital commitment deed is not required to meet the regulatory capital requirements, but to meet XLICSE's capital management policy of targeting a buffer over and above that level. Given the level of net assets of both XLB (\$11.6 billion as at 31 December 2018) and AXA SA (\$6 billion as at 31 December 2018), I consider such a scenario that prevents both the deed and the letter of credit backing it from AXA SA from paying out to be a remote one.

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

## Guarantees/risk sharing arrangements

5.11 There will be no change to the guarantees discussed in section 3.27 as a result of the Transfer. Therefore, I identify no effect on any groups of policyholders as a result of the Transfer.

## Treating Customers Fairly

### *Claims and policy administration*

5.12 As noted in section 4.17, the administration and operational services used by the Transfer Companies will be aligned to XLICSE's business model starting from 1 April 2020. This is part of the integration following the acquisition and is happening regardless of the Transfer.

XLICSE policyholders will not experience any change to claims and policy administration post Transfer. The people, systems and processes employed to perform this work will be unchanged as a result of the Transfer; therefore, AXA Art and ACS policyholders will not experience any change as a result of the Transfer either. The updated enhanced complaints process (as discussed in section 4.19) as part of the integration will positively impact AXA Art and ACS policyholders.

I therefore identify no material adverse impact due to administration changes upon any group of policyholders as a result of the Transfer.

### *Conduct Risk*

5.13 XLICSE policyholders will see no changes as a result of the Transfer

Following the Mergers, the Boards of ACS and AXA Art will dissolve and conduct risk will be handled by the XLICSE Board. The XLICSE Board is both larger and contains an increased number of independent members than the ACS and AXA Art Boards.

Whilst the primary regulators of AXA Art and ACS will change from BaFIN and ACPR respectively to the CBI, conduct regulation is driven by the location of the risk and where the policy is sold, so the conduct regime applicable to each policy should not change. The UK branch business of AXA Art and ACS that is subject to the Transfer remains under conduct rules determined by the FCA.

I therefore do not consider that these changes cause an adverse impact on any group of policyholders.

## The ease of presenting a new claim

5.14 There is no change in the way that claimants from any group of policyholders present a new claim as a consequence of the Transfer.

As discussed earlier in section 4.17, the claims management process will remain unchanged as a result of the Transfer.

I do not, therefore, identify any adverse impact on the ease of presenting new claims for any of the policyholder groups as a result of the Transfer.

## Protection of customer data

5.15 As discussed in section 4.20, ACS, AXA Art and XLICSE have established cyber security arrangements to protect against system breaches and data loss. There is no expectation that the protection of customers' data will diminish as a result of the Transfer and I conclude that there is no risk of any material adverse impact on policyholders resulting from the Transfer. Cyber-attacks are attempted on businesses on a regular basis, so there is always the risk that one may be successful, but the Transfer does not appear to increase that risk in any way. I therefore identify no impact on any group of policyholders as a result of the Transfer.

## Other considerations

5.16 Regulatory framework, executive management and governance

As discussed in section 4.19 there is no change in entitlement to protection under the FSCS for any group of policyholders, and there is no change in access to the FOS. Policyholders that currently benefit from protection by the FSCS will retain that protection following the Transfer. Policyholders with access to the FOS will also retain this access. There will be a change in the European regulator that oversees ACS and AXA Art, but the UK Branches will retain the same additional oversight from the FCA, and from the PRA through the Temporary Permissions Regime and PRA's branch regulation regime. The protections for all groups of policyholders are therefore materially the same post Transfer.

Each Transfer Company has executive management who, where required, are regulatory approved to act in their roles and are required to comply with requirements around governance of the businesses. Each has independent, non-executive directors on their Board. Following the Transfer, the Boards of ACS and AXA Art will dissolve and the Board of XLICSE will take over the governance functions.

For policyholders whose policies remain with XLICSE, there will be no change in any of the executive management, governance arrangements or regulatory regime as a result of the Transfer, and hence no risk of adverse impact on these policyholders that might otherwise have arisen following such changes.

For policyholders that transfer from ACS and AXA Art to XLICSE, I note that the protections provided by the regulatory regime are such that, despite their policies moving to a new insurance carrier, there is little risk of any change to their customer experience as a consequence of the differences in executive managements and governance arrangements between ACS, AXA Art and XLICSE.

Furthermore, as discussed in section 4.15 I do not see any reason why policyholder perception of the reputation of the entity where they hold their policy will decrease as a result of the Transfer.

I therefore see no reason why any group of policyholders would see an adverse impact in this regard as a result of the Transfer.

## **6. Methodology, stress and scenario analysis**

### **Overview**

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

- Modelling approach – I have considered the methods used by the Transfer Companies to calculate the estimate of insured losses at differing levels of confidence, allowing me to have confidence that the results of the model prepared by the Transfer Companies are based on appropriate assumptions and capture the relevant aspects of each Transfer Company's risk.
- Analysis of sensitivity of the model estimates to alternative assumptions – I have considered how sensitive my opinion is to variations in the underlying assumptions used by the Transfer Companies, and whether the reasoning behind my opinion would be different using alternative assumptions.
- Stress test analysis – I have considered the impact of a set of specific severe adverse events on each of the Transfer Companies' legal entities, allowing me to gain comfort at a high level that the economic loss estimates used in my analysis are meaningful when compared with real world loss assumptions.

### **Loss modelling approach**

6.2 Modelling approach

XLICSE and AXA Art both use the Standard Formula to calculate their respective SCR (the required regulatory capital amount) while ACS use a regulatory approved Internal Model. XLICSE also have an (unapproved) ECM that they use internally to manage their respective businesses.

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

I have considered the increase in losses that would be experienced by the Transfer Companies under a number of stress scenarios and considered how such a stress would affect the solvency position of the Transfer Company's legal entities.

The Transfer Companies have applied standard actuarial methods to generate their calculations of potential losses for each entity. The required capital figures that have been provided to me as at 31 December 2018 have been subject to full internal review and governance processes, and in the case of XLICSE are audited.

A broad spectrum of risks is considered within the Standard Formula calculation that XLICSE and AXA Art use which are:

- Risk arising from insurance business, for example, the risk of losses from natural catastrophes or deterioration in the valuation of insurance liabilities.
- Market risk, for example, the risk that investment returns are not as high as anticipated.
- Counterparty default risk, for example, the risk that a reinsurance counterparty becomes insolvent and cannot honour its obligations.

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

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

The most significant risks contributing to ACS's required capital relate to:

- the underlying general insurance business and associated uncertainties relating to the value of existing insurance liabilities and potential for adverse outcomes to that expected in the reserves currently set, particularly in the liabilities that would be expected to settle over a longer time period (especially disease related claims and motor injury reserves). ACS is also exposed to catastrophe losses.
- market risk driven by the investment strategies employed, particularly the credit risk due to the large bond holdings

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

Whilst I have not performed a detailed validation of ACS's Internal Model results, the assumptions, methodology and outputs from their models are consistent with my expectations for business of this nature and I am satisfied that they are informative as to the change in risk which would occur following the Transfer compared with the position assuming no Transfer occurs. I note that I have performed my stress test analysis on ACS's Standard Formula rather than Internal Model for purposes of consistency.

## **Stress test analysis**

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

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

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

Moreover, during the period of policyholder consultation before the proposed Sanctions Hearing it is possible that major events could occur that cause real-life stresses to the Transfer Companies. By confirming that the Transfer Companies can withstand certain stresses and

that the occurrence of these would not change any of my conclusions with regard to the impact of the Transfer on policyholder groups, then if events do occur in that time that are no larger in impact than those that I consider here my conclusions can be considered to hold at that time. This is particularly important in the case of this Transfer when there are many different forecasts of the extent of investment market turmoil that could occur as a consequence of a no deal Brexit. I have intentionally selected a strong asset-related stress test to consider how the Transfer Companies may fare in such circumstances. I note that the reality of the aftermath of a no deal Brexit is unknowable at the time of writing of this report and may in fact be materially different from the stresses I have considered here.

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

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

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

As discussed in sections 3.24 and 5.9, the capital requirements under the Solvency II regime are based on policyholders being secure at the 99.5% confidence level.

Whilst these stresses do not represent an exhaustive list of all adverse events that could impact the Transfer Companies' legal entities, they include those risks I consider most material and relevant to my analysis. I note that the Transfer Companies' legal entities perform such stress testing as part of their business as usual risk management processes as expected under Solvency II. Taking the base financial projections provided by the Transfer Companies as a starting point, the severe adverse scenarios I have considered include:

- Catastrophe Risk – Natural Catastrophe post Transfer: A combination of natural disasters that are designed to affect the post Transfer state but where each individual event is less severe;
- Aggregation Risk – Natural Catastrophe Aggregation: A three part scenario showing the effects of a natural disaster relevant to each pre Transfer entity in turn;
- Reserve Risk - Reserve Deterioration: An event that causes a 10% increase to the net reserves of each of the entities;
- Market Risk - EU Breakup: An asset shock caused by events within the EU; and
- Conduct risk – Data Breach: A scenario where a group of hackers are able to conduct a ransomware attack on AXA's systems that leads to a data breach.

All capital figures are as at 31 December 2018, and hence exclude the additional capital that will be available to XLICSE after the Mergers.

6.5 Severe adverse stress: Natural Catastrophe post Transfer

I consider a scenario where two European Earthquake events, one South American Earthquake event, plus a variety of small events, all occur in a short time frame, which is considered to be roughly a 1 in 200 year event for the combined XLICSE business post Transfer and Mergers. 20% of losses are assumed to be paid immediately, with the rest impacting the Capital Cover Ratio through unpaid reserve volumes.

Capital Cover Ratio	Pre Transfer			Post Transfer and Mergers
	XLICSE	ACS	AXA Art	XLICSE
Base Case	123%	98%	185%	116%
Natural Catastrophe post Transfer	107%	83%	146%	100%

Source: Management information

ACS drops further below 100%, as would be expected, but remains above its MCR.

The events of this scenario have been chosen to target the post Transfer XLICSE. Even in this case, it sees a similar drop to ACS and pre Transfer XLICSE and still retains a Capital Cover Ratio of 100%.

#### 6.6 Severe adverse stress: Natural Catastrophe Aggregation

I consider the following three scenarios:

A natural catastrophe relevant to XLICSE where there is a Taiwan Earthquake and Australia Earthquake plus several small / immaterial events; a natural catastrophe relevant to ACS where there is a European Earthquake and two South American Earthquakes, accompanied by an aggregation of many small events; and a natural catastrophe relevant to AXA Art where there are a series of two North American Earthquakes, two North Atlantic Hurricanes and a European Windstorm, accompanied by several small events. All these are based on a 1 in 200 year event to the original Transfer Company.

Capital Cover Ratio	Pre Transfer			Post Transfer and Mergers
	XLICSE	ACS	AXA Art	XLICSE
Base Case	123%	98%	185%	116%
Natural Catastrophe - XLICSE	105%	97%	184%	109%

Capital Cover Ratio	Pre Transfer			Post Transfer and Mergers
	XLICSE	ACS	AXA Art	XLICSE
Base Case	123%	98%	185%	116%
Natural Catastrophe - ACS	119%	82%	182%	112%

Capital Cover Ratio	Pre Transfer			Post Transfer and Mergers
	XLICSE	ACS	AXA Art	XLICSE
Base Case	123%	98%	185%	116%
Natural Catastrophe - AXA Art	120%	93%	139%	110%

Source: Management information

ACS drops further below 100%, as would be expected, but remains above its MCR in all cases.



In each case, the effect on the post Transfer XLICSE is smaller than that of the affected pre Transfer entity, and the post Transfer Capital Cover Ratio is over 100%. Each specific case also has little effect on the other two pre Transfer companies, showing that the risk of aggregation is small.

#### 6.7 Severe adverse stress: Reserve Deterioration

I consider a scenario in which each entity's net reserves increase by 10%.

Capital Cover Ratio	Pre Transfer			Post Transfer and Mergers
	XLICSE	ACS	AXA Art	XLICSE
Base Case	123%	98%	185%	116%
10% increase in net reserves	108%	71%	180%	91%

Source: Management information

ACS drops further below 100%, as would be expected, but remains above its MCR. Post Transfer XLICSE Capital Cover Ratio still remains above its MCR. For ACS, the stress produced is greater than the 1 in 100 year cat event exposure, and when combined with the other entities (that will not be perfectly correlated with ACS in terms of reserves) this aggregate deterioration across all three would be less likely than a 1 in 200 year scenario. I also note that with the additional own funds of €590 million, as discussed in section 4.5, XLICSE post Transfer would not fall below 100%.

#### 6.8 Severe adverse stress: EU Breakup

I consider a scenario in which the cumulative effects of the refugee crisis, a return to low economic growth and austerity policies lead to political change that halts the integration process of the EU members and begins a rapid unwind of policies followed until now. This includes a breakup of the Schengen area and some countries departing the Euro area and European Union. The breakup is relatively orderly as some impacts are felt immediately (e.g. changes in allowable migration) while other changes are phased in over a longer period (e.g. return to national currencies, trade restrictions).

This scenario is performed assuming the investment portfolio mix of the entities is as it was at 30 June 2019, though the capital figures and movements are still as at 31 December 2018. This is due to the changes in investment portfolio seen since 31 December 2018, as discussed in section 5.4.

Capital Cover Ratio	Pre Transfer			Post Transfer and Mergers
	XLICSE	ACS	AXA Art	XLICSE
Base Case	123%	98%	185%	116%
EU Breakup	112%	75%	174%	96%

Source: Management information

ACS drops further below 100%, as would be expected, but remains above its MCR.

This scenario is based on one of the Transfer Companies' "Black Swan" scenarios (a set of asset shock scenarios created in conjunction with an external investment manager) and is a stronger scenario than their 1 in 200 year market risk events. This scenario is expected to be more severe than the aftermath of a no deal Brexit as it factors in more than one country undergoing a disorderly exit from the EU, but I include it as it has features that many commentators have suggested may happen after a no deal Brexit in terms of asset shocks. Even so, post Transfer XLICSE Capital Cover Ratio still remains above its MCR. I also note that with the additional own funds of €590 million, as discussed in section 4.5, XLICSE post Transfer would not fall below 100%.

## 6.9 Severe adverse stress scenario: Data Breach

I consider a scenario in which a data breach occurs that incurs the maximum penalty from the General Data Protection Regulation ('GDPR'). This is the higher of €20 million or 4% of global annual turnover of a company. A 4% of global turnover fine would equate to over €4bn, which would wipe out the capital of all of the Transfer Companies both before and after the Transfer. I note that no fine of that order of magnitude has been imposed under GDPR at the time of writing, and instead have selected a fine of €100m for illustrative purposes, though it is easy enough to extrapolate the impact of larger fines as they hit each Transfer Company by the same amount in this scenario.

Capital Cover Ratio	Pre Transfer			Post Transfer and Mergers
	XLICSE	ACS	AXA Art	XLICSE
Base Case	123%	98%	185%	116%
Data Breach	109%	91%	44%	111%

Source: Management information

As can be seen the impact from this stress is more marked on the smaller balance sheet companies, and lowest on the combined XLICSE post Transfer and Mergers. It would take a fine in this scenario of over €300m before XLICSE post Transfer and Mergers breached its SCR.

## 6.10 Findings of stress test analysis

Following these stress tests, each entity would be expected to meet its existing policyholder obligations in full, both before and after the Transfer and Mergers. As noted earlier, this helps provide comfort that the capital requirement calculations provided by the Transfer Companies are at a reasonable level, and that the reduction in capital coverage for policyholders of AXA Art as a consequence of the Transfer is not so large that there is material risk that their claims will not be met in full. In a number of the above cases, particularly for ACS whose Standard Formula calculation is already below 100%, though also for XLICSE post Transfer, the capital position would breach the SCR, but would not breach the MCR. This would result in some form of regulatory intervention and may prevent the entity in question from taking on any new business until the capital position is improved. However, the companies would remain solvent under each of these stress scenarios.

## 7. Summary of findings

### Summary of changes in circumstances of the existing XLICSE policyholders

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

- (a) The policies remain with XLICSE after the Transfer;
- (b) The anticipated Capital Cover Ratio of XLICSE is 116% after the Transfer, and remains at a comfortable level of greater than 100% of the regulatory requirements. Even though policyholders of XLICSE would see a drop in their Capital Cover Ratio based on 31 December 2018 figures, at the time that the Transfer would actually be taking place, there would be an additional €90 million capital available in XLICSE pre Transfer and an additional €590 million capital available in XLICSE post Transfer and Mergers, which would lead to an increase in the revised Capital Cover Ratios to 135% pre Transfer and to 145% post Transfer and Mergers. Even at the minimum of 130% for pre and post Transfer, XLICSE is consistently well capitalised. Reserving and other financial policies remain unchanged, and the chance that XLICSE would not be able to meet its respective future obligations in full remains remote; and,
- (c) There are no changes to the ability to make new claims, claims handling, the protection of policyholder data, regulatory or management framework, or the overall treatment of customers as a result of the Transfer and as such no impact on the existing XLICSE policyholders.

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

### Summary of changes in circumstances of ACS UK policyholders

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

- (a) The policies move from ACS UK to XLICSE UK;
- (b) The anticipated Capital Cover Ratio that ACS policyholders will decrease from 144% pre Transfer (as at 31 December 2018) to 116% post Transfer (though rising to 145% with the additional capitalisation post Mergers), though these figures are on different bases, with ACS using an Internal Model pre Transfer and post Transfer XLICSE using the Standard Formula. Even if assuming the 130% minimum for XLICSE post Transfer, I note that both ACS and XLICSE are well-diversified insurance businesses for which the Standard Formula provides an appropriate but conservative estimate of the capital required to support the risks in the business. If comparing on the same basis (Standard Formula), the capital coverage would increase from 98% to 116%, rising to 145% with the additional capitalisation post Mergers. I do not consider that the changes seen in reserving and other financial policies from ACS UK to post Transfer XLICSE cause any material adverse impact, as the impact of different levels of reserve margin under the Transfer Companies' accounting policies is stripped out in the Solvency II balance sheets that form the basis for my conclusions overall. Therefore, the chance that post Transfer XLICSE would not be able to meet its respective future obligations in full is remote;
- (c) There are no changes to the ability to make new claims, claims handling, protection of policyholder data, or any changes in the overall treatment of customers as a result of the Transfer. I do not consider the changes to the regulatory and management framework to cause any adverse material impact; and

- (d) With regard to regulatory supervision and the protections available:
  - (i) Those policyholders that currently benefit from FSCS protection will retain that entitlement post Transfer;
  - (ii) Those policyholders that do not currently benefit from FSCS protection will still have no protection from the FSCS post Transfer, and their situation has not been adversely affected as a consequence of this;
  - (iii) Those policyholders that currently benefit from FOS protection will retain that entitlement post Transfer; and
  - (iv) Those policyholders that do not currently benefit from FOS protection will still have no protection from the FOS post Transfer; their situation has not been adversely affected as a consequence of this.

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

### **Summary of changes in circumstances of AXA Art UK policyholders**

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

- (a) The policies move from AXA Art UK to XLICSE UK;
- (b) The anticipated Capital Cover Ratio that AXA Art policyholders will benefit from will drop from 185% pre Transfer (as at 31 December 2018) to 116% post Transfer on a Standard Formula basis, rising to 145% with the additional capitalisation post Mergers. I note that even if assuming the 130% minimum for post Transfer XLICSE, it remains at a comfortable level of greater than 100% of the regulatory requirements. I also note that the nominal capital base is much larger post Transfer; plus AXA Art writes short tailed business, so the substantial increase in nominal capital base outweighs the reduction in proportionate coverage. I do not consider that the changes seen in reserving and other financial policies from ACS UK to post Transfer XLICSE cause any material adverse impact, as the impact of different levels of reserve margin under the Transfer Companies' accounting policies is stripped out in the Solvency II balance sheets that form the basis for my conclusions overall. Therefore, the chance that post Transfer XLICSE would not be able to meet its respective future obligations in full is remote;
- (c) There are no changes to the ability to make new claims, claims handling, protection of policyholder data, or any changes in the overall treatment of customers as a result of the Transfer. I do not consider the changes to the regulatory and management framework to cause any adverse material impact; and
- (d) With regard to regulatory supervision and the protections available:
  - (i) Those policyholders that currently benefit from FSCS protection will retain that entitlement post Transfer;
  - (ii) Those policyholders that do not currently benefit from FSCS protection will still have no protection from the FSCS post Transfer, and their situation has not been adversely affected as a consequence of this;
  - (iii) Those policyholders that currently benefit from FOS protection will retain that entitlement post Transfer; and

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

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

## **Summary of changes in circumstances of non-UK Branches ACS policyholders**

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

- (a) The policies will move from ACS to XLICSE as a result of the Mergers. The sanction of the Transfer will enable the Mergers to take place;
- (b) The anticipated Capital Cover Ratio that ACS policyholders will benefit from will decrease from 144% pre Transfer (as at 31 December 2018) to 116% post Transfer (and rising to 145% with the additional capitalisation post Mergers), though these figures are on different bases, with ACS using an Internal Model pre Transfer and post Transfer XLICSE using the Standard Formula. If comparing on the same basis (Standard Formula), the Capital Cover Ratio would increase from 98% to 116% (and 145% as above). Even if assuming the 130% minimum for XLICSE post Transfer, I note that both ACS and XLICSE are well-diversified insurance businesses for which the Standard Formula provides an appropriate but conservative estimate of the capital required to support the risks in the business. I do not consider that the changes seen in reserving and other financial policies from ACS UK to post Transfer XLICSE cause any material adverse impact, as the impact of different levels of reserve margin under the Transfer Companies' accounting policies is stripped out in the Solvency II balance sheets that form the basis for my conclusions overall. Therefore, the chance that post Transfer XLICSE would not be able to meet its respective future obligations in full is remote;
- (c) There are no changes to the ability to make new claims, claims handling, protection of policyholder data, or any changes in the overall treatment of customers as a result of the Transfer. I do not consider the changes to the regulatory and management framework to cause any adverse material impact; and
- (d) Policyholders do not have access to the FSCS or FOS pre Transfer and will still have no protection post Transfer, and their situation has not been adversely affected as a consequence of this.

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

## **Summary of changes in circumstances of non-UK Branches AXA Art policyholders**

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

- (a) The policies will move from AXA Art to XLICSE as a result of the Mergers. The sanction of the Transfer will enable the Mergers to take place;
- (b) The anticipated Capital Cover Ratio that AXA Art policyholders will benefit from will drop from 185% pre Transfer (as at 31 December 2018) to 116% post Transfer on a Standard Formula basis, rising to 145% with the additional capitalisation post Mergers.

I note that even if assuming the 130% minimum for post Transfer XLICSE, it remains at a comfortable level of greater than 100% of the regulatory requirements. I also note that the nominal capital base is much larger post Transfer; plus AXA Art writes short tailed business, so the substantial increase in nominal capital base outweighs the reduction in proportionate coverage. I do not consider that the changes seen in reserving and other financial policies from ACS UK to post Transfer XLICSE cause any material adverse impact, as the impact of different levels of reserve margin under the Transfer Companies' accounting policies is stripped out in the Solvency II balance sheets that form the basis for my conclusions overall. Therefore, the chance that post Transfer XLICSE would not be able to meet its respective future obligations in full is remote;

- (c) There are no changes to the ability to make new claims, claims handling, protection of policyholder data, or any changes in the overall treatment of customers as a result of the Transfer. I do not consider the changes to the regulatory and management framework to cause any adverse material impact; and
- (d) Policyholders do not have access to the FSCS or FOS pre Transfer and will still have no protection post Transfer, and their situation has not been adversely affected as a consequence of this.

As a result I consider there to be no material adverse impact on non-UK Branches AXA Art policyholders as a consequence of the Transfer.

## 8. Details of proposed policyholder communication

### 8.1 Overview

Subject to the approval of the Court, with the exception of the below waivers, it is proposed that a cover letter and accompanying information leaflets, including a summary of this report, will be dispatched to:

- (a) policyholders of all transferring policies; and
- (b) all third party reinsurers that provide reinsurance to the UK Branches.

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

- the policyholders of AXA Art UK and ACS UK who will not be transferring under the Part VII Transfer.

These policyholders will already be receiving communications related to the Mergers. The Transfer Companies are of the opinion that the additional communication to notify policyholders of the Transfer as well would provide little benefit to the policyholders.

- the policyholders of XLICSE.

This waiver is being requested on the grounds that the size of the transferring UK Branches is small compared to the size of the Transferee (with total GWP of £325 million for the UK Branches compared to GWP of £4.8 billion for the consolidated XLICSE business post Mergers as at 31 December 2018). The key reasoning by which I believe this to be fair is that there will be no change in the day to day experience of these policyholders.

- save for policyholders with open claims, policyholders of the UK Branches whose policies have been cancelled or expired (and not renewed) before;
  - a six month period for Transferring Policies underwritten by AXA Art UK; and
  - a twelve month period for Transferring Policies underwritten by ACS UK,

immediately prior to the date of the Directions Hearing.

The waiver is requested on the grounds that only a very small percentage of claims are late reported or reopened before these periods. The Transferors have conducted an analysis of late reported and reopened claims on policies that were cancelled or otherwise expired since 2016. For AXA Art UK policies, on average 97.4% of all claims are made within 6 months of the date of expiry of the policy. For ACS UK policies, on average 95.25% of all claims are made within 12 months of the date of expiry of the policy.

- beneficiaries of motor fleet Group policies written by ACS UK and temporary insureds of AXA Art UK.

The rationale for requesting these waivers is that for motor fleet contracts, the beneficiaries are the employees of the policyholder; for the temporary insureds there are fluctuations in the number and identity of the beneficiaries that would make it difficult to communicate effectively.

- AXA Art UK and ACS UK policyholders where the Transfer Companies do not hold (or are not reasonably able to obtain) accurate and complete contact details.

This is a circumstance out of the Transferors' control. As noted below, details of the Transfer will be reported as part of a wider advertising campaign.

- AXA Art UK and ACS UK policyholders who might otherwise have received notice of the application in the event of accidental omission (in the very limited number of cases where this applies) or where a policyholder's contact details are out of date, incomplete or incorrect;

This is a circumstance out of the Transferors' control. As noted below, details of the Transfer will be reported as part of a wider advertising campaign.

- Star Assurance Legacy Policyholders (save for those with open claims); this is a historic run-off book, with very low claims experience where such policies have been in run-off for over 25 years.

This book has been in run-off for many years; the policyholder data is maintained by a third party and may no longer be complete or accurate.

Waivers are also being sought to change the method of communication to the following groups of policyholders:

- Star Assurance Legacy policyholders with open claims; as noted above, these are managed through a third party, Capita plc; and,
- ACS UK marine policies that have been written under Delegated Underwriting Authority arrangements in place with a third party. Delegated Underwriting Authority is an agreement between an insurer and an intermediary by which the authority to underwrite insurance policies is passed to the intermediary. There are 14 of these arrangements, with four of those arrangements having lapsed, and of the remaining 10, ACS UK's current understanding is that there are no more than 1,850 policies written between them. For these policies, ACS UK does not have access to the relevant contact information.

The Transfer Companies propose that for these groups, notification be carried out through the respective third parties. The intermediary will be instructed to pass on the same information to the policyholders as the Transfer Companies would send directly. If the intermediary will not do so, then the Transfer Companies will take steps to carry out the notification directly, including where necessary, requesting the contact details from the intermediary.

As at the date of this report, Capita plc, and 11 out of 14 of the relevant third parties for ACS UK have already agreed to send the notifications as soon as possible after the Directions Hearing. ACS UK and AXA Art UK will liaise with these third parties to ensure that if notifications are not sent to policyholders within three business days of the Directions Hearing, that they will receive the information to send them directly. The three remaining third parties for ACS UK have indicated that they are not willing to carry out the notifications; ACS UK has, as such, requested the policyholder contact details be provided to allow direct notification. Two out of three of the third parties have not yet responded to this request, though ACS will continue to attempt to make contact; I note that in any case, the arrangements with these two third parties are lapsed, that there are no active policies remaining within the arrangements, and ACS UK is not aware of any open claims under these two arrangements. Furthermore, the policies written under these arrangements are typically short tail.

There will also be a very small number of ACS UK and AXA Art UK policyholders (114 and 8 respectively) who are contacted via email, with a read receipt request, rather than by post; this being their preferred form of communication.

In addition a waiver is being applied for, for policyholders for whom no contact records can be traced. XLICSE have yet to identify any such policyholders but are requesting the waiver as a precaution.

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



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

#### *Wider communication*

The Transfer will be published in the following publications: the London Gazette, the Edinburgh Gazette and the Belfast Gazette; the Times newspaper in the UK; and the Daily Telegraph newspaper in the UK. It will also be published in the industry publication Insurance Day.

A website will also be operated on which this report and a summary of this report will be posted.

## 8.2 Notification period

I note that the FCA usually considers six to eight weeks sufficient for the notification process; this being a period long enough for policyholders to be notified, consider whether they may be adversely affected and make any representations they should wish to. Due to the shortened timeline of the Transfer (which has been driven externally by the Brexit timeline), the notification period in this case will be just over five weeks. The Transfer Companies have undertaken steps to ensure that policyholders are not disadvantaged by this slightly shortened notification period:

- Although the majority of the UK Branches' policies are distributed through third parties, the Transfer Companies intend to notify policyholders of the Transfer directly as opposed to relying on third party distributors (other than in the above noted limited cases of the Star Alliance Legacy policyholders and the ACS UK policies written under a Delegated Underwriting Authority). This is to ensure that the notification process is carried out as effectively as possible and that policyholders are provided with the full five week period to consider the Transfer. Sending the notifications directly will ensure that policyholders receive their notifications as soon as possible after the Directions Hearing;
- The Transfer Companies have undertaken an extensive data extraction exercise to ensure the quality of the policyholder data held to minimise the chance of failed deliveries;
- The Transfer Companies have established a dedicated section on AXA's website which has been accessible since 15 October 2019, that is, from before the Directions Hearing. The website provides policyholders with details of the Transfer ahead of the formal notification process and is available to policyholders for just over eight weeks prior to the Sanctions Hearing. To further increase awareness and publicity, the website has been promoted on AXA Group associated social media accounts (namely, Twitter and LinkedIn). Policyholders whose policies incept after 14 October 2019 will receive notification of the proposed Transfer and will also be referred to the website. An update on the number of policyholders who access the website will be provided to the court at the Directions Hearing; and,
- As noted above, in addition to the usual advertisements required to be placed, in order to further enhance awareness of the Transfer, it is also intended that notice of the Transfer be published in Insurance Day.

I have considered the above steps and am comfortable that the actions taken to mitigate the slightly shortened notification period are appropriate and reasonable.

## **Appendix 1 Curriculum Vitae of the Independent Expert**

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

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

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

### **Experience**

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

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

### **Professional & Educational**

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

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

## **Appendix 2 Extract from Letter of Engagement**

### **Scope of the Independent Expert's work**

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

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

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

## Appendix 3 Letter of Representation

Philip Tippin  
KPMG LLP  
15 Canada Square  
Canary Wharf  
London  
E14 5GL

28 October 2019

Dear Mr Tippin,

### Independent Expert Appointment – Part VII Transfer

I, Paul Bradbrook, am a director of XL Insurance Company Limited SE. This letter relates to the proposed transfer of the UK branch business currently carried on by AXA Art Versicherung AG ('AXA Art UK') and the UK branch business currently carried on by AXA Corporate Solutions Assurance ('ACS UK') into the UK branch of XL Insurance Company SE ('XLICSE UK') under Part VII of the UK Financial Services and Markets Act 2000 (as amended) ('the Transfer'). I have been authorised by the boards of directors of XLICSE UK and AXA ART and by ACS to give the representations set out in this letter on behalf of XLICSE UK, AXA Art UK and ACS UK ('the Transfer Companies'), which are given to the extent that each such company exercises control over the insurance business which is the subject of the Transfer both before and after the Transfer come into effect. In this capacity, I have reviewed the final version of the report produced by you as the Independent Expert ('the Report').

In respect of the Transfer, I can confirm that:

1. The data and information provided to you as Independent Expert was prepared by PRA approved persons or other members of the senior management of the Transfer Companies (or their agents) or responsible senior professionals of the Transfer Companies or their advisors.
2. I have disclosed all the information that in my opinion is relevant to the Independent Expert when forming a view as to whether policyholders are adversely affected by the proposed Transfer, including but not limited to discussions or disputes with regulatory authorities and key reinsurance and commercial counterparties.
3. To the best of my knowledge and belief, the Report accurately and fairly reflects my understanding of the details of the proposed Transfer and the facts relied upon in the Report are true and accurate, and that there are no material inaccuracies or omissions in the description of either of the Transfer Companies' business and practices (including details of specific contracts or claims) or in any statements attributed directly or indirectly to any of the Transfer Companies.
4. I will ensure that the Independent Expert is kept apprised of all matters and issues, up to the date of the Court hearings, which, in my opinion, may be relevant to the Independent Expert in opining on the proposed Transfer. These matters include, but are not limited to, Court documents and supporting materials, full details of any changes between draft versions previously provided to me and final versions of these documents and full details of any differences between the data and information underlying such draft and final documents.
5. In particular, the facts stated below are true and accurate to the best of my knowledge and belief:

- It is not planned that in XLICSE there will be a distribution of capital or increase in liability or risk exposure as a consequence of the Transfer that would not have occurred were the Transfer not to proceed;
- There will be no policyholders left in AXA Art UK or ACS UK after the Transfer, as all existing policyholders of AXA Art UK and ACS UK will become policyholders of XLICSE as a consequence of the Transfer;
- No significant VAT liabilities will be realised by XLICSE as a result of the Transfer;
- The financial position as stated in the audited accounts for the year ended 31 December 2018 gives a true and fair view of the Transfer Companies' entities' affairs at that date;
- Other financial projections you have used to prepare the Report have been prepared in good faith by persons with appropriate knowledge and experience on a reasonable basis and based on reasonable assumptions;
- There are no planned changes to the governance of XLICSE's UK branch following the Transfer.
- An ancillary own funds amount of €500 million will be provided to the post Transfer XLICSE as at the date of the Mergers, assuming the Mergers are sanctioned. This will be provided by means of a capital commitment deed from XL Bermuda Ltd ('XLB'), an AXA XL Division company domiciled in Bermuda, supported by a letter of credit issued by AXA SA; and
- XLICSE will continue to operate and has no current intentions to cease underwriting or carry out a further restructuring of their business as a consequence of the Transfer, other than that of the cross-border mergers of the non-UK branches of the Transfer Companies' entities and another future intended Part VII Transfer of UK business, which will separately go through the Court.

Yours sincerely



Paul Bradbrook

## **Appendix 4 List of Information provided**

### **Financial information, capital and risk management**

2018, 2017, 2016 SFCRs for XLICSE, ACS and AXA Art

2018, 2017, 2016 ORSAs for XLICSE, ACS and AXA Art

2019 ORSA for XLICSE

2018, 2017, 2016 XLICSE's Annual Report (UK GAAP)

2018, 2017, 2016 AXA Art's Annual Report (IFRS and German GAAP)

2018, 2017, 2016 ACS's Annual Report (IFRS and French GAAP)

2018, 2017, 2016 XLICSE's Actuarial Function Report

2018 ACS and AXA Art External Actuary Report

XLICSE Head of Actuarial Function Report

An Appendix to a Finance Report providing answers to questions required legally in respect of the Mergers

Stress Testing Documentation

ACS Internal Model Estimates

Reserving Policies

A walkthrough document prepared for the CBI of the finance and actuarial operational readiness for the Mergers

Claims Handling Principles documentation

### **Structure & Company information**

Company organisation charts pre and post Mergers

Details of current and post transfer Executive Board and governance arrangements

XLICSE, ACS and AXA Art Defined Benefit scheme details Information Security Policy documentation

Documentation on the Integration plans for AXA Group companies.

### **Significant risk sharing arrangements and material counterparties**

Reinsurance information

Guarantee information and documentation

### **Scheme information**

Scheme Document

Communication Strategy Document

Waiver proposal Document

### **Other information considered**

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

## **Appendix 5 Glossary of terms and definitions**

**Adverse impact** – A negative change of any size.

**AG** - Aktiengesellschaft, a German designation for a publically listed company

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

**ACS** – AXA Corporate Solutions Assurance, an insurer based in France providing commercial lines insurance.

**AXA Art** – AXA Art Versicherung AG, a specialist insurer based in Germany, providing mostly fine art and high net worth insurance business.

**AXA XL Division** – A group of AXA Group subsidiaries focussing on large property and casualty commercial lines and specialty risks. AXA XL Division includes XL Group Limited and its subsidiaries, ACS and its subsidiaries, and AXA Art and its subsidiaries.

**AXA Group** – The international group of companies for which AXA SA in France is the ultimate parent company, which includes XLICSE, ACS and AXA Art.

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

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

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

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

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

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

**CPR** – Civil Procedure Rules 1998.

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

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

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

**Employers' Liability Tracing Office ('ELTO')** – ELTO is a system set up to provide claimants with access to a database of EL policies through an online search engine. The system can be used, for

example, to find the insurer of a previous employer where the claimant has suffered from injury/disease caused by previous employment. ELTO requires all insurers to upload the details on all new and renewed EL policies post 2011 and any policies prior to that which have had new claims made against them.

**The EU** – The European Union

**EEA** – the European Economic Area made up of the EU nations plus Iceland, Liechtenstein and Norway.

**FIA** – Fellow of the Institute and Faculty of Actuaries.

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

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

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

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

**The Financial Services and Markets Act 2000 (Amendment) (EU Exit) Regulations 2019 (the 'FSMA amendment')** – An amendment to FSMA published by HM Treasury on 21 December 2018 which covers changes in the event of Brexit.

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

**Gross Written Premium ('GWP')** – Written premium is an accounting term in the insurance industry used to describe the total amount customers are required to pay for insurance coverage on policies issued by a company during a specific period of time. Gross written premium is the revenue generated by an insurance company before making deductions such as payments to reinsurers, commissions and other deductions.

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

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

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

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



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

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

**Long Tailed Business** – Insurance contracts where claims may be made many years after the contract has expired, for example liability insurance.

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

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

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

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

**One-year risk** - Solvency II refers to liabilities on an ultimate basis and a one-year basis. The one-year basis considers the uncertainty in valuation of liabilities over one financial year of the firm's own-funds. For Solvency II, the capital requirement is calculated as the one-year risk in the shortfall in own-funds over a time horizon of one year, with a confidence level at the 99.5th percentile

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

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

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

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

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

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

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

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

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

**The Report** – The report produced by the Independent Expert.

**Reserves** – See 'Claims Reserves'.

**Risk Margin** – An amount required to ensure the value of the Solvency II Technical Provisions, which are calculated on an ultimate basis, is increased from the discounted best estimate to an amount equivalent to the theoretical level required to transfer the obligations to another insurance undertaking.

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

**SA** - Société Anonyme, a French designation for a public limited company

**SE** – "Societas Europaea", a designation for a public company that is registered under the corporate law of the EU

**Short Tailed Business** – Insurance contracts where claims are made during or shortly after the expiration of the policy. An example is property insurance.

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

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

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

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

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

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

**The Transfer** – In the context of this report, I mean the proposal that AXA Art and ACS will transfer the policies of their UK branches into XLICSE under the provisions of Part VII of the Financial Services and Markets Act 2000.

**The Transfer Companies**—The UK branches of AXA Corporate Solutions Assurance ('AXA CS'), AXA ART Versicherung AG ('AXA Art'), and XL Insurance Company SE ('XLICSE')

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

**UK Branches** - The UK branches of AXA Corporate Solutions Assurance ('AXA CS'), AXA ART Versicherung AG ('AXA Art').

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

**Well capitalised**—Having capital resources comfortably in excess of the regulatory requirement; in this case I use it when the ratio is over 120%.

**Written premium** – See 'Premium'.

**XLICSE** – XL Insurance Company SE, an Irish domiciled company which AXA CS and AXA Art will be merged with.

## Appendix 6 List of interviews carried out

Name	Entity	Position
<b>Travis Stringer</b>	XLICSE	Senior Specialist, Financial Reporting & Accounting
<b>Eric Brown</b>	XLICSE (contractor)	Enterprise Risk Management
<b>Philip Whittingham</b>	AXA XL Division	UK CRO
<b>Andrew Johns</b>	AXA XL Division	Senior Analyst, Natural Perils Risk Management
<b>Timothy Williams</b>	XLICSE, XL Re Europe SE, XL Catlin Insurance Company UK Limited	Capital Actuary
<b>Gary Dunne</b>	XLICSE	Head of Actuarial Function
<b>Yann Miloe</b>	ACS UK branch	Deputy Chief Financial Officer
<b>Alexander Wiebe</b>	AXA Art	Chief Financial Officer
<b>Frédéric Fischer</b>	ACS	Chief Financial Officer
<b>Arnaud Sorel</b>	ACS	General Counsel
<b>Simon Smith</b>	ACS	Interim Head of UK Legal
<b>Martin Turner</b>	AXA XL Division	Head of UK and Global Speciality Claims
<b>David Cowan</b>	AXA XL Division	Senior Project Manager, Claims
<b>Lesley Turner</b>	AXA XL Division	Head of UK Claims Operations
<b>Andy Wragg</b>	ACS	Global Chief Compliance Officer
<b>Tina Owen</b>	AXA Art	Compliance Officer
<b>Alison Thompson</b>	AXA XL Division	Head of UK Compliance
<b>Rhic Webb</b>	AXA XL Division	General Counsel - Global Corporate
<b>Yvonne Slattery</b>	XLICSE	Chief Operating Officer
<b>Paul Lowin</b>	ACS	Chief Operating Officer
<b>Luke Khan</b>	AXA XL Division	Head of Information Security Services & Risk Management
<b>Cheryl Simmons</b>	AXA XL Division	Manager - Programme & Policy Management
<b>David Hawtin</b>	ACS	Information Security Officer
<b>Christopher Read</b>	AXA XL Division UK Region and Legal Entities	Chief Operating Officer
<b>Juliet Phillips</b>	AXA XL Division	Head of EMEA and Asia Tax
<b>Christopher Slydel</b>	AXA XL Division	Manager, Financial Reporting & Accounting



## Appendix 7 Cross reference to PRA Statement of Policy on insurance business transfers

Section of Statement of Policy	PRA Requirement	Relevant information covered in IE Report
2.30	<p>The scheme report should comply with the applicable rules on expert evidence and contain the following information:</p> <p>(1) who appointed the independent expert and who is bearing the costs of that appointment;</p> <p>(2) confirmation that the independent expert has been approved or nominated by the PRA;</p> <p>(3) a statement of the independent expert's professional qualifications and (where appropriate) descriptions of the experience that makes them appropriate for the role;</p> <p>(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;</p> <p>(5) the scope of the report;</p> <p>(6) the purpose of the scheme;</p> <p>(7) a summary of the terms of the scheme in so far as they are relevant to the report;</p> <p>(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;</p> <p>(9) the extent to which the independent expert has relied on:</p> <p>(a) information provided by others; and</p> <p>(b) the judgement of others;</p> <p>(10) the people the independent expert has relied on and why, in their opinion, such reliance is reasonable;</p> <p>(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:</p> <p>(a) transferring policyholders;</p> <p>(b) policyholders of the transferor whose contracts will not be transferred; and</p> <p>(c) policyholders of the transferee;</p> <p>(12) 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;</p>	<p>Costs – section 1.17</p> <p>Confirmation – section 1.14</p> <p>Information on the IE – section 1.13</p> <p>IE's CV – Appendix 1</p> <p>IE's interest – section 1.15 – 1.16</p> <p>Scope – section 1.9-1.12</p> <p>Purpose – section 1.9-1.12</p> <p>The Proposed Transfer – section 1.1-1.8</p> <p>List of information provided – Appendix 4</p> <p>Reliances – section 1.19 - 1.20</p> <p>List of interviews carried out – Appendix 6</p> <p>Throughout section 5, summarised in section 7</p> <p>Impact on existing reinsurers – section 5.6</p>

	(13) what matters (if any) that 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; and	N/A
	(14) for each opinion that the independent expert expresses in the report, an outline of their reasons.	Throughout section 5, summarised in section 7
2.32	The summary of the terms of the scheme should include:	
	(1) a description of any reinsurance arrangements that it is proposed should pass to the transferee under the scheme; and	Outwards Reinsurance (Programmes) – section 3.20 – 3.21 and 4.8
	(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.	Guarantees/risk sharing arrangements – section 3.27 and 4.9
2.33	2.33 The independent expert's opinion of the likely effects of the scheme on policyholders should:	
	(1) include a comparison of the likely effects if it is or is not implemented;	Section 4
	(2) state whether they considered alternative arrangements and, if so, what;	N/A
	(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 and	Throughout. Groups defined in Identification of policyholder groups – section 5.2
	(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;	Contractual arrangements – section 4.18
	(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:	Section 5
	(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.	Cost and tax impact of the Transfer – sections 4.6-4.7
2.37	Where the transfer forms part of a wider chain of events or corporate restructuring, it may not be appropriate to consider the transfer in isolation and the independent expert should seek sufficient explanations on corporate plans to enable them to understand the wider picture. Likewise, the independent expert will also need information on the operational plans of the transferee and, if only part of the business of the transferor is transferred, of the transferor.	Future intentions of XLICSE – section 4.12
	These will need to have sufficient detail to allow them to understand in broad terms how the business will be run.	
2.39	The PRA expects the independent expert to provide a supplementary report for the final court hearing. Any supplementary reports will form part of the scheme report required to be produced under section 109 of FSMA and must also comply with 2.30–2.37.	N/A for Jersey transfer

2.40	<p>The purpose of the supplementary report is for the independent expert to provide an update on any relevant new information or events that have occurred since the date of the scheme report and to provide an opinion on whether they have affected the transfer. Matters that should be considered include, but are not limited to:</p> <ul style="list-style-type: none"><li>(1) the latest available financial information in respect of the transferor and transferee;</li><li>(2) any recent economic, financial or regulatory developments; and</li><li>(3) any representations made by policyholders or affected persons that raise issues not previously considered in the scheme report.</li></ul>	N/A for Jersey transfer
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