



*cutting through complexity*

# Report of the Independent Actuary

Halifax Insurance Ireland Limited and St  
Andrews Insurance plc

21 June 2012

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# 1 Introduction

## 1.1 Background

Halifax Insurance Ireland Limited ("HIIL") is an Irish regulated non-life insurance company underwriting the non-life insurance risks of first party Payment Protection Insurance ("PPI") on a freedom of services basis in the United Kingdom ("UK"). (HIIL's sister company Halifax Assurance Ireland Limited ("HAIL") underwrites the life assurance risks on the same PPI business). HIIL (and HAIL) are part of the St Andrews Group ("St Andrews") which is part of the wider Lloyds Banking Group ("LBG"). HIIL is regulated by the Central Bank of Ireland ("CBI").

St Andrews Insurance plc ("StAI") is a UK regulated non-life insurance company selling non-life insurance business and is also part of St Andrews. StAI is regulated by the UK Financial Services Authority ("FSA").

LBG is a public listed company incorporated and domiciled in Scotland. It is regulated by the FSA. LBG stopped selling first party PPI in July 2010. As HIIL only underwrites PPI business sold by LBG it is now in a position where its business is in run-off. LBG is streamlining its insurance operations in the UK and has made a strategic decision to transfer HIIL's business into StAI by way of a Portfolio Transfer.

The terms covering the proposed transfer are set out in the 'Draft Scheme' that will be presented to the Irish High Court. In the remainder of this Report, I refer to that document as the "Scheme of Transfer" or the "Scheme". It is anticipated that directions will be sought in relation to the Scheme of Transfer in July 2012, in advance of its presentation to the Court in early October 2012, under Section 13 of the 1909 act. The Scheme of Transfer document has been prepared by HIIL's legal advisors.

The petition to the Court for the transfer of long term (or life assurance) business must be accompanied by a report on the terms of the Scheme by an Independent Actuary. There is no equivalent legal requirement for any such report for the transfer of non-life insurance business. The Board of Directors of HIIL however have engaged me to act in a similar and broadly comparable capacity for the transfer of non-life insurance business under this Scheme.

## 1.2 Terms of Reference

I have been appointed by HIIL as the Independent Actuary in connection with the Scheme. StAI has agreed to my appointment. The Central Bank of Ireland ("CBI") has been informed of my appointment and I understand has not raised any objections to my appointment.

No limitation has been placed on the scope of my work. The opinions in this Report about the proposed Transfer are mine, based on the information provided to me and the answers to any questions I have raised.

The terms on which I was formally appointed as the Independent Actuary are set out in an engagement letter dated 5 April 2012 and an extract of my scope is included in Appendix 1.

Costs incurred in connection with the preparation of this actuarial Report are being borne by LBG.

A key requirement is that the Independent Actuary is suitably qualified and independent for the purposes of the Scheme.

- I am a Fellow of the Society of Actuaries in Ireland, having qualified as an actuary in 2001. I am currently a Director in KPMG Ireland. I hold a Practising Certificate issued by the Society of Actuaries in Ireland and currently act in the role of Signing Actuary to a number of Irish regulated non-life re/insurance companies. Therefore I believe that I have the relevant practical knowledge and experience. My curriculum vita is included in Appendix 2.
- I can confirm that I am independent of the companies involved in the Scheme. I do not hold any policies with either HIL or StAI. I have also considered the position of KPMG. I can confirm that I have carried out appropriate internal checks in line with KPMG's internal risk management procedures.
- Neither I, nor any member of my team, is a qualified lawyer or tax expert and I have not sought legal or tax advice on any element of the Scheme.

### 1.3 Restrictions

This Report has been prepared for the High Court in accordance with Section 13 of the Assurance Companies Act, 1909, the Insurance Act, 1989 and the European Communities (Non-Life Insurance) Framework Regulations 1994 ("1994 Regulations"), solely in connection with and for the purpose of informing the High Court of my findings in respect of the work that I have performed at the request of HIL and StAI regarding the Scheme. The Report sets out my opinion on the likely effects caused by the Scheme on the policyholders affected by the Scheme and should not be relied upon for any other purpose.

The Report will be included in the evidence submitted to the High Court together with the other documents which need to be submitted to the High Court. The Report will be issued on a confidential basis with disclosure restrictions applying as detailed in our engagement letter dated 5 April 2012.

While no guidance exists in respect to the transfer of non-life insurance business, I have had regard to the Actuarial Standards of Practice ("ASP") issued by the Society of Actuaries in Ireland, ASP LA-6, "Transfer of long-term business of an authorised insurance company – role of the Independent Actuary" and the agreed requirements and particular features of HIL and StAI's respective circumstances determined by their needs at the time.

In accordance with, and on the basis set out in, our engagement letter, a copy of this Report may be made available by HIL or StAI to their respective legal advisors, the CBI, the FSA and any policyholder of HIL and StAI who requests a copy of it. I have prepared a summary of this Report for inclusion in the documentation to be distributed or otherwise made available to policyholders.

I recognise that the High Court will use this Report in connection with the High Court's discharge of its statutory functions concerning the Scheme. Subject to the terms and conditions of our engagement contract, the CBI, the FSA and the policyholders of HIL and StAI may rely on this Report. 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 such use or reliance other than HIL, StAI, the CBI, the FSA or the policyholders of HIL or StAI for any purpose or in any context. Any party other than HIL, StAI the CBI, the FSA or the policyholders of HIL or StAI who obtains access to this Report or a copy and chooses to rely on this Report (or any part of it) will do so at its own risk. To the fullest extent permitted by law, KPMG will accept no responsibility or liability in respect of this Report to any other party.

### 1.4 Reliances and Limitations

This Report has been produced for no other purpose other than to support my opinion as Independent Actuary.

In forming my opinion contained in this Report, I have relied upon data and other information provided by HILL and StAI, their authorised representatives and appointed legal and taxation advisers on this Scheme. I have not undertaken any audit or independent verification of this information. A summary of the information received in the course of my work is set out in Appendix 3.

This Report and the work undertaken to enable this Report to be produced is not intended to be an audit, or form part of any due diligence or actuarial process, and should not be relied upon as such. In addition, this Report is not a financial strength analysis nor is it intended for use as an investment recommendation.

This Report is based on information made available to me at or prior to 01 June 2012 and takes no account of developments after that date.

## 2 Scope of Report and method of preparation

### 2.1 Scope

This Report has been prepared in accordance with:

- Regulation 12 of the European Communities (Non-Life Insurance) Framework Regulations (S.I. No. 359 of 1994) ("1994 Regulations") contains the applicable Irish provisions on transfer of portfolio. Regulation 12 of the 1994 Regulations makes express reference to Section 13 of the Assurance Companies Act 1909 and Section 36 of the Insurance Act 1989. Both sections concern the sanction of transfers by the High Court.

I have had regard to the Actuarial Standard of Practice issued by the Society of Actuaries in Ireland, ASP LA-6, "Transfer of long-term business of an authorised insurance company – role of the Independent Actuary"

In particular, I owe an overriding duty to the High Court to assist the High Court and to give the High Court independent actuarial evidence on the proposed transfer.

This Report is prepared primarily to assess the likely impact that the Scheme will have on the transferring policyholders of HIL and the existing policyholders of StAI if it proceeds. It is limited in its scope to the assessment of this Scheme alone and not to any other possible scheme. It is intended that this Report be submitted, in full, as evidence to the High Court when it considers whether or not to sanction the Scheme.

The term "Effective Date", as used in this Report, refers to the date at which, if the Scheme proceeds, HIL's non-life insurance business, incorporating the insurance policies, together with the associated liabilities and assets will be transferred to StAI, such that the policyholder liabilities are extinguished. I note that there will be certain items excluded from the Transfer and will remain with HIL. It is expected that the Effective Date will be 31 October 2012.

It is not part of my scope to consider the effect of the Scheme on the Companies Act accounts of either HIL or StAI. My consideration of the financial effect of the Scheme has been based on the method of reporting required for HIL's regulatory returns to the CBI and for StAI's regulatory returns to the FSA (including the additional regulatory capital reporting requirements in the UK, namely the Individual Capital Assessment ("ICA")). I have considered the effect on the solvency calculations that non-life insurance companies are required to carry out. I am satisfied that consideration of the CBI regulatory returns and solvency calculations and the FSA regulatory returns and solvency calculations only is appropriate for the purposes of this Report. I have also considered the potential effect of the Scheme on a Solvency II basis to the extent possible, though I note that at the date of this Report Solvency II is due to be implemented with effect from 1 January 2014 and there is some uncertainty about some of the technical requirements feeding into the technical calculations.

### 2.2 Method of preparation

In preparing this Report I have used reasonable endeavours to be accurate and complete. I have mentioned all matters that I regard as relevant to the opinions I have expressed. All the matters on which I have expressed an opinion lie within my field of experience.

I have received assurances as follows:

- The Chief Executive Officer (Cian Quilty) of HIL and the Finance Director (Kevin Cracknell) of StAI have confirmed in a Factual Accuracy Letter that the information contained in this Report which

relates to HILL and StAI respectively and to how the Scheme of Transfer will be effected in practice is factually correct, all material information has been provided and full access has been given to HILL and StAI staff.

In the course of carrying out my work and preparing this Report I have considered various documents provided to me by HILL and StAI and A&L Goodbody (who are legal advisers to HILL). A summary list of the main documents I have considered is set out in Appendix 3.

All of the data and information which I have requested has been provided to me by HILL, StAI and their advisers as appropriate. I have relied upon the accuracy and completeness of this data and information, which has been provided to me both in written and oral form by HILL, StAI and their advisers. In addition, I have, where possible, reviewed the information provided for reasonableness. Where critical information has been initially provided orally, I have requested and obtained written confirmation.

In my role as Independent Actuary I have contacted the appropriate individuals within the CBI, and specifically inquired of them whether there were specific issues I should be aware of. No specific issues were noted.

## 2.3 Key areas for consideration

As the Independent Actuary, the key areas in my opinion that I need to consider for the different groups of policyholders that could potentially be affected by the Scheme, namely the transferring HILL policyholders and the existing StAI policyholders, are:

- policyholder benefits;
- security of policyholder benefits;
- wider expectations of policyholders (including Treating Customers Fairly ("TCF") issues in the UK) which include disclosures to policyholders, the use of discretion by companies, local legislative requirements and the day to day administration of policies.

## 2.4 Currency

The figures quoted in this Report are in Great British Pounds (£).

## 2.5 Structure of this Report

The remainder of this Report is structured as follows:

- Section 3 provides commentary on the companies and provides background to the business of each company.
- The proposed Scheme is described in Section 4.
- The proposed Scheme is assessed in Section 5.
- My conclusions are set out in Section 6.



## 3 Background

### 3.1 HIL

#### 3.1.1 Structure and background

HIL is domiciled and incorporated in Ireland as a private company with limited liability. It is a wholly owned subsidiary of St Andrews, a public limited company incorporated in 1995 in the UK, which is a wholly owned subsidiary of LBG. On 1 January 2001 HIL was granted authorisation as a non-life insurance undertaking to carry on Class 1, 2 and 16 non-life insurance business. HIL operates out of Shannon, Co Clare, but the business has focused on the UK market. It operates in the UK under the 'freedom of services' provisions of the EU's Third Non-Life Directive as implemented in Irish insurance regulation. HIL has no other authorisations and does not passport into any other jurisdictions.

The principle activities of HIL are the underwriting of non-life insurance elements of PPI for LBG customers. PPI cover is provided on credit card, personal loan and overdraft products. (HIL's sister company, HAL, underwrites the life assurance risks on the same PPI business.)

LBG stopped selling first party PPI in July 2010. As HIL only underwrites PPI business sold by LBG it is now in a position where its business is in run-off.

LBG has made a strategic decision to transfer HIL's business into StAI by way of a Portfolio Transfer in order to achieve a streamlined capital efficient outcome.

#### 3.1.2 Products

HIL underwrites various accident, sickness, critical illness and unemployment covers provided as part of the PPI protection provided to LBG customers in the UK. HIL's in-force portfolio can be split into the following product types:

- Recurrent single premium Credit Card Repayment Cover ("CCRC");
- Single and recurrent single premium Unsecured Personal Loans Repayment Cover ("UPLRC");
- Recurrent single premium Secured Personal Loans Repayment Cover ("SPLRC"); and
- Recurrent single premium Overdraft Repayments Cover.
- Recurrent single premium Mortgage Repayments Cover

At 30 April 2012 there were 57,475 single premium and 597,777 recurrent single premium policies in force in HIL.

We note that the majority of HIL's business was not sold directly to LBG customers by HIL and we refer to this business as indirect business. 211,000 policies were sold directly by HIL (and its sister company HAL) to LBG customers and we refer to this as direct business.

#### 3.1.3 Operational arrangements

HIL employs a team of people in Shannon, Co Clare, to handle most aspects of its business in-house. This includes general and financial management, product development and IT. The administration of the business is undertaken with support from another company within LBG namely Halifax Brokerage Ireland Limited ("HBIL"). HBIL is part of the St Andrews group based in Shannon. The administration of HIL business is currently carried out by HIL and HBIL which collectively employ a total of 214 employees of which 16 are part-time.

On 21 November 2011, HIIL, HAIL and HBIL made the decision to outsource HIIL and HAIL policy and claims administration to a third party. The decision to outsource came after significant consideration of strategic alternatives available to HIIL (and HAIL) following the decision by LBG in July 2010 to cease the sale of PPI business. A suitable third party has been identified and discussions are on-going. It is proposed that the third party supplier will take over the existing HIIL, HAIL and HBIL site facilities and a significant number of the administration staff of HIIL, HAIL and HBIL will transfer to the new supplier. Subject to the successful conclusion of the negotiations, LBG intends that the outsource arrangements will begin on 1 September 2012. Policyholders should see no change in the service provided.

I understand that if the proposed outsourcing arrangement is not approved the administration of HIIL and HAIL policies will continue to be carried on by the same HIIL, HAIL and HBIL administration staff. The required HIIL and HAIL administration staff will transfer to the HBIL entity which will administer the policies on closure of HIIL and HAIL. Policyholders should see no change in the service provided.

Actuarial and other professional services (excluding the role of the Signing Actuary) are provided internally by other LBG insurance entities. The Signing Actuary of HIIL is Fergal O'Shea of Towers Watson.

### 3.1.4 Financial information

#### Background

Irish insurance legislation requires all non-life insurance companies to provide an annual Statement of Actuarial Opinion ("SAO") to the CBI. The Signing Actuary must be in possession of a Practising Certificate issued by the Society of Actuaries in Ireland and may be an employee of the company (or its parent or another Group company) or may be an external consulting actuary.

The SAO certifies that technical reserves, both gross and net of reinsurance, reported to the CBI are at least as strong as an actuarial best estimate without any precautionary prudence margins. The SAO will be accompanied by a comprehensive actuarial report to the Board of the Company. The SAO should encompass all classes of business written by the company and cover the following components of the technical reserves:

- outstanding claim reserves;
- unearned premium reserves;
- additional amounts to cover unexpired risks;
- future claims-handling expense reserves; and
- MIBI reserve and any equivalent reserve in other jurisdictions.

But exclude:

- future reinsurance bad debt reserves; and
- claims equalisation reserves.

In addition, the Signing Actuary is required to comply with Actuarial Standards of Practice issued by the Society of Actuaries in Ireland relating to the valuation of non-life insurance business i.e. ASP GI-2: "Statement of Actuarial Opinion on Non-Life Technical Reserves".

#### Mathematical reserves

Table 1 below summarises HIIL mathematical reserves over the last three years to 31 December 2011 which is the date of the most recent available information.

**Table 1: HIL Mathematical Reserves**

<b>£m</b>	<b>YE09</b>	<b>YE10</b>	<b>YE11*</b>
Unearned premium reserve ("UPR")	67.4	34.4	16.1
Outstanding claims reserve	111.2	116.2	56.9
Claims expense reserve	8.4	9.0	3.0
<b>Total Mathematical Reserves</b>	<b>187.0</b>	<b>159.7</b>	<b>76.0</b>

Source: 2010 and 2011 Signing Actuary reports

At 31 December 2011, there were 668,867 policies in force and the mathematical reserves of the company totalled £76.0 million. As can be seen the mathematical reserves have reduced significantly in the period.

I have been provided with regulatory returns to the CBI and Signing Actuary reports supporting the figures included in Table 1 above. I have no issues to note from my review of the financial information prepared by HIL and the reporting of the Signing Actuary.

### **Redress reserve**

I note that in recent years HIL customers made a significant number of claims seeking compensation payments relating to PPI policies. These compensation claims relate to products where LBG customers believe a policy (underwritten by HIL) was inappropriately sold to them, and that the benefits and costs associated with these policies were inconsistent with their needs. There is continued focus on the PPI market in the UK and there continues to be a risk of possible future claims. I understand that HIL has not made any compensation payments for these claims. I note that HIL received internal legal advice in respect of the indirect business which states that HIL is not liable for any discrepancies within the sales and marketing process and any such claims will be met by LBG. We have relied on this legal advice. LBG made a provision during 2011 of £3.2 billion in this regard and this provision covers all PPI mis-selling complaints regardless of product type or underwriter.

HIL (and its sister company HAIL) directly sold 221 thousand PPI policies to UK policyholders and is holding a redress reserve of £17.1 million at 31 December 2011 in respect of PPI mis-selling complaints on this direct business. The approach used to determine this amount is consistent with the methodology being used in other LBG entities. This liability will not pass over to StAI as a result of the Scheme but the redress reserve will transfer to StAI and StAI will assume the liability through an indemnity agreement to be entered into between HIL and StAI. The indemnity agreement will be implemented at the same time as the Scheme. The assets in respect of the redress reserve will be paid to StAI at the date of the Scheme/ Indemnity Agreement. We have been provided with a draft copy of the proposed indemnity agreement.

### **3.1.5 Security**

#### **Solvency I capital requirement**

Table 2 below sets out the historic solvency position of HIL, under the CBI Solvency I framework, for the three years to 31 December 2011.

**Table 2: HIL Solvency I Capital Requirement**

<b>£m</b>	<b>YE09</b>	<b>YE10</b>	<b>YE11</b>
Assets available to meet liabilities to policyholders	310.1	258.4	221.1
Mathematical reserves	187.0	159.7	76.0
Net Assets available to cover required solvency margin	123.1	98.7	145.1
Calculated solvency margin	30.5	30.5	22.6
Excess of available assets over solvency margin	92.6	68.2	122.5
Solvency margin coverage ratio	404%	324%	643%

Source: Regulatory Returns to the CBI

As at 31 December 2011 the returns to the CBI showed that the total non-life insurance business available assets to meet liabilities of policyholders of HIL were £221.1 million while mathematical reserves amounted to £76.0 million. There were thus £145.1 million surplus assets available, an excess of £122.5 million over the required minimum solvency margin of £22.6 million. There was a solvency margin coverage ratio of 643%.

Over the past three years the Solvency I solvency margin coverage ratio has been well in excess of the 150% level which the CBI requires companies to exceed. Therefore, HIL has and continues to maintain a strong Solvency I capital position.

### Future regulatory capital requirements

I have considered the forecast solvency position at the effective date of transfer on a Solvency I basis prepared by HIL. Table 3 sets out the projected 2012 solvency position.

**Table 3: HIL Projected Solvency Position at Effective Date**

<b>£m</b>	<b>YE11</b>	<b>Effective Date*</b>
Net assets available to cover required solvency margin	145.1	66.6
Calculated solvency margin	22.6	17.5
Solvency margin coverage ratio	643%	381%

Note: \* This is the 2012 forecast solvency position and includes a dividend payment of £95 million agreed in May 2012.

Source: Regulatory Returns (2011) and 2012 Forecast Solvency position

Projected net assets at the proposed effective date (30 October 2012) are £66.6 million with a projected solvency margin requirement of £17.5 million giving a projected solvency margin coverage ratio of 381%. The projected net assets of £66.6 million and solvency margin coverage ratio of 381% allow for a dividend of £95 million which was agreed to be paid by HIL during a HIL Board meeting in May 2012. Therefore, HIL has a strong projected solvency position, after payment of dividend, at the Effective Date.

### Changes to the regulatory capital regime: Solvency II

The European Solvency II Directive is a fundamental review of the capital adequacy and solvency supervision regime for the European insurance industry. As Solvency II is an EU initiative it will apply in Ireland (and across Europe) in a harmonised way. The expected implementation date for Solvency II is expected to be 1 January 2014.

The Solvency II requirements have not yet been finalised and there are a number of outstanding issues that are still evolving. However, as the new regime will apply to both HIL and StAI, any future development of these issues will impact HIL and StAI policyholders in a similar way before and after the Scheme.

The Solvency II Pillar I framework sets out qualitative and quantitative requirements for the calculation of technical provisions and Solvency Capital Requirements ("SCR") using either a standard formula or an internal model.

HILL participated in the fifth Quantitative Impact Study ("QIS5") exercise. HILL estimated the potential SCR of the proposed Solvency II framework using both the QIS5 standard formula ("SF") methodology and basis and the HILL internal model ("IM"). A Solvency II SCR and available assets to cover the SCR were estimated at 31 December 2009 using the QIS5 specifications and guidelines and the results are summarised in Table 4.

<b>£m</b>	<b>Solvency I</b>	<b>Solvency II SF</b>	<b>Solvency II IM</b>	<b>Difference Solvency I - IM</b>
Assets available to cover required solvency margin	123	95	95	-28
Solvency Capital Requirement ("SCR")	30	84	63	+33
Excess of available assets over SCR	93	11	32	-61
Solvency coverage ratio	404%	113%	151%	

Note: Solvency II results are unaudited  
Source: QIS5 results presentation material

Under Solvency II the Solvency Capital Requirement ("SCR") has increased significantly and there has been a decrease in excess available assets. The solvency coverage ratio is projected to be significantly lower under the Solvency II framework than under the Solvency I framework. In the absence of the Scheme of Transfer, this would require more detailed analysis prior to the implementation date.

I note from discussions with HILL that HILL are no longer seeking internal model approval and have calculated the SCR on a SF basis during 2011 and 2012. The estimated SCR at 31 March 2012 was £47.5 million with £151.1 million own funds giving HILL solvency cover of 318% on a Solvency II SF basis.

I note that the calibration of the stress tests to derive the Solvency II capital requirements are not yet final and are subject to change with consultation still ongoing.

### 3.1.6 Comments on overall financial strength

HILL's solvency position on a Solvency I basis has been strong over the last three years to 31 December 2011. The solvency position is projected to remain strong at the Effective Date based on the solvency forecast provided and allowing for the agreed dividend.

I have considered the outputs of the Solvency II QIS5 assessment and the updated projections at 31 March 2012. Due to uncertainty in some of the technical details in relation to the solvency capital calculations, I have not placed significant reliance on the findings at this stage.

### 3.1.7 Risk profile

HILL is exposed to a range of risks including operational risk, financial/ solvency risk, market risk, insurance risk, counterparty default risk and regulatory/ fiscal risk.

These risks are overseen and managed by the Risk Committee. The Risk Committee reviews all risk and compliance issues affecting HILL. The primary risk to the security of HILL's policyholder benefits is that one or more of the risks identified give rise to an event which renders HILL insolvent. Given the risk profile of the company's business and the current level of available assets in excess of the

company's minimum solvency margin requirement, the risk of insolvency and any risk to the security of benefits could be considered remote.

### 3.1.8 Policyholder Reasonable Expectations

There is no statutory regulation in relation to PRE for non life insurance companies in Ireland. However, I have considered PRE in a general manner below. I note the following:

- The benefits arising under the transferring HIL policies are straightforward and guaranteed in nature.
- Security of benefits: transferring policyholders have a reasonable expectation that their benefits are secure and will be paid as they fall due. This will depend on the risks to which the transferring policyholders are exposed to before and after the transfer, including the relevant financial position of the companies.
- Entitlement to benefits: transferring policyholders have a reasonable expectation that valid claims will be paid in accordance with policy terms and conditions. I have reviewed HIL product documentation and am satisfied that it does not confer any particular additional reasonable expectations over and above the contractual provisions. I am not aware of any local legislative requirements which confer entitlements to policyholders beyond those in the policy terms, or constrain the use of discretion by HIL.
- Service standards: transferring policyholders have a reasonable expectation that the services they receive will be provided in a professional manner, that claims and enquiries will be dealt with promptly.
- Discretionary powers available to HIL: transferring policyholders have a reasonable expectation that any discretion available to HIL will be applied in a fair and reasonable manner. The use of discretion by HIL is reasonably limited and principally relates to the following:
  - the assessment as to whether a PPI claim is valid or not;
  - the level of premium to be refunded to a policyholder in respect of certain single premium policies in the event of their surrender; and
  - the ability to reprice recurring single premium policies.

The approach to the use of these discretionary practices should not be materially altered by the Scheme, we comment on this further in Section 5.2.3.

## 3.2 StAI

### 3.2.1 Structure and background

StAI is domiciled and incorporated in the UK as a private company with limited liability. It is a wholly owned subsidiary of St Andrews which is a wholly owned subsidiary of LBG. StAI is a non-life insurance undertaking authorised by the FSA since 2001 to carry out contracts of insurance and effect contracts of insurance for the following types of policies: accident, assistance, damage to property, fire, natural forces, general liability, legal expenses, miscellaneous financial loss and sickness.

The principle activity of StAI is the underwriting of non-life insurance products, including PPI, household and domestic all risks insurance. StAI currently underwrites PPI insurance making it well placed to take on the HIL business. StAI offers PPI cover in relation to credit cards, mortgage and loan protection.

StAI reinsures business with insurance entities external to LBG.

### 3.2.2 Products

StAI underwrites a range of non-life insurance contracts. StAI's in-force portfolio can be split into the following 2 product types:

- Household insurance products sold through the Retail banking network;
- PPI creditor products for Corporate customers.

### 3.2.3 Operational arrangements

StAI employs a team of people in the UK to handle most aspects of its business in-house. This includes general and financial management, product development, actuarial and IT.

The administration of the PPI business is undertaken with support from the same company in Shannon that partly administers the HIL business, namely HBIL.

### 3.2.4 Financial Information

We note that the approach to the calculation of solvency capital on a Solvency I Pillar 1 basis under UK regulatory rules is broadly similar to the Irish Solvency I regime. Under FSA guidelines UK firms must also undertake a Solvency I Pillar 2 assessment of the adequacy of its capital resources, known as the Individual Capital Assessment ("ICA") which is viewed as a more realistic capital measure compared to Pillar 1.

#### Mathematical reserves

Table 5 below summarises StAI mathematical reserves over the last three years to 31 December 2011 which is the date of the most recent available information.

<b>Table 5: StAI Mathematical Reserves</b>			
<b>£m</b>	<b>YE09</b>	<b>YE10</b>	<b>YE11</b>
Unearned premium reserve ("UPR")	333.7	294.6	270.4
Claims outstanding	160.9	198.5	160.9
Provision for unexpired risk	2.0	1.5	1.8
Equalisation provision	54.2	68.4	82.3
Reinsurance ceded	(1.6)	(7.5)	-
<b>Total Mathematical Reserves</b>	<b>549.1</b>	<b>555.6</b>	<b>515.4</b>

Source: Regulatory Returns to the FSA

At 31 December 2011, there were 1,795,968 policies (of which 295,282 policies are PPI) inforce and mathematical reserve of the company totalled £515.4 million.

We set out in Section 3.1.4 that LBG have made a provision during 2011 of £3.2 billion to cover all PPI mis-selling complaints regardless of product type or underwriter. We note that StAI, unlike HIL, does not have any further exposure to potential mis-selling complaints.

### 3.2.5 Security

#### Solvency I capital requirements

Table 6 below sets out the historic solvency position of StAI, under the FSA Solvency I Pillar 1 framework, for the three years to 31 December 2011.

<b>£m</b>	<b>YE09</b>	<b>YE10</b>	<b>YE11</b>
Capital resources available to cover solvency margin	344.5	197.2	184.1
Solvency margin requirement	91.8	101.9	87.9
Excess of available assets over solvency margin	252.7	95.2	96.2
Solvency margin coverage ratio	375%	194%	209%

Source: Regulatory Returns to the FSA

We note that there was a dividend payment during 2010 which contributed to the significant fall in capital resources between 31 December 2009 and 31 December 2010.

As at 31 December 2011 the returns to the FSA showed that the total capital resources available to cover the Pillar 1 solvency margin amounted to £184.1 million. There were £96.2 million excess assets over the required minimum Pillar 1 solvency margin of £87.9 million. There was a Pillar 1 solvency margin coverage ratio of 209%.

Similar to HILL, over the past three years StAI's solvency margin coverage ratio on a Solvency I Pillar 1 basis has been well in excess of the 150%. Therefore StAI has and continues to maintain a strong Solvency I capital position.

Under FSA guidelines UK firms must undertake a Pillar 2 assessment of the adequacy of its capital resources, known as the ICA which is viewed as a more realistic capital measure compared to Pillar 1. This is in addition to the Pillar 1 capital requirement assessment which is based on fixed percentages of premiums and claim amounts. Companies must hold assets in excess of the higher of the Pillar 1 requirement and the Pillar 2 ICA assessment.

I have been provided with StAI's ICA assessment at 31 December 2011. This showed available assets of £246 million leaving £112 million excess assets over the ICA capital requirement of £134 million. The solvency margin ratio under the ICA at 31 December 2010 was 183.6%.

### **Future capital requirements - changes to the regulatory capital regime: Solvency II**

During 2012 StAI estimated the potential capital requirements of the proposed Solvency II framework using the QIS5 Standard Formula ("SF") methodology and basis and an Internal Model ("IM"). I have considered these projected Solvency II assessments.

A Solvency II SCR and available assets to cover the SCR, on both a QIS5 SF and IM basis, were estimated at 31 December 2011 and the results are summarised in Table 7.

<b>£m</b>	<b>Solvency I (Pillar 1)</b>	<b>Solvency II SF</b>	<b>Solvency II IM</b>	<b>Difference Solvency I - IM</b>
Assets available to cover required solvency margin	184.1	426.4	426.4	+242.3
Solvency Capital Requirement ("SCR")	87.9	263.4	194.9	+107.0
Excess of available assets over SCR	96.2	163.1	231.5	+135.3
Solvency coverage ratio	209%	162%	219%	

Note: Solvency II results are unaudited  
Source: QIS 5 results at 31 December 2010

Under Solvency II the SCR has increased, on both the SF and IM basis. The increase in SCR has however been accompanied by an increase in the available assets to cover solvency margin and there



has been an increase in excess available assets, on both the SF and IM basis. The solvency coverage ratio is projected to be lower under the Solvency II framework than under the Solvency I framework when SCR is calculated using the SF but greater when the SCR is based on an IM. This is different to the HIL findings as StAI has a broader range of non life insurance business.

Further analysis was prepared by StAI examining the projected Solvency II regulatory capital position over the next two years. Table 8 sets out the projected 2012 and 2013 Solvency II capital requirements using the Internal Model.

<b>£m</b>	<b>YE11</b>	<b>YE12</b>	<b>YE13</b>
Assets available to cover required solvency margin	426.4	426.3	419.4
Required minimum solvency margin	194.9	159.8	134.4
Solvency margin coverage ratio	219%	267%	312%

Source: StAI solvency II projection

The solvency margin coverage ratio on a solvency II internal model basis is projected to increase from 219% to 267% in 2012 and 312% in 2013.

I note that the calibration of the stress tests to derive the Solvency II capital requirements are not yet final and are subject to change with consultation still ongoing. The use of an internal model is subject to approval by the FSA and I note that StAI are currently going through an approval process.

### 3.2.6 Comments on overall financial strength

StAI's solvency position on a Solvency I Pillar 1 basis has been strong over the last three years to 31 December 2011. StAI also has a strong solvency position under the Pillar 2 ICA assessment at 31 December 2011.

I have considered the outputs of the most recent Solvency II assessments at 31 December 2011 but due to uncertainty in some of the technical details in relation to the solvency capital calculations, I have not placed significant reliance on the findings, though note that no adverse consequences are projected to arise. I note that the Solvency II internal model coverage ratio is projected to increase over the next two years from 31 December 2011.

### 3.2.7 Risk Profile

StAI is exposed to a range of risks including operational risk, financial/ solvency risk, market risk, insurance risk, counterparty default risk and regulatory/ fiscal risk.

StAI assess the relative costs and concentrations of each type of risk through the ICA and material issues are escalated to the Risk Committee. StAI has documented insurance and other prudential risk policies and risk appetite limits in place. Risk management activities are delegated to the Risk Committee and to the relevant business area directors. StAI complies with the LBG risk management framework. Similar to HIL, the primary risk to the security of StAI's policyholder benefits is that one or more of the risks identified give rise to an event which renders StAI insolvent. Given the risk profile of the company's business and the current level of available assets in excess of the company's minimum solvency margin requirement, the solvency position and security of benefits to policyholders is projected to be strong.

### 3.2.8 Policyholders Reasonable Expectations

As set out in Section 3.1.8, there is no statutory regulation in relation to PRE for non life insurance companies in Ireland. There is a concept of PRE known as Treating Customers Fairly ("TCF") in the

UK and is documented under the UK FSA Conduct of Business Sourcebook (“COBS”) and Insurance Conduct of Business Sourcebook (“ICOBS”).

I have highlighted where HIL policyholders would have certain expectations in Section 3.1.8 and noted these with StAI. I understand that these expectations will not cause any issues in StAI in terms of their implementation of TCF.

## 4 The Proposed Scheme of Transfer

### 4.1 Rationale for the Scheme

Although not a direct consideration for me as Independent Actuary, it is nevertheless relevant for me to be aware of the rationale for the Scheme. As noted in the Background, Section 1.1, of this Report, LBG stopped selling PPI business in July 2010 and therefore HIL is in a position where its business is in run-off. LBG made a strategic decision to transfer HIL's business into StAI by way of a Portfolio Transfer in order to achieve a streamlined capital efficient outcome.

### 4.2 Overview of the Scheme

#### 4.2.1 Introduction

The Scheme proposed is one for the transfer of insurance business by order of the Irish High Court. The transfer of the HIL portfolio of insurance contracts to StAI will be achieved by using the provisions of Section 13 of the Assurance Companies Act 1909, Section 36 of the Insurance Act 1989 and Article 12 of the European Communities (Non-Life Insurance) Framework 1994 Regulations. The Scheme provides for the transfer of HIL's non-life insurance business, incorporating the insurance policies, together with the associated liabilities and assets as at the Effective Date to StAI, such that HIL's policyholder liabilities are extinguished.

I note that there are certain items excluded from the Transfer and will remain with HIL. These are outlined in Section 4.2.2.

It is proposed that there be no further monetary consideration made by StAI for the transfer of the business other than the amounts to be transferred above.

The key from an Independent Actuary's perspective is to consider the impact of the Transfer on policyholders' expectations. I note that the Scheme has been designed to ensure:

- There will be no changes to HIL or StAI policyholder terms or conditions;
- There are no plans to change the existing administration of HIL or StAI policies; and

As a result of the Scheme, there will be no change to the approach to the exercise of discretionary powers available to HIL or StAI.

#### 4.2.2 Transfer of assets and liabilities

Subject to the sanction of the Court, the Scheme provides for the transfer of HIL's insurance policies, together with the associated liabilities and assets (as defined in the Scheme) as at the Effective Date, such that the policyholder liabilities are extinguished in HIL.

The assets being transferred are sufficient to cover the transferring liabilities. There are certain items excluded from the Scheme of Transfer and will remain with HIL. Non policyholder related liabilities and all other assets are excluded from the Scheme of Transfer and will remain in HIL.

#### 4.2.3 Excluded policies

Policies held by policyholders who reside outside Ireland can not be transferred unless the relevant supervisory authority in the Member State where they reside has been notified of the transfer, and either agrees to it or does not object within 3 months of the notification.

I understand that all policyholders were UK resident when the policies were sold. Since then some 3000 policyholders are now resident in other jurisdictions both within and outside the EEA. I understand that approximately 1500 policyholders are now resident within other EEA member states including the Republic of Ireland. Another approximate 1500 policyholders reside in 66 jurisdictions outside the EEA. With respect to policyholders currently resident in EEA Member States, the CBI is obliged to notify the relevant supervisory authority, which has a period of 3 months from the date of notification to either agree to transfer or object. Should any such supervisory authority object to the Scheme, these policies will then become Excluded Policies and will be one hundred percent reinsured by StAI, unless/ until the relevant policyholder agrees to its novation to StAI. The proposed reinsurance documentation has not been prepared at this stage as HILL considers that the issue is unlikely to arise. If it does, I would expect the treaty to be structured in such a way that in the unlikely event of StAI winding up every excluded policyholder under the reinsurance treaty would rank equally to other StAI policyholders.

I have discussed this with HILL and it is their intention that all policyholders will transfer on the Effective date and therefore it is not envisaged that there will be any excluded policies.

#### 4.2.4 Continuity of proceedings

On the Effective Date, any legal proceedings which are pending or current by or against HILL in relation to the insurance business being transferred will become the responsibility of StAI.

My understanding of the wording of the Scheme and the parties' intentions is that the Scheme transfers the contractual liabilities under the policies as they stand at the date of the transfer and any additional liabilities to policyholders. Thus, in the event of any transferring policyholder being entitled to compensation in respect of any valid mis-selling claim, such liability will be taken on by StAI under the Scheme. This is relevant given the PPI complaints of direct business as noted in Section 3.1.4. I note that the redress reserve will not pass over to StAI as a result of the Scheme but the liability will transfer to StAI and become their responsibility through an indemnity agreement to be entered into between HILL and StAI. The indemnity agreement will be implemented at the same time as the Scheme. The assets in respect of the redress reserve will be paid to StAI at the date of the Scheme/ Indemnity Agreement.

#### 4.2.5 Rights and obligations

Every person who is a holder of a HILL insurance policy being transferred will be entitled to the same contractual rights against StAI as he or she may have had against HILL, so there are no changes to the policy terms and conditions as a result of the Scheme.

#### 4.2.6 Administration arrangements

It is intended that there will be no change to the existing administration of the policies of HILL or StAI following the Scheme.

As mentioned in Section 3.1.3 HILL are in the process of outsourcing policy and claims administration to a third party. I understand that the staff who administered claims pre transfer will be the same as those who administer claims post transfer whether the proposed outsourcing happens or not. In any event, this change will happen regardless of the Scheme.

#### 4.2.7 Taxation

It is intended that policyholder tax will be unchanged as a consequence of the Scheme and therefore transferring HILL policyholders and existing StAI policyholders will be unaffected by the Scheme in respect of taxation.

I understand that appropriate tax clearances will be obtained from the relevant taxation authorities before the Scheme of Transfer.

#### 4.2.8 Effective date

The effective date of the Scheme is expected to be 31 October 2012.

#### 4.2.9 Costs and Expenses

LBG will bear the costs of the lawyers, other advisers, the Court and will be responsible for any costs, liabilities or consequences arising from the Transfer.

The key is that no costs are borne by HIL or StAI policyholders.

#### 4.2.10 Policyholder communications

There is no statutory requirement for either HIL or StAI to write directly to their respective policyholders in relation to the proposed Scheme.

HIL is however proposing to transmit certain materials to each of its policyholders in the form of an information pack. These materials include a statement summarising the terms of the proposed Scheme, a copy of the summary of the Independent Actuary's Report and a "frequently asked questions" brochure. I have been provided with draft versions of this policyholder information pack and I have no issues to note with the detail included in it.

I note that StAI does not intend to write to its policyholders. I understand that the CBI and the FSA are aware of this approach. Subject to any overriding views of either Regulator I am satisfied that StAI does not write to its policyholders on the grounds that StAIs post transfer projected solvency coverage remains in excess of StAIs solvency capital internal target (see Section 5.1.2 for details). StAI policyholders will not be disadvantaged in any way by not being issued a copy of either the summary version or full version of the report.

I note that the full report is available to any interested party on request from the offices of HIL in Ireland and the offices of StAI in the UK. In addition, the summary report will be included in the information pack which will be available on the LBG website.

## 5 Assessment of Proposed Scheme

### 5.1 Financial Position

#### 5.1.1 Projected financial position

This section presents the proforma projected financial position of HIL and StAI as stand alone entities and as if the Scheme took place on 31 December 2011.

Table 10 below sets out the regulatory capital position of HIL (on CBI basis) and StAI (on FSA basis) at 31 December 2011 pre transfer and post transfer as if the Scheme took place at 31 December 2011. The HIL figures have not been restated to an FSA basis though this should not have a material impact on the figures.

£m	Pre Transfer		Post Transfer	
	HIL	StAI (Pillar 1)	HIL	StAI (Pillar 1)
Available Assets	238.2	699.5	50.1 <sup>(2)</sup>	792.6 <sup>(2)</sup>
Mathematical Reserves	93.1 <sup>(1)</sup>	515.4	0.0	608.5 <sup>(3)</sup>
Net Assets available to cover required minimum solvency margin	145.1	184.1	50.1	184.1
Required minimum solvency margin	22.6	87.9	3.5 <sup>(4)</sup>	110.5
Excess of available assets	122.5	96.2	46.6	73.6
Solvency margin coverage ratio	643%	209%	1431%	167%

Note:

1. This includes the redress reserve of £17.1 million for mis-selling cases sold directly by HIL that is commented on in Section 3.1.4.
2. If the proposed transfer took place on 31 December 2011 assets equal in value to basic mathematical reserves of £76.0 million (see Table 1 Section 3.1.4) plus redress reserve of £17.1 million would transfer.
3. The post transfer reserves in respect of HIL business have not been restated to an FSA basis. The post transfer reserves have been made on the prudent assumption that all reserves need to be established in StAI post transfer.
4. This is the minimum solvency margin requirement that HIL must hold until it relinquishes the insurance licence.

Source: 31 December 2011 Regulatory Returns

The proforma presentation reflects that HIL assets of £93.1 million would be transferred to StAI and liabilities of £93.1 million would be set up by StAI if the Scheme took place on 31 December 2011.

The assets being transferred are sufficient to cover the transferring liabilities though not the incremental solvency margin in StAI which is the driver for the reduction in the solvency margin coverage ratio as a result of the Scheme.

Other HIL assets net of liabilities of £50.1 million will be excluded from the transfer of assets and liabilities and will remain in HIL. A dividend payment of £95 million was agreed during a May 2012 HIL Board meeting and is reflected in the post HIL asset position in Table 10 above.

I note that there would be excess net assets remaining in HIL of £46.6 million if the transfer took place at 31 December 2011. Should there be any Excluded Policies (i.e. those described in Section 4.2.3) on the Effective Date HIL will continue to be capitalised sufficiently to meet its regulatory obligations in respect of these excluded policies.

I have been provided with projected reserves and solvency margin of HIL on the Effective Date and note that the mathematical reserves are projected to reduce to £51.4 million (from £76.0 million) and solvency margin to £17.5 million (from £22.6 million) by the Effective Date. The lower solvency

margin requirement at the Effective Date would increase the proforma solvency margin coverage ratio to 175%.

I have also been provided with the projected ICA assessment for StAI post transfer as if the transfer took place on 31 December 2011. This showed available assets of £246 million leaving £98 million excess assets over the ICA capital requirement of £148 million. The projected post transfer solvency margin ratio under the ICA at 31 December 2011 was 166%. Therefore, on an ICA basis StAI will have sufficient capital post transfer to meet both regulatory and internal capital targets.

### 5.1.2 Conclusion on projected financial position

I note that there is a strong Solvency I position in HIL and StAI pre Scheme. I note that the regulatory capital position remains strong in HIL after the proposed Scheme. The Scheme leads to a reduction in the solvency margin coverage ratio and the regulatory capital position in StAI. However the solvency position is still in excess of the regulatory requirements. Furthermore I note that the transferring business is running off quickly which will improve the solvency margin coverage ratio over the next two to three years. I consider the financial position to be reasonable post the Scheme from the perspective of the transferring HIL policyholders and the existing StAI policyholders based on the proforma financial analysis presented in Table 9 above.

I note that the LBG internal solvency target is a solvency cover ratio of 145%. The post transfer projected solvency cover on the Pillar 1 and ICA basis is in excess of this 145% target i.e. 167% on Pillar 1 and 166% on ICA basis.

Based on this I do not believe that the implementation of the Scheme will have a material adverse effect on the financial security of transferring HIL policyholders or existing StAI policyholders.

The position in HIL if there are any Excluded Policies will also be strong after implementation of the Scheme.

## 5.2 Effect on policyholders

### 5.2.1 Introduction

Having set out in the previous sections the relevant financial effects of the Scheme and the approach to be taken post transfer, this section considers the effect on policyholders from both these viewpoints and more widely.

### 5.2.2 Security of policyholders' benefits

HIL and StAI are both wholly owned subsidiaries of LBG who can provide capital support to the companies if required. Therefore, this support would be available whether the Scheme takes place or not.

StAI has a number of reinsurance arrangements in place with external reinsurance entities. There will be no change to the existing StAI reinsurance arrangements post Transfer that would impact on financial security.

If the proposed transfer takes place, the risk profiles of StAI after the transfer should not be materially changed from its risk profile before the transfer as the types of risks inherent in HIL's business are similar to the types of PPI business written by StAI (which is a component of StAI's overall exposure).

### 5.2.3 Policyholders Reasonable Expectations

Though there is no statutory regulation in relation to PRE for non life insurance companies in Ireland, I have considered a number of areas impacting on policyholder expectations more generally.

## Policy Terms and Conditions

There will be no change to policy terms and conditions of the transferring HIL policies or the existing StAI policies.

## Discretionary powers

The range of discretionary powers available to HIL for the transferring policies is reasonably limited and principally relates to the following:

- Assessment as to whether a PPI claim is valid or not: I understand that the staff who administers claims pre transfer will be the same as those who administer claims post transfer. These staff should apply similar discretion after the transfer in deciding whether a claim is valid or not so this should be unaffected by the Scheme.
- The level of premium to be refunded to a policyholder in respect of certain single premium policies in the event of their surrender: There is no guarantee of a premium refund on the lapse of a single premium policy, however it has been HIL practice to do so in the past. I understand that the staff who administer single premium policy lapses pre transfer will be the same as those who administer lapses post transfer. These staff should apply similar discretion after the transfer in deciding on the refund amount due so this should be unaffected by the Scheme.
- The ability to reprice recurring single premium policies: Changes to premium rates are permitted under the policy terms of recurrent single premium policies. Although there will be no immediate increase in premiums, it is important to note that as is common for this type of PPI business, the premiums are not guaranteed and could be increased. I consider that there is no greater likelihood of an increase in premiums after the transfer as there was before the transfer.

## Disclosure to policyholders

I am not aware of any disclosures or local legislative requirements which confer any additional reasonable expectations over and above the contractual terms of the policies.

## Services to policyholders

Transferring policyholders have a reasonable expectation that the services they receive are provided in a professional manner. As discussed in Section 3.1.3 the claims handling services of HIL policies will continue to be provided by the same staff who currently administer claims so there will be no change in the service provided to policyholders post transfer.

## 5.2.4 Other Risk Considerations

### Operational risk

There should be no change to administrative arrangements under the proposed Scheme and therefore there should be limited risk of operative errors occurring during the transfer process.

In addition I note that StAI currently underwrite PPI business and therefore have the necessary expertise to undertake the HIL business.

### Service levels

Based on initial discussions with HIL and StAI, I have no reason to believe that the service levels are likely to suffer any material diminution as a result of the implementation of the Scheme.

### Pending Legal proceedings



As noted in section 3.1.4 HIL customers have made a significant number of claims seeking compensation payments relating to PPI policies. HIL has not made any compensation payments for these claims and have received internal legal advice which states that HIL is not liable for any discrepancies within the sales and marketing process and any such claims will be met by LBG. I note that post transfer LBG will continue to meet any such claims.

HIL (and its sister company HAL) directly sold 221,000 PPI policies to UK policyholders and is holding a redress reserve of £17.1 million at 31 December 2011 in respect of PPI mis-selling complaints on the direct business. The approach used to determine this amount is consistent with that used in other LBG entities. This liability will be covered under the terms of an indemnity agreement between HIL and StAI post transfer and will become the responsibility of StAI.

I note that there are no legal proceedings pending or current against StAI at the date of this Report.

### **Legal risk**

In considering any legal risks, I have relied on the fact that HIL and StAI have followed the advice of their legal advisers and Counsel in finalising the legal agreements in relation to this transaction.

I have not obtained separate legal advice for the purposes of my work.

Thus, in my opinion, all reasonable steps have been taken to reduce the legal risks arising from the Scheme to a minimum.

### **Compensation Schemes**

StAI policyholders are covered by the Financial Services Compensation Scheme ("FSCS"). The FSCS will pay compensation if either of the LBG entities is unable to pay claims because it has stopped trading or has been declared in default. Generally the FSCS covers business conducted by firms authorised by the Financial Services Authority. However European firms that are authorised by their home state regulator that operate in the UK are also covered. I understand that following the Scheme of Transfer that there is no change to the position of the UK policyholders of HIL as regards their coverage by the FSCS.

### **Taxation risk**

I am not a tax expert and I have not obtained separate tax advice. I have relied on the independent tax advice prepared by the tax advisors to HIL and StAI. No tax issues have been noted that would impact on policyholders.

## 6 Conclusions

Having considered the impact of the Scheme on the transferring policyholders of HIL and on the existing policyholders of StAI, it is my opinion that the Scheme:

- Will not have a material adverse effect on the security of benefits for any of the policyholders involved; and
- Will not have a material adverse effect on the reasonable benefit expectations of any of the policyholders involved.

My opinion in relation to HIL and StAI policyholders is based on:

- My review of all the pertinent historic and current information provided by HIL and StAI; and
- Discussions with the management of HIL and StAI on what will happen post Transfer.

My assessments are made in the context of the Irish regulatory regime.



21 June 2012

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Noel Garvey, FSAI  
Independent Actuary

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Date

## Appendix 1

### Extract from KPMG Engagement Letter

#### **Scope of the Independent Actuary's work [extract from engagement letter dated 5 April 2012]**

The role of Independent Actuary will be to consider and to report to the Court on the proposed transfer of the Business, primarily from the perspectives of the policyholders of both HAIL and HILL and the existing policyholders in LBG Ins Co, and to opine as to whether any policyholders' interests could be in any way (either directly or indirectly) adversely affected by the proposed transfer.

In order to form our opinion as Independent Actuary, we will expect the tasks that will be carried out will include the following:

- Review of relevant existing company documentation;
- Review of the Scheme documentation and, if necessary, suggesting amended drafting in order to eliminate any concerns;
- Review the proposed transfer considering the effect on policyholders covering their contractual rights, benefit security, and benefit expectations; in particular, consider any potential changes in reviewable premium charges;
- Review actuarial reports prepared by the Appointed Actuary of HAIL, the Signing Actuary of HILL and the Actuarial Function of LBG Ins Co on the proposed transfer;
- Review changes to reinsurance arrangements in connection with the transfer;
- Review comparative solvency levels (on a Solvency I and projected Solvency II basis as necessary) before and after the proposed transfers;
- Review of the effects of the transfer on the risks within the three companies and the resources of those companies to meet those risks;
- Liaise and raise issues and questions as necessary with the appropriate persons at HAIL, HILL and LBG Ins Co; and
- Liaise and raise issues and questions as necessary with your advisers, including legal and tax advisers.

We will provide a detailed information request list to you setting out our information requirements.

You agree to provide us with such information as we may reasonably require in order to carry out our role, including providing access to your relevant staff members to deal with questions and queries. You agree to use all reasonable endeavours to ensure that the information you provide is accurate and complete and that any caveats relating to such information are made clear to us.

We will expect to meet with the Appointed Actuary of HAIL and Signing Actuary of HILL, and Chief Actuary for LBG Ins Co, and have access to relevant technical staff in the companies as appropriate.

We will also review the complete documentation to be sent to policyholders in order to check that everything is in accordance with our understanding of the Scheme.

The terms of this engagement do not extend to the delivery of legal advice, which you will obtain as required from legal advisers under separate terms and conditions. We will not be responsible for facilitating the supply of legal advice to you, nor will we be responsible for monitoring or managing the quality or timing of legal or any other advice that you may obtain from other advisers in connection with matters relevant to the subject of our work. We will have no responsibility or liability in connection with the performance of any other suppliers advising you.

As indicated above, it is envisaged that, subject to the qualification noted below, our tasks will include the review of the Scheme documentation and the suggestion of drafting changes where

appropriate. The qualification in respect of advice on the Scheme documentation is that our advice will be limited to issues of principle relating to actuarial considerations but will not extend to advice on drafting points. We will assist in identifying from the information provided to us areas of uncertainty in the relevant provisions of documentation and suggest amendments for consideration. However, the precise wording of the Scheme documentation is primarily a matter for lawyers and will reflect legal matters outside our expertise. Our comments and suggestions should not be relied upon as being suitable for incorporation into any documentation without further consideration by your legal advisers.

In our capacity as the Independent Actuary, we may receive correspondence from HAIL, HILL and LBG Ins Co policyholders or policyholder groups but there is no requirement on us to, and it is not expected that we will, enter into any form of communication with such policyholders. Accordingly, we will forward such correspondence to HAIL, HILL and LBG Ins Co (as appropriate, depending on the insurer with which any relevant correspondent policyholder(s) holds a policy (or policies)). In those circumstances, you agree that each Company and as relevant will, as a minimum, send a letter of acknowledgement to the relevant policyholder(s) indicating that the Independent Actuary has seen their letter and is aware of its contents but is not required to (and will not) respond to it. In addition, if any letters of objection to the proposed transfer are sent directly to you, copies of these letters will be sent to us for our consideration.

## Appendix 2

### Curriculum Vitae

Noel Garvey, Director, Financial Services Actuarial, KPMG Ireland

Fellow of Institute of Actuaries and Fellow of Society of Actuaries in Ireland

- Noel is responsible for heading up the non-life actuarial services practice in Dublin. He has over 15 years experience in the non-life insurance industry and holds an unrestricted practising certificate issued by the Society of Actuaries in Ireland
- His principle roles include: providing Statements of Actuarial Opinion on the technical provisions of non-life insurance and reinsurance clients; helping clients understand the impact of Solvency II on their capital requirements; and responsibility for all actuarial advice in relation to non-life insurance and reinsurance audit clients of KPMG
- Prior to joining KPMG, Noel was the Chief Actuary and a member of the senior management team of an international non-life reinsurance company. He was responsible for setting adequate level of reserves, performing the financial reporting function, capital management, setting business plans, managing the actuarial team, pricing personal accident business and assisting the CFO in raising capital by liaising with investment bankers and preparing investor presentations
- Noel began his career as a Pricing Actuary for Aviva General Insurance (Europe) Limited – formally Hibernian Insurance Limited. His key responsibilities were to make pricing recommendations to the private motor steering committee, developing and maintaining multivariate pricing models for personal lines business, designing and maintaining multivariate prediction models used to understand the effect rating actions may have on renewal and new business levels and performing return on capital calculations
- His current clients include Allianz plc, Allied World Assurance (Europe) Limited, Allied World Assurance (Reinsurance) Limited, Atradius Reinsurance Limited, Aviva General Insurance (Europe) Limited, Beazley Reinsurance Limited, Liberty Mutual Direct Insurance Company Limited and various captive re/insurers
- He is a member of various subcommittees of the Society of Actuaries in Ireland

## Appendix 3

### Information received

#### HIL data

- Summary of 2009, 2010 and Draft 2011 solvency position
- 2009 2010 and Draft 2011 Regulatory Returns
- 2009, 2010 and Draft 2011 Financial Statements
- 2009, 2010 and Draft 2011 Signing Actuary Report
- Product literature
- QIS5 results presentation
- Details of outsourcing arrangements and outsourcing proposal
- Details of legal entity structure and authorisations
- 2012 Reserve and Solvency projections

#### StAI data

- 2009 2010 and Draft 2011 UK FSA Regulatory Returns
- 2009, 2010 and Draft 2011 Financial Statements
- Details of reinsurance arrangements
- 2010 ICA results and 2009 ICA report
- Solvency II IM and SF QIS5 presentation
- Solvency II IM and SF future projections

#### Other data

- Draft communication to policyholders
- Draft legal documentation, including: Scheme; Petition; and Affidavit of James Murphy (HAIL Director)
- HAIL/ HIL briefing note for visit to CBI on 4 April 2012
- Draft Indemnity Agreement

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