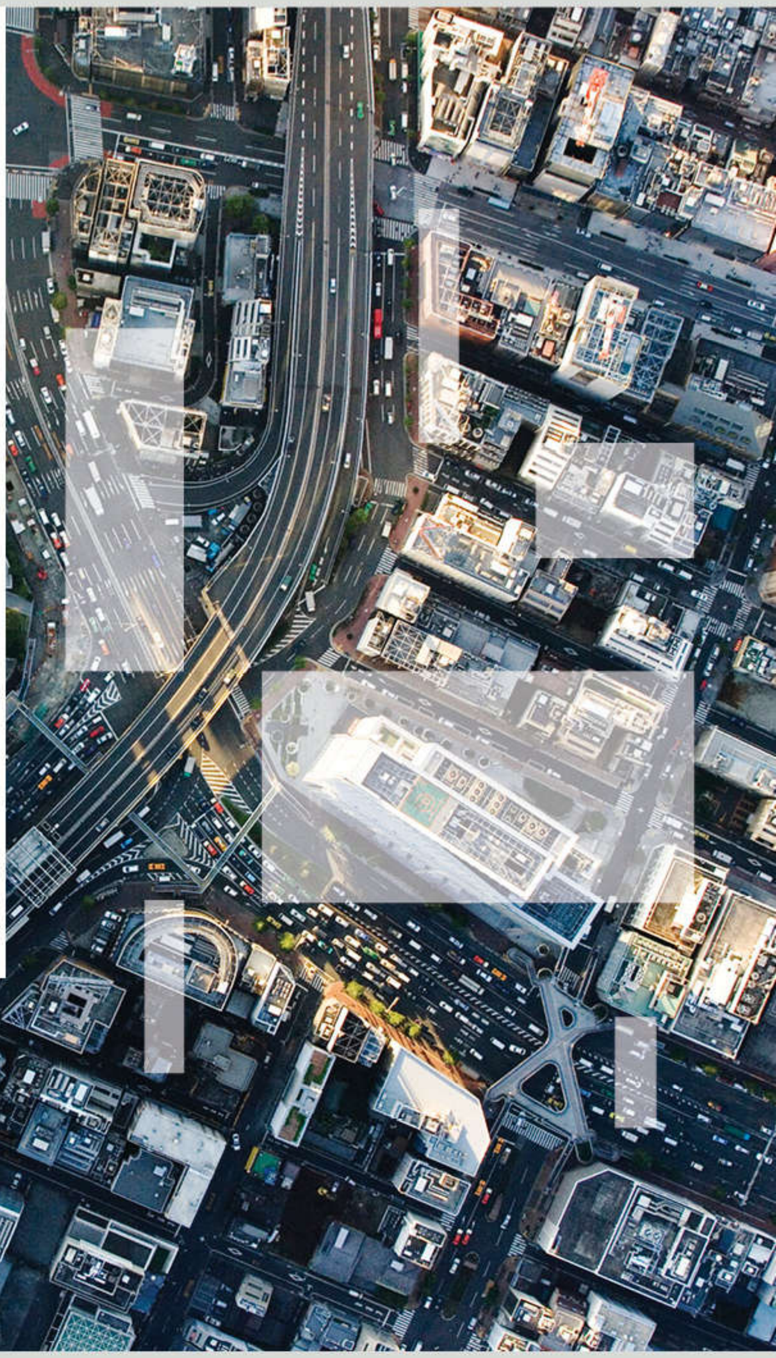
Willis Towers Watson

Supplementary Report of the Independent Expert on the Proposed Insurance Business Transfer Scheme from DAS Legal Expenses Insurance Company Limited to ARAG Allgemeine Versicherungs-AG under Part VII of the Financial Services and Markets Act 2000

16 July 2020

Prepared by Kate Angell, Independent Expert



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Section 1: Introduction

Background

1.1 When a scheme for transferring insurance business from one company to another is put to the High Court of Justice in England and Wales (the "Court") for approval it has to be accompanied by a report on the terms of the scheme from an independent expert (the "Independent Expert"). The Independent Expert's report (the "Scheme Report") is a requirement under Part VII of the Financial Services and Markets Act 2000 ("FSMA").

1.2 I, Kate Angell, have been appointed by DAS Legal Expenses Insurance Company Limited ("DAS") to act as the Independent Expert for the proposed Part VII transfer of certain policies from DAS to ARAG Allgemeine Versicherungs-AG ("ARAG") (the "Proposed Scheme").

1.3 DAS is incorporated in the UK, authorised by the Prudential Regulation Authority (the "PRA") and regulated by the PRA and the Financial Conduct Authority (the "FCA"). DAS is a wholly owned subsidiary of ERGO Versicherung AG, which is ultimately owned by Munich Re.

1.4 DAS has exercised its rights to passport its permissions into Ireland on a Freedom of Establishment ("FoE") basis for the purposes of establishing a branch in Ireland (the "DAS Branch").

1.5 ARAG is domiciled in Germany and is authorised and regulated by Bundesanstalt für Finanzdienstleistungsaufsicht ("BaFin") to carry out general insurance business in Germany. It is a wholly owned subsidiary of ARAG SE. ARAG has recently established a branch in Ireland (the "ARAG Branch") on a FoE basis.

1.6 The policies to be transferred under the Proposed Scheme are all of the policies which were underwritten by DAS, or underwritten by ARAG or its affiliates on behalf of DAS, through the DAS Branch, other than those policies underwritten for a person who is resident in Northern Ireland (the "Transferring Policies").

1.7 A strategic review of ERGO's international business was undertaken in response to the anticipated exit of the UK from the EU. As part of this strategic review a decision was made for DAS to cease underwriting any new business in Ireland. Following this decision, it was then decided that all assets and liabilities in relation to the DAS Branch would be sold to a third party and ARAG was subsequently selected as the purchaser, with all insurance liabilities to be transferred under a Part VII transfer to ARAG's Irish Branch.

1.8 The Proposed Scheme forms the final step as part of the sale transaction between DAS and ARAG, under which the following occurred on 1 December 2019:

- ARAG took over the DAS Branch business, which included the transfer of staff from DAS to an Irish ARAG group company in accordance with the TUPE Regulations[1]; and
- ARAG fully reinsured the Transferring Policies and provides run-off services to DAS (which includes claims handling) until their natural expiry. Accordingly the economic risk of the Transferring Policies has been borne by ARAG since 1 December 2019.

1.9 It is intended that the Effective Date of the Proposed Scheme will be 31 July 2020.

[1] Transfer of Undertakings (Protection of Employment) Regulations 1981

1.10 My opinions on the effect of the Proposed Scheme were set out in my Scheme Report dated 1 April 2020, based on the information that was available to me when I prepared the Scheme Report.

Purpose and Scope

1.11 The Scheme Report was based on financial information in respect of DAS and ARAG as at 31 December 2018 and financial projections performed by DAS and ARAG to the end of 2021 (based on actual management accounts as at 31 December 2018) and my Scheme Report was finalised on 1 April 2020.

1.12 As envisaged in paragraph 1.50 of my Scheme Report, the purpose of this supplementary Scheme Report (the "Supplementary Report") is to specify whether the conclusions set out in my Scheme Report have changed in light of the availability of updated financial information and any material issues that have arisen since the dates noted in the previous paragraph.

1.13 In both the Scheme Report and this Supplementary Report (together referred to as the "Scheme Reports") I have considered the likely effects of the Proposed Scheme on the following groups of affected policyholders:

- Those policyholders of DAS whose insurance policies are remaining with DAS (the "Remaining Policyholders");
- Those policyholders of DAS whose insurance policies are transferring to ARAG (the "Transferring Policyholders"); and
- Those policyholders of ARAG whose insurance policies were originally with ARAG (the "Existing Policyholders").

1.14 In each case I have considered the security of the policyholders on two bases:

- The position should the Proposed Scheme not proceed (the "No Scheme Position"); and
- The position should the Proposed Scheme proceed (the "Post Scheme Position").

1.15 I have therefore made the following comparisons:

- Remaining Policyholders - The No Scheme Position of DAS and the Post Scheme Position of DAS;
- Transferring Policyholders - The No Scheme Position of DAS and the Post Scheme Position of ARAG; and
- Existing Policyholders - The No Scheme Position of ARAG and the Post Scheme Position of ARAG.

1.16 In performing my review, I considered each of the following areas:

- The security of policyholders' contractual rights, including the likelihood and potential effects of the insolvency of the insurer;
- Matters such as investment management, new business strategy, management, administration, claims handling, governance arrangements, expense levels and valuation bases in relation to how they may affect the security of policyholders' contractual rights and levels of service provided to policyholders; and

- Matters such as cost and tax effects of the Proposed Scheme, in relation to how they may affect the security of policyholders' contractual rights.

1.17 For each of the above areas I considered whether the Remaining Policyholders, the Transferring Policyholders and the Existing Policyholders would be "materially adversely" affected under the Proposed Scheme.

- When considering the security of policyholders' contractual rights I have considered an outcome to be materially adverse if it raises the likelihood of insurer failure above a 1 in 200 likelihood (a 0.5^{th} percentile level of risk) over a one-year time horizon. This is the basis on which the regulatory capital for DAS and ARAG is set.

  Although I have focussed on the likelihood of insurer failure over a one-year time horizon, consistent with the regulatory requirements of both DAS and ARAG, I have also considered the impact on the security of policyholders' contractual rights over the full period during which the claims in respect of the insured policies will be paid.

- When considering the levels of service provided to policyholders I have compared the levels of service which can be expected in the No Scheme Position and the Post Scheme Position and relied on my judgement in assessing whether a difference in expected service levels can be considered to materially adversely affect policyholders, explaining the reasons for my opinion.

1.18 I have also considered the likely effect of the Proposed Scheme on reinsurers whose contracts of reinsurance are to be transferred by the Proposed Scheme.

1.19 This Supplementary Report must be considered in conjunction with my Scheme Report. All abbreviations and technical terms in this Supplementary Report have the same meaning as in my Scheme Report.

Statement of independence

1.20 I, Kate Angell, am a Fellow of the Institute and Faculty of Actuaries, having qualified in 1998. I am a Senior Director in the firm of Towers Watson Limited ("TWL") where I am part of the Insurance Consulting and Technology business line. TWL is part of Willis Towers Watson which is a leading global advisory, broking and solutions firm.

1.21 Neither I, nor any member of my immediate family, have any direct shareholdings, have any contracts of insurance or have any other financial interest in the legal entities involved in the Proposed Scheme or in any other companies in either the Munich Re or ARAG groups of companies.

1.22 I have not carried out any consulting work for the legal entities involved in the Proposed Scheme, or for any other companies in either the Munich Re or ARAG groups of companies, in the last three years.

1.23 Insurance Consulting and Technology associates and other TWL colleagues from other lines of business have carried out consulting work for the legal entities involved in the Proposed Scheme and for other companies in the Munich Re and ARAG groups of companies during the last three years. I will not consider any of this work in my Independent Expert role.

1.24 The insurance and reinsurance broking teams within Willis Towers Watson may have relationships with companies within the Munich Re and ARAG groups of companies. However, the broking businesses (from the Willis group of companies, which merged with the Towers Watson group of companies in 2016) are being maintained as separate lines of business to the Insurance Consulting and Technology business segment (of which I am part) within Willis Towers Watson, and Willis Towers Watson is committed to maintaining the confidentiality, objectivity and independence of the services it provides to its insurance clients. TWL remains a separate legal entity from the insurance and reinsurance broking businesses within Willis Towers Watson.

1.25 Save as disclosed above, I have no conflict of interest of any kind. I do not consider that any of the matters disclosed above affect my suitability to act as the Independent Expert for the Proposed Scheme.

Terms of reference

1.26 The terms of reference for my review of the Proposed Scheme were agreed by DAS and ARAG, and have been seen by the PRA and FCA.

1.27 This Supplementary Report has been prepared for the Court in order to aid the Court's consideration as to whether the Proposed Scheme should be approved. In reporting on the Proposed Scheme in accordance with Part VII of the FSMA, I owe a duty to the Court to help the Court on matters within my expertise. This duty overrides any obligation to any person from whom I have received instructions or by whom I am paid. I have complied, and continue to comply, with this duty.

1.28 In preparing this Supplementary Report I have taken account of the following:

- Part 35 of the Civil Procedure Rules;
- The Practice Direction supplement to Part 35 of the Civil Procedure Rules;
- The protocol for the instruction of experts to give evidence in civil claims drafted by the Civil Justice Council;
- The guidance in SUP18 of the FCA Handbook and the "PRA's Statement of Policy: The PRA's approach to insurance business transfers" which sets out guidance on the form of the Scheme Report; and
- The FCA guidance entitled "FG18/4: The FCA's approach to the review of Part VII insurance business transfers" which was issued on 29 May 2018.

Professional guidance

1.29 I am required to comply with relevant technical actuarial standards ("TASs") issued or adopted by the Financial Reporting Council ("FRC") in the UK, and relevant actuarial practice standards ("APSs") issued by the Institute and Faculty of Actuaries ("IFoA") in the UK. The Scheme Reports when considered together are in compliance with the principles of all applicable TASs and APSs. In particular, the Scheme Reports have been prepared in accordance with:

- TAS 100: Principles for Technical Actuarial Work, issued by the FRC;
- TAS 200: Insurance, issued by the FRC;
- The Actuaries' Code, issued by the IFoA; and
- APS X2: Review of Actuarial Work and APS X3: The Actuary as an Expert in Legal Proceedings, both issued by the IFoA.

Peer review

1.30 The work which has been documented in this Supplementary Report has been subject to an internal peer review by an appropriately qualified actuary who was not otherwise involved with my review of the Proposed Scheme.

Distribution

1.31 This Supplementary Report has been prepared on the instruction of DAS and ARAG for the benefit of the Court solely for the purposes of the FSMA requirements for Part VII transfers. I owe a duty to the Court to help the Court on matters within my expertise. This duty overrides any obligation to any person from whom I have received instructions or by whom I am paid.

1.32 This Supplementary Report may be:

- Made available to the PRA, the FCA, the Central Bank of Ireland ("CBI"), BaFin, any other competent regulator, the Court, policyholders and any other person entitled to receive a copy of the Scheme Report under law or regulation applicable to the Proposed Scheme;
- Made available on the DAS and ARAG websites in connection with the Proposed Scheme; and
- Relied upon by the Court.

1.33 Neither the Independent Expert nor Willis Towers Watson accept any responsibility or liability to any third party in relation to this Supplementary Report. Any reliance placed by such third parties on this Supplementary Report is entirely at their own risk.

1.34 This Supplementary Report has been prepared on an agreed basis for the purpose of reporting on the Proposed Scheme and must not be relied upon for any other purpose. It must be considered in its entirety because individual sections, if considered in isolation, may be misleading. This Supplementary Report is subject to the terms and limitations, including a limitation of liability, set out in my firm's engagement letter.

Reliances

1.35 In carrying out my review and producing this Supplementary Report I have relied without independent verification upon the accuracy and completeness of the data and information provided to me, both in written and oral form. Where possible, I have reviewed the information provided for reasonableness and consistency with my knowledge of the insurance and reinsurance industry. I have also met or spoken with representatives of DAS and ARAG to discuss in detail the information which they have provided to me in relation to the Proposed Scheme. I consider it is reasonable for me to rely on these individuals since they are PRA and FCA approved persons or are senior professionals employed by either DAS or ARAG. Reliance has been placed upon, but not limited to, the information detailed in Section 2.

1.36 I have obtained confirmation from DAS and ARAG that, to the best of their knowledge and belief:

- All of the items of data and information which they have provided to me for the purposes of the Scheme Report and this Supplementary Report are accurate and complete.
- There are no significant errors or omissions in the descriptions in the Scheme Report or this Supplementary Report of the business of their respective company or of the Proposed Scheme.

- There are no other material items of data and information which have not been provided to me regarding their respective company and which are likely to be relevant to the Scheme Report or this Supplementary Report.

1.37 Based on my review, I am satisfied that the information detailed in Section 2 represents an appropriate basis for the conclusions set out in this Supplementary Report and I consider that it is reasonable for me to rely on this information. There is no information which I requested from DAS or ARAG which has not been provided to me.

1.38 When producing this Supplementary Report I have also relied upon all of the information provided to me previously for the purposes of producing my Scheme Report.

1.39 A draft of this Supplementary Report has been made available to the PRA and FCA whose comments have been taken into account. The PRA (in consultation with the FCA) has approved the form of the Scheme Reports.

Limitations

1.40 No limitations have been imposed on the scope of my work and the opinions in the Scheme Reports about the Proposed Scheme are mine, based on the information provided to me and the answers given to the questions I have raised. There are no matters that I have not taken into account or evaluated in the Scheme Reports that might, in my opinion, be relevant to policyholders' consideration of the Proposed Scheme.

1.41 This Supplementary Report is based on:

- Financial information in respect of DAS and ARAG as at 31 December 2019;
- Financial projections performed by DAS to the end of 2023, based on actual management accounts as at 31 December 2018 and forecasting assumptions as at July 2019, which are the most recent financial projections available; and
- Financial projections performed by ARAG to the end of 2022, based on actual management accounts as at 31 December 2019.

1.42 In my judgement, the results and conclusions contained in the Scheme Reports are reasonable given the information made available to me. However, the actual cost of settling future claims and those still outstanding as at the valuation date is uncertain as, amongst other things, the actual cost depends on events yet to occur such as future court judgements. The actual cost of claims could be different from the estimates shown in the Scheme Reports, and possibly materially so. Such differences between the estimated and actual outcome could possibly have a material impact upon the balance sheet strength of the companies, and therefore upon the Proposed Scheme.

1.43 The Scheme Reports must not be construed as legal, investment or tax advice.

1.44 Figures in all tables in the Scheme Reports are subject to possible rounding differences.

Legal jurisdiction

1.45 This Supplementary Report is governed by and shall be construed in accordance with English law. Towers Watson Limited, DAS and ARAG submit to the exclusive jurisdiction of the English courts in connection with all disputes and differences arising out of, under or in connection with this Supplementary Report.

Exchange rates

1.46 All figures provided by ARAG were denominated in Euros. All of the updated financial information which has been provided for this Supplementary Report has been converted into GBP using the exchange rate £1.00 = €1.1812, which was the exchange rate as at 31 December 2019.

1.47 For the purposes of my Scheme Report, the figures were converted into GBP using the exchange rate £1.00 = €1.1092, which was the exchange rate as at 31 December 2018.

1.48 Where I quote figures from the Scheme Report in this Supplementary Report these have not been revised to reflect the change in exchange rates, but remain converted at the exchange rate which was used to convert figures for the Scheme Report.

Structure of this Supplementary Report

1.49 The structure of this Supplementary Report is as follows:

- Section 1 summarises the scope of my work as the Independent Expert, including the purpose of this Supplementary Report;
- Sections 2 to 10 describe the further information I have considered, and the analysis and judgements I have made in arriving at my findings;
- Section 11 contains my conclusions and Statement of Truth; and
- The Appendix contains a glossary of terms.

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Section 2: Overview of Methodology

Approach

2.1 The Scheme Report was based on financial information in respect of DAS and ARAG as at 31 December 2018 and financial projections performed by DAS and ARAG to the end of 2021 (based on actual management accounts as at 31 December 2018) and my Scheme Report was finalised on 1 April 2020.

2.2 I have requested and received additional information to assist me in considering whether the conclusions set out in my Scheme Report have changed in light of the availability of updated financial information and any material issues that have arisen since the dates noted in the previous paragraph.

2.3 In this Supplementary Report I have considered the updated financial information provided and addressed any statements or assumptions made in my Scheme Report which I consider are no longer correct or reasonable in light of the additional information provided to me for the purposes of this Supplementary Report.

2.4 This Supplementary Report is based on financial information in respect of DAS and ARAG as at 31 December 2019, financial projections performed by DAS to the end of 2023 (based on actual management accounts as at 31 December 2018 and forecasting assumptions as at July 2019, which are the most recent financial projections available) and financial projections performed by ARAG to the end of 2022 (based on actual management accounts as at 31 December 2019).

2.5 Throughout this Supplementary Report I compare this updated financial information to the financial information on which my Scheme Report was based. For DAS, my Scheme Report was based on financial information projected to Q4 2019, based on actual financial information as at 31 December 2018. For ARAG, my Scheme Report was based on financial information as at 31 December 2018.

2.6 Details of the analysis I have undertaken and the judgements I have made in arriving at my findings are set out in Sections 3 to 10 of this Supplementary Report, which cover the following areas:

- Sections 3 and 4 - The balance sheets for DAS and ARAG as at Q4 2019, including a comparison with the balance sheets included in my Scheme Report.
- Sections 5 and 6 – The capital requirements for DAS and ARAG as at Q4 2019 on a regulatory basis together with the available capital.
- Sections 7 and 8 - The projected capital requirements for DAS and ARAG on a regulatory basis, together with the available capital, along with consideration of some scenario tests and consideration of the likelihood of each insurer being able to meet its liabilities over the full period during which claims in respect of these policies will be paid.
- Section 9 – Other financial considerations arising from the Proposed Scheme
- Section 10 - Other non-financial considerations arising from the Proposed Scheme.

Structure of Proposed Scheme

2.7 I am not aware of any changes to the Scheme documentation or structure of the Proposed Scheme compared with those on which my Scheme Report was based.

Impact of Brexit

2.8 In my Scheme Report I concluded that, in respect of Brexit, whether or not the Proposed Scheme proceeds would have no impact on the Remaining Policyholders, the Existing Policyholders or the Transferring Policyholders.

2.9 The impact of Brexit on policyholders is set out in paragraphs 16.2 to 16.12 of my Scheme Report and my conclusion in the previous paragraph remains valid even in the event of a "No-Deal Brexit" at the end of the transition period. The transition period started on 31 January 2020 and will end on 31 December 2020[1].

2.10 I am not aware of any developments in relation to Brexit compared with the situation on which my Scheme Report was based, and therefore I have not changed my conclusions in respect of Brexit.

Norwegian Policies

2.11 In my Scheme Report (paragraph 5.29) I noted that DAS has historically conducted business in Norway on a Freedom of Services basis through a third-party distributor authorised to bind insurance policies on behalf of DAS. DAS ceased to operate in Norway on 22 March 2019.

2.12 This Norwegian business was not written by DAS's Irish Branch, does not form part of the Transferring Policies and accordingly will remain with DAS following the Proposed Scheme.

2.13 In the paragraphs immediately below, I consider the impact on the Norwegian policyholders of remaining with DAS, I outline why the decision was taken not to include them within the definition of Transferring Policies for the Proposed Scheme, and I explain why I have not considered the impact on these policyholders as a result of them not being included in the Proposed Scheme (and therefore not transferring from DAS to ARAG).

Definition of Transferring Policies

2.14 The Norwegian business was not included within the definition of the Transferring Policies under the Proposed Scheme because the Norwegian business was written by DAS rather than the DAS Branch in Ireland. The Norwegian business is not connected with the DAS Branch and the DAS Branch has never written business in Norway.

2.15 The policies being transferred under the Proposed Scheme only relate to policies written by the DAS Branch and hence the Norwegian business was not included in the definition of Transferring Policies for the purposes of the Proposed Scheme. This reflects the commercial agreement between DAS and ARAG, which relates only to the DAS Branch.

Undertaking in respect of Norwegian policyholders

2.16 As noted in my Scheme Report, although Norway is in the EEA it is a non-EU state, and in 2018 DAS's Norwegian distributor received informal confirmation from Finanstilsynet, the financial supervisory authority in Norway, that after Brexit the distributor will be allowed to continue to process and settle any claims in Norway on behalf of DAS arising from policies issued to Norwegian policyholders prior to Brexit. When asked to provide a more formal confirmation of the position in connection with the Norwegian business, Finanstilsynet was unwilling to provide any additional confirmation to DAS on the matter.

2.17 In the absence of a more formal confirmation, the PRA and the FCA requested that, in advance of the Sanctions Hearing, DAS gives an undertaking regarding the servicing of the

[1] The provision in the Withdrawal Agreement to extend the transition period by one or two years, as referred to in paragraph 16.3 of my Scheme Report, needed to be effected by 1 July 2020 and hence the transition period can no longer be extended.

Norwegian business following the expiry of the Brexit transition period in connection with the Proposed Scheme. DAS has agreed to provide the requested undertaking. It is intended that the undertaking will be given by DAS to the Court and will state that DAS will continue to comply with its obligations under such policies following the expiry of the Brexit transition period (which is currently due to end on 31 December 2020, although there is a provision in the Withdrawal Agreement to extend the transition period by one or two years).

Impact on Norwegian policyholders

2.18 As noted in paragraph 3.4 of my Scheme Report, in my Scheme Report (and similarly in this Supplementary Report) I do not consider any possible alternative schemes or arrangements which might provide a more efficient or effective outcome.

2.19 In my Scheme Report, and again in this Supplementary Report, I concluded that, in respect of Brexit, whether or not the Proposed Scheme proceeds would have no impact on the Remaining Policyholders.

2.20 In summary therefore, I consider that whether or not the Proposed Scheme proceeds will have no impact on the Norwegian policyholders. I have not considered the impact on the Norwegian policyholders as a result of them not being included in the Proposed Scheme and therefore not transferring from DAS to ARAG.

Additional information received

2.21 I have based my conclusions in this Supplementary Report on the following additional information received from DAS and ARAG, together with information which was used in preparing my Scheme Report. The additional information I have received includes the following:

Documents relating to the Proposed Scheme

- Final documents for the Proposed Scheme as submitted to the Court for the Directions Hearing
- Regular reports on policyholder communications and summary statistics on responses, together with details of any objections which have been raised by policyholders, or other potentially affected parties, on the Proposed Scheme.

Documents relating to DAS

- Balance sheets, on both a UK GAAP and Solvency II basis, as at 31 December 2019
- Regulatory capital requirements as at 31 December 2019
- Solvency II balance sheet and regulatory capital requirements as at 31 March 2020
- Balance sheet and capital projections as at 31 December 2020, 2021, 2022 and 2023
- Audited Financial Statements as at 31 December 2019
- SFCR as at 31 December 2019
- Own Risk and Solvency Assessment report for 2018
- Actuarial Function report for 2018

- Internal and external reserve reports as at 31 December 2019
- Information on the operational and financial impacts of COVID-19 on DAS

Documents relating to ARAG

- Balance sheets, on both a German GAAP and Solvency II basis, as at 31 December 2019
- Regulatory capital requirements as at 31 December 2019
- Solvency II balance sheet and regulatory capital requirements as at 31 March 2020
- Balance sheet and capital projections as at 31 December 2020, 2021 and 2022
- Audited Financial Statements as at 31 December 2019
- SFCR as at 31 December 2019
- Own Risk and Solvency Assessment report for 2019
- Actuarial Function report for 2019
- Internal reserve report as at 31 December 2019 (based on data as at 30 September 2019), dated 2 December 2019
- External reserve report as at 31 December 2019
- Validation report for the Partial Internal Model as at 31 December 2018
- Information on the operational and financial impacts of COVID-19 on ARAG

2.22 In respect of the documents provided by ARAG, these were all only available in German[1]. For these documents we used a confidential online translation tool to translate the documents for the purposes of producing this Supplementary Report.

2.23 This information and various other information (including information provided verbally) has been provided by the management team of DAS and ARAG.

2.24 I have relied upon the accuracy and completeness of the data and information provided without independent verification. However, I have reviewed the data and information for general consistency and overall reasonableness, and based on my wider experience this gives me no cause for concern.

2.25 I have received statements of data accuracy signed by Thomas Biermann, Chief Financial Officer of DAS and Uwe Grünewald, Chief Financial Officer of ARAG which confirm the accuracy and completeness of the information provided to me in performing my Independent Expert role, in order to produce both my Scheme Report and this Supplementary Report.

[1] Except for the Quantitative Reporting Templates included within the SFCR as at 31 December 2019 which were provided in both German and English.

Section 3: Balance Sheets - DAS

Introduction

3.1 In this section I set out my review of the GAAP and Solvency II balance sheets of DAS, immediately before and after the Proposed Scheme.

Impact of the Proposed Scheme on DAS GAAP balance sheet

3.2 The table below shows the balance sheets for DAS on a UK GAAP basis as at Q4 2019, on a projected (as included in the Scheme Report) and actual basis, immediately before and after application of the Proposed Scheme.

3.3 In my Scheme Report I noted that the projected balance sheets of DAS (on both a GAAP and Solvency II basis) as at Q4 2019, on which my Scheme Report was based, incorporated material recoveries which were expected to be received following legal action. Recoveries were received during 2019, although for a lower amount than was expected. The actual financials of DAS as at Q4 2019, on which this Supplementary Report is based, therefore incorporate the impact of the actual recoveries received during 2019.

Table 3.1: DAS UK GAAP balance sheets on a No Scheme and Post Scheme basis

All in £000's	Projected figures as at 31 Dec 2019 (Table 8.2 from Scheme Report)			Actual figures as at 31 December 2019		
	No Scheme basis	*Movement*	Post Scheme basis	No Scheme basis	*Movement*	Post Scheme basis
Assets						
Investment assets	128,400	*0*	128,400	113,645	*0*	113,645
Ceded UPR	106,800	*(800)*	106,000	100,732	*(2,044)*	98,688
Ceded claims reserve	105,800	*(3,700)*	102,200	107,194	*(3,015)*	104,179
Cash with bank	25,600	*0*	25,600	17,209	*0*	17,209
DAC asset	5,500	*0*	5,500	6,456	*0*	6,456
Receivables and fixed assets	136,000	*0*	136,000	141,403	*0*	141,403
Deferred tax	100	*0*	100	0	*0*	0
Other deferred items	1,400	*0*	1,400	1,058	*0*	1,058
Total assets	**509,600**	***(4,500)***	**505,200**	**487,697**	***(5,060)***	**482,637**
Liabilities						
UPR	117,900	*(800)*	117,200	111,093	*(2,044)*	109,049
Claims reserves	123,100	*(3,700)*	119,400	123,905	*(3,015)*	120,890
Other liabilities	19,800	*0*	19,800	8,964	*0*	8,964
Accruals and deferred income	37,200	*0*	37,200	34,522	*0*	34,522
Creditors arising out of reinsurance operations	179,800	*0*	179,800	179,452	*0*	179,452
Total liabilities	**477,800**	***(4,500)***	**473,400**	**457,936**	***(5,060)***	**452,876**
Total shareholders' funds	**31,800**	***0***	**31,800**	**29,761**	***0***	**29,761**

3.4 The impacts on the DAS balance sheet as a result of the Proposed Scheme are as follows:

- The gross reserves for the Transferring Business are removed from the DAS balance sheet.
- Given the 100% reinsurance which is in place with ARAG, an equal amount of reinsurance reserves are also removed resulting in no change to the shareholders' funds of DAS.

3.5 Since the Reinsurance Agreement covers 100% of any claims for the Transferring Policies, and the consideration paid as part of the Transaction was paid on the Initial Transfer Date (1 December 2019) rather than on the Effective Date, the Proposed Scheme is not estimated to have any impact on the shareholders' funds of DAS.

3.6 The UPR for the Transferring Policies has increased materially since the Scheme Report (from £0.8 million to £2.0 million). This increase is driven by a change in the Initial Transfer Date. The projected financials included in the Scheme Report were based on an assumed Initial Transfer Date of 31 March 2019. The actual financials shown above are based on the actual Initial Transfer Date of 1 December 2019. This has resulted in DAS writing additional policies through the DAS Branch (in the period from 1 April 2019 to 1 December 2019) which are included as Transferring Policies.

3.7 Compared with the projected figures as at 31 December 2019, the total shareholders' funds have reduced by around 6%. This reduction in total shareholders' funds (of £2 million) is predominantly driven by the lower recoveries than expected which were received during 2019 in connection with the legal action discussed in paragraph 3.3 above.

Impact of the Proposed Scheme on the DAS Solvency II balance sheet

3.8 The table below shows the balance sheets for DAS on a Solvency II basis as at Q4 2019 immediately before and after application of the Proposed Scheme.

Table 3.2: DAS Solvency II balance sheets on a No Scheme and Post Scheme basis

All in £000's	Projected figures as at 31 Dec 2019 (Table 8.3 from Scheme Report)			Actual figures as at 31 Dec 2019		
	No Scheme basis	*Movement*	Post Scheme basis	No Scheme basis	*Movement*	Post Scheme basis
Assets						
Investments	124,871	*0*	124,871	114,658	*0*	114,658
Reinsurers share of technical provisions	118,795	*(3,752)*	115,043	115,161	*(3,600)*	111,561
Other assets including cash	30,866	*0*	30,866	17,625	*0*	17,625
Receivables	44,511	*0*	44,511	50,258	*0*	50,258
Total assets	**319,043**	*(3,752)*	**315,291**	**297,702**	*(3,600)*	**294,102**
Liabilities						
Technical provisions	130,978	*(3,791)*	127,187	122,588	*(3,992)*	118,596
Deferred tax liability	2,352	*7*	2,358	1,354	*67*	1,421
Accruals and deferred income	722	*0*	722	0	*0*	0
Other liabilities (incl. reinsurance deposits)	141,726	*0*	141,726	137,803	*0*	137,803
Total liabilities	**275,778**	*(3,784)*	**271,994**	**261,745**	*(3,925)*	**257,820**
Solvency II Own Funds	**43,265**	*32*	**43,297**	**35,957**	*325*	**36,282**

3.9 The Proposed Scheme is estimated to result in a £325k increase in the Solvency II Own Funds of DAS. This is largely due to the net Technical Provisions in respect of the Transferring Business being slightly positive due to the impact of the allowance for reinsurance bad debt and the inclusion of the risk margin within the net Technical Provisions. In addition, the Proposed Scheme is estimated to result in a minor movement in deferred tax.

3.10 Compared with the projected figures as at 31 December 2019, the total Solvency II Own Funds have reduced by around 16% (or £7 million) on a Post Scheme basis. This reduction is partly driven by the lower recoveries than expected which were received during 2019 in connection with the legal action discussed above (in paragraphs 3.3 and 3.7). The remaining difference is driven by some limitations with the approach used by DAS to project the Solvency II balance sheets and an adjustment which was made to the Solvency II balance sheet (but not the UK GAAP balance sheet) as at 31 December 2019.

UK GAAP to Solvency II

3.11 When moving from a UK GAAP basis to Solvency II basis the impact on the Own Funds is as follows.

Table 3.3: Movement in Own Funds from UK GAAP to Solvency II basis

All in £000's	Projected figures as at 31 Dec 2019 (Table 8.4 from Scheme Report)			Actual figures as at 31 Dec 2019		
	No Scheme basis	*Movement*	Post Scheme basis	No Scheme basis	*Movement*	Post Scheme basis
UK GAAP Shareholders' Funds	31,800	*0*	31,800	29,761	*0*	29,761
Solvency II Own Funds	43,265	*32*	43,297	35,957	*325*	36,282
Movement	**11,465**	***32***	**11,497**	**6,196**	***325***	**6,521**

3.12 This increase in Own Funds is driven by the changes set out in the table below.

Table 3.4: Movement in Own Funds from UK GAAP to Solvency II basis

All in £000's	Projected figures as at 31 Dec 2019 (Table 8.5 from Scheme Report)			Actual figures as at 31 Dec 2019		
	No Scheme basis	*Movement*	Post Scheme basis	No Scheme basis	*Movement*	Post Scheme basis
Movement from UK GAAP reserves to Solvency II Technical Provisions, which comprises of:	16,217	*39*	16,256	19,645	*392*	20,037
Movement in best estimate reserves	*18,823*	*23*	*18,847*	*23,418*	*301*	*23,719*
Inclusion of risk margin	*(2,607)*	*16*	*(2,591)*	*(3,773)*	*91*	*(3,682)*
Other adjustments	(4,752)	*(7)*	(4,759)	(13,449)	*(67)*	(13,516)
Movement	**11,465**	***32***	**11,497**	**6,196**	***325***	**6,521**

3.13 The largest movement is driven by the movement in the UK GAAP reserves to the Solvency II Technical Provisions[1]. This is driven by the following key movements:

- Under Solvency II, the expected profit on unearned business is included as an asset. The removal of this profit is the key driver of the reduction in best estimate reserves on a Solvency II basis. This is partially offset by a slight increase in claims reserves on a Solvency II basis, due to various adjustments.

- Under Solvency II a risk margin is included in the Solvency II balance sheet as a liability. This is on a defined basis under Solvency II using a cost of capital approach. The inclusion of a risk margin results in an increase in the Solvency II Technical Provisions compared with the UK GAAP reserves, and therefore a reduction in Own Funds when moving from a UK GAAP to Solvency II basis.

3.14 Other adjustments then serve to partially offset the increase in Own Funds as a result of the movement in the UK GAAP reserves to the Solvency II Technical Provisions. These include the removal of the deferred acquisition costs and deferred reinsurance commissions payable which are fully eliminated in the Solvency II balance sheet.

[1] Technical Provisions comprise Claims Provisions (which cover earned exposures), Premium Provisions (which cover unearned periods of exposure) and the risk margin.

Premiums and claims reserving

3.15 There have been no changes to the premiums and claims reserving processes (on both a GAAP and Solvency II basis) since my Scheme Report.

3.16 In my Scheme Report I set out how I had satisfied myself with the reasonableness of the reserves of DAS and I concluded that, while I had not attempted to review in detail the internal or external calculations performed, the analysis I undertook, including my high-level estimate of the reserves, gave me comfort that the DAS reserves, on both a UK GAAP and Solvency II basis, were reasonable.

3.17 For this Supplementary Report, I have not changed my opinion that the DAS reserves, on both a UK GAAP and Solvency II basis, are reasonable. This conclusion is based on the following considerations which supplement the approaches described in my Scheme Report:

- As noted above, I have received confirmation from DAS that there have been no changes to the premiums and claims reserving processes (on both a GAAP and Solvency II basis) since my Scheme Report.

- I have reviewed DAS's internal estimates of ultimate claims at year-end 2019 as set out in the internal presentation to the Reserving Committee on 9 January 2020. This presentation was in line with my expectations and provided good support for the reasonableness of the reserves.

- I have reviewed the report produced by DAS's external auditors as at 31 December 2019. While I have not relied upon this report in reaching my conclusions, I consider that it supports the overall reasonableness of the reserves held by DAS.

3.18 My review of the historical performance of internal reserve estimates for DAS, as set out in my Scheme Report, was based on data as at 31 December 2019 and therefore did not need to be updated to support my conclusions as set out in this Supplementary Report.

Investments

3.19 There have been no changes to the investment strategy of DAS since my Scheme Report.

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Section 4: Balance Sheets - ARAG

Introduction

4.1 In this section I set out my review of the GAAP and Solvency II balance sheets of ARAG as at 31 December 2019.

4.2 Due to the low materiality of the Transferring Business when compared to the overall ARAG balance sheets, the figures included in this section have not been adjusted to allow for the impact of the Proposed Scheme.

ARAG GAAP balance sheet

4.3 The table below shows the balance sheet for ARAG on a German GAAP basis.

Table 4.1: ARAG German GAAP balance sheet – No Scheme basis

All in £000's	Figures as at 31 Dec 2018 *(Table 9.1 from Scheme Report)*	Figures as at 31 Dec 2019
Assets		
Investments	254,079	243,214
Loans	42,356	42,806
Ceded UPR	129	0
Ceded claims reserves	30,346	26,319
Other assets including cash	2,739	11,728
Receivables	22,961	16,257
Deferred items	475	355
Total assets	**353,086**	**340,680**
Liabilities		
UPR	22,942	23,860
Claims reserves	190,917	191,195
Claims equalisation provision	33,968	33,815
Payables	5,399	13,898
Pension provisions	28,688	27,412
Tax provisions	59	116
Deferred tax liability	0	0
Other liabilities	21,237	3,548
Total liabilities	**303,210**	**293,843**
Total shareholders' funds	**49,876**	**46,836**

4.4 As noted in paragraph 4.2 the figures in the table above have not been adjusted to allow for the impact of the Proposed Scheme. The approximate magnitude of the impact of ARAG reinsuring the Transferring Business from the Initial Transfer Date can be seen by considering the movements shown in Table 3.1.

4.5 Since the Proposed Scheme will move the Transferring Business from inwards reinsurance business to inwards direct business, I do not anticipate that there will be any change in the gross or ceded reserves on the ARAG balance sheet directly as a result of the Proposed Scheme.

4.6 As noted in paragraph 1.48, the figures shown above as at 31 December 2018 have not been revised to reflect the change in exchange rates, but remain converted at the exchange rate which was used to convert figures for the Scheme Report. Based on constant exchange rates, the total shareholders' funds remain unchanged since 31 December 2018, given the impact of the profit and loss transfer agreement which is in place (as described from paragraph 7.4 of my Scheme Report).

ARAG Solvency II balance sheet

4.7 The table below shows the balance sheet for ARAG on a Solvency II basis.

Table 4.2: ARAG Solvency II balance sheets – No Scheme basis

All in £000's	Figures as at 31 Dec 2018 *(Table 9.2 from Scheme Report)*	Figures as at 31 Dec 2019
Assets		
Investments	350,664	367,787
Reinsurers share of technical provisions	23,177	22,531
Insurance and intermediaries receivables	11,900	12,243
Other assets including cash	13,728	11,649
Total assets	**399,469**	**414,210**
Liabilities		
Technical provisions	151,647	146,067
Insurance and intermediaries payables	5,398	4,108
Pension provisions	34,597	35,015
Deferred tax liability	0	0
Other liabilities	21,236	17,863
Total liabilities	**212,879**	**203,052**
Solvency II Own Funds	**186,590**	**211,157**

4.8 As for the German GAAP balance sheet, I do not anticipate that the Proposed Scheme or the wider business transaction between DAS and ARAG will result in any material changes to the ARAG Solvency II balance sheet.

4.9 Based on constant exchange rates, the total Solvency II Own Funds have increased since 31 December 2018 whereas, as noted above, total shareholders' funds on a German GAAP basis have remained unchanged, given the impact of the profit and loss transfer agreement which is in place. The increase in the Solvency II Own Funds since 31 December 2018 is driven by an increase in the market value of investments over the period.

German GAAP to Solvency II

4.10 When moving from a German GAAP basis to Solvency II basis the impact on the Own Funds is as follows.

Table 4.3: Movement in Own Funds from German GAAP to Solvency II basis No Scheme basis

All in £000's	Figures as at 31 Dec 2018 *(Table 9.3 from Scheme Report)*	Figures as at 31 Dec 2019
German GAAP Shareholders' Funds	49,876	46,836
Solvency II Own Funds	186,590	211,157
Movement	**136,714**	**164,321**

4.11 This increase in Own Funds is driven by the changes set out in the table below.

Table 4.4: Movement in Own Funds from German GAAP to Solvency II basis No Scheme basis

All in £000's	Figures as at 31 Dec 2018 *(Table 9.4 from Scheme Report)*	Figures as at 31 Dec 2019
Movement from German GAAP reserves to Solvency II Technical Provisions, which comprises of:	88,882	99,015
Movement in best estimate reserves	*59,089*	*69,031*
Inclusion of risk margin	*(4,174)*	*(3,831)*
Removal of equalisation provision	*33,968*	*33,815*
Value of investments	54,228	81,766
Other adjustments	(8,793)	(16,460)
Movement	**136,714**	**164,321**

4.12 The largest movement is driven by the movement in the German GAAP reserves to the Solvency II Technical Provisions. This is driven by the following key movements:

- The reserves booked under German GAAP are significantly higher than the reserves recommended by ARAG's risk management department, and also include an equalisation provision which is intended to provide the insurer with liquidity where outwards cashflows may be subject to significant volatility. All assets and liabilities are valued on a best estimate basis under Solvency II, resulting in a lower reserve requirement (and an increase in Solvency II Own Funds).

- Under Solvency II, the future expected profit or loss on unearned business is included in the Technical Provisions. As the unearned business for ARAG is expected to be profitable, this part of the Technical Provisions has an additional positive impact on the Own Funds.

- Under Solvency II a risk margin is included in the Solvency II balance sheet as a liability. This is on a defined basis under Solvency II using a cost of capital approach. The inclusion of a risk margin results in an increase in the Solvency II Technical Provisions compared with the German GAAP reserves, and therefore a reduction in Own Funds when moving from a German GAAP to Solvency II basis.

4.13 In addition, the value of investment assets held by ARAG are significantly different under the two bases. This is due to the rules under which assets are booked under German GAAP resulting in a more prudent valuation than those reported under Solvency II, the latter of which is held at market value. This results in an increase in the Solvency II Own Funds.

Premiums and claims reserving

4.14 There have been no changes to the premiums and claims reserving processes (on both a GAAP and Solvency II basis) since my Scheme Report.

4.15 In my Scheme Report I set out how I had satisfied myself with the reasonableness of the reserves of ARAG and I concluded that, while I had not attempted to review in detail the internal or external calculations performed, the analysis I undertook, including my high-level estimate of the reserves, gave me comfort that the ARAG best estimate reserves and Solvency II Technical Provisions were reasonable.

4.16 For this Supplementary Report, I have not changed my opinion that the ARAG best estimate reserves and Solvency II Technical Provisions are reasonable. This conclusion is based on the following considerations which supplement the approaches described in my Scheme Report:

- As noted above, I have received confirmation from ARAG that there have been no changes to the premiums and claims reserving processes (on both a GAAP and Solvency II basis) since my Scheme Report.

- In my Scheme Report, I reviewed the performance of ARAG's historical claims reserve estimates by considering the ultimate claims by accident year as at each year-end between 2014 and 2018. For the purposes of this Supplementary Report, I have additionally reviewed the projected ultimate claims by accident year as at year-end 2019. I consider that the movements in the ultimate claims held by ARAG between year-end 2018 and year-end 2019 do not appear to be unreasonable given the inherent uncertainty surrounding estimates of claims liabilities. I therefore continue to believe that my review of the historical performance of internal reserve estimates supports the reasonableness of the ARAG reserves.

- I have reviewed ARAG's internal estimates of ultimate claims as at 31 December 2019 (based on data as at 30 September 2019) as set out in the internal presentation to the Reserving Committee on 2 December 2019.

- I have reviewed the report produced by ARAG's external auditors as at 31 December 2019. While I have not relied upon this report in reaching my conclusions, I consider that it supports the overall reasonableness of the reserves held by ARAG.

Investments

4.17 There have been no changes to the investment strategy of ARAG since my Scheme Report.

Section 5: Capital Requirements - DAS

Introduction

5.1 DAS assesses its regulatory capital using the Standard Formula under Solvency II. The same approach will be used to assess the regulatory capital requirements for DAS after the Proposed Scheme. I understand that there are no plans for DAS to apply for internal model approval under Solvency II.

5.2 In this section I consider the impact of the Proposed Scheme on the security of DAS immediately before and after the Proposed Scheme.

Appropriateness of the capital requirements

5.3 In my Scheme Report I set out how I had considered DAS's conclusions as to the appropriateness of the Standard Formula for calculating DAS's regulatory capital requirements as set out in DAS's ORSA.

5.4 As a result, I concluded that, in my opinion, the use of the Standard Formula to calculate the regulatory capital requirement was a reasonable approach for DAS.

5.5 For this Supplementary Report, I have not changed my opinion that the use of the Standard Formula to calculate the regulatory capital requirement is a reasonable approach for DAS. This conclusion is based on the following considerations which supplement the approaches described in my Scheme Report:

- I have reviewed the changes in the DAS Standard Formula SCR projected to 31 December 2019 with the actual calculation as at 31 December 2019 and consider the movements to be reasonable.
- In its 2018 ORSA DAS continues to conclude that the Standard Formula is an appropriate basis for calculating DAS's regulatory capital requirement and that the internal model of the ERGO group continues to estimate the SCR for DAS to be significantly lower than the Standard Formula SCR.

Impact of the Proposed Scheme on capital requirements

5.6 The table below shows the Standard Formula SCR results immediately before and after application of the Proposed Scheme.

Table 5.1: DAS Standard Formula SCR

All in £000's	Projected figures as at 31 Dec 2019 (Table 10.1 from Scheme Report)			Actual figures as at 31 Dec 2019		
	No Scheme basis	*Movement*	Post Scheme basis	No Scheme basis	*Movement*	Post Scheme basis
Premium and reserve risk	*7,111*	*0*	*7,111*	*6,736*	*(31)*	*6,705*
Lapse risk	*4,381*	*0*	*4,381*	*5,271*	*0*	*5,271*
Catastrophe risk	*0*	*0*	*0*	*0*	*0*	*0*
Diversification within underwriting risk	*(3,140)*	*0*	*(3,140)*	*(3,454)*	*7*	*(3,447)*
Total underwriting risk	8,352	*0*	8,352	8,553	*(24)*	8,529
Market risk	2,719	*0*	2,719	3,134	*69*	3,203
Counterparty default risk	7,767	*(6)*	7,761	7,644	*(355)*	7,289
Diversification	(3,863)	*1*	(3,862)	(4,094)	*27*	(4,067)
Basic SCR	**14,975**	***(5)***	**14,970**	**15,237**	*(283)*	**14,954**
Operational risk	3,818	*(114)*	3,703	3,564	*(117)*	3,447
Loss-absorbing capacity of deferred taxes	(2,352)	*(7)*	(2,358)	(1,354)	*(67)*	(1,421)
Total SCR	**16,441**	***(126)***	**16,315**	**17,447**	***(468)***	**16,979**
Solvency II Own Funds	**43,265**	***32***	**43,297**	**35,957**	***325***	**36,282**
Solvency II coverage ratio	**263%**	***2%***	**265%**	**206%**	***8%***	**214%**

5.7 DAS's SCR is not expected to change materially as a result of the Proposed Scheme. As a result of a small reduction in the SCR and a small increase in the Solvency II Own Funds, the SCR coverage ratio is expected to increase from 206% to 214% as a result of the Proposed Scheme.

5.8 The most significant movements in the SCR as a result of the Proposed Scheme are a reduction in counterparty default risk of £355k and a reduction in operational risk of £117k. These movements are driven, respectively, by a reduction in exposure to reinsurer default and a reduction in gross Technical Provisions resulting from the Proposed Scheme.

5.9 Since the Scheme Report, the SCR coverage ratio has fallen from 263% to 206% on a No Scheme Basis. This fall is driven by changes to the Solvency II balance sheet which have impacted both the Solvency II Own Funds and the allowance included in the SCR for the loss-absorbing capacity of deferred taxes (which has resulted in an increase in the SCR).

5.10 The SCR and Solvency Ratio figures shown in the table above have been prepared according to the Standard Formula, allowing for the amendments to the Solvency II Delegated Regulation which were adopted by the European Commission on 8 March 2019, including the amendments which did not come into effect until 1 January 2020. These amendments serve to reduce the Standard Formula SCR for DAS.

5.11 During the first quarter of 2020, DAS reduced its exposure to Euro denominated assets. This risk mitigating action was effected as a result of the Transferring Policies being fully reinsured from the Initial Transfer Date, although there was a small delay in effecting the change. The figures in the above table do not reflect the impact of this change. As a result of this action the

SCR of DAS decreased, and the SCR coverage ratio correspondingly increased. I have estimated the impact on the SCR coverage ratios as at 31 December 2019 as a result of this change, and estimate the SCR coverage ratio on a No Scheme Basis to increase to 213% (from 206%) and on a Post Scheme basis to increase to 221% (from 214%).

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Section 6: Capital Requirements - ARAG

Introduction

6.1 ARAG has obtained approval from their regulator (BaFin) to set their regulatory capital using a Partial Internal Model which they have developed. This Partial Internal Model uses an internal model for market risk and underwriting risk (primarily non-life underwriting risk). The remaining risks (namely operational risk and counterparty default risk) are set according to the Standard Formula.

6.2 The same approach will be used for the regulatory capital requirements for ARAG after the Proposed Scheme. Given the size of the Transferring Business, the inclusion of this business results in a “minor model change”. As such the Partial Internal Model can be updated to include the Transferring Business without any further approval required from BaFin.

6.3 In this section I consider the impact of the Proposed Scheme on the security of ARAG.

6.4 As noted in paragraph 4.2, due to the low materiality of the Transferring Business when compared to the ARAG’s overall capital requirements, the figures included in this section have not been adjusted to allow for the impact of the Proposed Scheme.

Appropriateness of the capital requirements

6.5 In my Scheme Report I set out how I had considered ARAG’s approach to calculating its regulatory capital requirements through a review of the key documents which I had been provided with, together with consideration of further information I had been provided on the detail of the model and responses to queries I had raised.

6.6 As a result, I concluded that, while I had not attempted to review the calculations performed in detail, I considered ARAG’s approach to calculating its’ regulatory capital requirements using its Partial Internal Model to be reasonable and proportionate to the scale and complexity of its operations and I had not identified any reasons to believe that the calculated SCR materially understates or overstates the regulatory capital of ARAG.

6.7 For this Supplementary Report, I have not changed my opinion that ARAG’s approach to calculating its’ regulatory capital requirements using its Partial Internal Model is reasonable and proportionate to the scale and complexity of its operations and I have not identified any reasons to believe that the calculated SCR materially understates or overstates the regulatory capital of ARAG. This conclusion is based on the following considerations which supplement the approaches described in my Scheme Report:

- I have reviewed the changes in the SCR during 2019. These are consistent with my expectations and my understanding of the model.

- I have reviewed the independent validation report for the Partial Internal Model as at Q4 2018 (and dated 22 April 2020).

Impact of the Proposed Scheme on capital requirements

6.8 The table below shows the Partial Internal Model SCR results before the application of the Proposed Scheme.

6.9 ARAG’s Partial Internal Model includes allowance for the risks, including longevity risk, arising from ARAG’s annuity business which arises primarily from income protection policies. Longevity risk is the risk that the annuitants live longer on average than anticipated, resulting in an increase in the liabilities of ARAG. However, in accordance with the requirements of Solvency II, the longevity risk arising from ARAG's employee defined benefit pension plan is not allowed for within the Partial Internal Model. I consider the impact of this through undertaking some scenarios in Section 8 of this Scheme Report.

Table 6.1: ARAG SCR – No Scheme basis

All in £000's **Risk**	**Figures as at 31 Dec 2018** *(Table 11.1 from Scheme Report)*	**Figures as at 31 Dec 2019**
Premium and reserve risk	*13,841*	13,145
Lapse risk	*1,035*	933
Man-Made Catastrophe risk	*1,412*	1,326
Natural Catastrophe risk	*8,682*	8,813
Total non-life underwriting risk	17,812	17,145
Total health underwriting risk	n/a	n/a
Total life underwriting risk	n/a	n/a
Market risk	53,662	66,054
Counterparty default risk	3,846	2,880
Diversification	(13,181)	(12,757)
Basic SCR	**62,140**	**73,322**
Operational risk	4,975	4,769
Loss-absorbing capacity of deferred taxes	0	
Total SCR	**67,115**	**78,090**
Solvency II Own Funds	**186,591**	**211,157**
Solvency II coverage ratio	**278%**	**270%**

6.10 The primary risk for ARAG is market risk, which is largely driven by equity risk. Market risk has increased since 31 December 2018, which is consistent with the increase seen in the value of investments on the Solvency II balance sheet, as shown in Table 4.2. In addition, the SCR has increased over the year as a result of a change to the calibration of the spread risk module (which is part of market risk) within the Partial Internal Model.

6.11 The Solvency II Own Funds have also increased during 2019, although overall the SCR coverage ratio has marginally fallen from 278% to 270% over the period.

Section 7: Projections - DAS

Introduction

7.1 In this Section, I have considered the impact of the Proposed Scheme on DAS's UK GAAP Shareholders' Funds, Solvency II Own Funds and SCR coverage ratios over the period 2020 to 2023.

7.2 I have also considered the likelihood of DAS being able to meet its liabilities over the full period during which claims in respect of the insured policies will be paid.

DAS balance sheet projection

7.3 The shareholders' funds for DAS are expected to increase in future periods, in a similar pattern to the projections which were provided for my Scheme Report.

7.4 The projections I have reviewed (on both a UK GAAP and Solvency II basis) do not allow for any capital extraction or distribution to shareholders. No such capital extractions or distributions have been made by DAS in the last 5 years.

7.5 The projections also make no allowance for any further recoveries which may be received in connection with the legal action discussed in paragraph 3.3, given the uncertainty regarding the amount and timing of any such recoveries.

7.6 The premium associated with the Transferring Business is immaterial in comparison to the overall size of DAS's annual revenue. As a result, I do not anticipate that the Proposed Scheme will materially concentrate any existing risks for the Remaining Policyholders, and in particular, I do not expect it to significantly affect DAS's profitability in future years.

Projected SCR coverage ratios

7.7 The projected SCR coverage ratios for DAS are projected to initially increase and then stay largely constant in the future, regardless of whether or not the Proposed Scheme takes place. The initial increase in the SCR coverage ratio is driven by a reduction in the SCR as a result of a reduction in currency risk. This is driven by DAS reducing its exposure to Euro denominated assets during the first quarter of 2020, which was effected subsequent to the Initial Transfer Date when the Transferring Policies were fully reinsured. Subsequently, the SCR is projected to increase resulting in the SCR coverage ratio remaining largely flat due to increases in the projected Solvency II Own Funds over the same period.

Ultimate capital

7.8 Given the short tail nature of DAS's business, the ultimate capital (being the capital required to protect an insurer's balance sheet over the full period during which claims in respect of insured policies will be paid) is likely to be only marginally higher than the SCR on a Solvency II basis (which considers the capital required to protect an insurer's balance sheet over a one-year period). In particular, I note that around 80% of claims arising from DAS's existing business are likely to be paid within three years and a significant proportion are expected to be paid in the first year. I therefore consider that the majority of the volatility surrounding DAS's balance sheet will emerge over the first year in which DAS's liabilities will be paid, and therefore consider that an allowance for additional volatility following this period will not result in a requirement for significant additional capital.

7.9 I also note the following:

- Some allowance for the volatility surrounding an insurer's balance sheet after the first year in which liabilities will be paid is incorporated into Solvency II requirements via the risk margin, which is calculated as part of the technical provisions. The inclusion of this risk margin on the Solvency II balance sheet provides some additional protection to policyholders.

- The work undertaken by DAS using the internal model for the ERGO group calculates the one-year SCR for DAS to be significantly lower than the one-year SCR based on the Standard Formula. Given the relatively fast emergence of DAS's risk profile which is indicated by the short-tailed nature of its business, I would therefore expect the economic capital on an ultimate basis (calculated using the ERGO group internal model) to be lower than the SCR on a Solvency II basis.

Section 8: Projections and Scenarios - ARAG

Introduction

8.1 In this Section, I have considered the impact of the Proposed Scheme on ARAG's GAAP Shareholders' Funds, Solvency II Own Funds and SCR coverage ratios over the period 2020 to 2022. I have also considered the impact of different scenarios on ARAG's Solvency II Own Funds and SCR coverage ratios, and the likelihood of ARAG being able to meet its liabilities over the full period during which claims in respect of the insured policies will be paid.

ARAG balance sheet projection

8.2 The shareholders' funds for ARAG are expected to remain flat in future periods. This is due to the profit and loss transfer agreement entered into with ARAG SE, under which ARAG are required to transfer the full sum of its profit for the year (on a German GAAP basis) to its parent company. Since no capital injections are planned, this results in no change in shareholders' funds on a German GAAP basis.

8.3 I note that the premium associated with the Transferring Business is immaterial in comparison to the overall size of ARAG's annual revenue. As a result, I do not anticipate that the Proposed Scheme will introduce any new risks to the Existing Policyholders, and in particular, I do not expect it to significantly affect ARAG's profitability in future years.

Projected SCR coverage ratios

8.4 The projected SCR coverage ratios for ARAG are forecast to increase in each future year, regardless of whether the Proposed Scheme takes place. The profit and loss transfer agreement entered into with ARAG SE is determined on a German GAAP basis, which is based on significantly higher reserves when compared to a Solvency II basis. As a result, the projected profit associated with normal business activity will emerge more quickly on a Solvency II basis, resulting in a year-on-year increase in Solvency II Own Funds.

Scenarios

ORSA scenarios

8.5 I have considered the impact of the Proposed Scheme on the probability of insolvency for ARAG. Under Solvency II, holding the SCR is intended to ensure that Own Funds are positive over a one-year timeframe with a probability of 99.5%.

8.6 ARAG has included two stress scenarios in its Own Risk and Solvency Assessment ("ORSA") which was produced during 2019 (with an effective date of 30 June 2019). The details and results of these scenarios are as follows:

- The first scenario tries to replicate the impact of a global financial crisis similar to that seen in 2008. This scenario incorporates a sharp decline in stock prices, an increase in credit spreads and a real estate shock. The scenario projects a significant reduction in Solvency II Own Funds of approximately £62m. This loss is lower than the total SCR projected via the Partial Internal Model and corresponds to the 99.7th percentile of the loss distribution of the market risk module included within the Partial Internal Model.

- The second scenario tries to replicate the impact of a recession similar to that seen in 2002, following the 11 September 2001 terrorist attacks. This scenario projects a less significant reduction in Solvency II Own Funds of approximately £23m. This loss is significantly lower than the total SCR projected via the Partial Internal Model and corresponds to approximately the 89.5th percentile of the loss distribution of the market risk module included with the Partial Internal Model.

8.7 The results of the scenarios provide an understanding of the robustness of the capital position of ARAG under different scenarios. Under the more extreme of the two scenarios, the SCR coverage ratio for ARAG (assuming that the scenario does not impact the SCR) would reduce to 191%, demonstrating that ARAG could continue to meet its regulatory capital requirements even after such a scenario. This reduced coverage ratio of 191% is below the coverage ratio of DAS of 206%, although not materially so and this comparison is on the basis that DAS is not impacted by any adverse scenarios and DAS could also be impacted by such a scenario.

Additional scenarios

8.8 In addition to the above scenarios which are included in ARAG's ORSA I have also considered the following further scenarios, in order to further understand the robustness of the capital position of ARAG.

- A deterioration of 5% of the gross Solvency II Technical Provisions. This would result in a reduction of Solvency II Own Funds of £7.1 million (compared with the Solvency II Own Funds of £211 million, as shown in Table 4.2) and a SCR coverage ratio of 261%.

- A deterioration of 10% of the gross Solvency II Technical Provisions. This would result in a reduction of Solvency II Own Funds of £14.2 million (compared with the Solvency II Own Funds of £211 million, as shown in Table 4.2) and a SCR coverage ratio of 252%.

- An instantaneous decrease of 20% in the mortality rates used to value the annuity business of ARAG (as described in paragraph 9.44). This would result in a reduction of Solvency II Own Funds of £2.3 million (compared with the Solvency II Own Funds of £211 million, as shown in Table 4.2) and a SCR coverage ratio of 267%.

8.9 The above scenarios therefore demonstrate that ARAG would be able to continue to meet its regulatory capital requirements after each of the above scenarios has materialised. All three of the scenarios result in reduced coverage ratios which remain above the coverage ratio of DAS of 206%.

8.10 I have also considered the impact of an instantaneous decrease of 20% in the mortality rates used to value the defined benefit pension scheme provided for the employees of ARAG. Based on the information provided to me regarding the key details of the pension scheme, I have estimated that this would result in a reduction of Solvency II Own Funds of £3.2 million (compared with the Solvency II Own Funds of £211 million, as shown in Table 4.2) and a SCR coverage ratio of 266%.

8.11 In accordance with the requirements of Solvency II, the longevity risk arising from ARAG's employee defined benefit pension scheme is not reflected in the SCR calculated by ARAG's Partial Internal Model (and is similarly also not reflected in the Standard Formula calculation under Solvency II). If I therefore increased ARAG's SCR by the amount of the stress calculated in the previous paragraph, this would result in an SCR of £81.3 million, unchanged Solvency II Own Funds (compared with those shown in Table 4.2) of £211 million and an adjusted SCR coverage ratio of 260%. In my opinion this adjusted SCR coverage ratio is more reflective of the risks to which ARAG is exposed, although I note that it is conservative as I have not allowed for any diversification between the pension scheme longevity risk and the other risks to which ARAG is exposed. This adjusted SCR coverage ratios remains above the coverage ratio of DAS of 206%.

Ultimate capital

8.12 The regulatory capital under Solvency II represents the amount of capital that insurers are required to hold to protect their balance sheet over a one-year period. When considering policyholder security, it is also important to consider whether an insurer will have sufficient assets to meet its liabilities over the full period during which the claims in respect of the insured policies will be paid (the "ultimate capital").

8.13 Given the immaterial impact of the Proposed Scheme on ARAG's financial position, it is my opinion that the Proposed Scheme will have a negligible impact on the ultimate capital required by ARAG. Therefore I consider that the security of the Existing Policyholders will not be materially adversely affected by the Proposed Scheme on both a one-year Solvency II basis and on an ultimate basis.

8.14 With regards to the Transferring Policyholders, it is my view that the ultimate capital for DAS is likely to be only marginally higher than the SCR on a Solvency II basis, for the reasons discussed in paragraph 7.8.

8.15 I would, however, expect the ultimate capital for ARAG to be higher than the SCR on a Solvency II basis given that ARAG has exposure to risks which may materialise over a longer period, including its' annuity business, the liability business which is written and the pension scheme to which ARAG is exposed.

8.16 However, I note that around 30% of claims arising from the Transferring Policies are likely to be paid within one year, around 70% are likely to be paid within three years and the vast majority (over approximately 90%) are likely to be paid within six years. Considering the risks which may materialise over the period during which the Transferring Policies will be exposed to ARAG, I think a reasonable approximate view of the ultimate capital over this period would be the SCR on Solvency II basis (£78.1 million) but additionally including the impact on Own Funds arising from the scenarios of a 5% deterioration in Technical Provisions (£7.1 million) and an instantaneous increase in mortality rates on the pension scheme liabilities (£3.2 million). This would give an estimated ultimate SCR of £88.4 million and an estimated ultimate SCR coverage ratio of 239%.

8.17 This estimated ultimate SCR coverage for ARAG remains significantly above 100% and is above the one-year SCR coverage ratio of DAS of 206%. I also note the following:

- I have not allowed for any diversification between the deterioration in Technical Provisions, the pension scheme longevity risk and the other risks to which ARAG is exposed, which adds some conservatism to my estimated ultimate SCR coverage ratio for ARAG.
- My estimated ultimate SCR for ARAG makes no allowance for the possibility of a capital injection into ARAG, from ARAG SE, under the profit and loss transfer agreement. My estimated ultimate SCR therefore includes some prudence.
- Some allowance for the volatility surrounding an insurer's balance sheet after the first year in which liabilities will be paid is incorporated into Solvency II requirements via the risk margin, which is calculated as part of the technical provisions. The inclusion of this risk margin on the Solvency II balance sheet, which was £3.8 million for ARAG as at 31 December 2019, is not allowed for in my analysis above and provides some additional protection to policyholders. If I were to increase the Own Funds by this amount, then the estimated ultimate SCR coverage ratio for ARAG would become 243%.

8.18 It is therefore my view that the Transferring Policyholders will not be materially adversely affected by the Proposed Scheme on both a one-year Solvency II basis and on an ultimate basis.

8.19 My considerations above are based on the SCR coverage ratios for DAS as at 31 December 2019 on a No Scheme basis as set in Table 5.1 of this Supplementary Report. I note that my conclusion that the Transferring Policyholders will not be materially adversely affected by the Proposed Scheme on both a one-year Solvency II basis and on an ultimate basis would remain unchanged had I based my consideration on the SCR coverage ratios for DAS on a No Scheme basis but additionally allowing for the reduction to currency exposure effected by DAS during the first quarter of 2020 (as quantified in paragraph 5.11 of the Supplementary Report).

Section 9: Other Financial Considerations

Introduction

9.1 In this section, I discuss other financial considerations arising from the Proposed Scheme. I have focussed on those aspects where I am aware that there have been developments since my Scheme Report.

COVID-19

9.2 Subsequent to 31 December 2019, it has become evident that COVID-19[1], an issue which developed rapidly and which continues to develop, is likely to have significant short-term effects on global economic activity and create extensive social disruption. Longer term socio-economic implications and the impact on the assets and liabilities of insurance companies remain uncertain.

9.3 This Supplementary Report is based on financial information as at 31 December 2019 (except where explicitly stated otherwise) and therefore the financial information on which this Supplementary Report is based makes no explicit allowance for the effects of COVID-19. In this section I consider the impact of COVID-19 on my conclusions – firstly due to operational impacts and secondly as a result of the financial impacts of the pandemic. I consider the impact on the communication of the Proposed Scheme (including the ability of potentially affected parties to make representations to the Court in writing or in person) in Section 10 of this Supplementary Report.

Operational impacts

9.4 The Remaining Policyholders will be insured by DAS both before and after the Proposed Scheme and the Existing Policyholders will be insured by ARAG both before and after the Proposed Scheme. There will be no change to the claims handling and administration of the Remaining Policies or the Existing Policies as a result of the Proposed Scheme.

9.5 In respect of the operational impacts of COVID-19, I therefore consider that whether or not the Proposed Scheme proceeds would have no impact on either the Remaining Policyholders or the Existing Policyholders.

9.6 The Transferring Policyholders will be insured by DAS before the Proposed Scheme and by ARAG after the Proposed Scheme. However, ARAG currently undertakes the administration and claims handling for the Transferring Policies on behalf of DAS, using staff employed by an Irish ARAG group company or by external lawyers contracted by the ARAG Branch. As set out in paragraphs 16.15 to 16.19 of my Scheme Report, I consider that the current policy administration and claims handling practices will remain unchanged for the Transferring Policies after the Proposed Scheme. As a result, the administration and claims handling of the Transferring Policies will be materially unaffected by the Proposed Scheme and will be undertaken by the same individuals, and in line with the same policies and procedures, both before and after the Proposed Scheme.

9.7 There have been some minor operational impacts of COVID-19 in respect of the administration and claims handling of the Transferring Policies. However, I note that there has been no material change in the service levels provided to the Transferring Policyholders as a result of COVID-19 and, as noted above, the administration and claims handling of the Transferring Policies will be materially unaffected by the Proposed Scheme.

[1] The coronavirus outbreak named as COVID–19 by the World Health Organisation on 11 February 2020.

9.8 In respect of the operational impacts of COVID-19, I therefore consider that whether or not the Proposed Scheme proceeds would also have no impact on the Transferring Policyholders.

9.9 In addition, I note that there are no operational impacts of COVID-19 which will impact the ability of either DAS or ARAG to effect the Proposed Scheme.

Financial impacts - DAS

9.10 The implications of COVID-19 were treated as a non-adjusting event after the reporting date by DAS as at 31 December 2019 and there were no implications on the timing of financial and regulatory reporting, including the provisions of the regular audit opinions, as a result of COVID-19.

9.11 In connection with its year-end accounts (and to support the appropriateness of using a going concern basis for the accounts), DAS conducted an assessment of the possible impact of COVID-19 on its ability to continue as a going concern. This assessment included:

- A consideration of the main threats posed by the pandemic to business continuity and the measures implemented to mitigate these.
- Stress-testing of potential ‘extreme’ adverse scenarios that could potentially arise due to COVID-19. ‘Extreme’ adverse scenarios for different aspects of the business were modelled, and the combined impact on DAS’s solvency position of all of these extreme but unlikely scenarios occurring in combination was assessed.

9.12 Whilst it still remains unclear how COVID-19 will develop, this assessment suggests that even in the unlikely event that DAS suffers an ‘extreme’ adverse impact on different aspects of its business simultaneously, it would be expected to remain solvent during the projection period, up to the end of 2022. Under these extreme scenarios the SCR coverage ratio of DAS reduces from 234% (projected as at 31 December 2020) but is estimated to remain above DAS’s capital risk appetite level of 140%.

9.13 The negative impacts of COVID-19 on the premium and claims of DAS, if they arise, might arise from the following:

- Second order claims linked to the implications of COVID-19, for example arising as a result of public, corporate and government responses to COVID-19.
- An increase in claims and / or a reduction in premium income as a result of the impact of the recession which is widely expected to arise as a result of COVID-19.

9.14 DAS has already received some claims of this nature and further potential claims, if they materialise, are likely to emerge over the coming months.

9.15 Subsequent to the year-end, DAS has continued to monitor the impacts of COVID-19 and has undertaken some further scenario testing. These included considering scenarios under alternative recessionary impacts, including a short, sharp recession and a longer and generally stronger recession.

9.16 As part of this scenario testing a proportion of the ‘extreme’ adverse impacts on different aspects of its business (as discussed above), rather than allowing for each adverse impact in full, was taken and hence the more recent scenario testing has resulted in a less extreme impact on DAS’s SCR coverage ratio.

9.17 The Remaining Policyholders will be insured by DAS both before and after the Proposed Scheme. The Proposed Scheme is expected to have an immaterial impact on the financial position of DAS – particularly in the context of the uncertainty arising from COVID-19.

9.18 In respect of the financial impacts of COVID-19, I therefore consider that the Remaining Policyholders will not be materially adversely affected by the Proposed Scheme.

Financial impacts - ARAG

9.19 The implications of COVID-19 were treated as a non-adjusting event after the reporting date by ARAG as at 31 December 2019 and there were no implications on the timing of financial and regulatory reporting, including the provisions of the regular audit opinions, as a result of COVID-19.

9.20 ARAG considers that the majority of exposure it has which is linked to COVID-19 is likely to arise in the following areas:

- The impact on the investment markets as a result of COVID-19;
- A reduction in new business (the main impact of which is expected to be seen during 2020);
- An increase in the number of cancellations (potentially throughout 2020 and 2021);
- A slight increase in bad debt losses (again, throughout 2020 and 2021); and
- An increase in claims costs (estimated to only be material in 2020).

9.21 In ARAG's view the impact on investment markets is likely to have been most extreme as at Q1 2020. I have been provided with ARAG's Solvency II balance sheet at this date, which shows a reduction in the market value of investments of £16 million compared with the figure as at 31 December 2019.

9.22 ARAG has estimated the negative impact of COVID-19 on the net underwriting result for 2020, compared to their business plan figures which were set before COVID-19 became a known issue. Although ARAG expect to see a fall in their annual result for 2020 (compared to the previous year and their business plan) they expect to see a corresponding recovery in 2021. The impact to the 2020 net underwriting result is driven by two factors:

- The impact of COVID-19 resulting in an expected reduction in new business, increase in policy cancellations and increase in bad debt losses, somewhat offset by a reduction in costs such as travel and training expenditure.
- Exposure to claims arising from business interruption insurance. Whether or not business interruption insurance provides cover for claims which arise as a result of the COVID-19 pandemic is currently under dispute throughout the global insurance market. As a gesture of goodwill, ARAG is currently offering to pay claimants a proportion of the maximum business interruption coverage provided. To date around 35% of the reported claims have accepted this goodwill gesture and when assessing the impact to the 2020 net underwriting result ARAG has assumed that most of the claimants with business interruption insurance will similarly accept this approach, although ARAG has allowed for a prudency buffer in its calculation.

9.23 Combining the impacts on ARAG from COVID-19 both from the investment markets and the estimated impact on the net underwriting result for 2020 results in a small reduction in the SCR coverage ratio for ARAG.

9.24 I have also considered a more extreme scenario combining the following two stresses:

- The impact of a global financial crisis similar to that seen in 2008, in order to replicate the potential impact of COVID-19 as a result of the recessionary effect of the pandemic. This scenario is set out in ARAG's 2019 ORSA and incorporates a sharp decline in stock prices, an increase in credit spreads and a real estate shock. The scenario projects a significant reduction in Solvency II Own Funds of approximately £62 million.

- An impact arising from the negative impact of COVID-19 on the net underwriting result for 2020 of twice the impact estimated by ARAG. By doubling the impact estimated by ARAG I am effectively assuming:
  - Twice the negative impact of COVID-19 on the net underwriting result arising from the first of the two factors described in paragraph 9.22; and
  - An extreme worst-case scenario arising from business interruption insurance, whereby no further claimants accept the goodwill gesture discussed in paragraph 9.22 above and all such claims are decided in favour of the policyholder, with their loss of profit claim being equal to the maximum insurance coverage provided by ARAG.

9.25 This more extreme scenario – and one which I feel is more comparable to the most extreme scenario produced by DAS – results in a significant reduction in the SCR coverage ratio for ARAG although it is estimated to remain above 150%, and also remain above the SCR coverage ratio of DAS under the extreme scenario discussed in paragraphs 9.11 and 9.12 above.

9.26 The Existing Policyholders will be insured by ARAG both before and after the Proposed Scheme. The Proposed Scheme is expected to have an immaterial impact on the financial position of ARAG – particularly in the context of the uncertainty arising from COVID-19.

9.27 In respect of the financial impacts of COVID-19, I therefore consider that the Existing Policyholders will not be materially adversely affected by the Proposed Scheme.

9.28 The Transferring Policyholders will be insured by DAS before the Proposed Scheme and by ARAG after the Proposed Scheme. Based on my understanding of the exposures of both companies which are quantified in the scenarios set out above, I consider that the impact of COVID-19 on both companies is likely to be materially comparable. In particular, in respect of the most extreme scenarios set out above both companies are estimated to see a significant reduction in their SCR coverage ratio, although the SCR coverage ratio is estimated to remain above 140% for both companies, with the SCR coverage ratio of ARAG remaining above that of DAS.

9.29 As noted in Section 8 of this Supplementary Report, with regards to the Transferring Policyholders, it is my view that the ultimate capital for DAS is likely to be only marginally higher than the SCR on a Solvency II basis. I would, however, expect the ultimate capital for ARAG to be higher than the SCR on a Solvency II basis given that ARAG has exposure to risks which may materialise over a longer period, including its' annuity business, the liability business which is written and the pension scheme to which ARAG is exposed.

9.30 If I take the more extreme scenario I have considered for ARAG (as described in paragraph 9.24 above) but additionally increase the SCR to given an estimated ultimate SCR (as described in paragraph 8.16 of this Supplementary Report) this would give an estimated ultimate SCR coverage ratio which is materially comparable with the SCR coverage ratio for DAS under the most extreme scenario (as considered in paragraphs 9.11 and 9.12 above).

9.31 In respect of the financial impacts of COVID-19, I therefore consider that the Transferring Policyholders will not be materially adversely affected by the Proposed Scheme.

Financial impacts - Conclusions

9.32 In respect of the operational impacts of COVID-19, for the reasons set out above I consider that whether or not the Proposed Scheme proceeds would have no impact on either the Remaining Policyholders, the Transferring Policyholders or the Existing Policyholders.

9.33 In respect of the financial impacts of COVID-19, for the reasons set out above I consider that the Remaining Policyholders, the Transferring Policyholders and the Existing Policyholders will not be materially adversely affected by the Proposed Scheme.

Access to compensation schemes

9.34 In my Scheme Report (starting from paragraph 15.26) I considered the impact of the Proposed Scheme on access to compensation schemes. In summary I concluded that:

- Remaining Policyholders which are currently entitled to FSCS protection will continue to be entitled to FSCS protection irrespective of whether or not the Proposed Scheme proceeds. The Proposed Scheme has no impact on the access to compensation schemes for the Remaining Policyholders.
- There are no arrangements in Germany equivalent to the FSCS. The Proposed Scheme has no impact on the access to compensation schemes for the Existing Policyholders.
- Transferring Policyholders which are not currently entitled to FSCS protection (“non-FSCS Transferring Policyholders”) will not be entitled to FSCS protection irrespective of whether or not the Proposed Scheme proceeds. The non-FSCS Transferring Policyholders include those Transferring Policyholders in respect of inwards reinsurance business. The Proposed Scheme therefore has no impact on the access to compensation schemes for the non-FSCS Transferring Policyholders.
- Transferring Policyholders which are currently entitled to FSCS protection (“FSCS Transferring Policyholders”) will continue to benefit from FSCS protection after the Effective Date until the expiry of their policy under the PRA’s rules for as long as ARAG maintains an authorised branch in the UK. In the event of ARAG ceasing to be authorised in the UK, FSCS Transferring Policyholders will no longer be covered by FSCS protection but should continue to be covered by the Irish Compensation Fund, although there is an extremely remote risk that cover from the Irish Compensation Fund may not be available (as discussed in paragraph 15.39 of my Scheme Report). For the reasons discussed in my Scheme Report, it is my opinion that the FSCS Transferring Policyholders will not be materially adversely affected by the potential loss of FSCS protection as a result of the Proposed Scheme.

9.35 I am not aware of any developments in relation to the access to compensation schemes compared with the situation on which my Scheme Report was based, and therefore I have not changed my conclusions in respect of the impact of the Proposed Scheme on access to compensation schemes, as summarised above.

Pension schemes

Pension schemes - DAS

9.36 DAS UK Holdings Limited (the immediate holding company of DAS) operates several defined contribution pension schemes and one defined benefit scheme for its UK employees. These pension schemes are sponsored by the intragroup service company, DAS Services Limited (which is also wholly owned by DAS UK Holdings Limited), and appear on the balance sheet of this company. As a result, no pension liabilities sit on the balance sheet of DAS.

Pension schemes - ARAG

9.37 ARAG has a defined benefit pension scheme which all regular employees of the company can benefit from, subject to specific requirements around service time. As of 31 December 2019, the total pension liabilities for ARAG were £35.0 million on a Solvency II basis.

9.38 An allowance for the potential deterioration of these pension liabilities due to market risk at the 99.5th level over a one-year time horizon is included in the SCR, as calculated by the Partial Internal Model. The only applicable stress arising from market risk is due to interest rate fluctuations.

9.39 In addition, ARAG carries out stress tests around the risk of interest rates changing on a quarterly basis. In the exercise as at 31 December 2019, it was found the most extreme stress, which assumed interest rates reduced by 100 basis points, resulted in a 17% increase in the pension liabilities. Based on the 2019 ARAG Solvency II balance sheet, a 380% increase in pension liabilities would be required in order for ARAG to have insufficient funds to cover the SCR.

9.40 I have considered the impact on the Transferring Policyholders of the longevity risk arising from ARAG's defined benefit pension scheme in Section 8 of this Scheme Report.

Conclusions

9.41 The impact of any pension schemes is therefore unchanged for both the Remaining Policyholders and Existing Policyholders.

9.42 For the Transferring Policyholders the impact of the ARAG pension scheme on market risk is incorporated within the ARAG Partial Internal Model in accordance with the requirements of Solvency II and I have additionally considered the impact of longevity risk arising from the pension scheme in Section 8 of this Scheme Report. Given my comments elsewhere in this Scheme Report I therefore consider that the impact of the ARAG employee defined benefit pension scheme does not affect the security of policyholders' contractual rights for the Transferring Policyholders.

Annuity business

9.43 DAS do not hold any reserves in respect of annuities or claims with annuity characteristics, and do not plan to write business under which such claims may arise in the future.

9.44 On a Solvency II basis, ARAG held £36.4 million of net reserves in respect of annuities as at 31 December 2019. These reserves arose primarily from income protection policies.

9.45 An allowance for the potential deterioration of these reserves at the 99.5th level over a one-year time horizon is included in the SCR, as calculated by the Partial Internal Model. This model projects a risk of the annuity reserves deteriorating by approximately 1% over the next year due to expense risk and 6% due to longevity risk.

9.46 The impact of any annuity business is unchanged for both the Remaining Policyholders and Existing Policyholders. For the Transferring Policyholders the risks associated with the ARAG annuity business is incorporated within the ARAG Partial Internal Model. Given my comments elsewhere in this Supplementary Report I therefore consider that the impact of such business does not affect the security of policyholders' contractual rights for the Transferring Policyholders.

Section 10: Other Non-Financial Considerations

Introduction

10.1 In this section, I discuss other non-financial considerations arising from the Proposed Scheme. I have only addressed those aspects where I am aware that there have been developments since my Scheme Report.

Ombudsman services

10.2 In my Scheme Report (in paragraphs 16.28 to 16.33) I considered the impact of the Proposed Scheme on access to ombudsman services. In summary I concluded that:

- There will be no change in relation to the access to ombudsman services for the Remaining Policies or the Existing Policies as a result of the Proposed Scheme.
- Complaints against a financial services firm in Ireland can be made through the Financial Services and Pensions Ombudsman ("FSPO"), which deals with unresolved complaints from consumers about their individual dealings with all financial services providers.
- Access to the FSPO which is currently available to Transferring Policyholders will continue to be available after the Proposed Scheme.

10.3 I therefore concluded that the Proposed Scheme will have no impact on access to ombudsman services for the Remaining Policyholders, the Transferring Policyholders or the Existing Policyholders.

10.4 I did not refer to the Financial Ombudsman Service ("FOS") in the UK and (as requested by the FCA in their report provided to the Court at the Directions Hearing) now consider the access which the Transferring Policyholders have to the FOS before and after the Proposed Scheme.

10.5 After the Proposed Scheme, the Transferring Policyholders will not have access to the FOS.

10.6 Before the Proposed Scheme, access to the FOS would have been available to the Transferring Policyholders if DAS in the UK had been involved in the administration (including claims handling) of the Transferring Policies. However, all policy administration and claims handling in relation to the Transferring Policies was handled by the DAS Branch in Ireland with DAS in the UK only becoming involved with the Transferring Policies in a very limited number of situations, as follows:

- Higher value claims would be reported to DAS in the UK if it might be necessary to notify reinsurers;
- DAS in the UK would be notified if there was an issue which involved a business partner and the relationship with that business partner was managed by DAS in the UK;
- Reports on claims were generated and reviewed by DAS in the UK as part of the performance reviews; and
- DAS in the UK would be called upon to assist with claims involving a dispute or legal proceedings following an accident in the UK (which may arise because some of the

Transferring Policies include cover for Irish policyholders while they are travelling in the UK), although the claim would continue to be handled by the Irish Branch.

10.7 Given the limited involvement of DAS in the UK, it is highly unlikely that any Transferring Policyholder would seek to refer a complaint to the FOS in the UK and, if for some reason a Transferring Policyholder did so, it is likely that the FOS would decline jurisdiction and refer the complainant to the Irish FSPO.

10.8 It is my view, therefore, that:

- The Transferring Policyholders will have access to the FPSO before and after the Proposed Scheme.
- The Transferring Policyholders will not have access to the FOS after the Proposed Scheme and the likelihood of the Transferring Policyholders successfully accessing the FOS before the Proposed Scheme is remote.

10.9 In addition, even on the assumption that a Transferring Policyholder would have successfully been able to access the FOS in the absence of the Proposed Scheme, and after the Proposed Scheme will only be able to the FSPO, I note that, in relation to the Transferring Policies, both the FOS and FPSO are free services and are largely equivalent in terms of scope and authority to issue binding decisions.

10.10 My conclusions are therefore materially unchanged from the Scheme Report and are as follows:

- I conclude that the Proposed Scheme will have no impact on access to ombudsman services for the Remaining Policyholders or the Existing Policyholders.
- I conclude that the Proposed Scheme will have no materially adverse impact on access to ombudsman services for the Transferring Policyholders.

Policyholder communication

Individual policyholder communication

10.11 As noted in paragraph 16.35 of my Scheme Report, for the purposes of policyholder communication DAS performed a review of its policyholders according to the following categories:

- The Remaining Policyholders of DAS.
- Transferring Policyholders whose policy expired on or before 31 December 2017 (“Dormant Policyholders”).
- Transferring Policyholders who have an open claim with DAS (“Claimant Policyholders”).
- Transferring Policyholders who hold a reinsurance contract with DAS (“Inwards Reinsurance Policyholders”).
- Transferring Policyholders who are not Dormant Policyholders nor Inwards Reinsurance Policyholders (“Live Policyholders”).
- The Existing Policyholders of ARAG.

10.12 In the following paragraphs I comment on whether DAS has satisfied the policyholder notification steps set out in paragraphs 16.34 to 16.56 my Scheme Report.

10.13 Firstly, I note that DAS received a waiver from the requirement to notify the Remaining Policyholders of DAS, the Dormant Policyholders and the Existing Policyholders of ARAG.

10.14 I consider the notification of the Claimant Policyholders, Inwards Reinsurance Policyholders and Live Policyholders in the subsequent paragraphs below.

Claimant Policyholders

10.15 I understand that the notification of the Claimant Policyholders took place as planned and in accordance with the order made by the Court on 7 April 2020 (the "Directions Order").

10.16 DAS holds contact details for the Claimant Policyholders (of which there were 994) and notified each of these policyholders on 27 May 2020 by post.

10.17 As at 10 July 2020, a total of 24 "return to sender" responses had been received in respect of notifications sent to Claimant Policyholders. This amounts to approximately 2.4% of the Claimant Policyholders. I understand that DAS or ARAG have not been able to make contact with these Claimant Policyholders using alternative means of communication, such as email or telephone.

10.18 As a result, the Claimant Policyholders were notified as planned and more than eight weeks in advance of the Sanction Hearing which is scheduled for 28 July 2020. In my opinion the failure rate of 2.4% is within a reasonable threshold.

Inwards Reinsurance Policyholders

10.19 There are four Inwards Reinsurance Policyholders and DAS notified each Inwards Reinsurance Policyholder directly by post on 22 April 2020, in accordance with the Directions Order. All of the notifications sent to these Inwards Reinsurance Policyholders were confirmed as having been received.

Live Policyholders

10.20 Given that neither DAS or ARAG hold contact details for the Live Policyholders, in accordance with the Directions Order a letter was sent to each of the binder counterparties asking them to either:

- Provide contact details of such policyholders so that DAS can notify policyholders directly; or
- Notify the policyholders for whom they have, or have been provided with, contact details by sending a copy of the notifications pack to such policyholders.

10.21 In accordance with the Directions Order all 163 binder counterparties (being third parties to whom DAS has or had granted a delegated binding authority to write business on behalf of the DAS Irish Branch) were initially contacted before 22 April 2020.

10.22 The responses received from the binder counterparties, as at 10 July 2020, are summarised in the table below.

Table 10.1: Responses from the binder counterparties

Response	Number of binder counterparties	Number of Live Policyholders	% of Live Policyholders
Data to be provided to the DAS to notify	4	19,106	6.56%
Willing to notify	5	7,130	2.45%
Still considering	8	25,522	8.77%
No response	132	76,013	26.11%
Unable or unwilling to notify	14	163,308	56.10%
Total	**163**	**291,079**	**100.00%**

10.23 As at 10 July 2020:

- One of the binder counterparties (representing 14,345 Live Policyholders) who had agreed to provide data to allow DAS to notify Live Policyholders directly had provided such data and these Live Policyholders were notified by post on 10 July 2020;
- The other three binder counterparties who had agreed to provide data to allow DAS to notify Live Policyholders directly had not provided such data; and
- None of the binder counterparties who stated they would notify their policyholders have confirmed to either DAS or ARAG that they had done so.

10.24 As the largest 10 binder counterparties represent in excess of 85% of Live Policyholders, DAS has focused its efforts on the binder counterparties who represent the greatest number of policyholders to ensure that the maximum number of policyholders as possible are notified. This has included regular emails and phone calls by ARAG to follow-up with these binder counterparties to obtain their responses.

10.25 14 binder counterparties, representing 46.64% of Live Policyholders, have stated that they are unable or unwilling to notify policyholders. Of those 14 binder counterparties, seven binder counterparties (representing around 6% of Live Policyholders) highlighted capacity constraints whilst handling issues related to COVID-19 as the reason they were unable or unwilling to comply.

10.26 While DAS has satisfied the notification steps set out in my Scheme Report, given the limited number of Live Policyholders who will have been contacted, DAS has considered whether there are steps they are able to take to mitigate the low proportion of Live Policyholders who will have received individual notifications. In particular, DAS has considered the following actions:

- Whether any additional steps can be taken to encourage the binder counterparties to notify their Live Policyholders. However, DAS is of the view that this is unlikely to make a material difference given that significant time and effort, over a number of weeks, has already been spent following up with the binder counterparties with limited success.
- Whether DAS might be able to notify any additional Live Policyholders themselves directly. However, the contact details of the Live Policyholders are only held by the binder counterparties and until such time as a Live Policyholder makes a claim under their policy DAS is unable to directly notify any Live Policyholders itself without the co-operation of the binder counterparties.

- Whether additional advertising might be effective at notifying Live Policyholders, either by repeating the newspaper advertisements already placed (as noted in paragraph 10.29 below) or publishing them in additional publications. However, such additional advertising is unlikely to be effective given the following:

  - A very large number of people will already have been reached by the initial newspaper adverts, given their circulation figures.

  - DAS has not received any enquiries from Live Policyholders who have stated they read about the Proposed Scheme in any of the newspaper adverts.

  - Policyholders may not recognise the names ARAG or DAS as being their legal expenses insurer. Policyholders are likely to regard the binder counterparty as their primary contact and often the legal expenses insurance has been sold as an "add-on" alongside household, motor or other insurance policies.

10.27 The lack of success in notifying the Live Policyholders was not anticipated at the time of my Scheme Report. However, I note that there are a number of mitigating reasons which enable me to reach my conclusion as set out in paragraph 10.28 below regarding DAS's approach to notifying the Live Policyholders. These mitigating reasons are as follows:

- None of the 76 policyholders who have responded to the communications exercise have raised any objections and the majority of such responses relate to ordinary course matters (such as general queries about their policy or the status of an outstanding claim) or ask common questions such as who is DAS / ARAG or why did I receive this letter.

- As the policies renew on an annual basis, the Live Policyholders will be contacted at the point of renewal, and such communication will include details of ARAG as the proposed insurer of the renewal policies. A number of Live Policyholders will have already implicitly acknowledged their comfort with ARAG as their insurer by renewing policies with ARAG in the period since 1 December 2019, when ARAG began writing most new policies.

- One of the binder counterparties has indicated that it is unwilling to notify policyholders of the Proposed Scheme because it believes that an exercise it undertook in December 2019 (on the basis of Irish legal advice it had received) to notify all of its policyholders that ARAG had acquired the business of DAS's Irish Branch should be sufficient. This involved contacting 22,410 policyholders (8,878 by post and 13,532 by email).

  I have seen examples of the letters which were sent by this binder counterparty to policyholders at that time and although the letters did not include the required level of information for a Part VII process the receipt of such a letter is likely to mean that many of these policyholders already believe ARAG is their insurer for their new, current and expired policies. I understand the feedback received by the binder counterparty in relation to this exercise was minimal.

- All policies will continue to be administered by the same Irish staff. In addition, phone numbers and addresses remain unchanged and will not change following the Proposed Scheme. Accordingly, policyholders will not experience any changes to the administration and handling of their arrangements.

- Approximately 60% of the Live Policyholders hold policies which are in respect of 'add-on' insurance to the main insurance product they have taken out with another insurance provider. As a result, it is likely that in many cases the Live Policyholder does not realise who provides the add-on insurance and has not explicitly selected to buy this add-on insurance with DAS or ARAG (as opposed to an alternative insurer).

- Further, I have concluded that in my opinion the Transferring Policyholders will not be materially adversely affected by the Proposed Scheme, although I note that I have not examined the position of each individual policyholder.

10.28 DAS is unable to notify the Live Policyholders directly and has expended considerable time and effort, over a number of weeks, liaising with their binder counterparties with limited success. Given the issues with the notification process, DAS considered whether there were steps they were able to take to mitigate the low proportion of Live Policyholders who will have received individual notifications but such steps are either not possible or unlikely to be successful. Given the difficulties DAS has encountered, and the mitigating reasons set out above, I am satisfied that DAS's approach to communication with the Live Policyholders has been appropriate, reasonable and proportionate.

Wider communication

10.29 I have received confirmation that advertisements were placed in the following publications on either 17 April 2020 or 20 April 2020:

- The London, Belfast and Edinburgh Gazettes;
- The International edition of the Financial Times; and
- The Times, the Sun and the Irish Times.

10.30 In addition, an advertisement was place in the online edition of Iris Oifigiúil on 15 May 2020, following feedback from the CBI. Hard copies of Iris Oifigiúil are not currently available due to COVID-19.

10.31 A full copy of the Scheme Report and the summary of the Scheme Report has been posted on the DAS and ARAG websites.

Conclusions on policyholder communication

10.32 DAS received a waiver from the requirement to notify some policyholders and the notification of the Claimant Policyholders and Inwards Reinsurance Policyholders took place as planned and in accordance with the Directions Order made by the Court. In my opinion the failure rate (covering "return to sender" responses) for the notification of the Claimant Policyholders is within a reasonable threshold.

10.33 While DAS has satisfied the notification steps set out in my Scheme Report, a very limited number of Live Policyholders (expected to be just over 8%) will have been notified of the Proposed Scheme in advance of the Sanction Hearing. DAS is unable to notify the Live Policyholders directly and has expended considerable time and effort, over a number of weeks, liaising with their binder counterparties with limited success. Given the issues with the notification process, DAS considered whether there were steps they were able to take to mitigate the low proportion of Live Policyholders who will have received individual notifications but such steps are either not possible or unlikely to be successful. However, there are a number of mitigating reasons (as listed in paragraph 10.27 above) and taking these into account, together with the difficulties DAS has encountered with the process of notifying the Live Policyholders, I am satisfied that DAS's approach to communication with the Live Policyholders has been appropriate, reasonable and proportionate.

10.34 DAS has placed a number of advertisements in various publications and a full copy and summary of my Scheme Report were posted on the DAS and ARAG websites.

10.35 As set out in paragraph 16.55 of my Scheme Report, I reviewed a draft of the notifications pack to be provided to policyholders and concluded that I was satisfied that the proposed material to be presented to policyholders was appropriate. I understand that no changes were made to the draft notification pack which I reviewed.

10.36 Based on the above, I am satisfied that the material presented to policyholders is appropriate and DAS's approach to communication with policyholders is appropriate, reasonable and proportionate.

Policyholder objections

10.37 I have been provided with regular reports on policyholder communications and summary statistics on responses. This has included details of any objections which have been raised to the Proposed Scheme.

10.38 As at 10 July 2020, 76 responses to the communications exercise have been received. I understand that all responses can be categorised as follows:

- General enquiries relating to the Proposed Scheme (such as to why they had been sent the letter and whether they needed to do anything further);
- General queries related to the current status of policyholders' ongoing claims; and
- General queries relating to business as usual operations (including the policyholder's knowledge of the product and generally queries about the policy itself).

10.39 I have been informed that all of the responses received as a result of the communication exercise have been responded to.

10.40 I have also been informed that, as at 10 July 2020, no objections have been received to the Proposed Scheme.

10.41 There have been some minor operational impacts as a result of COVID-19 in respect of the administration and claims handling of the Transferring Policies. However, given the interim measures which were put in place I do not believe that these minor operational impacts would have affected the ability of policyholders to contact DAS or ARAG or to raise an objection in connection with the Proposed Scheme.

Reinsurer communication

10.42 Other than ARAG, there is only one external reinsurer for whom reinsurance contracts will be transferred under the Proposed Scheme. DAS has engaged directly with this external reinsurer, Mapfre Asistencia Compañia Internacional de Seguros y Reaseguros ("Mapfre"), in relation to the Proposed Scheme and has also sent a formal notice to Mapfre as part of its Part VII communications strategy.

Allocation of outwards reinsurance assets

10.43 The Proposed Scheme will require the High Court to sanction the transfer of two outwards reinsurance assets from DAS to ARAG – one with ARAG and one with Mapfre. I do not believe the possibility that the transfer of these reinsurance assets is not effective raises a material risk to the contractual rights of the Remaining Policyholders, the Transferring Policyholders or the Existing Policyholders for the following reasons:

- The Remaining Policyholders and Existing Policyholders do not benefit from either transferring reinsurance asset, and therefore will not be affected by the transfer of the reinsurance assets;

- For the reasons set out in paragraph 16.70 of my Scheme Report, I do not consider that the ineffectiveness of the transfer of the reinsurance contract with ARAG will have any impact on the Transferring Policies; and

- Reinsurance assets in relation to the 100% quota share which covers all motor breakdown business written by the DAS Irish Branch, provided by Mapfre, is intended to be transferred under the Proposed Scheme. This reinsurance contract currently has £13k of reserves associated with it, representing less than 0.1% of ARAG's actuarial reserves on a net of reinsurance basis as at 31 December 2019. Due to the immaterial size of the future reinsurance recoveries expected under this contract compared to ARAG's overall reserve estimates, I do not consider that ineffectiveness of the transfer of this contract will have any material impact on the Transferring Policyholders.

Section 11: Conclusions

Introduction

11.1 In my Scheme Report dated 1 April 2020 I considered the likely effects of the Proposed Scheme on the Remaining Policyholders, the Transferring Policyholders and the Existing Policyholders. In each case, I considered the likely effects of the Proposed Scheme on the security of policyholders' contractual rights. I also considered the likely effects of the Proposed Scheme on the other factors which may impact security or service levels to the affected policyholders.

11.2 I also considered the likely effects of the Proposed Scheme on reinsurers whose contracts of reinsurance are to be transferred by the Proposed Scheme.

11.3 In this Supplementary Report I have considered whether any of the conclusions set out in my Scheme Report have changed in light of the availability of updated financial information and any material issues that have arisen since the dates noted in paragraph 1.11.

Summary

11.4 As set out below, my opinions on the Proposed Scheme are unchanged from those set out in my Scheme Report, which are as follows:

- It is my opinion that the Remaining Policyholders will not be materially adversely affected by the Proposed Scheme.
- It is my opinion that the Transferring Policyholders will not be materially adversely affected by the Proposed Scheme.
- It is my opinion that the Existing Policyholders will not be materially adversely affected by the Proposed Scheme.

Security of policyholders remaining within DAS

11.5 It is my opinion that the Remaining Policyholders will not be materially adversely affected by the Proposed Scheme.

11.6 The Remaining Policyholders currently have policies with DAS, a company whose level of Solvency II Own Funds exceed the Solvency II Solvency Capital Requirement.

11.7 After the Proposed Scheme, the Remaining Policyholders will continue to have policies with DAS. The Transferring Policies represent just over 2% of DAS's gross claims reserves and UPR. As the Transferring Policies are already fully reinsured by ARAG, the Proposed Scheme has no impact on the shareholders' funds of DAS on a UK GAAP basis and an immaterial impact on the Solvency II Own Funds of DAS.

11.8 As a result of the Proposed Scheme, the SCR coverage ratio for DAS is estimated to increase from 206% to 214%. These SCR coverage ratios are as at 31 December 2019 but additionally reflect the amendments to the Standard Formula which did not come into effect until 1 January 2020.

11.9 During the first quarter of 2020, DAS reduced its exposure to Euro denominated assets, resulting in a decrease in the SCR of DAS and an increase in the SCR coverage ratio. I have estimated the impact on the SCR coverage ratios as at 31 December 2019 as a result of this change. Based on my figures, the SCR coverage ratio for DAS is estimated to increase from

213% to 221% as a result of the Proposed Scheme if I additionally allow for the reduction in exposure to Euro denominated assets implemented by DAS in Q1 2020.

11.10 Future projected SCR coverage ratios over the period 2020 to 2023 are all expected to be marginally higher as a result of the Proposed Scheme.

11.11 The Proposed Scheme is therefore expected to have a positive, but largely immaterial, impact on the SCR coverage ratios for DAS, and consequently I consider that the security of the Remaining Policyholders will not be materially adversely affected by the Proposed Scheme.

Security of policyholders transferring from DAS to ARAG

11.12 It is my opinion that the Transferring Policyholders will not be materially adversely affected by the Proposed Scheme.

11.13 The Transferring Policyholders currently have policies with DAS and after the Proposed Scheme the Transferring Policyholders will have policies with ARAG. As a result, the Transferring Policyholders are moving from a company with Solvency II Own Funds of approximately £36 million and an SCR coverage ratio of 206% to a company with Solvency II Own Funds of approximately £211 million and an SCR coverage ratio of 270%.

11.14 ARAG has exposure to an employee defined benefit pension scheme and, in accordance with the requirements of Solvency II, the longevity risk of this scheme is not reflected in the SCR calculated by ARAG. If ARAG's SCR is adjusted to incorporate a longevity stress then the resulting adjusted SCR coverage ratio would decrease to 260%. In my opinion this SCR coverage ratio is more reflective of the risks to which ARAG is exposed, although I note that it is conservative as I have not allowed for any diversification between the pension scheme longevity risk and the other risks to which ARAG is exposed. This adjusted SCR coverage ratios remains above the coverage ratio of DAS of 206%.

11.15 I have also considered an estimated ultimate SCR for ARAG, which considers the full period during which the claims in respect of the Transferring Policies will be paid rather than the one-year view of Solvency II. I think a reasonable approximate view of the ultimate SCR coverage ratio for ARAG is 239%. This remains significantly above 100% and is also above the one-year SCR coverage ratio of DAS of 206%. In addition, my estimated ultimate SCR coverage ratio for ARAG includes some prudence.

11.16 The Transferring Policyholders are therefore moving to a company which is better capitalised and with a higher SCR coverage ratio on both a one-year basis and estimated ultimate basis. This is the case if I consider the SCR ratios of DAS as at 31 December 2019 but also reflecting the amendments to the Standard Formula which did not come into effect until 1 January 2020, as set out above, and also if I consider the SCR coverage ratios for DAS additionally allowing for the reduction to currency exposure effected by DAS during the first quarter of 2020.

11.17 In addition, the SCR coverage ratios for ARAG are higher than the corresponding SCR coverage ratios for DAS in all of the projections to 2022.

11.18 As such, I consider that the security of the Transferring Policyholders' contractual rights is not materially disadvantaged by the Proposed Scheme.

Security of existing policyholders of ARAG

11.19 It is my opinion that the Existing Policyholders will not be materially adversely affected by the Proposed Scheme.

11.20 The Remaining Policyholders currently have policies with ARAG, a company whose level of Solvency II Own Funds exceed the Solvency II Solvency Capital Requirement.

11.21 The SCR coverage ratio for ARAG on a No Scheme basis is 270%. Given the immaterial impact of the Proposed Scheme on the DAS SCR coverage ratio, and the higher Solvency II Own Funds of ARAG, the Proposed Scheme is expected to have a negligible impact on the ARAG SCR coverage ratio.

11.22 As such, I consider that the security of the Existing Policyholders' contractual rights is not materially disadvantaged by the Proposed Scheme.

COVID-19

11.23 Subsequent to 31 December 2019, it has become evident that COVID-19, an issue which developed rapidly and which continues to develop, is likely to have significant short-term effects on global economic activity and create extensive social disruption. Longer term socio-economic implications and the impact on the assets and liabilities of insurance companies remain uncertain.

11.24 This Supplementary Report is based on financial information as at 31 December 2019 (except where explicitly stated otherwise) and therefore the financial information on which this Supplementary Report is based makes no explicit allowance for the effects of COVID-19. I have therefore separately considered the impact of COVID-19 on my conclusions – firstly due to operational impacts and secondly as a result of the financial impacts of the pandemic.

11.25 In respect of the operational impacts of COVID-19, for the reasons set out in this Supplementary Report, I consider that whether or not the Proposed Scheme proceeds would have no impact on either the Remaining Policyholders, the Transferring Policyholders or the Existing Policyholders.

11.26 In respect of the financial impacts of COVID-19, for the reasons set out in this Supplementary Report, I consider that the Remaining Policyholders, the Transferring Policyholders and the Existing Policyholders will not be materially adversely affected by the Proposed Scheme.

Other considerations

11.27 I consider that the Proposed Scheme will have no significant effect on the Remaining Policyholders, the Transferring Policyholders and the Existing Policyholders in respect of matters such as investment management, new business strategy, management, administration, claims handling, governance arrangements, expense levels and valuation bases in relation to how they may affect the security of policyholders' contractual rights and levels of service provided to policyholders.

11.28 For the reasons set out in paragraphs 15.53 and 15.54 of my Scheme Report, which remain unchanged, I also consider that matters such as the cost and tax effects of the Proposed Scheme will have no significant effect on the security of policyholders' contractual rights.

11.29 I am satisfied that the material presented to policyholders is appropriate and the approach to communication with policyholders is appropriate, reasonable and proportionate.

11.30 I have been provided with regular reports on policyholder communications and summary statistics on responses and I have been informed that, as at 10 July 2020, no objections have been received to the Proposed Scheme.

External reinsurers

11.31 The external reinsurance of DAS and ARAG which covers the Remaining Policyholders and Existing Policyholders respectively will be unaffected by the Proposed Scheme.

11.32 Other than ARAG, there is only one external reinsurer for whom reinsurance contracts will be transferred under the Proposed Scheme. This external reinsurer, Mapfre, will reinsure the same liabilities after the Proposed Scheme and, as described in my Scheme Report, the claims handling of these liabilities will be undertaken by the same team under the same policies and procedures both before and after the Proposed Scheme. As such, I consider that the Proposed Scheme will have no material effect on the external reinsurers of the Transfer Companies.

Effect of Brexit on the above conclusions

11.33 In my Scheme Report I concluded that, in respect of Brexit, whether or not the Proposed Scheme proceeds would have no impact on the Remaining Policyholders, the Existing Policyholders or the Transferring Policyholders.

11.34 I am not aware of any developments in relation to Brexit compared with the situation on which my Scheme Report was based, and therefore I have not changed my conclusions in respect of Brexit.

Interaction with regulators

11.35 A draft of this Supplementary Report has been made available to the PRA and FCA whose comments have been taken into account. The PRA (in consultation with the FCA) has approved the form of the Scheme Reports.

Duty to the Court

11.36 As required by Part 35 of the UK Civil Procedure Rules, I hereby confirm that I understand my duty to the Court, I have complied with that duty and I will continue to comply with that duty.

Statement of truth

11.37 I confirm that I have made clear which facts and matters referred to in this Scheme 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.

Kate Angell
Independent Expert
Fellow of the Institute and Faculty of Actuaries

16 July 2020

Willis Towers Watson
Watson House
London Road
Reigate
Surrey
RH2 9PQ

Appendix A: Glossary of Terms

APS	Actuarial Practice Standards as issued by the IFoA
ARAG	ARAG Allgemeine Versicherungs-AG
ARAG Best Estimate Reserves	The reserves calculated by the ARAG risk management department which are used as the starting point for the Solvency II Claims Provisions
ARAG Branch	The branch recently established by ARAG in Ireland
ATE	After the event insurance
BaFin	Bundesanstalt für Finanzdienstleistungsaufsicht, the financial regulatory authority in Germany
BTE	Before the event insurance
Brexit	The UK's exit from the EU
CBI	The Central Bank of Ireland
Claimant Policyholders	Transferring Policyholders who either have an open claim with DAS or have previously made a claim against DAS in respect of a live policy or a policy which has expired on or before 31 December 2017
Closed ATE policies	After the event policies where the relevant case has been settled and no further claims payments are anticipated
Court	The High Court of Justice in England and Wales
Coverage Ratio	The ratio of available capital to the capital required on a regulatory basis
DAC	Deferred acquisition costs
DAS	DAS Legal Expenses Insurance Company Limited
DAS Branch	The branch of DAS in Ireland
Directions Order	The order made by the Court at the Directions Hearing on 7 April 2020
Diversification	The extent to which aggregate risk is less than the sum of the underlying individual risks
Dormant Policyholders	Transferring Policyholders whose policy expired on or before 31 December 2017
EEA	European Economic Area
Effective Date	The intended effective date of the Proposed Scheme, being 31 July 2020
ENIDs	Events not in data, an allowance for very extreme high severity, low probability claims in order to satisfy the Solvency II requirement that the best estimate has reference to "all possible outcomes"

ERGO	ERGO Versicherung AG
EU	European Union
EU27	The current countries in the European Union, other than the UK
Existing Policies	The insurance policies which are to remain with ARAG under the Proposed Scheme
Existing Policyholders	Those policyholders of ARAG whose insurance policies were originally with ARAG under the Proposed Scheme
FCA	The Financial Conduct Authority, one of the insurance industry regulators in the UK (the other being the PRA)
FoE	Freedom of Establishment, the ability of EU insurers to establish branches in member states of the EU
FoS	Freedom of Services, the ability of EU insurers to sell insurance products into any other EU member state
FOS	The Financial Ombudsman Service in the UK
FRC	The Financial Reporting Council, the UK's independent regulator responsible for promoting high quality corporate governance and reporting. The FRC sets standards for corporate reporting, audit and actuarial practice and monitors and enforces accounting and auditing standards
FSCS	The Financial Services Compensation Scheme, the UK's statutory compensation scheme which compensates customers of authorised financial services firms in the event that the company is unable pay claims against it
FSCS Transferring Policyholders	Transferring Policyholders which meet the criteria set out in paragraph 15.27 of the Scheme Report
FSMA	The Financial Services and Markets Act 2000, an Act of Parliament to make provision for the regulation of financial services which details the legal basis for the transfer of an insurance business in the UK
FSPO	The Financial Services and Pensions Ombudsman in Ireland
GAAP	Generally Accepted Accounting Principles
GWP	Gross written premium
IFoA	Institute and Faculty of Actuaries, a professional body which represents and regulates actuaries in the United Kingdom
ICF	The Irish Compensation Fund, the Republic of Ireland's compensation scheme which protects consumers of authorised non-life insurance companies that go into liquidation and are unable to pay insurance claims
Internal Model	An entity-specific, risk-based model approved by the regulator to be used by insurers to calculate their Solvency Capital Requirement under Solvency II

Inwards Reinsurance Policyholders	Transferring Policyholders who hold a reinsurance contract with DAS
Irish Bill	The General Scheme of the Miscellaneous Provisions (Withdrawal of the United Kingdom from the European Union on 29 March 2019) Bill 2019
Live Policyholders	Transferring Policyholders who are not Dormant Policyholders, Claimant Policyholders nor Inwards Reinsurance Policyholders
Long Stop Date	31 December 2020 or such later date on which any transition period agreed between the UK and the EU (in connection with the UK's withdrawal from the European Union) expires
Materially Adverse	In respect of the security of policyholders' contractual rights, an outcome which raises the likelihood of insurer failure above a 1 in 200 likelihood (a 0.5th percentile level of risk) over a one-year time horizon. In respect of the levels of service provided to policyholders, a difference in expected service levels as assessed by the Independent Expert as being materially adverse.
MGA	Managing General Agent
Mapfre	Mapfre Asistencia Compañia Internacional de Seguros y Reaseguros
MEAG	Munich ERGO Asset-Management GMBH
MoU	Memorandum of Understanding, a formal but non-legally binding agreement between two or more parties
Munich Re	Münchener Rückversicherungs-Gesellschaft AG, DAS's ultimate parent company
No-Deal Brexit	The scenario in which no terms can be agreed between the UK and the EU such that UK insurance firms lose their passporting (FoS and FoE) rights at the end of the Brexit transition period
Non-FSCS Transferring Policyholders	Transferring Policyholders which do not meet the criteria set out in paragraph 15.27 of the Scheme Report
No Scheme Position	The position if there were no Proposed Scheme
ORSA	Own Risk and Solvency Assessment
Own Funds	The level of available capital as measured under Solvency II rules
Own Risk and Solvency Assessment	The insurance or reinsurance undertaking's own assessment of the risks to which it is exposed and its solvency, as required under Solvency II
Part VII	Part VII of the FSMA
Partial Internal Model	The approach used by some insurers to calculate their Solvency Capital Requirement under Solvency II where one or more modules of the SCR are calculated using an Internal Model and the rest are calculated using the Standard Formula

Post Brexit EEA	The states currently included in the European Economic Area, excluding the UK
Post Scheme Position	The position should the Proposed Scheme proceed
PRA	The Prudential Regulation Authority, one of the insurance industry regulators in the UK (alongside the FCA)
Profit and Loss Transfer Agreement	The agreement in place between ARAG and ARAG SE whereby ARAG is required to transfer the full sum of its profit (on a German GAAP basis) for each financial year to ARAG SE and ARAG SE is required to pay to ARAG the full amount of any loss of ARAG (again on a German GAAP basis) in each financial year.
Proposed Scheme	The proposed transfer from DAS to ARAG as described in this Scheme Report
Prudent Person Principle	The principle whereby insurers may only invest in assets and instruments whose risks the undertaking concerned can properly identify, measure, monitor, manage, control and report and appropriately take into account in the assessment of its overall solvency needs. All assets are to be invested in a manner that ensures the security, quality, liquidity and profitability of the portfolio as a whole.
Reinsurance	This is where an insurance company purchases insurance from a reinsurer
Remaining Policies	The insurance policies which are to be remain with DAS under the Proposed Scheme
Remaining Policyholders	The policyholders of DAS whose insurance policies will remain with DAS under the Proposed Scheme
Scheme Report	Independent Expert's Scheme Report on the Proposed Scheme
SCR	Solvency Capital Requirement
SFCR	Solvency and Financial Condition Report, a report required under Solvency II which is publicly available, contains information on the company's solvency and financial condition and is designed to be used by policyholders, shareholders and other stakeholders
Solvency II	An EU directive aimed at harmonising the EU insurance regulation and enhancing consumer protection. The directive applies to all EU-domiciled insurance and reinsurance companies and was implemented on 1 January 2016
Solvency Capital Requirement	The level of capital required to be held by an insurer under the Solvency II regime. If the actual level of capital of an insurer comes close to or falls below this level then the regulator may intervene in or impose restrictions on the day-to-day running of the company
Standard Formula	A non-entity-specific, risk-based mathematical formula used by insurers to calculate their Solvency Capital Requirement under Solvency II
Summary	The summary of the Scheme Report

SUP18	Chapter 18, in relation to Transfers of Business, of the Supervision manual in the FCA Handbook
TAS	Technical Actuarial Standards, as issued by the FRC
Technical Provisions	Technical provisions represent the amount that an insurer requires to fulfil its insurance obligations and settle all expected commitments to policyholders and other beneficiaries arising over the lifetime of the insurer's portfolio of insurance contracts
Transaction	The wider business transaction between DAS and ARAG
Transfer Companies	DAS and ARAG together
Transferring Assets	The assets which are to be transferred from DAS to ARAG as part of the Proposed Scheme
Transferring Policies	The insurance policies which are to be transferred from DAS to ARAG as part of the Proposed Scheme
Transferring Policyholders	The policyholders of DAS whose insurance policies are transferring from DAS to ARAG under the Proposed Scheme.
Trust Funds	A ring-fenced pool of assets which are firstly used to pay policyholders who are protected by the Trust Fund
TWL	Towers Watson Limited, which is part of Willis Towers Watson
UK GAAP	Generally Accepted Accounting Practice in the UK, is the body of accounting standards and other guidance published by the UK Accounting Standards Board (ASB)
UK Law	The laws of England and Wales, Scotland and Northern Ireland
Ultimate Capital or Ultimate SCR	The capital required by an insurer such that it will have sufficient assets to meet its liabilities over the full period during which the claims in respect of the insured policies will be paid
Unearned Premium Reserve	The reserve held to cover the portion of written premium that represents the unearned portion of the insurance contracts as at a given point in time
UPR	Unearned Premium Reserve
Withdrawal Agreement	Agreement on the withdrawal of the United Kingdom of Great Britain and Northern Ireland from the European Union and the European Atomic Energy Community dated 19 October 2019