Scheme 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

1 April 2020

Prepared by Kate Angell, Independent Expert


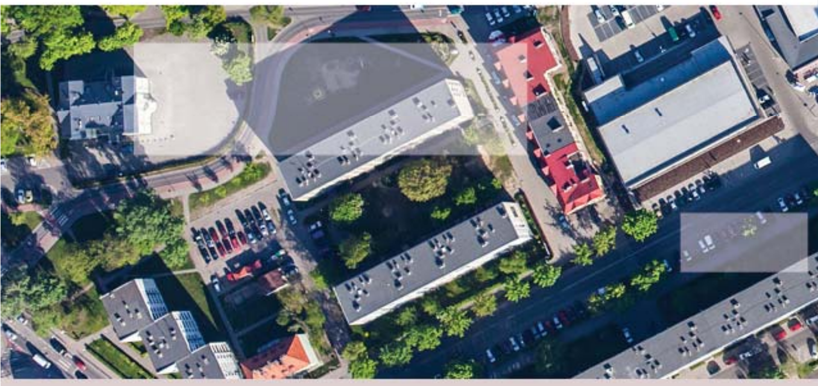

Table of Contents

Section 1 : Executive Summary 1
Introduction 1
About the Independent Expert 2
The Proposed Scheme 2
Scope of review 3
Findings of the Independent Expert 4
Supplementary Report 6
Section 2 : Introduction 9
Structure of this Scheme Report 9
Professional experience 10
Statement of independence 10
Terms of reference 10
Distribution 11
Reliances 11
Limitations 12
COVID-19 13
Legal jurisdiction 13
Section 3 : Scope 15
Scope of review 15
Professional guidance 16
Peer review 16
Section 4 : Overview of Methodology 17
Definition of "materially adverse" 17
Financial positions of the firms 18
Section 5 : Background - Proposed Scheme 21
Purpose and Selection of the Proposed Scheme 21
Overview of the Proposed Scheme 21
Overview of wider transaction 22
Transferring Policies 24
Transferring Assets 25
Section 6 : Background - DAS 27

Business description ... *27*

Reserves ... *28*

Reinsurance programme ... *29*

Profitability ... *29*

Investments ... *30*

Claims handling of Transferring Policies ... *31*

Section 7 : Background - ARAG ... 33

Business description ... *33*

Profit and loss transfer agreement ... *34*

Reserves ... *35*

Reinsurance programme ... *35*

Profitability ... *35*

Investments ... *36*

Section 8 : Balance Sheets - DAS ... 39

Introduction ... *39*

Transferring Business ... *39*

Impact of the Proposed Scheme on DAS GAAP balance sheet ... *39*

Impact of the Proposed Scheme on the DAS Solvency II balance sheet ... *41*

Premium reserving ... *42*

Claims reserving ... *43*

Approach to review of reserves ... *43*

Section 9 : Balance Sheets - ARAG ... 47

Introduction ... *47*

ARAG GAAP balance sheet ... *47*

ARAG Solvency II balance sheet ... *48*

Premium reserving ... *50*

Claims reserving ... *51*

Approach to review of reserves ... *51*

Section 10 : Capital Requirements - DAS ... 55

Solvency II capital requirements ... *55*

Details of Standard Formula ... *55*

Impact of the Proposed Scheme on capital requirements ... *56*

Section 11 : Capital Requirements - ARAG ... 59

Solvency II capital requirements ... *59*

Impact of proposed changes to the Standard Formula ... *60*

Impact of the Proposed Scheme on capital requirements ... *60*

Section 12 : Projections - DAS ... 63

Introduction ... *63*

DAS balance sheet projection *63*
Projected SCR coverage ratios *63*
Ultimate capital *63*
Section 13 : Projections and Scenarios - ARAG 65
Introduction *65*
ARAG balance sheet projection *65*
Projected SCR coverage ratios *65*
Scenarios *65*
Ultimate capital *67*
Section 14 : Conclusions on security of policyholders' contractual rights 69
Conclusions on security of policyholders' contractual rights – Remaining Policyholders *69*
Conclusions on security of policyholders' contractual rights – Transferring Policyholders *69*
Conclusions on security of policyholders' contractual rights – Existing Policyholders *70*
Section 15 : Other Financial Considerations 71
Introduction *71*
Implications of investment strategy *71*
Liquidity *72*
Implications of new business strategy *72*
Insolvency *72*
Trust funds and guarantees *77*
Accounting and reserving approach *77*
Tax implications *78*
Costs of the Proposed Scheme *78*
Pension schemes *79*
Annuity business *79*
Section 16 : Other Non-Financial Considerations 81
Introduction *81*
Impact of Brexit *81*
Policyholder service levels *82*
Comparison of regulatory regimes *83*
Ombudsman services *84*
Policyholder communication *84*
Reinsurer communication *87*
Recognition of the Proposed Scheme *87*
Allocation of outwards reinsurance assets *88*
Outwards reinsurers *89*
Section 17 : Overall Conclusions 91
Security of policyholders remaining within DAS *91*

Security of policyholders transferring from DAS to ARAG *91*
Security of existing policyholders of ARAG *92*
Other considerations *92*
External reinsurers *92*
Effect of Brexit on the above conclusions *93*
Interaction with regulators *93*
Effective challenge to DAS *93*
Supplementary Report *94*
Duty to the Court *94*
Appendix A : Glossary of Terms 95
Appendix B : Curriculum Vitae 101
Appendix C : Information Considered 103
Appendix D : Compliance with PRA and FCA requirements 105

Section 1: Executive Summary

Introduction

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 ("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 provide a Scheme Report for the proposed Part VII transfer of certain policies from DAS to ARAG Allgemeine Versicherungs-AG ("ARAG") (the "Proposed Scheme"). This Scheme Report has been prepared for the Court in order to aid the Court's consideration as to whether the Proposed Scheme should be approved.

1.3 I have also produced a summary of the Scheme Report (the "Summary") which is based on this Executive Summary of the Scheme Report. The Scheme Report contains detailed information that is not shown in the Summary. In particular, the Scheme Report contains the following sections:

- Section 2 sets out the details of the Proposed Scheme, my statement of independence and the terms of reference of my work;
- Section 3 sets out the scope of my work;
- Section 4 sets out an overview of the methodology I have followed;
- Sections 5 to 7 provide background to the Proposed Scheme and the companies involved;
- Sections 8 to 14 contain details of the review I have performed, and my findings, with regards to policyholder security;
- Section 15 sets out the details of my findings with regards to other financial considerations;
- Section 16 sets out the details of my findings with regards to other non-financial considerations, including the levels of service provided to policyholders;
- Section 17 contains my overall conclusions and statement of truth; and
- The Appendices contain a glossary of terms, my credentials, details of the information I have used in forming my conclusions and details of how this Scheme Report complies with the requirements of the Prudential Regulation Authority (the "PRA") and the Financial Conduct Authority (the "FCA").

1.4 The Scheme Report and the Summary have 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.

1.5 This Scheme Report, and the Summary, may be distributed to policyholders and any other person entitled to receive a copy under applicable law or regulation.

1.6 This Scheme Report and the Summary may be relied on by the Court. Neither the Independent Expert nor Willis Towers Watson accepts any responsibility or liability to any third party in relation to the Scheme Report or the Summary. Any reliance placed by such third parties on the Scheme Report or the Summary is entirely at their own risk.

About the Independent Expert

1.7 I 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.

1.8 DAS is a wholly owned subsidiary of ERGO Versicherung AG ("ERGO"), which is ultimately owned by Munchener Ruckversicherungs-Gesellschaft AG ("Munich Re"). ARAG is a wholly owned subsidiary of ARAG SE.

1.9 I consider that I have no conflict of interest or involvement, current or historical, with DAS, ARAG or any other Munich Re or ARAG group companies which would affect my suitability to act as the Independent Expert for the Proposed Scheme.

1.10 Willis Towers Watson, globally, has relationships with DAS, ARAG and other companies in the Munich Re and ARAG groups of companies. However, I do not consider that the nature and size of these involvements impact on my ability to act as Independent Expert for the Proposed Scheme. I have provided details of these relationships directly to the PRA and the FCA.

1.11 My appointment as the Independent Expert in connection with the Proposed Scheme has been approved by the PRA, in consultation with the FCA.

1.12 A more detailed statement of independence is included from paragraph 2.11 of this Scheme Report, and my curriculum vitae is enclosed at Appendix B.

The Proposed Scheme

1.13 The Proposed Scheme relates to the transfer of certain policies from DAS to ARAG.

1.14 DAS is incorporated in the UK, authorised by the PRA and regulated by the PRA and the FCA. DAS has exercised its rights to passport its permissions into Ireland on a Freedom of Establishment basis for the purposes of establishing a branch in Ireland (the "DAS Branch").

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

1.16 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").

1.17 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. The decision was made to allow DAS to focus on continuing to improve outcomes for its customers and business partners in the UK market (including Northern Ireland). Following the decision that DAS would cease to write new business in Ireland, 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 transferred under a Part VII transfer to ARAG's Irish Branch.

1.18 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 ARAG 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.

Scope of review

1.19 This Scheme Report considers 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").

1.20 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.

1.21 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 0.5th 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.
- 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] Transfer of Undertakings (Protection of Employment) Regulations 1981

1.22 Although I have focussed on the likelihood of insurer failure over a one-year time horizon when considering the security of policyholders' contractual rights, 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.

1.23 This Scheme Report also considers the likely effect of the Proposed Scheme on reinsurers whose contracts of reinsurance are to be transferred by the Proposed Scheme.

Findings of the Independent Expert

Security of policyholders remaining within DAS

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

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

1.26 After the Proposed Scheme, the Remaining Policyholders will continue to have policies with DAS. The Transferring Policies represent just under 2% of DAS's gross claims reserves and unearned premium reserve ("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.

1.27 As a result of the Proposed Scheme, the SCR coverage ratio for DAS is projected to increase marginally from 263% to 265%. Future projected SCR coverage ratios over the period 2019 to 2021 are all expected to be marginally higher as a result of the Proposed Scheme.

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

Security of policyholders transferring from DAS to ARAG

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

1.30 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 projected Solvency II Own Funds of approximately £43 million and an SCR coverage ratio of 263% to a company with projected Solvency II Own Funds of approximately £187 million and an SCR coverage ratio of 278%.

1.31 ARAG has exposure to a 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 266%. In my opinion the 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 263%.

1.32 I have also considered an estimated ultimate SCR for ARAG, which considers the full period during which the claims 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 240%. This is not materially below the one-year SCR coverage ratio of DAS of 263%

and remains significantly above 100%. In addition, my estimated ultimate SCR coverage ratio for ARAG includes some prudence.

1.33 The Transferring Policyholders are therefore moving to a company which is better capitalised and with a higher SCR coverage ratio on a one-year basis and remains strongly capitalised on an estimated ultimate basis. In addition, the SCR coverage ratios for ARAG are similar or higher than the corresponding SCR coverage ratios for DAS in all projections to the end of 2021.

1.34 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

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

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

1.37 After the Proposed Scheme, the Existing Policyholders will continue to have policies with ARAG. The SCR coverage ratio for ARAG on a No Scheme basis is projected to be 278%. The Proposed Scheme is expected to have a negligible impact on the ARAG SCR coverage ratio.

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

Other considerations

1.39 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.

1.40 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.

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

External reinsurers

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

1.43 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 paragraphs 16.13 to 16.19, 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

1.44 In February 2019 the Irish Government enacted the Withdrawal of the United Kingdom from the European Union (Consequential Provisions) Act 2019 (the "Irish Bill") which allows for a temporary run-off regime which will allow UK insurers (and intermediaries) to continue to service existing insurance contracts with Irish policyholders following Brexit for a period of three years, although no new business or policy renewals will be permitted.

1.45 Although the Irish Bill only applies for three years, the DAS Branch has been approved in principle by the Central Bank of Ireland as a third country branch, and it therefore remains legal for DAS to continue to pay claims in relation to Irish policies following Brexit.

1.46 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. In respect of Brexit, I therefore consider that whether or not the Proposed Scheme proceeds Brexit will have no impact on either the Remaining Policyholders or the Existing Policyholders.

1.47 The Transferring Policyholders will be insured by DAS before the Proposed Scheme and by ARAG after the Proposed Scheme. The Proposed Scheme aims to ensure that all policies where the policyholder is located in the "post Brexit EEA" (i.e. the current EEA excluding the UK) will be transferred to ARAG. As noted in paragraph 1.45 above, whether or not the Proposed Scheme proceeds, it remains legal for DAS to continue to pay claims in relation to Irish policies. On the assumption that the Proposed Scheme proceeds it will be legal for ARAG, as an EEA insurer, to pay claims in relation to the Transferring Policies.

1.48 Therefore, in respect of Brexit, I consider that whether or not the Proposed Scheme proceeds would also have no impact on the Transferring Policyholders.

1.49 Within my Supplementary Report I will consider the latest developments in relation to Brexit and any resulting impacts on my conclusions.

Supplementary Report

1.50 This Scheme Report is 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. I expect to produce a Supplementary Report based on the audited financial position of DAS and ARAG as at 31 December 2019 and updated financial projections, which will take into account any significant changes.

1.51 At the time of my Supplementary Report I will also consider whether the ongoing investigation and planning which is being undertaken by DAS and ARAG in respect of the Proposed Scheme will result in changes to the structure of the Proposed Scheme which requires my review. I will also consider the latest developments in relation to Brexit.

COVID-19

1.52 Shortly before finalising this Scheme Report, it has become evident that the coronavirus outbreak named as COVID–19 ("COVID-19"), a rapidly developing issue, 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 both liabilities and assets remain uncertain. The situation is fast moving and changing daily, leading to a high degree of uncertainty about the eventual type and scale of losses that may emerge.

1.53 The figures and conclusions in this Scheme Report make no explicit allowance for the effects of COVID-19. Within my Supplementary Report I will consider the anticipated effect of

COVID-19 on the financial positions of both DAS and ARAG, and any resulting impacts on my conclusions.

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Section 2: Introduction

2.1 When a scheme for transferring insurance business from one company to another is put to the Court for approval it has to be accompanied by a Scheme Report on the terms of the scheme from an Independent Expert. The Independent Expert's Scheme Report is a requirement under Part VII of the Financial Services and Markets Act 2000.

2.2 I, Kate Angell, have been appointed by DAS to provide a Scheme Report for the proposed Part VII transfer of certain policies from DAS to ARAG. This Scheme Report has been prepared for the Court in order to aid the Court's consideration as to whether the Proposed Scheme should be approved.

2.3 DAS is incorporated in the UK, authorised by the PRA and regulated by the PRA and the FCA. It is a wholly owned subsidiary of ERGO Versicherung AG, which is ultimately owned by Munich Re.

2.4 ARAG is domiciled in Germany and is authorised and regulated by BaFin to carry out general insurance business in Germany. It is a wholly owned subsidiary of ARAG SE.

2.5 It is intended that the Effective Date of the transaction will be 31 July 2020.

2.6 My appointment as the Independent Expert in connection with the Proposed Scheme was approved by the PRA, in consultation with the FCA, on 29 March 2019. In connection with this appointment there is an engagement letter dated 14 March 2019 in place between Towers Watson Limited and DAS.

2.7 The costs and expenses relating to my appointment as the Independent Expert will be shared equally by DAS and ARAG.

Structure of this Scheme Report

2.8 The structure of this Scheme Report is as follows:

- Section 3 sets out the scope of my work;
- Section 4 sets out an overview of the methodology I have followed;
- Sections 5 to 7 provide background to the Proposed Scheme and the companies involved;
- Sections 8 to 14 contain details of the review I have performed, and my findings, with regards to policyholder security;
- Section 15 sets out the details of my findings with regards to other financial considerations;
- Section 16 sets out the details of my findings with regards to other non-financial considerations, including the levels of service provided to policyholders;
- Section 17 contains my overall conclusions and statement of truth; and
- The Appendices contain a glossary of terms, my credentials, details of the information I have used in forming my conclusions and details of how this Scheme Report complies with the requirements of the PRA and the FCA.

Professional experience

2.9 I am a Fellow of the Institute and Faculty of Actuaries, having qualified in 1998.

2.10 I am a Senior Director in the firm of 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. My curriculum vitae is enclosed at Appendix B.

Statement of independence

2.11 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.

2.12 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.

2.13 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.

2.14 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.

2.15 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

2.16 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.

2.17 This Scheme Report is intended 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.

2.18 In preparing this Scheme 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.

2.19 Appendix D of this report sets out a mapping from the PRA requirements set out in paragraphs 2.27 to 2.40 of the "PRA's Statement of Policy: The PRA's approach to insurance business transfers" and the FCA requirements set out in paragraphs 18.2.31 to 18.2.41 of SUP18 to this Scheme Report.

Distribution

2.20 This Scheme Report has been prepared on the instruction of DAS for the benefit of the Court solely for the purposes of the FSMA requirements for Part VII transfers. This Scheme 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 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.

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

2.22 This Scheme 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 Scheme Report is subject to the terms and limitations, including a limitation of liability, set out in my firm's engagement letter.

Reliances

2.23 In carrying out my review and producing this Scheme 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 Appendix C.

2.24 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 this Scheme Report are accurate and complete.
- There are no significant errors or omissions in the descriptions in this Scheme 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 this Scheme Report.

2.25 Based on my review, I am satisfied that the information detailed in Appendix C represents an appropriate basis for the conclusions set out in this Scheme 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.

2.26 I met with the PRA and FCA at an early stage to establish whether there were matters or issues which they wanted me to consider in this Scheme Report. A draft of this Scheme 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 this Scheme Report.

Limitations

2.27 No limitations have been imposed on the scope of my work and the opinions in this Scheme Report 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 this Scheme Report that might, in my opinion, be relevant to policyholders' consideration of the Proposed Scheme.

2.28 This Scheme Report is 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.

2.29 This Scheme Report does not take into account any developments after the dates noted above unless stated explicitly to the contrary in this Scheme Report.

2.30 I expect to produce a Supplementary Report in due course, based on the updated financial position of DAS and ARAG, and revised financial projections, which will take into account any significant developments between the dates noted in paragraph 2.28 above and the final Court hearing.

2.31 In my judgement, the results and conclusions contained in this Scheme Report 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 this Scheme Report, 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.

2.32 This Scheme Report must not be construed as legal, investment or tax advice.

2.33 Figures in all tables in this Scheme Report are subject to possible rounding differences.

COVID-19

2.34 Shortly before finalising this Scheme Report, it has become evident that the coronavirus outbreak named as COVID–19 ("COVID-19"), a rapidly developing issue, 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 both liabilities and assets remain uncertain. The situation is fast moving and changing daily, leading to a high degree of uncertainty about the eventual type and scale of losses that may emerge. Some of the key drivers of uncertainty are expected to include:

- Public, corporate and government responses to COVID-19, and the extent to which these responses impact global supply chains and economic conditions;
- The extent to which the spread of COVID-19 may increase or reduce underlying insurance losses;
- Policy terms and conditions and the extent to which coverage is available for losses identified as being related to COVID-19;
- The impact of restrictions arising from the virus on the handling and settlement of current and future claims; and
- The effectiveness, duration and timing of containment measures in reducing future infection and fatality rates of the virus, the speed and effectiveness of vaccines or treatments and the ability of health systems to cope with potentially large numbers of individuals simultaneously requiring treatment.

2.35 The figures and conclusions in this Scheme Report make no explicit allowance for the effects of COVID-19. As noted in paragraph 1.50, I expect to produce a Supplementary Report based on the audited financial position of DAS and ARAG as at 31 December 2019 and updated financial projections. Within my Supplementary Report I will consider the anticipated effect of COVID-19 on the financial positions of both DAS and ARAG, and any resulting impacts on my conclusions.

Legal jurisdiction

2.36 This Scheme 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 Scheme Report.

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Section 3: Scope

Scope of review

3.1 This Scheme Report considers 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").

3.2 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.

3.3 This Scheme Report also considers the likely effect of the Proposed Scheme on reinsurers whose contracts of reinsurance are to be transferred by the Proposed Scheme.

3.4 This Scheme Report does not consider any possible alternative schemes or arrangements which might provide a more efficient or effective outcome.

3.5 This Scheme Report assesses the position of policyholders in relation to the Proposed Scheme on the basis of existing legal and regulatory frameworks. It does not attempt to predict or take account of how these frameworks may change in the future.

3.6 This Scheme Report does not consider the likely effects on new policyholders, that is, those whose contracts are entered into after the Effective Date of the Proposed Scheme.

3.7 I have not considered future changes of ownership or any other transactions (such as mergers or acquisitions) which involve any of the entities involved in this Proposed Scheme beyond those set out in this Scheme Report. I am not aware at the time of writing this Scheme Report of any proposed ownership changes or transactions.

3.8 This review does not comprise an audit of the financial resources and liabilities of DAS, ARAG or any other companies in either the Munich Re or ARAG groups of companies.

3.9 I have not reviewed the systems and controls currently operated by DAS, ARAG or any other companies in either the Munich Re or ARAG groups of companies.

Professional guidance

3.10 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. This Scheme Report complies with all applicable TASs and APSs. In particular, this Scheme Report has 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

3.11 The work which has been documented in this Scheme 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.

Section 4: Overview of Methodology

4.1 I have considered the likely effects of the Proposed Scheme on three distinct groups of affected policyholders:

- Remaining Policyholders;
- Transferring Policyholders; and
- Existing Policyholders.

4.2 For each group of policyholders I have considered the likely effects of the Proposed Scheme on:

- 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.

4.3 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").

4.4 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.

Definition of "materially adverse"

4.5 For each of the areas listed in paragraph 4.2 above I considered whether the Remaining Policyholders, the Transferring Policyholders and the Existing Policyholders would be "materially adversely" affected under the Proposed Scheme.

4.6 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.

4.7 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.

4.8 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.

Financial positions of the firms

4.9 Security for policyholders is provided by assets backing the technical reserves and by net shareholder assets. In considering policyholder security, it is also necessary to take into account the potential variability of future experience (including investment returns, claims experience, expense levels and wider operational risks), and potential future distributions to, or capital injections from, shareholders. Other factors are the nature of the reinsurance arrangements and the financial security of reinsurance counterparties. Finally, security is affected by the nature and volume of future new business.

4.10 Insurers are subject to capital requirements imposed by their regulators. If the actual level of capital of the insurer comes close to or falls below the level of required capital then the regulator may intervene in or impose restrictions on the day-to-day running of the company. The level of actual available capital compared to regulatory required capital ("Solvency Capital Requirement" or "SCR") is a measure of the security provided to policyholders.

4.11 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" or "ultimate SCR"). In order to assess the ultimate capital for each insurer I have also considered some scenario tests to assess the likelihood of each insurer being able to meet these liabilities over the full period during which claims in respect of these policies will be paid.

4.12 I have considered the impact of the Proposed Scheme on the following financial information for the Remaining Policyholders, Transferring Policyholders and Existing Policyholders:

- The balance sheets for DAS as at Q4 2019 and ARAG as at Q4 2018, including the valuation of the assets and liabilities. My findings are set out in Sections 8 and 9.
- The capital requirements for DAS as at Q4 2019 and ARAG as at Q4 2018 on a regulatory basis together with the available capital. My findings are set out in Sections 10 and 11.
- The projected capital requirements for DAS and ARAG over the period 2019 to 2021 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. My findings are set out in Sections 12 and 13.

4.13 I have primarily considered financial projections for DAS as at Q4 2019 when forming my conclusions, as I do not consider the corresponding Q4 2018 figures to be an appropriate representation of DAS's projected financial position in upcoming years for the following reasons:

- The amendments to the Solvency II Standard Formula which came into effect over the course of 2019 will have a material impact on DAS's SCR, as discussed in paragraph 10.15;

- The expectation of recoveries from a recent legal action may have a significant impact on DAS's net asset value, as discussed in paragraph 8.6; and

- The Q4 2018 financial results were materially affected by a one-off adverse impact of the change in commission rate on the ERGO quota share reinsurance during 2018, as discussed in paragraph 6.14.

4.14 Although I have been provided with financial projections for ARAG, I have primarily considered actual financial information for ARAG as at Q4 2018 when forming my conclusions. This is because a number of changes were implemented in ARAG's Partial Internal Model in late 2018 which are not reflected in the capital projections, and I therefore consider the information as at Q4 2018 to be a more appropriate representation of ARAG's projected financial position in upcoming years.

4.15 As noted previously, I expect to produce a Supplementary Report in due course, based on the audited financial position of DAS and ARAG as at 31 December 2019, and updated financial projections, which will take into account any significant developments between the dates noted above and the final Court hearing.

4.16 The actual and projected future capital and balance sheet figures (as at 31 December 2018, 2019, 2020 and 2021) which have been provided by ARAG include no allowance for the wider business transaction between DAS and ARAG taking place. However, the projected future figures provided by DAS have been adjusted to allow for the impact of this wider business transaction. Based on DAS's estimates, I do not consider ARAG's projections to be materially misstated as a result of this. However, I will consider any update to these figures which are available at the time of drafting my Supplementary Report and any resulting impacts on my conclusions.

4.17 All figures provided by ARAG were denominated in Euros. These figures have been converted into GBP for the purposes of this Scheme Report using the exchange rate £1.00 = €1.1092, which was the exchange rate as at 31 December 2018. I will consider the impact of updated exchange rates, alongside the updated financials of DAS and ARAG, at the time of drafting my Supplementary Report and any resulting impacts on my conclusions.

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Section 5: Background - Proposed Scheme

Purpose and Selection of the Proposed Scheme

5.1 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. The decision was made given the small size of the Irish business and therefore to allow DAS to focus on continuing to improve outcomes for its customers and business partners in the UK market (including Northern Ireland).

5.2 Following DAS's decision that it would cease to write new business in Ireland, two options were put to the ERGO board:

- The DAS Branch would be maintained in order to run-off the liabilities. Any assets relating to future business, such as renewal rights, would be sold to a third party.
- All assets and liabilities in relation to the DAS Branch would be sold, with all insurance liabilities transferred under a Part VII transfer.

5.3 Due to the estimation that all claims relating to business written through the DAS Branch would not be fully settled for at least five years, it was concluded by the ERGO board that the first option would not be cost effective. As a result, it was decided that a sale and Part VII transfer would be pursued and DAS entered into binding legal agreements for the sale and Part VII transfer to ARAG.

Overview of the Proposed Scheme

5.4 The Proposed Scheme relates to the transfer of certain policies from DAS to ARAG.

5.5 DAS is incorporated in the UK, authorised by the PRA and regulated by the PRA and the FCA. It is a wholly owned subsidiary of ERGO Versicherung AG, which is ultimately owned by Munich Re. Further background on DAS is provided in Section 6 of this Scheme Report.

5.6 ARAG is domiciled in Germany and is authorised by BaFin to carry out general insurance business in Germany. ARAG is a wholly owned subsidiary of ARAG SE. Further background on ARAG is provided in Section 7 of this Scheme Report. ARAG has recently established a branch in Ireland (the "ARAG Branch") on a FoE basis.

5.7 The policies to be transferred under the Proposed Scheme comprise the following:

- All of the policies which have been underwritten by DAS through the DAS Branch prior to the Initial Transfer Date (which is defined in paragraph 5.12 below) other than those policies underwritten by DAS for a person who is resident in Northern Ireland; and
- All of the policies which have been underwritten by ARAG or its affiliates on behalf of DAS on or after the Initial Transfer Date.

5.8 The Proposed Scheme forms the final step as part of the sale transaction between DAS and ARAG which is described from paragraph 5.10 below.

5.9 The policies to be transferred provide before the event ("BTE") legal expenses insurance, after the event ("ATE") legal expenses insurance and motor breakdown assistance insurance. These insurances are described in Section 6 of this Scheme Report.

Overview of wider transaction

5.10 As noted above, the Proposed Scheme forms part of a wider business transaction between DAS and ARAG (the "Transaction"). This Transaction includes the following agreements:

- Framework Agreement;
- Reinsurance Agreement;
- Transitional Services Agreement; and
- Delegated Authority (Coverholder) Agreement.

5.11 These agreements are discussed in turn below.

5.12 All of these agreements became effective on the Initial Transfer Date, which occurred on 1 December 2019.

5.13 Three conditions precedent were required to be met prior to the Initial Transfer Date occurring, which were as follows:

- That ARAG established a branch in Ireland, which the Transferring Policyholders will be transferred to. This branch has been established and received approval from BaFin.
- That ARAG established a new Managing General Agent ("MGA") in Ireland, which is an insurance intermediary pursuant to the Insurance Distribution Directive. This MGA has been established and approved by the CBI.
- That a certain proportion of binders (that is business agreements, distribution agreements and binding authority agreements entered into between DAS and third-party intermediaries and insurers) were assigned, novated or replaced with agreements with ARAG. This condition has been met.

5.14 On the Initial Transfer Date:

- ARAG paid DAS cash consideration;
- ARAG took over the DAS Branch business, which included the transfer of staff from DAS to ARAG in accordance with the TUPE Regulations;
- ARAG started to write new business via the ARAG Branch to its own balance sheet (except for those policies described in paragraph 5.20 below);
- DAS paid the agreed reinsurance premium to ARAG;
- ARAG fully reinsured the Transferring Policies and the MGA began provision of run-off services to DAS (which includes claims handling); and
- DAS began the provision of transitional services to ARAG and the MGA (as described in paragraph 5.19 below).

Framework Agreement

5.15 The Framework Agreement sets out the overall arrangement between DAS and ARAG, as described above.

5.16 The Framework Agreement also includes a condition such that DAS agrees to reimburse ARAG for any claim payments (and other costs) incurred in respect of "Closed ATE policies". This is discussed further from paragraph 5.31 below.

Reinsurance Agreement

5.17 Under this agreement ARAG fully reinsured the Transferring Policies (as defined in paragraph 5.27 below) with effect from the Initial Transfer Date, and handles, pays and settles all claims in respect of these Transferring Policies and otherwise administers the Transferring Policies.

5.18 This Reinsurance Agreement results in the economic risk of the Transferring Policies being transferred to ARAG with effect from the Initial Transfer Date.

Transitional Services Agreement

5.19 The Transitional Services Agreement is the agreement under which DAS provides services to ARAG for a temporary period from the Initial Transfer Date. These services include the provision of software, data centre services and management information.

Delegated Authority (Coverholder) Agreement

5.20 This agreement enables ARAG to write business on behalf of DAS from the Initial Transfer Date in respect of:

- Transferring Policies that are the subject of renewal notices sent to Transferring Policyholders prior to the Initial Transfer Date. ARAG had delegated authority to underwrite such policies on behalf of DAS for a period of 60 days after the Initial Transfer Date; and

- Contracts of insurance to be underwritten by a counterparty to a binder that has not yet been assigned, novated or replaced with an agreement with ARAG. DAS has delegated authority to ARAG to underwrite such policies on behalf of DAS for a period up to no later than the Effective Date.

5.21 Under this agreement, ARAG is only authorised to bind policies to DAS for risks where the policyholder is domiciled in Ireland.

Termination of agreements

5.22 The above agreements, other than the Reinsurance Agreement, terminate on the Effective Date of the Proposed Scheme.

5.23 In the situation where the Proposed Scheme is significantly delayed or does not happen, such that the Effective Date has not happened by the "Long Stop Date" (as defined in the following paragraph), then in the absence of any alternative agreement being made between DAS and ARAG:

- The Framework Agreement, with respect to the transfer of the Transferring Policies under the Proposed Scheme, shall terminate;

- The Transferring Policies will remain with DAS; and

- ARAG will continue to fully reinsure the Transferring Policies and continue to provide run-off services for the Transferring Policies (including handling, paying and settling all claims in respect of the Transferring Policies and otherwise administering the Transferring Policies) until their natural expiry.

5.24 The "Long Stop Date" is 31 December 2020 or such later date on which any transition period agreed between the UK and the EU (in connection with Brexit) expires. At the time of writing this report, no such later date has been agreed between the UK and the EU.

5.25 In this Scheme Report 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").

5.26 The No Scheme Position I consider therefore assumes that the Transferring Policies remain with DAS but are fully reinsured by ARAG, with ARAG also continuing to provide run-off services for the Transferring Policies until their natural expiry.

Transferring Policies

5.27 The policies to be transferred under the Proposed Scheme comprise the following:

- All of the policies which were underwritten by DAS through the DAS Branch prior to the Initial Transfer Date other than those policies underwritten by DAS for a person who is resident in Northern Ireland; and

- All of the policies which have been underwritten by ARAG or its affiliates on behalf of DAS on or after the Initial Transfer Date.

5.28 The approach aims to ensure that all policies where the policyholder is located in the "post Brexit EEA" (i.e. the current EEA excluding the UK) will be transferred to ARAG.

5.29 DAS has also 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. The 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. Although Norway is in the EEA it is a non-EU state, and DAS's Norwegian distributor has received informal confirmation from Finanstilsynet, the financial supervisory authority in Norway, that DAS will be able to continue to settle any claims arising from historical policies in future years. As stated above, these policies are not transferring from DAS to ARAG but are Remaining Policies and the Norwegian regulator is willing to allow DAS to run off these policies through its existing Norwegian distributor. However, in my Supplementary Report I will consider the impact on the Norwegian policyholders of not being transferred from DAS to ARAG, outline why the decision was taken not to include them within the definition of Transferring Policies for the Proposed Scheme, and confirm 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.

5.30 The policies to be transferred provide BTE legal expenses insurance, ATE legal expenses insurance and motor breakdown assistance insurance. These insurances are described in Section 6 of this Scheme Report.

5.31 With regards to the "after the event" ("ATE") legal expenses insurance, the Framework Agreement includes a condition such that DAS has agreed to reimburse ARAG for any claim payments (and other costs) incurred in respect of "Closed ATE" policies. DAS has not written "after the event" legal expenses insurance in Ireland since 2017, and only three cases remain open. DAS has agreed to reimburse ARAG for all claim payments in respect of "after the event" legal expenses insurance policies which are transferred to ARAG under the Proposed Scheme except in respect of these three open cases. While I understand that a number of cases written prior to 2005 remain partially open, no claims have been paid in relation to these for approximately ten years and DAS consider it highly unlikely that any further claims will be paid. DAS does not hold any claims reserves in respect of the "Closed ATE" policies.

Transferring Assets

Transfer of reinsurance

5.32 There are two reinsurance contracts which are relevant to the Transferring Policies:

- A 100% quota share provided by Mapfre Asistencia Compañia Internacional de Seguros y Reaseguros ("Mapfre") which covers all motor breakdown business written by the DAS Branch. This contract inures to the benefit of the 100% Reinsurance Agreement with ARAG and will be transferred as part of the Proposed Scheme.

- A 90% whole account quota share provided by ERGO which covers all of the business underwritten by DAS. It has been agreed that the 100% Reinsurance Agreement with ARAG will inure to the benefit of this contract (such that the 100% Reinsurance Agreement with ARAG will be applied to claims first). Therefore, in the event of ARAG's inability to pay claims under the Reinsurance Agreement prior to the Proposed Scheme, claims could be made under the ERGO quota share in respect of the Transferring Policies. However, following the Proposed Scheme, no further recoveries under the ERGO quota share will be possible in respect of the Transferring Policies.

5.33 Two reinsurance contracts will be transferred as part of the Scheme:

- The 100% quota share which covers all motor breakdown business written by the DAS Irish Branch, provided by Mapfre; and

- The Reinsurance Agreement with ARAG, effectively nullifying this contract under which ARAG fully reinsure the Transferring Policies.

5.34 Given the above points, as a result of the Proposed Scheme the benefit of the 90% whole account quota share provided by ERGO in respect of the Transferring Business will be lost. This results in an overall reduction in the reinsurance protection available, however given the low materiality of the Transferring Business when compared to the overall balance sheets of both DAS and ARAG – and the fact that the reinsurance protection which is being lost is contingent on ARAG's inability to pay claims – I consider the loss of this reinsurance protection to be immaterial.

5.35 The impact of the Proposed Scheme on the security of the Transferring Policyholders' contractual rights is set out in the subsequent sections of this Scheme Report. My considerations and conclusions as set out in this Scheme Report incorporate the impact on the Transferring Policies of the different reinsurance programmes purchased by DAS and ARAG.

Solvency regimes

5.36 DAS is currently regulated under the Solvency II regime. Immediately following the Proposed Scheme both DAS and ARAG will continue to be regulated under the Solvency II regime. Following Brexit the UK could adopt a different solvency regime. I have seen no information as to what such a future UK insurance solvency regime may look like, or whether the UK will continue to regulate insurance companies in line with the Solvency II regime. However, I would expect any such insurance solvency regime to be heavily based on Solvency II in the first instance and that any subsequent divergence between the two regimes is likely to be slow.

5.37 All of my analysis and conclusions in this report are therefore based on the assumption that the Solvency II regulatory regime will continue both in the UK, Ireland and Germany. I consider this assumption to be reasonable and in line with my understanding of the PRA's expectations for this report.

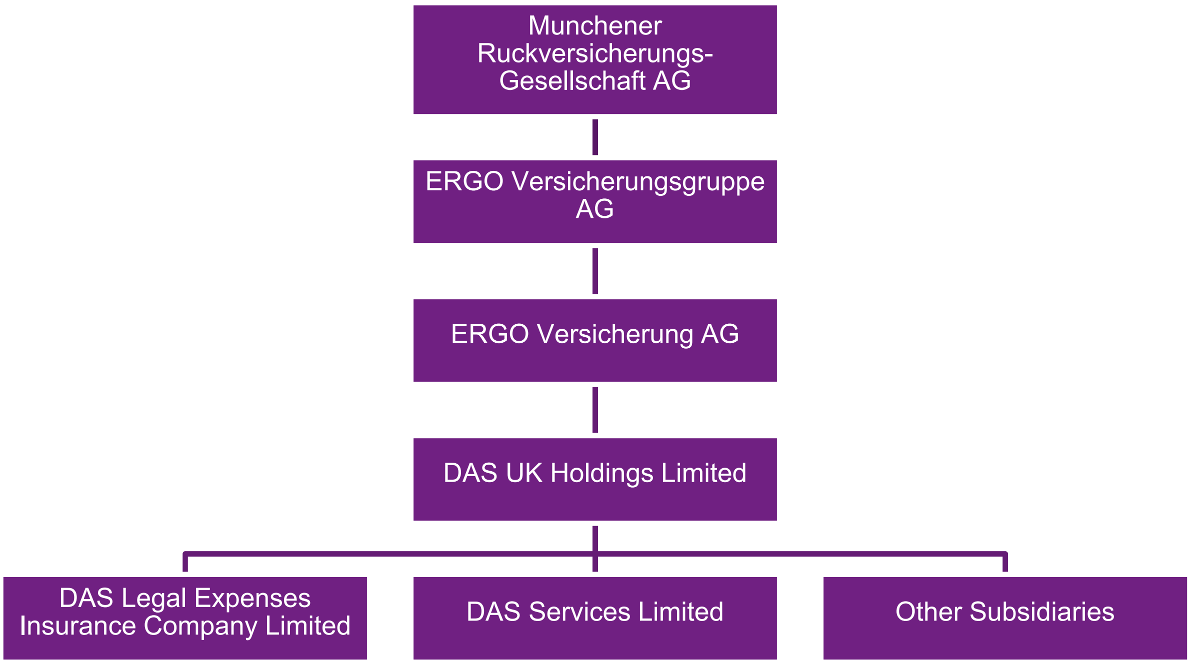
Section 6: Background - DAS

Business description

6.1 DAS is incorporated in the UK, authorised by the PRA and regulated by the PRA and the FCA. DAS exercised its rights under Solvency II to passport such permissions into Ireland on a Freedom of Establishment basis for the purposes of establishing its Irish branch ("the DAS Branch"). In addition, it has historically conducted business in Norway on a Freedom of Services basis but has recently ceased to operate in this region.

6.2 The immediate holding company of DAS Legal Expenses Insurance Company Limited is DAS UK Holdings Limited. This is in turn fully owned by ERGO-Versicherung AG, which is ultimately owned by Munich Re. The DAS UK Holdings Limited company structure is illustrated in the following diagram. All ownerships shown are 100%.

Chart 6.1: DAS UK Holdings Limited Company Structure



6.3 DAS has a credit rating from Standard & Poor's of 'A+'. This credit rating reflects the strong, long-term commitment of support from Munich Re and ERGO.

6.4 DAS is the market leader for legal expenses insurance in the UK and operates two core legal expenses classes of business (BTE and ATE) that remain the focus of its future strategy, alongside two further classes of business. The four classes of business written by DAS are as follows:

- BTE insurance, which provides insurance to protect policyholders against unforeseen legal events, such as disputes relating to employment, the purchase of goods and services, personal injury and medical negligence. BTE insurance is usually purchased by individuals and businesses as an add-on to another product (such as a personal household, motor or a commercial insurance policy). BTE insurance can also be purchased through a membership, affinity or benefit package.

- ATE insurance, which provides insurance after a substantive incident has occurred and the risk insured is the risk of losing the litigation. Cover is provided for defendants' costs, the insured's own disbursements and premium indemnity. Solicitors have an alignment of interest as their own costs, which are not indemnified under the terms of the policy, are at risk.

- Assistance insurance, which provides professional assistance in the event of a personal emergency. Products include home emergency, motor breakdown and cyber crime cover.

- Loss recovery insurance, which includes the provision of a loss adjuster to deal with large material damage and/or business interruption claims on behalf of business owners.

6.5 DAS provides no direct distribution of policies, with all business being sold through business partners, generally as add-ons to other products. These partners include banks, brokers and other insurers.

6.6 The table below shows a split of the gross written premium ("GWP") across these classes of business by territory.

Table 6.2: Split of DAS 2018 GWP across product types by territory (£000's)

Product type	Ireland	UK and Norway	Total GWP
Legal expenses – ATE	74	29,621	29,695
Legal expenses – BTE	4,505	72,592	77,097
Assistance and loss recovery	383	10,770	11,153
Total	**4,962**	**112,983**	**117,945**

6.7 As shown in Table 6.2 above, the majority of GWP in 2018 for Ireland related to BTE insurance. A small amount of GWP was recorded for Irish ATE insurance in 2018, which relates to policies written prior to 2015 for which legal cases settled in 2018.

Reserves

6.8 A summary of DAS's net reserves as at 31 December 2018 by reserving class is shown in Table 6.3 below.

Table 6.3: Split of DAS 2018 net reserves across product types by territory (£000's)

Region	Product Type	Net Reserves	Proportion of Total
UK & Norway	Legal expenses - ATE	1,302	8%
UK & Norway	Legal expenses - BTE	14,827	87%
UK & Norway	Assistance and loss recovery	252	1%
Ireland	Legal expenses - ATE	20	0%
Ireland	Legal expenses - BTE	732	4%
Ireland	Assistance and loss recovery	0	0%
Total	**Total**	**17,133**	**100%**

Reinsurance programme

6.9 DAS has purchased reinsurance protection from several counterparties in recent years. The projected reinsurance reserves by reinsurer as at 31 December 2019 are shown in Table 6.4 below. These projections have been carried out by DAS under the assumption that the Reinsurance Agreement with ARAG is in place, but that the Proposed Transfer has not yet occurred.

Table 6.4: DAS projected 2019 reinsurance reserves by reinsurer (£000's)

Reinsurer	Reinsurance Reserves	Proportion of Total
ERGO	208,100	98%
ARAG	4,400	2%
Mapfre	100	0%
Total	**221,600**	**100%**

6.10 The most significant contract is a quota share agreement with ERGO, which has been in place for approximately 15 years. This initially covered a 30% share of all business written by DAS, but this was increased to 70% in 2015 and to 90% in 2017. These contracts cover all policies underwritten by DAS.

6.11 In addition, DAS have a less material reinsurance contracts in place with Mapfre. This is a 100% quota share which covers all motor breakdown business written by the DAS Irish Branch. This contract inures to the benefit of the 100% Reinsurance Agreement with ARAG and will be transferred as part of the Proposed Scheme.

6.12 DAS has also historically purchased some further reinsurance, but these reinsurance contracts have now all been fully commuted.

Profitability

6.13 Table 6.5 below shows a summary of DAS's Profit and Loss Accounts from its published accounts over the last three years. As can be seen from this table, DAS has made an overall loss for the last three years. The results were in line with DAS's plan and reflect the growth phase of the turnaround of the business following a company-wide transformation programme which challenged the operating model of DAS.

6.14 Furthermore a large majority of the losses over these years were driven by changes in the quota share reinsurance contract with ERGO. In particular in 2018 there was a one-off adverse impact on the results as a consequence of the change in the commission rate effected from 1 January 2018. Although the increase in commission rate represents an increase in future income to DAS, this had an adverse impact on ceded deferred acquisition costs ("DAC") of approximately £10m. This arrangement has contributed to DAS's strong capital position but has had an adverse impact on DAS's reported results for the years which masks underlying profitability.

6.15 On a gross of reinsurance basis, DAS achieved a profitable combined operating ratio of 95.4% in 2018. The change in commission rate is expected to result in improved profitability for DAS in the future.

Table 6.5: Summarised Profit and Loss Accounts for DAS (£000's)

Item	2016	2017	2018
Earned premiums, net of reinsurance	36,345	27,417	11,496
Other technical income, net of reinsurance	3,606	3,891	5,016
Claims incurred, net of reinsurance	(32,472)	(28,057)	(11,838)
Net operating expenses	(28,052)	(9,820)	(15,250)
Other technical charges, net of reinsurance	264	(1,498)	(2,787)
Other income, expenses and charges	2,895	1,832	1,324
Tax on loss	3,624	1,026	2,085
Profit (Loss) for the Financial Year	**(13,790)**	**(5,209)**	**(9,954)**

Investments

6.16 DAS adopts a conservative investment strategy with a minimal (cautious) risk appetite, in line with ERGO investment guidelines. The aim is to limit volatility in the value of the portfolio in order to provide a stable financial platform which allows DAS to achieve its business strategy.

6.17 The DAS investment portfolio is managed by Munich ERGO Asset-Management GMBH ("MEAG"), DAS's appointed investment manager. The investment mandate, which is reviewed annually, forms part of the investment management contract between DAS and MEAG. The investment mandate sets out investment guidelines, specifying permitted asset classes and quality constraints, taking into account any relevant tax, accounting and local supervisory regulations. The investment mandate defines key figures and trigger thresholds for monitoring purposes. MEAG is responsible for the implementation of the investment mandate, which reflects DAS's conservative investment strategy.

6.18 Table 6.6 below shows the split of DAS's investment portfolio by asset class as at 31 December 2018. As shown in this table, the majority of investments held are government bonds.

Table 6.6: DAS investment portfolio split as at 31 December 2018

Asset class	Proportion of 2018 investment portfolio
Government bonds	67%
Corporate bonds	24%
Structured notes	1%
Loans	4%
Cash and cash equivalents	4%

6.19 The majority of investments are invested in Sterling. However, DAS also has exposure to Euros and Norwegian Krone. This is in line with its investment strategy where it aims to match foreign currency liabilities with assets invested in the same denominations.

Claims handling of Transferring Policies

6.20 Prior to the Initial Transfer Date, DAS undertook the administration and claims handling for the Transferring Policies itself, using staff employed by the DAS Branch or by external lawyers contracted by DAS Branch.

6.21 All employees of the DAS Branch were transferred to ARAG on the Initial Transfer Date in accordance with the TUPE Regulations.

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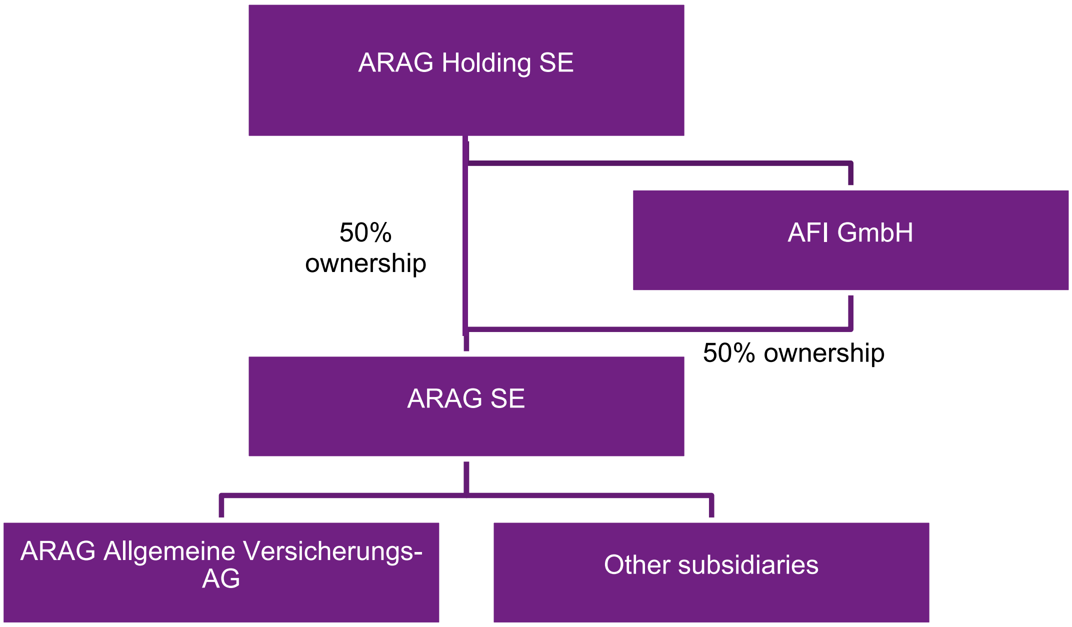
Section 7: Background - ARAG

Business description

7.1 ARAG is domiciled in Germany and is authorised by BaFin to carry out general insurance business in Germany. ARAG has recently exercised its rights under Solvency II to passport such permissions into Ireland on a Freedom of Establishment basis and established an Irish branch (the "ARAG Branch"). In addition, it also writes business in the UK through a branch established in 2016, although I understand that ARAG are considering whether to close this branch in response to Brexit.

7.2 ARAG is a wholly owned subsidiary of ARAG SE, which is ultimately owned by ARAG Holding SE. The ARAG Holding SE company structure is illustrated in the following diagram. All ownerships shown are 100%, unless specified otherwise.

Chart 7.1: ARAG SE Company Structure



7.3 ARAG's operations cover direct and indirect business across a number of insurance and reinsurance segments. Products sold include general accident insurance, general liability insurance and private property insurance, along with various other smaller lines. The table below shows a split of the gross written premium by class of business:

Table 7.2: Split of ARAG 2018 GWP across classes of business (£000's)

Business Class	Total GWP
General accident insurance	43,002
General liability insurance	38,191
Motor insurance	1,685
Fire and property insurance	43,045
Sundry and assistance insurance	12,554
Inwards reinsurance	25,466
Total	**163,942**

Profit and loss transfer agreement

7.4 ARAG has a profit and loss transfer agreement in place with ARAG SE (the "profit and loss transfer agreement"). Under this agreement:

- ARAG is required to transfer the full sum of its profit (on a German GAAP basis) for each financial year to ARAG SE (its' parent company); 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.

7.5 As a result, while the agreement is in place and remains effective, the profit or loss of ARAG in any financial year is zero. Given the historical profits which have been made by ARAG no payments have yet been made under the profit and loss transfer agreement from ARAG SE to ARAG as a result of a loss being made.

7.6 The purpose of the profit and loss transfer agreement is to formalise and simplify the transfer of profits to the parent company each year.

7.7 The existence of this profit and loss transfer agreement has no impact on my conclusions which are set out throughout this Scheme Report, given the following:

- The Solvency II capital requirements I have considered in Section 11 of this Scheme Report are all on a one-year basis and do not take into account the payments of any amounts from ARAG SE to ARAG under the profit and loss transfer agreement.

- The financial projections I have considered for future periods in Section 12 of this Scheme Report allow for the profit of ARAG to be paid to ARAG SE in accordance with the profit and loss transfer agreement. Therefore, if this profit and loss transfer agreement was no longer in place the impact on the Transferring Policyholders would likely be beneficial as ARAG would be projected to retain additional profits, which would only serve to reinforce my conclusions with respect to the security of the Transferring Policyholders.

- My conclusions relating to the scenarios I have considered in Section 12 of this Scheme Report do not allow for the recoveries of any losses from ARAG SE as a result of these extreme scenarios.

7.8 While I have not relied on the existence of this profit and loss transfer agreement in reaching my conclusions, I note that it does provide some additional protection to the Transferring Policyholders should an extreme event materialise in the future which results in a loss during a financial year for ARAG, and given that DAS does not have a similar arrangement in place with its parent company.

Reserves

7.9 A summary of the reserves booked by ARAG as at 31 December 2018, both gross and net of reinsurance, is shown in Table 7.3 below. These reserves are prepared by ARAG's finance department for the purpose of accounting submissions and are significantly higher than the reserves recommended by ARAG's risk management department which feed into the Solvency II Claims Provision figures presented in Section 9.

Table 7.3: Split of ARAG 2018 reserves across reserving classes (£000's)

Reserving Class	Gross Reserves	Reinsurance Reserves	Net Reserves
Accident insurance	80,829	3,359	77,470
Liability insurance	41,033	13,435	27,598
Motor liability insurance	12,960	9,775	3,185
Miscellaneous motor insurance	96	82	14
Assistance insurance	513	0	513
Other property insurance	24,896	3,696	21,199
Provision for claims handling	30,573	0	30,573
Total loss reserves	**190,900**	**30,346**	**160,554**

Reinsurance programme

7.10 ARAG purchases a range of reinsurance contracts from multiple counterparties, with a primary focus on reducing the risk from large claims and accumulation via non-proportional reinsurance treaties. In addition, it purchases facultative reinsurance arrangements for large and special risks.

7.11 An annual renewal process for this programme is used with the aim of ensuring that the risk mitigation provided remains effective on an ongoing basis.

Profitability

7.12 Table 7.4 below shows a summary of ARAG's profit and loss accounts from its published accounts over the last three years.

7.13 As can be seen from this table, ARAG has made a profit in each of the last three years, prior to the impact of the profit and loss transfer agreement. As discussed from paragraph 7.4 above, under this profit and loss transfer agreement ARAG are required to transfer the full sum of its profit (or loss) for each financial year to its parent company ARAG SE.

Table 7.4: Summarised profit and loss accounts for ARAG (£000's)

Item	2016	2017	2018
Earned premiums, net of reinsurance	151,651	156,709	156,857
Other technical income, net of reinsurance	871	714	710
Claims incurred, net of reinsurance	(82,219)	(87,379)	(86,173)
Net operating expenses	(58,308)	(60,473)	(66,042)
Other technical charges, net of reinsurance	(866)	(724)	(1,044)
Change in equalization provision and similar provisions	(4,529)	1,434	6,302
Other income, expenses and charges	6,053	5,912	6,097
Taxes paid	(14)	2	(6)
Profit (Loss) for the Financial Year, excluding profit-and-loss transfer agreement	**12,639**	**16,196**	**16,701**
Profits transferred under profit-and-loss transfer agreement	(12,639)	(16,196)	(16,701)
Profit (Loss) for the Financial Year	**0**	**0**	**0**

Investments

7.14 ARAG applies the "prudent person principle" to its investments. The prudent person principle stipulates that 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.

7.15 The application of the "prudent person principle" requires an appropriate diversification of the portfolio, as a result of which risk concentrations are generally restricted. The ARAG investment portfolio is managed by ARAG SE, who carry out this function for all companies in the ARAG group.

7.16 ARAG carries out a strategic asset allocation exercise to determine target bandwidths for each individual asset class. The deviation of ARAG's actual investment portfolio from these target bandwidths is monitored on a monthly basis.

7.17 Table 7.5 below shows the split of ARAG's investment portfolio by asset class as at 31 December 2018. As shown in this table, the majority of investments held are bonds.

Table 7.5: ARAG investment portfolio split as at 31 December 2018

Asset Class	Proportion of 2018 Investment Portfolio
Cash	2%
Covered bonds	10%
Government bonds	16%
Corporate bonds	26%
Emerging markets	10%
High yield bonds	3%
Shares	14%
Infrastructure	1%
Private equity	1%
Real estate	11%
Strategic investments	6%

7.18 ARAG's investment portfolio is primarily denominated in Euros, including all direct investments and the majority of bonds and equities. The majority of the remaining assets are denominated in USD, with only approximately 5% of the overall portfolio held in other currencies as at 30 August 2019.

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Section 8: Balance Sheets - DAS

Introduction

8.1 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. I consider the projected balance sheets over the period to the end of 2021 in Section 12 of this Scheme Report.

8.2 As part of my review of the balance sheets, I have reviewed the approach to reserving for DAS. I have considered the balance sheets both on a GAAP and Solvency II basis in my review and the key differences between the two bases.

8.3 Unless specifically stated otherwise, I have reviewed the balance sheets projected to Q4 2019, based on actual financial information as at 31 December 2018.

Transferring Business

8.4 A summary of the net reserves as at 31 December 2018 for the Transferring Policies on a UK GAAP basis is shown in the table below. BTE commercial non-motor is the most significant reserving class, representing 82% of the net claims reserves.

Table 8.1: Net UK GAAP Reserves as at 31 December 2018 for Transferring Policies

Reserving Class All in £000's	Net Claims Reserves	Net UPR
Irish Motor BTE	35	76
Irish Commercial non-motor BTE	613	110
Irish Personal non-motor BTE	83	34
Irish Insured Assistance	0	3
Irish Personal Non-Motor ATE	20	1
Total	**752**	**224**

Impact of the Proposed Scheme on DAS GAAP balance sheet

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

8.6 The projected balance sheets of DAS (on both a GAAP and Solvency II basis) at Q4 2019 incorporate material recoveries which are expected following recent legal action. Three individuals were found guilty of defrauding DAS during a trial in 2018 and a confiscation order was made in July 2019. As noted previously, I expect to produce a Supplementary Report in due course based on updated financials for DAS, which will take into account any developments in respect of these anticipated recoveries and any resulting impacts on my conclusions.

Table 8.2: Projected DAS UK GAAP balance sheets as at 31 December 2019 on a No Scheme and Post Scheme basis

All in £000's	No Scheme basis	*Movement*	Post Scheme basis
Assets			
Investment Assets	123,400	*0*	123,400
Loans	5,000	*0*	5,000
Ceded UPR	106,800	*(800)*	106,000
Ceded Claims Reserve	105,800	*(3,700)*	102,200
Cash with Bank	25,600	*0*	25,600
DAC Asset	5,500	*0*	5,500
Receivables	136,000	*0*	136,000
Deferred Tax	100	*0*	100
Other Deferred Items	1,400	*0*	1,400
Total assets	**509,600**	***(4,500)***	**505,200**
Liabilities			
UPR	117,900	*(800)*	117,200
Claims reserves	123,100	*(3,700)*	119,400
Other liabilities	19,800	*0*	19,800
Accruals and deferred income	35,900	*0*	35,900
Ceded DAC	1,300	*0*	1,300
Reinsurance Deposits Retained	179,800	*0*	179,800
Total liabilities	**477,800**	***(4,500)***	**473,400**
Total shareholders' funds	**31,800**	***0***	**31,800**

8.7 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.

8.8 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 (as described in paragraph 5.14) rather than on the Effective Date, the Proposed Scheme is not projected to have any impact on the shareholders' funds of DAS.

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

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

Table 8.3: Projected DAS Solvency II balance sheets as at 31 December 2019 on a No Scheme and Post Scheme basis

All in £000's	No Scheme basis	*Movement*	Post Scheme basis
Assets			
Investments	124,871	*0*	124,871
Reinsurers share of technical provisions	118,795	*(3,752)*	115,043
Other assets including cash	30,866	*0*	30,866
Receivables	44,511	*0*	44,511
Total assets	**319,043**	*(3,752)*	**315,291**
Liabilities			
Technical provisions	130,978	*(3,791)*	127,187
Deferred tax liability	2,352	*7*	2,358
Accruals and deferred income	722	*0*	722
Other liabilities (incl. reinsurance deposits)	141,726	*0*	141,726
Total liabilities	**275,778**	*(3,784)*	**271,994**
Solvency II Own Funds	**43,265**	***32***	**43,297**

8.10 The Proposed Scheme is projected to result in a £32k increase in the Solvency II Own Funds of DAS. This is largely due to the ceded Technical Provisions reducing by slightly less than the gross Technical Provisions in the Post Scheme projections, as a result of the different methods used to estimate these items. In addition, the Proposed Scheme is projected to result in minor movements in deferred tax and the risk margin.

UK GAAP to Solvency II

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

Table 8.4: Movement in Own Funds from UK GAAP to Solvency II basis

All in £000's	No Scheme basis	*Movement*	Post Scheme basis
UK GAAP Shareholders' Funds	31,800	*0*	31,800
Solvency II Own Funds	43,265	*32*	43,297
Movement	**11,465**	***32***	**11,497**

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

Table 8.5: Movement in Own Funds from UK GAAP to Solvency II basis

All in £000's	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
Movement in best estimate reserves	*18,823*	*23*	*18,847*
Inclusion of risk margin	*(2,607)*	*16*	*(2,591)*
Removal of deferred acquisition costs and deferred reinsurance commissions	(4,200)	*0*	(4,200)
Other adjustments	(552)	*(7)*	(559)
Movement	**11,465**	***32***	**11,497**

8.13 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.

8.14 In addition, deferred acquisition costs and deferred reinsurance commissions payable are fully eliminated in the Solvency II balance sheet. The removal of these items serves to reduce the Own Funds.

Premium reserving

8.15 For non-ATE policies, DAS earns the premium on a pro-rata basis, such that the unearned premium is calculated as the proportion of premiums written in the current year and in previous years that relates to unexpired terms of policies in force at the reporting date.

8.16 For ATE policies, insurance premiums are assumed to remain unearned until the outcome of the case is known.

8.17 This unearned premium is used as described below for the two relevant reporting bases.

GAAP reserving

8.18 For UK GAAP, the unearned premium reserve is equal to the full unearned premium amount, less an allowance for any deferred acquisition costs associated with the premium and other

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

deductions to allow for the probability that premiums will be written down during the course of the contract, or will not be fully recovered. In addition, an allowance for an additional unexpired risk reserve is included where appropriate.

Solvency II Premium Provisions

8.19 For Solvency II, Premium Provisions are held which include the cost of future claims and expenses using actuarial projections based on expected loss ratios and expense/commission factors applied to the unearned premiums and new business premiums for contractually bound business.

Claims reserving

8.20 DAS use standard actuarial methods to inform gross reserves held for UK and Norwegian business, including the chain ladder and Bornhuetter-Ferguson methods. The specific methods used in these projections vary by class, depending on data quality, reliability of models and particular features of the class, such as seasonality.

8.21 Reinsurance reserves for external contracts are estimated on a case-by-case basis.

8.22 In order to set reserves for the Irish business, DAS use a simplified approach given the level of materiality of the Irish business. For the motor breakdown assistance class, the gross, ceded and net reserves are all set to zero due to the size and very short tail of the class and the 100% quota share reinsurance. For all other classes a run-off pattern is derived from similar UK classes and applied to the Irish case reserves.

GAAP reserving

8.23 For the best estimate reserving for UK GAAP purposes, DAS holds the reserves derived using the reserving process set out in the paragraphs above, with a separate additional allowance for potential adverse experience.

Solvency II Claims Provisions

8.24 The following approaches are used for the calculation of the Solvency II Claims Provisions:

- The UK GAAP reserves are taken as a starting point and then adjusted for discounting and the potential for counterparty default. The allowance for potential adverse experience included in the booked reserves is considered to be an appropriate allowance for events not in data ("ENIDs"); and

- Any reinsurance deposits and commission relevant to the Claims Provision are also included.

Approach to review of reserves

8.25 I have used the following approaches to satisfy myself with the reasonableness of the reserves booked by DAS on both a UK GAAP and Solvency II basis:

- Review of internal reserving methodology and results

- Review of historical performance of internal reserve estimates

- Review of external reserve reviews

- My own high-level estimate of the reserves

8.26 When undertaking any reserving exercise there are a range of assumptions that could be considered reasonable, with any two actuaries looking at the same set of data likely to produce different projections of future claims depending on their individual judgment. This leads to the concept of a range of reasonable estimates of future claims, which can be seen as the range of estimates which could be produced from the data by making different but still reasonable actuarial judgments.

8.27 The focus of my review of the reserves has been to assess whether the DAS reserves sit within such a range and are therefore, in my opinion, "reasonable".

8.28 In particular, I have focussed my review on:

- The reserves which have been booked under UK GAAP, which are also used as the starting point for the Solvency II Claims Provisions; and

- The loss ratios which are applied to the unearned premium reserves to calculate the starting point for the Solvency II Premium Provisions.

8.29 I note that a number of subsequent adjustments are made to the starting points of the Solvency II Claims Provisions and Premium Provisions. In my view these adjustments are less material or largely mechanical in nature. I therefore consider that my review of the starting points for the Solvency II Claims Provisions and Premium Provisions is a reasonable proxy for a review of the final Solvency II Technical Provisions.

Review of internal reserving methodology and results

8.30 I have reviewed DAS's internal estimates of ultimate claims at year-end 2018 as set out in the internal presentation to the Reserving Committee on 8 January 2019. I have also reviewed the equivalent presentation from year-end 2017.

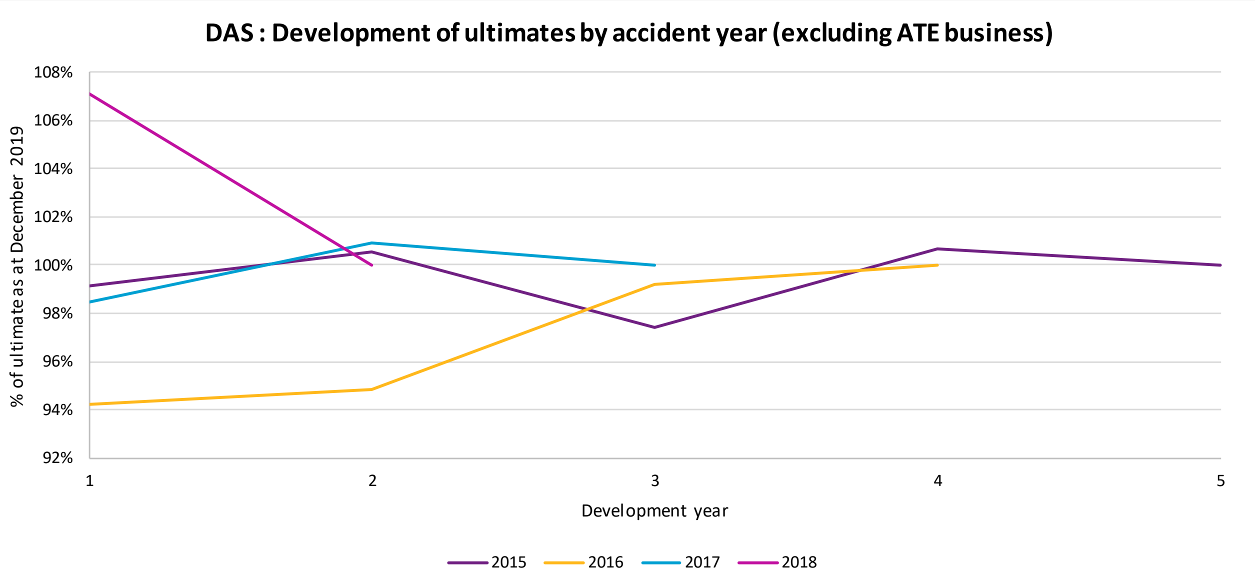
8.31 These presentations were in line with my expectations, including sufficient detail on the actuarial methods being used, the key judgments and assumptions made and explanations around significant movements. This provided good support for the reasonableness of the reserves.

Review of historical performance of internal reserve estimates

8.32 I have reviewed the performance of DAS's historical claims reserve estimates by considering the ultimate claims by accident year which were held by DAS as at each year-end between 2015 and 2019.

8.33 The progression of each accident year as a proportion of its selected ultimate as at 31 December 2019, for accident years 2015 onwards, is shown in Figure 8.1 below.

Figure 8.1: Historical reserving performance for DAS



8.34 It can be seen from the graph above that in the first few years there is some uncertainty in the estimated ultimate claims but that this reduces over time. The deterioration in projected ultimate claims for the 2016 accident year (between development years 2 and 3) was driven partly by a data issue together with some true reserve deterioration.

8.35 I note that the movements in DAS's ultimates do not appear to be biased in a particular direction, and the year-on-year movements do not appear to be unreasonable given the inherent uncertainty surrounding estimates of claims liabilities.

8.36 The above graph excludes the ATE business as there was an historical issue with the allocation of ATE claims to accident year. However I have reviewed the historical performance of the ATE business separately which, after allowing for the known data issue, also shows that DAS's ultimates do not appear to be biased in a particular direction, and the year-on-year movements do not appear to be unreasonable.

8.37 As a result, I believe this review supports the reasonableness of the DAS reserves.

Review of external actuarial reserve studies

8.38 DAS has engaged an external firm to undertake independent reserve assessments on a number of occasions as part of the annual audit of DAS, the latest of which was carried out as at 31 December 2018. This exercise concluded that the DAS actuarial best estimate of reserves was within the external firm's acceptable range.

8.39 I have reviewed the external reports as at both 31 December 2017 and 31 December 2018. I have not relied upon them in reaching my conclusions. However, I consider that they support the overall reasonableness of the reserves held by DAS.

High-level estimate of the reserves

8.40 I have received claims triangles showing the historical development of paid and incurred claims from accident years 2010 onwards for each of the BTE classes of business (BTE motor, BTE commercial non-motor and BTE personal non-motor). These classes of business make up around 90% of the claims reserves held by DAS.

8.41 I have used the data provided to undertake a high-level reserving exercise for each of these classes using standard actuarial claims reserving techniques and compared the results with the UK GAAP reserves booked by DAS. Where the results of my analysis initially came up with greater deviations than expected I discussed the differences with DAS to understand the reasons for the differences.

8.42 I also compared the results of my high-level reserving exercise and my selected initial expected loss ratio for the Bornhuetter-Ferguson method with the expected loss ratios selected by DAS to estimate the cost of future claims for the Solvency II Premium Provisions.

8.43 Based on the analysis I have carried out I consider that the reserves of DAS lie within an acceptable range.

Findings

8.44 While I have not attempted to review in detail the internal or external calculations performed; the above analysis, including my high-level estimate of the reserves, has given me comfort that the DAS reserves, on both a UK GAAP and Solvency II basis, are reasonable.

Section 9: Balance Sheets - ARAG

Introduction

9.1 In this section I set out my review of the GAAP and Solvency II balance sheets of ARAG as at 31 December 2018. I consider the projected balance sheets over the period to the end of 2021 in Section 12 of this Scheme Report.

9.2 As part of my review of the balance sheets, I have reviewed the approach to reserving for ARAG. I have considered the balance sheets both on a GAAP and Solvency II basis in my review and the key differences between the two bases.

9.3 As noted in paragraph 4.16, 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 Transfer or the wider business transaction between DAS and ARAG.

ARAG GAAP balance sheet

9.4 The table below shows the balance sheet for ARAG on a German GAAP basis as at Q4 2018.

9.5 I note that after the Proposed Scheme, the accounting standards which the Transferring Policies are subject to will change from UK GAAP to German GAAP, as these are the standards DAS and ARAG adhere to respectively. This change is discussed further from paragraph 15.21 of this Scheme Report. In summary, though, the change from UK GAAP to German GAAP will have no impact on the Solvency II Own Funds, and this is the primary basis under which the conclusions included in this report have been drawn.

Table 9.1: ARAG German GAAP balance sheet as at Q4 2018

All in £000's	No Scheme basis
Assets	
Investments	254,079
Loans	42,356
Ceded UPR	129
Ceded claims reserves	30,346
Other assets including cash	2,739
Receivables	22,961
Deferred items	475
Total assets	**353,086**
Liabilities	
UPR	22,942
Claims reserves	190,917
Claims equalisation provision	33,968
Payables	5,399
Pension provisions	28,688
Tax provisions	59
Deferred tax liability	0
Other liabilities	21,237
Total liabilities	**303,210**
Total shareholders' funds	**49,876**

9.6 As noted in paragraph 4.16, due to the low materiality of the Transferring Business when compared to the overall ARAG balance sheets, the figures in the table above have not been adjusted to allow for the impact of the Proposed Transfer or the wider business transaction between DAS and ARAG.

9.7 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 8.2.

9.8 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.

ARAG Solvency II balance sheet

9.9 The table below shows the balance sheet for ARAG on a Solvency II basis as at Q4 2018.

Table 9.2: ARAG Solvency II balance sheets as at Q4 2018

All in £000's	No Scheme basis
Assets	
Investments	350,664
Reinsurers share of technical provisions	23,177
Insurance and intermediaries receivables	11,900
Other assets including cash	13,728
Total assets	**399,469**
Liabilities	
Technical provisions	151,647
Insurance and intermediaries payables	5,398
Pension provisions	34,597
Deferred tax liability	0
Other liabilities	21,236
Total liabilities	**212,879**
Solvency II Own Funds	**186,590**
SCR	**67,115**
Solvency Ratio	**278%**

9.10 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.

German GAAP to Solvency II

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

Table 9.3: Movement in Own Funds from German GAAP to Solvency II basis as at Q4 2018

All in £000's	No Scheme basis
German GAAP Shareholders' Funds	49,876
Solvency II Own Funds	186,590
Movement	**136,714**

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

Table 9.4: Movement in Own Funds from German GAAP to Solvency II basis as at Q4 2018

All in £000's	No Scheme basis
Movement from German GAAP reserves to Solvency II Technical Provisions, which comprises of:	88,882
Movement in best estimate reserves	*59,089*
Inclusion of risk margin	*(4,174)*
Removal of equalisation provision	*33,968*
Value of investments	54,228
Other adjustments	(8,793)
Movement	**136,714**

9.13 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.

9.14 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.

Premium reserving

9.15 Gross unearned premiums for direct insurance business are calculated on a pro-rata basis for each individual policy. The gross unearned premiums for inward reinsurance business are recognised in accordance with the requirements of the primary insurer. The reinsurers' share of the unearned premiums is determined in accordance with the contractual agreements.

9.16 This unearned premium is then used as described below for the two relevant reporting bases.

GAAP reserving

9.17 For German GAAP, the unearned premium reserve is equal to the full unearned premium amount, plus an allowance for an additional unexpired risk reserve only where a specific insurance contract is expected to generate significant losses. In addition, this reserve may be reduced by a proportion of the income components intended to cover acquisition costs. This proportion is 85% for costs incurred through the group headquarters and is individually determined for international units of the company.

Solvency II Premium Provisions

9.18 For Solvency II, Premium Provisions are held which include the present values of the expected claims payments and costs relating to unearned premiums, along with an allowance for the outstanding premium income from in-force policies.

Claims reserving

9.19 ARAG's risk management department use standard actuarial methods to inform the actuarial gross best estimate reserve recommended for each reserving class, including the chain ladder and Bornhuetter-Ferguson methods. This reserve estimate includes an allowance for claims adjustment expenses, which are estimated using actuarial projections.

GAAP reserving

9.20 ARAG's GAAP reserves are set by the finance department, with the condition that they exceed the reserves as calculated by the risk management department using the process set out in the immediately preceding paragraph, plus an additional safety margin which is calculated to be the difference between the 50th percentile and the 75th percentile of the distribution of total reserves.

9.21 A significant degree of prudence is therefore included in the booked reserves when compared with those calculated by ARAG's risk management department, which is typical of firms reporting under German GAAP.

Solvency II Claims Provisions

9.22 In order to calculate the Solvency II Claims Provisions, ARAG takes the best estimate reserves calculated by the risk management department as their starting point, including claims adjustment expenses but excluding the safety margin. This is adjusted for discounting at the risk-free yield curves published by EIOPA.

9.23 In addition, reserves for reinsurance recoverables are estimated using ARAG's Partial Internal Model by applying historical and current reinsurance treaties to gross reserves. This estimate includes an allowance for the potential default of reinsurance counterparties.

9.24 Reserves in relation to annuities are calculated according to 'similar to life insurance techniques', including the use of mortality tables.

9.25 ARAG do not include any explicit allowance for Events Not In Data ("ENIDs") in their Solvency II Claims Provisions, as they believe that their data and projections sufficiently allow for extreme scenarios. This point has been discussed and agreed upon with ARAG's auditors.

Approach to review of reserves

9.26 I have used the following approaches to satisfy myself with the reasonableness of the reserves of ARAG:

- Review of internal reserving methodology and results
- Review of historical performance of internal reserve estimates

- Review of external reserve reviews
- My own high-level estimate of the reserves

9.27 When undertaking any reserving exercise there are a range of assumptions that could be considered reasonable, with any two actuaries looking at the same set of data likely to produce different projections of future claims depending on their individual judgment. This leads to the concept of a range of reasonable estimates of future claims, which can be seen as the range of estimates which could be produced from the data by making different but still reasonable actuarial judgments.

9.28 The focus of my review of the reserves has been to assess whether the ARAG reserves sit within such a range and are therefore, in my opinion, “reasonable”.

9.29 In particular, I have focussed my review on:

- The best estimate reserves calculated by the risk management department which are used as the starting point for the Solvency II Claims Provisions (the “ARAG best estimate reserves”); and
- The loss ratios which are applied to the unearned premium reserves to calculate the starting point for the Solvency II Premium Provisions.

9.30 I note that a number of subsequent adjustments are made to the starting points of the Solvency II Claims Provisions and Premium Provisions. In my view these adjustments are less material or largely mechanical in nature. I therefore consider that my review of the starting points for the Solvency II Claims Provisions and Premium Provisions is a reasonable proxy for a review of the final Solvency II Technical Provisions.

9.31 By focussing on the reserves noted above, I have primarily considered whether the Solvency II Technical Provisions booked by ARAG are “reasonable” as this is the primary basis under which the conclusions included in this report have been drawn.

9.32 I have not considered whether the booked reserves of ARAG are “reasonable” since, as noted in paragraph 9.20 above, these reserves include an additional safety margin.

Review of internal reserving methodology and results

9.33 I have reviewed ARAG’s internal estimates of ultimate claims as at 31 December 2018 (based on data as at 31 October 2018) as set out in the internal presentation to the Reserving Committee on 5 December 2018. I have also reviewed a document which sets out ARAG’s approach to reserving for their annuity exposures referred to in paragraph 9.24 above.

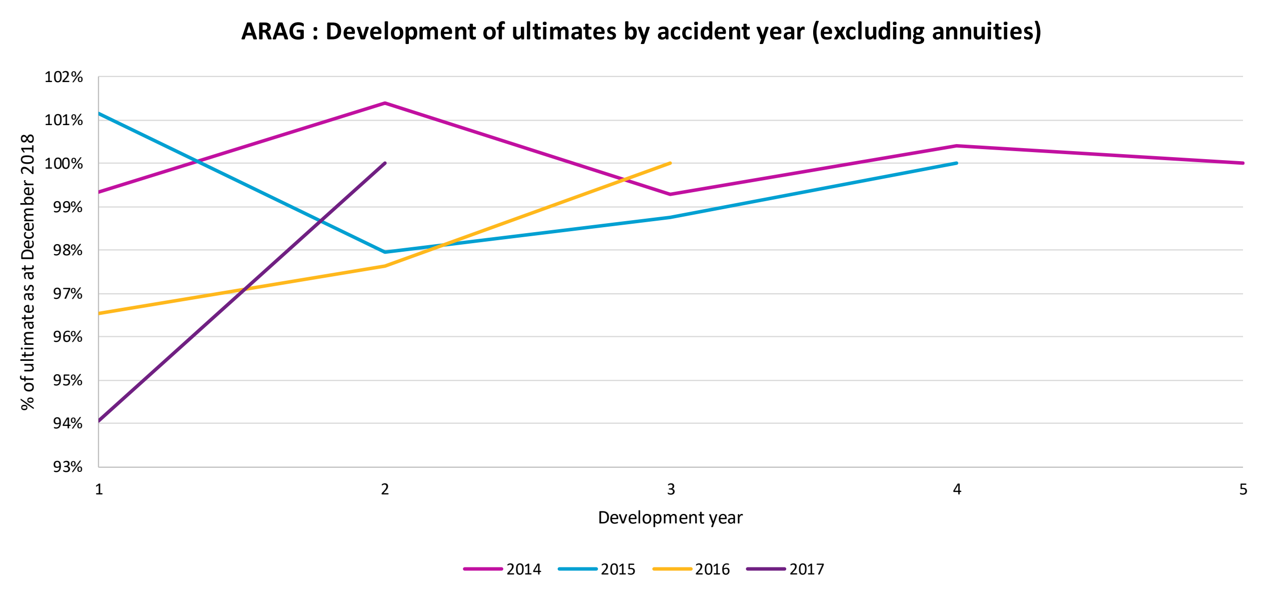
9.34 These documents were in line with my expectations, including sufficient detail on the actuarial methods being used, the key judgments and assumptions made and explanations around significant movements. This provided good support for the reasonableness of the reserves.

Review of historical performance of internal reserve estimates

9.35 I have 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.

9.36 The progression of each accident year as a proportion of its selected ultimate as at 31 December 2018, for accident years 2014 onwards, is shown in Figure 9.1 below.

Figure 9.1: Historical reserving performance for ARAG



9.37 It can be seen from the graph above that in the first few years there is some uncertainty in the estimated ultimate claims but that this reduces over time. The 2017 accident year shows a deterioration in projected ultimate claims of just over 6% between development years 1 and 2. This was driven by some unusual developments in large claims, including one exceptionally large claim whose deterioration accounts for over half of the total deterioration seen during this period.

9.38 I note that the movements in ARAG's ultimates do not appear to be biased in a particular direction, and the year-on-year movements do not appear to be unreasonable given the inherent uncertainty surrounding estimates of claims liabilities. As a result, I believe this review supports the reasonableness of the ARAG reserves.

Review of external actuarial reserve studies

9.39 The adequacy of loss reserves has been audited by ARAG's external auditors, most recently in February 2019. This audit made use of actuarial methods to assess the reserve adequacy for a number of ARAG's reserving classes, and covered both the German GAAP reserves and the Solvency II Technical Provisions. On the basis of this assessment, the auditors commented that they were able to convince themselves that the reserve estimates and assumptions made by ARAG were justified and sufficiently well documented.

9.40 I have reviewed the report produced by ARAG's external auditors as at 31 December 2018. I have not relied upon it in reaching my conclusions. However, I consider that it supports the overall reasonableness of the reserves held by ARAG.

High-level estimate of the reserves

9.41 I have received claims triangles showing the historical development of paid and incurred claims from accident years 1998 onwards for each of class of business, other than the annuity business (where, given the nature of reserving for such business, I instead focussed on my review of ARAG's documentation, as described in paragraph 9.33 above).

9.42 I have used the data provided to undertake a high-level reserving exercise for each of the key classes of business using standard actuarial claims reserving techniques and compared the results with ARAG's best estimate reserves. Where the results of my analysis initially came up with greater deviations than expected I discussed the differences with ARAG to understand the reasons for the differences.

9.43 The classes of business I modelled make up over 80% of the claims reserves held by ARAG (excluding the reserves for the annuity business).

9.44 I also compared the results of my high-level reserving exercise and my selected initial expected loss ratio for the Bornhuetter-Ferguson method with the expected loss ratios selected by ARAG to estimate the cost of future claims for the Solvency II Premium Provisions.

9.45 Based on the analysis I have carried out I consider that the reserves of ARAG lie within an acceptable range.

Findings

9.46 While I have not attempted to review in detail the internal or external calculations performed, the above analysis, including my high-level estimate of the reserves, has given me comfort that the ARAG best estimate reserves and Solvency II Technical Provisions are reasonable.

9.47 That said, there is uncertainty over the level of reserves and as such in my sensitivity testing in Section 13 I have tested the impact of reserves deteriorating by both 5% and 10%.

Section 10: Capital Requirements - DAS

Solvency II capital requirements

10.1 Under Solvency II, the regulatory capital for companies can be set according to different approaches, including the Standard Formula, an Internal Model or a Partial Internal Model. Solvency II aims to ensure that Own Funds are no less than the level required at a 1 in 200 adverse scenario over a one-year time horizon (a 0.5th percentile level of risk on a Value-at-Risk basis).

10.2 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, such that a bespoke capital model could be used to set the regulatory capital requirement.

10.3 In this section I consider the impact of the Proposed Scheme on the security of DAS immediately before and after the Proposed Scheme. In Section 12 of this report I consider the capital requirements of DAS over the period to the end of 2021, along with consideration of some scenario tests.

Details of Standard Formula

10.4 The Standard Formula is one of the approaches under Solvency II for calculating a company's Solvency Capital Requirement. The Standard Formula methodology, as prescribed in the Solvency II Delegated Acts for calculating an undertaking's SCR and MCR, uses a combination of factor and scenario based methods.

10.5 The Standard Formula approach looks at each risk individually and applies a prescribed factor or scenario based approach for each individual risk. The process followed is that firstly individual sub-risks and risks are calculated, with the results aiming to represent the 99.5th percentile (or 1 in 200 year outcome) for each component. The individual risks are then aggregated, incorporating an allowance for diversification.

10.6 The key risks included within the SCR calculation are as follows:

- Market risk
  - Interest rate risk
  - Equity risk
  - Property risk
  - Spread risk
  - Currency risk
  - Concentration risk
- Counterparty default risk
- Underwriting risk
  - Premium & reserve risk

  - Catastrophe risk
  - Lapse risk
- Operational risk

Appropriateness of the SCR

10.7 I have reviewed documents and calculations relating to the calculation of the SCR on the Standard Formula basis and have 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.

10.8 The SCR calculated using the Standard Formula approach has been audited by DAS's external auditors, most recently as at 31 December 2017 and previously as at 31 December 2016. The audit of the SCR was taken out of scope for the 2018 audit, consistent with the latest PRA guidance on the requirements for firms to receive an external audit of the SCR, which granted an exemption for small firms which meet specified criteria.

10.9 I have reviewed the calculation of the DAS Standard Formula SCR projected as at Q4 2019, based on the SCR as at 31 December 2018, and consider this to be reasonable.

10.10 DAS concludes in its 2017 ORSA that the Standard Formula is an appropriate basis for calculating DAS's regulatory capital requirement. Part of that assessment includes a comparison with the results of the internal model of the ERGO group, where the estimated underwriting risk is below that calculated by the Standard Formula. The 2018 ORSA has not yet been finalised, but I have been advised that the internal model continues to estimate the SCR for DAS to be significantly lower than the Standard Formula SCR.

10.11 In my opinion the use of the Standard Formula to calculate the regulatory capital requirement is therefore a reasonable approach for DAS.

Impact of the Proposed Scheme on capital requirements

10.12 The table below shows the Standard Formula SCR results projected as at Q4 2019, immediately before and after application of the Proposed Scheme.

Table 10.1: DAS Standard Formula projections as at Q4 2019

All in £000's	No Scheme basis	*Movement*	Post Scheme basis
Premium and reserve risk	*7,111*	*0*	*7,111*
Lapse risk	*4,381*	*0*	*4,381*
Catastrophe risk	*0*	*0*	*0*
Total underwriting risk	8,352	*0*	8,352
Market risk	2,719	*0*	2,719
Counterparty default risk	7,767	*(6)*	7,761
Diversification	(3,863)	*1*	(3,862)
Basic SCR	**14,975**	***(5)***	**14,970**
Operational risk	3,818	*(114)*	3,703
Loss-absorbing capacity of deferred taxes	(2,352)	*(7)*	(2,358)
Total SCR	**16,441**	***(126)***	**16,315**
Solvency II Own Funds	**43,265**	***32***	**43,297**
Solvency II coverage ratio	**263%**	***2%***	**265%**

10.13 DAS's SCR is not expected to change materially as a result of the Proposed Scheme. In particular, the SCR coverage ratio is expected to marginally increase from 263% to 265%.

10.14 The primary expected movement is a reduction in operational risk of £114k. This is driven by the reduction in gross Technical Provisions and gross earned premiums resulting from the Proposed Scheme.

10.15 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. These amendments serve to reduce the Standard Formula SCR for DAS.

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Section 11: Capital Requirements - ARAG

Solvency II capital requirements

11.1 Under Solvency II, the regulatory capital for companies can be set according to different approaches, including the Standard Formula, an Internal Model or a Partial Internal Model. Solvency II aims to ensure that Own Funds are no less than the level required at a 1 in 200 adverse scenario over a one-year time horizon (a 0.5th percentile level of risk on a Value-at-Risk basis).

11.2 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.

11.3 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. If the Transferring Business was more material then this may result in a “major model change” being required to the Partial Internal Model, which would require regulator approval.

11.4 In this section I consider the impact of the Proposed Scheme on the security of ARAG. In Section 13 of this report I consider the capital requirements of ARAG over the period to the end of 2021, along with consideration of some scenario tests.

11.5 As noted in paragraph 4.16, 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 Transfer or the wider business transaction between DAS and ARAG.

Appropriateness of the capital requirements

11.6 I have considered ARAG’s approach to calculating its regulatory capital requirements through a review of the key documents which I have been provided with, together with consideration of further information I have been provided on the detail of the model and responses to queries I have raised.

11.7 Based on the information I have been provided on the detail of the model, I have performed the following:

- A high-level benchmarking of the key parameters of the Partial Internal Model.
- A comparison of the key parameters of the Partial Internal Model with those underlying the Standard Formula.
- A high-level benchmarking of the Partial Internal Model and Standard Formula SCRs of ARAG to other comparable insurers based on external information available to me. This has focussed on key metrics such as the ratio of SCR to premium and the ratio of SCR to Technical Provisions.

11.8 I have also compared the results of the Partial Internal Model to the corresponding Standard Formula calculation carried out by ARAG as at 31 December 2018 and do not consider the relative sizes of the respective SCRs to be unreasonable.

11.9 I have also considered whether the counterparty default risk included within ARAG's SCR is materially understated. As noted above, counterparty default risk is calculated using the Standard Formula specification, although the default risk associated with cash amounts is included within ARAG's Partial Internal Model as part of credit spread risk. The reinsurers' share of Solvency II Technical Provisions as a proportion of gross is only 15% for ARAG and, as discussed in paragraph 7.10 of this Scheme Report, ARAG purchases a range of reinsurance contracts from multiple counterparties. Given that ARAG does not have significant counterparty exposure I would therefore not expect the counterparty default risk calculated using the Standard Formula to materially understate the counterparty default risk of ARAG. I also asked ARAG to undertake a scenario around the impact of reinsurer failure on their SCR. The results of this very extreme scenario support my conclusion that the Standard Formula does not materially understate the counterparty default risk of ARAG.

11.10 In addition, I have reviewed the independent validation report for the Partial Internal Model as at Q4 2017 (and dated 13 December 2018). ARAG's Partial Internal Model is validated via an annual cycle, responsibility for which lies with the actuarial function. This validation involves using qualitative and quantitative processes to check whether the results and forecasts of the Partial Internal Model are sufficiently accurate. Both the mathematical and statistical methods used in the Partial Internal Model and the governance processes relating to ARAG's Partial Internal Model are verified. At the end of the annual validation cycle, the actuarial function submits a comprehensive validation report to the ARAG Management Board, which makes sure that the Partial Internal Model is suitable for measuring solvency in accordance with Solvency II and can be used as a basis for management decisions and corporate management.

11.11 As is to be expected, the validation identified a number of limitations of the Partial Internal Model and recommendations have therefore been included in the independent validation report. However, there is nothing in the independent validation report that suggests that the SCR calculated using the Partial Internal Model is materially misstated.

11.12 ARAG's regulator, BaFin, are provided regular reports summarising the output of the Partial Internal Model by ARAG. This includes a sign-off requirement around any changes to the approved model.

11.13 While I have not attempted to review the calculations performed in detail, based on the above work I have carried out I consider 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 have not identified any reasons to believe that the calculated SCR materially understates or overstates the regulatory capital of ARAG.

11.14 I have also gained comfort from the fact that ARAG's Partial Internal Model has been reviewed and approved by BaFin.

Impact of proposed changes to the Standard Formula

11.15 During 2018, EIOPA communicated a number of changes that it proposed to make to the Standard Formula calculation. The resulting amendments to the Solvency II Delegated Regulation were adopted by the European Commission on 8 March 2019.

11.16 ARAG's Partial Internal Model only makes use of the Standard Formula in order to calculate operational risk and counterparty default risk. Since the amendments to the Standard Formula do not affect these risk calculations, they will have no impact on ARAG's SCR.

Impact of the Proposed Scheme on capital requirements

11.17 The table below shows the Partial Internal Model SCR results as at Q4 2018, before the application of the Proposed Scheme.

11.18 ARAG's Partial Internal Model calculates the SCR for existing business, as well as the new business expected to be written over the following 12 months, and corresponds to the Value-at-Risk of the basic own funds of ARAG subject to a confidence level of 99.5% over a one-year period.

11.19 The calculated SCR includes the following risks and allows for diversification between these.

- **Insurance risk:** the largest components of which are:
  - **Premium risk** – the failure of pricing, product or strategy. It encompasses losses due to the potential timing, frequency and severity of covered loss events differing from that assumed at the time of underwriting and pricing a risk.
  - **Reserve risk** – arising from adverse reserve development through failing to set sufficient reserves.
  - **Catastrophe risk** – arising from the failure to manage risk aggregation or accumulation that may result in increased exposure to natural or man-made catastrophe losses.
- **Market risk:** the risk that ARAG is adversely affected by movements in the fair value of its financial assets arising from market movements. Market risk includes the following sub-risks: credit spread risk, interest rate risk, property risk, equity risk and foreign exchange risks.
- **Counterparty default risk:** the change in the value of assets and liabilities caused by unexpected default or deterioration in the credit standing of counterparties and debtors, including reinsurers.
- **Operational risk:** the risk of loss or other adverse consequences resulting from inadequate or failed internal processes, people, systems or external events.

11.20 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 (see paragraph 15.63). 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 (see paragraph 15.56) is not allowed for within the Partial Internal Model. I consider the impact of this through undertaking some scenarios in Section 13 of this Scheme Report.

Table 11.1: ARAG SCR projections as at Q4 2018

All in £000's **Risk**	**No Scheme Basis**
Premium and reserve risk	*13,841*
Lapse risk	*1,035*
Man-Made Catastrophe risk	*1,412*
Natural Catastrophe risk	*8,682*
Total non-life underwriting risk	17,812
Total health underwriting risk	n/a
Total life underwriting risk	n/a
Market risk	53,662
Counterparty default risk	3,846
Diversification	(13,181)
Basic SCR	**62,140**
Operational risk	4,975
Loss-absorbing capacity of deferred taxes	0
Total SCR	**67,115**
Solvency II Own Funds	**186,591**
Solvency II coverage ratio	**278%**

11.21 The primary risk for ARAG is market risk, which is largely driven by equity risk.

11.22 As noted in paragraph 4.16, the actual and projected future capital and balance sheet figures (as at 31 December 2018, 2019, 2020 and 2021) which have been provided by ARAG (including those shown in the table above) do not include any allowance for the wider business transaction between DAS and ARAG taking place or for the Proposed Scheme. The Transaction and the Proposed Scheme are expected to have a negligible impact on the projected figures set out in the table above and therefore no separate results are shown on the basis of the Proposed Scheme being carried out. However, I will consider any update to these figures which are available at the time of drafting my Supplementary Report and any resulting impacts on my conclusions.

Section 12: Projections - DAS

Introduction

12.1 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 2019 to 2021.

12.2 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

12.3 The shareholders' funds for DAS are expected to increase in future periods. This is largely due to increases in non-insurance assets projected over the period, slightly offset by an increase in net UPR as a result of increasing planned premium volumes.

12.4 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.

12.5 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, do not expect it to significantly affect DAS's profitability in future years.

Projected SCR coverage ratios

12.6 The projected SCR coverage ratios for DAS are projected to generally increase in the future, regardless of whether or not the Proposed Scheme takes place. This is due to increases in projected Solvency II Own Funds over the period. The SCR is also projected to increase over the period but to a slightly lesser degree.

Ultimate capital

12.7 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.

12.8 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 13: Projections and Scenarios - ARAG

Introduction

13.1 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 2019 to 2021. 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

13.2 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.

13.3 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, do not expect it to significantly affect ARAG's profitability in future years.

Projected SCR coverage ratios

13.4 The projected SCR coverage ratios for ARAG are projected 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

13.5 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%.

13.6 ARAG has included two stress scenarios in its' Own Risk and Solvency Assessment ("ORSA") which could be reasonably expected to adversely affect ARAG's operations. These involve a strong and sudden change in interest rates (both up and down), along with additional shocks on other market risk parameters. The results of these scenarios are as follows:

- In the scenario that interest rates rise, a significant reduction in Solvency II Own Funds of approximately £50m is projected. This loss is slightly lower than that projected via the Partial Internal Model and corresponds to approximately the 99.47th percentile of the loss distribution output by this model.

- In the scenario that interest rates reduce, a less significant reduction in Solvency II Own Funds of approximately £5m is projected. This loss is significantly lower than that projected via the Partial Internal Model and corresponds to approximately the 63.34th percentile of the loss distribution output by this model.

13.7 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 224%, demonstrating that ARAG could continue to meet its regulatory capital requirements even after such a scenario. This reduced coverage ratio of 224% is below the coverage ratio of DAS of 263%, 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

13.8 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 £7.4 million (compared with the Solvency II Own Funds of £187 million, as shown in Table 9.2) and a SCR coverage ratio of 267%.
- A deterioration of 10% of the gross Solvency II Technical Provisions. This would result in a reduction of Solvency II Own Funds of £14.7 million (compared with the Solvency II Own Funds of £187 million, as shown in Table 9.2) and a SCR coverage ratio of 256%.
- An instantaneous decrease of 20% in the mortality rates used to value the annuity business of ARAG (as described in paragraph 15.63). This would result in a reduction of Solvency II Own Funds of £2.0 million (compared with the Solvency II Own Funds of £187 million, as shown in Table 9.2) and a SCR coverage ratio of 275%.

13.9 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. The first and third scenarios result in reduced coverage ratios which remain above the coverage ratio of DAS of 263%. The second scenario, of a deterioration of 10% of the Solvency II Technical Provisions, results in a reduced coverage ratio of 256% which is marginally below the coverage ratio of DAS of 263%, although this is on the basis that DAS is not impacted by any adverse scenarios and DAS could also be impacted by such a scenario.

13.10 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 (as described in paragraph 15.56). 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 £3.1 million (compared with the Solvency II Own Funds of £187 million, as shown in Table 9.2) and a SCR coverage ratio of 273%.

13.11 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 £70.3 million, unchanged Solvency II Own Funds (compared with those shown in Table 9.2) of £187 million and an adjusted SCR coverage ratio of 266%. 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 263%.

Ultimate capital

13.12 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").

13.13 Given the immaterial impact of the Proposed Scheme on ARAG's financial position, it is my opinion that the Proposed Scheme will only 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.

13.14 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 12.7.

13.15 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.

13.16 However, I note that around 45% of claims arising from the Transferring Policies are likely to be paid within one year, around 80% are likely to be paid within three years and the vast majority (over approximately 95%) 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 (£67 million) but additionally including the impact on Own Funds arising from the scenarios of a 5% deterioration in Technical Provisions (£7.4 million) and an instantaneous increase in mortality rates on the pension scheme liabilities (£3.1 million). This would give an estimated ultimate SCR of £77.6 million and an estimated ultimate SCR coverage ratio of 240%.

13.17 This estimated ultimate SCR coverage ratio of ARAG is below the one-year SCR coverage ratio of DAS of 263%, although not materially so and the ARAG estimated ultimate SCR coverage remains significantly above 100%. 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 £4.2 million for ARAG as at 31 December 2018, 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 246%.

13.18 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.

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Section 14: Conclusions on security of policyholders' contractual rights

Conclusions on security of policyholders' contractual rights – Remaining Policyholders

14.1 The Transferring Policies represent just under 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.

14.2 As a result of the Proposed Scheme, the SCR coverage ratio for DAS is projected to marginally increase from 263% to 265%. Future projected SCR coverage ratios over the period 2019 to 2021 are all expected to be marginally higher as a result of the Proposed Scheme.

14.3 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.

Conclusions on security of policyholders' contractual rights – Transferring Policyholders

14.4 The Transferring Policyholders are moving from a company with projected Solvency II Own Funds of approximately £43 million and an SCR coverage ratio of 263% to a company with projected Solvency II Own Funds of approximately £187million and an SCR coverage ratio of 278%.

14.5 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 266%. 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 263%.

14.6 I have also considered an estimated ultimate SCR for ARAG, which considers the period during which the liabilities 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 240%. This is not materially below the one-year SCR coverage ratio of DAS of 263% and remains significantly above 100%. In addition, my estimated ultimate SCR coverage ratio for ARAG includes some prudence.

14.7 The Transferring Policyholders are therefore moving to a company which is better capitalised and with a higher SCR coverage ratio on a one-year basis and remains strongly capitalised on an estimated ultimate basis. In addition, the SCR coverage ratios for ARAG are similar or higher than the corresponding SCR coverage ratios for DAS in all of the projections to 2021.

14.8 I therefore consider that the security of the Transferring Policyholders will not be materially adversely affected by the Proposed Scheme.

Conclusions on security of policyholders' contractual rights – Existing Policyholders

14.9 The SCR coverage ratio for ARAG on a No Scheme basis is projected to be 278%. 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.

14.10 I therefore consider that the security of the Existing Policyholders will not be materially adversely affected by the Proposed Scheme.

Section 15: Other Financial Considerations

Introduction

15.1 In this section, I discuss other financial considerations arising from the Proposed Scheme under the following headings:

- Implications of investment strategy
- Liquidity
- Implications of new business strategy
- Insolvency, including the ranking of policyholders in a winding-up and access to compensation schemes
- Trust Funds and guarantees
- Accounting and reserve approach
- Tax implications of the Proposed Scheme
- Costs of the Proposed Scheme
- Pension schemes

Implications of investment strategy

15.2 I have analysed the impact of the investment strategies of DAS and ARAG on the Remaining Policyholders, the Transferring Policyholders and the Existing Policyholders.

15.3 Since DAS and ARAG do not intend to make any changes to their respective investment strategies following the Proposed Scheme, I do not believe that the Remaining Policyholders or the Existing Policyholders will be materially impacted as a result of changes to investment strategy.

15.4 The vast majority of DAS's investments are in bonds. While the majority of ARAG's investments are also in bonds, there are also material holdings in other investments, including equity, real estate and emerging markets. I note that bonds typically exhibit a lower risk profile than these alternative investments, indicating that ARAG's investment returns may be more variable and subject to a greater risk of investment losses than DAS's. This is corroborated by the market risk stress calculated for ARAG's 2018 SCR, which indicates a 14% deterioration in the value of non-receivable assets over a year at the 0.5th percentile level of risk, compared to 2% for DAS (before allowance for counterparty default).

15.5 Given ARAG's high level of capital coverage, and the remoteness of probability calculated by ARAG's Partial Internal Model for investment losses to exceed this coverage, I believe that ARAG has sufficient Solvency II Own Funds to cover it against the risk of investment losses in all but extremely remote circumstances.

15.6 As a result of this, I do not consider that the transferring policyholders will be materially impacted as a result of the change in investment strategy.

Liquidity

15.7 I have analysed the impact of the Proposed Scheme on the availability of liquid funds to cover obligations to the Remaining Policyholders, the Transferring Policyholders and the Existing Policyholders.

15.8 DAS has an averse risk appetite for failing to meet any policyholder or other financial obligations as they fall due, with mitigation strategies in place which seek to minimise exposure to liquidity risk with the use of appropriate and reasonable controls. DAS ensures that it is in a position of being able to pay claims without delays in a 1-in-200 year scenario. Liquidity is monitored against the risk appetite on a daily basis and is considered green when there are cash holdings in bank accounts in excess of £3m, and red when the holdings are less than £1m. Liquidations of assets are made when necessary, to manage the liquidity.

15.9 ARAG estimates that approximately 78% of capital investments are either cash or can be sold in a period of 1 to 10 days. This is consistent with the Group Asset Management objective to be able to sell the majority of assets in less than 10 days.

15.10 I believe DAS and ARAG both have a high degree of liquidity within their investment portfolios and demonstrate sufficient awareness of the risks associated with this. As a result, I do not believe that either firm is subject to a material risk of being unable to support policyholder obligations due to a lack of liquid funds. I also note that neither company intends to make any change to investment strategy following the Proposed Scheme. I therefore consider that the Proposed Scheme will not have a material impact on the degree of liquidity risk for the Remaining Policyholders, the Transferring Policyholders or the Existing Policyholders.

Implications of new business strategy

15.11 I understand from DAS that the only significant change in new business strategy planned in the future surrounds the planned cessation of business written in Ireland following the Proposed Scheme. The business written through this branch does not represent a significant portion of DAS's total premium income, with just over 4% of the total gross written premium for 2018 arising from the Irish Branch. I therefore do not believe that DAS's exit from the Irish Branch will have a material impact on the Remaining Policyholders.

15.12 Similarly, I understand from ARAG that no significant changes are planned to its strategy, except for the recent opening of a branch and an MGA in Ireland. The business written in Ireland is not planned to grow significantly compared to the volume written by DAS historically, and the business written through the Irish branch by DAS in 2018 represents just over 3% of the ARAG's total gross written premium from 2018. I therefore do not believe that ARAG's establishment of the Irish Branch will have a material impact on the Existing Policyholders.

15.13 Neither DAS nor ARAG have a strategy centred around extreme growth, with DAS and ARAG both planning to increase gross written premium by less than 10% between 2018 and 2021. I therefore do not believe that a difference in new business strategy between DAS and ARAG will have a material impact on the Transferring Policyholders.

Insolvency

15.14 I am required to consider the effects of the insolvency of DAS and ARAG. As I have explained in this Scheme Report, the likelihood of either of these entities being able to pay all future claims will remain in excess of the level implied by the Solvency II solvency criterion of 99.5% value-at-risk over a one-year time horizon. This implies that the possibility of the insolvency of either DAS or ARAG after the Proposed Scheme is remote.

Ranking of policyholders

15.15 In the event of the insolvency of DAS then under UK insolvency rules policyholders would be paid in priority to all other unsecured debts, except employee remuneration and pension contributions. These rules mean that any sums available for insurance debts after the secured and preferred creditors have been satisfied are to be paid off in advance of all other debts. If there are insufficient sums to satisfy policyholder claims then, in the case of certain claims, the Financial Services Compensation Scheme ("FSCS") may contribute to the settlement of the claim. Access to compensation schemes such as the FSCS is discussed below.

15.16 In the event of the insolvency of DAS direct policyholders will rank ahead of any assumed reinsurance policyholders when the assets of the insolvent company are allocated to its creditors. The Remaining Policies and the Transferring Policies comprise both direct insurance policyholders and reinsurance policyholders.

15.17 Following the Proposed Scheme, the Transferring Policyholders will move from the UK insolvency regulations to the German insolvency regulations.

15.18 In the event of the insolvency of ARAG, then under German insolvency laws the general situation is that any policyholder claims on the insurer are of equal rank after certain priority creditors (such as the expenses of the insolvency administrator) have been met.

15.19 Therefore, in the remote possibility of an insolvency of DAS, the Remaining Policyholders will be subject to the same insolvency laws before and after the Proposed Scheme.

15.20 The Transferring Policyholders will be subject to the UK insolvency laws prior to the Proposed Scheme and the German insolvency laws after the Proposed Scheme. This change will result in a small change in the ranking of policyholders such that inwards reinsurance policyholders will rank equally (rather than below) direct insurance policyholders. This results in a marginal improvement for those Transferring Policyholders which are inwards reinsurance policyholders, which amount to around 5% of the Transferring Policies (by Solvency II Technical Provisions as at 31 December 2018).

15.21 For those Transferring Policyholders which are direct insurance policyholders the change results in a marginal deterioration in security, since they are moving from a company where they rank before inwards reinsurance policyholders to a company where they rank alongside inwards reinsurance policyholders. The proportion of inwards reinsurance business within DAS is 17% of Solvency II Technical Provisions as at 31 December 2018. The direct Transferring Policyholders therefore move from a company where they rank before 17% of the reserves (which relate to inwards reinsurance business) to a company where they rank alongside such reserves. I do not consider this to be a material reduction in policyholder security given the small proportion of inwards reinsurance business within DAS and the low probability of ARAG becoming insolvent (particularly in the period shortly after the Proposed Scheme which could potentially affect the Transferring Policyholders). This is discussed further from paragraph 15.40 of this Scheme Report (in relation to the impacted of reduced protection from compensation schemes) and concludes that:

- The assumption of an insolvency event immediately following the Proposed Scheme is, in my view, an unreasonable stress test given the capitalisation of ARAG at this time.
- In the event of the insolvency of ARAG one year following the Proposed Scheme, approximately £3m (or 2%) of the gross DAS Solvency II Technical Provisions excluding the risk margin at the time of the Proposed Scheme will potentially be impacted by the change in insolvency rules compared to their position in the event of no Proposed Scheme.
- In the event of the insolvency of ARAG two years following the Proposed Scheme, approximately £1m (or 1%) of the gross DAS Solvency II Technical Provisions excluding the risk margin at the time of the Proposed Scheme will potentially be impacted by the

change in the insolvency rules compared to their position in the event of no Proposed Scheme.

15.22 The Existing Policyholders will be subject to the German insolvency laws before and after the Proposed Scheme.

15.23 Given the small size of the Transferring Policies as a proportion of DAS, I consider that the security of policyholders' contractual rights for the Remaining Policyholders will not be materially affected by the Proposed Scheme in relation to the impact of insolvency laws.

15.24 Given the limited differences between the UK and German insolvency laws, the small proportion of inwards reinsurance business within DAS and the low probability of ARAG becoming insolvent (particularly in the period shortly after the Proposed Scheme which could potentially affect the Transferring Policyholders), I consider that the security of policyholders' contractual rights for the Transferring Policyholders will not be materially affected by the Proposed Scheme in relation to the impact of insolvency laws.

15.25 Given that the Existing Policyholders will be subject to the German insolvency laws before and after the Proposed Scheme, and that direct insurance policyholders and inwards reinsurance policyholders rank equally under German insolvency laws, I consider that the security of policyholders' contractual rights for the Existing Policyholders will not be affected by the Proposed Scheme in relation to the impact of insolvency laws.

Access to compensation schemes

Background

15.26 The FSCS is the compensation fund of last resort and covers contracts of insurance issued by a UK authorised insurer, including those issued on an outbound FoS or FoE basis where the risk or commitment is situated within an EEA state.

15.27 The FSCS scheme provides compensation in the event of insurer insolvency. In general, retail policyholders (private individuals and small businesses) are covered for all claims and large businesses are covered for claims in respect of compulsory liability insurance. Compulsory insurance (such as motor third party liability insurance), professional indemnity insurance and insurances covering the death or incapacity of the policyholder due to injury, sickness, or infirmity are fully covered. For other insurances protection is provided at 90% of the claim, with no upper limit on the amount payable. No protection is available for Goods in Transit, Marine, Aviation and Credit Insurance, or for contracts of reinsurance.

Conclusions for Remaining Policyholders

15.28 Remaining Policyholders which meet the criteria set out in the previous paragraph currently benefit from FSCS protection and 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.

Conclusions for Existing Policyholders

15.29 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.

Conclusions for Transferring Policyholders

15.30 Transferring Policyholders which do not meet the criteria set out in paragraph 15.27 above ("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.

Approximately 5% of the gross Solvency II Technical Provisions (excluding the risk margin) estimated for the Transferring Policyholders relate to inwards reinsurance business.

15.31 The Proposed Scheme therefore has no impact on the access to compensation schemes for the non-FSCS Transferring Policyholders.

15.32 Transferring Policyholders which meet the criteria set out in paragraph 15.27 above ("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.

15.33 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 below.

15.34 For the reasons set out below, 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.

Considerations to support conclusions for FSCS Transferring Policyholders

15.35 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 set out in the Policyholder Protection chapter of the PRA Rulebook, providing that ARAG continues to meet the definition of a "relevant person"[1] under the FSMA. The rules may change at the end of the transition period[2] between the UK and the EU (in connection with Brexit), but it is expected that FSCS protection would continue to be available for FSCS Transferring Policyholders for as long as ARAG maintains an authorised branch in the UK.

15.36 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 ("ICF"). The ICF provides cover for policyholders who are domiciled in Ireland and who are insured with an Irish authorised non-life insurer or a non-life insurer authorised in another EU member state.

15.37 The ICF is a fund of last resort in Ireland. Any payments from the ICF are subject to approval from the High Court and not all policyholder liabilities are covered by the ICF, although it is my understanding that all of DAS's policyholder liabilities should benefit from the cover. Payments made by the ICF are limited to the lower of 65% of the sum due to the policyholder and €825,000. Commercial policyholders are not covered by the ICF unless the claim is in respect of a liability to an individual.

15.38 There is a risk that cover from the ICF may not be available for the FSCS Transferring Policyholders. This risk arises due to the wording in the Insurance Act 1964, which covers payments made by the ICF, and states that amounts can be paid "under a policy issued by the insurer". However, in the situation of ARAG's insolvency, the policies held by FSCS Transferring Policyholders would have been issued by DAS rather than ARAG. I have been provided with legal advice obtained by the parties (which I believe appears reasonable to rely upon) that such a literal interpretation is unlikely to be applied, although the wording in the Insurance Act 1964 has never been formally tested in Ireland. I therefore consider that the risk

[1] The status of a 'relevant person' is achieved by a firm being an "authorised person" under FSMA. Firms will be "authorised persons" if they have a Part 4A permission, are an insurer within the Temporary Permission Regime or Supervised Run-off under the Financial Services Contracts Regime (with a deemed Part 4A permission), fall within Contractual Run-off under the Financial Services Contracts Regime, or have the benefit of market access rights via the Gibraltar Order for Gibraltarian-based firms.

[2] The transition period started on 31 January 2020 and is 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.

that cover from the ICF may not be available for the FSCS Transferring Policyholders is extremely remote.

15.39 It is therefore my understanding that in the event that ARAG ceases to be authorised in the UK the compensation protection available to the FSCS Transferring Policyholders will reduce as a result of the Proposed Scheme given the following key difference:

- Prior to the Proposed Scheme, the FSCS protection will cover 90% of any claim incurred; and
- After the Proposed Scheme, the ICF protection will cover 65% of any claim incurred (up to a maximum of €825,000) and there is a risk, albeit an extremely remote one, that the ICF protection is not available.

15.40 However, 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 for the following reasons:

- In order for there to be any loss, ARAG would need to cease being authorised in the UK and to become insolvent.
- In this situation, FSCS Transferring Policyholders should still benefit from protection under the ICF, although as noted in the previous paragraph this provides lower protection compared with the protection available under the FSCS.
- DAS has performed an analysis to estimate the volume of claims from Transferring Policies which would be expected to be impacted by reduced protection from compensation schemes were ARAG to suffer an insolvency event following the Proposed Scheme. The results of this analysis are set out below and, in addition, I note that the likelihood of these stresses arising is extremely remote since at the date of the Proposed Scheme ARAG will be capitalised in excess of the regulatory requirements.
  - This analysis indicates that if the insolvency of ARAG occurred immediately following the Proposed Scheme, out of total DAS gross Solvency II Technical Provisions (excluding the risk margin) of approximately £127m, approximately £6m (or 5% of the total) may be impacted by reduced protection from compensation schemes compared to their position in the event of no Proposed Scheme.
  - The assumption of an insolvency event immediately following the Proposed Scheme is, in my view, an unreasonable stress test given the capitalisation of ARAG at this time. I have therefore also estimated the volume of claims reserves which will be impacted by reduced protection from compensation schemes if the insolvency event occurs one or two years following the Proposed Scheme. While I consider this is an extremely remote risk I consider these are more plausible and informative stress tests.
  - In the event of the insolvency of ARAG one year following the Proposed Scheme, the analysis indicates that approximately £3m (or 2% of the gross DAS Solvency II Technical Provisions excluding the risk margin at the time of the Proposed Scheme) will be impacted by reduced protection from compensation schemes compared to their position in the event of no Proposed Scheme.
  - In the event of the insolvency of ARAG two years following the Proposed Scheme, the analysis indicates that approximately £1m (1% of the gross DAS Solvency II Technical Provisions excluding the risk margin at the time of the Proposed Scheme) will be impacted by reduced protection from compensation schemes compared to their position in the event of no Proposed Scheme.

15.41 In addition, DAS has confirmed that historically, when marketing and promoting itself to Irish policyholders, DAS has not made specific reference to FSCS protection in such a way as for it to have been a significant consideration for the policyholder in choosing DAS over a non-UK based competitor. Signposting to such protection has only been included to the extent required by the FCA.

15.42 It is therefore 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.

Trust funds and guarantees

15.43 Ring fenced trust funds ("Trust Funds") consist of a ring-fenced pool of assets which are firstly used to pay policyholders who are protected by the Trust Fund but any excess over the funding requirement may be released to general assets and so available for the benefit of all policyholders.

15.44 Policyholders can also sometimes be the beneficiaries of guarantees whereby in the event that their insurer is unable to pay their claims, the guarantor would meet the shortfall.

15.45 DAS and ARAG have confirmed that the Remaining Policyholders, the Transferring Policyholders and the Existing Policyholders do not benefit from any trust fund or guarantee arrangements either before or after the Proposed Scheme. As a result there are no trust fund or guarantee arrangements which benefit the Remaining Policyholders, the Transferring Policyholders or Existing Policyholders which will be affected by the Proposed Scheme.

Accounting and reserving approach

15.46 I understand from my discussions with DAS and ARAG that there will be no significant changes in the accounting and reserving approaches for the companies following the Proposed Scheme, as the transferring business does not represent a significant portion of either company's reserves.

15.47 However, DAS currently uses the UK GAAP accounting regime and ARAG uses German GAAP. The key differences between UK GAAP and German GAAP, to the extent that they are relevant to DAS and ARAG, are set out below.

Premium reserving

- As set out in paragraph 8.15, under UK GAAP DAS must hold an unearned premium reserve equal to the full unearned premium amount less a full allowance for any deferred acquisition costs associated with the premium.
- As set out in paragraph 9.15, under German GAAP ARAG must hold an unearned premium reserve equal to the full unearned premium amount less a proportion of the income components intended to cover acquisition costs. This proportion is 85% for costs incurred through the group headquarters and is individually determined for international units of the company.
- Under both UK and German GAAP, premium is recognised over the year in relation to contracts which incepted over the year, together with any differences between booked premiums for prior years and those previously accrued. This includes an estimate of premiums due but not yet received, less an allowance for cancellations.
- Under UK GAAP, if a company's unearned premium less deferred acquisition costs are insufficient to cover the cost of claims arising from unearned exposure, an 'additional unexpired risk reserve' is also required, which ensures sufficient reserves are held to cover

these claims. Under German GAAP, there is generally no equivalent requirement, except in circumstances where a specific insurance contract is expected to generate significant losses.

- As a result, the unearned premium reserve will be higher under German GAAP for firms whose unearned exposure is expected to be profitable, but may be higher under UK GAAP for other firms. The premiums earned will be the same under both accounting regimes.

Equalisation provisions

- Equalisation provisions are not permissible under UK GAAP but may be required under German GAAP. These provisions must be established under German GAAP if significant fluctuations in the annual requirement are expected. As of 2018, ARAG held an equalisation provision of £34.0m, representing 16% of booked reserves.

15.48 As a result, since DAS is not currently required to hold an additional unexpired risk reserve, the only direct change which will impact the Shareholders' Funds as a result of the Transferring Policies moving from UK GAAP accounting to German GAAP accounting will be an increase in the associated unearned premium reserve and the potential inclusion of an equalisation provision.

15.49 In addition, I note that the reserves ARAG book are prepared by the finance department without the use of actuarial analysis, and are significantly higher than the reserves recommended by ARAG's risk management department. I understand this is typical of firms reporting under German GAAP.

15.50 DAS's booked reserves are more heavily linked to the actuarial best estimate, and therefore do not include a significant degree of prudence. As a result, I anticipate that the reserves booked in respect of the Transferring Policies will be larger for ARAG than for DAS.

15.51 The change from UK GAAP to German GAAP will have no impact on either the Solvency II Own Funds of DAS or ARAG.

15.52 I do not consider that this change in accounting regime will have a material impact on the security of policyholders' contractual rights. This is because in forming my views on policyholder security I have focused on the Solvency II Own Funds and SCRs for each of these entities rather than the financial report and accounts.

Tax implications

15.53 I understand from DAS and ARAG that the Proposed Scheme is designed to be largely tax neutral. I am not a tax expert but given the materiality of the Proposed Scheme on DAS and ARAG I do not consider it is necessary for me to obtain independent expert advice on this issue.

Costs of the Proposed Scheme

15.54 The costs of the Proposed Scheme in relation to the Independent Expert, counsel, court fees and relevant regulator fees will be equally split between DAS and ARAG. Otherwise, each party will pay for their own respective preparations. These costs are not expected to materially affect the SCR or balance sheet projections to Q4 2021 for either DAS or ARAG. Given my comments elsewhere in this report on the security of DAS and ARAG at this date, I consider that these costs do not affect the security of policyholders' contractual rights.

Pension schemes

Pension schemes - DAS

15.55 DAS UK Holdings Limited 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, 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

15.56 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 2018, the total pension liabilities for ARAG were £34.6m on a Solvency II basis.

15.57 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.

15.58 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 2018, it was found the most extreme stress, which assumed interest rates reduced by 100 basis points, resulted in a 15% increase in the pension liabilities. Based on the 2018 ARAG Solvency II balance sheet, a 245% increase in pension liabilities would be required in order for ARAG to have insufficient funds to cover the SCR.

15.59 I have considered the impact on the Transferring Policyholders of the longevity risk arising from ARAG's defined benefit pension scheme in Section 13 of this Scheme Report.

Conclusions

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

15.61 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 13 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

15.62 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.

15.63 On a Solvency II basis, ARAG held £34.3m of net reserves in respect of annuities as at 31 December 2018. These reserves arose primarily from income protection policies.

15.64 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 5% due to longevity risk.

15.65 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 report I therefore consider that the impact of such business does not affect the security of policyholders' contractual rights for the Transferring Policyholders.

Section 16: Other Non-Financial Considerations

Introduction

16.1 In this section, I discuss other non-financial considerations arising from the Proposed Scheme under the following headings:

- Impact of Brexit
- Policyholder service levels
- Comparison of regulatory regimes
- Ombudsman services
- Policyholder communication
- Reinsurer communication
- Recognition of the Proposed Scheme
- Allocation of outwards reinsurance assets
- Outwards reinsurers

Impact of Brexit

16.2 The UK left the EU on 31 January 2020 in accordance with the "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 (the "Withdrawal Agreement").

16.3 The Withdrawal Agreement includes a transition period which started on 31 January 2020 and ends on 31 December 2020, although there is a provision in the Withdrawal Agreement to extend the transition period by one or two years. During the transition period the UK will no longer be a member of the EU but will continue to be subject to EU rules and remain a member of the single market and customs union. During the transition period the EEA passporting rights for UK insurers will therefore continue.

16.4 The transition period allows the UK to continue its current relationship with the EU while the terms on which the UK will trade with the EU after the end of the transition period can be negotiated. This may result in rules and/or reciprocal arrangements that either replicate, or are broadly equivalent to, existing passporting rights being established that would result in the security of policyholders not being directly affected by the UK leaving the EU.

16.5 If no such terms can be agreed before the end of the transition period then there would effectively be a "No-Deal Brexit" with effect from that date, with EEA passporting rights for UK insurers ending immediately.

16.6 DAS writes policies for UK residents from its UK office and, through the DAS Branch in Ireland, for Irish residents (including residents of Northern Ireland). DAS has confirmed to me that it has not sought to write policies for residents of any other territories within the EEA from either its UK office or its Irish branch, and includes in its standard agreement with its business partners a requirement that policies are only made available to individuals who reside in the appropriate territory. DAS does expect, however, that there could be a few policyholders that are resident in other EEA territories by virtue of having moved their domicile since effecting their policy with DAS.

16.7 In addition, DAS has also 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, although DAS ceased to operate in Norway on 22 March 2019. Although Norway is in the EEA it is a non-EU state, and DAS's Norwegian distributor has received confirmation from Finanstilsynet, the financial supervisory authority in Norway, that DAS will be able to continue to settle any claims arising from historical policies in future years, regardless of the outcome of Brexit. These policies are therefore not transferring from DAS to ARAG but are Remaining Policies. I will consider the Norwegian policyholders further in my Supplementary Report as described in paragraph 5.29. DAS has never operated in any other international regions.

16.8 Of particular relevance to the Proposed Scheme is the approach of the Irish regulator (the Central Bank of Ireland) to protecting Irish consumers. In February 2019 the Irish Government enacted the Withdrawal of the United Kingdom from the European Union (Consequential Provisions) Act 2019 (the "Irish Bill") which allows for a temporary run-off regime which will allow UK insurers (and intermediaries) to continue to service existing insurance contracts with Irish policyholders following Brexit for a period of three years, although no new business or policy renewals will be permitted.

16.9 Although the Irish Bill only applies for three years, the DAS Branch has been approved in principle by the CBI as a third country branch, and it therefore remains legal for DAS to continue to pay claims in relation to Irish policies following Brexit.

16.10 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. In respect of Brexit, I therefore consider that whether or not the Proposed Scheme proceeds would have no impact on either the Remaining Policyholders or the Existing Policyholders.

16.11 The Transferring Policyholders will be insured by DAS before the Proposed Scheme and by ARAG after the Proposed Scheme. The Proposed Scheme aims to ensure that all policies where the policyholder is located in the "post Brexit EEA" (i.e. the current EEA excluding the UK) will be transferred to ARAG. As noted in paragraph 16.9 above, whether or not the Proposed Scheme proceeds, it remains legal for DAS to continue to pay claims in relation to Irish policies. On the assumption that the Proposed Scheme proceeds it will be legal for ARAG, as an EEA insurer, to pay claims in relation to the Transferring Policies.

16.12 Therefore, in respect of a Brexit, I consider that whether or not the Proposed Scheme proceeds would also have no impact on the Transferring Policyholders.

Policyholder service levels

16.13 In this section I comment on the potential effects of the Proposed Scheme on matters related to claims handling and administration in so far as these will affect the security of policyholders' contractual rights or the levels of service provided to policyholders.

16.14 There will be no change to the claims handling and administration of the Remaining Policies or the Existing Policies. With regards to the Remaining Policies I note that the claims handling and administration of those policies sold by the DAS Branch but which relate to Northern Ireland policies is currently undertaken in the UK offices of DAS and therefore will not be impacted by the Proposed Scheme.

16.15 ARAG currently undertakes the administration and claims handling for the Transferring Policies on behalf of DAS, using staff employed by the ARAG Branch or by external lawyers contracted by the ARAG Branch.

16.16 As outlined in paragraphs 5.10 to 5.14, the relevant ARAG staff performing these administration and claims handling activities in relation to the Transferring Policyholders were transferred from the DAS branch under the TUPE Regulations to become staff of ARAG on the Initial Transfer Date. It is expected that these staff have and will continue to adhere to the same processes and service standards which were in place prior to the effective date of the Proposed Scheme.

16.17 ARAG's current approach is for all policy administration and claims handling to be managed locally, with no company-wide policy administration or claims handling guidance or incentives which may influence local practice. No changes are planned to this approach in the foreseeable future. Considering this, and given the relatively short-term nature of the Transferring Policies, I consider that the current policy administration and claims handling practices will remain unchanged for the Transferring Policies after the Proposed Scheme.

16.18 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.

16.19 I therefore consider that there will be no change to the administration and claims handling of the Remaining Policies or the Existing Policies, and that for the Transferring Policies ARAG will maintain a materially similar level of service to policyholders to that of DAS prior to the Proposed Scheme.

Comparison of regulatory regimes

16.20 In this section I consider the comparison of regulatory regimes under the categories of prudential regulation[1] and conduct regulation[2].

Prudential regulatory regimes

16.21 The Remaining Policyholders will be subject to the UK prudential regulatory regime both before and after the Proposed Scheme and so will not experience a change in prudential regulatory regimes.

16.22 The Existing Policyholders will be subject to the German prudential regulatory regime both before and after the Proposed Scheme and so will not experience a change in prudential regulatory regimes.

16.23 The Transferring Policyholders will be transferring from the UK regulatory regime where the PRA is responsible for prudential regulation to the German regulatory regime where BaFin is responsible for prudential regulation.

16.24 Solvency II has harmonised prudential regulation across the EU. As such, I consider that the prudential regulatory regime in Germany is materially similar to that in the UK.

[1] Broadly, regulation that requires financial firms to control risks and hold adequate capital as defined by capital requirements to promote the safety and soundness of the regulated firms.
[2] Typically including consumer protection, regulation of market conduct and setting and enforcing ethical codes of conduct.

16.25 As such, I do not consider that either the Remaining Policyholders, the Transferring Policyholders or the Existing Policyholders are likely to be materially adversely affected by the change in prudential regulatory regime as a result of the Proposed Scheme.

16.26 I comment in paragraph 5.36 of this report of the potential for the UK to adopt a different solvency regime following Brexit.

Conduct regulatory regimes

16.27 Conduct regulation is performed by the insurance regulator in the country in which the risk is located and/or the location from which the business is carried out. As such, since neither the location of the risk nor the location from which the business is being carried out is changing for the Remaining Policyholders, the Transferring Policyholders or the Existing Policyholders, the applicable conduct regime is unchanged by the Proposed Scheme. As such, I do not consider that the Remaining Policyholders, the Transferring Policyholders or the Existing Policyholders will be materially adversely affected by any change in conduct regulatory regime

Ombudsman services

16.28 A number of countries, including the UK and Ireland, operate ombudsman services which provide unbiased advice to policyholders in the event of an insurer and policyholder being unable to resolve a complaint.

16.29 There will be no change in relation to the access to such ombudsman services for the Remaining Policies or the Existing Policies as a result of the Proposed Scheme.

16.30 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.

16.31 As present eligible claimants from the DAS Branch can refer any complaint not dealt with satisfactorily by DAS to the FSPO in Ireland. One of the requirements for a claimant to be eligible is that the claimant must be a policyholder with an Irish authorised insurer or an EEA authorised insurer who is permitted to carry on business in Ireland on a passported basis.

16.32 Hence, access to the FSPO which is currently available to Transferring Policyholders will continue to be available after the Proposed Scheme.

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

Policyholder communication

16.34 DAS is required to notify policyholders and advertise the Proposed Scheme. Set out below is a summary of DAS’s proposed approach to policyholder communication and my conclusions on its appropriateness.

Individual policyholder communication

16.35 DAS has 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.

Remaining Policyholders and Existing Policyholders

16.36 DAS is seeking a waiver from the requirement to notify the Remaining Policyholders of DAS and the Existing Policyholders of ARAG for the following reasons:

- The Transferring Policies are not material in the context of the overall portfolios of DAS and ARAG; and
- As part of DAS's communication strategy (as discussed further below), DAS will be placing a number of advertisements in the press with information about the Proposed Scheme.

16.37 In particular, I note that the Transferring Policies represent just under 2% of DAS's gross claims reserves and unearned premium reserve. In addition, 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. I consider the level of materiality of the Transferring Policies when compared to the ARAG balance sheet to be similar.

16.38 In my opinion the proposed waiver is therefore proportionate and reasonable given the materiality of the Proposed Scheme in comparison to the existing business of both DAS and ARAG.

Claimant Policyholders

16.39 DAS holds contact details for the Claimant Policyholders and will be notifying each of these policyholders directly by email, or by post if an email address is not available or if the email is unable to be delivered.

16.40 DAS has confirmed that email communication is typically the normal method of communicating with policyholders during a claim.

16.41 If emails are undeliverable then:

- The email address will be checked for errors and if there are errors the email address will be corrected and resent;
- If no errors are identified or where a further undeliverable notification is received, then a communication pack will be sent using any alternative contact details held on file.

16.42 If all of the above steps are unsuccessful then that policyholder will be marked as "gone away".

16.43 In my opinion the proposed policyholder communication approach for Claimant Policyholders is proportionate and reasonable.

Inwards Reinsurance Policyholders

16.44 For the Inwards Reinsurance Policyholders, DAS will notify these policyholders directly. There are four Inwards Reinsurance Policyholders.

16.45 In my opinion the proposed policyholder communication approach for Inwards Reinsurance Policyholders is proportionate and reasonable.

Live Policyholders

16.46 For the Live Policyholders, DAS does not hold contact details but will ask its' binder counterparties 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.

16.47 Each binder counterparty will be requested to confirm they have made the requested notifications and to forward any responses they receive from policyholders to DAS.

16.48 In my opinion the proposed policyholder communication approach for Live Policyholders is proportionate and reasonable.

Dormant Policyholders

16.49 DAS is seeking a waiver from the requirement to notify the Dormant Policyholders. Dormant Policyholders are those Transferring Policyholders where the policy expired on or before 31 December 2017.

16.50 DAS has undertaken an analysis of the Transferring Policies by line of business to assess the proportion of total claim numbers reported in each year following the incident date (which must fall within the period of cover provided by the policy). This analysis shows that for the Transferring Policies, DAS would expect 95% of all claims to be reported within two years of the expiry of the policy. I have reviewed the analysis which DAS has undertaken to confirm that it is reasonable.

16.51 I consider that this is a reasonable strategy because very limited numbers of new claims are expected in respect of policies beyond this two year period following the expiry of the policy and the costs incurred in sending out additional communication materials is likely to be disproportionate to the benefit received without any guarantee of greater success in the communication result. In addition, the advertisements being placed by DAS (as discussed below) will provide an opportunity for past policyholders not otherwise notified to become aware of the Proposed Scheme.

Content of the notification pack

16.52 The standard communications approach to be followed by DAS is for policyholders to be sent a notification pack comprising the following:

- A clearly worded covering letter, including details of how recipients can obtain further information, ask questions and raise any objections to the Proposed Scheme;
- A frequently asked questions document;
- A summary of the legal document that sets out the terms of the Proposed Scheme;
- A summary of the Independent Expert's report; and

- A copy of a legal notice setting out details of the Court hearing for the Proposed Scheme.

Wider communication

16.53 DAS is proposing to place advertisements in the following publications:

- The London, Belfast and Edinburgh Gazettes;
- The International edition of the Financial Times;
- The Times, the Sun and the Irish Times; and
- Any additional advertising to the extent any is specifically prescribed by the competent regulatory authority in any EEA member state.

16.54 In addition, both a full copy and the summary of this Scheme Report will be posted on the DAS and ARAG websites at the following locations: www.das.co.uk/arag-transfer and www.arag.ie/DASIrelandSale.

Conclusions on policyholder communications

16.55 I have reviewed a draft of the notifications pack to be provided to policyholders and I consider that the level of information it contains is appropriate and its presentation is clear, fair and not misleading. I consider the notifications pack will allow policyholders to form their own view on the Proposed Scheme and know how to access additional information as required.

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

Reinsurer communication

16.57 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, in relation to the Proposed Scheme.

16.58 In addition, DAS also intends to send a formal notice to Mapfre as part of its Part VII communications strategy. This formal notice will explain the Part VII process and will include the Summary (of this Scheme Report) and the Q&A which form part of the communications pack which will be sent to policyholders.

16.59 Based on the above, I am satisfied that the proposed approach to reinsurer communication is appropriate, reasonable and proportionate.

Recognition of the Proposed Scheme

16.60 The Solvency II Directive (which is required to be implemented in all EEA jurisdictions) provides that a portfolio transfer authorised in a member state in accordance with the requirements of the Solvency II Directive shall automatically be valid against policyholders.

16.61 I have therefore considered the extent to which Brexit may have an impact on the recognition of the Proposed Scheme in EEA jurisdictions.

16.62 The UK left the EU on 31 January 2020 in accordance with the Withdrawal Agreement. This agreement includes a transition period which started on 31 January 2020 and ends on 31 December 2020, or such later date which may be agreed between the UK and the EU.

During the transition period the UK will no longer be a member of the EU but will continue to be subject to EU rules and remain a member of the single market and customs union.

16.63 The transition period allows the UK to continue its current relationship with the EU while the terms on which the UK will trade with the EU after the end of the transition period can be negotiated. If no such terms can be agreed before the end of the transition period then there would effectively be a “No-Deal Brexit” with effect from that date.

16.64 If the Proposed Scheme is sanctioned by the Court before the end of the transition period (as it is expected to do so) then the Proposed Scheme would be recognised in all EEA jurisdictions in accordance with the requirements of the Solvency II Directive.

16.65 In the event of a No-Deal Brexit, the provisions of the Solvency II Directive would, in the absence of any action by member states, cease to oblige member states to apply this requirement in relation to a portfolio transfer from a UK insurance company.

16.66 However, to cater for the possibility of such a No-Deal Brexit, the EU insurance regulators' body EIOPA has agreed to implement a number of measures. The relevant measure in relation to portfolio transfers provides that competent authorities of member states should allow the finalisation of portfolio transfers from UK insurance undertakings to EU27[1] insurance undertakings, provided they have been ‘initiated’ before the withdrawal date.

16.67 EIOPA recommends that member state regulators should deem a portfolio transfer to be initiated if the UK supervisory authorities have notified the member state regulator about the initiation of the portfolio transfer, the firm has paid the regulatory transaction fee to the supervisory authority in the UK and appointed an independent expert for the transfer. As a result, I understand that the Proposed Scheme will be deemed to have been initiated before the withdrawal date.

16.68 In my opinion it is reasonable to assume that the advice from EIOPA will be followed and therefore I see no reason why the Proposed Scheme from DAS to ARAG will not be recognised in all EEA jurisdictions.

Allocation of outwards reinsurance assets

16.69 As set out in Section 5 of this report, two existing reinsurance contracts in respect of the Transferring Policies will be transferred to ARAG.

16.70 The Proposed Scheme will therefore require the High Court to sanction the transfer of these two outwards reinsurance assets from DAS to ARAG. 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;
- The Reinsurance Agreement with ARAG is intended to be transferred under the Proposed Scheme. Under this contract, ARAG pay 100% of all claims arising from the Transferring Policies, with the exception of those covered by Mapfre. As a result, the transfer of this reinsurance asset is intended to nullify this contract only and regardless of its transfer status ARAG will be liable to pay the claims which benefit from it. I therefore do not

[1] EU27 refers to all of the current countries in the European Union, other than the UK.

consider that the ineffectiveness of the transfer of this contract 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 £99k of reserves associated with it, representing less than 1% of ARAG's actuarial reserves on a net of reinsurance basis for 2018. 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.

Outwards reinsurers

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

16.72 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 paragraphs 16.13 to 16.19 above, the claims handling of these liabilities will continue to 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.

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Section 17: Overall Conclusions

17.1 I have considered the likely effects of the Proposed Scheme on the Remaining Policyholders, the Transferring Policyholders and the Existing Policyholders. In each case, I have considered the likely effects of the Proposed Scheme on the security of policyholders' contractual rights. I have also considered the likely effects of the Proposed Scheme on the other factors which may impact security or service levels to the affected policyholders.

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

Security of policyholders remaining within DAS

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

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

17.5 After the Proposed Scheme, the Remaining Policyholders will continue to have policies with DAS. The Transferring Policies represent just under 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.

17.6 As a result of the Proposed Scheme, the SCR coverage ratio for DAS is projected to increase marginally from 263% to 265%. Future projected SCR coverage ratios over the period 2019 to 2021 are all expected to be marginally higher as a result of the Proposed Scheme.

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

Security of policyholders transferring from DAS to ARAG

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

17.9 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 projected Solvency II Own Funds of approximately £43 million and an SCR coverage ratio of 263% to a company with projected Solvency II Own Funds of approximately £187 million and an SCR coverage ratio of 278%.

17.10 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 266%. 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 263%.

17.11 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 240%. This is not materially below the one-year SCR coverage ratio of DAS of 263% and remains significantly above 100%. In addition, my estimated ultimate SCR coverage ratio for ARAG includes some prudence.

17.12 The Transferring Policyholders are therefore moving to a company which is better capitalised and with a higher SCR coverage ratio on a one-year basis and remains strongly capitalised on an estimated ultimate basis. In addition, the SCR coverage ratios for ARAG exceed the corresponding SCR coverage ratios for DAS in all of the projections to 2021.

17.13 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

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

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

17.16 After the Proposed Scheme, the Remaining Policyholders will continue to have policies with ARAG. The SCR coverage ratio for ARAG on a No Scheme basis is projected to be 278%. The Proposed Scheme is expected to have a negligible impact on the ARAG SCR coverage ratio.

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

Other considerations

17.18 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.

17.19 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.

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

External reinsurers

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

17.22 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 paragraphs 16.13 to 16.19 above, 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

17.23 In February 2019 the Irish Government enacted the Withdrawal of the United Kingdom from the European Union (Consequential Provisions) Act 2019 (the "Irish Bill") which allows for a temporary run-off regime which will allow UK insurers (and intermediaries) to continue to service existing insurance contracts with Irish policyholders following Brexit for a period of three years, although no new business or policy renewals will be permitted.

17.24 Although the Irish Bill only applies for three years, the DAS Branch has been approved in principle by the CBI as a third country branch, and it therefore remains legal for DAS to continue to pay claims in relation to Irish policies following Brexit.

17.25 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. In respect of Brexit, I therefore consider that whether or not the Proposed Scheme proceeds would have no impact on either the Remaining Policyholders or the Existing Policyholders.

17.26 The Transferring Policyholders will be insured by DAS before the Proposed Scheme and by ARAG after the Proposed Scheme. The Proposed Scheme aims to ensure that all policies where the policyholder is located in the "post Brexit EEA" (i.e. the current EEA excluding the UK) will be transferred to ARAG. As noted in paragraph 1.45 above, whether or not the Proposed Scheme proceeds, it remains legal for DAS to continue to pay claims in relation to Irish policies. On the assumption that the Proposed Scheme proceeds it will be legal for ARAG, as an EEA insurer, to pay claims in relation to the Transferring Policies.

17.27 Therefore, in respect of a Brexit, I consider that whether or not the Proposed Scheme proceeds would also have no impact on the Transferring Policyholders.

17.28 Within my Supplementary Report I will consider the latest developments in relation to Brexit and any resulting impacts on my conclusions.

Interaction with regulators

17.29 I met with the PRA and FCA at an early stage to establish whether there were matters or issues which they wanted me to consider in this Scheme Report. A draft of this Scheme Report has been made available to the PRA and FCA whose comments have been taken into account. A draft of this Scheme Report has also been made available to the CBI and BaFin. The PRA (in consultation with the FCA) has approved the form of this Scheme Report.

Effective challenge to DAS

17.30 During my review, I have provided challenge to the data, information and analyses provided to me by DAS and ARAG. This has included providing challenge and asking numerous questions in relation to the data and information which has been provided, and asking for further information when required.

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

Supplementary Report

17.32 My Independent Expert Scheme Report is based on audited financial information in respect of DAS and ARAG as at 31 December 2018 and financial projections performed by DAS and ARAG from financial year 2019 through to 2021. I expect to produce a Supplementary Report based on updated audited financial information as at 31 December 2019 in respect of DAS and ARAG, which will take into account any significant changes.

17.33 At the time of my Supplementary Report I will also consider whether the ongoing investigation and planning which is being undertaken by DAS and ARAG in respect of the Proposed Scheme will result in changes to the structure of the Proposed Scheme which requires my review.

17.34 I will also consider the latest developments in relation to Brexit within my Supplementary Report and any resulting impacts on my conclusions.

Duty to the Court

17.35 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

17.36 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

1 April 2020

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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
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
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
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
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
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

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Appendix B: Curriculum Vitae

Relevant experience / specialisation

Kate has over 20 years' experience in non-life actuarial work and has been involved in the provision of all aspects of actuarial advice to non-life insurers, having gained broad experience of the general insurance sector in a variety of roles. Kate joined Willis Towers Watson's general insurance team in January 2009 and is a Senior Director within Willis Towers Watson's Insurance Consulting and Technology division.

Kate's wide-ranging experience throughout the insurance and reinsurance industry includes: dynamic actuarial and financial modelling, including capital assessment projects; valuations of liabilities; assistance with meeting the requirements of Solvency II; pricing assignments; review and design of reinsurance programmes; exit strategies; independent expert and expert witness assignments; and due diligence for acquisitions. Kate has worked extensively in the London Market, UK and Europe, providing advice to (re)insurance companies, Lloyd's syndicates, government entities, corporations and captives.

Kate regularly leads reserve reviews for (re)insurance companies, captives and Lloyd's syndicates, covering both ongoing business and business in run-off. These reserve reviews have covered a variety of lines of business including APH liabilities, accident & health, aviation, cargo, construction, contingency, creditor, d&o, employer's liability, energy, e&o, legal expenses, liability business, marine, medical malpractice insurance, motor (both personal and commercial), political risks / trade credit, professional liability, property, public liability, travel and warranty. Kate's experience includes providing Statements of Actuarial Opinions for both Lloyd's syndicates and Irish non-life insurance companies.

Kate's extensive Solvency II experience has been gained from assisting clients across a number of areas. Her experience includes assessing capital requirements according to the SCR / MCR Standard Formula, undertaking Technical Provisions calculations, calculation of Undertaking Specific Parameters, assisting clients with ORSA submissions (including assessing the appropriateness of the Standard Formula and considering risks which are not included within the Standard Formula), providing assistance with the Pillar 3 requirements under Solvency II (including completion of the QRTs), assisting clients to fulfil the requirements of the Actuarial Function (including with respect to the required underwriting and reinsurance opinions) and providing training on Solvency II. Kate has acted as an outsourced Chief Actuary (SIMF 20) under the PRA's SIMR, and also acts as the Head of the Actuarial Function for Irish insurance companies under the Central Bank of Ireland's PCF regime.

Kate has been involved in a number of insurance business transfers, for both business in run-off and live business, covering a variety of lines of business and including business transferring within the UK and overseas. Kate has spoken on the topic of insurance business transfers at a number of conferences, together with writing articles on the subject and drafting new education material for the Institute of Actuaries on the topic of "Exit Strategies". She was also a member of an Institute of Actuaries Working Party on the topic of business transfers.

Kate's other experience includes reviews of capital models for ICA purposes; undertaking an independent review of a reinsurance premium calculation; assessment of fair value amounts in connection with a reinsurance commutation; undertaking due diligence exercises in connection with M&A transactions; and acting as an expert witness, including giving testimony in court.

Prior to joining Willis Towers Watson, Kate has worked as a consultant, as Syndicate Actuary for a Lloyd's Syndicate, for a (re)insurance broker and as an actuary at GE's financial services division.

Education and Credentials

Kate qualified as a Fellow of the Institute of Actuaries in 1998. She is also a Fellow of the Society of Actuaries in Ireland and an Associate of the Chartered Insurance Institute. She holds the required practising certificates for the purpose of providing Statements of Actuarial Opinion relating to Lloyd's syndicates, and to perform the Chief Actuary function in accordance with the PRA’s requirements in the UK.

Kate has previously been a member of the Institute and Faculty of Actuaries' General Insurance Board and the cross-practice Professional Affairs and Consultation Committee.

Appendix C: Information Considered

For the purposes of this Scheme Report I have reviewed various items of data and information, including the following:

Documents relating to the Proposed Scheme

- Final versions of the executed:
  - Framework Agreement;
  - Reinsurance Agreement;
  - Transitional Services Agreement; and
  - Delegated Authority (Coverholder) Agreement.
- Draft Scheme Document

Documents relating to DAS

- Audited Financial Statements at year-end 2016, 2017 and 2018
- SFCR reports at year-end 2016 and 2017, which were audited by KPMG
- SFCR report at year-end 2018, which has not been audited in accordance with the exemption granted to small firms which meet criteria specified by the PRA
- Own Risk and Solvency Assessment reports for 2016 and 2017
- Actuarial Function reports for 2015, 2016 and 2017
- Balance sheet and capital projections as at 31 December 2018
- Internal and external reserve reports for 2017 and 2018, along with breakdowns of latest reserves
- Solvency II results report for 2018

Documents relating to ARAG

- The Annual Report for year-end 2016, 2017 and 2018*
- SFCR reports at year-end 2016, 2017 and 2018*
- Own Risk and Solvency Assessment report for 2018†
- Actuarial Function report for 2018†
- Balance sheet and capital projections as at 31 December 2018
- Internal reserve reports for 2016, 2017 and 2018, along with breakdowns of latest reserves
- Validation report for the 2017 Partial Internal Model

- Report on the valuation of pension liabilities
- External audit report for 2018

In respect of the documents provided by ARAG, some of these were provided in English, having been translated by ARAG as part of the normal course of their business. These are denoted by an * in the list above.

Other documents, highlighted with a † in the list above, were only available in German. For these documents we arranged for these to be professionally translated into English and have relied upon the translated version of these documents for the purposes of producing this Scheme Report.

A number of other documents provided were only available in German. For these documents we used a confidential online translation tool to translate the documents for the purposes of producing this Scheme Report.

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

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.

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.

Appendix D: Compliance with PRA and FCA requirements

This section sets out a mapping from the PRA requirements set out in paragraphs 2.27 to 2.40 of the "PRA's Statement of Policy: The PRA's approach to insurance business transfers" and the FCA requirements set out in paragraphs 18.2.31 to 18.2.41 of SUP18 to this Scheme Report. The right column of the table below contains paragraph references from this Scheme Report. Note that it does not necessarily include all relevant paragraphs but, in some cases, only includes selected examples of relevant paragraphs to demonstrate that the PRA and FCA requirements have been met.

PRA Document	FCA SUP18	Independent Expert Report
2.27 – Under section 109 of FSMA, a scheme report must accompany an application to the court to approve an insurance business transfer scheme . . .	18.2.31	Whole report
2.28 – When the PRA has approved the form of a scheme report, the scheme promoter may expect to receive written confirmation to that effect	18.2.31 A	PRA approval is outstanding
2.29 – There may be matters relating to the scheme or the parties to the transfer that the regulators wish to draw to the attention of the independent expert. The regulators may also wish the report to address particular issues. The independent expert would therefore be expected to contact the regulators at an early stage to establish whether there are such matters or issues. The independent expert should form his own opinion on such issues, which may differ from the opinion of the regulators	18.2.32	Paragraph 2.26
2.30 (1) – Who appointed the independent expert and who is bearing the costs of that appointment	18.2.33 (1)	Paragraphs 2.2 and 2.7
2.30 (2) – Confirmation that the independent expert has been approved or nominated by the PRA	18.2.33 (2)	Paragraph 2.6
2.30 (3) – A statement of the independent expert's professional qualifications and (where appropriate) descriptions of the experience that makes them appropriate for the role	18.2.33 (3)	Paragraphs 2.9 and 2.10, and Appendix B
2.30 (4) – Whether the independent expert, or his employer, has, or has had, direct and indirect interest in any of the parties which might be thought to influence his independence, and details of any such interest	18.2.33 (4)	Paragraphs 2.11 to 2.15
2.30 (5) – The scope of the report	18.2.33 (5)	Section 3
2.30 (6) – The purpose of the scheme	18.2.33 (6)	Paragraphs 5.1 to 5.3
2.30 (7) – A summary of the terms of the scheme in so far as they are relevant to the report	18.2.33 (7)	Paragraphs 5.4 to 5.9
2.30 (8) – What documents, reports and other information the independent expert has considered in preparing the report and whether any information that they requested has not been provided	18.2.33 (8)	Appendix C and paragraph 2.25

PRA Document	FCA SUP18	Independent Expert Report
2.30 (9) – The extent to which the independent expert has relied on: (a) information provided by others; and (b) the judgement of others	18.2.33 (9)	Paragraphs 2.23 to 2.25
2.30 (10) – The people the independent expert has relied on and why, in their opinion, such reliance is reasonable	18.2.33 (10)	Paragraphs 2.23 to 2.25
2.30 (11) – Their opinion of the likely effects of the scheme on policyholders (this term is defined to include persons with certain rights and contingent rights under the policies), distinguishing between: (a) transferring policyholders; (b) policyholders of the transferor whose contracts will not be transferred; and (c) policyholders of the transferee	18.2.33 (11)	Sections 5 to 16, and summarised in Section 17
2.30 (12) – Their opinion on the likely effects of the scheme on any scheme on any reinsurer of a transferor, any of whose contracts of reinsurance are to be transferred by the scheme	18.2.33 (11A)	Paragraph 16.72
2.30 (13) – What matters (if any) that the independent expert has not taken into account or evaluated in the report that might, in their opinion, be relevant to policyholders' consideration of the scheme	18.2.33 (12)	No such matters exist
2.30 (14) – For each opinion that the independent expert expresses in the report, an outline of their reasons	18.2.33 (13)	Paragraphs 17.3 to 17.27 and 17.32, with detailed reasons in Section 5 to Section 16
2.31 – The purpose of the scheme report is to inform the court and the independent expert, therefore, has a duty to the court. However, reliance will also be placed on it by policyholders, reinsurers, and others affected by the scheme and by the regulators. The amount of detail that it is appropriate to include will depend on the complexity of the scheme, the materiality of the details themselves and the circumstances	18.2.34	Paragraphs 2.20 and 17.35
2.32 – The summary of the terms of the scheme should include: (1) a description of any reinsurance arrangements that it is proposed should pass to the transferee under the scheme; and (2) a description of any guarantees or additional reinsurance that will cover the transferred business or the business of the transferor that will not be transferred	18.2.35	Paragraph 5.33
2.33 – The independent expert's opinion on the likely effects on policyholders should: (1) - include a comparison of the likely effects if it is not implemented;	18.2.36 (1)	Paragraph 16.10
2.33 (2) – state whether they considered alternative schemes and, if so, what;	18.2.36 (2)	Paragraph 3.4

PRA Document	FCA SUP18	Independent Expert Report
2.33 (3) – where different groups of policyholders are likely to be affected differently by the scheme, include comment on those differences they consider may be material to the policyholders; and	18.2.36 (3)	Throughout Sections 5 to 16
2.33 (4) – include their views on: (a) - the effect of the scheme on the security of policyholders' contractual rights, including the likelihood and potential effects of the insolvency of the insurer;	18.2.36 (4a)	Paragraph 3.2
(b) – the likely effects of the scheme on matters such as investment management, new business strategy, administration, claims handling, expense levels and valuation bases in relation to how they may affect: (i) the security of policyholders' contractual rights (ii) levels of service provided to policyholders; or (iii) for long-term insurance business, the reasonable expectations of policyholders; and	18.2.36 (4b)	Paragraph 3.2
(c) - the cost and tax effects of the scheme, in so far as they may affect the security of policyholders' contractual rights, or for long-term insurance business, their reasonable expectations.	18.2.36 (4c)	Paragraph 3.2
2.34 – The independent expert is not expected to comment on the likely effects on new policyholders, that is, (those whose contracts are entered into after the effective date of the transfer)	18.2.37	Paragraph 3.6
2.35 – For any mutual company involved in the scheme . . .	18.2.38	Not applicable, as no mutual companies are involved in the Proposed Scheme
2.36 – For a scheme involving long-term insurance business . . .	18.2.39	Not applicable, as the Proposed Scheme does not involve any long-term insurance business
2.37 – Where the transfer forms part of a wider chain of events or corporate restructuring, it may not be appropriate to consider the transfer in isolation and the independent expert should seek sufficient explanations on corporate plans to enable them to understand the wider picture. Likewise, the independent expert will also need information on the operational plans of the transferee and, if only part of the business of the transferor is transferred, the transferor. These will need to have sufficient detail to allow them to understand in broad terms how the business will be run	18.2.40	Paragraph 3.7
2.38 – A transfer may provide for benefits to be reduced for some or all of the policies to be reduced . . .	18.2.41	Not applicable, as no benefits are to be reduced
2.39 – The PRA expects the independent expert to provide a supplementary report for the final court hearing . . .	n/a	Paragraphs 2.30 and 17.32

PRA Document	FCA SUP18	Independent Expert Report
2.40 – The purpose of the supplementary report . . .	n/a	Paragraphs 2.30 and 17.33, with more detail to be included in the supplementary report