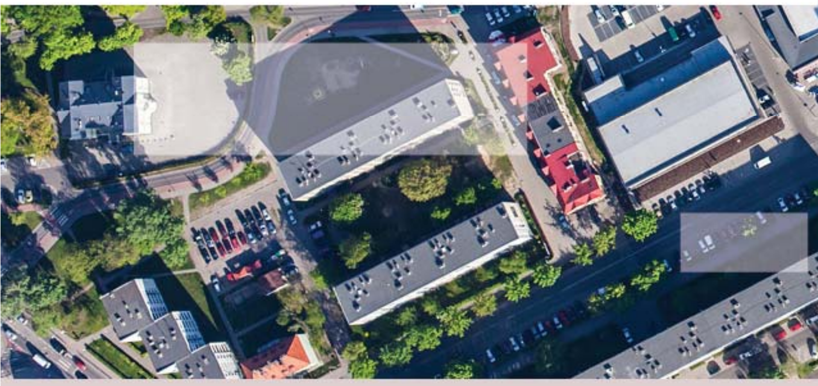
Willis Towers Watson

SUMMARY of the 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



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 This document is a summary of the Scheme Report (the "Summary") and the Scheme Report contains detailed information that is not shown in this Summary.

1.3 This Summary, and the Scheme Report, have been prepared on the instruction of DAS Legal Expenses Insurance Company Limited ("DAS") and ARAG Allgemeine Versicherungs-AG ("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.

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

1.5 This Summary and the 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. This Summary and the Scheme Report 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.

1.6 This Summary is subject to the same limitations as those set out in the Scheme Report and in the event of any real or perceived conflict between this Summary and the Scheme Report, the Scheme Report shall prevail.

About the Independent Expert

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

1.8 I consider that I have no conflict of interest or involvement, current or historical, with DAS, ARAG or any other Munich Re[1] or ARAG group companies which would affect my suitability to act as the Independent Expert for the Proposed Scheme.

1.9 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.

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

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

The Proposed Scheme

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

1.12 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").

1.13 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.

1.14 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").

1.15 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.

1.16 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

1.17 I have considered the likely effects of the Proposed Scheme on the following groups of affected policyholders:

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

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

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

- 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.

1.19 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.

1.20 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.

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

Findings of the Independent Expert

Security of policyholders remaining within DAS

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

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

1.24 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.

1.25 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.

1.26 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

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

1.28 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%.

1.29 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%.

1.30 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.

1.31 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.

1.32 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

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

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

1.35 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.

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

Other considerations

1.37 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.

1.38 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.

1.39 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

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

1.41 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 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

1.42 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.

1.43 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.

1.44 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.

1.45 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 1.43 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.

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

Supplementary Report

1.47 This Summary, and the Scheme Report, are 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.

1.48 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

1.49 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.

1.50 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.

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

1 April 2020

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