Proposed Part VII Transfer of the Insurance Business of

Travelers Casualty and Surety Company of Europe Limited

to

Travelers Insurance Company Limited

Report of the Independent Expert

23 October 2018

Prepared by: Alex Marcuson, Marcuson Consulting Ltd

Version: FINAL

www.marcuson.co

Prepared for: The High Court of Justice of England and Wales

Key acronyms and definitions

This report contains a number of acronyms, shorthand names for companies and technical terms. To aid readability, I have not defined each in the text, but prepared a consolidated glossary in Appendix 5. Where defined terms are used in the text, the first letter has been capitalised. The bold items below are key items from the glossary.

TCSCE	Travelers Casualty and Surety Company of Europe Limited, a company within the Travelers Group, the **Transferor** or company from which insurance business is being transferred.
TICL	Travelers Insurance Company Limited, a company within the Travelers Group, the **Transferee** or company into which insurance business is being transferred.
TIDAC	Travelers Insurance DAC, a newly established Irish-domiciled company within the Travelers Group to which TICL intends to transfer all of all of its business written on a Freedom of Services basis and business written by its Irish Branch established using TICL's Freedom of Establishment passporting rights.
TML	Travelers Management Limited, a company within the Travelers Group. It employs all UK-based Travelers staff and provides management services to its UK operations, including TICL and TCSCE.
Travelers/ TCI	A term used to refer to one or more companies within the **Travelers Group**, the group of companies with The Travelers Companies, Inc ("**TCI**") as ultimate parent.
TRV Pool	An intercompany pooling arrangement under which TCI's major insurance subsidiaries reinsure one another to share loss experience. The lead company of the TRV Pool is The Travelers Indemnity Company ("**TIC**"), and other participating companies include St. Paul Fire & Marine Insurance Company Limited ("**SPFMIC**") and Travelers Casualty and Surety, Inc. (the parent of Travelers Casualty and Surety Company of America ("**TCSCA**")).
Brexit	The departure of the UK from the European Union; or the date of departure.
Court	The High Court of Justice of England and Wales is responsible for approving the Transfers.
FCA and **PRA**	The two insurance regulators in the UK are the Financial Conduct Authority and the Prudential Regulation Authority. Both are consulted extensively prior to the Transfer going ahead. **SUP18** and the **SoP** are regulatory guidance that set out respectively the expectations of each regulator for the Report of the Independent Expert.
Freedom of Services	In the context of insurance business, the permission for a firm authorised in one EEA state to underwrite insurance business anywhere within the EEA as if they were an authorised firm in the EEA state where the risk in underwritten.
Freedom of Establishment	In the context of insurance business, the permission for a firm authorised in one EEA state to establish a branch office in any other state within the EEA to underwrite insurance business while remaining supervised by the prudential regulator of its home state.
FSMA 2000	The UK legislation enabling the Transfer to take place. Its full name is the Financial Services and Markets Act 2000.
Report and **Supplemental Report**	Under FSMA 2000, an **Independent Expert** must prepare a report for the Court setting out the effect of the Transfer on policyholders affected by it. It is normal practice for the independent expert to prepare a Supplemental Report shortly before the Court approves the Transfer. This is to update the Court on any significant matters arising in the months between when the Report was prepared and the Court approves the Transfers.
Transfer	The proposed insurance business transfer scheme moving certain assets and liabilities from TCSCE to TICL.

Affected Policyholders	These comprise the Existing Policyholders and the Transferring Policyholders.
Existing Policyholders	Policyholders of TICL prior to the Transfer.
Transferring Policyholders	Policyholders of TCSCE whose policies will move to TICL under the Transfer.
Terms describing financial strength	I use in my analysis four qualitative terms to describe the position of firms reviewed, assigning increasing levels of financial strength: **Under-capitalised, adequately-capitalised, well-capitalised** and **strongly-capitalised.** I give these self-descriptive terms precise definitions in the glossary but, as a guide: an *adequately-capitalised* firm has financial resources that exceed a firms' capital requirements by an appropriate margin or buffer. An under-capitalised firm has financial resources falling below this level.

Contents

A. Overview

1. Executive Summary

1.1. Introduction

1.1.1. I, Alex Marcuson, have been appointed to act as the independent expert for the proposed insurance business transfer of assets and liabilities from Travelers Casualty and Surety Company of Europe Limited to Travelers Insurance Company Limited. This role is established under Part VII of the Financial Services and Markets Act 2000 (along with supporting regulations) and described in the Prudential Regulation Authority's Statement of Policy issued on 1 April 2015 and section SUP18 of the Financial Conduct Authority's Handbook.

1.1.2. For the remainder of this Report, definitions of certain technical terms and abbreviations are set out in a glossary in Appendix 5.

1.1.3. I am a Fellow of the Institute and Faculty of Actuaries experienced in loss reserving and capital modelling for non-life insurance companies. I am satisfied that I am able to act independently in performing this review. The PRA, in consultation with the FCA, approved my appointment as independent expert for this Transfer on 1 December 2015.

1.1.4. As independent expert, I am required to prepare a report for the Court evaluating the impact of the scheme to be presented to the Court to bring about the proposed insurance business transfer. My Report contains the elements specified in the SoP and SUP18 and complies with the current technical actuarial standards issued by the UK Financial Reporting Council that apply to this work. The PRA, in consultation with the FCA, has approved the form of my Report.

1.2. Overview of the Transfer

1.2.1. The purpose of the Transfer is to rationalise TICL and TCSCE into a single insurance company and as a result achieve operational efficiency through lower running costs and reduced management time. Any excess assets held in TCSCE post-Transfer may be released to the Travelers Group.

1.2.2. To achieve this, the insurance liabilities of TCSCE together with associated reinsurance assets will be transferred. As the insurance liabilities are 100% reinsured to other Travelers Group companies, Travelers does not intend to transfer any cash or investment assets. At some point in the following twenty-four months, Travelers anticipate making an application to the Court for the liquidation of TCSCE.

1.2.3. TCSCE is a small insurer with two insurance portfolios: a live portfolio of surety business and a run-off portfolio. Both portfolios have long-standing 100% reinsurance to large US-domiciled insurance companies within the Travelers Group, meaning that TCSCE has nil net liabilities on a GAAP basis. Net assets were £15.1 million as at 31 December 2017.

1.2.4. The run-off portfolio was underwritten in the period from the late 1990s to 2002, when TCSCE was called Gulf Insurance Company UK Limited. Most of its remaining gross liabilities relate to provisions for claim notifications that may arise in future rather than existing claims. It is 100% reinsured to TIC.

1.2.5. The surety portfolio is made up of surety bonds issued in the UK. These are split between those issued on behalf of clients where the relationship is managed by TCSCE and those where the client relationship is managed by other Travelers Group entities. From the beginning of 2016, no new bonds were issued in TCSCE's name[1], and underwriting activity has been continued by TICL. All surety business, whether issued by TCSCE or TICL and whether for UK or non-UK managed client relationships are 100% reinsured to TCSCA.

1.2.6. TICL is a UK domiciled and regulated insurer and the Travelers Group's main non-Lloyd's underwriter of UK, Irish and European property and casualty insurance. In its 2017 statutory accounts it disclosed net assets of £445 million, net technical provisions of £714 million and net written premium of over £200 million.

1.2.7. TICL has the benefit of a long-standing guarantee provided by SPFMIC, a company within the Travelers Group, in respect of all of its insurance liabilities.

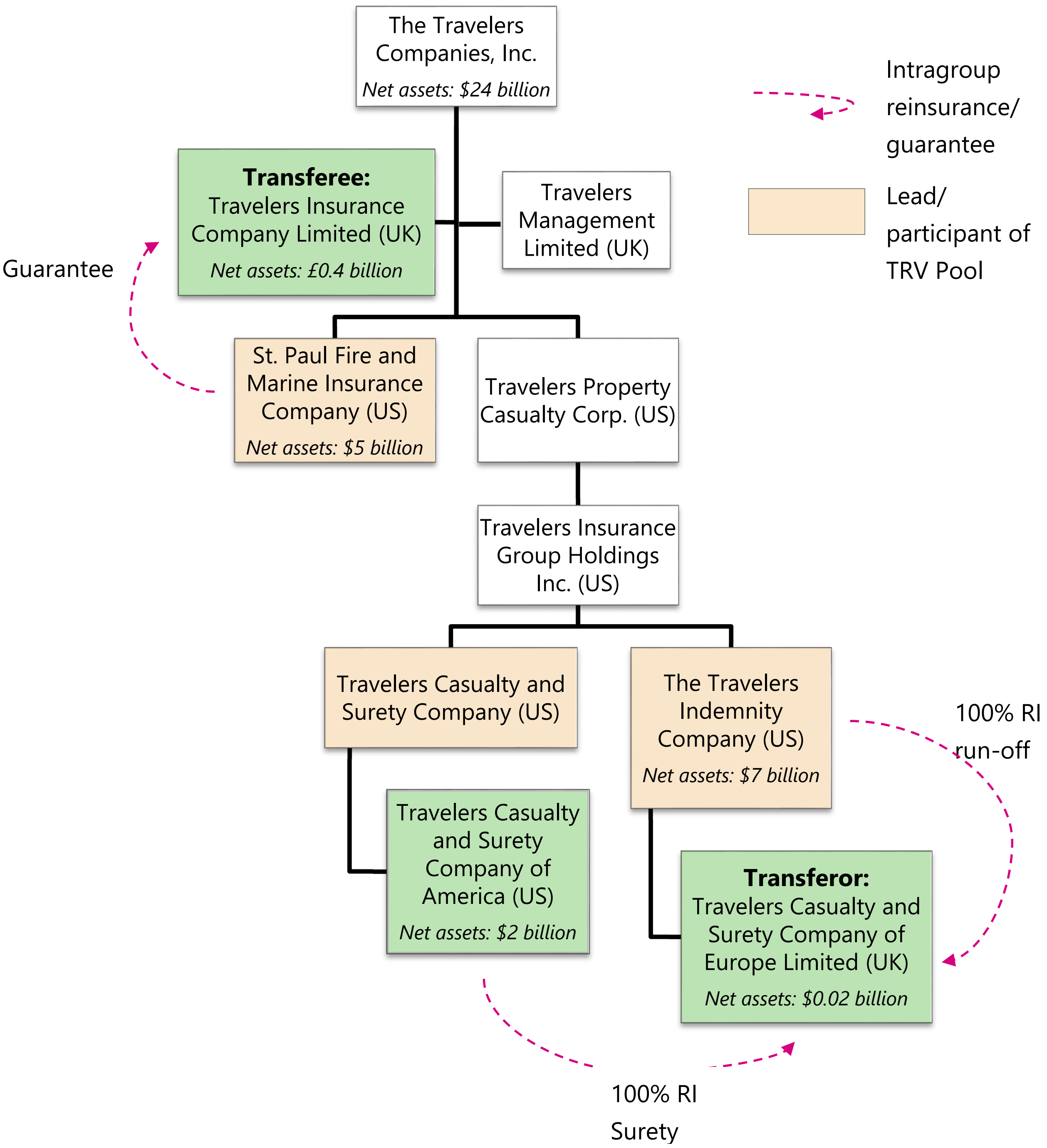
1.2.8. TCSCE does not employ any staff, making use of the services of individuals employed by TML and other Travelers Group companies. Equivalent services will be provided to TICL following the Transfer, resulting in no changes or disruptions to the current arrangements.

1.2.9. The consolidated shareholders' equity of TCI as at 31 December 2017 was $24 billion.

1.2.10. Figure 1.1 provides a simplified corporate structure chart for the Travelers Group, highlighting the major companies that are referred to in this Report. The coloured boxes indicate regulated insurance or reinsurance companies while the white boxes indicate holding and service companies within the group.

[1] Note that TCSCE did amend and extend existing bonds after this date and new surety exposures did accrue. This is described in Section 3.4.

Figure 1.1 Travelers Group - simplified structure chart



1.3. Conclusions

1.3.1. Table A-1 sets out my conclusions. Section 11 summarises conclusions (1) – (2) and Section 12 contains the analysis supporting conclusions (4) – (6). Conclusion (3), included for completeness, is factual.

Table A-1 – Conclusions of the Independent Expert	
(1)	The Transfer is unlikely[2] to materially adversely affect the policyholders of Travelers Casualty and Surety Company of Europe Limited transferring to Travelers Insurance Company Limited. My analysis suggests that under some measures of financial security these policyholders will be less secure, and under others they will have a more secure position. On balance, I believe that the improvements provide appropriate compensation for the reductions arising. In my quantitative testing, I have been careful to avoid relying on an assumption of support from elsewhere in the Travelers Group. I have identified in my qualitative tests where I have assumed such support. As policies issued using the Travelers brand, I believe it is important to recognise the implicit support that both TICL and TCSCE are likely to receive from the wider group should they experience financial difficulties. In the context of the size and financial strength of the wider Travelers Group, I see differences arising from quantitative measures of financial security as having limited impact on policyholders, and that these policyholders will continue to have a very low chance of any legitimate claims not being met as they fall due. This conclusion is based on a number of factors, including a review of the anticipated financial position of Travelers Insurance Company Limited and the chain of security supporting these policyholders following the Transfer.
(2)	The Transfer is unlikely to materially adversely affect the Existing Policyholders. This conclusion is based on a review of the anticipated financial position of Travelers Insurance Company Limited following the Transfer.
(3)	There will be no Remaining Policyholders in Travelers Casualty and Surety Company of Europe Limited after the Transfer.

[2] See Section 5.2 for an interpretation of "unlikely" and other terms used to compare the position of Affected Policyholders here and elsewhere in the Report.

Table A-1 – Conclusions of the Independent Expert	
(4)	The Transfer will have no non-financial impact affecting the position of the Affected Policyholders. There will be no change to the policy and claims administration arrangements in place as a result of the Transfer. I have not identified any other material changes in various regulatory and other aspects arising from the Transfer.
(5)	There are no material implications of the Transfer on any of the reinsurers of the Transferring Policyholders of Travelers Casualty and Surety Company of Europe Limited.
(6)	The notification arrangements proposed by Travelers are appropriate.

1.3.2. To reach these conclusions I have considered the effect of the Transfer on the following:

- The current and projected balance sheet and technical provisions of TCSCE and TICL.
- The risks faced by each company and the anticipated capital resources required to reduce the risk to policyholders of non-payment of claims to a sufficiently low level.
- The business plans of TICL post-Transfer.
- The relationship between TCSCE and TICL and the wider Travelers Group.
- Various non-financial matters affecting policyholders including changes in regulatory and legal environment brought about as a result of the Transfer. For many of these matters, while I have applied my experience of working in the insurance industry for many years, I have also placed reliance on material prepared for and by Travelers.

1.3.3. I have also considered the communications plans proposed by Travelers and whether they have taken an appropriate approach in determining which policyholders it need not write to directly regarding the Transfers.

1.3.4. In Section 5, I have set out an overview of the methodology I have adopted to reach the conclusions in Table A-1.

1.3.5. In Section 6, I have discussed five significant current issues and considered their impact on the Transfer.

1.3.6. I anticipate preparing a Supplemental Report close in time to the Sanction Hearing in which I will if necessary review any material changes to the factors described in the Report.

1.4. Core Arguments

1.4.1. The principal reasons why I have reached my conclusions are as follows:

1.4.2. My testing has shown that following the Transfer, TICL will be an *adequately-capitalised* company and therefore has a low risk of being unable to pay its liabilities as they fall due.

1.4.3. TICL is rated[3] A by A. M. Best and AA by S&P, two major credit ratings agencies, widely relied upon in insurance markets for their assessment of the ability of individual insurance and reinsurance companies to meet claims as they fall due. Ratings at this level indicate their assessment of there being an extremely low chance of legitimate claims not being met in full.

1.4.4. TICL has an explicit guarantee of financial support from SPFMIC, one of the largest insurance operating companies within the Travelers Group. An important consequence of this guarantee is the quality of rating provided to TICL by the major credit ratings firms described in paragraph 1.4.3[4].

1.4.5. According to its statutory financial statements, the net claims liabilities of TCSCE being transferred to TICL are nil, as such the impact of the Transfer on TICL is minimal. Therefore, the level of capitalisation of TICL post-Transfer is virtually the same as it is pre-Transfer.

1.4.6. From 2016, no new surety bonds were issued in TCSCE's name and underwriting activity for this portfolio has been continued by TICL[5]. As the surety bonds have a finite policy exposure period, I expect one effect of the Transfer will be to accelerate a shift in surety portfolio exposures from TCSCE to TICL.

1.4.7. While the total face value of the surety bonds being transferred from TCSCE to TICL is very large, my examination of the operation of these policies and the chain of security protecting beneficiaries of these bonds has led me to conclude that there will remain a sufficiently low risk of non-payment post-Transfer.

1.4.8. There are no Remaining Policyholders for me to consider.

1.4.9. The Transfer is between two companies, both of which are wholly-owned companies within the Travelers Group. As such, their policyholders will continue to benefit from any implicit support from other companies within this multinational insurance group. By *implicit support* I mean that, beyond their strict legal obligations to one another, the financial and other resources of companies within the group may be shared, since it may be in their interest to protect the group's reputation for meeting claims as they fall due. Clearly the value of this implicit support will depend upon the specific circumstances in which it might be needed.

[3] Ratings and the rating agencies that issue them are described further in the Glossary in Appendix 5.
[4] SPFMIC has a financial strength rating of AA from S&P and A++ from A. M. Best.
[5] Additional details are set out in paragraph 3.4.2.

1.4.10. I have carefully considered [6] the nature of financial support provided to the Transferring Policyholders, and how this will change as a result of their moving between companies in different parts of the Travelers Group. This analysis concluded that the Transferring Policyholders would benefit from an improvement to their position as a result of the Transfer.

1.4.11. Both companies are subject to the same legal and regulatory regime; the Transfer does not introduce any changes in this respect.

1.4.12. Both companies will be subject to exactly the same administration and claims handling arrangements following the Transfer as now.

1.5. Important Limitations

1.5.1. The Transfer involves the movement of policies between two companies within the Travelers Group. As can be seen in Figure 1.1, TICL and TCSCE lie in different parts of Travelers Group.

1.5.2. My analysis looks in detail at the ability of the companies to pay the claims of the Affected Policyholders as they fall due. In comparing the chain of security protecting these policyholders before and after the Transfer, it also considers the effect of changes arising from differences in the ownership of TCSCE and TICL.

1.5.3. While I have considered the standalone financial security of TICL post-Transfers and compared the chain of security within the Travelers Group protecting the Transferring Policyholders before and after the Transfer (Tables 10.4 and 10.5), I have not analysed in detail the risk of the whole of the Travelers Group getting into major financial difficulties. This is because this is a remote scenario to which the Affected Policyholders are already exposed and is not, in my view, materially changed as a result of the Transfer. I note that each of the key underwriting entities of the Travelers Group has a very high financial strength rating given by two major credit rating agencies, S&P and A. M. Best.

1.5.4. The conclusions presented in my report relate to an assessment of the effect of the Transfer on policyholders and do not provide assurance that all claims will be paid in full in all possible outcomes. The nature of general insurance means that extreme events can arise from natural events and man-made circumstances that can render even the largest and most secure insurers unable to meet claims as they fall due.

1.5.5. Other than as described in the paragraph 1.5.6, Travelers has no alternative plans for the Transferring Policyholders if the Transfer does not go ahead. My analysis of the pre-Transfer position of TCSCE and TICL applies in this situation.

1.5.6. I have been told by Travelers that TCSCE has one remaining surety bond that was issued on a Freedom of Services basis in respect of Irish risks. Following the Transfer, Travelers intends for this bond to transfer from TICL to an EEA-domiciled insurer (TIDAC [7]) as part of TICL's preparations for Brexit. I have reviewed Travelers'

[6] In my qualitative analysis of the chain of security protecting policyholders set out in Section 10.5.

[7] Subject to authorisation by the Central Bank of Ireland.

contingency plans in the event that the Transfer is delayed or does not proceed and believe that they are appropriate.

1.5.7. Other more general limitations and assumptions are set out in Appendix 2.

1.6. Expert's declaration

1.6.1. I confirm that I fully understand my overriding duty to the Court and that I must help the Court on matters within my expertise. My duty to the Court overrides any obligation to those from whom I have received instructions or by whom I am paid. I believe that I have complied, and will continue to comply, with this duty.

1.6.2. I confirm that I am aware of the requirements of Part 35 and Practice Direction 35 of the Civil Procedure Rules, and the Guidance for the Instruction of Experts in Civil Claims 2014.

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

Alex Marcuson .... Alex Marcuson MA FIA 23 October 2018

2. Scope of work and approach

2.1. Appointment

2.1.1. I, Alex Marcuson, have been appointed by TCSCE and TICL to act as the Independent Expert for the Transfer. A copy of relevant sections from my letter of engagement appointing me to act in this role is included in Appendix 1.

2.2. Experience

2.2.1. I am a Fellow of the Institute and Faculty of Actuaries with over twenty years of experience advising non-life insurers. I have experience in loss reserving and capital modelling for non-life insurance companies and have previously advised a number of firms carrying out Part VII transfers including having acted as an independent expert. A copy of my curriculum vitae is included in Appendix 4.

2.3. Independence

2.3.1. To carry out this role, I am required to be able to act independently in performing a review of the Transfer. I believe I can do so for the following reasons:

- Neither I nor Marcuson Consulting Ltd has any direct shareholding or have identified any other direct financial interest in or relationship with TCSCE or TICL.
- Neither I nor Marcuson Consulting Ltd has any insurance policy with TCSCE or TICL.
- I am not aware of any other conflicts of interest that might impair my ability to act.
- Marcuson Consulting Ltd has not previously undertaken any work for TCSCE, TICL or companies within the Travelers Group.

2.3.2. I confirm that the PRA (in consultation with the FCA) has granted its approval for me to act as an Independent Expert for the purpose of producing the Report.

2.4. Costs

2.4.1. My costs incurred in the preparation of this Report are being borne by TCSCE.

2.5. Role

2.5.1. By accepting the appointment, I am required to produce the Report for the Court on the effects of the Transfer as required by Part VII of FSMA 2000; the Statement of Policy, entitled *'The Prudential Regulation Authority's approach to insurance business transfers'*, issued by the PRA in April 2015; and SUP18 of the FCA's Handbook.

2.6. Scope of the Report

2.6.1. This Report considers the effect of the Transfer on the Affected Policyholders, which are:

- the Transferring Policyholders; and
- the Existing Policyholders.

2.6.2. Should the Transfer proceed, I understand that there will be no Remaining Policyholders.

2.6.3. This Report should not be regarded as a legal opinion on the effectiveness of the Transfer.

2.7. Structure of the Report

2.7.1. The Report comprises four main sections:

Section A: Overview	Findings from my report and key limitations relating to them. Various details relating to my appointment, role, scope and structure of the Report, together with limitations on my work and use of the Report. Overview of the methodology used in my work and facts and people on which I have placed reliance.
Section B: Pre-Transfers Review	Review of the companies pre-Transfer, including their assets, liabilities and risks.
Section C: Post-Transfers Review	Review of TICL post-Transfer, including detailed analysis of financial and non-financial aspects of TICL.
Section D: Appendices	Supporting material referred to elsewhere in my Report.

2.7.2. The Report should be considered in its entirety as parts taken out of context could be misleading.

2.8. Purpose and use of the Report

2.8.1. This Report has been prepared to set out my findings in respect of the Transfer to the Court following the guidance set out in the SoP and SUP18. It should not be used for any other purpose, for any other insurance business transfer or in any other legal forum.

2.8.2. Marcuson Consulting Ltd and I do not owe or accept any duty to any party other than the Court or to any party seeking to use the Report for any purpose other than in connection with the Transfer. We shall not be liable for any loss, damage or expense (including interest) of whatever nature that is caused by any party choosing to rely on this report for any other purpose.

2.9. Compliance with SoP, SUP18 and UK Actuarial Professional Standards

2.9.1. This Report has been prepared in line with the relevant regulations and guidance of the PRA and FCA.

2.9.2. When marked as final: This Report has been prepared in compliance with the Financial Reporting Council's Framework for FRC Technical Actuarial Standards and relevant Technical Actuarial Standards (TAS 100 and TAS 200) together with the relevant Actuarial Profession Standard of the IFoA (APS X2: Review of Actuarial Work).

2.9.3. The PRA (in consultation with the FCA) has approved the form of this Report in the context of the Transfer.

3. Description of the Transfer and the Transferring Policyholders

3.1. Introduction

3.1.1. This section of my report sets out my understanding of the Transfer, including relevant background details of the companies and portfolios included in my analysis.

3.1.2. The elements covered are:

- Description of the Transfer;
- Purpose of the Transfer;
- Subsequent plans;
- The Transferring Policyholders;
- Reinsurance;
- Alternative arrangements should the Transfer not go ahead; and
- Policy administration and claims handling.

3.2. Description of the Transfer

3.2.1. The Transfer is from TCSCE to TICL, and comprises the entirety of the insurance and reinsurance policies underwritten by TCSCE together with associated outwards reinsurance policies, investments and other assets and liabilities of TCSCE such that the GAAP value of assets and liabilities to be transferred will be equal. The remaining assets of TCSCE will not be transferred to TICL.

3.2.2. The Scheme explicitly transfers to TICL the benefit of any and all additional and associated rights of TCSCE in respect of Surety business, in particular the indemnities provided to it by Surety Clients of Travelers Group companies.

3.3. Purpose of the Transfer

3.3.1. The purpose of the Transfer is to rationalise TICL and TCSCE into a single insurance company. The motivation of the Transfer is to achieve operational efficiency through lower running costs and reduced management time. Any excess assets held in TCSCE post-Transfer may be released to the Travelers Group.

3.4. Subsequent Plans

3.4.1. From the beginning of 2016, no new surety business has been underwritten by TCSCE, with new bonds now being issued by TICL.

3.4.2. TCSCE has told me that it has accrued additional surety exposures since 1 January 2016 in circumstances where it was not practical to substitute TICL for TCSCE in an existing or ongoing surety arrangement. It has described to me three circumstances or sets of circumstances where this has arisen:

- Where it has needed to amend or extend an existing surety bond which was issued prior to 1 January 2016.
- Where it had an existing commitment made prior to 1 January 2016 to provide co-surety support to a surety facility operated after this date by another surety underwriter. TCSCE has told me that this did not involve taking on any new risks.
- Under an existing 3-year master participation agreement to which TCSCE provided co-surety support between 2014 and 2017 and which TCSCE elected to renew in 2017.

3.4.3. I have taken account of these additional exposures arising since 1 January 2016 in reaching my conclusions and am satisfied that they do not have a material impact on them.

3.4.4. Before the completion of the Transfer, TCSCE will have requested the withdrawal of its permissions to underwrite business. After the Transfer it will request withdrawal of any remaining permissions. At some point in the following twenty-four months, the Travelers Group anticipates making an application to the Court for the liquidation of TCSCE.

3.4.5. For TICL, I have been told in writing that its directors plan to:

- Continue to issue surety bonds and manage this portfolio in a similar manner to the previous arrangements for TCSCE.
- Continue to run-off the Gulf Portfolio liabilities that are transferring from TCSCE.
- Otherwise continue to underwrite and manage the existing business of TICL in line with pre-Transfer arrangements.

3.4.6. Travelers has carried out contingency planning in response to the departure of the United Kingdom from the European Union. Travelers has decided to transfer its EEA business from TICL to a new Irish-domiciled subsidiary (TIDAC[8]) under a separate Part VII Transfer. This Brexit-related transfer will take place after the Transfer is completed. My discussion of Brexit issues is contained in Section 6.2.

3.5. The Transferring Policyholders

3.5.1. The Transferring Policyholders refer to all the policyholders of TCSCE.

[8] Subject to authorisation by the Central Bank of Ireland.

3.5.2. The Transferring Policyholders comprise two portfolios:

- **The Gulf Portfolio**. This is a portfolio of specialty lines business placed in the London insurance market, including professional indemnity, financial institutions and directors' and officers' liability business. It was underwritten from the late 1990s to 2002, when TCSCE's company name was then Gulf Insurance Company UK Limited, which in turn was owned by Gulf Insurance Company. On 1 July 2005, Gulf Insurance Company was merged into TIC, and all policies were placed into runoff.

  Travelers has told me that there are approximately 860 policyholders in this portfolio.

  The bulk of the remaining liabilities of the Gulf Portfolio relate to IBNR reserves for circumstances where there is believed by claims handlers to be the possibility of future claim notifications. It has been 100% reinsured to TIC since 1 August 2002.

- **The Surety Bond Portfolio**. This is a portfolio of Surety business, described further in Section 3.6. It has been 100% reinsured to TCSCA since 1 October 2001. From the beginning of 2016, TCSCE stopped underwriting this portfolio and bonds were issued instead by TICL.

  Travelers has told me that as at 30 September 2018 there were approximately 124 live bonds in this portfolio.

3.5.3. As at 31 December 2017, TCSCE had gross outstanding claims reserves of $114.0 million and (on a GAAP basis) nil net claims reserves.

3.5.4. The nil net insurance liabilities of TCSCE are as a result of the 100% reinsurance policies of the Gulf and surety bond portfolios with TIC and TCSCA respectively.

3.6. Surety Bond Portfolio

3.6.1. Surety bonds are used to provide a guarantee of performance in commercial contracts. They have many similarities to letters of credit issued by banks. In surety business, the Surety Client asks the Surety Insurer to issue a bond as a form of financial security to an Obligee for the performance of a particular obligation of the Surety Client.

3.6.2. Surety bonds can give rise to large aggregate exposures for the value of bonds issued to the Obligees of a client for whom they are issued. For example, TCSCE's top 3 clients each had aggregate exposures of over £50 million as at 20 April 2018.

3.6.3. Surety Clients (normally the top-level company within the Surety Client group) provide Surety Insurers with an indemnity in respect of all losses incurred by the Surety. This means that the Surety Insurer only loses out financially in the event of a claim arising on a bond *and* the Surety Client getting into financial difficulty.

3.6.4. The nature of this exposure to the default of a client means that surety underwriters have a close understanding of the financial position of their clients, similar to banks.

3.6.5. Considered together with the indemnities provided by Surety Clients, the Surety Insurer is therefore exposed to economic risks that might result in multiple corporate failures.

PORTFOLIO BREAKDOWN

3.6.6. TCSCE's Surety Bonds comprise two classes:

- Commercial bonds, issued for a variety of purposes, for example to meet court requirements during litigation, customs bond obligations or other contractual or tender process requirements;
- Construction bonds, to guarantee that the Surety Client performs work to a required specification.

3.6.7. Some Surety Bonds are Sole Surety business, being written entirely by Travelers Group companies, while for larger amounts, the bonds are Co-Surety business. Each Co-Surety underwriter is usually only liable up to the face value of the Surety Bonds it has issued, but in some cases they are liable up to the face value of the Surety Bonds issued by the other Co-Surety insurers.

3.6.8. Within Travelers, TCSCE issues Surety Bonds for Surety Clients with which it manages the relationship. For these Surety Clients, TCSCE will arrange the indemnity agreement between the Surety Client and Travelers. Most of this business is construction bonds.

3.6.9. TCSCE also issues Surety Bonds to Surety Clients where the relationship is managed by other Travelers Group companies that write surety business, including TCSCA. This business is entirely commercial bonds. In these cases, indemnity arrangements between the Surety Client and Travelers are not arranged or managed by TCSCE. TCSCE's involvement arises because the client requires a bond issued by a UK-authorised insurance company.

3.6.10. All of the surety business underwritten by Travelers Group companies, including TCSCE, is 100% reinsured by TCSCA. Therefore, the ultimate economic effect of whether a bond is issued by TCSCE or another Travelers Group company is the same.

3.6.11. As at 20 April 2018, the gross outstanding value of each type of exposure underwritten by TCSCE is shown in Table 3.1. Note that these figures include potential exposure to TCSCE where it can be liable for Surety Bonds issued by other Co-Surety insurers.

Table 3.1 – Summary of TCSCE Bond Values (Gross of Reinsurance) as at 20 April 2018 (£million)					
Bond type	TCSCE Client		Non-TCSCE client		Total
	Sole Surety	Co-Surety	Sole Surety	Co-Surety	
Construction	160	18	0	0	178
Commercial	0	0	206	182	388
Total	160	18	206	182	566

Expiry of TCSCE Surety Bond Portfolio and Loss Payment Events

3.6.12. Each bond has a fixed monetary limit and may expire on a given date or on satisfaction of certain completion terms. Some bonds are payable on demand following a trigger event, while others require the beneficiary of the surety bond to prove the value of the loss.

3.6.13. For the construction bonds issued by TCSCE, the underlying projects generally have an expected maximum length of three years. I understand that there is a tendency for large construction projects to take longer to complete than planned, possibly as a result of extensions to the original project.

3.6.14. For these projects, the surety bonds do not have fixed expiry dates. Therefore TCSCE cannot consider that they present no further risk to it until:

- Travelers has paid the full value of the Surety Bond to the Obligee following one or more claim events;
- The Obligee issues a certificate of completion of works confirming the satisfactory completion of works or otherwise returns the Surety Bond; or
- In the event that no certificate of completion of works is issued, the legal limitation period within which a claim must be brought by the Obligee expires.

3.6.15. Travelers has told me that not all Surety Clients obtain certificates of completion of works from Obligees. In practical terms, there is an incentive for Surety Clients to obtain certificates of completion of works or otherwise ensure the issued Surety Bonds are returned. Without this, their ability to obtain further bank finance or surety bonds for future projects is constrained and ongoing premiums are payable to the Surety.

3.6.16. TCSCE maintains a schedule of open exposures, which shows that it has a small amount of bond exposure that has remained open for a number of years.

3.6.17. Travelers has told me that it issues Surety Bonds under a trust deed. They have explained that this means that the limitation period within which a claim must be brought by the Obligee is twelve years from the date of project completion.

3.6.18. As a result, I believe it is reasonable to conclude that the surety bond portfolio will retain exposure to potential, even if remote, claim liabilities for many years. This is relevant when modelling TCSCE's risk profile and capital requirements owing to the extended period over which it will have a credit exposure to TCSCA. I have taken this into account when considering the capital requirements for TCSCE later in this report.

Impact of the Transfer upon the Surety Client Indemnity

3.6.19. I have been supplied with an example of specimen wording for an indemnity to be given by a client to TCSCE. This states that the beneficiary of the indemnity is the "Travelers Companies", with this defined to include all current and future companies within the Travelers Group. The indemnity states that each of them will be "entitled to enforce" its terms.

3.6.20. I note that this is only a sample wording, and it is possible that the wordings used by TCSCE have changed over time and differ from those used by other Travelers Group companies. In the event that there is an indemnity wording which benefits TCSCE without express or implied reference to TICL, I believe that TICL will still benefit from the indemnity, because the Scheme will transfer "*all rights, … of whatever nature used in, or relating to, the insurance and reinsurance business of TCSCE*" to TICL.

3.6.21. I have reviewed the legal advice received by Travelers prepared by Karen Spencer, a partner with Gateley Plc and nationally recognised expert in surety law, relating to the indemnity wording. This states, regarding the indemnity agreements entered into by its surety clients, that "*The indemnity arrangements will not be affected by the proposed transfer of business. The indemnities are and will continue in full force and effect and enure for the benefit of TCSCE and other companies within the Travelers group, including those companies which may issues bonds for clients of TCSCE…*"

3.6.22. I am satisfied that it has been independently prepared by suitably qualified lawyers with experience of this field. This advice confirms my interpretation of the specimen indemnity wording, that they will continue to provide additional protection to Travelers group companies (including TICL) post-Transfer.

3.6.23. I understand that a copy of this legal advice has been supplied to the FCA/PRA by Travelers and will be provided to the Court.

3.6.24. As a result, I have no reason to believe that the Transfer will have any adverse impact upon the effectiveness of these indemnities, and I am therefore satisfied that where it proves necessary, TICL would be able to seek recovery from clients in the same manner as TCSCE currently can.

3.6.25. The Transfer moves the benefit of any indemnity of TCSCE to TICL. The specimen indemnity states that the governing law is English Law and that the jurisdiction of the Courts of England and Wales applies to the parties to the indemnity. There remains a slight residual risk that the indemnity may have been provided under non-EEA law, with the possible effect that, if the indemnity is called upon, the Transfer may not be recognised under the governing law of the indemnity.

3.6.26. I do not believe that this risk arises in practice because I have been told by Travelers staff that, where TCSCE issues surety bonds in the EEA for non-TCSCE[9] clients, to avoid the risks arising from differences in governing law for the enforcement of indemnities, it is TCSCE's practice for separate indemnities to be provided both under the governing law of the indemnity provider *and* under the governing law of the surety bond issued. This means that TCSCE will have an indemnity from the client that will be governed under the law of an EEA member state.

ADDITIONAL COMMENTARY RELATING TO CONSTRUCTION BONDS

3.6.27. For the construction bonds, TCSCE will often not need to pay out in the event of a claim from an Obligee. This is because the Surety Client will have the option to remediate any defective works. Commercial efficacy and common sense mean that this is often the most efficient and cost-effective means of resolving an issue.

3.6.28. Even in a scenario where the contractor gets into financial difficulties, the amount of the ultimate financial loss (gross of reinsurance) that TCSCE suffers can be significantly less than the value of the bond. This is because the surety underwriter will rank alongside the contractor's bankers and will work alongside other creditors to organise a restructuring of the business to mitigate their losses.

3.6.29. During this restructuring period, the client or its successor companies can continue and may even complete the construction project at its own expense. If this occurs, then even in the event of a claim circumstance arising and the contractor getting into financial difficulties, the ultimate amount payable by TCSCE would be significantly less than the exposure of policies issued.

3.7. Reinsurance and guarantees

REINSURANCE

3.7.1. Under the Transfer, the intention is for all of the reinsurance associated with the Transferring Policyholders to be transferred to TICL.

3.7.2. This reinsurance comprises:

- policy-specific outwards reinsurance;
- a TIC-provided 100% aggregate reinsurance of all of the net of policy-specific reinsurance liabilities of the Gulf Portfolio; and
- a TCSCA-provided 100% aggregate reinsurance of all of the net of policy-specific reinsurance past and future underwriting liabilities of the Surety Bond Portfolio.

3.7.3. Travelers has not identified any reinsurance contracts that cannot be transferred under the Transfer.

3.7.4. Travelers has confirmed that no existing TICL reinsurance will cover any of the liabilities of the Transferring Policyholders.

[9] This arises when TCSCE issues bonds for surety clients of other Travelers surety companies in the USA and Canada.

GUARANTEES

3.7.5. TICL has the benefit of a long-standing intragroup guarantee provided by SPFMIC. An important consequence of this guarantee is the quality of the Financial Strength Rating provided to TICL by the major credit ratings firms is enhanced to reflect the rating given to SPFMIC[10]. TICL has advised that it believes that the Transferring Policyholders will benefit from this guarantee post-Transfer. I review this in Section 4.7.

3.8. Alternative arrangements should the Transfer not go ahead

3.8.1. Travelers has advised me that in the event that the Transfer does not proceed, there are no other arrangements in place for me to consider and the Transferring Policyholders will remain policyholders of TCSCE.

3.8.2. I have therefore not considered any alternatives to the Transfer, as TICL and TCSCE believe the Transfer to be appropriate and there are no alternative proposals available for my consideration.

3.9. Policy administration, staffing and claims handling

3.9.1. TCSCE currently has three full-time and one part-time members of staff. All of the staff allocated to TCSCE (as well as to TICL) are employed by a UK service company, TML. TML provides general administrative services across Travelers' European entities, including TICL and TCSCE. Some actuarial services are provided by other group companies. These arrangements will continue following the Transfer.

3.9.2. In summary, the Transfer will not give rise to any changes or disruptions to current administration, staffing or claims handling arrangements for the Transferring Policyholders or the Existing Policyholders.

[10] The treatment by the two credit rating firms differs, with S&P awarding TICL the same rating as SPFMIC while A. M. Best awards a slightly lower rating to TICL.

4. Description of the Companies

4.1. Introduction

4.1.1. This section describes both companies who are parties to the Transfer: TICL, TCSCE, together with TCI, their ultimate parent company.

4.1.2. Additionally, some high-level commentary is included for TCSCA and TIC, as they are material reinsurers of TCSCE, and for SPFMIC, as it provides a guarantee to TICL in respect of its insurance liabilities.

4.2. The Travelers Companies, Inc.

4.2.1. TCI is an insurance group holding company domiciled in Minnesota, United States of America, publicly listed on the New York Stock Exchange, and a component of the Dow Jones Industrial Average. It was established on 1 April 2004 to bring about the merger of The St. Paul Companies, Inc. and Travelers Property Casualty Corp. Prior to 2007, this company was called The St. Paul Travelers Companies, Inc.

4.2.2. TCI is the ultimate holding company for the Travelers Group of Companies. See Figure 1.1 for a simplified company structure chart. This shows that both companies who are parties to the Transfer are wholly owned subsidiaries of TCI, as are all of the other companies I consider in this section of my Report.

4.2.3. The principal nature of TCI's business is the management of non-life insurance companies, which provide property and casualty insurance for auto, home and businesses. Its key ongoing business segments are Business and International Insurance, Bond and Specialty Insurance and Personal Insurance.

4.2.4. TCI's business is subject to catastrophe exposures in the United States and Canada, including hurricanes, tornadoes, earthquakes, wildfires and terrorism. In addition, TCI has exposure to asbestos and environmental claims.

4.2.5. The underwriting risks of certain TCI subsidiaries are pooled via an intercompany pooling arrangement, the TRV Pool. The lead company of the TRV Pool is TIC, and other participating companies include SPFMIC and Travelers Casualty and Surety Company (the parent of TCSCA). This pooling of underwriting risks is a reason why A. M. Best and S&P have given the same financial strength ratings (A++ and AA respectively) to all participating companies of the TRV Pool.

4.2.6. For the year ending 31 December 2017, TCI's consolidated shareholders' equity was $23.7 billion, with earned premium of $25.7 billion. Most of its business is based in the United States of America, with 93.7% of direct written premiums written in the country.

4.3. Travelers Insurance Company Limited

4.3.1. TICL is a limited company domiciled and regulated in the UK. It is a wholly-owned subsidiary of TCI and is its main non-Lloyd's underwriter of UK, Irish and other European property and casualty insurance. It is rated as A by A.M. Best and AA by S&P.

4.3.2. It was incorporated on 10 December 1971 as St Katherine Insurance Company Limited. In October 1984, one of its founding shareholders, Tugu Insurance Company Limited of Hong Kong, divested its shareholding, which was taken up by The St Paul Companies, Inc. Since then, The St Paul Companies, Inc. acquired the remaining shares of TICL.

4.3.3. TICL has undergone a series of name changes since its incorporation, including:

Period	Company Name
10/12/1971 – 01/10/1992	St Katherine Insurance Company Limited
01/10/1992 – 29/10/2004	St. Paul International Insurance Company Limited
29/10/2004 – 01/02/2008	St. Paul Travelers Insurance Company Limited
01/02/2008 - Current	Travelers Insurance Company Limited

4.3.4. TICL has the benefit of a guarantee from SPFMIC (as mentioned in 3.7.5) that I discuss further in Section 4.7.

4.3.5. As at 31 December 2017, TICL's total net assets were £445 million and its net of reinsurance GAAP technical provisions were £714 million. During 2017, its net written premium was £203 million. The annual accounts report a pre-tax profit in 2017 of £27.9 million (2016: loss of £6.4m). The improved profitability from 2016 to 2017 was primarily because:

- The 2016 accounts of TICL included an additional increase in GAAP technical provisions (and corresponding reduction in profits) of £50 million. This was to allow for the effect of the announcement by the Lord Chancellor in February 2017 of the change in the discount rate used for compensation calculations for severe bodily injury claims from 2.5% to minus 0.75%.
- Favourable claims experience and prior year reserve releases arising during 2017.

This was partially offset by lower investment returns during 2017 (2016: £25.7m, 2017: £19.1m).

4.3.6. I anticipate including an update on the mid-year 2018 position in a Supplemental Report.

4.3.7. Summarised balance sheets can be found in Section 7.3.

4.4. Travelers Casualty and Surety Company of Europe Limited

4.4.1. TCSCE is a limited company domiciled and regulated in the UK. It is a wholly-owned subsidiary of TIC. It is rated as A++ by A.M. Best and AA by S&P.

4.4.2. It was incorporated on 13 April 1992, and went through a series of name changes:

Period	Company Name
13/04/1992 – 13/08/1992	Law 421 Limited
13/08/1992 – 25/11/1997	Aetna National Accounts U.K. Limited
25/11/1997 – 18/07/2003	Gulf Insurance Company U.K. Limited
18/07/2003 – 21/12/2004	Travelers Casualty and Surety Company of Europe, Limited
21/12/2004 – 27/04/2007	St. Paul Travelers Casualty and Surety Company of Europe Limited
27/04/2007 – Current	Travelers Casualty and Surety Company of Europe Limited

4.4.3. Since October 2002, TCSCE has only underwritten surety business, and from 1 January 2016, it has ceased underwriting new surety bonds. For practical reasons, some surety bonds continue to be amended and extended by TCSCE until the Transfer.

4.4.4. All of the insurance liabilities of TCSCE are 100% reinsured by other Travelers Group companies: TCSCA providing reinsurance for surety business and TIC providing reinsurance for the Gulf portfolio.

4.4.5. As at 31 December 2017, TCSCE's total net assets were $20.4 million and its gross of reinsurance GAAP technical provisions were $114 million. During 2017, its gross written premium was $1.9 million. Net of reinsurance, its year-end 2017 GAAP technical provisions and its 2017 written premium were nil. The annual accounts report a pre-tax profit in 2017 of $1.0 million, which mainly resulted from movements in currencies.

4.4.6. Summarised balance sheets can be found in Section 8.2.

4.5. Travelers Casualty and Surety Company of America

4.5.1. TCSCA is a Connecticut, US-domiciled and regulated insurer. It was incorporated on 18 July 1974. It operates as a subsidiary of Travelers Casualty and Surety Company, Inc., with The Travelers Companies, Inc. as the ultimate parent. It is rated A++ by A.M. Best and AA by S&P. Travelers Casualty and Surety Company, Inc. is a member of the TRV Pool.

4.5.2. As at 31 December 2017, TCSCA's total net assets were $2.0 billion and its net of reinsurance GAAP technical provisions were $1.9 billion. During 2017, its net written premium was $1.5 billion. The annual accounts report a post-tax profit in 2017 of $0.4billion.

4.5.3. TCSCA provides a 100% reinsurance of the surety bond technical provisions and underwriting of TCSCE. As at 31 December 2017, the TCSCE gross technical provisions are approximately 6.0% of those of TCSCA's net technical provisions, and the TCSCE 2017 gross written premiums are less than 0.1% of those of TCSCA.

4.5.4. As at 20 April 2018, the face value of all of the bonds issued by TCSCE (£566 million), including those issued on behalf of TCSCA and third-party companies, is less than the total net assets of TCSCA ($2.0 billion).

4.6. Travelers Indemnity Company

4.6.1. TIC is a Connecticut, US-domiciled and regulated insurer. It was incorporated on 25 March 1903, and is a subsidiary of Travelers Insurance Group Holdings Inc., with TCI being its ultimate parent. It is the lead company of the TRV pool (see 4.2.5), and is rated A++ by A.M. Best and AA by S&P.

4.6.2. As at 31 December 2017, TIC's total net assets were $6.8 billion and its net of reinsurance GAAP technical provisions were $11.3 billion. During 2017, its net written premium was $5.3 billion. The annual accounts report a post-tax profit in 2017 of $1.0 billion.

4.6.3. TIC provides a 100% reinsurance of the casualty technical provisions of TCSCE. As at 31 December 2017, the TCSCE gross technical provisions are 1% of TIC's net technical provisions.

4.7. St. Paul Fire & Marine Insurance Company Limited

4.7.1. SPFMIC is a Connecticut domiciled and regulated insurer incorporated on 20 April 1925. As one of the largest underwriting companies in the Travelers group, it is a participating company of the TRV pool (see 4.2.5), and is rated A++ by A.M. Best and AA by S&P.

4.7.2. As at 31 December 2017, SPFMIC's total net assets were $5.4 billion and its net of reinsurance GAAP technical provisions were $12.6 billion. During 2017, its net written premium was $5.7 billion. The annual accounts report a post-tax profit in 2017 of $0.7 billion.

4.7.3. SPFMIC has provided a guarantee to meet the claims of policyholders of TICL in the event that TICL proves unable to do so in a timely fashion. This guarantee was put in place to enable TICL to obtain the benefit from rating agencies of the financial strength rating assigned to SPFMIC and is not taken into account by TICL when determining the financial resources that it requires to enable it to meet its regulatory capital requirements.

4.7.4. The guarantee can be amended or terminated, however it states that twelve months' notice must be provided by SPFMIC to the rating agencies and, in the event of termination, TICL prior to any changes coming into force[11]. Any such changes would only affect contracts entered into by TICL after the effective date of amendment.

4.7.5. As at 31 December 2017, the TICL net technical provisions are approximately 8% of those of SPFMIC and the TICL 2017 net written premiums are approximately 5% of those of SPFMIC.

[11] If both rating agencies confirm that the change does not affect the ratings awarded, then the change may be made in less than 12 months.

4.7.6. My interpretation of the guarantee is that, post-Transfer, the Transferring Policyholders will obtain the benefit of the guarantee.

4.7.7. I have received legal advice on the interpretation of the wording of this guarantee from Chris Finney, a partner with law firm Fox Williams LLP. Chris is an experienced lawyer and is listed in the Legal 500 as a leading practitioner in the field of corporate and regulatory insurance work. Before joining Fox Williams LLP, Chris spent nearly ten years working in the General Counsel's Division at the UK Financial Services Authority. The advice considers the specific question of whether the guarantee will apply to the Transferring Policyholders. Given the advice provided (described in the following paragraphs) and the way in which I have taken account of the guarantee, I am satisfied that Mr Finney is appropriately qualified to provide me with this advice.

4.7.8. The advice concludes that my interpretation is appropriate. It highlights a theoretical risk that the drafting of the guarantee might permit SPFMIC to argue against this interpretation, but indicates that given the intra-group nature of the Transfer and SPFMIC's position in the Travelers Group, it "*is difficult to imagine any circumstances in which SPF&M is likely to take the point.*"[12]

4.7.9. I have provided a copy of the legal advice to the PRA and FCA and I understand that Travelers will provide a copy of this advice to the Court.

4.7.10. I have therefore concluded that it is appropriate for me to take account of the benefit to the Transferring Policyholders of the SPFMIC guarantee in my analysis.

4.7.11. In my *quantitative* tests of the standalone financial strength of TICL post-Transfer in Section 10, I have not taken any explicit account of the benefit to policyholders of the guarantee. I take account of its benefit *qualitatively* when considering the wider chain of security protecting policyholders pre- and post-Transfer.

[12] SPF&M refers to SPFMIC.

5. Approach and overview of methodology

5.1. Introduction

5.1.1. This section provides an overview of the methodology I have followed for assessing the consequences of the Transfer for the Affected Policyholders. It contains the following sub-sections:

- Comparison criteria – this sets out the overarching principles that I adopt when considering the financial and non-financial effects of the Transfers;
- Reliance on others and assumptions - the matters and individuals that I have relied upon in the methodology I apply.

5.2. Comparison Criteria – financial effects

5.2.1. To assess the financial effects of the Transfer I have applied the following types of analysis:

a. A review of the balance sheets of each company, in particular the methodology and assumptions underpinning technical provisions. This is covered in Sections 7 to 8 for TICL and TCSCE pre-Transfer, and Section 9 for TICL post-Transfer.

b. A review of the financial resources and regulatory capital requirements for each company prepared for me by Travelers is set out in Sections 7 and 8 pre-Transfer, and Section 10 post-Transfer.

c. Consideration of changes to the Chain of Security protecting Transferring Policyholders is presented in Section 10.

d. Tests of the ratio of financial strength of TICL post-Transfer using the regulatory capital requirement compared to its financial resources. In doing so I investigated how this ratio changed under alternative assumptions and following a range of scenarios. This was to satisfy myself that it had an appropriate margin in its capital over and above a minimum regulatory or economic capital requirement. This analysis is set out in Section 10.

e. Testing the extent to which total available financial resources of TICL post-Transfer can withstand severe loss scenarios that render TICL insolvent (sometimes referred to as Reverse Stress Tests). These tests are described in Section 10.

5.2.2. Tests *a*, *b* and *c* compare the position of the companies pre- and post-Transfer, while tests *d* and *e* look at the position of TICL post-Transfer.

5.2.3. The reason why I look solely at the position of TICL post-Transfer for the last two tests is because I want to be satisfied that, post-Transfer, the Affected Policyholders have at least an adequate level of security.

Measures of financial resources and capital requirements

5.2.4. I review the financial resources and regulatory capital requirements calculations of the companies using the approach established under the Solvency II directive, the current prudential regulatory regime in the UK and EEA. Key features of this approach are that it seeks to value assets and liabilities using a fair market value. The approach recognises that for some assets and liabilities, no market price exists and so an approach must be used that provides a value consistent with a market price. Regulatory capital requirements for most firms are calculated using a risk-based formula, the Standard Formula SCR.

5.2.5. This regulatory capital requirement has been set to target a low chance of companies failing to meet policyholder claims. In addition, companies are expected to have policies in place to ensure a certain buffer of capital in excess of their regulatory minimum and to consider the appropriateness of the Standard Formula SCR for the risks faced by the company.

5.2.6. In Section 7.5 I have considered whether the Solvency II Standard Formula regulatory capital calculation provides an appropriate quantitative assessment of the risks facing the business for my purposes, and in Section 10.4 I consider whether an appropriate capital buffer in excess of this requirement is held by performing some sensitivity tests on the company's position.

5.2.7. This capital buffer is to allow for:

- the risk of short-term fluctuations in asset and liability values; and
- uncertainty in the choice of some of the parameters in the regulatory capital requirement calculation.

5.2.8. Capital requirements provide a quantitative measure of the financial resources that an insurance company needs to have in order to meet the totality of the risks that it faces and be in a position to meet all policyholder claims as they fall due with a given degree of confidence over a specified time horizon. Under Solvency II the regulatory capital requirement is for a confidence level of 199 times out of every 200 over a one-year time horizon.

Comparison criteria

5.2.9. An important measure in assessing the financial impact of the Transfer is the ratio of financial resources to capital requirements. This is because it enables companies with different risk profiles and sizes to be compared using a single measure. Where a reduction in this ratio arises, this can be described as adversely affecting policyholders.

5.2.10. I use the terms *Undercapitalised, Adequately-Capitalised, Well-Capitalised and Strongly-Capitalised* to translate this quantitative ratio into qualitative terms. This is to provide a natural interpretation of the measure and to avoid providing an impression of undue precision in the evaluation process.

5.2.11. Table 5.1 summarises the banding points used.

Table 5.1 – Qualitative descriptions of insurer financial strength	
Term	**Interpretation**
Undercapitalised	Financial resources less than capital requirements plus a capital buffer (see paragraph 5.2.5).
Adequately-capitalised	Financial resources exceed capital requirements plus capital buffer, but less than 150% of capital requirements.
Well-capitalised	Financial resources fall between 150% and 200% of capital requirements.
Strongly-capitalised	Financial resources over 200% of capital requirements.

5.2.12. If the Transfer were to cause some policyholders to change from being policyholders of a company that appeared to be adequately-capitalised, well-capitalised or strongly-capitalised to one that appeared to be undercapitalised, then, in the absence of compensating factors, I would consider the policyholders to be materially adversely affected.

5.2.13. The reason for my adopting this threshold is that I believe that it is consistent with a level of capital in excess of the regulatory capital requirements that UK-regulated companies are required to hold, and therefore provides a minimum level that policyholders can reasonably expect to be maintained.

5.2.14. I also look at other test results, including those listed in 5.2.1, to provide me with an acceptable level of confidence that claims will be paid as they fall due. The range of tests that I use is to help me to identify:

- if there are compensatory factors for adversely affected policyholders that enable me to be satisfied with the overall effects of the Transfer on policyholders; or
- if there are other adverse effects on policyholders that cause me to be concerned by the Transfer's effect on them.

5.2.15. For some of the financial consequence analysis, the conclusions rely on judgements regarding very remote scenarios (often estimated as being less likely than 1 outcome in every 200). Because of this, I do not believe it is appropriate to use language that overstates the precision or reliability of such forecasts.

5.2.16. I therefore use the term "unlikely" to indicate that there remains a degree of residual uncertainty in my comparative measurement of non-payment of policyholder claims. While this is a subjective test, as a guide I have adopted a 5% chance as a suitable threshold of an outcome being something that I would consider for these purposes as "unlikely".

5.2.17. In Section 11 I weigh up the overall effects of the quantitative tests on the Affected Policyholders.

5.3. Comparison Criteria – non-financial effects

5.3.1. The non-financial consequences of the Transfers are less clearly defined. In this Report I have considered the following matters:

- Claims handling and policy administration;
- Policyholder protection, regulation and insurance law;
- Policyholder priority on insolvency and winding-up and set-off rights;
- Policyholder protection schemes, policyholder complaints and Employers' Liability Tracing Office;
- Impact on Reinsurers and Indemnitors;
- Solvency II Arrangements;
- Notification of Affected Policyholders of the Transfer;
- Governing Law; and
- Coverage of MCR post-Transfer.

5.3.2. For each of these I consider whether there has been any change and whether it has been adverse to the interests of a group of policyholders within the Affected Policyholders. I then consider whether the cumulative effect of all of the changes is materially adverse to these policyholders. In doing so, I also consider whether the Transfer give rise to specific areas of concern relating to conduct risk.

5.3.3. For these non-financial matters, I have indicated where my comparisons rely upon my subjective judgements rather than what I consider to be a more straightforward interpretation of the facts.

5.3.4. Unless I have highlighted where I have made use of advice provided by other specialists, my conclusions make use of my general understanding of the issue based upon my experience working in the general insurance industry over a number of years.

Communication plans

5.3.5. I also look at policyholder communication plans, in particular those groups of policyholders where the company does not propose to make direct contact and is seeking approval from the Court for this approach.

5.3.6. For this review, I am seeking to understand and explain whether in my view:

- The segmentation of the Affected Policyholders is appropriate in this context; and
- The rationale for excluding certain policyholders is appropriate.

5.4. Reliance on others and assumptions regarding future plans

5.4.1. My analysis has made use of material prepared by and for Travelers. The data is listed in Appendix 3.

5.4.2. I believe it is appropriate for me to rely upon the data and information supplied to me by representatives of Travelers because:

- The data and information appeared to me to be reasonable, based upon my insurance knowledge and experience. I have not, however performed an audit of the data nor have I sought to test the controls surrounding their preparation.
- Where my testing highlighted features or anomalies that had not been explained, I sought clarification from Travelers Staff.
- I have considered the statements made to the Court by Michael Gent in his draft witness statement at paragraph 8.3 and that are included as part of the Transfer documents. In his draft witness statement made to the Court, Mr. Gent confirms (at paragraph 8.3) the reliability of the data and information (including those that are based upon opinions, views or forecasts) that has been provided to me.
- I consider that Mr. Gent, as Chief Financial Officer of TICL and a Board member of TCSCE, is suitably placed to provide such confirmation as he is a senior officer of TICL, an approved person on the Financial Services Register maintained by the PRA and FCA and an experienced insurance professional. Most of the individuals who have provided me with information report, either directly or indirectly, to Mr. Gent.

5.4.3. The data provided also includes material relating to future business plans of TICL which may be subject to change. It is not feasible for me to consider the consequence of any possible future change to the plans of TICL, so I have assumed any such change will remain consistent with the plans provided to me.

5.4.4. I believe it is reasonable for me to make this assumption as:

- Risks relating to changes in future plans that might be materially adverse to the interests of the Affected Policyholders are already present prior to the Transfer; and
- Currently, the PRA (and FCA) have in place criteria [13] that individuals with responsibility for management and oversight of UK insurance companies must meet relating to their fitness and propriety to discharge these roles.

5.4.5. Some of the information provided to me and upon which I have relied has been prepared by qualified lawyers in an external law firm advising Travelers. I believe it is reasonable for me to rely on the bulk of this information because it is of a largely factual nature, rather than expressing an opinion regarding the interpretation of a matter of law.

5.4.6. I have discussed my approach for two specific points at 3.6.19 to 3.6.24 (regarding indemnities provided to TCSCE by its surety clients) and 4.7.7 (relating to the guarantee provided to TICL by SPFMIC). For the latter, TICL has commissioned some legal advice addressed to me to aid my understanding of the issues presented and confirm my interpretation of the position. Travelers has confirmed my interpretation of these issues in the witness statement of Mr. Gent at paragraphs 5.10 – 5.11.

[13] Known as the Senior Insurance Managers' Regime

6. Implications for the Transfer of Significant Current Issues

6.1. Introduction

6.1.1. In this section I have discussed five significant current issues and their implications for my conclusions regarding the Transfer. They are:

- The decision by Her Majesty's Government to commence the process of the UK's departure from the European Union.
- The insurance implications arising from the Grenfell Tower fire on 14 June 2017.
- The announcement by the Lord Chancellor on 27 February 2017 to reduce the discount rate used in the calculation of lump sum awards for damages in respect of future loss of earnings and future cost of care, and subsequent developments following the announcement.
- Periodical Payment Order claim settlements.
- Major natural catastrophe losses arising between August and October 2017 in the USA, Mexico and Caribbean.

6.2. Departure of United Kingdom from the European Union

6.2.1. On 29 March 2017, the UK Government informed the Council of the European Union that it intended to leave the European Union. Under Article 50 of the Lisbon Treaty, the United Kingdom will leave the European Union two years after this date. Currently the two parties are negotiating the terms on which the exit will take place and the nature of the ongoing relationship between them, including the way in which trade terms will operate.

6.2.2. Unless an agreement is put in place to continue the arrangements, UK-domiciled insurance companies that write insurance contracts throughout the EEA will no longer be able to do so using the current Freedom of Services or Freedom of Establishment arrangements. These permit firms to write and administer insurance contracts through the EEA as if they were a locally established insurance firm (Freedom of Services) or to establish a branch office anywhere in the EEA that can carry out these functions (Freedom of Establishment).

6.2.3. Travelers has told me that approximately 17% of TICL's 2017 gross written premiums are written in the EU excluding the UK, the majority of which is written through its branch in Ireland, and approximately 1.5% of its 2017 gross written premiums are written on a Freedom of Services basis in the UK in respect of EEA risks.

6.2.4. Following the Transfer, TICL intends to transfer its business written by its EEA Branches[14] established using TICL's Freedom of Establishment passporting rights to a new Irish domiciled insurer, TIDAC[15]. The transfer will be carried out using another

[14] These are its Ireland branch (a live underwriting operation) and its France, Germany and Netherlands branches (all of which are in run-off).
[15] Subject to authorisation by the Central Bank of Ireland.

Part VII Transfer and TICL has started preparing for this. This Brexit-related transfer is expected to take place after the Transfer. I believe that there are sufficient protections in the Part VII transfer process to protect the interests of TICL policyholders under this transfer.

6.2.5. TCSCE has one surety bond written on a Freedom of Services basis in Ireland. The Irish bond is, and will remain, 100% reinsured; the associated net liability being nil. Travelers has told me that its current intention is that this bond will be included in the scope of the Brexit-related transfer from TICL to TIDAC following the Transfer moving it from TCSCE to TICL.

6.2.6. I have reviewed the contingency plans that Travelers has in place to protect this sole policyholder's interests in the event that the Transfer is delayed and does not take place before the Brexit-related transfer. I am satisfied that these plans are appropriate and address the relevant uncertainties surrounding the impact of Brexit on this policy.

6.2.7. If necessary, I will comment on any further developments around this issue in my Supplemental Report.

6.3. Grenfell Tower Fire

6.3.1. TICL and TCSCE have confirmed to me that they have not identified any material claims exposure arising from the Grenfell Tower Block fire on 14 June 2017. While this disaster presents a number of complex issues, and potential scenarios involving an indirect increase in claims costs to either company, at this stage I do not believe that it materially affects my conclusions regarding the Transfer. If there have been any material changes to this position, I will note this in my Supplemental Report.

6.4. Change to rate of interest used (the "Ogden Discount Rate") in calculation of compensation for future losses in personal injury and fatal accident cases[16]

6.4.1. On 27 February 2017, the Lord Chancellor changed the rate of interest to be used by the Court in the calculation of damages awarded to compensate for certain types of future losses. The compensation is for lost future earnings of and the future cost of caring for victims.

6.4.2. An interest rate is required because the damages are calculated to allow for the fact that these types of financial losses are expected to be incurred over the future working life or lifetime of the victim which may be many years into the future. As a result, it is considered reasonable by the Court to allow for a risk-free investment return to be earned by the victim.

6.4.3. The calculation is performed using the "Ogden Tables[17]", a set of actuarial tables that enable the Court to determine the capitalised value of an annuity given the person's

[16] Note that this section is based upon facts as known at the date of this report. It is possible that the position may be changed materially by the subsequent developments discussed in this section.
[17] The official title is: *Actuarial Tables with explanatory notes for use in Personal Injury and Fatal Accident Cases*. Colloquially, the discount rate is often referred to as the *Ogden Rate*.

life expectancy and the specified rate of interest. The rate of interest is specified by the Lord Chancellor under section 1 of the Damages Act 1996.

6.4.4. Prior to the announcement on 27 February 2017, the rate of interest in use was 2.5%. This was set in a House of Lords judgement in 1999. Following a consultation exercise, the rate of interest was changed to *minus* 0.75% to reflect the considerable reduction in the benchmark interest rate that had been used to set the previous Ogden Rate.

6.4.5. The consequence of the change in interest rate is to increase considerably the size of damages awarded using this mechanism. Because the calculation relies upon the age and life expectancy of the victim, the increase varies widely from case to case, with the largest proportionate increases arising from younger victims. On average, the claim settlement for this element of compensation may double, however some claims may increase by significantly more.

6.4.6. At the same time as the announcement was made by the Lord Chancellor, the UK Ministry of Justice launched a consultation regarding the approach to setting the interest rate. On 7 September 2017, the Ministry of Justice published its findings and proposals in light of responses to the consultation.

6.4.7. The proposals include draft legislation that are expected to increase the rate of interest used by the Court in setting compensation awards. They indicate that if the proposals were adopted on the date they were published, the rate of interest would be expected to increase to between 0% and 1%. This would reduce compensation awards from the level that would be calculated using an interest rate of minus 0.75%, but they would still be greater than the level obtained using an interest rate of 2.5%.

6.4.8. TICL is exposed to changes in this interest rate because a significant proportion[18] of its claims reserves relate to UK motor, employers' liability and public liability. In its statutory accounts as at 31 December 2016, it increased its technical provisions by £50 million to allow for the effect of the interest rate change.

6.4.9. As part of my review I have considered the analysis performed by TICL in support of this change within the context of my review of the technical provisions of the company. Based on this, I make the following observations:

- Quantifying the impact of the change in interest rates on technical provisions requires a high degree of expert judgement. It is necessary for firms to estimate how much the future settlement values of a small number of large claims, both reported and unreported, will increase. The actual increase will therefore depend upon the size of the actual claims arising.
- As at year-end 2016[19], approximately 55% of TICL's net earned claims reserves were for its underwriting of motor, employers' and public liability business. TICL's *public sector large* and *transport* portfolios make up just over 50% of these

[18] Paragraph 6.4.9 provides an indication of this proportion.

[19] i.e. at the time the adjustment was calculated. The proportion is approximately the same at 2017 year-end.

reserves, and these policies have large per claim deductibles, typically of the order of £250,000. As compensation awards relating to future loss tend to give rise to larger personal injury claims, these large per claim deductibles mean that estimates of claims reserves for TICL's liability portfolio are more sensitive to changes in the discount rate than would otherwise be the case.

- Since year-end 2016, TICL has continued to monitor case estimates and claim settlements for affected large bodily injury claims. It has told me that no further adjustments have been made to reserves for this issue because (i) loss reserves set by claims handlers now reflect the environment since the Lord Chancellor's announcements; (ii) Settlements have been more favourable than a level implied by a minus 0.75% interest rate, anecdotally falling in the 0% to 1% range anticipated by the Ministry of Justice proposals; and (iii) There remains uncertainty regarding how the position will evolve and TICL believes it is too soon to take credit for this favourable experience.
- My analysis has led me to conclude that, using the current minus 0.75% interest rate, it is relatively easy to construct alternative estimates of the impact of the change in interest rates to those used by TICL in its reserves at year-end 2016. Using such assumptions, I have estimated a plausible, larger allowance that is approximately £30 million greater than TICL's. For the purposes of considering this Transfer, I have made use of this larger allowance.
- The main source of difference between this alternative estimate and TICL's arises from the assumed proportion of large claims (being those with a settlement value of over £250,000 to TICL, i.e. above applicable per-claim deductibles) that will be affected by the change in the interest rate used in the damages award calculation.
- The proposals brought forward by the UK Ministry of Justice on 7 September 2017 would, on their introduction, give rise to lower settlement costs than the current minus 0.75% interest rate. There remains uncertainty whether the proposed legislation will be approved by parliament and the possibility of further sustained levels of negative real interest rates upon which the current and proposed interest rate calculation methodologies depend.
- I therefore think that, for the purposes of assessing the Transfer, an adverse test is to estimate the effect of reducing the Ogden Discount Rate to minus 2%. A severe scenario of this nature could increase TICL's liabilities by approximately £100 million above its current reserves. This highlights the scale of uncertainty that TICL faces from this single issue – an uncertainty faced by firms in the wider UK non-life industry that are also exposed to UK bodily injury claims and which has prompted the government to bring forward its proposals.

6.4.10. In summary, for the purposes of evaluating the Transfer I have carried out my quantitative tests in Section 10 by making the following allowances in my calculations:

- Increasing TICL's technical provisions and SCR to allow for a £30 million increase in the cost of claims. This reduces the Solvency II Own Funds by a corresponding amount.
- Including a scenario that tests the impact on TICL of a further decrease in the interest rate used for valuing these liabilities that increases claims costs by a further £70 million.

6.5. Periodical Payment Order claim settlements

6.5.1. A related feature of the claims liabilities is the scope for large bodily injury claims to be settled by means of PPOs. These settlement arrangements enable a claimant's long-term care to be funded by an annuity payable for the rest of the claimant's life that increases in line with a survey of care costs published by the UK Office for National Statistics. These claim settlements are exposed to uncertainty arising from how long the annuity will continue to be payable and future levels of the index.

6.5.2. TICL maintains a schedule in which claims handlers have identified 13 claims (whose aggregate case estimates make up c. 2% of TICL's net Technical Provisions) that have the potential to settle as PPOs. TICL has assigned a risk score to each assessing the likelihood of such an outcome. To date TICL has only settled one claim using a PPO (and representing less than 1% of TICL's net Technical Provisions) despite having underwritten significant volumes of motor, employers' and public liability business for many years.

6.5.3. My understanding is that it is normal practice for firms exposed to PPO settlements to make an additional allowance in their claims liability provisions for the greater cost of PPO settlements than traditional lump sum settlements. TICL does not make such an additional allowance on the basis that its current exposure is not material, and that TICL believes that it has sufficient margins in its existing claims provisions.

6.5.4. This argument is supported by its only ever having settled one claim using a PPO, TICL's structured approach to monitoring claims that have potential to settle as PPOs and the argument that for many claims the uncertainty in the settlement value is far greater than the potential increase in their cost arising from how the claim is settled.

6.5.5. I believe that the approach adopted by TICL is not unreasonable for the arguments given. While there are plausible arguments for adopting a more prudent reserve for PPO claims given the difficulty in quantifying the liabilities, the types of claims that might be settled using a PPO are the same as those affected by the Ogden Discount Rate discussed in Section 6.4. I therefore believe that no further allowance is necessary beyond the treatment I have described in Section 6.4.[20]

6.6. Major natural catastrophe losses arising between August and October 2017 in the USA and Caribbean

6.6.1. Since August 2017, there have been a number of major natural catastrophes in the USA and neighbouring countries, including the Californian wildfires (most notably for

[20] Being a £30m reduction in own funds and an additional £70m stress test.

Travelers the Tubbs fire) and mudslides, a number of hurricanes that made landfall in the USA, Caribbean and other Gulf of Mexico states and two earthquakes in Mexico. In aggregate these have given rise to significant losses to the insurance industry.

6.6.2. As at year-end 2017, the Travelers Group's has published pre-tax loss estimates of $507 million, $254 million and $187 million for the Tubbs fire, Hurricane Harvey and Hurricane Irma respectively. While these losses have affected the profitability of the Travelers Group, it has remained profitable overall for the year ending 31 December 2017. Its financial strength ratings have remained the same.

6.6.3. TICL and TCSCE were not directly exposed to these catastrophe events through their underwriting activity. TICL had some indirect exposure to them from the assets TICL has pledged at Lloyd's to support the underwriting activity of Travelers Syndicate 5000 (being the FAL of c. £27 million), however this was not drawn upon by the syndicate and its losses from these catastrophic events were funded by capital provided from elsewhere in the Travelers Group.

B. Review of companies pre-Transfer

7. Review of TICL

7.1. Introduction to sections 7 - 8

7.1.1. Sections 7 – 8 of the Report contain the results of my review of the balance sheets of TICL and TCSCE as at 31 December 2017. I anticipate describing any material changes to the position of each company arising during 2018 in my Supplemental Report.

7.1.2. For each company I have reviewed at a high level:

- The main assets and liabilities on their respective GAAP and Solvency II balance sheets in order to confirm that there are no areas where I take a materially different view, or need to make specific valuation adjustments.
- The Standard Formula SCR calculations, seeking to identify any elements where I disagreed with the treatment applied or the appropriateness of the Standard Formula SCR and that would materially affect my conclusions regarding the Transfer.

7.1.3. My review is carried out by considering each of the material elements of the companies' balance sheets. For the financial strength assessments (both before and after the Transfer), I have relied upon the calculations performed by Travelers, overlaying my own reasonableness checks on them.

7.2. Overview

Net asset valuation adjustments

7.2.1. To test the effect of the Transfer and for the reasons described in Section 6.4, I have added £30 million to the technical provisions of TICL in respect of the recent Ogden Discount Rate movement. For the purpose of my review of the Transfer, I believe it is appropriate to adopt a more conservative approach than the company's in some of the analysis I have performed.

7.2.2. I did not identify any other elements of the calculation of the net assets of TICL as at 31 December 2017 with which I materially disagreed. In making this statement, I note that the nature of the claims liabilities for liability portfolios means that there is scope for reasonable best estimates using more conservative assumptions. Beyond this general characteristic, there is specific uncertainty surrounding three areas:

- Profitability of the underwriting in the most recent accident year, where claims will need more time to develop and estimates are based upon the business's planned level of profitability;
- Latent claims, in particular those arising from exposure to asbestos-related products; and
- Bodily injury claims, particularly those arising from the uncertainty in the Ogden discount rate and the valuation of PPO claims.

Material risks facing TICL

7.2.3. Based on my review of TICL's ORSA and discussion with its management, I have concluded that the most significant risks facing TICL that I need to consider are:

- A sustained period of low underwriting profitability;
- Material deteriorations in claims reserves for liability lines of business, possibly crystallising at the same time as a period of poor profitability;
- Uncertainty surrounding future levels of the Ogden Discount Rate;
- A major catastrophe claim event, such as a severe windstorm affecting Southern England or a major UK river flood event; and
- Emergence of a new type of latent claims loss, or deterioration in estimates of losses from existing latent claim loss types.

7.2.4. In Section 6 I have identified five current issues that each have the potential to increase the risks facing TICL. Based on current information I believe that the risks arising from the departure of the United Kingdom from the European Union, the 2017 catastrophe events and for claims scenarios that may arise following the Grenfell Tower Block fire do not lead me to conclude that additional capital is required over and above the SF SCR calculation for TICL post-Transfer. For the change to the Ogden Discount Rate I have carried out a scenario test to assess the potential impact of this risk on TICL. This test addresses the same reserves that are exposed to the risks arising from PPO claims, I have therefore not performed an additional scenario test in respect of PPO claims.

7.2.5. As at 31 December 2017, TICL had pledged £27 million of its assets as Funds at Lloyd's ("FAL") to support the underwriting activity of Syndicate 5000. Syndicate 5000 is a Lloyd's Syndicate for which the Lloyd's managing agent and 100% of the underwriting capital is provided by Travelers Group companies. These assets therefore support the underwriting activity of the Syndicate.

7.2.6. Travelers believes that, if required by TICL, the remaining pledged assets can be replaced at short notice by arranging for a bank to issue an LoC to Lloyd's and relying on the strong financial credit rating of the Travelers Group.

7.2.7. Therefore, for my sensitivity tests, scenario modelling and Reverse Stress Tests in Section 10.4, I have recognised the FAL assets in my calculations but have applied a reduction or "haircut" to their value (excluding the amount redeemed) of 25% to make an allowance for the risk of their not being available when needed[21].

Assessment of pre-Transfer capital adequacy

7.2.8. Based on my review of the capital requirements and financial resources of TICL pre-Transfer, I have concluded that it is adequately-capitalised.

[21] Possible causes of this might include: Syndicate 5000 experiencing severe losses, wider capital issues in the Travelers Group or general market liquidity issues restricting the rapid availability of LoCs.

7.3. TICL balance sheet and commentary

7.3.1. Table 7.1 shows some key financial information as at 31 December 2017, comparing the Statutory GAAP Accounts and Solvency II PRA returns as at 31 December 2017. For convenience the accounting headings used here and in subsequent similar tables in this Report have followed the GAAP convention. I note that strictly speaking, the Solvency II names will differ, for example, Capital and Reserves being referred to as Own Funds under Solvency II.

Table 7.1

TICL Summary Accounting Information - £m

31.12.2017

ASSETS	Solvency II	GAAP	Solvency II – GAAP	Paragraph reference
Investments & Cash in hand	1,098.3	1,085.5	12.8	7.3.2
Reinsurers' share of technical provisions	43.9	61.1	(17.2)	7.3.4
Debtors & prepayments	25.9	88.8	(62.9)	7.3.5
Other assets	23.0	21.5	1.5	
	1,191.1	1,256.8	(65.7)	
LIABILITIES				
Capital & reserves[1]	436.8	445.4	(8.6)	
Technical provisions	738.5	775.0	(36.5)	7.4
Creditors	0.0	10.2	(10.2)	7.3.4
Other liabilities	15.8	26.2	(10.4)	
	1,191.1	1,256.8	(65.7)	

Notes:

1. *The Capital & reserves figures related to TICL above include 100% of the value of the remaining assets pledged to Lloyd's which at the time of writing my report amounts to £27 million.*

7.3.2. **Investments & Cash in hand.** This is a combination of cash assets, government and corporate bonds. The difference between GAAP and Solvency II arises from accrued interest being treated under this heading under Solvency II rather than as a **Debtor** under GAAP.

7.3.3. The currency of the assets held by TICL broadly match its liabilities, with c. 1% of its gross Technical Provisions not being held in a matching currency. Most of the net assets are invested in GBP. This means that it has limited direct exposure to large movements in foreign exchange rates.

7.3.4. The **reinsurer's share of technical provisions** is net of allowances for reinsurance bad debt. The reinsurer's share of technical provisions is net of allowances for reinsurance bad debt. As at 2017 year-end, the top 5 reinsurers make up around 74% of the exposures and 98% of the reinsurance asset is with counterparties with an equivalent rating of A or higher with S&P. The Solvency II figure is less than the GAAP amount owing to future premiums owed to reinsurers being included here rather than as a **Creditor** item and the inclusion here of reinsurance of unexpired periods of cover.

7.3.5. **Debtors and prepayments** is mostly broker balances, deferred acquisition costs and accrued interest under GAAP. These are excluded or accounted for elsewhere under Solvency II, with the bulk of the amount remaining arising from reinsurance recoverables.

7.3.6. **Technical Provisions** are discussed in detail in section 7.4.

7.4. Technical Provisions review

CONCLUSIONS REGARDING TECHNICAL PROVISIONS

7.4.1. The technical provisions are the largest item on TICL's balance sheet. I have performed a high-level review of reports setting out the actuarial projections of these claims liabilities by TICL's internal and external actuaries and compared them to the booked reserves as at 31 December 2017. Based on this review and subject to my adopting a more conservative position on the Ogden Discount Rate in some of my tests, I have formed the view that the net technical provisions form a reasonable basis upon which I can draw my conclusions regarding the Transfer.

7.4.2. As a large item on TICL's balance sheet, small changes in the Technical Provisions can affect the capital position of the company materially. I have therefore used my review of technical provisions to inform my sensitivity testing that I describe in Section 10.4. These tests consider the impact on excess capital of applying more conservative assumptions or judgement to the largest areas of uncertainty in the technical provisions.

7.4.3. I stress that the tests are not intended to provide an envelope within which the ultimate outcome for claims will fall, but to provide me with comfort regarding the appropriateness of the margin of excess capital held by TICL over and above its regulatory capital.

7.4.4. The remainder of this Section summarises how TICL determines its technical provisions and my review and findings.

7.4.5. Technical provisions are set internally taking into account any external actuarial advice commissioned. To satisfy myself regarding the level of technical provisions, I have:

- Sought to understand the process and methods used by TICL to set reserves and discussed with the actuaries responsible for reserving this process.
- Performed a high-level review of the reserving of a small sample of classes of business at year ending 31 December 2016 and 2017, being those with the largest net IBNRs and together comprising c. 70% of the total. In doing so, I have tested whether plausible, alternative reserve levels (and higher than those booked by the company) would materially affect my conclusions.
- Reviewed the reasonableness of the translation of these (UK GAAP) reserve estimates onto a Solvency II basis.

7.4.6. The TICL portfolio comprises a diverse mix of lines of business, including employers', public and professional liability, property and motor risks. Most of the portfolio is for risks based in the UK or Republic of Ireland, however there are some run-off exposures from continental Europe. Specialist sectors include solicitors, medical practitioners and property surveyors, large transport groups and public sectors.

7.4.7. The nature of risks underwritten means that TICL has exposure to latent claims (including those arising from industrial diseases stemming from exposure to asbestos and other harmful substances, and against organisations where failure to protect vulnerable individuals from abuse is alleged), and a small number of claims where settlement could be made using a PPO. I discuss TICL's treatment of and exposure to PPO claims further in Section 6.5.

7.4.8. While individual risk exposures can be large, excess of loss reinsurance protects TICL from individual risk losses above £7.5 million (£10 million for UK Solicitors) and from catastrophe events above £40 million.

7.4.9. As at 31 December 2017, the Solvency II Technical Provisions split approximately between 77% casualty lines (including employers', public and professional liability), 10% property lines, 13% motor and less than 1% from other lines (including marine, financial institutions and surety). Approximately 80% of the reserves relate to UK risks, with the bulk of the remainder arising from the Republic of Ireland.

7.4.10. TICL have used what I would consider to be generally accepted actuarial reserving techniques to estimate technical provisions.

7.4.11. Aside from the question of the impact of the Ogden Discount Rate, my review of a sample of portfolios did not lead me to conclude that there was a manifest misstatement of aggregate reserves. Clearly, reserve estimates, particularly for casualty business, are subject to a degree of uncertainty, and as a result, there is a range of estimates that might be considered reasonable at any point in time.

7.4.12. TICL's additional allowance in the reserves as a result of the Lord Chancellor's announcement in February 2017 regarding the rate of interest used for calculating future loss awards in personal injury cases is discussed in Section 6.4.

7.4.13. The allowance in the reserves for reinsurance recoveries appears to have been estimated in an appropriate fashion. As all of the reinsurers are highly rated, the allowance for potential reinsurance bad debts for TICL is commensurately small.

SOLVENCY II TECHNICAL PROVISIONS

7.4.14. I have reviewed the translation of TICL's GAAP technical provisions to a Solvency II basis. The elements that I would have expected to see in the calculation have been included, and the adjustments appear to be of an appropriate magnitude. Table 7.2 sets out the key elements in this translation.

Table 7.2

TICL translation of GAAP to Solvency II technical provisions - £m

31.12.2017

GAAP technical provisions (net of reinsurance)	714	
Remove profit in UPR and unincepted risks *Add* anticipated future premium		(87)
Remove margin in GAAP reserves *Add* provision for Events not in Data		3
Add additional provision for expenses		30
Discount reserves for time value of money		(13)
Add risk margin		49
Solvency II technical provisions (net of reinsurance)	695	

7.5. Key policyholder risks, capital requirements and Standard Formula appropriateness

KEY POLICYHOLDER RISKS

7.5.1. I have reviewed TICL's 2017 ORSA report which includes its assessment of its risks. This document includes its Standard Formula SCR as at 31 December 2016 (being the latest year-end prior to its preparation) updated for the impact of the change in Ogden discount rate. Together with my review of technical provisions described in Section 7.4, I have formed a view on the key risks for TICL, and the key scenarios that I wish to consider in my analysis in Section 10.

7.5.2. TICL is exposed to losses arising from large natural and man-made **catastrophe events**. To mitigate this risk, it purchases catastrophe reinsurance. This reinsurance is set at a level that would require multiple major catastrophe loss events (windstorms, floods and earthquakes) to occur in order to consume the capital held by TICL in respect of such risks.

7.5.3. TICL purchases outwards reinsurance so that the net loss it expects to suffer from the loss of an individual property risk, or from an individual liability claim is relatively limited. It is, however, exposed to general **underwriting losses**, where these exceed the level anticipated in business plans whether as a result of excess claims or pricing pressures. In the case of pricing pressures, the losses may arise and not become apparent until a few years of unprofitable underwriting have arisen.

7.5.4. Other sources of risk that could give rise to underwriting losses that are identified in the ORSA are where TICL writes less premium income and as a result, is unable to generate sufficient profits to cover its fixed expenses. This could arise as a result of a decision to withdraw from unprofitable business or as a result of a failure of an existing broker relationship, where the intermediary places business with another insurer.

7.5.5. TICL is exposed to the risk of **deterioration in claims reserves**. This arises from the significant proportion of public, professional, employers' and motor liability business underwritten over many years. For these lines of business, the size of claims reserves can be hard to estimate owing to the extended period of time over which claims are reported and settled. This uncertainty in estimates is particularly acute for claims exposed to the rate of interest used in calculating compensation for future costs in settling personal injury cases, and those potentially involving PPOs, where the ultimate cost may not be known for very many years. While TICL is exposed to PPOs, its experience to date has been relatively benign.

7.5.6. As a company that has underwritten casualty insurance classes for many years, it is further exposed to the risk of new types of **latent claims** or changing behaviour of such claims (for example including those relating to asbestos disease, hearing losses or child abuse). The extended period over which policies have been underwritten can give rise to an accumulation of exposure to such losses.

Capital Requirements

7.5.7. In Section 10 I perform a set of quantitative tests to assess the extent to which TICL will have sufficient financial resources to meet its capital requirements and pay policyholder claims post-Transfer.

7.5.8. The quantitative tests in Section 10 are applied to post-Transfer TICL. Because the liabilities of TCSCE being transferred are 100% reinsured, the capital requirements of TICL are not changed materially by the Transfer. I have therefore not repeated my analysis (contained in Section 10) here, but for convenience, my conclusion regarding the capital adequacy of TICL post-Transfer (that TICL is adequately capitalised) also applies to pre-Transfer TICL.

Appropriateness of Standard formula SCR

7.5.9. I have reviewed the Standard Formula SCR calculations as at 31 December 2017 at a high-level. In doing so, I have not sought to perform a detailed check of the calculations.

7.5.10. The Standard Formula SCR has been calibrated to meet general requirements of firms across Europe. It is therefore important for me to consider whether there is a risk that it underestimates an appropriate level of financial resources required by TICL.

7.5.11. TICL is a company that continues to underwrite new business. As a result, a large proportion of the risks it faces relate to factors that are sufficiently well-represented when considered over a one-year time horizon. In my experience, this is a normal time-frame for such calculations for live underwriting companies.

7.5.12. The classes of business underwritten and the investment assets of TICL appear to me to be relatively standard in nature and well-represented in the data used by EIOPA to calibrate the relevant parts of the Standard Formula SCR.

7.5.13. The company faces employers' and public liability claims, for example those arising from exposure to asbestos and other hazardous materials (described in paragraph 7.4.7). While the risks relating to such claims may emerge over a number of years, in each year I would expect them to only be a small part of the overall risk profile of the company. In my view this is a normal feature of insurance companies writing these mainstream classes of business.

7.5.14. In my opinion, the Standard Formula has some limitations in the manner in which it allows for all of the insurance risks associated with PPO claims. Given the relatively small amount of PPOs settled to date by TICL (comprising less than 1% of its total Technical Provisions), I do not think that this materially limits the current overall appropriateness of the Standard Formula when applied to TICL.

7.5.15. My qualitative review of the nature of risks underwritten by TICL, and the level at which it purchases outwards reinsurance have led me to conclude that the Standard Formula SCR is unlikely to underestimate the financial resource requirements of TICL. Therefore, I am satisfied that the Standard Formula SCR provides a suitable economic capital reference point.

8. Review of TCSCE

8.1. Overview

Net asset valuation adjustments

8.1.1. I do not believe that any material adjustments are required to the net asset valuation of TCSCE.

Material risks facing TCSCE

8.1.2. Based on discussions with TCSCE's management, I have concluded that for TCSCE to be in a position where it is unable to pay claims, either or both of its reinsurers (TIC and TCSCA) will need to fail. As these are both core operating entities of the Travelers Group, I see this as akin to failure of the Travelers Group. As a large and very highly rated insurance group, I believe that this is a highly unlikely scenario.

Assessment of pre-Transfer capital adequacy

8.1.3. Based on my review of the capital requirements and financial resources of TCSCE pre-Transfer, I have concluded that it is strongly-capitalised.

8.2. TCSCE balance sheet and commentary

8.2.1. Table 8.1 shows some key financial information on a GAAP and Solvency II basis as at 31 December 2017.

Table 8.1 TCSCE Summary Accounting Information - £m 31.12.2017				
ASSETS	Solvency II	GAAP	Solvency II – GAAP	Paragraph reference
Investments & Cash in hand	15.7	15.6	0.1	8.2.2
Reinsurers' share of technical provisions	82.2	84.3	(2.1)	8.2.3
Debtors & prepayments	0.4	1.4	(1.0)	
Other assets	0.0	0.0	0.0	
	98.3	101.3	(3.0)	
LIABILITIES				
Capital & reserves	14.8	15.1	(0.3)	
Technical provisions	82.5	84.3	(1.8)	8.2.3
Creditors	0.3	1.1	(0.8)	
Other liabilities	0.7	0.8	(0.1)	
	98.3	101.3	(3.0)	

Note: Converted at £1 = $1.35 using exchange rate as at 31 December 2017

8.2.2. **Investments & Cash in hand**. This is a combination of high-quality government bonds and cash.

8.2.3. On a GAAP basis, all of the **technical provisions** of TCSCE are 100% reinsured by other group companies. On a Solvency II basis, there is a small residual net technical provision. Technical Provisions are discussed further in section 8.3.

8.3. Technical Provisions review

8.3.1. All of the outstanding claims of TCSCE are 100% reinsured to other Travelers Group companies and TCSCE holds nil net technical provisions of TCSCE on a GAAP basis.

8.3.2. On a Solvency II Basis, TCSCE holds a risk margin that is non-zero. This is largely because it needs to hold regulatory capital for the small risk that its reinsurers default. As the term of the surety bonds issued by TCSCE is potentially several years, Travelers has calculated that TCSCE needs to hold a risk margin of £0.3 million.

8.4. Capital requirements & key policyholder risks

8.4.1. The key risk for TCSCE policyholders is the failure of one or both of internal reinsurers, TIC and TCSCA. As both of them are core operating entities of the Travelers Group, this is akin to a failure of the group. As a large and highly-rated insurance group, I consider this scenario to be highly unlikely.

8.4.2. Using the Solvency II risk categories of insurance, credit, market and operational risk, the most significant element that could give rise to a policyholder loss is credit risk. This is because of its material reliance on its group reinsurance counterparties.

8.4.3. For the other elements: insurance risk is very small owing to the reinsurance arrangements; market risk arises solely as a result of TCSCE holding its net assets in cash and investments that have volatility in their value. As for any other insurance company, TCSCE has various operational risks, however I have not identified as part of my review any unexpected elements here.

8.4.4. In my view, the Standard Formula SCR is an appropriate measure of risk for TCSCE over a 1-year horizon, as it assesses the most material risk elements faced by TCSCE.

8.4.5. Because surety bonds can stay in place for a number of years, this could mean that a one-year time horizon is too short a period over which to assess the emergence of risk. However because these liabilities are 100% reinsured with another Travelers Group company with a AA rating from S&P, I believe that using an equivalent risk measure over a longer time horizon is not likely to provide a better quantitative measure of risk.

CAPITAL REQUIREMENTS

8.4.6. TCSCE's only material risks relate to those of the failure of either or both of TIC or TCSCA. I therefore believe that it is reasonable to conclude that an appropriate economic capital requirement for TCSCE to be minimal.

8.4.7. As at 31 December 2017, TCSCE had net assets of £15.1 million on a GAAP basis, and Solvency II Own Funds of £14.8 million. Its Solvency II Standard Formula SCR was £2.6 million. Over the longer term, while there is a greater risk of a TIC and/ or TCSCA default, its excess capital and risk margin helps to mitigate the risk of policyholder losses pre-Transfer.

8.4.8. I therefore believe it is reasonable to conclude that TCSCE is strongly-capitalised as at 31 December 2017.

C. Review of Companies Post-Transfer

9. Consolidated Balance Sheets (pre and post-Transfer)

9.1. Consolidated position as at 31 December 2017

9.1.1. Table 9.1 shows the consolidated balance sheet position of the two entities on an "as-if" basis using the position as at 31 December 2017 on a GAAP basis. Table 9.2 shows the corresponding figures on a Solvency II basis.

Table 9.1
Consolidated Summary Accounting Information - £m
Based on GAAP accounts as at 31.12.2017

ASSETS	TICL	TCSCE	Total[1]	TCSCE retained[2]	TICL post-Transfer
	A	B	C = A + B	D	E = C – D
Investments & Cash in hand	1,085.5	15.6	1,101.1	15.7	1,085.4
Reinsurers' share of technical provisions	61.1	84.3	145.4	0.0	145.4
Debtors	88.8	1.4	90.1	0.0	90.1
Other assets	21.5	0.0	21.5	0.0	21.5
	1,256.8	101.3	1,358.1	15.7	1,342.4
LIABILITIES					
Capital & reserves[4]	445.4	15.1	460.5	15.0	445.5
Technical provisions	775.0	84.3	859.3	0.0	859.3
Creditors	10.2	1.1	11.2	0.0	11.2
Other liabilities	26.2	0.8	27.0	0.7	26.3
	1,256.8	101.3	1,358.1	15.7	1,342.4

Notes:

1. *No consolidation adjustments are anticipated.*
2. *TCSCE intends to retain all its surplus capital and repatriate it to its shareholders after the Transfer. In providing these figures, Travelers has assumed that by the time of the Transfer, most debtor items will have converted to cash.*
3. *There may be immaterial differences of the order of £0.1m due to rounding.*
4. *The Capital & reserves figures related to TICL above include 100% of the value of the remaining assets pledged to Lloyd's which at the time of writing my report amount to £27 million.*

Table 9.2
Consolidated Summary Accounting Information - £m
Solvency II basis as at 31.12.2017

ASSETS	TICL	TCSCE	Total[1]	TCSCE retained[2]	TICL post-Transfer
	A	B	C = A + B	D	E = C – D
Investments & Cash in hand	1,098.3	15.7	1,114.0	15.7	1,098.3
Reinsurers' share of technical provisions	43.9	82.2	126.1	0.0	126.1
Debtors	25.9	0.4	26.3	0.1	26.2
Other assets	23.0	0.0	23.0	0.0	23.0
	1,191.1	98.3	1,289.4	15.8	1,273.6
LIABILITIES					
Capital & reserves[3]	436.8	14.8	451.5	15.1	436.5
Technical provisions	738.5	82.5	821.0	0.0	821.0
Creditors	0.0	0.3	0.3	0.0	0.3
Other liabilities	15.8	0.7	16.5	0.7	15.8
	1,191.1	98.3	1,289.4	15.8	1,273.6

Notes:

1 *No consolidation adjustments are anticipated.*

2 *TCSCE intends to retain all its surplus capital and repatriate it to its shareholders after the Transfer. In providing these figures, Travelers has assumed that by the time of the Transfer, most debtor items will have converted to cash.*

3 *Under Solvency II, Capital and Reserves is called Own Funds. These figures related to TICL above include 100% of the value of the remaining assets pledged to Lloyd's which at the time of writing my report amount to £27 million.*

10. Review of financial strength of TICL post-Transfer

10.1. Introduction

10.1.1. In this section, I set out my review of the financial strength of TICL post-Transfer. I have approached this review by comparing the anticipated capital resources of TICL relative to the risks it will face post-Transfer.

10.1.2. For this Section 10, TICL will refer to the consolidated entity, unless otherwise stated.

10.1.3. TICL's regulatory capital is set using the Standard Formula SCR. In this Section 10, I have assessed TICL's financial strength by:

- Reviewing TICL's Standard Formula SCR as at 31 December 2017, considering its appropriateness as a measure of risk for TICL, and Solvency II Own Funds;
- Reviewing TICL's capital adequacy by testing the robustness of TICL's coverage of its SCR by performing some sensitivity tests on its Own Funds; and
- Assessing the robustness of TICL's capital coverage in a number of adverse scenarios and reverse stress tests. The scenarios are based upon my review of TICL and TCSCE and informed by my review of the key risks of TICL described in its most recent ORSA Report.

10.1.4. I have also described my understanding of the chain of security protecting the Transferring Policyholders and how it is affected by the Transfer.

10.1.5. No testing can provide absolute assurance in this respect. My testing aims to enable me to meet the criteria I described in Section 5.

10.2. Review of Standard Formula, its appropriateness and Solvency II Own Funds

10.2.1. I have reviewed the SF SCR of TICL at a high-level, supplemented by some detailed checks on certain elements. Based on this review I have satisfied myself that it has been calculated appropriately. I stress that I have not sought to perform a detailed check of every element of the calculation, and this review is only for the purpose of reaching my conclusions relating to the Transfer.

10.2.2. I have also reviewed the calculation of Solvency II Own Funds of TICL and satisfied myself that these are appropriate.

10.2.3. Table 10.1 shows the SF SCR and Solvency II Own Funds of pre-Transfer TICL, pre-Transfer TCSCE and post-Transfer TICL, broken down by risk category. These are the figures prepared by TICL and exclude my additional allowance for the Ogden Discount Rate.

Table 10.1 – Standard Formula SCR and Own Funds pre- and post-Transfer			
31.12.2017 (£m)	**TICL pre-Transfer**	**TCSCE pre-Transfer**	**TICL post-Transfer**
1. Non-Life Underwriting risk			
a) Premium and Reserve Risk	*199*	-	*199*
b) Catastrophe Risk	*151*	-	*151*
c) Lapse Risk	*15*	-	*15*
Total Non-Life Underwriting risk	278	-	278
2. Life Underwriting Risk	1	-	1
3. Market Risk	24	1	25
4. Counterparty Default Risk	7	1	9
5. Undiversified BSCR	311	3	314
6. Diversification credit	-22	-1	-23
7. Basic SCR	**289**	**2**	**290**
8. Operational risk	21	1	23
Standard Formula SCR	**310**	**3**	**313**
Solvency II Own Funds	**410**	**15**	**409**
Surplus	**100**	**12**	**96**
Capital ratio %	**132%**	**568%**	**131%**

Notes:

1. *The Solvency II Own Funds shown in the table exclude the £27 million assets pledged to Lloyd's during 2017.*
2. *Most of TCSCE's Own Funds will not transfer to TICL.*

10.2.4. As described in paragraph 7.5.15, I concluded that the SF SCR provide a suitable economic capital reference point for TICL pre-Transfer. As one can see in Table 9.1, the effect of the Transfer on TICL's risks and capital adequacy are minimal. In light of this, my conclusion for the appropriateness of SF SCR remains unchanged for TICL post-Transfer, and I have not adopted modifications to the SF SCR in my assessment of TICL's capital adequacy post-Transfer.

10.2.5. I have compared the size of these adjusted Own Funds relative to the Standard Formula SCR.

10.2.6. This testing shows that relative to its approximate Solvency II Own Funds, TICL is adequately-capitalised post-Transfer. While there is a small reduction in the surplus capital and capital ratio shown in Table 10.1, I consider the change to be negligible in the context of the Transfer.

10.3. TICL's business plans and prospective capital adequacy

10.3.1. TICL's business plans are to seek to grow premium income through expansion of its more profitable business lines while withdrawing selectively from less profitable accounts and unprofitable lines of business. I believe that in current market conditions, competitive pressures increase the risk that TICL will not succeed in fully achieving these objectives.

10.3.2. I have therefore tested the ability of TICL to withstand sustained underwriting pressures in my scenario and reverse stress testing described in Section 10.4. They also indicate the severity of underwriting pressures that it would be able (without SPFMIC or other group support) to withstand before policyholder claims would not be met in full.

10.3.3. The sensitivity tests showed that TICL has sufficient financial resources to be able to remain adequately-capitalised under the sensitivities investigated.

10.3.4. Under some of the scenario tests, the losses would lead TICL to be under-capitalised. I describe the measures Travelers has told me it would adopt in paragraph 10.4.12.

10.3.5. In its latest ORSA dated 20 September 2017, TICL states it has an internal solvency target of 113% of SF SCR. Events leading to the capital ratio falling under this 113% target would trigger mitigating procedures from TICL (described in paragraph 10.4.12) to bring its capital ratio back to 113%. Paragraph 10.4.6 to 10.4.8 discusses the adequacy of this internal solvency target applying a series of sensitivity tests and how I have satisfied myself with this target for my purposes.

10.3.6. All of these tests have assumed a larger allowance is included in TICL's reserves as at 31 December 2017 for the impact of the reduction in the Ogden Discount Rate. This caters for a more conservative position regarding this uncertain element of the reserves. They also allow for the remaining FAL to be redeemed, but with a 25% "haircut" reduction in its value.

10.4. Sensitivity Tests, Modelled Scenarios and Reverse Stress Tests

10.4.1. To assess the ability of TICL to provide an appropriate level of financial security to policyholders post-Transfer, I have performed a set of quantitative tests applied to the Own Funds and capital requirements.

10.4.2. The sensitivity tests illustrate the effect of a more conservative, but plausible, view of TICL's reserves / underwriting profits on its level of capital. These assess the ability of TICL to maintain its regulatory capital requirements under short-term fluctuations or reasonable alternative assumptions. These tests indicate the sensitivity margin I believe is needed in addition to its SF SCR for TICL to be considered by me to be adequately capitalised.

10.4.3. The scenario tests assess the robustness of TICL's capital, and the circumstances under which it may need to take steps to restore its capital position, by looking at the impact of severe but not the most extreme loss events.

10.4.4. The reverse stress tests indicate the severity of losses required to render TICL insolvent before any assistance is received from other companies in the TCI Group. The more extreme these events need to be, the more robust is TICL's capital position.

10.4.5. Unless specified, these quantitative tests have not sought to allow for all second order effects in the calculations. I am satisfied that this is an acceptable simplification and would not change my conclusions.

SENSITIVITY TESTS

10.4.6. I applied the following sensitivity tests to TICL's position post-Transfer to test whether there is a sufficient margin in the Own Funds of the company:

(i) Prospective year underwriting results below plan (i.e. not achieving profitability improvements), and giving rise to a pre-tax loss of c. 12% of Net Earned Premium (consistent with experience arising over the period 2013-2017);

(ii) Adopting a more prudent reserving basis for the more uncertain elements of the prior year reserves, such as liability classes and latent claims (this equates to a c. 5% increase in the total technical provisions net of reinsurance recoverables); and

- Actual claims experience worse than planned loss ratios for the most recent underwriting year (c. 1% increase in technical provisions net of reinsurance recoverables for the most recent underwriting year), together with the corresponding increase in reserve risk in the SF SCR.

Table 10.2 – Post-Transfer TICL Capital requirement Sensitivity Tests (£m)

		Sensitivity tests		
	Base[22]	(i)	(ii)	(iii)
SCR	321	321	329	322
SII Own Funds	400	375	367	392
Surplus	79	54	37	70
Capital ratio %	125%	117%	111%	122%

10.4.7. These tests confirm that the anticipated Own Funds contain a sufficient capital buffer for me to describe TICL as adequately-capitalised. This is because the company remains in a position where its SII Own Funds exceeds its SCR after the application of these sensitivity tests.

10.4.8. These tests also lead me to conclude (by subtracting 12% from each of the capital ratio % shown in Table 10.2) that an internal solvency target of 113% of the company's SF SCR is appropriate.

[22] These figures all adopt the treatment of the Ogden Discount Rate in the calculated SCR and SII Own Funds set out in Section 6.4. The SII Own Funds also allow for recognition of 75% of the FAL assets.

10.4.9. I applied the following scenarios to TICL's position post-Transfer:

(i) Single major natural catastrophe event that uses up the first outwards catastrophe reinsurance protection of TICL, together with the impact on SF SCR catastrophe risk and increase in reserve volume.

(ii) Pre-tax losses arising from underwriting during each of 2018 – 2020 years of 5% of premium (whether driven through weak premiums or adverse claims events).

(iii) 10% increase in estimated technical provisions, together with the corresponding increase in the SF SCR reserve risk.

(iv) Combined prospective year underwriting year loss of 12% of net premium (pre-tax losses averaged over years 2013-2017) together with 5% increase in estimated technical provisions and the corresponding increase in the SF SCR reserve risk.

(v) Repeat of 2013 underwriting year loss (c. 140% combined ratio).

(vi) An event that leads TICL to take on all of TICL's pensions obligations from the defined benefit pension scheme sponsored by TML, combined with a 50% fall in the value of equity holdings in the pension scheme (scenario based on fund values as at 31 December 2016).[23]

(vii) Downgrade of rating by two grades (e.g. AA to BBB on S&P rating), of all of TICL's outwards reinsurance.

(viii) A stronger reserving basis for the effects of the change in Ogden discount rate, adding an additional reserve of £70 million.

10.4.10. Table 10.3 sets out the impact of these scenarios on TICLs SCR and Own Funds.

Table 10.3 – Post-Transfer TICL Capital requirement Scenario Tests (£m)

	Scenario tests								
	Base	(i)	(ii)	(iii)	(iv)	(v)	(vi)	(vii)	(viii)
SCR	321	329	321	338	329	321	321	333	341
SII Own Funds	400	356	367	327	338	318	380	400	330
Surplus	79	28	46	(11)	9	(3)	59	67	(11)
Capital ratio %	125%	108%	114%	97%	103%	99%	118%	120%	97%

10.4.11. Under all these scenarios, TICL will continue to have assets considerably in excess of its liabilities. However most of these scenarios would require it to take steps to restore its financial position to its 113% of SCR target.

[23] At 31 December 2016, the value of the assets in this pension scheme was £48 million (including £25 million of equities), and the present value of funded pensions obligations was £55 million.

10.4.12. For the four scenarios where TICL would suffer a more significant reduction in surplus (these scenarios ranging between £70 million and £90 million), TICL has the following options to mitigate any capital shortfall in the future:

- *Requesting financial support from Travelers Group companies.* While SPFMIC provides a guarantee to meet any shortfall in *claims payments* for TICL, there is no obligation for SPFMIC to provide financial support just to meet *regulatory capital requirements*. Nevertheless, given the size of TICL ($0.6 billion[24] net assets) relative to the wider Travelers Group companies ($23.7 billion net assets), it is reasonable to believe that the wider Travelers Group companies would be likely to be able to support TICL to remain above regulatory capital requirements, and that there is interest for it to do so in order to protect its reputation.
- *Reducing its premium income.* In the event that no capital support is provided by other TCI Group companies, TICL (with or without regulatory intervention) may elect to reduce or, in an extreme case, cease underwriting and run off its liabilities. Since prospective underwriting forms a significant part of the risks faced by TICL, and the duration for the bulk of its liabilities is relatively short, this would help TICL improve its capital position to cover its SCR relatively quickly.

10.4.13. This analysis enables me to conclude that TICL is able to withstand a range of plausible adverse scenarios, meet policyholder claims as they fall due, and has realistic and achievable options available to it to restore its financial resources or amend its business plans to a level to enable it to continue trading.

REVERSE STRESS TESTING

10.4.14. I additionally performed the following Reverse Stress Tests, to assess how severe loss scenarios would need to be in order to render TICL insolvent (i.e. having Own Funds that fall below zero). These are:

- 3 successive years (2018 – 2020) of pre-tax losses of 61% of premium (whether driven through weak premiums or adverse claims events).
- 55% deterioration in technical provisions.

10.4.15. I consider that these reverse stress tests provide me with sufficiently extreme tests of the financial resources of TICL to support my conclusions regarding its resilience even if it is unable to obtain financial support from other Travelers Group companies.

10.5. Chain of security for Transferring Policyholders

10.5.1. I have looked at the way in which the chain of security protecting the Transferring Policyholders changes as a result of the Transfer. The chain of security is the series of elements that, in sequence, act to provide layers of protection to policyholders and accumulate to provide policyholders with confidence that their claims will be met. The analysis is split between the Surety and the Gulf portfolios. I have made some simplifications in the analysis (notably relating to individual indemnities provided to

---

[24] Assuming exchange rates of £1 = $1.35 as at 31 December 2017

TCSCE by each surety client) and am satisfied that these to do not affect my conclusions.

10.5.2. I believe that this is helpful because the Transfer is an internal reorganisation with both TICL and TCSCE being companies within the much larger Travelers Group. Both companies benefit from explicit support from elsewhere in the group, and it is important for me to consider whether the Transfer will result in any reduction in this support.

10.5.3. The total value of the surety bonds issued by TCSCE gross of reinsurance (at approximately £0.6 billion as at 20 April 2018) is very large relative to the size of the assets of both TCSCE and TICL. These bonds are 100% reinsured with TCSCA, meaning that the net of reinsurance exposure to TCSCE is nil.

10.5.4. Tables 10.4 and 10.5 consider the impact of the Transfer on the Gulf and Surety portfolios separately. Amounts quoted are as at 31 December 2017.

<table>
<tr><th colspan="3">Table 10.4 – Gulf Portfolio – changes to chain of security</th></tr>
<tr><th>Pre-Transfer</th><th>Post-Transfer</th><th>Impact</th></tr>
<tr><td colspan="2">Gulf portfolio claim
Gulf portfolio gross reserves of ~ $40 million</td><td>NA</td></tr>
<tr><td colspan="2">1. 100% TIC reinsurance
TIC net assets of ~ $7 billion</td><td>No change</td></tr>
<tr><td colspan="2">2. TRV Pool Co-insurance
The major operating companies of TCI, including both TIC and SPFMIC have a pooling arrangement in which they mutually co-insurance one another's insurance and reinsurance liabilities.</td><td>No change</td></tr>
<tr><td colspan="2">3. Implicit Group support to TIC
TIC is a major operating company of TCI. TCI has group-wide net assets of ~$24 billion.</td><td>No change</td></tr>
<tr><td>4. TCSCE net assets
$20m</td><td>4. TICL net assets
~$0.6 billion[25]</td><td>Increase in absolute value of net assets, however policyholders become exposed to TICL claims risks</td></tr>
<tr><td></td><td>5. SPFMIC guarantee
SPFMIC has net assets of ~$5 billion.</td><td>Additional protection to policyholders. See discussion in paragraphs 10.5.7 - 10.5.8.</td></tr>
</table>

[25] Assuming exchange rates of £1 = $1.35 as at 31 December 2017

Table 10.5 – Surety Portfolio – changes to chain of security		
Pre-Transfer	**Post-Transfer**	**Impact**
Surety portfolio claim Surety portfolio gross reserves of ~ $70 million		*NA*
1. Insured remediation This step will vary on a case-by-case basis and typically applies to the construction surety business. In general, it is more cost effective for client to remediate than to call upon surety insurer.		*No change*
2. Insured indemnity to surety insurer Indemnity will normally be provided by the top-level surety client company and will be to the face value of the bond.		*No change*
3. 100% TCSCA reinsurance TCSCA net assets of ~ $2 billion		*No change*
4. Implicit Group support to TCSCA TCSCA is a major operating company of TCI. TCI has group-wide net assets of ~$24 billion.		*No change*
5. TCSCE net assets $20m	**5. TICL net assets** ~$0.6 billion[26]	Increase in absolute value of net assets, however policyholders become exposed to TICL claims risks
	6. SPFMIC guarantee SPFMIC has net assets of ~$5 billion.	Additional protection to policyholders. See discussion in paragraphs 10.5.7 - 10.5.8.

10.5.5. These two tables show that there are two improvements compared to the current arrangements for each sub-class of TCSCE policyholders:

- The greater size of TICL compared to TCSCE; and
- The SPFMIC guarantee.

10.5.6. The absolute amount of net assets available to protect policyholders is increased by TICL taking the place of TCSCE. This is offset by TICL being exposed to a greater amount of risk arising from its existing operations. Section 10.4 sets out an analysis of the capital position of TICL relative to its risks.

10.5.7. After the Transfer, both portfolios gain the benefit of the additional protection provided by the SPFMIC guarantee. I have described this and the legal advice I have received regarding its operation in Section 4.7.

10.5.8. I believe that even if the guarantee is interpreted as not protecting the Transferring Policyholders, its existence provides an indirect benefit to them. This is because it removes the risk that the Existing Policyholders or policies underwritten by TICL post-Transfer will have any policyholder shortfall. I believe that this will effectively remove the risk under insolvency that the value of the 100% reinsurance of the Transferring Policyholders' liabilities might be reduced.

[26] Assuming exchange rates of £1 = $1.35 as at 31 December 2017

10.5.9. In summary, I believe that this chain of security analysis indicates an improvement to the position of the Transferring Policyholders as a result of the Transfers.

10.6. Conclusions regarding the financial resources of TICL

10.6.1. From my analysis, I have drawn the following conclusions:

- Post-Transfer, TICL will be adequately-capitalised, through considering the Standard Formula SCR capital requirements, TICL's internal modelling of its capital requirements and my own stress and scenario testing. For the last of these I have considered the resilience of my calculations to a range of alternative assumptions.
- TICL's plans and anticipated post-Transfer financial resources suggest to me that it will remain adequately-capitalised post-Transfer.

10.6.2. I anticipate confirming in a Supplemental Report prepared closer to the anticipated date of the Transfer that these conclusions remain unchanged.

11. Comparison of financial position of Affected Policyholders

11.1. Assessment of capital strength of TICL and TCSCE

11.1.1. My analysis has led me to conclude that pre-Transfer, I should consider TICL as adequately-capitalised and TCSCE as strongly-capitalised.

11.1.2. Post-Transfer, my analysis has led me to conclude that TICL will be adequately capitalised.

11.1.3. All of the Affected Policyholders will be protected by the security available from TICL, a large diverse insurer which in my view is adequately-capitalised and is likely to remain adequately-capitalised under a range of sensitivities, and meet all policyholder claims without requiring recourse to support from other Travelers Group companies under the various adverse scenarios I have considered.

11.1.4. There will be a small increase in the risk to the Existing Policyholders. This stems from the credit risk exposure of TICL to TIC and TCSCA, the reinsurers of 100% of the technical provisions and underwriting of TCSCE. I do not believe that this materially affects the Existing Policyholders because:

- Both TIC and TCSCA are large and highly-rated insurance companies, and core operating companies within the Travelers Group;
- TICL policyholders retain the benefit of the SPFMIC guarantee; and
- The surety underwriting portfolio of TCSCE is being renewed into TICL from the beginning of 2016.

11.1.5. The Transferring Policyholders will have a reduction in the financial security available to them, moving from a company that I consider to be strongly-capitalised pre-Transfer to one that is adequately-capitalised. Offsetting this are various factors:

- It may be possible for TCSCE to obtain regulatory approval to extract some of its excess capital.
- TICL is a much larger company than TCSCE, with a more diverse set of risks.
- Legal advice I have received suggests that the Transferring Policyholders are highly likely to gain the benefit of an existing guarantee from SPFMIC, another very large insurer within the Travelers Group.

11.1.6. I therefore believe that the Transfer will not introduce a material change to the financial security provided to the Transferring Policyholders or the beneficiaries under their policies.

11.2. Rating agencies

11.2.1. TICL and TCSCE both have Financial Strength Ratings[27] of AA from S&P, while A. M. Best has given TCSCE a rating of A++ but TICL a rating of A. This means that

[27] Appendix 5 sets out the meaning of the different Financial Strength Ratings awarded by S&P and A.M. Best.

Transferring Policyholders (including beneficiaries who are recipients of surety bonds issued by TCSCE) will have the benefit of a lower security rating when assessed using the rating issued by A. M. Best.

11.2.2. I do not believe that this change represents a material adverse change for the following reasons:

- I have concluded that there is a sufficiently low likelihood of claims under these policies not being paid as they fall due.
- The ratings for both companies are ultimately dependent upon the large group companies that reinsure or guarantee respectively TCSCE and TICL. All of these companies (TIC, TCSCA and SPFMIC) have received identical ratings of AA from S&P and A++ from A. M. Best.

11.2.3. I therefore do not believe that the differences in ratings between TCSCE and TICL gives rise to a material adverse change to the Transferring Policyholders.

11.3. Summary

11.3.1. I have concluded that, in respect of the financial implications of the Transfer:

- None of the Existing Policyholders are likely to be materially adversely affected by the Transfer; and
- None of the Transferring Policyholders are likely to be materially adversely affected by the Transfer. While there is a reduction in the degree of excess capital in TICL compared to TCSCE, I do not believe that this is a significant factor when considering the overall financial effects of the Transfer.

12. Non-financial aspects relating to the Transfer

12.1. Introduction

12.1.1. This section summarises various other non-quantitative aspects of my review:

- Claims handling and policy administration;
- Policyholder protection, regulation and insurance law;
- Policyholder priority on insolvency and winding-up and set-off rights;
- Policyholder protection schemes, policyholder complaints and Employers' Liability Tracing Office;
- Impact on Reinsurers and Indemnitors;
- Solvency II Arrangements;
- Notification of Affected Policyholders of the Transfer;
- Governing Law; and
- Coverage of MCR post-Transfer.

12.1.2. I have concluded that none of these items give rise to any material adverse consequences for the Affected Policyholders.

12.2. Claims handling and policy administration

12.2.1. Travelers has advised me that no changes will take place to any claims handling or policy administrative arrangements a result of the Transfer.

12.2.2. I have therefore concluded that none of the Transferring Policyholders and the Existing Policyholders will be affected by matters relating to claims handling.

12.3. Policyholder protection, regulation and insurance law

12.3.1. I am not anticipating there to be any change in any of the arrangements for policyholder protection, insurance company law or regulation or insurance company taxation affecting TCSCE or TICL brought about as a result of the Transfer. This is because TCSCE and TICL are all domiciled in the UK and are subject to the same legal environment and regulatory regime.

12.4. Policyholder priority on insolvency and winding-up and set-off rights

12.4.1. Under UK law, I understand that direct policyholders receive priority in the event that a firm is subject to insolvency.

12.4.2. Each of TCSCE and TICL comprises a mixture of direct and reinsurance policyholders. Following the Transfer, and under UK law, direct policyholders have priority over any reinsurance[28] policyholders on insolvency. The Transfer therefore has the potential to change the priority of policyholders.

[28] Which I understand only arises from business which is fronted for TICL or TCSCE by another insurer.

12.4.3. As both companies that are party to the Transfer are and will remain wholly-owned subsidiaries within the Travelers Group, I do not anticipate there being any material impact on set-off rights arising.

12.4.4. In paragraph 11.1.3 I have concluded that post-Transfer, the Affected Policyholders will be in an adequately-capitalised company. This means that I consider the risk of insolvency of TICL post-Transfer to be low.

12.4.5. Because I have concluded that the likelihood of an insolvency event is low, I have therefore concluded that there will be no material impact of the Transfer on the wind-up priorities or set-off rights of the Affected Policyholders.

12.5. Policyholder protection schemes, policyholder complaints and Employers' Liability Tracing Office

12.5.1. I understand that all of the Affected Policyholders will continue to be provided with the same protection from the FSCS and the FOS following the Transfer as they are before the Transfer. This is because both TCSCE and TICL are UK-domiciled and regulated insurers and:

- There are no changes to the arrangements in place for the Existing Policyholders, as they are remaining with the same insurer; and
- The Transferring Policyholders are unlikely to be eligible for protection from either arrangement (as they are not individuals or very small firms).

12.5.2. TCSCE is a member of ELTO and has uploaded ten run-off accounts with employer liability cover to the ELTO database. TICL is a member of ELTO and will continue to be a member post-Transfer.

12.6. Impact on Reinsurers and Indemnitors

12.6.1. Travelers has confirmed to me that they believe that all of the existing Reinsurance of TCSCE will be fully transferred to TICL under the Transfer.

12.6.2. Travelers has confirmed to me that they believe that all of the existing Indemnities arranged by TCSCE in respect of its clients will continue to provide benefit to other Travelers Group companies, including TICL, post-Transfer and once TCSCE has been wound-up. I discuss my consideration of this point in paragraphs 3.6.19 to 3.6.24.

12.6.3. Travelers has confirmed that no existing TICL reinsurance will cover any of the liabilities of the Transferring Policyholders.

12.6.4. Travelers has confirmed to me that all administrative arrangements relating to outwards reinsurance will remain unchanged as a result of the Transfer.

12.6.5. There are no changes to the insurance law or regulatory regime applicable as a result of the Transfer.

12.6.6. As I state in 12.4.5, I believe that the impact of the Transfer on set-off rights will not be material because the risk of insolvency of TICL post-Transfer is low.

12.6.7. I have therefore concluded that there is unlikely to be any material impact on reinsurers or indemnitors arising from the Transfer.

12.6.8. I note that while SPFMIC is not a reinsurer of TICL or TCSCE, the legal advice regarding the operation of the SPFMIC guarantee means that it will be exposed to an increased level of risk. I do not believe that this is a material change to its position because of its size and its existing indirect exposure to these risks via the operation of the TRV pool.

12.7. Solvency II Arrangements

12.7.1. Solvency II is the regulatory regime that has applied to insurance companies across Europe since 1 January 2016. UK firms have been actively preparing for the introduction of this new regime as it has wide-ranging implications for the financial resources that firms need to maintain, the manner in which they are governed and risk is managed, and the regulatory and public reporting they need to perform.

12.7.2. Prior to the Transfer, TICL and TCSCE anticipate remaining compliant with Solvency II.

12.7.3. Following the Transfer, there are not expected to be any Remaining Policyholders in TCSCE. It will then seek to be de-authorised as an insurance company and as a result will no longer need to comply with Solvency II or other insurance regulatory requirements.

Conclusions regarding Solvency II Arrangements

12.7.4. I have reviewed at a high-level the descriptions of the state of both companies' Solvency II arrangements provided to me by Travelers. I made some observations on each of the main elements of Solvency II in the following paragraphs.

12.7.5. These comments are made only in the context of my review and should not be construed as a detailed check of compliance with the detailed requirements of Solvency II as set out in the directive and supporting regulations.

12.7.6. Overall I have concluded that the state of the TICL's and TCSCE's Solvency II preparations does not have a material impact on the consequences of the Transfer for the Affected Policyholders.

Pillar 1

12.7.7. TICL and TCSCE have prepared Standard Formula SCR calculations for me to use in my analysis. I have reviewed these calculations at a high-level and considered them to be a reasonable basis for me to use in my review. During the course of my work preparing this report I have fed back comments on the calculations performed.

12.7.8. TICL and TCSCE have prepared opening statements (showing their technical provisions, balance sheet and Standard Formula SCR) as at 1 January 2016 for me to review prior to the Transfer, and have also prepared some pro-forma combined opening statements as at this date. I note that owing to the size and nature of the Transferring Policyholders, the impact of the Transfer on TICL is not material.

Pillar 2

12.7.9. Travelers has confirmed to me that it has an appropriate governance framework in place to meet the requirements of Solvency II. I have seen evidence in this through the ORSA report (dated 20 September 2017) prepared by TICL setting out the findings of its ORSA processes carried out during 2016 and 2017. I have not identified any material issues in them that I believe will affect the position of the Affected Policyholders.

12.7.10. TICL has a very low appetite for investment risk, reflected in its Investment and Market Risk Policy. Based on this and discussions with TICL management, I am satisfied that TICL complies with the Prudent Person Principle requirements of Solvency II.

12.7.11. TICL includes within its ORSA, details of its Medium Term Capital Management Plan. Its target level of Own Funds is 113% of its calculated SCR. I have commented on this target level of capital in my analysis in Section 10.

12.7.12. TICL's actuarial function has prepared reports as at 31 December 2017 that provide opinions on each of the technical provisions, underwriting and reinsurance arrangements. None of these give rise to any material issues that affect my conclusions.

Pillar 3

12.7.13. Travelers has and continues to put in place processes to enable it to be able to comply with its Pillar 3 reporting requirements under Solvency II for TCSCE and TICL, including providing an opening Solvency II balance sheet. I anticipate reviewing its progress with regard to its Pillar 3 obligations in my Supplemental Report.

Group requirements

12.7.14. I understand that neither TICL nor TCSCE are part of an insurance group for Solvency II purposes. This is because both of these companies are wholly-owned, direct subsidiaries of US domiciled insurers.

12.7.15. Currently the United States of America is not considered to be an equivalent regulatory regime for the purposes of Solvency II, but the PRA has granted a waiver modifying 20.1 and 20.2 of the Group Supervision part of the PRA Rulebook for Solvency II firms. As a result, the Travelers Group is only required to provide certain key information to the PRA, and does not need to comply more generally with the Solvency II regime.

12.8. Notification of Affected Policyholders of the Transfer

12.8.1. In this section I have commented upon the approach Travelers proposes to take in notifying Affected Policyholders. This is based upon the material supplied to me at the time of writing my Report. In this section 12.8, I have set out my understanding of the proposed approach, its rationale and my view on its appropriateness.

12.8.2. I understand that it will be for the Court to decide the necessary notifications, and the proposal upon which I have commented in the following paragraphs may be amended by the Court and therefore may not be the final approach taken to notifying Affected Policyholders.

12.8.3. I also note here that my comments in this section 12.8 are based on my general industry experience and arising from my understanding of the Affected Policyholders, rather than specific expertise in the area of policyholder communication.

Proposed approach to notification and rationale provided by Travelers

12.8.4. Travelers' overall approach is to directly notify the surety policyholders transferring from TCSCE to TICL. In addition, they will also directly notify the small number of policyholders and third-party claimants (including where available their legal representatives) of TCSCE for which there is a current notified outstanding claim.

12.8.5. Travelers has told me that there will be:

- Approximately[29] 52 surety policyholders in respect of 124 surety bonds and 9 third-party claimants in respect of third party claims currently being administered; and
- 860 Gulf portfolio policyholders with claimants arising from 18 associated claims files and 13 relevant run-off policyholders

to whom they will be sending notification of the Transfer.

12.8.6. For the remainder of the Affected Policyholders, Travelers is seeking a waiver from the notification requirements.

12.8.7. In Table 12.1, I have set out Travelers proposed approach for the three portfolio segments.

12.8.8. In Section 12.9 I have considered the publicity arrangements proposed by Travelers; these are intended to complement the notification arrangements, particularly where waivers are being sought, to increase the likelihood that these policyholders will be made aware of the Transfer to compensate for their not being directly notified. Under these proposals, Travelers will publish a notice, in an approved form, in various administrative and trade publications, national newspapers and web-sites.

Table 12.1 – Policyholder notification arrangements	
Portfolio segment	**Whom Travelers will notify**
EXISTING POLICYHOLDERS OF TICL	No policyholders to be directly notified.

[29] The figure is approximate after allowing for the removal of policyholder names which appear to be duplicates but have been recorded slightly differently. For completeness, Travelers will notify policyholders using all of the variations recorded.

Table 12.1 – Policyholder notification arrangements	
Portfolio segment	**Whom Travelers will notify**
SURETY POLICYHOLDERS OF TCSCE	Subject to the additional detail paragraph 12.8.9, all surety clients of TCSCE, being those with unexpired surety bonds. Policyholders and the third-party claimants for surety bonds where there is a current or outstanding claim.
GULF PORTFOLIO POLICYHOLDERS OF TCSCE	All policyholders for which TCSCE maintains computer records. The company has told me that there are 18 claim files that have been identified in respect of 13 policyholders. TCSCE is not aware of any other claims. Claimants and / or their legal representatives will also be notified in respect of these 18 claims files.

12.8.9. For 4 of the approximately 52 Surety Clients to be contacted, and because in all of these cases the relationship is managed by TCSCA (as described in paragraph 3.6.9), TCSCE will ask TCSCA to review its policy records and forward the notification to these policyholders.

My observations regarding the proposed approach to notification of policyholders

12.8.10. Assessing whether policyholder notification arrangements are appropriate can be a subjective exercise. I am comparing the risk that policyholders who will subsequently have a claim will not have been consulted on the Transfer against arguments presented by the company that it is either not possible to identify all policyholders, or doing so would be disproportionate in the context of the impact of the Transfer.

12.8.11. For the Transfer, ultimate policyholder security (as shown in figures 10.3-1 to 10.3-4) falls to other companies in the Travelers Group both before and after the Transfer. As a result, I think that risk of adverse consequences for policyholders or third-party claimants who do not receive notification is likely to be low.

12.8.12. For the TCSCE surety policyholders, almost all policyholders and all third-party claimants are being notified.

12.8.13. While TCSCE will have information regarding the parties to whom surety bonds are issued originally, it is permissible for them to be reassigned without requiring TCSCE's notification or consent. TCSCE therefore does not intend to notify these third-party surety bondholders. I believe that it is reasonable for TCSCE to request a waiver from such notification on the grounds that it is impossible for it to be certain that all such bond recipients will have been identified. Given these facts, and taking into account my comments in paragraph 12.8.11, I think that the proposed approach is appropriate for these policyholders. I have also noted the additional advertising in a specialist construction industry publications / web-site in Section 12.9.

12.8.14. For the Gulf Portfolio policyholders, Mr Gent states in his witness statement at paragraph 5.2 that there have only been 18 new claims notified since 1 January 2012. TCSCE has confirmed to me that none of these was from a newly identified policyholder not present in the computer records of the company at the time. While an IBNR reserve is held by the company for potential sources of claims, I have been told that it is not held in respect of particular claimants. The likelihood of claims arising in future from policyholders who are not being contacted are therefore, in my view, acceptably low to enable me to reach my conclusions below in paragraph 12.8.18.

12.8.15. Travelers has told me that has undertaken an extensive exercise to locate policyholders in its paper records for this portfolio, both in the UK and USA for the purposes of providing policyholder data to ELTO. I have been told by TCSCE that the policies written in the portfolio did not include standalone employers' liability business, and so this exercise was in effect to identify any policyholders. The exercise did not prove successful in identifying a comprehensive set of additional policyholders beyond those with computerised records. Therefore, based on the low likelihood of new claimants, the lack of success in identifying additional policyholders in the company's paper records and taking into account my comments in paragraph 12.8.11, I think that the proposed arrangements for these policyholders are appropriate. I have also noted the additional advertising in an insurance industry publication in Section 12.9.

12.8.16. For the Existing Policyholders, my financial analysis has indicated that the impact on their position will be negligible. Clearly, writing to all of TICL's current and past policyholders would also incur significant costs, disproportionate to any benefit derived. I therefore think that the proposed approach is reasonable for these policyholders.

12.8.17. Travelers has shown to me the wording sent to each Surety client with a policy underwritten by TICL and whose Surety bonds were previously underwritten by TCSCE. These made each of these policyholders aware of the Transfer. Clearly, given its timing, it could not satisfy the policyholder notification arrangements for the Transfer, however it does provide some evidence of additional efforts made by Travelers to raise awareness of the Transfer with this group of policyholders.

Conclusions regarding the proposed approach to notification of policyholders

12.8.18. Based on the considerations above, my assessment of the proposed policyholder notification arrangements is that they are appropriate in the context of the Transfer. In making this statement I reiterate that it will be for the Court to approve the notification arrangements.

12.9. Publicity Arrangements of the Transfer

12.9.1. Travelers propose to publicise the Transfer in the following publications in order to meet its obligations under the Financial and Services Markets Act 2000 (Control of Business Transfer) (Requirements on Applicants) Regulations 2001 (S.I. 2001/3625):

- The London Gazette, the Edinburgh Gazette and the Belfast Gazette;
- Two national newspapers in the UK: The Guardian and The Daily Mail;
- Two national newspapers in each EEA state other than the UK; and
- One business newspaper in each EEA state other than the UK.

12.9.2. In addition, Travelers propose additional publicity beyond meeting these requirements through the use of additional targeted advertising:

- In respect of the Gulf Portfolio: in the Insurance Day, an insurance industry publication with international circulation; and
- In respect of the Surety Portfolio: in each of Building magazine and Construction News in the UK. I have been told by Travelers that by virtue of publishing in Construction News, the notice will also be available through the Construction Index, an online directory and search engine which attracts more than 4 million visitors per year viewing more than 26 million pages of construction-related information.

12.9.3. This additional publicity shows to me a clear spread of insurance industry and construction-industry-specific publications, aimed at readers who appear to me to be most likely to be interested in the Transfer. This is because they are what I would expect to be the industries of the Transferring Policyholders.

12.9.4. The additional targeted advertising has satisfied me that Travelers is carrying out sufficient additional publicity activity to make up for the waivers regarding the Transferring Policyholders that it is applying for (described in Section 12.8). I believe that the additional advertising arrangements will help to reduce the risk of there being Transferring Policyholders who will not have been made aware of the Transfer.

12.9.5. Finally, Travelers has indicated that it will comply with any additional requirements as to publication of notices regarding the Transfer as specified by the supervisory authorities in all EEA states.

12.9.6. Overall, the publicity arrangements appear to me to meet each of the requirements of the Financial and Services Markets Act 2000 (Control of Business Transfer) (Requirements on Applicants) Regulations 2001 (S.I. 2001/3625). This is because there is a spread of outlets, by country and type, and with specific attention paid to the likely industries of Transferring Policyholders.

12.9.7. I therefore believe that it is reasonable for me to conclude that Travelers are adopting an appropriate approach to publicity of the Transfer.

12.10. Other matters

Non-EEA policyholders

12.10.1. Travelers has confirmed to me that there are no non-EEA policies that were issued by TCSCE arising in either the Surety or Gulf portfolio. As a result, they believe that there is no reason for the Transfer not to be effective on all of the Affected Policyholders. Travelers has confirmed to me that this will be stated in the witness statement of Michael Gent.

Coverage of MCR post-Transfer

12.10.2. As can be seen in Table 8.1, TCSCE will retain some assets post-Transfer. I am satisfied that these are clearly more than its MCR obligations so that it will be able to meet its regulatory capital requirements until its insurance authorisation is withdrawn.

D. Appendices

Appendix 1. Scope of services

This Appendix shows the relevant extract regarding the scope of services from our engagement letter dated 9 December 2015. Note that some defined terms in this extract differ slightly from those used in the Report.

Scope and purpose of Your Project

You would like Alex Marcuson to act as independent expert for the Proposed Transfer and prepare a report for the Court on its effects in accordance with the requirements described in Part VII of the Financial Services and Markets Act 2000 and UK regulatory guidance contained in the Prudential Regulation Authority ("**PRA**") Policy Statement PS 7/15 and in the Financial Conduct Authority ("**FCA**") Handbook SUP18.

The purpose of the Project is to consolidate TCSCE and TICL into a single insurance company.

Services

We will carry out a review of the effects of the Proposed Transfer on:

- The policyholders of TCSCE transferring to TICL;
- The existing policyholders of TICL;
- The reinsurers of any transferring policyholders whose contracts of reinsurance are to be transferred; and
- Any policyholders remaining in TCSCE following the Proposed Transfer, although there are currently not expected to be any of these.

In doing so, We will consider the effect of the financial and non-financial implications of the Proposed Transfer to determine whether We can be satisfied that no group of policyholders will be materially adversely affected. Where necessary, We will apply the wider meaning given to the term *policyholder* in the Financial Services and Markets Act 2000 (Meaning of "Policy" and "Policyholder") Order 2001.

As necessary, We will correspond and liaise with the PRA and FCA when carrying out the role as the independent expert to the Proposed Transfer.

We will arrange for the independent expert to attend court for the sanction hearing as reasonably required.

We will prepare the Deliverables set out later in this letter.

Our team will be led by Alex Marcuson, assisted by other consultants as necessary.

This assistance will take place from the date of this letter. It is intended that the Proposed Transfer will be approved by the Court during the 3rd Quarter of 2016, with the initial Court Directions hearing taking place during the 1st Quarter of 2016. We will make reasonable efforts to provide You with the Deliverables (as described later in this letter) in line with this timetable.

Appendix 2. Reliances, limitations and assumptions

D.2.1 Reliances

D.2.1.1 In preparing this Report I have relied on various sources of information, including:

- Data and information provided to me by representatives of TCSCE and TICL. This information includes spreadsheet models, internal and externally prepared reports and matters described to me in meetings;
- Publicly available data and information.

D.2.1.2 In doing so, I have considered the reasonableness of this information, but I have not independently verified all sources, nor have I carried out any form of audit of the data and information supplied. Should any of these sources prove unreliable or inaccurate, my findings may change, potentially materially.

D.2.1.3 In particular, I have not reviewed the case estimates established for individual claims and have relied upon the quality of case estimates in the data supplied by TCSCE and TICL.

D.2.1.4 I have relied upon the statements made on behalf of TCSCE and TICL in the witness statements of Mr. Gent (at paragraph 8.3) on behalf of TCSCE, and of Mr. Gent (at paragraph 8.3) on behalf of TICL, that confirm the accuracy and reliability of the data and other information supplied to me as part of this project. I discuss why I believe it is appropriate for me to rely upon these statements in Section 5.4.

D.2.2 Limitations and uncertainty

D.2.2.1 General insurance and general insurance processes are by their nature uncertain. In the case of long-tail liabilities, particularly those with exposure to latent claims, this uncertainty is acute. The reader is cautioned regarding the high degree of uncertainty surrounding the quantitative analysis, and the consequences for my conclusions. The analysis in this Report seeks to provide an indication at various points of the potential for alternative legitimate results to be obtained and their consequences, but these should not be taken as the upper boundary within which estimates could lie. In particular, events could give rise to outcomes beyond the higher scenarios indicated, and the scope and consequences of adverse experience is generally greater than for favourable experience.

D.2.2.2 General insurance gives rise to a wide range of potential uncertainties, particularly in times of extreme events. Matters that could affect the outcome in unexpected ways include, but are not limited to:

- Legal, judicial, regulatory and social changes;
- New types of claim or sources of claim that are interpreted as covered under policies;
- Economic effects – including significant exchange rate movements and hyper-inflation scenarios.

- Operation / control breaches by (re-)insurers or one of their agents;
- New environmental effects, including the effects of climate change; and
- Technological changes.

D.2.2.3 Unless I have indicated otherwise, I have not made an explicit allowance for any of these effects or other new classes of claims that give rise to significant levels of claims.

D.2.2.4 Estimation of reserves and capital requirements, while based on quantitative analysis, remain inherently subjective exercises, based on experience, internal and external data and a number of critical judgements. The use of the techniques set out in this report is intended to provide an independent, quantitative and evidence-based approach to preparing these estimates.

D.2.2.5 Where provided, the estimates set out in this report are intended to provide an alternative view to those of the company considered. There may be factors of which the managers and directors of that company are aware that I have not taken into account.

D.2.2.6 The estimates prepared should be considered in their totality. While I have tried not to cross-subsidise between different segments other than where indicated, individual estimates of segments are provided to assist the reader in understanding the analysis performed, and may contain over-estimates or under-estimates that are not material to the estimates in aggregate.

D.2.2.7 Certain parts of the work presented in this report provide estimates of variability in the future outcome of insurance companies. These estimates are not themselves accompanied by explicit statements or quantification regarding the uncertainty in them, but seek to include what I consider to be an appropriate allowance within them.

D.2.3 Assumptions

D.2.3.1 I have used the following rates of exchange in my analysis, which are the same as those used by Travelers in their Standard Formula SCR calculations:

- £1 = $1.47 as at 31 December 2015
- £1 = $1.23 as at 31 December 2016
- £1 = $1.35 as at 31 December 2017

D.2.3.2 I have assumed that the past development behaviour of claims can be a useful guide to future behaviour.

Appendix 3. Data Received

In writing this report, I relied upon the accuracy of certain documents and information provided by TICL and TCSCE. These included, but were not limited to the following[30]:

#	Item	TICL	TCSCE
1	Audited Statutory Financial Statements as at 31 December 2017	✓	✓
2	Standard formula SCR calculation as at 31 December 2017	✓	✓
3	Solvency and Financial Condition Report as at 31 December 2017	✓	✓
4	Own Risk and Solvency Assessment (ORSA) report as at 20 September 2017	✓	
5	Actuarial Function Report as at 31 December 2017	✓	
6	As-if post-Transfer balance sheet positions as at 31 December 2017	✓	✓

Additional items received:

- Travelers group structure chart.
- SPFMIC's guarantee to TICL dated 22 August 1995, and subsequent amendment dated 1 March 2006.
- Legal advice to Alex Marcuson on whether Transferring Policyholders will benefit from the existing SPFMIC's guarantee to TICL.
- Internally and externally prepared actuarial reviews of the reserves of TICL prepared as at various dates:
    - Internal reserve reports as at 31 December 2014, 30 September 2016, 31 December 2016, 30 September 2017 and 31 December 2017
    - External review carried out by PwC as at 31 December 2014

[30] Note, where successive reporting exhibits were provided to me (e.g.: reserving or ORSA reports), I have in some circumstances solely referenced the more/most recent versions.

- Information related to reserve estimates for TICL that are used in statutory financial statements as at 31 December 2016, including:
  - Aggregate triangles for the majority of the reserving classes in UK and Ireland.
  - Methodology behind the reserving of UK and Ireland latent claims, aggregate breach and Periodical Payment Orders.
  - Methodology behind the estimated impact of the Ogden Rate change as of 27 February 2017.
  - General ledgers as at 31 December 2016.
- Information related to reserve estimates for TICL that are used in statutory financial statements as at 31 December 2017, including:
  - Aggregate loss ratio and combined ratios by high-level reserving classes and accident years, compared to historic business plan.
  - Updated information on Periodical Payment Orders.
  - Updated information on the methodology and results of the estimated impact of the Ogden Rate change.
  - General ledgers as at 31 December 2017.
- Information related to reserve estimates for TCSCE that are used in statutory financial statements as at 31 December 2015, 2016 and 2017, including:
  - Selected reserves in the Surety portfolio.
  - Selected reserves in the Gulf portfolio.
- TICL reinsurance résumés, which summarise the reinsurance arrangements for each year between October 2008 and April 2018.
- Details of calculations underlying TICL and TCSCE Solvency II technical provisions and balance sheet.
- TICL's Capital Management Policy dated 25 October 2016
- Sample surety bond indemnity agreement wording.
- Legal advice to Travelers relating to TCSCE surety bond portfolio.
- Spreadsheet setting out TCSCE surety bond portfolio live exposures as at 20 April 2018.
- Information regarding the Funds at Lloyd's for TICL.
- TICL's 2018 business plan, and three-year-business plan (2018-2020) as submitted as part of the statutory returns (National Specific Templates).
- Letter from Travelers to the PRA regarding Brexit contingency planning.

Other information has been gathered from email correspondence and meetings with staff and representatives of TICL and TCSCE, as well as public sources including company accounts from the UK Companies House, Form 10-K returns from the U.S. Securities and Exchange Commission, and public domain rating agency reports from A.M. Best and S&P.

Appendix 4. Curriculum Vitae of Alex Marcuson

Professional summary

Alex Marcuson is a general insurance consulting actuary. He has over 20 years' experience of advising non-life insurers and reinsurers both UK-based and overseas, and including companies, mutuals, Lloyd's syndicates, captives, P&I clubs, brokers and other similar operations.

He has expertise across the lines of non-life insurance business written in the UK and overseas: personal, commercial and specialty lines. His advice has spanned a wide range of areas of actuarial involvement.

Between 2008 and 2013, Alex chaired the Institute and Faculty of Actuaries' General Insurance Professional Standards Committee and was a member of its General Insurance Board. He is currently a member of its Professional Support Service, a team of recognised experts who provide confidential assistance and responses to members of the Institute and Faculty of Actuaries on ethical and technical questions, and the General Insurance Reserve Oversight Committee.

Alex is managing director of Marcuson Consulting Ltd. a team of ten general insurance consulting actuaries.

Professional specialisms

- Reserving and liability valuations
- Capital and financial modelling, including Solvency II internal models
- Expert witness work and Part VII insurance business transfer schemes
- Corporate restructuring and M&A transaction support

Career history

1994 – 2000	Bacon & Woodrow – actuarial trainee
2000 – 2002	Trowbridge Deloitte, Australia – actuary
2002 – 2010	Deloitte – Associate Partner
2010 – present	Marcuson Consulting Ltd, Managing Director

Education and professional qualifications

1991 – 1994	Queens' College, Cambridge University. Mathematics – MA Hons. Double 1st
1998	Fellow of the Institute and Faculty of Actuaries
1999 – 2015	Holder of Lloyd's signing actuary practising certificate

Appendix 5. Glossary of defined terms and abbreviations

Defined terms, abbreviations and acronyms	
A.M. Best	A term used to refer to one of the subsidiaries of A.M. Best Rating Services, Inc., which is an independent credit rating agency specialised in rating insurance companies. Its European subsidiary, A.M. Best – Europe Rating Services Limited (AMBERS), is an External Credit Assessment Institution (ECAI) in the EU.
A.M. Best rating	A term used to refer to the FSR from A.M. Best. The ratings are grouped into the following categories: • **Superior (A+ to A++):** superior ability to meet ongoing insurance obligations • **Excellent (A- to A):** excellent ability to meet ongoing insurance obligations • **Good (B+ to B++):** good ability to meet ongoing insurance obligations • **Fair (B- to B):** fair ability to meet ongoing obligations. Financial strength is vulnerable to adverse changes in underwriting and economic conditions. • **Marginal (C+ to C++):** marginal ability to meet ongoing insurance obligations. Financial strength is vulnerable to adverse changes in underwriting and economic conditions. • **Weak (C- to C):** weak ability to meet ongoing insurance obligations. Financial strength is very vulnerable to adverse changes in underwriting and economic conditions. • **Poor (D):** poor ability to meet ongoing insurance obligations. Financial strength is extremely vulnerable to adverse changes in underwriting and economic conditions.
ACR	Adjusted capital requirement – this is the financial resource requirement that I apply as my reference point for reviewing the financial consequences of the Transfer. It includes modifications to the Standard Formula SCR to reflect the specific risks of each firm that is party to the Transfer.
Adequately-capitalised	Financial resources exceed capital requirements plus capital buffer, but less than 150% of capital requirements.
Affected Policyholders	All of the policyholders affected by the Transfer. This comprises the Transferring Policyholders, the Existing Policyholders and the Remaining Policyholders.
Brexit	The departure of the UK from the European Union; or the date of departure.

Defined terms, abbreviations and acronyms	
Capital buffer	An allowance in my analysis for additional capital over and above a firm's SCR to allow for: • The risk of short-term fluctuations in asset and liability values; and • Uncertainty in the choice of some of the parameters in the regulatory capital requirement calculation.
Chain of Security	The series of elements that, in sequence, act to provide layers of protection to policyholders and accumulate to provide policyholders with confidence that their claims will be met.
Co-Surety	Surety Bonds issued by a panel of Surety Insurers. Each Surety Insurer is only liable up to the face value of the Surety Bonds it issues.
Court	The High Court of Justice of England and Wales
Directions Hearing	Initial Court hearing at which Court approval is sought for the proposed notification arrangements for Affected Policyholders.
ECAI	External Credit Assessment Institution. Credit ratings issued and endorsed by ECAIs may be used for regulatory purposes in the EU as per Directive 2006/48/EC.
EIOPA	European Insurance and Occupational Pensions Authority, one of the three European Supervisory Authorities. EIOPA is an independent advisory body to the European Parliament, the Council of the European Union and the European Commission. Under the incoming Solvency II directive, EIOPA issues various technical standards that ultimately apply to insurance firms operating in the European Union.
ELTO	Employers' Liability Tracing Office. Statutory body established to assist employees trace statutory employers' liability insurer
Existing Policyholders	The policyholders of TICL prior to the Transfer.
Funds at Lloyd's / FAL	This refers to the assets that TICL has pledged as Funds at Lloyd's to support the underwriting activity of Syndicate 5000.
FCA	Financial Conduct Authority, a statutory body established by Act of Parliament and responsible for conduct regulation of insurers operating in the UK.
FLAOR	Forward Looking Assessment of Own Risks. This is effectively the predecessor of the ORSA requirements which will be in force on 1 January 2016. Based on the existing ORSA principles, EIOPA released preparatory guidelines for the FLAOR requirements in 2013. These were expected to be carried out in 2014 and 2015.
FOS	Financial Ombudsman Scheme, body responsible for resolving disputes between individual policyholders and insurers.

Defined terms, abbreviations and acronyms	
Framework for FRC technical actuarial standards	This framework document explains the authority, scope and application of the FRC's technical actuarial standards and guidance.
FRC	Financial Reporting Council
Freedom of Establishment	In the context of insurance business, the permission for a firm to establish a branch office anywhere within the EEA to underwrite insurance business while remaining supervised by the prudential regulator of its home state.
Freedom of Services	In the context of insurance business, the permission for a firm to underwrite insurance business anywhere within the EEA as if they were a locally authorised firm.
FSCS	Financial Services Compensation Scheme. Statutory body responsible for meeting claims of individuals and small businesses in the event of UK insurer insolvency.
FSMA 2000	The Financial Services and Markets Act 2000, together with its supporting regulations and statutory instruments.
FSR/ Financial Strength Rating	Financial Strength Rating, an independent opinion from a rating agency of an insurer's financial strength and ability to meet its ongoing insurance policy and contract obligations.
GAAP	Generally Accepted Accounting Principles, the standard framework of guidelines for financial accounting used in any given jurisdiction, more generally known as accounting standards or standard accounting practice.
Handbook/Rulebook **The FCA's Financial Services Handbook and the PRA Rulebook**	These contain regulatory rules for firms regulated by the PRA and FCA. Both the PRA and FCA have been modifying their Hand/Rulebooks since they became separate entities in 2013 to reflect their differing roles. In particular, as of 1 January 2016 when the Solvency II Directive came into force, the FCA continue to maintain relevant sections of GENPRU and INSPRU whilst the PRA have removed most of these sections, adjusting its guidance to reflect the new solvency regime. Note that the PRA's Handbook is now referred to as the PRA's Rulebook and no longer contains guidance.
ICA	Individual Capital Assessment. As set out in the PRA and FCA Handbooks GENPRU and INSPRU, insurers are required to assess and manage the risks to which they are exposed and make their own assessment of their capital needs, measured by a 99.5% confidence level over a one-year timeframe that the value of assets will exceed the value of liabilities.

Defined terms, abbreviations and acronyms	
ICAS Regime	Individual Capital Adequacy Standards. These are the PRA's requirements for insurers which focus on 3 sub-principles: (1) there must be a coherent and complete assessment of the risks faced by the business (2) there should be a clear common definition of survival, ensuring that there is a 99.5% confidence level over a one-year timeframe that the value of assets exceeds the value of liabilities (3) the assessment must be sensible and document the underlying reasoning and judgements
IFoA	Institute and Faculty of Actuaries, the UK Actuarial Professional Body.
INSPRU	Section of FS Handbook relating to prudential supervision of UK insurance firms
Lloyd's	The Society of Lloyd's
LoC	Letter of Credit
MCL	Marcuson Consulting Ltd
MCR (Solvency II)	Minimum Capital Requirement. Under Solvency II (with effect from 1 January 2016), the MCR is calculated using a linear formula and must fall between 25% and 45% of the SCR.
Obligee	The recipient of the Surety Bond. The Surety Insurer issues a Surety Bond to the Obligee to provide them with a form of financial security in the event that the Surety Client fails to perform certain specified obligations.
Ogden Rate or **Ogden Discount Rate**	The rate of interest used in calculation of compensation for future losses in personal injury and fatal accident cases
ORSA	Own Risk and Solvency Assessment. Under Solvency II, all firms must prepare an ORSA annually for submission to the national supervisory body (being the PRA in the UK). Amongst other elements, the ORSA sets out a firm's own assessment of the risks it faces and the capital it needs to support its business over a suitable time-horizon, often in the range of 3 – 5 years. Firms should consider the risks that may affect the business arising from the run-off of their existing liabilities.
Own Funds	This is the surplus of assets over liabilities, plus subordinated debt, as determined under the Solvency II Insurance Directive.
Part VII Transfer	An insurance business transfer under the legal mechanism established in Part VII of FSMA 2000
Pillar 1 (Solvency II)	This sets out the quantitative requirements, including the rules to value assets and liabilities, and to calculate capital requirements.
Pillar 2 (Solvency II)	This sets out the qualitative requirements for governance, risk management, and supervisory interactions.
Pillar 3 (Solvency II)	This focuses on public disclosure and transparency requirements.

Defined terms, abbreviations and acronyms	
PPO	Periodical Payment Order, an annuity claim settlement used in the UK for covering the costs associated with the care of very severely injured individuals.
PRA	Prudential Regulation Authority, a part of the Bank of England. Responsible for prudential regulation of UK insurers.
Remaining Policyholders	The policyholders of TCSCE that will not be transferred to TICL under the Transfer.
Report	This report prepared by the PRA-approved independent expert for submission to the Court at the initial directions hearing for the Transfer. Prepared following the guidance set out in the SoP and SUP18.
RST or Reverse Stress Test	A method of testing insurer capital strength by increasing / decreasing one or more assumptions until a threshold (typically insurer default) is reached.
S&P	A term used to refer to one of the subsidiaries of Standard & Poor's Rating Services, an independent credit rating agency. Its UK subsidiary, Standard & Poor's Credit Market Services Europe Limited, is an ECAI in the EU.

Defined terms, abbreviations and acronyms	
S&P rating	A term used to refer to the FSR from S&P. The ratings are grouped into the following categories: • **AAA:** extremely strong financial security characteristics • **AA:** very strong financial security characteristics, differing only slightly from those rated higher • **A:** strong financial security characteristics, but is somewhat more likely to be affected by adverse business conditions than are insurers with higher ratings • **BBB:** good financial security characteristics, but is more likely to be affected by adverse business conditions than are higher-rated insurers • **BB; B; CCC; and C:** vulnerable characteristics that may outweigh its strengths. 'BB' indicates the least degree of vulnerability within the range; 'CC' the highest. • **R:** under regulatory supervision owing to its financial condition. During the pendency of the regulatory supervision, the regulators may have the power to favour one class of obligations over others or pay some obligations and not others. The rating does not apply to insurers subject only to nonfinancial actions such as market conduct violations. • **SD or D**: in default on one or more of its insurance policy obligations but is not under regulatory supervision that would involve a rating of 'R'. • The 'D' rating also will be used upon the filing of a bankruptcy petition or the taking of similar action if payments on a policy obligation are at risk. A 'D' rating is assigned when Standard & Poor's believes that the default will be a general default and that the obligor will fail to pay substantially all of its obligations in full in accordance with the policy terms.
S&P rating (continued)	• An 'SD' rating is assigned when Standard & Poor's believes that the insurer has selectively defaulted on a specific class of policies but it will continue to meet its payment obligations on other classes of obligations. A selective default includes the completion of a distressed exchange offer. Claim denials due to lack of coverage or other legally permitted defences are not considered defaults.

Defined terms, abbreviations and acronyms	
Sanction Hearing	Final Court hearing at which Court approval for the Transfer is sought by the parties to the Transfer.
Scheme *(of Arrangement)*	The term for the legal mechanism by which the Transfer is brought about under Part VII of FSMA 2000.
SCR	Solvency Capital Requirement. This is the level above which there is no supervisory intervention for financial reasons, and is calculated as the Value-at-Risk of the basic own funds of an insurance or reinsurance undertaking subject to a confidence level of approximately 99.5% over a one-year time horizon (i.e. a "1-in-200 scenario").
SF SCR or Standard Formula SCR	A formula-based approach to calculating a firm's SCR using a methodology and parameters specified in the Solvency II Directive implementing measures.
Sole Surety	Surety Bonds underwritten by a single Surety Insurer
Solvency I	Europe-wide Insurance Directive in force prior to 1 January 2016. Sets out minimum capital requirements on insurance firms.
Solvency II	Europe-wide Insurance Directive which came into force from 1 January 2016. Solvency II sets out wide-ranging requirements on firms and supervisors relating to financial resources, risk and governance and reporting requirements. The Solvency II framework consists of three main areas (pillars) which are described in the relevant glossary item.
SoP	Statement of Policy, entitled *"The Prudential Regulation Authority's approach to insurance business transfers"*, issued by the PRA in April 2015 and replaces the guidance in SUP18 of the PRA's Handbook.
SPFMIC	St. Paul Fire & Marine Insurance Company Limited, the guarantor of the Transferee (TICL)
Strongly-capitalised	Financial resources over 200% of capital requirements.
SUP18	The section of the FCA's Handbook setting out requirements and guidance for insurance business transfers.
Surety or **Surety Insurer**	The insurance company issuing a Surety Bonds. The term Surety is sometimes used in place of Surety Insurer.
Surety Bonds	A financial guarantee issued by an insurer. In the event that the Surety Client fails to perform certain obligations, the Surety will pay the Obligee an amount specified in the Surety Bond.
Surety Client	The client of the Surety Insurer requesting the Surety Bond.
Supplemental Report	Additional report prepared by the PRA-approved independent expert for submission to the Court prior to the final hearing at which the Court's approval of the Transfer is sought.

Defined terms, abbreviations and acronyms	
TAS	Technical Actuarial Standard. The TASs are professional standards which are set and maintained by the FRC. They are intended to be "applicable to work which involves the use of actuarial principles and/or techniques and the exercise of judgement or is presented as such, including for example financial models used in insurance and pensions and projections of contingent events. Compliance with the TASs for work in their scope, is required for members of the IFoA and encouraged when such work is undertaken by non-actuaries, consulting firms or financial institutions."
TAS 100	Technical Actuarial Standard 100: Principles for Actuarial Work. A generic TAS which promotes high quality technical actuarial work. It establishes high-level principles and outcomes which users and the public can expect to be followed and achieved for all technical actuarial work in the UK.
TAS 200	Technical Actuarial Standard 200: Insurance. It promotes high quality technical actuarial work in insurance on matters where there is a high degree of risk to the public interest.
TCI	The Travelers Companies, Inc., the ultimate parent of both Transferor and Transferee
TCSCA	Travelers Casualty and Surety Company of America, an American insurance company which 100% reinsures the Surety businesses written by TCSCE
TCSCE	Travelers Casualty and Surety Company of Europe Limited, the Transferor
TIC	The Travelers Indemnity Company, an American insurance company which both 100% owns TCSCE and reinsures 100% of the run-off portfolio of TCSCE
TICL	Travelers Insurance Company Limited, the Transferee
TIDAC	Travelers Insurance DAC, a newly established Irish-domiciled company within the Travelers Group to which TICL intends to transfer all of all of its business written on a Freedom of Services basis and business written by its Irish Branch established using TICL's Freedom of Establishment passporting rights.
TML	Travelers Management Limited, a UK registered company that employs the Travelers Group UK-based staff and provides management services to its UK operations (including TICL and TCSCE.)
Transfer	The proposed insurance business transfer scheme of the Transferring Policyholders from TCSCE to TICL.
Transferring Policyholders	The policyholders of TCSCE transferred to TICL under the Transfer.
Travelers	A term used to refer to one or more companies within the Travelers Group of companies where the precise entity is not important in the context in which it is being used in my Report.
Travelers Group	The collection of companies with TCI as its ultimate parent.

Defined terms, abbreviations and acronyms	
TRV Pool	An intercompany pooling arrangement where the underwriting risks of TCI's major subsidiaries are pooled. The lead company of the TRV Pool is TIC, and other participating companies include SPFMIC and Travelers Casualty and Surety, Inc. (the parent of TCSCA).
Undercapitalised	Financial resources less than capital requirements plus a capital buffer.
Well-capitalised	Financial resources fall between 150% and 200% of capital requirements.