INDEPENDENT EXPERT REPORT
OF PHILIP TIPPIN FIA
In the matters of

COVEA INSURANCE PLC
AND
STERLING INSURANCE COMPANY LIMITED

AND IN THE MATTER OF PART VII OF THE FINANCIAL
SERVICES AND MARKETS
ACT 2000

IN THE HIGH COURT OF JUSTICE

DATED 12 AUGUST 2015

Contents

1. Introduction

Purpose of the report

1.1 Sterling Insurance Company Limited ("Sterling") is a wholly owned direct subsidiary of Sterling Insurance Group Limited, and writes non-life insurance business as a subsidiary of the French group Société de Groupe d'Assurance Mutuelle (SGAM) Covéa ("Covéa Group"). Covéa Group acquired the Sterling Insurance Group during 2015, through its UK holding company MMA Holdings UK plc. It has been proposed that Sterling will transfer its entire insurance and reinsurance business under the provisions of Part VII of the Financial Services and Markets Act 2000 ("FSMA") under a transfer to be approved by the High Court of Justice, England ("the Court").

The proposed transfer moves the insurance and reinsurance policies of Sterling to Covea Insurance plc ("Covea"). Both Sterling and Covea are wholly owned indirect subsidiaries of Covéa Group. In addition to the English transfer a parallel transfer to Covea is proposed in Jersey in respect of Jersey business written by Sterling. The transfer of businesses carried on in or from within Jersey must be approved by the Royal Court of Jersey.

Following the transfer, Sterling will be deauthorised. The proposed date for this transfer to be effective is 31 December 2015.

I refer to the transfer of insurance business of Sterling as the "Transfer". I refer to Sterling and Covea as the "Transfer Companies".

1.2 Under FSMA, a proposed transfer of insurance business from one entity to another can only take place if it has been approved by the Court. As part of the approval process a report is required from an expert (the "Independent Expert") to aid the Court in its deliberations.

1.3 This report describes the proposed transfer and discusses its possible effects on the relevant policyholder groups, including effects on security and levels of service.

This report is organised into seven sections as follows:

Section 1 – The purpose of this report and the role of the Independent Expert

Section 2 – Executive summary and conclusions

Section 3 – Relevant background information on Covéa Group and each of the Transfer Companies

Section 4 – Setting out the effect of the Transfer on the Transfer Companies

Section 5 – Discussion of the potential impact of the Transfer on stakeholders

Section 6 – Consideration of the appropriateness of the information provided to me which informs my opinion, including consideration of methodologies for calculations used in provision of data and scenarios following the Transfer taking effect that may affect policyholder security.

Section 7 - Summary of findings

Independent Expert

1.4 I, Philip Tippin, am a partner in the actuarial practice of KPMG LLP ("KPMG"). I have been a Fellow of the Institute and Faculty of Actuaries for 17 years. My detailed curriculum vitae is included in Appendix 1.

1.5 I have been appointed by Covea to act as the Independent Expert in connection with the Transfer. My appointment has subsequently been approved by the Prudential Regulation Authority ("PRA") on 26 March 2015.

1.6 To the best of my knowledge, information and belief, I have no conflicts of interest in connection with the parties involved in the proposed Transfer and I therefore consider myself able to act as an Independent Expert on this transaction.

1.7 I can confirm that I have no financial interest in the Transfer Companies, nor do I work for any entity belonging to Sterling or its parent Covéa Group. Neither I, nor any of my immediate team assisting me in producing this report, have carried out any work with the Transfer Companies or any of the wider Covéa Group companies over the last three years.

1.8 I can confirm that the contribution of Covea and its subsidiaries to KPMG's global fee income has not exceeded 0.01% over the last 3 years.

1.9 The costs and expenses associated with my appointment as Independent Expert and the production of this report will be charged to Covea.

1.10 In reporting to the Court on the proposed Transfer my overriding duty is to the Court. This duty applies irrespective of any person or firm from whom I have been instructed or paid.

Proposed Transfer

1.11 The Transfer Companies are owned indirectly by Covéa Group, and the Transfer represents an internal reorganisation of Covéa Group's UK general insurance business.

It is proposed that the insurance and reinsurance policies of Sterling will be transferred to Covea. This is intended to take effect from 31 December 2015 (the "Effective Date"). The majority of the transferring policies relate to creditor, household, and commercial insurance policies written through brokers and coverholders, but also include a small amount of personal accident business.

1.12 Under the proposed terms of the Transfer, all assets and liabilities relating to the policies transferring to Covea, and the remaining assets of Sterling (with the exception of a residual asset pre deauthorisation, as detailed in 1.15), will also transfer to Covea.

1.13 Jersey policies issued by Sterling will not transfer unless the Scheme is approved by the Royal Court of Jersey. The Jersey Scheme, which provides for the transfer of policies on the same terms as the UK Scheme, is conditional on the sanction of the Scheme by the High Court of England. The hearing of the Royal Court of Jersey will follow that of the Court; however the Jersey Scheme will have an effective date that is intended to mirror the Scheme Effective Date. I understand that under the terms of the English Scheme, the obligations of Sterling to Jersey policyholders will be indemnified by Covea in the event there is a delay in approving the Jersey Scheme until after the English Scheme's Effective Date.

1.14 It is intended that the reserves transferring to Covea will be protected additionally by the parental guarantee already held by Covea by its parent entity MMA IARD Assurances Mutuelles ("MMA IARD"), so as to protect the level of security enjoyed by the existing policyholders before the transfer takes effect. MMA IARD is a parent entity within the Covéa Group. This is further detailed in Section 4.6.

1.15 It is proposed that no policyholders will remain in Sterling following the Transfer. I note the terms of the proposed Transfer contain provisions that any policies of Sterling not transferred under the Transfer will be insured by Covéa Group as appropriate through an indemnity from Covéa Group under the Transfer. The Transfer provides for the possibility of there being a limited number of policies which may be residual to the transfer ("residual policies"), though none are expected. It will be known by the date of the final Court hearing whether there are any residual policies.

The circumstances in which a policy may be residual to the Transfer include where the Court for any reason determines that a policy should not transfer or where Sterling agrees with Covea that a policy should not be transferred. A policy may also be treated as being residual if relevant EEA regulators have not provided the requisite consents/non objection to the Transfer.

In the event of residual policies, Sterling shall remain liable for the policies until any subsequent Transfer can be agreed, retaining the legal obligation to pay its share of the liabilities until a subsequent arrangement can be agreed. A subsequent agreement may include a settlement of outstanding claim or agreement to a subsequent Transfer.

Subject to there being no residual policies, Sterling will be deauthorised following the transfer of its business to Covea and completion of the administrative procedures required to cancel its permission to carry on regulated activities by the PRA, which is expected to occur shortly after the Transfer effective date. Sterling will retain a residual asset sufficient to meet the base capital resources requirement for an authorised insurance company until such cancellation is provided, following which the residual asset will transfer to Covea.

Scope

1.16 As Independent Expert, it is my duty to the Court to consider the impact of the Transfer on the policyholders of Sterling and Covea, along with any other policyholders affected by the transfer. In particular, it is my duty to consider the impact on their security and service levels for their benefits as set out in Appendix 2. In this instance, I have not identified any policyholders other than those of Sterling and Covea to be potentially affected.

1.17 This report does not consider any possible alternative arrangements to those referred to in sections 1.11 to 1.15. I am not aware of any other significant transaction relating to Sterling or Covea other than those set out in sections 1.11 to 1.15.

Reliances

1.18 I understand that my role is to produce a report in a form approved by the PRA for submission to the Court. Whilst I have been assisted by my team, the report is written in the first person singular and the opinions expressed are my own.

1.19 My work has been based on the data and other information made available to me by the Transfer Companies. A list of data and other information that I have considered is shown in Appendix 4.

I have not sought independent verification of data and information provided to me by the Transfer Companies, nor does my work constitute an audit of the financial and other information provided to me. Where indicated, I have reviewed the information provided for reasonableness and consistency and with the benefit of my experience this has not raised any concerns. I note that the information has been provided to me by PRA and FCA approved persons or other members of the senior management of the Transfer Companies or by responsible senior professionals from the Transfer Companies' advisors.

I have met in person or conducted conference calls with representatives of the Transfer Companies to discuss the information provided to me and specific matters arising out of the considerations and analysis conducted. This includes the legal advisers and the tax advisers to the Transfer, where appropriate.

Where significant pieces of information have been provided orally I have requested and received written confirmation.

Use and limitations

1.20 This report must be read in its entirety. Reading individual sections in isolation may be misleading.

1.21 Copies of this report will be sent to the PRA and the FCA (the relevant UK financial regulators), and to the Jersey Financial Services Commission. This report will be used in evidence in the applications submitted to the Court and to the Royal Court of Jersey. It will also be made available to policyholders and other members of the public as required by the relevant legislation and will be made available on the Covea website.

1.22 This report has been prepared under section 109 of FSMA in a form approved by the PRA in consultation with the FCA. This report is prepared solely in connection with, and for the purposes of, informing the Court, the PRA, the FCA and policyholders of the Transfer Companies of my findings in respect of the impact of the Transfer on the security and service levels of policyholders and may only be relied on for this purpose. This report is subject to the terms and limitations, including limitation of liability, set out in my firm's engagement letter of 26 March 2015. An extract from this letter describing the scope of my work is contained in Appendix 2.

This report should not be regarded as suitable to be used or relied on by any party wishing to acquire any right to bring action against KPMG LLP in connection with any other use or reliance. To the fullest extent permitted by law, KPMG LLP will accept no responsibility or liability in respect of this report to any other party.

1.23 In the normal course of conducting my role as Independent Expert, I have been provided with a significant and appropriate amount of information and data about the Transfer Companies' activities and performance. In forming my view as set out in this report, this information has served a necessary and vital contribution. Due to a combination of legal, regulatory and commercial sensitivities some of the information I have relied upon to reach my conclusions cannot be disclosed in a public report such as this. However I can confirm that appropriate detailed information has been provided to me to enable me to form the opinions I express to the Court in this report.

Professional guidance

1.24 This report has been prepared in accordance with the guidance set out in Part 35 of the Civil Procedure Rules and the accompanying practice direction, including the protocol/guidance for the instruction of experts to give evidence in civil claims (2014) issued by the Civil Justice Council.

This report also complies with the guidance for transfer reports set out in the Statement of Policy issued by the PRA in April 2015 entitled "The Prudential Regulation Authority's Approach to Insurance Business Transfers" and in Chapter 18 of the FCA Supervision Handbook, in particular, sections 18.2.31 to 18.2.41 inclusive, regarding the content and considerations of the report.

In preparing this report I have taken into account the requirements of the Technical Actuarial Standards ("TASs") issued by the Financial Reporting Council. The TAS Standards which apply to the work performed in preparing this report are Transformations, Modelling, Data, Insurance and Reporting Actuarial Information. In my opinion, there are no material departures from any of these TASs in my performance of this work and this report.

I understand that my duty in preparing my report is to help the Court on all matters within my expertise and that this duty overrides any obligations I have to those instructing me and/or paying my fee. I confirm that I have complied with this duty.

Terminology

1.25 In my discussion of the effects of the proposed Transfer on the Transfer Companies concerned, I use various technical terms. The definitions of these terms as used in this report are contained in the Glossary in Appendix 5.

1.26 I make reference throughout this report to financial items or events that are material or immaterial. I consider an event immaterial if the expected impact of the event is very small, such that it would not influence the decisions of a reader, either on its own or in conjunction with other immaterial events. This could be because the event has a very low probability of occurring, a very low financial impact if it did occur, or a combination of these. Similarly a financial item (such as an insurance claim reserve for a particular line of business) is immaterial if its value is very small in the context of the whole, and the probability of significant variability in the value of that item in the context of the whole is similarly small. Conversely material items and events would be of such a size that they could influence the decisions of a reader of this report, and where I have identified these I have considered them specifically in my discussion of the effects of the proposed Transfer.

2. Executive Summary & Conclusions

Overview of Transfer

2.1 This report considers the impact of the proposed transfer of the insurance business of Sterling to Covea. The transferring policyholders are a mixture of private individuals and businesses, holding policies largely relating to creditor, household, and commercial insurance, and a small amount of personal accident business.

As a consequence of the Transfer the insurance obligations and other assets and liabilities of Sterling will transfer to Covea. The existing policyholders of Covea are a mixture of private individuals that have purchased motor or home policies or businesses that have purchased commercial property and liability policies.

Covea will receive assets with an estimated value of £134m as at 31st December 2014. The estimated claims liabilities transferring, of £47m, represent 10% of Covea's existing claims liabilities. Based on business written in 2014 the inclusion of Sterling's business will increase Covea gross written premium by 30%.

2.2 Prior to the Transfer, Sterling policyholders do not benefit from any intra-group guarantee.

After completion of the Transfer, it is intended that the Sterling policyholders will receive the benefit of Covea's exsiting parental guarantee, as described below.

Covea policyholders benefit from the guarantee provided by one of the ultimate parents MMA IARD Assurances Mutuelles ("MMA IARD"), which is one of the insurance mutuals in the Covéa Group. The business structure is detailed below in section 3.

This guarantee responds in circumstances where Covea is unable to meet its contractual insurance obligations to policyholders. The guarantee has been in place since 2004; however it may be terminated with respect to new policies at 90 days' notice. Covea intend that the guarantee will continue after the Transfer, and that policyholders transferring into Covea fall within its scope after the Transfer comes into effect. This change is likely to provide additional security to transferring Sterling policyholders after the Transfer comes into effect. However given the significant additional security that will be received at the time of the transfer, my view is that the additional security provided by the guarantee is marginal. My overall conclusion would be the same whether or not the parental guarantee extended to these incoming policyholders and whether or not the guarantee is legally or economically effective in practice.

2.3 The Transfer is primarily a legal and financial re-organisation of the businesses operating under the Covéa Group brand and will not result in any significant changes to the administration of the Covéa Group business.

It is intended that Sterling will be deauthorised following approval of the Transfer.

2.4 Policyholder communication

Sterling intends to communicate details of the Transfer to its policyholders. I have set out my understanding of the proposed approach to communicating the Transfer to policyholders in Appendix 7.

I consider the proposed approach to communicating the Transfer to be appropriate, reasonable and proportionate, but I note and accept that the Court is the ultimate arbiter on this issue. I also consider that the non-circularisation to specific groups of policyholders (as set out in appendix 7) is appropriate, reasonable and proportionate taking account of the publicity announcements in a range of daily newspapers and given the information to be posted on the Covea website.

Background of the Transfer Companies

2.5 Covea is a UK insurance company, wholly owned by Covéa Group, through its UK holding company MMA Holdings UK plc. Covea writes Motor, Household and Commercial Lines business, all of which is distributed entirely through brokers and intermediaries.

Sterling is a UK insurance company also wholly owned by Covéa Group, writing policies to businesses, the general public, and mid to high net worth individuals. It is mainly focussed on

UK creditor, household, and commercial insurance, with a small amount of personal accident business.

It is considered to have an adequate financially stable outlook by market observers – by way of example, it held a “BBB+” credit rating from Fitch Ratings before the acquisition by Covéa Group.

While Covéa Group is based in France, it operates in Europe (with a small amount of policies in US and Canada) through a network of branches and subsidiaries including, in the UK, the Transfer Companies. Covéa Group and Covea hold an “A” credit rating by Standard and Poor’s.

Purpose of the Transfer

2.6 The proposed Transfer constitutes an internal reorganisation of the UK subsidiaries of the Covéa Group, thereby enabling more effective management of capital following the introduction of the new prudential regulatory regime known as Solvency II. It will consolidate Covéa Groups’ presence in the UK non-life market into one main vehicle.

2.7 My approach to assessing the likely effects of the Transfer on policyholders is to:

- Understand the businesses of the entities affected by the Transfer; and
- Understand the effect of the Transfer on the assets and liabilities of the companies and businesses involved.

The above stages are contained in sections 3 and 4 of this report.

Having identified the effects of the Transfer on the various companies and businesses, I then do the following in section 5:

- Identify the relevant groups of policyholders within each company;
- Consider the impact of the Transfer on the security of each group of policyholders and other stakeholders; and
- Consider other non-financial aspects of the impact of the Transfer (for example, policyholder service).

I note that Sterling and Covea operate in markets which may require market participants to maintain higher standards of financial security than the regulatory minimum in order to continue to access new business. Both Transfer Companies are part of the Covéa Group, a leading French mutual insurance group that writes business in Europe, and benefit from this association (for example referencing of their ownership in their marketing).

Given the levels of capital cover (as a proportion of the regulatory minimum requirement) held by Covea, I expect the chance that Covea would not be able to meet its respective future obligations in full to be remote, and if this is as expected, no Sterling policyholder will suffer detriment to their security if the Transfer proceeds. Sterling has lower capital cover, though it is small compared to Covea, and will benefit from the economies of scale and diversification that transferring to Covea brings. Sterling currently has sufficient capital to meet all of its regulatory capital requirements in the current solvency capital regime that is operating in the UK.

From 1st January 2016 a new Europe-wide solvency capital regime (“Solvency II”) will be introduced and will apply to both Covea and Sterling. Under this new regime Sterling is expected to become substantially more capital constrained. Therefore I have focussed my analysis on the level of capital cover over and above regulatory and economic capital requirements for the Transfer Companies, and how these change as a result of the proposed Transfer. The above stages, along with an explanation of the Solvency II regime, are contained in section 5 of this report.

2.8 Financial and economic information considered

In order to consider the effect of the proposed Transfer on each of the companies and groups of policyholders concerned, I have been provided with comparative information for each legal entity, including:

- Balance sheet information based on the most recently audited balance sheet figures as at 31 December 2014;
- External actuarial reserve review for Covea as at 31 December 2014;
- Estimates of the regulatory capital required for each entity as at 31 December 2014; and
- Internal management information provided over the course of preparing this report.

I will issue a supplemental report containing the most up-to-date financial information prior to the final hearing. I do not expect at the time of writing this report any material changes to the market or environment within which the Transfer Companies operate that may change my conclusion (for example a significant change to capital cover caused by a large claims event). Regardless of these expectations, I will issue a supplemental report to address any such developments and any policyholder responses.

In forming my opinion, I have conducted a number of interviews with key personnel responsible for core functions in the Transfer Companies (a complete list of interviewees is provided in Appendix 6), and I have placed reliance on, amongst other information, estimates of economic risk provided by the Transfer Companies. In this report I use the term "economic risk" to describe the degree to which the economic position of policyholders may be adversely affected by potential future events (such as catastrophic claims or a crash in equity values). This is considered through estimating the capital required to be held by the Transfer Companies, such that the companies are able to fulfil their policyholder obligations in the event of an extreme event or scenario. I describe the measures of economic risk I have used in performing my analysis in more detail in sections 5.11 and 5.12. In order to satisfy myself that these estimates are an appropriate basis on which to form an opinion, I have considered:

- The appropriateness of the methods used by the Transfer Companies to calculate the estimates of economic risk; and
- The impact of a set of specific severe adverse events on each of the Transfer Companies pre and post Transfer in order to gain comfort that, at a high level, the economic capital estimates are reasonable.

The above stages are contained in section 6 of this report.

Key Assumptions

2.9 In conducting my analysis I have assumed the following:

- There will be no policyholders left in Sterling after the Transfer, as all existing policyholders of Sterling will become policyholders of Covea as a consequence of the Transfer. Whilst the Transfer allows for the possibility of residual policies, none are expected at this time, and any residual policies would be known before or at the date of the final Court hearing. In the event that such policies are identified I will address them in a supplemental report;
- The Transfer is to be broadly tax neutral for both of the Transfer Companies;
- It is not planned that there will be any reduction in the aggregate level of capital held in the Transfer Companies or any increase in insurance liability or risk exposure as an immediate

consequence of the Transfer that would not have occurred were the Transfer not to proceed;

- The same level of assets and liabilities will exist within the Transfer Companies in aggregate after the Transfer as before the Transfer (when valued on the same accounting basis before and after);

- Covea will continue to operate and has no current intentions to cease underwriting or carry out a further restructuring of their business as a consequence of the Transfer;

The above assumptions underlie the analysis and conclusions in my report. If these assumptions were to change my opinion may also change. At the time of writing my report the above assumptions are the current intentions for the Transfer and the Transfer Companies and I have received written representations from the Transfer Companies substantially similar to Appendix 3 confirming my understanding.

Findings

2.10 The findings of my report are summarised below and apply equally to the English and Jersey transfers:

- I have identified two distinct policyholder groups. These are:

  i) The existing insurance policyholders of Sterling that will transfer to Covea; and

  ii) The existing policyholders of Covea.

I have considered using other policyholder groupings within my report as summarised below, however I have not identified any material difference in impact on policyholders when split differently to that above. I considered the following alternative groupings but came to the conclusion that each subsets interests were aligned:

  i) Insurance and Reinsurance policyholders;

  ii) Policyholders of compulsory and non-compulsory insurance; and

  iii) Policyholders related to latent risks and the remainder of book

- With respect to the Sterling policyholders transferring to Covea under the Transfer, I do not expect any adverse impact on policyholder security as a consequence of the Transfer. In addition to my findings in this report, I note that Covea has a higher credit rating (A from Standard and Poor's credit agency) than that of Sterling (BBB+ from Fitch credit agency), and the level of capital cover exhibited in meeting the various regulatory and economic capital requirements for Covea is higher than the equivalent for Sterling. Because these ratings are given by different companies using different methodologies they are hard to compare, so I have not relied on the existence of these ratings in forming my conclusions.

- Additionally the policies will continue to be subject to Prudential Regulatory Authority ("PRA") and Financial Conduct Authority ("FCA") regulation, and those who currently receive protection from the UK Financial Services Compensation Scheme ("FSCS") will continue to do so. In addition, although I do not rely upon this to reach my opinion in this Report, these policyholders are intended to be further protected by a guarantee from MMA IARD (which also has an A credit rating from Standard & Poor's).

- With respect to the existing policyholders of Covea, I expect there to be an immaterial adverse impact on policyholder security as a consequence of the Transfer. This is due to a slight dilution of the economic capital coverage from transferring in the Sterling portfolio, though the dilution is immaterial because of the relative size of the Sterling liabilities. The probability that policyholders will not be paid in full will remain remote. No change is expected to the external credit rating of Covea as a result of the Transfer.

- There is an immaterial proportion of the Sterling policyholders who are reinsurance policyholders. Whilst these policyholders rank behind insurance policyholders in the event of an insolvency situation, I do not consider them as a separate policyholder group because I consider the possibility of insolvency of either Transfer Company to be remote and that they already rank last in terms of policyholder creditors if the Transfer were not to proceed.

- Legacy risks exist in both Transfer Companies, but in neither case do they make up a material proportion of the reserves or resources available for paying claims. I discuss this in more detail in section 5.2.2. Given the relative capital positions of the Transfer Companies I do not distinguish between legacy and ongoing business policies as their interests as policyholders are aligned in each case.

- I expect there will be no substantial change in the standards of service which the policyholders will receive as a consequence of the Transfer, as services including Claims, IT, Finance, Actuarial, HR and Legal will continue to be provided post Transfer via the same services teams in many cases and where not, they are held to the same standard as pre-transfer. The culture of the Transfer Companies is difficult to assess due to being so subjective, but from my interactions with management it appears very similar in each of the Transfer Companies. In the course of my interviews management of the Transfer Companies have repeatedly stated their desire to ensure that the culture and process will either stay the same or improve, particularly where the service teams will be changed. Underwriting personnel will also remain unchanged.

- Covea intend to maintain current claims handling procedures, with the bespoke High Net Worth claims service being one of the attractive features of the Sterling purchase. There may exist changes to the claims handling administration on other lines of business for both the Covea and Sterling Policyholders, however these are a consequence of the integration of Sterling into Covea and not the Transfer. The regulatory oversight which the policyholders are subject to will remain unchanged following the Transfer and integration, with the FCA continuing to be primary regulator and FSCS continuing to provide protection to policyholders that previously received it prior to the changes. Following the Transfer, it is intended that there will be no changes to the systems and processes used, the contact details needed to make a claim or amend a policy, or the locations in which they are dealt with as a direct result of the Transfer, and therefore there will be no anticipated impact on policyholders with regard to administration. In summary, from the policyholders point of view the systems and people will remain the same post Transfer and therefore there will be no anticipated impact on policyholders with regard to service levels.

- I summarise my reasoning and findings with respect to each group of policyholders in section 7.

Conclusion

2.11 I have considered the Transfer and its likely effect on each of the policyholder groups. I have concluded that the risk of any policyholder being adversely affected by the proposed Transfer is sufficiently remote for it to be appropriate to proceed with the proposed Transfer as described in this report.

Expert’s declaration

2.12 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.

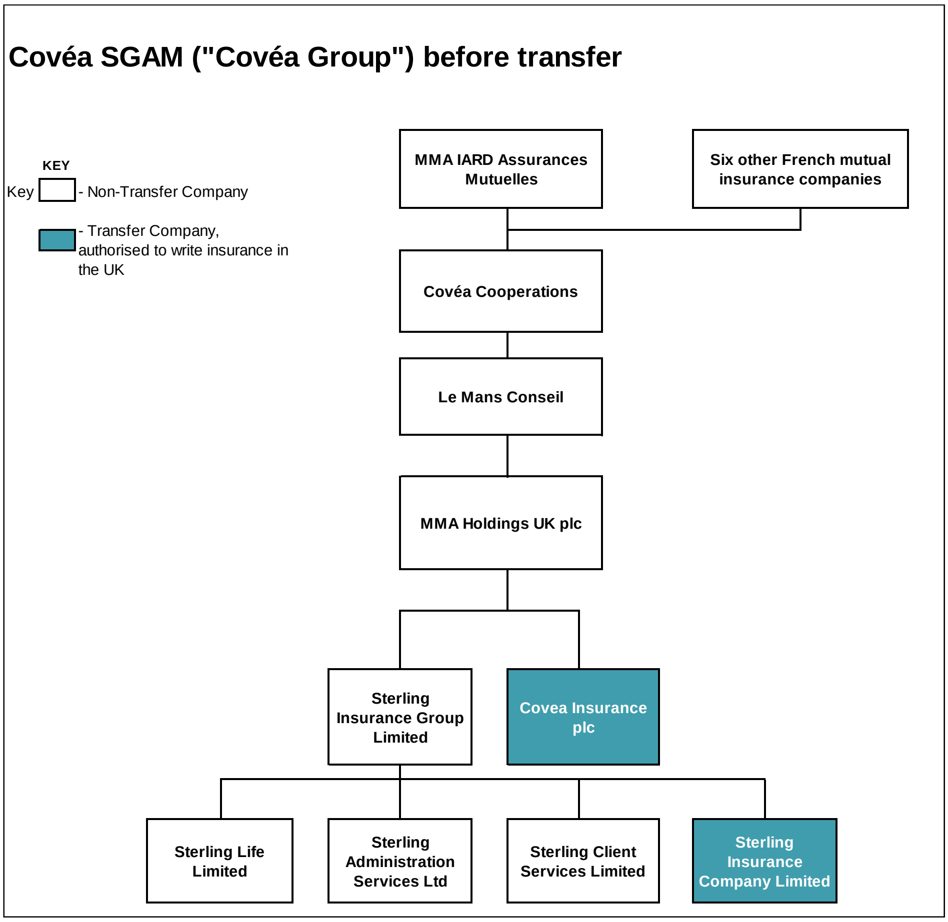
Philip Tippin
Fellow of the Institute and Faculty of Actuaries
Partner, KPMG LLP
12 August 2015

3. Background

Covéa Mutual Insurance Group

3.1 Covéa Société de Groupe d'Assurance Mutuelle (SGAM) is an entity which consolidates the business of its participating mutuals. It operates as a vehicle which brings together three very large mutual groups – MMA, MAAF and GMF. Its businesses include property and liability insurance, life insurance and a range of associated activities including assistance and asset management businesses

Seven French mutual companies together own the French subsidiary Covéa Cooperations which in turn wholly owns Le Mans Conseil. Le Mans Conseil wholly owns the UK subsidiary MMA Holdings UK plc. The seven mutuals therefore ultimately controls the Transfer Companies through MMA Holdings UK plc. Covéa Group reported a gross earned premium of €16.5 billion and a net income of €961 million at 31st December 2014.



Covea Insurance plc ("Covea")

3.2 Covea is a UK general insurance business operating in the personal motor, household, and commercial property and liability insurance UK markets. It was established in 1958 under the name Norman Insurance Co Ltd which subsequently became MMA Insurance PLC, and grew noticeably through transferring in the business of Provident Insurance plc and Gateway Insurance Company on 1 October 2012. It was renamed Covea Insurance plc following the 2012 transfers and has two main offices, one in Reading and one in Halifax.

3.3 Commercial business is sourced through intermediaries where the intermediary is usually the first point of contact for the policyholder in the event of a claim.

3.4 Covea is authorised by the PRA, and currently regulated by the PRA and the FCA, and is a member of the FSCS, a statutory scheme funded by members of the UK financial services industry that provides protection to policyholders. Under current FSCS rules, claims made by UK private individuals and compulsory commercial policyholders are protected in the event of a default of a covered insurer. However, most non-compulsory commercial policyholders are not covered by the FSCS.

The table below provides an overview of the annual financial performance of Covea from 31st December 2011 to 2014:

Covea (£000's)	2014	2013	2012	2011
Net Earned Premium	372,546	369,437	288,094	219,074
Profit / (Loss) after tax	17,060	12,435	4,336	6,359
Gross Insurance Liabilities	(718,643)	(717,550)	(800,684)	(338,753)
Total Liabilities	(746,140)	(739,881)	(833,423)	(352,322)
Total Assets	963,790	944,490	1,032,509	447,668
Net Assets	217,650	204,609	199,086	95,346

Source: Annual Report and Financial Statements, UK GAAP

Figures for 2012 contain twelve months of trading of the former MMA Insurance plc business and three months of the Provident Insurance plc and Gateway Insurance Company business. Figures from 2011 correspond to MMA Insurance plc business only.

Covea's profits and net assets have increased steadily over the past few years.

Sterling Insurance Company Limited ("Sterling")

3.5 Sterling is a direct subsidiary of Sterling Insurance Group Limited. It is wholly owned by the Covéa Group and writes UK non-life insurance comprising creditor, household and commercial insurance. It also writes a small amount of personal accident policies. Its head office is in West Malling, Kent.

Sterling Insurance Group Limited is the parent company of Sterling. Sterling was renamed from Albion Insurance Company in July 2001, and Sterling Insurance Group Limited and its subsidiaries were acquired by Covéa Group in February 2015. Sterling Insurance Group Limited is a non-insurance entity, with the majority of net assets held relating to its two regulated subsidiaries, Sterling Insurance Company Limited and Sterling Life Limited.

On 1 May 2015, CUNA Mutual Insurance (Europe) Limited, an Irish regulated non-life insurance company which is authorised by the Central Bank of Ireland ("CBI"), was transferred to Sterling via a portfolio transfer similar to the Part VII process through the Irish High Court. As a result of this Portfolio Transfer, Sterling received €700k (£580k) of non-life accident, sickness, injury and unemployment insurance liabilities written in both the UK and Ireland.

Sterling sources its business through high street retailers, regional brokers and affinity brands with its household insurance geared mainly towards the mid to high net worth sector or individuals. The commercial insurance it sells is mainly multi section and package products to meet the needs of premises-based businesses, offices and retailers.

The table below provides an overview of the annual financial performance of Sterling from 31st December 2011 to 2014:

Sterling (£000's)	2014	2013	2012	2011
Net Earned Premium	93,377	91,238	67,081	67,796
Profit / (Loss) after tax	3,808	4,289	2,896	6,138
Gross Insurance Liabilities	(120,158)	(114,379)	(109,104)	(104,461)
Total Liabilities	(134,058)	(130,418)	(125,329)	(118,823)
Total Assets	171,712	164,254	160,708	154,453
Net Assets	37,654	33,836	35,379	35,630

Source: Annual Report and Financial Statements, UK GAAP basis

As with Covea, Sterling is authorised by the PRA, and currently regulated by the FCA and PRA. It is a member of the FSCS so that claims made by UK private individuals and commercial policyholders of compulsory insurance policies are protected in the event of a default of a covered insurer.

Sterling's net assets have been largely stable since 2011. Sterling's profits have remained broadly stable as a percentage of net earned premium since 2012.

Insurance business of the Transfer Companies

3.6 As a consequence of the Transfer the insurance obligations and other assets and liabilities of Sterling will transfer to Covea.

A split of the different types of policies written by Sterling is shown below.

Transfer Companies' Business Profile as at 31/12/2014							
£000s	Sterling						
Class	Property	Creditor	Personal Accident	Public Liability	Employers Liability	Total	Covea Total
Gross Earned Premium (2014)	77,824	28,864	8,294	11,110	4,059	130,151	405,275
Net Earned Premium (2014)	70,408	28,827	8,294	9,894	3,545	120,968	372,546
Gross Claims Reserves (£000s)	22,505	1,811	1,541	10,925	10,062	46,844	492,164
Net Claims Reserves (£000s)	20,355	1,807	1,541	9,473	9,148	42,324	337,282

Source: Internal Management information

At the time of the Transfer, it is expected that there will be 533,930 unexpired policies transferring to Covea.

It is worth noting that of the £47m worth of open claims reserves, gross of reinsurance, transferring to Covea, there are only £0.9m of claims reserves relating to the legacy latent and marine business.

The open market commercial and property (mostly of medium to high net worth individuals) business in particular is expected to complement Covea's existing business.

3.7 Business written by Covea

Covea currently writes a range of insurance risks including motor, household, and commercial lines, writing £445 million of premium gross of reinsurance in 2014.

The majority of Covea's risk exposure relates to private motor insurance (54% of premiums in 2014) with the remainder comprising commercial lines (23% of premiums in 2014) and household (16% of premiums in 2014), and miscellaneous products.

Covea has generally experienced improving claims performance over recent years, believed to be due to the impact of the 2013 Legal Aid, Sentencing and Punishment of Offenders Act ("LASPO") reforms. However for business written in 2014 premium rates have been reduced in anticipation of the effects of LASPO.

The LASPO reforms had the double effect of accelerating payment of and reducing legal costs associated with motor insurance claims. The effect of this was felt over the whole UK motor insurance market.

3.8 Business written by Sterling

The predominant policy types written by Sterling are creditor, household, and commercial insurance policies, which account for 20%, 41%, and 32% of premium respectively in 2014.

These are written through a mixture of retail policies to individual policyholders and commercial policies.

Although Sterling offer customers creditor policies which typically make debt repayments on the customer's behalf in the event of death, disability, job loss or critical illness, the life insurance element of the policy is actually underwritten by Sterling Life Limited, a sister subsidiary within Sterling Insurance Group Limited. This life insurance element of the creditor policies will remain unchanged with Sterling Life Limited following the Transfer and therefore I do not consider it further in this report.

In addition Sterling writes personal accident insurance which accounted for 6% of premium in 2014. In total, Sterling wrote £133 million of premium gross of reinsurance in 2014. The number of non UK policyholders within the book is around 6% of the total number of policyholders within Sterling (approximately 3% of the written premium in 2014) with the vast majority located in Ireland.

3.8.1 Run off business

Sterling has 12 policies in run off that still have claims that are yet to settle. These relate to US Asbestos exposure, written from one particular co-insurance arrangement during 1963 and 1964 with estimated net reserves of £68k in Sterling, and one further arrangement with estimated net reserves of $52k in US dollars. Although this business is still technically an open exposure since claims take a significant period to be notified and settle, this exposure has had no new claims notified since 2012 and the reserves are immaterial compared to the wider Transfer liabilities.

Similarly, Sterling has a small exposure to Marine, Aviation and Transport policies they previously underwrote, from a portfolio which has been in run off since 1999. This business may take significant time to settle, although Sterling has not received any new claims notifications since 2012. There will be no change to the treatment of these policies due to the transfer.

3.8.2 Payment Protection insurance

Sterling has exposure to Payment Protection insurance ("PPI") mis-selling claims arising prior to 14 January 2005, as a result of it selling largely through intermediaries. Sterling is only liable where the distributors were agents or sub-agents of Sterling and The Financial Ombudsman Service has ruled that Sterling is responsible for compensating policyholders (as a result of the agency relationship). PPI was a type of creditor insurance sold to policyholders taking out mortgages, loans and credit cards, to protect the policyholder in the event that sickness, unemployment or similar occurrences would render them unable to pay their debts. However, across the UK insurance market many policies were sold without policyholders being made sufficiently aware of the details, or were sold inappropriately due to conduct failings by the intermediaries. It is to be noted that while PPI claims may have a life element (insured by Sterling Life Limited, the sister company of Sterling) only liabilities and/or claims relating to the mis-selling of general insurance business (i.e. that written by Sterling) are captured under the Transfer.

In December 2010, Sterling commenced writing credit card payment protection insurance with MBNA (a subsidiary of Bank of America Corporation), which covered both UK and Ireland exposures. The premiums and claims were 100% reinsured by a quota share, with Sterling remunerated by a fronting fee. The reinsurance provider was another Bank of America subsidiary. On 31 December 2012, this reinsurance was commuted, and the exposure transferred to Sterling. Policies after 31 December 2012 continue to be written by Sterling without reinsurance, with £14.9m in premium in 2014.

3.8.3 International risks

Outside of the UK, and taking account of Sterling's services/branch operations and the location of agents who procured its marine business, Sterling is likely to have written business in the following countries: Republic of Ireland, Denmark, Austria, Belgium, France, Germany, Greece, the Netherlands, Hong Kong, the US, Norway, Spain, France, Italy, Luxembourg, and Portugal. There are also some policyholders in the Isle of Man, Jersey and Guernsey. As shown in the below table, the vast majority of written premium relates to UK policyholders between 2012 and 2014 – the main countries for policyholders outside the UK were Spain, France and Ireland.

Geographical GWP (£000s)						
Geographical Area	**2012**		**2013**		**2014**	
United Kingdom	138,066	95.2%	129,414	96.5%	129,776	97.2%
Other Europe	6,994	4.8%	4,684	3.5%	3,682	2.8%
- Household	*105*	*0.1%*	*112*	*0.1%*	*113*	*0.1%*
- Creditor/ PA	*6,890*	*4.7%*	*4,572*	*3.4%*	*3,570*	*2.7%*
Total	**145,061**	**100.0%**	**134,098**	**100.0%**	**133,459**	**100.0%**

Source: Management

3.9 Covea will receive Sterling's existing insurance policies, including the small proportion located outside the UK. As at 31 December 2014, the claims reserve related to this non-UK business was estimated at £1.0m gross of reinsurance, and so represents a relatively immaterial amount of the transferring reserve.

Reinsurance programmes

3.10 The Transfer Companies have purchased reinsurance protections to mitigate their insurance risks. These protections are typical of those used by other insurance companies for the types of insurance business underwritten by the Transfer Companies.

3.11 The nature of these protections is described below:

- Catastrophe Reinsurance is purchased by both Covea and Sterling to mitigate the effect of large claims events. Such reinsurance is designed to mitigate the financial impact of catastrophic events that may lead to material claims across a number of different types of insurance and a number of entities – for example, severe weather affecting large areas of the UK leading to multiple property damage claims from wind damage and flooding.

- Excess of Loss Reinsurance is purchased by Covea and Sterling to mitigate the effect of individual large claims such as high value bodily injury claims arising from Motor business in the case of Covea, and high value property or liability claims in the case of both Covea and Sterling.

- Sterling additionally has proportional reinsurance arrangements in place whereby it shares a percentage of all premiums and claims with a reinsurer.

- Following the Transfer, the reinsurance arrangements of Sterling will be transferred with the reinsured policies, such that both Covea and former Sterling policyholders will still be protected by the same reinsurance, from the same reinsurers as pre transfer.

Intra-group guarantees

3.12 MMA IARD currently provides a parental guarantee which covers obligations of Covea to policyholders arising under insurance contracts written by Covea.

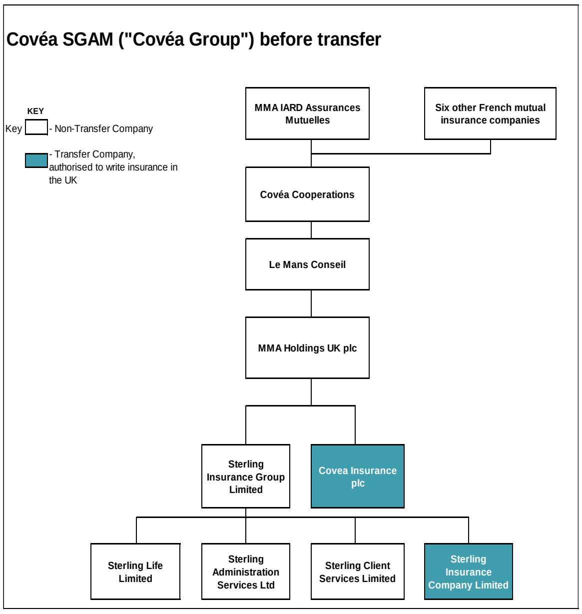
It is intended Sterling policyholders will also receive the benefit of the current parental guarantee to Covea from MMA IARD, after completion of the Transfer.

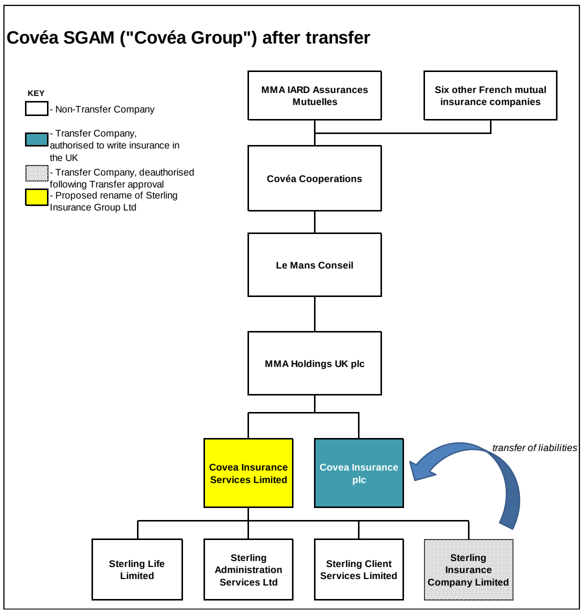
3.13 Sterling has no guarantee in place within the group, with policyholders relying solely upon the entity resources.

4. Effect of the Transfer

Effect of the Transfer on group structure

4.1 As a consequence of the Transfer the insurance obligations and other assets and liabilities of Sterling will transfer to Covea. This includes all liabilities of Sterling, whether insurance-related or otherwise, including any mis-selling claims related to General Insurance liabilities that may arise. Following which Sterling is intended to be deauthorised. The structure charts below identify the before and after transfer group structure (with relevant entities to the Transfer) highlighting which entities will retain insurance liabilities after the transfer.





Following the Transfer, it is intended that the policyholders of Sterling transferring to Covea will receive the benefit of a parental guarantee provided by MMA IARD.

In the event that Covea were unable to pay the claims arising from its policies, including the transferred policies, then the capital of MMA IARD would be available to meet further deterioration of these reserves. I believe that the possibility of Covea not paying claims is extremely remote, and therefore do not rely on the existence of this guarantee in forming my conclusions.

Although Sterling lose an apparent level of security through no longer being a subsidiary of Sterling Insurance Group Limited, this is a holding company with small liquid assets, and the capital resources of Covea are materially larger.

Please see section 4.7 below for further details on exact nature of the Guarantees.

Effect of the Transfer on Transfer Company balance sheets

4.2 I have carried out my analyses based on figures as at 31 December 2014 for the purposes of this Independent Expert Report, however I will update the analyses to 30 June 2015 in a supplemental report when these updated figures are available.

4.3 There are no material differences between the accounting treatments of items in the statutory accounts of the Transfer Companies as presented in Section 3, with all figures reported on a UK GAAP basis.

4.4 The table below illustrates the financial position of the Transfer Companies following the Transfer based on the financial position of the Transfer Companies at 31 December 2014:

As at 31 December 2014 £000's	Covea (pre transfer)	Sterling	Covea (post transfer)
Assets			
Investments and cash	642,758	105,085	747,843
Reinsurers share of provisions	154,884	5,122	160,007
Other assets	166,148	61,505	227,653
Total Assets	963,790	171,712	1,135,503
Liabilities			
Insurance Liabilities	507,851	56,607	564,458
Unearned Premium Reserve	210,792	63,551	274,343
Other Liabilities	27,497	13,900	41,398
Total Liabilities	746,140	134,058	880,198
Net Asset Surplus	217,650	37,654	255,304

Source: Annual Report and Financial Statements 2014, Covea proposed combined business plan, UK GAAP

The net asset position of Covea is £218 million.

Under the proposed Transfer, Covea will receive the insurance and reinsurance policies of Sterling. Assuming the Transfer had occurred at 31 December 2014 the resulting balance sheet would therefore show £1,135 million of assets, £880 million of gross liabilities and increased net assets position of £255 million.

4.5 Cost and tax impact of the Transfer

I have received written confirmation from the management of Sterling and Covea that no significant tax liabilities will be realised as the result of the Transfer, following advice from independent advisers. Whilst there are some potential tax liabilities that may emerge, it is estimated currently that the Transfer will be broadly tax neutral (that is to say will not create a significant tax asset or liability), and therefore I am satisfied that they would not be sufficient to change any of my conclusions within this report. Covea and Sterling have performed due diligence including commissioning analysis from specialist tax advisors on the tax implications of the Transfer in order to make this statement.

I understand that most costs associated with the Transfer will be incurred whether or not the Transfer proceeds, as the majority of these costs relate to activities occurring prior to the sanction hearing (for example, with respect to legal fees and policyholder communications). Therefore I identify no significant additional costs arising from the implementation of the Transfer. Covea will meet these costs.

4.6 Reinsurance

Reinsurance contracts entered into by Sterling in respect of prior periods are intended to transfer to Covea as a consequence of the Transfer. Each Transfer Company is protected by similar reinsurance arrangements for business written in 2014 and this will not change as a consequence of the Transfer. I understand that the benefit of reinsurance protections of Sterling, which as the agreements/arrangements are governed under English law and referenced under the scheme, will transfer along with the underlying policy exposures under the terms of the Transfer, as permitted by the powers provided in FSMA.

The only material change to Covea's reinsurance will be a change to the terms of the catastrophe reinsurance held by Covea in order to reflect the exposure of the post transfer business.

4.7 Guarantees

Covea policies benefit from a guarantee provided by MMA IARD. This guarantee responds in circumstances where Covea is unable to meet its contractual insurance obligations to policyholders. The guarantee has been in place since 2004, however may be terminated with respect to new policies at 90 days' notice.

Covea intend that the guarantee will continue after the Transfer, and that policyholders transferring into Covea fall within its scope after the Transfer comes into effect. This change is likely to provide additional security to transferring Sterling policyholders after the Transfer comes into effect, however given the significant financial resources expected at the time of the transfer, my view is that the additional security provided by the guarantee is marginal. My overall conclusion would be the same whether or not the guarantee is extended to these incoming policyholders and whether or not the guarantee is legally or economically effective in practice.

4.8 Dividends and capital structure

It is expected that any surplus assets in Sterling, being assets in excess of the transfer of reserves, will be passed to Covea as part of the Transfer, subject to a regulatory minimum requirement remaining in Sterling. This minimum requirement will remain in Sterling until Sterling is deauthorised, when it will then pass to Covea. As a consequence of the Transfer the capital of Covea will increase to reflect the combined capital resources of the Transfer Companies. Management of Covea have confirmed to me that there is no intention that the assets of Covea be distributed, whether by way of special dividend or other capital distribution method, as a result of the Transfer occurring. I note that Covea intend to continue to pay dividends in the normal course of business out of future profits.

Non-financial effect of the Transfer

4.9 Executive management

The combined group is in the process of integrating the businesses of Covea and Sterling Insurance Group Limited following Covéa Group's acquisition of Sterling Insurance Group Limited, including restructuring the executive management team of the combined business in order to build a unified management team. As a consequence several senior management appointments have been announced, including a single chief executive officer for the combined business. The restructuring of the executive management is occurring regardless of the Transfer, being a part of the integration of the Sterling business following acquisition.

4.10 Administration of the business

Sterling employs no staff itself. At present Sterling uses the services of Sterling Insurance Group Limited in the administration and operations of its business, including underwriting and claims.

The vast majority of Covea administration is currently conducted in house. Covea's liability claims handling is currently outsourced but is intended to be brought in house as part of the ongoing integration of Sterling into Covéa Group.

With the integration of Sterling within the Covéa Group, the administration and operational services used by the Transfer Companies are being organised to create a unified business model, as would be expected following an acquisition. I understand that the current Service Level Agreements for each business will remain the same. There will be no change for the transferring policyholders between the systems and processes used, the contact details needed to make a claim or amend a policy, or the locations in which they are dealt with as a direct result of the Transfer, and therefore there will be no anticipated impact on policyholders with regard to administration.

It is proposed that Sterling Insurance Group Limited will be renamed as Covea Insurance Services Limited, and will employ the underwriting, administration and other service staff of both Covea and Sterling Insurance Group post transfer.

These administrative changes are all being introduced as part of the integration programme running with Covea and Sterling following the acquisition. Whilst they represent changes to the way things are currently carried out, they will be occurring whether or not the Transfer occurs.

4.11 Contractual arrangements

I understand that the Transfer is to have no impact on contractual terms to insurance policies, other than changing the party to the contract from Sterling to Covea. In addition, I understand that the Transfer is intended to have no impact on contractual terms and arrangements with third party contracts, other than changing the party to the contract from Sterling to Covea.

I understand that there could be a number of policies subject to the proposed Transfer that include auto-renewal terms. For these policies these terms will remain on the same basis after the Transfer as the contracts will hold as before; the only difference will be the change in insurer. There are no provisions in the Transfer which would alter the terms on which policies would be renewed. The process used to come to a premium will not change from that currently followed by Sterling.

Sterling Executives' contracts including incentives will be appropriately aligned with those of current Covea Insurance Executives as part of the wider integration project.

4.12 Regulatory arrangements

Both Sterling and Covea's primary regulators are currently the PRA and the FCA, so there will be no regulatory change as a result of the Transfer.

The policyholders of Sterling that are eligible for protection under the FSCS will retain this protection in the event that claims cannot be paid in full out of current reserves, capital, reinsurance and parental guarantees. In practice there will be no change to any policyholders with regard to their protection under the FSCS. Similarly no policyholders' right of access to the Financial Ombudsman Service will change as a result of the Transfer.

4.13 Business mix

Covea have exposure to Periodic Payment Orders ("PPOs"), including a number of settled PPOs, which potentially impact a number of Covea's classes of business; particularly motor liability classes and other commercial liability classes. A PPO is a court order to pay an accident victim's compensation through an annual payment for life rather than as a lump sum. PPOs are awarded as compensation following injury. This creates the potential for very long term exposure (in excess of 20 years) and exposure to a range of risks including those arising from future investment returns, economic factors such as inflation and longevity risk. Sterling also currently has one settled PPO on its liability book, though this is reserved to policy limits and is therefore not subject to the same uncertainty around inflation and mortality risk as associated with the unlimited covers available for motor policies.

Covea has a relatively small exposure to asbestos through a similar portfolio of legacy business to that on the Sterling balance sheet, such that the transfer of this business into Covea does not necessarily bring a new risk to the existing policyholders. There will be no change to the treatment of these policies because of the transfer.

Neither of these instances lead to either of the Transfer Companies being exposed to a new type of risk to which they have already not been exposed.

5. Potential impact of Transfer on stakeholders

Overview of analysis performed

5.1 In considering the impact of the proposed Transfer on the security of policyholders, I have focused my analysis on comparing the financial resources available to support policyholders in the event the Transfer proceeds and also in the event it does not. I have followed a five step approach as outlined below:

(i) I have considered the specific circumstances of each policyholder group.

(ii) I have considered the management and governance framework in place and the future intentions and strategies adopted by the Covéa Group with respect to the Transfer Companies.

(iii) I have compared the amount of financial resources available to meet policyholder claims in the event the Transfer proceeds with the financial resources available if the Transfer does not proceed. I have made this comparison using three alternative measures of financial strength, and considered the change in both the absolute level of financial resources and the change in the ratio of financial resources available to existing liabilities and to insured exposure before and after the Transfer.

(iv) I have compared the position of policyholders before and after the Transfer under a variety of stressed scenarios to consider the ability of the Transfer Companies to deal with adverse scenarios.

(v) Having considered the change in capital available and the potential change in the risks to which the policyholder groups may be exposed, I have performed any further analysis I consider necessary to form an opinion.

My approach to considering the effect of the Transfer on service levels experienced by policyholders has been to determine if a change in service arrangements would occur if the Transfer were to proceed, and to compare any changes with the arrangements that would be in place were the Transfer not to take place.

Identification of policyholder groups

5.2 Consideration of Policyholder groupings

5.2.1 Policyholder characteristics

I have identified a number of policyholder characteristics that would influence the magnitude of the Transfer’s impact on policyholder security. The policyholder characteristics that I have considered include:

- The original company (Covea or Sterling) that the insurance policy was issued by.
- The nature of the regulatory regime and other policyholder protections which apply before and after the Transfer to different groups of policyholders.
- The nature of the type of business written and whether policyholders are:

  i) Insurance or Reinsurance policyholders;
  ii) Policyholders of compulsory or non-compulsory insurance; or
  iii) Policyholders related to latent risks or those with products that continue to be underwritten.

- The length of time that policyholders are likely to continue to receive benefits under the terms of their policies.

- The ability of policyholders to access the financial resources of each Transfer Company in the event of Covea or Sterling entering administration, rehabilitation or insolvency and how this changes as a result of the Transfer.

- The extent to which policyholders can call upon other mechanisms that protect their financial security, such as the FSCS.

5.2.2 Reasoning for policyholder groupings

I have considered the various combinations of the above characteristics which exist within the transferring policyholders of Sterling and the existing policyholders of Covea. I note that:

- There are a very small number of known reinsurance policyholders in Sterling (with no known reinsurance policyholders in Covea). These reinsurance exposures relate to legacy policies where Albion Insurance wrote very small lines through London Market-type pool arrangements in the 1960s to 1980s. There are no reinsurance exposures in either of the Transfer Companies' ongoing portfolios. In the event of the insolvency of any of the Transfer Companies pre or post Transfer, these Sterling reinsurance policyholders would rank behind insurance policies as creditors under the EU Insurance Winding-Up Directive. This remains the case whether the Transfer proceeds or not. These reinsurance policyholders will rank behind a larger pool of insurance policyholders, but in a combined business where the probability of failure to meet all contractual liabilities is remote, and with a larger pool of assets to support the more diversified portfolio of insurance risks. Given that the reserves established for these policies are immaterial in the context of the overall transferring reserves and that the reinsurance/insurance mix is similar for both Transfer Companies, I have decided not to distinguish between insurance and reinsurance policyholders within different policyholder groups in this report.

- Both Sterling and Covea policyholders are within an environment regulated by the PRA and FCA. Retail policyholders (Personal Motor, Creditor and Household) and compulsory commercial insurance policyholders of Sterling and Covea currently benefit from the protection of the FSCS which exists to pay out direct personal policyholders and compulsory commercial policyholders in the UK in the event of their insurer not being able to meet their claim payment in full. Non-compulsory commercial insurance policyholders of Sterling and Covea are not covered by the FSCS. None of these situations change as a result of the proposed Transfer and all policyholders will have the same protections and be subject to the same regulatory regime that they were going to have if the Transfer did not occur. I have therefore decided not to distinguish between compulsory and non-compulsory product policyholders, nor between retail and commercial policyholders, within different policyholder groups in this report.

- Both Transfer Companies have a small exposure (relative to their overall claims reserves) to legacy business. Claims settlement, though processed through a different route from the claims for the ongoing business lines, follows the same principles in each case as for ongoing business. In many businesses, significant legacy portfolios are often associated with increased volatility of reserving, which can be of concern to policyholders. In both Covea and Sterling the legacy exposure is immaterial in the context of the wider reserves and ongoing business. Given that there are substantial capital resources in total relative to the legacy exposure to provide for the claims to be paid in the event of a deterioration in ongoing business performance, I believe the legacy claims volatility will not trouble the ongoing policyholders. Additionally there is no change proposed in the management of either legacy portfolio as a result of the Transfer, so I have not distinguished between legacy and ongoing policyholders within different policyholder groups in this report. As a result I conclude that the difference between the interests of these policyholder groups is not so different as to require their separate consideration.

5.2.3 Policyholder groupings chosen

Based on my analysis of policyholder characteristics and the fact that there is no practical change in administration or regulation as a result of the Transfer I have identified the following two major policyholder groups. These are:

- Existing Sterling policyholders, that are transferring to Covea; and

- Current policyholders of Covea.

There is a theoretical third group of policyholders that I consider. In the event that there are residual policyholders left behind in Sterling after the Transfer (though none are intended to be left behind), transitional arrangements are being put in place until such a time as those policies can be either transferred, novated or commuted. Given that the Transfer makes arrangements for these policyholders to be dealt with by a specified Subsequent Transfer Date, and for Covea to make good any claims or other liabilities between the Transfer Date and this Subsequent Transfer Date, I have elected to consider this group of policyholders, were they to come about, in the same way as all other existing policyholders of Sterling and do not make any distinction between them further in my report. In the event that such policyholders are identified before or at the date of the final Court hearing, I will address them in my supplemental report.

Future intentions of Covéa Group

5.3 Subject to the Transfer of all policies, it is intended to deauthorise Sterling. This is intended to enable Covéa Group to manage capital more effectively, and to achieve financial savings through the elimination of costs associated with the operation of Sterling. Both regulatory capital requirements and costs will increase as a consequence of the introduction of the new European Solvency II regulatory regime effective from 1st January 2016. The Transfer also represents a legal reorganisation of the UK general insurance business of Covea into a single underwriting entity. This is intended to simplify the legal entity structure, thereby simplifying the governance and regulatory arrangements of the Scheme Companies.

I understand that Covea has no intention to reduce the aggregate level of capital or change the mix of business written by the companies as a consequence of the Transfer. The Covéa Group's current intention is that following the Transfer, Covea will become the only operating company writing general insurance for the Covéa Group within the UK, and it will be the main vehicle for the execution of Covéa Group's strategy to build its underwriting presence in the UK general insurance market.

There is no current intention to discontinue or deregister the operation of Covea.

Given the above I identify no adverse impact on policyholders arising from the intentions or motives of the Covéa Group in proposing the Transfer.

Governance and management framework

5.4 Management framework

Following the acquisition of Sterling Insurance Group Limited by Covéa Group, the combined group is in the process of restructuring the executive management team of Covea and Sterling Insurance Group Limited in order to build a unified management team, and a number of announcements have been made, including a single chief executive officer for the combined business.

The restructuring is occurring as part of the integration of the Sterling business following acquisition, and there are no changes to management that would not have occurred regardless of the Transfer of liabilities.

A consequence of the Transfer will be a reduction in the quantity of financial and regulatory reporting required due to the elimination of these requirements for Sterling, and consequent routine changes required to align financial and regulatory reporting of the transferred business in Covea. However, I note the Transfer Companies already operate within a wider Covéa Group financial reporting framework, and I do not identify a risk of any significant adverse impact arising from this change.

5.5 Governance framework

Policyholders transferring to Covea will continue to benefit from very similar governance arrangements as both Sterling and Covea share similar board members and operate on the same governance framework, which follows current UK market practice for businesses of this nature (for example, each has a unitary board which includes independent non-executives) and applicable company law.

The risk committees of Covea and Sterling will be amalgamated into one by end of the year (prior to transfer) as a result of the reorganisation following the acquisition. I note that all of the Transfer Companies are wholly owned subsidiaries and ultimately controlled by Covéa Group and this will not change as a consequence of the Transfer. Therefore, I do not identify any significant adverse impact caused by changes in management or governance frameworks on any group of policyholders as a consequence of the Transfer.

Impact of changes in regulatory regime and jurisdiction

5.6 Change in regulatory regimes

As noted in section 4.12, there is no material change to any of the regulatory arrangements as a result of the Transfer. Therefore I do not identify any adverse impact caused by changes in the regulatory regime on any group of policyholders as a consequence of the Transfer.

5.7 Prudential capital requirements

The Transfer Companies are currently subject to a prudential capital regime which requires them to hold capital of an amount at least equivalent to the current European Union wide minimum capital requirement, which I refer to as the “Solvency I” capital requirement. This regime specifies the minimum amount of capital resources using a simple formula based on the value of premiums and movements in the value of insurance liabilities. Capital resources are calculated based on financial accounts, adjusted to reflect specific admissibility requirements with respect to certain types of asset.

In addition, the UK regulatory regime currently imposes additional capital requirements which are determined individually for each company based on the company’s own assessment of the nature of the business and consequent levels of risk combined with additional capital requirements imposed by the regulator on a case by case basis. This is variously described as the Individual Capital Assessment or "ICA” regime.

A new European Union wide regulatory regime for insurance companies known as “Solvency II” is being introduced with effect from 1st January 2016. The key changes include:

- The current UK prudential capital regime will be replaced by a requirement for insurance entities to meet a solvency capital requirement calibrated to ensure that policyholders are secure at the 99.5% confidence level of potential future liability outcomes.

- Insurance entities will calculate their Solvency II capital requirement either using a complex set of rules specified in EU legislation (the “Standard Formula”), or, subject to the approval of their regulator, using an internally developed economic capital model (an “internal model”). In either case, the determinants of the solvency capital requirement relate to the nature of the risks within the regulated entity, including market related investment risk, insurance risk arising from new business or existing liabilities, and other business risks including credit risk and operational risk. Although different in application, the current UK regime applies a risk based approach to determining regulatory capital requirements similar in concept to Solvency II.

- Regulatory capital requirements will be defined in terms of a Solvency Capital Requirement (“SCR”) and a Minimum Capital Requirement (“MCR”) which will replace the existing “Solvency I” minimum capital requirement. Under existing UK regulations the minimum capital requirement is calculated using a formulaic approach based on premiums, paid claims and incurred claims. This will be replaced by a more complex formula based on the technical provisions, written premiums, reinsurance, deferred tax and administrative expenses.

- The regime under which insurance entity balance sheets and the definition of capital are calculated for regulatory purposes will change to one based on largely economic measures of assets and liabilities, rather than accounting based measures.

- A range of minimum standards relating to insurance entity governance and disclosure will be introduced (known as “Pillar II” and “Pillar III”), including a requirement to perform and document an “Own Risk and Solvency Assessment” or “ORSA”.

- If an insurer's available resources fall below the SCR, then supervisors are required to take action with the aim of restoring the insurer’s finances back to the level of the SCR as soon as possible. If, however, the financial situation of the insurer continues to deteriorate, then the level of supervisory intervention will be progressively intensified. The aim of this 'supervisory ladder' of intervention is to identify any ailing insurers before a serious threat to policyholders' interests eventuates. If, despite supervisory intervention, the available resources of the insurer fall below the MCR, then 'ultimate supervisory action' will be triggered. This means that the insurer's liabilities could be transferred to another insurer, the licence of the insurer withdrawn and the insurer closed to new business and its in-force business liquidated.

- It is important to consider how the methods for capital requirement calculation differ before drawing conclusions about their comparability. The Standard Formula is a relatively simplistic approach to calculating capital requirements compared to both the ICA and Internal Model approaches. The ICA is further not directly comparable to the measures of Solvency II SCR as they use different bases for valuing the balance sheets and different time horizons for risk (amongst other differences); they are however both intended to estimate capital requirements to a 1 in 200 year return period.

After the Transfer Covea will be required to comply with the Solvency II capital requirements, as these become effective from 1 January 2016. Should the Transfer not proceed, Sterling will also be subject to Solvency II capital requirements. Therefore Sterling policyholders will be insured by a business subject to Solvency II capital requirements irrespective of whether the Transfer proceeds.

I note that:

- I have looked at the Solvency II Standard Formula calculations and the Individual Capital Assessments ("ICA"s) of Covea and Sterling to compare the relative difference in policyholder positions before and after the transfer of liabilities. The appropriateness of this approach and more detailed description of this analysis can be found in section 5.11 below.

- I have considered the ORSAs produced by each of the Transfer Companies in determining the stress-tests to apply when considering the policyholder security for each group in section 6 below.

Financial and economic information considered

5.8 Consideration of the nature of assets available to meet policyholder obligations

In assessing the impact of the Transfer, I have considered the nature of assets within each Transfer Company before and after the Transfer occurs. The assets of each Transfer Company can be classified into four broad categories.

- Investments and Cash – Financial investments held by the Transfer Companies are predominantly held in cash and bonds, with a small amount of equities.

  Sterling has been selling equities and unit trusts, and gradually moving its investment portfolio into assets that attract a lower Solvency II capital charge. It is expected that it will continue to do this in the time leading up to the Transfer Date, and I will reflect the impact of this change in asset mix in my supplemental report. I do not anticipate that this will cause any difference in my conclusion. Because of the need to comply with Solvency II by 1st January 2016, this asset allocation shift would continue whether the Transfer was to proceed or not.

- Reinsurance share of provisions – Subject to the specific terms of the relevant reinsurance contracts, reinsurance assets have the capacity to absorb losses arising from the underlying reinsured insurance liabilities, thereby reducing financial risk. The nature and level of utilisation of such arrangements is in line with my expectations for both Transfer Companies.

- Other assets – Other balance sheet assets include sundry assets arising in the normal course of business such as tax assets, accounts receivable from intermediaries and suppliers, and intercompany balances due from other members of the Covéa Group largely arising as a consequence of recharges of expenses between group companies. These balances are in line with my expectations for a business of this nature.

I do not identify any matter arising from balance sheet assets held by the Transfer Companies that would cause me to perform specific further additional analysis. I note that no change in the overall asset composition of the Transfer Companies will arise as a direct consequence of the Transfer.

5.9 Valuation of insurance liabilities

I have considered the valuation of insurance liabilities included in each Transfer Company balance sheet. The process of estimating insurance liabilities is inherently uncertain due to unknown future events or circumstances and the effect these may have on the frequency and cost of claims. For example, future legal changes may increase the number of claims to which insurers are exposed, inflation may change the costs of remediation of insured events and new types of claim may emerge which are not currently anticipated. Recent examples of this uncertainty include the market-observed significant increases in the number of claims reported to EL policies for Noise-Induced Hearing Loss, or the increasing costs to the market of PPO claims.

In performing my analysis of the relative impact of the Transfer on different policyholder groups I have considered the appropriateness of the methods and assumptions used by the Covéa Group to value its insurance liabilities.

Covea's reserving philosophy is to reserve at a consistently conservative level throughout the cycle, with reserves typically carried at their estimate of the 75th percentile of potential outcomes (that is to say that the reserves would be adequate in three of every four potential future scenarios). The aim of a best estimate value is to estimate a realistic value; one which is conceptually equal to the arithmetic mean of all possible future outcomes. In contrast Sterling reserve at best estimate with no margin. Covea's actuarial function and reserving calculations are performed independently from other functions such as finance, underwriting and claims. In contrast, Sterling's actuarial team work closely with their finance team. Reserves are approved in each case by the management and executive board of that Company. Covea also submits information to and seeks approval from its audit committee.

Covea's reserves are reviewed on a quarterly basis internally and annually externally; Sterling's are reviewed on a half yearly basis internally.

After the Transfer, it is intended that reserves for Sterling's policyholders will also be subject to the current Covea philosophy – that is, quarterly reserving, holding a margin over the best estimate, and independence in actuarial calculations. Covea plan to address the increase in reserves using the high excess they hold above their current margin. The increase in automation and streamlining of the process that is planned here is intended to allay any resourcing difficulties for the increased workload that the Sterling reserving team will be subject to. I note that this change will increase the strength of the reserves and the governance over the reserving for Sterling policyholders.

I have performed an analysis to satisfy myself that the insurance liabilities are consistent with my expectations for insurance business of this nature. This analysis involved:

- A review of both internal and (where available) external reserve reports on the business prepared by qualified actuaries;
- A review of the methods used to estimate reserves compared with industry best practice;
- A number of interviews with key personnel responsible for estimating the value of insurance liabilities within the actuarial and claims management functions discussing the analyses performed and results of these analyses; and
- Consideration of the actual run-off profit or loss on prior underwriting years exhibited by each of the Transfer Companies.

Conservative reserves contain some margin for risk of deterioration over and above the expected ultimate outcome which provides an additional level of policyholder security on top of the capital in the business.

Covea has generally experienced improving experience over recent years believed to be due to the impact of the LASPO reforms. It has been able to reduce reserve estimates for injury claims from private and commercial motor, including those from PPO claims. However for business written in 2014 premium rates have been reduced in anticipation of the effects of LASPO. There was also a higher amount of large motor injury claims in 2014 than expected.

Sterling has had more claims recently on its Personal Accident business than expected. This is expected to be due to policies sold as "add-on" products which may have been forgotten about by policyholders, but about which Sterling recently contacted policyholders to raise awareness of their existence. Sterling is monitoring the situation to determine whether this is a one off or developing issue. Sterling holds a separate reserve for potential future liabilities arising as a result of the mis-selling of Payment Protection Insurance ("PPI").

5.10 Consistency of insurance liability valuation

Whilst I have not conducted an in depth analysis of reserve adequacy, I have investigated the policies, methods and assumptions used to set the reserves for the various types of insurance liabilities within the Transfer Companies. Specifically, I have considered the policies, methods and assumptions that are applied within each entity to result in a consistent reserve valuation for each Transfer Company and policyholder group. I am therefore comfortable that they are an appropriate basis on which to form my opinion of the position of each policyholder group before and after the Transfer.

Consideration of capital and risk

5.11 Measures of economic capital

I have considered the value of each legal entity's net assets compared with risk where both are measured using firstly the ICA model, and secondly the Standard Formula. Both Covea and Sterling have chosen not to use an internal model for Solvency II, citing that the complexity of the construction is hard to justify given the size and nature of the companies, and this is in line with what I would expect for companies of their size and nature. These estimates compare in principle the value of each legal entity's economic resources with the Transfer Companies' estimates of the amount of capital required to ensure that policyholders are secure at the 99.5% confidence level, but under the Solvency I and Solvency II regimes respectively and thus show how the Transfer Companies' capital strength will change as a result of the imminent change in the regulatory environment. The risks considered in these estimates include:

- The ultimate potential insurance liabilities;
- Potential losses from investments;
- Potential losses arising from new underwriting exposure over the following year;
- Potential losses arising from the failure of third parties to which each company has exposure; and
- Potential losses arising from operational risks.

It is important to consider how the two methods of risk measurement differ before considering the implications of my analysis. The Standard Formula is a relatively simplistic approach to calculating capital requirements compared to the ICA approach. The ICA is further not directly comparable to the measures of Solvency II SCR as they use different bases for valuing the balance sheets and different time horizons for risk (amongst other differences); they are however both intended to estimate capital requirements to be able to withstand a 1 in 200 year event.

With the Standard Formula being based on the insurance risks within the "average" insurance company, it will not reflect the risk profile of any company perfectly, in particular companies writing niche insurance. Notwithstanding the risk profiles of both companies are not going to be perfectly captured through use of the Standard Formula, I believe that it appropriately demonstrates the relative change in policyholder security before and after the transfer to support my opinion within this report.

I note that these estimates:

- Have been produced by suitably qualified individuals from within the Sterling and Covea entities;
- Have been reviewed and agreed by senior members of Sterling's and Covea's management; and

- Are consistent with the estimates submitted to the PRA.

I have not performed a detailed verification of the calculations performed by the Transfer Companies. However, in order to satisfy myself that the estimates are reasonable, I have performed stress tests on the areas I consider material to the Transfer Companies' assessment of available and required economic capital, or where other market participants have to my knowledge experienced deteriorations recently and to which one or both of the Transfer Companies are exposed. These stresses are intended to describe real life scenarios that are conceptually easier to understand than, for example, a 1 in 200 year event. In each case the available capital for each remaining business post-Transfer more than meets the scenario tested. Whilst this does not constitute a formal re-estimation of the economic capital required for each of these scenarios, the fact that each scenario is contained within the capital amounts estimated under the Standard Formula and ICA approaches reassures me that these estimates are capturing and covering the appropriate risks. I discuss the results of this analysis in sections 6.6 to 6.12.

5.12 The economic capital cover ratio

In considering the impact of the Transfer on both capital and risk, I have compared the economic capital cover ratio experienced by each policyholder group before and after the transfer. This ratio is made up of two elements:

- Available economic capital resources, which represents the net assets and liabilities valued on an economic basis; and

- An estimate of the maximum loss value each relevant company could experience with a 99.5% confidence level, based on one or more of the capital measurements described in 5.10 above (ICA and/or Standard Formula).

Impact of Transfer on capital available to policyholders

5.13 Change in financial accounting ratios

The table below summarises the assets, liabilities and publicly available financial ratios for the Transfer Companies before and after the transfer.

As at 31 December 2014 £000's	Covea (pre transfer)	Sterling	Covea (post transfer)
Net assets	217,650	37,654	255,304
Total assets	**963,790**	**171,712**	**1,135,503**
Gross insurance liabilities	(718,643)	(120,158)	(838,801)
Total liabilities	**(746,140)**	**(134,058)**	**(880,198)**
Net assets as a percentage of total assets	23%	22%	22%
Net assets as a percentage of gross insurance liabilities	30%	31%	30%
Net assets as a percentage of total liabilities	29%	28%	29%

Source: Management, UK GAAP

The ratios above constitute a simple measure of the change in capital position based on information readily available from the UK GAAP balance sheets. On each of these metrics, policies of Sterling that transfer to Covea see no material change in their implied security on these metrics, and neither do policies within the current Covea business, suggesting that the Transfer does not have an adverse impact of either set of policyholders. Ratios on an economic capital basis are discussed below in section 5.14.

5.14 Change in regulatory and economic capital cover ratios

When considering the impact of the Transfer in terms of the economic capital cover ratio, I note that neither business is expected to use an internal model to calculate their SCR under the Solvency II regime, and that both will instead use the Standard Formula.

I have considered the SCR for both companies, and the view of the Transfer Companies on how the combined SCR may have looked if the transfer had taken place for 31 December 2014. The results are not in the public domain so I do not show them here.

I observe the following:

- Prior to the Transfer, the ICA capital cover ratio (available capital in Solvency I regime divided by ICA capital estimate) for both existing Covea policyholders and Sterling policyholders is greater than one, indicating that the probability that policyholder benefits may not be paid in full is remote (as a ratio greater than one suggests capital is held to a level greater than that required for the standard of 99.5% confidence);

- Prior to the Transfer, the Standard Formula capital cover ratio for the existing Covea policyholders remains materially in excess of one, indicating that Covea comfortably meets the Standard Formula SCR ready for when the Solvency II regime begins;

- Prior to the Transfer, the Standard Formula capital cover ratio for the current Sterling policyholders is less than one, indicating that the business will need a capital injection to meet its SCR if the Transfer does not proceed. I note that this does not change the current solvency position of the business, but rather reflects the difference between the Solvency I and Solvency II calculation bases. Should the transfer not proceed, and with no capital injection, Sterling would face supervisory intervention as described in section 5.7. This would hinder Sterling's ability to complete its business plan, with potential impacts on policyholder security if the business incurs additional costs and/or missed profits as a result of this;

- After the Transfer, Covea will have a Standard Formula capital cover ratio comfortably greater than one, indicating the probability that policyholder benefits may not be paid remains remote for existing Covea policyholders;

- As a result of the Transfer, policyholders of Sterling see a material increase in their Standard Formula capital cover ratio. Policyholders of Covea see a small decrease in their Standard Formula capital cover ratio, although the ratio is still comfortably in excess of one;

- I have also considered the situation where there is a lag between the Transfer and the deauthorisation of Sterling, which would require a regulatory minimum of assets to be left in Sterling after the Transfer. Covea would as expected see a slightly larger decrease than above in their Standard Formula capital cover ratio, but this would still be comfortably greater than one, indicating the probability that policyholder benefits may not be paid remains remote for existing Covea policyholders;

Given the above, I identify no material adverse change in the economic circumstances of any of the main groups of policyholders.

Impact on existing reinsurers

5.15 Reinsurance arrangements

Reinsurance assets along with the liabilities associated with them will transfer under the Transfer with the reinsured party's name changing from Sterling to Covea. I understand that all outwards reinsurance contracts are subject to English law (which gives effect to the Part VII process). If the Transfer goes ahead at the proposed date, there will be no special termination provisions which would be triggered by the Part VII Transfer.

Other than this change, the Transfer has no further effect on the coverage provided by current or historic reinsurers, creating neither an increase nor decrease in the exposure of reinsurers. This will mean existing reinsurers of the receiving entity will not be liable for the transferred liabilities, which will instead be reinsured by the current Sterling reinsurers that will transfer also. Given there is a small amount of inwards reinsurance business transferring from Sterling, I have also considered the potential for set-off of reinsurance balances in the event of the failure of Covea at some point in the future. The likelihood of this event is remote and the balances are sufficiently small that I conclude that any potential rights of set-off will not materially change the economic outcomes as a result of the Transfer for any group of policyholders.

Pension scheme obligations

5.16 Pension Scheme Obligations

Sterling is not the sponsor of any pension schemes. Sterling Insurance Group is the sponsor of Sterling's defined benefit pension scheme, and this will not change following the transfer. The defined benefit scheme is closed to new members and in surplus as of 31 December 2014. Covea's existing policyholders will therefore not have the potential disadvantages of Covea taking on an additional pension scheme.

Covea operates a defined benefit scheme in the UK which on a funding basis as of 31 December 2013 held liabilities of £34.0m and a slight surplus of £0.5m. It had been in surplus for the previous three years on a UK GAAP basis. I will consider the funding results at 31 December 2014 in my supplemental report.

This scheme will also not change sponsor following the transfer. After the Transfer, transferring Sterling policyholders will be protected by the entity obliged to fund Covea's pension scheme and therefore are exposed to a new type of risk (that assets otherwise available to pay claims are used instead to make good pension funding obligations). Having reviewed the actuarial information provided to me, I do not believe this to be a material risk that would change any of the conclusions reached in this report however I will consider updated information in my supplemental report.

6. Methodology, stress and scenario analysis

Overview

6.1 In performing my analysis of the impact of the proposed Transfer, I have considered estimates prepared by the Transfer Companies of the maximum losses each of the Transfer Companies would face at differing confidence levels. I have restricted this analysis to the impact under the imminent Solvency II regime as I believe this to be more relevant given the timing of the proposed Transfer. In order to satisfy myself that these estimates are an appropriate basis on which to form an opinion, I have performed further analysis in three main areas:

- Modelling approach – I have considered the methods used by the Transfer Companies to calculate the estimate of insured losses at differing levels of confidence, allowing me to have confidence that the results of the model prepared by the Transfer Companies are based on appropriate assumptions and capture the relevant aspects of each Transfer Company's risk.

- Analysis of sensitivity of the model estimates to alternative assumptions – I have considered how sensitive my opinion is to variations in the underlying assumptions used by the Transfer Companies, and whether the reasoning behind my opinion would be different using alternative assumptions.

- Stress test analysis – I have considered the impact of a set of specific severe adverse events on each of the Transfer Companies, allowing me to gain comfort at a high level that the economic loss estimates used in my analysis are meaningful when compared with real world loss assumptions.

Loss modelling approach

6.2 Modelling approach

The Standard Formula estimates of economic capital are prepared by local business units within a common risk management framework. These estimates are prepared for inclusion within the regulatory submissions made by the respective entities and are subject to internal review by the respective company's risk management function. A broad spectrum of risks is considered within this Standard Formula estimate including:

- Risk arising from insurance business, for example, the risk of losses from natural catastrophes, unexpected adverse losses on new business written or deterioration in the valuation of insurance liabilities.

- Market risk, for example, the risk that investment returns are not as high as anticipated.

- Counterparty default risk, for example, the risk that a bond or reinsurance counterparty becomes insolvent and cannot honour its obligations.

- Operational risk, for example, the risk that there is a failure in underwriting controls.

The range of risks considered by each Transfer Company is prescribed by the Solvency II guidelines and is intended to reflect the inherent risk within the activities of each entity. In each case senior management is closely involved in the calculation of required capital. For each entity, the results require approval from the respective board.

I consider the processes which have been adopted in calculating this Standard Formula estimate to be consistent with industry practice for insurance businesses of the size and complexity of Covea and Sterling. I am therefore comfortable that these processes are appropriate in nature and scope.

6.3 Findings of review of the modelling approach

I have discussed the results of this model with the Transfer Companies' management and been provided with a range of related material including required capital estimates using alternative methods and descriptions of the methodology used.

The Transfer Companies have applied standard actuarial methods to generate their estimates of potential losses for each entity.

The most significant risks contributing to the Transfer Companies' required capital relate to the underlying general insurance business and associated uncertainties relating to the value of existing insurance liabilities and potential for adverse underwriting outcomes.

The relative contribution of different risk types to the required capital estimates for Sterling and Covea are consistent with my understanding of the underlying business and in line with my expectations.

Whilst I have not performed a detailed validation of model results, the assumptions, methodology and outputs from the model are consistent with my expectations for business of this nature and I am satisfied that they are informative as to the change in risk which would occur following the Transfer compared with the position assuming no Transfer occurs.

Stress test analysis

I have considered a variety of severe adverse scenarios that could have a material impact on the financial security of policyholders. I have performed this analysis in order to:

- Quantify the impact of a stress event on the Transfer Companies and hence policyholder security; and
- Satisfy myself that the estimates produced by the respective entities on the basis of their Solvency II Standard Formula calculations, together with the resulting economic capital cover ratios, are broadly reasonable when compared with the impact of a combination of specific adverse events.

The estimates of capital required from the Standard Formula calculation prepared by Sterling are intended to represent the full range of realistic economic risks that each Transfer Company could experience, and represents a more complete consideration of business risk than an analysis of specific stress events. However, such economic capital estimates are based on multiple modelling assumptions which rely on expert judgement. By contrast my consideration of specific adverse stresses provides qualitative information on the security of policyholders in a single defined scenario. Such specific severe adverse scenario testing does not rely on expert judgements regarding the frequency and range of uncertainty, and provides an alternative source of information from which I can gain insight into the levels of security of policyholders.

I note that the output from the Transfer Companies' economic capital models (in their varying levels of sophistication) is consistent with the results of my analysis of specific severe adverse stresses.

6.4 I have considered a variety of potential severe adverse circumstances or extreme events that could affect the Transfer Companies, all of which represent stresses that fall outside the normal course of business. In selecting the scenarios to model, I have considered:

- Current developments occurring in the insurance markets in which each Transfer Company operates.
- The typical risks faced by an insurance business.
- My overall understanding of each Transfer Company including its portfolio mix, structure and business model.

- The key risks identified by each Transfer Company in its estimates of required economic capital from its Own Risk and Solvency Assessment ("ORSA").

- The scenarios identified by each Transfer Company as part of its normal risk management processes.

Whilst these stresses do not represent an exhaustive list of all adverse events that could impact the Transfer Companies, they include those risks I consider most material and relevant to my analysis. I note that the Transfer companies perform such stress testing as part of their business as usual risk management processes as expected under Solvency II. Taking the base financial projections provided by the Transfer Companies as a starting point, the severe adverse scenarios I have considered include:

- Motor PPO claims: Motor PPO claims represent a significant uncertainty to Covea (and indeed the wider general insurance market) because of the different types of risks they bring to a general insurance business. There remains considerable regulatory risk associated with PPOs and so I have considered a change in the assumptions used to measure these.

- Adverse liability claims experience: Test sensitivity of liabilities to a general market increase to amounts payable for liability claims

- Counterparty default: Test robustness of entities to failure of large counterparty to whom the entities have exposure through reinsurance, bond holding, bank / client relationship or business arrangements (e.g. balances with brokers).

- Adverse economic environment: This test will stress the investment holdings of the entities through a significant fall in equity values, showing the relative positions of the policyholders across each entity.

- UK floods/windstorm: Two property catastrophe events occur in one calendar year. These may be combinations of a big and a small event or two or more medium sized events.

- Group Risk: Being part of the Covéa Group, I consider the potential for contagion risk from the wider business group.

6.5 Severe adverse stress: PPO uncertainty increasing

I have considered the impact of an increase in the risk surrounding PPOs for the Transfer companies. Covea have significant exposure to the uncertainty from PPOs through the uncertainty of how long the insurer may be liable to pay for cost of care, how much cost of care may be expected to be in the future and the frequency of potential new claimants. This is increasingly commonly seen within the insurance market in the UK, particularly in Motor liability accidents (through severe accidents which require ongoing care for the claimant), though is also being seen in other liability books of business (e.g. Employers liability). The specific scenario I have considered is that all losses settle at a significantly higher amount than current trends suggest and claimants have an improved life expectancy over that assumed in the reserving models for PPO claims, during which they require ongoing care. This scenario would affect Covea substantially more than Sterling.

The specific assumptions used within this scenario are:

- Future ongoing claims are inflated at an annual rate that is 1% higher than that assumed in the reserving analysis at 31 December 2014 to reflect the higher than expected increases to cost of care.

- Annual payments increase by 50% for settled and potential PPOs.

6.6 Severe adverse stress: Adverse liability claims experience.

I have considered a scenario in which employer and public liability claims increase for both Transfer Companies. The scenario assumes an increase of the Covea reserves to the 75th percentile, and a scenario which is estimated to be as equivalently adverse to the Sterling reserving assumptions such that:

- the average cost per claim increases by 15%,
- three month slowing down of claims,
- There is a 15% increase to the Initial Expected Loss Ratio used to calculate the reserves for more recent accident years, meaning claims experience in these years will be heavier than previously expected.

6.7 Severe adverse stress: Failure of a large counterparty

I have considered a scenario in which a major counterparty to Covea and Sterling defaults. The largest exposure to the counterparty of the Transfer Companies is used as the stress. The stress affects any bond holdings, and the relationship or business arrangements with the counterparty.

6.8 Severe adverse stress: Financial crisis causing significant equity crash across Europe

I have considered a scenario which would test the investment portfolios of the Transfer Companies. This scenario assumes equity markets fall 50% in value across Europe for all entity investment. The scenario does not allow for any management action to reallocate the investment portfolios. It therefore represents an extreme market movement rather than a gradual drop in values over a longer period of time.

6.9 Severe adverse stress: A major natural catastrophe across UK

This scenario assumes two significant UK windstorm/flood losses with each estimated to be an event that may occur once every 50 years.

This is a particular stress for property business, of which the Transfer Companies both hold sizeable exposures.

6.10 Severe adverse stress: Covéa Group drop in credit rating

I have considered a scenario where Covéa Group's credit rating falls. Here, I want to consider the potential for contagion risk from the wider business group. The expectation would be for Covea and Sterling to be capitalised sufficiently on their own such that this would have a minimal effect, though there may be knock on effects such as counterparty defaults and guarantee losses.

6.11 Findings of stress test analysis

Having analysed the results of the stress tests outlined above, I find that:

- After the transfer Covea will continue to have a surplus of assets over liabilities in any single scenario. Additionally it is only if all of the above scenarios were to happen within a short time period that the Transfer Companies' solvency would be threatened. Based on the analysis provided by the Transfer Companies and my review of their Own Risk and Solvency Assessment documents I consider the likelihood of this occurring to be remote, and substantially beyond the "1 in 200" event probability.
- Sterling policyholders will not be materially adversely impacted as a result of the transfer of liabilities and in many of the scenarios will actually benefit from the larger capital base of Covea.

7. Summary of findings

Summary of changes in circumstances of transferring Sterling policyholders

7.1 For all Sterling policyholders whose policies are transferring to Covea there is an improvement in the regulatory capital ratios under the incoming Solvency II regime as a result of the Transfer, which represents an increase in the security for these policyholders. In addition they will continue to be in an environment regulated by the PRA and FCA and have no change in their protection under the FSCS.

7.2 Additionally it is intended that the current MMA IARD guarantee that covers current Covea policies will also cover the transferring policyholders, though my conclusion below would stand without recourse to this guarantee.

7.3 As noted in sections 5.3 and 5.4, I do not identify any adverse effect arising from the Transfer in relation to the management of the business for any of the policyholders transferring to Covea.

7.4 As a result of the above observations I do not identify any adverse effect on any of the policyholders whose policies are transferring out of Sterling to Covea under the Transfer.

Summary of changes in circumstances of existing Covea policyholders

7.5 Covea policyholders will remain in their current underwriting entity, retaining all of the existing Covea processes and procedures. The regulatory capital ratios for Covea drop slightly but not materially after the proposed Transfer and remain at a very high level.

7.6 There is no change in the regulation of Covea or in the executive management responsible for administering the business of Covea, other than a reduction in the amount of management effort required to administer an additional legal entity.

7.7 The assets held directly by Covea will increase as a consequence of the Transfer.

7.8 As a result of the above observations I do not identify any material adverse effect on policyholders of Covea as a result of the Transfer.

Appendix 1 Curriculum Vitae of the Independent Expert

Philip Tippin is a non-life actuarial partner in KPMG.

Philip Tippin has been an actuarial services partner since 2004. He joined in 2001 and has led KPMG's general insurance actuarial business for much of his time with the firm. He has worked on a number of previous Part VII transactions over this period. Philip qualified as a Fellow of the Institute and Faculty of Actuaries in 1998 with Watson Wyatt, having specialised in general insurance actuarial work since the start of his career.

Prior to joining KPMG Philip worked as a consultant in Watson Wyatt and Deloitte, and spent several years as a syndicate actuary in the Lloyd's Market with Venton (latterly Alleghany) Underwriting.

Experience

Philip has a wide range of experience in finance, insurance and reinsurance, covering both retail and wholesale markets, as well as having performed engagements looking at financial guarantee products. He has assisted clients in reserving, pricing, risk management, underwriting control, capital management and strategic consulting projects. His experience includes substantial exposure to UK and US law and regulation as they apply to insurance. Examples of recent assignments include:

- Acting as Independent Expert in general insurance Part VII business transfers.
- Undertaking the formal role of Scheme Actuary for a large number of Schemes of Arrangement, for both insolvent and solvent companies.
- Negotiation of commutations with policyholders and cedants on behalf of businesses in run-off.
- Expert witness appointment in the United States, covering reinsurance, reserving and pricing of specialist products, providing advice through the lifecycle of the case.
- Acting as independent expert for complex liability valuation determinations.
- Estimation of claim emergence and quantification of liabilities from environmental disasters in the United States.
- Gap analyses and development of implementation plans for Solvency II for large insurance groups.
- Review of credit risk liability models.
- Capital model design and review.
- Providing actuarial due diligence reporting for a number of major London Market acquisitions.
- Strategic reviews of business models for insurance risk management for providers and buyers of insurance.
- Providing statements of actuarial opinion for Lloyd's syndicates, including provision of opinions for US trust funds.
- Technical pricing of retail and commercial insurance products.
- Providing support to the audit of major UK and international insurance groups.

Professional & Educational

Philip is a Fellow of the Institute and Faculty of Actuaries (FIA). He holds a Practising Certificate to act as a Syndicate Actuary at Lloyd's, and has previously held a similar certificate to act for insurance and reinsurance entities in Ireland. He acted as an examiner and senior examiner for the general insurance papers of the Institute and Faculty of Actuaries exams for 6 years until 2005.

He holds an MA in Mathematics and Philosophy from the University of Oxford.

Appendix 2 Extract from Letter of Engagement

"Scope of the Independent Expert's work

My role as Independent Expert will be to consider and to report to the Court on the proposed Transfer from the perspectives of the policyholders of the Transferor and Transferee, and to give a reasoned opinion on the likely effects of the Transfer on the policyholders of the Transferor and Transferee including whether any of their interests could be in any way (either directly or indirectly) adversely affected by any of the Transfer. Under Chapter 18 of SUP of the PRA Handbook (in particular, SUP 18.2.33G), the Report must comply "with the applicable rules on expert evidence". No guidance on what is meant by "applicable rules" is supplied in SUP and my understanding therefore is that the PRA expects an independent expert to prepare a report in accordance with Part 35 of the Civil Procedure Rules 1998 ("CPR"), the relevant Practice Direction and the protocol for the Instruction of Experts to give evidence in Civil Claims, to the extent relevant ("the Requirements"). I will therefore conduct my work as if the Requirements apply. In particular, I will owe an overriding duty to the Court to assist the Court and to give the Court independent expert evidence on the Transfer.

I expect that my work will include the following tasks in order for me to form my opinion:

- reviewing existing company documentation, as set out in the appendix to this letter;
- reviewing the documentation for the Scheme and, if necessary, suggesting amended drafting in order to eliminate any concerns;
- reviewing the Transfer, considering the effect on policyholders of the Transferor and Transferee, covering their contractual rights, benefit security, and benefit expectations;
- reviewing any changes to reinsurance arrangements in connection with the Transfer;
- reviewing the effects of the Transfer on the risks remaining within the Transferor and the resources of that company to meet those risks;
- reviewing the effects of the Transfer on the risks within the Transferee and the resources of each entity to meet those risks;
- reviewing comparative solvency levels before and after the proposed transfer;
- liaising and raising issues and questions as necessary with the appropriate persons at Covea and Sterling;
- liaising and raising issues and questions as necessary with your advisers, including tax and legal advisers;
- such other tasks as you, I or the PRA and/or FCA consider reasonably necessary for the proper discharge of my role as independent expert. "

Appendix 3 Specimen Letters of Representation

I have received a signed letter of representation from a director of Covea Insurance Plc, authorised by the Transfer companies, directly involved in the Transfer as shown below:

covea Insurance

Philip Tippin
KPMG LLP
15 Canada Square
Canary Wharf
London
E14 5GL

10th August 2015

Dear Mr Tippin,

Independent Expert Appointment – Part VII Transfer

I, Steven Whittaker, am a director of Covea Insurance Plc. This letter relates to the proposed transfer of insurance business currently carried on by Sterling Insurance Company Limited (the "Transferor") into Covea Insurance plc ("Covea Insurance" and /or "the Transferee") ("the Transfer"). I have been authorised by the board of directors of the Transferor and the Transferee ("the Transfer Companies") to give the representations set out in this letter on behalf of each such company, which are given to the extent that each such company exercises control over the insurance business which is the subject of the Transfer both before and after the Transfer come into effect. In this capacity I have reviewed the final version of the report produced by the Independent Expert ("the Report").

In respect of the Transfer, I can confirm that:

1. The data and information provided to you as Independent Expert was prepared by PRA approved persons or other members of the senior management of the Transfer Companies or responsible senior professionals from the Transfer Companies' advisors.

2. I have disclosed all the information that in my opinion is relevant to the Independent Expert when forming a view as to whether policyholders are adversely affected by the proposed Transfers, including but not limited to discussions or disputes with regulatory authorities and key reinsurance and commercial counterparties.

3. To the best of my knowledge and belief, the Report accurately and fairly reflects my understanding of the details of the proposed Transfer and the facts relied upon in the Report are true and accurate, and that there are no material inaccuracies or omissions in the description of either of the Transfer Companies' business and practices (including details of specific contracts or claims) or in any statements attributed directly or indirectly to any of the Transfer Companies.

4. I will keep the Independent Expert apprised of all matters and issues, up to the date of the Court hearings, which, in my opinion, may be relevant to the Independent Expert in opining on the proposed Transfer. These matters include, but are not limited to, Court documents and supporting materials, full details of any changes between draft versions previously provided to me and final versions of these documents and full details of any differences between the data and information underlying such draft and final documents.

5. In particular, the facts stated below are true and accurate to the best of my knowledge and belief:
   - There will be no policyholders left in Sterling Insurance Company Limited after the transfer, as all existing policies will be transferred to Covea Insurance;

Covea Insurance plc
Norman Place, Reading, Berkshire RG1 8DA. Telephone 0844 902 1000 Fax 0118 955 2211 www.coveainsurance.co.uk
Registered in England and Wales 613259. Authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority No. 202277

- No significant additional tax assets or liabilities will arise as a consequence of the Transfer for any of the Transfer Companies;
- The financial position as stated in the audited accounts for the year ended 31 December 2014 gives a true and fair view of the Transfer Companies affairs at that date;
- Other financial projections you have used to prepare the Report have been prepared in good faith by persons with appropriate knowledge and experience on a reasonable basis and based on reasonable assumptions;
- It is not planned that there will be a distribution of capital or increase in liability or risk exposure as a consequence of the Transfer that would not have occurred were the Transfer not to proceed;
- Substantially the same assets and liabilities will exist within the Transfer Companies in aggregate after the Transfer as before the Transfer;
- Covea Insurance has no current intentions to cease underwriting or carry out a further restructuring of their business as a consequence of the Transfer;
- All outwards reinsurance contracts for Sterling are subject to English law; and
- The current Service Level Agreements for each business will remain the same and there will be no change for the transferring policyholders between the systems and processes used, the contact details needed to make a claim or amend a policy, or the locations in which they are dealt with as a direct result of the Transfer.

Yours sincerely

Steven Whittaker

Appendix 4 List of Information provided

Financial Information

Covea and Sterling regulatory returns for the prior 3 years

Covea and Sterling accounts for the prior 3 years.

Covea and Sterling business plans

Proforma balance sheet and other financial information - post Transfer.

Structure and Company Information

Company organization chart.

Details of current and post transfer Board(s) and governance arrangements.

Description of current and post transfer administration systems and arrangements

Significant Risk Sharing Arrangements & Material Counterparties

Details of current intragroup guarantees and support arrangements given and received by each affected company.

Reinsurance arrangements, including a list of material reinsurance contracts and summary terms.

Transfer Information

Draft Transfer documents (including material in respect of the proposed communication approach to policyholders and a draft witness statement in respect of the application)

Policy overview - premiums and claims - split over lines of business

Extra information on the Marine and Asbestos policies in run off

Capital and Risk Management

Standard Formula estimates for Covea and Sterling pre and post Transfer, with accompanying methodology and documentation

ICA estimates for Covea and Sterling

2014 ORSA for Covea and Sterling

Internal Reserve Review as at Q3 and Q4 2014 for Sterling and Covea

Internal Reserve Review as at Q4 2013 for Sterling

Independent Reserve Review as at Q3, Q4 2014 for Covea

2014 Audit Committee Pack for Covea

Other information considered

Discussions with key staff within the executive team. Numerous e-mails and documents confirming statements and information provided verbally during these meetings.

Letter to confirm intention of securing ELTO report on Sterling's ELTO process

2014 external report for factual findings in relation to Employers' Liability Insurance: Disclosure by Insurers

Appendix 5 Glossary of terms and definitions

Approved persons regime - Regulation that the PRA applies to regulated firms which is designed to ensure senior management is appropriately experienced and qualified.

Asset - Generally, any item of property whether tangible or intangible, that has financial or monetary value.

Capital - Defined as total assets less total liabilities as measured using either an economic method of valuation (“economic capital”), PRA mandated valuation rules or Statutory Accounting principles, as indicated by the accompanying text.

Claims Reserves - Funds to be set aside for the future payment of incurred claims that have not yet been settled, and hence are classified as liabilities on the company’s balance sheet.

Covea Insurance plc (“Covea”) – An insurance company which is wholly owned by Covéa Group.

Coverholders – brokers who act as agents to underwrite business on behalf of the insurer

Société de Groupe d’Assurance Mutuelle (SGAM) Covéa (“Covéa Group”) – the immediate parent company of MMA Holdings UK plc, and the indirect parent of the Transfer Companies.

CPR - Civil Procedure Rules 1998.

The Court - the High Court of Justice of England and Wales.

Credit risk - The risk of financial loss resulting from changes in the value of assets due to actual default or perception of the risk of default in the future. The term is commonly used to describe the risk that the market value of a financial investment such as a bond will fall due to an increase in the perceived likelihood of default, for example, due to an opinion issued by a credit rating agency, but would also cover the risk of non-payment of reinsurance recoveries or broker balances.

Earned Premium – See “Premium”.

Economic basis - A method of measuring the value of assets and liabilities using market consistent valuation techniques including reflecting the time value of money on cashflows occurring in the future, and excluding “prudent” valuation margins included in estimates of the valuation of insurance liabilities. In this report the word “economic” is used to represent the closest representation to the real value of the assets or liabilities in question, disregarding the effect of accounting or regulatory measurement rules.

Economic capital - Defined as total assets less total liabilities, where each element of the valuation is measured on an “economic” basis, for example, using market consistent valuation techniques including reflecting the time value of money on cashflows occurring in the future, and excluding “prudent” valuation margins included in estimates of the valuation of insurance liabilities.

Effective Date - The date and time on which the Transfer takes effect.

FIA - Fellow of the Institute and Faculty of Actuaries.

Financial Conduct Authority - The Financial Services Authority was reorganised into two separate regulatory agencies during 2013. The successor organisations are the Prudential Regulation Authority and the Financial Conduct Authority. The Financial Conduct Authority focuses on the regulation of conduct by retail and wholesale financial services firms.

FSMA - The Financial Services and Markets Act 2000, the legislation which under Part VII governs the transfer of insurance business between insurance undertakings.

Gross - Excluding the effect of reinsurance arrangements. For example, “gross insurance liabilities” refers to insurance liabilities before taking into account any offsetting of reinsurance assets.

Holding company - A holding company is a company established for the sole or main purpose of holding shares in subsidiary companies.

ICA - Individual Capital Assessment. An insurance company’s own assessment of the capital it needs for regulatory purposes in order to mitigate the risks to which it is exposed and that could otherwise cause it to be unable to meet its liabilities as they fall due.

Independent Expert - The person appointed to report on the terms of the Transfer pursuant to section 109 of FSMA, or any successor appointed to report on the same and whose appointment is approved by the PRA. The Independent Expert’s primary duty lies with the Court, and the opinions of the expert are developed independently of the sponsoring Transfer Companies and the PRA.

Insolvency - The condition of having more liabilities than assets which might be available to pay them, even if the assets were mortgaged or sold.

Insured exposure – The maximum probable loss to the insurer.

Insurance reserves - The estimated value of future claims costs recorded in the balance sheet of an insurance company, also referred to as the “value of insurance liabilities”.

Jurisdiction - The concept that a court or government authority or regulator may exercise control over a person or property because of the location of the property, the activities of a person within a geographic area, or a person's request for assistance from that authority, thereby voluntarily subjecting themselves to jurisdiction.

KPMG - KPMG LLP, a UK limited liability partnership, is a subsidiary of KPMG Europe LLP and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative, a Swiss entity.

Liability - A claim against the assets, or legal obligations of a person or organisation, arising out of past or current transactions or actions.

MMA Holdings UK Limited – The holding company of the Transfer Companies, owned by Covéa Group

MMA IARD Assurances Mutuelles (“MMA IARD”) – Coordinated and directed by Covéa Group, indirect parent of the Transfer Companies

Net - Including the effect of reinsurance arrangements. For example, “net insurance liabilities” refers to insurance liabilities after deducting any offsetting reinsurance assets from the gross insurance liabilities.

Parameter / Parameterised - A numerical input which affects the result of a calculation.

Part VII Transfer - A court process for transferring insurance business, ranging from single contracts to an entire portfolio, to another insurer. The insurers involved can either be in the same insurance/reinsurance group or from different corporate groups. For companies to achieve a successful transfer, they must appoint an Independent Expert who considers the impact of the proposed transfer on the various groups of affected policyholders and submits a report to the Court.

Policyholder obligation - The contractual obligation of an insurer to its policyholders.

Policyholder security - The degree of certainty that policyholders have that an insurer will have the financial resources available to meet its policyholder obligations.

Premium - The amount of money received by an insurer in return for providing an insurance policy providing protection to an insured against the financial consequences of a specified set of potential events. Premium can be measured gross or net of reinsurance, meaning before or after the deduction of any associated reinsurance premiums paid by the insurer. Premium is measured on a "written" basis, meaning all premiums receivable on policies commencing within a given period, or is measured on an "earned basis", meaning the amount of premium attributable to the accounting period based on some allocation of the premium across the period during which the underlying policy is exposed to risk.

Prudential Regulation Authority - The Financial Services Authority was reorganised into two separate regulatory agencies during 2013. The successor organisations are the Prudential Regulation Authority and the Financial Conduct Authority. The Prudential Regulation Authority is part of the Bank of England and carries out the prudential regulation of financial firms, including banks, investment banks, building societies and insurance companies.

Reinsurance - An insurance contract between one insurer (the reinsurer) and another insurer (the cedant) to indemnify against losses of the cedant on one or more contracts issued by the cedant in exchange for a consideration (the premium). Reinsurance is "insurance for insurers", allowing insurers to share potential insurance losses with a reinsurer and hence reduce their own risk. Similar to insurance policies, reinsurance policies are written to cover specific pre-agreed risks and eventualities, as detailed in the reinsurance contract.

The Report - the report produced by the Independent Expert.

Reserves – See "Claims Reserves".

Set-off – the right of a reinsurance provider to an insurance company that is also a policyholder of that same company to offset amounts owed by the company to them against their reinsurance liabilities. This becomes relevant when the insurance company is unable to meet its claims and effectively makes that particular reinsurer a higher ranked creditor than would otherwise be the case. Set-off also applies to other entities that are both creditors and debtors of the insolvent insurer, but the relevance in this report is to reinsurance exposures.

Solvency I capital requirement - UK insurance companies must comply with an EU wide minimum capital requirement, which I refer to as the "Solvency I" capital requirement. It requires insurance companies to hold capital in excess of an amount calculated under a formula based on the value of premiums and insurance liabilities. It is distinct from new "Solvency II" regulations (see Solvency II below)

Solvency II - The European Commission's proposed revision of EU insurance law designed to improve consumer protection, modernise supervision, deepen market integration and increase the international competitiveness of European insurers, elements of which are expected to become effective from 1st January 2016. Under this new system insurers will be required to take into account a wide variety of different types of risk to which they are exposed and to demonstrate they manage those risks effectively. The new system will introduce more sophisticated solvency requirements for all EU insurers, in order to guarantee that they have sufficient capital to withstand adverse events (for example, floods or investment market crises).

Sterling Insurance Company Limited ("Sterling") - An insurance company which is a subsidiary of Sterling Insurance Group Limited

Sterling Insurance Group Limited - the immediate parent company of Sterling.

Stressed scenario - Consideration of the impact (current and prospective) of a particular defined set of alternative assumptions or outcomes that are adverse. Consideration is given to the effect on the insurance company assets, liabilities and operations of a defined adverse scenario.

Subsidiary - An enterprise controlled by another (called the parent) through the ownership of greater than 50 percent of its voting stock.

Surplus – An insurance undertaking is obliged to hold assets of greater value than its contractual liabilities. The difference between these two amounts is often described as the surplus assets, and is usually compared against the amounts of regulatory capital that the undertaking is required to hold.

TASs - Technical Actuarial Standards issued by the Financial Reporting Council.

The Transfer - In the context of this report, I mean the proposal that Sterling will transfer its insurance business to Covea through English and Jersey transfers under the provisions of Part VII of the Financial Services and Markets Act 2000 and the Insurance Business (Jersey) Law 1996 (respectively).

The Transfer Companies – Sterling Insurance Company Limited ("Sterling") and Covea Insurance plc ("Covea")

Transferring policyholders - includes policyholders of Sterling for which any liability or contingent liability remains unsatisfied or outstanding at the Effective Date.

Underwriting - In general insurance, this is the process of consideration of an insurance risk. This includes assessing the appropriate premium, together with the terms and conditions of the cover as well as assessing the risk in the context of the other risks in the portfolio.

Written premium - see "Premium".

Appendix 6 List of interviews carried out

Name	Business Unit	Position
Adrian Furness	Covea	Claims Director
Annabel Wilson	Covea	General Counsel
Clive Bryant	Covea	IT & Business Services Director
James Reader	Covea	Chief Executive
Laurent Eckert	Covea	Chief Risk Officer
Mark Joyce	Covea	Solvency II manager
Simon Kneller	Covea	Actuarial Director
Steven Whittaker	Covea	Finance Director
Brett McWilliam & Glen Potter	Sterling	Chief Risk Officer & Actuarial Manager
Edgar Penollar	Sterling	Group Finance Director
Graham Rivers-Moore	Sterling	Head of Legal and Compliance
John Blundell	Sterling	Managing Director
Tony Pritchard	Sterling	Director and Chief Operating Officer

Appendix 7 Details of proposed policyholder communication

Sterling policyholders

Save as provided below, Sterling proposes to send a policyholder statement setting out details of the Transfer, a copy of the legal notice in respect of the Transfer, and a summary of the terms of the Transfer and of the Independent Expert's report (the "Summary") together, the "Circular", to each person (subject to certain limited exceptions – details of which I have reviewed) who holds a policy under which:

(a) the period of insurance is continuing;

(b) a claim has been made and is outstanding; or

(c) the period of insurance lapsed or was cancelled in the six months prior to the Directions Hearing date and the policy relates to Commercial or Protection insurance.

in each case where the name and address of that policyholder appear on the computerised records of Sterling. There are exceptions to this notification process (subject to approval of the Court) which relate to situations where it is not possible, not appropriate or not proportional to directly mail a circular to the policyholder.

A Circular will also be sent to each third party claimant or, where Sterling corresponds with a representative of such a claimant, that representative, in each case where the claimant has notified a claim which is outstanding and the name and address of the claimant or, where relevant, his representative, appear on the computerised records of Sterling.

Covea policyholders

Existing policyholders of Covea will not be contacted individually for a variety of reasons including:

- The cost would be disproportionate to the benefit given (amongst other factors), that the terms and conditions of the insurance policies of the Covea policyholders will not change in any manner as a result of the Transfer and further taking account of the relatively small size of the transferring business compared with the existing business of Covea;
- There is a concern that contacting policyholders individually will not be appropriate because they will receive routine correspondence during the mailing period (such as renewal notices) that is of greater relevance to them and mailing policyholders on matters of minimal interest may mean policyholders not giving attention to these other communications;
- There may be confusion caused by sending mailings to policyholders who hold products through brokers, who have sold the products under their own branding, with their own policy wording;
- There are significant practical issues with contacting Covea's policyholders taking account of both the volume of data and of the fact that not all policyholder data is held by Covea – much is held by a variety of intermediaries;
- The parties will take a reactive approach and information will be available on Covea's website, with a prominent link on the front page

Records held

Sterling has confirmed that it has current addresses for all its external reinsurers, and will send a letter to each of its reinsurers together with its reinsurance brokers to notify them of the Transfer.

Sterling has confirmed to me that it has computerised records for the majority of their business written as Sterling. Some data is held by brokers/intermediaries and is not in the possession of Sterling. I expect that the computerised records will be complete for all policies written since computerisation of the underwriting records, and the corresponding addresses will be largely up to date, as this is a current book (though where the policies are not underwritten directly by Sterling, this information may be difficult to access or not as complete). There may be some records related to the legacy business which may not be computerised, however there is regular correspondence with representatives of those with outstanding claims or co-ordinating brokers and the address details for these representatives and brokers are up to date. Furthermore, for policyholders with compulsory employers' liability covers (written since 1960 in Sterling) I have seen the ELTO audit report from Year End 2013 and the draft report from Year End 2014 which provide me comfort that should such policyholders have claims in future years they will be able to trace their insurer post-Transfer.

For policyholders whose policy was written before Sterling was renamed as Sterling Insurance Company Limited ("legacy policyholders") (which includes the former marine, aviation and transport business and those risks affected by asbestos claims), given the age of those policies, there may be some addresses which are out of date but it is not possible to estimate how many. The vast majority of any future claims on these policies will be from asbestos-related liabilities, and there are only 12 open asbestos-related claims at the time of writing on policies, going back to 1963 and 1964 underwriting years. Covea will notify only those legacy policyholders with live claims.

Wider communication

The Transfer contains provisions for notice of the proposed Transfer to be advertised in the London, Belfast and Edinburgh gazettes, The Sun and the Daily Mail. As there are insurance risks situated outside of the UK, notice of the proposed Transfer will be advertised in the following EEA state publications: the international edition of the Times, and in the Republic of Ireland, in the Sunday Independent and the Sunday World. In addition it will be advertised in a similar newspaper in Hong Kong and USA.

Outside of the international edition of the Times, the Transfer will not be published in national newspapers in each EEA state except in the Republic of Ireland, which has a significant number of policyholders. The policyholders of the remaining EEA states will receive the Circular (subject to Sterling have access to addresses), and/or be able to access the information on the Transfer Companies' websites, and considering this, and the lack of material risks in these countries, the cost of translation and advertising in local newspapers is not proportionate.

A breakdown of numbers of affected policyholders and claims is included in section 3.6 of this report.

A website will also be operated on which the Summary and a full copy of this report will be posted.