cutting through complexity

Report of the Independent Actuary

CUNA Mutual Insurance (Europe) Limited and Sterling Insurance Company Limited

19 November 2014

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1 Introduction

1.1 Purpose of the Report

CUNA Mutual Insurance (Europe) Limited ("CMIEL"), an Irish regulated non life insurance company which is authorised by the Central Bank of Ireland ("CBI"), underwrites non life accident, sickness, injury and unemployment insurance business in Ireland and also on a freedom of services basis in the United Kingdom ("UK"). (CMIEL's sister company CUNA Mutual Life Assurance (Europe) Limited ("CMLAE"), which is authorised by the CBI, underwrites whole of life term insurance business and group life business in Ireland and also on a freedom of services basis in the UK). CMIEL (and CMLAE) are part of the CUNA Mutual Group Holdings Europe Limited ("CMG").

Sterling Insurance Company Limited ("SICL") is a UK regulated assurance company, authorised by the Prudential Regulation Authority ("PRA") in the UK with responsibility for ensuring prudential solvency and also by the Financial Conduct Authority ("FCA") who have responsibility for conduct issues, to transact non-life insurance business in the UK and also on a freedom of services basis in Ireland. (SICL's sister company Sterling Life Limited ("SLL") is a UK regulated insurance company, which is authorised by the PRA in the UK to transact life and pensions insurance business (mainly term assurance and creditor business) and reassurance business in the UK and also on a freedom of services basis in Ireland). SICL (and SLL) are part of the Sterling Insurance Group Limited ("Sterling").

CMG has made a strategic decision to transition CMG's European underwriting operations to Sterling in the UK due to being unable to meet certain financial expectations. CMG has transferred a portion of the CMLAE business into SLL by way of a Renewal Rights Arrangement. It is proposed the remainder of the CMLAE business and CMIEL business will be transferred to SLL and SICL respectively via a Portfolio Transfer, in order to achieve a streamlined capital efficient outcome.

Under the Portfolio Transfer, it has been proposed that CMIEL will transfer its non life insurance business to SICL (and CMLAE will transfer its life insurance business to SLL). CMIEL will transfer its non life insurance business to SICL under the provisions of Section 13 of the Assurance Companies Act 1909, Section 36 of the Insurance Act 1989 and the European Communities (Non Life Insurance) Framework Regulations 1994. I refer to the proposed transfer as the "Scheme". This Report is in respect of the proposed non life insurance business Portfolio Transfer; a separate report will be provided in respect of the proposed life insurance business Portfolio Transfer.

The terms covering the proposed Portfolio Transfer are set out in the 'Draft Scheme' that will be presented to the Irish High Court ("Court"). It is anticipated that directions will be sought in relation to the Scheme of Transfer in late November/ early December 2014 under Section 13 of the 1909 Act. The Scheme of Transfer document has been prepared by CMIEL's legal advisors.

The petition to the Court for the transfer of long term (or life insurance) business must be accompanied by a Report on the terms of the Scheme by an Independent Actuary. I understand that there is no equivalent legal requirement for any such Report for the transfer of non life insurance business. The Board of Directors of CMIEL however have engaged me to act in a similar and broadly comparable capacity for the transfer of non life insurance business under this Scheme.

This Report is a report prepared by the Independent Actuary in order to aid the Court in its deliberations.

This Report describes the proposed transfer and discusses its possible effects on the relevant policyholder groups, including effects on security and levels of service. The Report is organised into the following sections:

- Section 1: Describes the purpose of this Report and the role of the Independent Actuary;
- Section 2: Executive Summary and Conclusions;
- Section 3: Provides relevant background information on CMIEL;
- Section 4: Provides relevant background information on SICL;
- Section 5: Commentary on the proposed Scheme;
- Section 6: Describes the general considerations when reviewing the proposed Scheme;
- Section 7: An assessment of the proposed Scheme on the security of policies and on the fair treatment of policies.

1.2 Independent Actuary

I, Noel Garvey, am a Director in KPMG Ireland ("KPMG") specialising in non life insurance actuarial services. I am a Fellow of the Society of Actuaries in Ireland ("SAI") having qualified as an actuary in 2001. I hold a Signing Actuary Certificate issued by the SAI. I currently act in the role of Signing Actuary to a number of regulated non life insurance companies in Ireland. My curriculum vita is included in Appendix 3.

I have been appointed by CMIEL to act as the Independent Actuary in connection with the Scheme. SICL has agreed to my appointment. The CBI, PRA and FCA have been informed of my appointment by CMIEL and SICL and I understand have not raised any objections to my appointment. The terms on which I was formally appointed as the Independent Actuary are set out in an engagement letter dated 17th September 2014 and an extract of my scope is included in Appendix 1.

To the best of my knowledge, I have no conflicts of interest in connection with the parties involved in the proposed Scheme and I consider myself able to act as an Independent Actuary on this transaction.

I have also considered the position of KPMG. I can confirm that I have carried out appropriate internal checks in line with KPMG's internal risk management procedures.

Neither I, nor any member of my team, is a qualified lawyer or tax expert. I have not considered it necessary to seek my own specific legal or tax advice on any element of the Scheme.

The costs and expenses associated with my appointment as Independent Actuary and the production of this Report will be met by CMG and Sterling. CMIEL and SICL policyholders are not funding this cost.

In reporting to the Court on the proposed Scheme my overriding duty lies with the Court.

1.3 Scope of report

This Report has been prepared in accordance with:

- Regulation 12 of the European Communities (Non Life Insurance) Framework Regulations (S.I. No. 359 of 1994) ("1994 Regulations") contains the applicable Irish provisions on transfer of portfolio. Regulation 12 of the 1994 Regulations makes express reference to Section 13 of the Assurance Companies Act 1909 and Section 36 of the Insurance Act 1989. Both sections concern the sanction of transfers by the Court.

- The Actuarial Standard of Practice ("ASP") issued by the Society of Actuaries in Ireland, ASP LA-6, "Transfer of long-term business of an authorised insurance company – role of the Independent Actuary". Even though the ASP is related to life business, I consider it reasonable to consider it in my work.

In particular, I owe an overriding duty to the Court to assist the Court and to give the Court independent actuarial advice on the proposed transfer.

This Report is prepared primarily to assess the likely impact that the Scheme will have on the transferring policyholders of CMIEL and the existing policyholders of SICL if it proceeds. It is limited in its scope to the assessment of this Scheme alone and not to any other possible scheme. It is intended that this Report be submitted, in full, as evidence to the Court when it considers whether or not to sanction the Scheme.

The term "Effective Date", as used in this Report, refers to the date at which, if the Scheme proceeds, CMIEL's non life insurance business, incorporating the insurance policies, together with the associated liabilities and assets will be transferred to SICL, such that the policyholder liabilities are extinguished in CMIEL. CMIEL will no longer have exposure to insurance risk. It is expected that the Effective Date will be March/ April 2015.

My consideration of the financial effects of the Scheme has been based on the method of reporting required for CMIEL's regulatory returns to the CBI (on a Solvency I or Pillar 1 basis as it is known in the UK) and for SICL's regulatory returns to the PRA (under both the Pillar 1 and Pillar 2 capital frameworks (as defined in Appendix 4)). I have also considered the potential effect of the Scheme on a Solvency II basis which is the new regulatory standard due to be implemented from 1 January 2016. I am satisfied that consideration of the CBI regulatory returns and solvency calculations and the PRA Pillar 1 regulatory returns and solvency calculations, Pillar 2 and Solvency II calculations is appropriate for the purposes of this Report.

1.4 Assurances

Whilst I have been assisted by my team, the Report is written in the first person singular and the opinions expressed are my own.

In preparing this Report I have done my best to be accurate and complete. I have considered all matters that I regard as relevant to the opinions I have expressed, and I have considered all matters that I believe may be relevant to the policyholders of CMIEL and SICL in their consideration of the Scheme. All the matters on which I have expressed an opinion lie within my field of experience.

I have received assurances as follows:

- I have circulated this Report to the management of CMIEL and SICL respectively to ask for commentary on the detail within the Report including confirming all material information has been provided to me and how the Scheme of Transfer will be effected in practice. No issues were noted with the commentary and detail presented in the Report by either set of management. I have also been given full access to CMIEL and SICL staff as necessary.

- I have provided the Signing Actuary of CMIEL (Michael Culligan) and the Chief Risk Officer ("CRO") of Sterling Brett McWilliam with my Report to ensure they are aware of comments I have made in this Report in relation to actuarial information. No issues have been noted by them as a result of their review of my Report.

In the course of carrying out my work and preparing this Report I have considered various documents provided to me by CMIEL, SICL and Matheson (who are CMIEL's legal advisers in relation to the proposed Scheme). A summary list of the main documents I have considered is set out in Appendix 2.

All of the data and information which I have requested has been provided to me by CMIEL, SICL and their advisers as appropriate. I have relied upon the accuracy and completeness of this data and information, which has been provided to me both in written and oral form by CMIEL, SICL and their advisers. I have not sought independent verification of data and information provided to me by the Scheme Companies, nor does my work constitute an audit of the financial and other information provided to me. In addition, I have, where possible, reviewed the information provided for reasonableness. Where critical information has been initially provided orally, I have requested and obtained written confirmation.

In my role as Independent Actuary CMIEL has contacted the appropriate individuals within the CBI and SICL has contacted the PRA on my behalf. I have been made aware of relevant discussions between CMIEL and the CBI and SICL and the PRA and FCA, and specifically inquired of them whether there were specific issues I should be aware of. I am not due to meet with the FCA but understand that they will have access to my Report.

1.5 Qualifications and Limitations

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

A copy of this Report will be made available to the Court, the CBI, the PRA, the FCA, the Board of Directors (of CMIEL and SICL), the Signing Actuary of CMIEL and the CRO of SICL. It will also be made available to policyholders free of charge from the following:

- The registered office of CMIEL (The Harcourt Building, Harcourt Street, Dublin 2);
- The registered office of SICL (50 Kings Hill Avenue, Kings Hill, West Malling, Kent, ME19 4JX); and
- The registered office of Matheson in both the UK and Ireland (UK:16th Floor, 110 Bishopsgate, London, EC2N 4AY; Ireland: 70 Sir John Rogerson's Quay, Dublin 2).

This Report has been produced for no other purpose other than to support my opinion as Independent Actuary.

This Report is prepared solely in connection with, and for the purposes of, informing the Court, the CBI, the PRA, the FCA and relevant potentially affected policyholders of my findings in respect of the impact of the Scheme on the security and service levels of potentially affected 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 dated 17th September 2014. An extract from this contract describing the scope of my work is contained in Appendix 1.

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 in connection with any other use or reliance. To the fullest extent permitted by law, KPMG will accept no responsibility or liability in respect of this Report to any other party.

In my role as Independent Actuary, I have in the normal course of conducting this role, been provided with a significant and appropriate amount of information and data about the Scheme Companies activities and performance. When forming my view as set out in this Report, these disclosures and information have formed a necessary and vital contribution.

This Report is based on information made available to me at or prior to 19 November 2014 and takes no account of developments after that date.

1.6 Terminology

In my discussion of the effects of the proposed Scheme on the Scheme 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.

1.7 Currency

The exchange rates used in this Report are as follows:

- EUR to GBP exchange rate at 31 December 2013 was €1 = £0.83.

Figures are presented in Euro throughout the majority of the report. Figures relating to SICL business in Section 4 are presented in GBP. I have identified clearly the currency of figures presented.

2 Executive Summary and Conclusions

2.1 Executive Summary

2.1.1 Overview

CMG has made a strategic decision to transition CMG's European underwriting operations to Sterling in the UK due to being unable to meet certain financial expectations. It has been proposed that CMIEL will transfer its non life insurance business to SICL (and CMLAE will transfer its life insurance business to SLL). CMG has transferred a portion of CMLAE business into SLL by way of a Renewal Rights Arrangement (which is not part of my assessment of the Scheme was implemented with effect from 1 October 2014) and it is proposed the remained of the CMLAE business and the CMIEL business will be transferred to SLL and SICL respectively via a Portfolio Transfer, in order to achieve a streamlined capital efficient outcome. This Report considers the impact of the proposed transfer of the non life insurance business of CMIEL into SICL, a separate report will be provided in respect of the proposed life insurance business Portfolio Transfer.

The Scheme proposed is one for the transfer of insurance business by order of the Irish High Court. The transfer of the CMIEL portfolio of insurance contracts to SICL will be achieved by using the provisions of Section 13 of the Assurance Companies Act 1909, Section 36 of the Insurance Act 1989 and Regulation 12 of the European Communities (Non Life Insurance) Framework Regulations (S.I. No. 359 of 1994). The Scheme provides for the transfer of CMIEL's non life insurance business, incorporating the insurance policies, together with the associated liabilities and assets as at the Effective Date to SICL, such that CMIEL's policyholder liabilities are extinguished in CMIEL.

The Scheme proposes on the Effective Date to:

- Transfer the assets supporting the policyholder liabilities of CMIEL into SICL; and
- All in force CMIEL policies and policies in respect of which any potential liability exists at the effective date should be included in the transfer. Upon transfer SICL will establish regulatory reserves in respect of the transferring CMIEL liabilities under their UK regulatory basis and methodology.

There will be no changes to policyholder benefits or to the administration of the business as a result of the Scheme and all rights and obligations of CMIEL will transfer to SICL.

The effective date of the Scheme is expected to be March/April 2015.

2.1.2 Approach

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

i. Understand the businesses of the companies affected by the Scheme; and

ii. Understand the effect of the Scheme on the assets, liabilities and capital (on the various regulatory bases) of the companies and businesses involved.

Having identified the effects of the Scheme on the various companies and businesses, I then:

i. Identify the groups of policyholders directly affected;

ii. Consider the impact of the Scheme on the security of each group of policyholders;

iii. Consider the impact of the Scheme on the benefit expectations of each group of policyholders; and

iv. Consider other aspects of the impact of the Scheme (for example, policyholder service).

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

- CMIEL and SICL balance sheet information based on audited regulatory balance sheet figures as at 31 December 2013 and 31 December 2012, including proforma balance sheet information illustrating the impact of the transfer as if it had occurred as at 31 December 2013;
- Estimates of the levels of risk-based capital (under the PRA Pillar 2 framework) in SICL (on a pre transfer basis), at 31 December 2013;
- Estimates of the impact of the introduction of Solvency II on CMIEL and SICL (on a pre transfer basis), at 31 December 2013;
- The Pillar 2 and Solvency II data has been fully disclosed to me by CMIEL and SICL for my analysis, however due to commercial sensitivities; I have not reproduced the detail of the data within this Report;
- In forming my opinion, I have raised queries with key personnel responsible for core functions in the Scheme Companies, and I have placed reliance on, amongst other information, estimates of the impact on CMIEL policyholders of moving to a UK regulatory basis;
- 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 Scheme Companies to calculate the estimate of Pillar 1 and of Pillar 2 capital required.
  - The extent to which the reasoning behind my opinion would be affected using alternative estimates of required risk-based capital based on Solvency II capital.
  - The impact of potential adverse events on each of the Scheme Companies to gain comfort that, at a high level, the Pillar 1, Pillar 2 and Solvency II capital estimates are reasonable.
  - Consideration of the range of management actions available to the Scheme companies to manage adverse events on a UK regulatory and Solvency II basis.

A list of all significant information provided is set out in Appendix 2.

2.1.3 Key assumptions

I understand that:

- SICL intend to continue to underwrite similar business as currently written prior to the Scheme.

- Post transfer, transferring CMIEL business in respect of Irish policyholders will continue to be subject to CBI conduct of business rules, although prudential regulation will be the responsibility of the PRA and conduct regulation will be the responsibility of the FCA for the UK policyholders.

- There will be no change to policy terms and conditions of the transferring CMIEL policies or the existing SICL policies.

- The range of discretionary powers currently available to CMIEL for the transferring policies is reasonably limited relating to claims acceptance, premium refunds, premium repricing ability on renewal and this discretion will remain with SICL; therefore, I do not expect that the Scheme will cause a change in the approach to the use of discretionary powers.

- No material change is expected in the risk profile of SICL, while CMIEL will no longer have exposure to insurance risk.

The above assumptions underlie the analysis and conclusions in my Report. If any of these assumptions were to change, my opinion may also change. I have circulated this Report to the management of CMIEL and SICL respectively to ask for commentary on the detail within the Report including the underlying assumptions. No issues were noted with the commentary and detail presented in the Report by either set of management reflecting the fact that the key assumptions listed above correctly represent the current intentions, and that the information I have been provided accurately reflects these businesses.

2.1.4 Findings

The findings of my Report are summarised below.

- I do not identify any adverse impact on service levels experienced by transferring CMIEL policyholders as a result of the Scheme; particularly as the administration is currently undertaken by Sterling Group. I expect no change in the levels of service experienced by SICL policyholders.

- Although the transferring CMIEL policyholders will be protected by a different regulatory capital regime in the UK as a result of the Scheme, I do not expect any materially adverse impact on policyholder security as a consequence of this change, as the UK regulatory capital requirements are also designed to ensure that the probability that policyholders will not be paid their benefits is remote.

- I have considered the relative capital strength of CMIEL and SICL respectively prior to the transfer and SICL post the transfer.

  - I note that the proforma financial information presented is based on 31 December 2013 audited financial information which is dated at this stage. However I am comfortable that it is a reasonable basis to assess the effects of the Scheme. A Supplementary Report will be prepared for the final Court hearing which will reflect the 31 December 2014 financial position for both CMIEL and SICL.

  - Financial analysis: I have based my analysis on the most recent audited financial information at 31 December 2013 including regulatory returns to the CBI and PRA and 30 June 2014 management information. At this point, I am not aware of material negative adjustments since 31 December 2013 likely to adversely impact the financial analysis below.

- Risk profile: If the proposed transfer takes place, the risk profile of SICL after the transfer should not be materially changed from its risk profile before the transfer as the types of risks inherent in CMIEL's business are similar to the business risks underwritten by SICL.

- Pillar 1: The Pillar 1 capital and solvency position of CMIEL and SICL as standalone entities pre transfer and as a combined entity post transfer are set out in the table below.

Table 2.1 Proforma projected Solvency I capital requirement as at 31 December 2013

	Pre Transfer		Post Transfer	
€m	**CMIEL**	**SICL (Pillar 1)**	**CMIEL**	**SICL (Pillar 1)**
Assets available to meet liabilities to policyholders	7.4	194.1	6.7	194.9
Technical provisions**	0.7	137.0	0.0	137.7
Other liabilities*	3.1	19.2	3.1	19.2
Net Assets available to cover required minimum solvency margin	3.6	37.9	3.6	37.9
Required minimum solvency margin	2.5	27.2	2.5	27.2
Excess of available assets	1.1	10.7	1.1	10.7
Solvency margin coverage ratio	**144%**	**140%**	**144%**	**140%**

Note: *Includes items such as expense accruals, taxation, experience rebate accruals, commission, unallocated premiums and intercompany payables
** Includes UPR reserve

Source: Summary of key numbers 2013-12-31 V2 2014-10-06 .xls

As can be seen, the transferring liabilities are not material given the size and strength of SICL's balance sheet.

The proforma presentation at 31 December 2013 post the transfer reflects that CMIEL assets of €0.7m would be transferred and liabilities of €0.7m would be set up by SICL. The assets being transferred are sufficient to cover the transferring liabilities (basic mathematical reserves of €0.7m). CMIEL Other liabilities of €3.1m will be excluded from the transfer and assets net of liabilities of €3.6m will remain in CMIEL.

There is a strong regulatory capital position on a CBI regulatory basis in CMIEL at 31 December 2013 before the Scheme. The UK Pillar 1 regulatory capital position in SICL remains strong on a standalone and a combined basis after the proposed Scheme of Transfer from the perspective of the transferring CMIEL policyholders and the existing SICL policyholders based on the proforma financial analysis prepared.

CMIEL do not expect there to be any Excluded Policies at the time of transfer, as such these have not been considered further.

- Pillar 2 Position: I have been provided with Pillar 2 information for SICL which illustrates a strong regulatory capital position. There is no requirement for CMIEL to prepare Pillar 2 information.

Given the strong Pillar 2 position pre transfer and the effects identified above, I am comfortable that the Pillar 2 position will remain strong post the transfer for transferring CMIEL policyholders and remaining SICL policyholders.

– Solvency II: I have been provided with estimates of the impact of Solvency II for CMIEL and for SICL on a pre transfer basis at 31 December 2013. The CMIEL position under Solvency II remains broadly unchanged compared to the Solvency I position. The figures reviewed are based on SICL's interpretation of the proposed Solvency II rules at that point in time, and work continues in SICL to refine its methods and models and additional supervisory guidance is still expected which may result in revisions to SICL's interpretation of the rules. I note the current assessment of the impact of Solvency II on SICL on a standard formula basis is that there is a material reduction in the solvency coverage ratio; however SICL still remains solvent under Solvency II though the solvency margin coverage is below its risk appetite level. SICL has identified a number of technical aspects of the Solvency II rules which give a more adverse solvency margin treatment compared to Pillar 2 requirements. While work continues to refine SICL's technical basis, analysis has been provided which sets out a range of potential strategic management actions available to SICL to improve its solvency margin coverage ratio during 2015 above its risk appetite level. The actions cover areas such as dividend policy, reinsurance arrangement, asset rebalancing and redistribution of capital within the Sterling Group. A further list of actions has been identified though not quantified which would also improve the Solvency II position. These actions have been presented to the SICL Board.

  I note from the proforma analysis that the transfer is not likely to impact materially on SICL's Solvency II position post the Scheme. I note that SICL policyholders are not disadvantaged by the Scheme as a result of the implementation of Solvency II i.e. the Solvency II solvency coverage position is broadly unchanged as a result of the Scheme; however the transferring CMIEL policyholders are being transferred into an entity which has a weaker solvency coverage position on a Solvency II basis. Given the strategic management actions which are available to SICL, I conclude that SICL should be able to implement necessary management actions in addition to the refinement of their detailed technical basis which should bring the solvency coverage ratio to an acceptable level. On that basis, the transferring CMIEL policyholders should not be disadvantaged by the Portfolio Transfer as a result of the implementation of Solvency II. I will monitor progress of the Solvency II implementation ahead of the final Court hearing in March/ April 2015 time.

– Business Plan: When assessing the financial consequences on the security of policyholders, I have considered the SICL business plan which outlines projected profits in the period to 2018.

I intend to issue a Supplementary Report containing an update on any developments that may have occurred in the period between the directions hearing and the formal order sanctioning the Portfolio Transfer to proceed. In this Supplementary Report I will review my findings and opinion which will include consideration of the following:

- Business performance in the period and updated financial information based on the position at 31 December 2014;

- Progress on the implementation of Solvency II given the comments above;

I understand that this Supplementary Report is intended to be made available on the CUNA Mutual Europe website and Sterling Insurance Group Limited website no later than three weeks prior to the final hearing date, in March/ April 2015.

2.2 Conclusions

Having considered the impact of the Scheme on both the transferring policyholders of CMIEL and the existing policyholders of SICL, it is my opinion that:

- The Scheme will not have a material adverse effect on the security of benefits for any of the policyholders involved; and
- The Scheme will not have a material adverse effect on the reasonable benefit expectations of any of the policyholders involved.

My opinion in relation to CMIEL and SICL policyholders is based on:

- My review of all the pertinent historic and current information provided by CMIEL and SICL;
- The investigations completed by the CMIEL's and SICL risk management function and in-house / external actuarial advisors and their respective conclusions based on those investigations; and
- Discussions with the management of CMIEL and SICL on what will happen post transfer including capital management and Solvency II implementation plans post transfer.

My assessments are made in the context of the current Irish and UK regulatory regimes and the proposed Solvency II regime from 1 January 2016.

19 November 2014

Noel Garvey, FSAI

Date

Independent Actuary

KPMG in Ireland

3 CUNA Mutual Insurance (Europe) Limited

3.1 Structure and background

CMIEL is an Irish regulated non life insurance company underwriting non life accident, sickness, injury and unemployment insurance business in Ireland and also on a freedom of services basis in the UK. It is a wholly owned subsidiary of CMG, an Irish company which is a wholly owned subsidiary of CUNA Mutual International Holdings Limited, registered in the Cayman Islands which is a wholly owned subsidiary of CMFG Life Insurance Company registered in Iowa in the United States. On 26 September 2008 CMIEL was granted authorisation as a non life insurance undertaking to carry on Class 1 Accident, Class 2 Sickness and Class 16 Misc. financial loss business. CMIEL operates out of Harcourt Street, Dublin, the business has focused on both the Irish and UK market. It operates in the UK under the 'freedom of services' provisions of the EU's Third Life Directive as implemented in Irish insurance regulation. CMIEL has no other authorisations and does not passport into any other jurisdictions.

The principle activity of CMIEL is the underwriting of non life accident, sickness, injury and unemployment insurance business in Ireland and also on a freedom of services basis in the UK. CMIEL is regulated by the CBI.

CMG has made a strategic decision to transfer CMIEL's business into SICL by way of a Portfolio Transfer in order to achieve a streamlined capital efficient outcome.

Products are distributed in Ireland and the UK through two distribution companies, CUNA Mutual Group Services (Ireland) Limited and CUNA Mutual Group Limited, who develop and manage the relationships with policyholders and sub-agents such as Credit Unions, Building Societies and other affinity partners.

It is intended that the distribution companies, CUNA Mutual Group Services (Ireland) Limited and CUNA Mutual Group Limited, will be sold to new owners who will enter into a new distribution agreement with SICL.

3.2 Nature of business written

CMIEL underwrites non life accident, sickness, injury and unemployment insurance business in both the UK and Ireland. The company focuses on the following market sectors: Irish and UK credit unions, building societies and other affinity partners. CMIEL's in-force portfolio can be split into the following product types:

- Payment Protection Insurance ("PPI");
- Short Term Income Protection ("STIP");
- Commercial Liability Income Protection ("CLIP");
- Lifestyle Protection (Accident, Sickness and Involuntary Unemployment); and
- Mortgage Protection Payment Insurance ("MPPI").

Table 3.1 CMIEL's business

	31 December 2011		31 December 2012		31 December 2013	
	APE	**Net of Reinsurance Reserves**	**APE**	**Net of Reinsurance Reserves**	**APE**	**Net of Reinsurance Reserves**
	€m	**€m**	**€m**	**€m**	**€m**	**€m**
UK Borderaux business	1.7	0.5	0.9	0.4	0.4	0.2
UK Direct business	0.3	0.1	0.4	0.2	0.4	0.2
Irish Borderaux business	0.8	0.5	0.7	0.5	0.6	0.3
Irish Direct business	-	-	-	-	-	
Total	**2.8**	**1.1**	**2**	**1.1**	**1.4**	**0.7**

Source: Non life premium analysis.pdf; regulatory returns

At 31 December 2013 all business was monthly premium business.

3.3 Risk Profile and management

3.3.1 Overview of risks

CMIEL is exposed to a range of risks including operational risk, financial liquidity/ solvency risk, market risk, insurance risk, counterparty default risk and regulatory/ fiscal risk.

These risks are overseen and managed by the Board Risk Committee. The Board Risk Committee reviews all risk and compliance issues affecting CMIEL. The primary risk to the security of CMIEL's policyholder benefits is that one or more of the risks identified give rise to an event which renders CMIEL insolvent. Given the risk profile of the company's business and the current level of available assets in excess of the company's minimum solvency margin requirement, the risk of insolvency and any risk to the security of benefits could be considered remote.

3.3.2 Risk Appetite

In line with the Corporate Governance Code, published by the CBI in 2010, CMIEL has a Board-approved Risk Appetite Statement. CMIEL's Risk Appetite Statement is reviewed and approved by the Board on an annual basis. The Risk Appetite Statement sets out both qualitative and quantitative risk measures and is built around 4 risk groups (Strategy/ Business Model Risk, Insurance Risk, Market Risk and Operational risk). The performance of the company against the Risk Appetite is monitored on a monthly basis and formally reported to the Board Risk Committee on a quarterly basis (although any risk measures which fall outside defined tolerances are immediately reported to the chair of the Board Risk Committee).

The Risk Appetite Statement seeks to connect CMIEL's strategy and the required level of regulatory capital with the company's risk management framework, which is supported by a suite of risk policies and manuals. These policies and manuals were drafted by CMIEL's Board.

3.3.3 Governance

The company has implemented a risk management framework which includes:

- A three year rolling strategic plan which is updated on at least an annual basis supported by a capital plan to ensure the company has sufficient capital to deliver this strategic plan;

- A Risk Appetite Statement which is reviewed and approved by the Board on an annual basis;
- Formal policies established by the Board for key risk areas such as underwriting risk, re-insurance and Asset Liability Matching and Investment risks. These are supplemented with a compliance manual containing policies & procedures covering the broader operations of the business.
- The CRO (together with the broader executive team) maintains a formal risk register. Identified risks are managed by the executive on an on-going basis through mitigating controls and policies, key risk indicators and specific actions and the risks are rated by reference to probability of occurrence and impact. The resulting risk landscape is reported to the Board Risk Committee on a quarterly basis;
- The risk register / risk landscape is informed by the output from on-going compliance monitoring activity and risk incidents and errors reported by the business. Material risk incidents and the output from the compliance monitoring program are also reported to the Board Risk Committee on a quarterly basis; and
- There is also an internal audit function in place which acts as a third line of defence.

As well as the Board of Directors:

- There are two sub-committees of the Board – an Audit Committee and a Risk Committee.
- At the executive management level, there is an Operations Committee ("OpCo") which comprises the heads of the various functions and which meets monthly. There is also an Asset & Liability Committee ("ALCo") comprising the CEO, CFO and CRO which meets quarterly. The OpCo is supported by a number of executive sponsored committees including the Executive Risk Committee, the Product & Claims Quality Committee and a Credit Committee.

3.4 Operational arrangements

There are no employees within the company. CMLAE (life business sister company) employees perform services for CMIEL. The company operates on a fully outsourced business model with services being provided by third parties as follows:

- CMLAE provides staff resource in departments such as Operations & Administration, Marketing and Finance, Product Development and Pricing.
- Policy and claims administration is outsourced to Sterling Group;
- Other functions, such as Human Resources and Asset Management Services are provided in whole or in part by the company's ultimate parent in the USA; and
- Milliman provides Signing Actuary and other actuarial consulting services. The Signing Actuary is Michael Culligan of Milliman.

3.5 Reinsurance

There are no reinsurance treaties in force on this business.

3.6 Financial Profile

3.6.1 Background

The general requirement by which a Signing Actuary must calculate the mathematical reserves relating to non life insurance business is described in Statutory Instrument 359 of 1994 (S.I. 359) European Communities (Non Life Insurance) Framework Regulations 199. In addition the Signing Actuary is required to comply with:

- Actuarial Standards of Practice issued by the Society of Actuaries in Ireland in particular Actuarial Standard of Practice GI–2 : Statements of actuarial opinion on non life insurance business (version 2.4 effective 01.11.2010).
- Guidelines issued by the Central Bank of Ireland relating to the valuation of non life insurance business entitled "Guidelines on the actuarial certification of the technical reserves of non life companies", latest version dated April 2008.

3.6.2 Mathematical reserves

Table 3.2 below summarises CMIEL's mathematical reserves over the last three years to 31 December 2013 which is the date of the most recent available information.

Table 3.2 CMIEL Mathematical Reserves (net of reinsurance)

€m	31 December 2011	31 December 2012	31 December 2013
Irish business	0.5	0.5	0.3
UK business	0.6	0.6	0.5
Total	**1.1**	**1.1**	**0.7**

Source: SAO reports 2011, 2012 and 2013

At 31 December 2013, there was €1.4m of earned premium in force and the mathematical reserves of the company totalled €0.7m. The ultimate loss ratios by financial year have varied between 50% and 75% from 2011 to 2013.

I have been provided with regulatory returns to the CBI and reports supporting the Statement of Actuarial Opinion which include the figures presented in Table 3.2 above. I have no issues to note from my review of the financial information prepared by the Signing Actuary and my discussions with the Signing Actuary.

3.7 Solvency Position

3.7.1 Solvency I (CBI basis) capital requirement

Table 3.3 below sets out the historic solvency position of CMIEL, under the CBI Solvency I framework, for the three years to 31 December 2013.

Table 3.3 CMIEL Solvency I Capital Requirement			
€m	31 December 2011	31 December 2012	31 December 2013
Net Assets available to cover required solvency margin	5.9	4.7	3.6
Required minimum solvency margin	2.3	2.5	2.5
Excess of available assets over solvency margin	3.6	2.2	1.1
Solvency margin coverage ratio	**258%**	**189%**	**144%**

Source: Regulatory Returns to the CBI

As at 31 December 2013 the returns to the CBI showed that the total available assets to meet the solvency margin of CMIEL were €3.6m. There were €1.1m surplus assets available in excess of the required minimum solvency margin of €2.5m. There was a solvency margin coverage ratio of 144%.

The declining Solvency I solvency margin coverage ratio over the last couple of years is due to a combination of poor experience and insufficient premiums to cover overheads of the company, causing a loss making position combined with the change to the Minimum Guarantee Fund of €2.3m for 2011 and €2.5m for 2012 and 2013. This is projected to continue in the absence of specific management actions.

3.7.2 Solvency II

I note that Ireland and the UK (with the rest of Europe) plan to replace the current Solvency I regime with the risk based Solvency II regime with effect from 1 January 2016, a regime which incorporates economic capital modelling into insurer capital requirements. The European Solvency II Directive is a fundamental review of the capital adequacy and solvency supervision regime for the European insurance industry. As Solvency II is an EU initiative it will apply in Ireland and the UK (and across Europe) in a harmonised way.

I have been provided with estimates of the impact of Solvency II on CMIEL on a pre transfer basis at 31 December 2013. The figures reviewed are based on CMIEL's interpretation of the proposed regulations, and additional supervisory guidance may result in revisions to this interpretation. The interpretations of the Solvency II effects as presented to me are reasonable. I note that the current assessment of the impact of Solvency II on CMIEL on a standard formula basis is that it should have sufficient capital. Therefore, as a standalone entity prior to the transfer, CMIEL policyholders should not be materially impacted by a move to Solvency II based on the financial analysis presented.

3.8 Policyholder Reasonable Expectations

There is no statutory regulation in relation to PRE for non life insurance companies in Ireland. However, I have considered PRE in a general manner below. I note the following:

- The benefits arising under the transferring CMIEL policies are straightforward and guaranteed in nature;
- Security of benefits: transferring policyholders have a reasonable expectation that their benefits are secure and will be paid as they fall due. This will depend on the risks to which the transferring policyholders are exposed to before and after the transfer, including the relevant financial position of the companies.
- Entitlement to benefits: transferring policyholders have a reasonable expectation that valid claims will be paid in accordance with policy terms and conditions. I have reviewed CMIEL's product

documentation and am satisfied that it does not confer any particular additional reasonable expectations over and above the contractual provisions. I am not aware of any local legislative requirements which confer entitlements to policyholders beyond those in the policy terms, or constrain the use of discretion by CMIEL.

- Service standards: transferring policyholders have a reasonable expectation that the services they receive will be provided in a professional manner, that claims and enquiries will be dealt with promptly.

- Discretionary powers available to CMIEL: transferring policyholders have a reasonable expectation that any discretion available to CMIEL will be applied in a fair and reasonable manner. The use of discretion by CMIEL is reasonably limited and principally relates to:

  - the assessment as to whether a claim is valid or not;

  - the appropriate premium rate to charge.

  The approach to the use of these discretionary powers will not be materially altered as a result of the Scheme, I comment on this further in Section 7.2.

3.9 Other regulatory matters

I am not aware of any other regulatory matters.

4 Sterling Insurance Company Limited

4.1 Structure and background

Sterling Insurance Company Limited ("SICL") is a UK regulated insurance company, which is authorised by the Prudential Regulation Authority ("PRA") in the UK to transact non life insurance business with responsibility for ensuring prudential solvency and also by the Financial Conduct Authority ("FCA") who have responsibility for conduct issues. SICL's sister company Sterling Life Limited ("SLL") is a UK regulated insurance company, which is authorised by the Prudential Regulation Authority ("PRA") in the UK to transact life and pensions insurance business (mainly term insurance and creditor business) and reassurance business. SICL (and SLL) are part of the Sterling Insurance Group Limited ("Sterling"). It operates in the Ireland under the 'freedom of services' provisions of the EU's Third Life Directive.

The principle activity of SICL is the underwriting of household, commercial, non-life accident, sickness, injury and unemployment insurance business in the UK and Ireland. SICL's sister company SLL underwrites term life assurance, critical illness and creditor insurance business in the UK and also on a freedom of services basis in Ireland.

CMG has made a strategic decision to transfer CMIEL's business into SICL by way of a Portfolio Transfer in order to achieve a streamlined capital efficient outcome.

4.2 Nature of business written

SICL underwrites non life business in the UK and on a freedon of service basis in Ireland. SICL's in-force portfolio can be split into the following product types:

- Personal and Commercial lines property;
- Personal and Commercial lines liability;
- Unemployment; and
- Accident & Health.

Table 4.1 SICL's business

	31 December 2011			31 December 2012			31 December 2013		
£m	**Gross W. Prem**	**Gross O/s Claims**	**Gross Unearned Prem**	**Gross W. Prem**	**Gross O/s Claims**	**Gross Unearned Prem**	**Gross W. Prem**	**Gross O/s Claims**	**Gross Unearned Prem**
Household	46.6	10.3	24.4	50	13.1	26.4	50.6	13.6	26.3
Commercial	36.1	22.3	16.1	33.4	23.8	16.5	37.6	26.8	18.6
Creditor	68.3	4.5	15.1	51.4	3	14.6	36.7	2.1	15.3
Personal Accident	10.4	1.2	0	10.2	1.1	0.1	9.2	1.1	0.1
Run-Off	0	0.6	-	0	0.6	-	-	0.6	-
Total	161.4	38.9	55.6	145.1	41.5	57.5	134.1	44.2	60.2

Source: PRA returns
Note: Total technical provisions include claims handling provisions and equalisation reserves which are not included in this table.
Gross W. Prem = Gross Written Premiums in prior 12 months
Gross O/s Claims = Gross Outstanding Claims
Gross Unearned Prem = Gross Unearned Premiums

4.3 Risk Profile and management

4.3.1 Overview of risks

SICL is exposed to a range of risks including operational risk, financial liquidity/ solvency risk, market risk, insurance risk, counterparty default risk and regulatory/ fiscal risk.

These risks are overseen and managed by the Board Risk Committee. The Board Risk Committee reviews all risk and compliance issues affecting SICL. The primary risk to the security of SICL's policyholder benefits is that one or more of the risks identified give rise to an event which renders SICL insolvent. Given the risk profile of the company's business and the current level of available assets in excess of the company's minimum solvency margin requirement, the risk of insolvency and any risk to the security of benefits could be considered remote.

4.3.2 Risk Appetite

Annually the Board of SICL reviews risk appetites and provide guidance on the risk tolerance of the Company within the areas of Insurance Risk, Market Risk, Counterparty Risk, Liquidity Risk, Operational Risk, Business & Strategic Risk and Group Risk. For each risk category, risk limits and monitoring criteria are established with clear definition of those responsible for carrying out and reporting on the monitoring activity and any exceptions observed. This risk appetite document also lays out the oversight responsibilities for the approval of risk appetite and the operational responsibilities for the management of the business within the approved appetite.

4.3.3 Governance

SICL has various committees in place which are responsible for management, monitoring and reporting of risk which form part of the risk management framework of the company. The risk management framework also consists of:

- A Risk Appetite Statement which is reviewed and approved by the Board on an annual basis;
- A Risk Committee, an Investment Committee and a Management Committee each with their own objectives. The Risk Committee agree and review performance indicators and management information to monitor and assess risk on a regular basis and report these matters to the Board on a regular basis. The Investment Committee communicates the existence and nature of new market, investment credit or liquidity risks, or changes to such, to the Risk Committee on a quarterly basis. The duties of the Management Committee include the need to actively manage the risks to the Group's continuing business and ongoing operations.
- The Board of Directors have ultimate responsibility over corporate governance polices, although the responsibility of day-today implementation is delegated to the Risk Committee and Management Committee.
- Governance applied in line with a Group governance manual;
- Policies and procedures covering key risk areas.

4.4 Operational arrangements

Sterling's Head Office is in Kent, UK with 387 employees (as at May 2014). These employees provide the capabilities to support the operations of SLL, SICL and Sterling Administrations Services Limited ("SAS"). In addition to providing administration services to CMG, SAS provides administration services to other insurance operations in the UK and Ireland.

Core services are provided in house however Sterling uses various sub-service organisations to provide services, which are managed and controlled through the Material Third Party Arrangements Policy. Such arrangements include Mimecast Services Ltd to provide a cloud based email service and Strawberry Global Technology Ltd to manage the internal and external networks for Sterling.

4.5 Reinsurance

There are a variety of reinsurance treaties in force as at 31 December 2013 written on both proportional and non-proportional bases.

4.6 Financial Profile

4.6.1 Background

The prudential regulation of insurance companies in the UK is carried out by the PRA. The PRA has rules to govern the conduct of insurance companies, which encompass the requirements of European Insurance Directives and UK legislation. As well as the financial reporting that applies to other types of companies, insurers are also required to provide additional financial information publicly and privately to the PRA. If a firm fails to meet its regulatory capital requirements the firm is normally required to submit a plan to the PRA showing how it will restore its capital resources to the required level.

I note that the approach to the calculation of solvency capital on a Solvency I Pillar 1 basis under UK regulatory rules is broadly similar to the Irish Solvency I regime. Under PRA guidelines UK firms must also undertake a Solvency I Pillar 2 assessment of the adequacy of its capital resources, known as the Individual Capital Assessment ("ICA") which is viewed as a more realistic capital measure compared to Pillar 1. Sections 4.7.1 and 4.7.2 below include commentary on the financial profile of SICL under the Pillar 1 and Pillar 2 bases.

4.6.2 Mathematical reserves

Table 4.2 below summarises SICL's mathematical reserves over the last three years to 31 December 2013 which is the date of the most recent available information.

Table 4.2 SLL Mathematical Reserves

	31 December 2011			31 December 2012			31 December 2013		
£m	**Gross**	**Ceded**	**Net**	**Gross**	**Ceded**	**Net**	**Gross**	**Ceded**	**Net**
Mathematical reserves	104.5	9.4	95.1	109.1	4.5	104.6	114.4	6.0	108.3

Source: PRA returns

At 31 December 2013, there was an annual earned premium in force of £131.4m and the gross mathematical reserves of the company totalled £114.4m. The loss ratio in the year to 31 December 2013 was 30.1%.

4.7 Solvency Position

4.7.1 Solvency I capital requirement

Table 4.3 below sets out the historic solvency position of SICL, under the Solvency I Pillar 1 framework, for the three years to 31 December 2013.

Table 4.3 SICL Solvency I Capital Requirement

£m	31 December 2011	31 December 2012	31 December 2013
Net Assets available to cover required solvency margin	35.1	34.8	31.7
Calculated solvency margin	22.7	22.7	22.7
Excess of available assets over solvency margin	12.4	12.1	9.0
Solvency margin coverage ratio	**155%**	**153%**	**140%**

Source: PRA returns

As at 31 December 2013 the returns to the PRA showed there were £31.7m surplus assets available, to cover the required minimum solvency margin of £22.7m. There was a solvency margin coverage ratio of 140%. SICL has and continues to maintain a strong Solvency I Pillar 1 capital position.

4.7.2 Pillar 2

Under PRA guidelines UK firms must undertake a Pillar 2 assessment of the adequacy of its capital resources, known as the ICA which is viewed as a more realistic capital measure compared to Pillar 1. This is in addition to the Pillar 1 capital requirement assessment which is based on fixed percentages of premiums and claim amounts. Companies must hold assets in excess of the higher of the Pillar 1 requirement and the Pillar 2 ICA assessment. The Pillar 2 capital assessment is a risk-based capital assessment that considers the appropriate capital required for the specific risks of the company.

The Pillar 2 results were fully disclosed to me by SICL but due to commercial sensitivities I have not reproduced the detailed results within this Report. However, I have been provided with detailed methodology, assumption and results reports and the approach appears reasonable for the specific risks in question. I can confirm that the SICL is well capitalised on a Pillar 2 basis.

4.7.3 Future regulatory capital requirements

I have been provided with the current SICL business plan which outlines projected profits over the period to 2018.

4.7.4 Solvency II

I note that Ireland and the UK (with the rest of Europe) plan to replace the current Solvency I regime with the risk based Solvency II regime with effect from 1 January 2016, a regime which incorporates economic capital modelling into insurer capital requirements. The European Solvency II Directive is a fundamental review of the capital adequacy and solvency supervision regime for the European insurance industry. As Solvency II is an EU initiative it will apply in Ireland and the UK (and across Europe) in a harmonised way.

I have been provided with estimates of the impact of Solvency II on SICL on a pre transfer basis at 31 December 2013 which has been shared with the PRA. The figures reviewed are based on SICL's interpretation of the proposed Solvency II rules at that point in time, and work continues in SICL to refine its methods and models and additional supervisory guidance is still expected which may result in revisions to SICL's interpretation of the rules. I note the current assessment of the impact of Solvency II on SICL on a standard formula basis is that there is a material reduction in the solvency coverage ratio; however SICL still remains solvent under Solvency II though the solvency margin coverage is below its risk appetite level. SICL has identified a number of technical aspects of the Solvency II rules which give a more adverse solvency margin treatment compared to Pillar 2 requirements. While work continues to refine SICL's technical basis, analysis has been provided which sets out strategic management actions available to SICL to improve its solvency margin coverage ratio above its risk appetite level. These actions have been presented to the SICL Board. The actions cover areas such as dividend policy, reinsurance arrangement, asset rebalancing and redistribution of capital within the Sterling Group. A further list of actions has been identified though not quantified which would also improve the Solvency II position.

I note that SICL policyholders are not disadvantaged by the Scheme as a result of the implementation of Solvency II i.e. the Solvency II solvency coverage position is broadly unchanged as a result of the Scheme. Given the strategic management actions which are available to SICL, I conclude that SICL should be able to implement necessary management actions in addition to the refinement of their detailed technical basis which should bring the solvency coverage ratio to an acceptable level.

4.7.5 Treating Customers Fairly

As set out in Section 3.8, there is no statutory regulation in relation to PRE for non life insurance companies in Ireland. There is a concept of PRE known as Treating Customers Fairly ("TCF") in the UK and is documented under the UK FSA Conduct of Business Sourcebook ("COBS") and Insurance Conduct of Business Sourcebook ("ICOBS").

I have highlighted where CMIEL policyholders would have certain expectations in Section 3.8 and noted these with SICL. I understand that these expectations will not cause any issues in SICL in terms of their implementation of TCF and I understand the existing treatment of CMIEL policyholders which will remain unchanged, and I have no further issues to note.

4.8 Other regulatory matters

I understand that SICL has some exposure to Payment Protection Insurance ("PPI") compensation claims. These compensation claims relate to products where customers believe a policy (underwritten by SICL) was inappropriately sold to them by a distributor (unconnected to the Sterling Group), and that the benefits and costs associated with these policies were inconsistent with their needs. There is continued focus on the PPI market in the UK and there continues to be a risk of possible future claims. Based on the advice presented to me, this risk relates to certain business underwritten prior to 14 January 2005 where the responsibility for redress is clear though the responsibility for making the initial settlement with the policyholder is less clear if a distributor has gone into liquidation and an agency relationship exists between the parties or there are no clear undertakings for such responsibility; in such instances the underwriter (i.e. SICL) makes the settlement and can attempt to recover it from the distributor. There are a small number of mis-selling claims for pre-2005 business across Sterling and some claims have been settled. The effort to manage these claims will continue into 2015. This exposure is provided for in the financial analysis presented above and does not impact materially on my analysis.

I am not aware of any other regulatory matters.

5 The Proposed Scheme of Transfer

5.1 Rationale for the Scheme

Although not a direct consideration for me as Independent Actuary, it is nevertheless relevant for me to be aware of the rationale for the Scheme. CMG has made a strategic decision to transition CMG's European underwriting operations to Sterling in the UK due to being unable to meet certain financial expectations. As such CMG proposes to transfer the business into Sterling by way of a Portfolio Transfer and a Renewal Rights Arrangement in order to achieve a streamlined capital efficient outcome. It has been proposed that CMIEL will transfer its non life insurance business to SICL (and CMLAE will transfer its life insurance business to SLL).

5.2 Overview of the Scheme

5.2.1 Introduction

The Scheme proposed is one for the transfer of insurance business by order of the Irish High Court. The transfer of the CMIEL portfolio of insurance contracts to SICL will be achieved by using the provisions of Section 13 of the Assurance Companies Act 1909, Section 36 of the Insurance Act 1989 and Regulation 12 of the European Communities (Non Life Insurance) Framework Regulations (S.I. No. 359 of 1994). The Scheme provides for the transfer of CMIEL's non life insurance business, incorporating the insurance policies, together with the associated liabilities and assets as at the Effective Date to SICL, such that CMIEL's policyholder liabilities are extinguished in CMIEL.

The Scheme proposes on the Effective Date to:

- Transfer the assets supporting the liabilities of the CMIEL technical accounts to the technical accounts of SICL; and

- All in force CMIEL policies and policies in respect of which any potential liability exists at the effective date should be included in the transfer. Upon transfer SICL will establish regulatory reserves in respect of the transferring CMIEL liabilities under UK regulatory basis and methodology.

The operation of policies will not change and all supporting contractual arrangements such as reinsurance, fund administration etc should remain unchanged. There will be no material changes to policyholder benefits or to the administration of the business as a result of the Scheme and all rights and obligations of CMIEL will transfer to SICL.

The effective date of the Scheme is expected to be March/April 2015.

It is proposed that there be no further monetary consideration made by SICL for the transfer of the business other than the amounts to be transferred above.

The Independent Actuary has to consider the security of benefits and the impact of the Scheme on policyholders' expectations. My understanding is that the Scheme has been designed to ensure:

- There will be no changes to CMIEL or SICL policyholder terms or conditions; and

- There are no plans to change the existing administration of CMIEL or SICL policies.

As a result of the Scheme, there will be no change to the approach to the exercise of discretionary powers available to CMIEL or SICL.

5.2.2 Transfer of transferred reserves

Subject to the sanction of the Court, the Scheme provides for the transfer of CMIEL's reserves known as "Transferred Non Life Reserves" from CMIEL to SICL as at the Effective Date. The conditions around this transfer as well as the methodology and assumptions to be used to determine the reserves are defined in the Scheme.

In my opinion the methodology and assumptions to be used to calculate the reserves are consistent with generally accepted actuarial principles and practices.

I give a brief overview of the UK regulatory regime in Appendix 4

5.2.3 Post-completion adjustment to transferred reserves

The Scheme sets out the assumptions and methodology to use in the calculation of the true-up payment for non life reserves. The responsibility for calculating the true-up rests with CMIEL's parent company CUNA Mutual International Holdings Limited. The adjusted reserves calculation is based on the methodology used by CMIEL's Signing Actuary to calculate the 31 December 2014 reserves with assumptions updated where appropriate to reflect emerging experience between that taken into account in the development of the 31 December 2014 reserves and that available at the adjusted reserves valuation date.

5.2.4 Excluded policies

CMIEL do not expect there to be any excluded policyholders at the time of transfer as such this has not been considered further.

In the event of there being Excluded Policies, it is proposed that a reinsurance treaty will be put in place such that these Excluded Policies will be one hundred percent reinsured from CMIEL to SICL, unless/until the relevant policyholder agrees to its novation to SICL. I would expect the reinsurance treaty to be structured in such a way that in the unlikely event of SICL winding up every excluded policyholder under the reinsurance treaty would rank equally to other SICL policyholders. So in the event of there being Excluded Policies, at the Effective Date CMIEL will have this reinsurance treaty in place and will continue to be capitalised sufficiently to meet its regulatory obligations. CMIEL do not expect there to be any excluded policies at the Effective Date. In addition, I do not expect there to be any excluded policies.

5.2.5 Continuity of proceedings

My understanding of the wording of the Scheme is that where a mis-selling claim in respect of CMIEL business is notified to SICL after the Effective Date CMG agrees to pay an amount equal to any mis-selling liability to Sterling, where the circumstances giving risk to the mis-selling claim occurred prior to the Effective Date.

5.2.6 Rights and obligations

Every person who is a holder of a CMIEL insurance policy being transferred will be entitled to the same contractual rights against SICL as he or she may have had against CMIEL, so there are no changes to the policy terms and conditions as a result of the Scheme.

5.2.7 Administration arrangements

It is intended that there will be no material change to the existing administration of the policies of CMIEL or SICL following the Scheme. As mentioned in Section 3.4 CMIEL currently outsources policy and claims administration to Sterling. This is not expected to change post transfer.

5.2.8 Maintenance of existing reinsurance arrangements

There is no reinsurance arrangement in place with CMIEL. The existing SICL reinsurance arrangements will not change as a result of the Scheme.

5.2.9 Taxation

I understand that appropriate tax clearances will be obtained from the relevant taxation authorities before the Scheme of Transfer.

5.2.10 Effective date

The effective date of the Scheme is expected to be March/April 2015.

5.2.11 Costs and Expenses

The costs and expenses associated with the Scheme will be met by CMG and Sterling. The key is that no costs are borne by the CMIEL or SICL policyholders.

5.2.12 Policyholder communications

Section 13 of the 1909 Act requires that, unless the Court otherwise directs, certain materials must be transmitted to each policyholder of both CMIEL and SICL.

CMIEL have taken advice from their lawyers, Matheson, who state there is no legal requirement to contact non life policyholders. As such CMIEL do not intend to communicate to any non life policyholders.

I note that SICL does not intend to write to its policyholders either. I note that the transferring business is not material to SICL in terms of total assets, total liabilities and regulatory capital and the solvency position of SICL would not be adversely affected by the Scheme. I am satisfied that SICL does not write to its policyholders regarding the Scheme, on the basis that the impact of the transfer on SICL policyholders is not sufficiently material to warrant the additional expense in doing so. SICL policyholders will not be disadvantaged in any way by not being issued a copy of either the summary version or full version of the Independent Actuary Report.

I understand that the CBI, the PRA and the FCA are aware of this communication approach.

I note that the full Report is available to any interested party on request from the offices of CMIEL in Ireland and the offices of SICL in the UK.

5.2.13 Other aspects

Compensation Schemes

There is no compensation scheme in Ireland.

SICL policyholders are covered under the UK Financial Services Compensation Scheme ("FSCS"). Transferring CMIEL policyholders will not be covered by the FSCS scheme so no change. For new business written post transfer, all new policyholders will be covered and the FSCS levy will be paid by SICL shareholders.

Custody of assets

I understand sovereign bond assets are held in a custody account with State Street The transferred assets in the form of cash will be managed by SICL in line with its own custody arrangements (with LCF Edmond de Rothschild Securities Limited) though changes will be made in the normal course of business and decisions made as part of normal governance processes.

Winding up priorities

There are no changes in winding up priorities as a result of the Scheme.

6 General considerations when reviewing the proposed scheme

6.1 Introduction

As the Independent Actuary, the key areas in my opinion that I need to consider for the different groups of policyholders that could potentially be affected by the Scheme, namely the transferring CMIEL policyholders and the existing SICL policyholders, are:

- Security of policyholder benefits; and
- PRE in a general manner. Although there is no statutory regulation in relation to PRE for non life insurance companies in Ireland, I have considered wider PRE and TCF issues which include disclosures to policyholders, the use of discretion by companies, local legislative requirements and the day to day administration of policies.

The considerations when reviewing the proposed Scheme are discussed briefly below and then assessed in Section 7 of this Report.

6.2 Impact on the security of policyholders' benefits

Aspects of the business and the Scheme which could impact on the security of policyholder benefits and should therefore be considered when reviewing the Scheme include:

- Regulatory financial position prior to the Scheme and following implementation of the Scheme for which I have considered the Pillar 1 (akin to Solvency I in UK), Pillar 2 (economic capital basis in UK) and Solvency II projections;
- PRA assessment of SICL solvency and regulatory capital position;
- SICL projected capital plan and management actions anticipated;
- Risk appetite frameworks;
- Regulatory differences in Ireland and the UK;
- Quality of reinsurance arrangements and reinsurance counterparties;
- Custody of assets;
- Compensation Schemes; and
- Other miscellaneous aspects.

6.3 Fair treatment of policyholders and the impact on policyholders' reasonable benefit expectations

Aspects of the business and the Scheme which could impact on the fair treatment of policyholders and policyholders reasonable expectations and should therefore be considered when reviewing the Scheme include:

- Fair treatment of all policies:
  - Policy terms and conditions;
  - Servicing of policies
  - Expenses and charges;
  - Costs of the Scheme;
  - Current practices and approaches;
  - Complaints and redress;
- Specific considerations including investment strategy and taxation.

7 Assessment of Proposed Scheme

7.1 Impact on the security of policyholders' benefits

7.1.1 Proforma financial position

This section presents the proforma financial position of CMIEL and SICL as standalone entities and as if the Scheme took place on 31 December 2013.

Pillar 1 Position

Table 7.1 below sets out the regulatory capital position of CMIEL (on CBI basis) and SICL (on PRA basis) at 31 December 2013 pre transfer and post transfer as if the Scheme took place at 31 December 2013. The CMIEL figures have not been restated to a PRA basis though this should not have a material impact on the figures.

Table 7.1 Proforma projected Solvency I capital requirement at 31 December 2013

	Pre Transfer		Post Transfer	
€m	**CMIEL**	**SICL (Pillar 1)**	**CMIEL**	**SICL (Pillar 1)**
Assets available to meet liabilities to policyholders	7.4	194.1	6.7	194.9
Technical provisions**	0.7	137.0	-	137.7
Other liabilities*	3.1	19.2	3.1	19.2
Net Assets available to cover required minimum solvency margin	3.6	37.9	3.6	37.9
Required minimum solvency margin	2.5	27.2	2.5	27.2
Excess of available assets	1.1	10.7	1.1	10.7
Solvency margin coverage ratio	**144%**	**140%**	**144%**	**140%**

Note: *Includes items such as expense accruals, taxation, experience rebate accruals, commission, unallocated premiums and intercompany payables
** Includes UPR reserve
Source: Summary of key numbers proforma 2013-12-31 - draft 2.pdf

As can be seen, the transferring liabilities are not material given the size and strength of SICL's balance sheet.

The proforma presentation at 31 December 2013 post the transfer reflects that CMIEL assets of €0.7m would be transferred and liabilities of €0.7m would be set up by SICL if the Scheme took place on 31 December 2013. The assets being transferred are sufficient to cover the transferring liabilities (basic mathematical reserves of €0.7m). Other CMIEL assets net of liabilities of €6.7m will be excluded from the transfer of assets and liabilities and will remain in CMIEL as they relate to shareholder funds.

The post transfer SICL regulatory capital position remains strong at the proforma date. I note that the assets and liabilities relating to CMIEL business are less significant than SICL business. There is a strong regulatory capital position on a CBI regulatory basis in CMIEL at 31 December 2013 before the

Scheme. The UK Pillar 1 regulatory capital position in SICL remains strong on a standalone and a combined basis after the proposed Scheme of Transfer from the perspective of the transferring CMIEL policyholders and the existing SICL policyholders based on the proforma financial analysis prepared. Therefore the transfer does not have any significant impact on the solvency of SICL post transfer on a Solvency I basis.

I have been provided with projected liabilities of CMIEL on the Effective Date and note that the total liabilities are projected to reduce from €3.8m to €2.3m due to the passage of time and run off of claim liabilities; and basic mathematical reserves are projected to reduce from €0.7m to €0.6m by the Effective Date. Therefore, assets of €0.6m are projected to transfer to SICL on the Effective Date to cover the projected basic mathematical reserves. I have not been provided with the projected SICL reserves or solvency margin requirements on the Effective Date and therefore have not included a projected post transfer position at the Effective Date. However, I would not expect the CMIEL or SICL solvency position at the Effective Date to be materially different from the post transfer position presented in Table 7.1.

Pillar 2 Position

The Pillar 2 results were fully disclosed to me by SICL but due to commercial sensitivities I have not reproduced the detailed results within this Report. I can confirm that the SICL is well capitalised on a Pillar 2 basis. Given the strong Pillar 2 position pre transfer and the effects identified above, I am comfortable that the Pillar 2 position will remain strong post the transfer for transferring CMIEL policyholders and remaining SICL policyholders.

Solvency II

I have been provided with estimates of the impact of Solvency II on SICL on a pre transfer basis at 31 December 2013 which has been shared with the PRA. Analysis for CMIEL has also been provided to me. The figures reviewed are based on SICL's interpretation of the proposed Solvency II rules at that point in time, and work continues in SICL to refine its methods and models and additional supervisory guidance is still expected which may result in revisions to SICL's interpretation of the rules. I note the current assessment of the impact of Solvency II on SICL on a standard formula basis is that there is a material reduction in the solvency coverage ratio; however SICL still remains solvent under Solvency II though the solvency margin coverage is below its risk appetite level. SICL has identified a number of technical aspects of the Solvency II rules which give a more adverse solvency margin treatment compared to Pillar 2 requirements. While work continues to refine SICL's technical basis, analysis has been provided which sets out strategic management actions available to SICL to improve its solvency margin coverage ratio above its risk appetite level. These actions have been presented to the SICL Board. The CMIEL position under solvency II is broadly unchanged compared to the Solvency I position.

I note from the proforma Solvency I analysis that the transfer is not likely to impact materially on the Solvency II position post the Scheme. I note that SICL policyholders are not disadvantaged by the Scheme as a result of the implementation of Solvency II i.e. the Solvency II solvency coverage position is broadly unchanged as a result of the Scheme; however the transferring CMIEL policyholders are being transferred into an entity which has a weaker solvency coverage position on a Solvency II basis. Given the strategic management actions which are available to SICL, I conclude that SICL should be able to implement necessary management actions in addition to the refinement of their detailed technical basis which should bring the solvency coverage ratio to an acceptable level. On that basis, the transferring CMIEL policyholders should not be disadvantaged by the portfolio transfer as a result of the implementation of Solvency II.

Business Plan

When assessing the financial consequences on the security of policyholders, I have considered the SICL business plan which outlines a strong level of profits over the period to 2018.

7.1.2 Projected financial position

The future financial position also needs to be considered. The main influences (with the exception of future regulatory capital change) on the future financial position SICL are the surplus arising from existing business, the amount of new business and any dividend policy.

I have considered the SICL business plan which outlines projected profits over the period to 2018.

Post transfer CMIEL policyholders will be part of a larger company as shown in Table 7.1.

7.1.3 Reinsurance Arrangements

CMIEL does not have any reinsurance arrangements in place. No change will be made to SICL reinsurance policies due to the Scheme.

7.1.4 Compensation Scheme

SICL policyholders are covered by the FSCS. The FSCS will pay compensation if SICL is unable to pay claims because it has stopped trading or has been declared in default. Generally the FSCS covers business conducted by firms authorised by the PRA and FCA. However European firms that are authorised by their home state regulator that operate in the UK are also covered.

CMIEL UK policyholders are covered by the FSCS and will continue to be covered post transfer. CMIEL Irish policyholders were not covered by a compensation scheme in Ireland before transfer of the business to SICL and will not be covered by the FSCS after the transfer. There is therefore no reduction in protection for CMIEL policyholders in this regard. For new business written post transfer, the FSCS levy will be paid by SICL shareholders.

7.1.5 Regulatory difference

As mentioned in Section 7.1.1 any difference between the CBI regulatory basis and the PRA regulatory basis is expected to be minimal and would not have a material impact on the security of transferring CMIEL policyholders or existing SICL policyholders.

7.1.6 Miscellaneous Aspects

Assets are currently held with State Street via a custodian arrangement. SICL will manage the transferred assets in line with its own custody arrangements, with LCF Edmond de Rothschild Securities Limited, in line with its own internal governance arrangements. I do not see any issues with this.

Staff matters including pension scheme

There are no staff transferring to SICL.

Expense Synergies

One of the benefits of the portfolio transfer is to rationalise operations including eliminating the duplicate overhead costs of CMG underwriting operations. As Sterling currently administer the CMIEL book of business, the synergies should not be material.

Asset/ Liability modelling

Asset liability modelling is not a key issue given the materiality of the assets and liabilities transferred.

Quality of capital and asset profile

The capital profile of CMIEL's business would be generally low risk consisting of sovereign and corporate bond exposures i.e. no gearing or financing arrangements in place. The assets would be regarded as conservative other than a material exposure to European sovereigns, though the exposure is to more highly rated sovereigns, Austria, Netherlands, Germany and France. This exposure would have remained regardless of the Scheme.

Risk profile

If the proposed transfer takes place, the risk profile of SICL after the transfer should not be materially changed from its risk profile before the transfer as the types of risks inherent in CMIEL's business are similar to the non life insurance business written by SICL.

7.1.7 Conclusion

I note that there is a strong Solvency I position in CMIEL and SICL pre Transfer. I note that the regulatory capital position remains strong in both entities after the proposed Scheme from the perspective of the transferring CMIEL policyholders and the existing SICL policyholders based on the proforma financial analysis presented in Table 7.1 above.

The Scheme will not impact materially on SICL's Solvency II position. I note that SICL policyholders are not disadvantaged by the Scheme as a result of the implementation of Solvency II i.e. the Solvency II solvency coverage position is broadly unchanged as a result of the Scheme; however the transferring CMIEL policyholders are being transferred into an entity which currently has a weaker solvency coverage position on a Solvency II basis. Given the strategic management actions which are available to SICL, I conclude that SICL should be able to implement necessary management actions in addition to the refinement of their detailed technical basis which should bring the solvency coverage ratio to an acceptable level. On that basis, the transferring CMIEL policyholders should not be disadvantaged by the portfolio transfer as a result of the implementation of Solvency II.

The risk to policyholder security is remote. Therefore, in my view, policyholders will not be materially adversely affected by the proposed Scheme.

7.2 Fair treatment of policyholders

7.2.1 Introduction

Although there is no statutory regulation in relation to PRE for non life insurance companies in Ireland, I have considered wider PRE and TCF issues which include disclosures to policyholders, the use of discretion by companies, local legislative requirements and the day to day administration of policies.

Some of the following points are also discussed in Section 7.1 but have been included here for completeness.

7.2.2 Security of policyholders' benefits

As set out in Section 7.1 there is a strong regulatory capital position in CMIEL and SICL at 31 December 2013 before the Scheme of Transfer and that the regulatory capital position remains strong on a combined basis after the proposed Scheme of based on the proforma financial analysis prepared.

7.2.3 Policy Terms and Conditions

The Scheme generally makes no reference to CMIEL policy terms and conditions, so these will remain unchanged as a consequence of the Scheme. There is no impact on existing SICL policyholders' terms and conditions.

7.2.4 Servicing of Policies

As described in Section 5.2.7, there will be no material changes in the administrative arrangements and servicing of CMIEL or SICL policies post transfer therefore there should be limited risk of operative errors occurring during the transfer process. Transferring policyholders have a reasonable expectation that the services they receive are provided in a professional manner.

In my opinion the implementation of the Scheme will not have a material adverse effect on the service levels that policyholders receive. I form this opinion based on the information I have received and considered.

7.2.5 Expenses and charges

CMIEL policyholders, for the majority, have charges that are effectively fixed by the terms of the contracts. The implementation of the Scheme makes no explicit changes to the policy charges.

The expense basis of SICL is not expected to be adversely affected as a consequence of the Scheme and therefore I don't expect SICL policyholders to be adversely affected by the Scheme.

7.2.6 Costs of the Scheme

The costs and expenses associated with implementing the Scheme will be met met by CMG and Sterling. The key is that no costs are borne by the CMIEL or SICL policyholders. Therefore, in my opinion the implementation of the Scheme will not have an adverse effect on the fair treatment of policyholders in this regard.

7.2.7 Discretionary powers

The range of discretionary powers available to CMIEL for the transferring policies is reasonably limited and principally relates to the following:

- the assessment as to whether a claim is valid or not; and
- the appropriate premium rate to charge.

Overall, I do not expect that the Scheme will cause a change in the approach to the use of discretionary powers.

7.2.8 Disclosure to policyholders

I am not aware of any disclosures or local legislative requirements which confer any additional reasonable expectations over and above the contractual terms of the policies.

7.2.9 Policyholder Communications

No policyholders will be communicated with as a result of the Scheme - this is based on legal advice for CMIEL policyholders and based on my assessment of the materiality of the Scheme for existing SICL policyholders. The CBI, PRA and FCA are aware of the approach being taken.

7.2.10 Pending Legal proceedings

I understand that there are no legal proceedings pending or current against CMIEL at the date of this Report.

Sterling is exposed to PPI claims and the exposure has been provided for in the financial statements and regulatory returns.

7.2.11 Legal risk

In considering any legal risks, I have relied on the fact that CMIEL and SICL have followed the advice of their legal advisers and Counsel in finalising the legal agreements in relation to this transaction.

I have not obtained separate legal advice for the purposes of my work.

Thus, in my opinion, all reasonable steps have been taken to reduce the legal risks arising from the Scheme to a minimum.

7.2.12 Conclusion

Based on the points above I am comfortable that policyholders will be treated fairly post transfer and their reasonable expectations will not be adversely affected due to the Scheme.

Appendix 1

Extract from KPMG Engagement Letter

Scope of the Independent Actuary's work. This is an extract from engagement letter dated 17th September 2014.

The role of each Independent Actuary will be to consider and to report to the Court on the proposed transfer of business, primarily from the perspectives of the remaining policyholders in CMG, the transferring policyholders of CMG and the existing policyholders of Sterling, and to opine as to whether any policyholders' interests could be in any way (either directly or indirectly) adversely affected by the proposed transfer.

In order to form my opinion, we will expect the tasks that will be carried out will include the following:

- *review of existing documentation of the Companies (in particular, documentation sent to policyholders);*
- *review of the Scheme documentation and, if necessary, suggest amended drafting in order to eliminate any concerns;*
- *review the transfer considering the effect on policyholders covering their contractual rights, benefit security and benefit expectations;*
- *in particular review the different regimes in place for the books of business from a financial and PRE perspective and the proposals post transfer;*
- *review existing and proposed fund structures;*
- *review projected comparative solvency levels on both a Solvency I basis and an assessment of the estimated Solvency II basis before and after the transfer being proposed;*
- *review of the effects of the transfer on the risks within the Companies and the resources of those Companies to meet those risks;*
- *liaise and raise issues and questions as necessary with the appropriate persons at CMG and Sterling; and*
- *liaise and raise issues and questions as necessary with your advisers, including legal and tax advisers.*

Appendix 2

Information received

We received a large amount of information which is summarised below.

CMIEL data

- SAO reports 2011, 2012, 2013
- Regulatory returns 2011, 2012, 2013
- Policyholder policy documentation for all products
- Board of Directors minutes 2014
- Portfolio transfer agreement
- Memorandum and Articles of Association
- Reinsurance review
- TPA services agreement
- Background information
- Financial statements 2011, 2012, 2013
- Proforma numbers 31 December 2013
- Forecast position as at the Effective Date

SICL data

- Risk Appetite 2014
- PRA Submission on Solvency II capital analysis 2013
- PRA returns 2011, 2012, 2013
- ICA assumptions, methodology and results
- Solvency II SCR planning
- Business plan 2014

Appendix 3

Curriculum Vitae of Independent Actuary

Noel is a qualified actuary with over 17 year's experience.

- Noel is responsible for heading up the non life actuarial services practice in Dublin. He has over 17 years experience in the non life insurance industry and holds an unrestricted practicing certificate issued by the Society of Actuaries in Ireland.

- His principle roles include: providing Statements of Actuarial Opinion on the technical provisions of non life insurance and reinsurance clients; helping clients understand the impact of Solvency II on their capital requirements; and responsibility for all actuarial advice in relation to non life insurance and reinsurance audit clients of KPMG.

- He has acted as actuarial peer reviewer on a range of technical matters.

- He holds a Signing Actuary role for a number of non life (re)insurance companies regulated in Ireland.

- He is a member of the General Insurance Committees of the Society of Actuaries in Ireland.

Appendix 4

Overview of UK Regulatory Regime

Three Pillars and Twin Peaks

There are a number of ways in which the PRA require insurance companies to demonstrate their solvency and capital strength. This is based around the concept of three pillars:

- Pillar 1, which is a requirement to calculate and publicise assets, liabilities and capital requirements in accordance with detailed rules. The results of the Pillar 1 valuation are published annually in the companies' returns to the PRA.

- Pillar 2, termed the Individual Capital Assessment ("ICA"), requires companies to calculate their own capital requirement using more sophisticated techniques which recognise all the risks that the business faces. The Pillar 2 calculations are submitted privately to the PRA and are not publicised.

- Pillar 3 relates to market discipline and disclosure.

Pillar 1

Capital requirements

A firm must always ensure that it has enough capital to cover its Capital Resources Requirement ("CRR"). The CRR is determined formulaically. The PRA categorise capital in different tiers which reflects the characteristics of the capital. The CRR must be covered by capital of a certain quality as specified by the regulations.

The Regulatory Peak

All firms are required to calculate the Regulatory Peak. The Regulatory Peak is calculated using deterministic assumptions and includes margins for prudence within the liabilities (or statutory reserves). Only certain types of assets, as specified in the regulations, are included within the admissible assets.

The CRR is equal to the MCR (Minimum Capital Requirement). The MCR is the higher of:

- The base capital resources requirement which is set amount described in the regulations depending on the category of the company; and

- The general insurance capital requirement which is the higher of the premiums amount, claims amount or brought forward amount.

A firm must also calculate an ECR (Enhanced Capital Requirement) as the sum of its asset-related capital requirement, insurance–related capital requirement and equalisation provisions.This is reviewed by the regulator to help assess the adequacy of a firm's capital resources.

Pillar 2

Under Pillar 2, or the Individual Capital Assessment ("ICA"), the insurance company is required to assess internally the adequacy of the capital they are holding based on all the risks to which they are exposed. The ICA should represent the amount of capital which the company needs to hold to ensure it has less than a very small, typically 1 in 200, chance of being unable to cover all its risks over a one year period. There are a number of risks which need to be considered in assessing the ICA, including:

- Credit risk: the risk of loss from another party if it fails to meet its obligations or fails to meet them in a timely manner;
- Market risk: the risks that arise from fluctuations in market values, including assets, exchange rates, interest rates;
- Liquidity risk: the risk that an insurance company will be unable to meet its liabilities as they fall due;
- Insurance risk: the risks that are inherent in writing insurance business (including premium and reserve risk, lapse risk and cat risk);
- Operational risk: the risk of loss resulting from the failure of people, processes, systems or external events, and; and
- Other relevant risks, e.g. pension scheme risks or reinsurance risks.

Some of the above risks are not explicitly assessed in Pillar 1, for example operational risks. The risks above are combined and any diversification benefits are taken into account by allowing for the nonindependence of the risks.

The firm then submits its ICA to the PRA, including reasoning and judgements as to the amount of required capital it has derived and the treatment of the various risks. The overall level of capital required is ultimately set by the PRA, following an assessment of the firm’s ICA submission, and is known as the Individual Capital Guidance (“ICG”), which is often set as a percentage of the ICA. The ICA and ICG remain confidential and are not, in general, publicly available.

Companies are required to cover both the CRR (Pillar 1 capital requirement) and the ICA (Pillar 2 capital requirement) with certain types of assets.

Solvency II

Solvency II is a new European regulatory regime which was initiated by the European Commission (“EC”) in 2000 to implement a fundamental change to European insurance regulations, and is currently expected to take effect during 2016. It will replace the corresponding elements of the current regulatory regime. Solvency II will introduce significantly different reserving and capital requirements to those which apply under the current regime. The impact will vary between companies, and may lead to either an increase or a reduction in regulatory capital requirements, which in some instances may be significant.

However, the initiative is not only in relation to capital requirements but will also fundamentally affect the way insurance companies will need to be managed; companies will need to undertake a wide-ranging review of their operations in order to encompass the new requirements.

The proposed Solvency II framework is made up of three Pillars.

Pillar 1 defines the financial resources that a company needs to hold in order to be considered solvent. In particular, it contains guidance on the valuation of assets, liabilities (technical provisions) and solvency capital requirements (the Minimum Capital Requirement (“MCR”) and Solvency Capital Requirement (“SCR”)). The higher of the solvency capital requirements, the SCR, is the capital required to withstand adverse 1 in 200 events over a one year period and is therefore based on a similar approach in this respect as the current regulatory regime's Pillar 2 capital requirements. However it should be noted that in practice the SCR is likely to be very different to the current UK Pillar 2 capital requirements.

Failure to maintain sufficient financial resources to cover the SCR will require immediate notification to the supervisory authority, and the submission of a recovery plan. Standard formulae (including standard stress tests and correlations) or internal models may be used to calculate the SCR, although internal models will need to be approved by the regulators (the PRA in the UK).

Pillar 2 focuses qualitatively on the governance and risk management systems in place and the supervision of these systems and controls. In particular, this includes a review of the SCR and the firm's Own Risk and Solvency Assessment ("ORSA"). The ORSA is an assessment of the firm's capital needs taking into account the specific risk profile and strategy of the firm. It analyses areas in which the SCR does not fully reflect this risk profile.

Pillar 3 involves disclosure of a firm's financial condition in order to improve transparency to outsiders.

The final Solvency II requirements and timetable will come into effect from 1st January 2016, although there continue to be a number of technical and practical issues that remain to be resolved. In particular there is still considerable uncertainty over the level of reserving or capital requirements that will be implemented.

An insurer can choose one of two routes for Solvency II capital reporting. They can report on a prescribed standardised basis set out by regulation, or the insurer can choose to apply for regulatory approval to use an internal model to calculate the Solvency II capital requirement. The current planned approach for both SICL and CMIEL is to report Solvency II on the standard formula basis.

KPMG

Appendix 5

Glossary

AA	Appointed Actuary
AFH	Actuarial Function Holder
CBI	Central Bank of Ireland
COBS	Conduct of Business Sourcebook
Court	Irish High Court
FCA	Financial Conduct Authority
FCR	Financial Condition Report
FSCS	Financial Services Compensation Scheme
FOS	Financial Ombudsman Service
ICA	Individual Capital Assessment
ICG	Individual Capital Guidance
PRA	Prudential Regulation Authority
PRE	Policyholders Reasonable Expectations
RAF	Risk Appetite Framework
RP	Regular premium
SAI	Society of Actuaries in Ireland
SCR	Solvency Capital Requirements
SP	Single premium

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