

*Scheme Report of the Independent Expert on the
proposed transfer of insurance business from*

Domestic & General Insurance PLC

to

Domestic & General Insurance Europe AG

*in accordance with Part VII of the Financial
Services and Markets Act 2000*

For the High Court of Justice of England and Wales

24 August 2020

Prepared by:

Tom Durkin FIA

LCP

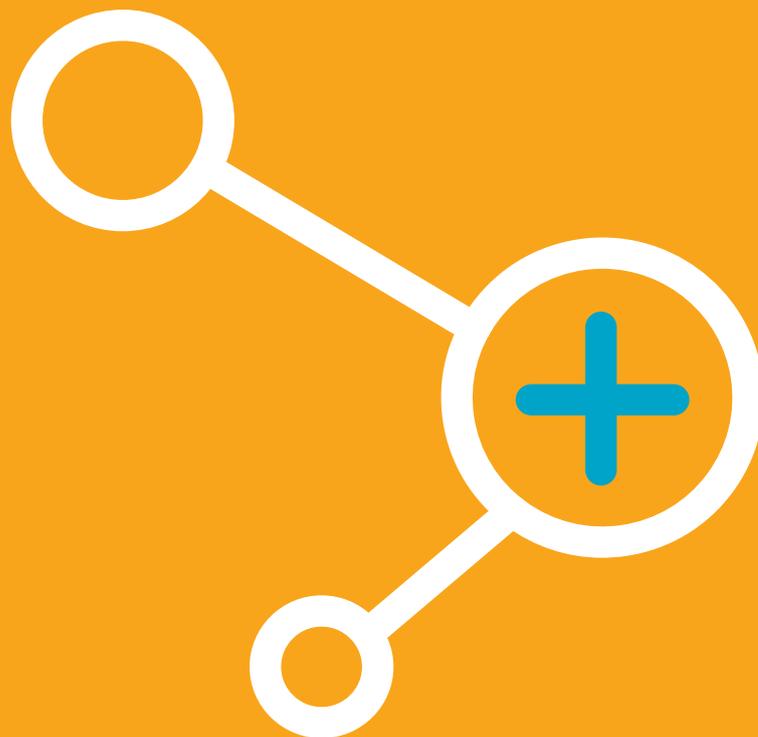


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1. Executive summary

1.1. The Proposed Transfer

Domestic & General Insurance (DGI) is a UK insurer and currently operates across the UK, the European Economic Area (EEA) and Australia. Its operations across the EEA utilise the EEA's Freedom of Services (FoS) and Freedom of Establishment (FofE) arrangements.

If negotiations between the European Union (EU) and United Kingdom (UK) result in the withdrawal of FofS and FofE rights (or equivalent) for DGI upon expiry of the Brexit transition period, DGI may not legally be able to carry on the non-UK EEA business. For example, DGI would not be able to issue new or renewal insurance policies across the EEA, and might not legally be able to pay valid claims to existing non-UK EEA policyholders.

To provide certainty that DGI can continue to carry on non-UK EEA business after the Brexit transition period with minimum disruption, DGI is proposing to transfer the relevant non-UK EEA business from DGI into its wholly-owned subsidiary, Domestic & General Insurance Europe AG (DGIEU), a German-domiciled insurance company (the Proposed Transfer). The planned Effective Date of the Proposed Transfer is 31 December 2020.

On 23 October 2019, DGI sought and obtained the approval of the High Court for an equivalent transfer of business to DGIEU. That transfer was only intended to proceed if the UK left the EU without a withdrawal agreement. Given that the UK agreed its withdrawal from the EU (and entered a Brexit transition period), the previous transfer lapsed. The Proposed Transfer follows on from the previously approved (but not completed) transfer and comprises a new application to the High Court.

1.2. My role as Independent Expert

DGI and DGIEU have jointly appointed me to act as the Independent Expert (IE) for the Proposed Transfer. The Prudential Regulation Authority (PRA), in consultation with the Financial Conduct Authority (FCA), has approved my appointment.

As IE, my overall role is to assess whether:

- The security provided to policyholders of DGI and DGIEU will be materially adversely affected by the implementation of the Proposed Transfer.
- The Proposed Transfer will have any adverse impact on service standards experienced by policyholders.

DGI has no outwards reinsurance arrangements, so I have not needed to consider the impact of the Proposed Transfer on reinsurers covering the transferring business.

This report is my Scheme Report for the Proposed Transfer. I will also prepare a Supplementary Report ahead of the Sanctions Hearing for the Proposed Transfer. The purpose of the Supplementary Report is to confirm and/or update my conclusions in this report, based on any new material or issues that arise.

1.3. Summary of my conclusions

I have set out below my summary conclusions, considering the effect of the Proposed Transfer on the following groups of policyholders:

- "Non-transferring Policyholders", who will remain with DGI after the Proposed Transfer.
- "Transferring Policyholders", who will transfer from DGI to DGIEU as a result of the Proposed Transfer.
- "Existing DGIEU Policyholders", ie policyholders of DGIEU at the time of the Proposed Transfer, who will remain with DGIEU after the Proposed Transfer.

Non-transferring Policyholders

At the Effective Date of the Proposed Transfer, there are projected to be 7.7 million Non-transferring Policyholders which represent 65% of DGI's projected pre-transfer business by number of policyholders and 72% based on projected IFRS technical provisions.

I have concluded that the security provided to Non-transferring Policyholders will not be materially adversely affected by the Proposed Transfer. I have concluded that no material impact on service standards is expected for Non-transferring Policyholders following the Proposed Transfer.

Summary rationale:

- I am satisfied that the approaches used to calculate the Solvency II and IFRS technical provisions for DGI are appropriate, and DGI has confirmed that these will be materially unchanged post-transfer.
- The SCR coverage ratio for DGI is projected to decrease from 202% to 189% as a result of the Proposed Transfer. I do not consider the security provided to Non-transferring Policyholders to be materially adversely affected by this decrease as DGI remains well capitalised. Further, DGI's coverage ratio is projected to increase to pre-transfer levels by March 2021, ie within 3 months of the Proposed Transfer, and is projected to stay above this level throughout the projected period to March 2025.
- I am satisfied that DGI is expected to remain well capitalised under a range of adverse scenarios. In more extreme adverse scenarios, such as DGI's reverse stress test, I am satisfied that Non-transferring Policyholders are not materially adversely affected as a result of the Proposed Transfer.
- DGIEU is not planning any material changes to how the business is carried out. In particular, there are no plans to change how Non-transferring Policyholders are serviced post-transfer.

Transferring Policyholders

At the Effective Date of the Proposed Transfer, there are projected to be 4.2 million Transferring Policyholders which represent 35% of DGI's projected pre-transfer business by number of policyholders and 28% based on projected IFRS technical provisions.

I have concluded that the security provided to Transferring Policyholders is unlikely to be materially adversely affected by the Proposed Transfer. I have concluded that no material impact on service standards is expected for Transferring Policyholders following the Proposed Transfer.

Summary rationale:

- The Transferring Policyholders will remain within the Domestic & General Group of companies.
- I am satisfied that the approaches used to calculate the Solvency II and IFRS technical provisions for DGIEU are appropriate. The approaches used by DGI and DGIEU are materially the same.
- The SCR coverage ratio for Transferring Policyholders is expected to increase from 202% (DGI pre-transfer) to 280% (DGIEU post-transfer) as a result of the Proposed Transfer. D&G has committed to make an additional capital injection into DGIEU simultaneously with the Effective Date of the Proposed Transfer, so that DGIEU is projected to remain well capitalised throughout the projected period to March 2025.
- DGIEU submitted a pre-application to the German regulator, BaFin, in August 2020 to use Undertaking Specific Parameters (USPs) in the Solvency II standard formula when calculating DGIEU's SCR, and plan to make a full application in September 2020. Assuming this application is approved (expected by 31 March 2021), DGIEU is expected to remain very well capitalised throughout the projected period to March 2025.
- If the application for USPs is not approved, DGIEU is projected to have a lower SCR coverage, but still remain well capitalised throughout the projected period.
- I am satisfied that DGIEU is expected to remain well capitalised under a range of adverse scenarios (with or without approval to use USPs). In particular, the amount of the additional capital injection mentioned above has been set by D&G to help ensure that DGIEU is expected to remain well capitalised under these adverse scenarios. In more extreme adverse scenarios, such as DGIEU's reverse stress test, I am satisfied that Transferring Policyholders are not materially adversely affected as a result of the Proposed Transfer.
- Policyholder security for DGIEU is provided through a combination of assets held within DGIEU itself and security provided by DGI, in the form of a significant quota share arrangement (with 90% of DGIEU's business reinsured back to DGI). In the event of insolvency of DGI, amounts owed to DGIEU under the reinsurance would ordinarily rank behind DGI policyholder claims. Therefore, without appropriate additional security in place for DGIEU, this could materially adversely affect Transferring Policyholders in the event of DGI insolvency.

- To help ensure that Transferring Policyholders are not adversely affected in this scenario, DGI and DGIEU will have in place a Reinsurance Account. In the event of DGI insolvency, the Reinsurance Account would be ringfenced which means that the assets in the Reinsurance Account would remain available to DGIEU. Based on my analysis of how the Reinsurance Account will operate, I am satisfied that this arrangement is expected to provide appropriate protection to Transferring Policyholders.
- Transferring Policyholders will lose access to the Financial Services Compensation Scheme (FSCS) as a result of the Proposed Transfer. I have concluded that it is unlikely that the policyholders will be materially adversely affected by the loss of access to the FSCS given an insolvency scenario, which would be required to trigger FSCS protection, is unlikely. In addition, the Transferring Policyholders may value the certainty that valid claims can be lawfully paid after the Effective Date more than the loss of access to the FSCS which only benefits them in the event of the insolvency of DGI.
- Transferring Policyholders who currently have access to the Financial Ombudsman Service (FOS) will lose access to the FOS in respect of acts and omissions taking place after the Effective Date of the Proposed Transfer, but will gain access to a similar insurance ombudsman in Germany.
- DGI and DGIEU, through the D&G Group, are planning to minimise any changes as to how the transferring business is carried out, to avoid disruption to the operating model or its customers. For example, DGIEU is not planning any changes to how Transferring Policyholders are serviced following the Proposed Transfer.

Existing DGIEU Policyholders

At the Effective Date of the Proposed Transfer, there are projected to be 1.7 million Existing DGIEU Policyholders which represent 29% of DGIEU's projected post-transfer business by number of policyholders and 38% based on projected IFRS provisions.

I have concluded that the security provided to Existing DGIEU Policyholders will not be materially adversely affected by the Proposed Transfer. I have concluded that no material impact on service standards is expected for Existing DGIEU Policyholders following the Proposed Transfer.

Summary rationale:

- I am satisfied that the approaches used to calculate the Solvency II and IFRS technical provisions for DGIEU are appropriate, and DGIEU has confirmed that these will be materially unchanged post-transfer.
- The SCR coverage ratio for DGIEU Policyholders is expected to increase from 244% to 280% as a result of the Proposed Transfer. Further, as set out above, DGIEU is projected to remain well capitalised throughout the projected period to March 2025.
- I am satisfied that DGIEU is expected to remain well capitalised under a range of adverse scenarios (with or without approval to use USPs). In more extreme adverse scenarios, such as DGIEU's reverse stress test, I am satisfied that Existing DGIEU Policyholders are not materially adversely affected as a result of the Proposed Transfer.
- DGIEU is not planning any material changes to how the business is carried out. In particular, there are no plans to change how Existing DGIEU Policyholders are serviced following the Proposed Transfer.

Further details on my conclusions, and other supporting information, are set out in this report.

I will be reviewing these conclusions and preparing a Supplementary Report ahead of the Sanctions Hearing for the Proposed Transfer. The purpose of the Supplementary Report is to confirm and/or update my conclusions based on any new material or issues that arise.

1.4. Potential impact of COVID-19 on the Proposed Transfer

The uncertainty around the impact of COVID-19 is expected to continue over the coming months, perhaps even until the Effective Date of the Proposed Transfer and beyond.

DGI and DGIEU's view, based on emerging experience, is as follows:

- The most significant impact of COVID-19 on DGI and DGIEU's business so far has been a fall in new business (and therefore premium volumes) during the pandemic, as a result of social distancing being enforced across Europe, particularly the closure of retail stores and the corresponding reduction in sales of new appliances.
- The fall in new business is unlikely to result in a material change to the size of the Proposed Transfer, as the transferring business is made up of existing non-UK EEA business and expected renewals on such policies. The majority of new non-UK EEA business is already being written by DGIEU.
- Both DGI and DGIEU experienced around 20% lower claims volumes than usual between April and June 2020. July 2020 experience appears to indicate a return to pre-COVID-19 expectations for claims volumes. There have been no material changes in average size of claims, or in reporting and settlement delays.
- Changes in customer behaviour could lead to a change in the size of the Proposed Transfer, eg an increase in lapses or cancellations resulting from the economic impacts COVID-19 could lead to a reduction in the size of the Proposed Transfer.

DGI and DGIEU have informed me that there are no other operational issues arising from COVID-19 that are impacting or expected to impact policyholders. In particular they have stated that the service team had sufficient resource and has been able to maintain coverage with minimal disruption and that customers continue to be positive about continuity and service levels; this is evidenced by an increase in D&G's Net Promoter Scores over the COVID-19 period (January 2020 vs May 2020). Should additional resource be needed to support the service teams, D&G has budgeted for additional temporary staff to help service the Proposed Transfer.

DGI has also informed me that it has reviewed the impact of COVID-19 on the value of its products in line with the FCA's product value guidance (Product value and coronavirus: guidance for insurance firms). DGI's view is that appliance usage has typically gone up during COVID-19 as customers are spending more time at home, and therefore COVID-19 has not had an adverse impact on the value of DGI's insurance products. DGI is continuing to review the impact of COVID-19 on the value of its products, and I will provide an update on this in my Supplementary Report.

All of the base case figures in this report reflect DGI and DGIEU's best view of the potential impact of COVID-19. I also consider an adverse scenario under which the impact of COVID-19 on DGI and DGIEU is more severe than expected. I will provide an update on the potential impact of COVID-19 in my Supplementary Report.

2. Introduction

2.1. Background

Part VII, Section 109 of the Financial Services and Markets Act 2000 (FSMA) requires that a scheme report (the Scheme Report) must accompany an application to the High Court of Justice of England and Wales (the High Court) to approve an insurance business transfer scheme (Part VII transfer).

The Scheme Report should be produced by a suitably qualified independent person (the Independent Expert or IE) who has been nominated or approved by the Prudential Regulation Authority (PRA) having consulted with the Financial Conduct Authority (FCA). The Scheme Report should address the question of whether any policyholders or reinsurers impacted by the insurance business transfer are adversely affected to a material extent.

DGI and DGIEU have jointly nominated Tom Durkin (I or me) of Lane Clark & Peacock LLP (LCP, we, or us) to act as the Independent Expert for the proposed insurance business transfer scheme (the Proposed Transfer) of the insurance business of DGI to DGIEU under Section 105 of the FSMA. The Proposed Transfer is intended to be effected on 31 December 2020 (the Effective Date).

This report is the Scheme Report for the Proposed Transfer. I will also prepare a Supplementary Report ahead of the Sanctions Hearing for the Proposed Transfer. The purpose of the Supplementary Report is to confirm and/or update my conclusions in this report, based on any new material or issues that arise.

On 23 October 2019, DGI sought and obtained the approval of the High Court for an equivalent transfer of business to DGIEU. That transfer was only intended to proceed if the UK left the EU without a withdrawal agreement. Given that the UK agreed its withdrawal from the EU (and entered a Brexit transition period), the previous transfer lapsed. The Proposed Transfer follows on from the previously approved (but not completed) transfer and comprises a new application to the High Court.

2.2. Domestic & General group structure

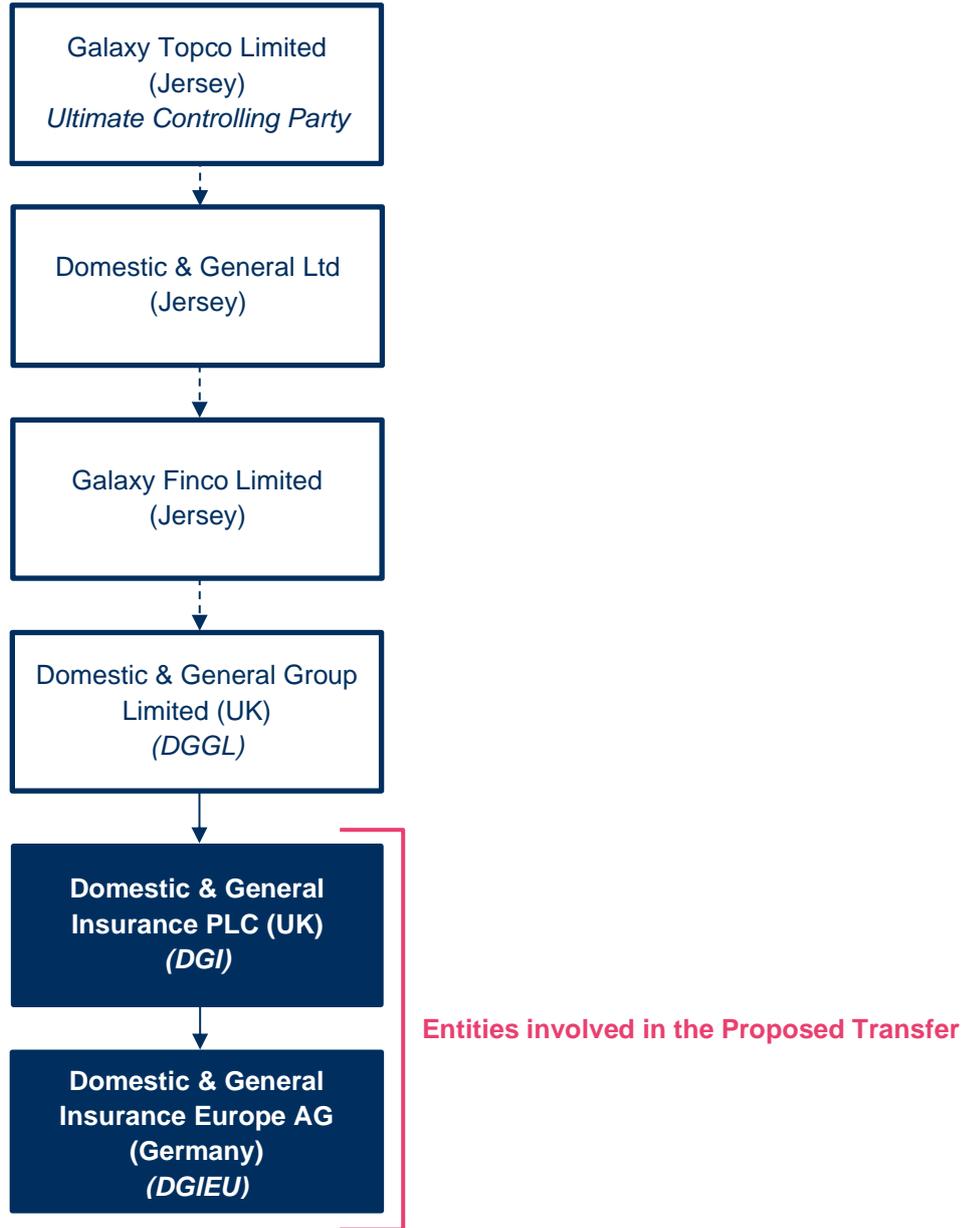
DGI's parent company is Domestic & General Group Limited (DGGL), an insurance company incorporated in England and Wales.

DGIEU is an insurance company incorporated in Germany and is a wholly owned subsidiary of DGI.

In this report, I have used the term 'Domestic & General Group' (D&G) to refer to DGGL and all subsidiary companies.

The diagram below shows a simplified structure chart for the Domestic & General Group.

Simplified group structure chart



The dotted arrows indicate where there are intermediate entities that have not been shown. DGIEU is wholly owned by DGI and DGI is wholly owned by DGGL.

Domestic & General Limited is the statutory entity at which the operational board sits. Galaxy Finco Limited is a subsidiary of Domestic & General Limited and is a holding company within the Domestic & General Group. An Annual Report and Accounts are prepared for Galaxy Finco Limited and it is the largest group of companies for which the results of the Domestic & General Group are consolidated. The ultimate controlling party of the Group is Galaxy Topco Limited, an entity whose shareholders are funds managed and advised by subsidiaries and affiliates of CVC Capital Partners and the Abu Dhabi Investment Authority (ADIA).

DGI and DGIEU are the only regulated insurance entities within the Group.

2.3. The Proposed Transfer

DGI currently writes insurance policies in the UK and 10 countries across the EEA. DGI primarily provides insurance to cover breakdown of household appliances and consumer electronics after the manufacturer's guarantee has expired.

Brexit occurred when the UK left the European Union (EU) on 31 January 2020. There is a transition period which is due to expire on 31 December 2020 during which the UK and EU will conduct trade negotiations. The outcome of these negotiations, including any decisions about regulatory equivalence between the UK and EU, remains uncertain. Until 31 December 2020 the current rules remain in place. The Proposed Transfer described in this report is due to complete before the anticipated expiry of the transition period on 31 December 2020.

If negotiations between the EU and UK result in the withdrawal of FofS and FofE rights (or equivalent) for DGI upon expiry of the Brexit transition period, DGI's current operating model would no longer be viable. Under this scenario, DGI may not legally be able to carry on the non-UK EEA business. For example, DGI would not be able to issue new or renewal insurance policies across the EEA, and might not legally be able to pay valid claims to existing non-UK EEA policyholders unless DGI obtains appropriate authorisation in all relevant EEA member states.

Under the Proposed Transfer, the relevant non-UK EEA insurance business will transfer from DGI to DGIEU, a German-domiciled wholly-owned subsidiary of DGI. The purpose of the Proposed Transfer is to provide certainty that DGI can continue to carry on non-UK EEA business after the Brexit transition period with minimum disruption to its operating model and its customers.

2.4. Independent Expert appointment

My appointment

DGI and DGIEU have jointly appointed me to act as the IE for the Proposed Transfer. The PRA, in consultation with the FCA, has approved my appointment. DGI will bear the costs associated with the production of my report. I understand that no costs or expenses of the Proposed Transfer will be borne by policyholders.

My experience

I am a Fellow of the Institute and Faculty of Actuaries (IFoA) and am a holder of Chief Actuary (non-Life with Lloyd's) practising certificate.

I am a Partner in the Insurance Consulting practice at LCP. I have experience in a wide range of areas of general insurance actuarial work, and have provided peer review or support to the IE for a number of other insurance Part VII transfers.

Appendix 5 contains my CV with further details of my experience.

Independence statement

I confirm that the LCP Part VII Team have no direct or indirect interests in Domestic & General Group ("D&G") or any of its subsidiaries either personally or via Lane Clark & Peacock LLP (LCP). In particular:

- The LCP Part VII team and their immediate family members are not shareholders in D&G or any of its subsidiaries and are not members of any pension scheme under the management of D&G; and
- Members of the LCP Part VII team do not hold any insurance policies issued by D&G or any of its subsidiaries.

A family member of one of the team supporting me on this transfer has insurance policies with D&G to provide warranty cover for a dishwasher and washing machine. I am satisfied that this does not fetter my independence as IE on the Proposed Transfer.

LCP has not previously worked with D&G, so there is no risk of any perceived independence concerns.

2.5. Scope of this Scheme Report

Appendix 4 contains an extract from my terms of reference, which defines the scope of my work in relation to the Proposed Transfer. The actual work performed is in line with this agreed scope.

This Scheme Report considers the effect of the Proposed Transfer upon the policyholders of DGI and DGIEU. It contains a description of the Proposed Transfer, the methodology I have used to analyse the Proposed Transfer, the opinions I have formed, and reasons why I have formed those opinions.

The use of “I”, “me” and “my” in this report generally refers to work carried out by me or by the team operating under my direct supervision. However, when it is used in reference to an opinion, it is mine and mine alone.

There are significant uncertainties as to how the UK Government’s trade negotiations will develop over the coming months and I have considered alternative options in section 3.4 and key dependencies in section 3.5.

2.6. Use of this Scheme Report

This Scheme Report has been produced by Tom Durkin FIA of LCP under the terms of our written agreement with DGI. It is subject to any stated limitations (eg regarding accuracy or completeness).

This Scheme Report has been prepared for the purpose of accompanying the application to the High Court in respect of the proposed insurance business transfer scheme described in this report, in accordance with Section 109 of the Financial Services and Markets Act 2000. The Scheme Report is not suitable for any other purpose.

A copy of the Scheme Report will be sent to the PRA and the FCA and will accompany the Scheme application to the High Court.

This report is only appropriate for the purpose described above and should not be used for anything else. No liability is accepted or assumed for any use of the Scheme Report for any other purpose other than that set out above.

2.7. Reliances

I have based my work on the data and other information made available to me by DGI and DGIEU. Appendix 6 contains a list of key data and other information that I have considered. I have also held discussions with the relevant staff of DGI, DGIEU and their advisors.

My analysis is based on data from two separate dates:

- 31 March 2020 data has been used for any analysis as at that date, including DGI and DGIEU’s balance sheet as at that date. This is the latest set of year-end accounts available at the time of preparing this report. At the time of preparing this report, the audits for the 31 March 2020 accounts for DGI and DGIEU are near completion and in the process of being finalised. I will consider any findings from the audits in my Supplementary Report.
- 31 December 2019 data has been used by D&G as the starting point for projections to 31 December 2020 and beyond. This data has been used to be consistent with the projections that each of DGI and DGIEU’s management use to manage their businesses. The projections reflect DGI and DGIEU’s best view of the potential impact of COVID-19 at the time of preparing this report.

Prior to the Sanctions Hearing for the Proposed Transfer, I will prepare a Supplementary Report to confirm and/or update my conclusions in this report, based on any new material or issues that arise.

I have received all of the information that I have requested for the purposes of the production of my report. In this respect:

- DGI and DGIEU will submit witness statements to the High Court stating that all information provided to me (and to the High Court) by DGI and DGIEU is correct and complete in all material aspects to the best of their knowledge, information and belief.
- Each of DGI and DGIEU has provided a Data Accuracy Statement confirming that the data and information provided to me regarding the Proposed Transfer is accurate and complete.
- DGI and DGIEU have provided attestations that there have been no material adverse changes to the financial position of DGI or DGIEU since that information was provided to me.
- DGI and DGIEU have read this IE Scheme Report and each has agreed that it is correct in terms of all factual elements of the Proposed Transfer.
- I have conducted basic checks on the data provided to me for internal consistency and reasonableness.

- My checks of the data have not revealed any cause for me to doubt that it is materially appropriate for me to rely on the integrity of the information provided for the purpose of this report.

The conclusions in my report take no account of any information that I have not received, or of any inaccuracies in the information provided to me.

As set out in sections 7.4 and 7.7 respectively, D&G's legal advisers have advised me on specific aspects of the Reinsurance Agreement between DGI and DGIEU, and insurance regulation. I have not needed to take any other third-party legal advice on any aspects of the Proposed Transfer. DGI has confirmed that it has received no other specific legal advice relevant to my role as IE for the Proposed Transfer.

Figures in this report may be subject to small rounding differences and so totals within the tables may not equal the sum of the rounded components. D&G's assumed exchange rate of £1 = €1.17 has been used throughout this report to ensure consistency.

2.8. Professional standards

This report complies with the applicable rules on expert evidence and with the guidance for scheme reports set out by the PRA in their Statement of Policy, the FCA guidance to their approach to review of Part VII transfers issued in May 2018 and by the PRA Rulebook and the FCA Handbook.

This report complies with Technical Actuarial Standard 100: Principles for Technical Actuarial Work (TAS 100) and Technical Actuarial Standard 200: Insurance (TAS 200) issued by the Financial Reporting Council (FRC). The FRC is responsible for setting technical actuarial standards in the UK.

I have considered The Actuaries' Code as issued by the IFoA while producing this report.

This report has been subject to independent peer review prior to its publication, in line with Actuarial Professional Standard X2: Review of Actuarial Work (APS X2) as issued by the IFoA. This peer review has been undertaken by another Partner at LCP. The peer reviewer was not involved in the production of the report. They have appropriate experience and expertise to act as peer reviewer of this report, and have themselves been the Independent Expert for a number of other transfers.

2.9. Materiality

The FRC considers that matters are material if they could, individually or collectively, influence the decisions to be taken by users of the actuarial information. It accepts that an assessment of the materiality is a matter of reasonable judgement that requires consideration of the users and the context.

I have applied this concept of materiality in planning, performing and reporting the work described in this Scheme Report. In particular, I have applied this concept of materiality when using my professional judgement to determine the risks of material misstatement or omission and to determine the nature and extent of my work.

In complying with the reporting requirements of TAS 100, I have made judgements on the level of information to include in this Scheme Report. For example, to make the report easier to read, I have not included all the details that would normally be included in a formal actuarial report, such as details of the methodologies and assumptions underlying the reserve and capital assessments.

2.10. Definition of "materially adverse"

In order to determine whether the Proposed Transfer will have a "materially adverse" impact on any group of policyholders, it has been necessary for me to exercise my judgement in the light of the information that I have reviewed.

The Proposed Transfer will affect different policyholders in different ways and, for any one group of policyholders, there may be some effects of the Proposed Transfer that are positive, and others that are adverse. When assessing whether the Proposed Transfer will have a "materially adverse" impact, I have considered the aggregate impact of these different effects on each group of policyholders.

Throughout the report, I have provided the rationale for my judgements and conclusions. These explain why, in each case, I have concluded whether policyholders are materially adversely affected or otherwise.

3. Outline of Proposed Transfer

3.1. The companies involved in the Proposed Transfer

Domestic & General Insurance PLC (DGI)

The company was founded in 1912 and listed on the stock market in 1988. DGI is an insurance company incorporated in England and Wales, authorised by the PRA and regulated by the PRA and FCA. Domestic & General Group is the parent company of DGI owning 100% of the issued share capital. DGI's accounting year-end is 31 March.

Consumer extended warranty business makes up the vast majority of DGI's business, both in the UK and in the other EEA countries where it operates. This cover is designed to protect against the unexpected risks and losses which arise from the breakdown of, accidental damage to, or theft of household appliances and consumer electronics after the manufacturer's guarantee has expired. The products are mostly domestic appliances of an electrical nature.

The table below sets out the types of goods covered:

Description	Typical items covered
White goods	Dishwashers, microwaves, refrigeration appliances, home laundry appliances and vacuum cleaners
Brown goods	Television sets, audio equipment and similar household appliances
Grey goods	Computing equipment
Heating products	Boilers and extended controls
Gadgets	Personal computers, laptops and cameras

As at 31 March 2020, over half of DGI's claims and unearned premiums were in respect of UK risks. Apart from a small proportion underwritten in Australia via DGI's branch there, the remainder is business underwritten via a network of four branches across the EEA. The branches are located in:

- Germany;
- France
- Italy; and
- Spain

The branches are permitted to carry out business in each of the branch countries on an FofE basis. DGI also currently issues policies in the following six EEA member states using FofS rights out of the UK head office and network of four branches:

- Austria;
- Belgium;
- Republic of Ireland (ROI);
- Netherlands;
- Poland; and
- Portugal.

DGI also has a small portfolio of general liability business which has been in run-off since the late 1970's. These liabilities stem from DGI's participation in the EIROS Pool, which is the UK Electricity Industry Insurance Pool managed by Electricity Industry Run Off Services Limited. These liabilities relate to UK business only and therefore are not being transferred as part of the Part VII. According to the latest information provided by EIROS as at 31 March 2018), DGI's share of liabilities is approximately £589k, which is 0.1% of DGI's forecast post-transfer total IFRS technical provisions as at 31 December 2020.

DGI does not have, nor intend to purchase, any outwards reinsurance arrangements.

The following table shows key financial information of DGI as at 31 March 2020, the latest set of year-end accounts.

DGI key financials – £m as at 31 March 2020			
IFRS Profit and Loss Account		IFRS Balance Sheet	
Gross premiums written	502.4	Net assets	54.8
Net profits after tax	29.6	Technical provisions	519.0

Source: DGI. P&L Account and IFRS Balance Sheet as at 31 March 2020

Domestic & General Insurance Europe AG (DGIEU)

DGIEU is an insurance company, regulated by the German regulator, BaFin, incorporated in Germany on 30 May 2018 and is a wholly-owned subsidiary of DGI. DGIEU's accounting year-end is also 31 March.

DGIEU began writing business on 1 November 2019 for new non-UK EEA business (excluding renewals) for the majority of territories. The exceptions to this are:

- A limited amount of trading through its Spanish branch commenced in August 2019.
- A small amount of new business from DGI's manufacturer clients in the ROI is still written by DGI. It is intended that DGIEU write all new ROI business in place of DGI as soon as possible (see details of DGIEU's UK branch application below).
- DGI continues to write a small amount of repair and protect business for a client in the Netherlands. It is intended that DGIEU write this business in place of DGI by 31 August 2020.

At the Effective Date of the Proposed Transfer, it is expected that DGIEU will have 1.7m existing policyholders with €76m gross unearned premium reserves.

DGI and DGIEU have confirmed that there are no other insurance business transfers expected into DGIEU or related to either DGI or DGIEU.

As at 31 March 2020, over half of DGIEU's claims were in respect of Spanish risks. DGIEU's business is underwritten via the German head office and a network of three branches across the EEA. The branches are located in:

- France;
- Italy; and
- Spain

The branches are permitted to carry out business in each of the branch countries on an FofE basis. DGIEU also issues policies in the following six EEA member states using FofS rights out of the German head office and network of branches:

- Austria;
- Belgium;
- Republic of Ireland (ROI);
- Netherlands;
- Poland; and
- Portugal.

DGIEU submitted an application to BaFin in August 2020 to establish a UK branch on a FofE basis. If the application is approved, then DGIEU's expectation is the UK branch will be established in November 2020.

The purpose of the UK branch is to minimise customer disruption and to ensure the availability of suitable personnel, as DGIEU will utilise DGI's existing infrastructure in the UK (principally an English language call centre) to operate the ROI business and to service Transferring Policyholders located in the ROI. I have discussed the UK branch application with DGIEU and I am satisfied with the rationale for establishing a UK branch.

Unless the continued availability of passporting rights (or similar) are agreed in trade negotiations between the UK and the EU, the UK Branch will become a "third country branch" for UK regulatory purposes upon expiry of the Brexit transition period on 31 December 2020. DGIEU has informed me that it intends to apply to the PRA and FCA for approval under Part IV A of FSMA prior to 31 December 2020 and will therefore benefit from the Temporary Permissions Regime (TPR). The TPR will permit DGIEU to continue to operate the ROI business through the UK branch while its application for approval is pending.

I will provide an update on the status of the UK branch in my Supplementary Report.

DGIEU has a quota share arrangement with DGI. DGIEU does not have, nor intends to purchase, any other outwards reinsurance arrangements.

The following table shows key financial information of DGIEU as at 31 March 2020, the latest set of year-end accounts.

DGIEU key financials – €m as at 31 March 2020			
IFRS Profit and Loss Account		IFRS Balance Sheet	
Gross premiums written	41.8	Net assets	22.7
Net profits after tax	(3.9)	Technical provisions (gross of reinsurance)	38.8
		Technical provisions (net of reinsurance)	3.9

Source: DGIEU. P&L Account and IFRS Balance Sheet as at 31 March 2020

As set out in the table above, DGIEU made a net loss over the year to 31 March 2020 of €3.9m. DGIEU is a relatively new insurer, and its business plan assumes the business will run at a loss in the early years due to the costs of writing new business exceeding initial premium. DGIEU project that profitability will improve over time as the business matures.

3.2. Description of the Proposed Transfer

Transferring policies

If sanctioned by the High Court, the Proposed Transfer will move the following business written by DGI to DGIEU:

- All business written by the EEA Branches of DGI: DGIEU will receive the business of these branches, which it will carry on servicing using its own branch network.
- The Non-UK EEA components of FofS business written by DGI itself: the part of this business relating to exposure in EEA30 member states (ie the 30 member states of the EEA after the UK leaves) will transfer to DGIEU.

All rights and obligations of DGI relating to the transferring policies will also be transferred to DGIEU. Following the Effective Date, any new or renewed direct insurance policies for non-UK EEA domiciled insureds or non-UK EEA located risks will be insured by DGIEU.

The business that is being transferred from DGI is extended warranty business. This type of business is generally "short tail" – ie claims are reported and settled in a relatively short time. In particular:

- The average duration of the unearned premiums on transferring policies is around 1 year, corresponding to an average remaining length of warranty cover of around 2 years.
- 99% of claims on earned business are reported within 6 months, and valid claims are on average paid within 15 days.

The following table presents projections for the number of policyholders and booked provisions as at the Effective Date of the Proposed Transfer, 31 December 2020.

Projection as at 31 December 2020	Number of policyholders (000s)		IFRS provisions gross of reinsurance Converted £m
Non-transferring Policyholders	7,651		341.9
Transferring Policyholders	4,167		114.1
Spain	2,418	58.0%	61.4
Portugal	824	19.8%	22.4
Germany	529	12.7%	22.9
Republic of Ireland	330	7.9%	2.2
France	32	0.8%	2.5
Netherlands	20	0.5%	2.1
Italy	6	0.1%	0.1
Belgium	9	0.2%	0.6
Total DGI Policyholders	11,818		456.0
Existing DGIEU Policyholders	1,741		70.5

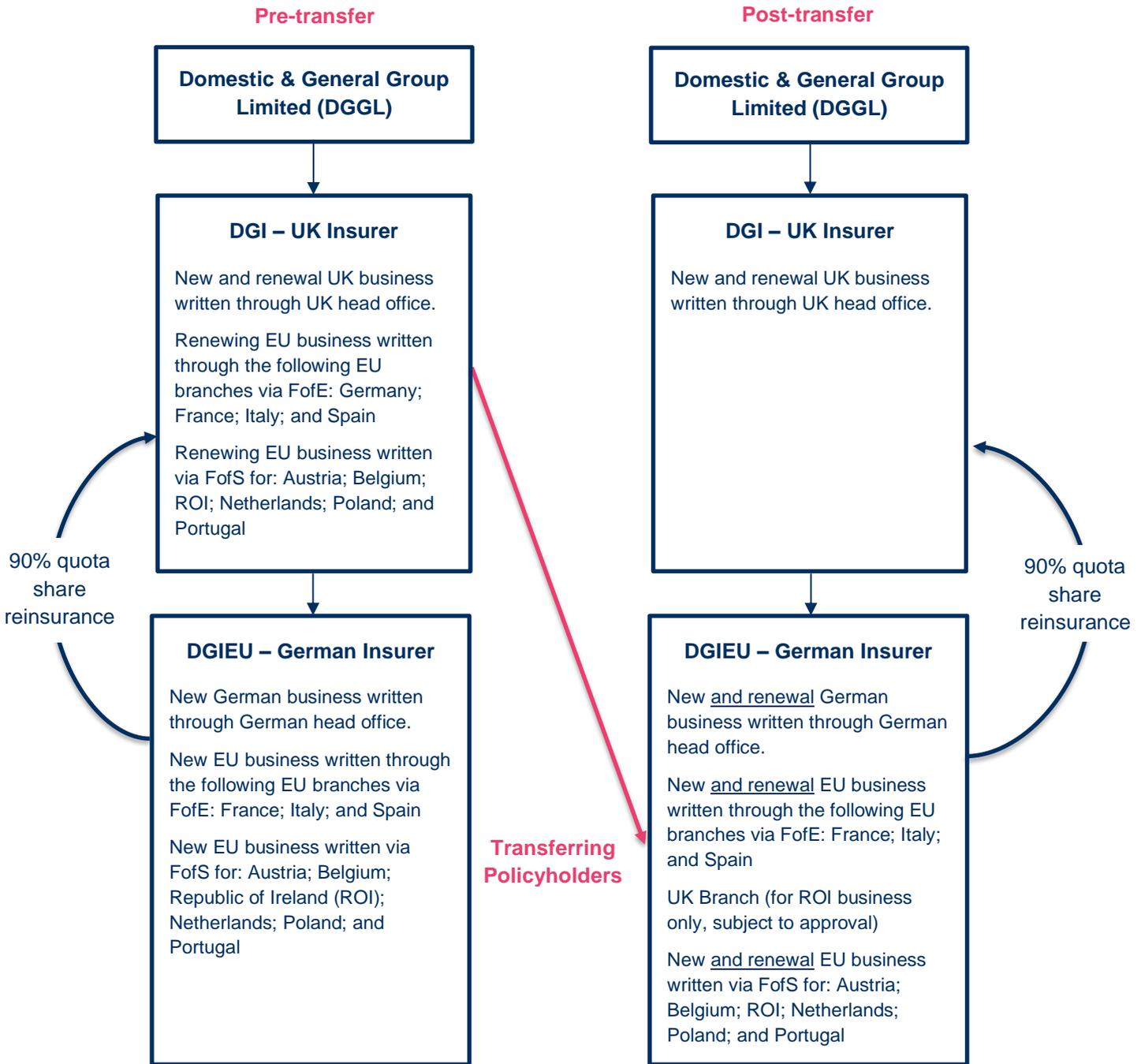
Source: DGI, DGIEU. DGIEU figures converted assuming £1 = €1.17

The IFRS provisions are made up of the earned claims reserves and unearned premium reserves

As at the Effective Date of the Proposed Transfer, there are projected to be 11.8 million DGI policyholders, of which there are projected to be 4.2 million policyholders in scope to transfer to DGIEU. The transferring policies are projected to represent IFRS provisions of £114.1m compared to total IFRS provisions for DGI of £456.0m.

DGI expect that all policies they plan to transfer to DGIEU will be able to transfer at the Effective Date. Should this not be possible for any reason, there are provisions in the Scheme Document to allow for the transfer of such policies at a later date.

Illustration of the proposed Transfer



The above diagram shows the business currently written by each entity and the transfer of business following the Proposed Transfer. There is also a small amount of business underwritten in Australia via DGI’s branch there, which will remain in DGI post-transfer.

Currently, DGIEU has a quota share reinsurance policy with DGI where DGIEU cede 90% of the business they write to DGI. As part of the Proposed Transfer, all business that DGI has written through its EU branches will be transferred to DGIEU. Post-transfer DGIEU will retain this 90% quota share in place and the quota share will apply to both the transferred business and the existing business written by DGIEU.

Reinsurance

Reinsurance is an arrangement with another insurer to share or pass on risks. Reinsurance contracts may be underwritten by an external reinsurer or by a reinsurance entity in the same group.

DGI and DGIEU have entered into a Reinsurance Agreement pursuant to which DGIEU has purchased quota share reinsurance from DGI. Quota share is a common type of reinsurance arrangement, where an insurer shares a set proportion of premiums with the reinsurer in exchange for the reinsurer assuming a set proportion of claims from the insurer. Under this quota share, DGIEU cedes 90% of both new/renewal business and transferred business to DGI.

3.3. Purpose of the Proposed Transfer

There are uncertainties as to how the UK Government's negotiations with the EU will develop over the coming months.

DGI currently operates across the EEA utilising the EEA's FofS and FofE arrangements. If negotiations between the EU and UK result in the withdrawal of FofS and FofE rights (or equivalent) for DGI upon expiry of the Brexit transition period, DGI may not legally be able to carry on the non-UK EEA business. For example, DGI would not be able to issue new or renewal insurance policies across the EEA, and might not legally be able to pay valid claims to existing non-UK EEA policyholders.

The purpose of the Proposed Transfer is to provide certainty that DGI can continue to carry on non-UK EEA business after the Brexit transition period with minimum disruption. DGI is proposing to transfer the relevant non-UK EEA business from DGI into its wholly-owned subsidiary, Domestic & General Insurance Europe (DGIEU), a German-domiciled insurance company.

3.4. Alternative options considered and contingencies

Under alternative Brexit scenarios, a legal route for UK insurance companies to continue their non-UK EEA business may be agreed by the UK Government and the EU. However, there is no certainty that any such routes will be available.

The Proposed Transfer therefore assumes a position where DGI no longer has FofS or FofE rights for existing or new policyholders following expiry of the transition period on 31 December 2020.

Under this scenario, D&G has stated that its view is the Part VII transfer is the best option available to continue to carry on its non-UK EEA business and to pay claims to DGI's existing EEA policyholders on expiry of the Brexit transition period.

DGI has informed me that there are no alternative plans in place if the Proposed Transfer does not proceed.

3.5. Key dependencies

The key dependencies of the Proposed Transfer are as follows:

- High Court approval required for the Proposed Transfer – the Directions Hearing is scheduled for 2 September 2020 and the Sanctions Hearing is expected to be 15 December 2020. The High Court will take into account whether the PRA and FCA have any objections to the Proposed Transfer.
- Any objections raised by policyholders or non-UK EEA regulators after the Directions Hearing – I will comment on these (if any exist) in my Supplementary Report.

4. My approach as IE

As IE, my overall role is to assess whether:

- The security provided to policyholders of DGI and DGIEU will be materially adversely affected by the implementation of the Proposed Transfer.
- The Proposed Transfer will have any adverse impact on service standards experienced by policyholders.
- Any reinsurer of DGI covering the transferring business will be materially adversely affected. There are no relevant reinsurers and I have therefore not considered this aspect further.

To make these assessments, I have considered the effect of the Proposed Transfer from the perspectives of the following groups of policyholders:

- Non-transferring Policyholders, who will remain with DGI after the Proposed Transfer.
- Transferring Policyholders, who will transfer from DGI to DGIEU as a result of the Proposed Transfer.
- Existing DGIEU Policyholders, ie policyholders of DGIEU at the time of the Proposed Transfer, who will remain with DGIEU after the Proposed Transfer.

My approach to assessing the Proposed Transfer has been to perform the following five steps analysing evidence provided by DGI and DGIEU to support the Proposed Transfer:

Step 1: Assessing the provisions of DGI and DGIEU

The first important form of security that an insurer provides to policyholders is the level of provisions. Provisions are based on an estimate of the amount of money the insurer will need to pay policyholders' claims and to cover the other costs associated with running the insurer.

Therefore, I have assessed the appropriateness of the provisions included on DGI's balance sheet and the approach to be used for the calculation of provisions for both DGI and DGIEU pre- and post-transfer. Details of this step are set out in section 5.

Step 2: Assessing the capital positions of DGI and DGIEU

In addition to the level of provisions, insurers hold capital designed to withstand more extreme levels of claims. The level of capital held is the second important form of security provided to policyholders.

For both DGI and DGIEU, the level of capital required is set under the European Solvency II standard. A key metric under Solvency II is the Solvency Capital Requirement. This is an estimate of the capital required to cover the loss that an insurer could experience over the next 12 months with a probability of 99.5% (ie, a 1 in 200 event).

I have assessed the appropriateness of the projected capital requirements of DGI and DGIEU. Details of this step are set out in section 6.

Step 3: Assessing overall policyholder security

Under this step, I have considered the level of provisions and capital (from steps 1 and 2) in the context of the assets held by each of DGI and DGIEU and other forms of security such as compensation schemes.

For this analysis, I have considered the current balance sheets of DGI and DGIEU as well as the post-transfer pro-forma balance sheets for each of DGI and DGIEU. Details of this step are set out in section 7.

Step 4: Assessing policyholder communications

I have assessed the appropriateness of DGI's communication strategy to inform policyholders and other stakeholders of the Proposed Transfer. The key focus of my assessment was whether the policyholders and other stakeholders are to be provided with sufficient and clear enough information so that they can understand how the Proposed Transfer may affect them. Details of this step are set out in section 8.

Step 5: Assessing potential impact on customer service and other considerations that might affect policyholders

I have considered how the level of customer service provided to policyholders could change following the Proposed Transfer. I have also considered a range of other factors that might affect policyholders, such as ongoing expense levels and tax implications. Details of this step are set out section 9.

5. Reserving considerations

5.1. Introduction to insurance reserving

For an insurance company, the primary purpose of reserving is to assess the provisions that need to be set in order to pay policyholders' claims and to cover the other costs associated with running an insurer.

Depending on how they are set, the provisions may be on a "best estimate" basis (with no deliberate optimism or pessimism) or include a "margin for prudence" (additional provisions to cover higher than expected claims). This is sometimes referred to as a "management margin". Where the provisions include a margin for prudence, this is typically designed to cover claims that are moderately higher than expected rather than more extreme levels of claims. A best estimate basis may indicate a single point estimate of the provisions, but practically there often exists a range of estimates that could be justified as a best estimate.

In addition to any margin for prudence, the insurer would nearly always hold additional capital designed to withstand more extreme levels of claims. My considerations related to capital for the Proposed Transfer are set out in section 6.

5.2. Introduction to reserving bases

Insurers use a range of different reserving bases (ie different measures of the provisions), for different purposes.

For example, financial accounting standards require the provisions to be calculated in particular ways, and an insurer may also use a different basis for internal management accounts. Solvency II calculates the provisions in yet another way.

For the Proposed Transfer, I have considered the provisions under three reserving bases, which are each relevant for different purposes, namely:

- International Financial Reporting Standards ("IFRS") – these are the accounting standards used to set the provisions underlying the consolidated published financial accounts of D&G Group, covering DGI and DGIEU. IFRS provisions are relevant for policyholders as they are used as a reference point when setting provisions to cover future claims and other costs.
- German Generally Accepted Accounting Principles ("GAAP") – these are the accounting standards used for local reporting for DGIEU. While many of the underlying principles are similar to IFRS, there are a number of differences that are important in the context of DGIEU's business, particularly given the nature of the portfolio of business being transferred. The consequence of these differences means that DGI needs to consider the German GAAP balance sheet position of DGIEU when determining the level of assets transferred to DGIEU from DGI, as part of the Proposed Transfer, in order to ensure DGIEU remains solvent on a German GAAP basis as well as on a Solvency II basis.
- Solvency II technical provisions – these are calculated in line with the European Solvency II regulations that apply to almost all EU insurance and reinsurance companies, including both DGI and DGIEU. These provisions are relevant for policyholders as they are the basis for calculating the capital required and assessing solvency for both DGI and DGIEU.

In each case, the provisions are typically analysed separately between a claims provision (to cover incidents that have already occurred, including an estimate for claims that have occurred but have not yet been reported to DGI – IBNR claims) and a provision for unearned premiums (to cover future incidents).

5.3. My considerations relating to reserving

As IE, my overall assessments related to reserving are:

- whether an appropriate level of provisions is maintained for all relevant policyholders, that is: Transferring, Non-transferring and Existing DGIEU Policyholders; and
- whether any aspects of the reserving may lead to policyholders being materially adversely affected by the Proposed Transfer.

To make these assessments, I have considered the following areas:

- Appropriateness of provisions for DGI and DGIEU (section 5.5), including:
 - Approach for setting IFRS technical provisions;
 - Independent projections of best estimate provisions; and
 - Approach for setting Solvency II technical provisions.
- Key uncertainties when setting the provisions (section 5.6);
- Current DGI and DGIEU reserving process and governance (section 5.7); and
- Future reserving approach and governance (section 5.8).

Within these areas, I have also considered any expected differences in the reserving approach between DGI and DGIEU to understand how this may affect policyholders.

Further details on each of these considerations are set out below, and I have stated my overall conclusion related to reserving in section 5.9.

5.4. Approach to my review

I have reviewed a number of documents provided by DGI and DGIEU relating to the setting of provisions, including the reserving process and governance. I have had meetings with D&G to discuss the information provided and any questions I have had on the reserving approach.

I have independently calculated best estimate earned provisions for each of DGI and DGIEU as at 31 March 2020, (without any adjustment to allow for other expected delays in reporting or processing of claims mentioned below), based on the data provided by DGI and DGIEU. In addition, I have reviewed the methodology used to determine the best estimate unearned premium provision, and the appropriateness of the earnings assumptions on a sample basis.

I have also independently reconciled the outputs of the reserving process carried out by DGI and DGIEU to the gross best estimate claims reserves used as the starting point for the calculation of their respective Solvency II technical provisions.

5.5. Appropriateness of provisions for DGI and DGIEU

The following table shows the level of IFRS technical provisions as at 31 March 2020 (the latest available figures at the time of my writing of my report) for DGIEU and DGI, split between the Non-transferring, Transferring and Existing DGIEU Policyholders. The provisions for Transferring Policyholders represent 31% of DGI's total provisions as at 31 March 2020 (projected to reduce to 28% as at 31 December 2020).

Summary of IFRS technical provisions at 31 March 2020

£m	Gross of reinsurance
Non-transferring Policyholders	358.1
Transferring Policyholders	160.9
Total DGI	519.0
Existing DGIEU Policyholders	33.2

Source: DGI and DGIEU. DGIEU figures converted assuming £1 = €1.17
The provisions are made up of the earned claims reserves and unearned premium reserves

The business transferring to DGIEU relates to non-UK EEA business and is made up of extended warranty business.

Approach for setting IFRS technical provisions

I have reviewed the process by which DGI and DGIEU calculate their respective IFRS technical provisions, which includes both a claims provision and a premium provision for each entity.

DGI

DGI has been writing many of its schemes, where each scheme represents a Client and DGI product combination, for several years meaning there is a number of years of historical claims experience on which to rely on when setting provisions. DGI calculates the provisions at each month-end. For the UK book of business, ie the non-transferring business, it calculates provisions separately for each scheme. For the non-UK EEA business, ie the transferring business, it uses a less granular approach and calculates provisions for each territory.

DGI claims provision

The approach taken is a standard actuarial technique known as development factor modelling (defined in appendix 3) for all schemes and/or territories. DGI calculates IBNR provisions using development factor modelling applied to historical monthly paid claims data at either the scheme or territory level. Additionally, when setting its year-end claims provision, the actual claims experience is compared to expectations over the previous year.

DGI applies adjustments for known backlogs in processing claims and delays to policy start dates. To produce the best estimate provision, DGI makes a 20% adjustment to allow for other expected delays in reporting or processing of claims. I have discussed with DGI the rationale for the application of the 20% adjustment, and I am satisfied that it is reasonable to include an adjustment to allow for these other expected delays. However, DGI has informed me that the amount of the adjustment has not been reviewed recently, and I recommend this is reviewed by DGI to ensure it isn't introducing prudence into the best estimate projections. If the 20% adjustment were to include an element of prudence, then this would not affect my overall conclusions set out in this report.

DGI also holds a management margin within the IFRS claims provision. The margin is considered on a scheme-by-scheme (for UK business) or territory-by-territory (for EU business) basis. At 31 March 2020, the management margin accounted for around 37% of DGI's IFRS claims provision (ie, the IFRS provisions are around 59% higher than the best estimate projections). DGI has noted that the margin has built up over the past 12-18 months as a result of better than expected claims experience, which has not yet been reflected in the IFRS claims provision. DGI has stated that it intends to release around €1m of this margin, held in respect of the transferring business, prior to the Effective Date of the Proposed Transfer. The exact timing of this release has not yet been agreed. DGI has confirmed that the decision to release the margin is unconnected to the Proposed Transfer and would be proposed even if the Part VII were not taking place.

The IFRS provisions for the Transferring Policyholders, including the corresponding management margin at the time of Proposed Transfer, will transfer to DGIEU.

DGI unearned premium provision

DGI calculates the best estimate of its unearned premium provision assuming that annual policies are earned evenly over the cover period. Multi-year policies are earned based on the specific risk profile, which tends to be weighted towards the end of the policy. DGI uses the same approach for calculating the provision for unearned premiums for both transferring and non-transferring business, with different earning assumptions that reflect the different characteristics of the respective books of business.

As part of the Proposed Transfer, DGI will transfer a provision for unearned premiums, in respect of the transferring business, to DGIEU.

DGIEU

DGIEU follows broadly the same approach to calculating its IFRS technical provisions as DGI, with the following differences:

- DGIEU uses a loss ratio approach to calculate the best estimate IBNR provisions. Post the Proposed Transfer, DGIEU intends to adopt the same loss development factor approach as DGI, on the basis that there will be sufficient data for the claims triangles to produce credible projections.
- DGIEU applies a 20% (multiplicative) uplift to the business plan loss ratios, as part of calculating its best estimate IBNR provisions. This is consistent with the 20% adjustment applied by DGI and is intended to allow for expected delays in reporting or processing of claims.
- DGIEU currently applies an additional 20% "new branch uplift" when calculating the best estimate claims provision. This is to reflect the additional uncertainty of estimating the claims provision based on only a small

amount of historical data. DGIEU has informed me that the new branch uplift will not be required post the Proposed Transfer, once it is using the development factor approach mentioned above.

- DGIEU currently holds a smaller level of management margin than DGI, and this margin is also included in the best estimate. At 31 March 2020, the management margin accounted for around 11% of both DGIEU's IFRS and best estimate provisions.
- However, post the Proposed Transfer DGIEU has stated its intention is to maintain similar levels of management margin as DGI, and it will achieve this by moving its methodology for setting the best estimate to be more in line with that used by DGI. Specifically, it will be able to utilise the historical monthly paid claims data as the starting point and the new branch uplift would be taken as a management margin. Further, the management margin would no longer be included within the best estimate provisions.
- Based on data as at 31 March 2020, DGI and DGIEU have calculated implied management margins as a percentage of IFRS and best estimate provisions, based on its intended future approach. The calculations are based on assuming a €1m management margin release on the transferring business and DGIEU applying the same development factor modelling approach as DGI.

Margin as a % of:	IFRS provisions	Best estimate provisions
Total DGI	37%	59%
Transferring business	37%	58%
Non-transferring business	37%	59%
Total DGIEU	37%	58%

Source: DGI and DGIEU

- The implied margin percentages in the table above indicate that DGI and DGIEU are expected to have similar margins following the €1m release of margin from DGI and once DGIEU adopts the same development factor modelling approach as DGI.

Independent projections of best estimate provisions

DGI

I have performed my own independent claims projections on DGI's business, on a territory-by-territory basis, (without any adjustment to allow for other expected delays in reporting or processing of claims), using data as at 31 March 2020. I applied triangular-based reserving methodologies to these key classes deriving my own assumed development patterns, making use of historical loss ratio data to inform my selected assumptions where this was deemed necessary.

In aggregate across DGI's UK business, my independent projections were within 1% of DGI's estimate of total earned claims on a best estimate basis. In aggregate across DGI's Non-UK EEA business, which is the transferring business as part of the Proposed Transfer, my independent projections were within 1% of DGI's estimate of total earned claims on a best estimate basis. This comparison was done before the 20% adjustment for other expected delays in reporting or processing of claims. I consider these differences to be within a range of reasonable best estimates given the type of business written by DGI.

DGI will also transfer a provision for unearned premiums to DGIEU as part of the Proposed Transfer. As set out above, I have reviewed the methodology used to determine the best estimate unearned premium provision and the appropriateness of the earnings assumptions for a sample of schemes, but have not sought to re-perform the calculation of the unearned premium provision or verify the calculations performed by DGI or DGIEU. Based on my review, I am satisfied that the methodology for calculating the unearned premium provision is appropriate.

Based on my own independent projections of the provisions for DGI as at 31 March 2020, I concluded that the level of best estimate provisions for DGI was reasonable and I did not identify any concerns around their appropriateness. The management margin in the IFRS provisions as at 31 March 2020 is higher than I would typically expect.

DGIEU

I have performed my own independent projections on DGIEU's business, on a territory-by-territory basis, using data as at 31 March 2020. To do this, I used the independent projections I carried out for DGI's Non-UK EEA business in order to calculate an average loss ratio for each EEA territory. I then applied these loss ratios to the premium data provided by DGIEU in order to calculate best estimate provisions for each territory.

In aggregate across the EEA territories, my independent projections were within 1% of DGIEU's estimate of total unearned claims on a best estimate basis, before the application of any loadings. I consider this to be within a range of reasonable best estimates given the type of business written by DGIEU.

Based on my own independent projections of the provisions for DGIEU as at 31 March 2020, I concluded that the level of best estimate provisions for DGIEU was reasonable and I did not identify any concerns around their appropriateness. I consider that the management margin in the IFRS provisions is at the higher end of what I would typically expect to see from an insurer writing this type of business.

Approach for setting Solvency II technical provisions

The Solvency II technical provisions (TPs) are made up of a claims provision and premium provision. The starting point for the calculation of the Solvency II claims provision is the best estimate claims provisions, and I have reviewed the approach taken by DGI and DGIEU to convert the best estimate claims provisions into the Solvency II TPs. This involves removing certain provisions that are not required under Solvency II, and the addition of other provisions that are required under Solvency II, but are not in the best estimate.

The starting point for the calculation of the Solvency II premium provision is the unearned premiums. I have reviewed the approach taken by DGI and DGIEU to convert the unearned premiums into the premium provisions for the Solvency II TPs.

My review has focussed on the areas which are material for DGI and DGIEU along with areas that involve a higher degree of subjectivity and, in my experience, are the areas of interest to an independent reviewer.

For the claims provision, this included Events Not in the Data (ENIDs) and removal of the management margin. For the premium provision, this included Events Not in the Data (ENIDs), the removal of the profit on unearned premium (UPR) and the removal of future premium. I also reviewed the approach taken by DGI and DGIEU to calculate the Solvency II Risk Margin.

The table below shows the main steps involved in going from IFRS provisions to Solvency II TPs for both DGI and DGIEU, based on data as at 31 March 2020.

Steps from IFRS to Solvency II technical provisions at 31 March 2020

Gross of reinsurance

	DGI £m	DGIEU €m
Claims provision		
IFRS claims provision	17.64	1.76
Removal of management margin and other adjustments	(5.75)	0.00
Best estimate claims provision	11.89	1.76
ENIDs	0.15	0.02
Expenses	0.44	0.07
Discounting	(0.01)	(0.00)
Solvency II claims provision	12.46	1.86
Premium provision		
Unearned premium	501.39	37.06
Removal of profit on UPR	(292.86)	(26.32)
ENIDs	4.82	0.22
Expenses	65.40	1.68
Future premium	(328.60)	(17.36)
Discounting	0.58	0.00
Solvency II premium provision	(49.29)	(4.72)
Solvency II risk margin	6.35	0.42
Solvency II TPs including risk margin	(30.48)	(2.44)

Source: DGI and DGIEU

The actuarial function for DGI and DGIEU, which is outsourced to an actuarial consultancy, is responsible for preparing an annual opinion on the appropriateness of the Solvency II TPs calculation performed by DGI and DGIEU. Given DGIEU has been operating for less than a year, an opinion on the TPs calculation performed by DGIEU is not yet available. Therefore, I have only been able to consider the 2019 opinion on the TPs prepared for DGI (the latest available opinion) as part of my review. For both DGI and DGIEU, I have been provided with the Excel spreadsheets used to calculate the TPs at 31 March 2020.

For DGI and DGIEU an allowance for ENIDs is made within the TPs as the data used to calculate the best estimate claims provision does not typically include experience from rare events. ENIDs are not a material component of the TPs. DGI and DGIEU both use a common approach known as a truncated distribution to calculate the ENID load.

DGI and DGIEU's ENID loads, as at 31 March 2020, are around 1% and 2% respectively of the total gross best estimate claims provisions. In my experience, I consider these loadings to be in line with that typically held by other insurers writing similar classes of business.

The risk margin within the TPs under Solvency II represents the amount in addition to the best estimate that a third-party insurer would require to take over the insurance obligations. There are various simplified methods to calculate the risk margin, and DGI and DGIEU use a method that assumes that the SCR runs off in line with the best estimate TPs (ie excluding the risk margin). They have adjusted the run-off pattern of the best estimate TPs by excluding the cash inflows related to warranty debtors to eliminate negative best estimate TPs. DGI and DGIEU's actuarial function has indicated that a consistent approach is used for both DGI and DGIEU.

The average duration of the run-off pattern implied by the best estimate TPs is around 1.0 and 1.5 years for DGI and DGIEU respectively (covering both earned and unearned business). This is a short run-off pattern, which reflects the generally short term nature of the business.

DGI's risk margin as at 31 March 2020 is approximately 2% of the best estimate gross technical provisions (excluding cash inflows related to warranty debtors).

The significant majority of DGI's technical provisions (around 99.8% of total best estimate gross technical provisions) is reported as miscellaneous financial business, with the remaining 0.2% reported as general liability business.

LCP's market review of Solvency II reporting as at 2018 year-end, based on 100 non-life insurers in the UK and the ROI, showed that the risk margin is typically around 5% of gross best estimate technical provisions for miscellaneous financial business. DGI's risk margin is therefore lower than average for this class of business. However, the type of business DGI writes is likely to be less volatile than the miscellaneous financial loss class of business as a whole, and so this is in line with my expectations. This is supported by the relatively short run-off pattern of the best estimate TPs and DGI's USPs (see section 6), which allow it to use a lower volatility parameter for its business, in place of the much higher volatility parameter applied to the miscellaneous financial loss class of business in the standard formula.

DGIEU's risk margin as at 31 March 2020 is 3% of the best estimate gross technical provisions. All of DGIEU's technical provisions relates to miscellaneous financial business, for which a typical risk margin based on LCP's market review is around 5% of best estimate gross technical provisions. As for DGI, I consider DGIEU's risk margin, as a percentage of best estimate gross technical provisions, being lower than the figure from LCP's market review, to be in line with my expectations. This is supported by the relatively short run-off pattern of the best estimate TPs.

On a net basis, DGIEU's risk margin as a proportion of net TPs is higher reflecting the increased proportionate volatility from non-insurance risks volatility due to the relatively high proportion of business (90%) that is ceded to DGI.

My overall conclusion is that DGI and DGIEU's approach used to calculate the TPs is appropriate. I have not sought to re-perform the calculation of the TPs or verify the calculations performed by DGI or DGIEU.

5.6. Key uncertainties when setting provisions

The ultimate costs of settling general insurance claims are subject to uncertainty in terms of both the frequency (ie how many valid claims there will be) and severity (ie the cost of settling each claim) including exposure to inflation in claim amounts over time. Therefore, there are uncertainties when setting the corresponding provisions.

There are several uncertainties in setting provisions for the classes of business written by DGI and DGIEU:

- DGI and DGIEU are exposed to the risk of claims being higher than expected, and the fundamental uncertainty in determining the correct price to charge customers. This risk is reduced by the extensive use of historical data, the substantial element of renewal business, fixed repair and replacement arrangements, and the use of profit commission arrangements with UK and EU business clients.
- The latest policy months have been affected by lower than expected sales volumes and potentially late reporting of claims, owing to the COVID-19 pandemic. The full impact of the pandemic is not yet clear.
- DGI has a small amount of exposure to asbestos which is very long-tail. The IBNR provision for this has remained the same for a number of years. None of this exposure is transferring as part of the Proposed Transfer.
- Potential disputes over liability and the complexity of settlement negotiations can lead to delays. DGI and DGIEU have specialist claims handling teams and insist on full control throughout the claims settlement process.
- Sales of DGI and DGIEU's policies are likely correlated with the economic environment, in that customers are less likely to purchase policies during periods of austerity when they have less disposable income. This is managed through regular reviews of performance and monitoring of emerging issues.

DGIEU's reinsurance arrangements help mitigate the impact of some of these key uncertainties that impact its business and also a management margin is held within the IFRS technical provisions for both DGI and DGIEU.

5.7. Current reserving process and governance

DGI and DGIEU reserving process

DGI and DGIEU perform their IBNR calculations in IBM Cognos, which is a business intelligence tool, and the results from this tool are presented in Excel spreadsheets. I have reviewed the Excel spreadsheets containing the claims triangles and IBNR projections used by DGI, but have not reviewed the calculation performed in the IBM Cognos claims software.

The exercise is performed monthly and the triangles are updated to include the most recent month of data. The analysis performed allows DGI to estimate the level of provisions required at any reporting date.

DGI and DGIEU have reconciliation processes in place to check that the data used in the claims triangles reconciles with the various sources of data. This helps ensure that all necessary data is being used appropriately and allows DGI and DGIEU to check for any material variances in the data.

Wider stakeholder involvement in the reserving process

DGI and DGIEU each has its own Solvency II working group that is responsible for overseeing matters relating to Solvency II, including reserving, capital setting and regulatory filings. To date, the two working groups have been meeting jointly.

The purpose of the working groups is to monitor Solvency II capital requirements and compliance with EIOPA guidelines. Consistent with this purpose, claims reserves, which form the basis for the Solvency II technical provisions, are regularly monitored. DGI and DGIEU have informed me that the Solvency II working group is a forum where concerns regarding the appropriateness of the reserves would be raised and I understand that going forwards an assessment of the reserves will be made a permanent agenda item. One of the responsibilities of the respective Solvency II working groups for DGI and DGIEU is to consider the appropriateness of the provisions prior to these numbers being booked.

For DGI, members include the Corporate Financial Director, International Finance Director, Group Head of Commercial Management and Underwriting, Chief Risk Officer, Group Head of Risk, Head of Cash and Capital Management and representatives from the outsourced actuarial function for DGI. For DGIEU, members include the International Finance Director, Group Head of Commercial Management and Underwriting, Chief Risk Officer, Group Head of Risk, and representatives from the outsourced actuarial function for DGIEU.

At the Solvency II working group meetings, DGI, DGIEU and their respective outsourced actuarial functions have the opportunity to raise concerns regarding the appropriateness of the provisions prior to these numbers being booked. Minutes of Solvency II working group meetings are recorded, distributed, and approved. Actions from the Solvency II working group meetings and any changes recommended are recorded in the minutes and circulated to attendees. The recording of minutes strengthens policyholder protection by improving governance and allows for consistency to be monitored over time by the Solvency II working groups.

DGI has also provided a sample presentation pack which was prepared for its Board to sign-off the 2019 year-end accounts (an important element of which is the reserves). This provided a high-level overview of the year-end accounts, which included the IFRS provisions, and acts as evidence of the items covered during the Board meeting.

Reserving process governance

DGI and DGIEU carry out their respective calculations of the best estimate provisions and their outsourced actuarial function have the opportunity to challenge and raise objections during their review of the Technical Provisions template each quarter and, more thoroughly, during the preparation of input data with respect to the annual calibration of the USP parameters. The input data used to calibrate the reserving models are reviewed and signed off by the Head of Management Information who performs checks to ensure that claims triangles reconcile with source data and that projections for the IBNR provision are in line with relevant patterns.

After the best estimate provisions have been signed off, they are used as the starting point for determining the booked Solvency II provisions for each quarterly submission. The booked Solvency II provisions are then reviewed by a subset of the members of the respective Solvency II working groups. Once this provision has been agreed by the members of the Solvency II working group, the reserves are reviewed and approved by the respective Chief Financial officers for DGI and DGIEU. The reserves are then presented to the respective boards of DGI and DGIEU for final sign-off before being booked into the accounts.

I have been provided with the terms of reference for the various committees and discussions with DGI and DGIEU as evidence of appropriate governance around the reserving process.

5.8. Future reserving approach and governance

DGI has confirmed that it plans to continue to use the same approach to reserving for the non-transferring business after the Effective Date of the Proposed Transfer.

DGIEU has confirmed that it plans to change from the loss ratio method it is currently using to the same loss development factor approach as DGI once there is sufficient data available for the claims triangles to produce credible projections.

DGI and DGIEU have both informed me that they do not expect any other changes to the governance process for reserving.

5.9. Overall conclusion: Reserving considerations

I have set out below my overall conclusions related to reserving. These reserving considerations should not be considered in isolation. For example, the overall level of protection for policyholders also depends on the level of capital held, and a range of other considerations. My overall conclusions on the Proposed Transfer are set out in section 10.

Non-transferring Policyholders DGI

I have concluded that the Non-transferring Policyholders will not be materially adversely affected by the reserving aspects of the Proposed Transfer.

The key reasons for reaching my conclusions for Non-transferring Policyholders are as follows:

- The calculation of provisions has been performed using techniques and approaches appropriate for the classes of business written by DGI and DGIEU.
- My own independent best estimate projections as at 31 March 2020 are similar to DGI's projections.
- DGI has confirmed that the future reserving process and governance for DGI will be materially unchanged post-transfer.

Transferring Policyholders and Existing DGIEU Policyholders

I have concluded that the Transferring Policyholders and the Existing DGIEU Policyholders will not be materially adversely affected by the reserving aspects of the Proposed Transfer.

The key reasons for reaching my conclusions for the Transferring Policyholder and Existing DGIEU Policyholders are as follows:

- The calculation of provisions for DGIEU has been performed using techniques and approaches appropriate for the classes of business written by DGIEU.
- My own independent projections as at 31 March 2020 are similar to DGIEU's projections.
- The DGI and DGIEU reserving processes are materially the same.
- DGIEU has confirmed that the future reserving process and governance for DGIEU will be materially unchanged post-transfer.

6. Capital considerations

6.1. Introduction to insurance capital setting

A key reason why insurers hold capital is to withstand adverse or extreme levels of claims and other losses. The capital is held in excess of the provisions for policyholders' claims and for the other costs associated with running an insurer.

A key metric under Solvency II is the Solvency Capital Requirement (SCR). This is an estimate of the capital required to cover the loss that an insurer could experience over the next 12 months with a probability of 99.5% (ie, a 1 in 200 event). Firms are required to hold capital equal to at least 100% of the SCR.

An insurer's SCR coverage ratio is calculated as the available capital in excess of provisions divided by the SCR. This is a measure of capital strength, with a higher ratio indicating there is more capital available per £ or € of capital required. The SCR coverage ratio does not capture all aspects of policyholder protection, but a higher coverage ratio indicates more protection, all else being equal. Under Solvency II, the level of available capital is referred to as "own funds".

I consider the SCR coverage ratio an appropriate measure to consider as part of my assessment of policyholder security before and after the transfer, as the SCR is a risk-based metric that is disclosed to both regulators and the public. My assessment of the capital considerations regarding policyholder security is also supported by consideration of capital beyond a "one-year" view (section 6.4) and a review of the impact of a range of adverse scenarios on each of DGI and DGIEU (section 6.10).

For the purposes of this report, I describe a company as having "sufficient capital" if the SCR coverage ratio is between 100% and 150%. I describe a company as "well capitalised" if the SCR coverage ratio is between 150% and 200% and "very well capitalised" if the SCR coverage ratio is in excess of 200%.

6.2. My consideration related to capital

As IE, my overall assessments related to capital are:

- whether the projected capital requirements have been calculated appropriately for both DGI and DGIEU;
- whether there are expected to be any material adverse changes in the strength of capital protection for any group of policyholders (I have assessed this by comparing the projected SCR coverage ratios pre- and post-the Proposed Transfer); and
- whether any other aspects of the capital considerations may lead to policyholders being materially adversely affected by the Proposed Transfer.

To make these assessments, I have considered the following areas:

- DGI and DGIEU's approach to calculating capital requirements (section 6.4);
- Capital requirements beyond a "one-year" view (section 6.4);
- The capital policy for each of DGI and DGIEU (section 6.6);
- SCR appropriateness for DGI and DGIEU (section 6.7);
- Projected SCR coverage ratios as at 31 December 2020 (section 6.8);
- The planned capital structures for DGI and DGIEU (section 6.9); and
- The SCR under stressed scenarios (section 6.10).

6.3. Approach to my review

I have reviewed a number of documents provided by DGI and DGIEU relating to the calculation of capital requirements and projected coverage ratios. A list of the key data and documentation reviewed is provided in appendix 6.

As part of my review, I reviewed the spreadsheets which set out a summary of the SCR projections for each entity. I have reviewed these on a number of different bases, including assuming the Proposed Transfer does and does not go ahead, both with and without USPs for DGIEU, and under a number of stress scenarios.

6.4. Calculating capital requirements

For both DGI and DGIEU, the level of capital required is set in line with the European Solvency II standard.

Under Solvency II, there are three ways in which the SCR can be calculated:

- **Standard formula:** under this approach, the SCR is set using a prescribed calculation and parameters, as specified in the Solvency II regulations. Within the standard formula framework, insurers can use undertaking-specific parameters (USPs) to tailor specific aspects of the parameterisation of the calculation to better reflect their risk profile.
- **Internal model:** under this approach, the SCR is set using the insurer's own internal capital model. The internal model is developed and parameterised by the insurer to reflect their specific business.
- **Partial internal model:** under this approach, the SCR is set using a combination of the standard formula and the insurer's own internal capital model. Under this approach, some aspects of the SCR are calculated using the internal model, and the remainder is calculated using the standard formula.

The choice of approach is made by the insurer; however, an insurer needs to obtain regulatory approval in order to use USPs, an internal model or a partial internal model to calculate its SCR. An insurer does not need approval to calculate its SCR using the standard formula without USPs but does need to complete its own assessment of the appropriateness of the standard formula for this purpose.

DGI uses the standard formula with USPs to calculate its SCR.

DGIEU currently uses the standard formula without USPs to calculate its SCR, but submitted a pre-application to the German regulator, BaFin, in August 2020 to use USPs, and plans to make a full application in September 2020. DGIEU has indicated that it expects this application to be approved after the Effective Date of the Proposed Transfer, ahead of 31 March 2021 year-end. I have therefore considered the Proposed Transfer in terms of DGIEU both with and without USPs.

Capital requirements beyond a “one-year” view

The SCR is a “one-year” view of risk as it focuses on risks that an insurer faces over the next 12 months. As part of their overall capital management, insurers typically also consider an “ultimate” view of risk that considers the risks faced over the period until the business is fully run-off.

DGI and DGIEU use the standard formula, which does not give an estimate of the SCR on an ultimate view. However, due to the generally short term nature of the business, DGI and DGIEU have informed me that the measure of capital over an ultimate time horizon is similar to the one-year SCR.

Projected SCR coverage ratios for DGI and DGIEU

DGI and DGIEU have provided projections for the SCR and balance sheets covering the period immediately prior and a number of years after the Proposed Transfer. These projected SCR coverage ratios are shown in the chart below. The projections show the projected position immediately pre- and post- the Proposed Transfer; and also with and without USPs approval for DGIEU.

The projections include allowance for capital injections made from DGI to DGIEU, and assumed future injections as summarised in the table below. The assumed future capital injections are different with or without the Proposed Transfer, reflecting the different expected requirements of DGIEU in each case. In both cases, the projections assume no dividends are declared or paid during the projected period.

As part of my discussions with D&G in my role as Independent Expert, D&G committed to increase the capital injection into DGIEU simultaneously with the Effective Date of the Proposed Transfer by €8m, from €5m to €13m. The €8m increase has been set by D&G to help ensure that DGIEU is expected to remain well capitalised under a range of adverse scenarios (see section 6.10) in the event that DGIEU does not receive approval from BaFin to use USPs. The amount of the additional capital injection will be reviewed by D&G ahead of my Supplementary Report, and I will comment on any changes in my Supplementary Report.

If the Proposed Transfer does not take place, two €10m capital injections are planned on 30 April 2021 and 30 April 2023 respectively and would be required to support DGIEU’s growth whilst maintaining capital coverage in the absence of the reserves that would have been transferred into DGIEU as part of the Proposed Transfer.

DGIEU capital injections (€m)

	Without Proposed Transfer	With Proposed Transfer
Up to 30 June 2020	36.8	36.8
31 December 2020 (simultaneously with the Proposed Transfer)	5.0	13.0
30 April 2021	10.0	-
30 April 2023	10.0	-
Total	61.8	49.8

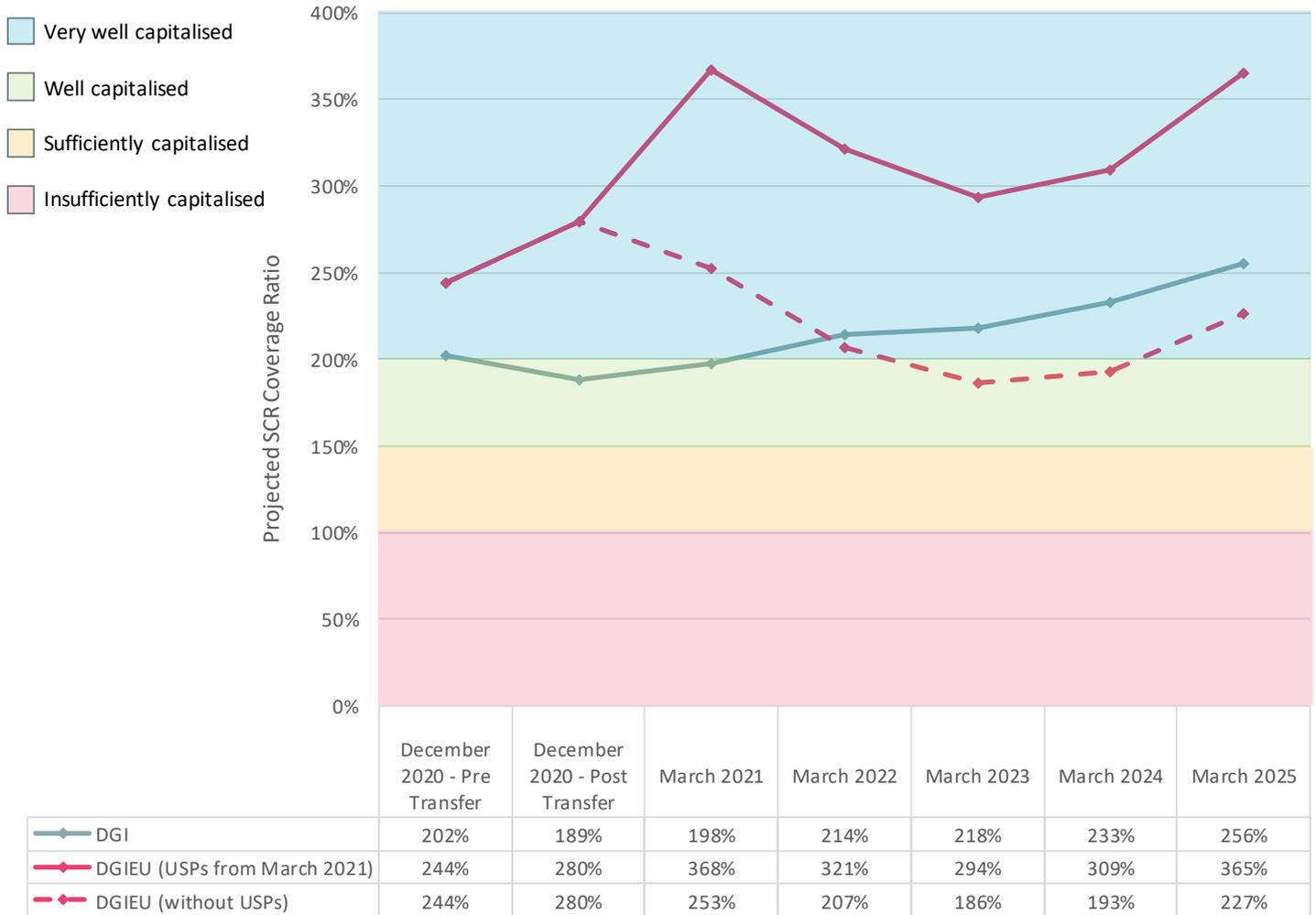
For DGI, the SCR coverage ratio is projected to reduce from 202% to 189% immediately following the Proposed Transfer. This reduction is primarily driven by a slight increase in the SCR as a result of increased currency risk, as well as a reduction in eligible own funds following the transfer of assets to DGIEU. The increase in currency risk is due to a projected increase in net exposure to non-sterling currencies, following the transfer of assets to DGIEU whilst retaining 90% of the DGIEU claims through the quota share arrangement. The SCR coverage ratio is then projected to increase each year for the following 4 years, reflecting the expected ongoing profitability of the business.

For DGIEU, the SCR coverage ratio is projected to increase from 244% to 280% immediately following the transfer. Assuming DGIEU’s application to use USPs is successful (shown by the solid red line), the coverage ratio is projected to remain in the range 280% to 370% throughout the projection, although there are a number of offsetting factors that lead to the SCR coverage ratio varying during this period. In particular:

- New business strain within DGIEU, due to the costs of taking on new business typically being higher than the initial premium, leads to a reduction in coverage between March 2021 and March 2023.
- The coverage ratio starts to increase again from March 2023. As for DGI, this reflects the expected ongoing profitability of the business.

Both DGI and DGIEU are expected to be either “well capitalised” or “very well capitalised” throughout the projection period (as defined in section 6.1).

Projected SCR coverage ratios for DGI and DGIEU



Source: DGI and DGIEU

In practice, the actual coverage ratios may be higher or lower than these projections depending on the claims and other experience of each insurer. Both DGI and DGIEU will also routinely monitor their capital and projected capital position in line with their respective capital management policies (considered in section 6.6 below) – this could also lead to the coverage ratios being higher or lower than projected.

In particular, DGIEU has informed me that, if it receives authorisation to use USPs, then it is likely that it will review its capital position at that time. All else being equal, using USPs, DGIEU’s SCR coverage ratio is projected to be around 300% or higher. Based on my discussions with DGIEU, I understand it is likely that DGIEU would consider returning the additional capital injection of €8m back to D&G, as a capital distribution via DGI. Under this scenario, DGIEU’s SCR coverage ratio would be projected to return to a similar level as DGI. Any release of capital would be subject to review by DGIEU’s board, in light of DGIEU’s stated risk appetite and the board’s regulatory responsibilities.

Minimum Capital Requirement

In addition to the SCR, another key measure of capital under Solvency II is the Minimum Capital Requirement (MCR). This is a simpler calculation than the SCR, using a formula based on volumes of premiums and Solvency II technical provisions. For non-life insurers, the MCR is between 25% and 45% of the SCR, subject to a minimum of €3.7m. This minimum typically only bites for the smallest insurers and is therefore not relevant here.

Firms need to hold capital equal to at least 100% of the greater of the SCR and the MCR. The purpose of the MCR is to ensure that firms are holding at least a minimum level of capital. Breaching the MCR will result in more intensive regulatory intervention than would be the case for a breach of the SCR.

Both DGI and DGIEU are projected to be very well capitalised on this measure (with MCR coverage ratios of 341% and 452% respectively pre-transfer, and 311% and 531% post-transfer) as at 31 December 2020 and throughout the projection period. The MCR coverage ratio is calculated as the available capital in excess of provisions divided by the MCR.

Therefore, I have not considered the MCR further as part of my assessment of capital considerations, and my primary focus is on the SCR.

6.5. Components of capital requirements

The key components of the SCR common to both DGI and DGIEU are:

- *Underwriting risk*: the risk that the value of insurance claims proves to be higher than expected. This includes the risk of an increase in claims and uncertainties related to existing liabilities included on the balance sheet. This also includes the risk of experience being worse than planned for business that will be earned or written over the following year.
- *Market risk*: the risk of changes in an insurer's financial position due to changes in the market value of assets, liabilities and financial instruments. For example, this includes the risk of falls in the value of investment assets, that are being held to make future claims payments.
- *Counterparty default risk*: the risk of defaults or downgrades by counterparties that either owe the insurer money, or hold money on its behalf. For example, for DGIEU, this includes the risk of the failure of DGI because the reinsurance contract makes DGI a counterparty of DGIEU.
- *Operational risk*: the risk of losses caused by failures in an insurer's operational processes, people and systems, or from events that are external to the insurer. For example, this would include the risk of fraud or IT failure.
- *Loss-Absorbing Capacity of Deferred Tax (LACDT)*: the offsetting tax benefit that an insurer may be able to recognise in certain circumstances following a loss, and which therefore can be used to reduce the capital requirement.

DGI and DGIEU have provided SCR projections which contain the SCR risk components. I have summarised the key risks as a percentage of the total SCR as at 31 December 2020 below. For this purpose, I have excluded the LACDT when considering risk composition of the SCR as differences in the LACDT are more of a reflection of differences in tax regimes of DGI and DGIEU, rather than the underlying risks of the portfolios. I consider the differences in LACDT in section 6.7 below.

DGI: Projected breakdown of SCR risk components pre- and post- Proposed Transfer

Risk components £m	Pre-transfer		Post-transfer	
	Value	Percentage	Value	Percentage
Underwriting risk	52.7	70%	52.4	69%
Market risk	12.7	17%	15.5	20%
Counterparty default risk	9.9	13%	8.9	12%
Diversification	(12.4)	(16%)	(13.5)	(18%)
Operational risk	12.6	17%	12.7	17%
SCR (excluding LACDT)	75.5	100%	76.0	100%
LACDT	(14.3)		(14.4)	
SCR	61.2		61.6	

Source: DGI

DGIEU: Projected breakdown of SCR risk components pre- and post- Proposed Transfer

Risk components €m	Pre-transfer		Post-transfer		Post-transfer (with USPs*)	
	Value	Percentage	Value	Percentage	Value	Percentage
Underwriting risk	6.9	61%	10.6	65%	5.2	43%
Market risk	0.5	5%	0.5	3%	0.5	4%
Counterparty default risk	4.3	38%	6.2	38%	5.3	44%
Diversification	(1.8)	(16%)	(2.5)	(15%)	(1.8)	(15%)
Operational risk	1.4	12%	1.5	9%	2.8	23%
SCR (excluding LACDT)	11.3	100%	16.3	100%	12.0	100%
LACDT	(0.8)		(4.9)		(3.6)	
SCR	10.5		11.4		8.4	

Source: DGIEU, *Figures with USPs are as at 31 March 2021

The most material component of the SCR for DGI is underwriting risk, which represents 70% and 69% of the total SCR pre- and post- transfer respectively before allowing for the LACDT.

For DGIEU (assuming no USPs), the most material component of the SCR is underwriting risk, which represents 61% and 65% of the SCR pre- and post- transfer respectively before allowing for the LACDT. Counterparty default risk is also a material contributor to the SCR, representing 38% of the SCR both pre- and post- transfer. This is on account of the significant reinsurance arrangement in place with DGI (considered in section 7.4).

Assuming USPs are approved for DGIEU, underwriting risk reduces as a proportion of the SCR pre- and post- transfer. This would result in underwriting risk and counterparty default risk each contributing a similar proportion to the SCR post- transfer.

6.6. The capital policy for each of DGI and DGIEU

I have reviewed the capital policies for each of DGI and DGIEU. There are no material differences between them.

The risk appetite for the SCR coverage ratio is the same for both entities with DGI and DGIEU each targeting a minimum level of coverage of 130%. Based on the projections in section 6.4, both DGI and DGIEU are expected to remain above this risk appetite throughout the projection period.

The main difference in the capital policy between DGI and DGIEU is that DGIEU includes stated policies related reinsurance. This is because DGIEU has reinsurance (with DGI), but DGI has no reinsurance in place. The additional stated policies for DGIEU include policies related to regularly reviewing the reinsurance to ensure there remains appropriate protection against failure of the reinsurer to meet its commitments.

The boards for DGI and DGIEU regularly assess whether to make, and the level of, dividend payments. Under the terms of the capital policies, the boards do this in a way that ensures that such payments will not decrease the SCR coverage ratio for either entity to below the 130% level.

6.7. SCR appropriateness for DGI and DGIEU

I have considered the SCR appropriateness for DGI and DGIEU considering two aspects:

- reviewing DGI and DGIEU's SCR calculations to satisfy myself that they are being performed in line with the Solvency II Delegated Regulations; and
- reviewing DGI and DGIEU's assessments of the appropriateness of using the standard formula for the purposes of setting the SCR.

My review identified two areas where DGI and DGIEU's approach to calculating the SCR is different to what I would expect based on my interpretation of the Solvency II regulations (further details are set out later in this section). I have discussed these with D&G's outsourced actuarial function to understand the rationale for and materiality of the approach taken. As a result, I am satisfied that the SCRs projected for each entity are being calculated materially in line with the Solvency II Delegated Regulations.

Based on my review, I am also satisfied that using the standard formula for purposes of setting the SCR (with USPs) is appropriate for both DGI and DGIEU. The use of USPs by DGIEU is subject to approval by BaFin.

Review of SCR calculations

As part of my review, I reviewed the spreadsheets which set out a summary of the SCR calculations for DGI and DGIEU pre- and post- transfer and both with and without USPs for DGIEU. In addition, I have had discussions with D&G's outsourced actuarial function to better understand the details of the approach taken. One minor change was made to the standard formula projections as a result of the discussions, which did not materially impact the SCRs.

DGI

My review identified two areas where the approach to calculating the SCR is different to what I would expect based on my interpretation of the Solvency II regulations. Specifically:

- Catastrophe risk: DGI's main exposure to catastrophes is to bad weather which may generate claims on its Sky policies as a result of weather damage to covered satellite dishes. DGI calculates the relevant risk figure under the standard formula by estimating the proportion of the Sky premium that covers this specific risk, and then applying the standard risk factor for the sub-module for other non-life catastrophe risk of 40% to this. My understanding is that the standard formula would instead require DGI to split this business into the Miscellaneous Financial Loss line of business (for the extended warranty) and Fire and Other Damage line of business (for the property damage element), and calculate the catastrophe risk accordingly. Given the level of complexity that would be required to do this, DGI has taken a simplified approach on the grounds of proportionality.
- Lapse risk: DGI has applied a factor of 37% to the IPM business, rather than the 40% factor prescribed in the regulations. I understand that, as at 31 March 2020, the SCR would increase by 2.2% if the 40% factor was applied. This difference is not material, given the SCR coverage ratios being considered as part of this analysis.

DGI has historically been granted approval from the PRA to recognise in full the Loss Absorbing Capacity of Deferred Tax (LACDT) following a 1 in 200 year stress. This means that DGI's SCR can be reduced to the extent DGI estimates that in the event of the 1 in 200 stress, its deferred tax liabilities would be lower than they are currently. The projected capital positions assume that this approval will continue to be granted going forwards. DGI has informed me that there are no expected reasons why this approval would be withdrawn and therefore I am satisfied that this approach is appropriate for the purposes of my analysis.

Subject to my comments above, based on my review, I am satisfied that the SCRs calculated for DGI both pre- and post- the Proposed Transfer are being calculated materially in line with the Solvency II Delegated Regulations.

DGIEU

For the purpose of SCR projections, DGIEU applies some simplifications to the standard formula projections. For example, an assumption that the capital charge for concentration and interest rate risks will be proportional to the capital charge for those risks for DGI. I am satisfied with these simplifications on the grounds of proportionality.

DGIEU has not applied for approval from BaFin to recognise in full the LACDT following a 1 in 200 year stress. As a result, the LACDT assumed in the SCR calculation is limited to the lesser of the tax relief expected following a 1 in 200 year stress and the deferred tax liability on the balance sheet at the valuation date. I am satisfied that this approach is appropriate for the purposes of my analysis.

Based on my review, I am satisfied that the SCRs calculated for DGIEU both pre- and post- the Proposed Transfer, and both with and without USPs, are being calculated materially in line with the Solvency II Delegated Regulations.

Appropriateness of the standard formula

Underwriting risk (excluding catastrophe risk): DGI

In 2015, DGI received regulatory approval from the PRA to use USPs to calculate the underwriting risk capital within the standard formula. USPs may be used in capital calculations where specific aspects of a firm's own risk profile deviate significantly from the risk profile assumed within the standard formula. To do this, a firm must be able to demonstrate that its 1 in 200 year stress is more appropriately estimated using USPs, rather than the standard formula's prescribed parameters.

DGI has prepared detailed statistical analysis, based on DGI's own portfolio and claims experience, together with supporting rationale, and submitted this to the PRA as part of DGI's application to use USPs. The analysis supports DGI's view that the volatility of DGI's underwriting and reserve risks are materially lower than those implied by the standard formula's prescribed parameters.

The results of the analysis are in line with my expectations, given that all of DGI's business falls within the "Miscellaneous financial loss" Solvency II line of business. This line is a generic category for classes of insurance that are not covered by more specific categories. Miscellaneous financial loss therefore includes insurance obligations across a very wide range of risks, including those which are much longer tailed and uncertain in nature than the extended warranty business written by DGI.

I have reviewed the application, together with supporting documents setting out the queries raised by the PRA as part of the approval process. Based on my review of these documents, together with the fact that the PRA granted DGI approval to use USPs, I am satisfied that the risk capital calculated under standard formula with the approved USPs is appropriate for assessing DGI's underwriting risk pre-Transfer.

Furthermore, given that post-Transfer DGI's insurance risk will be broadly unchanged when compared with the pre-transfer risk profile (on account of 90% of the transferring risk being reinsured back to DGI via a quota share arrangement), I am also satisfied that the risk capital calculated under standard formula with the approved USPs is appropriate for assessing DGI's underwriting risk post-Transfer.

Underwriting risk (excluding catastrophe risk): DGIEU

DGIEU submitted a pre-application to the German regulator, BaFin, in August 2020 to use USPs, and plan to make a full application in September 2020. I am in the process of reviewing the submitted pre-application and I plan to report my conclusions on this and the full application in my Supplementary Report ahead of the Sanctions Hearing for the Proposed Transfer.

In the meantime, I am satisfied to rely on the USPs calculated by DGIEU for the purposes of the 31 March 2021 SCR and future projections as, based on my understanding of DGIEU's business, I have no reason to believe that DGIEU will not achieve regulatory approval to use USPs, or that its calculated USPs are inappropriate.

Catastrophe risk

For DGI, as noted above, I requested additional evidence from D&G's outsourced actuarial team to support the appropriateness of the approach used by DGI for the catastrophe risk capital. D&G has provided additional evidence to confirm that the approach used does not make a material difference to the SCR compared to my interpretation of the Solvency II Delegated Regulations. Based on my review of the evidence provided, I am satisfied that the catastrophe risk component of the SCR for DGI is materially appropriate.

Catastrophe risk for DGIEU is zero. On the basis that DGIEU writes only extended warranty business that specifically excludes cover for product recall, and which is not exposed to product damage as a result of bad weather, I am satisfied that this is appropriate.

Lapse risk

I have reviewed analysis prepared by D&G's outsourced actuarial function which projected scenarios for lapses based on historical data corresponding to the 99.5th percentile, the same percentile as the standard formula is calibrated to. The analysis demonstrated that the lapse risk calculated within the standard formula is prudent relative to DGI's historical experience.

Whilst D&G has not performed this analysis for DGIEU, the outsourced actuarial function has confirmed that it has no reason to suggest that this conclusion should not be extended to the DGIEU portfolio.

I am therefore satisfied that the lapse risk capital calculated under the standard formula is appropriate for DGI and DGIEU.

Market, counterparty default and operational risks

DGI's most recent Own Risk and Solvency Assessment (ORSA) from 2019 states that DGI has satisfied itself that the standard formula is appropriate for calculating its market, counterparty default and operational risks. DGIEU has also informed me that it has also satisfied itself that the standard formula is appropriate in this regard.

I have been provided with rationale from the risk functions of both entities as to why the standard formula does not understate these risks. In summary:

- **Market risk:** DGI and DGIEU have a low appetite for market risk. Since COVID-19, both entities have further reduced risk by limiting investments to cash and government bonds. Both DGI and DGIEU are therefore satisfied that the standard formula does not understate the materiality of the relatively small market risk exposure.
- **Counterparty default risk:** For DGI, the structure of its products means that counterparty default risk largely comprises the prepayment with one of DGI's large clients rather than insurance debtors. DGI monitors this client's creditworthiness as part of an ongoing control framework, and retains the right to demand repayment in the event that it has material concerns regarding the client's ability to pay. DGI is therefore satisfied that the standard formula does not understate the materiality of counterparty risk exposure. For DGIEU, counterparty default risk is predominantly the default risk on cash, the majority of which is held by a bank with a credit rating of A from Standard & Poor's, and reinsurance recoverables from DGI for which there is a Reinsurance Account in place which is designed to protect against loss should DGI default. Both DGI and DGIEU are therefore satisfied that the standard formula does not understate the materiality of counterparty default.
- **Operational risk –** DGI and DGIEU manage operational risk exposure through a defined risk management framework, with risk appetite statements, regular assessments of risks and controls, and key risk indicators to track adherence to risk appetites on an ongoing basis. Both entities perform regular stress testing on operational risk exposure, including through the ORSA, to look at how operational risk incidents could impact cash and capital. The stable historical performance of DGI's business, coupled with the commission and client pricing mechanisms in place, mean that operational risk scenarios have to be extreme to materially impact solvency. Similar considerations apply to DGIEU. Both DGI and DGIEU are therefore satisfied that the standard formula does not understate the materiality of operational risk exposure.

In addition, in my experience, the standard formula is typically appropriate for calculating these risks for most insurers across the market, unless the firm has particularly unusual or complex investments, credit arrangements or operational features in place. Both DGI and DGIEU have informed me that there are no features of either insurer that would render the standard formula inappropriate for calculating the market, counterparty default or operational risk capital for DGI or DGIEU.

Based on the above rationale and analysis, I am satisfied that the standard formula appropriately reflects these risks for both entities.

Other risks

There are some non-quantifiable risks that are not captured within the standard formula, but which DGI and DGIEU have identified and which they monitor and mitigate. These include:

- Group risk
- Environmental risk
- Technology risk
- Strategy risk
- Conduct risk
- Brexit risk
- Concentration risk
- Contagion risk

Both entities have concluded that no adjustments or additional capital loads are required in addition to the SCR calculated using the standard formula. Based on my review of the description of the monitoring of non-quantifiable risks within DGI's ORSA, and through further discussions with DGIEU, I have concluded that it is appropriate for DGI and DGIEU not to include additional loads to the SCR as calculated by the standard formula.

6.8. Projected SCR coverage ratios as at 31 December 2020

The following table sets out the projected SCR and coverage ratios, prepared by DGI and DGIEU, as at 31 December 2020 immediately before and after the Proposed Transfer.

Projected as at 31 December 2020	Own Funds	SCR	Own Funds less SCR	SCR coverage ratio	Change in coverage ratio
Day 0 – before Transfer					
DGI £m	123.8	61.2	62.6	202%	
DGIEU (no USPs) €m	25.6	10.5	15.1	244%	
Day 1 – after-Transfer					
DGI £m	116.0	61.6	54.5	189%	-14%
DGIEU (no USPs) €m	32.0	11.4	20.6	280%	35%

Source: DGI and DGIEU

In summary:

- Non-transferring Policyholders: the SCR coverage ratio of Non-transferring Policyholders is projected to decrease from 202% to 189%. However, DGI is still projected to be well capitalised (as defined in Section 6.1) immediately after the Proposed Transfer.
- Transferring Policyholders: The SCR coverage ratio for policyholders transferring from DGI to DGIEU is projected to increase from 202% to 280%.
- Existing DGIEU Policyholders: the SCR coverage ratio for Existing DGIEU Policyholders is projected to increase from 244% to 280% after the Proposed Transfer.

Based on this analysis, both DGI and DGIEU are projected to remain either well capitalised or very well capitalised both immediately pre- and post- Transfer. Therefore, I do not expect the changes in SCR coverage ratios immediately pre- and post- the Proposed Transfer to lead to any material adverse changes in the strength of capital protection for any group of policyholders.

6.9. The planned capital structures for DGI and DGIEU

Based on data as at 31 March 2020, 78% of DGI's and 81% of DGIEU's own funds were classified as unrestricted tier 1, ie the highest quality and 22% of DGI's and 19% of DGIEU's own funds were classified as tier 2.

D&G has informed me that additional ancillary own funds have been put in place for DGI during 2020, in the form of a letter of credit for £30m. The purposes of this is to help D&G manage its capital position effectively during its response to Brexit. D&G has informed me that no other changes are planned to DGI's and DGIEU's capital structure.

DGI will transfer assets to DGIEU equal to the IFRS provisions, including management margin, and other net liabilities related to the Proposed Transfer.

6.10. SCR scenarios analysis

I have considered the impact of a range of adverse scenarios on each of DGI and DGIEU, based on projections prepared by D&G. These include scenarios consistent with those included in DGI's most recent ORSA and, in addition, a number of further scenarios that I have specified. I have considered each scenario assuming the Proposed Transfer does and does not go ahead, both with and without USPs for DGIEU.

The purpose of the analysis is to assess whether DGI and DGIEU can withstand plausible adverse experience on their business and whether, under these circumstances, each insurer still provides appropriate security to all groups of policyholders. Except where stated, each scenario has been applied to both DGI and DGIEU simultaneously.

I have split the scenarios into two groups:

- Adverse scenarios: Scenarios that have an adverse, but not extreme, impact on the businesses. These are scenarios that might be expected to occur more frequently than every 20 years.
- Extreme scenarios: More severe scenarios, that could potentially lead to a materially adverse impact on the businesses. These are scenarios that might be expected to occur less frequently than every 20 years.

The assessment of how often a particular scenario is expected to occur is very subjective. I have assessed these based on a combination of analysis of D&G's historical experience prepared by D&G and my judgement based on my wider experience of actuarial and insurance work.

The extreme scenarios include a "reverse stress tests" – reverse stress tests are scenarios that, by design, consider potential events that could lead to insolvency of an insurer.

The following tables summarise the adverse and extreme scenarios considered.

Adverse scenarios

Scenario	Description
A. 10% higher claims	A 10% increase in claims reported for the 2021 financial year
B. 10% increase in expenses	An increase in expenses of 10% starting from the 2021 financial year
C. 20% less new business	A 20% decrease in new business for the 2021 financial year
D. More adverse COVID-19	A decrease in new business sales persists until the end of September 2020 due to COVID-19
E. Worsening combined ratio	The worst combined ratio that DGI/DGIEU has experienced in the past 15 years is assumed for all future years
F. 10% more renewal cancellations	A 10% increase in renewal cancellations for the 2021 financial year
G. Invested assets devalued by 10%	A 10% fall in the value of invested assets (excluding cash)
H. Credit downgrade for DGI	A credit downgrade for DGI which will impact the counterparty default risk for DGIEU

Extreme scenarios

Scenario	Description
I. Insolvency of key client	Insolvency of the biggest client for each of the DGI and DGIEU
J. Combined underwriting stress	An increase of 10% in the cost of claims, a reduction in new business of 20% and an increase in non-renewals or lapses of 10%
K. Data breach	A severe data breach leading to a GDPR fine of €20 million or up to 4% of the annual worldwide turnover of the preceding financial year (whichever is greater)
L. Non-equivalence of solvency regimes	A scenario where the UK solvency regime following the expiry of the Brexit transition period is not given Solvency II equivalence status by EU insurance regulators
M. Reverse stress test	See appendix 1 for details of the stressed assumptions

For each scenario, I have considered the projected SCR coverage ratio for the period to 31 March 2025 and assessed whether each of DGI and DGIEU:

- Is expected to remain well capitalised during the projected period – ie, a SCR coverage ratio of 150% or higher.
- Is expected to meet its risk appetite – ie, a SCR coverage ratio of 130% or higher.
- Is expected to remain solvent under Solvency II – ie, an SCR coverage ratio of 100% or higher.

In each case, these assessments are done across the projection period. For example, if the SCR coverage ratio for one of the insurers falls below 130% at any point during the projection, then this insurer would be deemed as not meeting its risk appetite.

The assessments for each scenario are set out in appendix 2. This includes the assessment for each scenario assuming the Proposed Transfer does and does not go ahead, both with and without USPs for DGIEU. The assessments are summarised as follows:

- With or without the Proposed Transfer proceeding, DGI is expected to remain well capitalised under all of the above adverse (but not extreme) scenarios.
- With or without the Proposed Transfer proceeding, DGIEU is projected to remain well capitalised throughout the projected period to March 2025 under all of the above adverse (but not extreme) scenarios. In particular, the amount of the additional capital injection mentioned in section 6.4 above of €8m has been set by D&G to help ensure that DGIEU is expected to remain well capitalised under these adverse scenarios. The amount of the capital injection will be reviewed by D&G ahead of my Supplementary Report, and I will comment on any changes in my Supplementary Report.
- With or without the Proposed Transfer proceeding, both DGI and DGIEU remain solvent under the extreme scenarios I to L, although as set out in the following bullets, in some circumstances scenarios J and L are expected to lead to either DGI or DGIEU's risk appetite being breached. As expected, both insurers become insolvent under the reverse stress tests.
- Under scenario J, DGI's risk appetite is not expected to be breached without the transfer, but is expected to be breached if the Proposed Transfer were to proceed. I am satisfied that this does not represent a material adverse change in security for Non-transferring Policyholders, as the absolute change in projected SCR coverage ratio is less than 10%. In addition, following the Proposed Transfer, under this extreme scenario, DGI's risk appetite is only projected to be breached by around 3% and DGI is projected to remain solvent.
- Under scenario L, DGIEU's risk appetite is not expected to be breached without the transfer, but is expected to be breached if the Proposed Transfer were to proceed. I am satisfied that this does not represent a material adverse change in security for Transferring or Existing DGIEU Policyholders, as this scenario represents a regulatory reporting risk, rather than an impact on the underlying insurance liabilities.

My conclusions from this analysis are as follows:

Non-transferring Policyholders

- For Non-transferring Policyholders, I compared the impact of the scenarios on DGI with and without the Proposed Transfer proceeding.
- In both cases, DGI is able to withstand a range of plausible adverse experience on its business.
- Therefore, under these scenarios, I am satisfied that Non-transferring Policyholders are not materially adversely affected as a result of the Proposed Transfer.

Transferring Policyholders

- For Transferring Policyholders, I compared the impact of the scenarios on DGI without the Proposed Transfer proceeding to DGIEU with the Proposed Transfer proceeding.
- In both cases, each of DGI and DGIEU are able to withstand a range of plausible adverse experience on its business. This is the case whether or not DGIEU's application to use USPs is successful.
- Therefore, under these scenarios, I am satisfied that Transferring Policyholders are not materially adversely affected as a result of the Proposed Transfer.

Existing DGIEU Policyholders

- For Existing DGIEU Policyholders, I compared the impact of the scenarios on DGIEU with and without the Proposed Transfer proceeding.

- In both cases, DGIEU is able to withstand a range of plausible adverse experience on its business. This is the case whether or not DGIEU's application to use USPs is successful.
- Therefore, under these scenarios, I am satisfied that Existing DGIEU Policyholders are not materially adversely affected as a result of the Proposed Transfer.

6.11. Overall conclusion: Capital considerations

I have set out below my overall conclusions related to capital. These capital considerations should not be considered in isolation. For example, the overall level of protection for policyholders also depends on a range of other considerations. My overall conclusions on the Proposed Transfer are set out in section 10.

Based on the work and rationale described above I have concluded that:

- **The projected capital requirements have been calculated materially appropriately for both DGI and DGIEU.**
- **Following the Proposed Transfer, and after allowing for the additional capital injection into DGIEU, I do not expect there to be any materially adverse changes in the strength of capital protection for any group of policyholders.**

7. Policyholder security

7.1. My considerations relating to policyholder security

As IE, my overall assessments related to policyholder security are:

- whether the likelihood of valid policyholder claims being paid is maintained following the Proposed Transfer for Non-transferring, Transferring and Existing DGIEU Policyholders.
- whether any change in policyholder security results in policyholders being materially adversely affected by the Proposed Transfer.

To make these assessments, I have considered the following areas:

- The IFRS/GAAP balance sheets of DGI and DGIEU (section 7.2)
- The solvency positions of DGI and DGIEU (section 7.3)
- Reinsurance arrangements between DGI and DGIEU (section 7.4)
- Access to the Financial Services Compensation Scheme (section 7.5)
- Access to the Financial Ombudsman Service (section 7.6)
- Insurance regulation (section 7.7)

Further details on each of these considerations are set out below, and my overall conclusion related to policyholder security is set out in section 7.8.

7.2. Impact on the balance sheets of DGI and DGIEU

I have based my analysis on projected balance sheets immediately pre- and post- the Proposed Transfer, on the anticipated Effective Date of 31 December 2020.

IFRS balance sheets of DGI and DGIEU: Projection as at 31 December 2020

Converted £m	Pre-Transfer		Post-Transfer	
	DGI	DGIEU	DGI	DGIEU
Deferred acquisition costs	162.0	41.2	109.0	94.5
Cash and deposits	42.3	24.0	19.2	47.6
Investment in subsidiary	36.6	0.0	43.4	0.0
Intercompany	(6.4)	(7.7)	(13.5)	(6.0)
Warranty debtors	328.7	26.8	297.5	58.1
Trade receivables	11.4	0.1	11.4	0.2
Other debtors	12.6	0.0	27.6	0.0
Prepayments and accrued income	60.2	7.4	59.9	7.6
Other assets	6.8	2.5	7.7	1.5
Total assets	654.3	94.3	562.3	203.5
Technical provisions	486.1	42.5	415.3	113.7
Claims payables	6.4	(0.2)	5.5	0.7
Commissions payables	7.1	6.1	5.8	7.5
Marketing payables	26.2	0.2	26.1	0.3
Accruals	17.2	2.6	10.3	9.5
Reinsurance payables	0.0	12.7	0.0	27.7
Other taxation and social security	35.2	2.2	27.5	9.9
Other Liabilities	3.2	2.1	3.1	2.3
Total liabilities	581.5	68.3	493.5	171.7
Total equity	72.8	26.0	68.8	31.9

Source: DGI, DGIEU. DGIEU figures converted assuming £1 = €1.17

The table above shows simplified IFRS balance sheets for DGI and DGIEU pre- and post- the Proposed Transfer. The impact of the transfer is that around 15% of DGI's IFRS provisions are expected to be transferred out of DGI (net of the reinsurance back from DGIEU to DGI).

As expected given the Proposed Transfer, the key movements in the balance sheet for DGI are the reduction in technical provisions, together with a corresponding reduction in deferred acquisition costs, and a reduction in investments and cash.

In total across both insurers, assets increase by £17.3m (from £748.5m to £765.8m) and liabilities increase by £15.5m (from £649.7m to £665.2m) as a result of the Proposed Transfer. DGIEU has stated that the main reasons for this are as follows:

- The Reinsurance Account increases, which creates a larger receivable (asset) for DGI and larger payable (liability) for DGIEU, both going up by £15.0m.
- An additional €8.0m (£6.8m) capital injection (Investment in subsidiary) into DGIEU simultaneously with the Proposed Transfer (as set out in section 6.4, the total planned capital injection to be made simultaneously with the Proposed Transfer is €13m).
- A £5.4m reduction in Intercompany assets which is due to a write-off as part of the Proposed Transfer.

DGIEU's own accounts will be prepared under German GAAP, rather than IFRS. The table below shows a comparison between German GAAP and IFRS balance sheets for DGIEU pre- and post-transfer.

Comparison of IFRS and German GAAP for DGIEU as at 31 December 2020

Converted £m	Pre-Transfer		Post-Transfer	
	IFRS	German GAAP	IFRS	German GAAP
Goodwill	0.0	9.5	0.0	40.3
Customer/OEM relationships	0.0	0.0	0.0	1.3
Deferred acquisition costs	41.2	0.0	94.5	0.0
Cash and deposits	24.0	24.0	47.6	47.6
Intercompany	(7.7)	(7.7)	(6.0)	(6.0)
Warranty debtors	26.8	15.7	58.1	16.4
Prepayments and accrued income	7.4	7.4	7.6	7.6
Other assets	2.5	2.5	1.5	1.5
Total assets	94.3	51.5	203.5	108.9
Technical provisions	42.5	1.9	113.7	55.4
Deferred tax liabilities	0.0	3.3	0.0	0.0
Claims payables	(0.2)	0.4	0.7	0.7
Commissions payables	6.1	6.1	7.5	7.5
Accruals	2.6	2.6	9.5	9.5
Reinsurance payables	12.7	8.8	27.7	13.0
Other taxation and social security	2.2	2.5	9.9	9.9
Other Liabilities	2.1	2.1	2.3	2.3
Total liabilities	68.3	28.0	171.7	98.6
Total equity	26.0	24.4	31.9	10.2

Source: DGIEU. Figures converted assuming £1 = €1.17

The goodwill and deferred tax liability lines are only applicable to the German GAAP balance sheet

Under German GAAP, the Part VII transfer results in a number of adjustments to the balance sheet from IFRS. The main adjustments are:

- Future instalments of monthly paid premiums are not included in the assets.
- Deferred acquisition costs are not included in the assets.
- An additional asset is included for goodwill. DGIEU has stated that the asset it has included for goodwill is less than 50% of what could be allowable under German GAAP.
- An additional asset is included for the "Value in Force" of the transferred policies in Customer/OEM relationships, although this is reduced by 90% due to the reinsurance.
- The reinsurance ceding commission is realised immediately when the premium has been collected, which decreases the liabilities. However this is almost entirely offset by the reinsurance premium being earned quicker which increases the liabilities.

7.3. Impact on the solvency positions of DGI and DGIEU

The projected solvency positions of DGI and DGIEU pre- and post-transfer are summarised in the following table.

Projected solvency positions of DGI and DGIEU as at 31 December 2020

	DGI £m	DGIEU (no USPs) €m
Pre-transfer		
Total own funds eligible to meet SCR	123.8	25.6
SCR	61.2	10.5
SCR coverage ratio	202%	244%
Post-transfer		
Total own funds eligible to meet SCR	116.0	32.0
SCR	61.6	11.4
SCR coverage ratio	189%	280%

Source: DGI, DGIEU

DGI and DGIEU are both well or very well capitalised immediately before and after the Proposed Transfer (as described in sections 6.1 and 6.8). I have considered the projected solvency positions in terms of DGIEU without USPs as DGIEU's latest expectation is for USPs to be approved before 31 March 2021, but after 31 December 2020 (the Effective Date of the Proposed Transfer).

7.4. Reinsurance arrangements between DGI and DGIEU

DGI and DGIEU entered into a quota share Reinsurance Agreement on 11 March 2019 prior to the Sanctions Hearing for the previous lapsed Part VII. In preparation for the Proposed Transfer, DGI and DGIEU have filed with the German Commercial Registry an amendment to the Reinsurance Agreement to better reflect the status of the parties at the time of the Proposed Transfer in December 2020. In particular:

- DGIEU is now a fully operational business that will have had over 12 months of trading activity by December 2020.
- The size of the transferring book is expected to be significantly smaller than in December 2018 such that the capital burden on both DGI and DGIEU in servicing the transferring book is reduced.

The two main changes to the agreement are:

- Under the amended agreement, DGIEU reinsures 90% of all of its business with DGI. Under the previous agreement, 70% of the Part VII transferring business and 90% of DGIEU's new and renewal business was to be reinsured.
- Under the amended agreement, the Reinsurance Account will be rebalanced more regularly (compared to annually in the previous agreement), with additional protections to DGIEU under certain "Trigger Points" outlined below. The purpose of this change is to ensure the Reinsurance Account more closely tracks DGIEU's potential exposure from the quota share arrangement over time.

The amendment is expected to be confirmed by the end of August 2020 and I will provide an update on the final confirmation of the Reinsurance Agreement in my Supplementary Report.

In the event of insolvency of DGI, amounts owed to DGIEU under the reinsurance would ordinarily rank behind DGI policyholder claims. Therefore, without appropriate additional security in place for DGIEU, this could materially adversely affect Transferring Policyholders in the event of DGI insolvency. To help ensure that Transferring Policyholders are not adversely affected in this scenario, DGI and DGIEU will have in place a Reinsurance Account arrangement.

The proposed mechanics are as follows:

- DGIEU will set up a ring-fenced account that is separate to any other DGIEU accounts, referred to as the Reinsurance Account. This account will be owned by DGIEU.

- DGIEU will collect customer premiums on new/renewal business and place DGI's share of these in the Reinsurance Account. It will also place in the Reinsurance Account DGI's share of unearned premium transferred by DGI in respect of the transferring business. In both cases, DGI's share is 90% less ceding commission.
- The Reinsurance Account will be used to pay DGI's quota share of DGIEU policyholder claims and to manage payment of reinsurance premium back to DGI on the terms summarised below.
- DGI will ensure that the Reinsurance Account holds sufficient funds, at any point in time, to pay forecast reinsurance recoveries to DGIEU over a three month period.
- DGIEU will pay:
 - 90% of Unearned Premium collected less ceding commission for the transferring business into the Reinsurance Account.
 - 90% of Gross Premium collected less ceding commission for new and renewal business into the Reinsurance Account.
- All ceding commission and the share of premium not reinsured will be retained in DGIEU's own account.
- DGIEU will pay DGI the reinsurance premium collected (less ceding commission) out of the Reinsurance Account on a monthly basis unless a "Trigger Event" has occurred. Subject to any Trigger Events, the monthly reinsurance premium payable to DGI is DGI's share of the gross premium written by DGIEU in the immediately preceding month.
- DGI will calculate its SCR coverage ratio as at the last day of each calendar month and shall provide DGIEU with such calculations within eight weeks of the relevant calculation date.

Trigger Events include:

- the amount of cash in the Reinsurance Account falls below DGI's forecast total reinsurance claims cashflows over the following 3 month period.
- DGI's SCR coverage ratio falls below 130% SCR.

Following a Trigger Event, DGIEU will be entitled to:

- direct DGI to pay additional collateral into the Reinsurance Account to top it up until the point at which the Trigger Event ceases to occur; and/or
- suspend reinsurance premium payments to DGI.

D&G has provided documentation of the proposed revised Reinsurance Agreement including a near-final draft of the legal documentation. D&G intends that the revised Reinsurance Agreement will be in place prior to the Effective Date of the Proposed Transfer, and I have carried out my analysis on this basis. I have also been provided by D&G with monthly projections of the expected Reinsurance Account cashflows over the next 3 years, along with scenario testing of these cashflows. I have relied on the projections provided by D&G to reach my conclusions.

Non-transferring Policyholders are impacted by the reinsurance arrangement because of DGI's role as reinsurer to DGIEU. The impact is limited to the scenario where DGI becomes insolvent, in which case DGI may not be able to access the funds held in the Reinsurance Account by DGIEU, that are owed to it. Overall, I am satisfied that DGI's policyholders are not materially impacted as, in the unlikely event that DGI becomes insolvent, the funds held in the Reinsurance Account are only available to be used to pay DGI's share of claims and any excess funds will be returned to DGI.

Conclusion on reinsurance

Based on my review of the proposed reinsurance arrangements and the information provided by D&G, I am satisfied that the reinsurance arrangements provide appropriate protection for Transferring Policyholders and Existing DGIEU Policyholders. I am satisfied that Non-transferring Policyholders are not materially impacted by the reinsurance arrangements.

The rationale for my conclusion on the reinsurance arrangements is as follows:

- The Reinsurance Account will be maintained to cover a minimum of at least 3 months of forecast recoveries to DGIEU under the reinsurance arrangement. Based on D&G's projections, this amount is expected to be relatively steady over time and remain higher than the claims provision.

- The primary role of the Reinsurance Account in the context of the Part VII transfer is to protect policyholders transferring to DGIEU in the event of DGI insolvency as Transferring Policyholders would ordinarily rank lower in line for DGI's assets than Non-transferring Policyholders after the Part VII transfer. D&G has confirmed that in the event of DGI insolvency, the Reinsurance Account would be ringfenced which means that the assets in the account would remain available to Transferring Policyholders in the event of DGI insolvency and would allow DGIEU to pay for the run-off of claims related to existing policies (from both Existing DGIEU and Transferring Policyholders).
- D&G's legal advisers have advised me that the Trigger Event clause of the Reinsurance Agreement will be enforceable in Germany and in the UK.
- There is a Trigger Event if DGI's solvency ratio falls below 130%. This means DGI is still solvent at this point and is therefore expected to be able to pay top-ups as required. In the event of a sudden insolvency event for DGI, the Reinsurance Account without further top-up is expected to be sufficient to cover DGIEU's expected cashflows (and so also the reinsurance recoveries it would lose) in respect of earned business.
- Under either of these scenarios, following the Trigger Event, DGIEU would retain the unearned reinsurance premiums. The business is projected to be profitable, so these retained premiums are expected to be sufficient to cover DGIEU's cashflows from the unearned business.

7.5. Access to the Financial Services Compensation Scheme

The Financial Services Compensation Scheme (FSCS) in the UK provides consumer protection. This statutory "fund of last resort" compensates customers in the event of the insolvency of a financial services firm. Insurance protection exists for individuals and small businesses in the situation where an insurer is unable to meet its liabilities for direct policyholders only (ie reinsured policyholders are not covered). For certain insurance that is compulsory in the UK (eg motor third party liability insurance), insurance protection also exists for direct policyholders whether or not they are individuals or small businesses (being business with an annual turnover of less than £1m).

The FSCS will pay 100% of any claim incurred for compulsory insurance (eg motor third party liability insurance) and 90% of claims incurred for non-compulsory insurance (eg home insurance), without any limit on the amount payable. No protection is available for Goods in Transit, Marine, Aviation and Credit Insurance.

Following the Proposed Transfer, all Transferring Policyholders will retain access to the FSCS in respect of events or circumstances arising before the Proposed Transfer but would lose access for events or circumstances which arise after the Proposed Transfer as set out in the PRA's Policy Statement PS5/15 'Policyholder protection'.

In Germany an FSCS equivalent scheme does not exist for general insurance companies. Therefore, Transferring Policyholders will lose access to a compensation scheme as a result of the Proposed Transfer. However, I have concluded that, due to the financial strength of DGIEU, an insolvency scenario which would be required to trigger FSCS protection is unlikely.

In addition, the Transferring Policyholders may value the certainty that valid claims can be lawfully paid following the expiry of the Brexit transition period, more than the loss of access to the FSCS which only benefits them in the unlikely event of the insolvency of DGI.

Therefore, I have concluded that it is unlikely that the policyholders will be materially adversely affected by the loss of access to the FSCS.

7.6. Access to the Financial Ombudsman Service

The Financial Ombudsman Service (FOS) provides private individuals, and small businesses with a free, independent service for resolving disputes with financial companies. For the purposes of the FOS, small businesses are defined to be businesses with less than £6.5m turnover and either fewer than 50 employees or a balance sheet total of less than £5m.

It is not necessary for the private individual, micro enterprise or small business to live or be based in the UK for a complaint regarding an insurance policy to be dealt with by the FOS. However, it is necessary for the insurance policy concerned to be, or have been, administered from within the UK and/or issued from within the UK.

The Transferring Policyholders, all of whom currently have access to the FOS, will retain access to the FOS in respect of acts or omissions by DGI before the Effective Date, but will lose access to the FOS in respect of acts and omissions taking place after the Effective Date. The Transferring Policyholders will gain access to a similar insurance ombudsman in Germany (the Ombudsmann für Versicherungen) in respect of acts and omissions by

DGIEU taking place after the Effective Date. The Ombudsmann für Versicherungen is a voluntary ombudsman scheme that German insurers may join and which can make binding arbitration rulings on its members where the award value does not exceed €10,000. The service is free of charge to the complainants. D&G has informed me that, given the nature of the transferring business, the €10,000 limit will be sufficient to fully compensate any complainants. Additionally, DGI has informed me that only 2 non-UK EEA policyholders have referred a complaint to the FOS in the last six months. This represents less than 0.01% of non-UK EEA policyholders.

DGIEU currently submits voluntarily to the jurisdiction of the Ombudsmann für Versicherungen in respect of its existing policyholders and DGIEU has confirmed that it will submit voluntarily to its jurisdiction in respect of all Transferring Policyholders to ensure that they are able to gain protection.

DGIEU has undertaken to comply with the FCA rules (set out in DISP, the Dispute Resolution: Complaints part of the FCA Handbook) that apply to the handling of complaints brought to the FOS and any award or direction made or given by the FOS, relating to acts or omissions prior to the Effective Date. DGIEU has informed me that it will comply with FCA conduct rules and FOS jurisdiction for all Transferring Policyholders, where the proceedings have commenced but have not settled against DGI before the Effective Date, or which relate to acts or omissions on the part of DGI which took place prior to the Effective Date. In addition, if a UK branch of DGIEU is established, transferring ROI policyholders will have access to FOS for complaints related to certain administrative tasks undertaken by the regulated UK branch.

I have therefore concluded that the Transferring Policyholders are not disadvantaged from loss of access to FOS.

7.7. Insurance regulation

Prudential regulation

Prudential regulation requires financial firms to control risks and hold adequate capital to ensure regulated firms are being run in a safe and sound way.

Both the UK and Germany are currently regulated under Solvency II. Solvency II covers the prudential regulation of insurers, including risk management and capital requirements. The position regarding UK insurance regulation after the Brexit transition period is currently unclear. However, the expectation is that the UK will seek to maintain equivalence with Solvency II.

Transferring Policyholders will move from DGI which is regulated by the PRA on prudential matters, to DGIEU which is regulated by BaFin on such matters. The nature of prudential regulation under BaFin is similar to the PRA in that both follow Solvency II regulatory requirements for insurance firms.

Based on the above considerations, I do not expect Transferring Policyholders to be materially adversely affected by the changes in prudential insurance regulation governing their policies from the UK to Germany.

Conduct regulation

Conduct regulation of financial firms typically includes consumer protection, market conduct rules and ethical codes of conduct. Conduct is generally regulated by the insurance regulator in the country in which a risk is located and/or the location from which the business is carried out.

Therefore, the key relevant comparison is between the conduct regulations in the UK and those in Germany. If these were materially different, this could potentially affect Transferring Policyholders where the business is currently carried out in the UK and post-transfer will be carried out in Germany – ie, the German business and business that will be written through DGIEU's German headquarters under FofS.

There is currently less harmonisation in conduct regulation across the EEA compared to prudential regulation. For example, the UK has a particularly strong focus on conduct regulations, including through the FCA's focus on policyholder protection and treating customers fairly.

However, a number of EU Directives govern consumer regulation across the EEA, and so currently apply to the UK and Germany. For example, the Insurance Distribution Directive (IDD) covers the distribution of insurance and reinsurance across EEA member states, and also the administration and performance of an insurance policy once it has been written. D&G's legal advisers have confirmed to me that Germany, like the UK, has implemented the IDD without material deviation. As for Solvency II, the position regarding the compliance with IDD in the UK in the medium to long term after the Brexit transition period is currently unclear.

Whilst there will be changes in conduct regulation for certain Transferring Policyholders, I am satisfied that they are unlikely to be materially adversely affected by these changes.

Conclusion on regulation

Based on the above considerations, I am satisfied that Transferring Policyholders are unlikely to be materially adversely affected by the change in insurance regulation governing their policies.

7.8. Overall conclusion: Policyholder security

Based on the work and rationale described above, I have concluded that it is unlikely that policyholders will be materially adversely affected by the Proposed Transfer.

8. Policyholder communications

8.1. My considerations relating to policyholder communications

I have assessed the appropriateness of DGI's proposed communication strategy to inform policyholders of the Proposed Transfer.

The key focus of my assessment was whether the policyholders are to be provided with sufficient and clear enough information so that they can understand how the Proposed Transfer may affect them.

8.2. Overview of communications strategy

DGI has developed a communication strategy to notify affected parties of the Proposed Transfer and allow time for affected parties to raise objections to the High Court. I have summarised the main points of the communications strategy below:

- **Non-transferring Policyholders:** DGI does not propose to issue individual notifications to the Non-transferring Policyholders. DGI is seeking a dispensation in this regard.
- **Transferring Policyholders:** DGI will notify Transferring Policyholders, subject to the dispensations sought as discussed in Section 8.3.
- **Existing DGIEU Policyholders:** DGI does not propose to issue individual notifications to Existing DGIEU Policyholders. A dispensation is being sought in this regard.

I am satisfied that the communications strategy will ensure that those who will be affected by the Proposed Transfer will be informed appropriately.

D&G has been through a similar communications exercise for the previous lapsed transfer and has informed me that the existing service team is expected to have sufficient scope to carry out the communications and to respond to subsequent policyholder responses. In addition, D&G has budgeted for additional temporary staff to support the work if required. On this basis, I am satisfied that D&G has sufficient resources to carry out the communications and to deal with any objections, enquiries or complaints received following the Part VII communication exercise.

8.3. Requested waivers and rationale

DGI will be seeking a waiver from the requirement to send a notice to every policyholder in respect of:

- Non-transferring Policyholders;
- Transferring Policyholders who fall into the following groups:
 - low premium policyholders except those for whom DGI has a relevant email address;
 - policyholders where DGI does not hold customer data;
 - policyholders who are not sent the documents solely by reason of accidental omission (in the unlikely event that there are any such policyholders); and
 - any policyholder with an expired, cancelled or lapsed policy who does not have an open claim or complaint at the date of the Directions Hearing.
- Existing DGIEU Policyholders.

DGI has provided a rationale to support their request for dispensation with indirect reference to the judgement of Norris J in the Directions Hearing in *Re Aviva International Insurance Limited* [2011] EWCH 1901 (Ch.) (the Aviva Judgement). The Aviva Judgement summarised the following factors as a rationale for granting a dispensation:

- the **impossibility** of contacting policyholders;
- the **practicality** of contacting policyholders;
- the **utility** of contacting policyholders;
- the **availability of other information channels** through which notice of the application can be made available;
- the **proportionality** of strict compliance and the impact of collateral commercial concerns; and
- the likely **impact** of the Proposed Transfer on policyholders.

Non-transferring DGI Policyholders

DGI does not intend to notify Non-transferring Policyholders, and its rationale is as follows (I have included in brackets the reference to the factors from the Aviva Judgement where applicable):

- DGI believe the cost of direct notification of all Non-transferring Policyholders is disproportionate to the benefit received from direct notification, particularly given Non-transferring Policyholders are not expected to be materially adversely affected by the Proposed Transfer and the Proposed Transfer is intra-group and being undertaken to provide certainty of business continuity following the end of the Brexit transition period ([proportionality and impact](#)).
- DGI's view is that Non-transferring Policyholders will have access to the information from a broad advertising campaign, including published notifications in the UK, and so will have the opportunity to be made aware of the Proposed Transfer without direct notification ([availability of other information channels](#)).
- DGI do not consider that it is necessary to notify the Non-transferring Policyholders that their policies are remaining with the same insurer and that nothing is changing for them in terms of:
 - their insurer's governance structure and regulatory framework;
 - their policy terms and conditions; and
 - their security of benefits ([utility](#)).

Transferring Policyholders

Low Premium Policyholders

DGI is seeking a dispensation from sending notices to "Low Premium Policyholders" (defined as transferring policies which have an annual fee of less than €70) where it does not hold a valid email address. DGI's rationale for the waiver sought for Low Premium Policyholders is as follows (I have included in brackets the reference to the factors from the Aviva Judgement where applicable):

- DGI believe the cost of direct notification of all Low Premium Policyholders is disproportionate to the benefit received from direct notification, particularly given it is unlikely that the Transferring Policyholders will be materially adversely affected by the Proposed Transfer and the Proposed Transfer is intra-group and being undertaken to provide certainty of business continuity for DGI following the end of the Brexit transition period ([proportionality and impact](#)).
- DGI's view is that Low Premium Policyholders will have access to the information from a broad advertising campaign, including the publications in the UK, and so will have the opportunity to be made aware of the Proposed Transfer without direct notification ([availability of other information channels](#)).

Policies that DGI do not hold customer data for

DGI is seeking a waiver from sending notices to Transferring Policyholders where policies were bought at the point of sale ("Till Receipt Policyholders") or where the contact information held by DGI is incomplete or incorrect. Its rationale is as follows:

- DGI are seeking this waiver as it is not possible or practical to notify such policyholders ([impossibility and practicality](#)).
- DGI's view is that policyholders that it does not hold customer data for will have access to the information from a broad advertising campaign, including the notices to be placed in newspapers and the D&G website, and via in-store advertising in the stores of clients where the Till Receipt Policies were sold, and so will have the opportunity to be made aware of the Proposed Transfer without direct notification ([availability of other information channels](#)).

Accidental omission

DGI's intention is that no Transferring Policyholders would fail to receive notification due to reasons of accidental omission. In the event that accidental omissions occur, DGI will not practically be able to make individual notifications and has therefore requested a waiver for the requirement to notify these policyholders ([practicality](#)).

Policyholders with expired policies

DGI is seeking a waiver from sending notices to Transferring Policyholders with cancelled, lapsed or expired policies, except in the case where there is an open claim or complaint at the date of the Directions Hearing. Its rationale is as follows:

- DGI believe the cost of direct notification of all Transferring Policyholders with expired policies is disproportionate to the benefit received from direct notification, particularly given these Transferring Policyholders are not expected to be materially adversely affected by the Proposed Transfer and the Proposed Transfer is intra-group and being undertaken to provide certainty of business continuity for DGI following the end of the Brexit transition period ([proportionality and impact](#)).

New policyholders

Where new policyholders purchase a policy with DGI after the notification exercise has commenced and would subsequently be transferred under the Proposed Transfer, DGI will provide them with an insert in their policy documentation describing the Proposed Transfer.

Existing DGIEU Policyholders

DGI is seeking a waiver from sending notices to Existing DGIEU Policyholders, and its rationale is as follows:

- DGI believes the cost, both monetary and time, of direct notification of all Existing DGIEU Policyholders is disproportionate to the benefit received from direct notification, particularly given the Existing DGIEU Policyholders are not expected to be materially adversely affected by the Proposed Transfer and the Proposed Transfer is intra-group and being undertaken to provide certainty of business continuity for DGI following the end of the Brexit transition period ([proportionality and impact](#)).
- DGI's view is that Existing DGIEU Policyholders will have access to the information from a broad advertising campaign, including inserts in policy documentation for policies purchased from early May 2020 (early July 2020 for some Clients in Germany and ROI) up to the date of the Sanctions Hearing, and so will have the opportunity to be made aware of the Proposed Transfer without direct notification ([availability of other information channels](#)).
- DGI do not consider that it is necessary to notify the Existing DGIEU Policyholders that their policies are remaining with the same insurer and that nothing is changing for them in terms of:
 - their insurer's governance structure and regulatory framework;
 - their policy terms and conditions; and
 - their security of benefits ([utility](#)).

DGIEU has confirmed that at 30 June 2020 approximately 245,600 DGIEU policyholders have already received an insert with their policy documentation informing them of the transfer. DGIEU has informed me that this represents over 90% of new DGIEU policies sold since May 2020. DGIEU has also confirmed that inserts will continue to be provided with policies up to the Effective Date of the Proposed Transfer. DGIEU has informed me that, although requested by DGIEU, two ROI clients are unable to provide the inserts to certain new DGIEU policyholders. I understand that in-store notices will be placed in the stores of those clients as an alternative.

DGI has confirmed that copies of the Independent Expert's report, the summary of the report, the Scheme Document, the scheme summary and FAQs will also be given free of charge to anyone who requests them by telephone or in writing, and will be available on the D&G website.

I am satisfied with DGI's rationale for the various dispensations sought, as information regarding the Proposed Transfer is available from other sources and my conclusions in this report are that it is unlikely that any group of Non-Transferring, Transferring or Existing DGIEU Policyholders will be materially adversely affected by the Proposed Transfer.

8.4. Planned notices

DGI will comply with the regulations and place a notice of the Proposed Transfer in:

- the London, Edinburgh and Belfast Gazettes; and
- two national newspapers in the UK (The Sun and The Daily Mail) to increase the breadth of the UK advertising.

DGI also proposes to place notices in at least two national newspapers in each of the 10 non-UK EEA states in which insured risks are situated. These are Austria, Belgium, France, Germany, Republic of Ireland (ROI), Italy, the Netherlands, Poland, Portugal and Spain.

DGI has informed me that these newspapers have been chosen as a result of their wide and diverse readership base. DGI has also given consideration to those papers with the highest national circulation, specifically to ensure that they reach as many customers as possible. I am satisfied with the selection of newspapers.

DGI also plans to undertake:

- a digital advertising exercise in addition to the print advertisement noted above to reach policyholders who may be more likely to respond to a digital communication (including via the Domestic & General website); and
- an in-store advertising campaign for retailers of policies that are sold in-store.

I am satisfied with the proposed approach to advertisements.

8.5. Translation of key documents

The relevant individual policyholder notifications, as well as attachments (including a summary of this Independent Expert report, the Scheme Document, the scheme summary and FAQs) will be translated into the main languages of the countries in which D&G operates.

I have discussed this with D&G and D&G has informed me that the documents will be translated into the following main languages, in line with the preferred language flag for each policyholder for individual communications:

- Italian
- German (for German and Austrian customers)
- Spanish
- Portuguese
- French (for French and Belgian customers)
- Dutch (for Dutch and Belgian customers)

D&G is responsible for ensuring that the translations into each language are accurate and therefore readers of such translations are relying on D&G, and not myself or LCP, for the accuracy of the translations.

8.6. Clarity of communication

I have reviewed a draft of the proposed letters and FAQ document to be provided to policyholders explaining the background to the Proposed Transfer and the transfer process. I have additionally reviewed the in-store, newspaper and gazette notices to be provided to be published.

I am satisfied the communication to policyholders regarding the Proposed Transfer is clear, fair and not misleading.

8.7. Overall conclusion: Policyholder communications

Based on my review of the communication strategy, I have concluded the planned communications strategy will ensure adequate coverage of affected parties.

DGI is applying for a number of dispensations from communicating to some affected parties, each of which is supported by appropriate rationale.

I have also concluded that the planned communication is sufficiently clear for policyholders to understand the effects of the Proposed Transfer and that D&G has sufficient resources to deal with any objections, enquiries or complaints received following the Part VII communication exercise.

9. Customer service and other considerations

9.1. Customer service

DGI and DGIEU have informed me that there will be no material changes to policyholder administration and claims handling, ie the policyholder experience, in respect of:

- Non-transferring Policyholders;
- Transferring Policyholders; and
- Existing DGIEU Policyholders.

As discussed in section 3.1, DGIEU submitted an application to BaFin in August 2020 to establish a UK branch on a FofE basis. The purpose of the UK branch is to minimise customer disruption and to ensure the availability of suitable personnel, as DGIEU will utilise DGI's existing infrastructure in the UK (principally an English language call centre) to operate the ROI business and to service Transferring Policyholders located in the ROI.

DGI and DGIEU have further informed me that there are no planned changes to the way policies will be serviced or to the teams who will service them, ie no material changes from the policyholder's point of view.

DGI will maintain previous contact details for policyholders to contact regarding claims and servicing policies and will forward any policyholder correspondence to DGIEU.

As such, I do not expect that policyholders will receive a materially different level of customer service following the Proposed Transfer.

9.2. Tax implications

In relation to the Proposed Transfer, the three types of tax that potentially impact the premium policyholders are charged are:

- Corporation tax: this is levied on profits and policyholders are not directly affected by the obligation for DGI or DGIEU to pay corporation tax.
- Value added tax (VAT): policyholders do not pay VAT on insurance premiums.
- Insurance premium tax (IPT): the applicable IPT rate for each policyholder is determined by the location of the risk insured which will not change. Therefore, the amount of IPT charged will not be affected by the Proposed Transfer.

Therefore, there are no direct tax implications of the Proposed Transfer on Non-transferring, Transferring or Existing DGIEU Policyholders.

9.3. Investment management implications

DGI and DGIEU's investment strategies are approved by their investment committees with oversight by their boards. Each committee adheres to similar governing principles and guidelines set at the Group level.

- As at 31 March 2020, the majority of DGI's invested assets were in corporate bonds and holdings in other undertakings. A small proportion was invested in property and cash.
- As at 31 March 2020, the vast majority of DGIEU's invested assets were in cash, with a small proportion in property.

Both DGI and DGIEU have informed me that, more recently, they are limiting investments to cash and government bonds in response to COVID-19.

Investment management is outsourced to specialists outside D&G. The same investment management company manages both DGI and DGIEU's portfolios.

The investment strategies of DGI and DGIEU follow the wider strategy of D&G and both are managed in a similar manner. No changes to DGI or DGIEU's investment strategies are planned as a result of the Proposed Transfer.

Therefore, I do not anticipate any materially adverse impact for any group of policyholders in terms of investment management as a consequence of the Proposed Transfer.

9.4. Implications on ongoing expense levels

All costs and expenses incurred relating to the Proposed Transfer will be borne by DGI and DGIEU and will not be borne by policyholders. One-off costs associated with the Proposed Transfer are expected to be modest relative to the size of the transferring business and existing portfolios of DGI and DGIEU.

Therefore, there are no impacts for any group of policyholders as a result of any changes to ongoing expense levels.

9.5. Impact on liquidity position

The liquidity position of a company represents its ability to meet all claim payments and other obligations as and when they fall due. DGI monitors asset liquidity as part of their ORSA process. DGIEU will follow the same process. DGI invests mainly in government bonds and corporate bonds which are normally readily convertible into cash. DGI invests mainly in cash investments. As DGI and DGIEU write new business, liquidity is also available from premium income.

Therefore, I do not anticipate any materially adverse impacts on the liquidity position for any group of policyholders as a consequence of the Proposed Transfer.

9.6. Set-off

I have considered whether the Proposed Transfer is likely to lead to any changes in the rights of set-off for creditors or debtors of DGI or DGIEU. "Set-off" is a right that allows parties to cancel or offset mutual debts with each other by subtracting one from the other and paying only the balance.

The quota share arrangement between DGI and DGIEU implicitly allows DGIEU to offset the reinsurance premiums due to DGI against DGI's share of claims from the Reinsurance Account. This has been implemented for reasons of practicality, to reduce the number of transactions between DGI and DGIEU. I have not identified any other material set-off rights as part of my review. Therefore, considerations around set-off do not impact my conclusions.

9.7. Overall conclusion: Customer service and other considerations

Based on the work and rationale described above, I have concluded that no material impact on service standards (or any other considerations within this section of the report) is expected following the Proposed Transfer.

10. Conclusions and Statement of Truth

I have considered the Proposed Transfer and its likely effects on the Non-transferring Policyholders, the Transferring Policyholders and the Existing DGIEU Policyholders.

In reaching the conclusions set out below, I have applied the principles as set out in relevant professional guidance, being the Technical Actuarial Standards (TASs) TAS 100: Principles for Technical Actuarial Work and TAS 200: Insurance.

I have concluded that:

- The security provided to Non-transferring Policyholders will not be materially adversely affected by the Proposed Transfer. No material impact on service standards is expected for Non-transferring Policyholders following the Proposed Transfer.
- The security provided to Transferring Policyholders is unlikely to be materially adversely affected by the Proposed Transfer. No material impact on service standards is expected for Transferring Policyholders following the Proposed Transfer.
- The security provided to Existing DGIEU Policyholders will not be materially adversely affected by the Proposed Transfer. No material impact on service standards is expected for Existing DGIEU Policyholders following the Proposed Transfer.

10.1. Issues to highlight

I consider it necessary that I review the most recent information, up to the date of the Sanctions Hearing for the Proposed Transfer, when this becomes available later in the year, before confirming my opinion and conclusions.

Specific issues that I have highlighted in this report which require further review include:

- Considering the latest position on COVID-19.
- Any findings from the audits of the DGI and DGIEU 31 March 2020 accounts.
- Any changes to D&G's planned additional capital injection of €8m.
- Reviewing DGIEU's submitted USP application.
- The status of DGIEU's UK branch application.
- Any policyholder objections received.
- Final confirmation of the reinsurance arrangement between DGI and DGIEU, once this has been approved by the German Commercial Registry.

I will consider these points further as part of my Supplementary Report.

10.2. IE duty and declaration

My duty to the High Court overrides any obligation to those from whom I have received instructions or paid for this Report. I confirm that I have complied with that duty.

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

I confirm that I am aware of the requirements applicable to experts in Part 35 of the Civil Procedure Rules, Practice Direction 35 and the Guidance for the Instruction of Experts in Civil Claims 2014. As required by Part 35 of the Civil Procedure Rules, I hereby confirm that I have understood and complied with my duty to the Court.



Tom Durkin FIA
Partner

24 August 2020

The use of our work

This work has been produced by Lane Clark & Peacock LLP under the terms of our written agreement with Domestic & General Insurance PLC. It is subject to any stated limitations (eg regarding accuracy or completeness).

This Scheme Report, which is our work, has been prepared for the purpose of accompanying the application to the High Court of Justice of England and Wales in respect of the insurance business transfer scheme described in this report, in accordance with Section 109 of the Financial Services and Markets Act 2000. The Scheme Report is not suitable for any other purpose.

A copy of the Scheme Report will be sent to the Prudential Regulatory Authority, the Financial Conduct Authority and will accompany the Scheme application to the High Court.

This work is only appropriate for the purpose described above and should not be used for anything else. No liability is accepted or assumed for any use of the Scheme Report for any other purpose other than that set out above.

Professional Standards

Our work in preparing this document complies with Technical Actuarial Standard 100: Principles for Technical Actuarial Work, together with Technical Actuarial Standard 200: Insurance, and Actuarial Profession Standard X2: Review of Actuarial Work.

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Appendix 1 – Description of best estimate projections and reverse stress tests

Best estimate projections

The best estimate projections are based on DGI and DGIEU's historical experience and forward looking business plan. They represent DGI and DGIEU's best estimate view of each insurer's projected financial position, and are in line with the projections that each of DGI and DGIEU's management use to manage their businesses.

In addition, the following assumptions have been made related to the COVID-19 pandemic. These reflected DGI and DGIEU's current best view on the expected impact of COVID-19 on each business:

- UK monthly sales fall by between 25% and 15% for subscription sales and between 67% to 20% for retail cash sales between April and August 2020 (with a peak fall in June 2020) and then 10% thereafter until March 2021.
- EU monthly sales fall by between 20% and 55% for subscription sales and between 67% to 20% for retail cash sales between April and July 2020 (with a peak fall in April 2020) and then 10% thereafter until March 2021.
- UK monthly renewals increase by between 0% and 1% between April and June 2020 (with a peak fall in June 2020) and then fall by 1% thereafter until March 2021.
- EU monthly renewals fall by 3% from April 2020 to March 2021.
- Client stores begin to reopen from July onwards.
- A recession will occur after client stores reopen. This will reduce the sales of new appliances and both DGI and DGIEU will see higher cancellations on existing policies.
- Although both DGI and DGIEU are currently seeing lower claims volumes than usual, these claims will return when social distancing measures are eased.
- Best Estimate Lapse rates have been increased by 1% for UK and 3% for EU (this applies to both DGI UK business and DGI EU business).
- Furloughing of outbound staff benefit has been included in the model.
- As D&G Group is projected to make a profit in this year, the losses will allow for a tax relief.

Reverse stress tests

DGI and DGIEU have performed two Reverse Stress Tests which use the same set of assumptions, but with and without the Part VII. The Reverse Stress Test without the Part VII assumes two additional capital injections of €10m in each of FY22 and FY24. These are the same capital injections that are assumed in the without Part VII base projections.

The Reverse Stress Tests use the following common assumptions:

- DGI UK pays a £10m dividend on 31 March 2020.
- New business for DGI and DGIEU reduces by 68% and 100% respectively.
- Renewals cancellations for both entities increase by 50%.
- Lapse rate has increased to account for the increase in cancellation rate.
- No savings from internal acquisition costs.
- Claims reduce as risk exposure decreases.
- Commission related to sales reduce in line with contractual terms.
- Savings will be made from contact centre staff dealing with fewer claims and calls.
- Loss in sales feed into renewals offered in following years.
- Remaining claim costs and expenses increase by 10% and 15% for FY21 respectively.
- DGI will receive a fine of £9.3m for a GDPR Data Breach.
- A 10% increase in claims reported for the 2021 financial year.
- Cash and investments increase by £30m (due to use of a Letter of Credit), with an offsetting intercompany liability.

Appendix 2 – SCR scenario analysis

For each scenario, I have considered the projected SCR coverage ratio for the period to 31 March 2025 and assessed whether each of DGI and DGIEU:

- Is expected to remain well capitalised during the projected period – ie, a SCR coverage ratio of 150% or higher.
- Is expected to meet its risk appetite – ie, a SCR coverage ratio of 130% or higher.
- Is expected to remain solvent under Solvency II – ie, an SCR coverage ratio of 100% or higher.

In each case, these assessments are done across the projection period. For example, if the SCR coverage ratio for one of the insurers falls below 130% at any point during the projection, then this insurer would be deemed as not meeting its risk appetite. The assessments for each scenario are set out below:

DGI

Scenario:	Remains well capitalised?		Remains within risk appetite?		Remains solvent?	
	Without transfer	With transfer	Without transfer	With transfer	Without transfer	With transfer
A. 10% higher claims	Yes	Yes	Yes	Yes	Yes	Yes
B. 10% increase in expenses	Yes	Yes	Yes	Yes	Yes	Yes
C. 20% less new business	Yes	Yes	Yes	Yes	Yes	Yes
D. More adverse COVID-19	Yes	Yes	Yes	Yes	Yes	Yes
E. Worsening combined ratio	Yes	Yes	Yes	Yes	Yes	Yes
F. 10% more renewal cancellations	Yes	Yes	Yes	Yes	Yes	Yes
G. Invested assets devalued by 10%	Yes	Yes	Yes	Yes	Yes	Yes
H. Credit downgrade for DGI	Yes	Yes	Yes	Yes	Yes	Yes
I. Insolvency of key client	Yes	Yes	Yes	Yes	Yes	Yes
J. Combined underwriting stress	No	No	Yes	No	Yes	Yes
K. Data breach	Yes	Yes	Yes	Yes	Yes	Yes
L. Non-equivalence of solvency regimes	Yes	Yes	Yes	Yes	Yes	Yes
M. Reverse Stress Test	No (by design)					

DGIEU (with USPs from 31 March 2021)

Scenario:	Remains well capitalised?		Remains within risk appetite?		Remains solvent?	
	Without transfer	With transfer	Without transfer	With transfer	Without transfer	With transfer
A. 10% higher claims	Yes	Yes	Yes	Yes	Yes	Yes
B. 10% increase in expenses	Yes	Yes	Yes	Yes	Yes	Yes
C. 20% less new business	Yes	Yes	Yes	Yes	Yes	Yes
D. More adverse COVID-19	Yes	Yes	Yes	Yes	Yes	Yes
E. Worsening combined ratio	Yes	Yes	Yes	Yes	Yes	Yes
F. 10% more renewal cancellations	Yes	Yes	Yes	Yes	Yes	Yes
G. Invested assets devalued by 10%	Yes	Yes	Yes	Yes	Yes	Yes
H. Credit downgrade for DGI	Yes	Yes	Yes	Yes	Yes	Yes
I. Insolvency of key client	Yes	Yes	Yes	Yes	Yes	Yes
J. Combined underwriting stress	Yes	Yes	Yes	Yes	Yes	Yes
K. Data breach	Yes	Yes	Yes	Yes	Yes	Yes
L. Non-equivalence of solvency regimes	No	No	Yes	No	Yes	Yes
M. Reverse Stress Test	No (by design)					

DGIEU (without USPs)

Scenario:	Remains well capitalised?		Remains within risk appetite?		Remains solvent?	
	Without transfer	With transfer	Without transfer	With transfer	Without transfer	With transfer
A. 10% higher claims	Yes	Yes	Yes	Yes	Yes	Yes
B. 10% increase in expenses	Yes	Yes	Yes	Yes	Yes	Yes
C. 20% less new business	Yes	Yes	Yes	Yes	Yes	Yes
D. More adverse COVID-19	Yes	Yes	Yes	Yes	Yes	Yes
E. Worsening combined ratio	Yes	Yes	Yes	Yes	Yes	Yes
F. 10% more renewal cancellations	Yes	Yes	Yes	Yes	Yes	Yes
G. Invested assets devalued by 10%	Yes	Yes	Yes	Yes	Yes	Yes
H. Credit downgrade for DGI	Yes	Yes	Yes	Yes	Yes	Yes
I. Insolvency of key client	Yes	Yes	Yes	Yes	Yes	Yes
J. Combined underwriting stress	No	Yes	Yes	Yes	Yes	Yes
K. Data breach	Yes	Yes	Yes	Yes	Yes	Yes
L. Non-equivalence of solvency regimes	No	No	Yes	No	Yes	Yes
M. Reverse Stress Test	No (by design)					

Appendix 3 – Glossary

Legal, regulatory and Part VII transfer terminology

Term	Definition
Effective Date	The effective date of the Proposed Transfer, expected to be 31 December 2020.
Financial Conduct Authority (FCA)	The UK regulatory agency that focuses on the regulation of conduct by retail and wholesale financial services firms. The FCA operates as part of the regulatory framework implemented under the Financial Services Act 2012.
Financial Ombudsman Service (FOS)	Set up by the UK Parliament, the FOS is the UK’s official expert in sorting out problems with financial services. Parliament set up the FOS and has legal powers in the UK to address unresolved complaints between a business and a customer relating to financial services.
Financial Reporting Council (FRC)	The body responsible for setting actuarial standards in the UK. The FRC also regulates auditors and accountants and sets the UK’s Corporate Governance and Stewardship Codes.
Freedom of Establishment (FofE)	Under the EU Insurance Directives and Insurance Mediation Directive, insurance companies have the right to provide business services through a permanent presence within the EEA under the principle of FofE utilising the “passporting” system in place between EEA regulators.
Freedom of Services (FofS)	Under the EU Insurance Directives, insurance companies have the right to provide business services on a cross-border basis within the EEA under the principle of FofS utilising the “passporting” system in place between EEA regulators.
Financial Services Compensation Scheme (FSCS)	The FSCS is the compensation fund of last resort for customers of UK authorised financial services firms. This covers insurance for individuals and some insurance for small businesses.
Financial Services and Markets Act 2000 (FSMA)	The legislation under which Part VII governs the transfer of (re)insurance business between (re)insurance undertakings.
Generally accepted accounting principles (GAAP)	A collection of commonly-followed accounting rules and standards for financial reporting. GAAP specifications include definitions of concepts and principles, as well as industry-specific rules.
High Court	The High Court of Justice of England and Wales.
Prudential Regulation Authority (PRA)	The part of the Bank of England that carries out the prudential regulation of financial firms in the UK, including banks, investment banks, building societies and insurance companies. The PRA operates as part of the regulatory framework implemented under the Financial Services Act 2012.
PRA’s Statement of Policy	The Statement of Policy issued by the PRA entitled “Statement of Policy – The PRA’s approach to insurance business transfers – April 2015”
Proposed Transfer	The proposed insurance business transfer of DGI to DGIEU under Section 105 of the FSMA.
Scheme Document	A document submitted to the High Court setting out details of the Scheme or Proposed Transfer.
Scheme Report	This report prepared by me, as the Independent Expert, for submission to the High Court.
Solvency Financial Condition Report (SFCR)	Solvency II requires each insurer to publish an SFCR annually that contains certain qualitative and quantitative information.
Solvency II	The system for establishing (among other things) minimum capital requirements for EEA insurers under the Solvency II Directive 2009/138/EC.
TAS 100	The FRC issued Technical Actuarial Standard 100: Principles for Technical Actuarial Work (TAS 100) which applies to all actuarial work produced after 1 July 2017.

Term	Definition
TAS 200	The FRC issued Technical Actuarial Standard 200: Insurance (TAS 200) which applies to all actuarial work produced after 1 July 2017.
Transferee	The insurer to which the business is being transferred, Domestic & General Insurance Europe AG (DGIEU).
Transferor	The insurer from which the business is being transferred, Domestic & General Insurance PLC (DGI).
Transferring Policyholders	DGI policyholders who will have their policies transferred to DGIEU by the Proposed Transfer. After the Proposed Transfer takes place, DGIEU will service these policies instead of DGI.
Non-transferring Policyholders	DGI policyholders who will not have their policies transferred to DGIEU by the Proposed Transfer.
Existing DGIEU Policyholders	DGIEU policyholders who will not have their policies transferred by the Proposed Transfer. These policies were or will be written before the Effective Date of the Proposed Transfer.

Reserving terminology

Term	Definition
Best estimate	An estimate prepared with no margin for either prudence or optimism included.
Bornhuetter-Ferguson (BF) method	A blend of development factor modelling and the Expected Loss Ratio Method (defined later in this glossary). The weighting given to each is dependent on how developed the claims are for a policy year.
Cede	When a company reinsures its liability with another. The insurance company that purchases reinsurance is the "ceding company" that "cedes" business to the reinsurer.
Development factor modelling	An actuarial method for estimating future payments or numbers by using the historical pattern of past payments or numbers to estimate a development profile, which can be used to extrapolate future payments or numbers.
Events not in data (ENIDs)	An estimate of possible future events or developments that are not in existing data. Insurers need to make allowance for ENIDs in their Solvency II technical provisions.
Expected Loss Ratio method	An actuarial method for estimating future payments or numbers based on combining an exposure measure and an assumed rate per unit of exposure (the "initial expected loss ratio") for the written business.
Incurred but not enough reported (IBNER)	See definition of IBNR.
Incurred but not reported (IBNR)	The provision for claims that are reported in the future but relate to events that have already occurred. This includes provision for estimated developments to existing open claims, ie those that have been reported but not fully settled. The provision for these open claims is called IBNER (Incurred But Not Enough Reported). Depending on the type of insurance being considered and the claims handling approach, both the IBNR and IBNER can be either positive or negative.
Quota share reinsurance	A reinsurance contract in which the insurer and reinsurer share both claims and premiums in the same proportion. The reinsurer usually pays a commission to the insurer to allow for their costs of selling and administering the policy.
Reinsurance	An arrangement with another insurer to share or pass on risks. For example, in the case of the Proposed Transfer, DGIEU is transferring underwriting (insurance) risk to DGI using a reinsurance quota share arrangement.
Reinsurance bad debt	Reinsurance bad debt is a provision for amounts that are owed by reinsurers but which may not be paid, eg due to the insolvency of the reinsurer.

Term	Definition
Technical provisions	Under Solvency II, the technical provisions cover the ultimate costs of settling all claims arising from events occurring up to the balance sheet date plus the provisions for future claims (and premiums) arising on unexpired periods of risk.
Unallocated Loss Adjustment Expenses (ULAE)	Unallocated Loss Adjustment Expenses are expenses relating to the handling of claims that are not allocated to specific claims, eg claim handlers' salaries and office space.
Unearned Premium Reserve (UPR)	A provision for the unexpired portion of insurance policies. This appears as a liability on the insurer's balance sheet, since the premium would be paid back upon cancellation of the policy.

Capital setting terminology

Term	Definition
Counterparty default risk	The risk of defaults or downgrades by counterparties that either owe an insurer money or hold money on its behalf. For example, this covers the risk of the failure of a reinsurer or a broker.
Market risk	The risk of changes in an insurer's financial position due to changes in the market value of assets, liabilities and financial instruments. For example, this covers the risk of falls in the value of assets that are being held to make future claims payments.
Minimum Capital Requirement (MCR)	A formulaic calculation of the capital requirement as part of the existing European Solvency II regulations for insurers. Breaching the MCR defines the point of intensive regulatory intervention. The calibration of the MCR is to be the capital required to give an 85% confidence level of sufficient capital to last one year. The MCR is a simpler calculation than the SCR and is typically a less onerous requirement.
MCR coverage ratio	The MCR coverage ratio is the ratio of Available Capital to Required Capital (MCR). This is a measure of the capital strength of the insurer – the higher the ratio, the stronger the insurer.
Operational risk	The risk of losses caused by failures in an insurer's operational processes, people and systems, or from events that are external to the insurer. For example, this would cover the risk of fraud or IT failure.
Own funds	The capital in excess of provisions available to meet the SCR capital requirements under Solvency II.
Required capital	The amount of capital an insurer must hold in order to meet its regulatory capital requirements (ie the SCR).
Solvency Capital Requirement (SCR)	The amount of capital insurers are required to hold under Solvency II regulations. This is an estimate of the capital required to cover the loss that an insurer could experience over the next 12 months with a probability of 99.5% (ie, a 1 in 200 event). If an insurer's capital (ie the excess of its assets over its liabilities) falls below the SCR, it will trigger regulatory intervention, with the intention of remedying that position.
SCR coverage ratio	The SCR coverage ratio is the ratio of available capital to required capital (SCR). This is a measure of the capital strength of the insurer – the higher the ratio, the stronger the insurer.
Standard formula	A prescribed approach under Solvency II for the calculation of capital based on an insurer's financial information (eg premiums and claims provisions).
Tier 1 capital	Under Solvency II, capital is categorised into 3 tiers based on the permanence and loss absorbency of the form of capital. Tier 1 capital is the highest quality.
Underwriting risk	The risk that the value of insurance claims proves to be higher than expected.

Other terminology

Term	Definition
Clients	The firms who act as intermediaries in selling DGI and DGIEU products.
Direct policyholders	Any policyholders that are not insurers or reinsurers.
European Economic Area (EEA)	<p>The EEA Agreement established the EEA on 1 January 1994. The EEA unites the 28 EU member states with Iceland, Liechtenstein, and Norway into an internal market governed by the same basic rules. These rules aim to enable goods, services, capital, and persons to move freely about the EEA in an open and competitive environment, a concept referred to as the four freedoms.</p> <p>With effect from 31 January 2020, the UK ceased to be a part of the EEA following its withdrawal from the EU. However, for added clarity, I have referred to “non-UK EEA” in this report.</p>
European Union (EU)	The EU prior to Brexit, ie the 28 member states. After the Brexit transition period the EU will consist of 27 member states ie excluding the UK.

Appendix 4 – Extract from Terms of Reference

Summary of agreed scope of work

I, Tom Durkin will act as IE to support your planned Part VII transfer of Domestic & General Insurance PLC (DGI) business into Domestic & General Insurance Europe AG (DGIEU).

Your primary requirement is for the IE to act in line with Section 109 of the Financial Services Markets Act 2000.

The key deliverables from the work will be:

- The main and supplementary IE reports;
- Input as required to address any issues arising;
- Presenting my findings as IE to the High Court and responding to any queries and additional court requests; and
- A summary report to support policyholder communications.

Appendix 5 – CV of Tom Durkin FIA

Head of Insurance Consulting at LCP. Fellow of the Institute and Faculty of Actuaries (qualified 2006). Holder of Chief Actuary (non-Life with Lloyd's) practising certificate. Currently appointed Chief Actuary (SMF 20) for a number of insurers on an outsourced basis.

Part VII and Section 13 transfers

- Peer reviewer for three Part VII / Section 13 transfers in recent years.
- Supported the Independent Expert / Independent Actuary on a further two recent Part VII / Section 13 transfers.
- Leading LCP team researching trends in Part VII transfers in response to Brexit, including regular industry presentations during 2019.

Reserving and Solvency II technical provisions

- Assessed or peer reviewed reserve requirements for insurers with combined reserves of over £25,000m.
- Developed reserving governance processes, including establishing new reserving committees and/or reserving approaches for a range of insurers.
- Reviewed appropriateness of Solvency II technical provisions for a range of insurers, including as Chief Actuary.

Capital modelling and validation

- Significant experience of building, parameterising or reviewing capital models, including in relation to Part VII / Section 13 transfers.
- Designed and implemented internal model validation frameworks for a large number of insurers.
- Assessed all major risk categories, including underwriting, reserve, credit, market, pension, operational and liquidity risks.

Underwriting, reinsurance and risk

- Provided actuarial opinions and recommendations on underwriting approaches and reinsurance arrangements.
- Developed management information and analytics dashboards for a new personal lines insurer, including for board-level reporting, underwriting and risk management.
- Supported risk committees as Chief Actuary, including developing stress and scenario testing.

Appendix 6 – Summary of data provided

The following is a list of the key data items I have requested and received in assessing the Proposed Transfer. All data I have requested has been provided to me. Each of DGI and DGIEU has provided a Data Accuracy Statement confirming that the data and information provided to me regarding the Proposed Transfer are accurate and complete.

- Draft High Court and regulatory documents prepared by DGI for the Proposed Transfer, including:
 - Scheme Document (dated 24 July 2020)
 - DGI First Witness Statement (dated 20 August 2020)
 - DGIEU First Witness Statement (dated 20 August 2020)
 - Directions Order (dated 19 June 2020)
- Draft proposed communication plan and communications prepared by DGI:
 - Proposals for notices, communications and waivers (dated 31 March 2020)
 - Template letter to policyholders (dated 22 July 2020)
 - In-store notice (dated 22 July 2020)
 - Policyholder FAQs (dated 22 July 2020)
 - Newspaper and Gazette notice (dated 19 June 2020)
- Documentation and data relating to provisions and reserving processes, including:
 - DGI and DGIEU summary of IBNR provisions as at 31 March 2020
 - DGI and DGIEU IBNR triangles as at 31 March 2020
 - DGI Actuarial Function Report on Technical Provisions 2019
 - DGI and DGIEU Technical Provisions as at 31 March 2020
 - Documentation of expert judgement used to determine earnings profiles and IBNR provisions
 - DGI's EIROS pool claims reserves
 - DGI's Board presentation for year ending 31 March 2019
- Documents relating to capital and related processes, including:
 - Solvency and Financial Condition Report (SFCR) for DGI year ending 31 March 2019
 - DGI 2019 Own Risk and Solvency Assessment (ORSA) report
 - DGI and DGIEU Capital Management Policy 2020
 - DGI and DGIEU standard formula SCR calculations
 - Various additional stress scenarios for DGI and DGIEU
- Other evidence prepared by DGI and DGIEU to support the Proposed Transfer, including:
 - Projections of future balance sheets and capital requirements up to 31 March 2025 for DGI and DGIEU
 - Internal document on access to FSCS and FOS for Transferring Policyholders
- Data Accuracy Statement
 - For each of DGI and DGIEU

Appendix 7 – Mapping to requirements

The table below shows the relevant section references in the Scheme Report where I have addressed each point in the guidance from Chapter 18 of the Supervision Manual of the FCA Handbook and the PRA’s “Statement of Policy – The PRA’s approach to insurance business transfers – April 2015” with regards to the Scheme Report.

The guidance references for “PRA x.x” are taken from the PRA Statement of Policy and “FCA x.x” are taken from Chapter 18 of the Supervision Manual.

Guidance reference	Guidance	Scheme report reference
PRA 2.30 (1) FCA 18.2.33 (1)	Who appointed the independent expert and who is bearing the costs of that appointment	2.4 (page 10)
PRA 2.30 (2) FCA 18.2.33 (2)	Confirmation that the independent expert has been approved or nominated by the appropriate regulator (the PRA)	2.4 (page 10)
PRA 2.30 (3) FCA 18.2.33 (3)	A statement of the independent expert’s professional qualifications and (where appropriate) descriptions of the experience that makes them appropriate for the role	2.4 (page 10) Appendix 5
PRA 2.30 (4) FCA 18.2.33 (4)	Whether the independent expert, or his employer, has, or has had, direct or indirect interest in any of the parties which might be thought to influence his independence, and details of any such interest	2.4 (page 10)
PRA 2.30 (5) FCA 18.2.33 (5)	The scope of the report	2.5 (page 10)
PRA 2.30 (6) FCA 18.2.33 (6)	The purpose of the scheme	3.3 (page 18)
PRA 2.30 (7) FCA 18.2.33 (7)	A summary of the terms of the scheme in so far as they are relevant to the report	3 (page 13)
PRA 2.30 (8) FCA 18.2.33 (8)	What documents, reports and other material information the independent expert has considered in preparing the report and whether any information that they requested has not been provided	Appendix 6
PRA 2.30 (9) FCA 18.2.33 (9)	The extent to which the independent expert has relied on: (a) information provided by others; and (b) the judgement of others	2.7 (page 11)
PRA 2.30 (10) FCA 18.2.33 (10)	The people the independent expert has relied on and why, in their opinion, such reliance is reasonable.	2.7 (page 11)
PRA 2.30 (11) FCA 18.2.33 (11)	Their opinion of the likely effects of the scheme on policyholders (this term is defined to include persons with certain rights and contingent rights under the policies), distinguishing between: (a) Transferring Policyholders; (b) policyholders of the transferor whose contracts will not be transferred; and (c) policyholders of the transferee	1.3 (page 4) 10 (page 56)
PRA 2.30 (12) FCA 18.2.33 (11A)	Their opinion on the likely effects of the scheme on any reinsurer of a transferor, any of whose contracts of reinsurance are to be transferred by the scheme.	1.3 (page 4) 10 (page 56)

Guidance reference	Guidance	Scheme report reference
PRA 2.30 (13) FCA 18.2.33 (12)	What matters (if any) that the independent expert has not taken into account or evaluated in the report that might, in their opinion, be relevant to policyholders' consideration of the scheme.	10 (page 56)
PRA 2.30 (14) FCA 18.2.33 (13)	For each opinion that the independent expert expresses in the report, an outline of their reasons	Reserving: 5.9 (page 28) Capital: 6.11 (page 41) Policyholder security: 7.8 (page 49) Policyholder communications: 8.7 (page 53) Customer service and other considerations: 9.7 (page 55)
PRA 2.32 (1) FCA 18.2.35 (1)	A description of any reinsurance arrangements that it is proposed should pass to the transferee under the scheme	N/a – No transferring reinsurance
PRA 2.32 (2) FCA 18.2.35 (2)	A description of any guarantees or additional reinsurance that will cover the transferred business or the business of the transferor that will not be transferred	3.2 (page 15)
PRA 2.33 (1) FCA 18.2.36 (1)	Include a comparison of the likely effects if it is or is not implemented	3.4 (page 18)
PRA 2.33 (2) FCA 18.2.36 (2)	State whether they considered alternative arrangements and, if so, what	3.4 (page 18)
PRA 2.33 (3) FCA 18.2.36 (3)	Where different groups of policyholders are likely to be affected differently by the scheme, include comment on those differences they consider may be material to the policyholders	1.3 (page 4)
PRA 2.33 (4) FCA 18.2.36 (4)	Include their views on: (a) the effect of the scheme on the security of policyholders' contractual rights, including the likelihood and potential effects of the insolvency of the insurer; (b) the likely effects of the scheme on matters such as investment management, new business strategy, administration, claims handling, expense levels and valuation bases in relation to how they may affect: (i) the security of policyholders' contractual rights; (ii) levels of service provided to policyholders; or (iii) for long-term insurance business, the reasonable expectations of policyholders; and (c) the cost and tax effects of the scheme, in relation to how they may affect the security of policyholders' contractual rights, or for long-term insurance business, their reasonable expectations	(a) 1.3 (page 4) (b) and (c) 9 (page 54)

The Proposed Transfer does not involve any mutual companies or long-term insurance business. As such, PRA 2.35 and PRA 2.36 (FCA 18.2.38 and FCA 18.2.39) do not apply.

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