Scheme Report of the Independent Expert on the Proposed Insurance Business Transfer Scheme from:

1. AIG Europe Limited to American International Group UK Limited

and

2. AIG Europe Limited to AIG Europe S.A.

under Part VII of the Financial Services and Markets Act 2000

26 February 2018

Prepared by Steve Mathews, Independent Expert

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Section 1: Executive Summary

Introduction

1.1 When a scheme for transferring insurance business from one company to another is put to the High Court of Justice in England and Wales ("High Court") for approval it has to be accompanied by a report on the terms of the scheme from an independent expert ("the Independent Expert"). The Independent Expert's Scheme Report ("Scheme Report") is a requirement under Part VII of the Financial Services and Markets Act 2000 ("FSMA").

1.2 In addition to this Executive Summary I have also produced a separate summary of this Scheme Report ("Summary"). This Scheme Report contains detailed information that is not shown in either this Executive Summary or the Summary. In particular, this Scheme Report contains the following sections:

- Section 2 sets out the details of the Proposed Scheme, my statement of independence and the terms of reference of my work;
- Section 3 sets out the scope of my work;
- Section 4 sets out the methodology I have followed;
- Section 5 provides background to the Proposed Scheme and the companies involved;
- Sections 6 to 9 contain details of the review I have performed;
- Section 10 sets out the detail of my findings;
- Section 11 contains my conclusions and Statement of Truth; and
- The Appendices contain a glossary of terms, my credentials and details of the information I have used in forming my conclusions.

1.3 The Scheme Report and the Summary have been prepared on the instruction of AIG Europe Limited ("AEL") for the benefit of the High Court solely for the purposes of the FSMA requirements for Part VII transfers. I owe a duty to the High Court to help the High Court on matters within my expertise. This duty overrides any obligation to any person from whom I have received instructions or by whom I am paid.

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

1.5 This Scheme Report and the Summary have been prepared for the benefit of the High Court and may be relied on by the High Court. Neither the Independent Expert nor Willis Towers Watson accepts any responsibility or liability to any third party in relation to the Scheme Report or the Summary. Any reliance placed by such third parties on the Scheme Report or the Summary is entirely at their own risk.

About the Independent Expert

1.6 I, Steve Mathews, am a Fellow of the Institute and Faculty of Actuaries, having qualified in 1999. I am a Senior Director in the firm of Towers Watson Limited of Watson House, London

Road, Reigate, RH2 9PQ ("Willis Towers Watson" or "WTW"). I have experience of the types of business written by AEL.

1.7 I consider that I have no conflict of interest or involvement, current or historical, with AEL or other AIG Group companies which would affect my suitability to act as the Independent Expert for the Proposed Scheme (as defined in paragraph 1.11).

1.8 Willis Towers Watson, globally, has relationships with AIG Group companies; however, I do not consider that the nature and size of these involvements impact on my ability to act as Independent Expert for the Proposed Scheme. I have provided details of these relationships directly to the Prudential Regulation Authority ("PRA") and the Financial Conduct Authority ("FCA").

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

1.10 A more detailed statement of independence in included from paragraph 2.10 of this Scheme Report, and my curriculum vitae is enclosed at Appendix B.

The Proposed Scheme

1.11 The proposed scheme ("Proposed Scheme") involves the Part VII transfers of the entire business of AEL to:

- American International Group UK Limited ("AIG UK") which will receive:
  - that part of insurance policies relating to UK risk issued by or on behalf of AEL, other than where such insurance policy has been issued by AEL through or on behalf of any of its branches in the European Economic Area ("EEA") or Switzerland;
  - that part of insurance policies relating to non-EEA risk issued by or on behalf of AEL, other than where such insurance policy has been issued by AEL through or on behalf of any of its branches in the EEA or Switzerland; and
  - reinsurance policies issued by or on behalf of AEL, other than where such reinsurance policy has been issued by AEL through or on behalf of any of its branches in the EEA or Switzerland.
- AIG Europe SA ("AESA"), which will have branches in the EEA and Switzerland and will receive that part of any (re)insurance policies issued by AEL and not transferred to AIG UK. Further details on the Proposed Scheme are set out at the beginning of Section 5 of this Scheme Report.

1.12 It is intended that the Effective Date of the transaction will be 1 December 2018.

The Companies

1.13 AEL, AIG UK and AESA are indirectly wholly owned subsidiaries of American International Group, Inc. ("AIG"). The collection of AIG member companies is referred to in this Scheme Report as the AIG Group ("AIG Group").

1.14 AEL and AIG UK are both incorporated in the UK, authorised by the Prudential Regulation Authority ("PRA") and regulated by the PRA and the Financial Conduct Authority ("FCA").

AESA is domiciled in Luxembourg and authorised by the Minister of Finance and subject to the supervision of the Commissariat aux Assurances ("CAA").

Findings of the Independent Expert

1.15 I have considered the Proposed Scheme and its likely effects on the following groups of policyholders:

- Policyholders of AEL, that part of whose insurance policies are transferring to AIG UK ("UK Transferring Policyholders"); and

- Policyholders of AEL, that part of whose insurance policies are transferring to AESA ("European Transferring Policyholders").

1.16 A decision tree, produced by AIG, to determine if a policy will result in the policyholder being considered a UK Transferring Policyholder, European Transferring Policyholder or both is shown in Chart 3.1 on page 13 of this Scheme Report.

1.17 I have considered the likely effects of the Proposed Scheme on the UK Transferring Policyholders and the European Transferring Policyholders. In each case, I have considered the likely effects of the Proposed Scheme on the security of transferring policyholders' contractual rights. I have also considered the likely effects of the Proposed Scheme on other factors which may impact the security or service levels of affected policyholders, including the effect of the change in the regulatory regime for European Transferring Policyholders.

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

1.19 The opinions I have reached based on the methodology set out in Section 4 of this Scheme Report, and the review I have performed as set out in Sections 6 to 9 of this Scheme Report, are as follows.

Security of policyholders transferring from AEL to AIG UK

1.20 It is my opinion that the UK Transferring Policyholders, both the direct and reinsurance policyholders, will not be materially adversely affected by the Proposed Scheme.

1.21 UK Transferring Policyholders currently have policies with AEL, a company whose level of financial resources exceeds the regulatory capital requirements. Further, AEL meets its target financial resources, which is an enhancement over the regulatory capital requirements.

1.22 After the Proposed Scheme, UK Transferring Policyholders will have policies with AIG UK, a company whose level of financial resources is projected to exceed the regulatory capital requirements. Further, AIG UK is projected to meet its target financial resources, which is an enhancement over the regulatory capital requirements.

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

Security of policyholders transferring from AEL to AESA

1.24 It is my opinion that the European Transferring Policyholders, both the direct and reinsurance policyholders, will not be materially adversely affected by the Proposed Scheme.

1.25 European Transferring Policyholders currently have policies with AEL, a company whose level of financial resources exceeds the regulatory capital requirements. Further, AEL meets its target financial resources, which is an enhancement over the regulatory capital requirements.

1.26 After the Proposed Scheme, European Transferring Policyholders will have policies with AESA, a company whose level of financial resources is projected to exceed the regulatory capital requirements. Further, AESA is projected to meet its target financial resources which is an enhancement over the regulatory capital requirements.

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

1.28 In reaching this conclusion I note that some European Transferring Policyholders currently have the benefit of the Financial Services Compensation Scheme ("FSCS") which may in certain cases provide compensation in the event of an insurer insolvency. Following the Proposed Scheme, those same European Transferring Policyholders with claims occurring before the transfer date (whether reported or unreported) will still have the benefit of FSCS protection under the FSCS's 'successor rules'. However, under assumptions set out in the footnotes to paragraph 10.48, European Transferring Policyholders with claims occurring after the transfer date will not have cover under the FSCS following the Proposed Scheme in respect of such claims and may not be eligible for any other insurance compensation scheme. I have considered this in my Scheme Report (starting at paragraph 10.43) and, despite this, consider that European Transferring Policyholders will not be materially adversely affected by the Proposed Scheme.

Other considerations

1.29 I consider that the Proposed Scheme will have no significant effect on the UK Transferring Policyholders and the European Transferring Policyholders in respect of matters such as investment management, new business strategy, management, administration, claims handling, governance arrangements, expense levels and valuation bases in relation to how they may affect the security of policyholders' contractual rights and levels of service provided to policyholders.

1.30 In reaching this conclusion I note that a very small proportion of European Transferring Policyholders whose policies have been written by AEL from an establishment in the UK into other EEA States currently have the right to address complaints to The Financial Ombudsman Service ("TFOS"). Following the Proposed Scheme these European Transferring Policyholders will not have access to TFOS in respect of complaints relating to acts or omissions occurring post transfer carried out from outside of the UK. Such disputes in relation to such complaints will, however, be able to be heard by the Luxembourg ombudsman services or remain with dispute resolution services in the country in which the risk is located. I have considered this in my Scheme Report (starting at paragraph 10.109) and, despite this, consider that European Transferring Policyholders will not be materially adversely affected by the Proposed Scheme.

1.31 I also consider that matters such as the tax and cost effects of the Proposed Scheme will have no significant effect on the security of policyholders' contractual rights. These aspects are considered in paragraphs 10.107 and 10.108 of this Scheme Report respectively.

1.32 I am satisfied that the proposed material to be presented to policyholders is appropriate and AEL's approach to communication with policyholders, including the exceptions to the standard communications approach, are appropriate, reasonable and proportionate. Details of my review and consideration with regards to policyholder communication are set out from paragraph 10.165 of this Scheme Report.

1.33 The external reinsurance of AIG UK and AESA will cover the same liabilities as under AEL and the claims teams will maintain the same level and quality of service both before and after the Proposed Scheme. As such, I consider the transfer will have no material effect on the external reinsurers of AEL.

1.34 The Scheme Report is based on financial information in respect of AEL as at 30 November 2016 and financial projections based on actual management accounts as at 28 February 2017.

1.35 The Scheme Report does not take into account any developments after the dates noted above unless stated explicitly to the contrary in the Scheme Report.

1.36 I will provide a supplementary Scheme Report to the High Court based on updated financial information and identifying any material issues that have arisen between the dates noted in paragraph 1.34 and the final High Court hearing.

Additional questions

Why is this restructuring necessary?

1.37 In June 2016, the UK voted to leave the European Union ("EU") ("Brexit"). The UK Government began the formal process for negotiating the terms of the UK's exit in March 2017 by triggering Article 50 of the Lisbon Treaty. The negotiation process is likely to take at least two years.

1.38 AIG operations in Europe are currently structured with AEL being domiciled in the UK with a network of branches in the EEA plus Switzerland. It is likely that this structure will not be viable post-Brexit.

1.39 In anticipation of the UK leaving the EU, AIG has made a decision to restructure its operations in Europe. From the existing AEL insurance business, AIG plans to create two separate sub-groups; one based in the UK containing AIG UK and one based in Luxembourg containing AESA.

What would be the impact on policyholders if there was no restructuring?

1.40 In the absence of the Proposed Scheme and in the event of the UK losing its passporting rights there would be material concerns over the ability of AEL to meet its regulatory capital requirements, settle claims in line with regulatory rules, service existing EEA based policyholders, and renew EEA based policies. This is considered in further detail from paragraph 5.75 of this Scheme Report.

Who will pay the claims of policyholders following the Proposed Scheme?

1.41 Following the Proposed Scheme, AIG UK will pay the claims of UK Transferring Policyholders and AESA will pay the claims of European Transferring Policyholders. Claims staff previously employed by AEL will continue to provide claims handling services on behalf of AIG UK and AESA following the Proposed Scheme.

Will the Proposed Scheme affect the outwards reinsurance arrangements of AEL?

1.42 AEL will request the High Court to make an ancillary order to allow both AIG UK and AESA to retain the benefit of outwards reinsurance to the extent it covers any part of any AEL insurance policies transferring under the Proposed Scheme. In the event that the High Court does not sanction this ancillary order this is not expected to impact my conclusions. This is discussed further in paragraphs 9.10 to 9.12 of this Scheme Report.

Section 2: Introduction

2.1 When a scheme for transferring insurance business from one company to another is put to the High Court for approval it has to be accompanied by a Scheme Report on the terms of the scheme from an Independent Expert. The Independent Expert's Scheme Report is a requirement under Part VII of the Financial Services and Markets Act 2000.

2.2 I, Steve Mathews, have been appointed by AEL to provide an Independent Expert Scheme Report for the proposed Part VII transfers of the entire business of AEL to:

- AIG UK, which will receive:
  - that part of insurance policies relating to UK risk issued by or on behalf of AEL, other than where such insurance policy has been issued by AEL through or on behalf of any of its branches in the European Economic Area ("EEA") or Switzerland;
  - that part of insurance policies relating to non-EEA risk issued by or on behalf of AEL, other than where such insurance policy has been issued by AEL through or on behalf of any of its branches in the EEA or Switzerland; and
  - reinsurance policies issued by or on behalf of AEL, other than where such reinsurance policy has been issued by AEL through or on behalf of any of its branches in the EEA or Switzerland.
- AESA, which will have branches in the EEA and Switzerland and will receive that part of any (re)insurance policies issued by AEL and not transferred to AIG UK, in each case using a Part VII transfer pursuant to the FSMA. The transfers from AEL to AIG UK and AESA are defined in this Scheme Report as the Proposed Scheme.

2.3 It is intended that the Effective Date of the transaction will be 1 December 2018.

2.4 AEL, AIG UK and AESA are indirectly wholly owned subsidiaries of AIG and are members of the AIG Group.

2.5 AEL and AIG UK are both incorporated in the UK, authorised by the PRA and regulated by the PRA and the FCA. AESA is domiciled in Luxembourg and authorised and regulated by the CAA.

2.6 My appointment as the Independent Expert in connection with the Proposed Scheme was approved by the PRA, in consultation with the FCA, on 28 June 2017. In connection with this appointment there is an engagement letter dated 28 June 2017 in place between Towers Watson Limited and AEL.

2.7 The costs and expenses relating to my appointment as the Independent Expert will be incurred by AEL.

2.8 In parallel to the Proposed Scheme, there will be a separate scheme in Jersey (the "Jersey Scheme") to transfer the insurance business carried on by AEL in or from within Jersey to AIG UK and to AESA. The policyholders whose policies comprise insurance business carried on in or from within Jersey are included within (i) UK Transferring Policyholders where such business relates to AEL's UK business and (ii) European Transferring Policyholders where such business relates to AEL's European business, and my considerations and conclusions in this report therefore apply equally to them and to the Jersey Scheme.

Structure of this Scheme Report

2.9 The structure of this Scheme Report is as follows:

- Section 3 sets out the scope of my work;
- Section 4 sets out the methodology I have followed;
- Section 5 provides background to the Proposed Scheme and the companies involved;
- Sections 6 to 9 contain details of the review I have performed;
- Section 10 sets out the detail of my findings;
- Section 11 contains my conclusions and Statement of Truth; and
- The Appendices contain a glossary of terms, my credentials and details of the information I have used in forming my conclusions.

Statement of independence

2.10 Neither I, nor any member of my immediate family, hold any shares, have any contracts of insurance or have any other financial interest in the legal entities involved in the Proposed Scheme or in other AIG Group companies.

2.11 I have not carried out any consulting work for the legal entities involved in the Proposed Scheme, or for other AIG Group companies in the last five years, and to the best of my recollection, ever.

2.12 Willis Towers Watson, globally, has relationships with the AIG Group companies; however, I do not consider that the nature and size of these involvements would impact on my ability to act as Independent Expert for the Proposed Scheme. I have provided details of these relationships directly to the PRA and FCA.

2.13 With effect from 5 January 2016, the Towers Watson group of companies merged with the Willis group of companies. I understand that the broking teams within legacy Willis have relationships with the AIG Group. However, the broking lines of business are being maintained as separate lines of business to the Insurance Consulting and Technology business segment (of which I am part) within Willis Towers Watson, and Willis Towers Watson is committed to maintaining confidentiality, objectivity and independence in the services it provides to its insurance clients. Towers Watson Limited remains a separate legal entity within Willis Towers Watson.

2.14 Save as disclosed above, I have no conflict of interest of any kind. I do not consider that any of the matters disclosed above affect my suitability to act as the Independent Expert for the Proposed Scheme.

Professional experience

2.15 I am a Fellow of the Institute and Faculty of Actuaries, having qualified in 1999. I am a Senior Director in the firm of Towers Watson Limited of Watson House, London Road, Reigate, RH2 9PQ ("Willis Towers Watson" or “WTW”). I have experience of the types of business written by AEL. My curriculum vitae is enclosed at Appendix B.

Terms of reference

2.16 The terms of reference for my review of the Proposed Scheme were agreed by AEL and have been seen by the PRA.

2.17 This Scheme Report is intended to aid the High Court's deliberations as to whether the Proposed Scheme should be approved. In reporting on the Proposed Scheme in accordance with Part VII of the FSMA, I owe a duty to the High Court to help the High Court on matters within my expertise. This duty overrides any obligation to any person from whom I have received instructions or by whom I am paid. I have complied, and continue to comply, with this duty.

2.18 In preparing this Scheme Report I have taken account of the following:

- Part 35 of the Civil Procedure Rules;
- The Practice Direction supplement to Part 35 of the Civil Procedure Rules;
- The protocol for the instruction of experts to give evidence in civil claims drafted by the Civil Justice Council; and
- The guidance in SUP18 of the FCA Handbook and the “PRA’s Statement of Policy: The PRA’s approach to insurance business transfers” which sets out guidance on the form of the Scheme Report. This Scheme Report also has regard to the FCA guidance consultation entitled “GC17/5: proposed guidance on the FCA’s approach to the review of Part VII insurance business transfers” which was issued on 15 May 2017.

Distribution

2.19 This Scheme Report has been prepared on the instruction of AEL for the benefit of the High Court solely for the purposes of the FSMA requirements for Part VII transfers. This Scheme Report may be:

- made available to the PRA, the FCA, the CAA, any other competent regulator, the High Court, policyholders and any other person entitled to receive a copy under law or regulation applicable to the Proposed Scheme;
- presented to the Royal Court of Jersey and the Jersey Financial Services Commission to satisfy the requirement for a report by an independent actuary on the terms of the Jersey Scheme; and
- relied upon by the High Court.

2.20 Neither the Independent Expert nor Willis Towers Watson accept any responsibility or liability to any third party in relation to this Scheme Report. Any reliance placed by such third parties on the Scheme Report is entirely at their own risk.

2.21 This Scheme Report has been prepared on an agreed basis for the purpose of reporting on the Proposed Scheme, and must not be relied upon for any other purpose. It must be considered in its entirety because individual sections, if considered in isolation, may be misleading. This Scheme Report is subject to the terms and limitations, including a limitation of liability, set out in my firm's engagement letter.

Reliances

2.22 In carrying out my review and producing this Scheme Report I have relied without independent verification upon the accuracy and completeness of the data and information provided to me, both in written and oral form. Where possible, I have reviewed the information provided for reasonableness and consistency with my knowledge of the insurance and reinsurance industry. I have also met with representatives of AEL to discuss in detail the information which they have provided to me in relation to the Proposed Scheme. I consider it is reasonable for me to rely on these individuals since they are PRA and FCA approved persons or are senior professionals employed by AEL. Reliance has been placed upon, but not limited to, the information detailed in Appendix C.

2.23 I have obtained confirmation from AEL that, to the best of their knowledge and belief:

- All of the items of data and information which have been provided to me by AEL for the purposes of this Scheme Report are accurate and complete.
- There are no significant errors or omissions in the descriptions in this Scheme Report of the business of AEL, AIG UK, AESA or of the Proposed Scheme.
- There are no other material items of data and information which have not been provided to me by AEL and which are likely to be relevant to this Scheme Report.

2.24 Based on my review, I am satisfied that the information detailed in Appendix C represents an appropriate basis for the conclusions set out in this Scheme Report and I consider that it is reasonable for me to rely on this information. There is no information which I requested from AEL which has not been provided to me.

2.25 I contacted the PRA and FCA at an early stage to establish whether there were matters or issues which they wanted me to consider in this Scheme Report. A draft of this Scheme Report has been made available to the PRA and FCA whose comments have been taken into account. The PRA (in consultation with the FCA) has approved the form of this Scheme Report.

2.26 When assessing the reasonableness of the reserves and the capital modelling I have relied upon benchmarks from wider market experience. Whilst AEL's own characteristics can be expected to vary from benchmarks based on individual circumstances, I consider that the use of benchmarks is reasonable. Benchmarks are revised periodically as new information and trends emerge, so, it is possible that these benchmarks will not be predictive of the future.

Limitations

2.27 No limitations have been imposed on the scope of my work and the opinions in this Scheme Report about the Proposed Scheme are mine, based on the information provided to me and the answers given to the questions I have raised. There are no matters that I have not taken into account or evaluated in this Scheme Report that might, in my opinion, be relevant to policyholders' consideration of the Proposed Scheme.

2.28 This Scheme Report is based on:

- financial information in respect of AEL as at 30 November 2016; and
- financial projections performed by AEL to 1 December 2018 and from financial year 2019 through to 2021 in respect of AIG UK and AESA, based on actual management accounts as at 28 February 2017.

2.29 This Scheme Report does not take into account any developments after the dates noted above unless stated explicitly to the contrary in this Scheme Report.

2.30 I expect to produce a supplementary Scheme Report in due course, based on the financial position of AEL as at 30 November 2017 and revised financial projections to 1 December 2018, which will take into account any significant developments between the dates noted in paragraph 2.28 above and the final High Court hearing.

2.31 In my judgment, the results and conclusions contained in this Scheme Report are reasonable given the information made available to me. However, the actual cost of settling future claims and those still outstanding as at the valuation date is uncertain as, amongst other things, it depends on events yet to occur such as future court judgments. It could be different from the estimates shown in this Scheme Report, and possibly materially so. Such differences between the estimated and actual outcome could possibly have a material impact upon the balance sheet strength of the companies, and therefore upon the Proposed Scheme.

2.32 This Scheme Report must not be construed as legal, investment or tax advice.

2.33 Figures in all tables in this Scheme Report are subject to possible rounding differences.

Legal jurisdiction

2.34 This Scheme Report is governed by and shall be construed in accordance with English law. Willis Towers Watson and AEL submit to the exclusive jurisdiction of the English courts in connection with all disputes and differences arising out of, under or in connection with this Scheme Report.

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Section 3: Scope

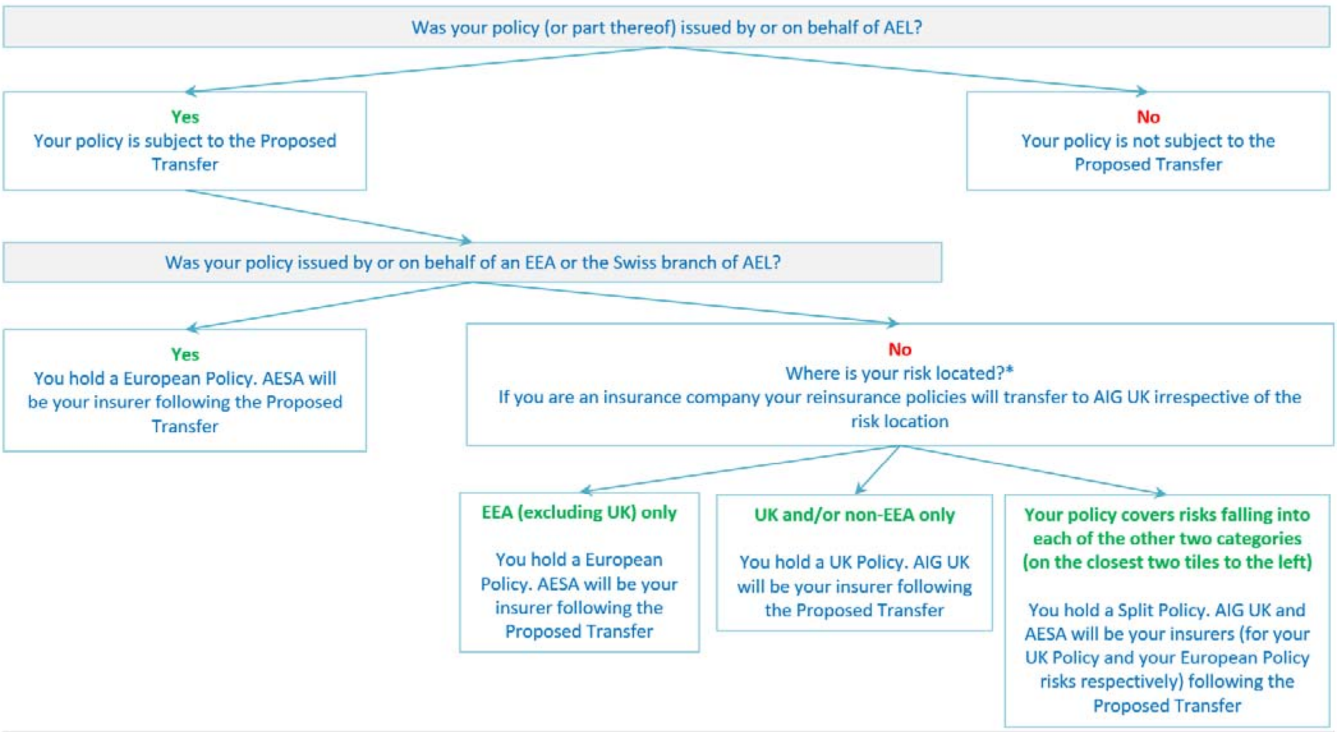
3.1 This Scheme Report considers the likely effects of the Proposed Scheme on the following groups of affected policyholders:

- Policyholders of AEL, that part of whose insurance policies are transferring to AIG UK (UK Transferring Policyholders); and
- Policyholders of AEL, that part of whose insurance policies are transferring to AESA (European Transferring Policyholders).

3.2 It is possible that a single policy may have elements which transfer to AIG UK and elements which transfer to AESA. Thus, a policyholder with a single AEL policy may be both a UK Transferring Policyholder and a European Transferring Policyholder.

3.3 A decision tree, produced by AIG, to determine if a policy will result in the policyholder being considered a UK Transferring Policyholder, European Transferring Policyholder or both is shown in Chart 3.1 below.

Chart 3.1 - UK and/or European Transferring Policyholder Decision Tree



KEY

* The location of your risk depends on a number of factors. The below is a general (but non-exhaustive) summary of these factors to help guide you:

1) If your insurance relates to **property** and its contents (so far as the contents are covered by the same policy), then your risk location is generally in the territory in which the property is situated (or is normally situated) at the date your policy was entered into.

2) If your insurance relates to **vehicles** (aircraft, ships and motor vehicles) the risk location may be determined by one or more of the following criteria: physical location of the vehicle, place of registration of the vehicle or location of residence or establishment of the insured.

3) If your insurance relates to **other** risks (ie it does not relate to property or vehicles), then: (a) where you are an individual, your risk location is generally in the territory in which you have your habitual residence at the date your policy was entered into; or (b) where you are a corporate entity, your risk location(s) is (are) at your place(s) of establishment at the date your policy was entered into. If you are a corporate entity and your policy covers more than one of your establishments which are in different territories, your policy is likely to have multiple risk locations.

3.4 For certain of my considerations (specifically the servicing of claims as discussed in paragraph 9.5 of this report and access to Ombudsman services as discussed from paragraph 10.109) I additionally consider the European Transferring Policyholders in two sub-groups of “Branch European Transferring Policyholders” and “FoS European Transferring Policyholders”, in each case as defined in Appendix A.

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

- the security of policyholders’ contractual rights, including the likelihood and potential effects of the insolvency of the insurer;
- matters such as investment management, new business strategy, management, administration, claims handling, governance arrangements, expense levels and valuation bases in relation to how they may affect the security of policyholders’ contractual rights and levels of service provided to policyholders; and
- matters such as cost and tax effects of the Proposed Scheme, in relation to how they may affect the security of policyholders’ contractual rights.

3.6 For each of the above areas I considered whether UK Transferring Policyholders and/or European Transferring Policyholders would be materially adversely affected under the Proposed Scheme. When considering the security of policyholders’ contractual rights I have considered an outcome to be materially adverse if it raises the likelihood of insurer failure above a 1:200 likelihood over a one-year time horizon (a 0.5th percentile level of risk). In some cases I have been able to use quantitative models to help me assess this likelihood. In other cases no quantitative models exist and I have relied on my judgment in forming this assessment. When considering the levels of service provided to policyholders I have compared the pre- and post- Proposed Scheme levels of service which can be expected and relied on my judgment in assessing whether a change in service levels can be considered to materially adversely affect policyholders, explaining the reasons for my opinion.

3.7 As AIG UK has been established for the purpose of receiving the UK Transferring Policyholders there will be no policyholders of AIG UK before the Proposed Scheme and hence I have not carried out any assessment on policyholders in AIG UK before the Proposed Scheme.

3.8 As AESA has been established for the purpose of receiving the European Transferring Policyholders there will be no policyholders of AESA before the Proposed Scheme and hence I have not carried out any assessment on policyholders in AESA before the Proposed Scheme.

3.9 As all the assets and liabilities of AEL will be transferred to either AIG UK or AESA, I understand that no policyholders will remain in AEL after the Proposed Scheme and hence I have not carried out any assessment on policyholders remaining in AEL after the Proposed Scheme.

3.10 This Scheme Report also considers the likely effect of the Proposed Scheme on reinsurers whose contracts of reinsurance are to be transferred by the Proposed Scheme.

3.11 This Scheme Report does not consider any possible alternative schemes.

3.12 This Scheme Report assesses the position of transferring policyholders pre and post the Proposed Scheme on the basis of existing legal and regulatory frameworks. It does not attempt to predict or take account of how these frameworks may change in the future.

3.13 This Scheme Report has been produced in English and has been translated into other languages by AEL. The foreign language versions of this Scheme Report have not been reviewed by me. In the event of conflicts between the versions, the English language version of this Scheme Report shall prevail.

3.14 This Scheme Report does not consider the likely effects on new policyholders, that is, those whose contracts are entered into after the Effective Date of the Proposed Scheme.

3.15 I have not considered future changes of ownership or any other transactions (such as mergers or acquisitions) which involve any of the entities involved in this Proposed Scheme beyond those set out in this Scheme Report. I am not aware at the time of writing this Scheme Report of any proposed ownership changes or transactions.

3.16 This review does not comprise an audit of the financial resources and liabilities of AEL, AIG UK, AESA or any other AIG Group companies.

3.17 I have not reviewed the systems and controls currently operated by AEL, AIG UK, AESA or any other AIG Group companies.

Professional guidance

3.18 I am required to comply with relevant technical actuarial standards ("TASs") issued or adopted by the Financial Reporting Council ("FRC") in the UK, and relevant actuarial practice standards ("APSs") issued by the Institute and Faculty of Actuaries ("IFoA") in the UK. This Scheme Report complies with all applicable TASs and APSs. In particular, this Scheme Report has been prepared in accordance with:

- TAS 100: Principles for Technical Actuarial Work, issued by the FRC;
- TAS 200: Insurance, issued by the FRC;
- The Actuaries' Code, issued by the IFoA;
- APS X2: Review of Actuarial Work and APS X3: The Actuary as an Expert in Legal Proceedings, both issued by the IFoA; and
- Paragraphs 2.27 to 2.40 of "The Prudential Regulation Authority's approach to insurance business transfers".

Peer review

3.19 The work which has been documented in this Scheme Report has been subject to an internal peer review by an appropriately qualified actuary who was not otherwise involved with the work on the Proposed Scheme.

Exchange rates

3.20 AEL's year-end 2016 (30 November 2016) exchange rates are £1 = USD 1.25 = EUR 1.18. In AEL's projections of financials to 1 December 2018 exchange rates as at 28 February 2017 of £1 = USD 1.24 = EUR 1.17 have been used.

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Section 4: Methodology

4.1 I have considered the likely effects of the Proposed Scheme on two distinct groups of affected policyholders:

- UK Transferring Policyholders; and
- European Transferring Policyholders.

4.2 For each group of policyholders I have considered the likely effects of the Proposed Scheme on:

- the security of policyholders' contractual rights, including the likelihood and potential effects of the insolvency of the insurer;
- matters such as investment management, new business strategy, management, administration, claims handling, governance arrangements, expense levels and valuation bases in relation to how they may affect the security of policyholders' contractual rights and levels of service provided to policyholders; and
- matters such as cost and tax effects of the Proposed Scheme, in relation to how they may affect the security of policyholders' contractual rights.

4.3 I have further considered the likely effects of the Proposed Scheme on both the direct and reinsurance policyholders within each of these groups.

4.4 In each case I have considered the security of the policyholders on two bases:

- The position should the Proposed Scheme proceed (the "Post Scheme Position"); and
- The position should the Proposed Scheme not proceed (the "No Scheme Position").

4.5 I have therefore made the following comparisons:

- UK Transferring Policyholders - The Post Scheme Position of AIG UK and the No Scheme Position of AEL; and
- European Transferring Policyholders - The Post Scheme Position of AESA and the No Scheme Position of AEL.

Financial positions of the firms

4.6 Security for policyholders is provided by assets backing the technical reserves and by net shareholder assets. In considering policyholder security, it is also necessary to take into account the potential variability of future experience (including investment returns, claims experience, expense levels and wider operational risks), and potential future distributions to, or capital injections from, shareholders. Other factors are the nature of the reinsurance arrangements and the financial security of reinsurance counterparties. Finally, security is affected by the nature and volume of future new business.

4.7 Insurers are subject to capital requirements imposed by their regulators. If the actual level of capital of the insurer comes close to or falls below the level of required capital then the regulator may intervene in or impose restrictions on the day-to-day running of the company. The level of actual available capital ("Own Funds") compared to regulatory required capital

("Solvency Capital Requirement" or "SCR") is another measure of the security provided to policyholders.

4.8 I have considered the Own Funds and SCR of AEL as at:

- 30 November 2016 – the latest set of audited accounts; and
- 30 November 2018 – the projected position immediately prior to the Proposed Scheme.

4.9 I have also considered the projected Own Funds and SCR of AIG UK and AESA as at 1 December 2018, immediately following the Proposed Scheme.

Assets and liabilities as at 30 November 2016

4.10 I have considered the valuation of AEL's assets and liabilities shown on the 30 November 2016 balance sheet. I consider the following are the key areas:

- **Claims reserves and reinsurance asset** – Claims reserves are an estimate of the amounts which will become payable by the firm in respect of policies which have been previously sold. The reinsurance asset is the corresponding recovery from reinsurers in respect of these claims. The claims reserves are often the largest liability on an insurer's balance sheet, and can be particularly uncertain.
- **Investments** – While most of AEL's investments are liquid and tradeable, approximately 3% are in respect of illiquid assets such as Residential Mortgage Backed Securities.

4.11 My findings are set out in Section 6.

Solvency II Balance Sheet and Capital Requirements as at 30 November 2016

4.12 The European Union ("EU") has developed insurance company solvency requirements known as "Solvency II" aimed at harmonising EU insurance regulation and enhancing consumer protection. The directive applies to all EU-domiciled insurance and reinsurance companies and was implemented on 1 January 2016 and therefore applies (or will apply[1]) to AEL, AIG UK and AESA.

4.13 A key metric for regulatory intervention under Solvency II is the SCR which is the amount of Own Funds required to ensure the insurer is able to meet its obligations over the next 12 months with a probability of adequacy of at least 99.5%.

4.14 Under Solvency II there are two possible ways to calculate the SCR: an Internal Model ("IM") or Standard Formula ("SF").

4.15 I have reviewed the modelling undertaken by AEL to assess the SCR as at 30 November 2016 and the available Own Funds.

4.16 My findings are set out in Section 7.

Projections to 30 November 2018

4.17 I have reviewed the assumptions underlying AEL's projected Own Funds and SCRs from 30 November 2016 to 30 November 2018.

[1] I consider in paragraph 5.74 that the UK could adopt a different solvency regime following Brexit.

4.18 My findings are set out in Section 8.

Allocation of Assets and Liabilities to AIG UK and AESA

4.19 I have considered how AEL's assets and liabilities will be allocated between AIG UK and AESA.

4.20 I have then reviewed AEL's projection of Own Funds and SCRs for AIG UK and AESA immediately following the Proposed Scheme.

4.21 I have also reviewed AEL's projections of its Own Funds and SCRs in the event that the Proposed Scheme does not proceed.

4.22 My findings are set out in Section 9.

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Section 5: Background

Purpose of the Proposed Scheme

5.1 On 23 June 2016, the UK voted to leave the EU ("Brexit"). The UK Government began the formal process for negotiating the terms of the UK's exit in March 2017 by triggering Article 50 of the Lisbon Treaty. The negotiation process is likely to take at least two years.

5.2 AIG operations in Europe are currently structured with the main non-life insurance carrier AEL being domiciled in the UK with a network of branches in the EEA plus Switzerland. AEL is regulated by the PRA and the FCA.

5.3 There are a number of direct benefits of the UK's membership of the EU including the ability to establish branches in member states through Freedom of Establishment ("FoE") and the ability to sell insurance policies into any other member state through Freedom of Services ("FoS"). It is likely (subject to the terms of any transitional arrangement) that UK authorised insurers will lose these freedoms on Brexit and it is currently unclear what form the UK's future relationship with the remaining EU members will take.

5.4 In anticipation of the UK leaving the EU, AIG has made a decision to restructure its operations in Europe. From the existing AEL insurance business, AIG plans to create two separate insurers: one based in the UK (AIG UK) authorised by the PRA and regulated by the PRA and FCA and one based in Luxembourg (AESA) under the supervision of the CAA.

The Proposed Scheme

Overview

5.5 AIG UK and AESA have been established in advance of the Proposed Scheme and will have written no insurance business at the Effective Date of the Proposed Scheme.

5.6 The Proposed Scheme consists of the following steps, which will take place in combination with each other. None of the steps will take place without the other steps also taking place:

a. Part VII transfer of the assets matching the technical reserves, balance sheet liabilities and shareholders' funds relating to UK Transferring Policyholders from AEL to AIG UK.

b. A cross border merger of AEL (including the assets matching the technical reserves, balance sheet liabilities and shareholders' funds relating to European Transferring Policyholders) into AESA (with the transfer of insurance business under the cross border merger being sanctioned under Part VII of the FSMA).

c. As a result of step b above, AEL will dissolve without going into liquidation.

5.7 The subsidiaries of AEL will also be transferred to AIG UK or AESA. None of the subsidiaries are insurance companies.

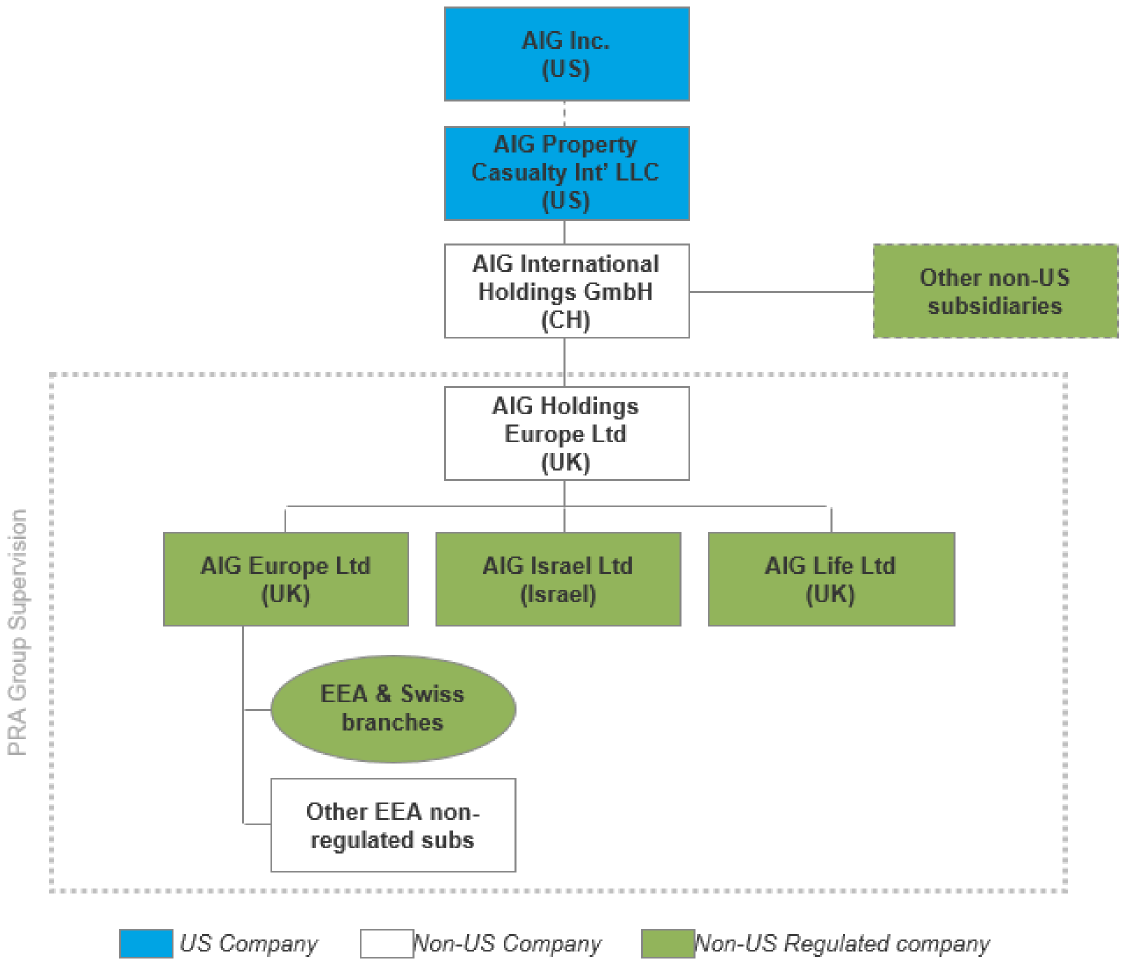
5.8 The policies are being transferred within the AIG Group and there is no third party insurance company involved in this transaction.

5.9 The two transfers will form two components of a single Part VII transfer scheme and cross border merger process to be presented to the High Court on a single unified basis. The Proposed Scheme will be sanctioned in whole or not at all with no scope for one transfer to have a different outcome to the other. As such, I have considered the Proposed Scheme as a whole and have not considered intermediate steps as no step will take place without all the other steps taking place. The terms of the cross border merger are subject to conditions precedent[1]. The status of these conditions precedent will be known before the intended Effective Date of the Proposed Scheme. In the event that the conditions precedent are not met the Proposed Scheme will not become effective.

Structure

5.10 Chart 5.1 below depicts a simplified version of the relevant parts of the AIG Group structure before the Proposed Scheme.

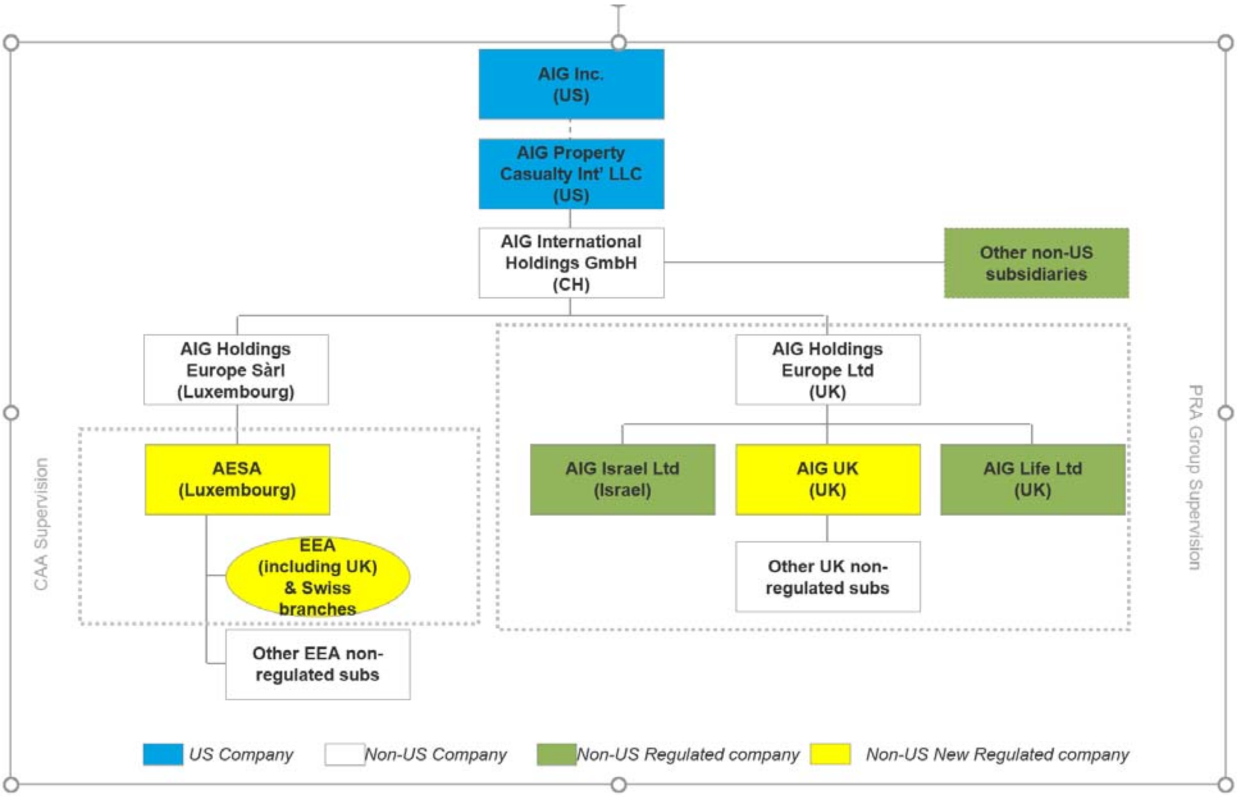
Chart 5.1 - Pre Proposed Scheme



[1] These conditions precedent include the decision of the Swiss Financial Market Supervisory Authority to issue to AESA, effective from the completion date, the insurance licence necessary for the continuation of the insurance portfolio in Switzerland following the completion date.

5.11 Chart 5.2 below depicts a simplified version of the relevant parts of the AIG Group structure after the Proposed Scheme. AEL is not on this chart following its dissolution and the new regulated companies not shown in Chart 5.1 are shown in yellow.

Chart 5.2 - Post Proposed Scheme



Allocation of assets and liabilities between AIG UK and AESA

5.12 Insurance policies transferred to AIG UK will comprise the relevant part of UK Transferring Policyholders' policies (see paragraph 2.2). AEL's remaining polices, which will be in respect of European Transferring Policyholders, will be transferred to AESA.

5.13 Assets will be transferred from AEL to AIG UK to ensure that it commences trading at its target Own Funds level. When AEL merges into AESA, the whole balance sheet of the remnant business within AEL (i.e. that which is not transferred to AIG UK) will transfer to AESA.

5.14 AEL will request the High Court to make an ancillary order to allow both AIG UK and AESA to retain the benefit of outwards reinsurance to the extent it covers any part of any AEL insurance policies transferring under the Proposed Scheme[1]. The benefit of outwards reinsurance will be allocated between AIG UK and AESA in accordance with their share of the total paid loss.

5.15 Specific investments will be allocated between AIG UK and AESA based on the results of a strategic asset allocation programme which will allocate assets to match the liabilities by

[1] In the event that the High Court does not sanction this, most of AEL's recent reinsurance treaties and facultative contracts contain a provision which will allow AIG UK and AESA to benefit from the outwards reinsurance. However, a small proportion of reinsurance treaties (which are mostly historical) may not contain this provision. This point is explored in paragraph 9.12.

currency and duration. This is discussed further starting at paragraph 9.13 of this Scheme Report.

Completion mechanics

5.16 This section summarises the detailed steps which will be taken to effect the Proposed Scheme on 1 December 2018. The full explanation of the completion mechanics is set out in the Scheme Document.

5.17 The proposed sequence of (summarised) events is as follows:

- The assets matching the technical reserves, balance sheet liabilities and shareholders' funds in respect of UK Transferring Policyholders are transferred to AIG UK in exchange for shares issued by AIG UK to AEL which are then immediately distributed by AEL to its holding company, AIG Holdings Europe Limited ("AHEL").

- Immediately following this, the transfer of the remaining assets and liabilities of AEL will take place under a cross border merger[1] in accordance with the Proposed Scheme. The assets matching the technical reserves, balance sheet liabilities and shareholders' funds relating to European Transferring Policyholders will be transferred to AESA in exchange for shares issued by AESA to AHEL and AEL is automatically dissolved by operation of law without going into liquidation, pursuant to the terms of the cross border merger.

- Immediately following this, the shares issued by AESA to AHEL are distributed by AHEL to AIG International Holdings GmbH ("AIGIH").

- Immediately following this, the shares issued by AESA are contributed by AIGIH to AIG Europe Holdings SARL.

Excluded policies and policyholder mis-allocation

5.18 Policies will either be transferred to AIG UK, to AESA or both AIG UK and AESA as shown in Chart 3.1. There is no possibility for any part of any AEL policies to be excluded from the scope of the Proposed Scheme since that part of AEL policies not transferred to AIG UK will be transferred to AESA under the Proposed Scheme and the cross border merger.

5.19 Moreover, the Scheme Document provides that if on or after the date of the Proposed Scheme, either AIG UK or AESA discovers that any policy, asset, right, property, contract or agreement should have been transferred to the other company then such property will be transferred to or otherwise vested in the relevant company or disposed of (whereupon the erroneous transferee will account to the relevant company for the proceeds of the sale thereof).

Possible alternative structures for the Proposed Scheme

5.20 As an alternative to the Proposed Scheme, AEL could effect a Part VII transfer of its European business to a new EU insurance company leaving behind the UK business in AEL. Although this would achieve the same result as the Proposed Scheme, this would be considered a taxable transaction in most jurisdictions in Europe in which AEL operates. In addition, to the extent that there are any tax losses these would most likely expire unutilised in most branch jurisdictions at that time.

[1] Pursuant to the provisions of Directive (EU) 2017/1132 of the European Parliament and of the Council of 14 June 2017 relating to certain aspects of company law, including on cross-border mergers of limited liability companies, transposed into English law by the Companies (Cross-Border Mergers) Regulations 2007 (SI 2007/2974) (the UK Regulations).

5.21 Effecting the restructure via an EU cross border merger, the Proposed Scheme mitigates the above tax issues and the impact on transferring policyholders is identical in all other respects.

5.22 Another alternative would be to arrange for each of AEL's EEA branches to be individually licenced by their respective regulator, rather than effect a Part VII transfer. This scenario is discussed further below, starting at paragraph 5.75.

Companies

AIG Europe Limited ("AEL")

5.23 AIG Europe Limited ("AEL"), a UK incorporated limited liability company, is the largest US headquartered property-casualty insurer in Europe with a presence in 26 countries, operating through a network of European branches.

5.24 AEL is incorporated in the UK and authorised by the PRA and regulated by the PRA and the FCA.

5.25 AEL is fully owned by AHEL which is ultimately owned by AIG.

5.26 AEL has an Insurer Financial Enhanced Rating of A+ (negative outlook) by the credit rating agency Standard and Poor's. This is defined as having a strong capacity to meet its financial commitments but is somewhat more susceptible to the adverse effects of changes in circumstances and economic conditions than insurers in higher-rated categories.

5.27 Table 5.1 shows AEL's balance sheet as at 30 November 2016, its 2016 year-end.

Table 5.1 - Balance Sheet at 2016 Year-end

Figures in Sterling Millions	
Company	**AEL**
Accounting Basis	IFRS
Investment in subsidiary undertakings	46
Other financial investments	9,794
Deposits with ceding undertakings	0
Investments	**9,839**
Claims outstanding	2,077
Unearned premium reserve	586
Reinsurers' share of technical provisions	**2,663**
Debtors arising out of insurance operations	1,364
Debtors arising out of reinsurance operations	217
Amounts owed by group undertakings	0
Other debtors	0
Debtors	**1,580**
Cash at bank and in hand	290
Prepayments and accrued income	626
Other assets	**916**
Intangibles	26
Gross DAC	289
Assets	**15,313**
Claims outstanding	8,431
Unearned premium reserve	2,119
Technical provisions	**10,550**
Provision for other risks and charges	**113**
	0
Arising out of direct insurance operations	55
Arising out of reinsurance operations	429
Deposits received from reinsurers	0
Amounts owed to group undertakings	0
Other creditors including taxation and social security	721
Creditors	**1,205**
Accruals and deferred income	**73**
Liabilities	**11,941**
Called up equity share capital	197
Profit and loss amount	1,603
Other reserves	1,572
Shareholders' funds	**3,372**

5.28 During its 2016 financial year, AEL’s written premium gross of reinsurance was £4,899m. AEL manages its business split between UK and Rest of Europe (“RoE”) segments. Table 5.2 below shows this 2016 gross written premium split between UK and RoE segments and within this for the RoE segment, by territory.

Table 5.2 - AEL - Written premium by territory - 2016 Financial Year - £m

		Gross premiums written
UK Segment		
	United Kingdom	2,045
	UK Subtotal	**2,045**
Rest of Europe Segment		
	Austria	30
	Belgium	176
	Bulgaria	8
	Cyprus	18
	Czech Republic	26
	Denmark	86
	Finland	54
	France	561
	Germany	461
	Greece	67
	Hungary	27
	Ireland	237
	Italy	373
	Lithuania	-
	Luxembourg	9
	Malta	3
	Netherlands	184
	Norway	76
	Poland	47
	Portugal	38
	Romania	13
	Slovakia	9
	Spain	161
	Sweden	83
	Switzerland	108
	RoE Subtotal	**2,854**
Grand Total		**4,899**

5.29 The UK segment includes the Lexington division ("Lexington") which underwrites US risk and accounts for approximately 15% of the UK segment gross premiums written.

5.30 In its 2019 financial year, AEL projects writing gross premium of £5,779m across AIG UK and AESA, an increase of £880m or 18% over its 2016 gross written premium of £4,899m.

5.31 Table 5.3 below shows total comprehensive income for AEL as stated in its report and accounts from 2013 onwards and projected comprehensive income for 2017 and 2018.

Table 5.3 - Total comprehensive income for the year - £m

	Financial Year End					
	Actual				Projected	
	2013	2014	2015	2016	2017	2018
Comprehensive income	328	299	55	143	270	237

American International Group UK Limited ("AIG UK")

5.32 AIG UK will be established to accept the inward transfer of AEL's UK insurance portfolio. In addition, non-EEA risks other than those written by AEL's EEA branches will also be transferred into AIG UK, in particular those risks written by its Lexington division under AEL's listing as an eligible alien insurer with the US National Association of Insurance Commissioners to write certain surplus lines business.

5.33 AIG UK will be a wholly owned subsidiary of AHEL. AHEL is wholly owned by AIGIH, a holding company for AIG's non-US businesses incorporated in Switzerland. The ultimate parent company of both UK entities is AIG.

5.34 AIG UK is authorised by the PRA and is regulated by the PRA and FCA.

5.35 AIG UK is expected to secure a financial strength rating at least equivalent to that of AEL, which is currently "A+", from at least one of the credit rating agencies: Standard and Poor's, Moody's, A.M. Best or Fitch.

5.36 In its 2019 financial year, AEL projects AIG UK writing gross premium of £2,599m.

AIG Europe SA ("AESA")

5.37 AESA will be established to accept the inwards transfer of those policies from AEL which are not being transferred to AIG UK.

5.38 AESA will be a wholly owned subsidiary of the Luxembourg holding company, AIG Europe Holdings S.à.r.l. AIG Europe Holdings S.à.r.l. is wholly owned by AIGIH. The ultimate parent company of both Luxembourg entities is AIG.

5.39 AESA is authorised by the Luxembourg Minister of Finance, and subject to the supervision of the CAA.

5.40 AESA is expected to secure a financial strength rating at least equivalent to that of AEL, which is currently "A+", from at least one of the credit rating agencies: Standard and Poor's, Moody's, A.M. Best or Fitch

5.41 In its 2019 financial year, AEL projects AESA writing gross premium of £3,180m.

UK branches of AESA

5.42 It is proposed that one or more UK branches of AESA will be established, which will, with AIG UK, jointly employ individuals working in functions supportive of AIG UK and AESA's core insurance business such as Legal, HR, Finance, Tax, Capital Management, Enterprise Risk Management, Compliance, Operations and Systems. In addition, subject to regulatory consents, a branch of AESA will, with AIG UK, jointly employ individuals conducting regulated insurance activities in respect of both AIG UK and AESA. These activities include underwriting and claims handling. Save for the change of employer all other terms and conditions of employment of the employees, including their continuous service, will remain unaffected by the Proposed Scheme.

5.43 It is intended that these UK branch(es) will facilitate AESA in maintaining a materially similar level of service to policyholders to that of AEL prior to the Proposed Scheme.

American International Group, Inc.

5.44 AIG is a leading global insurance organisation. The business was founded in 1919, and currently operates with approximately 60,000 employees serving customers in more than 100 countries and jurisdictions. AIG companies serve commercial, institutional and individual customers through one of the most extensive worldwide Property-Casualty networks of any insurer. In addition, AIG companies are leading providers of life insurance and retirement services in the United States. AIG common stock is listed on the New York Stock Exchange (NYSE: AIG) and the Tokyo Stock Exchange with a market capitalisation of approximately US$54bn as of 9 February 2018.

Intra-group arrangements

Reinsurance

5.45 AEL cedes risk to other insurers in the AIG Group via intra-group reinsurance treaties. The largest intra-group reinsurance cessions are on Lexington and the casualty, energy and property classes. As at its 2016 year-end AEL ceded 9% of its gross claims reserves via intra-group reinsurance.

5.46 The approach to intra-group reinsurance will change following the Proposed Scheme for both AIG UK and AESA. The principal change in AIG UK's cession to intra-group reinsurance treaties when compared to AEL's prior book is an increase in the Lexington business quota share treaty from 20% to 55% for the 2019 underwriting year with Lexington Insurance Company as the counterparty. Lexington Insurance Company is part of the AIG Group and has a credit rating of A+ with Standard and Poor's, a credit rating agency.

5.47 AEL projects that immediately following the Proposed Scheme AIG UK will cede 12% of its claims reserves via intra-group reinsurance and this will remain at approximately 12% over the three years that AEL has projected for AIG UK's balance sheet, increasing to 13% by the end of 2021.

5.48 It is projected that the principal changes in AESA's intra-group reinsurance will be the replacement of AEL's current treaties with:

- A whole-entity 55% quota share treaty for the 2019 underwriting year with the AIG US Pool as the counterparty. The AIG US Pool is a pool of AIG Group insurers each of which has a credit rating of A+ with Standard and Poor's. In the event that the US Pool's US Risk Based Capital ratio (a US measure of financial security) falls to below 300% (compared to the US Pool's target Risk Based Capital level in the range of 400-450%) then the quota share will be collateralised to the level of expected claims.

- A whole-entity accident year stop loss reinsurance treaty for the 2019 accident year with the AIG US Pool as counterparty. Premiums paid by AESA for the first three years will be held by the US Pool in a ring-fenced trust fund which may only be accessed to pay AESA claims.

5.49 AEL projects that immediately following the Proposed Scheme AESA will cede 5% of its claims reserves via intra-group reinsurance and this will increase to 11% at the end of 2019, 18% at the end of 2020 and 21% at the end of 2021.

Guarantees

5.50 Some AEL policyholders who were subject to historical portfolio transfers into AEL are the beneficiaries of guarantees whereby in the event that AEL fails to pay liabilities arising from policies of insurance (including valid claims) the guarantor will meet the shortfall. In all cases the guarantor is an AIG group company.

5.51 Under the Proposed Scheme the guarantees will move with the transferring policyholder. AEL is not a party to the guarantee (being issued directly by the AIG group company in favour of certain groups of policyholders as noted below) and as a result, the transfers will have no effect on the validity of the guarantees.

5.52 The portfolios subject to guarantees are:

- Guarantee dated 15 September 1998 provided by American Home Assurance Company to policyholders of AIG Europe S.A. (subsequently renamed Chartis Europe S.A.) and terminated as regards any new obligations entered into after 31 December 2012.

- Guarantee dated 15 September 1997 provided by National Union Fire Insurance Company of Pittsburgh, Pa to policyholders of AIG Europe (Ireland) Limited (subsequently renamed Chartis Insurance Ireland Limited) and terminated as regards any new obligations entered into after 31 January 2012.

- Guarantee dated 23 December 1998 provided by National Union Fire Insurance Company of Pittsburgh, Pa to policyholders of AIG Romania Insurance Company S.A. (subsequently renamed Chartis Romania Insurance Company S.A.) and terminated as regards any new obligations entered into after 31 January 2012.

5.53 The policies subject to these guarantees will be transferred to AESA under the Proposed Scheme. AEL estimate that at year-end 2016 approximately 25% (approximately €1bn) of claims reserves in respect of European Transferring Policyholders have the benefit of one of the above guarantees.

5.54 AEL policyholders whose policies were written through the Institute of London Underwriters have the benefit of a guarantee with AHEL as the guarantor. Under the Proposed Scheme all polices written through the Institute of London Underwriters will transfer to AIG UK and the guarantee will move from AEL to AIG UK with AHEL remaining as the guarantor. AEL estimate that at year-end 2016 less than £100k (less than 0.01%) of claims reserves in respect of UK Transferring Policyholders have the benefit of the Institute of London Underwriters guarantee.

5.55 As noted above, for each guarantee all of the policyholders who are beneficiaries of the guarantee are either all transferring to AIG UK or all transferring to AESA under the Proposed Scheme. Hence, there are no instances where the underlying exposures of a guarantee will be split between AIG UK and AESA after the Proposed Scheme.

Capital Maintenance Agreement ("CMA")

5.56 AEL currently has a Capital Maintenance Agreement ("CMA") in place with AIG.

5.57 The CMA is a legally enforceable commitment by AIG to unconditionally provide a sufficient amount of capital of the appropriate kind to restore AEL's capital level to above its SCR.

5.58 Upon receipt of a written request, AIG will make the required capital contribution within 14 days. The CMA can be cancelled with 90 days' notice by either party.

5.59 Over the last few years AIG has been unwinding CMAs in order to simplify arrangements for recovery and resolution purposes. For this reason AESA will not have a CMA.

5.60 AEL's CMA will be transferred to AIG UK.

Target Own Funds policy

5.61 AEL aims to maintain a buffer over the SCR to give assurance that it will not routinely breach regulatory capital requirements.

5.62 While AEL's SCR was assessed on the Standard Formula basis (up to and including the 2016 year-end) AEL held a buffer calculated as the worst financial result expected in seven years (i.e. a 1 in 7 year expected loss) based on AEL's Internal Model.

5.63 Since July 2017 AEL has had an approved Internal Model. Under the Internal Model, AEL's capital policy is to hold a buffer equal to the difference between the Internal Model SCR and the Internal Model SCR calculated on a run-off to ultimate basis. The 'ultimate' view represents the amount of capital required to fully run-off all liabilities, whereas the Solvency II Internal Model SCR represents only one year of risk emergence.

5.64 AIG UK and AESA will adopt the same target Own Funds policy as AEL. This will be determined by whether the Standard Formula or Internal Model SCR basis is in force for each of AIG UK and AESA as from the date of the Proposed Scheme.

Dividend policy

5.65 AEL's normal dividend policy is to distribute Own Funds in excess of target Own Funds by way of a dividend such as to maintain the target level of Own Funds in AEL.

5.66 Since it is possible that the capital requirements of AIG UK and AESA will both be assessed on the Standard Formula SCR basis following the Proposed Scheme, the financial projections assume that no dividend distributions will be made from AEL during 2017 and during 2018 up to the date of the Proposed Scheme.

5.67 AIG UK and AESA will adopt the same dividend policy as AEL.

Trust Funds

5.68 Ring fenced trust funds ("Trust Funds") consist of a ring-fenced pool of assets which are firstly used to pay policyholders who are protected by the Trust Fund but any excess over the funding requirement may be released to general assets and so available for the benefit of all policyholders.

5.69 AEL has 11 Trust Funds covering approximately 6% of the assets of AEL. Under the Proposed Scheme Trusts Funds will transfer to the respective legal entities where underlying liabilities reside and will continue to contain the required level of assets. All AEL policyholders who are currently covered by a Trust Fund will continue to have the benefit of that Trust Fund under the Proposed Scheme:

- AIG UK will have three Trust Funds covering approximately 6% of the assets of AIG UK.
- AESA will have nine Trust Funds covering approximately 6% of the assets of AESA.
- There is one instance of a Trust Fund where the underlying exposures will need to be split as the underlying policies will either be transferred to AIG UK or AESA. The existing Trust Fund will transfer to AIG UK as 84% of the liabilities are in respect of UK Transferring

Policyholders and a new Trust Fund will be created for AESA to cover the remaining 16% of liabilities in respect of European Transferring Policyholders.

Accounting regimes

5.70 AEL presents its accounts using the International Financial Reporting Standards ("IFRS"). AIG UK will use UK GAAP and AESA, Luxembourg GAAP ("Lux GAAP"). I have seen a conversion analysis undertaken by AEL with the support of relevant accounting experts to assess the impact of moving from IFRS to UK GAAP and Lux GAAP for AIG UK and AESA respectively.

5.71 In the case of AIG UK, UK GAAP has broadly converged with IFRS and no significant differences are expected between the two accounting standards.

5.72 In the case of AESA, there are three areas of conversion required to move between IFRS and Lux GAAP:

- **Investments** – Under IFRS AEL reports financial investments at fair value (mark to market) with unrealised gains and losses being reported to Other Comprehensive Income. Under Lux GAAP AESA's investments will be recognised at cost less impairment.
- **Deferred tax –** There is no accounting concept of deferred tax under Lux GAAP.
- **Pension obligations –** It is understood that there is no provision for funded pension obligations under Lux GAAP and therefore AESA's pension provisions under the IFRS forecast has been removed. The provision for AESA's unfunded retirement plans has been retained however.

5.73 AEL's analysis shows that the impact of the above changes is to reduce AESA's shareholders' equity as estimated in its projected accounts by approximately 0.5%.

Solvency regimes

5.74 AEL is currently regulated under the Solvency II regime. Immediately following the Proposed Scheme both AIG UK and AESA will also be regulated under the Solvency II regime. Following Brexit the UK could adopt a different solvency regime. I have seen no information as to what such a future UK insurance solvency regime may look like, or whether the UK will continue to regulate insurance companies in line with the Solvency II regime. However, I would expect any such insurance solvency regime to be heavily based on Solvency II in the first instance and that any subsequent divergence between the two regimes is likely to be very slow.

Scenario should the Proposed Scheme not proceed

5.75 If the Proposed Scheme does not proceed then AEL would need to perform the necessary restructuring to continue to trade in Europe following Brexit.

5.76 There are two broad scenarios for how Brexit will affect UK insurance companies currently trading across Europe:

- UK insurance companies retain passporting (FoS and FoE) rights into other EEA countries ("Soft Brexit"); and
- UK insurance companies lose their passporting rights into other EEA countries ("Hard Brexit").

5.77 Under Soft Brexit AEL could trade forward in its current form by continuing to use its FoS and FoE rights.

5.78 Under Hard Brexit, AEL would become a "third country entity" from an EEA perspective. It is unclear what steps AEL would need to take to continue trading in EEA countries. Based on my discussions with AEL I consider that a plausible restructuring model is as follows:

- AEL's EEA branches would have to individually apply to their respective local regulator so as to be licenced at the point of Brexit.
- AEL would then have to capitalise each of these as a third country branch (similar to how the Swiss branch is currently capitalised), resulting in a significant loss of AEL's capital diversification benefit.

5.79 This would result in each of AEL's EEA branches having different prudential regulators, thus creating a large amount of regulatory overlap and complexity. Greater tax costs and increased operating expenses would also be likely.

5.80 An alternative Hard Brexit restructuring model for AEL could be to have a single EEA prudential branch regulator under Article 167 of the Solvency II Directive. This could result in an EEA SCR broadly in line with that of AESA on a Standard Formula basis, mitigating some of the loss of capital diversification experienced by simply capitalising at an individual branch level.

5.81 However, Article 167 requires agreement among all the EEA branch regulators, the consent of any of which can be withdrawn at any time subsequently, at which point the advantages of Article 167 would be withdrawn simultaneously by all member states concerned. Therefore, it would require a willingness to co-operate by all of the EEA branch regulators in the first place, and on a continuing basis thereafter, to make this an effective restructuring model.

5.82 It would create an unacceptable level of risk and vulnerability for the business if one EEA branch regulator could decide to withdraw its consent at any time due to factors beyond AEL's control, necessitating a future restructuring. If such a future restructuring occurred after the UK had left the EU, it may not be possible to effect it using the current insurance business transfer and cross-border merger mechanisms which derive from EU law.

5.83 As such, I consider the Article 167 based model for restructuring after a Hard Brexit would be unstable. I am aware of over 15 cases where UK based insurers are currently planning Brexit related restructurings. At least ten of these are making preparations based on a two-entity approach and the remainder involve some form of transfer to the EEA and then accessing the UK using a branch or subsidiary structure. I have not seen any reference to a firm planning to make use of Article 167.

5.84 From the perspective of the policyholder, each of the above scenarios would potentially mitigate against the loss of protection, benefits and contract continuity for the policyholder, but each scenario has certain limitations as follows:

- Soft Brexit scenario – While this scenario is unchanged from the current situation it is critically dependent on ongoing discussions between the UK and the EU, the outcome of which is unlikely to be known for some time.
- Hard Brexit scenario with individual branch capitalisation – This scenario would provide continuity of the UK regulatory regime for European policyholders although it would result in a large amount of regulatory overlap and complexity, greater tax costs and likely increased operating expenses and would result in AEL failing to meet its regulatory solvency requirements.

- Hard Brexit scenario under an Article 167 based model – This scenario would again provide continuity of the UK regulatory regime for European policyholders but it would result in an ongoing significant level of risk and vulnerability for the business, which could impact the ongoing ability of the firm to service policyholders' claims and meet its regulatory solvency requirements.

5.85 For these reasons, I consider individual branch capitalisation to be a realistic alternative restructuring model following a Hard Brexit. I shall use this alternative restructuring model as a comparison to AEL's Proposed Scheme, in order to assess the impact on AEL and its policyholders if it chose not to implement the Proposed Scheme.

Section 6: Reserves and Investments

6.1 In this section I set out my review of the valuation of the key items on AEL's IFRS balance sheet at 30 November 2016 as shown in Table 5.1.

6.2 The largest items on the balance sheet are claims outstanding (and the corresponding reinsurers' share of claims outstanding), and other financial investments. As such in this section I discuss my review of the valuation of these items.

6.3 The next largest items on the balance sheet are Unearned Premium Reserves ("UPR") (both as an asset and as a liability) and debtors arising out of reinsurance operations which are both in excess of £1,000m. I briefly discuss these below:

- **UPR** – This amounts to £2,119m in respect of inward business and £586m in respect of ceded reinsurance. AEL has not considered it necessary to set up an additional unexpired risk reserve which would be required if the business was expected to be loss making. Based on my review of the reserves and the AEL business plan I consider this is reasonable.

- **Debtors arising out of insurance operations** – This amounts to £1,364m. More than 98% of these amounts are due within one year. I am not aware of any significant outstanding debtors the non-payment of which would impact the security of policyholder's contractual rights.

Claims reserves

Background

6.4 Table 6.1 below shows the AEL claims reserves at 30 November 2016 net of reinsurance by reserving category. AEL reserves its business split between UK and Rest of Europe ("RoE") segments. RoE contains business written by the EEA and Swiss branches under AEL's FoE rights. UK consists of other risks including risks written from outside of Europe such as the Lexington business from North America. At the bottom of the table is a reconciliation of the total claims reserve to the gross and reinsurance claims reserves that can be derived from Table 5.1.

Table 6.1 - AEL Reserves at 30 November 2016

Figures in Sterling Millions

Reserving Category	UK	RoE	Total
Casualty	763	1,362	2,125
Consumer Lines	124	435	559
Financial Lines	552	1,199	1,750
Global Property	208	318	526
Specialty	488	152	641
Specials	96	6	102
Lexington & Cat XS	414	0	414
Active Life Reserves	3	17	20
Unallocated Loss Adjustment Expenses	89	139	229
Target Operating Model Benefits	-13	-20	-33
Other Finance Adjustments	1	20	21
Total Reserves	**2,726**	**3,628**	**6,354**

Reconciliation to Balance Sheet (Table 5.1)

Line Item	AEL
Claims Outstanding	8,431
Claims Outstanding - reinsurer share	2,077
Net Claims Outstanding	**6,354**
Difference	**0**

6.5 Table 6.1 shows that AEL's reserves are split approximately 43%/57% between the UK and RoE segments. Casualty and Financial Lines have the largest reserves for both the UK and RoE. These reserving categories are long tailed with large-value claims and this is where I have focussed my review of the reserves.

6.6 The UK segment has a large specialty book of business which includes marine and aviation lines which are traditionally written out of the UK. The UK segment dominates the specials line. This contains challenging claim types which are typically not amenable to traditional reserving approaches. These include asbestos and deafness claims and mortgage guarantee business.

6.7 Beyond Casualty and Financial Lines the RoE segment is dominated by consumer lines. These are typically very short tailed.

6.8 AEL started writing Excess Casualty through the Cat XS book and Casualty and Property business through Lexington in 2013. The Lexington reserves are split broadly equally between Casualty and Property classes of business.

6.9 Where Accident & Health policies have a sickness component and a level premium is charged, an Active Life Reserve is generally required. The aim of these reserves is to set aside excess premium being collected today to cover a potential deficit in the future where the claim costs are expected to exceed the premium.

Approach

6.10 I have used the following approaches to satisfy myself with the reasonableness of the net of reinsurance reserves booked by AEL:

- Review of internal reserving methodology and process
- Review of internal reserving at year-end 2016
- Review of historical performance of internal reserve estimates
- Review of external reserve reviews
- My own high-level test of the reserves

6.11 When undertaking any reserving exercise there are a range of assumptions that could be reasonable with any two actuaries looking at the same set of data likely to produce different projections of future claims depending on their individual judgment. This leads to the concept of a range of reasonable estimates of future claims which can be seen as the range of estimates it would be reasonable to produce from the data by making different but still reasonable actuarial judgments.

6.12 The focus of my review of the reserves has been to assess whether the reserves booked by AEL sit within such a range and are therefore, in my opinion, “reasonable”.

Data

6.13 I was provided with the following key pieces of information to conduct my review:

- The terms of reference for AEL’s internal reserving function
- Claims triangulations for AEL split by main distribution channel and line of business
- AEL’s internal estimates of ultimate claims at year-end 2016
- AEL’s ‘deep dive’ reviews on key classes during 2016
- AEL’s reserve committee packs during 2016
- An extract from the year-end 2016 audit report relating to reserve assessments
- An external reserve review at year-end 2016
- AEL’s Actuarial Function Holder’s Report on Technical Provisions at year-end 2015 (with discussions about changes anticipated for the 2016 Report)
- History of reserve performance taken from the 2016 report and accounts but with greater granularity
- A reconciliation from the reserves to the booked results in the report and accounts
- I also had weekly calls and meetings with AEL throughout my review. These were attended by representatives of the AEL reserving function and I was able to discuss questions arising here.

6.14 AEL has confirmed to the best of its knowledge and belief that the data underlying the actuarial reports liabilities is accurate and complete.

Review of internal reserving methodology and process

6.15 I have reviewed the terms of reference of the actuarial function of AEL.

6.16 I have reviewed the reserving process undertaken by AEL and the communication of its findings via the reserve committee and actuarial function reports.

6.17 These are in line with my expectations and have not required me to review these in any further detail.

Review of internal reserving at year-end 2016

6.18 I have reviewed AEL's internal estimates of ultimate claims at year-end 2016 as presented in AEL's 2016 report and accounts. To aid me in this review I have had access to:

- AEL's reserve committee packs produced during 2016; and
- AEL's 'deep dive' reviews performed during 2016 on key classes selected by me. I have focussed on those classes with the largest and most uncertain reserves and those where traditional actuarial reserving techniques might not be appropriate. I have reviewed deep dive reserve reports which account for over 70% of AEL's gross reserves.

6.19 The reserve committee packs and deep dive reviews provided good support for the reasonableness of the reserves. I validated these findings with my other reviews described below.

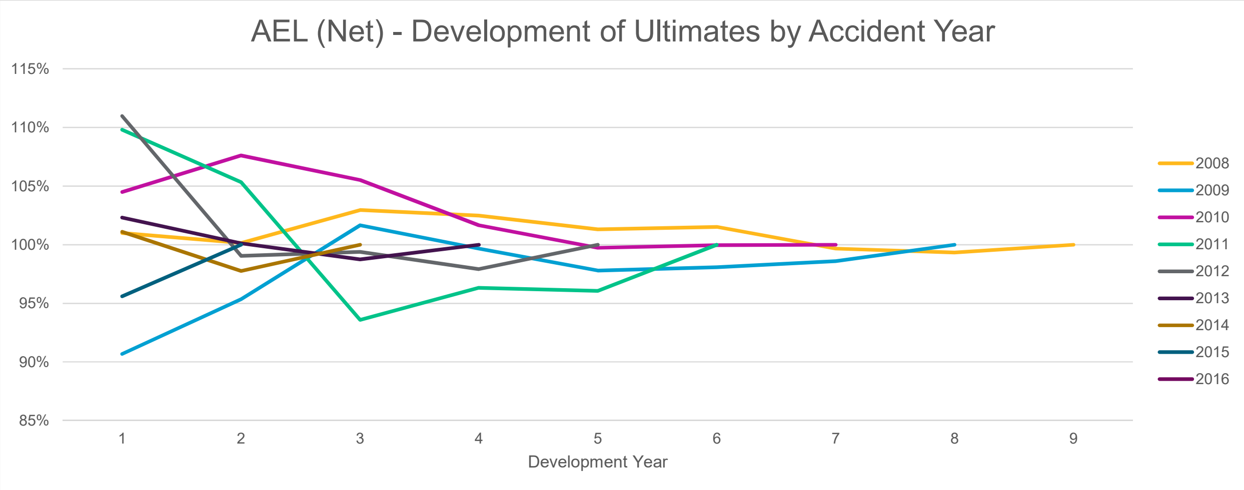
Review of historical performance of internal reserve estimates

6.20 I have reviewed the performance of AEL's historical reserve estimates.

6.21 The 2016 report and accounts shows estimates of ultimate claims by accident year for each year of development from 2008 onward.

6.22 The progression of each accident year as a proportion of its current selected ultimate is shown in Chart 6.1 below.

Chart 6.1 – AEL Historical Reserving Performance



6.23 It can be seen that in the first few years there is some uncertainty in the result but this reduces over time.

6.24 Aggregating across all accident years from 2008 to 2015, after allowing for reinsurance, the current estimated ultimate claims are approximately 1% lower than the initial estimates of ultimate claims.

6.25 Estimated ultimate claims during 2016 have increased which can be seen as an uptick in the last data point on most of the lines in the chart. This is attributable to a change in the Ogden discount rate (which occurred during early 2017, was reflected in the booked reserves as at 30 November 2016, and impacts UK bodily injury cases) and adverse prior year development on Property, Special Risks, Liability and Financial Lines.

6.26 The above review considers all AEL's claims liabilities. AEL was separately able to produce the above information split between the UK and RoE segments. Where possible, AEL also included back-history prior to the formation of AEL in 2013.

6.27 This shows similar historical reserve performance with the UK and RoE segments showing estimated ultimate claims approximately 2% and 1% lower than the initial estimates of ultimate claims respectively.

6.28 This supports the reasonableness of the reserves for AEL and the UK and RoE segments of AEL.

Review of external actuarial reserve studies

6.29 AEL's report and accounts have been audited, which includes an actuarial review of reserves. The actuarial review focussed on the most material and uncertain lines of business and elements of the reserves (covering 45% of AEL's net reserves) with a higher level review of methodology and assumptions for the remaining elements.

6.30 Separately, AEL commissioned an independent reserve review at year-end 2016 from another actuarial consultant. This review considered reserves comprising 74% of AEL's booked reserves and also considered reserves separately for the UK and RoE segments.

6.31 I have reviewed both external reports. I have not relied upon them in reaching my conclusions. However, I consider that they support the overall reasonableness of the AEL reserves and, in the case of the independent reserve review, the reasonableness of AEL's reserves on the UK and RoE segments. To the extent that these external reports suggest variances to AEL's reserves by class or segment I have paid particular attention to these in my high-level test of the reserves below.

High-level test of the reserves

6.32 I have received claims triangles showing the historical development of paid and incurred claims from accident years 1994 onwards. These are split between the UK and RoE segments.

6.33 I have instructed a team at WTW which is experienced in claims reserving to perform a granular analysis ("Granular Analysis") of the claims triangles using standard actuarial claims reserving techniques.

6.34 The Granular Analysis has been performed separately on the UK and RoE segments. For each segment, mechanical reserving and benchmarking models have been run at a granular level with approximately 80 individual classes of business modelled in each of the UK and RoE segments. In cases where there are material deviations between these 'mechanical techniques' and the AEL selected reserves I have reviewed the models to understand the differences and where necessary have reviewed the 'deep dive' analysis performed by AEL and the external reserve reviews to look for justification of the alternative selections.

6.35 The specials line was not amenable to modelling using the Granular Analysis. In forming my views on this line of business I relied on my review of the AEL deep dives and my review of the external reserving reports.

6.36 Lexington and Cat XS were not included in the Granular Analysis. AEL provided claims triangulations and their analysis of the reserves which I reviewed.

6.37 The active life reserves were not included in the Granular Analysis. AEL shared their reserving methodology document and I discussed this with a colleague who is familiar with life insurance reserving techniques.

6.38 I have also performed high level 'reasonableness' tests on the reserves for the UK and RoE segments, allowing for the post year-end adjustments applied by AEL in respect of Ogden on the UK segment and specific excess casualty claims on the RoE segment.

6.39 Based on the Granular Analysis and my other reviews and high level tests I consider the reserves of AEL and the UK and RoE segments each lie within an acceptable range.

Findings

6.40 While I have not attempted to review in detail the internal or external calculations performed, the above analysis, including my high level review of reserves, has given me comfort that the AEL booked reserves are reasonable and while I may have made different selections this would not have resulted in me changing my opinion on the reserves.

6.41 Further, the reserving process for AEL's UK and RoE segments are very similar and result in reserves with broadly equal strength.

6.42 That said, there is uncertainty over the level of reserves and as such in my sensitivity testing in Section 10 I have tested the impact of reserves deteriorating by 5%, approximately £300m.

Investments

Data

6.43 I was provided with the following key pieces of information to conduct my review:

- AEL 2016 annual report and prior annual reports; and
- Internal Model documentation around design, methodology and parameterisation of the structured products.

Review of methodology and process

6.44 I have reviewed the approach used to value AEL's investments at the 2016 year-end. The methodology employed relies on direct market valuations in actively traded markets where available. Where this is not available it uses other observable direct or indirect valuations such as quoted market prices for similar assets in active markets, and other inputs other than quoted prices that are observable for the asset such as interest rates and yield curves that are observable at commonly quoted intervals.

6.45 At year-end 2016, of AEL's financial instruments of £9.7bn, 93% were valued in this way. 4% of the financial instruments were loans and receivables which were recorded at cost and less than 0.1% related to equities.

6.46 The balance of 3% relates to financial instruments where active market valuations are not available. In this case AEL has based the valuation on prices provided by brokers derived from valuation techniques (models) that use significant inputs that are unobservable. These financial instruments are referred to as Level 3. At year-end 2016 Level 3 investments solely comprise Residual Mortgage Backed Securities ("RMBS") but at prior year-ends other asset types have been included in Level 3.

6.47 AIG has informed me that since year-end 2016 the investment portfolio has been de-risked and by November 2017 all RMBS assets had been sold. AIG has further informed me that there is no intention to re-risk the asset portfolio ahead of the Proposed Scheme.

6.48 The valuation and the valuation process at year-end 2016 has been subject to audit by a firm experienced in the valuation of financial instruments.

6.49 In light of the sale of the RMBS investments I have not sought any additional guidance on the valuation of the RMBS assets.

6.50 In Section 10 I have tested the impact of the valuation of the Level 3 financial instruments falling to zero compared to their valuation at 30 November 2016.

Review history of valuation performance

6.51 Table 6.2 below has been extracted from AEL's report and accounts between 2013 and 2016.

Table 6.2 - Valuation of Level 3 Assets

	Financial Year-end			
	2013	**2014**	**2015**	**2016**
Fair Value at year-end - £m	708	581	237	225
Gains / (Losses) Over Year - £m	25	16	-12	6

6.52 This shows that the Level 3 portfolio of assets has been reducing over time which is a function of AEL divesting this portfolio.

6.53 Three of the last four valuations have resulted in a gain.

Conclusions

6.54 My conclusions are as follows:

- The Level 1 and 2 valuations are reasonable since they are based on market valuations in actively traded markets.
- While I am not an expert in the valuation of illiquid assets such as RMBS, I consider the valuation approach used is in line with market standards and is reasonable.
- The Level 3 financial instruments are less than 3% of AELs investments at year-end 2016.
- The Level 3 portfolio has been contracting over time and has generally resulted in gains rather than losses.
- The valuation and the valuation process has been subject to audit by a firm experienced in the valuation of financial instruments.

6.55 As such, I consider the valuation of AEL’s investments is reasonable.

Section 7: Solvency II Balance Sheet and Capital Requirements

7.1 In this section I set out my review of the modelling undertaken to assess AEL's Solvency Balance Sheet, its Own Funds and its SCR at 30 November 2016.

Background

7.2 AHEL has developed an Internal Model ("IM") which was approved by the PRA in 2017 as a partial Internal Model. The AEL component of the AHEL Internal Model has received full Internal Model approval. The Internal Model for AHEL received a partial approval as AHEL includes AIG Life and AIG Israel whose capital requirements are calculated using the Standard Formula ("SF").

Solvency II Balance sheet and Own Funds

7.3 AEL's transition from the IFRS balance sheet at 30 November 2016 to the Solvency II Balance Sheet resulting in AEL's Own Funds on the SF basis is shown in AEL's Solvency and Financial Condition Report ("SFCR") which is available on the AEL website and is summarised in Table 7.1 below.

Table 7.1 - Translation of AEL Balance Sheet at Year-end 2016 - Standard Formula

Figures in Sterling Millions **Accounting Basis**	**IFRS**	**Solvency II adjustments**	**Solvency II Balance Sheet**
Assets			
Intangibles	26	(26)	0
Cash and investments	10,129	118	10,248
Ceded technical provisions	2,663	(745)	1,918
Insurance debtors	1,580	(1,354)	227
Gross deferred acquisition costs	289	(289)	0
Other prepayments and accrued income	626	(94)	532
Tier 2 Own Funds		537	537
Total Assets	**15,313**	**(1,851)**	**13,462**
Liabilities			
Technical provisions (excl. risk margin)	10,663	(1,995)	8,668
Risk margin	0	576	576
Creditors	1,205	(631)	574
Ceded deferred acquisition costs	73	(73)	0
Total Liabilities	**11,941**	**(2,122)**	**9,819**
Shareholders' Funds / Solvency II Own Funds	**3,372**	**271**	**3,643**

7.4 The key changes in moving from the IFRS basis to the Solvency II basis are:

- **Discounting of cashflows** – Cashflows are discounted on the Solvency II balance sheet. This mainly impacts technical provisions and ceded technical provisions.
- **Risk Margin** – Under Solvency II a risk margin is included in the Solvency II balance sheet as a liability. This is on a defined basis under Solvency II using a cost of capital approach.

- **Insurance premium receivables** (included in the insurance debtors line) and reinsurance premium payables (included in the creditors line) which are due in less than 90 days are reclassified to technical provisions under Solvency II. The remaining balance within the insurance debtors line reflects reinsurance receivables.

- **Tier 2 Own Funds** – these are letters of credit (£500m) and subordinated liabilities (£37m) which comprise Tier 2 Own Funds and do not appear on the IFRS Balance Sheet.

7.5 Since AEL now has an approved Internal Model, AEL has also produced pro-forma results on the Internal Model basis. This is shown in Table 7.2 below.

Table 7.2 - AEL Solvency II Balance Sheet under SF and IM at Year-end 2016

Figures in Sterling Millions			
Solvency Basis	**Standard Formula**	**Internal Model**	**Difference**
Assets			
Intangibles	0	0	0
Cash and investments	10,248	10,248	0
Ceded technical provisions	1,918	1,918	0
Insurance debtors	227	227	0
Gross deferred acquisition costs	0	0	0
Other prepayments and accrued income	532	532	0
Tier 2 Own Funds	537	537	0
Total Assets	**13,462**	**13,462**	**0**
Liabilities			
Technical provisions (excl. risk margin)	8,668	8,668	0
Risk margin	576	466	(110)
Creditors	574	574	0
Ceded deferred acquisition costs	0	0	0
Total Liabilities	**9,819**	**9,709**	**(110)**
Solvency II Own Funds	**3,643**	**3,753**	**110**

7.6 The only change over the Standard Formula basis is a reduction in the risk margin from £576m to £466m, a reduction of £110m which is driven by a lower SCR under the Internal Model basis.

7.7 I have reviewed the above balance sheet translations and have questioned AEL where necessary such as over the calculation of the risk margin. These questions have been answered to my satisfaction. While I have not performed a detailed and granular review of the Solvency II balance sheets I consider they are in line with my expectations. In forming this opinion I note the Solvency II balance sheet at 30 November 2016 under the Standard Formula has been audited by AEL's auditors.

Solvency Capital Requirements

7.8 At year-end 2016 AEL used the Standard Formula to assess its capital requirements. In early 2017 AEL received approval from the PRA to use its Internal Model to calculate capital requirements.

7.9 At my request AEL has produced pro-forma SCRs on an Internal Model basis at 30 November 2016.

7.10 In addition to the above pro forma SCRs I have also been provided with:

- The 30 November 2016 SFCR for AEL and other materials supporting the SF SCR calculation; and
- The index of all materials from AEL's IM library from which I have selected materials to review. In total I have reviewed over 50 internal model documents from the Internal Model library.

7.11 AEL has confirmed to the best of its knowledge and belief that the data underlying the pro forma Solvency II SCR assessments is accurate and complete.

AEL's Internal Model

7.12 AEL's Internal Model is required to calculate the SCR so as to ensure that all quantifiable risks to which AEL is exposed are taken into account. It covers existing business, as well as the new business expected to be written over the following 12 months.

7.13 It corresponds to the Value-at-Risk of the basic own funds of AEL subject to a confidence level of 99.5% over a one-year period.

7.14 It includes the following risks and allows for diversification between these.

- **Insurance risk:** the largest components of which are
  - **Premium risk** – the failure of pricing, product or strategy. It encompasses losses due to the potential timing, frequency and severity of covered loss events differing from that assumed at the time of underwriting and pricing a risk.
  - **Reserve risk** – arising from adverse reserve development through failing to set sufficient reserves.
  - **Catastrophe risk** – arising from the failure to manage risk aggregation or accumulation that may result in increased exposure to natural catastrophe or man-made catastrophe losses.
  - **Outward reinsurance** - A significant mitigating factor of insurance risk is the reinsurance purchased by AEL.
- **Market risk:** the risk that AEL is adversely affected by movements in the fair value of its financial assets arising from market movements such as credit spreads, interest rates and foreign exchange or other price risks.
- **Credit risk:** the change in the value of assets and liabilities caused by unexpected default or deterioration in the credit standing of counterparties and debtors.
- **Pension risk:** the market and longevity risk relating to employee defined benefit pension plans.
- **Operational risk:** the risk of loss or other adverse consequences resulting from inadequate or failed internal processes, people, systems or external events. Operational risk include risks relating to the AIG Group such as parent rating downgrade.

7.15 Liquidity risk refers to the costs associated with having to redeem investments prematurely to generate sufficient cash resources to meet payment obligations as they fall due. Cash and other liquid assets are held to manage liquidity and these form part of Own Funds. They receive an appropriate capital charge through the Internal Model. As such, liquidity risk is monitored and managed through AEL's Internal Model but there is no explicit liquidity risk charge in the Internal Model.

7.16 Further information about these risk categories and the risk mitigation techniques employed by AEL can be seen in AEL's SFCR available on AEL's website.

7.17 The Standard Formula produces the SF SCR under similar risk categories but using calculations and parameters which are standard across all insurers and reinsurers rather than being specific to AEL.

7.18 Table 7.3 below shows AEL's pro forma IM SCR at 30 November 2016.

Table 7.3 - AEL Internal Model SCR at Year-end 2016

Risk Category	Risk Charge £m	% of SCR
Insurance Risk	2,060	81%
Market Risk	848	33%
Credit Risk	229	9%
Operational Risk	262	10%
Pension Risk	67	3%
Diversification	(933)	-37%
SCR	**2,533**	**100%**
Target Buffer over SCR	760	
Target Own Funds	**3,293**	

7.19 Insurance risk is the primary risk for AEL, accounting for 81% of diversified capital. This is followed by market risk which represents 33% of diversified capital. Operational risk accounts for 10% of diversified capital and credit risk, 9%. Pension risk accounts for just 3% of diversified capital.

7.20 Diversification reflects the view that extreme events in these risk categories will not necessarily occur simultaneously. There is a significant reduction in the overall SCR required due to diversification.

7.21 Notable drivers of risk within each category are:

- **Insurance Risk:** Commercial D&O, Commercial Property and Excess Casualty are allocated about half of the total insurance risk capital. Within insurance risk Natural Catastrophe Risk: European Windstorm is the greatest driver of natural catastrophe risk for AEL.

- **Market Risk:** Credit spread and currency exchange rate risks are ranked first and second respectively.

- **Credit Risk:** On a standalone basis AEL's most significant credit risk is the default risk of external reinsurers though significant exposure also exists to internal reinsurance.

- **Operational Risk:** Insurance-related operational risk scenarios feature highly in the ranking of operational risk scenarios. This is because they are correlated with insurance risk which is the largest driver of risk in AEL.

7.22 As explained in Section 5, AEL's buffer on the Internal Model basis is defined as being the difference between the ultimate and one year view of risks. I consider this is a reasonable way to define target Own Funds so as to protect the contractual rights of policyholders.

Standard Formula

7.23 Table 7.4 below shows the AEL SCR on a Standard Formula basis. The risk category and diversification definitions used in the Internal Model and Standard Formula are slightly different. However, where possible the table compares the Standard Formula risk charges to the Internal Model risk charges.

Table 7.4 - AEL Standard Formula SCR at Year-end 2016 and comparison with IM - £m

Risk Category	AEL SF	AEL IM	Difference
Non-life underwriting risk	2,577	2,060	517
Health underwriting risk	222		222
Life underwriting risk	12		12
Market risk	1,052	848	204
Counterparty default risk	175	229	(54)
Other		67	(67)
Diversification	(896)	(933)	37
Basic SCR	**3,142**	**2,271**	**871**
Operational risk	256	262	(7)
Loss Absorbing Capacity of Deferred Taxation	(37)		(37)
SCR	**3,361**	**2,533**	**827**
Target Buffer over SCR	460	760	(300)
Target Own Funds	**3,821**	**3,293**	**527**

7.24 The loss absorbing capacity of deferred taxation reduction to the SCR is limited to carry back losses in the UK and there is no forward-looking credit based on forecasts. I understand this approach has been agreed with the PRA.

7.25 The Standard Formula SCR of £3,361m is £827m larger than the Internal Model SCR of £2,533m for AEL. This is to be expected as the Standard Formula is calibrated for small to average European insurance companies rather than for AEL. AEL is much larger than an 'average' European insurer and so would be expected to have internal synergies and diversification credits which would not be recognised in the Standard Formula.

7.26 Although AEL does not underwrite life insurance risks it does contain life underwriting risks. This is in respect of longevity risks on periodical payment orders which are regular payments awarded by High Courts in the UK on serious bodily injury cases, often impacting motor insurance and employers' liability insurance policies. This risk is captured under insurance risk in the Internal Model.

7.27 As explained in Section 5, AEL's buffer on the Standard Formula basis is defined as being the worst annual loss expected over seven years based on the Internal Model. The target Own Funds on the Standard Formula basis exceeds the target Own Funds on the Internal Model basis and on that basis I consider it is a reasonable level of target Own Funds.

Process

7.28 I have reviewed documents and calculations relating to the calculation of the SCRs on the Standard Formula and Internal Model bases and have had the opportunity to discuss and challenge AEL staff involved in the running of the Internal Model and the calculation of the SCRs.

7.29 I have performed a high level benchmarking of the Internal Model and Standard Formula SCRs of AEL to other comparable insurers based on internal and external information available to me. This has focussed on key metrics such as the ratio of SCR to Premium, the ratio of SCR to Technical Provisions and the ratio of Risk Margin to Technical Provisions.

Findings

7.30 I found the methods and assumptions underlying the SCR on an Internal Model basis for AEL to be generally reasonable.

7.31 In forming this opinion I note the recent approval of AEL's Internal Model by the PRA and AEL's active use of the Internal Model in determining the strategy of the firm.

7.32 I have reviewed the calculation of the AEL Standard Formula SCR at 30 November 2016 and also consider this reasonable. In forming this opinion I note the AEL Standard Formula SCR has been audited by AEL's auditors.

7.33 My comparison of the SCRs with benchmarks from other insurers is consistent with my expectations and has not revealed any areas of material concern.

Section 8: Projections to 30 November 2018

8.1 In this section I set out my review of AEL's projection of its surplus over target Own Funds from 30 November 2016 to 30 November 2018.

8.2 AEL has projected its Own Funds and SCR to 30 November 2018 using the multi-year version of its 2017 business plan.

8.3 Table 8.1 below compares the surplus over Own Funds at 30 November 2016 and 30 November 2018.

Table 8.1 - Surplus over target Own Funds for AEL at 30 November 2016 and 30 November 2018 - £m

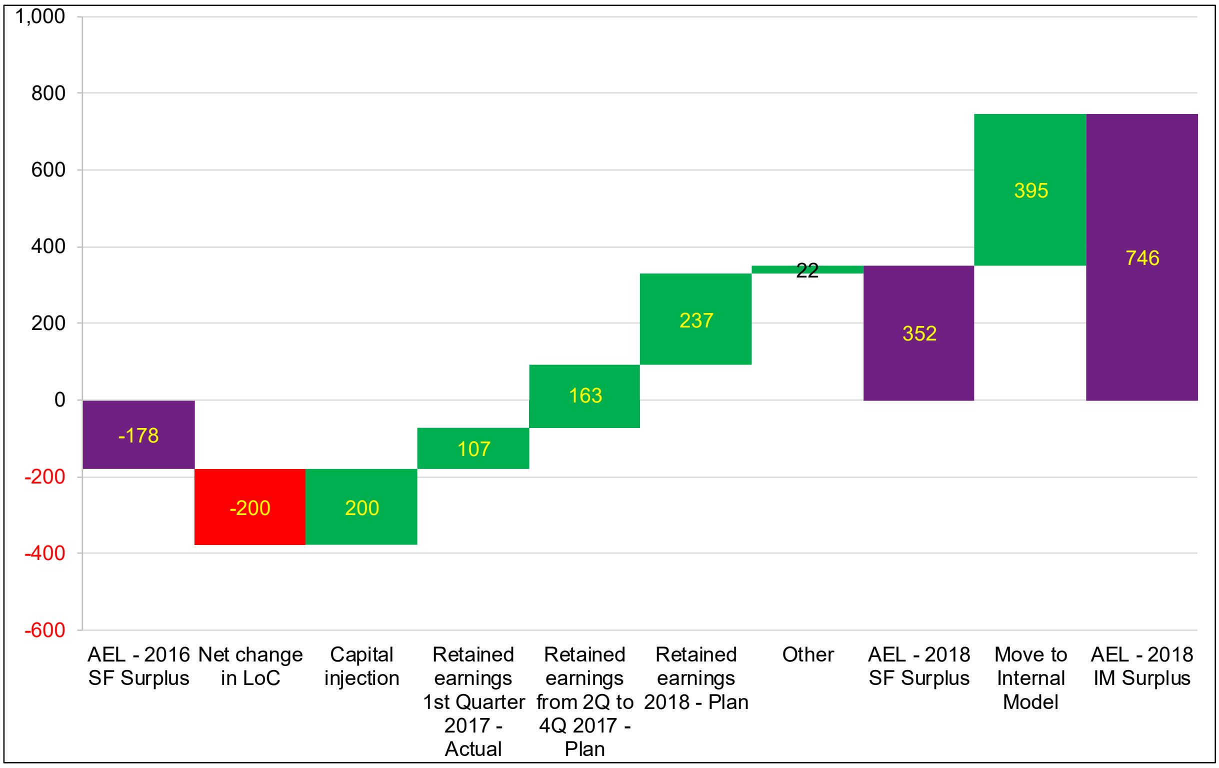
	30-Nov-16	30-Nov-18	Difference
Solvency Capital Basis	Standard Formula	Internal Model	
Assets			
Intangibles	0	0	0
Cash and investments	10,248	11,115	867
Ceded technical provisions	1,918	1,950	32
Insurance debtors	227	186	(41)
Gross deferred acquisition costs	0	0	0
Other prepayments and accrued income	532	738	205
Tier 2 Own Funds	537	337	(200)
Total Assets	**13,462**	**14,325**	**863**
Liabilities			
Technical provisions (excl. risk margin)	8,668	8,862	194
Risk Margin	576	459	(118)
Creditors	574	795	220
Ceded deferred acquisition costs	0	0	0
Total Liabilities	**9,819**	**10,115**	**296**
Solvency II Own Funds	**3,643**	**4,210**	**567**
SCR	**3,361**	**2,665**	**(696)**
Surplus over SCR	**282**	**1,545**	**1,263**
Target Buffer over SCR	460	799	339
Target Own Funds	**3,821**	**3,464**	**(356)**
Surplus over Target Own Funds	**(178)**	**746**	**923**

8.4 At 30 November 2016 AEL, which was then on the Standard Formula, has a deficit against target Own Funds of £178m. Own Funds of £3,643m were £282m in excess of the SCR of £3,361m so AEL met its Solvency Capital Requirement at 30 November 2016. AEL made a capital injection of £200m in March 2017 to bring its Own Funds to in excess of its target level.

8.5 At 30 November 2018 AEL, which at this point will be on the Internal Model, estimates its surplus over target Own Funds will be £746m, an increase of £923m.

8.6 Chart 8.1 below attributes the movement in surplus over target Own Funds between 30 November 2016 and 30 November 2018.

Chart 8.1 - Surplus over Target Own Funds between 30 November 2016 and 30 November 2018 - £m



8.7 The movements in the surplus over target Own Funds comprise:

- A net reduction in Letters of Credit (LoCs) of £200m which is replaced with a capital injection of £200m;
- Retained income after tax of £507m, £107m which has been accrued to 1Q2017, £163m projected for the remainder of 2017 and £237m projected in 2018;
- Other increases of £22m resulting from projected changes in the Solvency II Balance Sheet and the SCR; and
- Moving from the Standard Formula to the Internal Model basis results in an increase of £395m. This is the combination of a reduction in the SCR of £867m and an increase in the target buffer over SCR of £582m, reducing target Own Funds by £285m, and an increase in Own Funds of £110m.

8.8 I have reviewed the movement in Own Funds and SCRs on both the Internal Model and Standard Formula basis and I consider these are reasonable and in line with my expectations subject to the changes attributable to retained earnings after tax which are discussed below.

8.9 The most uncertain items in this projection are the retained earnings after tax (total comprehensive income). The key drivers for this are profit on new business and whether reserves run-off in line with expectations. I have commented on the reasonableness of reserves in Section 6 and have tested the sensitivity of my conclusions in Section 10. I discuss profit on new business below.

8.10 AEL's profit forecasts are based on the AEL 2017 and 2018 Business Plans. I have reviewed the business plans for AEL. In addition, I have reviewed the Actuarial Function Holder's

Underwriting Opinion which (amongst other things) considers the sufficiency of premiums to be earned to cover future claims and expenses.

8.11 AEL has projected total comprehensive income of £270m in 2017 and £237m in 2018. As shown previously in Table 5.2, AEL had total comprehensive income in 2016 of £143m. Its total comprehensive income between 2013 and 2015 averaged £227m in each year. AEL's result in 2016 was depressed by a higher level of claims activity and a strengthening of reserves in response to the reduction of the Ogden discount rate in early 2017. AIG has produced its business plans in the light of these results.

8.12 I understand total comprehensive income for the first quarter of 2017 is £107m which is in excess of the plan.

8.13 I consider that the projected Own Funds, SCRs, capital surplus and the projected total comprehensive income are reasonable and I take additional comfort that the total comprehensive income emerging in the first half of 2017 is ahead of this plan. In Section 10 I test the impact on my conclusions of assuming no future total comprehensive income.

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Section 9: Allocation of Assets and Liabilities to AIG UK and AESA

9.1 In this section I discuss the anticipated allocation of assets and liabilities between AIG UK and AESA.

Allocation of insurance liabilities

9.2 AEL's projected allocation of liabilities in respect of AIG UK and AESA is aligned with the transfer of risks from AEL to AIG UK and AESA as set out in paragraph 2.2.

9.3 As explained in Section 6, AEL monitors reserves split between UK and RoE segments which correspond to the location of the branch which writes the policy. Policies written in the UK may include elements of EEA risk written under FoS rights. I understand that post-Brexit EEA claims may not be permitted to be serviced by a UK insurer. In order that these claims may be serviced post-Brexit, under the Proposed Scheme this EEA element of the policy will transfer to AESA.

9.4 AEL estimates that in the absence of Brexit, £160m of 2019 gross written premium in the UK segment would relate to EEA risks. Separately, AEL estimates that £178m of reserves net of reinsurance at the date of the Proposed Scheme relates to EEA risks in the UK segment.

9.5 AEL has been advised that in the UK insurance does not have to be purchased from locally authorised insurers. Insurers can issue and service policies from abroad if they have been approached by a policyholder or an intermediary in their home jurisdiction and they do not carry out regulated activity in the UK. As such, post-Brexit, in contrast to the position for UK insurers, EEA insurers which do not carry out regulated activities in the UK will be able to service claims relating to UK risks. As such, all business in relation to Branch European Transferring Policyholders (i.e. all business written by AEL's EEA branches, including that element which relates to UK risks written under FoS rights) will be transferred to AESA.

9.6 I have seen the advice received by AEL on this point. It aligns with my understanding of the UK regulatory framework and as such I do not consider it is necessary for me to obtain independent legal advice on this point.

9.7 It has not been possible for me to directly test the reserve adequacy of the EEA business written in the UK segment under FoS rights. However, I have reviewed the allocation performed by AEL, I have reviewed a number of high level reserving metrics and I have discussed the nature of this business with AEL.

9.8 The reserving metrics show no indication of systemic variation from the overall portfolio of similar risks and I have identified no reasons why this business is likely to be reserved differently from the remainder of the AEL book. Also, 84% of the EEA business in the UK segment relates to case reserves which are typically more certain than IBNR reserves.

9.9 As such I consider the allocated reserves form a reasonable provision for the liabilities covered by AIG UK and AESA.

Allocation of reinsurance assets

9.10 As explained in paragraph 5.14, AEL will request the High Court to make an ancillary order to allow both AIG UK and AESA to retain the benefit of reinsurance to the extent it covers any part of any AEL insurance policies transferring under the Proposed Scheme.

9.11 In 2003 the High Court sanctioned what I understand to be a similar split of reinsurance in a Part VII Transfer between insurance companies within the Groupama group. Based on this precedent and the supporting views of AEL's legal advisors and counsel, I consider that it is reasonable to expect that the High Court will agree to AEL's request and as such I have used this assumption as my central basis when considering the security of policyholders' contractual rights.

9.12 However, in the event that the High Court does not sanction this, most of AEL's current reinsurance treaties and facultative contracts contain a provision which will allow AIG UK and AESA to benefit from the outwards reinsurance to the extent such reinsurance covers policies transferred to each company. I consider this is a robust second line of defence. However, some of AEL's reinsurance polices do not contain the necessary provision to enforce the split (these are mostly historic). At my request, AEL has undertaken an exercise to identify that element of the reinsurance asset which does not have this provision. From an inventory which included entries for 168 treaty reinsurance arrangements that AIG are aware of going back to 2008, 33 arrangements (i.e. 20%) did not have the relevant provision. AEL has then run a sensitivity test, under my direction, to assess the impact on Own Funds in the event that neither AIG UK nor AESA retains the benefit of such reinsurance. This scenario assumes that, in addition to the policies since 2008 which have been identified as not having the relevant provision, all treaty reinsurance arrangements prior to 2008 do not have the relevant provision. The results of this scenario test are set out in Section 10.

Allocation of investments

9.13 The allocation of investments assumed by AEL in its capital projections uses a simple branch-based allocation of investments between AIG UK and AESA. Both AIG UK and AESA are projected to hold approximately 82% of their investments in investment grade bonds, 5% in high yield bonds, 5% in structured products (including residential mortgage backed securities) with the balance split broadly evenly between mid-market loans, property, equity and cash.

9.14 AEL is undertaking a more sophisticated allocation in preparation for the Proposed Scheme in which specific investments will be allocated between AIG UK and AESA based on the results of an asset allocation programme. This will allocate assets to match the liabilities by currency and duration. The result of the asset allocation programme will be available by mid-2018.

9.15 I consider the allocation of AEL's investments between AIG UK and AESA as modelled in the capital projections is a reasonable estimate of the final allocation to be determined by the asset allocation programme. Further, I consider that the impact of any change in investment allocation between that in the capital projections and the final allocation is unlikely to have a material impact on the SCRs of AIG UK and AESA as market risk largely diversifies away in the SCR.

9.16 That said, if the final allocation is materially different from that assumed in the projections I will test the impact of this in my supplementary Scheme Report.

Allocation of letters of credit

9.17 Immediately prior to the Proposed Scheme AEL's Own Funds are expected to include three letters of credit with an aggregate value of £300m. These letters of credit will transfer to AIG UK under the Proposed Scheme.

AIG UK and AESA Internal Models

9.18 AEL currently has an approved Internal Model. AHEL is making a major model change which will require approval from the PRA in order that AIG UK will have an approved Internal Model.

AESA is making an Internal Model pre-application with the CAA. The AEL IM is in the process of being adapted to apply to AIG UK and AESA.

9.19 While the AIG UK and AESA Internal Models are fundamentally unchanged from the AEL Internal Model the reduced scale of each entity relative to AEL and, for example, the higher exposure to natural catastrophe risk in AIG UK and AESA's greater use of reinsurance mean that the risk ranking will change the focus of each model and so further calibration of the risks has been required.

9.20 Additional updates have been required since:

- Calibration of insurance risk is not in all cases split between UK and RoE in the AEL Internal Model.
- Man-made catastrophes need to be considered for the separate entities.
- Operational risks need to be recalibrated for the two entities.
- The dependency structure needs to reflect that AIG UK risk is driven by UK factors only and AESA risk by European factors only.

9.21 No further material changes to the model are planned.

9.22 Since AIG UK is a subsidiary of AHEL the Proposed Scheme will constitute a major model change which will require approval by the PRA. The internal model for AESA will require approval by the CAA.

9.23 The AEL Internal Model is built on a business unit basis where the business units are defined as UK, the Lexington business carried on out of London, Germany, France and Other Europe.

9.24 AIG UK has been modelled as UK and the Lexington business carried on out of London and AESA as Germany, France and Other Europe.

9.25 Business volume assumptions are taken from the AIG UK and AESA business plans.

9.26 The AIG UK and AESA business plans recognise revisions to premiums resulting from FoS changes, proposed reinsurance changes and additional costs arising as a result of the Proposed Scheme.

9.27 The new risk rankings for AIG UK and AESA change the focus of the Internal Models:

- **AIG UK** is more natural catastrophe exposed and additional reinsurance is planned to bring down the 1 in 200 risk levels to within the AIG UK risk appetite. AIG UK will include UK windstorm/flood as well as including North American exposures written through Lexington. Additional reinsurance purchase is anticipated on all lines to reduce net limits to within risk appetite.
- **AESA** is planning a greater use of reinsurance which will reduce insurance risk (both underwriting and reserve risk). In addition, the use of quota share reinsurance will reduce market risk as assets reduce to meet lower net liabilities. As a consequence, other risks become more material. Credit risk and operational risk will become an area of increased focus as they become a larger proportion of the overall SCR.
- The credit risk attributable to the additional reinsurance purchased by both companies is considered within the Internal Model.

9.28 The AIG UK and AESA Internal Models are in the process of being tested and validated and so the SCRs are subject to possible change in the future. In the event that these changes are material I will address this in my supplementary Scheme Report.

9.29 Table 9.1 below shows for AEL immediately pre-Proposed Scheme on 30 November 2018 and AIG UK and AESA immediately following the Proposed Scheme on 1 December 2018, the Solvency II Balance Sheet, SCR and Surplus over target Own Funds with all entities assessed on the Internal Model basis. It also compares the sum of AIG UK and AESA to AEL.

Table 9.1 - Surplus over target Own Funds by Company at Effective Date - Internal Model - £m

	AEL	AIG UK	AESA	AIG UK + AESA	Difference
Assets					
Intangibles	0	0	0	0	0
Cash and investments	11,115	4,428	6,690	11,118	3
Ceded technical provisions	1,950	1,300	652	1,952	2
Insurance debtors	186	128	51	180	(6)
Gross deferred acquisition costs	0	0	0	0	0
Other prepayments and accrued income	738	420	317	738	0
Tier 2 Own Funds	337	337	0	337	0
Total Assets	**14,325**	**6,614**	**7,711**	**14,325**	**(1)**
Liabilities					
Technical provisions (excl. risk margin)	8,862	4,314	4,549	8,862	0
Risk Margin	459	209	267	475	17
Creditors	795	330	465	794	(0)
Ceded deferred acquisition costs	0	0	0	0	0
Total Liabilities	**10,115**	**4,853**	**5,280**	**10,132**	**17**
Solvency II Own Funds	**4,210**	**1,761**	**2,431**	**4,192**	**(18)**
Risk Category					
Insurance Risk	2,179	1,154	701	1,856	(324)
Market Risk	871	458	456	914	43
Credit Risk	235	139	162	301	66
Operational Risk	269	173	192	365	96
Pension Risk	69	57	35	92	23
Diversification	(958)	(626)	(452)	(1,078)	(121)
SCR	**2,665**	**1,355**	**1,095**	**2,449**	**(216)**
Target Buffer over SCR	799	406	328	735	(65)
Target Own Funds	**3,464**	**1,761**	**1,423**	**3,184**	**(281)**
Surplus over Target Own Funds	**746**	**0**	**1,008**	**1,008**	**263**

9.30 It can be seen that the assets of AIG UK and AESA broadly sum to the AEL figure.

9.31 The sum of the risk margins for AIG UK and AESA shows an increase of £17m compared to AEL which is attributable to the loss of diversification benefit that AEL experiences under deconsolidation, the impact of which has been partly offset by the influence of the different reinsurance programmes (which serve to reduce the risk margin).

9.32 The risk rankings for both AIG UK and AESA are unchanged from that of AEL.

9.33 The sum of the AIG UK and AESA insurance risk charges is smaller by £324m than the equivalent AEL insurance risk charge. This is a result of AIG UK and AESA's greater use of outwards reinsurance. Due to its smaller size and corresponding lower risk appetite, AIG UK plans to reduce the deductible on a number of its outward reinsurance protections and increase the reinsurance on its Lexington business reducing its insurance risk charge by £85m. AESA plans more substantial changes including a whole entity 55% quota share reinsurance and a whole entity accident year stop loss both with the AIG US Pool as counterparty. These changes have the impact of reducing the AESA insurance risk charge by £604m. This combined reduction of £689m is offset by a loss of diversification benefit of £366m, resulting in the overall reduction in the insurance risk charge of £324m.

9.34 For each other risk category the sum of the AIG UK and AESA risk category charges is larger than the equivalent AEL figure which is as expected since there is a loss of diversification benefit in each of the risk categories.

9.35 Finally, on de-consolidation there is an increased diversification benefit of £121m as a result of the larger combined risk charges on the non-insurance risk categories.

9.36 At the date of the Proposed Scheme, assets are allocated to AIG UK such that its Own Funds equal its SCR plus a buffer and the balance of assets are allocated to AESA. Hence, AIG UK's surplus over target Own Funds is zero.

9.37 I have reviewed the benchmarking study referred to in paragraph 7.29 for the Internal Model and Standard Formula SCRs for AIG UK and AESA. The ratios are consistent with my expectations and this has not revealed any areas of material concern.

9.38 The projected SCRs are dependent on the assumptions regarding the reinsurance in place at the date of the Proposed Scheme. The SCRs have been calculated based on the AIG UK and AESA business plans. Should there be material changes in the proposed reinsurance structures this may impact my opinion and I would expect to address this in my supplementary Scheme Report if required.

9.39 The equivalent table on a Standard Formula basis is shown in Table 9.2 below.

Table 9.2 - Surplus over target Own Funds by Company at Effective Date - Standard Formula - £m

	AEL	AIG UK	AESA	AIG UK + AESA	Difference
Assets					
Intangibles	0	0	0	0	0
Cash and investments	11,115	4,679	6,439	11,118	3
Ceded technical provisions	1,950	1,300	652	1,952	2
Insurance debtors	186	128	51	180	(6)
Gross deferred acquisition costs	0	0	0	0	0
Other prepayments and accrued income	738	420	317	738	0
Tier 2 Own Funds	337	337	0	337	0
Total Assets	**14,325**	**6,865**	**7,459**	**14,325**	**(1)**
Liabilities					
Technical provisions (excl. risk margin)	8,862	4,314	4,549	8,862	0
Risk Margin	569	251	328	579	10
Creditors	795	330	465	794	(0)
Ceded deferred acquisition costs	0	0	0	0	0
Total Liabilities	**10,225**	**4,895**	**5,341**	**10,236**	**10**
Solvency II Own Funds	**4,100**	**1,970**	**2,118**	**4,089**	**(11)**
Risk Category					
Non-life underwriting risk	2,597	1,417	1,341	2,759	162
Health underwriting risk	257	165	174	339	82
Life underwriting risk	12	12	0	12	(0)
Market risk	873	346	349	694	(178)
Counterparty default risk	169	129	86	215	46
Diversification	(832)	(438)	(412)	(849)	(17)
Basic SCR	**3,073**	**1,632**	**1,538**	**3,169**	**96**
Operational risk	273	119	120	239	(34)
LAC DT	(58)	(37)	(21)	(58)	0
SCR	**3,289**	**1,713**	**1,637**	**3,350**	**61**
Target Buffer over SCR	460	257	246	503	43
Target Own Funds	**3,749**	**1,970**	**1,882**	**3,853**	**104**
Surplus over Target Own Funds	**351**	**0**	**236**	**236**	**(115)**

9.40 The risk rankings for AIG UK and AESA are unchanged from that of AEL.

9.41 The sum of the AIG UK and AESA risk category charges are larger than the equivalent AEL figures for underwriting risks and credit risks as in contrast to that seen for the IM the SF provides less recognition for the risk mitigating benefits of reinsurance.

9.42 The sum of the AIG UK and AESA risk category charges are lower than the equivalent AEL figures for market risk. This is because under the Standard Formula AESA has a lower currency risk charge since its Euro denominated exposures are no longer subject to foreign exchange rate stresses.

9.43 I have reviewed the impact of deconsolidating AIG UK and AESA under the Proposed Scheme on the resulting SCRs and consider the changes are in line with my prior expectation or where this is not the case, sufficient explanation has been provided to make me comfortable with the movement.

9.44 Target Own Funds are larger under the Standard Formula basis than the Internal Model basis. I consider the target Own Funds are reasonable to protect policyholders' contractual rights.

9.45 Table 9.3 below shows surplus over target Own Funds for AIG UK and AESA immediately after the implementation of the Proposed Scheme on 1 December 2018. This encompasses the possible combinations of SCR bases for AIG UK and AESA following the Proposed Scheme.

Table 9.3 - Surplus over target Own Funds by SF and IM Scenario Post Proposed Scheme on 1 December 2018 - £m

	SCR Basis			
AIG UK	Internal Model	Internal Model	Standard Formula	Standard Formula
AESA	Internal Model	Standard Formula	Internal Model	Standard Formula
AIG UK				
Solvency II Own Funds	1,761	1,761	1,970	1,970
SCR	1,355	1,355	1,713	1,713
Target Buffer over SCR	406	406	257	257
Target Own Funds	1,761	1,761	1,970	1,970
Surplus over Target Own Funds	**0**	**0**	**0**	**0**
AESA				
Solvency II Own Funds	2,431	2,388	2,198	2,118
SCR	1,095	1,637	1,095	1,637
Target Buffer over SCR	328	246	328	246
Target Own Funds	1,423	1,882	1,423	1,882
Surplus over Target Own Funds	**1,008**	**505**	**775**	**236**

9.46 It can be seen in Table 9.3 that:

- Under each SCR scenario, the surplus over target Own Funds for AIG UK is zero. This is since assets are first used to satisfy AIG UK's target Own Funds and remaining assets are allocated to AESA;
- Whether AESA is assessed on an Internal Model or Standard Formula basis has no effect on AIG UK; and
- AESA is affected by whether AIG UK is assessed on an Internal Model or Standard Formula basis.

9.47 AEL has also produced projections of the Own Funds and SCR for AEL in the event that the scheme does not proceed. In this case the AEL position is presented for Soft Brexit and Hard Brexit scenarios.

9.48 Table 9.4 below shows the position for AEL immediately prior to the Proposed Scheme and on 1 December 2018 on Soft and Hard Brexit bases if there were no scheme. This is on an Internal Model basis as this is the basis that the SCR for AEL is assessed under each of these scenarios.

Table 9.4 - Impact of Brexit on AEL Surplus over target Own Funds at 1 December 2018 - £m

	Pre Proposed Scheme	Soft Brexit	*Impact of Soft Brexit*	Hard Brexit	*Impact of Hard Brexit*
AEL					
Solvency II Own Funds	4,210	4,210	*0*	3,465	*(745)*
SCR	2,665	2,665	*0*	6,793	*4,129*
Target Buffer over SCR	799	799	*0*	2,038	*1,239*
Target Own Funds	3,464	3,464	*0*	8,831	*5,367*
Surplus over Target Own Funds	**746**	**746**	***(0)***	**(5,366)**	***(6,112)***

9.49 Under the Soft Brexit scenario no changes have been assumed in the financials for AEL pre-Brexit as it is assumed that AEL will continue to operate as it does today with all FoS and FoE rights being maintained. As such the surplus over target capital remains at £746m.

9.50 Under the Hard Brexit scenario, as described in paragraphs 5.76 to 5.85, I have assumed that individual branches will have to be individually capitalised with much less scope for diversification. AEL has estimated the SCR in this scenario using its Internal Model. The AEL Internal Model is already set up to calculate standalone capital requirements for the largest branches (UK, France and Germany) and a simplified method was applied for the smaller branches. This increases the SCR by £4,129m. I have reviewed the methodology used by AIG to estimate this increase in SCR and consider it is reasonable. Total comprehensive income is assumed to have decreased by £34m resulting from greater tax costs and increased operating expenses. No additional capital injections have been assumed. This results in AEL under a Hard Brexit having a deficit in its regulatory capital with Own Funds of £3,465m being £3,328m deficient in meeting the SCR of £6,793m.

9.51 I consider the assumptions used to produce the above projections of surplus over target Own Funds for AIG UK, AESA and AEL on Soft Brexit and Hard Brexit scenarios are reasonable and the results are in line with my expectations.

Section 10: Policyholder security and other considerations

Introduction

10.1 In this section, I discuss considerations arising from the effect of the Proposed Scheme on:

- the security of policyholders' contractual rights; and
- the levels of service provided to policyholders and other considerations.

10.2 I have considered the likely effects of the Proposed Scheme on:

- The UK Transferring Policyholders; and
- The European Transferring Policyholders.

10.3 I have discussed these considerations under the following headings:

- Financial position, including under stress scenarios
- Insolvency, including the ranking of policyholders in a winding-up and access to compensation schemes
- Trust Funds
- Non-EEA and Swiss policyholders
- Policyholder service levels, including claims handling, investment management, new business strategy, administration and governance
- Expense levels
- Other considerations, which include:
    - Future profitability of AIG UK and AESA
    - Target Own Funds
    - Comparison of regulatory regimes
    - Accounting and reserve approach
    - Tax implications of the Proposed Scheme
    - Costs of the Proposed Scheme
    - Ombudsman services
    - Liquidity
    - Allocation of outwards reinsurance

- Intra-group reinsurance
- Guarantees
- Capital Maintenance Agreement
- Policyholder mis-allocation
- Outward reinsurers
- Pension Schemes.

10.4 I also discuss my findings on policyholder communication.

Financial position

UK Transferring Policyholders

10.5 Table 10.1 below shows the financial position of UK Transferring Policyholders under the possible scenarios of:

- AIG UK SCR assessed with Internal Model;
- AIG UK SCR assessed with Standard Formula;
- No scheme and there is a Soft Brexit; and
- No scheme and there is a Hard Brexit.

Table 10.1- Coverage Ratio at Effective Date - UK Transferring Policyholders - £m

	AIG UK	AIG UK	AEL - Soft Brexit	AEL - Hard Brexit
AIG UK SCR Basis	Internal Model	Standard Formula	Internal Model	Internal Model
AESA SCR Basis	n/a	n/a	n/a	n/a
Before Dividend				
Solvency II Own Funds	1,761	1,970	4,210	3,465
SCR	1,355	1,713	2,665	6,793
Surplus over SCR	407	257	1,546	(3,328)
Coverage Ratio over SCR	**130%**	**115%**	**158%**	**51%**
Target Own Funds	1,761	1,970	3,464	8,831
Surplus over Target Own Funds	0	0	746	(5,366)
Coverage Ratio over Target Own Funds	**100%**	**100%**	**122%**	**39%**
Dividend	**0**	**0**	**746**	**0**
After Dividend				
Solvency II Own Funds	1,761	1,970	3,464	3,465
SCR	1,355	1,713	2,665	6,793
Surplus over SCR	406	257	799	(3,328)
Coverage Ratio over SCR	**130%**	**115%**	**130%**	**51%**
Target Own Funds	1,761	1,970	3,464	8,831
Surplus over Target Own Funds	0	0	0	(5,366)
Coverage Ratio over Target Own Funds	**100%**	**100%**	**100%**	**39%**

10.6 It is unlikely that AIG UK's major change to the Internal Model will be approved before mid-2018 so I have considered both the Internal Model and Standard Formula scenarios.

10.7 The SCR coverage ratio is calculated as the Own Funds as a proportion of the SCR and the target Own Funds coverage ratio is calculated as the Own Funds as a proportion of target Own Funds.

10.8 AIG UK has a SCR coverage ratio in excess of 100% which is that of a sufficiently capitalised company on both the Internal Model and Standard Formula bases.

10.9 On both Internal Model and Standard Formula bases AIG UK has Own Funds equal to its target Own Funds so its coverage ratio over target Own Funds is 100%. Since target Own Funds are greater under the Standard Formula than the Internal Model this means that AIG UK can meet its liabilities to at least a 99.5 percentile confidence level to ultimate.

10.10 I have reviewed the composition of AIG UK's Own Funds under both Internal Model and Standard Formula bases, which includes the £300m of letters of credit discussed in paragraph 9.17, and I consider these will be acceptable as eligible Own Funds under Solvency II.

10.11 If the Proposed Scheme does not proceed and there is a Soft Brexit then UK Transferring Policyholders would remain in AEL and would have the benefit of a higher SCR coverage ratio and a higher target Own Funds coverage ratio. But under this scenario AEL would look to issue a dividend of £746m to bring the target Own Funds coverage ratio to 100% in line with its target Own Funds policy. In this case, AEL's coverage ratios in a Soft Brexit scenario would be 130% of SCR and 100% of target Own Funds.

10.12 As such, under an Internal Model AIG UK's SCR coverage ratio of 130% is the same as under AEL in a Soft Brexit scenario post dividend. In this case I consider that the security of UK Transferring Policyholders' contractual rights is not materially disadvantaged by the Proposed Scheme.

10.13 AIG UK's SCR coverage ratio under the Standard Formula basis of 115% is lower than the 130% under AEL in a Soft Brexit scenario. However, AIG UK's Own Funds on the Standard Formula basis of £1,970m exceed its Own Funds on the Internal Model basis of £1,761m, a level at which I have already concluded the security of UK Transferring Policyholders' contractual rights is not materially disadvantaged. Thus, in this case I consider that the security of UK Transferring Policyholders' contractual rights is not materially disadvantaged by the Proposed Scheme.

10.14 If the Proposed Scheme does not proceed and there is a Hard Brexit then UK Transferring Policyholders would remain in AEL and AEL would not meet its SCR. Since AIG UK is projected to meet its SCR on both the Internal Model and Standard Formula bases I consider that in this case the security of UK Transferring Policyholders' contractual rights is improved by the Proposed Scheme.

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

European Transferring Policyholders

10.16 Table 10.2 below shows the financial position of European Transferring Policyholders under the possible scenarios of:

- AESA SCR assessed with Internal Model and AIG UK with Internal Model;
- AESA SCR assessed with Standard Formula and AIG UK with Internal Model;

- AESA SCR assessed with Internal Model and AIG UK with Standard Formula;
- AESA SCR assessed with Standard Formula and AIG UK with Standard Formula;
- No scheme and there is a Soft Brexit; and
- No scheme and there is a Hard Brexit.

Table 10.2 - Coverage Ratio at Effective Date - European Transferring Policyholders - £m

	AESA	AESA	AESA	AESA	AEL - Soft Brexit	AEL - Hard Brexit
AIG UK SCR Basis	Internal Model	Internal Model	Standard Formula	Standard Formula	n/a	n/a
AESA SCR Basis	Internal Model	Standard Formula	Internal Model	Standard Formula	n/a	n/a
Before Dividend						
Solvency II Own Funds	2,431	2,388	2,198	2,118	4,210	3,465
SCR	1,095	1,637	1,095	1,637	2,665	6,793
Surplus over SCR	1,336	751	1,103	481	1,546	(3,328)
Coverage Ratio over SCR	**222%**	**146%**	**201%**	**129%**	**158%**	**51%**
Target Own Funds	1,423	1,882	1,423	1,882	3,464	8,831
Surplus over Target Own Funds	1,008	505	775	236	746	(5,366)
Coverage Ratio over Target Own Funds	**171%**	**127%**	**154%**	**113%**	**122%**	**39%**
Dividend	**1,008**	**505**	**775**	**236**	**746**	**-**
After Dividend						
Solvency II Own Funds	1,423	1,882	1,423	1,882	3,464	3,465
SCR	1,095	1,637	1,095	1,637	2,665	6,793
Surplus over SCR	328	246	328	246	799	(3,328)
Coverage Ratio over SCR	**130%**	**115%**	**130%**	**115%**	**130%**	**51%**
Target Own Funds	1,423	1,882	1,423	1,882	3,464	8,831
Surplus over Target Own Funds	0	0	0	0	0	(5,366)
Coverage Ratio over Target Own Funds	**100%**	**100%**	**100%**	**100%**	**100%**	**39%**

10.17 It is unlikely that AESA's Internal Model application will be decided before mid-2018 as is also the case for AIG UK so I have considered each of the combinations of the Internal Model and Standard Formula for AIG UK and AESA.

10.18 AESA has a SCR coverage ratio in excess of 100% which is that of a sufficiently capitalised company on each of the Internal Model and Standard Formula bases.

10.19 On both Internal Model and Standard Formula bases AESA has Own Funds equal to its target Own Funds so its coverage ratio over target Own Funds is 100%. Since target Own Funds are greater under the Standard Formula than the Internal Model this means that AESA can meet its liabilities to at least a 99.5 percentile confidence level to ultimate.

10.20 I have reviewed the composition of AESA's Own Funds under both Internal Model and Standard Formula bases and consider these will be acceptable as eligible Own Funds under Solvency II.

10.21 If the Proposed Scheme does not proceed and there is a Soft Brexit then European Transferring Policyholders would remain in AEL and would have the benefit of a higher SCR coverage ratio and a higher target Own Funds coverage ratio under some of the IM and SF combinations. But in this case AEL would look to issue a dividend of £746m to bring the target Own Funds coverage ratio to 100% in line with its target Own Funds policy. In this case, AEL's coverage ratios in a Soft Brexit scenario would be 130% on SCR and 100% on target Own Funds.

10.22 AESA would also do the same and as such, under an Internal Model AESA's SCR coverage ratio of 130% is the same as under AEL in a Soft Brexit scenario post dividend. In this case I consider that the security of European Transferring Policyholders' contractual rights is not materially disadvantaged by the Proposed Scheme.

10.23 AESA's SCR coverage ratio under the Standard Formula basis of 115% is lower than the 130% under AEL in a Soft Brexit scenario. However, AESA's Own Funds on the Standard Formula basis of £1,882m exceed its Own Funds on the Internal Model basis of £1,423m, a level at which I have already concluded that the security of European Transferring Policyholders' contractual rights is not materially disadvantaged. Thus, in this case I consider that the security of European Transferring Policyholders' contractual rights is not materially disadvantaged by the Proposed Scheme.

10.24 If the Proposed Scheme does not proceed and there is a Hard Brexit then European Transferring Policyholders would remain in AEL and AEL would not meet its SCR. Since AESA is projected to meet its SCR on both the Internal Model and Standard Formula bases I consider that in this case the security of European Transferring Policyholders' contractual rights is improved by the Proposed Scheme.

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

Scenario testing

10.26 AIG UK will be capitalised to its target Own Funds at the date of the Proposed Scheme with the balance of AEL's assets being allocated to AESA. As such, the financial position of AIG UK and of UK Transferring Policyholders will not be affected by the scenarios described in paragraph 10.29 below. For this reason I consider my opinion relating to UK Transferring Policyholders is resilient to realistic alternative scenarios.

10.27 Since AIG UK will be capitalised to its target capital at the date of the Proposed Scheme with the balance of AEL's assets being allocated to AESA, AESA and the European Transferring Policyholders will bear the full impact of events affecting AEL before the Proposed Scheme, whether or not these are in respect of EEA risks.

10.28 As shown in Table 10.2, prior to any shareholder distribution, AESA has a surplus over SCR which varies between £481m and £1,336m and a surplus over target Own Funds which varies between £236m and £1,008m depending on the IM/SF basis applied.

10.29 I have tested the impact on the capital surplus and coverage ratios under the following stress scenarios:

- **No future retained earnings –** The AEL projections assume retained earnings of £400m from the second quarter of 2017 until the end of its fourth quarter of 2018. If these are not forthcoming it will imply Own Funds are reduced by £400m for AESA and for AEL in both the Soft Brexit and Hard Brexit scenarios. Under this scenario AESA would have a SCR coverage ratio in excess of 100% and would meet its target Own Funds on all IM/SF bases other than if both AIG UK and AESA were both assessed on the SF basis in which case AESA's Own Funds would be deficient by £164m.

  I consider the impact of no retained earnings of AIG UK and AESA in the three years following the effective date of the Proposed Scheme in paragraph 10.86.

- **Reserve Deterioration –** I have tested the impact of a reserve deterioration of 5% of claims reserves to 30 November 2018, approximately £300m. This reduces Own Funds by £300m for AESA and for AEL in both the Soft Brexit and Hard Brexit scenarios. Under this scenario AESA would have a SCR coverage ratio in excess of 100% and would meet its target Own Funds on all IM/SF bases other than if both AIG UK and AESA were both assessed on the SF basis in which case AESA's Own Funds would be deficient by £64m.

- **Level 3 valuation stress –** In this stress I have tested the impact of the valuation of Level 3 investments (RMBS) falling to zero compared to their valuation in the year-end 2016 accounts of £225m. This would reduce the Own Funds by £225m for AESA and for AEL in both the Soft Brexit and Hard Brexit scenarios and would reduce AESA's SCR by approximately £23m. Under this scenario AESA would have a SCR coverage ratio in excess of 100% and would meet its target Own Funds on all IM/SF bases.

- **Level 3 investment allocation –** Level 3 investments (RMBS) are expected to be shared between AIG UK and AESA. In this stress scenario I have examined the impact of fully allocating the Level 3 investments to either AIG UK or AESA with the balance of Own Funds comprising Level 1 or Level 2 investment instruments. The most severe realisation of this scenario is a full allocation of the Level 3 assets to AESA which reduces AIG UK's SCR by £31m and increases AESA's SCR by £40, a reduction of Own Funds in excess of SCR by £9m and Own Funds in excess Target Own Funds £12m. Under this scenario AESA would have a SCR coverage ratio in excess of 100% and would meet its target Own Funds on all IM/SF bases.

- **Outwards reinsurance stress –** In this stress I have tested the impact of the High Court not sanctioning the split of AEL's outwards reinsurance between AIG UK and AESA. I have assumed that the provision in outwards reinsurance treaties allowing any company in the AIG Group to be a beneficiary is enforceable. However, for outward reinsurance contracts without this provision I have assumed that AEL is unable to allocate the benefit of the reinsurance to either of AIG UK or AESA. This scenario reduces AESA's Own Funds by £137m and increases its SCR by £11m. This implies a reduction of Own Funds in excess of SCR by £149m and Own Funds in excess target Own Funds by £152m. Under this scenario AESA would have a SCR coverage ratio in excess of 100% and would meet its target Own Funds on all IM/SF bases.

10.30 In summary, AESA has sufficient projected Own Funds to be able to withstand any one of these adverse scenarios without its Own Funds reducing to below the SCR and to meet its target Own Funds on all IM/SF bases other than if AIG UK and AESA were both assessed on the SF basis.

10.31 I do not consider that there is a high likelihood of these scenarios occurring simultaneously and as such I have only considered them individually. In the event of any one of these scenarios occurring prior to the date of the Proposed Scheme or in the event that I consider that a material positive correlation has arisen between the likelihoods of these scenarios occurring then I would expect to consider this in my supplementary Scheme Report and would consider the full implications on the Own Funds and SCR at that stage.

10.32 As such, it is my opinion that the security of European Transferring Policyholders' contractual rights is not materially worsened compared to a Soft Brexit and they are in a better position than under a Hard Brexit. Since it is not clear whether AEL would experience a Soft Brexit or Hard Brexit it is my opinion that European Transferring Policyholders are not materially disadvantaged when compared to a no scheme scenario.

Insolvency

10.33 I am required to consider the effects of the insolvency of AEL, AIG UK or AESA. As I have explained above, the likelihood of any of these entities being able to pay all future claims will remain in excess of the level implied by the Solvency II solvency criterion of 99.5% value-at-risk over a one-year time horizon. In addition, the companies' target Own Funds implies a 99.5% value-at-risk over an ultimate time horizon on an Internal Model basis. This implies that the possibility of the insolvency of AEL before the Proposed Scheme or either AIG UK or AESA after the Proposed Scheme is remote.

10.34 In the event of the insolvency of AEL or AIG UK then under UK insolvency rules policyholders would be paid in priority to all other unsecured debts, except employee remuneration and pension contributions. These rules mean that any sums available for insurance debts after the secured and preferred creditors have been satisfied are to be paid off in advance of all other debts. If there are insufficient sums to satisfy policyholder claims then, in the case of certain claims, the Financial Services Compensation Scheme ("FSCS") may contribute to the settlement of the claim.

10.35 In the event of the insolvency of AESA then, although there is no protection scheme similar to the FSCS, Luxembourg law has rules aimed at protecting insurance creditors in case of insolvency of the insurance undertaking.

10.36 AESA will be required to establish technical provisions for all the liabilities arising from the insurance contracts that have been concluded, for the entirety of its insurance activities. Such technical provisions must at all times be covered by equivalent and matching assets ("Tied Assets"). The Tied Assets constitute a separate pool of assets, which must be clearly segregated from the other assets and liabilities of the insurance company.

10.37 The Tied Assets are allocated, in absolute preference/priority, to the guarantee of the payment of insurance claims payable by the insurance undertaking to its insurance creditors. If the insurance undertaking becomes insolvent, the insurance creditors are paid out of Tied Assets, preferentially and in priority to other creditors.

10.38 My understanding is that many insurance company failures are due to poor loss experience and reserve deteriorations beyond the level of the technical provisions. In such a scenario the Tied Assets are not likely to be sufficient and so would not provide much additional protection from insolvency.

Ranking of policyholders in a winding-up

10.39 In the event of the insolvency of AEL, AIG UK or AESA direct policyholders will rank ahead of the assumed reinsurance policyholders when the assets of the insolvent company are allocated to its creditors.

10.40 The companies are expected to have different mixes of direct and assumed reinsurance business.

- For AEL the approximate split is expected to be 88% direct and 12% assumed reinsurance.
- For AIG UK the approximate split is expected to be 79% direct and 21% assumed reinsurance.
- For AESA the approximate split is expected to be 94% direct and 6% assumed reinsurance.

10.41 Thus European Transferring Policyholders which are reinsurers will have a relatively larger proportion of direct policyholders ranking ahead of them compared to AEL. By contrast, UK Transferring Policyholders which are reinsurers will have a relatively smaller proportion of direct policyholders ranking ahead of them compared to AEL.

10.42 This may reduce the financial security of European Transferring Policyholders who are reinsurers. However, as AESA remains more than adequately capitalised after the Proposed

Scheme, it is my opinion that the European Transferring Policyholders who are reinsurers will not be materially adversely affected by the Proposed Scheme.

Access to compensation schemes

10.43 The FSCS covers contracts of insurance issued by a UK authorised insurer, including those issued on an outbound FoS or FoE basis where the risk or commitment is situated within an EEA state.

10.44 The FSCS scheme provides compensation in the event of insurer insolvency. In general, retail policyholders (private individuals and small businesses) are covered for all claims and large businesses are covered for claims in respect of compulsory liability insurance. Compulsory insurance[1], professional indemnity insurance and insurances covering the death or incapacity of the policyholder due to injury, sickness, or infirmity are fully covered. For other insurances protection is provided at 90% of the claim, with no upper limit. No protection is available for Goods in Transit, Marine, Aviation and Credit Insurance, or for contracts of reinsurance.

10.45 Luxembourg has no equivalent compensation scheme.

10.46 AEL policyholders which meet the criteria set out in paragraphs 10.43 and 10.44 currently benefit from the FSCS and will continue to do so in the event of no Proposed Scheme.

10.47 UK Transferring Policyholders which meet the criteria set out in paragraphs 10.43 and 10.44 will continue to have the benefit of FSCS protection.

10.48 European Transferring Policyholders which meet the criteria set out in paragraphs 10.43 and 10.44 with claims occurring before the transfer date (whether reported or unreported) will have the benefit of FSCS protection under the FSCS's 'successor rules'[2]. However, European Transferring Policyholders with claims occurring after the transfer date will not have cover under the FSCS after the Proposed Scheme in respect of such claims[3].

10.49 There is no EEA-wide equivalent non-life Insurance Compensation Scheme ("ICS"). I have seen an analysis of national non-life ICSs undertaken by AEL's legal advisors for the top ten jurisdictions in which AESA will write policies and additionally including Belgium. This indicates that policyholders of AESA under policies written through local branches in jurisdictions such as in Ireland and Spain may have access to national non-life general ICSs. An ICS exists in Denmark but it has not yet been determined if AESA will participate in the ICS[4]. Policyholders in other jurisdictions may have access to national non-life ICSs for specific claim types[5]. In two jurisdictions reviewed, Sweden and the Netherlands, it indicates that there is no form of either general or specific non-life ICS.

10.50 Under my direction, AEL has performed an analysis using what I consider are reasonable assumptions, to estimate the volume of AESA claims which would be expected to have lost the

[1] Compulsory insurance in the UK includes motor third party liability and Employers' Liability.
[2] The PRA's Policy Statement PS5/15 provides that all claims that arise (whether reported or unreported) against the predecessor firm before the assumption of liabilities by a successor (i.e. in circumstances where the insured event happened before the transfer) fall under the FSCS's 'successor rules'. The relevant section in the PRA's rule book is rule 11 of the Policyholder Protection part.
[3] This is based on the position under the existing successor rules in the Policyholder Protection (PP) part of the PRA Rulebook and assumes that AESA will not be a "relevant person" for the purpose of the PP rules post transfer. If AESA were considered a "relevant person" then cover may be available from the FSCS for such claims. However, there is uncertainty over whether this protection would be available following Brexit. In this report I have prudently disregarded the possibility of European Transferring Policyholders having access to the FSCS in respect of claims occurring after the transfer date.
[4] To be determined prior to the Proposed Scheme
[5] Examples include Belgium – workers' accidents; Finland – statutory employment accident insurance, statutory patient insurance and statutory traffic insurance; France – most mandatory insurance contracts including household, motor vehicle, construction works and professional liability insurance; Greece – motor accident liability; Italy – motor insurance and hunter's liability insurance and Poland – farmers, farm buildings, professional and motor third party liability. A private health insurance ICS exists in Germany but AESA will not be participating.

benefit of FSCS protection were AESA to suffer an insolvency event following the Proposed Scheme. I have reviewed the AEL analysis and consider it to be reasonable and in line with my prior expectations.

10.51 The AEL analysis indicates that if the insolvency of AESA occurred immediately following the Proposed Scheme, out of total AESA claims reserves of approximately £4,300m, approximately £583m of AESA claims reserves (or 13% of the total) would lose the benefit of FSCS protection compared to their position in the event of no Proposed Scheme.

10.52 At the time of the Proposed Scheme AESA is expected to be capitalised to in excess of its target Own Funds. As such, the assumption of an insolvency event immediately following the Proposed Scheme is, in my view, an unreasonable stress test. I have directed AEL to also estimate the volume of claims reserves which will lose the benefit of FSCS protection if the insolvency event occurs one or two years following the Proposed Scheme. While I consider this is an extremely remote risk I consider these are more plausible and informative stress tests.

10.53 In the event of an insolvency of AESA one year following the Proposed Scheme, the AEL analysis indicates that approximately £26m (0.6% of the claims reserves at the time of the Proposed Scheme) will lose the benefit of FSCS protection compared to their position in the event of no Proposed Scheme.

10.54 In the event of an insolvency of AESA two years following the Proposed Scheme, the AEL analysis indicates that approximately £11m (0.3% of the claims reserves at the time of the Proposed Scheme) will lose the benefit of FSCS protection compared to their position in the event of no Proposed Scheme. The amounts outstanding beyond two years almost totally relate to extended warranty business where policies can provide up to 10 years of coverage.

10.55 AEL's intention to create AESA has been in the public domain since March 2017. Policyholders taking out a policy with AEL after this date would have had the opportunity to make themselves aware of AEL's Brexit related plans and will therefore have been able to make alternative arrangements if they considered this necessary. If we consider just those policies which were written prior to March 2017 then in the event of an insolvency of AESA one year following the Proposed Scheme, the AEL analysis indicates that that approximately £8m (0.2% of the claims reserves at the time of the Proposed Scheme) will have lost the benefit of FSCS protection compared to their position in the event of no Proposed Scheme.

10.56 AEL's active communication with policyholders is scheduled to commence in April 2018. Policyholders taking out a policy with AEL after this date should be aware of AEL's Brexit related plans and will therefore be able to make alternative arrangements if they consider this is necessary. If we consider just those policies which are expected to have been written prior to April 2018 then, in the event of an insolvency of AESA one year following the Proposed Scheme, the AEL analysis indicates that approximately £14m (0.3% of the claims reserves at the time of the Proposed Scheme) will have lost the benefit of FSCS protection compared to their position in the event of no Proposed Scheme.

10.57 AEL has confirmed with its EEA branches that historically, when marketing and promoting itself to EEA policyholders, AEL has not made specific reference to FSCS protection in such a way as for it to have been a significant consideration for the policyholder in choosing AEL over a non-UK based competitor.

10.58 In summary, certain European Transferring Policyholders will lose the benefit of FSCS protection in respect of losses occurring following the Proposed Scheme. Thus, in the event of an insolvency of AESA these policyholders will be in an adverse position compared to their position in the event of no Proposed Scheme. Using what I consider are reasonable stress tests indicates that out of total AESA claims reserves of £4,300m, less than £26m (or 0.6%) of claims reserves are expected to lose the benefit of FSCS protection. I take comfort that the likelihood of these stresses arising is extremely remote since at the date of the Proposed Scheme AESA will be capitalised to its target Own Funds and that if the insolvency event occurs later than one year after the Proposed Scheme the volume of claims reserves affected by the loss of FSCS protection will be less, reducing to £11m (0.3%) on the second anniversary of the Proposed Scheme. It is therefore my opinion that UK Transferring Policyholders and European Transferring Policyholders will not be materially adversely affected by the Proposed Scheme.

Trust Funds

10.59 Information regarding AEL's Trust Funds and the allocation of these between AIG UK and AESA is set out in Section 5. Any benefit transferring policyholders have from Trust Funds will not be lost as a result of the Proposed Scheme. Policyholders not covered by these Trust Funds ("Other Policyholders") may have less security than those covered by a Trust Fund. However, as both AIG UK and AESA remain more than adequately capitalised after the Proposed Scheme, it is my opinion that neither the UK Transferring Policyholders nor the European Transferring Policyholders (either those with the benefit of a Trust Fund or Other Policyholders), will be materially adversely affected by the Proposed Scheme.

Non-EEA and non-Swiss Policyholders

10.60 Certain policies of AEL insure or reinsure policyholders who are located outside the EEA and Switzerland, for example in the United States. Such policies are typically governed by the law of the location of the policyholder, for example the law of a US state, under which it may not be clear how a Part VII transfer and/or cross-border merger is to be treated.

10.61 AIG UK will enter into a legally binding obligation, as a matter of English law by way of unilateral deed poll[1], to respond to all valid claims and other liabilities which arise under that part of policies transferring to it that cover non-EEA and non-Swiss business, with effect from the completion date.

10.62 I understand this approach has been used successfully in other schemes including AEL's prior transfer from France to the UK.

10.63 Upon completion of the cross-border merger element of the Proposed Scheme, AESA will constitute the universal legal successor to AEL under Luxembourg law, including in relation to any policy entered into, or in respect of any risks, outside of the EEA and Switzerland. This ensures that AESA will respond to all valid claims and other liabilities which arise under that part of policies transferring to it that cover non-EEA and non-Swiss business, with effect from the completion date.

10.64 The above approach should remove any uncertainty for policyholders and beneficiaries of AEL's current non-EEA and non-Swiss business written out of non-UK branches as to the effectiveness of the Proposed Scheme in transferring the non-EEA and non-Swiss business. I have considered whether from the point of view of non-EEA and non-Swiss policyholders, the Proposed Scheme is likely to make it any more difficult to bring a claim against AIG UK or AESA than it would be to do so against AEL should the Proposed Scheme not go ahead. I consider that there is no real risk of the Proposed Scheme making it more difficult for a non-EEA and non-Swiss policyholder to bring a claim under a transferring policy.

[1] A deed poll is a legal document used to legally commit a person to undertake certain actions. AIG UK will sign an irrevocable deed poll to commit itself to respond to all valid claims and other liabilities which arise under policies written as part of the UK business outside of the EEA, with effect from the completion date. Therefore, even if there is any uncertainty as to whether certain non-EEA business has transferred to AIG UK under the Proposed Scheme, AIG UK will be bound under English law under the deed poll as though the business had transferred to it, such that it will be required to respond to all valid claims and other liabilities.

Policyholder service levels

10.65 Here I comment on the potential effects of the Proposed Scheme on matters such as claims handling, investment management, new business strategy, administration and governance and expense levels in so far as these will affect the security of policyholders' contractual rights or the levels of service provided to policyholders.

10.66 As described in paragraphs 5.42 and 5.43, AIG UK and a UK branch of AESA will jointly employ certain individuals. It is intended that across the UK and the rest of Europe, staff will maintain materially the same level and quality of service and the joint employment in the UK is a long-term solution and not a transitional measure. I consider that this this will allow AIG UK and AESA to maintain a materially similar level of service to policyholders to that of AEL prior to the Proposed Scheme.

10.67 All key functions of AEL under the Solvency II regime (Audit, Risk, Actuarial, and Compliance) are undertaken by expert teams within the AIG group. It is intended that the same AIG teams will be performing these roles for AIG UK and AESA, although certain functions will be headed by new heads in respect of AESA (as set out below). The teams will be performing these roles in respect of AIG UK and AESA under materially similar policies and procedures.

10.68 **Audit Function -** The AESA Audit function will be headed by a new Head of Internal Audit, based in Luxembourg. This role will be supported by the current AIG team.

10.69 **Actuarial Function -** The AESA Actuarial function will be headed by a new Head of Actuarial, based in Luxembourg. This role will be supported by the current AIG team.

10.70 **Risk Function -** The AESA Risk function will be headed by a new Head of Risk, based in Luxembourg. This role will be supported by the current AIG team.

10.71 **Compliance Function -** The AESA Compliance function will be headed by a new Head of Compliance, based in Luxembourg. This role will be supported by the current AIG team.

Claims handling

10.72 I do not expect a change in policyholder treatment as claims staff employed by AEL prior to the Proposed Scheme will, following the Proposed Scheme, be employed by AIG UK and/or AESA. The intention is that claims staff will maintain the same level and quality of service.

10.73 In addition, under a no Proposed Scheme with Hard Brexit scenario, AEL may be in breach of regulatory rules by servicing claims in EEA branches as a third country insurer.

Investment management

10.74 I do not expect a change in investment management strategy as a result of the Proposed Scheme, with both AIG UK and AESA adopting a relatively low risk investment strategy in line with that followed by AEL and administered by the same investment team within the AIG Group.

New business strategy

10.75 The combination of the AIG UK and AESA new business strategies following the Proposed Scheme is a natural continuation of AEL's new business strategy up to the Proposed Scheme.

Administration/Governance

10.76 Each of AIG UK and AESA will implement a governance structure based around the existing committee structure for AEL, which will enable both companies to benefit from existing knowledge and experience and at the same time enable them to maintain continuity and avoid unnecessary disruption during the transition to the new structure. Each board will have its own sub-board risk committee, reserves committee, audit committee and executive committee and further oversight across the business units is being developed.

Expense levels

10.77 AIG UK and AESA's projected expense ratios for 2019 are both 17%. These are lower than AEL's projected expense ratio for 2017 of 19% as a result of the planned closure of a number of AEL's branches. AEL estimate costs for the establishment of a head office in Luxembourg of approximately £5m per annum for financial years 2019 to 2021 which is an additional 0.1% on the expense ratio. While expenses relating to the governance and reporting functions will inevitably be larger in two firms rather than one, the overall impact on expenses is modest.

10.78 I do not consider that any of the above factors identified from paragraphs 10.65 to 10.77 will materially impact the security of policyholders' contractual rights or the levels of service provided to policyholders for either UK Transferring Policyholders or European Transferring Policyholders.

Other considerations

10.79 Here I comment on other considerations in so far as these will affect the security of policyholders' contractual rights or the levels of service provided to policyholders.

Future profitability of AIG UK and AESA

10.80 Policyholders with exposure to long tailed claims may not become aware of these claims until many years and possibly decades into the future. As such, transferring policyholders will reasonably seek assurance that the firm will be able to meet these claims as they fall due in the future.

10.81 The Solvency II regime is calibrated such that a firm can withstand a one in two hundred year result over the next year and have sufficient funds to transfer its business to another fully capitalised insurer.

10.82 The Own Funds which AIG UK and AESA target on the Internal Model basis are calibrated such that the firm could suffer a one in two hundred year outcome which emerges over the whole run-off of the existing book and business to be written over the next year, which is a higher level of security.

10.83 This level of security would be degraded if the firms were to write loss making business in the future as this would potentially reduce Own Funds. Table 10.3 below is an extension of Table 5.3 which in addition shows the projected total comprehensive income of AIG UK and AESA for years 2019, 2020 and 2021. It also shows the sum of these amounts across AIG UK and AESA and allows a comparison to AEL's historical and projected total comprehensive income.

Table 10.3 - Total comprehensive income - £m

	Financial Year End								
	Actual				Projected		Projected AIG UK and AESA		
	2013	2014	2015	2016	2017	2018	2019	2020	2021
AEL	328	299	55	143	270	237			
AIG UK + AESA							226	246	269
AIG UK							147	153	164
AESA							79	93	105

10.84 Table 10.3 shows that the projected combined profitability of AIG UK and AESA is broadly in line with the historical and projected profitability of AEL. Further, both firms are projected to be profitable.

10.85 As set out in paragraph 8.13, I consider AEL's projection of total comprehensive income in 2017 and 2018 is reasonable. I have reviewed AIG UK and AESA's business plans which contain their future profitability assumptions and business strategy. Projecting profitability out beyond 2018 is subject to increasing uncertainty. However, subject to this increasing uncertainty, I consider AIG UK and AESA's projected profitability is reasonable and broadly in line with what could be expected from AEL in the absence of the Proposed Scheme in a Soft Brexit scenario.

10.86 I have also reviewed future projections of AIG UK and AESA's capital resources and SCR coverage ratios assuming that retained profits are zero from the second quarter of 2017 until November 2021. These show that on both the Internal Model and Standard Formula bases AIG UK is able to meet its SCR requirement during this period and the target Own Funds coverage ratio is always greater than 92%. AESA is also able to meet its SCR requirement during this period. On the Internal Model basis AESA can meet its target Own Funds and on the Standard Formula basis the target Own Funds coverage ratio is always greater than 97%.

10.87 As such, I do not consider that the Proposed Scheme materially adversely affects the security of the contractual rights for UK Transferring Policyholders or for European Transferring Policyholders.

Target Own Funds

10.88 The target Own Funds policy for AEL, AIG UK and AESA is set out from paragraph 5.61. The target Own Funds exceed the SCR and it is possible that in the future AEL, AIG UK or AESA could elect to change this target Own Funds policy; possibly lowering it to the level of SCR.

10.89 Changing the target Own Funds policy could have implications for the firm's credit rating, its market reputation and its ability to generate new business.

10.90 I have discussed the target Own Funds policy with AEL and understand there is no intention to change the policy and that the same applies to AIG UK and AESA.

10.91 Based on these discussions, I do not consider it any more or less likely that AIG UK or AESA would change its target Own Funds policy than would AEL in the absence of the Proposed Scheme. As such, I do not consider that the Proposed Scheme materially changes the security of the contractual rights for UK Transferring Policyholders or for European Transferring Policyholders.

Comparison of Regulatory Regimes

10.92 In this section I consider the comparison of regulatory regimes under the categories of prudential regulation[1] and conduct regulation[2].

Prudential Regulatory Regimes

10.93 UK Transferring Policyholders will be subject to the UK prudential regulatory regime both before and after the Proposed Scheme and so will not experience a change in prudential regulatory regimes.

10.94 European Transferring Policyholders will be transferring from the UK regulatory regime where the PRA is responsible for prudential regulation to the Luxembourg Regulatory Regime where the CAA is responsible for prudential regulation.

10.95 Solvency II has harmonised prudential regulation across the EU. As such, I consider that the prudential regulatory regime in Luxembourg is materially similar to that in the UK.

10.96 As such, I do not consider that either UK Transferring Policyholders or European Transferring Policyholders are likely to be materially adversely affected by the change in prudential regulatory regime as a result of the Proposed Scheme.

Conduct Regulatory Regimes

10.97 There is currently less harmonisation in conduct regulation across the EU, although the Insurance Distribution Directive which is expected to apply across EU member states from October 2018 is expected to more closely align certain aspects of conduct regulation.

10.98 In general, conduct regulation is performed by the insurance regulator in the country in which the risk is located and/or the location from which the business is carried out. As such, for UK Transferring Policyholders and Branch European Transferring Policyholders, since neither the location of the risk nor the location from which the business is being carried out is changing, the applicable conduct regime is unchanged by the Proposed Scheme. As such, I do not consider that UK Transferring Policyholders or Branch European Transferring Policyholders are likely to be materially adversely affected by the change in conduct regulatory regime.

10.99 In the case of FoS European Transferring Policyholders, although the location of the risk is not changing, the location from which the business is being carried out may change from the UK to Luxembourg, although I note that AESA's preference, subject to applicable regulatory consents, is to service claims in respect of FoS European Transferring Policyholders from a UK branch of AESA which would mean that the UK conduct regulatory regime would continue to apply in respect of activities carried out from that branch.

10.100 To cover the eventuality that the Luxembourg conduct regulatory regime, rather than the UK conduct regulatory regime, applies to FoS European Transferring Policyholders, I have reviewed advice received from AEL's Luxembourg counsel which sets out the duties insurers have to their policyholders under the Luxembourg conduct regulatory regime. Having reviewed this advice, I have concluded that, broadly speaking, conduct obligations on insurers in Luxembourg are comparable to key FCA handbook provisions such as Principle 6 (treating customers fairly)[3] and ICOBS 8.1.1 (no unfair rejection of claims)[4]. In particular, under the

[1] Broadly, regulation that requires financial firms to control risks and hold adequate capital as defined by capital requirements to promote the safety and soundness of the regulated firms.
[2] Typically including consumer protection, regulation of market conduct and setting and enforcing ethical codes of conduct.
[3] A firm must pay due regard to the interests of its customers and treat them fairly.
[4] An insurer must (1) handle claims promptly and fairly, (2) provide reasonable guidance to help a policyholder make a claim and appropriate information on its progress, (3) not unreasonably reject a claim (including by terminating or avoiding a policy), and (4) settle claims promptly once settlement terms are agreed.

Luxembourg Civil Code, insurance companies have a duty to act at all times loyally and in good faith towards their contractual counterparties (i.e. policyholders). This general duty of loyalty and good faith (which is absent from UK Law) has a similar effect as Principle 6 and ICOBS 8.1.1, i.e. an insurer must deal with its customers loyally and in good faith in all of its interactions (including in respect of rejection of claims).

10.101 Further, AESA has no proposal to fundamentally change the policies and procedures currently applied by AEL as a result of the restructuring. If as part of its ordinary course of compliance, quality and audit checks, it identifies detrimental differences in approach to conduct of business in relation to policies held by FoS European Transferring Policyholders between the periods pre and post the Proposed Scheme, it will interrogate the reasons for these in order to determine whether remediation is required and if material, report the differences to the Board.

10.102 As such, for the reasons set out in paragraphs 10.99 to 10.101, I do not consider that FoS European Transferring Policyholders are likely to be materially adversely affected by the change in conduct regulatory regime.

10.103 Where there are other specific factors as in the case of FSCS protection and TFOS where the UK regulatory regime has provided protection and services in addition to those provided by the insurance regulator in the country in which the risk is located or the location from which the business is carried out, I have addressed these in my report (from paragraph 10.33 in the case of FSCS protection and paragraph 10.109 in the case of TFOS) and have concluded that European Transferring Policyholders are not likely to be materially adversely affected by the loss of these protections and services.

Conclusion on Comparison of Regulatory Regimes

10.104 In conclusion, I do not consider that either UK Transferring Policyholders or European Transferring Policyholders are likely to be materially adversely affected by the change in regulatory regime as a result of the Proposed Scheme.

Accounting and reserve approach

10.105 I understand from my discussions with AEL that there will be no significant change in the accounting and reserving approaches for AIG UK and AESA following the Proposed Scheme as both companies are subject to the same Group accounting and reserving policies and the same personnel will be involved after the Proposed Scheme.

10.106 As noted in paragraph 5.70, AEL uses the IFRS accounting regime, AIG UK will use UK GAAP and AESA will use Lux GAAP. I do not consider this variation in accounting bases will have a material impact on the security of policyholders' contractual rights. This is because in forming my views on policyholder security I have focussed on the Solvency II Own Funds and SCRs for each of these entities rather than the financial report and accounts.

Tax implications of the Proposed Scheme

10.107 I understand from AEL that the Proposed Scheme is designed to be tax neutral. I am not a tax expert, but given my discussions with AEL I am satisfied with the explanations provided and do not consider it is necessary for me to obtain independent expert advice on this issue.

Costs of the Proposed Scheme

10.108 The costs of the Proposed Scheme are to be covered by AEL. These costs have been included in the projections of Own Funds to 1 December 2018. As such, since AIG UK and AESA are both expected to meet or exceed their target Own Funds at this date I consider that this allocation of costs to AEL does not affect the security of policyholders' contractual rights or the levels of service provided to policyholders.

Ombudsman services

10.109 If an insurer and a policyholder cannot resolve a complaint they may use an Ombudsman service which will provide unbiased advice.

10.110 Certain eligible AEL policyholders have redress to The Financial Ombudsman Service ("TFOS") and will continue to do so in the event of no Proposed Scheme. Those AEL policyholders eligible to use the TFOS are:

- A consumer;
- A micro-enterprise, which employs fewer than 10 persons and has a turnover or annual balance sheet that does not exceed €2 million;
- A charity which has an annual income of less than £1 million at the time the complaint is referred; or
- A trustee of a trust which has a net asset value of less than £1 million at the time the complaint is referred.

where the activities are carried out from an establishment in the UK, or from the rest of the EEA but directed at the UK and the policy is governed by English and Welsh, Scottish or Northern Irish law ("UK Law").

10.111 TFOS offers a free, English language service to provide an unbiased view about what has happened. If TFOS decide that someone has been treated unfairly, they have legal powers to put things right. TFOS is able to compel firms to respond to complaints in a timely fashion and is able to apply a test of fairness rather than being restricted to applying rules. TFOS's decisions are binding on the firm.

10.112 Following the Proposed Scheme certain AESA policyholders will, in addition to the national ombudsman in the EEA State in which the risk is located, have access to the National Consumer Ombudsman Service of Luxembourg. The National Consumer Ombudsman Service is a neutral and independent entity which makes available to consumers and professionals a voluntary and confidential process, the aim of which is to resolve consumer disputes by amicable agreement. If the parties do not reach an amicable agreement the National Consumer Ombudsman Service can propose a solution that the parties to the disagreement are free to accept or refuse.

10.113 In addition, the Luxembourg Insurance Association (*Association des Companies d'Assurance*) has, together with the Luxembourg Consumer Union (*Union Luxembourgeoise des Consommateurs*), set up an additional ombudsman service, the Luxembourg Insurance Mediator (*Médiateur en assurance*), which is responsible for handling disputes between Luxembourg insurance undertakings and policyholders, residing in Luxembourg or abroad.

10.114 I refer in this report to the National Consumer Ombudsman Service and the Médiateur en assurance together as the "Luxembourg Ombudsman Services".

10.115 The Luxembourg Ombudsman Services offers a free service in English, French, German or Luxembourgish with fixed timescales for reaching a solution.

10.116 Further, one of the missions of the CAA is to receive and examine the complaints raised by policyholders or other interested parties.

10.117 Prior to the Proposed Scheme, TFOS will have compulsory jurisdiction in respect of complaints raised by eligible UK Transferring Policyholders. This will continue to be the case following the Proposed Scheme.

10.118 Prior to the Proposed Scheme, Branch European Transferring Policyholders will have access to dispute resolution services in the country in which the risk is located. Within this category, eligible policyholders in the UK whose policies were written by a branch of AEL under FoS where the polices are governed by UK Law will have access to TFOS since TFOS will have voluntary jurisdiction over any complaints. Following the Proposed Scheme, Branch European Transferring Policyholders will continue to have access to dispute resolution services in the country in which the risk is located and, in addition, will also have access to the Luxembourg Ombudsman Services. I have been advised that AESA intends to opt-in to the Voluntary Jurisdiction of TFOS in respect of eligible Branch European Transferring Policyholders where the risk is located in the UK and where the policy is governed by UK Law and so these policyholders will also retain access to TFOS.

10.119 Prior to the Proposed Scheme FoS European Transferring Policyholders will have access to dispute resolution services in the country in which the risk is located and, in addition, eligible policyholders will have access to TFOS. Following the Proposed Scheme, FoS European Transferring Policyholders will have access to dispute resolution services in the country in which the risk is located and in addition will also have access to the Luxembourg Ombudsman Services. However, while eligible FoS European Transferring Policyholders will have access to TFOS in respect of complaints in respect of acts or omissions occurring prior to the Proposed Scheme, they will not have access to TFOS in respect of acts or omissions occurring after the Proposed Scheme unless such acts or omissions are carried out from the UK. Such complaints will instead be able to be directed to the Luxembourg Ombudsman Services as well as the disputes resolution service in the country in which the risk is located.

10.120 I have compared the services and powers of TFOS and the Luxembourg Ombudsman Services. Both offer a free service in a timely fashion with the Luxembourg Ombudsman Services offering a range of languages. However, the Luxembourg Ombudsman Services cannot provide binding determinations which is a lack of power when compared to TFOS.

10.121 However, if, following a complaint to the CAA, an insurer does not agree to follow the CAA's opinion or recommendation, the CAA informs the policyholder and provides them with a copy of its opinion or recommendation. Having been provided with the CAA's assessment, a policyholder can take the matter to court by relying upon the CAA's assessment, which is likely to be considered persuasive. As such, instead of a power of determination, the Luxembourg Ombudsman Services offer the possibility of enforcement of the assessment through a court led judicial process. Therefore, although the regimes are not identical, both regimes are designed to channel complaints and resolve disputes in practice, TFOS using enforceable determinations and the Luxembourg Ombudsman Services by allowing the policyholder to reach a mediated solution or pursue a subsequent judicial process.

10.122 AEL has estimated that the volume of TFOS eligible premium written in respect of FoS European Transferring Policyholders is less than £18m per annum, or 0.35% of AEL's annual premium income.

10.123 AEL has informed me that it has not had any complaints in relation to which a dispute has been referred to the TFOS which relates to FoS European Transferring Policies in the last five years. This is likely to be indicative that such policyholders will not look to use TFOS in the future and as such are unlikely to suffer a loss from the withdrawal of this service.

10.124 In summary, the only policyholders whose access to ombudsman services is being possibly restricted by the Proposed Scheme are eligible (under the criteria set out above) FoS European Transferring Policyholders in respect of complaints relating to acts or omissions occurring following the Proposed Scheme carried out from outside of the UK. Disputes in relation to such complaints will however be eligible to be heard by the Luxembourg Ombudsman Services or (as before) the dispute resolution services in the country in which the risk is located. I consider that although not identical, both TFOS and the Luxembourg Ombudsman Services are broadly comparable, the volume of policies affected is very small and no previous complaints have been made by these policyholders to TFOS. On balance, I therefore consider that neither European Transferring Policyholders nor UK Transferring Policyholders will be materially adversely affected by the Proposed Scheme.

Liquidity

10.125 AEL, AIG UK and AESA have a high degree of liquidity within their investment portfolios, reflecting substantial holdings of liquid investments such as cash and short-dated government and corporate bonds. I consider therefore that the Proposed Scheme will not have a material impact on the degree of liquidity risk for either the UK Transferring Policyholders or the European Transferring Policyholders.

Allocation of outwards reinsurance

10.126 As set out in my scenario tests described from paragraph 10.26, my conclusions on the security of policyholders' contractual rights will not be affected if the High Court chooses to not sanction AEL's proposal to split the outward reinsurance asset between AIG UK and AESA.

10.127 As such, I conclude that the Proposed Scheme will not have a material adverse impact on the security of the contractual rights of UK Transferring Policyholders or European Transferring Policyholders.

Intra-group reinsurance – Introduction to stress tests

10.128 As set out in paragraphs 5.46 and 5.48 there will be an increase in the amount of intra-group ceded reinsurance for AIG UK and AESA.

10.129 I understand that the amount of intra-group reinsurance of AIG UK and AESA after the Proposed Scheme will be within the limits specified by the PRA and CAA respectively.

10.130 The counterparties for the intra-group reinsurance are highly credit-rated reinsurers within the AIG Group and the credit risk associated with this reinsurance has been included within the SCRs for AIG UK and AESA. However, I have performed stress tests to assess the resilience of AIG UK and AESA in the event that there is a default on the intra-group reinsurances. The likelihood of such an event is estimated to be more remote than a 1:1000 year level of risk (or 0.1% likelihood) based on rating agency analysis which is well beyond the level of risk which insurance companies are typically required to be capitalised to.

10.131 Under my direction, AEL has performed stress tests; the first looks at the ability of the firms to meet their target Own Funds and SCR following an intra-group reinsurance default under a number of assumptions that I consider are reasonable; and the second tests the resilience of the firms to meet the expected level of policyholder claims following an intra-group reinsurance default under more prudent assumptions.

10.132 The following assumptions are common across both stress tests:

- Following the failure of the group reinsurance both AIG UK and AESA cease underwriting new business and move into run-off.

- The default will create a deferred tax asset for the firms. I have assumed that since the firms are entering run-off and so are unlikely to generate future profit, this asset will not be realised and as such I have not taken credit for this asset in the stress tests.

- The stress test does not consider the possibility of wider contagion risks affecting other reinsurers.

Intra-group reinsurance – Comparison to target Own Funds and SCR

10.133 This stress test looks at the ability of the firms to meet their target Own Funds and SCR following an intra-group reinsurance default.

10.134 Under this stress test I have made the following additional assumptions:

- AIG UK and AESA will both receive a proportion of the amount due from the reinsurer. Such a recovery given default for reinsurance insolvencies might be expected to be in the region of 50%. AEL has assumed a recovery given default of 47.8% based on the output of the Internal Model which I consider is reasonable.

- Neither AIG UK nor AESA will distribute surplus assets over and above their target Own Funds. I note that any future distribution of Own Funds from AIG UK or AESA will need to be approved by their relevant regulator; the PRA and CAA respectively. In considering an application to distribute Own Funds I would expect the regulator to consider the resilience of the firm to reinsurer failure.

10.135 In the event of a default the AEL stress test assumes that AIG UK and AESA will provision for 52.2% of the expected recoveries under the relevant intra-group treaties.

10.136 The reinsurance default will increase credit risk, as a result of uncertainty in the recovery given default percentage. However, underwriting risk will be reduced by AIG UK and AESA entering into run-off. I have seen an analysis performed by AEL which demonstrates that the overall impact will be an increase of the SCRs for both AIG UK and AESA in the order of 2-3% if the firms' capital requirements are assessed on the Standard Formula basis and 10-14% if the firms' capital requirements are assessed on the Internal Model basis.

10.137 If default occurs prior to the Proposed Scheme and both AIG UK and AESA have capital assessed on the Standard Formula basis then AIG UK could be funded to its target Own Funds and AESA to 83% of its target Own Funds (approximately £270m short of its target Own Funds) but would have a SCR coverage ratio of 107%.

10.138 If default occurs prior to the Proposed Scheme and both AIG UK and AESA have capital assessed on the Internal Model basis then both AIG UK and AESA would meet or exceed their target Own Funds.

10.139 I have also considered the impact on AIG UK and AESA if default occurs in the three years following the Proposed Scheme.

10.140 If default occurs in the three years following the Proposed Scheme and both AIG UK and AESA have capital assessed on the Standard Formula basis then AIG UK would have Own Funds at about 88% of its target level (approximately £250m short of its target Own Funds) and would meet or exceed its SCR. The result would be similar if AIG UK's capital is assessed on an Internal Model basis.

10.141 If default occurs in the three years following the Proposed Scheme and both AIG UK and AESA have capital assessed on the Standard Formula basis then AESA is unlikely to meet its target Own Funds and may be up to £90m (or 6%) short of meeting its SCR. If both AIG UK and AESA have capital assessed on the Internal Model basis then AESA will exceed its target Own Funds and SCR.

10.142 In summary, under these assumptions, following an intra-group reinsurance default, while AEL and AIG UK would be expected to meet their SCR there is a risk that AESA would not meet its SCR. Although AESA is more exposed to intra-group reinsurance failure than AIG UK, on the Standard Formula basis this is largely mitigated by the assumption that AESA will not distribute surplus assets over and above its target Own Funds and on the Internal Model basis is more than mitigated by this assumption. I have relaxed this distribution assumption in the next stress test below.

Intra-group reinsurance – Comparison to expected claims

10.143 This stress test illustrates the resilience of the firms to meet the expected level of policyholder claims following an intra-group reinsurance default. In the event of assets being insufficient to meet expected policyholder liabilities I assess the percentage level of recovery from the intra-group reinsurance which would be required to allow assets to exceed expected liabilities.

10.144 This test focusses on expected (mean average) levels of policyholder claims and does not consider the ability of the firm to withstand claims above this expected level.

10.145 Under this stress test I have made the following additional assumption:

- Both AIG UK and AESA distribute all surplus assets over and above their target Own Funds. As such, at the time of the default they are both capitalised to their target Own Funds.

10.146 Under this stress test, in the event of an intra-group reinsurance default AEL (prior to the Proposed Scheme) and AIG UK (following the Proposed Scheme) would be able to meet expected policyholder claims without any recovery from the intra-group reinsurance.

10.147 If AESA has capital assessed on the Standard Formula basis then in the event of intra-group reinsurance default AESA would not be able to meet expected policyholder claims unless the recovery from the intra-group reinsurance exceeded 5%. If AESA has capital assessed on the Internal Model basis then in the event of intra-group reinsurance default AESA would not be able to meet expected policyholder claims unless the recovery from the intra-group reinsurance exceeded 30%. As noted in paragraph 10.134, the expected level of recovery from the intra-group reinsurance following a default might be expected to be in the order of 50%.

10.148 The above two stress tests demonstrate that AIG UK has a broadly similar although possibly slightly lower level of resilience to intra-group reinsurance default than that of AEL before the Proposed Scheme. AESA is less resilient to intra-group reinsurance default than AEL before the Proposed Scheme and in the event of the recovery given default falling below 30% could have expected liabilities in excess of its assets.

10.149 I consider that that the impact of this reduced resilience on policyholders is mitigated by the following factors.

- In the event of a downgrade of the intra-group reinsurers the AESA quota share reinsurance will be capitalised as set out in paragraph 5.48 and the ring-fenced premiums in respect of the accident year stop loss would be for the exclusive benefit of AESA, both of which would provide additional security to European Transferring Policyholders and which have not been included in the above stress tests.

- The AIG Group entities providing the reinsurance protection are strongly rated, with ratings of A.M. Best (A), Standard & Poor's (A+), Moody's (A2) and Fitch (A).

- The default risk of the intra-group reinsurance is modelled as part of the Solvency Capital Requirement under both the Internal Model and Standard Formula.
- The likelihood of a default of the intra-group reinsurance is considered to be more remote than a 1:1000 year event based on AIG's credit rating, which is well in excess of the 1:200 level typically required for insurance companies.

10.150 In summary, European Transferring Policyholders and, to a much lesser extent, UK Transferring Policyholders are more exposed to downside risks in the event of failure of intra-group reinsurance than in the case of no scheme. However, I consider that, on balance, and for the reasons set out in paragraph 10.149 above, the security of neither UK Transferring Policyholder's contractual rights nor European Transferring Policyholder's contractual rights is materially disadvantaged by the Proposed Scheme.

10.151 The intra-group reinsurances are necessary to ensure that AIG UK and AESA are able to meet their target Own Funds under each IM and SF SCR scenario. The AESA whole account quota share and stop loss reinsurances are subject to regulatory approval by the CAA. If such approval is not received and the reinsurance is not placed then the Proposed Scheme may not provide sufficient security of transferring policyholder's contractual rights. In the event that such regulatory approval is not forthcoming I will address this point in my supplementary Scheme Report.

Guarantees

10.152 As described in paragraph 5.50, some AEL policyholders are the beneficiaries of guarantees whereby in the event that AEL is unable to pay their claims, the guarantor would meet the shortfall. Under the Proposed Scheme the guarantees will move with the transferring policyholders and in all cases the guarantor is an AIG group company so will accept the change in assignment of guarantee. Further, I do not consider the presence of the guarantee affects the security of those policyholders without the benefit of the guarantee. As such, I am satisfied that the security of neither UK Transferring Policyholders' contractual rights nor European Transferring Policyholders' contractual rights is materially disadvantaged by the Proposed Scheme.

Capital Maintenance Agreement ("CMA")

10.153 CMAs are described in paragraph 5.56.

10.154 AEL currently has a CMA in place with AIG. AIG UK will maintain a CMA with AIG on materially similar terms.

10.155 As described in paragraph 5.59, over the last few years AIG has been unwinding CMAs in order to simplify arrangements for recovery and resolution purposes. For this reason AESA will not have a CMA.

10.156 The lack of a CMA for AESA reduces the chain of security for European Transferring Policyholders compared to their chain of security with AEL. However, since the CMAs may be cancelled by AIG with 90 days' notice I do not consider that they enhance the security of policyholders' contractual rights in distressed scenarios. Further, AESA's Own Funds will be of a high quality and at the date of the proposed scheme will be in excess of the SCR and AESA's target level of Own Funds. Taken together, I consider that the lack of a CMA for AESA will have no materially adverse effect on the security of European Transferring Policyholders' contractual rights.

Excluded policies and policyholder mis-allocation

10.157 For the reasons explained in paragraph 5.18 I consider that there is no possibility of the scheme giving rise to excluded policies. Furthermore, for the reasons explained in paragraph 5.19, I consider that transferring policyholders can be assured that they will ultimately be transferred to the correct company.

Outward reinsurers

10.158 The external reinsurance of AIG UK and AESA will cover the same liabilities as under AEL and the claims handling will be undertaken by the same team under the same policies and procedures both before and after the Proposed Scheme. As such, I consider the transfer will have no material effect on the external reinsurers of AEL.

Pension Schemes

10.159 AEL operates multiple defined benefit employee pension schemes across the EEA and Switzerland. The largest schemes are in the UK, Germany, the Netherlands and Ireland. The UK schemes will transfer to AIG UK and will continue to be covered by UK pensions legislation. The remaining schemes will transfer to AESA.

10.160 At year-end 2016 the pension schemes were projected to be in deficit by £50m, with the UK scheme in surplus by £21m and the other pension schemes in deficit by £71m.

10.161 The sponsoring employer of the pension schemes will change following the Proposed Scheme. However, both AIG UK and AESA will be large insurance companies with a stream of projected future profits. UK defined benefit pension plan liabilities are currently guaranteed by AHEL and will continue to be following the Proposed Scheme.

10.162 None of the pension schemes transferring to AESA currently fall within the remit of UK pensions legislation. Consequently, the Proposed Scheme will not change the access to protection schemes in the event of employer failure for those pension schemes which are transferring to AESA.

10.163 As such, I consider that pensioners' contractual rights are unlikely to be materially affected by the Proposed Scheme.

10.164 AIG UK and AESA's obligations to transferring policyholders rank above their obligations to make good pension scheme deficits and, further, the AEL Internal Model includes a capital charge for pension risk which covers interest rate risk, inflation risk, equity risk and longevity risk. As such, I consider that the Proposed Scheme will not have a material adverse impact on the security of the contractual rights of UK Transferring Policyholders or European Transferring Policyholders.

Policyholder communication

10.165 AEL is required to notify policyholders (including policy beneficiaries) of the Proposed Scheme. However, consideration may be given to the practicality and costs of sending notices against the likely benefits for policyholders of receiving such communications.

10.166 AEL has shared with me a document setting out its standard communication approach and how this will be modified where this is not considered possible or practical.

10.167 AEL has performed a review of its policyholders in the following categories:

- Policyholders in respect of in-force policies

- Policy beneficiaries in respect of in-force policies
- Active claimants
- Potential claimants from expired policies

10.168 Across these four categories AEL estimates it has approximately 34 million policyholders with approximately 21% of these in the category of policyholders in respect of in-force policies and approximately 79% of these in the category of beneficiaries in respect of in-force policies.

10.169 In addition, AEL has identified other interested parties whom it will notify of the Proposed Scheme. This includes professional bodies, brokers, outward reinsurers, third party administrators, vendors and employees.

10.170 AEL's standard communications approach will be to send a notification pack directly to each policyholder or other interested party, comprising:

- A clearly worded covering letter
- A frequently asked questions document
- A legal notice of the Proposed Scheme
- A scheme booklet summarising the Proposed Scheme and containing the summary of the Scheme Report and
- Details of how recipients can obtain further information, ask questions and raise any objections to the Proposed Scheme.

10.171 The notification pack will be translated to reflect the local language or the language of the issued policy.

10.172 AEL will set up websites for each country which will contain the information in the notification pack as well as this Scheme Report and the scheme booklet and will allow policyholders to request this information by post.

10.173 This Scheme Report will be provided in English, but will also be made available in other relevant languages (or braille), free of cost, upon request.

10.174 AEL will publish notice of the Proposed Scheme in two national UK newspapers and in the London, Belfast and Edinburgh Gazettes. In addition, AEL will also publish the notice in two national newspapers in each EEA state where it has larger branches, including Belgium, Denmark, Finland, France, Germany, Ireland, Italy, Norway, Spain, Sweden and Switzerland, and in one national newspaper in all the remaining EEA states.

10.175 In addition to the legal notices described in paragraph 10.174, AEL will also publish 'user friendly' advertisements in UK and European newspapers. The advertisements will be designed to draw policyholders' attention to the Proposed Scheme and to state where further information can be found. As a result of this approach, AEL will be publishing either a legal notice or a user friendly advert at least twice in each EEA state.

10.176 AEL writes business through its Lexington division in respect of clients resident in the US, with US based risks. The company therefore also intends to publish a notice in US newspapers.

10.177 Based on my review of the AEL communications material I consider this standard communications approach is reasonable.

10.178 AEL estimates that all commercial policyholders in respect of in-force policies and approximately 45% of consumer policyholders in respect of in-force policies will be advised of the Proposed Scheme in this way. AEL estimates that fewer than 1% of policy beneficiaries in respect of in-force policies will be advised of the Proposed Scheme in this way.

10.179 I set out below specific circumstances in which AEL's communication strategy deviates from the standard communications approach.

Email, text messaging and summarised notification

10.180 In certain cases email or text messaging is the usual method of communication with the policyholder or beneficiary, and this is managed and controlled by the service programme sponsor or group policyholder. As such, in these cases, AEL will communicate with an email or text message, or through a summarised notification placed in a usual communication, such as a monthly bill. In all cases AEL will provide a link to the scheme website where full notification information can be found. Where such an alternative approach is necessary, AEL will supplement the notification with an enhanced advertising campaign which will include advertisements in national newspapers.

10.181 As part of this communication approach AEL will encourage service programme sponsors to monitor the proportion of emails and text messages which register as failed deliveries to ensure that there is no widespread issue with this method of communication. Additional methods of communication will be considered by AEL if such a widespread issue occurs.

10.182 AEL estimates that approximately 39% of consumer policyholders in respect of in-force policies and approximately 25% of policy beneficiaries in respect of in-force policies will be advised of the Proposed Scheme in this way.

10.183 I consider this is a reasonable strategy since notification by post may not be practical and it follows the communication method with which the policyholder is already familiar. Further, since there will be an enhanced advertising campaign there will be more opportunity for the policyholders to become aware of the Proposed Scheme through other information channels.

Policyholder contact details not available

10.184 There are cases where AEL may not be in possession of contact details for its policyholders and may not be able to obtain such information. Examples include:

- 'White label' products where policies are sold through a third-party strategic partner (e.g. mobile phone insurance); and
- Group policies where coverage is provided to corporate entities and associates, to cover their employees or members (e.g. corporate travel insurance policies).

10.185 On a case by case basis AEL is exploring whether the third-party strategic partners will distribute information regarding the Proposed Scheme on AEL's behalf. AEL will also be requesting all group policyholders to make the scheme notification available to policy beneficiaries using their normal communication methods.

10.186 AEL will supplement the above with an enhanced advertising campaign, advertising in all EEA states in major newspapers which have a wide coverage and readership base.

10.187 AEL estimates that policy beneficiaries in respect of in-force policies will form the significant majority of this category and approximately 71% of these policy beneficiaries will be advised of the Proposed Scheme in this way.

10.188 I consider this is a reasonable strategy in the case where policyholder contact details are not available and despite AEL's best efforts it is not possible to obtain these. In the event that AEL is not successful in encouraging third-party strategic partners and corporate entities to forward the information then the enhanced advertising campaign will provide an opportunity for the policyholders to become aware of the Proposed Scheme.

Active claimants

10.189 AEL will, in general, send notification packs to relevant parties who have an open claim. However, there are some exceptions to this, where an alternative approach will be used:

- Personal lines claims (for example extended warranty business) and retail travel claims where claims are generally low value and high volume, and the average period for settlement is very fast (5-7 days, often less), and so will be settled well in advance of the Effective Date of the Proposed Scheme. In this case claimants who bring new claims to the company will be provided with a letter or email bringing their attention to the Proposed Scheme, with relevant links to further information. I consider this is a reasonable communication strategy as it can be demonstrated in all reasonable likelihood that policyholders' claims will be settled well in advance of the Proposed Scheme.

- Third party claimants where AEL is working with their insured to defend a claim, but they are not dealing directly with the claimant. This is frequently the case on commercial lines business where it could prejudice AEL's insured's position with respect to the claim if the claimant was aware there was insurance available. In this case no notification will be made to third-party claimants. I consider this is a reasonable communication strategy since a third-party claimant's knowledge of the presence of insurance could prejudice AEL's insured's position.

Unreachable policyholders

10.190 It is likely that a small proportion of policyholders will no longer live or be based at the address which is held by AEL. For notification packs that are returned to sender, efforts will be made to trace an alternative address for the policyholder and volumes of returned communications will be tracked.

10.191 I consider this is a reasonable strategy since even in the case where no alternative contact details can be found, the enhanced advertising campaign will provide an opportunity for the policyholders to become aware of the Proposed Scheme.

Potential claimants from expired policies

10.192 AEL writes lines of business where it is possible for claims to be advised many years following the expiry of the policy. This will most typically affect lines of business which are exposed to third party liability claims, such as excess casualty, auto (motor) liability and general liability.

10.193 AEL has undertaken an analysis by line of business to assess the proportion of total claim numbers reported in each quarter or year following the expiry of the policy. AEL has identified the time period required for at least 90% of total claims to be reported ("the 90% period"). I have reviewed the analysis which AEL has undertaken to confirm that it is reasonable.

10.194 AEL will send notification packs to policyholders with expired polices up to the 90% period but will not send notification packs to policyholders with policies expired for longer than this.

10.195 I consider that this is a reasonable strategy because very limited numbers of new claims are expected in respect of policies beyond this 90% period and the cost incurred in sending out additional communication materials is likely to be disproportionate to the benefit received without any guarantee of greater success in the communication result. Further, the majority of AEL's policyholders renew their policies annually and so are likely to be notified as more recent policyholders. And finally, the enhanced advertising campaign will provide an opportunity for past policyholders not otherwise notified to become aware of the Proposed Scheme.

10.196 An exception to this strategy is for UK Employers' Liability ("EL") insurance. In this class of insurance claims notification can occur in excess of 10 years and in some cases decades after the policy has expired. AEL submits details of all of its known EL policies to the Employers' Liability Tracing Office ("ELTO") database. AEL will send notification packs to all of its current and past EL policyholders as identified in the ELTO database. The ELTO database is subject to a limited assurance annual external audit, the most recent audit being completed in July 2017. I have reviewed the limited assurance audit report and AEL's Director's statement.

10.197 I consider this enhanced level of notification to UK EL policyholders is appropriate and reasonable given the particularly long potential delay in claims notification and that the ELTO database (despite some limitations in its completeness) is a suitable and the best available source for the identification of EL policyholders.

Content of the notification pack

10.198 I have reviewed a draft of the notification pack which includes a covering letter, a question and answer document and a policyholder document which contains a summary of the Proposed Scheme, my Summary and a legal notice of the Proposed Scheme. I consider the level of information contained in the notification pack is appropriate and its presentation is clear, fair and not misleading. I consider the notification pack will allow policyholders to form their own view on the Proposed Scheme and know how to access additional information as required.

Conclusion on policyholder communications

10.199 I am satisfied that the proposed material to be presented to policyholders is appropriate and AEL's approach to communication with policyholders, including the exceptions to the standard communications approach, is appropriate, reasonable and proportionate.

Section 11: Conclusions

11.1 I have considered the likely effects of the Proposed Scheme on the UK Transferring Policyholders and the European Transferring Policyholders. In each case, I have considered the likely effects of the Proposed Scheme on the security of transferring policyholders' contractual rights. I have also considered the likely effects of the Proposed Scheme on the other factors which may impact security or service levels to the affected policyholders.

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

Security of policyholders transferring from AEL to AIG UK

11.3 It is my opinion that the UK Transferring Policyholders, both the direct and reinsurance policyholders, will not be materially adversely affected by the Proposed Scheme.

11.4 UK Transferring Policyholders currently have policies with AEL, a company whose level of Own Funds exceeds the Solvency II Solvency Capital Requirement. Further, AEL meets its target Own Funds policy which is an enhancement over the Solvency II requirements.

11.5 After the Proposed Scheme, UK Transferring Policyholders will have policies with AIG UK, a company whose level of Own Funds is projected to exceed the Solvency II Solvency Capital Requirement. Further, AIG UK is projected to meet its target Own Funds policy which is an enhancement over the Solvency II requirements.

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

Security of policyholders transferring from AEL to AESA

11.7 It is my opinion that the European Transferring Policyholders, both the direct and reinsurance policyholders, will not be materially adversely affected by the Proposed Scheme.

11.8 European Transferring Policyholders currently have policies with AEL, a company whose level of Own Funds exceeds the Solvency II Solvency Capital Requirement. Further, AEL meets its target Own Funds policy which is an enhancement over the Solvency II requirements.

11.9 After the Proposed Scheme, European Transferring Policyholders will have policies with AESA, a company whose level of Own Funds is projected to exceed the Solvency II Solvency Capital Requirement. Further, AESA is projected to meet its target Own Funds policy which is an enhancement over the Solvency II requirements.

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

11.11 In reaching this conclusion I note that some European Transferring Policyholders currently have the benefit of the Financial Services Compensation Scheme ("FSCS") which may in certain cases provide compensation in the event of an insurer insolvency. Following the Proposed Scheme, those same European Transferring Policyholders with claims occurring before the transfer date (whether reported or unreported) will still have the benefit of FSCS protection under the FSCS's 'successor rules'. However, under assumptions set out in the footnotes to paragraph 10.48, European Transferring Policyholders with claims occurring after the transfer date will not have cover under the FSCS following the Proposed Scheme in respect of such claims and may not be eligible for any other insurance compensation scheme.

I have considered this in my Scheme Report (starting at paragraph 10.43) and, despite this, consider that European Transferring Policyholders will not be materially adversely affected by the Proposed Scheme.

Effect of Internal Model Approval on the above conclusions

11.12 AEL currently has an approved Internal Model. AHEL is making a major model change which will require approval from the PRA in order that AIG UK will have an approved Internal Model. AESA is making an Internal Model pre-application with the CAA.

11.13 I consider it is not certain that AIG UK and AESA will both have approved Internal Models immediately following the Proposed Scheme. As such, in my Scheme Report I have tested the impact of either or both of AIG UK and AESA having to use the Standard Formula to calculate the Solvency II Solvency Capital Requirement and this does not change my conclusions.

Effect of Brexit on the above conclusions

11.14 I consider that this Proposed Scheme is a viable strategy to allow the AIG Group to maintain and grow its non-life insurance activities across Europe (including the UK) following Brexit. Further, I consider that the Proposed Scheme provides assurance for policyholders that their insurer will be able to settle claims in line with regulatory rules following Brexit.

11.15 In the absence of this Proposed Scheme and in the event of a Hard Brexit I consider that there would be material concerns over the ability of AEL to meet its Solvency Capital Requirements and settle claims in line with regulatory rules.

Effect of stress scenarios on the above conclusions

11.16 I have tested the impact on my conclusions of plausible stress scenarios that AEL, AIG UK and AESA may experience. These stresses include:

- Reduced future profits
- Reserve deteriorations
- Alternative allocation of Level 3 investments
- The High Court not sanctioning the split of reinsurance assets
- Impairment of intra-group reinsurance

11.17 I consider that my conclusions are resilient to these stresses but note that in the event of these stresses being realised ahead of the Proposed Scheme I would expect to address this in my supplementary Scheme Report.

Other considerations

11.18 I consider that the Proposed Scheme will have no significant effect on the UK Transferring Policyholders and the European Transferring Policyholders in respect of matters such as investment management, new business strategy, management, administration, claims handling, governance arrangements, expense levels and valuation bases in relation to how they may affect the security of policyholders' contractual rights and levels of service provided to policyholders.

11.19 In reaching this conclusion I note that a very small proportion of European Transferring Policyholders whose policies have been written by AEL from an establishment in the UK into other EEA States currently have the right to address complaints to The Financial Ombudsman Service ("TFOS"). Following the Proposed Scheme these European Transferring Policyholders will not have access to TFOS in respect of complaints relating to acts or omissions occurring post transfer carried out from outside of the UK. Such disputes in relation to such complaints will, however, be able to be heard by the Luxembourg ombudsman services or remain with dispute resolution services in the country in which the risk is located. I have considered this in my Scheme Report and, despite this, consider that European Transferring Policyholders will not be materially adversely affected by the Proposed Scheme.

11.20 I also consider that matters such as the cost and tax effects of the Proposed Scheme will have no significant effect on the security of policyholders' contractual rights.

11.21 I am satisfied that the proposed material to be presented to policyholders is appropriate and AEL's approach to communication with policyholders, including the exceptions to the standard communications approach, are appropriate, reasonable and proportionate.

External reinsurers

11.22 The external reinsurance of AIG UK and AESA will cover the same liabilities as under AEL and the claims handling will be undertaken by the same team under the same policies and procedures both before and after the Proposed Scheme. As such, I consider the transfer will have no material effect on the external reinsurers of AEL.

Interaction with regulators

11.23 I contacted the PRA and FCA at an early stage to establish whether there were matters or issues which they wanted me to consider in this Scheme Report. A draft of this Scheme Report has been made available to the PRA, FCA and CAA whose comments have been taken into account. The PRA (in consultation with the FCA) has approved the form of this Scheme Report.

Effective challenge to AEL

11.24 During my review, I have provided challenge to the data, information and analyses provided to me by AEL. For example:

- I have challenged AEL's calculation of the Risk Margin for AIG UK and AESA.
- I have requested additional information on the reserves relating to Freedom of Services risks.
- I have specified Brexit scenarios for which AEL has investigated its capital position.
- I have specified stress scenarios for which AEL has investigated its capital position.
- I have specified the form of exhibits provided to me by AEL to allow me to assess the security of policyholders' contractual rights.

11.25 No limitations have been imposed on the scope of my work and the opinions in this Scheme Report about the Proposed Scheme are mine, based on the information provided to me and the answers given to any questions I have raised. There are no matters that I have not taken into account or evaluated in this Scheme Report that might, in my opinion, be relevant to policyholders' consideration of the Proposed Scheme.

Supplementary Scheme Report

11.26 My Independent Expert Scheme Report is based on financial information in respect of AEL as at 30 November 2016 and financial projections performed by AEL to 1 December 2018 and from financial year 2019 through to 2021 in respect of AIG UK and AESA, based on management accounts available at 28 February 2017. I expect to produce a supplementary Scheme Report based on the financial position of AEL as at 30 November 2017 and revised financial projections to 1 December 2018 and from 2019 through to 2021 in respect of AIG UK and AESA, which will take into account any significant changes.

11.27 At the time of my supplementary Scheme Report I will also consider whether the ongoing investigation and planning which is being undertaken by AEL in respect of the Proposed Scheme will result in changes to the structure of the Proposed Scheme which requires my review. Such areas may include but are not limited to:

- AEL's asset allocation between AIG UK and AESA as a result of its asset allocation programme;
- The validation of AIG UK and AESA's Internal Models as described in paragraph 9.28;
- The outwards reinsurance programmes for AIG UK and AESA; and
- The impact of a series of US windstorm losses in August and September 2017.

Duty to the High Court

11.28 As required by Part 35 of the UK Civil Procedure Rules, I hereby confirm that I understand my duty to the High Court, I have complied with that duty and I will continue to comply with that duty.

Statement of truth

11.29 I confirm that insofar as the facts stated in my Scheme Report are within my own knowledge I have made clear which they are and I believe them to be true, and that the opinions I have expressed represent my true and complete professional opinion.

Steve Mathews
Independent Expert
Fellow of the Institute and Faculty of Actuaries

26 February 2018

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

Appendix A: Glossary of Terms

Accident Year	The grouping of claims that were reported in the same 12 month period irrespective of when the claims actually occurred or the underlying policy incepted.
AEL	AIG Europe Limited
AESA	AIG Europe S.A.
AIG	American International Group, Inc.
AIG UK	American International Group UK Limited
AIGIH	AIG International Holdings GmbH
AIG Group	The group of companies owned by AIG
AHEL	AIG Holdings Europe Limited
APS	Actuarial Practice Standards as issued by the IFoA
Branch European Transferring Policyholders	European Transferring Policyholders with policies written by AEL from its branches
Brexit	The UK's exit from the EU.
CAA	Commissariat aux Assurances
CMA	Capital Maintenance Agreement, a legally enforceable commitment to unconditionally provide a sufficient amount of capital of the appropriate kind to restore the insurer's capital level to above its SCR.
Coverage Ratio	The ratio of Own Funds to the capital required either on a regulatory (SCR) basis or the company's own (target) basis.
Diversification	The extent to which aggregate risk is less than the sum of the underlying individual risks.
EEA	European Economic Area

Effective Date	The intended effective date of the Proposed Scheme, being 1 December 2018
EL	Employers' Liability
ELTO	Employers' Liability Tracing Office
EU	European Union
European Transferring Policyholders	The policyholders of AEL, that part of whose insurance policies are transferring from AEL to AESA. European Transferring Policyholders comprise FoS European Transferring Policyholders and Branch European Transferring Policyholders.
FCA	The Financial Conduct Authority, one of the insurance industry regulators in the UK (the other being the PRA).
FoE	Freedom of Establishment, the ability of EU insurers to establish branches in member states of the EU.
FoS	Freedom of Services, the ability of EU insurers to sell insurance products into any other EU member state.
FoS European Transferring Policyholders	European Transferring Policyholders with policies written by AEL on a FoS basis from the UK.
FRC	The Financial Reporting Council, the UK's independent regulator responsible for promoting high quality corporate governance and reporting. The FRC sets standards for corporate reporting, audit and actuarial practice and monitor and enforce accounting and auditing standards.
FSCS	The Financial Services Compensation Scheme, the UK's statutory compensation scheme which compensates customers of authorised financial services firms in the event that the company is unable pay claims against it.
FSMA	The Financial Services and Markets Act 2000, an Act of Parliament to make provision for the regulation of financial services which details the legal basis for the transfer of an insurance business in the UK.
GAAP	Generally Accepted Accounting Principles
Granular Analysis	The running of mechanical reserving and benchmark models on individual lines of business within the UK and RoE segments.

Hard Brexit	The scenario in which UK insurance firms lose their passporting (FoS and FoE) rights after Brexit.
High Court	The High Court of Justice in England and Wales.
IBNR	Incurred But Not Reported, the estimate of unpaid loss amounts to cover claims events that may have occurred before the evaluation date but still have to be reported to the insurer, the development on outstanding case reserves and future claim events that relate to policies written before the evaluation date, but where there remains future exposure.
ICS	Insurance Compensation Scheme
IFoA	Institute and Faculty of Actuaries, a professional body which represents and regulates actuaries in the United Kingdom.
IFRS	International Financial Reporting Standards
IM	Internal Model, an entity-specific, risk-based model approved by the regulator to be used by insurers to calculate their Solvency Capital Requirement under Solvency II.
Jersey Scheme	A separate scheme in Jersey to transfer the insurance business carried on by AEL in or from within Jersey to AIG UK and AESA.
Lexington	The Lexington division underwrites US risk and accounts for approximately 15% of the UK segment gross premiums written.
Lux GAAP	Luxembourg GAAP
Luxembourg Ombudsman Services	The National Consumer Ombudsman Service and/or the Médiateur en assurance
No Scheme Position	The position if there were no Proposed Scheme.
Other Policyholders	Policyholders not covered by Trust Funds.
Own Funds	The level of actual available capital as measured under Solvency II rules.
Part VII	Part VII of FSMA
Post Scheme Position	The position should the Proposed Scheme proceed.

PRA	The Prudential Regulation Authority, one of the insurance industry regulators in the UK (alongside the FCA).
Proposed Scheme	The transfers from AEL to AIG UK and AESA as described in this Scheme Report.
Reinsurance	This is where an insurance company purchases insurance from a reinsurer.
RMBS	Residual Mortgage Backed Securities, of form of structured investment product.
RoE	Rest of Europe, the reserving segment which excludes the UK segment.
Run-off	Describes the status of an insurance or reinsurance business when it does not accept new business (including policy renewals). The liabilities will gradually reduce over time, or run-off, as the company settles and pays the claims to the policyholders.
Scheme Report	Independent Expert's Scheme Report on the Proposed Scheme.
SCR	Solvency Capital Requirement, is the capital requirement under the Solvency II regime.
SF	Standard Formula, a non-entity-specific, risk-based mathematical formula used by insurers to calculate their Solvency Capital Requirement under Solvency II.
SFCR	Solvency and Financial Condition Report, a report required under Solvency II which is publicly available, contains information on the company’s solvency and financial condition and is designed to be used by policyholders, shareholders and other stakeholders.
Soft Brexit	The scenario in which UK insurance firms maintain their passporting (FoS and FoE) rights after Brexit.
Solvency II	An EU directive aimed at harmonising the EU insurance regulation and enhancing consumer protection. The directive applies to all EU-domiciled insurance and reinsurance companies and was implemented on 1 January 2016.
SUP18	Chapter 18, in relation to Transfers of Business, of the Supervision manual in the FCA Handbook.
TAS	Technical Actuarial Standards, as issued by the FRC

Technical Provisions	Technical provisions represent the amount that an insurer requires to fulfil its insurance obligations and settle all expected commitments to policyholders and other beneficiaries arising over the lifetime of the insurer's portfolio of insurance contracts.
TFOS	The Financial Ombudsman Service
Tied Assets	A pool of assets equalling technical provisions which must be segregated from the other assets of the insurance company and which may only be used to pay insurance claims under Luxembourg law.
Trust Funds	Ring fenced Trust Funds, a ring-fenced pool of assets which are firstly used to pay policyholders who are protected by the Trust Fund.
UK GAAP	Generally Accepted Accounting Practice in the UK, is the body of accounting standards and other guidance published by the UK Accounting Standards Board (ASB).
UK Law	The laws of England and Wales, Scotland and Northern Ireland.
UK Transferring Policyholders	The policyholders of AEL, that part of whose insurance policies are transferring from AEL to AIG UK.
Unallocated Loss Adjustment Expenses	Unallocated Loss Adjustment Expenses are expenses which are not attributable to a specific insurance claim. They form part of an insurer's expense reserve and are one of the largest expenses for which an insurer has to set aside funds.
Underwriting Year	The grouping of claims relating to policies that incepted in the same 12 month period irrespective of when the claims actually occur or when the claims are reported. Also known as policy year.
UPR	Unearned Premium Reserve, the reserve held to cover the portion of written premium that represents the unearned portion of the insurance contracts as at a given point in time.
VaR	Value-at-Risk
Value-at-Risk	A statistical technique used to measure and quantify the level of financial risk within a firm or investment portfolio over a specific time frame.
Willis Towers Watson	Towers Watson Limited, authorised and regulated by the FCA.
WTW	Towers Watson Limited, authorised and regulated by the FCA.

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Appendix B: Curriculum Vitae

Specialist area of expertise

Steve Mathews is an experienced actuary with 24 years of non-life (re) insurance industry experience.

He has extensive experience of reserving UK and European lines of commercial insurance business, personal lines, as well as most lines of London Market insurance and reinsurance business. He is a holder of a Lloyd's Syndicate Actuary Practising Certificate and has been responsible for providing Statements of Actuarial Opinion for Lloyd's Syndicates and London Market Companies for over 15 years.

Steve leads Willis Towers Watson's European Legacy Claims team and has extensive experience of assisting companies to reserve, capitalise, manage and transfer their latent claim liabilities.

Steve has co-developed Willis Towers Watson's innovative approach toward Lloyd's RITC which Willis Towers Watson has used to successfully RITC in excess of 10 portfolios over the last five years. In addition Steve has run numerous buy-side M&A projects for clients.

Steve has been heavily involved in assisting companies develop and validate their internal capital models under both ICA and Solvency II regimes and is a Chartered Enterprise Risk Actuary (CERA).

Steve has been active in pricing, reinsurance analysis and strategy development for many different lines of primary and reinsurance business.

Steve has previously performed an Independent Expert assignment and regularly carries out the peer review required on other actuaries work; this includes IE experience.

Role at Willis Towers Watson

Steve Mathews is a Senior Director of Willis Towers Watson's Insurance Consulting and Technology (ICT) Division and a Fellow of the Institute of Actuaries. Steve joined Willis Towers Watson following the acquisition of EMB in February 2011 where Steve was a Partner.

Education and credentials

Steve graduated from Bristol University (UK) in 1993 and has been a Fellow of the UK Institute of Actuaries for 18 years. He is a holder of the Lloyd's Syndicate Actuary Practicing Certificate, a member of the London Market Actuaries Group and a Specialist Member of the Institute of risk Management.

He speaks regularly at seminars and conferences on insurance topics, has written articles for the insurance press and has served on industry working parties.

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Appendix C: Information Considered

For the purposes of this Scheme Report I have reviewed various items of data and information, including the following:

Documents relating to the Proposed Scheme

- Draft Scheme Document
- Draft of Cross Border Merger document
- Draft of Communications Strategy Paper
- Draft Directors Explanatory Report
- Details of Trust Funds and Guarantees impacted by the Proposed Scheme
- Analysis of policyholder protection schemes in the EU commission by AEL
- Legal note on the scope of the FSCS commissioned by AEL
- Legal note on the ability of the High Court to split reinsurance assets between AIG UK and AESA commissioned by AEL
- Draft Scheme Booklet
- Draft Jersey Scheme document

Documents Relating to AEL

- Report and accounts at year-ends 2014, 2015 and 2016
- Reserve committee meeting packs at 1Q16, 2Q16, 3Q16 and 4Q16 plus February 2017 update (post Ogden adjustment)
- Deep-dive reserve review reports produced during 2016 (26 documents requested and received)
- Actuarial Function Reports at year-end 2015
- Management accounts at 1Q17
- External reserving reports at year-end 2016
- 2017 business plan
- Own Risk and Solvency Assessment report
- SFCR at year-end 2016
- Documents requested from Internal Model library (57 documents requested and received)

- Details of any material exposures to litigation, reinsurance disputes, doubtful reinsurance security or underwriting disputes.
- Strategic Asset Allocation report produced in November 2016

Documents Relating to AIG UK

- Business plan for 2019 (including projections to 2021)
- Own Risk and Solvency Assessment report

Documents Relating to AESA

- Business plan for 2019 (including projections to 2021)
- Own Risk and Solvency Assessment report

Other

- Claims triangulations as at 30 November 2016 for detailed classes of business for AEL.
- Projection of pro forma accounting balance sheets and income statements and Solvency II balance sheets, Own Funds and SCRs to 1 December 2018 for AEL, AIG UK and AESA under the various scheme and Brexit scenarios.
- Stress tests on the above.

This information and various oral supplementary information has been provided by the management team of AEL.

I have relied upon the accuracy and completeness of the above data and information without independent verification. However, I have reviewed the data and information for general consistency and overall reasonableness and based on my wider experience this gives me no cause for concern.

I have received a statement of data accuracy signed by Fabrice Brossart, Chief Risk Officer of AEL which confirms the accuracy and completeness of the information provided to me in performing my Independent Expert role.