Actuarial Report on Scheme Transfers – GLA and HSB to Gordian

Gordian RunOff Limited

Great Lakes Insurance SE

HSB Engineering Insurance Limited

March 2020

Actuarial and Insurance Consultants

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Dear Sandra, Shalaj and Anya

Actuarial Report on Scheme Transfers – GLA and HSB to Gordian

I am pleased to enclose my actuarial report relating to the transfer of the insurance business of the Australian Branches of Great Lakes Insurance SE and HSB Engineering Insurance Limited to Gordian RunOff Limited.

I would like to record my appreciation for the assistance provided by staff of each of the three companies that commissioned the report.

Please do not hesitate to contact me if you have any questions.

Yours sincerely

Geoff Atkins
Fellow of the Institute of Actuaries of Australia

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Part I Report

1 Introduction

This report has been prepared at the request of Gordian RunOff Limited (Gordian), and the Australian Branch of Great Lakes Insurance SE (GLA) and the Australian Branch of HSB Engineering Insurance Limited (HSB). Gordian is an insurance company authorised by the Australian Prudential Regulation Authority ("APRA") in Australia that is in run-off. GLA and HSB are branches in Australia of overseas insurers, both of which are entities within the Münchener Rückversicherungs-Gesellschaft AG corporate group (collectively referred to as "Munich Re").

The report covers the proposed transfers of assets and liabilities from GLA and HSB to Gordian. The proposed transfers will take place in accordance with schemes prepared under Part III Division 3A of the Insurance Act 1973 (referred to in this report as the "Insurance Schemes" or "Schemes").

This report provides my opinion on aspects of the two Schemes that the expert actuary would be required to assess, and specifically whether the interests of affected policyholders would be materially adversely impacted by the Schemes.

This report will be provided to APRA and the Australian Federal Court as part of the documentation supporting the Schemes. I anticipate that a copy of the report will be made available to affected policyholders.

Readers of this report should note the reliances and limitations detailed in Section 6.

1.1 Compliance

1.1.1 Prudential Standard GPS 410

APRA's Prudential Standard GPS 410 sets out the procedural requirements for insurers transferring or amalgamating insurance business, which include a requirement for an actuarial report on which the Scheme is founded.

While GPS 410 provides no specific guidance on the content of actuarial reports on which insurance business transfers are based, in my experience it is usual for such actuarial reports to provide an opinion as to whether or not the interests of affected policyholders are materially adversely affected by the proposed scheme.

1.1.2 Federal Court Practice Note

I acknowledge that I have read, understood and complied with the Federal Court of Australia's Expert Evidence Practice Note (GPN-EXPT).

1.2 Authorship of Report

This report has been prepared by Geoff Atkins of Finity Consulting, who has been appointed by Gordian, GLA and HSB to prepare the actuarial report on the Schemes for the purpose of Division 3A of Part III of the Insurance Act. The report has been peer reviewed internally by Gae Robinson of Finity Consulting.

1.3 Qualifications and Involvement

Geoff Atkins, the author of this report, has been a qualified actuary for more than 30 years and has prepared a number of reports on Insurance Schemes. Geoff is currently the Appointed Actuary to Gordian and the Group Actuary for Enstar Australia Holdings Pty Limited.

Gae Robinson of Finity is HSB's Appointed Actuary and Andrew Cohen of Finity is HSB's Agent in Australia. These roles are continuing and will remain following the Schemes until such time as HSB obtains approval by APRA for the revocation of HSB's authorisation.

1.4 Policyholder Interests

I consider that policyholder interests relate to the payment of claims when they fall due, both now and in future, with such payments being made reasonably promptly and efficiently once liability and quantum have been established. In forming a view on policyholder interests, I have considered:

- The contractual rights of existing policyholders
- The expected future claims management procedures
- The nature of the risks faced by policyholders before and after the transaction
- The financial security provided to policyholders of the insurance entities before and after the transaction.

The transaction does not involve all the policyholders of GLA. Those transferring are set out in the Scheme document (the transferring GLA policyholders). Others will remain insured by GLA (the remaining GLA policyholders). All of the policyholders of HSB are being transferred by the Scheme.

The affected policyholders are the transferring GLA policyholders and the HSB policyholders and it is principally their interests that I have considered.

It is customary for the actuarial report to also make some commentary on the impact of the Scheme(s) on the interests of existing policyholders of the receiving insurer (in this case Gordian) and I have done so. In a similar manner I have commented briefly on the impact of the Scheme on the interests of those policyholders whose insurance remains with GLA.

This report deals with the interests of policyholders of Gordian, GLA and HSB as groups, rather than each individual policyholder.

1.5 Effective date of relevant information

Most of the financial information in this report is as at 31 December 2018. There are two reasons for this – firstly, the drafting of the report was done in the latter part of 2019 so 31 December 2019 information was not available, and secondly the 31 December 2018 information was the most recent audited financial material.

Up-to-date financial information is relevant to assessment of the Schemes. I intend to review the financial information as at 31 December 2019 as it becomes available and provide an update letter that can be included in information provided to the Court by way of affidavit.

1.6 Approach

My approach involved the following steps:

1. Review and understand the agreement among Gordian, GLA and HSB governing the Schemes (the Framework Deed).
2. Review the nature and valuation of the liabilities to be transferred.
3. Examine the financial security of policyholders pre-transfer of Gordian, GLA and HSB and post-transfer of Gordian following the transfer of the GLA and HSB businesses under the Schemes. One aspect of financial security is the capital adequacy position. This step included consideration of the latest annual APRA balance sheet and Prudential Capital Amount (PCA) calculations available at the time of preparing this report, and considering the expected impacts up to and after the proposed transfer. I also considered the capital management approaches of the relevant entities, and the potential for capital support from respective parent companies.
4. In this transaction the most important element of financial security is that provided by reinsurance. I examined the current reinsurance arrangements and analysed the reinsurance arrangements with Cavello Bay Reinsurance Limited (Cavello Bay), an affiliate of Gordian and a wholly-owned (via an intermediate holding company) subsidiary of Enstar Group Limited (Enstar). Cavello Bay will reinsure Gordian for 100% of the liabilities in respect of the GLA and HSB business. The reinsurance arrangement is collateralised via a trust fund with an independent trustee (the Australian Trust Fund) securing the interests of transferring policyholders.
5. Assess the other impacts of the Insurance Schemes on policyholders of Gordian, GLA and HSB, including consideration of the terms and conditions applying to the policyholders and the claims handling procedures to be adopted.

1.7 Information

In preparing this report, I have liaised with, and received assistance from, management of GLA, HSB and Gordian. I have found all parties to be open in their dealings with me, and all material requested has been made available to me. Gordian, GLA and HSB have reviewed my report, and none have any objections to the information presented. The information used in preparing this report is set out in Appendix A.

2 Background Information

The purpose of this section is to provide information about the three relevant entities and the transferring policyholders that are relevant to the proposed Schemes (Section 3) and my assessment of the impact on affected policyholders (Section 4).

2.1 Gordian, GLA and HSB

Gordian is a wholly-owned (via an intermediate holding company) subsidiary of Enstar Group, which is publicly traded on the NASDAQ stock market (ticker symbol: ESGR). Gordian is managed by a related company in the group - Enstar Australia Limited (Enstar Australia), an Enstar group entity - which provides all management services for Gordian.

Enstar specialises in the acquisition and management of run off insurance businesses. Gordian was originally acquired by the Enstar group from AMP Limited in 2008. Since that time Gordian has acquired by similar process more than ten Australian insurance businesses or portfolios that are in run off.

Great Lakes Australia (GLA) is a branch of Great Lakes Insurance SE (GLISE), an insurance company based in Munich and domiciled in Germany. It is a wholly owned subsidiary of Munich Re. GLA's main business in Australia was underwriting of insurance business for managing general agents and some other scheme businesses. In 2014 Munich Re acquired Calliden Insurance Limited (CIL) and the insurance business of CIL was subsequently transferred to GLA by way of a Scheme under the Insurance Act.

Over the course of 2017, GLA ceased writing all agency business (with the exception of Calibre, which was terminated from 31 March 2018, and which from 1 January 2018 was 100% reinsured to Hollard). GLA continues to maintain its licence and operations in Australia; however since March 2018 GLA's new business is limited to a niche portfolio of large single risk business and agricultural business via a Managing General Agent (MGA).

GLA is only transferring run-off portfolios related to policies issued via 9 selected MGAs and the former business of CIL. GLA will continue to insure and manage the remaining portfolios. The business transferring represents 56% of the total business of GLA (based on case estimates) with 44% remaining with GLA. The transferring business is mostly casualty (including builder's warranty) with property business being largely run-off. The bulk of claims are expected to be settled in the next 2 to 4 years, although there will be a tail of claims extending for many years.

HSB is a branch in Australia of HSB Engineering Insurance Limited (HSBEIL), a company domiciled in England. The company is a wholly owned subsidiary of Munich Re, having been acquired in 2008. In 2016 HSBEIL ceased writing single risk engineering business and all other business was ceased in the first quarter of 2017.

2.2 Purpose of the Transaction

GLA, HSB and Enstar have reached a commercial agreement to transfer the transferring businesses of GLA and all the business of HSB in Australia to Gordian. I understand that the objectives of GLA are to undertake a portfolio transfer of these non-core portfolios of business in order to release management time and attention and gain economic finality and elimination of volatility in connection with these legacy run-off portfolios. I understand that for HSB the purpose is to be able to achieve finality for the Australian branch which is now very small, incurring both management expenses and requiring capital in Australia.

I understand that Enstar has entered into the agreement as a commercial venture, noting that this activity is its specialisation.

The transaction involves transfer of certain select portfolios of run-off insurance business of GLA (those parts that are transferring) and HSB to Gordian under the Schemes. Gordian, which is an APRA-authorised insurer in Australia, will reinsure 100% of the business to Cavello Bay, retaining the protection of an Australian Trust Fund that meets APRA's requirements for protection of Australian policyholders. More details of Cavello Bay, the reinsurance and the Australian Trust Fund are discussed in Section 3.5.

2.3 Gordian

Gordian is an authorised Australian insurer. It entered run-off in September 1999. Gordian has three key portfolios:

- Corporate Direct – direct insurance policies written in the 1990s including Professional Indemnity, Directors & Officers, Public Liability, as well as several acquired portfolios
- Assumed Reinsurance – reinsurance treaty and facultative business
- Compulsory Third Party ("CTP") personal injury.

Gordian has no remaining unexpired policies or any unearned premium. The only insurance liabilities are the outstanding claims liabilities.

2.3.1 Gordian's Financial Performance

Table 2.1 summarises Gordian's financial performance for the three calendar years to December 2018.

Table 2.1 – Gordian's Income Statements ($ million)

	2016	2017	2018
Gross Earned Premium	(0.5)	(0.2)	(0.0)
Reinsurance Premium	-	-	-
Net Earned Premium	(0.5)	(0.2)	(0.0)
Net Claims Expense	2.9	(0.4)	0.5
Underwriting Expenses	-	-	-
Other Insurance Income	-	-	-
Underwriting Result	**2.4**	**(0.6)**	**0.4**
Investment Income	3.5	1.5	5.1
Other Income & Expenses	(4.5)	(2.5)	(2.2)
Profit before Tax	1.4	(1.6)	3.4
Tax	(0.4)	0.5	(1.0)
Profit after Tax	**1.0**	**(1.1)**	**2.4**

Source: APRA Returns

Gordian's financial results have fluctuated, with small profits and losses depending on progress of the run-off of claims and investment markets.

2.3.2 Gordian's Reinsurance Arrangements

Gordian does not purchase new reinsurance protection unless business portfolios are transferred into Gordian. Any existing reinsurance (or retrocession in the case of assumed reinsurance) is limited to that purchased by the originating insurer at the time the business was written, provided it has not since been commuted.

Gordian has a large quota share reinsurance treaty with Cavello Bay which reinsurers 100% of a run-off portfolio of compulsory third party insurance in NSW that Gordian acquired in 2018. Cavello Bay will also reinsure 100% of the business transferring from GLA and HSB (net of any external reinsurance that continues to apply) under the Schemes.

2.3.3 Gordian's Insurance Liabilities

Table 2.2 summarises Gordian's insurance liabilities at 31 December 2018.

Table 2.2 – Gordian Insurance Liabilities at 31 December 2018 ($ million)

	Direct Business		Reinsurance	Total
	CTP	Other[1]		
Gross Central Estimate	209	32	17	258
Reinsurance Recoveries	(190)	(5)	(0)	(195)
Other Recoveries	(19)	(1)	(1)	(20)
Net Central Estimate	-	26	16	43
Risk Margin	-	6	3	9
Net Provision	**-**	**33**	**19**	**52**
Risk Margin %	-	24%	18%	22%

Source: APRA Return

[1] Includes Liability, Professional Lines, Employers Liability

Gordian's insurance liabilities of $52 million at 31 December 2018 all relate to outstanding claims.

2.3.4 Latent claim exposure in Gordian

The Enstar Group specialises in the acquisition and management of legacy portfolios, many of which contain exposure to latent claims.

Gordian has exposure to asbestos related disease claims, both from its original business and from acquired portfolios. The original business includes some assumed reinsurance that has a run-off of very old US asbestos, environmental and health hazard exposures.

There is also exposure to child sexual abuse claims. Prior to the Royal Commission into Institutional Responses to Child Sexual Abuse, Gordian had received a small number of claims and since the Commission the number of claims received has increased.

Progress of the latent claim segments is an important part of the actuarial valuation process, as well as of management reporting. At the present time the latent claim exposures, including the developments in child sexual abuse, do not threaten the solvency of Gordian.

2.3.5 Gordian's Capital Management

Gordian's capital management approach is set out in its 3 year Run-Off Plan. Taking into account APRA's capital requirements, Gordian's Board has determined a target level of capital of 2.2 times the Prescribed Capital Amount (PCA)[1].

[1] The **Prescribed Capital Amount** (PCA) is the minimum capital requirement defined under APRA's risk based capital requirements. Insurers hold capital in excess of the PCA in order to withstand fluctuations in capital levels.

Gordian is relatively active in managing its capital. Over the years it has returned capital to its parent as the business has run-off, always subject to APRA approval. With the CTP transaction in 2018 Gordian needed extra capital to meet its Board-determined target and this was provided by the parent prior to approval of the scheme.

2.3.6 Gordian's Financial Security

Balance Sheet

Table 2.3 summarises the reported assets and liabilities of Gordian at 31 December 2018.

Table 2.3 – Gordian Balance Sheet at December 2018 ($ million)

Assets	
Cash	16.1
Investments	517.4
Premium and Other Receivables	15.0
Reinsurance Assets	195.3
Non-Reinsurance Recovery Assets	20.4
Deferred Assets	3.6
Total Assets	767.8
Liabilities	
Creditors and Accruals	25.2
Claims Liabilities	267.5
Unearned Premium	-
Amounts Due to Reinsurers	2.4
Income Tax Liability	1.7
Total Liabilities	296.9
Net Assets	471.0

Source: GRF_300_0_L

Gordian's balance sheet has some large elements that are worthy of explanation:

- The claims liabilities of $267 million less the reinsurance and non-reinsurance recovery assets of $195 million and $20 million (respectively) gives the net insurance liabilities of $52 million shown in Table 2.2.
- The $517 million of investments includes about $400 million relating to intercompany loans, which (as shown later) are not admissible for regulatory capital purposes.
- Most of the $25 million in creditors and accruals relates to amounts due to related parties.

APRA Capital Adequacy

Table 2.4 shows Gordian's APRA Prescribed Capital Amount (PCA) and its makeup at 31 December 2018.

Table 2.4 – Gordian APRA PCA at December 2018 ($ million)

Insurance Risk Charge	7.5
Insurance Concentration Risk Charge	-
Asset Risk Charge	28.4
Asset Concentration Risk Charge	-
Operational Risk Charge	1.1
Aggregation Benefit	(5.1)
Prescribed Capital Amount (PCA)	**31.9**

Source: APRA Returns

The insurance liabilities of $52 million produce an insurance risk charge of $7.5 million. The asset risk charge is by far the largest amount, which includes risk charges on the assets held in the Australian Trust Fund for the CTP business. Table 2.5 summarises the calculation of the APRA Capital Base, starting with the net assets from Table 2.3. This is then compared to the PCA from Table 2.4 to determine the Capital Adequacy Multiple (CAM) as at 31 December 2018.

Table 2.5 – Gordian APRA Capital Adequacy at December 2018 ($ million)

Net Assets	471.0
Adjustments:	
Insurance Liability Surplus	-
Intangibles and Other Adjustments	(400.8)
APRA Capital Base	70.2
Prescribed Capital Amount (PCA)	31.9
Capital Adequacy Multiple (CAM)	**2.20**

Source: APRA Return

Table 2.5 shows $401 million of adjustments to the net assets; the bulk of this relates to intercompany loans which are not admissible for regulatory capital purposes[2].

The CAM of 2.2 is a comfortable level of capital adequacy, based on our experience of authorised general insurers in the Australian market.

Update at 30 June 2019

Most of the information in Section 2.3.6 was sourced from Gordian's Annual APRA Return at 31 December 2018. Table 2.6 shows how the CAM has moved in the six months to 30 June 2019[3].

[2] Following the Enstar group's acquisition of Gordian in 2008, around $400 million was repatriated in the form of non-interest bearing non-callable loans to its immediate and ultimate Australian parent.

[3] The information at June 2019 was provided by Gordian in early August 2019. Subsequently, Gordian advised us that it needed to resubmit the June 2019 and September 2019 quarterly returns, and this table is based on the resubmitted information.

Table 2.6 – Gordian APRA Capital Adequacy: Dec-18 v Jun-19 ($ million)

	Dec-18	Jun-19	Change
Insurance Risk Charge	7.5	8.2	0.7
Insurance Concentration Risk Charge	-	-	-
Asset Risk Charge	28.4	26.2	(2.2)
Asset Concentration Risk Charge	-	-	-
Operational Risk Charge	1.1	1.2	0.1
Aggregation Benefit	(5.1)	(5.4)	(0.3)
Prescribed Capital Amount (PCA)	**31.9**	**30.2**	**(1.7)**
Capital Base	**70.2**	**75.2**	**5.1**
Capital Adequacy Multiple (CAM)	**2.20**	**2.49**	**0.29**

Source: APRA Returns

The movements in the six months were:

- Gordian's PCA reduced by $5.0 million. This is due to the run-off CTP portfolio being paid out quickly: the assets in the Australian CTP Trust Fund are decreasing accordingly, so the Asset Risk Charge is reducing. This trend is expected to continue as Gordian's CTP claims are paid out.
- The Capital Base increased by $5.1 million to $75.2 million. The net assets increased due to an increase in retained earnings.
- The CAM increased from 2.20 to 2.49 at June 2019, which is above the target level of 2.2 (see Section 2.3.5).

In section 4.4 I consider the significance of expected further changes in Gordian's capital adequacy up to the date of approval of the Schemes.

2.3.7 Gordian's Corporate Structure

Gordian's ultimate parent is Enstar Group Limited (the ultimate parent company of the Enstar group), an insurance group offering capital release solutions and specialty underwriting capabilities through its network of group companies. At 31 December 2018, the Enstar group reported:

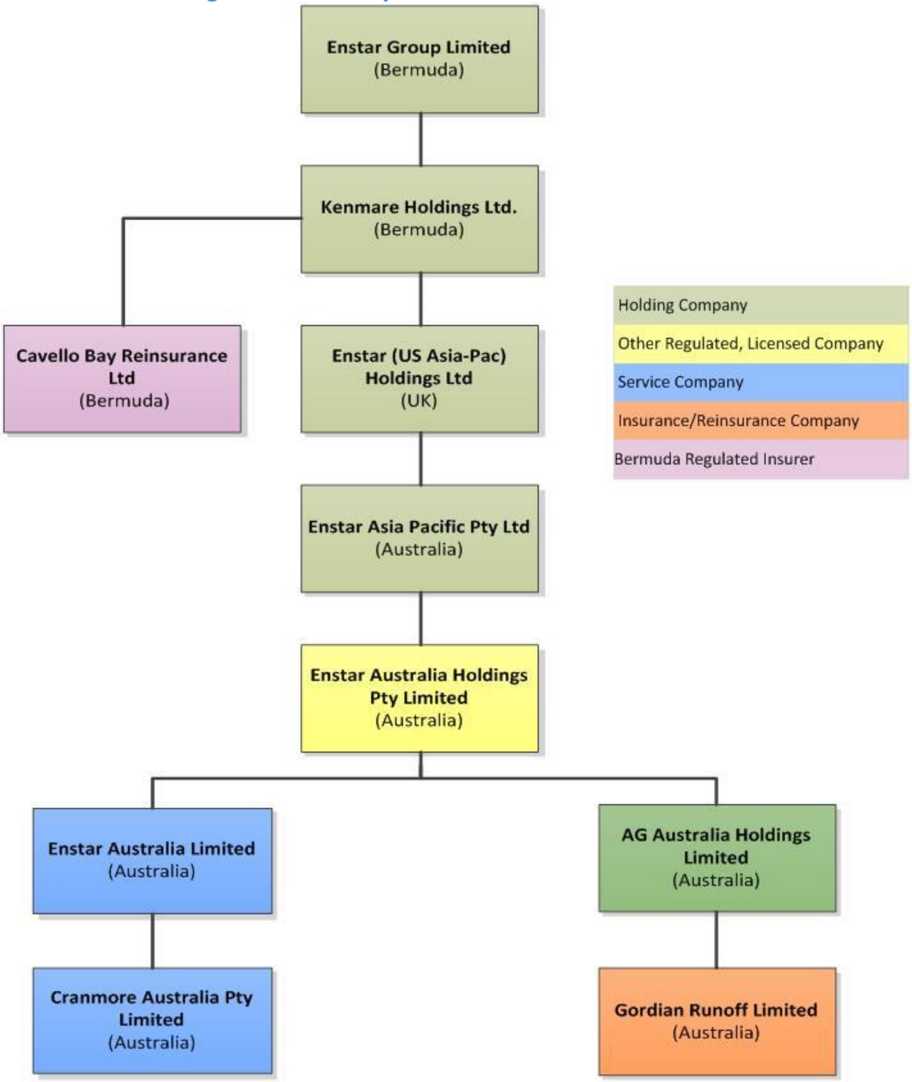
- Total assets of US$16.6 billion
- Total liabilities of US$12.2 billion
- Redeemable non-controlling interests of US$0.5 billion.

The resulting net assets of US$3.9 billion included a small amount of goodwill (US$0.1 billion).

Figure 2.1 presents the simplified corporate structure of the Enstar group at 31 December 2018, showing the key companies involved in the proposed transaction:

- Gordian
- Enstar Australia
- Cavello Bay.

Figure 2.1 – Corporate Structure of Gordian



Cavello Bay

Cavello Bay is domiciled in Bermuda and licensed as a Class 3B insurer by the Bermuda Monetary Authority. At 31 December 2018, Cavello Bay had total assets of US$4.1 billion, total liabilities of US$2.4 billion, giving net assets of US$1.6 billion[4].

Enstar Australia

Gordian is managed locally by Enstar Australia Limited (Enstar Australia), a service company specialising in managing insurance and reinsurance companies in run-off.

2.4 GLA and the Transferring Business

GLA is authorised by APRA to underwrite general insurance business in Australia, effective 1 January 2008. GLA is the Australian branch of GLISE and is part of Munich Re Group's operations in Australasia.

GLA is not transferring all of its business to Gordian. The transfer is of the business generated by nine (9) specified MGAs of GLA and the former business of CIL. All of the transferring portfolios are in run-off.

[4] Totals may appear not to add due to rounding.

GLA has historically written agency business (written through MGA agreements) and corporate business (large single-risk contracts). GLA ceased writing agency business during 2017, with the exception of Calibre which was no longer written from 31 March 2018. Business that was written via Calibre between 1 January 2018 and 31 March 2018 is 100% reinsured to Hollard and this reinsurance agreement will be transferred to Gordian at the time of the Scheme's confirmation.

GLA continues to maintain its licence and operations in Australia. The ongoing business and other non-transferring business will remain with GLA after the Schemes become effective. The New Zealand branch of GLISE was reorganised into GLA from 1 January 2019 and this business is remaining with GLA.

2.4.1 The Transferring GLA business

The Framework Deed states that the following GLA agency business will be transferred under the Scheme:

- Calibre Commercial Insurance Pty Ltd, renamed as Hollard Commercial Insurance Pty Ltd
- Celestial Underwriting Agency Pty Ltd
- Latitude Underwriting Pty Ltd, renamed as Austagencies Pty Ltd and SURA Construction Pt Ltd
- MECON Insurance Pty Ltd
- PEN Underwriting Pty Ltd
- Residential Builders Underwriting Agency Pty Ltd
- Solution Underwriting Agency Pty ltd
- Sports Underwriting Australia Pty Ltd
- Steeves Agnew Underwriting Agency Pty Ltd, renamed as ATC Insurance Solutions Pty Ltd

In addition to the above, the CIL run-off portfolio acquired by GLA under a scheme of transfer as at December 2017 is also included in the transfer.

2.4.2 Reinsurance Arrangements – GLA

From 1 January 2018, GLA implemented a 100% quota share reinsurance arrangement with the Australian branch of Munich Reinsurance Company (MRAu) covering existing business (net of any external reinsurance arrangements). This means GLA's net insurance liabilities (including claims expenses) are nil.

Only external reinsurance arrangements will be transferred under the Scheme. As at 31 December 2018, the external reinsurers made up less than 4% of total reinsurance recoveries (transferring and remaining business combined).

External reinsurance relates to:

- Calibre business written from 1 January 2018 to 31 March 2018, which is 100% reinsured to Hollard
- Builders' Warranty business written in South Australia since 1 October 2013 and in Western Australia since 1 November 2013, which is 100% recoverable from the respective state governments

- Business covered by external reinsurers under the various reinsurance arrangements that applied to the former CIL portfolio.

For clarity it should be noted that all GLA's reinsurance arrangements with MRAu in respect of the transferring portfolios will be commuted, whilst all external reinsurance contracts will transfer to Gordian as at the scheme confirmation.

2.4.3 Latent Claim Exposure – Transferring business

GLA has latent claim exposures arising from asbestos, pollution and health hazard risks as a result of the acquisition of CIL's run-off reinsurance portfolio (originally Reinsurance Australia Corporation) and treaty arrangements with Australian World Underwriters (AWU) written between 1967 and 1972. The provision for future claims arising from CIL's run-off reinsurance business at 31 December 2018 is $0.1 million including risk margin (based on the Appointed Actuary's advice). Gordian specialises in this type of risk, and has the greatest remaining share of the AWU liabilities.

I am not aware of any exposure to child sexual abuse claims in the transferring business, although it cannot be ruled out from exposures such as Sports Underwriting.

I have concluded that there is no significant latent claim exposure in the GLA transferring business that may have a material impact on the interests of affected policyholders.

2.4.4 Capital Management – GLA

GLA's capital management approach changed significantly in 2018 with the 100% quota share to MRAu introduced. There is ample historical evidence of the company injecting capital to the Australian branch when needed for growth or due to poor results.

Because of the 100% reinsurance GLA anticipates that from the end of 2019 the Prudential Capital Amount will be $5 million (the minimum amount). The capital management policy is to maintain capital of at least 175% of the Prescribed Capital amount with a minimum of $10 million.

2.4.5 Financial Security – GLA

With the business changes in GLA, including the 100% reinsurance, the financial security of policyholders is now represented mainly by the security of the reinsurance arrangements. We have reviewed the historical and recent capital position of GLA but it is not shown because it is now not relevant. After the 100% reinsurance arrangement the PCA comprises only the asset risk charge (mainly deriving from reinsurance recoverables) and the operational risk charge.

The financial security of the transferring policyholders is currently sound, comprising mainly the 100% reinsurance from MRAu and the implied support of the Munich Re Group. MuRAu is a substantial reinsurer in this market, and part of one of the two largest reinsurance groups in the world. The global reputation of Munich Re would be severely damaged if it were to allow a part of the group to become insolvent and unable to pay claims.

2.5 HSB

HSBEIL is a specialist commercial insurer domiciled in the UK. In Australia the business it wrote via its branch, HSB, comprised Construction, Plant, Erections All Risk, Machinery Breakdown and a Construction portfolio issued on behalf of HSB by an underwriting agency Ensurance. HSB ceased writing direct business from 1 July 2016 and Ensurance business from 7 March 2017. Some

Construction policies are multi-year contracts relating to a particular project. At the time of drafting this report HSB has one multi-year Construction contract that is still on risk, under which the policyholder has a contractual right to extend based on the project completion date, and that an extension of this policy may occur. Whether or not an extension occurs makes no material difference to the risk profile of the portfolio.

Construction contracts sometimes cover a 'maintenance period' after completion of the contract, and HSB insured some home construction projects where the policies have expired but they are within a one year maintenance period. All other coverage has expired and (apart from the one contract referred to above) none of the business can be renewed.

As all of the policyholders of HSB will be transferring to Gordian, I have outlined the recent circumstances for these policyholders in order to assess the impact of the Scheme on their interests.

2.5.1 Nature of Business – HSB

Table 2.7 summarises HSB's gross written premium for calendar years 2014 to 2017.

Table 2.7 – Gross Written Premium: HSB ($ million)[5]

	2014	2015	2016	2017
Construction	4.4	3.7	1.1	0.0
Plant	1.7	0.4	0.3	(0.0)
All Risks	-	0.0	-	-
Breakdown	0.3	0.3	0.3	-
Ensurance - Construction	0.3	1.2	2.1	0.6
Total (net of ARPC Premium)	**6.8**	**5.6**	**3.7**	**0.6**
Total (gross of ARPC Premium)	**7.0**	**5.9**	**3.8**	**0.6**

The Construction and Plant portfolios dominated HSB's business. In 2015 and 2016, HSB wrote further construction business for the Ensurance MGA. There has been no business written since 2017.

I am not aware of any exposure to latent claims such as asbestos-related or child sexual abuse claims in the HSB business.

2.5.2 Reinsurance Arrangements – HSB

HSB is currently protected by the following external reinsurance arrangements:

- For larger risks, facultative reinsurance arrangements as required; these operate before other reinsurance covers.
- HSBEIL's global catastrophe and excess of loss reinsurance program.

At present HSB also has some intra-group reinsurance protecting the Australian business, which will not transfer to Gordian.

The Scheme will transfer the benefit of external (non-Munich Re) reinsurance to Gordian. In addition, the facultative proportional (50%) arrangement in place with Munich Re for one multi-year construction risk will also transfer under the Scheme. At 31 December 2018 there were no claims expected to be recovered from reinsurers, and it is very unlikely that any would emerge now from the run-off portfolio.

[5] ARPC is the Australian Reinsurance Pool Corporation, the national terrorism insurance arrangement.

2.5.3 Insurance Liabilities – HSB

Table 2.8 summarises HSB's insurance liabilities at 31 December 2018.

Table 2.8 – Insurance Liabilities at December 2018: HSB ($ million)

	Outstanding Claims	Premium Liabilities	Insurance Liabilities
Gross Central Estimate[1]	2.4	0.1	2.5
Gross Risk Margin	1.2	0.1	1.3
Gross Provision	3.6	0.2	3.8
Net Provision	**3.6**	**0.2**	**3.8**
Gross Risk Margin %	50%	50%	50%

Source: APRA Returns

[1] Includes CHE

The total insurance liabilities of HSB at December 2018 were $3.8 million, including a risk margin of 50% of the central estimate.

2.5.4 Capital Management – HSB

HSB's capital management approach is set out in its ICAAP Summary Statement and is now largely irrelevant since it is deep into run-off.

2.5.5 Financial Security – HSB

Balance Sheet

Table 2.9 summarises the reported assets and liabilities of HSB at December 2018.

Table 2.9– Balance Sheet: HSB ($ million)

	Dec-18
Assets	
Cash	0.4
Investments	21.3
Premium and Other Receivables	0.1
Deferred Assets	0.0
Total Assets	21.8
Liabilities	
Creditors and Accruals	0.2
Claims Liabilities	3.6
Unearned Premium	0.2
Amounts Due to Reinsurers	0.1
Total Liabilities	4.1
Net Assets	17.7

Source: APRA Returns

APRA Capital Adequacy

Table 2.10 shows HSB's PCA at 31 December 2018. Since the sum of the risk charges is below $5 million, APRA's minimum PCA of $5 million applies.

Table 2.10– APRA PCA at December 2018: HSB ($ million)

	Dec-18
Insurance Risk Charge	0.4
Insurance Concentration Risk Charge	1.4
Asset Risk Charge	0.8
Asset Concentration Risk Charge	-
Operational Risk Charge	0.1
Aggregation Benefit	(0.5)
Sum of Risk Charges	2.2
Minimum PCA	5.0
Prescribed Capital Amount (PCA)	**5.0**

Source: APRA Returns

Table 2.11 summarises the calculation of the APRA Capital Base, starting with the net assets from Table 2.9. This is then compared to the PCA from Table 2.10 to determine the CAM as at 31 December 2018.

Table 2.11 – APRA Capital Adequacy at December 2018: HSB ($ million)

	Dec-18
APRA Capital Base	17.7
Prescribed Capital Amount (PCA)	5.0
Capital Adequacy Multiple (CAM)	**3.53**

Source: APRA Returns

During 2018 there was a repatriation of $2.7 million of current period profits from the branch to HSBEIL (UK). The CAM of 3.53 is well above HSB's Target Operating Range of 1.5 to 2.1.

There were no capital repatriations in 2019. We understand that once the Scheme is effective, HSB will apply to have its authorisation revoked by APRA and then repatriate any remaining capital in the Branch. HSB had planned a capital repatriation for 2019 but this has not occurred pending the Scheme.

3 Proposed Schemes

3.1 The GLA Business to Be Transferred

The transfer from GLA is of the insurance business derived from the sources listed in Section 2.4.1: nine specified agencies and the run-off of business acquired from CIL.

3.2 The HSB Business to be Transferred

The transfer from HSBEIL is the entirety of all the insurance business underwritten by or on behalf of HSB's Australian branch (including by an agent).

3.3 Nature of the Schemes

The proposed Schemes will implement the following actions on the effective date:

- All rights, obligations, and insurance liabilities arising from insurance contracts issued by GLA (in respect of the transferring business) and HSB will be transferred to Gordian.
- GLA and HSB will transfer assets or securities of an agreed value to Gordian.

At the same time the reinsurance agreement with Cavello Bay (see Section 3.5) will commence and the funds received by Gordian will be transferred to the Australian Trust Fund. The Australian Trust Fund is explained in detail in Section 3.5.

The amount payable by Munich Re has already been agreed with Enstar in a commercial agreement. That amount was calculated as at a nominated date, and the actual amount paid will be the agreed amount less the amount of claims paid since that date.

Prior to the effective date, Gordian will make an updated estimate of its capital position. Prior to the Schemes, if needed, Enstar will inject assets into Gordian in order to maintain coverage above its capital target. As noted in section 4.4, at the time of drafting this report, the projections suggested that Gordian would probably not require additional capital to meet the requirements for the transfers, but the situation needs to be assessed closer to the confirmation hearing.

3.4 Timing

The effective date of the Schemes is not known at this time. It will depend on approval by APRA and confirmation by the Court. The parties had a target effective date of 28 February 2020, although recent information suggests that 30 April 2020 is now a likely date.

It will be important to review the circumstances closer to that time to identify any changes in financial or other matters between the date of this report and the confirmation date. One component of this review will be to assess whether (and how much) additional capital needs to be contributed to Gordian.

3.5 Reinsurance with Cavello Bay

Cavello Bay Reinsurance Limited is a subsidiary of Enstar Group, domiciled in Bermuda. Many of the legacy businesses acquired by the Enstar group are transferred to or are reinsured by Cavello Bay.

Cavello Bay and Gordian will enter into a quota share reinsurance agreement whereby 100% of the claims risk in relation to business that is part of the Schemes will be transferred from Gordian to Cavello Bay from the effective date of the Schemes. The documentation has been agreed but not yet signed (at the date of drafting). Gordian will remain the insurer, will be responsible for all claims and portfolio management, and will have certain other reporting obligations.

Gordian is authorised as an insurer in Australia, while Cavello Bay is not. The Insurance Act and APRA's prudential standards have several measures to protect policyholders in Australia in the event of failure of a foreign reinsurer. The approach used by Gordian and Cavello Bay is as follows:

- The reinsurance treaty is governed by Australian law and requires payments to be made in Australia
- An Australian Trust Fund is established, to protect Australian policyholders, holding assets sufficient to back the liabilities
- The Australian Trust Fund is held by a local trustee (a major Australian bank) and the funds are invested at arm's length by an external investment manager
- The funds are available only to Gordian and only for the purpose of meeting claims recoverable under the reinsurance treaty (except for surplus assets which may be withdrawn by Cavello Bay)
- The Australian Trust Fund is capitalised at a minimum of 105% of the estimated claim liabilities under the treaty, with a requirement for Cavello Bay to immediately top up the Australian Trust Fund if at any time it falls below 105%.

This structure with a 100% quota share reinsurance treaty and an Australian Trust Fund specifically for the CTP policyholders has been used for the NSW compulsory third party insurance portfolio acquired by Gordian since the end of 2018. The structure was subject to extensive legal and regulatory scrutiny before that time, and it has operated successfully since then.

4 Impacts of Proposed Schemes

This section considers the impacts on affected policyholders of the proposed Schemes.

4.1 Insurance Policies

There will be no changes to the terms and conditions of the insurance policies issued by HSB or GLA (or CIL prior to that) as a result of the Schemes, apart from Gordian being substituted as the insurer.

4.2 Claims

At the present time, GLA claims are managed by staff in Australia. For the few remaining HSB claims, home construction project claims of up to $23,000 are managed under a delegated arrangement with a third party claims management firm and all other claims are managed by HSBEIL (UK)'s claims department using Australian agents and experts as needed.

The GLA claims team in Australia oversees all claims in line with the various manuals and guidelines set by the Munich Re Group; these set out details of the claims management philosophy, claims mandate, claims recording and administrative procedures involved. For claims relating to agency business, some individual agencies have delegated authorities to settle claims below specified thresholds without referral to GLA (generally below $250,000 for most agencies). In addition, a third party claims service provider manages claims relating to certain transferring run-off portfolios.

It is Gordian's intention to retain claims management practices after the Schemes. I understand that Gordian intends to:

- Retain arrangements with the managing agents whose business is transferring and who have claims management authority
- Retain arrangements with the third party claims service provider mentioned above
- Increase in-house head count for claims staff to the extent required (head count required is dependent on the maturity of Gordian's other run-off portfolios).

Gordian has arranged access to a claims management system from the transfer date which will have all details of open claims. The history of finalised claims will be transferred to an Enstar Group system. The costs of migration will be carried by Enstar Group, not Gordian.

Gordian has been managing claims for diverse run-off businesses in Australia for more than twenty years. To my knowledge there have been no significant complaints about the management of claims, which are managed in a manner consistent with local industry standards.

I am satisfied that the transfer is not likely to present any threat to the interests of Gordian's existing and transferring policyholders arising from the management of claims.

4.3 Financial Security

In a typical transfer arrangement, the first line of financial security for policyholders is the assets in Australia of the entity, and can be judged in part by the level of capital in Australia relative to the Prescribed Capital Amount under the APRA prudential standards.

The proposed arrangement is different in that the first line of financial security is the assets held in an Australian Trust Fund that are available only to meet claims of transferring policyholders. This arrangement involving the Australian Trust Fund is in accordance with APRA's requirements for recognising acceptable collateral for reinsurance recoveries from overseas insurers, and in my view is sound. There is no likelihood of this financial security being diminished by other claims against the receiving insurer (Gordian).

Having assessed the first line of financial security as sound, my assessment of financial security is then based on stepping through the available sources of financial security should the first line fail (the first line is included in the table).

Table 4.1 – Financial Security of Transferring Policyholders

Source	Analysis
Trust Fund for transferring policies	Initially 105% of estimated liabilities If liabilities increase, top-up from Cavello Bay to 105% Funds available only to meet claims of transferring policyholders
Cavello Bay	Should Cavello Bay be unwilling or unable to top-up the Australian Trust Fund, Gordian has a legally enforceable right against Cavello Bay.
Gordian	Should the reinsurance fail entirely, the assets of Gordian are available to meet claims (noting these assets are ring-fenced in Australia). These assets, including available capital of about $75m, are available to support the business currently insured by Gordian, including the CTP business (if the CTP Trust Fund for that business also fails).

In addition to the financial security set out in Table 4.1, it is possible that the Enstar group may support Cavello Bay and/or Gordian, although there are no contractual agreements in place. In my view the reputation of a global listed insurer will be substantially damaged if it allows a significant subsidiary to become insolvent.

Our assessment is that the chance of all these sources of financial security failing is very remote and that there is no material detriment to the financial security of transferring policyholders.

4.4 Balance Sheet

While it is not directly relevant to the security of transferring policyholders because of the Cavello Bay reinsurance and the Australian Trust Fund, in this section I show pro-forma calculations of Gordian's balance sheet and capital adequacy under APRA standards.

Table 4.2 shows the pre-transfer balance sheets of the relevant Australian entities at 31 December 2018, together with the estimated post-transfer balance sheet of Gordian, assuming the transfer had occurred on that date.

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Table 4.2 – Estimated Balance Sheets at December 2018 ($ million)

	Pre-Transfer			Post-Transfer
	Gordian	GLA	HSB	Gordian
Assets				
Cash	16.1	53.0	0.4	16.1
Investments	517.4	-	21.3	517.4
Premium and Other Receivables	15.0	46.6	0.1	15.0
Non-Reinsurance Recovery Assets	20.4	-	-	20.4
Reinsurance Assets	195.3	421.3	-	423.5
Deferred Assets	3.6	15.7	0.0	3.6
Current Tax Assets	-	2.9	-	-
Other Assets	-	2.5	-	-
Total Assets	767.8	542.0	21.8	996.0
Liabilities				
Creditors and Accruals	25.2	0.1	0.2	25.2
Claims Liabilities	267.5	420.1	3.6	495.7
Unearned Premium	-	13.5	0.2	-
Amounts Due to Reinsurers	2.4	28.3	0.1	2.4
Provisions	-	2.5	-	-
Income Tax Liability	1.7	0.1	-	1.7
Total Liabilities	296.9	464.7	4.1	525.1
Net Assets	471.0	77.3	17.7	471.0

In order to make sense of this table it is necessary to understand several of the relevant numbers:

(i) For Gordian, the investments ($517m) and the net assets ($471m) include a non-interest bearing loan to the parent company of $401m. This loan was the method by which past profits were repatriated to the parent company, and the amount is not immediately available to meet claims and does not count for APRA capital adequacy.

(ii) For Gordian, a large part of the reinsurance asset ($195m) is the CTP reinsurance with Cavello Bay, supported by the relevant CTP Trust Fund.

(iii) For GLA, the outstanding claims ($420m) are matched by the reinsurance asset ($421m) arising from the 100% reinsurance of Australian claims.

(iv) The GLA figures include the total business of GLA in Australia, which includes a large volume of business that is not transferring to Gordian.

(v) The pro-forma balance sheet of Gordian after the transfer is very similar to that before the transfer. The only change is the addition of a large amount of outstanding claims offset by a equal increase in the reinsurance asset. The ‘cash’ Gordian receives from the portfolio transfer will be paid to Cavello Bay (and held in the new Australian Trust Fund), which means that there is no change to Gordian’s ‘cash’ balance post-transfer.

Note that these figures are as at 31 December 2018. By the time of the transfer (likely date 30 April 2020) many of the figures will be significantly lower, because both Gordian business and GLA business are running off relatively quickly.

Appendix B shows the post-transfer balance sheet of Gordian if only GLA or HSB business is transferred to Gordian. This is a very unlikely scenario, but is included for completeness.

4.4.1 APRA Capital Adequacy

Table 4.3 shows the estimated impact of the transfer on the capital adequacy position at 31 December 2018, assuming the transfer had occurred on that date.

Because of the running-off of relevant figures noted above, we have also shown a preliminary estimate of the position at 31 March 2020. Most of the figures for the estimate were prepared by Enstar. With my staff I have reviewed the calculations, and found them to be reasonable based on the information made available to me and my understanding of the Schemes. It must be remembered, though, that the estimates were prepared nearly 12 months ago.

It will be important to update estimates of the relevant position prior to the Court approval hearing. I anticipate that updating will be undertaken in March 2020 based on quarterly returns to APRA.

Table 4.3 – Estimated Capital Adequacy Impact at Dec-18 and Mar-20 ($ million)

	Pre-Transfer at Dec-18			Post-Transfer at Dec-18	Post-Transfer at Mar-20
	Gordian	GLA	HSB	Gordian	Gordian
Insurance Risk Charge	7.5	-	0.4	7.5	6.4
Insurance Concentration Risk Charge	-	-	1.4	-	-
Asset Risk Charge	28.4	11.4	0.8	41.3	28.1
Asset Concentration Risk Charge	-	-	-	-	-
Operational Risk Charge	1.1	6.6	0.1	1.1	1.0
Aggregation Benefit	(5.1)	-	(0.5)	(5.4)	(4.4)
Sum of Risk Charges	31.9	18.0	2.2	44.6	31.0
Minimum PCA	5.0	5.0	5.0	5.0	5.0
Prescribed Capital Amount (PCA)	31.9	18.0	5.0	44.6	31.0
Net Assets	**471.0**	**77.3**	**17.7**	**471.0**	**471.0**
Adjustments:					
Goodwill	-	-	-	-	-
Adjustments:	(400.8)	(2.1)	-	(400.8)	(400.8)
APRA Capital Base	**70.2**	**75.2**	**17.7**	**70.2**	**70.2**
Capital Adequacy Multiple (CAM)	**2.20**	**4.19**	**3.53**	**1.57**	**2.27**

Using the December 2018 capital position (for illustrative purposes only), Gordian's CAM post-transfer would reduce from 2.20 to 1.57. However, as substantial claims are projected to be paid out from both Gordian CTP and GLA by March 2020, the Asset Risk Charge is estimated to reduce from $41 million to $28 million by that date, resulting in a CAM of 2.27 (above Gordian's Board approved level).

On this basis I do not assess any capital or solvency issues arising from the transfer. From these projections it is possible that Gordian would not require additional capital to complete the transfers. On the other hand, it is possible that figures at the time would show that the capital of Gordian at the time would not be adequate and that a capital injection would be required,

If additional capital is required, Gordian will seek a capital injection from the parent, which would need to be in place prior to the confirmation hearing. I expect that Enstar Australia will provide an undertaking to APRA that an injection, if needed, would occur prior to the transfer date and/or evidence that the capital injection has occurred. This is the process that was followed at the time of Gordian taking on the CTP portfolio.
Appendix C shows the post-transfer capital position of Gordian if only GLA or HSB business is transferred to Gordian, equivalent to the balance sheet estimates in Appendix B.

4.5 Capital Management

4.5.1 ICAAP

No changes are expected to Gordian's Internal Capital Adequacy Assessment Process (ICAAP) as a result of the Schemes. Enstar Group is a relatively active manager of the capital in its various operating subsidiaries. During the time of its ownership of Gordian, it has withdrawn capital as profits have resulted in capital surplus to needs (always with APRA approval) and has injected capital when required such as for the NSW CTP acquisition in 2018.

4.5.2 Significant Capital Plans

I am not aware of any significant capital plans for Gordian. The rapid run-off of the CTP business has resulted in the release of capital relative to target during 2019, which is expected to continue. Projections show that the available capital in Gordian may be adequate to support the acquired business at a level in excess of Gordian's target capital adequacy, and these projections will be updated prior to confirmation of the Schemes.

4.6 Reinsurance Arrangements

GLA's business in Australia is protected by a small number of external (third party) reinsurance arrangements, with the remainder 100% reinsured to Munich Re Australia (MRAu), an APRA-authorised insurer and reinsurer. The MRAu reinsurance makes up the majority of the recoveries.

HSB's business is protected by a number of excess of loss reinsurance treaties protecting the overall global business of HSBEIL against very large claims and catastrophes affecting multiple policies. There is only one active reinsurance arrangement specifically relevant to Australia: a facultative proportional (50%) arrangement for one multi-year construction risk which remains in force.

At the time of the transfers, the external (third party) reinsurance arrangements will transfer to Gordian and continue to protect the relevant claims. All of the intra-group reinsurance with Munich Re entities will not transfer, with liabilities then protected by the Cavello Bay reinsurance and Australian Trust Fund arrangement.

While the details appear complex, the ultimate impact on policyholders is mainly to substitute Enstar, Cavello Bay and the Australian Trust Fund as the ultimate source of reinsurance protection rather than Munich Re and its subsidiary companies.

4.7 Policyholders remaining with GLA

As noted in section 4.6 above, the business of GLA is reinsured 100% with MRAu, along with a small amount of external reinsurance.

GLA will remain as a Branch authorised by APRA in Australia and the reinsurance will continue to protect those policyholders remaining with GLA.

As a result there is no material impact on policyholders remaining with GLA.

5 Conclusions

The main interest of policyholders is to have valid claims paid when due. I have also examined a range of other likely effects on affected policyholders of the proposed Schemes. This section summarises my findings and opinions.

5.1 Nature of the Business to Be Transferred

The GLA business and the HSB business being transferred are both portfolios of insurance written in Australia. There is no new or renewal business being written in any of the transferring portfolios[6].

5.2 Policy Terms and Conditions

There will be no changes to the terms and conditions of the insurance policies as a result of the Schemes, apart from Gordian being substituted for GLA or HSB respectively as the insurer.

5.3 Claims Handling

I am satisfied that the proposed claims handling arrangements do not present any threat to the interests of policyholders.

5.4 Financial Security

5.4.1 GLA and HSB Policyholders

The policyholders transferring to Gordian will be protected by the reinsurance agreement with Cavello Bay and the Australian Trust Fund, along with the back-up security set out in Table 4.1.

Policyholders remaining with GLA will have no material change arising from the Schemes.

5.4.2 Gordian Policyholders

While the existing policyholders of Gordian are not technically 'affected policyholders' it is customary to consider the interests of this group:

- The CTP policyholders that transferred to Gordian in 2018 are not impacted since they are supported by a separate reinsurance agreement with Cavello Bay and a separate trust fund.
- Other existing policyholders of Gordian should not be impacted by the Schemes as the transferring liabilities are fully covered by the reinsurance with Cavello Bay and the Australian Trust Fund. No claim payments for transferring business will be made from Gordian funds except in the most extreme circumstances where both the Australian Trust Fund and Cavello Bay have failed.

The longevity of the Enstar group's Australian business will be improved as Gordian continues to acquire more run-off business.

5.5 Conclusion

My opinion is that the interests of the affected policyholders (i.e. the transferring policyholders of GLA and HSB) will not be adversely affected in a material way as a consequence of the Insurance Schemes.

[6] Exception: there is one HSB policy that has a right to be extended based on project completion, and this may occur (refer to Section 2.5)

Similarly the transfers will have no material adverse impact on the existing policyholders of Gordian or those remaining with GLA.

5.6 Declaration as Expert Witness

I declare that I have made all the enquiries that I believe are desirable and appropriate and that no matters of significance that I regard as relevant have, to my knowledge, been withheld from my report.

6 Reliances and Limitations

6.1 Reliance on Information

In preparing this report, I have relied extensively on the accuracy and completeness of the information provided by GLA, HSB and Gordian (both qualitative and quantitative). In particular, reliance was placed on the insurance liability valuations and the APRA returns of the entities as at 31 December 2018.

While I have reviewed the information for reasonableness and consistency, I have not independently verified or audited the data. The accuracy of my findings is dependent on the accuracy of this information; therefore, any material discrepancies may change the conclusions I have made in this report. The reader of this report is relying on GLA, HSB and Gordian, and not Finity, for the accuracy and reliability of the data. If any of the data or other information provided is inaccurate or incomplete, my advice may need to be revised and the report amended accordingly.

I note that my report has been prepared based on draft Scheme documents. While my understanding is that there are not expected to be any material changes between the draft and final documents, if any material changes are made, my analysis, conclusions and findings may need to be updated accordingly.

6.2 Uncertainty

Future financial security is subject to many external factors that are impossible to predict, including legislative, social and economic forces. In this report, I consider only the impact of the proposed Schemes.

It is not possible to be certain about the impact of the proposed Schemes on the affected policyholders. While I believe my conclusions are reasonable based on known information, there may be adverse impacts in future that I have not identified or evaluated.

6.3 Limitations on Use

This report has been prepared for the sole use of GLA, HSB and Gordian, for the purpose stated in Section 1. I understand that the report will also be provided to:

- Legal advisers of the insurers
- APRA
- The Federal Court of Australia.

No other use of, or reference to, this report may be made without the prior written consent of Finity, nor should the whole or part of the report be disclosed to any unauthorised person.

I understand that a copy of the full report will be made available to affected policyholders and in practice will be in the public domain.

Third parties, whether authorised or not to receive this report, should recognise that the furnishing of this report is not a substitute for their own due diligence and should place no reliance on this report or the data contained herein which would result in the creation of any duty or liability by Finity to the third party.

This report should be considered as a whole. While due care has been taken in the preparation of this report, Finity accepts no responsibility for any action which may be taken based on its contents.

Part II Appendices

A Information Received

This appendix sets out the information received to prepare this report.

Information for Gordian

- APRA Returns at December 2018 (annual) and June 2019 (quarterly)
- Enstar Group Corporate Structure

In addition, as Appointed Actuary to Gordian, I had access to the Insurance Liability Valuation Report at 31 December 2018 (dated 21 March 2019) and the Run-Off Plan 2019 - 2021 (dated March 2019).

Information for GLA

- Annual APRA Returns at December 2016, December 2017, and December 2018
- Quarterly APRA Return at June 2019
- Insurance Liability Valuation Report at 31 December 2018 (dated 26 March 2019)
- Financial Condition Report at 31 December 2018 (dated 26 March 2019)
- ICAAP Annual Report 2018 (dated November 2018)
- Premium, payment and case estimate triangulated data for transferring agency and Calliden business as at September 2018

Information for HSB

- Annual APRA Returns at December 2016, December 2017, and December 2018
- Quarterly APRA Return at June 2019
- Capital and Risk Management Strategy 2019 (dated 19 March 2019)
- ICAAP Annual Report 2019 (dated 19 March 2019)
- Insurance Liability Valuation Report at 31 December 2018 (dated 7 February 2019)
- Financial Condition Report at 31 December 2018 (dated 11 April 2019)

Other Information

- Reinsurance Agreement between Gordian and Cavello Bay, in draft
- Framework and Transfer Deed (among GLA, HSB and Gordian), dated 10 September 2019
- Enstar's Project Grape capital projections, dated September 2018

I also liaised with, and received assistance from, representatives of Gordian, GLA and HSB.

B Pro forma Balance Sheet

Table B.1 shows the pro forma balance sheet of Gordian after the transfer if i) only GLA business is transferred, ii) only HSB business is transferred and iii) GLA and HSB are both transferred to Gordian.

Table B.1 – Estimated Balance Sheets at December 2018 ($ million)

	Pre-Transfer			Post-Transfer - Gordian		
	Gordian	GLA	HSB	i) GLA only	ii) HSB only	iii) Combined
Assets						
Cash	16.1	53.0	0.4	16.1	16.1	16.1
Investments	517.4	-	21.3	517.4	517.4	517.4
Premium and Other Receivables	15.0	46.6	0.1	15.0	15.0	15.0
Non-Reinsurance Recovery Assets	20.4	-	-	20.4	20.4	20.4
Reinsurance Assets	195.3	421.3	-	420.0	198.9	423.5
Deferred Assets	3.6	15.7	0.0	3.6	3.6	3.6
Current Tax Assets	-	2.9	-	-	-	-
Other Assets	-	2.5	-	-	-	-
Total Assets	767.8	542.0	21.8	992.4	771.4	996.0
Liabilities						
Creditors and Accruals	25.2	0.1	0.2	25.2	25.2	25.2
Claims Liabilities	267.5	420.1	3.6	492.1	271.1	495.7
Unearned Premium	-	13.5	0.2	-	-	-
Amounts Due to Reinsurers	2.4	28.3	0.1	2.4	2.4	2.4
Provisions	-	2.5	-	-	-	-
Income Tax Liability	1.7	0.1	-	1.7	1.7	1.7
Total Liabilities	296.9	464.7	4.1	521.5	300.4	525.1
Net Assets	471.0	77.3	17.7	471.0	471.0	471.0

C Pro forma Capital Position

Table C.1 shows the pro forma capital position of Gordian after the transfer if i) only GLA business is transferred, ii) only HSB business is transferred and iii) GLA and HSB are both transferred to Gordian.

Table C.1 – Estimated Capital Adequacy Impact at Dec-18 and Mar-20 ($ million)

	Pre-Transfer at Dec-18			Post-Transfer at Dec-18			Post-Transfer at Mar-20		
	Gordian	GLA	HSB	i) GLA only	ii) HSB only	iii) Combined	i) GLA only	ii) HSB only	iii) Combined
Insurance Risk Charge	7.5	-	0.4	7.5	7.5	7.5	6.4	6.4	6.4
Insurance Concentration Risk Charge	-	-	1.4	-	-	-	-	-	-
Asset Risk Charge	28.4	11.4	0.8	41.1	28.2	41.3	28.0	19.9	28.1
Asset Concentration Risk Charge	-	-	-	-	-	-	-	-	-
Operational Risk Charge	1.1	6.6	0.1	1.1	1.1	1.1	1.0	1.0	1.0
Aggregation Benefit	(5.1)	-	(0.5)	(5.4)	(5.1)	(5.4)	(4.4)	(4.2)	(4.4)
Sum of Risk Charges	31.9	18.0	2.2	44.4	31.7	44.6	30.8	23.0	31.0
Minimum PCA	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0
Prescribed Capital Amount (PCA)	31.9	18.0	5.0	44.4	31.7	44.6	30.8	23.0	31.0
Net Assets	**471.0**	**77.3**	**17.7**	**471.0**	**471.0**	**471.0**	**471.0**	**471.0**	**471.0**
Adjustments:									
Goodwill	-	-	-	-	-	-	-	-	-
Adjustments:	(400.8)	(2.1)	-	(400.8)	(400.8)	(400.8)	(400.8)	(400.8)	(400.8)
APRA Capital Base	**70.2**	**75.2**	**17.7**	**70.2**	**70.2**	**70.2**	**70.2**	**70.2**	**70.2**
Capital Adequacy Multiple (CAM)	**2.20**	**4.19**	**3.53**	**1.58**	**2.21**	**1.57**	**2.27**	**3.04**	**2.27**

I note that prior to the transfer the latest Capital Adequacy Multiples for GLA and HSB are higher than they will be after the transfer. This does not represent any material adverse impact for those policyholders because:

- Their financial security, both before and after the transfer, relies on the unlimited 100% reinsurance arrangements, with the capital in the insurer being one of several back-ups to security
- The PCA does not depend on the gross risk profile of the business, but is mainly asset and operational risk charges (and in the case of HSB the $5 million statutory minimum).