WillisTowersWatson

Supplementary 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

17 September 2018

Prepared by Steve Mathews, Independent Expert

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Section 1: Introduction

Background

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 is a requirement under Part VII of the Financial Services and Markets Act 2000 ("FSMA").

1.2 I, Steve Mathews, have been appointed by AIG Europe Limited ("AEL") to act as the Independent Expert for the proposed scheme ("Proposed Scheme") which 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:
    - a) such reinsurance policy has been issued by AEL through or on behalf of any of its branches in the EEA or Switzerland; or
    - b) such reinsurance policy relates to risks in Argentina or Venezuela; and
- 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;

in each case using a Part VII transfer pursuant to the FSMA, and in respect of the business transfer to AESA, by virtue of a cross-border merger by absorption of AEL by AESA pursuant to the European Cross Border Merger Directive.

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

1.4 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 report as the AIG Group ("AIG Group").

1.5 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").

1.6 My opinions on the effect of the Proposed Scheme are set out in my Independent Expert report dated 26 February 2018 (the "Scheme Report").

Purpose and scope

1.7 The Scheme Report was 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.

1.8 As envisaged in paragraph 1.36 of my Scheme Report, the purpose of this supplementary Scheme Report (the "Supplementary Report") is therefore to specify whether the conclusions set out in my Scheme Report have changed in light of the availability of updated financial information and any material issues that have arisen since the dates noted in paragraph 1.7 above.

1.9 In both the Scheme Report and this Supplementary Report (together referred to as the "Scheme Reports"), 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").

1.10 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.

1.11 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.

1.12 This Supplementary Report must be considered in conjunction with my Scheme Report. All abbreviations and technical terms in this Supplementary Report have the same meaning as in my Scheme Report.

1.13 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.

Statement of independence

1.14 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.

1.15 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.

1.16 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 the Independent Expert for the Proposed Scheme. I have provided details of these relationships directly to the PRA and FCA.

1.17 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.

1.18 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.

Terms of reference

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

1.20 The Scheme Reports are 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.

1.21 In preparing the Scheme Reports 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;
- 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; and
- The FCA guidance entitled “FG18/4: The FCA’s approach to the review of Part VII insurance business transfers” which was issued on 29 May 2018.

Professional guidance

1.22 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. The Scheme Reports when considered together are in compliance with the principles of all applicable TASs and APSs. In particular, the Scheme Reports have 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

1.23 The work which has been documented in this Supplementary 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.

Distribution

1.24 This Supplementary 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 Supplementary 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.

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

1.26 This Supplementary 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 and must be considered in conjunction with my Scheme Report. This Supplementary Report is subject to the terms and limitations, including a limitation of liability, set out in my firm's engagement letter.

Reliances

1.27 In carrying out my review and producing this Supplementary 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 Section 2.

1.28 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 the Scheme Report and this Supplementary Report are accurate and complete.
- There are no significant errors or omissions in the descriptions in the Scheme Report or this Supplementary 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 the Scheme Report or this Supplementary Report.

1.29 Based on my review, I am satisfied that the information detailed in Section 2 represents an appropriate basis for the conclusions set out in this Supplementary 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.

1.30 When producing this Supplementary Report I have also relied upon all of the information provided to me previously for the purposes of producing my Scheme Report.

1.31 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 Supplementary Report. A draft of this Supplementary 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 the Scheme Reports.

Limitations

1.32 No limitations have been imposed on the scope of my work and the opinions in the Scheme Reports 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 the Scheme Reports that might, in my opinion, be relevant to policyholders' consideration of the Proposed Scheme.

1.33 This Supplementary Report is based on:

- Financial information in respect of AEL as at 30 November 2017; 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 2018 and using the current versions of the firms' internal models at the time of writing.

1.34 In addition, I have reviewed additional financial information produced by AEL between 30 November 2017 and the date of this Supplementary Report.

1.35 In my judgment, the results and conclusions contained in the Scheme Reports 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 the Scheme Reports, 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.

1.36 The Scheme Reports must not be construed as legal, investment or tax advice.

1.37 Figures in all tables in the Scheme Reports are subject to possible rounding differences.

Legal jurisdiction

1.38 This Supplementary 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 Supplementary Report.

Exchange rates

1.39 AEL's year-end 2017 (30 November 2017) exchange rates of £1 = USD 1.3522 = EUR 1.1368 have been used in AEL's projections of financials to 1 December 2018.

Structure of this Supplementary Report

1.40 The structure of this Supplementary Report is as follows:

- Section 1 summarises the scope of my work as the Independent Expert, including the purpose of this Supplementary Report;
- Section 2 describes the further information considered, and the analysis and judgements I have made in arriving at my findings;
- Section 3 describes my conclusions; and;
- The Appendix contains a glossary.

Section 2: Supplementary analysis and findings

Approach

2.1 The Scheme Report was 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, and my Scheme Report was finalised on 26 February 2018.

2.2 I have requested and received additional information to assist me in considering whether the conclusions set out in my Scheme Report have changed in light of the availability of updated financial information and any material issues that have arisen since the dates noted in paragraph 1.7.

2.3 In this section of my Supplementary Report I therefore cover the following areas:

- Details of the additional information I have received to produce this Supplementary Report.
- Consideration of any changes to the Proposed Scheme and any business developments since the production of my Scheme Report.
- Review of the AEL balance sheet as at 30 November 2017 (the 2017 year-end).
- Review of AEL's technical provisions as at 30 November 2017, including consideration of the movements in these technical provisions since 30 November 2016 (the date of the latest available year-end figures at the time of my Scheme Report).
- Consideration of changes since my Scheme Report in respect of investments, including the likely composition of investments for both AIG UK and AESA.
- Consideration of changes since my Scheme Report in respect of the reinsurance arrangements of AIG UK and AESA.
- Updated forecast profitability for AEL for the 2018 financial year, and for AIG UK and AESA for the 2019 to 2021 financial years.
- Developments in the Internal Model applications made by AIG UK and AESA.
- The applications to recognise letters of credit as Tier 2 Ancillary Own Funds made by both AIG UK and AESA.
- Consideration of updated projections of the Solvency II Balance Sheet, Own Funds and SCR for both AIG UK and AESA, as at the Effective Date of the Proposed Scheme.
- Review of updated scenario tests relating to events which could take place prior to the Effective Date of the Proposed Scheme.
- Consideration of updated projections of the Solvency II Own Funds, target Own Funds and SCR for both AIG UK and AESA for the three years following the Effective Date of the Proposed Scheme.
- Review of scenario tests relating to events which could take place after the Effective Date of the Proposed Scheme.

- Updates on policyholder access to insolvency compensation schemes, the implementation of policyholder communications and details of any policyholder objections received.

Additional information received

2.4 I have based my conclusions in this Supplementary Report on the following additional information received from AEL, together with information which was used in preparing my Scheme Report. The additional information includes:

Documents relating to the Proposed Scheme

- Final Proposed Scheme documentation as presented at the Directions Hearing (and as subsequently amended ahead of the Sanctions Hearing).
- Full details of any objections raised by AEL policyholders, or other potentially affected parties, on the Proposed Scheme.
- Summary statistics of the nature of questions raised by policyholders regarding the Proposed Scheme and copies of objections raised by policyholders or other interested parties.

Documents relating to AEL

- Report and accounts at year-end 2017.
- Reserve committee meeting packs at 2017 Q4, 2018 Q1 and 2018 Q2.
- AEL deep dive internal reserve reviews conducted on specific lines of business based on 2017 Q3 information.
- Actuarial Function Component Reports in respect of technical provisions (for year ended 2016 and dated June 2017), underwriting (review as at 30 November 2017) and reinsurance (2017 review dated November 2017).
- Management accounts at 2018 Q1 and 2018 Q2.
- External reserving reports at year-end 2017.
- 2018 business plan.
- Own Risk and Solvency Assessment report (for year-end 2017).
- Solvency and Financial Condition Report at year-end 2017.
- Report on the validation of the Internal Model.
- Updated details of any material exposures to litigation, reinsurance disputes, doubtful reinsurance security or underwriting disputes.
- Strategic Asset Allocation report produced in June 2018.

Documents relating to AIG UK

- Own Risk and Solvency Assessment report (dated March 2018).
- Report on the validation of the Internal Model.

- Major model change application to the PRA.

Documents relating to AESA

- Own Risk and Solvency Assessment report (dated March 2018).
- Report on the validation of the Internal Model.
- Internal model application to the CAA.

Other

- Updated 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, based on AEL's latest financial projections at year-end 2017, reflecting subsequent experience in 2018 Q1 and using the current versions of the firms' internal models at the time of writing. These internal models are subject to ongoing regulatory approval processes as described from paragraph 2.71.
- Stress tests on the above.

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

2.6 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.

2.7 I have received an attestation statement 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, in order to produce both my Scheme Report and this Supplementary Report.

Structure of Proposed Scheme

2.8 I am aware of a number of changes to the Proposed Scheme from that on which my Scheme Report was based. One of these changes relates to reinsurance licences in Argentina and Venezuela and the remaining changes are clarifications.

2.9 The clarification changes do not modify the intended consequence of the Proposed Scheme upon which my Scheme Report was based, I consider that that these changes to the Proposed Scheme do not impact the conclusions set out in my Scheme Report.

2.10 The change relating to reinsurance licences in Argentina and Venezuela is necessary since AEL currently holds reinsurance licenses in Argentina and Venezuela and has been advised that, in respect of each jurisdiction, it will be able to obtain an AESA reinsurance license as AEL's current reinsurance license will transfer to AESA by virtue of the Proposed Scheme but that it is at risk of not obtaining a reinsurance license for AIG UK by 1 December 2018.

2.11 I have seen legal advice obtained by AEL that confirms that the Proposed Scheme will transfer AEL's reinsurance licence in Argentina to AESA. The legal advice in respect of Venezuela is less definitive but considers, following consultation with the relevant authorities, that the best interpretation of Venezuelan law is that AEL's reinsurance licence in Venezuela will transfer to AESA.

2.12 As a result, the Proposed Scheme has been amended to transfer the UK produced reinsurance business written in each of Argentina and Venezuela to AESA. This is to avoid the risk of any legal or regulatory breaches that may result from conducting that reinsurance business out of AIG UK without an appropriate license in place and to enable the AIG Group to continue to service the transferring policies and pay claims on those policies.

2.13 In the event that AEL's Venezuela licence does not transfer to AESA then AESA will remain contractually liable to settle claims from the reinsurance business written in Venezuela by AEL. AEL has informed me that AESA is committed to paying valid claims under these reinsurance policies in a timely fashion while ensuring compliance with Venezuelan law and insurance regulations and will, if necessary, work with reinsureds to find compliant ways of paying any claim.

2.14 The level of annual premiums in respect of the total of this business is expected to be in the region of £12m; approximately £7m in respect of Argentina and £5m in respect of Venezuela. Total claims reserves are expected to be less than £20m at the Effective Date of the Proposed Scheme. These volumes represent less than 1% of premiums and claims reserves of each of AIG UK and AESA. I do not consider that the amendment to the Proposed Scheme will result in a material change of the risk profile of either AIG UK or AESA and as such this does not affect the conclusions set out in my Scheme Report.

2.15 Other than as described above, I am not aware of any other changes to the scheme documentation or structure of the Proposed Scheme since the production of my Scheme Report.

Business developments

2.16 I am aware of the following business developments since the production of my Scheme Report:

- AIG UK has been established as described in paragraph 5.32 of my Scheme Report.
- AESA has been established as described in paragraph 5.37 of my Scheme Report.

2.17 In paragraphs 5.35 and 5.40 of my Scheme Report I stated that both AIG UK and AESA were expected to receive financial strength ratings of at least "A+" from at least one of the credit rating agencies. In line with this expectation, in May 2018 Standard and Poor's confirmed financial strength ratings for both AIG UK and AESA of A+ with negative outlook and also in May 2018 Moody's assigned a preliminary financial strength rating of A2 with a stable outlook to both AIG UK and AESA.

2.18 In January 2018 AIG announced its intention to acquire Validus Holdings Ltd and the acquisition completed on 18 July 2018. This is a material acquisition for the AIG Group and AIG's short and medium term plans for the Validus entities have been described to me. These plans do not impact the policyholders or reinsurers of AEL, AIG UK or AESA and as such, I do not consider either UK Transferring Policyholders or European Transferring Policyholders will be materially affected by the acquisition. Therefore, the acquisition of Validus Holdings Ltd does not change the conclusions of my Scheme Report.

2.19 In July 2018 AEL started a staff redundancy consultation process with a view to implementing around 120 redundancies, approximately 6% of AEL's workforce. This is part of a wider expense reduction programme intended by AEL management to deliver cost savings and improve profitability. The expected impact of the expense reduction programme has been included in the business planning forecasts used in this Supplementary Report. I have discussed with AEL whether the expense reduction programme is likely to result in a reduction of policyholder service levels for UK Transferring Policyholders and / or European Transferring

Policyholders compared to policyholder service levels of AEL in the event of no scheme. My conclusion is that neither UK Transferring Policyholders nor European Transferring Policyholders will suffer significantly reduced policyholder service levels compared to those service levels in the event of no scheme. I have reached this conclusion because:

- The expense reduction programme is independent of the Proposed Scheme so the programme would continue in the event of the rejection of the Proposed Scheme by the High Court; and

- AEL informs me that the impact of the expense reduction programme is spread broadly equally between the future AIG UK and AESA sides of the business.

2.20 While the ultimate success of the expense reduction programme is not guaranteed, I take comfort that the programme is not likely to significantly affect policyholder service levels under either the Proposed Scheme or no scheme scenarios for the following reasons:

- AEL informs me that its expense reduction programme is intended to bring its cost base more into line with that of its peers;

- I understand from AEL that the roles subject to redundancy are mostly within support functions in the back office, with no expected reduction in the quality of service provided to policyholders. I also understand from AEL that claims and underwriting teams are largely unaffected and where changes have been proposed, the potential impact has been assessed and the risks identified will be appropriately managed; and

- AEL's expense reduction plan has been subject to internal review and independent challenge by AEL's Risk team. I have also been informed that AEL has been supported by external advisors with extensive experience of delivering successful expense reduction programmes.

2.21 In line with the process set out in paragraph 5.42 of my scheme report, AESA has applied to the CAA to establish a branch of AESA in the UK on a Freedom of Establishment basis. Discussions have been held with the PRA and CAA around the applicability of the UK's third country branch regime to this branch once EU insurers lose the ability to operate on a Freedom of Establishment basis in the UK. The UK Treasury has published a draft statutory instrument, the Temporary Permissions Regime, which is to be presented to the UK Parliament for approval. The Temporary Permissions Regime would allow former FoE branches to carry on regulated activities for up to three years (and thereafter extendable in increments of 12 months at the discretion of the UK Treasury) from when the UK leaves the EU. Thereafter, subject to relevant regulatory approvals, the AESA branch would be licensed under the UK's third country branch regime as it stands at the time. It is possible that the PRA will not at that point consent to authorising the branch, but AEL is not currently aware of any reason why the PRA should withhold consent at such time or any current intention of the PRA to do so. In paragraph 5.43 of my Scheme Report I stated *'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'*.

2.22 If the UK branch of AESA was not authorised, the outcome could potentially be detrimental to European Transferring Policyholders as it would necessitate the passing of claims decisions to EEA claims handlers who may be less familiar with the policies written out of the UK (which typically are English law governed) and who would lack prior knowledge of these policyholders. However, I do not consider that the non-authorisation of the UK branch of AESA would result in a significant reduction in the level of service to policyholders because AEL has informed me that under this scenario the claims handling team in the UK employed in the AESA UK branch would still provide guidance and expertise on evaluating the claims. In addition, by the end of the Temporary Permissions Regime which is likely to be not before

March 2022, the number and volume of outstanding claims in respect of European Transferring Policyholders will be much reduced.

2.23 I am not aware of any other AIG business developments which could impact the conclusions set out in my Scheme Report.

2.24 In this Supplementary Report I have addressed any statements or assumptions made in my Scheme Report, which I consider are no longer correct or reasonable in light of the additional information provided to me for the purposes of this Supplementary Report.

AEL Balance sheet at 2017 year-end

2.25 Table 2.1 below shows a simplified version of AEL's balance sheet at 30 November 2017 (its 2017 year-end), its conversion to a Solvency II Economic Balance Sheet ("EBS") at 2017 year-end and a comparison to the 2016 year-end Solvency II EBS. The full version of this table can be found on Pages 60 and 61 of AIG European Group's Solvency and Financial Condition Report 2017 which is available from AIG's website[1]. The 2016 Solvency II Balance Sheet from Table 2.1 below reconciles in aggregate to Table 7.1 from my Scheme Report although the level of granularity in which it is presented differs.

2.26 The 2016 Solvency II Economic Balance Sheet figures shown below are on a Standard Formula basis, whereas the 2017 Solvency II Economic Balance Sheet figures are on an Internal Model basis (since this was approved by the PRA in 2017). This is discussed in further detail in Section 7 of my Scheme Report.

Table 2.1 - AEL IFRS Balance Sheet at 2017, Conversion to SII Balance Sheet and Comparison to Year-end 2016

Figures in Sterling Millions	IFRS	Adjustments and Reclassifications from IFRS to EBS 2017	Solvency II EBS 2017	Solvency II EBS 2016	Comparison: 2017- 2016
Assets					
Deferred acquisition costs	306	(306)			
Intangible assets	20	(20)			
Deferred tax assets	102	35	137	91	46
Pension benefit surplus	31	0	31	21	10
Property, plant & equipment held for own use	137	0	137	142	(5)
Investments	9,700	123	9,823	9,487	336
Loans and mortgages	516	5	521	409	112
Reinsurance recoverables	2,811	(717)	2,094	1,918	176
Insurance and intermediaries receivables	1,293	(1,263)	30	10	20
Reinsurance receivables	223	1	224	217	7
Receivables (trade, not insurance)	507	(89)	417	421	(3)
Cash and cash equivalents	329	0	329	210	119
Tier 2 Own Funds		653	653	537	116
Total assets	**15,973**	**(1,576)**	**14,397**	**13,462**	**935**
Liabilities					
Technical Provisions	11,466	(1,398)	10,068	9,132	936
Liabilities other than Technical Provisions	1,343	(689)	654	687	(33)
Total liabilities	**12,809**	**(2,087)**	**10,722**	**9,819**	**903**
Excess of assets over liabilities	**3,164**	**511**	**3,675**	**3,643**	**32**

2.27 Table 2.1 above shows the key changes between AEL's 2017 year-end EBS and its 2016 year-end EBS are in respect of an increase in technical provisions of £936m. This has been

[1] See https://www.aig.co.uk/content/dam/aig/emea/united-kingdom/documents/Report-and-Accounts/aig-european-group-sfcr-2017.pdf

largely offset by an increase in assets, mainly comprising investment and reinsurance, resulting in an increase in excess of assets over liabilities (or Own Funds) of £32m.

2.28 During AEL's 2017 financial year, AEL made a loss of £424m on an IFRS basis. However, the impact of this has been more than offset in AEL's change in Own Funds over the period by the introduction of a letter of credit and the move from a Standard Formula to Internal Model basis for calculating the risk margin of the SCR.

2.29 In the sections below, I discuss the changes in technical provisions and also changes in investments and forecast profitability and whether these impact the conclusions from my Scheme Report.

Technical Provisions

2.30 Table 2.2 below shows AEL's estimated IFRS technical provisions at 30 November 2017, net of reinsurance and by reserving category, along with a comparison to the equivalent figures from year-end 2016. At the bottom of the table is a reconciliation of the total technical provisions to the IFRS net technical provisions that can be derived (for year-end 2017 only) from Table 2.1. Table 2.2 is an update of Table 6.1 from my Scheme Report but which focuses on technical provisions rather than claims outstanding. Technical provisions are calculated as claims outstanding plus unearned premium reserve.

Table 2.2 - AEL Net IFRS Technical Provisions at 30 November 2017 and Comparison to 2016

Figures in Sterling Millions Reserving Category	Year-end 2017	Year-end 2016	Comparison: 2017- 2016	Prior year development
UK	**3,744**	**3,479**	**265**	**207**
Casualty	807	763	44	11
Consumer Lines	111	124	(13)	3
Financial Lines	658	552	106	128
Global Property	192	208	(17)	29
Specialty	485	488	(4)	27
Specials	81	96	(15)	
Lexington & Cat XS	512	414	98	9
Active Life Reserves	3	3	0	
Unallocated Loss Adjustment Expenses	90	89	1	
Target Operating Model Benefits	-7	-13	6	
Other Finance Adjustments	1	1	0	
Unearned Premium Reserve	812	753	59	
Rest of Europe	**4,911**	**4,409**	**503**	**223**
Casualty	1,607	1,362	245	198
Consumer Lines	466	435	31	(26)
Financial Lines	1,347	1,199	148	(10)
Global Property	375	318	57	37
Specialty	182	152	29	24
Specials	5	6	(1)	
Lexington & Cat XS	0	0	0	
Active Life Reserves	16	17	(1)	
Unallocated Loss Adjustment Expenses	142	139	3	
Target Operating Model Benefits	-11	-20	9	
Other Finance Adjustments	12	20	(7)	
Unearned Premium Reserve	770	781	(10)	
Total Net Technical Provisions	**8,655**	**7,887**	**768**	**430**
Reconciliation to IFRS Balance Sheet (Table 2.1 for 2017)				
Technical Provisions - Liability	11,466	10,550	916	
Reinsurance recoverables	2,811	2,663	148	
Net Technical Provisions	**8,655**	**7,887**	**768**	
Difference	**0**	**0**	**(0)**	

2.31 Table 2.2 shows that IFRS net technical provisions have increased by £768m from year-end 2016 to year-end 2017 which is broadly in line with the £760m increase in Solvency II Technical Provisions which can be calculated from Table 2.1 as technical provisions (liability) of £936m less reinsurance recoverables of £176m.

2.32 Changes in technical provisions do not necessarily indicate surpluses or deficits in prior year technical provisions because the underwriting of new business increases technical provisions, the payment of claims reduces technical provisions and foreign exchange rate changes also impacts the technical provisions. A better indicator of reserve surpluses or deficits is the Prior Year Development ("PYD") which is a like-for-like comparison of the estimated results between reviews. If the estimated ultimate claims between reviews were unchanged in respect of the 2016 and prior accident years, the PYD would be zero. A positive PYD represents a deterioration in the result and a negative represents an improvement.

2.33 Table 2.2 above shows that AEL experienced Prior Year Development of £430m from year-end 2016 to year-end 2017. This was due to a combination of higher than expected claims experience during 2017, strengthening of the AEL reserving basis in key lines of business including Rest of Europe ("RoE") Casualty, UK Financial Lines and Global Property (which I discuss further in the bullet points below) and additional reserve increases as a result of the change in the Ogden discount rate which affected UK bodily injury claims (as discussed in paragraph 6.25 of my Scheme Report):

- During 2017 the RoE Casualty book experienced unusually large claims activity. A deep dive reserve review was performed by AEL (the results of which I discussed with AEL when producing my Scheme Report) and this resulted in AEL strengthening its reserving basis.
- For UK Financial Lines, the PYD over 2017 was the result of introducing more robust reserving techniques following the availability of improved reserving data, adverse claims experience and a strengthening in the reserving basis resulting from a deep dive reserve review which I discussed with AEL when producing my Scheme Report.
- For Global Property, the deterioration was due to a combination of a number of large losses and a change in claims handling practice which resulted in fewer reinsurance recoveries being projected for the UK and the RoE books of business.

2.34 In my Scheme Report I used a number of approaches to satisfy myself regarding the reasonableness of the AEL net technical provisions. The prior year development recognised by AEL over 2017 of £430m is 5.5% of the net technical provisions at year-end 2016. At the time of my Scheme Report I was aware of the adverse claims activity experienced by AEL and the broad magnitude of the reserve strengthening which was proposed and I discussed these with AEL when preparing my Scheme Report. In order to satisfy myself of the reasonableness of the AEL net technical provisions at year-end 2017, I have performed additional tests and reviews of the reserves. These have included:

- Review of AEL's quarterly reserving reports produced during 2017.
- Review of AEL's deep dive reserve reviews as at 2017 Q3.
- Review of historical performance of internal reserve estimates.
- Review of external reserve reviews.
- Review of most recent reserving information.

2.35 When undertaking any reserving exercise there is a range of assumptions that could be considered to be reasonable. 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.

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

Review of AEL’s quarterly reserving reports through 2017

2.37 I have reviewed AEL’s quarterly reserving reports through 2017. I have paid particular attention to those lines of business which have experienced reserve deteriorations over 2017. These documents provided good support for the reasonableness of the reserves.

2.38 In addition, I have reviewed AEL’s actual claims experience compared to AEL’s expected experience over 2017. On most lines of business the prior year development has broadly moved in line with the deviation between actual and expected experience (in that the prior year development is of a comparable magnitude to the difference between the actual development of incurred claims during the year and that which was expected based on the reserving exercise which was undertaken as at 30 November 2016). However, across the UK Financial and RoE Casualty Lines, which account for most of the PYD, the deviation between actual and expected is only 30% of the PYD that AEL has recognised. I consider that this is consistent with the strengthening in the reserving basis which I have discussed with AEL.

Review of AEL’s deep dive reserve reviews

2.39 I have reviewed a selection of AEL’s deep dive reserve reviews based on 2017 Q3 information for the most material lines of business. I had the opportunity to discuss the most material findings of the deep dive reviews with AIG during the production of my Scheme Report. My review of the deep dive reports supports the conclusions I reached in my Scheme Report.

Review of historical performance of internal reserve estimates

2.40 I have updated the analysis of the historical performance I performed on AEL’s historical reserve estimates and discussed in my Scheme Report from paragraph 6.10.

2.41 The 2017 report and accounts for AEL shows estimates of ultimate claims by accident year for each year of development from 2008 onward.

2.42 Whereas up to 2015 there was a consistent trend of favourable reserve releases, 2016 and 2017 have seen reserve deteriorations, particularly impacting the 2015 and 2016 accident years.

2.43 Aggregating across all accident years from 2008 to 2016, after allowing for reinsurance, the current estimated ultimate claims are approximately 1% higher than the initial estimates of ultimate claims (which compares to a reduction of 1% when I performed this test in my Scheme Report).

2.44 AEL was able to produce the above information split between the UK and RoE segments. This shows similar historical reserve performance with the UK and RoE segments showing estimated ultimate claims approximately 1% and 2% higher than the initial estimates of ultimate claims respectively (equivalent figures from my Scheme Report being reductions of 2% and 1% respectively).

2.45 While these figures are higher than quoted in my Scheme Report they are still relatively small and demonstrate a general level of robustness in the estimated ultimate claims over a nine year period.

Review of external actuarial reserve studies

2.46 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 50% of AEL's net reserves) with a higher level review of methodology and assumptions for the remaining elements.

2.47 Separately, AEL commissioned an independent reserve review at year-end 2017 from a separate actuarial consultant. This review considered reserves comprising 87% of AEL's booked reserves and also considered reserves separately for the UK and RoE segments.

2.48 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 as at 30 November 2017 and also 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 review.

Review of most recent reserving information

2.49 I have been provided with AEL's reserve committee reports for 2018 Q1 and 2018 Q2. Prior year adverse claims development has been minimal at £12m and overall claims activity has been favourable when compared with expectations.

Technical Provisions - Conclusion

2.50 Based on my above reviews I remain of the view that AEL's booked reserves, both at year-end 2017 and at 2018 Q2, are reasonable and, while I may have made different selections, this would not have resulted in me changing my opinion on the reserves.

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

2.52 That said, there is uncertainty over the level of reserves and as such in my scenario testing, described from paragraph 2.86 of this Supplementary Report, I have tested the impact of the technical provisions as at 30 November 2017 deteriorating by 5%, or approximately £430m, which is broadly equivalent to the deterioration observed over 2017.

2.53 In later sections of this Supplementary Report, I have commented on the impact of the recognition of prior year deteriorations on AEL's projected profitability both up to the end of 2018 and for the 2019 to 2021 financial years.

Investments

2.54 In my Scheme Report from paragraph 6.46 I commented on Residential Mortgage Backed Securities ("RMBS") held by AEL at year-end 2016. These assets are challenging to value but AEL has reported in its 2017 report and accounts that these assets have been divested. Further, Level 3 assets which are those investments where active market valuations are not available now comprise just 0.1% of the AEL investment portfolio. This de-risking of the investment portfolio, which was anticipated in my Scheme Report in paragraph 6.47, does not change my conclusions from my Scheme Report.

2.55 In the first quarter of 2018 AEL experienced net fair value losses on available-for-sale investments of £52m which was above the budgeted level and resulted in AEL recording an overall loss in the first quarter of £10m. The £52m loss relates to unrealised investment losses due to increasing yields across all major currency portfolios in 2018 Q1. The 2018 projected profitability shown in Table 2.3 and the capital projections described from paragraph 2.79 onwards have been updated to reflect the actual 2018 Q1 loss of £10m. This loss on investments of £52m has been largely offset by favourable returns on investments in 2018 Q2.

2.56 In my Scheme Report from paragraph 9.13 I described the likely composition of investments of both AIG UK and AESA. AEL has subsequently undertaken a more granular strategic asset allocation exercise to allocate the assets between AIG UK and AESA. I have reviewed the results of this allocation exercise. Generally, compared to the simple allocation described in my Scheme Report, both AIG UK and AESA are invested more heavily in investment grade bonds with AIG UK at about the expected level for structured products and lighter in all other asset classes and with AESA slightly more heavily in high yield bonds and lower in all other asset classes. I consider that the overall allocations of assets by class are broadly similar to those described at the time of my Scheme Report and any resulting impact on AIG UK or AESA's market risk will be captured within their internal model SCRs. As such this does not change the conclusions from my Scheme Report.

Reinsurance arrangements

2.57 AIG UK's proposed reinsurance arrangements are largely unchanged from those presented in my Scheme Report.

2.58 The only material change in AESA's proposed reinsurance arrangements from those presented in my Scheme Report is that AESA will maintain its external corporate excess of loss programme on high limit policies which will inure to the benefit of the 55% Quota Share of the 2019 Underwriting Year and the 2019 Accident Year Stop-Loss, both written by the AIG US Pool. This change does not have a material impact on AESA's capital position and will marginally reduce its exposure to the AIG US Pool in the event of the failure of intra-group reinsurance. The change has been made to better align the coverages purchased from the AIG US Pool with that which would be available from external reinsurers.

2.59 The capital projections in this Supplementary Report use the updated reinsurance arrangements described above.

2.60 I do not consider the changes to the reinsurance arrangements change the conclusions reached in my Scheme Report.

2.61 I understand the reinsurance arrangements for AESA remain subject to regulatory approval from the CAA and the State regulators in the US of the reinsurers. Based on discussions with AEL, I understand that AESA's proposed reinsurance structure has been agreed in principle with the CAA. In the US, the applicable State insurance regulators of a domiciled insurer must approve inter-company reinsurance agreements that exceed certain monetary thresholds. Submissions for the approval of the agreements were submitted in a timely manner to the applicable State insurance regulators. The US insurers requested State regulatory approval on or about 1 October 2018. I have been informed by AEL that it currently has no reason to believe that the State insurance regulators will not respond positively to the filings submitted by their domiciled insurers. As such, in my central scenario I have assumed these reinsurances are approved and placed as described above. However, I have performed a scenario test from paragraph 2.86 to estimate the impact if these reinsurances are not approved or placed.

2.62 As described in paragraph 2.95, in the event that AESA's intra group reinsurance arrangements are rejected by the relevant regulator or their terms or scope are materially varied then I consider it will be necessary for me to produce a second supplementary report to assess the impact of this outcome on my opinion.

Historical and projected profitability

2.63 In light of the adverse development in technical provisions and the poor performance of the 2017 financial year, AEL has re-forecast its expected profitability of the 2018 financial year and the expected profitability of AIG UK and AESA for the 2019 to 2021 financial years.

2.64 Table 2.3 shows AEL's historical and projected Total Comprehensive Income (referred to more generally as profit or profitability) for the 2013 to 2021 financial years. It shows the current projected amounts, the projected amounts at the time of my Scheme Report and the differences between these amounts. This is an update of Table 10.3 in my Scheme Report.

Table 2.3 - Total comprehensive income - £m

	Financial Year End								
	Actual					Projected	Projected AIG UK and AESA		
	2013	2014	2015	2016	2017	2018	2019	2020	2021
AEL Current Forecast									
AEL	328	299	55	143	(424)	65			
AIG UK + AESA							90	146	192
AIG UK							88	108	124
AESA							2	39	68
2017Q1 Forecast (as presented in Scheme Report)									
AEL	328	299	55	143	270	237			
AIG UK + AESA							226	246	269
AIG UK							147	153	164
AESA							79	93	105
Difference									
AEL	0	0	0	0	(694)	(172)			
AIG UK + AESA							(136)	(100)	(77)
AIG UK							(59)	(45)	(40)
AESA							(77)	(54)	(38)

2.65 The 2016 and 2017 financial years have faced a challenging operating environment which included low interest rates, increasing inflation, pressure on rates and reduced investment income. The catastrophes in 2017 (hurricanes Harvey, Irma and Maria) materially contributed to the 2017 loss as well as prior year development of approximately £430m (mainly from RoE Casualty and UK Financial Lines) as discussed in paragraph 2.33.

2.66 I have reviewed the updated 2018 business plan for AEL. The 2018 business plan loss ratio takes into account a number of actions which result in a lower loss ratio than that of the prior two years. The improvement in result is driven by a number of actions broadly categorised as remediation, growth in high margin lines and targeting rating improvements. I have reviewed these measures and consider that AIG's projected profitability in 2018 is reasonable. Further, I note that AEL's 2018 financial year profit of £21m up to 2018 Q2 is not materially out of line with its full year projected profit of £65m shown in Table 2.3.

2.67 I have also reviewed the updated ORSAs for AIG UK and AESA which project AEL's forecast 2018 profitability on to the 2019 to 2021 financial years. I consider that 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.

2.68 AESA's projected profitability in 2019 and 2020 is suppressed as a result of projected increases in yields on Euro denominated investments, which are anticipated to result in unrealised losses as has occurred in 2018 Q1 (as described in paragraph 2.55).

2.69 These profit projections are used in the projected Own Funds which are discussed from paragraph 2.79.

2.70 In the scenario tests described from paragraph 2.86 and from paragraph 2.98 I have reviewed projections of AIG UK and AESA's capital resources and SCR coverage ratios under stress scenarios of a repeat of the 2017 financial year loss and, separately, assuming zero profit in AIG UK and AESA's 2019 to 2021 financial years.

AIG UK and AESA Internal Models

2.71 As described from paragraph 9.18 of my Scheme Report, AIG Holdings Europe Limited was preparing a major model change application to the PRA in respect of AIG UK and AESA was preparing an Internal Model Application to the CAA. The application process is continuing in line with expectation and in March 2018 the major model change application in respect of AIG UK was approved for submission by the PRA and also in March 2018 the Internal Model Application was approved for submission by the CAA.

2.72 I have reviewed the summary information supplied with these applications and the internal validation of these models performed by AEL. The AIG UK and AESA internal models are fundamentally unchanged from that of AEL although modifications have been required since:

- The 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 predominantly driven by UK factors and AESA risk by predominantly European factors.

2.73 I consider that the most likely scenario is that both the major model change application and the internal model application are approved. As such I have used this as my central scenario when assessing the Proposed Scheme. However, I have also examined the impact of either one or both of the applications failing in my scenario testing which is described from paragraph 2.86 and from paragraph 2.98.

2.74 As described in paragraph 2.95, in the unlikely event the AESA Internal Model application is unsuccessful then I consider it will be necessary for me to produce a second supplementary report to assess the impact of this outcome on my opinion.

Capital structure

2.75 AIG UK made a full application to the PRA on 25 June 2018 for the recognition of a £300m letter of credit (which is transferring from AEL) as Tier 2 Ancillary Own Funds. This is now moving through a three-month approval process with a decision expected from the PRA by 25 September 2018.

2.76 AESA will be making an application to the CAA for the recognition of a €340m (£299m) letter of credit as Tier 2 Ancillary Own Funds. The application to the CAA has been approved in principle by the CAA Board. The full application will be submitted in early August 2018 with a view to a 15 November 2018 commencement.

2.77 I consider it is likely that both of these applications will be successful and so have assumed this is the case in my central scenario. However, I have performed a scenario test of the impact if these letters of credit are not approved (or placed) which is described from paragraph 2.86.

2.78 As described in paragraph 2.95, in the event that either of AIG UK or AESA's letter of credit applications are rejected by the relevant regulator, or not placed for another reason, then I consider it will be necessary for me to produce a second supplementary report to assess the impact of this outcome on my opinion.

Updated projections to the Effective Date

2.79 AIG has updated its projection of its Own Funds and SCR from those used in my Scheme Report. The current projections are based on AEL's year-end 2017 business planning, updated for actual experience in the first quarter of 2018 and using the current versions of the firms' internal models at the time of writing. Table 2.4 below shows the projected Solvency II Balance Sheet, Own Funds and SCR at the Effective Date based on the current projections and compares these to those from my Scheme Report for both AIG UK and AESA.

Table 2.4 - Movement in Surplus over target Own Funds by Company at Effective Date - Internal Model - £m

	AIG UK			AESA		
Projection Date	**Current**	**Scheme Report**	**Difference**	**Current**	**Scheme Report**	**Difference**
Assets						
Intangibles	0	0	0	0	0	0
Cash and investments	4,199	4,428	(229)	5,909	6,690	(781)
Ceded technical provisions	1,137	1,300	(164)	884	652	233
Insurance debtors	136	128	8	86	51	35
Gross deferred acquisition costs	(0)	0	(0)	0	0	0
Other prepayments and accrued income	222	420	(199)	378	317	61
Tier 2 Own Funds	300	337	(37)	299	0	299
Total Assets	**5,993**	**6,614**	**(621)**	**7,557**	**7,711**	**(153)**
Liabilities						
Technical provisions (excl. risk margin)	3,851	4,314	(462)	4,984	4,549	436
Risk Margin	188	209	(20)	281	267	15
Creditors	215	330	(115)	315	465	(150)
Ceded deferred acquisition costs	0	0	0	(0)	0	(0)
Total Liabilities	**4,255**	**4,853**	**(597)**	**5,580**	**5,280**	**300**
Solvency II Own Funds	**1,738**	**1,761**	**(24)**	**1,977**	**2,431**	**(453)**
Risk Category						
Insurance Risk	1,108	1,154	(47)	931	701	230
Market Risk	403	458	(55)	301	456	(155)
Credit Risk	85	139	(54)	140	162	(23)
Operational Risk	186	173	13	176	192	(16)
Pension Risk	51	57	(6)	41	35	6
Diversification	(492)	(626)	134	(407)	(452)	45
SCR	**1,340**	**1,355**	**(14)**	**1,182**	**1,095**	**87**
Target Buffer over SCR	398	406	(9)	335	328	7
Target Own Funds	**1,738**	**1,761**	**(23)**	**1,517**	**1,423**	**95**
Surplus over Target Own Funds	**(0)**	**0**	**(1)**	**460**	**1,008**	**(548)**

2.80 The current projections in Table 2.4 above assume that both AIG UK and AESA have their internal model and letter of credit applications approved by their respective regulators and that

AESA has its reinsurance structure application approved. From paragraphs 2.86 and 2.98 I test the effect on my conclusions of these assumptions not being borne out in practice.

2.81 Table 2.4 shows that AIG UK's surplus over target Own Funds is unchanged from that in my Scheme Report and AESA's surplus over target Own Funds has reduced by £548m from £1,008m to £460m. The sources for this change are as follows:

- **2017 Financial Year – Actual Experience** – The difference between expected net of tax profit and actual loss on an IFRS basis is £694m (as shown in Table 2.3) and on a pre-tax basis this is £802m. 86% or £686m of this pre-tax difference is attributable to the combined effects of PYD and adverse deviation between business plan and actual experience on the 2017 accident year. The PYD of £430m is described in paragraph 2.33. Of the adverse deviation between business plan and actual experience on the 2017 accident year, the majority is attributable to the Global Property, Lexington and Cat Excess classes account with a key driver being the catastrophe losses in 2017 (hurricanes Harvey, Irma and Maria) which resulted in net of reinsurance losses of £218m. The impact on Own Funds is mitigated by an increase of £16m in share based compensation resulting in surplus Own Funds reducing by £678m.

- **2018 Financial Year – Projections** – Reduction in profit projection of £172m as shown in Table 2.3 resulting in surplus Own Funds reducing by £172m.

- **Ancillary Own Funds** - Increase in ancillary Own Funds for AESA due to the introduction of the letter of credit of €340m, as described in paragraph 2.76. This increases surplus Own Funds by £299m.

- **Capitalisation of subordinated debts** – Increases surplus Own Funds by £13m.

- **Change in Solvency II Balance Sheet Adjustments** – Increases surplus Own Funds by £56m.

- **AIG UK Internal Model SCR** - Changes in the calibration of AIG UK's internal model made during the internal model approval process. The changes relate to an increase in insurance risk and a reduction in diversification. This reduces surplus Own Funds by £73m.

- **Target Own Funds Buffer** – Increase in target Own Funds reduces surplus Own Funds by £17m.

- **Refinement of calibration of target Own Funds buffer** – AEL has re-assessed the calculation of the target Own Funds buffer. This has resulted in the AIG UK uplift remaining broadly unchanged at 30% and the AESA uplift reducing from 30% to approximately 28%. The reduction of the AESA uplift relative to AIG UK is attributable to differences in the timing of the business written throughout the year and to a lesser extent, differences in the classes of business written. This increases surplus Own Funds by £19m.

- **Other** – Increase in surplus Own Funds of £6m.

2.82 Table 2.5 below is an update of Tables 10.1 and 10.2 from my Scheme Report which compares the financial position of UK and European Transferring Policyholders between the Proposed Scheme and no Proposed Scheme, where the no Proposed Scheme outcome considers two scenarios, Soft Brexit and Hard Brexit which are described and explained in my Scheme Report from paragraph 5.75.

Table 2.5 - Coverage Ratio at Effective Date - Internal Model - £m

	UK Transferring Policyholders			European Transferring Policyholders		
	With Proposed Scheme	Without Proposed Scheme		With Proposed Scheme	Without Proposed Scheme	
	AIG UK	AEL - Soft Brexit	AEL - Hard Brexit	AESA	AEL - Soft Brexit	AEL - Hard Brexit
Before Dividend						
Solvency II Own Funds	1,738	3,416	2,649	1,977	3,416	2,649
SCR	1,340	2,660	6,672	1,182	2,660	6,672
Surplus over SCR	397	756	(4,023)	795	756	(4,023)
Coverage Ratio over SCR	**130%**	**128%**	**40%**	**167%**	**128%**	**40%**
Target Own Funds	1,738	3,468	8,673	1,517	3,468	8,673
Surplus over Target Own Funds	(0)	(52)	(6,024)	460	(52)	(6,024)
Coverage Ratio over Target Own Funds	**100%**	**99%**	**31%**	**130%**	**99%**	**31%**
Dividend	**0**	**0**	**0**	**460**	**0**	**0**
After Dividend						
Solvency II Own Funds	1,738	3,416	2,649	1,517	3,416	2,649
SCR	1,340	2,660	6,672	1,182	2,660	6,672
Surplus over SCR	397	756	(4,023)	335	756	(4,023)
Coverage Ratio over SCR	**130%**	**128%**	**40%**	**128%**	**128%**	**40%**
Target Own Funds	1,738	3,468	8,673	1,517	3,468	8,673
Surplus over Target Own Funds	(0)	(52)	(6,024)	0	(52)	(6,024)
Coverage Ratio over Target Own Funds	**100%**	**99%**	**31%**	**100%**	**99%**	**31%**

2.83 Based on the assumptions set out in paragraph 2.80, and in line with my findings in my Scheme Report as shown in Tables 10.1 and 10.2, Table 2.5 above shows that both AIG UK and AESA will still meet their target Own Funds at 1 December 2018. I test the impact of relaxing the assumptions referenced in paragraph 2.80 and test other stresses in the scenario tests below.

2.84 In my Scheme Report as shown in Tables 10.1 and 10.2, AEL under a Soft Brexit was shown to be able to meet its SCR and Own Funds. As shown in Table 2.5 above, AEL under a Soft Brexit is still expected to meet its SCR (exceeding it by £756m) but is not expected to meet its target Own Funds, being deficient by £52m.

2.85 In line with my findings in my Scheme Report as shown in Tables 10.1 and 10.2, Table 2.5 above shows that AEL under a Hard Brexit is still not expected to be able to meet its SCR or target Own Funds. As explained in paragraph 9.50 of my Scheme Report, under the Hard Brexit scenario I have assumed that individual branches of AEL will have to be individually capitalised with much less scope for diversification, resulting in a SCR of £6.7bn, a substantial increase in SCR of approximately £4.0bn over the Soft Brexit scenario SCR of £2.7bn as shown in Table 2.5 above.

Scenario tests – events prior to Effective Date

2.86 AIG UK will be capitalised to its target Own Funds at the Effective 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 this section which are assumed to occur prior to the Effective Date. For this reason I consider my opinion relating to UK Transferring Policyholders is resilient to realistic alternative scenarios.

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

- **Internal Model approval** – Scenarios testing the three alternative possible combinations of outcomes of AIG UK and AESA's Internal Model applications, being:
  - AIG UK's Internal Model not approved and AESA's Internal Model approved
  - AIG UK's Internal Model approved and AESA's Internal Model not approved
  - AIG UK's Internal Model not approved and AESA's Internal Model not approved
- **Reinsurance approval –** Testing the impact if the regulatory approval for AESA's reinsurance programme as described in paragraph 5.48 of my Scheme Report and in paragraph 2.58 of this report, is not forthcoming.
- **Letter of Credit approval –** Testing the impact if the regulatory approval for both AIG UK and AESA's Letters of Credit as Ancillary Own Funds as described in paragraphs 2.75 and 2.76 is not forthcoming.
- **Court does not approve reinsurance split** – Testing the impact of the High Court not sanctioning the split of AEL's outwards reinsurance between AIG UK and AESA as described in paragraphs 9.10 to 9.12 of my Scheme Report. 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.
- **Prior Year Reserve Deterioration –** Testing the impact of a reserve deterioration of 5% of technical provisions to 30 November 2018 as described in paragraph 2.52.
- **Repeat of 2017 loss** – Testing the impact of a repeat of the 2017 financial year loss of £424m in the 2018 financial year.

2.88 In my Scheme Report I also performed scenario tests on the allocation and valuation of Level 3 insurance assets. As explained in paragraph 2.54, these assets classes are no longer material and so these scenario tests are not updated here.

2.89 Since AIG UK will first be capitalised to its target capital at the Effective 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.

2.90 Table 2.6 below shows the impact of the scenarios tested on AESA as at the 1 December 2018 Effective Date.

Table 2.6 - Alternative Scenarios - £m

	AESA			
	Surplus Over SCR	Difference	Surplus over Target Own Funds	Difference
Central scenario	**795**	**0**	**460**	**0**
AIG UK Internal Model not approved	569	(226)	234	(226)
AESA Internal Model not approved	231	(564)	(22)	(482)
Both AIG UK and AESA Internal Models not approved	5	(791)	(248)	(708)
Reinsurance not approved for AESA	254	(541)	(218)	(678)
Letters of Credit not approved for AIG UK and AESA	196	(599)	(139)	(599)
Court does not approve reinsurance split	647	(148)	309	(151)
Prior Year Reserve Deterioration of £430m (5% of TPs)	316	(480)	(30)	(490)
Repeat of 2017 loss	258	(537)	(88)	(548)

2.91 As shown in Table 2.6, based on the assumptions set out in paragraph 2.80 and prior to any shareholder distribution, AESA has a surplus over SCR of £795m and a surplus over target Own Funds of £460m.

2.92 Table 2.6 shows that in each of the scenarios shown, AESA (and also AIG UK) meets its SCR at the Effective Date of the Proposed Scheme. In three scenarios (highlighted in orange in Table 2.6 above) AESA's Own Funds are over £100m short of its target Own Funds. These are the scenarios in which the internal model or letters of credit applications are refused for both of AIG UK and AESA and the scenario in which the reinsurance application is refused for AESA. These scenarios would have no impact on AEL in the event of no Proposed Scheme. In three other scenarios (highlighted in yellow in Table 2.6 above) AESA does not meet its target Own Funds but is less than £100m short of its target. These are the scenarios in which AESA's internal model is not approved, there is a prior year reserve deterioration of £430m and there is a repeat of the 2017 loss. The scenario of AESA's internal model not being approved would have no impact on AEL in the event of no Proposed Scheme. The other two scenarios would have a similar impact on AEL in the event of no Proposed Scheme.

2.93 In my Scheme Report AESA was able to meet its target Own Funds under each of my scenario tests.

2.94 By combining scenarios it is possible to create a composite scenario in which AESA fails to meet its SCR at the Effective Date of the Proposed Scheme but in which AEL would have met its SCR in the event of no Proposed Scheme.

2.95 AEL has confirmed to me that the AIG Group is committed to ensuring that both AIG UK and AESA meet their target Own Funds on the Effective Date of the Proposed Scheme. In the event of adverse scenarios, measures to be taken could include issuing temporary letters of credit, providing intra-group reinsurance targeted at specific lines of business and would ultimately include capital injections. The AIG Group has significant financial resources and as such, I consider this commitment is credible. Therefore, I consider that under all likely scenarios AIG UK and AESA will both meet or exceed their target Own Funds at the Effective Date. In the event that it is projected that either one or both of AIG UK or AESA will not meet their target Own Funds at the Effective Date it will be necessary for me to produce a second supplementary report to assess the impact of this outcome on my opinion. Further, in the event of any of the below scenarios, I consider it will also be necessary for me to produce a second supplementary report to assess the impact of this outcome on my opinion:

- The Internal Model application for AESA fails to gain regulatory approval.

- The intra-group reinsurance arrangements of AESA are rejected by the relevant regulator or their terms or scope are materially varied.
- The letter of credit applications for either AIG UK or AESA are rejected by the relevant regulator.

Updated projections post 1 December 2018

2.96 Based on the updated profit forecasts discussed from paragraph 2.63, AEL has re-projected AIG UK and AESA's Own Funds, SCR and target Own Funds for three years following the Effective Date of the Proposed Scheme. This is shown in Table 2.7 below.

Table 2.7 - Projection of Own Funds for Three Years Beyond Effective Date - Internal Model - £m

	AIG UK				AESA			
	01-Dec-18 Day 1	FY 2019 End of Year 1	FY 2020 End of Year 2	FY 2021 End of Year 3	01-Dec-18 Day 1	FY 2019 End of Year 1	FY 2020 End of Year 2	FY 2021 End of Year 3
Before Dividend								
Solvency II Own Funds	1,738	1,817	1,919	2,037	1,977	1,991	2,032	2,096
SCR	1,340	1,344	1,352	1,361	1,182	1,031	991	966
Surplus over SCR	397	473	568	675	795	961	1,041	1,130
Coverage Ratio over SCR	**130%**	**135%**	**142%**	**150%**	**167%**	**193%**	**205%**	**217%**
Target Own Funds	1,738	1,739	1,747	1,757	1,517	1,318	1,264	1,233
Surplus over Target Own Funds	(0)	78	173	279	460	673	768	863
Coverage Ratio over Target Own Funds	**100%**	**104%**	**110%**	**116%**	**130%**	**151%**	**161%**	**170%**
Dividend (Cumulative)	**0**	**78**	**173**	**279**	**460**	**673**	**768**	**863**
After Dividend								
Solvency II Own Funds	1,738	1,739	1,747	1,757	1,517	1,318	1,264	1,233
SCR	1,340	1,344	1,352	1,361	1,182	1,031	991	966
Surplus over SCR	397	395	395	396	335	288	273	267
Coverage Ratio over SCR	**130%**	**129%**	**129%**	**129%**	**128%**	**128%**	**128%**	**128%**
Target Own Funds	1,738	1,739	1,747	1,757	1,517	1,318	1,264	1,233
Surplus over Target Own Funds	(0)	0	0	0	0	0	0	0
Coverage Ratio over Target Own Funds	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**

2.97 Table 2.7 shows that, as was the conclusion of in my Scheme Report, based on the assumptions set out in paragraph 2.80, both AIG UK and AESA will meet their target Own Funds at the Effective Date of the Proposed Scheme. Further, for the 2019 to 2021 financial years both AIG UK and AESA are expected to grow their Own Funds faster than target Own Funds and hence be in a position to distribute dividends while meeting target Own Funds.

Scenario testing (events post Effective Date)

2.98 In paragraph 2.87, I investigated the impact of a number of adverse scenarios prior to the Effective Date of the Proposed Scheme and, based on the commitment of the AIG Group for AIG UK and AESA to meet their target Own Funds at the Effective Date of the Proposed Scheme as described in paragraph 2.95, I concluded that AIG UK and AESA would meet their target Own Funds at the Effective Date of the Proposed Scheme. Given this, I consider that these scenarios, occurring prior to the Effective Date, would still result in AIG UK and AESA meeting their target Own Funds in the 2019 to 2021 financial years, other than in the case of the scenario of the rejection of the internal model applications which I have investigated, along with other adverse scenarios below.

2.99 I have investigated the impact of three adverse scenarios on the ability of AIG UK and AESA to meet their SCRs and Own Funds. These scenarios are:

- **No Internal Model Approval** – Testing the impact if the regulatory approval for both AIG UK and AESA's internal model applications is not forthcoming.

- **No profit** – Testing the impact of neither AIG UK nor AESA making profits in their 2019 to 2021 financial years.

- **Intra-group reinsurance failure** – Failure of AIG UK and AESA's reinsurance with reinsurers in the AIG Group.

2.100 I have concluded that, other than in the case where events identified in paragraph 2.95 occur, in which case it will be necessary for me to consider the impact of these events in a second supplementary report, neither UK Transferring Policyholders not European Transferring Policyholders will be materially adversely affected by the Proposed Scheme.

No Internal model approval

2.101 Table 2.8 below is in the same format as Table 2.7 above, but assuming that both the AIG UK and AESA internal models fail to gain regulatory approval but that, in line with paragraph 2.95, the AIG Group ensures that AESA meets its target Own Funds at the Effective Date.

Table 2.8 - Projection of Own Funds for Three Years Beyond Effective Date - Standard Formula - £m

	AIG UK				AESA			
	01-Dec-18	FY 2019	FY 2020	FY 2021	01-Dec-18	FY 2019	FY 2020	FY 2021
	Day 1	End of Year 1	End of Year 2	End of Year 3	Day 1	End of Year 1	End of Year 2	End of Year 3
Before Dividend								
Solvency II Own Funds	1,906	1,981	2,082	2,199	1,941	1,961	2,003	2,068
SCR	1,657	1,616	1,604	1,624	1,688	1,530	1,451	1,410
Surplus over SCR	249	365	478	575	253	431	552	658
Coverage Ratio over SCR	**115%**	**123%**	**130%**	**135%**	**115%**	**128%**	**138%**	**147%**
Target Own Funds	1,906	1,858	1,845	1,867	1,941	1,760	1,669	1,622
Surplus over Target Own Funds	0	123	237	331	(0)	202	334	447
Coverage Ratio over Target Own Funds	**100%**	**107%**	**113%**	**118%**	**100%**	**111%**	**120%**	**128%**
Dividend (Cumulative)	**0**	**123**	**237**	**331**	**0**	**202**	**334**	**447**
After Dividend								
Solvency II Own Funds	1,906	1,858	1,845	1,867	1,941	1,760	1,669	1,622
SCR	1,657	1,616	1,604	1,624	1,688	1,530	1,451	1,410
Surplus over SCR	249	242	241	244	253	230	218	212
Coverage Ratio over SCR	**115%**	**115%**	**115%**	**115%**	**115%**	**115%**	**115%**	**115%**
Target Own Funds	1,906	1,858	1,845	1,867	1,941	1,760	1,669	1,622
Surplus over Target Own Funds	0	0	0	0	(0)	0	0	0
Coverage Ratio over Target Own Funds	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**

2.102 It can be seen that, in the event that AIG UK and AESA are both required to set their SCR using the Standard Formula, then as long as the AIG Group ensures that both AIG UK and AESA meet their target Own Funds at the Effective Date of the Proposed Scheme then, for the 2019 to 2021 financial years, both AIG UK and AESA are expected to grow their Own Funds faster than their target Own Funds and hence be in a position to distribute dividends while meeting target Own Funds.

No future profit

2.103 Table 2.9 below shows the impact of assuming that retained profits are zero for the 2019 to 2021 financial years.

Table 2.9 - Projection of Own Funds for Three Years Beyond Effective Date - Internal Model - No Profit Scenario - £m

	AIG UK				AESA			
	01-Dec-18	FY 2019	FY 2020	FY 2021	01-Dec-18	FY 2019	FY 2020	FY 2021
	Day 1	End of Year 1	End of Year 2	End of Year 3	Day 1	End of Year 1	End of Year 2	End of Year 3
Before Dividend								
Solvency II Own Funds	1,738	1,729	1,724	1,717	1,977	1,990	1,991	1,988
SCR	1,340	1,344	1,352	1,361	1,182	1,031	991	966
Surplus over SCR	397	385	372	355	795	959	1,001	1,022
Coverage Ratio over SCR	**130%**	**129%**	**128%**	**126%**	**167%**	**193%**	**201%**	**206%**
Target Own Funds	1,738	1,739	1,747	1,757	1,517	1,318	1,264	1,233
Surplus over Target Own Funds	(0)	(10)	(23)	(41)	460	671	727	755
Coverage Ratio over Target Own Funds	**100%**	**99%**	**99%**	**98%**	**130%**	**151%**	**158%**	**161%**
Dividend (Cumulative)	**0**	**0**	**0**	**0**	**460**	**671**	**727**	**755**
After Dividend								
Solvency II Own Funds	1,738	1,729	1,724	1,717	1,517	1,318	1,264	1,233
SCR	1,340	1,344	1,352	1,361	1,182	1,031	991	966
Surplus over SCR	397	385	372	355	335	288	273	267
Coverage Ratio over SCR	**130%**	**129%**	**128%**	**126%**	**128%**	**128%**	**128%**	**128%**
Target Own Funds	1,738	1,739	1,747	1,757	1,517	1,318	1,264	1,233
Surplus over Target Own Funds	(0)	(10)	(23)	(41)	0	0	0	0
Coverage Ratio over Target Own Funds	**100%**	**99%**	**99%**	**98%**	**100%**	**100%**	**100%**	**100%**

2.104 In line with the result of this scenario test in my Scheme Report, this shows that AIG UK is able to meet its SCR requirement during this period and the target Own Funds coverage ratio is always greater than 98%. AESA is also able to meet both its SCR and target Own Funds during this period.

Intra-group reinsurance failure

2.105 These stress tests assess the ability of AIG UK and AESA to withstand the failure of the intra-group reinsurances.

2.106 In summary, I have run two forms of stress tests, the first (the "SCR Test") tests the ability of the firm to meet its SCR in the event of no distributions of Own Funds. The second (the "Expected Claims Test") tests the ability of the firm to meet expected claims if the firm is capitalised to target Own Funds immediately prior to the failure, i.e. Own Funds in excess of target Own Funds are distributed. Further information on these stress tests including the underlying assumptions are described in my Scheme Report from paragraph 10.128 and are not repeated here. The following results assume the SCR for AEL, AIG UK and AESA is assessed on the Internal Model basis.

2.107 Under my direction, AEL has re-run these stress tests using the capital projections provided for my Supplementary Report.

2.108 In the event of intra-group reinsurance failure prior to the Proposed Scheme, on the SCR Test, AEL will be in a weaker position than that described in the Scheme Report as a result of the variance between actual and projected profits shown in Table 2.3. However, its Own Funds would be expected to exceed its SCR. On the Expected Claims Test it would be able to meet its expected claims in full.

2.109 In the three years following the Proposed Scheme, the impact on AIG UK of the stress tests are broadly unchanged from that described in my Scheme Report. On the SCR Test, in the event of a failure in 2019, AIG UK's Own Funds would be at 98% of its SCR, deficient by approximately £29m but it would be able to meet its SCR if recovery from the intra-group reinsurance following default exceeded 53%. As described in my Scheme Report from 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%. In the event of a failure in 2020 or 2021 it would be expected to meet its SCR. On the Expected Claims Test it meets its expected claims in full.

2.110 In the three years following the Proposed Scheme, on the SCR Test, AESA is in a weaker position than that described in the Scheme Report as a result of the variance between actual and projected profits as shown in Table 2.3. If failure occurred in 2019 its Own Funds would be expected to exceed its SCR but if failure occurred in 2020 or 2021 Own Funds would be expected to be at 97% and 83% of its SCR respectively (deficiencies of £36m and £203m respectively). However, it would be able to meet its SCR if recovery from the intra-group reinsurance following default exceeded 57%. On the Expected Claims Test AESA would not be able to meet expected policyholder claims unless the recovery from the intra-group reinsurance following default exceeded 42%. In my Scheme Report, the equivalent figure was 30% so this represents a weakening of AESA's security. However, as described in my Scheme Report from 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%. In the event that AESA does not distribute Own Funds in excess of target Own Funds then AESA would be expected to meet its expected claims in full.

2.111 Having reviewed the above intra-group reinsurance stress tests my overall conclusions remain unchanged from those in my Scheme Report. I consider that AIG UK has a broadly similar level of resilience to intra-group reinsurance default to 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 42% could have expected liabilities in excess of its assets in the event that AESA has distributed Own Funds in excess of target Own Funds. However, I consider that that the impact on policyholders of this reduced resilience 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 of my Scheme Report 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.

- 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.

- AESA's requests to distribute Own Funds in excess of target Own Funds will need to be approved by the CAA and I would expect the firm's resilience to group-reinsurance failure to be a matter the CAA would take into consideration when considering such a request.

2.112 In conclusion therefore, European Transferring Policyholders and, to a 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 2.111 above, the security of neither UK Transferring Policyholders' contractual rights nor European Transferring Policyholders' contractual rights is materially disadvantaged by the Proposed Scheme.

Access to insolvency compensation schemes

2.113 In my Scheme Report (from paragraph 10.43) I discussed the impact on European Transferring Policyholders of possible changes in policyholders' right of redress to insolvency compensation schemes in the event of an insolvency of AESA following the Proposed Scheme compared to the insolvency of AEL in the event of no Proposed Scheme. I am aware of two developments since my Scheme Report, as follows:

- As referenced in footnote 4 to paragraph 10.49 of my Scheme Report, AEL has confirmed to me that AESA will participate in the Danish insolvency compensation scheme. This expands the scope of insolvency compensation schemes available to certain European Transferring Policyholders and so does not change the conclusions of my Scheme Report.
- From paragraph 10.50 of my Scheme Report I described an analysis undertaken by AEL under my direction to understand the volume of AESA claims likely to lose the benefit of FSCS protection were AESA to suffer an insolvency event following the Proposed Scheme. AEL has updated this analysis based on actual claims experience observed in 2017. I consider this updated analysis to be reasonable and in line with my prior expectations. This updated analysis does not show any material changes to the impacts noted in my Scheme Report and as such, this does not change the conclusions of my Scheme Report.

Policyholder communications

2.114 I have reviewed AEL's weekly reports on policyholder communications and summary statistics on responses as well as the Communication Manager's draft witness statement to the Court. I am satisfied that AEL has taken the notification steps as described from paragraph 10.165 of my Scheme Report and as set out in the scheme document which was presented to the Court at the Directions Hearing. In reaching this conclusion I make the following observations which do not change my conclusions:

- I am aware that in some cases communications to policyholders may occur less than six weeks prior to the Sanction Hearing. These cases are solely in respect of service programmes. In line with the process described in paragraph 10.180 of my Scheme Report, AEL has provided the full communication pack to the service programme sponsor and requested that they undertake onward transmission of the notice to underlying customers, with AEL continuing to offer support such as provision of additional packs. In practice, some sponsors have not, or have not fully, implemented these requests. This lack of support was expected and was the reason for the enhanced advertising campaign described in paragraph 10.180 of my Scheme Report. AEL has continued to engage with sponsors wherever possible to encourage them to comply with the notification requests. It is in these circumstances that some sponsors have agreed to comply but are doing so later than requested by AEL. In this case, AEL is still sending these notifications out in case the relevant underlying policyholders have not seen the press adverts. In the case that further sponsors agree to implement the requests it is possible that communications to some policyholders may occur less than six weeks prior to the Sanction Hearing. However, I do not consider that this significantly undermines the communication steps that have occurred in line with the process described in my Scheme Report.
- AEL has experienced returned mail with address unknown, bounced emails and rejected SMS messages. The failure rate is approximately 1.8% for mail, 13% for email and 17% for SMS, as at 24 August 2018. In each case of failed communication AEL has conducted a further tracing exercise on the relevant recipient to try to obtain new contact information. The proportion of rejected communications is within expected thresholds and, as explained in paragraph 10.191 of my Scheme Report, the impact of these rejected communications has been mitigated by the enhanced advertising campaign.

- AEL has received 25 queries from policyholders (as at 24 August 2018) that it has logged as complaints. One of these complaints has been categorised as a query raising a concern specific to the Proposed Scheme, but it is not a formal objection to the Proposed Scheme (I address policyholder objections in paragraph 2.115 below). I have reviewed these 25 complaints and AEL's responses. These complaints primarily relate to questions over data privacy and requests for information to identify the AIG policy in question. Five policyholder queries raise a complaint over the complexity of the language and length of materials provided within the communications. I consider that AEL and its advisors have gone to considerable lengths to communicate what is a complex transaction as simply as possible. A number of the complaints are seeking AEL's advice on what to do but under the Proposed Scheme AEL is required to explain the facts of the Proposed Scheme and is not permitted to provide such advice. In conclusion, I do not consider that these complaints raise issues which are substantive to the Proposed Scheme and I am satisfied with the responses provided by AEL.

Policyholder objections

2.115 I have received details of all of objections which have been raised to the Proposed Scheme. As of 31 August 2018, twelve responses raising objections to the Proposed Scheme have been received by AEL. I have reviewed the nature of the objection in each of these cases. In many cases the objection is not motivated by or grounded in genuine arguments against the Proposed Scheme as it is more in nature of a general query about the restructure and a request for further information on the policies impacted. AEL is in the process of addressing these queries, and is attempting to ascertain if there is any substantive reasoning for these objections. I am aware of three cases where the nature of the objection is clear:

- One objection is based on an issue the policyholder has with an ongoing claim. I do not consider this objection relates to the Proposed Scheme.

- One objection is based on AESA being located in Luxembourg as the policyholder views this as a means of reducing tax paid. My Scheme Reports have consider the security of policyholders' contractual rights after all relevant taxes have been paid. I do not consider this objection changes my conclusions.

- One policyholder, a European Transferring Policyholder, objects to the loss of FSCS protection for claims occurring after the Effective Date of the Proposed Scheme. I have addressed the issue of the loss of FSCS protection in my Scheme Report from paragraph 10.43 and in this Supplementary Report in paragraph 2.113. I do not consider the objection raises any points not already covered in my Scheme Reports and as such, I do not consider this objection changes my conclusions.

2.116 In summary, no objections received change my conclusions from my Scheme Report.

Section 3: Conclusions

3.1 In my Scheme Report dated 26 February 2018 I considered the likely effects of the Proposed Scheme on the UK Transferring Policyholders and the European Transferring Policyholders. In each case, I considered the likely effects of the Proposed Scheme on the security of transferring policyholders' contractual rights. I also considered the likely effects of the Proposed Scheme on the other factors which may impact security or service levels to the affected policyholders.

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

3.3 In this Supplementary Report I have considered whether any of the conclusions set out in my Scheme Report have changed in light of the availability of updated financial information and any material issues that have arisen since the dates noted in paragraph 1.7

Summary

3.4 As set out below, my opinions on the Proposed Scheme are unchanged from those set out in my Scheme Report, which are as follows:

- 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.
- 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 subject to none of the four scenarios listed in paragraph 3.5 below occurring.

3.5 It will be necessary for me to produce a second supplementary report in the event of any of the below scenarios materialising before the Effective Date:

- If it is projected that either one or both of AIG UK or AESA will not meet their target Own Funds at the Effective Date.
- If the Internal Model application for AESA fails to gain regulatory approval.
- If the intra-group reinsurance arrangements of AESA are rejected by the relevant regulator or their terms or scope are materially varied.
- If the letter of credit applications for either AIG UK or AESA are rejected by the relevant regulator.

3.6 If it becomes necessary for me to produce a second supplementary report then this second supplementary report will confirm whether the impacts of the scenarios which have materialised have changed my opinions on the Proposed Scheme.

Security of policyholders transferring from AEL to AIG UK

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

3.8 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.

3.9 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.

3.10 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

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

3.12 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.

3.13 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.

3.14 While I have identified scenarios which may result in AESA not being able to meet its target Own Funds and possible combinations of scenarios which may result in AESA not being able to meet its Solvency II Solvency Capital Requirement I have received a commitment, which is described in paragraph 2.95, that in the event of such adverse scenarios the AIG Group will take measures to ensure that AESA meets its target Own Funds at the Effective Date.

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

3.16 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 my Scheme Report in 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 considered this in my Scheme Report and again in this Supplementary Report from paragraph 2.113 and I remain of the opinion that European Transferring Policyholders will not be materially adversely affected by the Proposed Scheme.

Effect of Internal Model Approval and other regulatory applications on the above conclusions

3.17 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 application with the CAA.

3.18 Further, AIG UK has outstanding applications with the PRA for LoCs and AESA with the CAA for LoCs and intra-group reinsurance arrangements.

3.19 While I consider it likely that AIG UK and AESA will both have approved Internal Models immediately following the Proposed Scheme and the LoC and reinsurance applications will be approved, I have tested scenarios in which these approvals are not forthcoming.

3.20 On the basis that the AIG Group will ensure that in all scenarios AIG UK and AESA will meet their target Own Funds on 1 December 2018, this does not change my conclusions.

Effect of Brexit on the above conclusions

3.21 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.

3.22 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

3.23 I have tested the impact on my conclusions of plausible stress scenarios that AEL, AIG UK and AESA may experience following 1 December 2018. These stresses include:

- Internal model applications not approved;
- No profits in the 2019 to 2021 financial years; and
- Impairment of intra-group reinsurance.

3.24 I consider that my conclusions remain resilient to these stresses.

Other considerations

3.25 It remains my opinion that the Proposed Scheme will have no significant effect on UK Transferring Policyholders and 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.

3.26 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 the 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.

3.27 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.

3.28 I am satisfied that the material 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.

3.29 I have received details of all of objections which have been raised to the Proposed Scheme. In summary, no objections received change my conclusions from my Scheme Report.

External reinsurers

3.30 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, it remains my opinion that the transfer will have no material effect on the external reinsurers of AEL.

Interaction with regulators

3.31 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 Supplementary Report. A draft of this Supplementary 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 the Scheme Reports.

3.32 No limitations have been imposed on the scope of my work and the opinions in the Scheme Reports 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 the Scheme Reports that might, in my opinion, be relevant to policyholders' consideration of the Proposed Scheme.

Possible second supplementary report

3.33 In paragraph 3.5 I have set out the scenarios in which it would be necessary for me to produce a second supplementary report.

Duty to the High Court

3.34 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

3.35 I confirm that insofar as the facts stated in my Supplementary 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

17 September 2018

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Appendix A: Glossary of terms

This Appendix contains a glossary of terms, covering those terms used in either or both of my Scheme Report and this Supplementary Report.

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 Cross Border Merger Directive	Directive (EU) 2017/1132 of 14 June 2017 relating to certain aspects of company law, which repealed and codified with effect from 20 July 2017 the Directive 2005/56/EC of 26 October 2005 on cross-border mergers of limited liability companies, as transposed into Luxembourg law under articles 1020-1 seq. of the Luxembourg Commercial Code of 10 August 1915 and into English law by the Companies (Cross-Border Mergers) Regulations 2007 (SI 2007/2974)
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	Residential Mortgage Backed Securities, a 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	My Independent Expert's Scheme Report on the Proposed Scheme dated 26 February 2018.
Scheme Reports	The Scheme Report and the Supplementary Report when considered together.
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.
Supplementary Report	This report, the supplementary Scheme Report
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 equaling 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.