Proposed Part VII Insurance Business Transfer relating to:

USAA Limited

and

USAA S.A.

Report of the Independent Expert

19 July 2022

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Version: FINAL

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Key acronyms and definitions

This Report contains various acronyms, shorthand names for companies and technical terms. To aid readability, these are defined in a consolidated glossary in Appendix E.8. Where used, the first letter has been capitalised. The bold items below are key items from the glossary that I have used in Section A of this Report.

Companies	**USAA**	United Services Automobile Association, ultimate owner of all the companies within the **USAA Group**; including USAA SARL, USAA LTD and USAA SA. A company domiciled in the US.
	USAA LTD	USAA Limited, the **Transferor** and a wholly-owned subsidiary of USAA SARL. A non-life insurance company domiciled in the UK.
	USAA SA	USAA S.A., the **Transferee** and a wholly-owned subsidiary of USAA SARL. A non-life insurance company domiciled in Luxembourg.
	USAA SARL	USAA International Services SARL, a wholly-owned subsidiary of USAA. A Luxembourg-regulated insurance holding company that employs all USAA Staff in the UK and EU. It has delegated responsibility to perform insurance and operational activities on behalf of USAA LTD and USAA SA.
	USAA Staff	Employees of USAA SARL or another company within the USAA Group.
Legal, regulatory and Pt. VII Transfer Terms	**Brexit**	The departure of the UK from the European Union; or the date of departure (i.e. 31 January 2020).
	CAA	Commissariat aux Assurances. The Luxembourg insurance regulator for both prudential and conduct matters.
	Court	The High Court of Justice of England and Wales, which is responsible for approving the Transfer.
	EEA and **EEA member states**	For the avoidance of doubt, unless explicitly expressed otherwise, this refers to countries that are *currently* EEA member states and excludes the UK (which was an EEA member state at the time when some of the Affected Policies were underwritten).
	European Business	Business written by USAA LTD and USAA SA in the UK (**UK Business**) and EEA member states (**EEA Business**).
	FCA and **PRA**	The two insurance regulators in the UK (the Financial Conduct Authority and the Prudential Regulation Authority). Both are consulted prior to the Transfer going ahead. References to **SUP18** and the **SoP** are references to regulatory guidance that set out respectively the expectations of each regulator for the Report.
	Freedom of Establishment	In the context of insurance business, the permission for a firm authorised in one EEA member state to establish a branch office in any other state within the EEA to underwrite insurance business while remaining supervised by the prudential regulator of its home state.
	Freedom of Services	In the context of insurance business, the permission for a firm authorised in one EEA member state to underwrite insurance business anywhere within the EEA as if they were an authorised firm in the EEA member state where the risk is underwritten.
	FSMA 2000	The UK legislation enabling the Transfer to take place. Its full name is the Financial Services and Markets Act 2000. Part VII of FSMA 2000 relates to insurance business transfers, commonly referred to as **Part VII Transfers.**
	Parties	The Transferor: USAA LTD; and the Transferee: USAA SA.
	Report and **Supplemental Report**	The report of the **Independent Expert** prepared for the Court in accordance with FSMA 2000 setting out the effect of the Transfer on policyholders affected by it. A Supplemental Report is prepared for the Court before it is asked to approve the Transfer to update the Court on any significant matters arising since the Report was prepared.
	Transfer	The proposed Part VII Transfer of certain assets and liabilities from USAA LTD to USAA SA. This is set out in the **Scheme** submitted to the **Court**. This will take place on the **Transfer Date**, expected to be on or around 31 December 2022.

Policyholders	**Affected Policyholders**	These comprise the **Existing Policyholders** and the **Transferring Policyholders**. As all policyholders of USAA LTD will transfer, there are no **Remaining Policyholders**.
	Existing Policyholders	Policyholders of USAA SA prior to the Transfer.
	Transferring Policyholders	The policyholders of USAA LTD whose policies will transfer to USAA SA under the Transfer. These comprise: (i) **EEA Transferring Policyholders,** being those with **EEA Transferring Policies** written in respect of EEA risks. USAA LTD ceased writing such business on 31 December 2018. (ii) **UK Transferring Policyholders,** being those with **UK Transferring Policies** written in respect of UK risks. USAA LTD ceased writing such business on 31 March 2022. Transferring Policyholders have **Transferring Policies** that will move from USAA LTD to USAA SA under the Transfer and there will be no Remaining Policyholders in USAA LTD.
Other Insurance Terminology	**EOF** or **Eligible Own Funds**	This is the surplus of assets over liabilities as determined under Solvency II. There are limits on the proportion of the **SCR** that can be met by certain types of Eligible Own Funds.
	GAAP	Generally Accepted Accounting Principles. USAA LTD's Statutory Financial Statements are prepared using UK GAAP, while USAA SA's Statutory Financial Statements are prepared using Luxembourg GAAP (**Lux GAAP**).
	GWP	Gross written premium.
	NWP	Net written premium. Premium written net of ceded reinsurance.
	SCR or **Solvency Capital Requirement**	The regulatory capital requirement for a firm under Solvency II. Most firms use the prescribed **Standard Formula** to determine their SCR.
	Solvency Ratio	A quantitative measure of financial strength used in this Report, formally: $Solvency\ Ratio\ \% = \frac{financial\ resources}{capital\ requirements}$ Under Solvency II, EOFs are normally used for measuring financial resources, and SCR is used for capital requirements.
	Technical Provisions	These are the amounts set aside by insurance companies, at a given date, to pay for all potential future cashflows that would be incurred in meeting liabilities to policyholders from existing insurance and reinsurance contracts. The principles which are followed to calculate these provisions will differ depending on their purpose, e.g. regulatory (Solvency II) or annual accounts reporting (UK GAAP or Lux GAAP). In this report, the term Technical Provisions is used interchangeably with the term **Reserves**.
Other	**Comparative terms**	I use the term **remote** to describe terms that I believe are sufficiently unlikely so as to be immaterial to my conclusions. This is discussed in greater detail in Section 5 of my Report.
	COVID-19	Coronavirus disease 2019, an infectious disease caused by severe acute respiratory syndrome coronavirus 2 (SARS-CoV-2). It was first identified in December 2019 in Wuhan, China, and has since spread globally resulting in an ongoing pandemic.

Except where indicated, all amounts in this Report have been converted to Sterling at £1 = €1.1924 = US$1.3497

Contents

A. Introduction and Executive Summary

1. Introduction

1.1. Background

1.1.1. This Report covers the proposed Part VII Transfer[1] relating to USAA LTD and USAA SA. The project was initiated by the Parties in response to the uncertainty created by Brexit in relation to the legality of USAA LTD continuing to service insurance contracts for policyholders with EEA risks after the UK left the European Union.

1.2. Purpose of the Transfer

1.2.1. The purpose of the Transfer is to bring about a reorganisation of the USAA Group's European Business, by transferring all insurance business from USAA LTD to USAA SA. USAA LTD is in run-off as it stopped writing EEA Business on 31 December 2018 and UK business on 31 March 2022.

1.2.2. The Transfer will remove uncertainty for the EEA Transferring Policyholders and for USAA LTD in respect of whether these contracts can be serviced legally post Brexit. Additionally, by moving its UK Business into USAA SA's UK branch, it is anticipated that some of the operating costs arising from having two separate insurance companies will be reduced.

1.3. Independent Expert

1.3.1. The Scheme specifies the terms on which the Transfer will take effect. The Parties must request that the Court uses its powers under FSMA 2000 to sanction the Scheme so that the Transfer can become effective. Under FSMA 2000, the Parties must obtain a report prepared for the Court by an independent expert, commenting on the effects of the Scheme.

1.3.2. I, Alex Marcuson, have been appointed by the Parties to act as the Independent Expert for the Transfer. This role, established under Part VII of FSMA 2000 (along with supporting regulations), is described in the PRA's SoP and in SUP18 of the FCA's Handbook. The PRA (in consultation with the FCA) approved my appointment on 18 December 2020. A copy of relevant sections from my letter of engagement appointing me to act in this role is included in Appendix E.1.

1.3.3. I am the Managing Director of Marcuson Consulting Ltd, a specialist non-life insurance actuarial consulting firm. I am a Fellow of the Institute and Faculty of Actuaries with over twenty-five years of experience advising non-life insurers and reinsurers. I have experience in loss reserving and capital modelling for non-life (re)insurance companies and have previously acted as an independent expert and advised a number of firms carrying out Part VII transfers. A copy of my curriculum vitae is included in Appendix E.4.

1.3.4. To carry out this role, I am required to be able to act independently in performing a review of the Transfer. I believe I can do so for the following reasons:

- Neither I nor Marcuson Consulting Ltd has identified any direct shareholding or any other direct financial interest in or relationship with any entity within the USAA Group.

[1] Formally, this is a Transitional Insurance Business Transfer as defined in Regulation 36 of, and the Schedule to, the Financial Services (Miscellaneous) (Amendment) (EU Exit) Regulations 2019. As a result, in this Report, references to FSMA 2000 and the associated regulations and statutory instruments, and other guidance and standards relating to Part VII Transfers should be amended by or interpreted in order to be consistent with the relevant provisions of the Financial Services (Miscellaneous) (Amendment) (EU Exit) Regulations 2019.

- Neither I nor Marcuson Consulting Ltd has any insurance policy with any entity within the USAA Group.
- None of the members of the team who have assisted me in performing my review (including carrying out peer review of my work) have any shareholding or other direct financial interest in or relationship with or any insurance policy with any entity within the USAA Group.
- I am not aware of any other conflicts of interest that might impair my ability to act.
- Marcuson Consulting Ltd has not previously undertaken any other work for any entity within the USAA Group.

1.3.5. My review has been carried out between September 2021 and July 2022, making use of data available to me during this period. My fees incurred in the preparation of this Report are payable by USAA LTD[2].

1.3.6. I anticipate preparing a Supplemental Report close to the Transfer Date that updates the Court on information arising since I finalised this Report and confirming my conclusions.

1.4. Role

1.4.1. My role as Independent Expert is to review the terms of the Scheme and produce this Report for the Court describing its effects. In doing so, I am required to consider the financial and non-financial effects of the Transfer on the Affected Policyholders, and the effects of the Transfer on the Reinsurers of the Transferring Policyholders. The Affected Policyholders can be subdivided into:

- the Transferring Policyholders; and
- the Existing Policyholders.

1.4.2. USAA LTD will have no Remaining policyholders.

1.5. Structure of the Report

1.5.1. This Report contains the following sections:

Section A: Introduction and Executive Summary	
1.	Introduction
2.	Executive Summary
Section B: Overview of the Transfer	
3.	Description of the Transfer and the Transferring Policyholders
4.	Description of the Companies
5.	Approach – additional description
Section C: Detailed Review – Financial effects	
6.	Introduction
7 – 8.	Review of company Technical Provisions and Balance Sheets
9 – 11.	Qualitative and quantitative risk and capital analysis
12.	Summary of financial positions of the Affected Policyholders
Section D: Detailed Review – Non-financial effects, notifications and publicity	
13.	Non-financial aspects of the Transfer
14.	Notifications and publicity arrangements
Section E: Appendices	

1.5.2. The Report should be considered in its entirety as parts taken out of context could be misleading.

[2] I have been told by USAA Staff that some of these costs are borne by USAA.

1.6. Purpose and use of the Report

1.6.1. This Report has been prepared to set out for the Court my findings in respect of the Transfer, following the guidance set out in the SoP and SUP18. It should not be used for any other purpose, for any other insurance business transfer or in any other legal forum.

1.6.2. Marcuson Consulting Ltd and I do not owe or accept any duty to any party other than the Court or to any party seeking to use the Report for any purpose other than in connection with the Transfer. We shall not be liable for any loss, damage or expense (including interest) of whatever nature that is caused by any party choosing to rely on this Report for any other purpose.

1.7. Compliance with SoP, SUP18 and UK Actuarial Standards

1.7.1. This Report follows the guidance set out in the SoP and SUP18, and considers the guidance set out in FCA FG 22/1: *The FCA's approach to the review of Part VII insurance business transfers* issued in February 2022 and in PRA SoP: *The PRA's approach to insurance business transfers* issued in January 2022.

1.7.2. This Report has been prepared in compliance with the FRC's Framework for FRC Technical Actuarial Standards and relevant Technical Actuarial Standards (TAS 100 and TAS 200) together with the relevant Actuarial Profession Standard of the IFoA (APS X2: Review of Actuarial Work).

1.7.3. The PRA (in consultation with the FCA) has approved the form of this Report in the context of the Transfer.

1.8. Reliances

1.8.1. In preparing this Report I have been assisted in performing the analysis by my colleagues at Marcuson Consulting Ltd. Where I refer to work that I have carried out, this may have been performed by members of the team working under my supervision. The conclusions and opinions expressed in this Report are however my own.

1.8.2. I have relied upon the data, reports and other information provided to me by USAA Staff. A list of this information is contained in Appendix E.3. USAA Staff have checked the information contained in this Report for factual accuracy and confirmed the accuracy of the data and other information provided to me. I have relied upon the confirmation to the Court of this in the Witness Statement prepared on behalf of the Parties.

1.8.3. Although I have not sought to verify independently each item of data, I have sought to perform reasonableness checks on the material received to satisfy myself that I could rely upon it for the purposes of reaching the conclusions in this Report. Where necessary I have sought clarification from USAA Staff. Where possible, this has included reconciling information to audited financial information.

2. Executive Summary

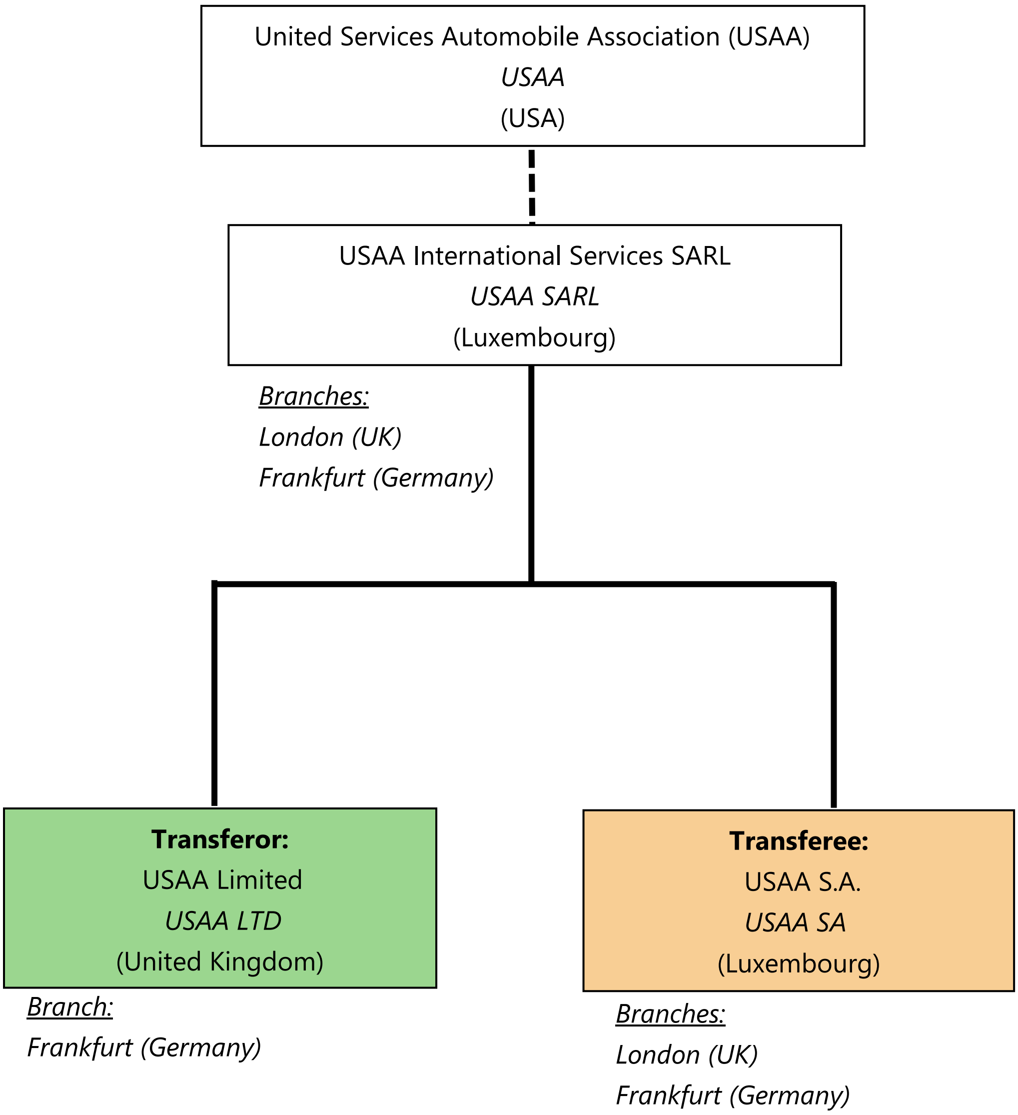
2.1. Overview of the Scheme

2.1.1. The Scheme is an internal reorganisation within the USAA Group comprising the transfer to USAA SA of all of the European Business of USAA LTD. The EEA Business will transfer to USAA SA and the UK Business will transfer to USAA SA's UK branch. Both Parties are indirect wholly-owned subsidiaries of USAA.

2.1.2. The USAA Group is a mutually-owned organisation providing a wide range of financial services to its members and their dependents. Founded in 1922, its members consist of active and retired US military services personnel. The financial services products provided to its members cater for the specific needs of US military service personnel whether stationed in the USA or overseas.

2.1.3. Figure 1 is a schematic diagram indicating where in the USAA Group each of the Parties is located.

Figure 1 Schematic summary of the Parties and the Transfer



2.1.4. The Transfer brings about no material change to the position at the consolidated level of USAA Group.

2.1.5. The Transfer will move the assets and liabilities associated with the Transferring Policies. The cash and investments to be transferred will be determined close to the Transfer Date and will be set so that the impact on the net assets (measured on a GAAP basis) of each of the Parties of the Transfer will be nil (or very close to this amount).

2.1.6. The remainder of USAA LTD's net assets will be moved to USAA SA by means of one or more dividends from USAA LTD to USAA SARL. USAA SARL will then in turn invest these proceeds into USAA SA in the form of equity.

2.1.7. I have been told by USAA Staff that the current intention of the Parties is for there to be at least two dividends to achieve this:

- A dividend payable prior to the Transfer (possibly as early as 30 September 2022) that will reduce USAA LTD's Solvency Ratio (pre-Transfer) to no less than 150%. It is expected that this dividend will amount to approximately €35 million.
- A second dividend payable comprising the balance of USAA LTD's net assets and taking place after the Transfer at the time that USAA LTD is wound up. There is the possibility that this amount may be payable by means of more than one dividend.

2.1.8. The approach being adopted by the Parties of moving financial resources between the Parties has been selected so that:

- USAA LTD will have financial resources with which to settle any remaining liabilities associated with its pensions obligations and comfortably meet its regulatory capital requirements both pre- and post-Transfer prior to it being deauthorised as an insurance company;
- The Parties avoid the operational challenges of USAA LTD needing to pay a dividend and USAA SARL injecting capital into USAA SA simultaneously with the Transfer over the New Year's Eve public holidays;
- It will result in USAA SA being in a position to comfortably meet its regulatory capital requirements both pre- and post-Transfer; and
- All of USAA LTD's financial resources will be moved to USAA SA in a timely fashion once they are no longer required by USAA LTD.

2.1.9. USAA LTD will not be wound up immediately post-Transfer because at the Transfer Date it will retain a UK and a German defined benefit pension scheme with combined liabilities accounted for by the company in its year-end 2021 accounts of c. £27 million.

2.1.10. On 10 May 2022, USAA LTD agreed a price at which the entirety of the UK pension liabilities would be transferred to an external insurer and paid this premium. This transaction is expected to complete by 31 March 2023 and will take place regardless of whether the Transfer goes ahead. There may be a balancing payment to be made on completion but this is not expected to be material. USAA LTD anticipates entering into a similar arrangement with respect to its smaller German pension liabilities in the next few months. I have discussed these arrangements further in paragraphs 2.10.21 to 2.10.24 of this executive summary.

2.1.11. USAA Staff have told me that there are no alternative plans in place if the Transfer does not proceed. If this scenario arises, USAA Staff have told me that USAA LTD will continue to administer policies and pay claims in respect of its UK Business. For its EEA Business, USAA Staff have told me that they have concluded that it will not be lawful for USAA LTD to continue to pay claims without it being properly authorised. It may therefore need to apply for third country branch authorisation for its German branch or permission to run off the claims liabilities for its EEA Business through its German branch. In my opinion, while this appears to be the most straightforward approach for USAA LTD to adopt, it cannot be assumed that this permission will be obtained.

2.1.12. Should this approach (of USAA LTD paying EEA claims via an authorised third country German branch) not be permissible, USAA Staff have told me that USAA LTD intends to establish an authorised third country branch in each of the jurisdictions in which it has outstanding claims[3]. These countries are: Belgium, France, Germany, Greece, Italy, the Netherlands, Portugal (including the Azores) and Spain.

2.1.13. Table 1 shows the number of open claims and the corresponding case estimates as at 30 June 2022 held for each country for which USAA LTD has open claims.

Table 1 USAA LTD - Open claims as at 30 June 2022

Country	Number of open claims files	Outstanding claims reserves US$m[4]
UK	1,650	36
Germany	53	18
Italy	87	2
Belgium	7	0.3
Netherlands	2	0.1
Spain	2	<0.1
Other countries	0	Nil

2.2. Description of the Parties

2.2.1. USAA LTD wrote a mixture of motor, property and general liability business for individual consumers (being US military service personnel stationed in Europe). It wrote business across the EEA until 31 December 2018 and in the UK until 31 March 2022. Until it ceased to do so, EEA Business was written from the UK under USAA LTD's Freedom of Services rights. Claims in respect of its EEA Business are administered through its branch office in Germany, operating under USAA LTD's Freedom of Establishment rights.

2.2.2. USAA SA underwrites the same lines of business as USAA LTD. It commenced underwriting EEA Business on 1 January 2019 and UK Business (via its UK branch) on 1 April 2022. USAA SA's UK branch was approved by the PRA on 28 January 2022.

2.2.3. USAA LTD's and USAA SA's portfolios cover members, including their families, who are current and retired US military service personnel. As such, all business underwritten is consumer business. USAA's policyholders insure with the Parties when they are on a tour of duty (typically lasting for three years) in the UK or EEA or are stationed here on a long-term basis.

2.2.4. For both companies, the most material line of business is motor third-party liability, which comprises 95% of USAA LTD's Reserves gross of reinsurance and 77% of USAA SA's Reserves as at 31 December 2021.

2.3. Scope of Report and Approach

2.3.1. The scope of this Report is to consider and set out my findings on the following four matters:

- The financial impact of the Transfer on the Affected Policyholders.
- The non-financial impact of the Transfer on the Affected Policyholders.
- The impact of the Transfer on the reinsurers of the Transferring Policies.

[3] Unless it is otherwise permitted or has reached an agreement with the relevant regulator to continue to settle these claims.

[4] Note that these have been converted for reporting purposes using £1 = US$1.2319.

- The approach adopted by the Parties to the notification of Affected Policyholders and reinsurers of the Transferring Policies of the Scheme and the proposed publicity arrangements surrounding the Transfer.

2.3.2. In describing the impact of the Transfer on the Affected Policyholders, I have highlighted those matters that I consider **material**. These are matters that have, or would have, led me to change my conclusions regarding the Transfer's effects. Throughout the Report, I have sought to provide context and set out my rationale for such judgements.

2.3.3. To consider the financial effects of the Transfer at the Transfer Date, I have looked at the latest audited balance sheets for pre-Transfer USAA LTD and USAA SA as at 31 December 2021. I anticipate updating the Court in a Supplemental Report regarding any changes arising in the financial position of the Parties during 2022 that I become aware of closer to the Transfer Date.

2.3.4. The Parties' balance sheets as at 31 December 2021 that I have used for my analysis are shown in Appendix E.6. These are presented on an *as-if* basis to show the effects of the Transfer were it to have taken place on 31 December 2021. In practice, because USAA LTD is in run-off and its business is renewing into USAA SA there will be changes by the Transfer Date to the pre-Transfer position of both of the Parties from their position at this date, with the Reserves of USAA LTD reducing and those of USAA SA increasing. Despite this, I still believe that I can use these balance sheets to inform my conclusions because:

- The post-Transfer position of USAA SA will be unchanged by this effect; and
- The pre-Transfer net assets of the Parties are not expected to change materially prior to the Transfer.

2.3.5. To assess the **financial impact** of the Transfer on the Affected Policyholders, I have carried out the following analyses:

TECHNICAL PROVISIONS

- Reviewed the Parties' Technical Provisions (and the process for determining them) as at 31 December 2021, the date of their most recent audited accounts. The Technical Provisions are the largest or one of the largest items, and the source of most uncertainty, on an insurer's balance sheet.

BALANCE SHEETS AND FINANCIAL RESOURCES

- Reviewed the actual 31 December 2021 balance sheets of USAA LTD and USAA SA on both a GAAP accounting basis and a Solvency II basis, in order to understand their financial resources pre-Transfer.

CAPITAL REQUIREMENTS AND FINANCIAL RESOURCES

- Considered the projected regulatory capital calculations for the Parties. In addition to reviewing the calculations, I have performed additional tests to satisfy myself that the regulatory capital is an appropriate measure of the risks facing each company for the purpose of considering the Transfer.
- Compared the risks, capital requirements and available financial resources of each of the Parties both before and after the Transfer. This review is to: (i) confirm that the Parties will hold sufficient financial resources to exceed their regulatory capital requirements; and (ii) compare the financial strength of the Parties before and after the Transfer. This comparison is to identify whether (and why) any of the Affected Policyholders are in a company post-Transfer with a materially lower Solvency Ratio than their existing position.

- Considered whether a significant reduction in the Solvency Ratio indicates a corresponding increase in the probability of the Affected Policyholders' insurer becoming insolvent. In doing so, where the Solvency Ratio remains very high (typically well in excess of regulatory requirements and the firm's capital risk appetite) I do not consider such a reduction in Solvency Ratio to be material. Usually in such circumstances, the firm would be permitted to release this excess capital by way of a dividend and the risk presented to policyholders by this reduction is not one that I would consider to be real or significant.
- Considered, in light of their respective business plans and capital management policies, the impact of the Transfer on the capital requirements and financial resources of the Parties over a longer time horizon.

2.3.6. To review the **non-financial** impact of the Transfer on the Affected Policyholders, I have looked at how the Transfer will affect matters including differences in the ways in which the Parties are managed and policies are administered, and changes in the legal and regulatory protections provided to policyholders. I have also looked at the question of which governing laws apply to the policies of the Transferring Policyholders, in order to understand the risk that the Transfer may not be recognised under some of them.

2.3.7. To review the **impact on reinsurers** of the Transferring Policies, I have considered how the Scheme treats reinsurance policies, and whether differences between the Parties before and after the Transfer could affect the level of claims arising under reinsurance policies being transferred.

2.3.8. To review **notification and publicity arrangements**, I have considered whether the proposed communications strategy for the Scheme is appropriate for the relevant policyholders and reinsurers and I have given my opinion on the waivers being sought by the Parties from the requirements of FSMA 2000.

2.3.9. In my analysis, I have not sought to compare the position of the EEA Transferring Policyholders post-Transfer with a scenario that could arise if the Transfer did not take place and the Transferor were then unable to continue to administer all of their EEA Business and settle associated claims. The reason for my setting a comparison with this scenario to one side[5] is because:

- It might be possible to conclude that potentially quite disadvantageous arrangements for the Transferring Policyholders post-Transfer were preferable to a situation under which their claims could not lawfully be settled by the Transferor; and
- USAA Staff have told me that were such a scenario to arise, the Transferor would be likely to develop alternative plans to enable them lawfully to continue to administer policies and settle claims for their EEA Business.

2.3.10. Notwithstanding my observation in the previous paragraph, I note that the Transfer is being primarily carried out in response to Brexit and the detriment that would arise to the EEA Transferring Policyholders were it not to proceed.

2.4. Ukraine-Russia conflict

2.4.1. On 24 February 2022, Russia launched a full-scale invasion of Ukraine[6]. Following the invasion, the United Kingdom, European Union, United States, Australia, Canada and Japan announced punitive sanctions and export controls. These included blocking-sanctions on significant Russian financial institutions and members of Russia's government and elite and trading restrictions on Russia's sovereign debt. The sanctions not only apply to direct payments to named individuals or

[5] Other than noting that the Transfer removes the regulatory risks associated with Brexit for the Transferor.
[6] https://en.wikipedia.org/wiki/2022_Russian_invasion_of_Ukraine

entities, but also apply to any payments or financial services that would lead to a benefit to these parties. Payments of (re)insurance claims are therefore covered by the sanctions.

2.4.2. USAA Staff have confirmed to me that the Parties have undertaken a careful examination of underwriting and claims exposures to sanctioned individuals and entities. They have not identified any exposures. While USAA Staff believe it is too early to evaluate all of the possible scenarios arising from the invasion from an investment risk perspective, USAA Staff have told me that the Boards of the Parties remain confident that the Parties' future performance should not be materially impacted.

2.4.3. At the time of finalising this Report, the conflict in Ukraine is ongoing and there remains considerable uncertainty regarding its long-term consequences. USAA Staff have confirmed to me that they do not currently expect significant changes in their exposure if troop deployments escalate as a result of this conflict. Clearly this position has scope to change, and in this regard I note the recent announcement by the US Department of Defense on 29 June 2022[7]. I have been told by USAA Staff that their understanding is that at this point in time, briefings by US military leaders have stated that these additional forces will almost entirely be deployed from US bases rather than representing an increase in permanent European-based forces who would need coverage from the Parties.

2.4.4. I have considered in my quantitative analysis in Section 11 the impact of any significant change in US military personnel deployment in Europe, however, I do not believe it affects my conclusions regarding the Transfer because:

- The cover provided by USAA SA to its policyholders is in respect of their activities when not engaged in military activities. As such, any short-term increase in US military personnel in response to an urgent military requirement will not result in a corresponding increase in demand for insurance from USAA SA.
- Were a longer-term increase in military personnel to arise, USAA Staff have told me that USAA would deploy capital to USAA SA to enable it to increase its underwriting capacity as required.

2.4.5. More generally, I do not believe that ongoing wider uncertainties arising from the conflict will affect one of the Parties more than the other. As a result, I do not believe that the ongoing conflict affects my conclusions regarding the Transfer.

2.4.6. *I have concluded that the Ukraine-Russia conflict does not change my conclusions regarding the Transfer.*

2.4.7. I will update the Court in my Supplemental Report should there be any material change in my assessment of the effects of the Ukraine-Russia conflict on my conclusions regarding the Transfer.

2.5. COVID-19 pandemic

2.5.1. The COVID-19 pandemic has been a significant event leading to wide-ranging effects on the insurance industry. Although there remains significant uncertainty surrounding the long-term financial implications of the COVID-19 pandemic I do not believe it affects my conclusions regarding the Transfer because:

- Neither of the Parties has been materially adversely financially affected by the pandemic either in terms of increased insurance losses or investment exposures.

[7] https://www.defense.gov/News/News-Stories/Article/Article/3078087/biden-announces-changes-in-us-force-posture-in-europe/

- I do not believe that ongoing wider uncertainties arising from the pandemic will affect one of the Parties more than the other.

2.5.2. *The COVID-19 pandemic information available to me at the time of writing this Report has not led me to change my conclusions regarding the Transfer.*

2.5.3. I will update the Court in my Supplemental Report should there be any material change in my assessment of the effects of the pandemic on my conclusions regarding the Transfer.

2.6. Recent Increases in Price inflation and changes to Foreign Exchange Rates

2.6.1. Since the start of 2022, price inflation has surged across western advanced economies, including the UK, countries in the EEA and the United States. This was the end of a long period of low and stable price inflation for many western advanced economies. For instance, the Consumer Price Index (CPI) in the UK rose by 7.0% in the 12 months to March 2022, the highest rate in 30 years. Drivers of this surge in inflation include the Ukraine-Russia conflict, rising energy prices, the COVID-19 pandemic and supply chain disruptions.

2.6.2. Overall, I expect that increases in price inflation are likely to increase insurance claims inflation too, but the extent of this effect depends on the type of insurance and specifics of the claims. Due to long periods of lower inflation in recent history, reserves estimated by standard actuarial methods would require adjustments to reflect any expected increases in claims inflation.

2.6.3. Increase in price inflation could also have a knock-on impact on bond yields and risk-free interest rates to discount Technical Provisions, potentially affecting an insurer's balance sheets for both assets and liabilities.

2.6.4. The balance sheets and SCR calculations for the Parties were both estimated before this recent surge in price inflation. In my sensitivity and scenario tests in Section 11 I have taken account of the potential impact on the Parties of higher levels of future claims inflation.

2.6.5. During 2022, the US Dollar has strengthened relative to both the British Pound and the Euro. As the Parties' premiums are payable in US Dollars but the claims and some expenses are payable in Pounds and Euros, it has exposure to fluctuations in the US Dollar. While I believe that the strengthening in the US Dollar is favourable to the financial position of the Parties, I anticipate reviewing the overall effect of this on my conclusions in my Supplemental Report.

2.6.6. *Increases in price inflation, the strength of the US Dollar and uncertainty over future inflation levels have not caused me to change my conclusions regarding the Transfer.*

2.6.7. I will update the Court in my Supplemental Report should there be any material change in my assessment of the effects of recent higher price inflation or foreign exchange rates on my conclusions regarding the Transfer.

2.7. Climate change-related risks

2.7.1. Climate change-related risks are an important area of emerging risk for the insurance industry. While these are important, I do not believe that risks associated with climate change affect my conclusions regarding the Transfer because:

- Neither of the Parties has identified any specific material exposures to climate change related risks that could affect their solvency; and
- I do not believe that either one of the Parties has materially different exposure to such risks to the other.

2.7.2. *Uncertainty relating to climate change does not affect my conclusions regarding the Transfer.*

2.8. Key Metrics of the Parties

2.8.1. Table 2 and Table 3 set out some key metrics for USAA LTD and USAA SA respectively pre- and post-Transfer as at 31 December 2021. These are presented on an "as-if" basis, assuming that the Transfer had happened on that date. They therefore do not, except where indicated, allow for profits or loss arising during 2022.

2.8.2. The tables additionally show (in the central two columns) the impact of the pre-Transfer movement of EOF from USAA LTD to USAA SA described in paragraph 2.1.7[8].

2.8.3. This presentation of the key metrics shows the likely progression for each of the Parties from the end of 2021 to the ultimate position once the Transfer is completed and USAA LTD has been wound up.

2.8.4. The net assets and EOF of the Parties are assumed to remain unchanged by the Transfer. The second order effects of the change in excess EOF have not been allowed for in the SCR shown in this table, nor has any allowance been made for the impacts of taxation. I do not believe that either simplification will affect my conclusions regarding the Transfer, but will confirm this in my Supplemental Report.

Table 2 Key metrics pre- and post-Transfer as at 31 December 2021 – USAA LTD – All amounts shown converted into Euros.

USAA LTD, €m				
	Year-end 2021 as-if	**Allowing for €35 million dividend and other adjustments[9]**		**Ultimate position**
	Pre-Transfer		**Post-Transfer**	
Total assets	152	102	42	-
Net assets	88	38	38	-
Net SII TPs	29	29	-	-
EOF	90	40	40	-
SF SCR	23	23	3.8	-
Solvency Ratio	384%	171%	1043%	-

Table 3 Key metrics pre- and post-Transfer as at 31 December – USAA SA

USAA SA, €m				
	Year-end 2021 as-if	**Allowing for €35 million injection and other adjustments[10]**		**Ultimate position[11]**
	Pre-Transfer		**Post-Transfer**	
Total assets	160	191	252	294
Net assets	66	97	97	135
Net SII TPs	36	36	66	66
EOF	62	93	93	133
SF SCR	36	36	54	54
Solvency Ratio	169%	256%	173%	246%

2.8.5. The post-Transfer SCRs for USAA SA shown in Table 3 are expected to be slightly higher than the amounts shown. This is because the net assets injected into SA will be predominantly in Sterling

[8] Note that Table 2 shows amounts for USAA LTD converted into Euros.

[9] Other adjustments are (i) the £9.4m payment made by USAA LTD in respect of the buy-out of the UK pension scheme liabilities during the first half of 2022 and (ii) c.£3m of unrealised investment losses as at 30 June 2022.

[10] Other adjustments are c. €3.5m of unrealised investment losses as at 30 June 2022.

[11] Includes an allowance for the other adjustments noted in Footnote 9.

denominated bonds. Because the accounting currency of USAA SA is Euros and not Pounds (which is the case for USAA LTD) this increases the SCR because the formula used to calculate the SCR determines the currency risk component of the SCR by reference to a firm's accounting currency. The size of this increase will depend upon the actual amount of excess capital held by USAA SA but USAA Staff do not expect the Solvency Ratio of USAA SA to fall below 150% as a result of this effect. USAA Staff have told me that as the Sterling denominated bonds mature, the proceeds will be reinvested into Euro bonds and this effect will reduce.

2.8.6. I have not adjusted the SCR that I have used for USAA SA for this currency mismatch effect because:

- The actual size of the impact will depend upon the actual projected positions of USAA SA and the amount and currencies of the dividend and injection of capital;
- I am satisfied that the Solvency Ratio of USAA SA will remain above 150% over the period I have considered;
- This is a transitional effect that will dissipate once the Sterling bonds mature and the amounts are reinvested into Euro-denominated assets; and
- I consider the effect to be an artificial consequence of the Standard Formula SCR and does not give rise to a material adverse effect on the financial security of policyholders.

2.8.7. I anticipate reviewing the updated projections of the Parties' SCRs in my Supplemental Report.

2.8.8. These tables show that, comparing the year-end 2021 as-if position with the ultimate position:

- the Transferring Policyholders will be moving from a firm with a Solvency Ratio of 384% to one of 246%; and
- USAA SA's Existing Policyholders will benefit by having their Solvency Ratio increase from 169% to 246%.

2.8.9. Allowing for the effect of the pre-Transfer dividend of financial resources from USAA LTD and corresponding capital injection into USAA SA, shows that:

- the Transferring Policyholders will be moving from a firm with a Solvency Ratio of 171% to 173% and then ultimately to a firm with 246%; and
- USAA SA's Existing Policyholders will initially see a reduction in their Solvency Ratio from 256% to 173% before ultimately increasing to 246%.

2.8.10. This analysis shows that reductions in Solvency Ratio are expected to arise:

- For the Transferring Policyholders, comparing the year-end 2021 solvency ratio to its subsequent positions. I note that the reduction is caused by the payment of a dividend by USAA LTD and not as a result of the Transfer.
- For the Existing Policyholders, comparing the positions immediately pre- and post-Transfer. This reflects the fact that excess financial resources were placed in USAA SA in anticipation of the Transfer. These projections indicate that USAA SA's Solvency Ratio is expected to remain at more than double its regulatory capital requirement over this period.

2.8.11. As a result, even though there will be some reductions in the Solvency Ratio for the Affected Policyholders over the period I have analysed, I do not consider that these indicate a material adverse effect arising as a consequence of the Transfer.

2.8.12. In summary:

- Both of the Parties will maintain financial resources well in excess of their regulatory capital requirements, both pre- and post-Transfer.
- The Transferring Policyholders will move to a company with a lower Solvency Ratio, albeit not in my opinion materially less, compared to their position at year-end 2021. This change does not arise as a result of the Transfer, but as a result of the release of excess financial resources from USAA LTD.
- The Solvency Ratio of the insurer of the Existing Policyholders will ultimately increase relative to its current position. The Transfer will bring about a temporary reduction, however this reflects the injection of excess financial resources into USAA SA in anticipation of the Transfer.

2.9. Conclusions – Financial Impact of the Transfer on Affected Policyholders

2.9.1. Having reviewed the balance sheets of the Parties as at 31 December 2021, including the Technical Provisions, I have satisfied myself that they provide me with an appropriate basis with which to assess the Transfer. This review also helped me to identify some of the key risks affecting the Parties.

2.9.2. I have reviewed the approach taken by the Parties to calculate their current and projected capital requirements and their financial resources under the Solvency II prudential regulatory regime. Based on this I have concluded that the Standard Formula SCR provides a reasonable basis with which to compare the financial strength of the Parties.

2.9.3. I have also considered the medium-term position of both of the Parties. Based on these reviews, I have concluded that the Parties are projected to maintain financial resources in excess of their respective regulatory capital requirements.

2.9.4. I have performed some additional quantitative tests on the Parties. These have enabled me to satisfy myself regarding the:

- Robustness and reliability of my conclusions regarding the SCR and each firm's Solvency Ratio;
- Adequacy of the capital buffers set out in the capital risk appetites of the Parties; and
- Resilience of the Parties both pre- and post-Transfer to extreme stress tests.

2.9.5. These tests have showed that:

- There do not appear to be any material adverse financial effects arising from the Transfer; and
- The financial resources of the Parties are appropriate for the risks they face.

2.9.6. *Based on this analysis, I have concluded that the Transfer does not have a materially adverse effect on the Affected Policyholders.*

2.9.7. *The various tests performed have enabled me to be satisfied that the chance that either of the Parties will fail to meet legitimate policyholder claims is remote.*

2.9.8. *I expect to confirm in my Supplemental Report that this conclusion is unchanged as a result of new information made available to me in the intervening period.*

2.10. Conclusions – Non-Financial Impact of the Transfer on Affected Policyholders

GOVERNANCE, STRATEGY AND OPERATIONAL MATTERS

2.10.1. I have concluded that there will be no material changes or disruptions as a result of the Transfer, and no material differences between the Parties in respect of:

- The model for governance and internal control applied;
- The business strategy of the USAA Group or the manner in which this strategy is carried out by the Parties; and
- The manner in which policies are administered or claims are handled and other operational matters affecting the Affected Policyholders.

2.10.2. I have reached this conclusion because I have not identified in my investigations any material changes arising from the Transfer, or differences in the way in which USAA SA will operate compared to USAA LTD.

2.10.3. USAA Staff have told me that the same staff and third-party agents will be administering the Transferring Policies and handling their claims pre- and post-Transfer.

TREATMENT OF POLICYHOLDERS UNDER INSOLVENCY: WINDING-UP PRIORITIES AND SET-OFF RIGHTS

2.10.4. I have concluded there will be no material changes to winding-up priorities and set-off rights arising as a result of the Transfer. USAA Staff have confirmed to me that policyholders of a Luxembourg non-life insurer have priority on wind-up over non-secured creditors of the insurer as Luxembourg law provides protection in relation to the assets backing the Technical Provisions as discussed in paragraph 2.10.7 Under Luxembourg law, there is no difference in the treatment of UK, EEA or other policyholders.

POLICYHOLDER PROTECTION SCHEMES, COMPLAINT SCHEMES AND ELTO

2.10.5. I have concluded that EEA Transferring Policies should retain their existing protection that the FSCS currently provides to these policyholders. This is because these policies have all expired and the FSCS provides protection for claims arising out of insured events occurring before the Transfer. In the case of an expired policy, the insured event must necessarily have already occurred pre-Transfer. These policies therefore meet the requirements for coverage.

2.10.6. As USAA SA now has a UK branch and intends to continue to meet the supervisory requirements set out by the PRA to maintain it, UK Transferring Policyholders eligible to receive protection from the FSCS pre-Transfer will retain this protection.

2.10.7. USAA Staff have told me that under Luxembourg law, assets allocated by an insurer in respect of a non-life insurer's Technical Provisions are maintained separately on the balance sheet and are protected from other creditors of the insurer. These arrangements provide a degree of financial protection to policyholders, albeit in a form that differs significantly from that provided by the FSCS. For consumer policyholders the protection provided under the Luxembourg arrangements differs from, and in my opinion is more limited than, the protection provided by the FSCS. This is because the Luxembourg arrangements only provide protection up to the estimated value of the Technical Provisions rather than in respect of scenarios where the Technical Provisions prove to have been materially underestimated.

2.10.8. To the extent that Transferring Policyholders currently have their policies administered and claims handled by USAA employees located in the UK, they will continue to do so following the Transfer.

Such policyholders will therefore retain any pre-Transfer eligibility to access the Financial Ombudsman Service.

2.10.9. Despite this, I cannot rule out the possibility that there may be some EEA Transferring Policies where policyholders will lose eligibility to access the Financial Ombudsman Service. This is because it may only be possible to determine eligibility at the time at which a policyholder seeks to access the Financial Ombudsman Service. In practice, I do not believe that this will represent a material change to these policyholders because:

- USAA LTD has had very few cases referred to the Financial Ombudsman Service over the last six years (approximately one referral each year); and
- They may gain access to the ombudsman schemes in operation in Luxembourg in place of the Financial Ombudsman Service.

2.10.10. Therefore, I have concluded that there will be no material change in the protection and complaint schemes provided to policyholders as a result of the Transfer.

2.10.11. The Parties have not written any UK employers' liability business and are not listed in the ELTO directory of employers' liability insurers.

Supervisory authorisations and waivers, Prudential Supervision and Conduct Supervision

2.10.12. USAA Staff have told me that USAA SA has not identified any EEA licences or permissions required prior to the Transfer which are outstanding. Its UK branch was authorised by the PRA on 28 January 2022.

2.10.13. USAA SA's UK branch will be responsible for servicing UK policies and claims post-Transfer. While it is outside the scope of the Transfer, sales activities in respect of new business will be carried out by USAA SARL, acting as USAA SA's UK branch appointed representative for sales activities. USAA Staff have told me that USAA SARL will be applying for this UK appointed representative authorisation so that it can fulfil these sales activities post-Transfer. USAA Staff have told me that the Parties will confirm to the Court at the Sanctions hearing the status of this application and any contingency arrangements if required.

2.10.14. I have concluded that while there will be a change in the lead prudential supervisor of the insurer of the Transferring Policyholders (with the CAA replacing the PRA), I do not believe the effect will be material. I note that the UK Transferring Policyholders retain some prudential supervision from the PRA in respect of its authorisation and oversight of USAA SA's UK Branch.

2.10.15. Similarly, while there will be a change in the lead conduct supervisor for the insurer of the EEA Transferring Policyholders (with the CAA replacing the FCA), I do not consider this to be material. In addition, conduct supervision in local markets will remain unchanged. The FCA will remain responsible for conduct supervision of USAA SA's UK Branch.

Insurance law and Governing law considerations

2.10.16. I am not aware of any material differences between the way in which the EU-wide Solvency II insurance law was implemented in the UK and Luxembourg.

2.10.17. USAA Staff have carried out an exercise to analyse the governing law applicable to the Transferring Policies. They have not identified any policies which specify a governing law other than that of an EEA member state or English law.

2.10.18. I have not identified any scenario under which a Transferring Policyholder would rationally wish to challenge the validity of the Transfer.

2.10.19. Based on this, I am therefore satisfied that none of the Affected Policyholders will be disadvantaged as a result of the authorities in the member state of the governing law of the policy not recognising the Transfer.

Tax Effects of the Scheme

2.10.20. USAA Staff are in the process of calculating the tax liabilities that may arise as a result of the Transfer. I expect to provide an update relating to this in the Supplemental Report.

Pension funds and employee benefit plans

2.10.21. On 19 May 2022, USAA LTD agreed a price at which the entirety of its UK defined benefit pension scheme liabilities would be transferred to an external insurer. This involved a payment of £9.4 million to the insurer on top of the assets of the pension scheme. This transaction is expected to complete by 31 March 2023 and will take place regardless of whether the Transfer goes ahead. I have been told by USAA Staff that as a result there is limited residual uncertainty regarding these liabilities.

2.10.22. In respect of these pension liabilities, USAA Staff have told me that:

- In order to cater for this residual uncertainty and until a final amount is agreed with the external insurer, £5 million of financial resources will be retained by USAA LTD in addition to those that it must retain: (a) to meet its regulatory capital requirements post-Transfer and (b) to cover the expected costs associated with winding-up the company.
- USAA SA has provided a guarantee to USAA LTD's defined benefit pension scheme to cater for the event that USAA LTD is unable to fund any shortfall in the assets of its pension scheme.

2.10.23. USAA LTD anticipates agreeing on terms to enable a similar buy-out of the German pension scheme liabilities prior to the Transfer. This fully-funded pension scheme is considerably smaller than the UK scheme (relating to only five members of staff) and has estimated liabilities of less than €3 million. I will update the Court in the Supplemental Report regarding the arrangements that have been put in place regarding this German pension scheme but do not anticipate at this stage that it will cause me to change my conclusions regarding the Transfer.

2.10.24. I have not identified any other issues arising from the Transfer relating to pensions or other employee benefit plans that I consider necessary to highlight in this Report.

2.11. Conclusions – Impact of the Transfer on Reinsurers

2.11.1. The benefit of any outwards third-party reinsurance will transfer from USAA LTD to the UK branch of USAA SA with no change to the amounts payable under them. Stop loss reinsurance provided by USAA will not transfer because USAA SA already has a similar stop loss reinsurance policy. I have therefore concluded that there is unlikely to be any material impact on reinsurers arising from the Transfer.

2.12. Conclusions – Notification and publicity arrangements

2.12.1. The Parties are seeking a waiver from the notification requirements under FSMA 2000. They propose to send notification of the Transfer to the following groups:

- All Transferring Policyholders with an open claim, or with a potential claim circumstance notified on or after 1 August 2019;
- All Transferring Policyholders whose policy expired on or after 1 August 2019;
- All third-party claimants (or their legal representatives) with an open claim;
- All reinsurers (or their appointed brokers or agents) of Transferring Policies for which there is an open claim expected to result in a reinsurance recovery from the relevant policy;

- All reinsurers (or their appointed brokers or agents) of Transferring Policies for which the reinsurance policy incepted on or after 1 January 2017;
- The following key market bodies and associations: Association of British Insurers, Association of Personal Injury Lawyers, Forum of Insurance Lawyers, Ministry of Justice, and International Bar Association.

2.12.2. For the other Affected Policyholders, the Parties believe that writing to them would incur a disproportionate cost relative to the materiality of the change to their position.

2.12.3. A general waiver is therefore being sought from notifying all of the policyholders that they are required to notify under the FSMA 2000 because:

- The definition of policyholder under FSMA 2000, as described in the FSMA Order, is very broad;
- The Affected Policyholders will experience no change in terms of their policies or the way in which their claims are handled as a result of the Transfer. The same people will be handling claims pre- and post-Transfer.
- I have concluded that none of the Affected Policyholders will be materially adversely affected by the Transfer.
- It will be impossible for the Parties to identify all policyholders under the definition in the FSMA Order owing to the broad definition used, and in any case, the Parties cannot be certain of notifying them all owing to the possibility of human error and limitations in their computer records.

2.12.4. The Parties are seeking a waiver from notifying all reinsurers of Transferring Policies on the grounds that there is not expected to be any change to the reinsurance policies being transferred and the low likelihood of there being any reinsurance recoveries from reinsurers other than those whom they intend to notify. The Parties are intending to notify all reinsurers from the last six years together with those reinsurers from whom there are expected recoveries relating to open claims.

2.12.5. I have reviewed the arguments regarding the waivers sought regarding the policyholder communication plans and concluded that they are appropriate.

2.12.6. The Parties propose to publicise the Transfer by means of a notice in:

- The London, Edinburgh and Belfast Gazettes;
- Four UK, two US and one Luxembourg national daily newspapers; and
- One specialist publication for US military service personnel.

2.12.7. In addition, they intend to publicise the Transfer on the USAA website, and on USAA member portals where policy documents and communications are provided to policyholders and former policyholders.

2.12.8. The Parties are seeking a waiver from the publicity requirements under FSMA 2000 on the grounds that all of the Affected Policyholders are English speakers and widespread publicity in non-English language newspapers would serve little purpose. Instead, they are proposing to make use of advertising in an increased number of English-language newspapers and a specialist publication read by Affected Policyholders.

2.12.9. I have reviewed these arguments regarding the waivers sought regarding publicity surrounding the Transfer and concluded that they are appropriate.

2.13. Conclusions – Summary

2.13.1. I have concluded that the Transfer will not have a materially adverse impact on the financial position of the Affected Policyholders.

2.13.2. I have concluded that the Transfer will not have a materially adverse impact on the non-financial position of the Affected Policyholders.

2.13.3. I have concluded that the Transfer will not have a material impact on reinsurers of the Transferring Policies.

2.13.4. I have concluded that the notification and publicity arrangements for the Transfer are appropriate.

2.14. Important Limitations

2.14.1. My role as Independent Expert is not to provide an independent estimate of the Technical Provisions or the capital requirements of the Parties, nor should this Report be considered an audit or validation of the accounts, financial statements, financial projections or capital calculations of the Parties. This Report should therefore not be used for any of these purposes.

2.14.2. While I have satisfied myself that the projected financial position and balance sheets of the Parties included in this Report provide a suitable basis upon which I can form my conclusions, readers of this Report are warned that the actual position at the Transfer Date may differ. Such differences may be material and could arise as a result of emerging claims experience, changing business plans or the timing of cashflows differing from those assumed. The purpose of their inclusion is solely to help readers of this Report understand the Transfer and its anticipated effect on the Parties.

2.14.3. Insurance companies are exposed to a wide range of risks which can lead to failure. This Report does not provide any form of guarantee against the failure of any of the companies considered in it. It is particularly important that readers of this Report recognise this in the context of the current COVID-19 pandemic and the Ukraine-Russia conflict and any increased economic uncertainty associated with them. The pandemic is an unprecedented event facing the modern insurance industry and at the time of writing there remain many gaps in scientific knowledge, and considerable uncertainty over the consequences of the economic and political responses to the pandemic adopted in many countries.

2.14.4. My work is not an audit of any of the companies considered and should not be taken as providing any form of audit assurance.

2.14.5. This Report should not be taken as providing any form of investment advice relating to any of the companies considered.

2.14.6. This Report does not provide a legal opinion on the effectiveness of the Scheme or the Transfer.

2.14.7. My opinion relates to the totality of the position of each of the Parties, their ability to meet policyholder claims as they fall due and the comparative position of the Affected Policyholders as a result of the Transfer.

2.14.8. Other more general limitations and assumptions are set out in Appendix E.2.

2.15. Expert's declaration

2.15.1. I confirm that I fully understand my overriding duty to the Court and that I must help the Court on matters within my expertise. My duty to the Court overrides any obligation to those from whom I have received instructions or by whom I am paid. I believe that I have complied, and will continue to comply, with this duty.

2.15.2. I confirm that I am aware of the requirements of Part 35 and Practice Direction 35 of the Civil Procedure Rules, and the Guidance for the Instruction of Experts in Civil Claims 2014.

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

Alex Marcuson

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Alex Marcuson MA FIA 19 July 2022

B. Overview of the Transfer

3. Description of the Transfer and the Transferring Policyholders

3.1. Introduction

3.1.1. This part of my Report (Part B) provides more detail regarding the Transfer. It contains the following elements:

- Section 3 (this Section) provides a detailed description of the Transfer and the Transferring Policyholders.
- Section 4 provides a description of each of the companies within the USAA Group that are relevant to my consideration of the effects of the Transfer. It does not provide an in-depth review of any of them, as this is reserved for my analysis in Part C.
- Section 5 provides additional description and supporting explanation for the approach I have adopted, including how I have segmented the Affected Policyholders and where I have placed reliance on USAA Staff.

3.1.2. In this Section, the elements covered are:

- Purpose of the Transfer;
- Description of the Transfer;
- Subsequent plans;
- The Transferring Policyholders;
- Transferring branches, Licences and Service Companies;
- Reinsurance;
- Alternative arrangements should the Transfer not go ahead; and
- Policy administration and claims handling.

3.2. Purpose of the Transfer

3.2.1. The Parties and USAA Group are primarily carrying out this Transfer in response to Brexit. The EEA Transferring Policies are a portfolio of run-off business which, prior to the withdrawal of the UK from the European Union and the subsequent loss of passporting rights, was being run off by the Transferor handling claims through its branch in Germany.

3.2.2. This portfolio is being transferred to USAA SA in order to provide certainty that the Transferring Policies can be administered and claims settled post-Brexit in an EEA-domiciled insurance company with the required licences and authorisations.

3.2.3. Additionally, rather than maintain two European insurance companies the USAA Group believes that it will be more efficient and cost-effective to continue its UK insurance underwriting activities via a branch of USAA SA. Therefore, it has established a UK Branch of USAA SA which started writing UK Business on 1 April 2022. All UK Business since that date is renewing into the UK Branch. The Parties are therefore planning to transfer the UK Transferring Policies to the UK Branch of USAA SA. Following the Transfer, USAA intends to wind up USAA LTD[12].

3.3. Description of the Transfer

3.3.1. The Transfer will bring about an internal reorganisation of the assets and liabilities within USAA Group.

[12] Once the buy-out of USAA LTD's defined benefit pension scheme has completed and its insurance authorisation has been withdrawn.

3.3.2. The Transfer comprises the transfer from USAA LTD to USAA SA of all policies of USAA LTD. This comprises:

- UK Business, that was written by USAA LTD and incepted prior to 1 April 2022. These policies will transfer to the UK Branch of USAA SA.
- EEA Business, that includes elements written by USAA LTD on a Freedom of Services basis in EEA member states and for which claims are administered via USAA LTD's German Branch, operating on a Freedom of Establishment basis. These policies all incepted prior to 1 January 2019.

3.3.3. The Transfer will move the assets and liabilities associated with the Transferring Policies. The cash and investments to be transferred will be determined closer to the Transfer Date, such that there will be nil (or approximately nil) change to the GAAP net assets of the Parties. Once USAA LTD has been wound up, its remaining net assets will be invested in USAA SA following a dividend payment to USAA SARL.

3.4. Subsequent Plans

3.4.1. USAA Staff have told me about their wider restructuring plans after the Transfer. Future plans include:

- The deauthorisation and wind-up of USAA LTD once all of its liabilities are extinguished. Prior to its being wound up, USAA LTD intends to complete the transfer of its UK defined benefit pension liabilities to an external insurer. Pursuant to the contract agreed between the pension scheme trustees and the external insurer dated 10 May 2022, the final amount payable under that contract is expected to be determined by 31 March 2023. Similarly, for its German defined benefit pension liabilities, USAA LTD anticipates entering into a similar buy-out prior to the Transfer Date.
- The proposed unwinding of the outsourcing by USAA LTD of certain services to USAA SARL. This will involve the closure of USAA SARL's German branch and the subsequent transfer (expected to take place during 2023) of employees of USAA SARL engaged in the administration of the UK Transferring Policies to USAA SA.
- Inverting the ownership structure of the USAA Group within Europe, such that USAA SA becomes the top company in Europe and USAA SARL moves one tier down to become a wholly-owned subsidiary of USAA SA.

3.4.2. These plans do not have any material bearing on my conclusions because:

- The intention to deauthorise USAA LTD and wind it up is a natural consequence of the Transfer, as the insurance company is no longer required;
- The pension scheme buy-out is on fixed agreed terms[13] with a reputable insurance company; and
- The change in ownership structure is not contingent upon the Transfer and has no bearing on my conclusions regarding the Transfer.

3.4.3. I am not aware of any other plans following the Transfer that would have any material bearing on my conclusions.

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[13] There is a limited amount of residual uncertainty, as discussed in Section 13.10, but this does not affect my conclusions for the reasons given there.

3.5. The Transferring Policyholders

3.5.1. The Transferring Policyholders[14] are:

- Any and all direct insurance policyholders[15] holding direct policies written by USAA LTD incepting before 1 January 2019 and comprising risks situated in EEA member states.
- Any and all direct insurance policyholders[16] holding direct policies written by USAA LTD incepting before 1 April 2022 and comprising risks situated in the UK.

3.5.2. None of the Transferring Policies incepted on or after 1 April 2022.

3.5.3. The EEA Transferring Policyholders include risks written in the following countries: Belgium, France, Germany, Greece, Italy, the Netherlands, Portugal (including the Azores) and Spain.

3.5.4. I have been told by USAA Staff that it has not been possible to determine the total number of Transferring Policies from each EEA member state. This is because USAA LTD has operated in Europe since 1962, providing insurance to large numbers of US military service personnel stationed in the UK and Europe since then. During its earlier years of operation, the EEA state within which a risk was located was not recorded on its operational computer records. Owing to changes in its IT systems, USAA Staff have only been able to identify the EEA state within which a risk was located for Notified Policies[17]. Notified Policies are those for which there is an open claim, an unresolved claim notification arising on or after 1 August 2019, a policy that has an unexpired period of cover at the Transfer Date, or a policy that expired on or after 1 August 2019.

3.5.5. To provide an indication of the approximate make-up of the Transferring Policies, Table 4 shows the total number of policies underwritten between 2016 and 2021 inclusive. Table 5 shows the total number of policies underwritten by both USAA LTD and USAA SA split by Country for policies underwritten from 2019 onwards.

Table 4 - Number of Transferring Policies underwritten by USAA LTD between 2016 and 2021 inclusive (all countries)

Underwriting Year	Number of Policies
2016	58,740
2017	55,848
2018	55,313
Total 2016-2018	**169,901**
2019	10,169
2020	8,995
2021	10,547
Total 2016-2021	**199,612**

[14] Excluding any Excluded or Residual Policyholders as defined in the Scheme, although there are not expected to be any of these.
[15] Using the meaning of policyholder given by the FSMA Order.
[16] Using the meaning of policyholder given by the FSMA Order.
[17] Excluding its Valuable Personal Property portfolio, for which data in 2019 was unavailable split by country. These policies have been estimated in Table 4 to fall in the same proportion by country as in 2020.

Table 5 - Number of Policies underwritten by USAA LTD and USAA SA between 2019 and 2021 inclusive

Country	Number	%
Belgium	3,429	2%
France	781	1%
Germany	83,462	53%
Greece	927	1%
Italy	28,657	18%
The Netherlands	1,923	1%
Portugal (including the Azores)	1,240	1%
Spain	5,925	4%
Total EEA member states	**126,344**	**81%**
United Kingdom	29,711	19%
Total EEA and UK	**156,055**	**100%**

3.5.6. Table 4 and Table 5 show that, there are estimated to be just under 200,000 Transferring Policyholders for the period 2016-2021 inclusive. Assuming a stable mix between the UK and EEA member states over this period, approximately 20% of those from 2016 to 2018 were UK policies and 100% of those from 2019 to 2021 were UK policies.

3.5.7. All of the Transferring Policyholders are individual consumers.

3.5.8. At the time of writing no Excluded Policies have been listed in the Scheme.

3.5.9. At the time of writing no Residual Policies have been identified.

3.5.10. USAA Staff have estimated that there are approximately 30,000 Transferring Policyholders who hold Notified Policies. Notified Policies are those for which, as at 1 August 2022, there is an open claim, an unresolved claim notification arising on or after 1 August 2019, a policy that has an unexpired period of cover at the Transfer Date, or a policy that expired on or after 1 August 2019. USAA Staff have told me that they will confirm the number of Notified Policies for my inclusion in the Supplemental Report.

3.5.11. As I describe in Section 14.2 of this Report, these Notified Policyholders are the policyholders that the Parties propose to notify of the Transfer. With underwriting dating back to 1962 and typical military tours of duty lasting for three years, the actual number of Transferring Policyholders is likely to be considerably greater than 30,000 or the total figure shown in Table 4.

3.6. Transferring branches, Licences and Service Companies

3.6.1. No branches, licences or service companies are being transferred under the Transfer.

3.7. Reinsurance

3.7.1. Under the Scheme, all of the rights, benefits and powers of USAA LTD under inuring outwards excess of loss reinsurance contracts will be transferred to USAA SA.

3.7.2. USAA LTD's stop loss reinsurance will not be part of the Transfer, and, up until USAA LTD is wound up or the stop loss agreement is terminated, USAA LTD will continue to benefit from the stop loss reinsurance protection.

3.8. Alternative arrangements should the Transfer not go ahead

3.8.1. Should the Transfer not proceed, USAA Staff have told me that the present intention is that the liabilities associated with the Transferring Policies will continue to be run off by USAA LTD. USAA SA will continue to underwrite new and renewal business within the EEA and its UK branch will continue to underwrite new and renewal business within the UK.

3.8.2. Under such a scenario, at some point in time USAA LTD may no longer be legally permitted to settle claims for some European risks. Therefore, if the Transfer does not proceed, USAA Staff have told me that USAA LTD may therefore need to apply for third country branch authorisation for its German branch or permission to run off the claims liabilities for its EEA Business through its German branch. In my opinion, while this appears to be the most straightforward approach for USAA LTD to adopt, it cannot be assumed that this permission will be obtained.

3.8.3. Should this approach (of USAA LTD paying EEA claims via an authorised third country German branch) not be permissible, USAA Staff have told me that USAA LTD will seek to establish an authorised third country branch in each of the jurisdictions in which it has outstanding claims[18]. These countries are: Belgium, France, Germany, Greece, Italy, the Netherlands, Portugal (including the Azores) and Spain. In my opinion, this is an appropriate fall-back contingency plan.

3.9. Policy administration, staffing and claims handling

3.9.1. Staff based in the UK carrying out work on the Transferring Policies are employed by USAA SARL, an insurance holding company with outsourcing arrangements with both USAA LTD and USAA SA. Staff based in the EEA carrying out work on the Transferring Policies are employed by USAA SARL or USAA SA.

3.9.2. The result of these arrangements will be that the Transferring Policies are administered and claims settled in the same manner by USAA SARL and/or USAA SA as pre-Transfer, but with the relevant regulated activities being deemed to be conducted on behalf of USAA SA post-Transfer in place of USAA LTD.

3.9.3. USAA Staff have told me that no changes to policy and claims arrangements relating to the Transferring Policies are therefore anticipated to be required as a result of the Transfer. This has been confirmed in the Witness Statement.

3.9.4. Accordingly, my understanding of the proposed arrangements is that the same people (whether USAA Staff or external providers of services to the USAA Group) will continue to perform the same tasks relating to the Transferring Policies after the Transfer as before the Transfer.

3.9.5. While it is outside the scope of the Transfer, sales activities in respect of new business will be carried out by USAA SARL, acting as USAA SA's UK branch appointed representative for sales activities. USAA Staff have told me that USAA SARL will be applying for this UK appointed representative authorisation so that it can fulfil these sales activities post-Transfer. USAA Staff have told me that the Parties will confirm to the Court at the Sanctions hearing the status of this application and any contingency arrangements if required.

3.9.6. USAA Staff have confirmed to me that other than the changes described here, which are necessary as a result of the Transfer or the subsequent changes described in Section 3.4, no changes to outsourcing arrangements and claims-handler staffing levels relating to the Transferring Policies are currently planned.

[18] Unless it is otherwise permitted or has reached an agreement with the relevant regulator to continue to settle these claims.

4. Description of the Companies

4.1. Introduction

4.1.1. This section describes the Parties, USAA LTD and USAA SA, together with USAA (including the wider USAA Group) and USAA SARL.

4.1.2. Section 7 contains my description of the insurance portfolios and review of each of the Parties' Technical Provisions, and Section 8 contains my review of their balance sheets.

4.2. United Services Automobile Association (USAA) and the USAA Group

4.2.1. The ultimate parent company for USAA LTD and USAA SA is USAA Group, a large mutual insurance company domiciled in the United States of America and headquartered in San Antonio, Texas. USAA was established in 1922. It is regulated by the Texas Department of Insurance which is also the regulator responsible for group supervision.

4.2.2. USAA provides a wide range of services to its members, including property and casualty insurance, life insurance, annuities, and banking services. Members consist of active and retired US Military personnel and their dependents.

4.2.3. Members of the US Military often undertake international duties outside of the US with the average duration of these tours of duty being three years. As a result, USAA has established subsidiary operations in Europe and elsewhere around the world where the US has overseas military bases. These are to enable members stationed there to obtain appropriate consumer insurance policies. Owing to the specialist nature of the risks (for example, as a result of being expatriate citizens who are seeking insurance in markets that are primarily geared towards local consumers) and the ability of USAA to provide them with convenient product access, USAA seeks to provide products to members that are closely aligned to members' specific needs.

4.2.4. USAA has a financial strength rating from S&P of A++ with a stable outlook. Table 6 contains key financials from USAA's Report to Members.

Table 6 USAA Group key financials as at 31 December 2020, $ billion

P&L		Balance sheet	
Net earned premium	25.4	Net assets	200.3
Net profits after tax	6.1	Net Insurance Reserves	29.9

Source: Report to Members, 2020 year-end

4.2.5. Figure 1 (on page 8) contains a simplified group structure chart setting out where the companies mentioned in this Report lie within the USAA Group. This shows that all of the companies that I refer to in this Report are indirect wholly-owned subsidiaries of USAA.

4.2.6. USAA reinsures each of USAA LTD and USAA SA separately under an annual aggregate stop loss reinsurance agreement. The stop loss protects each of USAA LTD and USAA SA from incurring operational losses (i.e. after allowing for claims, reinsurance costs and underwriting and loss adjustment expenses) above £0.5 million and €1 million respectively, up to a limit of £25 million and €25 million.

4.3. USAA Limited (USAA LTD)

4.3.1. USAA LTD is an insurance company, domiciled in the United Kingdom and incorporated in 1962. It is a wholly owned indirect subsidiary of USAA. It is authorised by the PRA to write insurance business and is regulated by the PRA and FCA. It underwrites four insurance products: Auto Insurance, Renters' Insurance, Valuable Personal Property Insurance and Umbrella Insurance.

4.3.2. USAA LTD's business is to underwrite the risks of US military service personnel based in the UK and the EEA as described in paragraph 4.2.3. Its most material line of business is its motor insurance product (i.e. Auto Insurance) with the majority of the remainder being its property insurance products (i.e. Renters Insurance and Valuable Personal Property Insurance).

4.3.3. Prior to 1 January 2019, USAA LTD wrote new and renewal business in the UK and the EEA. From 1 January 2019 to 31 March 2022, USAA LTD continued to write new and renewal business in the UK only and placed its EEA Business into run-off. From 1 April 2022, all of its business was placed into run-off.

4.3.4. Table 7 contains key financials from USAA LTD's statutory financial statements.

Table 7 USAA LTD key financials as at 31 December 2021, £ million

P&L		Balance sheet	
Net earned premium	14.8	Net assets	73.5
Net profits after tax	0.5	Net Technical Provisions	36.0

Source: Audited UK GAAP accounts 2021 year-end

4.3.5. More detail on USAA LTD's technical provisions is contained in Section 7, and on its balance sheet in Section 8.

4.3.6. USAA LTD operates two small defined-benefit pension schemes in the UK and in Germany. In its 2021 statutory accounts, USAA LTD discloses that the fair value of the UK scheme's assets is £28.9 million, the present value of its liabilities is £24.4 million, giving rise to a surplus of £4.5 million. The fair value of the German scheme's assets is €2.7 million, the present value of its liabilities is €2.6 million, giving rise to a surplus of €0.1 million. As discussed in Sections 3.2 and 13.10, USAA LTD is in the process of completing the transfer of its defined-benefit pension liabilities to the external insurer.

4.4. USAA S.A. (USAA SA)

4.4.1. USAA SA is an insurance company, domiciled in Luxembourg and incorporated in 2018. It is a wholly-owned indirect subsidiary of USAA. It is authorised and regulated by the CAA. It obtained authorisation on 1 January 2019 and began writing new business and renewing business previously underwritten by USAA LTD in respect of risks located in the EEA in Belgium, France, Germany, Greece, Italy, the Netherlands, Portugal (including the Azores) and Spain. It underwrites business in the same four classes of business as USAA LTD: Auto Insurance, Renters' Insurance, Valuable Personal Property Insurance and Umbrella Insurance.

4.4.2. USAA SA has permission to underwrite insurance business in Luxembourg and across the EEA on a Freedom of Services basis and has an EEA Claims branch in Germany through which it carries out administrative activities.

4.4.3. On 28 January 2022, the PRA authorised USAA SA's UK branch. On 1 April 2022, the branch began writing UK Business, comprising new business and renewal of UK Business previously underwritten by USAA LTD.

4.4.4. Table 8 contains key financials from USAA SA's statutory financial statements.

Table 8 USAA SA key financials as at 31 December 2021, € million

P&L		Balance sheet	
Net earned premium	77.1	Net assets	65.6
Net profits after tax	7.5	Net Technical Provisions	81.3

Source: Audited Lux GAAP accounts 2021 year-end

4.4.5. More detail on USAA SA's technical provisions is contained in Section 7, and on its balance sheet in Section 8.

4.4.6. USAA SA operates a small defined-benefit scheme for its employees in Germany, which is closed to new entrants. In its 2021 statutory accounts, USAA SA discloses that the fair value of the scheme's assets is €15.0 million and the present value of its liabilities is €14.9 million, giving rise to a surplus of €0.1 million.

4.5. USAA SARL

4.5.1. USAA SARL is a limited company incorporated and domiciled in Luxembourg. It is an active insurance holding intermediary and a wholly-owned subsidiary of USAA.

4.5.2. USAA SARL employs USAA Staff in the UK. It has delegated responsibility to perform insurance and operational activities on behalf of its subsidiary insurance companies, such as claims handling and policy administration. As stated in Section 3.4, it is intended to unwind this arrangement following the Transfer.

5. Approach – additional description

5.1. Introduction

5.1.1. This section provides additional description and supporting explanation for the approach I have adopted. It covers the following matters:

- Language and terminology used to describe concepts relating to risk and uncertainty;
- Measures of financial resources and capital requirements used in my analysis;
- Comparison criteria for financial effects of the Transfer;
- Comparison criteria for non-financial effects of the Transfer;
- Evaluation of the approach to communications relating to the Transfer;
- Segmentations of the Affected Policyholders used in my analysis;
- Reliance on data and information from USAA;
- Reliance on others; and
- Contact with regulators during my review.

5.2. Language and terminology

5.2.1. For both financial and non-financial aspects, the Transfer may improve the position of a group of Affected Policyholders in one way and worsen their position in another. Therefore, it is necessary for me to exercise my judgement to weigh up the positive and negative effects in order to determine whether the Transfer will have a "**materially adverse**" impact in aggregate on a group of Affected Policyholders. I consider the overall impact in each case to be materially adverse if the Transfer causes policyholders to be placed in a demonstrably worse position than currently[19]. While it will be for the Court to satisfy itself regarding whether the Transfer should proceed, where such effects arise, my aim is to bring these to the Court's attention. I have provided the rationale for my judgements and conclusions throughout the Report.

5.2.2. For some of the analysis relating to risk and uncertainty, the conclusions rely on judgements regarding scenarios that I consider to be "**remote"**. In a quantitative sense these are less likely than 1 outcome in every 200, potentially considerably less likely. Because of this, I do not consider their impact to be material. However, owing to the uncertainty inevitably associated with the assessment of such probabilities, I do not believe it is appropriate to use language that overstates the precision or reliability of such forecasts.

5.2.3. I therefore use the term "**unlikely**" to indicate that there remains a degree of residual uncertainty in my comparative measurement of non-payment of policyholder claims. While this is a subjective test, as a guide I have adopted a 5% chance as a suitable threshold of an outcome being something that I would consider for these purposes as "unlikely".

5.3. Measure of financial resources and capital requirements used in my analysis

5.3.1. I calculate financial resources and regulatory capital requirements of the entities considered using the approach established under Solvency II. I have adopted this approach because:

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[19] In using this approach, I have taken account of the ruling by the Court of Appeal in *Re The Prudential Assurance Company Ltd* that "An adverse effect will only be material to the court's consideration if it is: (i) a possibility that cannot sensibly be ignored having regard to the nature and gravity of the feared harm in the particular case, (ii) a consequence of the scheme, and (iii) material in the sense that there is the prospect of real or significant, as opposed to fanciful or insignificant, risk to the position of the stakeholder concerned. In some cases, it may also be relevant for the court to consider whether there would be such material adverse effects in the event that the scheme was not sanctioned."

- It seeks to value assets and liabilities consistently and, where possible, using a fair market value. The approach recognises that for some assets and liabilities, no market price exists and so an approach must be used that provides a value consistent with a market price.
- It has been adopted by all firms in the UK and across the European Union and therefore provides a consistent and widely recognised means of framing the financial strength of a firm using a risk-based measure tailored to the needs of insurance.
- The regulatory capital of the Parties has been calculated using a prescribed formulaic approach, the Standard Formula SCR.

5.3.2. The Solvency II prudential capital requirements have been set to target a high chance of companies being able to meet all policyholder claims, with a confidence level of 199 times out of every 200, or 99.5%, over a one-year period. In addition, to satisfy Solvency II Pillar 2 prudential requirements, companies have policies in place to ensure a certain buffer of capital is in place in excess of their regulatory minimum. The purpose of this buffer is to cover short term fluctuations in asset or liability values and to address the uncertainty inherent in some of the judgements made when establishing the prudential capital requirements.

5.3.3. Under Solvency II, companies use their ORSA to consider their position over a longer period and risks not captured in the scope of the Standard Formula SCR. As part of this, companies also present their medium-term capital plans which explain their approach to capital target levels and dividend strategy over the next 3 to 5 years.

5.4. Comparison Criteria – financial effects

5.4.1. My comparison of the effects of the Scheme comprises both a qualitative review of the changes brought about by the Scheme and quantitative testing of its effects.

5.4.2. The qualitative review (contained in Section 9) compares the risks that each segment of the Affected Policyholders faces before and after the Transfer and describes the main elements that change.

5.4.3. It also considers the overall size of the balance sheet and net assets of the Parties to the Transfer. This provides an indication of changes in the absolute size of adverse loss event that each company can withstand and hence whether the Affected Policyholders are materially adversely affected in terms of their financial security.

5.4.4. My quantitative testing is presented in Sections 10 and 11. The key measure used for this testing is the Solvency Ratio, the ratio of a company's financial resources to its capital requirements (this will normally be the firm's SCR). The Solvency Ratio provides an objective and generally recognised measure of the absolute financial strength of a company and a means of comparing companies' relative financial strength.

5.4.5. Interpreting the Solvency Ratio of an insurer requires taking into account the size and nature of its business. I would consider or describe a company with a Solvency Ratio below 100% as under-capitalised. If a company's Solvency Ratio falls below 100%, this would mean it is failing to meet its regulatory capital requirements.

5.4.6. In practice, for me to consider a company to be adequately-capitalised, it would need to hold a margin or buffer of capital in excess of a solvency ratio of 100%. This is to allow for:

- Short-term fluctuations in asset and liability values;
- The inherent uncertainty in valuing assets and liabilities;
- The range of reasonable assumptions and methods that might be used in quantifying the regulatory capital requirements of a firm; and

- The passage of time (in the context of a Part VII Transfer, between my review and the transfer date).

5.4.7. To test the target buffer that the Parties set for themselves under their respective capital risk appetites, I have performed a number of sensitivity tests in Section 11. This enables me to form a view as to the appropriateness of the margin and therefore whether the Parties to the Transfer will maintain a level of capital that is at least adequate. These tests also show whether the Transfer will lead to a material change in the size of the margin appropriate for each of the Parties.

5.4.8. In Section 11 I have also performed the following tests:

- Assessing how the Solvency Ratio changes for each of the Parties under a set of sensitivity tests and scenarios. The sensitivity tests address the main subjective elements within the Parties' balance sheets. The scenario tests address the main risks facing the Parties.
- Performing one or more Reverse Stress Tests on each of the Parties to understand the impact of the most severe types of scenario arising.

5.4.9. Considering and comparing the impact that each scenario has on the Solvency Ratio, together with assessing the Reverse Stress Tests and the respective capital risk appetites of the Parties, has helped me to form a view on:

- the reliability of the projected SCR calculations of each company to reach my conclusions; and
- the effects of the Transfer on the absolute and relative level of security that each company provides to the Affected Policyholders.

5.4.10. The Reverse Stress Tests also enable me to test extreme scenarios (notably one involving the run-off of reserves) that, in my view, are likely to manifest themselves over a number of years rather than over the one-year time horizon addressed by the Standard Formula. These scenarios fall outside the scope of the SCR and test the resilience of the excess financial resources of a firm.

5.5. Comparison Criteria – non-financial effects

5.5.1. The non-financial consequences of the Transfer are less clearly defined. In this Report I have considered the following elements, many of which relate to matters of conduct:

- Governance, strategy and operational matters;
- Policyholder priority on insolvency and winding-up and set-off rights;
- Policyholder protection schemes and policyholder complaints;
- Impact on reinsurers;
- Supervisory authorisations and waivers;
- Insurance law and governing law considerations;
- Tax effects of the Scheme; and
- Pension funds and employee benefit plans.

5.5.2. If needed, I also flag specific areas of concern relating to conduct risk and other relevant operational matters.

5.5.3. For these non-financial matters, I have indicated where my comparisons rely on my subjective judgements rather than what I consider to be a more straightforward interpretation of the facts. My conclusions for these non-financial topics make use of my general understanding of the issues based upon my experience working in the general insurance and reinsurance industry over a number of years.

5.6. Evaluation of approach to communications

5.6.1. I have looked at the approach proposed by the Parties to communicating details of the Transfer to the Affected Policyholders.

5.6.2. In doing so, I have looked at:

- The rationale for any waivers being sought from the Court by the Parties in respect of their obligations to notify all of the Affected Policyholders. This includes consideration of the reasons for excluding certain policyholders from communications and the way in which the Parties have identified them (including how policyholder segmentation has been carried out and other analysis in support of the waiver);
- The mode and content of communication proposed by the Parties to the policyholders they intend to notify of the Transfer;
- The suitability of arrangements put in place by the Parties to handle enquiries arising from the notified policyholders; and
- The suitability of the publicity and advertising arrangements proposed by the Parties given the nature of the Affected Policyholders.

5.6.3. I have also considered:

- The likelihood of those affected by waivers making a claim;
- The materiality of changes arising from the Transfer for those policyholders excluded from the notification exercise as a result of the waiver;
- The cost-saving from the waiver to the USAA Group versus the benefit to the policyholders excluded by the waiver; and
- Whether any arrangements have been proposed by the Parties to counterbalance the effect of the waiver (such as advertising at a greater level than the regulatory minimum required for the Transfer).

5.7. Segmentations of the Affected Policyholders used in my analysis

5.7.1. For my review, the principal segmentation of the Affected Policyholders that I have adopted is between:

- Transferring Policyholders; and
- Existing Policyholders.

5.7.2. This segmentation covers all of the policyholders of the Parties.

5.7.3. I considered but did not explicitly segment long-tail policyholders[20] and short-tail policyholders. As the name indicates, claims generally take more time to be reported and settled for long-tail business than for short-tail business. This means, for example, that these policyholders are exposed to risks that may emerge some time after the Transfer in addition to those that may arise in the short term. I did not use this additional segmentation as I concluded that the relative position of these segments will not be affected by the Transfer. Both of the Parties underwrite a mixture of long-tail and short-tail risks and so the Transfer does not give rise to a material change in this regard. In my scenario testing in Section 11 I have considered the ability of the Parties to withstand significant increases in reserves estimates over the expected run-off of the liabilities.

[20] Most notably German and Italian motor liability claims that can take many years to be legally resolved, but also severe motor liability claims (in particular in the UK) where settlements may be made using periodical payment orders, a form of inflation-linked whole of life annuity.

5.8. Reliance on data and information from USAA

5.8.1. My analysis has made use of material prepared by and for USAA Group and its subsidiaries. This data is listed in Appendix E.3. There were no material data items requested that USAA Staff were not able to provide.

5.8.2. I believe it is appropriate for me to rely upon the data and information supplied to me by USAA Staff because:

- The data and information appeared to me to be reasonable, based upon my (re)insurance knowledge and experience. I have not, however, performed an audit of the data; nor have I sought to test the controls surrounding their preparation.
- I performed the following additional checks to provide myself with comfort that the data supplied was appropriate:
    - Reconciliation checks of claims information to published accounts to check for completeness;
    - Independent tests of certain calculations or review of the interpretation of their results. These have been described in the relevant parts of this Report;
    - Inspection of various aggregated and individual data items supplied to confirm that they were consistent with my understanding;
    - Where calculation results were supplied, performing approximate checks of the results to test for any anomalies; and
    - Where my testing highlighted features or anomalies that had not been explained, I sought clarification from USAA Staff.
- I have considered the statements made to the Court in the Witness Statement and those that are included as part of the Transfer documents. In the Witness Statement made to the Court, the Parties confirm the reliability of the data and information (including those that are based upon opinions, views or forecasts) that have been provided to me.
- I consider that Simon Keith is suitably placed to provide such confirmation, as he is the General Manager International, is a Board member of both USAA LTD and USAA SA, has been approved by both Boards to make the Witness Statements on behalf of each of the Parties, is an approved person on the Financial Services Register maintained by the FCA, and is an experienced insurance professional. Within USAA LTD and USAA SA, the individuals who have provided me with information report, either directly or indirectly, to Mr Keith.

5.8.3. The data provided also includes material relating to future business plans for the Parties. Other than those explicitly referred to in this Report, I have not been advised of any material changes to these plans, for example, other new Part VII transfers or changes to the level of capital targeted by the Parties.

5.9. Reliance on others

Translation of documents

5.9.1. USAA Staff have told me that all of the material to be sent to policyholders notifying them of the Transfer will be written in English as all of the policyholders are US military service personnel or their family members. Third-party claimants and their representatives will be sent a covering letter in the language in which the claim is being conducted. Where requested the material will be professionally translated. I anticipate confirming in my Supplemental Report whether any translation was required and that, where relevant, the Parties have obtained certificates (or equivalent confirmations) provided by each translator verifying the accuracy of the material translated.

OTHER MATTERS

5.9.2. Given the material portion of liabilities relating to German motor risks, I received the assistance of Dr Knut Schäfer of Beltios GmbH, an experienced German actuary, in respect of this portfolio.

5.9.3. I have relied on the information provided to me by USAA Staff in respect of policyholder protection arrangements in Luxembourg. I did not seek my own independent legal advice on this matter given that this is material of a factual nature, and the Transferring Policyholders will not be losing their existing protections provided by the FSCS as a result of the Transfer.

5.10. Contact with regulators

5.10.1. I have held an on-line meeting with the PRA and FCA relating to the Transfer. Both the PRA and FCA have had the opportunity to review this Report before it was finalised and to ask me questions relating to it. The PRA, in consultation with the FCA, has approved the form of my Report.

5.10.2. USAA Staff have told me that in their correspondence with the CAA, they have included my contact details in the event that the CAA have any matters regarding the Transfer that they wish to raise with me directly. I have been told by USAA Staff that a copy of this document, once signed off by all stakeholders, will be submitted to the CAA by the Parties in order to obtain the solvency certificate required.

5.10.3. I will comment in my Supplemental Report on any matters raised with me by the CAA.

C. Detailed Review – Financial Effects

6. Introduction

6.1.1. This part of my Report, Part C, contains my in-depth analysis of the financial strength of the Parties before and after the Transfer. It is presented in the sections listed below.

6.2. Technical Provisions and Balance Sheets

6.2.1. Section 7 sets out my review of the Technical Provisions of the Parties as at 31 December 2021.

6.2.2. Section 8 summarises the remainder of the balance sheets pre- and post-Transfer for each company as at 31 December 2021.

6.3. Review of Risks and Capital Requirements

6.3.1. Section 9 draws on the ORSA reports, together with my analysis in Sections 7 and 8, and summarises the key risks for the Parties pre-Transfer, and how I believe that these will change under the Transfer.

6.3.2. Section 10 reviews the approaches taken by the Parties when determining their SCR pre- and post-Transfer. I comment on the appropriateness of the Standard Formula approach for the Parties. I also compare the SCRs pre- and post-Transfer with the available financial resources and how I anticipate these will evolve over the medium term.

6.3.3. Section 11 sets out the results of a number of additional tests on the quantitative financial strength for the Parties pre- and post-Transfer. The tests are based on existing scenario tests used by USAA Staff and additional tests performed by me and reviewed by USAA Staff. Together, they provide me with an alternative perspective on the financial strength of the Parties from that indicated by the SCR calculations in Section 10.

6.4. Summary

6.4.1. Section 12 summarises the results of Part C and my analysis of the financial effects of the Transfer.

7. Review of GAAP reserves and Solvency II Technical Provisions as at 31 December 2021

7.1. Introduction

7.1.1. For both USAA LTD and USAA SA, the Technical Provisions are one of the largest items on the balance sheet and the largest area of uncertainty, making them a key component for me to consider in my analysis. This section:

- Provides a description of the insurance portfolios of USAA LTD and USAA SA.
- Sets out the matters that I have reviewed and my conclusions from reviewing the GAAP reserves and Solvency II Technical Provisions of the Parties as at 31 December 2021.
- Highlights the main sources of uncertainty associated with the GAAP reserves and Solvency II Technical Provisions and identifies how these will be transferring between the companies as a result of the Transfer.

7.2. Conclusions regarding the GAAP reserves and Solvency II Technical Provisions

7.2.1. *Overall, I have concluded that the GAAP Reserves and Solvency II Technical Provisions provide me with a suitable basis upon which to perform my review of the Transfer.*

7.2.2. The key judgements underpinning the reserves that dominate the uncertainty in the reserve estimates are the following:

- The nature of business underwritten by USAA LTD and USAA SA combined with large or unlimited individual loss limits can lead to volatility in the reserves on a gross of reinsurance basis. While this is mitigated substantially by outwards reinsurance, the relatively small size of both companies means that a small number of major losses can materially affect reserve estimates. These large losses are therefore key in reserve estimates;
- The extent to which claims will continue to develop in future, particularly for long-tail classes of business. This may arise because USAA Group, USAA LTD and USAA SA do not have experience of the full run-off of the claims arising from this type of business in each country where the risks are located, or because the rate at which these claims develop changes materially over time. As a result, claims experience may differ from assumptions and could mean that future claims costs are mis-estimated, potentially materially; and
- Estimates of expected profitability in current and recent underwriting years. For longer-tailed classes, reserving techniques often place greater weight upon initial profitability assumptions where it is too early to estimate the ultimate loss experience based solely upon the losses reported to date.

7.2.3. These key judgements about the reserves:

- Can lead to a risk of future adverse loss development should emerging claims experience exceed the level anticipated in each company's reserves.
- Are issues faced by all insurers writing similar lines of business, but are exacerbated by the current market environment, particularly for motor, where levels of price inflation (and consequently claims inflation) are greater than has been experienced in European economies for several years.

7.2.4. I have tested the resilience of USAA LTD and USAA SA to more conservative judgements in these key areas in Section 11.

7.3. Description of portfolios

7.3.1. Table 9 sets out the gross and net Technical Provisions of the Parties on a GAAP basis as at 31 December 2021 and the corresponding as-if position had the Transfer already taken place at that date.

Table 9 Summary of Statutory reserves as at 31 December 2021

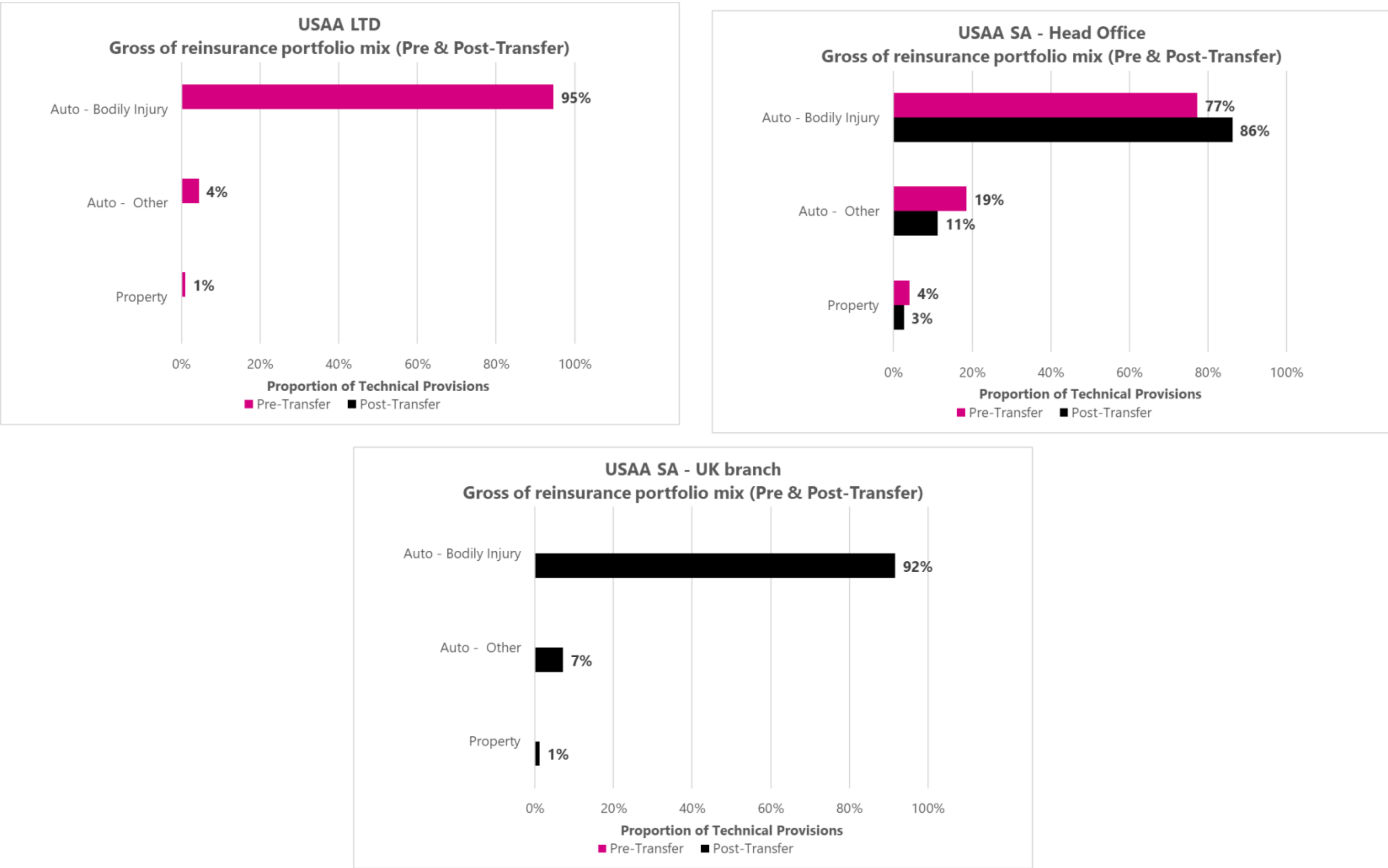
Pre-Transfer				
	USAA LTD £m	**USAA LTD €m**	**USAA SA €m**	**Of which USAA SA (UK Branch) €m**
Gross	49	59	81	-
Reinsurance	13	16	-	-
Net	36	43	81	-
"As-if" Post-Transfer				
	USAA LTD £m	**USAA LTD €m**	**USAA SA €m**	**Of which USAA SA (UK Branch) €m**
Gross	-	-	140	27
Reinsurance	-	-	16	7
Net	-	-	124	20

7.3.2. Table 9 shows how the gross and net GAAP Reserves of USAA LTD would have reduced to nil, while those of USAA SA would have increased by the corresponding amount by adding the Reserves of USAA LTD. These reserves would have been split between the Head Office and the UK Branch, with 46% of the net GAAP Reserves transferring to USAA SA's UK Branch. I have shown the Reserves of the UK Branch separately because post-Brexit, branches of non-UK insurers need to maintain financial resources in the UK as-if they were a standalone authorised insurance company.

7.3.3. The total net Reserves across the two companies will not change as a result of the Transfer, hence there is no change to the reserves of USAA Group.

7.3.4. Figure 2 below shows the approximate breakdown of Reserves by class of business for each entity before and after the Transfer were it to have taken place at 31 December 2021.

Figure 2 Statutory reserves as at 31 December 2021 - Approximate breakdown by class of business[21]



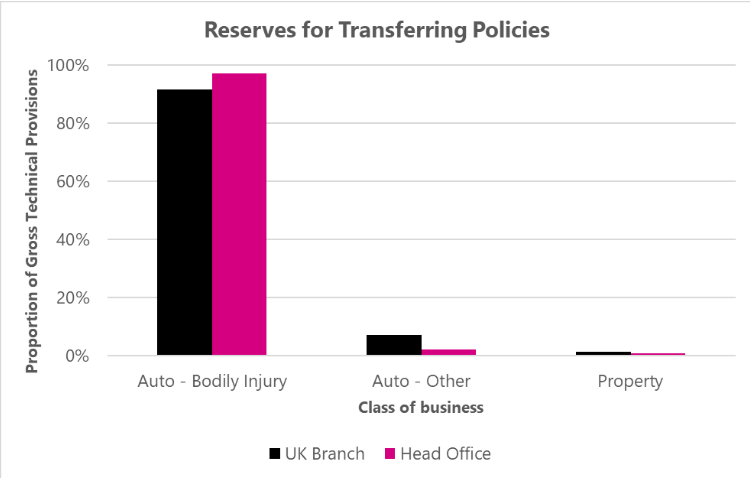
7.3.5. The charts above show that:

- For USAA LTD, there would be no Reserves remaining after the Transfer.
- For USAA SA (Head office) post-Transfer, the proportion of Auto Bodily Injury would have increased by approximately 10%, with Auto Other reducing proportionately overall.
- For USAA SA (UK Branch) post-Transfer, the mix of the gross Technical Provisions by line of business post-Transfer changes slightly from USAA LTD pre-Transfer. This is a result of the fact that USAA LTD's portfolio consists of a mix of UK and European business, whereas USAA SA's UK branch will have only the UK Transferring Business.

[21] USAA SA – Head Office refers to the balance of the Reserves of this company after deducting the part attributable to USAA SA's UK Branch.

7.3.6. Figure 3 shows the split of reserves for the Transferring Policies by segment and entity. It shows that over 85% of the transferring gross Reserves fall within Auto Bodily Injury for both entities, with the remainder arising in the other classes.

Figure 3 Reserves for Transferring Policies as at 31 December 2021



USAA LTD AND USAA SA PORTFOLIO - DETAILED DESCRIPTION

7.3.7. USAA LTD and USAA SA write business of a similar nature, with the difference between the Parties being principally the extent to which the underlying risks are located in the EEA or the UK. Therefore, the descriptions below of the portfolios apply to the business of both companies.

7.3.8. The Auto Insurance business provides coverage of automobiles used by members of USAA serving overseas, and comprises bodily injury, property damage and personal injury.

7.3.9. The Property Insurance business provides coverage for members serving overseas, and comprises:

- Valuable Personal Property Insurance, which covers high value items owned by members.
- Renters Insurance, which protects members' possessions in the event of theft or damage and protects members from claims from third-parties for injuries or property damage.
- Umbrella Insurance, which is extra insurance that provides protection beyond existing limits and coverages of other policies. It can provide coverage for injuries, property damage, certain lawsuits, and personal liability situations.

7.4. Approach to my review

7.4.1. My review of the companies' GAAP Reserves and Solvency II Technical Provisions has comprised the following elements:

- A review of the processes followed to prepare the GAAP Reserves and Solvency II Technical Provisions, including the data and other information used, the actuarial and other estimation methodologies applied and the documentation and sign-off performed.
- A high-level review of the GAAP Reserves and Solvency II Technical Provisions to assess the appropriateness of the key reserving judgements made.

7.4.2. My work has been performed using the position of USAA LTD and USAA SA as at 31 December 2021. I anticipate updating the Court in my Supplemental Report regarding material developments[22] in the GAAP Reserves or Solvency II Technical Provisions in the intervening period that affect my conclusions.

7.5. Review of the documentation, reserving process, methodology, data, and sign-off process

7.5.1. The following paragraphs in this sub-section describe the review I carried out on the reserving process applied by USAA Staff for USAA LTD and USAA SA.

Documentation

7.5.2. The Parties' reserving process is documented in the following material that I received and reviewed:

- Internal actuarial reserve reports as at 31 December 2021;
- Actuarial Function Reports regarding Solvency II Technical Provisions, Underwriting, and Reinsurance opinions issued during 2021 and 2022.
- Reconciliations between the booked GAAP Reserves and the Solvency II Technical Provisions as at 31 December 2021.

7.5.3. *I am satisfied that the process for setting the GAAP Reserves and Solvency II Technical Provisions for USAA LTD and USAA SA as at 31 December 2021 is appropriately documented for the purposes of enabling me to reach my conclusions in this Report.*

Data

7.5.4. The GAAP Reserves as at 31 December 2021 are calculated by USAA Staff based on data extracted from USAA's claims and underwriting systems.

7.5.5. The Actuarial Function have confirmed that the data used for the calculation of Solvency II Technical Provisions is adequate in terms of its accuracy, completeness and appropriateness. I have assumed that this confirmation also applies to the data used for the GAAP Reserves.

7.5.6. I did not identify anything in my review of the GAAP Reserves and Solvency II Technical Provisions to suggest that the data was inappropriate.

7.5.7. *I have concluded that the data used for estimating GAAP Reserves and Solvency II Technical Provisions is appropriate for me to reach my conclusions in this Report.*

Methodology

7.5.8. USAA Actuarial Staff have applied standard non-life actuarial techniques in estimating the GAAP Reserves for USAA LTD and USAA SA. Their work includes the use of Chain-Ladder, Bornhuetter-Ferguson and Cape Cod techniques, and the use of rate-monitoring systems to estimate the profitability of business written.

7.5.9. USAA Actuarial Staff do not explicitly book any reinsurance recoveries in respect of gross IBNR claims reserves due to the extremely low historical volume of reinsurance recoveries. Any known large outstanding claims, including reinsurance recoverables, are considered on a case-by-case basis by USAA Staff in the reinsurance team.

7.5.10. I have read the actuarial reports on Reserves prepared by USAA Actuarial Staff who are responsible for USAA LTD and USAA SA. These describe approaches that comply with normal practice to determine the best estimate Reserves.

[22] Note that with USAA LTD going into run-off from 1 April 2022, changes in the amounts are to be expected by the Transfer Date.

7.5.11. The Actuarial Function Reports highlight the use of rate monitoring and technical rate pricing of new and renewal business. This information is used to inform reserving assumptions for the more recent underwriting periods where there is insufficient claims experience to assess business performance.

7.5.12. *I am satisfied that the methodology used to estimate the GAAP Reserves is appropriate.*

Reserving Process

7.5.13. Internal actuarial estimates for the GAAP Reserves of USAA LTD and USAA SA are split into estimates for each reserving class, region and accident year.

7.5.14. The reserving process is as follows:

- Reserve reviews are carried out quarterly to set estimates of ultimate claims for each accident year, supplemented with a deep dive review carried out on bodily injury large losses, using data as at 30 November.
- The 30 November estimates are rolled forward by one month to allow for the earning of exposure between the reserve review date and the balance sheet date with adjustments for major claim movements, claim payments and events arising.

7.5.15. USAA Actuarial Staff have told me that there is usually little to no change in the estimates of ultimate claims at year-end as a result of this roll-forward exercise. This is because the claims management team have already reviewed the open claims before year-end to reduce the likelihood of large movements.

7.5.16. I have reviewed the movements in paid and incurred claims in the month of December 2021 and confirm there were no material changes since the prior month-end.

7.5.17. *Based on the explanations received from USAA Actuarial Staff, I have concluded that the output of this process is suitable for use in my analysis in this Report.*

7.5.18. The GAAP Reserves are then converted to Solvency II Technical Provisions by making allowance for the differences between these two calculation bases.

7.5.19. I have reviewed this conversion in order to be comfortable with the adjustments made as at 31 December 2021. I anticipate confirming in my Supplemental Report that there are no changes to my conclusions arising from differences emerging in subsequent conversions.

7.5.20. *I have reviewed the steps performed to convert the GAAP Reserves to the Solvency II Technical Provisions that I have used in forming my opinion. Where I believed it necessary, I have performed some additional checks on the calculations performed. Based on this analysis, I have satisfied myself that an appropriate process has been used to prepare the Technical Provisions and have used them for forming my opinions in this Report.*

Sign-off Process

7.5.21. As part of my review of reserving documentation I have considered the sign-off process adopted by USAA Staff, and the experience and qualifications of the members of staff responsible for setting the GAAP Reserves and Solvency II Technical Provisions.

7.5.22. I have received and reviewed the USAA LTD and USAA SA internal reserve reports relating to the 2021 year-end, and the Actuarial Function Reports regarding Technical Provisions, Underwriting and Reinsurance. The actuarial reserve estimates appear to have been prepared by suitably qualified and experienced individuals with clear accountability.

7.5.23. Neither of the Parties uses external actuaries to conduct an independent actuarial review of their Reserves. The Actuarial Function of each of the Parties is outsourced to actuaries working for USAA Group based in the USA, with the same actuaries performing work for both Parties.

7.5.24. However the 2021 year-end audit of each of the Parties confirmed that no material issues were found arising in either set of financial statements in respect of Technical Provisions, following review by actuaries assisting the respective audit teams. This provides me with comfort that reserves have been subject to scrutiny by independent actuarial teams as part of the overall year-end sign-off.

7.5.25. *I have concluded that an appropriate process is in place for the sign-off of the estimates for the two companies' Technical Provisions as prepared by the Actuarial Function.*

7.6. High-level review of the GAAP Reserves

PRE-TRANSFER

7.6.1. My review was performed on data at a more aggregated level than that adopted by USAA.

7.6.2. My review, where relevant, included looking at:

- The appropriateness of the allowance for future loss development in the more mature underwriting years;
- The consistency over time of the level of future loss development across underwriting years; and
- The consistency of assumed profitability levels in the most recent underwriting periods with the level and trend of profitability in the recent past.

7.6.3. USAA Staff have also confirmed that they are not aware of any major reinsurance disputes as at 31 December 2021.

7.6.4. This review cannot, and should not, be taken as providing assurance regarding the level at which the Reserves have been set. Equally, it is not an exhaustive test of the Reserves. It does, however, provide me with a useful perspective on the degree of uncertainty arising in the estimation of Reserves by the actuarial team and comfort regarding the level of Reserves held by each company.

7.6.5. *My quantitative review of the portfolios provided me with comfort regarding the level of the GAAP Reserves and their suitability for the purposes of considering the Transfer. I have therefore satisfied myself that no adjustment was necessary to the USAA LTD or USAA SA balance sheets in respect of the Reserves for the purposes of my review.*

REINSURANCE PROTECTIONS

7.6.6. USAA LTD and USAA SA have an excess of loss reinsurance treaty provided by a panel of reinsurers (where the share of each reinsurer is contractually defined), each with strong credit ratings. This treaty serves to mitigate against large third-party liability claims occurring in the EEA or the UK and consists of two sections. Section A of the treaty consists of three consecutive layers and provides unlimited cover in excess of €2.5 million (or its approximate equivalent in Pound Sterling in respect of losses arising in the UK), excluding any awards made or settlements reached in the USA. Section B of the treaty consists of one layer ($22 million limit excess of a $3 million attachment) for claims occurring in Europe or the UK, where losses are settled in the USA. This section may be reinstated twice per contract period.

7.6.7. All of the attachment points and limits are subject to indexation clauses as specified in the treaty.

7.6.8. This treaty helps to reduce reserve and underwriting volatility but exposes both firms to reinsurance credit risk. Reinsurance credit risk is the risk of a reinsurer defaulting on the recoveries they are due to pay.

7.6.9. As at 31 December 2021, USAA LTD and USAA SA recoveries for outstanding claims from the treaty were £13.2 million (49% of net of reinsurance claims outstanding) and €0 million (0% of net of reinsurance claims outstanding) respectively. USAA do not estimate reinsurance recoveries on IBNR claims.

7.6.10. In addition to the excess of loss reinsurance treaty, each of the Parties has a separate stop loss agreement with the parent company, USAA. For USAA LTD, £25 million of cover is provided in excess of a loss of £0.5 million. For USAA SA, €25 million of cover is provided in excess of a loss of €1 million. The stop loss is protection against losses arising from claims net of reinsurance plus underwriting and loss adjustment expenses exceeding premiums earned in the calendar year.

7.6.11. Because USAA SA already has in place its own stop loss reinsurance agreement with USAA, USAA LTD's stop loss reinsurance will not be part of the Transfer, and, up until USAA LTD is wound up or the stop loss agreement is terminated, USAA LTD will continue to benefit from the stop loss reinsurance protection. The USAA stop loss reinsurance policy allows for it to include losses arising post-Transfer on the Transferring Policies in its calculation of any recoveries.

7.6.12. In my quantitative risk analysis contained in Section 11, I have tested the impact of various adverse scenarios relating to these reinsurance contracts, including major counterparty failure and credit rating downgrades.

7.6.13. *Based on my analysis of reinsurance protections, I have identified scenarios for further testing in Section 11, but have not identified any issues that have led me to modify my conclusions regarding the Transfer.*

7.7. Reserves for Transferring Policies

7.7.1. Reserves for the Transferring Policies are determined as part of USAA LTD's normal quarterly reserving exercise, since the reserves are split by region. This means that it is simple to identify the portions of the portfolio relating to the EEA Transferring Policies and the UK Transferring Policies, which are transferring to USAA SA's UK branch.

7.7.2. Between 31 December 2021 and the Transfer Date some claims will be settled. USAA Staff will therefore perform an updated calculation of the reserves for the Transferring Policies closer to the Transfer Date.

7.7.3. *Based on my high-level review of the Technical Provisions, I have satisfied myself that the approach to calculating the transferring Technical Provisions is suitable for me to use as the basis for forming my opinions in this Report.*

7.8. Conversion of GAAP Reserves to Solvency II Technical Provisions

7.8.1. I have reviewed the conversion between the GAAP Reserves and Solvency II Technical Provisions for USAA LTD and USAA SA pre- and post-Transfer performed by USAA Staff. The main steps include allowances for the following:

- Future premium receipts on incepted contracts: These are accounted for within Technical Provisions under Solvency II.
- Unearned premium (for incepted and unincepted business) and associated claims costs: Provision for unearned premiums (net of any deferred acquisition costs), which is included under GAAP accounting, but is removed under Solvency II and replaced by provisions for the

expected claims on unearned premiums only. Future cashflows for business bound at the valuation date which has not yet incepted are also included here.

- Future expenses (for incepted and unincepted business): Under Solvency II, insurers are required to consider all future expenses incurred in servicing existing (re)insurance obligations to run-off. This is an additional allowance for expenses that are not included under GAAP accounting.
- ENIDs: Under Solvency II, insurers are required to allow for all possible future events when setting Technical Provisions. This includes those that have not yet been observed in the historic claims experience of the insurer.
- Discounting: Cashflows are discounted at a prescribed rate under Solvency II to allow for the time value of money.
- Risk margin: An amount is required within the Technical Provisions under Solvency II for the cost of capital needed to support a notional run-off of the insurance obligations.

7.8.2. My review comprised a combination of tests, including reconciliation of data to other sources, diagnostic tests, and other sense checks.

7.8.3. Appendix E.7 sets out a summary of the pre-Transfer conversions from GAAP Reserves to Solvency II Technical Provisions.

7.8.4. *These tests led me to conclude that the pre-and post-Transfer Solvency II Technical Provisions were appropriate for me to use in my analysis in this Report.*

7.9. Sources of uncertainty in the GAAP Reserves and Solvency II Technical Provisions

7.9.1. This final part of my review of the GAAP Reserves and Solvency II Technical Provisions summarises my observations on various sources of uncertainty in the Reserves and Technical Provisions of USAA LTD and USAA SA pre- and post-Transfer. These elements are based on my review of the internal actuarial reserving reports together with my wider market experience and my own observations from reviewing the Reserves and Technical Provisions.

7.9.2. I have highlighted key elements of uncertainty and how each will change for the Parties under the Transfer.

7.9.3. The list of observations below does not include sources of uncertainty associated with other areas of risk facing the company, such as credit, group or operational risks. Therefore, failure of key (re)insurance counterparties does not appear on this list. The low loss retention for individual claims net of reinsurance for both USAA LTD and USAA SA means that certain other types of risk (for example major natural or man-made catastrophe claims) are not included.

7.9.4. The following general sources of uncertainty affect the Reserves and Technical Provisions of USAA LTD and USAA SA:

- Inadequate allowance for claims development of long tail insurance classes in reserve estimates.
- Systemic factors that increase levels of claims inflation, including changes to the legal environment.
- Profitability of recent underwriting years proving to be lower than assumed in projection techniques.
- Emergence of new types of latent claim.
- Macro-economic effects including Brexit, and repeats of systemic loss events affecting multiple lines of business simultaneously (such as the global financial crisis, the COVID-19

pandemic and more recently the spikes in price inflation and the consequences of the Ukraine-Russia conflict).

- Weaknesses in the data quality and/or errors arising from complexity of the Technical Provisions calculation process.

7.9.5. The following specific sources of uncertainty affect USAA LTD and USAA SA:

- The nature of the business underwritten by the Parties and large individual loss limits leads to some volatility gross of reinsurance. While this is mitigated by outwards reinsurance, the relatively small size of both companies means that a small number of major losses can materially affect reserve estimates.
- Bodily injury claims from the Auto business can be complex and can take many years to be settled due to the long length of time for court cases; hence the true performance of each accident year cohort is not known for many years. These claims are also subject to general price inflation and court award inflation, such as changes to the Ogden rates in the UK.
- Portfolios affected by volatility in foreign exchange rates and scenarios that give rise to greater levels of inflation. This could be as a result of changes to the cost of importing goods, disruptions to supply chains or the availability of workers. Where this inflation feeds through to an increased cost of claims over time, ultimate claims costs may exceed the levels currently forecast. Both of the Parties receive premiums in US Dollars but claims are paid in local currency (Sterling and Euros).

7.9.6. The following specific sources of uncertainty affect USAA LTD pre-Transfer and USAA SA (Head Office) pre- and post-Transfer, but do not affect USAA SA's UK Branch directly[23]:

- For large bodily injury claims in Germany, these are often subject to Court Orders which require the Parties to hold ongoing long-term claims reserves for lifelong payments to claimants.
- For large bodily injury claims in Italy, these are often subject to long settlement delays with claims pending at the Court. These are instances where the claimant has filed an appeal after losing the court case.

7.9.7. The following specific sources of uncertainty affect USAA LTD and USAA SA[24]:

- For large bodily injury claims in the UK that are settled by means of annuities, the rate at which costs are increased each year is uncertain, as is the future lifespan of the annuitant. Even with a reasonable number of such annuitants, improvements in medical science and population mortality give rise to a systemic exposure to increased life expectancies. In the UK, the increase in costs each year is normally linked to an index[25] published by the UK Office for National Statistics.
- UK large bodily injury claims are currently subject to increased levels of uncertainty in the size of settlements, whether they are settled as a lump sum or by means of an annuity. The Ogden Rate of interest used to calculate lump sum awards for the most seriously injured victims was reduced in early 2017 and this change materially increased the cost of these awards. While the UK government has subsequently increased the rate in early-2019 (and therefore reduced the awards), these rates will be reviewed periodically.

[23] There will be an indirect effect on USAA's UK Branch because the branch depends upon the wider company for its ongoing ability to continue trading.

[24] USAA SA is affected by these risks arising in the UK through the exposure of its UK Branch.

[25] Earnings and hours worked, care workers: ASHE Table 26 - Office for National Statistics (ons.gov.uk)

- Trends in UK small bodily injury claims are uncertain, including legislative changes and levels of UK claims inflation.

7.9.8. *Based on this analysis of sources of uncertainty for each company, I have concluded that the portfolios are exposed to a diverse range of risks associated with the GAAP Reserves and Solvency II Technical Provisions. As a result:*

- *Transferring Policyholders will continue to be exposed to risks posed by similar classes of business post-Transfer.*
- *Existing Policyholders do not appear to be exposed to material changes in the types of risks to which they are exposed as a result of the Transfer.*

7.9.9. *I have considered the impact of these risks qualitatively in Section 9 and quantitatively in Section 11.*

8. Review of Balance Sheets as at 31 December 2021

8.1.1. This section of my Report reviews the remainder of the items on the balance sheets of the Parties. The purpose of this review is to explain the main elements on the balance sheet on the two accounting bases used and the reasons for the differences between them, and to identify any material uncertainties relevant to my consideration of the Transfer.

8.1.2. This review should not be taken as an audit of any of the company balance sheets.

8.1.3. *Based on this review, I have concluded that the company balance sheets provide a suitable basis upon which to perform my review of the Transfer.*

8.2. USAA LTD balance sheet and commentary

8.2.1. The summary balance sheet for USAA LTD on both a UK GAAP and Solvency II basis as at 31 December 2021 is shown in the table below.

Table 10 USAA LTD Balance Sheets Pre-Transfer - £ million as at 31 December 2021

ASSETS	UK GAAP	SII	Difference (SII – UK GAAP)	Paragraph reference
Investments & Cash in hand	91.6	92.3	0.8	8.2.2-8.2.4
Reinsurers' share of Technical Provisions	13.2	11.8	(1.4)	8.2.5-8.2.7
Debtors, prepayments & other assets	22.9	14.7	(8.2)	8.2.8-8.2.9
Total Assets	**127.7**	**118.9**	**(8.8)**	
LIABILITIES AND CAPITAL				
Technical Provisions	49.2	36.4	(12.8)	8.2.5
Creditors & other liabilities	5.0	7.3	2.3	8.2.10-8.2.11
Total Liabilities	**54.2**	**43.7**	**(10.4)**	
Net assets	73.5	75.1	1.6	8.4
	127.7	**118.9**	**(8.8)**	
Net TPs	**36.0**	**24.6**	**(11.4)**	

8.2.2. **Investments & Cash in hand**. Under a UK GAAP basis, 87% is in debt securities and other fixed income securities, and the remaining 13% is cash and cash equivalents. Of the debt and fixed income securities, 64% is rated A or better, 28% is rated BBB or BB, and less than 9% is Not Rated.

8.2.3. The currency split of USAA LTD's investments is 80% GBP, 10% US dollar and 10% Euro denominated. USAA LTD has exposure to currency risk i.e. net asset exposure in non-US dollar currencies. It also has exposure to increases in interest rates owing to the excess assets it holds. The average duration of both its assets and insurance liabilities is approximately 3 years.

8.2.4. Under Solvency II, the difference of £0.8 million is due to the reclassification of accrued interest from other assets.

8.2.5. **Technical Provisions** and **Reinsurers' share of Technical Provisions.** In Section 7, I have described USAA LTD's approach to calculating this item and my review of its approach and calculations. Appendix E.7 provides a breakdown of the differences between the UK GAAP and Solvency II bases.

8.2.6. Under a UK GAAP basis, there are £13.2 million of expected recoveries net of reinsurance bad debt on USAA LTD's reserves for claims incurred, and nil unearned reinsurance premiums.

8.2.7. All of the expected recoveries are with external counterparties that have a credit rating of A- or better.

8.2.8. **Debtors, prepayments & other assets.** The main UK GAAP elements are:

- £9.4 million of debtors arising from direct insurance operations (mainly premiums receivable);
- £5.3 million of amounts owed from group undertakings pertaining to set up costs for USAA SARL;
- £4.6 million of pension benefit surplus on the UK and German schemes;
- £2.0 million of amounts owed from overseas tax authorities;
- £0.8 million of accrued interest; and
- £0.4 million of other debtors, prepayments, and other assets, including taxation and deferred tax asset.

8.2.9. Under Solvency II, the main differences of £8.2 million are as follows:

- £9.4 million of the debtors from direct insurance operations are removed and treated as Technical Provisions;
- £0.8 million due to the reclassification of accrued interest from other assets as investments; offset by
- £1.6 million due to the reclassification of non-insurance receivables;
- £0.5 million due to the reclassification of insurance and intermediaries receivables.

8.2.10. **Creditors & other liabilities.** The main elements are:

- £1.9 million of creditors from direct insurance operations (mainly amounts owing on claims);
- £1.5 million of other creditors including intercompany charges for services provided by USAA SARL;
- £0.9 million of deferred tax; and
- £0.7 million of accruals and deferred income.

8.2.11. Under Solvency II, the main difference of £2.3 million is primarily due to a netting off against non-insurance receivables.

8.2.12. USAA LTD's Solvency II Net Assets are equal to the total Eligible Own Funds available to cover its SCR. Section 8.4 shows the composition of the Eligible Own Funds.

8.3. USAA SA balance sheet and commentary

8.3.1. The summary balance sheet for USAA SA on both a Lux GAAP and Solvency II basis as at 31 December 2021 is shown in the table below.

Table 11 USAA SA balance sheets pre-Transfer as at 31 December 2021

USAA SA Balance Sheets Pre-Transfer – € million As at 31 December 2021				
ASSETS	**Lux GAAP**	**SII**	**Diff (SII – Lux GAAP)**	**Paragraph reference**
Investments & Cash in hand	107.3	108.1	0.9	8.3.2-8.3.4
Reinsurers' share of Technical Provisions	0.0	(4.3)	(4.3)	8.3.5-8.3.7
Debtors, prepayments & other assets	52.6	2.9	(49.7)	8.3.8-8.3.9
Total Assets	**159.9**	**106.7**	**(53.1)**	
LIABILITIES AND CAPITAL				
Technical Provisions	81.3	32.1	(49.2)	8.2.5
Creditors & other liabilities	13.0	13.0	0.0	8.3.10
Total Liabilities	**94.3**	**45.1**	**(49.2)**	
Net assets	65.6	61.7	(3.9)	8.4
	159.9	**106.7**	**(53.1)**	
Net TPs	**81.3**	**36.4**	**(44.9)**	

8.3.2. **Investments & Cash in hand**. Under a Lux GAAP basis, 71% is in debt securities and other fixed income securities, and 29% is cash and cash equivalents. Of the debt and other fixed income securities, 52% is rated A or better, 42% is rated BBB and less than 2% is Not Rated.

8.3.3. The currency split of USAA SA's investments is 100% Euros. It also has exposure to increases in interest rates owing to the excess assets it holds. The average duration of both its assets and insurance liabilities is approximately 3 years.

8.3.4. Under Solvency II, the difference of €0.9 million is made up of:

- €0.6 million due to the reclassification of accrued interest from other assets; and
- €0.3 million for the revaluation of investments based on market values, whereas under Lux GAAP, this is valued at an amortised cost.

8.3.5. **Technical Provisions** and **Reinsurers' share of Technical Provisions** In Section 7, I have described USAA SA's approach to calculating these items and my review of its approach and calculations. Appendix E.7 provides a breakdown of the differences between the Lux GAAP and Solvency II bases.

8.3.6. Under a Lux GAAP basis, there are €0.01 million of expected recoveries net of reinsurance bad debt on USAA SA's reserves for claims incurred, and nil unearned reinsurance premiums.

8.3.7. All of the **Reinsurers' share of Technical Provisions** are with counterparties having a credit rating of A- or better.

8.3.8. **Debtors, prepayments & other assets.** The main GAAP elements are:

- €47.9 million of debtors from direct insurance operations (premiums receivables); and
- €0.6 million of other debtors, prepayments, and other assets, including accrued interest and taxation.

8.3.9. Under Solvency II, the difference of €49.7 million breaks down as follows:

- €47.9 million of the debtors from direct insurance operations are removed and treated as Technical Provisions;
- €1.3 million of deferred tax asset; and
- €0.6 million of accrued interest which is reclassified as investments.

8.3.10. **Creditors & other liabilities**. The main elements are:

- €7.7 million provisions for taxation;
- €3.0 million of amounts owed to undertakings within the USAA Group;
- €1.8 million of other creditors including taxation, accruals and deferred income; and
- €0.5 million of creditors arising from direct insurance operations.

8.3.11. USAA SA's Solvency II Net Assets are equal to the total Eligible Own Funds available to cover its SCR. Section 8.4 shows the composition of the Eligible Own Funds.

8.4. Eligible Own Funds as at 31 December 2021

8.4.1. Under Solvency II, Eligible Own Funds represent the financial resources which can be used to meet a firm's SCR.

8.4.2. Table 12 below shows the breakdown of Eligible Own Funds for pre-Transfer USAA LTD and USAA SA as at 31 December 2021.

Table 12 Structure of Eligible Own Funds as at 31 December 2021

Structure of Eligible Own Funds as at 31 December 2021				
	USAA LTD		USAA SA	
	£m	%	€m	%
Tier 1	75.1	100%	60.4	98%
Tier 2	0	0%	0	0%
Tier 3	0	0%	1.3	2%
Total	**75.1**	**100%**	**61.7**	**100%**

8.4.3. All of the Eligible Own Funds of USAA LTD and almost all of the Eligible Own Funds of USAA SA are graded as sufficient quality to meet the requirements of Tier 1 Eligible Own Funds. These are the highest grade of financial resources recognised under Solvency II and are predominantly share capital and reconciliation reserve.

8.4.4. The Tier 3 Eligible Own Funds for USAA SA comprise of net deferred tax assets, arising as a result of differences between local GAAP and Solvency II accounting. I do not consider this to be material.

8.4.5. Under Solvency II, Tier 2 and Tier 3 Eligible Own Funds can be used to meet a firm's SCR, subject to the following quantitative limits:

- The eligible amount of Tier 1 items shall be at least 50% of the SCR;
- The eligible amount of Tier 3 items shall be less than 15% of the SCR; and
- The sum of the eligible amounts of Tier 2 and Tier 3 items shall not exceed 50% of the SCR.

8.4.6. *I am satisfied that the proportions of Eligible Own Funds that are classified as Tier 2 and Tier 3 are well within Solvency II quantitative limits for USAA SA before the Transfer.*

8.4.7. In my Supplemental Report, I anticipate confirming to the Court that the proportion of Tier 2 and Tier 3 EOFs used to meet each company's SCRs continue to be well within Solvency II quantitative limits.

8.5. Post-Transfer balance sheet

8.5.1. Table 13 show the balance sheet position post-Transfer for both of the Parties as at 31 December 2021. The table shows the ultimate position (i.e. once USAA LTD has been wound up) and does not allow for any pre-Transfer movement of EOF from USAA LTD to USAA SA (as described in paragraph 2.1.7) and assumes that all assets and liabilities of USAA LTD will have been moved to USAA SA following the winding up of USAA LTD.

8.5.2. The figures shown in Table 12 include the following adjustments made to the cash and investments to reflect developments during 2022. For USAA LTD, this includes: (i) the £9.4m payment made by USAA LTD in respect of the buy-out of the UK pensions scheme liabilities during the first half of 2022 and (ii) c.£3m of unrealised investment losses as at 30 June 2022. For USAA SA, there is an adjustment of c.€3.5m of unrealised investment losses as at 30 June 2022.

8.5.3. In Appendix E.6 I have presented these balance sheets again, with the pre- and post-Transfer positions for each of the Parties shown alongside one another for each accounting basis.

8.5.4. I anticipate setting out in my Supplemental Report updated figures showing the projected position of the Parties post-Transfer.

Table 13 - Post-Transfer GAAP and Solvency II Balance Sheets as at 31 December 2021

ASSETS	**GAAP Basis**		**Solvency II Basis**	
	USAA LTD	**USAA SA (Total) €m**	**USAA LTD**	**USAA SA (Total) €m**
Investment & Cash in Hand		198.1		200.0
Reinsurers' share of Technical Provisions		15.7		9.7
Debtors, prepayments & other assets		80.0		20.5
Total Assets		**293.8**		**230.2**
LIABILITIES & CAPITAL				
Technical provisions		140.0		75.5
Creditors & other liabilities		18.9		21.7
Total Liabilities		**158.9**		**97.2**
Net assets		134.9		133.0
		293.8		**230.2**
Net Technical Provisions		**124.3**		**65.8**

8.5.5. The majority of the portfolio of Transferring Policies are in run-off and therefore, I expect the size of the assets and liabilities to be transferred from USAA LTD to be smaller than the figures presented in this Report which have been estimated as at 31 December 2021.

8.5.6. In my Supplemental Report, I anticipate reviewing any updates to USAA Staff calculations of the amount of assets and liabilities to be transferred at the Transfer Date.

9. Summary of key risks and qualitative appraisal of impact of the Transfer

9.1. Introduction

9.1.1. This Section sets out:

- An overview and short description of the key risks I have identified that affect the Parties;
- A qualitative appraisal of the financial impact of the Transfer on each set of Affected Policyholders.

9.1.2. My quantitative assessments of these risks and the impact of the Transfer is presented in Sections 10 and 11.

9.2. Key risks identified

9.2.1. The list below details the key risks facing the Parties. It has been compiled using the Parties' latest available ORSA reports, Actuarial Function Reports and other information obtained from my review of the Technical Provisions and balance sheets of each of the Parties, together with my wider insurance market experience.

9.2.2. **Premium risk:** This is the risk that premium income is insufficient to cover claims, outwards reinsurance costs and expenses to the degree expected, i.e. underwriting profits being lower than expected.

9.2.3. The niche nature of the Parties' business, providing insurance products specifically tailored to the needs of US military service personnel while stationed overseas in Europe, means that the Parties are not subject to the intense levels of competition that is a characteristic of other consumer motor insurance markets in the UK and EEA. As a result, Premium risk for the Parties mainly relates to uncertainty over the cost of claims each year, in particular the incidence of very large claims.

9.2.4. The risk of very large personal injury claims is material for the Parties. This is because the nature of their insured policyholders is that they exhibit the following characteristics relative to an average UK or EEA motor insurance portfolio:

- Younger than average age profile, given the nature of military service personnel, meaning that drivers will be less experienced than average. In addition, younger drivers tend to be more likely than older drivers to have one another as passengers. This can result in an accumulation of exposure to multiple serious injuries in the event of an accident occurring.
- Less experienced or unfamiliar with driving in local market conditions. This is particularly significant in the UK where driving is on the opposite side of the road from in the USA. This lack of experience may combine to further increase risk for younger drivers and drivers who have had a period of service away from driving on public highways.
- Possibility that policyholders will be driving vehicles shipped from the USA which may be less suited to European driving conditions.

9.2.5. The Parties are also exposed to the impact of increased levels of inflation affecting claims costs. At the time of completing my Report, the COVID-19 pandemic and the Ukraine-Russia conflict have had the effect of increasing inflation in the UK and EEA economies. Some of this will translate to higher future costs for the Parties, relating to both claims costs and expenses, than the Parties would have allowed for when setting premiums.

9.2.6. Premium risk is a reducing risk for USAA LTD, because it ceased underwriting EEA Business from 1 January 2019 and all new business from 1 April 2022. As a result, by the Transfer Date, almost no unexpired policy exposures will remain.

9.2.7. Conversely, Premium risk is an increasing risk for USAA SA, because it only started underwriting EEA Business from 1 January 2019 and UK Business from 1 April 2022. Post-Transfer, it will have a balance between its Premium risk and Reserve risk that is consistent with a mature underwriting portfolio. This is because the Transfer will bring back together the prior year reserves with the current underwriting liabilities.

9.2.8. **Reserve risk:** This is the financial impact of deterioration in reserves which can occur from greater numbers of claims or larger claims than expected or both. This uncertainty can result in aggregate claims costs exceeding their expected settlement values. Consequences can be particularly severe if they arise from causes that affect all claims and across recent and less recent periods of underwriting (e.g. claims inflation). My comments relating to inflation made regarding Premium risk in paragraph 9.2.5 also apply to the Parties' exposure to Reserve risk.

9.2.9. Deterioration in claims reserves may emerge over a number of years reflecting the longer time horizon until claims have run off in full. The Standard Formula only considers the extent to which reserve deteriorations arise over a one-year time horizon, however my testing in Section 11 (in particular the Reverse Stress Tests performed) allows for scenarios involving severe reserve deteriorations that might arise over the full run-off of each company's reserves.

9.2.10. **Market risk:** Losses arising from falls in asset values, changes in interest rates and movements in foreign exchange rates can give rise to losses to the Parties. The current environment of economic and political uncertainty following the Brexit decision, the impact of the COVID-19 pandemic, and recent events in Ukraine increases the size of this risk. The Parties manage this risk by having an investment strategy that is predominantly invested in cash, government bonds and corporate bonds that are matched by duration and currency to the expected losses.

9.2.11. Despite this low risk and matched investment strategy adopted by the Parties, there are two important elements that contribute significantly to the Parties' Market risk:

- Each of the Parties is sponsor to a defined benefit pension arrangement. For USAA LTD, the Market Risk as at 31 December 2021 has since been removed as a result of the pension buy-out described in Section 3.2 and 13.10. For USAA SA, the pension fund has material exposure to equity investments, reflecting the long-term growth objectives of the fund. As a result, USAA SA is exposed to the additional volatility stemming from uncertainty in the asset values of the pension fund's underlying equity investments.
- Each of the Parties maintains significant amounts of excess financial resources. Such assets are not matched against specific liabilities and as a result, expose the Parties to fluctuations in their market values.

9.2.12. **Reinsurer counterparty default risk:** This is the financial impact of an insurer's counterparty defaulting on its contractual obligations (e.g. reinsurance recoveries, loan) due either to insolvency of the counterparty or the counterparty disputing the obligation.

9.2.13. The Parties make extensive use of two types of outwards reinsurance to limit their insurance risks:

- Risks arising from large claims are mitigated to a significant extent by the Parties purchasing unlimited excess of loss reinsurance with a retention for each and every claim of €2.5 million (for losses arising in an EEA member state) and its Pound Sterling equivalent each year of approximately £2 million (for losses arising in the UK). This reinsurance is provided by highly-rated third-party reinsurance companies. The unlimited excess of loss reinsurance protection does not apply for court awards arising in the US.

- All sources of underwriting risk (whether from excess claims cost or from associated underwriting and loss adjustment expenses, net of reinsurance) are mitigated to a significant extent by stop loss reinsurance contracts for each of the Parties covering when their earned losses arising from net of reinsurance claims and expenses exceed their earned premiums in a calendar year. The stop loss reinsurance contracts are provided by the Parties' ultimate parent company, USAA. For USAA LTD, £25 million of cover is provided in excess of a loss of £0.5 million. For USAA SA, €25 million of cover is provided in excess of a loss of €1 million. The stop loss reinsurance contracts can be terminated by mutual consent or by either of the parties to the stop loss with 90 days' notice.

9.2.14. The fact that the excess of loss reinsurance protection is not unlimited in respect of court awards arising in the US presents a specific mismatch risk to the Parties. This mismatch would arise when a loss under a motor insurance policy issued by the Parties (which by law may not be have a monetary limit on the cover provided) exceeds the excess of loss reinsurance policy limit. Such a scenario is conceivable because claimants may seek to have a case addressed in the USA (where court awards and other settlements are typically larger than in the UK and EEA member states) on the grounds that the policyholder is a member of the US armed forces.

9.2.15. **Group Risk:** The Parties have material risks arising from Group risk. This is the financial impact of risks arising from being a subsidiary of the USAA Group. If something were to happen that imperilled the viability of USAA, this would have a material bearing on both of the Parties. In particular, the value of the Stop Loss reinsurance would be materially impaired.

9.2.16. The Parties place significant reliance on outsourced services from USAA and other entities within the USAA Group. As a result, operational disruptions arising from elsewhere in the USAA Group are a key risk for both USAA SA and USAA LTD.

9.2.17. **Operational Risk:** The Parties have identified a number of other sources of risk to their business that broadly fall under the category of Operational risk. These are the financial impact of a failure in an insurer's systems, controls and processes. The most significant risks that I have identified are:

- **Cyber Security** – Global cyber security threats are perceived to be at an elevated level owing to the activities of cybercriminals and nation-state activities. The Parties' strong connections to the US military together with the financial services nature of its operations means that it is a natural target for such threats. Consequences of cyber attacks include: loss of key member information, downtime in operations, negative member experience, adverse PR, and fines for data breaches.
- **Compliance/Legal/Regulatory Risk** – Both Parties are conscious that there could be significant operational and financial impacts if regulatory compliance expectations are not met. Various compliance and legal metrics are embedded within the Parties' business processes to ensure continuous compliance with appropriate legislation and regulation

9.2.18. **Strategic Risk**: A wider strategic risk facing the Parties is uncertainty over the future European and Global geo-political and military landscape together with political decisions taken in the USA. This is because the demand for the Parties' insurance products depends directly upon the size of any US military troop deployment in Europe. A reduction in US military personnel in Europe will lead to a fall in new business and vice-versa. The Ukraine-Russia conflict highlights how the geo-political position can change rapidly[26]. A shrinking volume of business would result in a

[26] Although to date, this has not led to a material change in US military service personnel numbers.

gradual build-up of excess financial resources, while an increase in premium income will be likely to require the injection of capital from USAA to enable USAA SA to write more insurance policies.

9.2.19. Other important risks facing the Parties that I have considered are as follows:

- **Pandemic Risk:** The long-term effects of the Covid-19 pandemic on the Parties remain uncertain. The effect on Premium and Reserving risk appears to be limited, as lockdowns reduced car use and therefore motor claims. However, economic volatility is likely to increase, as a result of government responses to the pandemic, including both lockdowns, loosening of monetary policies and wider geo-political effects. This is likely to increase market and credit risk to the Parties. The Parties benefitted from the size and scale of USAA in their operational response to the pandemic and both were able to continue their operations with minimal disruption.
- **Natural and man-made catastrophe events**: Although both of the Parties are exposed to natural and man-made catastrophes, principally as a result of UK and European windstorms and floods, these are not believed to be material after allowing for the benefit of outwards reinsurance.
- **Regulatory uncertainties:** Regulatory action in response to breaches of laws, rules and standards can lead to fines, unplanned remediation costs and additional capital requirements or loss of profits from restrictions on business activities. Both Parties are exposed to this risk. USAA LTD is exposed to the uncertainties arising from Brexit owing to its loss of its ability to administer policies and settle claims in some EEA member states. This Transfer is being carried out in order to mitigate the known risks arising from Brexit.
- **Other risks:** The Parties are also exposed to a number of other, less material risks including credit risks on other assets (i.e. other than investments or reinsurance), operational risks and liquidity risks.

9.2.20. *I have concluded that these material risks have been appropriately considered in the Parties' ORSAs and these documents incorporate discussion of the risks that I would expect to see facing these firms. Other than strategic elements of risk arising from geo-political and military uncertainties, I believe that the Standard Formula captures each of the risks discussed.*

9.2.21. *The Standard Formula does not give firms credit for stop loss reinsurance policies. This may result in the Standard Formula overstating the capital requirements for the Parties for the protection provided by these stop loss policies. The fact that USAA or the Parties can decide to terminate this agreement at some point in the future means that while it is a valuable risk mitigant for the Parties, it is appropriate that no credit is provided in the SCR.*

9.2.22. I have considered each of these material risks further in my quantitative testing of the capital requirements and the effects of the Transfer in Section 11.

9.3. Impact of the Transfer on the Affected Policyholders – risk profile of insurer

TRANSFERRING POLICYHOLDERS

9.3.1. The Transferring policyholders will remain exposed to all of the material risks outlined in Section 9.2. Changes will arise from the benefits of diversification within USAA SA that can serve to increase stability in the experience of an insurance portfolio.

9.3.2. *Qualitatively, I do not believe that these changes to the risk profile represent a materially favourable or unfavourable change to the position of the Transferring Policyholders.*

EXISTING POLICYHOLDERS

9.3.3. The Existing Policyholders will remain exposed to all of the key types of risk outlined in Section 9.2. Changes will arise from the introduction of the reserves associated with the Transferring Policies. There will be an increase in exposure to risks associated with ongoing policy exposures which will be offset by the benefits of diversification and a larger portfolio.

9.3.4. *Qualitatively, I do not believe that there will be a material change to the risks facing the Existing Policyholders.*

9.4. Impact of the Transfer on the Affected Policyholders – size of balance sheet of insurer

TRANSFERRING POLICYHOLDERS

9.4.1. The Transferring policyholders will be moving to a company with a larger balance sheet.

9.4.2. *All other things being equal*[27]*, a larger balance sheet presents advantages to these policyholders owing to the increased capacity of USAA SA to absorb large losses from a single claim.*

EXISTING POLICYHOLDERS

9.4.3. USAA SA will have a larger balance sheet post-Transfer. Its gross technical provisions will increase by c. 75%.

9.4.4. The larger balance sheet means that USAA SA can absorb a larger magnitude of any individual cause of loss without recourse to the USAA Group.

9.4.5. *All other things being equal, a larger balance sheet presents some advantages to these policyholders owing to the increased capacity of USAA SA to absorb large losses from a single claim.*

9.4.6. *The consolidation of USAA LTD and USAA SA into a single insurer means that the combined amount of stop loss reinsurance provided by USAA to the Parties will reduce. I do not consider this to represent a material increase in risk to the Affected Policyholders because the financial resources of the Parties have been established ignoring the benefit of the stop loss on each of their capital requirements. Therefore, the likelihood of insolvency of the Parties in the absence of the stop loss reinsurance is remote.*

9.5. Qualitative impact of the Transfer on the USAA Group

9.5.1. For the USAA Group, the Transfer represents a rearrangement of which subsidiary insurer meets claims for each risk. There are no material changes anticipated in the aggregate assets, liabilities or risks.

9.5.2. I anticipate that the reorganisation of its subsidiaries will bring about some short-term operational risks (for example arising from management time being devoted to ensuring its successful execution, or possible effects on claim behaviour as a result of receiving correspondence from the Parties relating to the Transfer). I do not anticipate that these are likely to be material for an organisation of the size of the USAA Group or likely to persist over time.

9.5.3. Were the reorganisation not to take place, the USAA Group would risk some disruption from USAA LTD's inability to meet claims on policies with EEA risks in those states where legal arrangements have not been put in place to permit their settlement.

[27] The wider risks and the resultant impact of the Transfer on the Affected Policyholders that inevitably arise from having a larger balance sheet have been addressed in Sections 9.2 and 9.3. This section 9.4 focuses solely on the size of the balance sheet.

9.5.4. *I therefore believe that the Transfer appears unlikely to have any material adverse impact on the USAA Group.*

10. Review of capital requirements and comparison with financial resources

10.1. Introduction

10.1.1. This section sets out my review of the financial resources of the Parties and compares them with their respective capital requirements. The capital requirements provide a quantitative measure of the aggregated risks facing each firm.

10.1.2. The regulatory capital requirements for each of the Parties are determined using the Standard Formula SCR which is the default means of calculating regulatory capital for firms under Solvency II. Using the Standard Formula requires firms to be satisfied that it appropriately reflects the risks facing their business.

10.1.3. In this Section 10, I have described the checks I have carried out to check the calculations of the Standard Formula SCR performed by USAA Staff as at 31 December 2021. My testing of the qualitative and quantitative appropriateness of the Standard Formula SCR is presented in Sections 9 and 11 respectively.[28]

10.1.4. In the remainder of this section, I have compared the Parties':

- Financial resources and capital requirements of the Parties pre- and post-Transfer.
- Capital risk appetites;
- Financial resources composition;
- MCRs; and
- Expected evolution of financial resources over the medium term.

10.1.5. In Section 11, I describe the further quantitative testing of the Parties' financial strength and how this is affected by the Transfer. This additional testing takes the form of various sensitivity, stress and scenario tests that I have performed with the assistance of USAA Staff.

10.2. Review of Standard Formula SCR calculations

10.2.1. The Standard Formula SCR is a model used by most firms under Solvency II to determine their SCR. It uses a prescribed methodology and parameters and provides an objective measure of the capital requirements for insurers which can be applied consistently to USAA LTD and USAA SA before and after the Transfer. The parameters of the model are standardised and, hence, are not calibrated to each of the Parties.

10.2.2. I have reviewed the Standard Formula SCR of the Parties as at 31 December 2021 at a high level, supplemented by some detailed checks on certain elements. Based on this review, I have satisfied myself that the Standard Formula SCRs have been calculated correctly for each of the Parties as at 31 December 2021. I stress that I have not sought to perform a detailed check of every element of the calculations and that this review is only for the purpose of reaching my conclusions relating to the Transfer.

10.2.3. Table 14 shows a breakdown of the Standard Formula SCR as at 31 December 2021 for each of the Parties.

[28] In Section 9 I reviewed the risks facing the Parties and satisfied myself that the risks facing them were captured by the Standard Formula SCR. In Section 11 I have compared the effects on each of the Parties of a range of scenario tests and some RSTs. One of the reasons for carrying out these scenario tests is to enable me to check that the Standard Formula SCR provides an appropriate and consistent risk measure for each of the Parties.

Table 14 Standard Formula SCR breakdown by entity as at 31 December 2021

Standard Formula SCR breakdown by entity				
Risk type[1]	**USAA LTD**		**USAA SA**	
	£m	**%**	**€m**	**%**
Premium & Reserve risk	8.1	42	23.3	64
Market risk	14.3	73	18.2	50
Counterparty default risk	0.9	5	2.0	6
Operational risk	1.1	5	2.4	7
less diversification	(4.8)	(25)	(9.5)	(26)
Total	**19.6**	**100**	**36.4**	**100**

1 *These risk types have been defined in the glossary.*

10.2.4. The two largest component parts of the SCR for both of the Parties are:

- Premium & Reserve risk; and
- Market risk.

10.2.5. Premium and Reserve risk is large for both of the Parties owing to their insurance activities, both the ongoing business exposures and the technical provisions. For USAA LTD, the Premium and Reserve risk is a smaller proportion of its SCR because as at 31 December 2021, USAA LTD ceased underwriting EEA Business from 1 January 2019 and intended to cease underwriting new business on 1 April 2022. Therefore, technical provisions have reduced and the associated contribution of Premium and Reserve risk in its SCR is reducing as a result. Conversely, USAA SA's technical provisions are growing as a result of its having started underwriting in 2019.

10.2.6. Market risk as at 31 December 2021 is large for both of the Parties because:

- Each of the Parties includes equity exposures within their respective defined benefit pension schemes within their SCRs. For USAA LTD, this risk has reduced as a result of the pension buy-out described in Section 3.2 and 13.10;
- As both of the Parties have significant amounts of Own Funds in excess of their respective technical provisions and these are invested in government and corporate bonds, they are both exposed to the impact of movements in interest rates on the value of these excess assets.

10.2.7. I have reviewed the Standard Formula SCR calculations carried out by the USAA Staff on behalf of the Parties and satisfied myself that have been performed correctly for the purposes of considering the financial effects of the Transfer.

10.2.8. I am satisfied that the risks that I described qualitatively in Section 9 are addressed in the SF SCR. I note however that the SF SCR makes no allowance for the stop loss reinsurance bought by the Parties from USAA Group. As a result, it is likely to overstate the total risk facing each of them.

10.2.9. *I have satisfied myself that the Standard Formula SCRs as at 31 December 2021 have been calculated appropriately for my purposes of considering the financial effects of the Transfer.*

10.3. Comparison of SCR and Eligible Own Funds

10.3.1. In Sections 7 and 8, I reviewed the Technical Provisions and Balance Sheets of the Parties as at 31 December 2021. This was to satisfy myself that the resulting Solvency II Eligible Own Funds of both firms were appropriate for use in my consideration of the financial effects of the Transfer.

10.3.2. Table 15 shows the EOF, SCR and Solvency Ratio for USAA LTD and USAA SA assuming that the Transfer took place on 31 December 2021. It shows the progression of the Parties' Solvency Ratios from the reported position at year-end 2021, through the anticipated pre-Transfer dividend from USAA LTD to USAA SARL and subsequent injection of these financial resources into USAA SA by USAA SARL, to the anticipated ultimate position of the Parties once USAA LTD has been wound up.

10.3.3. The pre-Transfer positions were prepared by USAA Staff, while the post-Transfer positions, which have been calculated on an "as-if" basis (i.e. assuming that the Transfer had taken place by that date), were calculated by me using information provided to me by the Parties. USAA Staff have reviewed my calculated amounts and confirmed that they believe that they are reasonable. USAA Staff have told me that they will prepare corresponding SCRs pre- and post-Transfer projected to 31 December 2022 for my review and I will update the Court in my Supplemental Report regarding any implications for my conclusions of these updated projections.

10.3.4. For the purposes of considering the post-Transfer SCR of USAA SA, two simplifying assumptions have been made:

- All excess assets that are moving from USAA LTD to USAA SA have been assumed to be moved at the Transfer Date rather than in the form of at least two separate dividend payments.
- No allowance has been made for the expected temporary increase in the SCR of USAA SA arising from the difference between the currency in which these excess assets will be held and the accounting currency of USAA SA. I have been told by USAA Staff that USAA SA intends to hold these assets (which are bonds) to maturity at which point they will be reinvested in Euro-denominated assets.

10.3.5. I have not adjusted the SCR that I have used for USAA SA for this currency mismatch effect because:

- The actual size of the impact will depend upon the actual projected positions of USAA SA and the amount and currencies of the dividend and injection of capital;
- I am satisfied that the Solvency Ratio of USAA SA will remain above 150% over the period I have considered;
- This is a transitional effect that will dissipate once the Sterling bonds mature and the amounts are reinvested into Euro-denominated assets; and
- I consider the effect to be an artificial consequence of the Standard Formula SCR and does not give rise to a material adverse effect on the financial security of policyholders.

10.3.6. I anticipate reviewing the updated projected SCRs of the Parties in my Supplemental Report. By then, I expect that the Parties will have determined which assets will have been moved to USAA SA and reflected this accordingly in their analysis.

Table 15 - Pre- and Post-Transfer Solvency Ratio Comparison - € million

	USAA LTD				USAA SA			
	Year-end 2021	Allowing for €35 million dividend and other adjustments[29]		Ultimate position	Year-end 2021	Allowing for €35 million capital injection and other adjustments[30]		Ultimate position[31]
	Pre-Transfer		Post-Transfer		Pre-Transfer		Post-Transfer	
EOF	90	40	40	-	62	93	93	133
SCR	23	23	4	-	36	36	54	54
Solvency Ratio	384%	171%	1043%	-	169%	256%	173%	246%

10.3.7. Table 15 enables a comparison to be made between the financial strength of the Parties pre- and post-Transfer based on their Solvency Ratios. This comparison relies upon use of the regulatory capital requirements of the Parties. I have set out the results of my testing of the regulatory capital requirements in Section 11.

10.3.8. Comparing the year-end 2021 position with the ultimate position:

- The Transferring Policyholders will move from a company with Solvency Ratio of 384% to one with a lower Solvency Ratio of 246%. As both Solvency Ratios are well in excess of 100%, this reduction is not in my opinion materially adverse to these policyholders.
- The Existing Policyholders will experience a significant increase in their insurer's Solvency Ratio, from 169% to 246%.

10.3.9. In addition, throughout the intervening period, these projections show that both of the Parties' Solvency Ratios will remain at or above approximately 150%. I note that the Transfer is projected to bring about a reduction in USAA SA's Solvency Ratio. This simply reflects the Parties' arranging for the financial resources required to support the Transferring Business to be in place prior to the Transfer.

10.3.10. I note that, other than where identified, this as-if analysis ignores any profits or losses emerging during 2022 and any additional tax liabilities that might arise as a result of the Transfer and the movement of EOF from USAA LTD to USAA SA. I will update the Court on the effect of these two issues in my Supplemental Report, but do not believe that these will affect my conclusions given the substantial amount by which the Solvency Ratios of the Parties are projected both their regulatory requirements.

10.4. USAA SA UK Branch

10.4.1. Post-Transfer, the UK Transferring Policyholders will be policyholders of the UK Branch of USAA SA. In its UK branch application, USAA SA has agreed to hold assets in the UK sufficient to cover the Technical Provisions of USAA SA and, in addition, 130% of the branch's SCR[32]. In practice, USAA Staff have told me that they intend to hold excess assets in the UK in relation to the branch sufficient to cover 150% of the branch's SCR. This is to provide it with a buffer of working assets over and above its target level.

[29] Other adjustments are (i) the £9.4m payment made by USAA LTD in respect of the buy-out of the UK pensions scheme liabilities during the first half of 2022 and (ii) c.£3m of unrealised investment losses as at 30 June 2022.

[30] Other adjustments are c. €3.5m of unrealised investment losses as at 30 June 2022.

[31] Includes an allowance for the other adjustments noted in Footnote 9.

[32] This is the SCR that is calculated by treating the branch as a standalone insurer.

10.4.2. This amounts to USAA SA holding assets in the UK of an amount in the range €15 – €20 million in respect of its Eligible Own Funds (using its position as at 31 December 2021 presented as if the Transfer had taken place) to be held in Euros and GBP. While this is only a modest proportion of the financial resources of USAA SA (being in the range 10-15% of USAA SA's EOF and, at 150% of SCR, representing a much lower Solvency Ratio when compared with USAA SA as a whole[33]) it provides a limited degree of additional financial security to the Transferring UK Policyholders. Clearly, however, the vast majority of the financial security for all of the Transferring Policyholders comes from the position of USAA SA post-Transfer and its very high expected Solvency Ratio.

10.4.3. *I have concluded that the Existing and Transferring Policyholders experience no materially adverse effects in their financial security, as measured by the Solvency Ratio.*

10.5. The effect of the Transfer on each company's ability to cover its MCR

10.5.1. I have looked at the MCRs and Eligible Own Funds for each of the Parties. Under Solvency II, the Eligible Own Funds that may be used to meet the MCR is more restrictive than those that may be used to meet the SCR. In practice, this means that USAA SA's Tier 3 Own Funds need to be excluded[34] from any comparison to the MCR.

10.5.2. The ratio of EOF to MCR for USAA SA is in excess of 535% at year-end 2021. This is because it is an established firm and will continue to underwrite new business, therefore the MCR will remain below its SCR post-Transfer.

10.5.3. For USAA LTD, its EOF to MCR Ratio is in excess of 2200% at year-end 2021.

10.5.4. USAA Staff have not calculated as-if MCRs post-Transfer, however I expect that:

- USAA LTD's MCR Ratio will fall to no less than 130%. This is because although the company's insurance risks will have fallen away as a result of the Transfer, the MCR is subject to a minimum permitted monetary value of the MCR of £3.2 million[35]. Therefore, USAA Staff have told me that they will retain Own Funds at a margin above (and potentially considerably above) the MCR in the company until it is no longer an authorised insurer.
- USAA SA's MCR Ratio will significantly increase compared to its pre-Transfer position. This is because, it is calculated using similar component risk elements to the SCR and I expect USAA's Solvency Ratio to increase as a result of the Transfer.

10.5.5. *Having reviewed the MCR calculations for the Parties, I have concluded that all of the Parties will continue to have financial resources in excess of their MCR following the Transfer.*

10.5.6. *For USAA LTD, the MCR Ratio will reduce considerably as a result of the Transfer. As there will be no Remaining Policyholders, this change will not adversely affect any policyholders.*

10.6. Capital Risk Appetite

10.6.1. The Parties have near identical Capital Management Policies. These set out and govern the target level of financial resources required of each Party relative to their respective SCRs.

10.6.2. Under the Capital Management Policy, each of the Parties aims to hold financial resources to cover at least 120% of SCR. This margin in excess of the SCR is to overcome any short-term fluctuations

[33] Which has an as-if Solvency Ratio post Transfer of 246% (see Table 15).
[34] No exclusion is required for USAA LTD as all of its EOF are Tier 1 (see Table 12 for details of the structure of the EOF of each of the Parties as at 31 December 2021).
[35] Note that this will exceed USAA LTD's SCR post-Transfer owing to the minimum monetary amount of MCR applicable.

in financial resources or Capital Requirements. Even so, USAA Staff have confirmed to me that immediate action would be taken if either of the Parties' Solvency Ratios fall below 130%.

10.6.3. In addition, the Parties each have the same capital risk appetite stated in their respective ORSA. This is a target Solvency Ratio of 130% and is monitored quarterly by the Board of each Party. USAA Staff have told me that should either of the Parties Solvency Ratio fall below 120%, the firm's capitalisation would be discussed with senior executives in the USAA Group to determine a plan to bring its Solvency Ratio back above 120% and towards 130% promptly.

10.6.4. USAA Staff have confirmed to me that the Capital Management Policy will not fundamentally change as a result of the Transfer. USAA LTD will hold in excess of its minimum MCR as it will no longer be writing insurance business or have any insurance liabilities.

10.6.5. In its UK branch application, USAA SA stated that it will hold assets of at least 130% of its standalone SCR plus its technical provisions in the UK. It retains the ability to call upon support from its parent, USAA SA, should the need arise.

10.6.6. Owing to the Parties desire to avoid breaching their capital risk appetites of 130%, USAA Staff have told me that for planning purposes, they have in fact sought to maintain financial resources in each of the Parties to maintain Solvency Ratios of in excess of 150%. In particular, they anticipate hold cash and investment assets in USAA SA's UK Branch at this level post-Transfer.

10.6.7. *The capital risk appetites have been set for each of the Parties:*

- *At a consistent level; and*
- *At a level which ensures that each will be able to meet their SCRs in wide range of adverse scenarios. I have tested the extent of this in my scenario testing in Section 11.*

10.7. Medium Term Evolution of Financial Resources

10.7.1. Both of the Parties include a forward-looking capital assessment for the next 3 years in their respective ORSAs. These show the projected financial resources and capital requirements for USAA SA post-Transfer for 2022 and 2023 year-ends giving Solvency Ratios of 243% and 244% respectively. These show a consistent Solvency Ratio for USAA SA post-Transfer at well in excess of the company's capital risk appetite of 130%.

10.7.2. For USAA LTD, excess financial resources will be transferred to USAA SA and are not projected for the 2023 year-end onwards. At 2022 year-end (being post-Transfer), it will retain sufficient financial resources to enable it to meet its MCR until it is no longer an authorised insurance company.

10.7.3. For USAA SA, its excess financial resources are projected to increase over time pre- and post-Transfer. This is consistent with my expectations as pre-Transfer USAA SA continues to write profitable business at a similar level to the combined performance of USAA LTD and USAA SA. The projected profits are expected to be more than sufficient to enable both its Solvency Ratio to be maintained or increased each year.

10.7.4. *Based on my review of the capital requirements and financial resources of the Parties over the medium term, I am satisfied that it does not indicate any materially adverse financial effects arising as a result of the Transfer.*

11. Additional testing of financial effects of the Transfer

11.1. Introduction

11.1.1. This section sets out the results of additional quantitative tests performed on the financial position of the Parties.

11.1.2. The purpose of this testing is three-fold:

- To provide additional independent testing of the appropriateness of the Standard Formula SCR for each company.
- To help me to assess whether the target Solvency Ratios under the Parties' respective capital risk appetites are appropriate by testing how sensitive the projected EOFs and SCRs are to alternative judgements.
- To understand the resilience of each firm to adverse scenarios, including extreme scenarios that are likely to manifest themselves over a longer time horizon than one year.

11.1.3. No testing can provide absolute assurance in this respect. My testing aims to enable me to meet the criteria I described in Section 5.

11.1.4. There are four groups of additional tests performed in this section:

- Sensitivity tests;
- Moderate adverse scenarios;
- Severe adverse scenarios; and
- Reverse Stress Tests.

11.1.5. *Sensitivity tests*. These are to assess the extent to which the Solvency Ratio changes as a result of using plausible, alternative judgements in the Parties' Technical Provisions and business plans. These also provide an examination of the adequacy of the target Solvency Ratio of the Parties under their capital risk appetites including in respect of the impact of the passage of time between my analysis and the Transfer Date.

11.1.6. *Moderate adverse scenarios* are those that I might expect to arise once in every 5 – 20 years (or *Low Return Periods*). They may significantly reduce profits or cause a small loss, but not require a material injection of capital.

11.1.7. *Severe adverse scenarios* are those that I might expect to arise once in every 20 – 100 years or more (or *High Return Periods*). They have the potential to cause a significant loss to (re)insurers and may require an injection of capital.

11.1.8. *Reverse stress tests.* These test how extreme an adverse scenario needs to be in order to render the company insolvent.

11.1.9. Using the test results, comparisons are made between the risks to which each company is exposed for the purposes of understanding the impact on each group of Affected Policyholders. To assess the impact of the Transfer on the:

- Transferring Policyholders, I compare the position of USAA LTD pre-Transfer with that of USAA SA post-Transfer.
- Existing Policyholders, I compare the position of USAA SA pre- and post-Transfer.

11.1.10. Comparing the Parties in this manner assists me with understanding the aggregate effect of the Transfer on each group of Affected Policyholders.

11.1.11. For all of the sensitivity, scenario and reverse stress tests, I have used an assumption that EOFs were consistent at 130% of the SCR. In reality, the EOFs are generally much greater (see Table 15). I have used this lower Solvency Ratio because:

- This provides a considerably more cautious basis for testing the financial resilience of the Parties, as it removes a considerable portion of the financial resources of the Parties.
- This approach enables the risk profiles of the Parties to be compared on a consistent basis. As a result, in my opinion it provides a greater insight into the different risks that policyholders are exposed to in each company.
- Conversely, performing these sorts of tests on companies holding substantial amounts of excess financial will simply show that these firms are holding excess financial resources in line with the information presented in Section 10, Table 15.
- It provides a means of testing the extent to which the SCR used by the company is appropriate.
- Given the Parties' capital risk appetites (See Section 10.6) are to hold financial resources of no less than 130% of their respective SCRs, this approach is aligned to the minimum level of financial resources that the Parties would accept before seeking additional financial resources from USAA.

11.1.12. I am satisfied that performing these tests using the actual, and materially higher, Solvency Ratios would not have affected my conclusions regarding the Transfer.

11.1.13. Because the SCRs depend upon the amount of excess assets held by the Parties, it is necessary for me to estimate the EOFs and SCRs that approximate to Solvency Ratios of 130%. I am satisfied that the approximate calculation performed is sufficiently accurate for my purposes.[36]

11.1.14. The sensitivity, scenario and Reverse Stress Tests that I have performed were reviewed and sense-checked by USAA Staff who have confirmed that they considered the results obtained to be reasonable reflections of how they expect the Solvency Ratios to change in each case.

11.1.15. The sensitivity and scenario tests that I have performed are set out in the following sections, with a consolidated and fuller description of the tests performed set out in Appendix E.1. These tests have been performed as arising immediately, however the underlying scenarios described, particularly in the higher return period insurance risk scenarios and Reverse Stress Tests, represent circumstances that may arise over the full run-off of the claims liabilities of the Parties.

11.1.16. A particular feature of the testing performed for my consideration of this Transfer and as set out below in this Section 11 is the effect of the stop loss reinsurance protections provided to both of the Parties by USAA. These reinsurance policies are described in paragraph 7.6.10. These stop loss reinsurance protections mean that most of the scenarios, even those set out in Table 18 that I consider to be highly unlikely to arise, prove to have very little impact on the financial resources and Solvency Ratios of the Parties. As a result of these stop loss policies, the test results highlight how it is only in the most extreme scenarios (such as those indicated by the Reverse Stress Tests) is it possible to have a material impact on the financial resources of the Parties or for differences between them to become apparent.

[36] To perform this approximate calculation, I have reduced the investments held on the Parties' balance sheets by the amount by which the EOF exceeds 130% of the actual SCR as at 31 December 2021 in each case. The SCR is then recalculated using this reduced level of investments (resulting in a lower market risk). Finally the EOFs to be assumed for these calculations are obtained by multiplying the revised SCRs by 130%.

11.2. Sensitivity tests

11.2.1. Table 16 sets out the set of sensitivity tests performed for the Parties, on a pre- and post-Transfer basis.

Table 16 Description of Sensitivity Tests

Sensitivity	Short Description
S.1	+20% business volumes
S.2	- 20% business volumes
S.3	+10% 2022 UWY combined ratio
S.4	- 10% 2022 UWY combined ratio
S.5	+5% net technical provisions

11.2.2. These tests address the items that are the main subjective uncertainties in the balance sheet and business plans of the Parties. Their purpose is to confirm that the Solvency Ratios change (i) in the direction expected; (ii) that small changes in these assumptions do not give rise to large step changes in the Solvency Ratio; and (iii) that none of them cause either of the Parties to breach their SCR. As such, they do not seek to address all of the key risks faced by the parties; these are addressed in the scenarios tests I have performed below.

11.2.3. For each of these tests, none gave rise to unexpected results and none resulted in either of the Parties' Solvency Ratios falling below, or even close to, 100%. In fact, owing to the stop loss reinsurance provided to each of the Parties by USAA, the adverse impact of these tests are minimal. Clearly none of these sensitivity tests has any impact on USAA LTD post-Transfer.

11.2.4. As USAA LTD is no longer writing new business, tests S.1 and S.2 have no impact on it pre-Transfer. Similarly, tests S.3 and S.4 have a smaller impact on USAA LTD pre-Transfer than on USAA SA (either pre- or post-Transfer) because USAA LTD stopped writing new and renewal business in the EEA from 2019 and all new business during 2022.

11.2.5. I have therefore concluded that there is a sufficient buffer of excess financial resources for the Parties, even when the Solvency Ratio is reduced to the 130% level specified in their respective capital risk appetite statements, to cater for:

- Uncertainty in some of the management judgements used in the Technical Provisions, Balance Sheets, EOF and inputs to Standard Formula SCRs;
- The passage of time between the effective date of the Standard Formula SCRs and the Transfer Date.

11.2.6. *The sensitivity test results support the conclusion that the Parties are maintaining an appropriate margin of financial resources in their SCR in respect of key estimation uncertainties.*

11.3. Scenario tests

11.3.1. Table 17 and Table 18 set out respectively the various low and high return period scenario tests that I have performed. These tests incorporate some existing scenario tests used by USAA Staff and have been supplemented by a number of additional tests I have performed. The choice of additional tests is based on my understanding of the key risks faced by each firm.

Table 17 Description of Low Return Period Scenario Tests

Scenario	Short Description
L.1	+10% net technical provisions
L.2	RI credit risk – downgrade all counterparties by 1 notch
L.3	Currency risk - stress 25% adverse shock of USD to GBP / EUR
L.4	Combined scenario: +10% 2022 UWY combined ratio +5% net technical provisions
L.5	Increase in interest rates by 1% (100 basis points) at all durations

Table 18 Description of High Return Period Scenario Tests

Scenario	Short Description
H.1	+30% reserve deterioration
H.2	+10% reserve deterioration **combined with** 50% reduction in cover from stop loss reinsurance
H.3	+20% 2022 UWY combined ratio **combined with** +20% reserve deterioration
H.4	-50% business volumes
H.5	+50% business volumes
H.6	Default (with no recoveries) of largest external third-party reinsurer
H.7	Increase in interest rates by 4% (400 basis points) at all durations **combined with** 25% fall in value of pension scheme assets[37].
H.8	Data/Cyber - Loss of €15 million (e.g. arising from regulatory fines, other IT remediation, incident management, PR/communication and marketing costs.

11.3.2. Using the scenario test results, I compared how the Solvency Ratios changed as a result of each scenario for each group of Affected Policyholders (see paragraph 11.1.9).

11.3.3. Table 19 sets out, for each group of Affected Policyholders, the scenarios for which there was a material difference in its effect on the Solvency Ratio of the relevant insurer post-Transfer when compared with its impact on the relevant insurer pre-Transfer.

11.3.4. Where, for a given scenario and a given policyholder grouping (using the pairings adopted in paragraph 11.1.9), the fall in the Solvency Ratio increased by more than 10%, I have described this as an *increased risk exposure*, as the Solvency Ratio of the insurer post-Transfer is more sensitive to the scenario than the insurer pre-Transfer. Conversely, if the fall in the Solvency Ratio is reduced by more than 10%, then this scenario is described as causing a *reduced risk exposure* for the relevant policyholder grouping.

[37] USAA SA only following the buy-out of the pension fund liabilities of USAA LTD described in Sections 3.2 and 13.10.

Table 19 Material increase or reduction in risk exposure after the Transfer

Group of Affected Policyholders (and associated Firm comparison)	Increased risk exposure	Reduced risk exposure
Transferring Policyholders (USAA LTD vs. USAA SA post-Transfer)	H.5 +50% business volume scenario	H.7 Severe investment scenario H.8 Data/Cyber loss scenario
Existing Policyholders (USAA SA pre- vs. post-Transfer)	H.3 Combined adverse underwriting and reserve scenario	None

11.3.5. Only one scenario showed an increased risk exposure to the Transferring Policyholders. This was the scenario where there was a significant increase in business volumes where USAA Group does not inject additional capital into USAA SA. The reason that there is an increased risk exposure is because USAA LTD is in run-off, so has no exposure to this risk. This scenario does not cause USAA SA's Solvency Ratio to come close to falling below 100%. As a result, it does not cause me to change my conclusions.

11.3.6. I note that these Transferring Policyholders benefit from a reduction in exposure to a number of scenarios, particularly those relating to investment risks and the data/cyber loss scenario. The latter is because the assumed loss for this scenario is for a fixed monetary amount, and USAA LTD is smaller than USAA SA. It is therefore less able to withstand large losses of this nature.

11.3.7. Only one scenario showed an increased risk exposure for the Existing Policyholders. This was the scenario where there was both a 20% increase in the combined ratio for the prospective underwriting year (here 2022) together with a 20% increase in Reserves. This reflects the fact that:

- USAA LTD is in run-off and therefore is not exposed to increases in the combined ratio for the prospective underwriting year; and
- The limit of the stop loss reinsurance provided to USAA SA by USAA is not increased from its current value of €25 million even though the total value of Reserves on USAA SA's balance sheet will materially increase.

11.3.8. Even under this severe scenario, USAA SA's Solvency Ratio remains above 100%. This means that it will continue to be able to meet its regulatory capital requirements without the addition of further financial resources and withstand further adverse scenarios.

11.3.9. The scenario tests did not give rise to any unexpected results. In addition, in combination they have provided me with comfort that the Standard Formula SCR provides an appropriate risk measure with which to reach my conclusions regarding the Transfer. In reaching this conclusion, I note that the Standard Formula SCR makes no allowance for the stop loss reinsurance provided by USAA to the Parties. As a result, the Standard Formula SCR appears to introduce a degree of prudence in their capital requirements. This can be seen by the fact that none of the scenarios relating to reserve deteriorations and/or decreases in prospective underwriting profitability cause either Party's Solvency Ratio to fall below 100%.

11.3.10. Both Parties maintain a Solvency Ratio of more than 100% in all of the low return period scenarios and in almost all of the high return period scenarios. Table 20 identifies those high return period scenarios under which either of the Parties have EOF that falls below their SCR.

Table 20 Scenarios giving rise to breach in SCR

Firm	Scenario
USAA LTD Pre-Transfer	H.7 – Severe investment scenario H.8 – Data/Cyber loss scenario
USAA SA Pre-Transfer	H.8 – Data/Cyber loss scenario
USAA SA Post-Transfer	H.8 – Data/Cyber loss scenario

11.3.11. Both of these very severe scenarios cause USAA LTD's pre-Transfer Solvency Ratio to fall below 100% (just above 90% for H.7 and just below 40% for H.8). In contrast to this:

- H.7, the severe investment scenario, does not cause USAA SA's Solvency Ratio to reduce materially. This lower exposure reflects: (i) its more closely matched assets and liabilities than those of USAA LTD, and (ii) its significantly smaller exposure to risks from its pension funds.
- H.8, the Data/Cyber loss scenario will cause USAA SA's Solvency Ratio to fall slightly below 100%. This lower exposure reflects the larger absolute size of its Balance Sheet than USAA LTD's.

11.3.12. *I have concluded that the Scenario tests do not indicate that any of the Affected Policyholders are materially adversely affected by the Transfer.*

11.4. Reverse stress tests

11.4.1. Reverse Stress Tests illustrate the severity of a scenario that is required to cause each of the Parties to exhaust, or nearly exhaust, all of its EOF. This type of test complements the scenario tests above by looking at the resilience of firms to the most extreme circumstances, focussing on the most material risks.

11.4.2. The following Reverse Stress Tests were applied:

- RST.1A - Exhaust each entity's own funds through reserve deterioration and taking into account recoveries from the stop loss reinsurance from USAA.
- RST.1B - Exhaust each entity's own funds through reserve deterioration, but assuming no recoveries obtained from the stop loss reinsurance from USAA.
- RST.2A and RST.2B – As RST.1A and RST.1B, after first applying the severe investment loss scenario H.5 and then exhausting each entity's own funds through reserve deterioration (with and without the benefit of the stop loss reinsurance from USAA.)

11.4.3. In each case, no secondary effects[38] have been taken into account beyond what is described. Each test was applied so that it resulted in the relevant entity having EOF close to nil.

11.4.4. In my opinion, the stresses or combination of stresses applied for these Reverse Stress Test are very severe and likely to be more remote than those that I would consider to be appropriately described as 1-in-200 events.

11.4.5. Table 21 shows the size of stress that needs to be applied to the Net Technical Provisions in each case in order to reduce residual EOF to approximately zero. For the purposes of these calculations, the risk margin has been removed from the Net Technical Provisions and the future premiums added back.

[38] Changes in other variables affecting the Parties that may also arise at a time of extreme stress. This is to enable the modelling to focus on the core driver(s) underpinning the Reverse Stress Tests.

Table 21 Reverse Stress Test applying indicated increases to the Net Technical Provisions – figures shown indicate stress applied to net Technical Provisions in each case

Reverse Stress Test	**LTD pre-Transfer**	**SA pre-Transfer**	**SA post-Transfer**
RST.1A Deterioration of Reserves with Stop Loss benefit	135%	110%	90%
RST.1B Deterioration of Reserves without Stop Loss benefit	55%	75%	65%
RST.2A Investment Scenario followed by Deterioration of Reserves with Stop Loss benefit	120%	110%	85%
RST.2B Investment Scenario followed by Deterioration of Reserves without Stop Loss benefit	40%	70%	60%

11.4.6. The results in Table 21 indicate that:

- The Parties can withstand considerable deterioration in Net Technical Provisions, particularly with the benefit of the Stop Loss reinsurance, before becoming close to being insolvent.
- In two cases, the Transferring Policyholders will have a reduced level of resilience to Reserve deterioration. In these cases however, USAA SA will have a high level of resilience to Reserve deterioration, at 85%-90% of Technical Provisions.
- In the other two cases, the Transferring Policyholders will have a greater level of resilience to Reserve deterioration post-Transfer.
- In all of the cases, the Existing Policyholders will have a reduced level of resilience to Reserve deterioration. In all of these cases however, USAA SA continues to have a high level of resilience to Reserve deterioration.

11.4.7. In my experience, a deterioration of more than 50% in Technical Provisions (noting that this is after the adding back of future premiums) on an ultimate run-off basis is a sufficiently remote scenario for my purposes, taking into account the outwards excess of loss reinsurance protecting the portfolio.

11.4.8. To provide a sense of scale of the severity of these RSTs, a 50% Reserve deterioration can be thought of as arising when USAA SA's largest reinsurer defaults with no recoveries payable and approximately 9 new large claims with a settlement value of €10 million. USAA Staff have told me that the Parties have not experienced more than 3 claims larger than the excess of loss reinsurance retention (of c. £2 million) in a given calendar year.

11.4.9. In each case, whether or not the stop loss reinsurance is in place, the Parties consistently show a capacity to absorb increased losses of more than this level before becoming insolvent. Therefore even where Table 21 shows a reduction in the amount by which the Technical Provisions can deteriorate post-Transfer in comparison with the position pre-Transfer, such reductions do not in my opinion represent material reductions in the financial security provided to policyholders.

11.4.10. These results also provide me with comfort that the SCR and the capital risk appetites of the Parties have been set at a suitable level to provide an appropriate level of financial resilience for the Parties.

11.4.11. I note that although I have applied these tests assuming Solvency Ratios of 130%, in line with the capital risk appetites of the Parties, in practice each of the Parties expect to maintain financial resources considerably in excess of this.

11.4.12. I am therefore satisfied that none of the RSTs suggest that any of the Affected Policyholders will experience a material reduction in their financial security.

11.4.13. *Based on these Reverse Stress Tests, I have concluded that:*

- *For each firm, it requires a very severe scenario to cause it to be unable to pay policyholder claims in full.*
- *Existing Policyholders will have reductions in their resilience to all of the scenarios investigated, but I consider that scenarios giving rise to insolvency remain sufficiently remote.*
- *Transferring Policyholders will have reductions in their resilience to some of the scenarios investigated, but I consider that scenarios giving rise to insolvency remain sufficiently remote.*

11.4.14. *These RSTs therefore support a conclusion that the Affected Policyholders are not materially adversely affected by the Transfer.*

11.5. Conclusions

11.5.1. *Based on this analysis, I have drawn the following overall conclusions from my sensitivity, stress and scenarios testing that:*

- *The Parties are all sufficiently well capitalised to withstand a wide range of scenarios and severe scenarios. To exhaust their financial resources and render them insolvent, severe stress scenarios are required, consistent with a combination of remote events taking place.*
- *While some scenarios I have investigated suggest that there may be a reduction in the resilience of the insurers of some of the Affected Policyholders to certain scenarios, for both of the Parties such scenarios are in my opinion sufficiently remote.*

11.5.2. *In reaching my conclusions, and for the various reasons I have set out in detail in paragraph 11.1.11, I have not taken into account the actual excess financial resources held by the Parties. Instead I have only allowed for the considerably lower levels of financial resources that the Parties target in the capital risk appetites.*

11.5.3. *Overall I have concluded that:*

- *There do not appear to be any material adverse financial effects arising from the Transfer.*
- *By targeting a level of financial resources at a margin above the SF SCR, the risk of non-payment of claims to the Affected Policyholders is remote for each of the Parties pre- and post-Transfer.*

12. Summary of financial positions of Affected Policyholders

12.1.1. This section summarises the conclusions from my detailed review in Part C of the financial implications of the Transfer.

12.1.2. In Sections 7 and 8, I concluded that the balance sheets, including the Technical Provisions, provided me with an appropriate basis upon which to assess the Transfer. I reviewed and did not identify any material issues with the calculations of financial resources for each of the Parties pre- and post-Transfer. This review also helped me to identify some of the key risks affecting the companies.

12.1.3. In Section 9, I summarised the key risks that I saw as affecting the Parties and performed a qualitative review of the impact of the Transfer. I noted that although there would be some changes to the relative size of risks facing each company, the risks facing each were similar and changes in risk profile would not be material, favourably or unfavourably to either of the Parties. As a result, there would be limited change in the risks to each group of policyholders I have considered as a result of the Transfer.

12.1.4. I noted as part of this qualitative review that the Transfer would reduce the regulatory risk facing USAA LTD arising from the uncertainties presented by Brexit.

12.1.5. In Section 10, I reviewed the approach taken by the Parties to calculate the current capital requirements and their financial resources under the Solvency II prudential regulatory regime. I concluded that, subject to my quantitative testing in Section 11 of its appropriateness as a risk measure for each of the Parties, comparing the Solvency Ratio of the Parties pre- and post-Transfer indicated that no group of policyholders appeared to be materially adversely affected by the Transfer.

12.1.6. I also considered the projected medium-term Solvency Ratio of the Parties. Based on this review, I concluded that all of the Parties were projected to have EOF in excess of their respective SCR, MCR and target Solvency Ratios.

12.1.7. In Section 11, I performed some additional quantitative tests on the Parties. These enabled me to satisfy myself regarding the:

- robustness and reliability of the SCR and Solvency Ratio to alternative valuation assumptions;
- appropriateness of the SF SCR as a risk measure for each of the Parties;
- ability of each of the Parties to withstand a range of adverse scenarios; and
- resilience of the Parties both pre- and post-Transfer to extreme stress tests.

12.1.8. These tests showed that:

- There did not appear to be any material adverse financial effects arising from the Transfer to any of the groups of Affected Policyholders considered; and
- The financial resources of the Parties were appropriate for the risks they face.

12.1.9. *Based on this analysis, I have concluded that the Transfer do not have a materially adversely effect on the Affected Policyholders.*

12.1.10. *The various tests performed have also enabled me to be satisfied that the chance that any of the Parties fails to meet policyholder claims is remote.*

D. Detailed Review – Non-financial effects, notifications and publicity

13. Non-financial aspects relating to the Transfer

13.1. Introduction

13.1.1. This section sets out the various non-financial aspects of my review. In particular, I consider whether the security of the Affected Policyholders' contractual rights or the levels of service provided to them would be affected as a result of the Transfer, in relation to the following:

- Governance, strategy and operational matters;
- Policyholder priority on insolvency, wind-up and set-off rights;
- Policyholder protection schemes and policyholder complaints;
- Impact on reinsurers;
- Supervisory authorisations and waivers;
- Insurance law and governing law considerations;
- Tax effects of the Scheme;
- Pension funds and employee benefit plans; and
- COVID-19 pandemic impact.

13.2. Governance, strategy and operational matters

CORE FUNCTIONS AND BOARD COMMITTEES

13.2.1. USAA Staff have told me that there are no intended changes to the core functions or governance structure of USAA SA as a result of the Transfer.

13.2.2. USAA LTD ceased underwriting insurance business from 1 April 2022. Post-Transfer, it will no longer have any claims liabilities and expects to seek to have its insurance authorisations withdrawn and then to be wound up. Prior to its being wound up, USAA LTD's management and staff will continue to be employed by USAA International Services SARL and will continue to provide services to USAA UK Branch substantially as they currently are.

13.2.3. The governance structure of the USAA SA and USAA LTD are outlined in their respective ORSAs. The governance structure of the UK Branch is outlined in the Branch Application. The summary in the following paragraphs is based on these documents.

13.2.4. Both USAA LTD and USAA SA are governed by their respective Boards of Directors. Both Boards are chaired by the same senior individual within the USAA Group, the Senior Vice President P&C Auto General Manager. Each Board has a sub-committee, the Audit Committee and the Risk Committee, and various management groups including: the Executive Approved Management Group, the Operational Routine, the Portfolio Routine, the Risk and Compliance Routine and the Large Loss Routine.

13.2.5. USAA SA is managed by the Dirigeant Agréé and the Chief Financial Officer, while USAA LTD is managed by the General Manager International and the Chief Financial Officer. In each case, these two individuals are supported by the following functions: Risk Management, Actuarial, Compliance, Internal Audit, Underwriting, Insurance Sales & Service, Claims and Human Resources. The Dirigeant Agréé, or *approved manager*, is a person approved to manage a firm in Luxembourg on a day-to-day basis[39]. For USAA SA, they also act as its chief underwriter and portfolio manager.

[39] https://www.luxembourgforfinance.com/publication/insurance-2/

13.2.6. USAA SA's Board is made up of its chair, the General Manager International, the Dirigeant Agréé, and three Non-Executive Directors. USAA LTD's Board is made up of its chair, the General Manager International and three Non-Executive Directors.

13.2.7. USAA SA's governance structure has remained unchanged following the approval of its UK Branch.

13.2.8. The four senior employees of USAA SA: the Dirigeant Agréé, Risk Management Director, Head of Legal and Chief Financial Officer are jointly employed by USAA SA and USAA International Services SARL.

13.2.9. Both of the Parties have an established management team who have been carrying out these roles for USAA LTD and USAA SA for a number of years and governance structure in place. In addition they can draw upon the expertise and resources available across the USAA Group. Using such approach allows the Parties to adopt common standards in a number of areas. Both Parties believe that they comply in all material respects with the requirements of the Solvency II regulations.

Business Strategy

13.2.10. USAA Staff have told me that there are no intended changes to the business objectives and strategy of the USAA Group with regard to its European operations as a result of the Transfer. Both of the Parties exist to provide insurance products to overseas US military service personnel while stationed in Europe which are tailored to the specific insurance product needs of these USAA members. While USAA LTD will cease to exist in the near future, its activities will be continued by USAA SA, with its UK-regulated activities being performed by its recently authorised UK Branch.

Underwriting and Claims Authority

13.2.11. The operation of underwriting and claims is very similar for both of the Parties.

13.2.12. In each case, the Underwriting Function provides pricing recommendations, performance analysis, and policies and procedures relating to all products. The Underwriting function is led by the Chief Underwriter. The Chief Underwriter is responsible for all of underwriting guidelines and decisions, policy wordings and rates. The Claims Function, led by the Claims Director, oversees and coordinates all the claims activities. These responsibilities include the adjustment of auto, property and physical damage claims and the management of catastrophe operations. In addition, the Claims Director ensures the claims function complies with relevant policies and procedures.

13.2.13. For USAA LTD, the Chief Underwriter is the General Manager International, while for USAA SA, it is the Dirigeant Agréé. The Dirigeant Agréé's responsibilities include oversight and responsibility for the activities of USAA SA's UK Branch, in collaboration with the SA UK Branch Manager

13.2.14. Both USAA LTD and USAA SA outsource certain day-to-day activities to call centre staff in London, Luxembourg and Texas.

Internal Control

13.2.15. USAA SA and USAA LTD both operate an internal control framework that is designed to deliver legal and compliance minimum standards, including the standard required under Article 46 of the Solvency II Directive.

13.2.16. The Internal Audit function of both USAA SA and USAA LTD is predominately outsourced to a specialist audit function with USAA Group. The services and deliverables under this outsourcing arrangement are managed in accordance with service agreements between USAA SA and USAA LTD and the internal audit provider. The internal audit role periodically evaluates the effectiveness and efficiency of related risk management, control and governance processes within USAA LTD and USAA SA.

13.2.17. No change is anticipated to these arrangements as a result of the Transfer.

Investment Strategy and Investment Management

13.2.18. I have reviewed the investment strategy and policy documents for each of USAA LTD and USAA SA as summarised in their respective ORSAs and USAA SA's UK Branch application.

13.2.19. USAA SA and USAA LTD both have similar and conservative investment strategies with strict investment guidelines in place. These require them to maintain well-diversified high-quality bond portfolios. Both of their investment management guidelines seek to ensure compliance with the requirements of the Prudent Person Principal set out in Article 132 of the Directive 2009/138/EC. They set out strategic asset categories, limits and allocations that are suitable for their risk profile and strategic investment objectives. Neither USAA SA nor USAA LTD invest in any asset category that is not included in their investment management guidelines.

13.2.20. The investment management guidelines are approved by the respective Boards and reviewed annually. Performance and compliance are monitored by each company's Risk Committee and reported quarterly to their Boards.

13.2.21. USAA Staff have confirmed to me that no material changes to the investment strategy or asset allocation of either USAA SA or USAA LTD are anticipated. USAA Staff have told me that there will, however, be some non-material differences arising, with a slightly more restrictive set of guidelines applicable to USAA SA than was applied to USAA LTD.

Claims Handling and Policy Administration

13.2.22. USAA Staff have told me that no changes will take place to any claims handling or policy administration arrangements (described in Section 3.9) as a result of the Transfer. Essentially, the same people (whether USAA Staff or external providers of services to the USAA Group, will continue to perform the same tasks relating to the Transferring Policies after the Transfer as before the Transfer.

IT and Data

13.2.23. USAA Staff have confirmed to me that there are no intended changes to the IT systems used to manage policyholder or claims data arising as a result of the Transfer.

13.2.24. USAA Staff have confirmed that none of the data handling arrangements will change for any of the Parties as a result of the Transfer.

13.2.25. Where the data includes personal data, USAA SA will replace USAA LTD as the data controller. USAA SA will be under the same legal duty that USAA LTD was under in respect of the privacy and confidentiality of any personal data relating to the Transferring Policies.

Cost of Restructuring

13.2.26. The costs of the restructuring (including the costs of the Scheme) are being borne by USAA LTD[40]. I do not believe that the costs of restructuring are such that it will affect the security of any of the Affected Policyholders.

[40] Other than costs arising from certain outsourced services that are borne by USAA.

CONCLUSIONS

13.2.27. *I have therefore concluded that there will be no material changes or disruptions as a result of the Transfer to:*

- *The model for governance and internal control applied across the Parties;*
- *The international business strategy of USAA Group or the manner in which the strategy is carried out by the Parties;*
- *The manner in which policies are administered, claims are handled or other operational matters for the Affected Policyholders.*

13.2.28. *I have reached this conclusion because I have not identified in my investigations any material change or difference in the way in which the Parties operate.*

13.3. Policyholder priority on insolvency and winding-up and set-off rights

POLICYHOLDER PRIORITY ON INSOLVENCY

13.3.1. There is no change to the corporate domicile of the insurer of the Existing Policyholders.

13.3.2. The Transferring Policyholders will move to a Luxembourg-domiciled insurer from a UK-domiciled insurer.

13.3.3. USAA Staff have confirmed to me that under Luxembourg law, insurance policyholders are preferred creditors and will therefore, in relation to assets allocated to represent Technical Provisions, rank ahead of other creditors in the event of insolvency as discussed in paragraph 13.4.6. Under Luxembourg law, there is no difference in the treatment of UK, EEA or other policyholders. This is a different means of providing policyholder protection to that which applies for the Transferring Policyholders in the UK pre-Transfer. If the Technical Provisions are sufficient to cover the liabilities then it can provide greater protection than that available in the UK.

13.3.4. The requirement for USAA SA's UK Branch to hold assets in the UK and maintain own funds in excess of its SCR may provide some additional security to UK policyholders.

13.3.5. Because I have concluded in this Report that the likelihood that USAA SA will become insolvent is remote, I do not consider that any changes arising with regard to policyholder priority on insolvency will be material.

13.3.6. *I have concluded that any changes with respect to winding-up priorities of the Affected Policyholders as a result of the Transfer will not be material.*

SET-OFF RIGHTS

13.3.7. As both the Parties to the Transfer are and will remain wholly-owned subsidiaries of the USAA Group, I do not anticipate that the Transfer will confer any advantage to any companies within the USAA Group relative to the Affected Policyholders in this respect.

13.3.8. *I have therefore concluded that there will not be any material changes to set-off rights arising for the Affected Policyholders from the Transfer.*

13.4. Policyholder protection schemes

POLICYHOLDER PROTECTION SCHEMES

13.4.1. In the event of default by an insurer authorised to write business in the UK, certain types of insurance policyholders benefit from the protection provided by the FSCS[41]. As a general rule, this protection is only provided to individuals and small businesses[42].

13.4.2. For claims arising from UK compulsory insurance classes of business (predominantly employers' liability and third-party motor liability insurance), from professional indemnity insurance or from the death or incapacity of a policyholder through injury, sickness or infirmity, the FSCS provides 100% coverage for any insurer shortfall. In other cases, the coverage provided is 90%.

13.4.3. For the purposes of considering the effect of the Transfer, I note that the FSCS provides protection to:

- Transferring Policyholders in respect of losses occurring prior to the Transfer Date.
- Losses occurring on policies insured by authorised UK branches of overseas insurers.

13.4.4. All of the EEA Transferring Policies expired on or before 1 January 2020. Therefore the Transferring Policyholders will not, as a result of the Transfer, lose any protection provided by the FSCS as a result of the Transfer. This is because under the FSCS rules, claims occurring on policies issued by a UK authorised insurer pre-Transfer retain its protection.

13.4.5. All of the UK Transferring Policies will retain their protection provided by the FSCS following the Transfer. This is because they will continue to be policies of a UK authorised insurer, being the UK branch of USAA SA.

13.4.6. The Transferring Policyholders will acquire protection under Luxembourg law post-Transfer. USAA Staff have told me that under Luxembourg law, assets allocated by an insurer in respect of a non-life insurer's Technical Provisions are maintained separately on the balance sheet and are protected from other creditors of the insurer. These arrangements provide a degree of additional financial protection to policyholders, albeit in a form that differs significantly from that provided by the FSCS. For consumer policyholders the protection provided under the Luxembourg arrangements differs from, and in my opinion is more limited than, the protection provided by the FSCS. This is because the Luxembourg arrangements only provide protection up to the estimated value of the Technical Provisions rather than in respect of scenarios where the Technical Provisions prove to have been materially underestimated.

13.4.7. I have not investigated the Luxembourg policyholder protection arrangements further given my conclusions that:

- Transferring Policyholders' existing protections from the FSCS will be retained following the Transfer in respect of the Transferring Policies; and
- The likelihood of USAA SA becoming insolvent is remote.

13.5. Policyholder Complaints

UK ARRANGEMENTS

13.5.1. Subject to meeting certain specified criteria, policyholders of UK-domiciled insurance firms can take complaints to the Financial Ombudsman Service regarding the administration of their policy

[41] Described in the Policyholder Protection section of the PRA Rulebook.

[42] Those with an annual turnover of less than £1,000,000.

or claim from an establishment in the UK. The Financial Ombudsman Service is a free-to-use, public body established by law that makes awards of up to £375,000[43] that are binding upon insurance firms. If they wish to reject the award of the Financial Ombudsman Service, policyholders can then issue legal proceedings against firms to seek alternative redress.

13.5.2. USAA Staff have told me that during the last six years, there have been between 33 and 183 complaints handled by USAA LTD. Of these, no more than 1 claim has been escalated to the Financial Ombudsman Service in any given calendar year. The very low level of recent referrals suggests to me that the chance of any of the Transferring Policyholders needing to access the Financial Ombudsman Scheme is low.

13.5.3. The eligibility rules for complainants mean that only the following types of complainant are eligible to access the Financial Ombudsman Scheme:

- Consumers – essentially a natural person acting outside his or her trade, business or profession;
- A micro-enterprise – defined in the FCA Handbook (by reference to EU law) as an enterprise which (a) employs fewer than 10 persons and (b) has a turnover or annual balance sheet that does not exceed €2 million;
- A charity with annual income of less than £1 million at the time the complaint is made; or
- A trustee of a trust which has a net asset value of less than £1 million at the time the complaint is made.

13.5.4. USAA Staff have confirmed to me that all of the Transferring Policyholders are Consumers.

Luxembourg Arrangements

13.5.5. Policyholders of Luxembourg-domiciled firms can apply to seek resolution of complaints from one of two Luxembourg ombudsman services:

- The National Consumer Ombudsman Service of Luxembourg; and
- The Luxembourg Insurance Mediator.

13.5.6. In addition, they can approach both the CAA and the ACA (the professional association of Luxembourg insurers and reinsurers) for assistance.

13.5.7. USAA Staff have told me that both of these services are voluntary, and neither provides binding determinations upon insurers. However they have noted that the CAA can oblige a firm to respond appropriately to an ombudsman ruling. In addition, I have been told that their findings may be considered persuasive in Court were a consumer then to issue proceedings against USAA SA in respect of a complaint.

13.5.8. Although they operate differently, the arrangements in Luxembourg do not, in my opinion, appear to be materially weaker than those available under the UK's Financial Ombudsman Service. While rulings provided by the Luxembourg ombudsman services are not binding and therefore policyholders may still face the costs and risks associated with litigation, it appears that in practice the arrangements may result in an equivalent outcome for policyholders. Despite this, it is likely only to be possible to determine whether there has been a material change based on the facts and circumstances surrounding a particular complaint.

[43] In relation to new complaints made on or after 1 April 2022 in relation to acts or omission on or after 1 April 2019. Prior to these dates, lower amounts apply.

Impact of Transfer on UK Transferring Policyholders

13.5.9. UK Transferring Policyholders will be transferring to the UK Branch of USAA SA. As such, they will continue to fall within the remit of the Financial Ombudsman Service and will not lose any of their existing entitlements.

Impact of Transfer on EEA Transferring Policyholders

13.5.10. Before 1 January 2019, all regulated activities relating to the EEA Transferring Business took place in the UK. Any complaints in respect of activities prior to this date fall within the scope of the Financial Ombudsman Service; therefore, EEA Transferring Policyholders will not lose their ability to access the Financial Ombudsman Service as a result of the Transfer.

13.5.11. From 1 January 2019 onwards:

- All policies written in the EEA were underwritten by USAA SA; and
- All claims handling activities in respect of the EEA Transferring Business were performed in Germany by USAA LTD's German branch. From the Transfer Date, these activities will be performed by USAA SA.

13.5.12. In respect of this EEA Transferring Business, USAA Staff do not believe that any regulated activity took place in the UK from 1 January 2019 onwards. These policyholders should therefore not have been eligible to access the Financial Ombudsman Service in respect of regulated activities relating to their policies from this date onwards. As a result, USAA Staff do not believe that there will be any change to the EEA Transferring Policyholders' ability to access the Financial Ombudsman Service.

13.5.13. Although all regulated activity from 1 January 2019 took place outside the UK, there is the following hypothetical scenario that can only be argued pre-Transfer. This is where an EEA Transferring Policyholder successfully argues that their policy, issued in the UK by USAA LTD, entails the involvement of UK-based individuals (e.g. in overseeing the activity of the German branch). There is, however, no certainty that such arguments would have been successful pre-Transfer and it may only be possible to determine eligibility at the time at which a policyholder seeks to access the Financial Ombudsman Service.

13.5.14. Post-Transfer, grounds that a complaint might be considered in this way by the Financial Ombudsman Service will no longer exist because there will no longer be any activity performed either in the UK or in respect of a policy issued by a UK insurer. Given the low level of referrals of complaints to the Financial Ombudsman Service in recent years (see paragraph 13.5.2), I am satisfied that the impact of any such loss of rights arising is acceptably small.

13.5.15. In summary:

- EEA Transferring Policyholders will not experience any change to their existing arrangements. Where they currently have rights of access to the Financial Ombudsman Service in respect of pre-Transfer activities, these will be maintained.
- There is a hypothetical possibility that these policyholders will lose the ability to access the Financial Ombudsman Service in certain circumstances, however it may only be possible to determine eligibility at the time at which a policyholder seeks to access the service. In light of the low levels of referrals of complaints to the Financial Ombudsman Service in recent years, I am satisfied that the impact of any such change arising is acceptably small.

- Where the Transfer moves activities outside of the UK, the EEA Transferring Policyholders will no longer be able to access the Financial Ombudsman Service. For such complaints they will need to access one of the two Luxembourg ombudsman services post-Transfer.
- The policyholder complaint arrangements for a Luxembourg-domiciled insurer differ from a UK-domiciled insurer but appear to give rise to similar outcomes for the Transferring Policyholders. Without consideration of the facts and circumstances of a particular case, it is however not possible to say conclusively that there will be no change for all EEA Transferring Policyholders.
- UK Transferring Policyholders will continue to have a right to access the Financial Ombudsman Service post-Transfer.
- Recent experience of USAA LTD suggests that the likelihood of there being a complaint to the Financial Ombudsman Service from any of the Affected Policyholders is very low.

13.5.16. *Overall, I have concluded that certain policyholders might experience a theoretical reduction in the protection provided to them with respect to complaints as a result of the Transfer. Given the experience of USAA LTD of few recent policyholder complaints, I believe that this is unlikely to be material.*

13.6. Impact on Reinsurers

13.6.1. Outwards excess of loss reinsurance policies associated with the Transferring Policies will transfer to USAA SA. As both Parties share their excess of loss reinsurance programme, there will be no change to the outwards reinsurers of the Transferring Policies as a result of the Transfer.

13.6.2. Both Parties benefit from stop loss reinsurance from USAA Group. These policies provide £25/€25 million (for USAA LTD and USAA SA respectively) of cover in the event that the relevant company experiences a loss on a GAAP basis of more than £0.5/€1 million in a financial year. USAA LTD's stop loss reinsurance policy will not move as part of the Transfer. As a result, the risk of loss to this policy will reduce considerably, while the risk to the USAA SA policy will increase.

13.6.3. As the reinsurer, USAA Group, is the same for both stop loss policies, the change in risk will not in my opinion be material. In any case, USAA Staff have told me that the Transfer is being carried out with the involvement and approval of USAA Group.

13.6.4. *I have therefore concluded that there is unlikely to be any impact on the excess of loss reinsurers of the Transferring Policies arising from the Transfer.*

13.6.5. *While I expect there will be some changes to the position of the stop loss reinsurers of USAA LTD and USAA SA, I do not believe that these will be material. In any case, the Transfer is being performed with the involvement and approval of the relevant reinsurer, USAA Group.*

13.7. Supervisory Authorisations, Internal Model approvals and other waivers

PRUDENTIAL SUPERVISION

13.7.1. There will be no change as a result of the Transfer to the prudential supervisor of the Parties. The PRA is the supervisor for USAA LTD and will remain the supervisor for USAA SA UK Branch which is subject to the PRA's requirements for third country branches of insurers. For USAA SA, its supervisor will remain the CAA.

13.7.2. The EEA Transferring Policyholders will move from a firm supervised by the PRA to one supervised by the CAA. UK Transferring Policyholders will move to a firm that remains supervised by the PRA under requirements as a third country branch rather than a UK-domiciled insurance company.

13.7.3. Both the PRA and the CAA are well-established, experienced insurance supervisors who follow the requirements of Solvency II.

13.7.4. *Overall, I have concluded that while there is a change in the prudential supervisor for some of the Affected Policyholders, I do not believe the effect to be material.*

Conduct supervision

13.7.5. There will be no change as a result of the Transfer to the conduct supervisor of the Parties. For USAA LTD and USAA SA's UK branch this will remain the FCA and for USAA SA it will remain the CAA.

13.7.6. As a result of the Transfer, oversight of conduct supervision for the insurer of the EEA Transferring Policyholders will pass from the FCA to the CAA. For UK Transferring Policyholders, they will move to be policyholders of an insurer that is subject to conduct supervision by both the FCA and the CAA.

13.7.7. Pre-Transfer, the FCA is responsible for conduct supervision of all business written by UK-authorised firms including their overseas branches. Therefore, all of the USAA LTD policyholders fall within the FCA's oversight. In the UK, the Financial Conduct Authority has two statutory objectives: (i) a strategic objective to ensure that the relevant markets function well; (ii) operational objectives to secure an appropriate degree of protection for consumers; protecting and enhancing the integrity of the financial system; and promoting effective competition in the interests of consumers.

13.7.8. Conduct supervision for USAA SA is the responsibility of the CAA, the financial regulatory agency in Luxembourg. In addition to its prudential supervisory responsibilities, its website[44] states that it is responsible for:

- Approval of persons wishing to carry out regulated activities;
- Monitoring compliance with professional obligations relating to market conduct and product monitoring and governance requirements;
- Monitoring compliance with anti-money laundering obligations and countering financial crime; and
- Out-of-court settlement of disputes and the examination of claims relating to supervised activities.

13.7.9. In my opinion, its conduct supervision activities appear to be consistent with those of the FCA.

13.7.10. Based on this comparison of the objectives of each of the two conduct regulators, and their respective roles regarding the Affected Policyholders, I have satisfied myself that the Transfer will not give rise to a material change in the arrangements for conduct supervision that will affect outcomes for the Transferring Policyholders.

13.7.11. Conduct supervision in each EEA member state in which the Transferring Policies are carried out will remain unchanged.

13.7.12. *I have concluded that changes in conduct supervision for the Affected Policyholders will not be material.*

[44] https://www.caa.lu/fr/le-caa

OTHER REGULATORY APPLICATIONS AND WAIVERS

13.7.13. USAA Staff have confirmed that the Parties have no other ongoing regulatory applications.

13.7.14. *I did not identify any other material supervisory matters arising from the Transfer and affecting the Affected Policyholders.*

13.8. Insurance law and governing law considerations

INSURANCE LAW GOVERNING PRUDENTIAL SUPERVISION

13.8.1. Both the UK and Luxembourg have implemented the EU-wide Solvency II insurance law within their own laws. While I anticipate that there will be some differences in the manner in which they have been implemented, I am not aware of any material differences that apply. I note that both the EU and the UK are reviewing the operation of the Solvency II framework and future changes may arise. There is a risk that differences may emerge between the two arrangements in future however I do not believe that there it is clear whether any material differences will emerge. I am not aware of any plans by either the EU or the UK to materially weaken the protection provided to consumer policyholders such as those affected by the Transfer.

IMPACT OF GOVERNING LAW OF THE POLICIES OF THE TRANSFERRING POLICYHOLDERS

13.8.2. There is a theoretical risk that policyholders with policies governed by laws outside the EEA could be able to challenge the validity of the Transfer of their policy. I have not identified any scenarios under which a Transferring Policyholder would rationally wish to challenge the validity of the Transfer.

13.8.3. USAA Staff have confirmed that all of the UK Transferring Policies are governed by English law and all EEA Transferring Policies are governed by a law of an EEA member state.

13.8.4. In the unlikely event that a policy transpires to have been governed by the laws of a jurisdiction that does not recognise the Transfer, the Witness Statement states that Board of USAA SA has confirmed that it will pay any valid claim and shall not rely on such non-recognition to avoid the policy in question (and that it will meet any reasonable legal costs and reasonable expenses incurred by an Affected Policyholder or Claimant to the extent that they relate to the enforcement of a policy in a jurisdiction which does not recognise the Transfer). I therefore do not anticipate that there are any risks arising from the governing law of the Transferring Policies arising from the Transfer.

13.8.5. *I am satisfied that none of the Affected Policyholders will be disadvantaged as a result of the governing law of the policy.*

13.9. Tax effects of the Scheme

13.9.1. USAA Staff have advised me that they are in the process of calculating the extent of any tax liabilities arising for USAA LTD or USAA SA as a result of the Transfer.

13.9.2. *I expect to provide an update for the Court on how any such liabilities will affect the financial position of the Parties in my Supplemental Report, including whether there are any residual issues or material uncertainties arising that I need to highlight.*

13.10. Pension fund and employee benefit plans

13.10.1. USAA Staff have told me that there are no current or former UK employees of USAA LTD; all UK staff will continue to work for USAA SARL post-Transfer until they are transferred to USAA SA.

13.10.2. USAA LTD is the sponsor of a UK defined benefit pension scheme and a small German pension scheme. The size of the assets and liabilities of these schemes are set out in Section 4.3. These will remain in USAA LTD post-Transfer.

13.10.3. USAA LTD is intending on completing a pension buy-out of the UK defined benefit pension scheme during 2023. At the time of completing this report, the final terms for this buy-out have not yet been agreed and as a result there is a limited amount of residual uncertainty regarding these arrangements[45]. USAA Staff have told me that:

- £5 million of financial resources will be retained by USAA LTD in addition to those that it must retain to meet its regulatory capital requirements post-Transfer in order to cater for this residual uncertainty.
- USAA SA has provided a guarantee to USAA LTD's UK defined benefit pension scheme to cater for the event that USAA LTD is unable to fund any shortfall in the assets of its pension scheme.

13.10.4. USAA LTD anticipates agreeing on terms of the buy-out of the German pension scheme liabilities in the upcoming weeks between now and the Directions hearing. I will update the Court in the Supplemental Report regarding this.

13.10.5. *Based on this information I have concluded that there are no issues arising from the Transfer relating to pensions or other employee benefit plans that I need to highlight in my Report.*

13.11. COVID-19 pandemic impact

13.11.1. USAA Staff have told me that they do not anticipate that the COVID-19 pandemic will have any impact on the non-financial arrangements relating to the Transfer. All of the staff for both companies are able to work flexibly and can relocate their functions as needed. Post-Transfer, these contingency arrangements will continue to be available should they be required, unchanged from the position pre-Transfer.

13.11.2. *Based on this information I have concluded that there are no issues arising from the Transfer relating to the current COVID-19 pandemic that I need to highlight in my Report.*

[45] The residual uncertainty relates to a data validation exercise being performed by the external insurer prior to completion of the transaction and not to any uncertainty in the valuation of the pension scheme's assets and liabilities. The uncertainty is therefore believed by USAA Staff to be limited.

14. Notifications and Publicity arrangements

14.1. Introduction

14.1.1. In this section I have commented upon the approach the Parties propose to take in notifying Affected Policyholders and their proposed publicity arrangements. My understanding of the proposed approach is based upon the material supplied to me at the time of writing my Report by USAA Staff, including the Parties' Witness Statement.

14.1.2. Under FSMA 2000, the Parties are required to provide notification of the proposed Transfer to all Affected Policyholders and all Reinsurers of the Transferring Policies. They are also required to publicise the Transfer in a number of publications. The Parties are seeking a general waiver from notifying the Affected Policyholders and Reinsurers of the Transferring Policies and a waiver from the publicity requirements.

14.1.3. In this section I have described the proposed notification and publicity arrangements put forward by the Parties and the rationale for them. I have then commented on whether I believe that the arrangements proposed by the Parties are appropriate. I stress however, that it will be for the Court to approve these arrangements and any waivers sought and that it may amend some or all of them. If they are amended, I will comment on whether there are any changes to my conclusions in my Supplemental Report.

14.2. High level approach to Notification Arrangements - Policyholders

14.2.1. The Parties propose to send notification of the Transfer to the following groups of Affected Policyholders[46], (the Notified Policyholders):

- Transferring Policyholders meeting one of the criteria described in 14.2.2; and
- Third-party claimants (and/or their legal representatives) meeting the criteria described in 14.2.3.

14.2.2. Transferring Policyholders will receive notification where:

- Their policy has an unexpired period of cover at the Transfer date;
- Their policy expired on or after 1 August 2019;
- They notified USAA LTD of a claim and that the relevant claim file has not been closed (whether as a result of the mater being settled or USAA determining that there is no longer a risk of further activity arising on the claim); or
- They notified USAA LTD of a potential claim circumstance on or after 1 August 2019 and that has not to date resulted in a claim.

14.2.3. Third-party claimants will receive notification where:

- USAA LTD has been notified of a claim and that the relevant claim file has not been closed (whether as a result of the matter being settled or USAA determining that there is no longer a risk of further activity arising on the claim); or
- USAA LTD is aware of a potential claim circumstance on or after 1 August 2019 and that has not to date resulted in a claim.

14.2.4. The Parties propose to seek a general waiver from the strict notification requirements under FSMA 2000. This affects the following groups of policyholders:

- All Transferring Policyholders not listed in 14.2.2;
- Transferring Policyholders accidentally omitted from the notification arrangements;

[46] Under the definition contained in the FSMA Order.

- Transferring Policyholders for whom USAA LTD is not able to locate up-to-date contact information;
- All other third-party claimants not listed in 14.2.3; and
- All Existing Policyholders.

14.2.5. There are not expected to be any Remaining Policyholders.

14.2.6. The Parties propose to notify all reinsurers (or the reinsurance broker or agent acting on their behalf) of Transferring Policies:

- Where the relevant reinsurance contracts incepted on or after 1 January 2017; or
- Where USAA LTD has an open claim expected to give rise to a recovery under a relevant reinsurance contract. USAA Staff have told me that currently USAA LTD has no open claims expected to give rise to a reinsurance recovery with a date of loss prior to 1 January 2017.

14.2.7. The Parties have told me that under their proposals, they anticipate contacting:

- Approximately 5,000 Transferring Policyholders (being in respect of c. 8,000 policies that will not have expired at the Transfer Date);
- 121 third-party claimants and/or their legal representatives;
- Any policyholders and potential third-party claimants who made a notification of circumstances on or after 1 August 2019;
- All reinsurers of Transferring Policies for the last six years;
- All other reinsurers where there are open claims; and
- Approximately 30,000 Transferring Policyholders whose policies expired on or after 1 August 2019.

14.2.8. In Section 14.3 to 14.6 I have set out my opinion and supporting commentary in respect of each group of Affected Policyholders and reinsurers affected by these waivers.

14.3. Waiver for Transferring Policyholders

14.3.1. For the Transferring Policyholders, the Parties are seeking a waiver on the grounds that:

- The simple and straightforward nature of the insurance product issued, being predominantly annual consumer motor insurance;
- These policyholders are considered unlikely to give rise to a claim owing to the passage of time and the fact that almost all claims on their systems are reported within the proposed timeframe of approximately three years prior to the Transfer Date;
- Their intention that the Transfer should not materially adversely affect any of the Affected Policyholders; and
- The disproportionate costs involved in communicating with all of the Transferring Policyholders when some of these policies expired many years ago, and for the majority with no indication of any incident occurring that might give rise to a claim.

14.3.2. In my opinion, in the unlikely event of a claim arising outside of the three-year timeframe proposed by the Parties as a cut-off for notification purposes, the nature of USAA as a membership organisation for US military service personnel means that it will be straightforward for Transferring Policyholders (assisted by USAA Staff where necessary) to identify their insurer post-Transfer.

14.3.3. For third-party claimants, the Parties are seeking a waiver from notifying them where either the incident has been resolved between the claimant and USAA LTD, or where there appears to be no prospect of any further activity relating to the claim.

14.3.4. In my opinion, were further activity to arise, the nature of USAA as a membership organisation for US military service personnel means that, it will be straightforward for third-party claimants (assisted by USAA Staff where necessary) to identify the insurer post-Transfer. Writing to third-party claimants where a matter has been resolved would appear to be likely to incur significant cost for little if any benefit.

14.3.5. USAA Staff have provided me with an analysis showing that almost all[47] of USAA LTD's claims arising with a date of loss from 2015 onwards were reported within one year of the date of incident. This data provides evidence that the Parties' claims are reported rapidly and there are very few examples of slow claims reporting.

14.3.6. *Based on this analysis and the Parties' wider arguments, I believe that the arguments put forward for this waiver are appropriate.*

14.4. Waiver for Existing Policyholders

14.4.1. The Parties are seeking a waiver in respect of the Existing Policyholders of USAA SA on the grounds that:

- The simple and straightforward nature of the insurance product issued, being predominantly annual consumer motor insurance;
- The nature of USAA as a membership organisation for US military service personnel means that members do not distinguish between particular insurance carriers within the USAA Group;
- Their intention that the Transfer should not materially adversely affect any of the Affected Policyholders; and
- The disproportionate costs involved in notifying Existing Policyholders that there will be no changes to their existing or expired insurance policy with USAA.

14.4.2. Therefore, the Parties propose not to notify any of the Existing Policyholders of USAA SA on the basis of the expected lack of impact of the Scheme on the Existing Policyholders.

14.4.3. *I have reviewed these arguments and concluded that the arguments for this waiver put forward by the Parties are appropriate.*

14.5. Waiver for other Policyholders

14.5.1. The Parties are seeking a waiver from the strict requirements of FSMA 2000 on the grounds that the definition of policyholder is very broad and they do not wish to accidentally be in breach of the act owing to:

- Accidental omission of Affected Policyholders from the notification arrangements;
- Omission of Affected Policyholders[48] where USAA Staff have been unable to locate relevant contact information; or
- The fact that there may be third parties who will bring a claim in future but that USAA Staff are unaware of at the time of the notification exercise.

14.5.2. *I have reviewed these arguments and concluded that the arguments for this waiver put forward by the Parties are appropriate.*

14.6. Waiver for Reinsurers

14.6.1. The Parties are seeking a waiver from notifying reinsurers of Transferring Policies that incepted prior to 1 January 2017. This is on the grounds that there is no change being sought to these

[47] Approximately 99.3%.
[48] Under the definition contained in the FSMA Order.

reinsurance policies as a result of the Transfer. They will provide the same cover against the same underlying policies as pre-Transfer. The only change arising will be the identity of the insured, changing from USAA LTD to USAA SA.

14.6.2. USAA Staff have told me that there are no open claims affecting any of the reinsurance policies for which a waiver is being sought.

14.6.3. Note that for the stop loss reinsurance of USAA LTD and USAA SA:

- USAA LTD's stop loss reinsurance policies will not transfer and will be cancelled alongside the winding-up of USAA LTD[49];
- There is no obligation under FSMA 2000 to notify USAA SA's stop loss reinsurer. I note however that this reinsurer is USAA and USAA Staff have told me that they are aware of the Transfer.

14.6.4. *I have concluded that the arguments for this waiver put forward by the Parties are appropriate.*

14.7. Method of communication

14.7.1. As described above, the Parties intend to notify certain Transferring Policyholders and all third-party claimants (and/or their legal representatives) with open claims or with the potential for future claim activity. This notification exercise will be performed by USAA Staff.

14.7.2. The notification material will be made using the existing preferred means of communication identified for each policyholder. This is normally email because they are military service personnel and their families who have been posted to locations outside the USA.

14.7.3. For other parties who are being notified of the Transfer:

- Reinsurers will be notified by email; and
- Third-party claimants (and/or their legal representatives) will be notified by post.

14.7.4. Notification will take place shortly after the Directions Hearing so that recipients will have approximately 8-12 weeks to review the materials and raise any queries, representations and/or objections to the Transfer prior to the Sanction Hearing.

14.7.5. Checks will be carried out for obvious errors where postal communication packs are returned or communication packs sent by email bounce. They will then be resent, having been corrected where necessary. Where possible, communication packs that bounce a second time when sent by email will be resent by post. Where communication packs resent by post a returned (whether or not originally sent by email) then public searches and/or tracing agents will be used to identify a correct address to the extent reasonably possible.

14.7.6. The Parties have told me that they will have in place a helpline to respond to telephone, email and postal queries regarding the Transfer. They will record details of these queries and update the PRA, the FCA and me regularly regarding the nature and extent of these queries.

14.7.7. *I am satisfied that the proposed methods of communication for notifying policyholders, third-party claimants and reinsurers are appropriate.*

[49] This is because the stop loss reinsurance provides broader protection than as solely relates to claims and claims handling expenses.

14.8. Content of communication

14.8.1. The Parties intend to send the following material in their communication pack to notify Affected Policyholders and Reinsurers of the Transfer:

- A covering letter containing the prescribed information stating that the application for the proposed Part VII Transfer has been made by the Applicants to the Court. The covering letter will be tailored to reflect the category of recipient (e.g. where addressed to third-party claimants as opposed to policyholders);
- A copy of a formal legal notice setting out the details of the Court hearing;
- A statement setting out a summary of the terms of the proposed Part VII Transfer and containing a summary of the Independent Expert Report; and
- A question and answer booklet relating to the proposed Part VII Transfer that will address the immediate questions interested parties are expected to have about the Part VII Transfer in a simple and concise manner.

14.8.2. Other than as described below in paragraph 14.8.4, the Parties anticipate sending the Communication Pack solely in English as all of the Affected Policyholders are assumed (by virtue of their serving in the US armed forces) to be English speakers. USAA Staff have confirmed to me that English is the language used in all of USAA LTD's reinsurance contracts.

14.8.3. Copies of the communication pack translated into other languages or in other accessible forms will be made available upon request.

14.8.4. For third-party claimants located in EEA member states, the covering letter in the communication pack will be provided in the language in which the relevant claim is being conducted where this is not English. The covering letter will indicate that a translated copy of the other documents in the communication pack and other documents (such as this Report) will be made available on request.

14.8.5. *I have reviewed the near-final draft communication pack documents and satisfied myself that they are appropriate. I am satisfied that the proposed arrangements for non-English speaking recipients are appropriate.*

14.9. Proposed approach to publicity surrounding Transfer

14.9.1. The Parties propose to publicise the Transfer by means of a notice in the following publications:

- London, Edinburgh and Belfast Gazettes;
- Four national UK-based newspapers: Daily Mail, Daily Mirror, The Times, The Sun;
- Two national USA-based newspapers: New York Times, USA Today;
- One national Luxembourg-based newspaper: Luxemburger Wort; and
- One newspaper focused on US Military readership: Stars and Stripes.

14.9.2. The choice of non-legal publications has been to select English language publications, either addressing the UK and US mass market, or specifically focused on a US military personnel readership. This reflects the profile of Affected Policyholders. In addition, a Luxembourg-based national newspaper has been included in light of USAA SA's domicile.

14.9.3. Information regarding the Transfer will also be available on USAA webpages and on USAA's electronic portals (where relevant documentation and communications can be accessed remotely from wherever policyholders are located) and can therefore be accessed by former policyholders of the Parties.

14.9.4. A waiver is being sought from the requirements to publicise the Transfer in two national newspaper publications in each EEA member state where Affected Policyholders are located. This is because the Parties believe that no useful purpose would be served on the grounds that:

- The Affected Policyholders are all US nationals (or their families) who are English speakers and would not normally be expected to read EEA national newspapers which are not typically in English;
- Additional advertising will be carried out through advertising in four national UK newspapers (rather than the required two), in two national US newspapers and in two US-military readership focused newspapers.
- Additional publicity will be arranged on the USAA Group website and on USAA electronic member portals available worldwide to the Affected Policyholders and through which they routinely access their policy documents; and
- All third-party claimants (and/or their legal representatives) are to be notified directly.

14.9.5. The Parties will also comply with any additional publicity requirements under Luxembourg law and requested by the CAA.

14.9.6. The Parties intend to comply with any additional publication requirements specified by supervisory authorities in other EEA member states consulted by the PRA in respect of the Transfer.

14.9.7. The Parties intend to send a copy of the communication pack to the following organisations to further publicise the Transfer:

- Association of British Insurers;
- Association of Personal Injury Lawyers;
- Forum of Insurance Lawyers;
- Ministry of Justice; and
- International Bar Association.

14.9.8. *I consider that the approach taken to publicising the Transfer is appropriate and meets the requirements of FSMA 2000.*

14.9.9. *I consider that the waivers sought in respect of publicising the Transfer by the Parties are appropriate.*

E. Appendices

Appendix E.1. Scope of services

Below is an extract from our engagement letter dated 23 December 2020 regarding the scope of services. Note that some defined terms in this extract may differ slightly from those used in the Report.

Scope and purpose of Your Project

You would like Alex Marcuson to act as independent expert for the Proposed Transfer and prepare a report for the Court on its effects in accordance with the requirements described in Part VII of the Financial Services and Markets Act 2000, the Prudential Regulation Authority's ("**PRA**") Statement of Policy issued on 1 April 2015 and section SUP18 of the Financial Conduct Authority's Handbook.

The purpose of Your Project is to enable the USAA Group to continue to underwrite, service and settle claims related to the European business in USAA LTD without disruption in the event that the current negotiations for the United Kingdom to leave the European Union do not result in a continuation of the current legal framework

Services

We will carry out a review of the effects of the Proposed Transfer on:

- The policyholders of USAA LTD transferring into USAA SA;
- The existing policyholders of USAA SA;

In doing so, we will consider the effect of the financial and non-financial implications of the Proposed Transfer to determine whether we can be satisfied that no group of policyholders will be materially adversely affected.

As necessary, we will correspond and liaise with the PRA and Financial Conduct Authority ("**FCA**") when carrying out the role as the independent expert to the Proposed Transfer.

We will arrange for the independent expert to attend court for the sanction hearing as reasonably required.

We will prepare the Deliverables set out later in this letter.

Our team will be led by Alex Marcuson, assisted by other consultants and sub-contractors from as necessary.

This assistance will take place from the date of this letter and it is intended that the Proposed Transfer will be approved by the Court during 2022.

Appendix E.2. Reliances & limitations

E.2.1. Reliances

E.2.1.1. In preparing this Report I have relied on various sources of information, including:

- Data and information provided to me by USAA Staff. This information includes spreadsheet models, internally prepared reports and matters described to me in meetings;
- Publicly available data and information.

E.2.1.2. In doing so, I have considered the reasonableness of this information, but I have not independently verified all sources, nor have I carried out any form of audit of the data and information supplied. Should any of these sources prove unreliable or inaccurate, my findings may change, potentially materially.

E.2.1.3. In particular, I have not reviewed the case estimates established for individual claims and have relied upon the quality of case estimates in the data supplied by USAA Staff.

E.2.1.4. I have relied upon the statements made on behalf of USAA LTD and USAA SA in the Witness Statement that confirm the accuracy and reliability of the data and other information supplied to me as part of this project. I discuss why I believe it is appropriate for me to rely upon these statements in Section 5.

E.2.2. Limitations and uncertainty

E.2.2.1. General insurance and general insurance processes are by their nature uncertain. In the case of long-tail liabilities, particularly those with exposure to latent claims, this uncertainty is acute. The reader is cautioned regarding the high degree of uncertainty surrounding the quantitative analysis, and the consequences for my conclusions. The analysis in this Report seeks to provide an indication at various points of the potential for alternative legitimate results to be obtained and their consequences, but these should not be taken as the upper boundary below which estimates of ultimate claims should lie. In particular, events could give rise to outcomes beyond the higher scenarios indicated, and the scope and consequences of adverse experience are generally greater than for favourable experience.

E.2.2.2. General insurance gives rise to a wide range of potential uncertainties, particularly in times of extreme events. They rely on an assumption that the past provides a useful guide to the future. In practice changes and the possibility of change can lead to uncertainty. Matters that could affect the outcome in unexpected ways include, but are not limited to:

- Legal, judicial, regulatory and social changes;
- New types of claim or sources of claim that are interpreted as covered under policies;
- Economic effects – including significant exchange rate movements and hyper-inflation scenarios.
- Operation / control breaches by (re)insurers or one of their agents;
- New environmental effects, including the effects of climate change; and
- Technological changes.

E.2.2.3. Unless I have indicated otherwise, I have not made an explicit allowance for any of these effects or other new classes of claims that give rise to significant levels of claims.

E.2.2.4. Estimation of Reserves and capital requirements, while based on quantitative analysis, remain inherently subjective exercises, based on experience, internal and external data and a number of critical judgements. The use of the techniques set out in this Report is intended to provide an independent, quantitative and evidence-based approach to preparing these estimates.

E.2.2.5. Where provided, the estimates set out in this Report are intended to provide an alternative view to those of the company considered. There may be factors of which the managers and directors of that company are aware that I have not taken into account.

E.2.2.6. The estimates prepared should be considered in their totality. While I have tried not to cross-subsidise between different segments other than where indicated, individual estimates of segments are provided to assist the reader in understanding the analysis performed, and may contain over-estimates or under-estimates that are not material to the estimates in aggregate.

E.2.2.7. Certain parts of the work presented in this Report provide estimates of variability in the future outcome of insurance companies. These estimates are not themselves accompanied by explicit statements or quantification regarding the uncertainty in them, but seek to include what I consider to be an appropriate allowance within them.

LIMITATION RELATING TO REVIEW OF TECHNICAL PROVISIONS

E.2.2.8. My role as Independent Expert is not to provide an independent estimate of the Technical Provisions of any of the companies. Both USAA LTD and USAA SA have large portfolios of liability reserves that may take many years before the ultimate cost of claims are known. As a result, there is a wide range of estimates that might be considered to be appropriate.

E.2.2.9. The uncertainties inherent in liability reserves are increased in soft market conditions (where profit margins are being squeezed in many lines of business) and at the current time, where inflationary pressures not seen for many years are emerging in European economies.

E.2.2.10. My opinions regarding the Transfer relate to the totality of the positions of the companies and their abilities to meet policyholder claims as they fall due, and should not be taken as providing an opinion or assurance regarding the accuracy or adequacy of the Technical Provisions. My testing of the effect of the Transfer has sought to take into account the sources and scale of uncertainty arising from the estimation of USAA LTD and USAA SA’s Technical Provisions.

Appendix E.3. Data Received

In writing this Report, I relied upon the accuracy of certain documents and information provided by USAA Staff. These included but were not limited to the following:

Balance sheet and Business Forecast

- Audited UK GAAP/Lux GAAP accounts for USAA LTD and USAA SA as at 31 December 2021
- Solvency and Financial Condition Report (SFCR) for USAA LTD as at 31 December 2021
- Audited Solvency II balance sheet for USAA LTD as at 31 December 2021
- Solvency II balance sheet for USAA SA as at 31 December 2021
- Business plan forecast for USAA LTD pre-Transfer on a UK GAAP basis, for years ending 31 December 2020 to 2022
- Business plan forecast for USAA LTD pre-Transfer on an IFRS basis, for years ending 31 December 2020 to 2023
- Projected P&L, balance sheets and SCR calculations as at 31 December 2020 for:
    - USAA LTD pre-Transfer (UK GAAP and Solvency II)
    - USAA SA pre-Transfer (IFRS and Solvency II)
    - USAA LTD post-Transfer (UK GAAP and Solvency II)
    - USAA SA post-Transfer (IFRS and Solvency II)

Reserving

- Internal reserve reports for USAA LTD and USAA SA as at 31 December 2021
- Premium and claims triangulations for USAA LTD and USAA SA as at 31 December 2021
- Premium and claims reserves working files for USAA SA as at 31 December 2021
- Large losses claims listing for USAA LTD and USAA SA as at 31 December 2021
- Actuarial function reports for USAA LTD and USAA SA for Technical Provisions, Underwriting and Risk Management issued late-2021
- Sample reinsurance modelling files as at 31 December 2019

Capital

- Additional quantitative testing (sensitivity, scenario and reverse stress tests) as at 31 December 2020 for USAA LTD and USAA SA pre- and post-Transfer
- Standard Formula calculations for USAA LTD and USAA SA as at 31 December 2021
- Own Risk & Solvency Assessment (ORSA) report for USAA LTD and USAA SA dated as at 24 September 2021

Policyholder communications

- Letter to PRA/FCA (dated 27 January 2020) informing of the intention to request a waiver from certain notification requirements
- Draft communications documents
- Estimated costings of the notification exercise (in Witness Statement)

Other Non-Financials

- Final draft scheme documents and Court Order

- Governing law analysis (in Witness Statement)
- Final draft of first Witness Statement of Simon Patrick Kendall Keith
- Summary of the Luxembourg legal and regulatory framework applicable to insurance undertakings

Other information available in the public domain

- USAA Group and entity credit ratings as at 20 July 2020

Appendix E.4. Curriculum Vitae of Alex Marcuson

Professional summary

Alex Marcuson is a general insurance consulting actuary. He has over 20 years' experience of advising non-life insurers and reinsurers both UK-based and overseas, and including companies, mutuals, Lloyd's syndicates, captives, P&I clubs, brokers and other similar operations.

He has expertise across the lines of non-life insurance business written in the UK and overseas: personal, commercial and specialty lines. His advice has spanned a wide range of areas of actuarial involvement.

Between 2008 and 2013, Alex chaired the Institute and Faculty of Actuaries' General Insurance Professional Standards Committee and was a member of its General Insurance Board. He is currently a member of its Professional Support Service, a team of recognised experts who provide confidential assistance and responses to members of the Institute and Faculty of Actuaries on ethical and technical questions, and the General Insurance Reserve Oversight Committee.

Alex is managing director of Marcuson Consulting Ltd. a team of ten general insurance consulting actuaries.

Professional specialisms

- Reserving and liability valuations
- Capital and financial modelling, including Solvency II internal models
- Expert witness work and Part VII insurance business transfer schemes
- Corporate restructuring and M&A transaction support

Career history

1994 – 2000	Bacon & Woodrow – actuarial trainee
2000 – 2002	Trowbridge Deloitte, Australia – actuary
2002 – 2010	Deloitte – Associate Partner
2010 – present	Marcuson Consulting Ltd, Managing Director

Education and professional qualifications

1991 – 1994	Queens' College, Cambridge University. Mathematics – MA Hons. Double 1st
1998	Fellow of the Institute and Faculty of Actuaries
1999 – 2015	Holder of Lloyd's signing actuary practising certificate

Appendix E.5. Descriptions of additional tests of financial strength

E.5.1. Introduction

E.5.1.1. This appendix sets out the underlying rationale for the additional tests performed on USAA LTD and USAA SA.

E.5.2. Sensitivity tests

E.5.2.1. Table 22 shows the sensitivity tests performed.

Table 22 Sensitivity Tests Performed

<table>
<tr><th>Test</th><th>Short Description</th><th>Risks assessed</th><th>Rationale</th></tr>
<tr><td>S.1</td><td>+20% business volumes</td><td>Insurance Risk - Premium, Reserve and Cat Risk</td><td rowspan="2">All insurance businesses are exposed to the risk of premium volumes differing from planned levels. Aside from uncertainty in numbers of service personnel insured and demand for products offered, the Parties are additionally exposed to volatility in foreign exchange rates. This is because premiums are payable in US Dollars, so appreciation of the Dollar will result in increases in premium volumes. Note that this test only addresses the first order effect of changes in business volumes, and not any second order effects, including (for example) such as might arise when driven by currency movements (on unreceived premiums.)</td></tr>
<tr><td>S.2</td><td>- 20% business volumes</td><td>Insurance Risk – Premium Risk</td></tr>
<tr><td>S.3</td><td>+10% 2022 UWY combined ratio</td><td>Insurance Risk – Premium Risk</td><td rowspan="3">These tests have been performed to test the sensitivity of the Parties’ Solvency Ratios to the business plan loss ratio. The assumed 2022 underwriting year combined ratio and changes to the net technical provisions will affect the projected balance sheets of the Parties at the Transfer Date. Additionally, this test confirms the asymmetrical impact of the stop loss reinsurance contracts on the Parties.

The test on net technical provisions allows for increases to the Operational Risk component of the SCR.</td></tr>
<tr><td>S.4</td><td>- 10% 2022 UWY combined ratio</td><td>Insurance Risk – Premium Risk</td></tr>
<tr><td>S.5</td><td>+5% net technical provisions</td><td>Insurance Risk - Reserve Risk, Operational Risk</td></tr>
</table>

E.5.3. Low Return Period Scenario Tests

E.5.3.1. Table 23 shows the low return-period scenario tests performed.

Table 23 Low Return-Period Scenario Tests Performed

Test	Short Description	Risks Assessed	Rationale
L.1	+10% net technical provisions	Insurance Risk - Reserve Risk, Operational Risk	This test is designed to understand the impact on the Parties of what I would consider to be a material understatement in the Reserves that arises on a regular basis for insurers. This reflects the inherent uncertainty in the claims reserving process, uncertain external factors (such as jumps in levels of claims inflation) and adverse claims experience. As the vast majority of reserves relate to motor third party liability bodily injury, this scenario is severe enough to stress more than just a change in assumptions and encompasses a change in the external environment such as a legal change or further inflationary change. Increases in technical provisions are accompanied by increases in Solvency II risk margin and the Operational Risk component of the SCR.
L.2	RI credit risk – downgrade all counterparties by 1 notch	Credit Risk	This test is designed to assess how the SCR responds when reinsurers become impaired thus reducing the expectation of full recovery of reinsurance. This test does not allow for any impact on Technical Provisions arising from this downgrade although I do not believe that the effect would be material for the Parties owing to the credit ratings of the reinsurers all being A- or better.
L.3	Currency risk - stress 25% adverse shock of USD to GBP / EUR	Market Risk	Since USAA's premiums are collected in US Dollars and claims are paid in British Pounds or Euros, this test is designed to assess how the SCRs and the balance sheets of the Parties respond to adverse movements in foreign exchange rates.
L.4	Combined scenario: +10% 2022 UWY combined ratio +5% net technical provisions	Insurance Risk - Premium, Reserve	This test is designed to replicate a real-world scenario where Reserves are increased and, in light of this, the expected profitability is decreased in a corresponding fashion. This interconnection arises because Reserve estimates are used to form the basis of business plan profitability assumptions.
L.5	Increase in interest rates by 1% (100 basis points) at all durations	Market Risk	This test is designed to assess how the SCR responds to a modest increase in interest rates at all durations. This tests the extent of duration mismatches between assets and liabilities, although I note that the Parties both have prudent investment portfolios with assets and liabilities of similar durations of three years.

E.5.4. High Return Period Scenario Tests

E.5.4.1. Table 24 shows the high return-period scenario tests performed.

Table 24 High Return-Period Scenario Tests Performed

Test	Short Description	Risks Assessed	Rationale
H.1	+30% net technical provisions	Insurance Risk - Reserve Risk	This test is a much more extreme version of test L.1 but has been performed on a similar basis. As the vast majority of reserves relate to motor third party liability bodily injury, this scenario is severe enough to stress more than just a change in assumptions and encompasses a significant change in the external environment such as a legal change as well as sustained inflationary pressure.
H.2	+10% reserve deterioration **combined with** 50% reduction in cover from stop loss reinsurance (possibly arising if stop loss is cancelled or USAA defaults)	Insurance Risk - Reserve Risk, Operational Risk, Group Risk	This test is designed to assess how the SCR reacts if the claims reserves are under-reserved by a material margin and the stop loss reinsurance fails to protect the Parties. For example, this could arise if there is a serious systemic issue that leads to the need for an increase in reserves which also severely affects the USAA parent impairing their ability to provide the stop loss support to USAA LTD or SA.
H.3	+20% 2022 UWY combined ratio **combined with** +20% reserve deterioration	Insurance Risk - Premium, Reserve	This test is a much more extreme version of test L.4 but has been performed on a similar basis. A possible cause of this scenario might be from a change in the basis for legal liability for motor insurance claims.
H.4	-50% business volumes (possibly following large-scale troop withdrawal)	Insurance Risk - Premium, Reserve and Cat	This test designed to assess how the SCR reacts to a significant decrease in premium volume which will stress whether the company can continue to operate. Note that this test was designed and performed prior to the outbreak of the Ukraine-Russia conflict (see commentary in Section 2.4).
H.6	Default (with no recoveries) of largest external third-party reinsurer	Reserve Risk, Credit Risk	This test is designed to test how exposed each of the Parties are to a complete default by their largest third-party reinsurer.
H.7	Increase in interest rates by 4% (400 basis points) at all durations **combined with** 25% fall in value of pension scheme assets. [50]	Market Risk	This test is a much more extreme version of test L.5 but has been performed on a similar basis. In addition, an allowance has been included in respect of the risk of a fall in the value of pension scheme assets of USAA SA. Clearly there is a high degree of subjectivity in selecting such scenarios, with this choice seeking to have a material adverse impact on each of the Parties.
H.8	Data/cyber - Loss of €15 million (e.g. arising from regulatory fines, other IT remediation, incident management, PR/communication and marketing costs.	Operational Risk	This test is designed to assess how USAA responds to a significant reduction in their EOFs due to a major cyber incident. I have assumed that the SCR remains unaffected. For this scenario, I have assumed that the stop loss will not respond so that any losses will directly come out of the EOFs leading to Solvency ratios below 100%. Clearly there is a high degree of subjectivity in selecting the size of this operational loss, with this choice seeking to have a material adverse impact on each of the Parties.

[50] USAA SA only following the buy-out of the pension fund liabilities of USAA LTD described in Section 3.2 and 13.10.

Appendix E.6. Consolidated Balance Sheets (current and anticipated positions)

The following tables set out the pre-Transfer and the as-if post-Transfer positions of USAA LTD and USAA SA on a GAAP and Solvency II basis as at 31 December 2021.

E.6.1. GAAP basis

Table 25 - Pre- and Post-Transfer GAAP Balance Sheets as at 31 December 2021

ASSETS	Pre-Transfer, Pre-dividends			Pre-transfer, post-dividends €35m and other adjustments[51]		Post-transfer, post-dividends €35m and other adjustments		Post-Transfer, ultimate position including other adjustments	
	USAA LTD £m	USAA LTD €m	USAA SA €m	USAA LTD €m	USAA SA €m	USAA LTD €m	USAA SA (Total) €m	USAA LTD €m	USAA SA (Total) €m
Investment & Cash in Hand	92	109	107	59	139	25	173		198
Reinsurers' share of Technical Provisions	13	16	0	16	0	0	16		16
Debtors, prepayments & other assets	23	27	53	27	53	16	64		80
	128	**152**	**160**	**102**	**191**	**42**	**252**		**294**
LIABILITIES & CAPITAL									
Technical provisions	49	59	81	59	81	0	140		140
Creditors & other liabilities	5	6	13	6	13	4	15		19
Total liabilities	**54**	**65**	**94**	**65**	**94**	**4**	**155**		**159**
Net assets	74	88	66	38	97	38	97		135
	128	**152**	**160**	**102**	**191**	**42**	**252**		**294**
Net Technical Provisions	**25**	**29**	**36**	**29**	**36**	**-**	**66**		**66**

[51] For USAA UK, other adjustments are (i) the £9.4m payment made by USAA LTD in respect of the buy-out of the UK pensions scheme liabilities during the first half of 2022 and (ii) c.£3m of unrealised investment losses as at 30 June 2022.
For USAA SA, other adjustments are c. €3.5m of unrealised investment losses as at 30 June 2022.

E.6.2. Solvency II basis

Table 26 - Pre- and Post-Transfer Solvency II Balance Sheets as at 31 December 2021

ASSETS	Pre-Transfer, Pre-dividends			Pre-transfer, post-dividends €35m and other adjustments[52]		Post-transfer, post-dividends €35m and other adjustments		Post-Transfer, ultimate position including other adjustments	
	USAA LTD £m	**USAA LTD €m**	**USAA SA €m**	**USAA LTD €m**	**USAA SA €m**	**USAA LTD €m**	**USAA SA (Total) €m**	**USAA LTD €m**	**USAA SA (Total) €m**
Investment & Cash in Hand	92	110	108	60	140	29	171		200
Reinsurers' share of Technical Provisions	12	14	-4	14	-4	0	10		10
Debtors, prepayments & other assets	15	18	3	18	3	17	3		21
	119	**142**	**107**	**92**	**138**	**46**	**184**		**230**
LIABILITIES & CAPITAL									
Technical provisions	36	43	32	43	32	0	75		75
Creditors & other liabilities	7	9	13	9	13	6	16		22
Total liabilities	**44**	**52**	**45**	**52**	**45**	**6**	**91**		**97**
Net assets	75	90	62	40	93	40	93		133
	119	**142**	**107**	**92**	**138**	**46**	**184**		**230**

Net Technical Provisions	**25**	**29**	**36**	**29**	**36**	**-**	**66**		**66**
SCR	**20**	**23**	**36**	**23**	**36**	**4**	**54**		**54**
SII EOF for SCR	**75**	**90**	**62**	**40**	**93**	**40**	**93**		**133**
Solvency Ratio	**384%**	**384%**	**169%**	**171%**	**256%**	**1043%**	**173%**		**246%**

[52] For USAA UK, other adjustments are (i) the £9.4m payment made by USAA LTD in respect of the buy-out of the UK pensions scheme liabilities during the first half of 2022 and (ii) c.£3m of unrealised investment losses as at 30 June 2022.
For USAA SA, other adjustments are c. €3.5m of unrealised investment losses as at 30 June 2022.

Appendix E.7. GAAP to Solvency II Technical Provisions conversions

E.7.1. USAA LTD

The following table summarises the UK GAAP to Solvency II Technical Provision conversion as at 31 December 2021 for USAA LTD.

	Pre-Transfer, £m			Post-Transfer, £m			Calculation #
	Gross	RI	Net	Gross	RI	Net	
GAAP Technical Provisions	**49.2**	**13.2**	**36.0**				**1**
Prudence margin	(4.7)	0.0	(4.7)				2
Future premium receipts on incepted contracts	(9.7)	(1.5)	(8.2)				3
Unearned premium (incepted and unincepted) and associated claims costs	(0.7)	(0.1)	(0.6)				4
Other SII adjustments	1.7	0.6	1.1				5
Discounting	(0.3)	(0.5)	0.2				6
SII Technical Provisions excl. SII Risk Margin	**35.5**	**11.8**	**23.8**				**7 = sum 1 to 6**
SII Risk Margin	0.9	0.0	0.9				8
SII Technical Provisions	**36.4**	**11.8**	**24.6**				**9 = 7+8**

E.7.2. USAA SA

The following table summarises the Lux GAAP to Solvency II Technical Provision conversion as at 31 December 2021 for USAA SA.

	Pre-Transfer, €m			Post-Transfer, €m			Calculation #
	Gross	RI	Net	Gross	RI	Net	
GAAP Technical Provisions	**78.7**	**0.0**	**78.6**	**137.1**	**15.7**	**121.5**	**1**
Prudence margin	(3.5)	0.0	(3.5)	(9.1)	0.0	(9.1)	2
Future premium receipts on incepted contracts	(43.8)	(4.1)	(39.7)	(55.4)	(5.8)	(49.6)	3
Unearned premium (incepted and unincepted) and associated claims costs	(8.8)	(0.3)	(8.5)	(9.6)	(0.4)	(9.3)	4
Other SII adjustments	1.8	0.0	1.8	3.8	0.7	3.1	5
Discounting	0.2	0.0	0.2	(0.1)	(0.5)	0.4	6
SII Technical Provisions excl. SII Risk Margin	**24.5**	**(4.3)**	**28.8**	**66.7**	**9.7**	**57.1**	**7 = sum 1 to 6**
SII Risk Margin	7.5	0.0	7.5	8.6	0.0	8.6	8
SII Technical Provisions	**32.1**	**(4.3)**	**36.4**	**75.4**	**9.7**	**65.7**	**9 = 7+8**

Appendix E.8. Glossary

Defined terms, abbreviations and acronyms	
Actuarial Function Holder	Person responsible for the **Actuarial Function**, as defined in Article 47 of the Solvency II Directive. Each year, the Actuarial Function is required under the Solvency II Directive to prepare an **Actuarial Function Report** for the Board covering certain prescribed topics.
Adequately-capitalised	A company with a margin or buffer of EOF in excess of a Solvency Ratio of 100%.
Affected Policyholders	All of the policyholders affected by the Transfer. This comprises the Transferring Policyholders, the Existing Policyholders and the Remaining Policyholders.
Affected Reinsurers	All of the reinsurers affected by the Transfer.
APS	Actuarial Professional Standard. The APSs set out the requirements placed on all IFoA members, regardless of location. They are mandatory ethical standards issued by the Regulation Board of the IFoA.
APS X2	An APS which calls for the exercise of judgement in relation to the review of actuarial work. It is intended to assist members of the IFoA in deciding when and how to apply a review process.
Auto Insurance	Motor insurance product issued by the Parties. May also cover insuring the policyholder's motor vehicle while it is being shipped to and from the military base where the policyholder is stationed.
Board	Board of Directors of the company being discussed.
Bornhuetter-Ferguson method	Commonly used actuarial projection technique to estimate ultimate claims. It typically consists of a blend of the **Chain-ladder method** and an expected ultimate claims amount. Usually, the expected ultimate claims amount is derived through a combination of historical experience and the underwriter's views of profitability of the business written. The **Cape Cod method** is one of a number of generalisations of the Bornhuetter-Ferguson method.
Brexit	The departure of the UK from the European Union; or the date of departure.
Broker	A broker, agent or other third-party intermediary.
Claims Provision	The component of Solvency II Technical Provisions related to claim events prior to the valuation date.
Chain-ladder method	Commonly used actuarial projection technique to estimate ultimate claims. Subject to actuarial judgement, this method assumes that future claims development will follow the pattern of previous claims development.
Combined Ratio	(Net incurred claims *plus* Expenses) *divided by* Net Earned Premium.
Counterparty default risk	Reflect possible losses due to unexpected default, or deterioration in the credit standing, of the counterparties and debtors of insurance and reinsurance undertakings.
Court	The High Court of Justice of England and Wales, which is responsible for approving the Transfer.
EEA	The European Economic Area.
EEA Business	Insurance business carried out in one or more EEA member state.
ENID	Events not in Data. Under Solvency II, insurers are required to allow for all possible future events when setting Technical Provisions. This includes those that have not been observed in the historic claims experience of the insurer.
EOF or **Eligible Own Funds**	This is the surplus of assets over liabilities as determined under Solvency II. There are limits on the proportion of the SCR that can be met by certain types of Eligible Own Funds.

Defined terms, abbreviations and acronyms	
Excluded Policies	Excluded Policies are those policies that would otherwise fall within the definition of the Transferring Policyholders but the parties to the Transfer have agreed should be excluded or which cannot be transferred for another reason. **Excluded policyholders** are policyholders that hold Excluded Policies.
Existing Policyholders	The policyholders of the Transferee prior to the Transfer. Existing Policyholders have **Existing Policies** with USAA SA prior to the Transfer.
FCA	Financial Conduct Authority, a statutory body established by Act of Parliament and responsible for conduct regulation of insurers operating in the UK.
Financial Services Register	Public record maintained by FCA of firms, individuals and other bodies that are, or have been, regulated by the PRA, FCA and/or their predecessor the Financial Services Authority
Framework for FRC technical actuarial standards	This framework document explains the authority, scope and application of the FRC's technical actuarial standards and guidance.
FRC	Financial Reporting Council
Freedom of Establishment	In the context of (re)insurance business, the permission for a firm to establish a branch office anywhere within the EEA to underwrite (re)insurance business while remaining supervised by the prudential regulator of its home state.
Freedom of Services	In the context of (re)insurance business, the permission for a firm to underwrite (re)insurance business anywhere within the EEA as if they were a locally authorised firm.
FSCS	Financial Services Compensation Scheme. Statutory body responsible for meeting claims of individuals and small businesses in the event of UK insurer insolvency through its **Policyholder Protection Scheme**.
FSMA 2000	The Financial Services and Markets Act 2000. The UK legislation enabling the Transfer to take place, together with its supporting regulations and statutory instruments.
FSMA Order	FSMA 2000 (Meaning of "Policy" and "Policyholder") Order 2001 (SI 2001/2361)
GAAP	Generally Accepted Accounting Principles.
Handbook	Regulatory rules for firms regulated by the FCA. Formally, the FCA's Financial Services Handbook.
High Court	See Court.
IBNR	Incurred But Not Reported. Refers to insurance losses that have occurred but have not yet been reported to an insurer. This definition is often extended to include both claims that have been reported to the insurer but does not yet know the final amount of the loss, and those claims that will arise from events that have arisen but have not yet been reported to the insurer.
IFoA	Institute and Faculty of Actuaries, the UK Actuarial Professional Body.
Independent Expert	The independent expert approved pursuant to section 109(2)(b) of FSMA 2000
Market risk	Reflects the risk arising from the level or volatility of market prices of financial instruments which have an impact upon the value of the asset and liabilities of the undertaking.
MCR (Solvency II)	Minimum Capital Requirement. Under Solvency II (with effect from 1 January 2016), the MCR is calculated using a linear formula and must fall between 25% and 45% of the SCR. The MCR is also subject to an absolute floor. For USAA LTD and USAA SA's UK branch this floor is €3.7 million as defined in the PRA's Rulebook.
MCR Ratio	Ratio of EOF to MCR. For this calculation, the applicable EOF is more restrictive than the EOF that may be used to calculate the Solvency Ratio.

Defined terms, abbreviations and acronyms	
Motor	Insurance associated with vehicles, such as cars, vans and lorries. May cover damage to other people or property and damage to the insured's own vehicle. In many territories (including the UK) there is a legal obligation to purchase some form of this insurance.
Notified Policies	Transferring Policies for which there is an open claim, an unresolved claim notification arising on or after 1 August 2019, a policy that has an unexpired period of cover at the Transfer Date, or a policy that expired on or after 1 August 2019. Policyholders with Notified Policies are **Notified Policyholders.**
Operational risk	The risk of losses arising from human errors, external events, process or systems failures to the extent they are not already reflected in the Reserve, Market and Counterparty default risks.
ORSA	Own Risk and Solvency Assessment. Under Solvency II, all firms must prepare an ORSA annually for submission to the national supervisory body (in the UK this is the PRA). Amongst other elements, the ORSA sets out a firm's own assessment of the risks it faces and the capital it needs to support its business over a suitable time-horizon, often in the range of 3 – 5 years. Firms should consider the risks that may affect the business arising from the run-off of their existing liabilities.
Part VII Transfer	An insurance business transfer under the legal mechanism established in Part VII of FSMA 2000.
Parties	USAA LTD and USAA SA (including its UK branch)
Passporting Regulations	FSMA 2000 (EEA Passport Rights) Regulations 2001 (SI 2001/2511)
Pillar 1 (Solvency II)	This sets out the quantitative requirements, including the rules to value assets and liabilities, and to calculate capital requirements.
Pillar 2 (Solvency II)	This sets out the qualitative requirements for governance, risk management, and supervisory interactions.
Pillar 3 (Solvency II)	This focusses on public disclosure and transparency requirements.
Policyholder Protection Scheme	See FSCS.
PPO	Periodical Payment Order, a type of settlement arrangement used in the UK for some severe personal injury cases under which the insurer makes annuity payments instead of a lump sum compensation payment. The valuation of these annuities has proved particularly difficult for general insurers and increases the uncertainty in affected Reserves.
PRA	Prudential Regulation Authority, part of the Bank of England. Responsible for prudential regulation of UK insurers.
Premium and Reserve risk	The combination of Premium risk and Reserve risk, including an allowance for the diversification of risk between the two risk types.
Premium risk	Premium risk reflects the uncertainty in the ultimate claims cost estimated in unexpired policies and in business that an insurer anticipates writing in the year ahead.
Property Insurance	Insurance associated with property. Covers damage to the insured's own property (such as from fire or theft) and may also cover damage to other people or their property caused by the insured's property.
Remaining Policyholders	The policyholders of the Transferor who will remain with their respective companies following the Transfer.
Renters Insurance	One of USAA's insurance products. It provides cover for loss and damage to property which is rented and to the policyholder's assets in the rented property.

Defined terms, abbreviations and acronyms	
Report	This report prepared by the PRA-approved Independent Expert for submission to the Court. It has been prepared following the guidance set out in SUP18 and the SoP and is made available to any party requesting a copy.
Reserve risk	Reserve risk reflects the uncertainty in the ultimate claims cost estimated in the Reserves. Combined with Premium risk in SF SCR under **Premium and Reserve Risk**.
Reserves	See Technical Provisions
Residual Policies	Residual Policies are policies that it is not possible to transfer at the Transfer Date, for example because further steps need to be taken by the parties prior to their being transferred. **Residual Policyholders** are policyholders that hold Residual Policies.
RST or Reverse Stress Test	Reverse stress test – a method of testing insurer capital strength by increasing / decreasing one or more assumptions until a threshold (typically insurer default) is reached.
Rulebook	Regulatory rules for firms regulated by the PRA. Formally, the PRA's Rulebook.
Run-off	An insurer that is in run-off is not writing any new business but will continue to administer and pay claims for existing policies.
Sanction Hearing	Final Court hearing at which Court approval for the Transfer is sought by the parties to the Transfer.
Scheme	The legal mechanism by which the Transfer is brought about under Part VII of FSMA 2000.
SCR or Solvency Capital Requirement	The regulatory capital requirement for a firm under Solvency II. This is calculated as the level of financial resources that a (re)insurance firm needs to have in order to meet its financial obligations with a confidence level of 99.5% over a one-year time horizon. Most firms, including the Parties, use the prescribed **Standard Formula SCR** to determine their SCR.
SF SCR or **Standard Formula SCR** or **Standard Formula**	A formula-based approach to calculating a firm's SCR using a methodology and parameters specified in the Solvency II Directive implementing measures.
SFCR	Solvency and Financial Condition Report. These are publicly disclosed narrative reports, alongside data in standardised reporting templates, which form part of insurers' Pillar 3 disclosure obligations under Solvency II.
Solvency II	Europe-wide Insurance Directive which came into force from 1 January 2016. Solvency II sets out wide-ranging requirements on firms and supervisors relating to financial resources, risk and governance and reporting requirements. The Solvency II framework consists of three main areas (pillars) which are described in the relevant glossary items.
Solvency II Balance Sheet	A risk-based view of the balance sheet on a given date, where assets and liabilities are valued using a methodology specified in the Solvency II Directive implementing measures.
Solvency Ratio	A quantitative measure of financial strength used in this Report, formally: $$Solvency\ ratio\ \% = \frac{financial\ resources}{capital\ requirements}$$ Under Solvency II, EOFs are normally used for measuring financial resources; and SCR for capital requirements.
SoP	Statement of Policy, entitled *"The Prudential Regulation Authority's approach to insurance business Transfer"*, issued by the PRA in April 2015 and replacing the guidance in SUP18 of the PRA's Handbook.

Defined terms, abbreviations and acronyms	
Strongly-capitalised	A company with a substantial buffer of financial resources in excess of its regulatory capital requirements. I would describe a firm with financial resources of approximately 200% or more of its SCR (or equivalent 1 in 200 chance of insolvency over one-year time horizon risk measure) as strongly-capitalised.
Supplemental Report	Additional report prepared by the PRA-approved independent expert for submission to the Court prior to the final hearing at which the Court's approval of the Transfer is sought.
SUP18	The section of the FCA's Handbook setting out requirements and guidance for insurance business Transfer.
TAS	Technical Actuarial Standard. The TASs are professional standards which are set and maintained by the FRC. They are intended to be "applicable to work which involves the use of actuarial principles and/or techniques and the exercise of judgement or is presented as such, including for example financial models used in insurance and pensions and projections of contingent events. Compliance with the TASs for work in their scope is required for members of the IFoA and encouraged when such work is undertaken by non-actuaries, consulting firms or financial institutions."
TAS 100	Technical Actuarial Standard 100: Principles for Actuarial Work. A generic TAS which promotes high quality technical actuarial work. It establishes high-level principles and outcomes which users and the public can expect to be followed and achieved for all technical actuarial work in the UK.
TAS 200	Technical Actuarial Standard 200: Insurance. It promotes high quality technical actuarial work in insurance on matters where there is a high degree of risk to the public interest.
Technical Provisions	Technical Provisions, sometimes referred to as Reserves, are essentially the amounts set aside by insurance companies, at a given date, to pay for all potential future cashflows that would be incurred in meeting liabilities to policyholders from existing insurance and reinsurance contracts. The principles which are followed to calculate these provisions will differ depending on their purpose e.g. regulatory (Solvency II) or annual accounts reporting (GAAP).
Transfer	The proposed Part VII Transfer of certain assets and liabilities from USAA LTD to USAA SA. This is set out in the Scheme submitted to the Court. It will take place on the Transfer Date.
Transfer Date	The time and date on which it is intended that the Transfer shall take place. This is currently planned to be at 23:59 (CET) on 31 December 2022.
Transferee	USAA LTD
Transferring Liabilities	Reserves associated with the Transferring Policies.
Transferor	USAA SA
Transferring Policies	The policies which will transfer from the Transferor to Transferee under the Transfer.
Transferring Policyholders	The policyholders of the Transferor whose policies will transfer to the Transferee under the Transfer.
ULAE	Unallocated Loss Adjustment Expenses.
Umbrella Insurance	Extra insurance that provides protection beyond existing limits and coverages of other policies. It can provide coverage for liabilities resulting in personal injuries, (including lawsuits for defamation and breach of privacy), and from accidental damage to property.

Defined terms, abbreviations and acronyms	
Unearned Premium	The portion of premium income that is designated to cover risks in a future time period.
USAA	United Services Automobile Association, ultimate owner of all the companies within the **USAA Group**; including USAA SARL, USAA LTD and USAA SA. A company domiciled in the US.
USAA Actuarial Staff	USAA Staff employed in the actuarial department.
USAA LTD	USAA Limited, the **Transferor** and a wholly-owned subsidiary of USAA SARL. A non-life insurance company domiciled in the UK.
USAA SA	USAA S.A., the **Transferee** and a wholly-owned subsidiary of USAA SARL. A non-life insurance company domiciled in Luxembourg.
USAA SARL	USAA International Services SARL, a wholly-owned subsidiary of USAA. A Luxembourg-regulated insurance holding company that employs all USAA Staff in the UK and EU. It has delegated responsibility to perform insurance and operational activities on behalf of USAA LTD and USAA SA.
USAA Staff	Employees of USAA SARL or another company within the USAA Group.
UWY	Underwriting Year
Valuable Personal Property Insurance	One of USAA's property insurance products.
Witness Statement	A final draft version of the first witness statement of Simon Patrick Kendall Keith.