Is specialty insurance still special?
What’s on the horizon for the broader insurance industry?

The hunt for cost-efficiency
Slashing costs in a competitive environment

“I see wonderful opportunities everywhere. There’s a great future ahead.”
Inga Beale, CEO, Lloyd’s of London

EY
Building a better working world
Welcome

Welcome to the 2015 edition of the EY Specialty Journal! This publication is a result of combined efforts from our teams in the US, London and Bermuda, as we aim to showcase our commitment to and focus on the specialist insurance and reinsurance market.

In this edition, I am delighted to include a guest Interview with Inga Beale, CEO of Lloyd’s of London, who shares her views on the market as well as a wide array of topics that are important in the modern corporate world.

EY has also recently undertaken CFO and cost benchmarking surveys. In this edition, we provide the summary findings and key messages from these important pieces of research. While the low-interest-rate and soft-market environment persist, cost efficiency is gaining more focus. Finance now has to comply with increasing demands to be an effective business partner while also addressing regulatory requirements.

Greater focus is being given to the Senior Insurance Managers Regime, so our team has included a short article that highlights the key components of the regime and what steps management teams need to take as the deadline for compliance looms.

In light of recent market activity, we have included an article on post-merger integration, which outlines its core features and challenges, as well as an article on how the nature of specialty insurance has changed.

What’s more, we have included articles on the life market in Bermuda and how analytics is being used to combat fraud.

We hope you will enjoy reading this edition and will benefit from our industry commentary and insights.

Rodney Bonnard
Partner, UK Specialty Leader

“Finance has to comply with increasing demands to be an effective business partner.”
Specialty: moving with the times
Specialty insurance is poised to shape the broader insurance industry.

Post-merger integration
Recent M&A deals have not just been about market entry or strategic growth.

Innovations for a resilient future
An exclusive interview with Inga Beale, CEO of Lloyd’s of London.

Life: Bermuda’s best-kept secret
What has sparked increasing growth in Bermuda’s life insurance sector?

The hunt for cost-efficiency
The 2014 EY Cost and Operational Benchmarking Survey reveals what specialty reinsurers are working toward.

Senior Insurance Managers Regime
An outline of the proposals to replace the Approved Persons Regime.

Taking fraud detection upstream
Hybrid fraud analytics can, in a tough market, make a big difference to a reinsurer’s bottom line.

A fine balancing act for finance
Our latest Global Insurance Survey showed that finance professionals are facing a number of challenges.

Contacts
Specialty: moving with the times

Specialty insurance is dominating the growth agenda for many Property & Casualty (P&C) insurers and is poised to shape the broader insurance industry.

By Gail McGiffin
Flavors of specialty insurance have existed since the first insurance contract was inked in London in the 1600s. However, many underwriters, especially in the US, recall the “invention” of this subsector occurring during the hard market cycle of the 1980s. Some of the first management liability products were introduced at that time by a few pioneering, innovative insurers, such as AIG, Chubb, Reliance and Aetna. That market also accelerated the need for new capacity, giving birth to entirely new insurance companies, such as XL and ACE.

While new surplus in the market was timely and welcomed, especially by large businesses with significant risk transfer exposures, some of the newer professional products, such as directors and officers (D&O), fiduciary and employment practices liability (EPL), required proactive education and selling. With clear trends in litigation to support the need for this new protection, the coverage was nevertheless purchased primarily by the largest businesses in mature economies.

Similarly, the early media liability products that have now morphed into cyber, privacy, and network security products were challenging to sell in the early 1990s when the internet was just taking hold. Events such as the Tylenol recall, Enron, Hurricanes Andrew and Katrina and the 9/11 terrorist attacks turned the spotlight on the complexities of the need for professional products, as well as the need to address multiperil and multiproduct convergence and government backstop involvement where insurance was lacking.

The growth of specialty insurers was led by venture capital–funded start-up insurers (mostly generating out of Bermuda and consistently perceived as driving higher multiples for IPOs) and large, global insurers creating separate underwriting divisions to focus on specialty products. Today, the insurance industry landscape has an abundance of specialty insurance providers fueled by prolific talent-poaching among competitors. Underpinning these growth plays has been strategic motivation by standard lines writers to improve their profitability margins through inclusion of the higher-margin specialty business. At the same time, purely specialty writers have recognized the need to balance the inherent volatility of some of the specialty products with standard lines business. These strategic expansion efforts have yielded robust market options for agents, brokers and customers, with the ability for more and more insurers to provide a breadth of product offerings across standard and specialty lines.

Specialty redefined
Today’s profile of specialty insurance has taken on greater diversity and expanded definition. In some cases,
this has occurred through internal organizational consolidation to sweep all specialty products under singular leadership. In other cases, specialty writers have acquired additional product capabilities through mergers or targeted talent acquisition. In the broadest sense, specialty insurance can include the following product and segment areas, whether provided on an admitted or non-admitted or excess and surplus (E&S) basis:

- Management liability (D&O, EPL, Fiduciary, Fidelity, Kidnap & Ransom)
- Professional liability (Lawyer’s Errors and Omissions (E&O), Architects & Engineers E&O)
- Miscellaneous E&O
- M&A representations and warranties
- Cyber liability
- Surety
- Trade credit
- Marine (ocean, inland)
- Political risk
- Travel
- Special events

- Warranty
- Accident and health
- Aviation
- Excess Workers’ Compensation (WC)
- Programs (managing general agent (MGA) and managing general underwriter (MGU) driven with or without sponsor organizations, usually industry segment oriented)
- Financial instruments (insurance-linked securities (ILS), captives and fronting)

While several of these product areas continue to have unique distribution access (like trade credit or accident and health), others have been mainstreamed into the wider franchise and even bundled into package offerings to ease the selling proposition for agents and brokers.

**Horizon of innovation: customer centricity**

Not unlike other industries (medical and sportswear), P&C insurance has developed hyper-specialization in product offerings – and greater access to specialty products has certainly benefited the business buyer. However, as specialty writers face increased competition from a more saturated landscape of providers – and, one could argue, some dilution to the aura of underwriting complexity – it
will be important for these insurers to invest in new forms of innovation.

- Shift from product centricity to customer centricity: specialty insurers have prided themselves in driving product availability into the marketplace, untethered to the reliance on industry segmentation that standard lines underwriters thoroughly embrace (i.e., Standard Industry Classification- and North American Industry Classification System-driven underwriting appetite). However, this product-centric approach needs to merge with a more customer-centric one. More and more, business buyer expectations demand that insurers have a deep understanding of their industry, reflected in tailored solutions and expertise. There is a significant opportunity for specialty insurers to invest in developing unique customer and industry segment insights to develop better products and services.

- Integrated account management: while larger businesses often use multiple brokers and insurers to fill out their portfolio of coverage and risk management needs, middle market and smaller enterprises value greater simplicity in their distribution and carrier relationships to fulfill their risk transfer needs. Specialty insurers need to find better ways to bring an integrated approach to their agents, brokers, prospects and insureds that balance the advantage of specialized knowledge and products with holistic and collaborative account handling across underwriting, loss control, claims and premium audit. Similarly, specialty insurers need to work closely with their standard lines counterparts to align and integrate with shared agents or brokers across the franchise.

- Ease of doing business: the inherent complexity of many specialty products and underwriting exposures has not been conducive to focusing on ease of doing business in this market. As specialty insurers target more middle market and small businesses, they will need to find opportunities and make investments to streamline and simplify interactions with both distribution and insured customers, as omni channel access and consistent user experience have become the minimum requirement for insuring those segments.

- Organizational integration: from its origin, specialty insurance has driven product silos into the insurance organization, making natural opportunities for cross-selling challenging for field underwriters and sales and marketing teams. In order to optimize delivery of more customer-centric solutions and facilitate account rounding, the underwriting organization must operate more cohesively in the marketplace with both producers and customers. This becomes even more imperative as specialty insurers pursue a multinational growth agenda.

- Decision science: while the “art form”...
of specialty lines underwriting may still mystify the producers and insured buyers, it is not a differentiator in and of itself. With more history and digital data access available, specialty insurers must embrace more sophisticated rules and modeling capabilities to outpace the competition and sustain profitable results as the operation grows in size.

**Bold moves**
The same gumption and pioneering spirit that the founding insurance leaders had when they created the specialty marketplace are required now to advance specialty insurance to the next level of performance and market leadership. Trends in litigation, regulation, economic maturity, social and workforce issues and technology will continue to inspire new product innovations with specialty insurers. But the competitive landscape is more crowded, and bold moves are needed, including industry specialization and standard lines integration, to expand the specialty value proposition.
Post-merger integration: Creating mergers of equals

Recent M&A deals have not just been about market entry or strategic growth.

By Andy Worth

“... and they’re off!”

The start of a major horse race is always preceded by a mixture of excitement and surprise. Although everyone knows a race is about to unfold, with plenty of speculation on runners and form, the exact moment they head off is less precise, and the result even less certain.

The 2015 specialty mergers market has started in much the same way. Although consolidation has been forecast for some while, the exact timing and proposed combinations of players have still managed to provide surprises. At the start of the year, the XL and Catlin deal and the proposed Axis and PartnerRe mergers caught the imagination of the market, especially with the offers put forward by Arch and, in particular, Exor. Speculation
grew on other potential combinations. However, by the time the “summer events season” started, the market had really got into the spirit of things with Tokio Marine Kiln’s purchase of HCC, the Willis and Towers Watson merger and ACE’s bid for Chubb. Blink and you will miss the next one.

Unlike other recent transaction activity, which has involved Asian and Middle Eastern national champions and private equity investments, these deals include a considerable degree of overlap between the organizations, and therefore a lot of focus on post-merger integration (PMI). In other words, the rationale for previous deals has been around market entry and strategic growth, whereas the more recent deals will create mergers of equals. The drivers behind these deals tend to be expanding market presence, by creating scale, and driving economies of scale, due to the overlap that exists between the two organizations.

These benefits will be driven by the PMI program, which requires considerable energy, leadership and focus from the executives of both organizations to be delivered successfully. The very nature of PMI activity can make organizations very inward-looking throughout this period of upheaval, but it is far better for companies to go through this uncertain time as quickly and deliberately as possible, rather than leaving the PMI incomplete.

Mergers and PMI programs of this scale are new to the specialty market, where many of the leading players are relatively new and have largely grown organically. This means PMI skills and experience for the scale of deals we are now seeing are in relatively short supply. Awareness of the key PMI pitfalls is important in these situations, in order to mitigate their potential impact and provide the greatest opportunity for merger benefits to be realized. These challenges fall into five main areas.

“A successful integration program balances achievement of target state with active management of stakeholder expectations.”
First of all, companies must recognize, where there is a merger of equals, how this differs from normal takeovers. The considerable capabilities of both organizations should be recognized, and careful handling of the stakeholders on both sides needs to be understood.

Secondly, a good integration management structure, with clear accountabilities, processes and tools, needs to be put in place to drive the integration process. These programs typically touch every part of the organization, with considerable interdependencies across functions and stakeholders. In other words, they are complex and need to be managed carefully and comprehensively.

The combined organization needs a clearly articulated strategy and operating model. Many of the major organizations around the globe manage their operations deliberately to be a platform for growth and bolt-on acquisitions.

“Measuring, tracking and clear responsibilities for benefit realization should be agreed to early on.”

This means when a deal is done, there is no question as to which process or system will be adopted; these have all been predetermined. In many specialty market situations, the company operating models are still growing in terms of maturity and do not provide an ideal PMI platform. The target operating model (TOM) will be a platform to realize many of the deal benefits, so its design and execution is critical to the process. Target merger benefits should be assessed along three dimensions:

- **Source:** from where are the benefits derived in the operating model? These can range from distribution synergies to supply chain rationalization, along with operational overlap.
- **Size:** how large are the potential benefits?
- **Velocity:** how quickly can the benefit
be realized? There can often be delays in areas such as HR, tax and actuarial, while capacity in overlapping teams is taken up delivering legal entity rationalization and addressing HR matters in other functional areas driven by the PMI impact.

Many of the skills involved in creating a target integrated model are similar to those used in business-as-usual cost reduction and operating model design initiatives. Creating a robust baseline is a priority that gives a true reflection of the current state of both organizations in terms of cost and full-time equivalent (FTE). The baseline means that both sides are dealing with a common set of numbers they can trust. This is hugely important in what is a sensitive situation regarding future careers, and is typically consolidated into a single data model, which has been reviewed and signed off by relevant functional and divisional stakeholders.

Thirdly, for the integration to be successful, all of this activity must be supported by a sustained, cross-functional focus on stakeholder management. A successful integration program balances achievement of target state with the active management of stakeholder expectations – achieving synergy targets and other strategic objectives will be of limited value if the process to get there has disrupted client, broker and employee relationships. The complexities of transitioning to the target state may carry unintended consequences to key constituents, and it is only through a rigorous, disciplined approach that potential impacts can be identified early enough to pre-empt. Leading practices include:

- Testing the target state design from both a client and employee perspective to understand and assess both positive and negative impacts
- Providing clear focus on the overall client and broker experience through the transition, addressing impact and touchpoint analysis, risk mitigation and ongoing monitoring
- Providing focus on employee transition considerations, including cultural review and refinement as needed
- Developing and implementing a robust and timely communication program for all stakeholders (clients, employees, ratings agencies, regulators and media)

Linked to this is the fourth challenge, which is keeping a consistent and agreed focus on benefit realization. The integrated target state operating model design will include the business case that has to be delivered from the new model. Measuring, tracking and clear responsibilities for benefit realization should be agreed to early on in the process and tracked on an ongoing basis. Responsibilities may be split between finance and operations to track benefits. For example, operations may be responsible for executing an action to realize benefit, such as migrating to one policy platform, whereas finance may be responsible for reporting the actual benefits realized by this action. Typical areas of benefit leakage include operational unit claiming “cost reduction” when really they are proposing “cost of transfer,” by transferring teams to other
areas or “cost avoidance.” Careful trading should mitigate these pitfalls.

The final area that requires focus is to create a set of merger principles that is consistent with the rationale of the deal. For example, if it is a “merger of equals,” the guiding principles of the TOM design need to set the right tone and support the synergy opportunities. For example:

- The target state operating model will use the best people, processes and technologies from either legacy company in the new state.
- A single management structure will be created in the target state, selecting the best candidates from either organization.
- The target model will, as far as possible, leverage a single instance of capability on the future state.
- The TOM will identify opportunities to create centers of excellence and migrate the selected activity to those locations.

A typical characteristic of most successful programs is momentum, where key decisions are made early and executed as quickly as possible. EY has invested in an integrated transaction and post-merger integration capability to support clients in these challenging projects. The sooner the merged operating model is implemented, the quicker the organization can leverage the benefits of the new entity.
Inga Beale landed her role as CEO of Lloyd’s of London in 2014, after her eclectic and exciting career saw her take positions at several major companies including Prudential, GE Insurance Solutions, Converium (now part of the SCOR Group) and Zurich Insurance Group. With optimism and enthusiasm, Inga discusses her vision for Lloyd’s, her predictions for insurance markets and her hopes for innovation as the

“In the most important challenge for business is putting the customer at the center of what we do.”
industry navigates its way through numerous global challenges.

EY’s motto *Building a better working world* reflects our aim to make a difference to people. Why do you feel insurance matters?

Insurers build resilience into everything. We’re behind every big story you read in the newspaper, supporting the social infrastructure and helping people get their lives back on track. I think this particularly appeals to the new generation because we do make a noticeable difference.

**What can the new generation of insurers look forward to?**

I see wonderful opportunities everywhere, with emerging markets gaining strength and demand growing for new products. We’ll also need to make ourselves more local to clients, to try to regain some trust that was lost in big global corporations after the financial crisis. If we can handle this, there’s a great future ahead.

**“You have to be persistent and have confidence in your own abilities.”**

**What is Lloyd’s doing to innovate and drive changes in the market?**

Lloyd’s has always had the courage to take on brand new risks: insuring the first satellite going up into space and even the first motor car, for example. However, we are still a huge market with many competitive players who want to work independently. Our central role should be to encourage and facilitate innovation when brokers and underwriters want it.

**What will the main innovations be in your non-core markets?**

These are becoming more challenging. Many of our priority markets require Lloyd’s to have a local presence in order to get access. We’ve had great successes from this, though. Some of our syndicates with local representatives in Brazil have seen 55% annual growth over the last three years.

**What changes do you see happening in the Lloyd’s market over the next 10 years?**

As part of our Vision 2025 initiative we’re working to modernize, which means embracing technology much more than we have done. I also predict more trade ownership of syndicates, so we’ll have to make sure that smaller businesses remain vibrant. We’ll need to diversify our talent so we can nurture entrepreneurs and start-ups on a global scale.

**Which industries outside insurance do you think you can learn the most from?**

The most important challenge for business is putting the customer at the center of what we do. I think the television and film industries have understood and met this challenge

*You have to be persistent and have confidence in your own abilities.*
perfectly. They've managed to completely transform their product in recent years, so that people can now watch exactly what they want, whenever and wherever they want it. There's something we can learn from this tailored approach.

How has your life changed since taking on this role?
I have far less control over my time than I have had in other roles. Because there are so many stakeholders here, I get drawn into all sorts of things. Also, my travel schedule is packed as this role is so global.

Which three words would best describe the journey you’ve had in your career?
Firstly it’s been completely unexpected, especially as I left the industry in the 1980s! It’s also been challenging. I’ve never shied away from the challenges that not everybody likes doing. And, it’s been varied, allowing me to work in many countries round the world.

What is your biggest achievement to date?
People are often shocked when I don’t respond to this question with “Being CEO at Lloyd’s!” But I don’t feel I’ve been here long enough to make that claim. I always go back to my time at Converium in Switzerland. When I was appointed Group CEO, the business wasn’t in the best state, but we managed to turn everything round before selling it onto SCOR for an excellent deal. That was really my proudest moment.

What is the most important lesson you’ve learned in your career?
Patience. I am an incredibly impatient person, but you can’t be if you’re trying to work alongside other people. You also have to be patient in your career development. Sometimes, I’d wonder whether a career opportunity was absolutely right for me, but it always turned out to be a great stepping-stone onto something else which turned out to be amazing.

What do you get up to outside work?
I try to keep the weekends sacred. I still live in Zurich, so I like to hike with friends in the Swiss Alps in my free time.

As one of the few female leaders in the city, what advice would you give to young women trying to enter the insurance industry?
You have to be persistent, and have confidence in your own abilities. This confidence tends to separate men and women. I’ve known many women turn down a promotion because they didn’t think they were good enough – in fact, I’ve done it myself.

I also talk about the PIE model: Performance, Image and Exposure. Women often think that career development is all about performance and doing a good job. The other two...
are so important, though. Your image has to come across in the right way, and you need all kinds of exposure to get your break.

**What can companies do to encourage this?**

During my time at GE, my managers were given workforce diversity targets. I know that my career opportunities stemmed from this proactive approach. Targets around developing your talent across race, ethnicity, gender and LGBT communities are just as important as your other performance targets. In the Lloyd’s market we have joined forces with the Lloyd’s Market Association to actively champion diversity and inclusion through the Inclusion@Lloyds initiative.

I’ve also noticed a fear of talking about diversity, but we need to be more open about it. If people feel included, they’ll want to stay and they’ll want to perform well.
n recent years, while special purpose insurers have stolen the headlines as being the fastest-growing part of the Bermuda insurance sector, many were surprised to hear that, in 2014, the fastest-growing sector was life, or “long term,” as it is referred to by the Bermuda Monetary Authority (BMA).

Renewed interest
Prior to 2011, when the BMA revised the classification criteria for the long-term sector, relatively little information about it was publicly available. While a few of the better-known public company reinsurers associated with Bermuda had life businesses that were visible, there were a number of affiliated reinsurers of US and European insurance groups that were less so – and also a handful of insurers, again affiliates of large groups, writing business further afield.

While the changing, and increasingly robust and transparent, regulatory environment over the past six years may have led some companies to exit Bermuda, others cite the robust regulatory environment as a reason for their establishment of a licensed insurer in Bermuda. In fact, recent figures published on the BMS Group’s website (April 2015) show that the net position has been an increase – with the largest group, Class E, which included companies with balance sheets in excess of US$500m, comprising some 24 licensed insurers versus 14 in 2012.

“The challenge
A feature of the global life insurance industry is that typical product design varies by jurisdiction. Bermuda,
As primarily a reinsurance-focused jurisdiction, therefore assumes a wide range of risks from different places. These differences, together with a mix of focus between facilities focusing on providing security in retirement or long-term care situations, and others focused on mortality risk, can provide an interesting challenge in determining mechanisms to calculate whether capital requirements are in line with perceived real levels of risk.

There is also a mix of quota share business and block reinsurance.

As pension fund managers look for diversification and return in a low interest rate environment, and investment managers look for additional float to invest, there has been a renewed interest in this sector, increasing the pool of capital and, thus, market capacity.

Forward thinking
The changes in the Bermuda regulatory environment present some particular challenges for pockets of the life sector but, equally, recognition by Europe as equivalence under Solvency II will likely also present many new opportunities.

In terms of challenges, the BMA’s April 2015 consultation paper considers changes to head-office requirements that will need careful consideration, particularly for those (such as block reinsurers) that do not require many “business as usual” staff to operate; and the public disclosure requirements of the proposed financial condition report are quite different from those that

“The changes in the Bermuda regulatory environment present challenges and new opportunities.”

US and Canadian focused reinsurers have experienced before.

Most notably, the consultation paper issued in December 2014 by the BMA on the economic balance sheet presents key challenges in relation to those reinsurers that have investment risk stretching out many years into the future. In addition, the upcoming trial run process and subsequent finalization of the rules will be important. Capital requirements are arguably one of the reasons that fixed or guaranteed annuities are less common in Europe than in the US, and these products form a key part of the Bermuda reinsurance landscape.

Conversely, regulatory change also creates opportunity. As European insurers seek to cede capital-intensive
risks, Bermuda reinsurers can be the link that brings together the new capital entering the market and these insurable risks. It will be increasingly important that reinsurers can present and explain bespoke models and risk mitigation strategies to the BMA, while providing solutions that fit with European insurers’ needs.

Perhaps, with the increased maturity of the Bermuda-based life sector, along with suitably skilled professional service providers and a regulator that has a reputation for being accessible, it is time the life secret is revealed.

**International recognition**

Bermuda was one of the first jurisdictions to gain qualified jurisdiction status from the National Association of Insurance Commissioners (NAIC) – the US standard-setting and regulatory support organization. This elite status, initially enjoyed alongside the UK, Germany and Switzerland, means that reinsurers licensed and based in Bermuda are eligible to be certified for reduced reinsurance collateral requirements, potentially improving capital efficiency. On 1 January 2015, Japan, France and Ireland joined this elite group.

If Bermuda is successful in the long-anticipated achievement of “equivalent” status under the European Solvency II regime, further opportunities may exist to achieve greater capital efficiency for those ceding reinsurance from the EU. Equivalence under article 172 will mean the reinsurance provided by Bermuda reinsurers will be treated on the same basis as that from EU-based reinsurers and, under article 227, broadly means European groups will not be subject to additional European capital requirements in relation to their Bermuda subsidiaries.
The key findings from this year’s Cost and Operational Benchmarking Survey indicate that specialty reinsurers are taking action to become leaner, but there is still some way to go. In an environment where alternative capital models (e.g., Bermuda insurance-linked securities (ILS) platforms) have dramatically lower expense ratios than traditional players, reinsurers, particularly in the Bermuda market, could do more to reduce their cost of capital.

The results of the 2014 EY Cost and Operational Benchmarking Survey reveal how specialty reinsurers are working hard to slash costs in the midst of an increasingly competitive environment.

By Ben Reid
Now in its third year, the survey – published in October 2014 – analyzes the costs and head count of specialty insurers and reinsurers, allowing them to benchmark their expense base against their peer group. The results were segmented across the following sub-segments of the market:

- Lloyd’s
- Composites
- Reinsurers and ILS

In each of these groups, there was a substantial cost reduction across each specialty segment in comparison with the 2013 survey. However, some groups have been more successful than others in controlling their costs, with Lloyd’s boasting the lowest cost per net earned premium (NEP) and cost per gross world product (GWP) of the three segments.

The survey indicates specialty carriers are moving toward a simpler, more operational model, enabled by a focus on cross-class synergies in underwriting and claims. Streamlining business models in this way brings greater cost efficiencies. In contrast, complex organizational models – particularly among global specialty compositions – drive greater cost and reduce agility.

Underwriting remains the largest function by cost of head count. However, the cost of this function as a proportion of the total has reduced by 1.8% year on year. Across the three

### Scalable growth of the underwriting function

The cost per NEP ratio for the specialty market reduced 0.6% year on year, driven by efficiencies in underwriting.

<table>
<thead>
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<th>Function</th>
<th>FTE as % of total</th>
<th>Cost as % of total</th>
<th>Cost as % of NEP</th>
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<td>Underwriting (U/W)</td>
<td>36.6%</td>
<td>32.4%</td>
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<td>U/W operations</td>
<td>11.7%</td>
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<td>1.2%</td>
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<tr>
<td>Claims</td>
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<td><strong>Total</strong></td>
<td><strong>100%</strong></td>
<td><strong>100%</strong></td>
<td><strong>14.8%</strong></td>
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“Reinsurance claims functions have increased most notably in size and cost since the survey began in 2011.”
Renewed focus on cost disciplines

Many participants told us they are now realizing the benefits of a two- to three-year focus on cost and operational efficiency

<table>
<thead>
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<th>Trend</th>
<th>Description</th>
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<tr>
<td><strong>Cost as a source of competitive advantage</strong></td>
<td>• Sustainable cost of revenue (COR) advantage for those who have greatest maturity of cost reduction</td>
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<tr>
<td></td>
<td>• Alternative capital models (e.g., Bermuda ILS platforms) have dramatically lower expense ratios than traditional players</td>
</tr>
<tr>
<td><strong>Simplification is key</strong></td>
<td>• Complex organizational models – particularly among global specialty composites – drive increased cost and reduce agility</td>
</tr>
<tr>
<td></td>
<td>• Simplified, standardized operational models are becoming a reality for the market – enabled by a focus on cross-class synergies in</td>
</tr>
<tr>
<td><strong>Renewed focus on cost disciplines</strong></td>
<td>• Many specialty reinsurers are seeking to maintain a platform for growth – by re-investing savings from major initiatives in new capabilities</td>
</tr>
<tr>
<td></td>
<td>• To sustain benefits, there is a refreshed focus on cost control – e.g., the cost of supply and demand for third-party services</td>
</tr>
<tr>
<td><strong>Productivity focus for operations roles</strong></td>
<td>• Some specialty reinsurers are seeking to implement techniques more typically found within personal lines insurers. For example, resource modeling tools, productivity metrics and specialized operational</td>
</tr>
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</table>
segments, underwriting operations has grown significantly in proportional size and cost since the 2013 survey, but with only a marginal increase in cost per NEP, indicating the scalable growth of this function.

Surprisingly, the cost of claims functions went up year on year across all metrics since 2012. Reinsurance claims functions have increased most notably in size and cost since the survey began in 2011, potentially reflecting changing business models as once monoline Bermudian writers diversify into other specialty classes and new geographies, resulting in a greater complexity of claims systems and processes.

It is worth noting that while claims remains the third largest function by head count, it is sixth largest as a proportion of total cost. This demonstrates the relative maturity of cost reduction within claims compared with other functions.

Likely reflecting the increasingly challenging operating environment that specialty reinsurers currently face, the 2014 results also indicate a renewed focus on cost disciplines.

Two areas that have reduced since 2013 as a proportion of total cost and as a percentage of NEP are travel and entertainment, and consulting or professional costs. This indicates specialty carriers are making savings in their third-party spend as they refocus on core cost disciplines.

Facilities costs have also reduced, reflecting a move toward lower-cost locations and space optimization. However, more could be done to make better use of lower-cost offshore locations. At present, relatively few of the reinsurers or Lloyd’s managing agents surveyed were making use of offshore locations to reduce their overall property and staff costs.

Benchmarking Lloyd’s against its Bermuda reinsurance and global composite peers is particularly interesting, given current market dynamics and the recent uptick in M&A activity. The results suggest scale is not the only factor needed to achieve cost efficiencies and a sustainable combined operating ratio (COR).

For the first time in the survey, the reinsurance segment had a marginally higher average gross expense ratio.

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### Measuring employee costs

Cost and FTE analysis across location was a new theme in the 2014 survey.

<table>
<thead>
<tr>
<th>Location</th>
<th>Direct cost per FTE (US$k)</th>
<th>FTE as % of total FTE</th>
</tr>
</thead>
<tbody>
<tr>
<td>UK</td>
<td>203</td>
<td>54.3%</td>
</tr>
<tr>
<td>USA</td>
<td>221</td>
<td>21.6%</td>
</tr>
<tr>
<td>Singapore</td>
<td>171</td>
<td>1.2%</td>
</tr>
<tr>
<td>Switzerland</td>
<td>320</td>
<td>2.5%</td>
</tr>
<tr>
<td>Bermuda</td>
<td>353</td>
<td>9.8%</td>
</tr>
<tr>
<td>Other Europe</td>
<td>179</td>
<td>5.8%</td>
</tr>
<tr>
<td>Latin America</td>
<td>152</td>
<td>0.1%</td>
</tr>
<tr>
<td>Low-cost offshore</td>
<td>30</td>
<td>1.0%</td>
</tr>
<tr>
<td>Asia</td>
<td>185</td>
<td>3.6%</td>
</tr>
<tr>
<td><strong>Average cost/FTE</strong></td>
<td><strong>201</strong></td>
<td><strong>100%</strong></td>
</tr>
</tbody>
</table>

“The gross expense ratio was higher, reflecting greater organizational complexity.”

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Measuring employee costs

Cost and FTE analysis across location was a new theme in the 2014 survey.
than Lloyd’s. The gross expense ratio for the 16 composite participants in the survey was higher, reflecting greater organizational complexity.

For Bermuda reinsurers – the segment most impacted by encroaching competition from ILS and other forms of non-traditional capacity – the cost per GWP ratio went up in last year’s survey by 1.3%. This indicates softening premiums are having an impact on the segment by driving up expense ratios as premiums go down.

By contrast, the 10 pure Lloyd’s managing agents have seen a substantial reduction in cost per NEP, possibly reflecting changes to reinsurance structures, but also the fact Lloyd’s participants have become more scalable, i.e., better able to manage costs as premiums grow. It is also interesting to note that, despite the impending Solvency II regime, Lloyd’s actuarial costs did not increase substantially last year, which could reflect the market’s readiness for the regime.
Senior Insurance Managers Regime

An outline of the proposals to replace the Approved Persons Regime in the UK, and the implications for insurers and their management.

By Steve Southall and David Nancarrow

The Senior Insurance Managers Regime (SIMR), announced via a series of consultation papers published by the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA), aims to increase the level of personal accountability among senior managers and non-executive directors (NEDs) within UK insurers. Many of the new SIMR rules come into force on 1 January 2016.

SIMR covers two sets of requirements:
- Solvency II – required by 1 January 2016
- Full SIMR – required by 7 March 2016

Solvency II-related requirements and identification of key functions

Firms must identify their key functions by 1 January 2016. The PRA has set out, as a minimum, four required Key Functions that correspond to Solvency. These are:
- Risk management function
- Own Risk and Solvency Assessment (ORSA) requirements
- Compliance function
- Internal audit function
- Actuarial function

However, the PRA has confirmed that it does not expect this to be the complete list. Firms need to identify their own key functions over and above those that have been identified within the directive. This means being able to articulate clearly why functions have been selected as key and maintain a record of the decision-making process. A key part of this process will be the extent to which the function is essential to the proper running of the firm, whether it assumes complex financial market risks, whether the competence needed is specific and difficult to replace, or whether the failure of the function could threaten the firm, the group or policyholders. The PRA have suggested that the following Key Functions would meet these criteria:
- Investments
- Claims
- IT
- Reinsurance

As well as identifying the key functions, firms will also need to identify the individuals responsible for their delivery – the individuals that effectively run the insurer. These individuals need to be notified to the PRA, but they do not require pre-approval.
“As well as identifying the key functions, firms will also need to identify the individuals responsible for their delivery.”

**Governance map**

Once identified, the key functions need to be recorded on a governance map. The PRA has confirmed that it expects this to form a key part of the governance arrangements for firms. The requirement applies at a regulated entity level, so groups that operate multiple insurance entities will need multiple maps.

The PRA has also confirmed that the map will form a key record for the firm and that it will need to be made available on request. When they complete their maps, firms will need to ensure they are fully integrated into the governance arrangements. Firms that operate within the group structure will also need to demonstrate how the regulated entity’s governance arrangements interface with those of the group.

Although the governance map is a PRA requirement, it would make sense for insurers to include FCA-specific responsibilities on the map as well, to make sure that it covers all the
responsibilities of senior management. The maps will need to identify the individuals who hold the key functions and provide a summary of their responsibilities. Where responsibilities are shared, the map will need to be very clear as to how they have been allocated. It will also need to show the reporting lines for these individuals.

In future, whenever the regulators have concerns about specific issues within a firm, they will undoubtedly request the governance map and ask to speak to the individual with designated responsibility on the map.

**Fit and proper**

Key function holders will be supervised by the PRA, unless they also hold an FCA controlled function, in which case they will be supervised by the PRA and the FCA.

Minor amendments are being made to the fit and proper tests applied, although these are unlikely to have a significant impact on firms’ recruitment processes and procedures.

However, both regulators have been clear in stating that firms need to ensure they comply with Solvency II guidance in applying fit and proper criteria, which confirms that assessments are not limited to the moment of employment and should be ongoing. Individuals should also be provided with the support and training necessary to maintain their skills as their roles develop.

These changes will require firms to review and, where necessary, revise their supervision of, and support for, senior individuals in the firm.

**Full SIMR**

Following the implementation of the Solvency II requirements will be “full” SIMR in March 2016. This will bring controlled functions, new requirements for NEDs as well as new conduct standards.

“**The implementation of these requirements should not be underestimated by firms.**”

**Controlled functions**

The PRA is introducing a suite of controlled functions for which individuals will need to be pre-approved before they can take up their role. These functions – known as Senior Insurance Manager Functions, or SIMFs – include the chief executive, chief risk officer and chief actuary. There is also an SIMF designated for individuals from the group who exercise a significant influence over the regulated entity.

Controlled functions will sit alongside key functions and, in theory, an individual could hold a controlled and key function, although firms may want to separate these roles.

The controlled function holders will be individually responsible for the delivery
of their function and will, in addition, need to hold a number of prescribed responsibilities. These include:
  • Ensuring persons carrying out key functions are fit and proper
  • Leading the development of culture and standards
  • Allocating and maintaining capital and liquidity

In total, there are 11 prescribed responsibilities that need to be allocated to one or more controlled function holders. Some will be more easily allocated than others, and firms need to ensure they allow time to ensure they are distributed correctly and in line with existing responsibilities, where possible.

The FCA is also modifying some aspects of the Approved Persons Regime. In an attempt to avoid duplication, the FCA is proposing to only require pre-approval of control functions not already approved by the PRA. Those functions for which the FCA will seek pre-approval include Compliance Oversight (CF10), Anti-Money Laundering (CF11) and Significant Management (CF29).

Conduct standards
Both the PRA and the FCA will be introducing new conduct standards. The PRA is introducing two tiers of standards that will apply either to those who hold a key function, or to those who hold or perform one. In particular, Key Function holders will be required to take reasonable steps to ensure that the business is controlled and managed in a compliant manner.

Firms will need to ensure that these new standards are referenced within job descriptions or role profiles as appropriate, and individuals will have to demonstrate that they are taking reasonable steps.

NEDs
The initial SIMR proposals excluded NEDs, following the responses to the proposals for NEDs within banks. However, the regulators have now confirmed that some NEDs will be included in the new regime, effectively introducing two tiers of NED.

Those included as SIMFs will be the chairman, senior NED and chairs of the risk, audit, remuneration and nomination committees. All will be subject to PRA pre-approval, apart from the chair of the nomination committee, who will be approved by the FCA. Conduct standards will also apply to NEDS that require approval.

Actions for insurers
The implementation of these requirements should not be underestimated by firms. There are a number of significant decisions that need to be made and, for some firms, changes to governance and organizational structures may be needed. We think there are five immediate questions insurers should be asking:

1. What does a governance map look like in practice?

The consultation paper provides limited guidance on the contents of
the governance map. It seems unlikely that governance arrangements can be fitted on a single page, although we would expect it to comprise some form of short summary, with further detail provided in either an appendix or a separate document. Insurers will need to work out what level of detail will be acceptable to the regulators.

2. What are the key functions in scope?
It will be up to insurers to decide which key functions, beyond those specified by Solvency II, to include within the regime and how far within each function they allocate individual responsibility.

3. In what way should we be allocating control functions?
Insurers will need to determine what impact the group, operational and board structures have on the allocation of controlled function responsibilities.

4. How should we address the “reasonable steps requirements”?
Firms will need to work out how individuals will demonstrate they are taking reasonable steps to discharge their responsibilities, and what changes to record keeping requirements will be needed to support this.

5. What should our work program look like?
A work plan will be required to deliver SIMR by the 1 January 2016 deadline, given the need for the board to sign off the framework before that date.

Considerations
SIMR represents a step change in the way regulators will supervise UK insurers, with a much greater focus on individual accountability and responsibilities. Firms will need to ensure that they are taking the required actions to prepare for the new regime. In particular, insurers should consider:

- The resources they will need to involve – this is likely to include HR, compliance and legal as a minimum
- Their approach to document management
- How to leverage Solvency II outputs
- The key checkpoints with controlled function and key function holders to get their input to, and sign-off of, their responsibilities
- Key sign-off checkpoints for the board

Insurers’ internal policies, procedures and governance structures may need to be adjusted to face the implications of SIMR. They will need to assess what areas of their business will be affected and implement robust plans in order to meet the requirements by the set deadlines, which are fast approaching.

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Taking fraud detection upstream

In a tough market, hybrid fraud analytics - which include claim, application, entity, social networks and social media analytics - can make a big difference to an insurer's bottom line.

By Vishal Marria

Integrating hybrid fraud analytics into the fabric of the specialty insurance industry is at a pre-embryonic stage. However, this practice is gaining momentum in the general insurance market. Here we take an interesting look at some of the methods being adopted, the technological developments and their significant impacts on general insurers' bottom lines.

In the general insurance sector, a more analytical approach is being taken by some carriers to identify fraudulent claims. This method is to detect fraud earlier, taking it upstream so that insurers can recognize dishonest claims at the first notification of loss, or even at the application stage. Such an approach is easily transferable and is already being utilized by specialty writers as they look to prevent claims leakage.

A hybrid approach to fraud brings together best practice on a number of different levels, including training claims professionals in fraud detection and having the right procedures in place. But, ultimately, success is hinged on the ability to tap into multiple data sources and to use advanced analytics.

Lessons from motor insurance

Fraud is a big issue for insurers. The UK industry is clamping down, with various initiatives, such as data sharing via the Insurance Fraud Bureau and Credit Industry Fraud Avoidance System (CIFAS), as well as the Insurance Fraud Enforcement Department (IFED), the industry's dedicated anti-fraud police taskforce. In 2013, the number of detected frauds in the UK reached
£1.3b, up by 18% on 2012, according to the Association of British Insurers. Within motor classes, an estimated £811m worth of spurious claims were detected.

At EY, we have experience working with insurers to introduce a hybrid analytics approach that can spot patterns to indicate bogus claims that might otherwise be missed under conventional fraud detection. This is necessary, as the organized criminal gangs that regularly set out to defraud insurers are alert to loopholes that exist in conventional systems and seek to exploit these.

For instance, someone who is known to have defrauded an insurer in the past may, when they seek to take out another policy, simply reverse their name. Advanced analytics will be able to spot the pattern, particularly if other variables – such as date of birth, email and home address – remain the same.

It is important to take fraud detection upstream in this way, as there is a clear link between application fraud and claims fraud. One challenge for insurers as they seek to leverage existing data within their databases is to tackle data quality. Legacy policy and claims systems were never designed to be joined up, but this is now necessary in order to gain a holistic view upon which advanced analytics can be used.

It is not just industry data or the insurer’s internal data that can be used to spot fraudulent applicants, but also external data from other sources. Through the UK’s Driver and Vehicle Licensing Agency’s (DVLA) MyLicense database, insurers and brokers now have access to policyholders’ driving history in real time. Should an applicant fail to mention previous convictions, for instance, the system will now flag at the point of quote that there is a discrepancy with the information being provided.

**Beyond the naked eye**

Often, it is only by using advanced analytics and making better use of unstructured data that “fuzzy matching” is possible. For instance, often when an accident or incident
occurs, the policyholder’s first action is to notify their insurer by verbally telling them what has happened. In many cases with fraudulent claims, this narrative is duplicated. But it is only by mining the unstructured text from this first notification of loss that patterns begin to emerge between what would otherwise appear to be unrelated claims. Hybrid analytics is not just about using one data source, but looking to aggregate multiple variables in order to flag which claims appear spurious and will hence require further investigation.

In some instances, this method has been so successful in identifying fraudulent claims that it has saved insurers up to 2% of their overall claims spend. For a large insurer, this is equivalent to tens of millions of pounds, an improvement of one or two points in their loss ratio. Such an improvement can make all the difference when the combined operating ratio is creeping toward 100%.

It is not just the reduction in losses that is persuasive. The use of advanced analytics to identify fraud frees up resources within claims departments, allowing more effective claims “triage” to take place. This decision-tree analysis allows claims departments to determine the correct handling process, i.e., which cases to approve speedily and which cases require further investigation. Such an approach helps to avoid backlogs, reducing the claims life cycle and ensuring a satisfactory and speedy settlement for customers.

As a result, genuine claimants receive the best possible service, which in turn leads to greater customer satisfaction and retention. With claims as the shop window for our industry, a more favorable experience in either personal or commercial lines will enhance the industry’s reputation.

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A fine balancing act for finance

Our latest Global Insurance Survey showed that finance professionals are prioritizing growth but face a number of challenges over the coming years.

By David Foster and Ian Robinson

71% of CFOs want to be better business partners
We can all take encouragement from the ongoing economic recovery, but it’s clear that the continuing competitive and regulatory pressures facing the insurance sector are even more challenging than ever. Yet the ambition for growth and improved profitability remains high, with global insurance finance leaders focused on supporting business growth while managing the ever-increasing regulatory demands and cost pressures.

CFOs and senior finance professionals participating in EY’s 2014 Global Insurance Survey ranked their organization’s top three business priorities as:
- Achieving growth, expanding into markets or expanding through M&A activity (66%)
- Relieving pressure on costs and margin (54%)
- Responding to regulatory change (51%)

The percentages represent the number of respondents ranking these priorities in their top three.

CFOs are taking a lead role in supporting these business priorities and are focusing on prioritizing actions to meet the increasing demands on finance and actuarial teams through to 2020. Our survey indicates that the highest priority for most CFOs is for the finance and actuarial functions to add more value to the business through improved performance management and decision support.

Of those surveyed, “being a better business partner” came out as the highest priority, with 71% ranking it in their top three. For many, this was not simply about providing more and better information, but reflects the need for finance and actuarial functions to have a closer relationship with the business to understand it better and support it as a true partner.

While the ambition to be a better business partner may not be new, cost pressures, general economic challenges and responding to new regulation have typically demanded more attention and resource in recent years. Indeed,
some of these challenges still remain, with 56% of our survey participants ranking the implementation of new regulatory reporting as the second-highest priority overall. A particular driver for EMEIA-based specialty and other insurers is the implementation of Solvency II.

Also featuring high on the priority list was the need to improve the quality of internal and external reporting, with 50% of participants rating this in their top three priorities, the third-highest overall. This reflects the need to produce consistent information faster, on multiple reporting bases and in ever more granular detail. The increasing regulatory demands are also placing pressure on reporting, with far less tolerance for errors or surprises in the results.

The ability therefore to strike the right balance between delivering more value to the business, while responding to operational and increasing regulatory demands, will be the key to success. As a consequence, 85% of CFOs surveyed stated that they had either started, or planned to start, a significant change program to deliver on their priorities.

**Key levers for finance change**

The role of finance and actuarial functions has become ever more critical. While insurance companies around the globe continue to invest in data management and analytics capabilities, finance and actuarial functions remain the prime source for most financial management information. Improving the processes and systems supporting these functions is therefore key to unlocking the data and information held to enable the development of better and deeper insights into business performance.

When asked to rank the main challenges in becoming a better business partner, survey participants cite weakness in the quality and granularity of their data as the biggest challenge (66% ranked in top three), with technology not currently being fit
What do non-life insurance CFOs prioritize?

We asked 16 global non-life insurance CFOs to rank their main priorities for their organization through 2020.

<table>
<thead>
<tr>
<th>Priority</th>
<th>First</th>
<th>Second</th>
<th>Third</th>
</tr>
</thead>
<tbody>
<tr>
<td>Being a better business partner (understanding the business, improved decision support)</td>
<td>13%</td>
<td>25%</td>
<td>44%</td>
</tr>
<tr>
<td>Improving quality of reporting (internal and external)</td>
<td>31%</td>
<td>25%</td>
<td>6%</td>
</tr>
<tr>
<td>Implementing new regulatory and financial reporting requirements (includes accounting pronouncements)</td>
<td>6%</td>
<td>31%</td>
<td>6%</td>
</tr>
</tbody>
</table>

For many insurers, these challenges are indicative of legacy multiple-source systems resulting from a history of growth through acquisitions and a lack of investment in finance systems over the last 10 years or more. For the specialty market, the impact of multiple legacy systems may be less of an issue, but many are having to deal with the lack of the investment and an emerging growth agenda.

However, CFOs are responding, with many already planning or having embarked on a finance transformation program, for some specialty insurers, this is their first major investment in financial systems, with many making the move from a mid-sized general liability to an enterprise-wide financial system. We are also starting to see investments in data analytics capability and, even more recently, data robotics to automate and reduce the cost of finance processes further.

A key challenge identified by finance leaders in our survey relates to people and the potential lack of resources or the right skill sets to deliver on the business and finance priorities (54% ranked this in the top three). Accountants and actuaries have always been in high demand, but the challenge worthy of note is more reflective of the renewed focus on growth and business partnering. This requires very different skills from, for example, financial reporting production. As well as strong analytical skills, effective business partners must understand what makes the business tick.

The people focus also reflects a growing ambition for the wider organization to be seen as a great place to work, leading to a heightened war for talent.

**Finance vision 2020**

Encouragingly, the industry is shifting its focus toward growth. We are seeing the re-emergence of significant acquisitions and mergers in the market. Insurers are reviewing their product mixes and seeking to grow written premiums, whether by extending business lines, increasing their share of mature markets or developing new opportunities in emerging markets.

Finance and actuarial leaders recognize they have a key role in supporting these business objectives, but the outlook presents a number of challenges in the coming years. They share the ambition and see the
opportunity to deliver real value to the organization in the form of deeper insights into performance, risk management and strategic planning, helping lead their organizations to success. However, to do so in an increasingly complex, unforgiving and more stringently regulated environment will undoubtedly require some tough priority decisions along the way.

The balancing act is therefore set for some time to come, and the winners will be those that can:

1. Fix the current reporting process and industrialize in order to cope with yet more complex and demanding regulatory and financial reporting
2. Enhance the added value to the business by driving real commercial awareness through timely and relevant management information and by linking strategic objectives to performance indicators
3. Achieve points 1 and 2 while continuing to improve finance and actuarial operational efficiency and effectiveness by working “smarter not harder” with processes “right-skilled” and operated in the right place.

A fine balancing act indeed!
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