Rothesay

Report of the Chief Actuary of Rothesay Life Plc on the Proposed Insurance Business Transfer Scheme relating to the Transfer of Certain Annuity Business from The Prudential Assurance Company Limited to Rothesay Life Plc

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Introduction

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Background

1.1 The purpose of this report is to:

- Describe my understanding of the proposed insurance business transfer scheme (the "Scheme") as defined in section 105 of Part VII of the Financial Services and Markets Act 2000 ("FSMA") relating to the transfer of the in-scope long-term insurance business of The Prudential Assurance Company Limited ("PAC") to Rothesay Life Plc ("RLP" or "Rothesay"); and

- Consider the implications of the proposed Scheme on the security and benefit expectations of existing RLP policyholders and other beneficiaries of insurance policies issued by RLP, including the principles to treat customers fairly and to manage conflicts of interest fairly.

1.2 This report has been prepared for the Board of Directors of RLP in my capacity as the Chief Actuary of RLP.

1.3 In this report I address the effects of the Scheme on the security and benefit expectations of the existing RLP policyholders. For the purposes of this report I have interpreted 'policyholders' to include not only the individual policyholders (for instance, those arising from pension scheme buy-out arrangements) but also the trustee policyholders (for instance, those arising from pension scheme buy-in arrangements) and the individual pension scheme members in respect of whom the relevant buy-in liabilities relate. In addition, I have also interpreted 'policyholders' to include the contingent dependants of such other policyholders. I have also included PAC as a holder of reinsurance from RLP.

1.4 In preparing this report, I have been in regular contact with the Independent Expert, Nick Dumbreck FIA, of Milliman LLP, to consider all aspects of the proposed Scheme in detail, with a view to him providing an independent report on the likely effect of the Scheme on the policyholders of both RLP and PAC. The Prudential Regulation Authority ("PRA") has approved Mr Dumbreck as the Independent Expert following consultation with the Financial Conduct Authority ("FCA"). Mr Dumbreck's Report is required by section 109 of FSMA as part of the procedure for gaining approval of the Scheme by the High Court of Justice of England and Wales (the "Court").

1.5 While this report is addressed to the Board of Directors of RLP, it will also be provided to the Court, the Independent Expert, the PRA and the FCA in order to assist them with their considerations in relation to the proposed Scheme.

1.6 The contents of this report should be considered together with the Independent Expert's report.

1.7 This report has been prepared for only those users listed in 1.5 above. As such this report assumes familiarity with the insurance industry in the UK, including the regulatory and legal framework under which insurance companies operate. Any other readers of this report may wish to consult relevant publicly available information relating to RLP, including the most recent Annual Report and Accounts and Solvency and Financial Condition Report, which can be found on the RLP website (Rothesay.com).

1.8 I note that the Chief Actuary of PAC has produced a report which considers the impact of the Scheme on the transferring policyholders of PAC and on the remaining policyholders of PAC, and that the With-Profits Actuary of PAC has produced a report which considers the impact of the Scheme on PAC's with-profits policyholders. I have been in regular contact with the actuarial team at PAC and we have exchanged draft reports.

1.9 I intend to issue a Supplementary Report closer to the date of the Scheme, providing an update on the issues concerned.

Further background relating to this Scheme

1.10 In 2018 PAC and RLP applied to the High Court of Justice of England and Wales for sanction of an insurance business transfer scheme pursuant to Part VII of the FSMA on this Scheme. The Sanction Hearing took place between 10 and 20 June 2019. As part of that process I produced two documents in a similar form to this report, one dated January 2019 and a follow-up supplementary report dated May 2019.

1.11 On 16 August 2019 Mr Justice Snowden handed down his judgement on the proposed transfer, in which he declined to sanction the Scheme. Mr Justice Snowden granted PAC and Rothesay leave to appeal against his decision, and on 27 September 2019 PAC and Rothesay lodged an appeal against the High Court's decision. The main hearing for the Appeal took place between 27 and 29 October 2020.

1.12 On 2 December 2020 the Court of Appeal handed down its judgment in which it upheld the Appeal and ordered that the application for the sanction of the Scheme should be remitted to the High Court for consideration. The consequent process to be followed by the High Court in its consideration of the Scheme will take a similar form to the process that would be followed if a new application for the sanction of an insurance business transfer scheme had been made, but with suitable changes reflecting that it remains the same Scheme that is under consideration, and this should be considered as a continuation of the process which commenced in 2018. There will be a Directions Hearing to update the High Court on process and discuss procedural aspects relating to the Scheme, with a Sanction Hearing to follow.

1.13 It is anticipated that the Directions Hearing for the 2021 High Court Process will take place on 23 July 2021. A date has not yet been set for the Sanction Hearing, but it is expected to take place in November 2021. If the Scheme is sanctioned it is expected to become effective during December 2021.

1.14 This report is written and provided as a standalone document in the context of the 2021 High Court Process. I have considered the Scheme and its implication afresh, and readers of this report need not refer to my prior reports in respect of this Scheme.

Disclosures and reliances

1.15 I am a Fellow of the Institute and Faculty of Actuaries, having qualified in 2004, and hold a certificate issued by the Institute and Faculty of Actuaries to act as Chief Actuary (Life). I joined RLP to act as Chief Actuary in April 2018, having previously been the Chief Actuary for Zurich Assurance Ltd, and I have over 20 years of experience working in the UK life assurance industry.

1.16 Neither I nor my immediate family hold any insurance policies issued by either RLP or PAC, and I have no direct financial interest in either company other than as an employee and shareholder of the Rothesay Group. There are no other potential conflicts of interest.

1.17 In preparing this report I have had access to all relevant financial information in relation to RLP. In forming my conclusions, I have relied upon work carried out by other RLP employees, which has been subject to suitable peer review where appropriate, and which I have challenged or investigated personally where material.

Compliance with technical actuarial standards

1.18 The Financial Reporting Council ("FRC") sets technical standards for the members of the UK actuarial profession. This report is subject to and complies with these standards.

1.19 A full description of compliance with relevant actuarial standards is given in Section 7.

Executive summary

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The key points of the proposed Scheme are as follows:

Reinsurance arrangements

2.1 PAC has reinsured a portfolio of in-payment and deferred annuities to RLP, comprising approximately £12.2 billion of Solvency II best estimate liabilities as at end 2020. These policies will be referred to as the "PAC policies". These policies were reinsured with the intention from both parties that the Part VII transfer considered in this report would then take place. It is now proposed that the transfer will include the majority of these policies, other than a group of non-transferring policies (see 2.7).

2.2 The PAC policies have a variety of original sources, and include both individual and bulk annuity policies.

2.3 The reinsurance was structured as funded reinsurance where assets were passed from PAC to RLP. The transaction was structured with security such that the reinsurance is fully collateralised. The collateral assets are held in a security arrangement for the benefit of PAC.

2.4 Under certain circumstances, which are unlikely to materialise, PAC would be entitled to terminate the reinsurance agreement, with the termination amount determined using an agreed approach. Such termination amount is supported by the collateral assets.

2.5 Prior to the RLP reinsurance being effected, PAC had put in place longevity reinsurance ("PAC Longevity Reinsurance") with a number of counterparties, providing protection against adverse movements in longevity experience for some but not all of the liabilities proposed to transfer under the Scheme. It is intended that these reinsurance contracts form part of the transfer of business and therefore RLP will replace PAC as the cedant under those contracts.

The Scheme

2.6 Under the Scheme, PAC will transfer all insurance liabilities associated with the PAC policies to RLP, other than any non-transferring policies as described in 2.7.

2.7 A subset of the reinsured PAC policies (approximately £1.4 billion, or around 11% of the total) would not form part of the portfolio of transferring policies under the Scheme. This mainly relates to deferred annuity liabilities, plus other schemes or benefits which could be difficult to transfer because of specific features. These non-transferring policies will be referred to as the "non-transferring policies" in this report.

2.8 The non-transferring policies will remain reinsured by RLP under the existing reinsurance arrangement (appropriately amended), and so there is no change as a result of the Scheme in respect of these liabilities.

2.9 On the effective date of the Scheme, any collateralisation and security features relating to the transferring liabilities will be terminated or unwound.

2.10 Once the proposed Scheme takes effect, which is anticipated to be during December 2021, any policyholders or claimants in respect of the transferring PAC policies will be policyholders or claimants respectively of RLP. Any policyholders or claimants in respect of the non-transferring policies will continue to be policyholders or claimants of PAC.

2.11 There are special arrangements in relation to the risk of potential claims in relation to the mis-selling of annuities; RLP has already undertaken responsibility for some risk (mainly in relation to bulk annuities which comprised a particular category of the transferring annuities), RLP has also undertaken to accept responsibility in relation to all the other categories of annuities, comprising mainly individual annuities, after a further period of time has passed, and some specific mis-selling risks will remain with PAC in perpetuity. The economic position with respect to these mis-selling risks, whether they are borne by Rothesay or remain with PAC, will be the same whether the Scheme goes into effect or not. However, if the Scheme goes ahead, the legal liabilities will formally transfer and become direct liabilities of Rothesay.

Impact of the Scheme on RLP

2.12 The reinsurance transaction entered into by RLP and PAC was set up to replicate the economics of transferring the policies from PAC to RLP, on the assumption that the PAC Longevity Reinsurance will also be transferred to RLP. As a result, there is only a small net financial impact for RLP from cancelling the reinsurance transaction between PAC and RLP and transferring the in-scope PAC policies from PAC to RLP (see 2.18).

2.13 Following the Scheme RLP will also have responsibility for ensuring the policies are appropriately managed and administered. RLP and PAC have agreed that there will be a Transitional Services Agreement ("TSA") such that PAC will continue to provide administration services on behalf of RLP for the transferring policyholders for a period of between 6 and 12 months after the effective date of the Scheme. Therefore, following the Scheme RLP would have additional primary responsibilities and also a new material outsourcing relationship to manage. A new long-term administrator will be appointed by RLP to provide administration services after the TSA ends. This will be to a provider of Rothesay's choice (which may be an existing third-party administrator).

2.14 I have also considered the impact of the potential residual mis-selling liabilities that have or will transfer to RLP. These potential liabilities were accepted by Rothesay under the original transaction documents, and will be accepted by Rothesay regardless of the Scheme taking effect, either transferring under the Scheme or continuing via an indemnity provided to PAC by RLP. Given the time which will have elapsed since the initial sales of the policies I have assessed the likelihood of any material impact on the security of RLP's existing policyholders as being very small.

2.15 I am not aware of any other expected or potential adverse impacts on RLP or RLP's policyholders which would result from the transfer.

2.16 Upon completion of the Scheme, PAC will lose all security and recourse to any collateralised assets of RLP in relation to the transferring PAC policies, save in relation to any collateral assets required in respect of the non-transferring policies. Overall this will provide a liquidity management benefit, increase RLP's ability to manage the asset portfolio, and provide a small reduction in operational expense for RLP.

2.17 On transfer of the PAC Longevity Reinsurance RLP will also have additional reinsurance contracts to manage including new reinsurance counterparties, but RLP has extensive experience in managing reinsurance contracts of this type.

2.18 As a result of removing the constraints and operational overheads associated with operating the reinsurance with PAC compared to directly managing the transferring policies the Scheme taking effect is expected to produce a small net positive impact for Rothesay. This comes from removing the constraints associated with the management of the collateral assets in respect of the transferring policies, from Rothesay being able to appoint an administrator of its choice to provide administration services following the expiry of the TSA, and from Rothesay being able to more efficiently manage the external reinsurance in respect of the transferring policies. However, given that these expected benefits are small, positive and not certain in terms of amount or timing, they are not reflected in any pro-forma assessment of the impact of the Scheme.

Summary and Opinion of the Chief Actuary

2.19 I have considered the potential impacts resulting from the Scheme for the current policyholders of RLP.

My key conclusions are that:

- There are no changes to the terms and conditions for current policyholders of RLP;
- Their administration arrangements will also be unchanged;
- The economic risks and rewards relating to the transferring portfolio, which will transfer to Rothesay under the Scheme, have already been accepted by Rothesay under the original reinsurance transaction;
- The risks and rewards relating to the non-transferring policies will continue to be accepted by Rothesay, via reinsurance;
- As a result there is no change in the regulatory solvency position of Rothesay were the Scheme to go ahead, and therefore no change in the security of benefits for policyholders.

2.20 In light of the considerations set out in this report, I have therefore concluded that:

- The security of the current policyholders of RLP is not likely to be adversely affected as a result of the proposed transfer;
- The reasonable benefit expectations of the current policyholders of RLP are not likely to be adversely affected as a result of the proposed transfer;
- The administrative arrangements applicable to the policyholders of RLP are not likely to be adversely affected as a result of the proposed transfer;
- There are no features of the proposed Scheme that appear to me to breach either of the principles to treat customers fairly or to manage conflicts of interest fairly; and
- There are no features of the proposed Scheme that appear to me likely to prejudice Court approval of the Scheme.

Description of Rothesay Life Plc

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History of Rothesay Life Plc

3.1 RLP was established as a proprietary company on 26 February 2007, as a wholly owned subsidiary of Rothesay Life (Cayman) Limited. It was previously known as Hackremco (No. 2460) Limited (until 14 March 2007) and First Premium Company Limited (until 14 May 2007) and Rothesay Life Limited (until 24 March 2016).

3.2 Until 2013, RLP's ultimate parent company was The Goldman Sachs Group, Inc. ("Goldman Sachs") but, in December 2013, Goldman Sachs completed a partial sale of RLP, introducing three additional shareholders. As part of the deconsolidation from Goldman Sachs, Rothesay HoldCo UK Limited ("Rothesay HoldCo") was introduced as a holding company between Rothesay Life (Cayman) Limited and RLP. RLP became a PLC in March 2016.

3.3 RLP was authorised by the FSA as a regulated insurance company (licensed to write long-term classes I, III, IV and VII) on 12 July 2007.

3.4 RLP completed its first transaction in February 2008 and has since grown to become one of the largest providers of annuities in the UK market.

Rothesay Group structure and history

3.5 In 2017, Goldman Sachs sold all its remaining Rothesay HoldCo shares to The Blackstone Group L.P. ("Blackstone"), Government of Singapore Investment Corporation ("GIC") and MassMutual Financial Group ("MassMutual").

3.6 Rothesay HoldCo was renamed Rothesay Limited on 8 October 2020.

3.7 Effective from 1 December 2020, Blackstone sold its 36% stake in Rothesay Limited to GIC and MassMutual, resulting in GIC and MassMutual each becoming equal 49% shareholders.

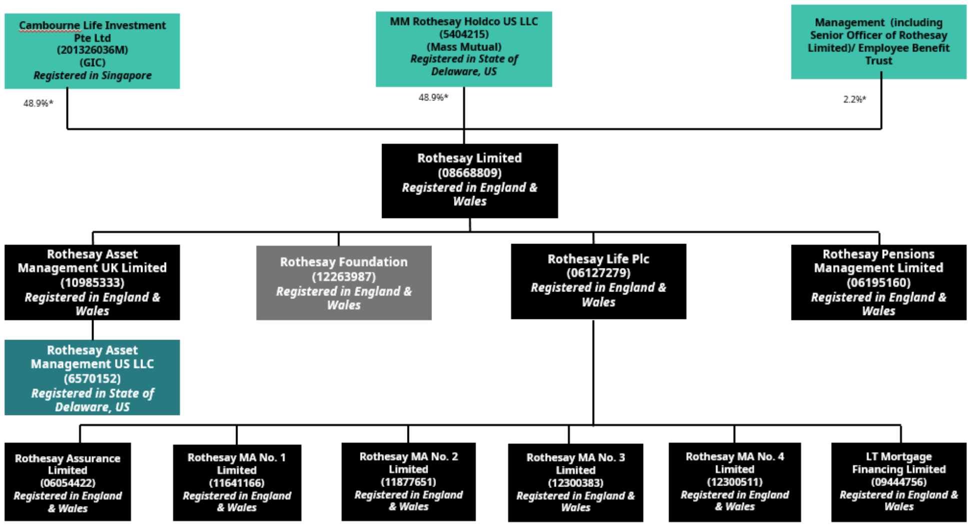
3.8 Hence RLP is a subsidiary of Rothesay Limited, which in turn is owned by:

- GIC;
- MassMutual; and
- The Directors, Management, Employees and Elian Employee Benefit Trustee Limited.

3.9 RLP is the only regulated insurance company within the Rothesay Group, but Rothesay Limited has several other subsidiaries. Rothesay itself also has a number of subsidiaries, which are companies principally used as vehicles to restructure certain investments to create investments that are eligible for inclusion in Rothesay's Matching Adjustment Portfolio.

3.10 The ownership structure of Rothesay Limited and its subsidiaries (together 'the Rothesay Group') is set out below as at 31 December 2020:

Rothesay Group Entity Structure



3.11 RLP has also established two Employee Benefit Trusts in 2016 and 2020. The first was established to purchase and hold shares of Rothesay HoldCo for delivery to employees under employee share schemes and the second an employee share incentive plan.

3.12 Rothesay Limited is the ultimate holding company with 11 wholly owned subsidiaries.

3.13 RLP is the Rothesay Group's regulated insurance entity.

3.14 Rothesay Asset Management US LLC is a company established to assist in sourcing financial assets from the USA. Rothesay Asset Management UK Limited is an intermediate holding company.

3.15 Rothesay Pensions Management Limited (RPML) provides services to the other companies in the RL Group.

3.16 Rothesay Assurance Limited (RAL) no longer writes business and is in the process of being wound up. Assets and liabilities previously held within RAL were transferred to RLP via a Part VII transfer in 2015.

3.17 LT Mortgage Financing Limited ("LTMF") was incorporated as a wholly owned subsidiary of RLP on 17 February 2015. The company remained dormant until December 2018 but now is the holding company for most of the Group's investments in equity release mortgages following the approval of the Group's partial internal model by the PRA. LTMF then issues a series of notes secured over the equity release mortgage portfolio to be held by RLP in its matching and non-matching adjustment funds.

3.18 Rothesay MA No.1 Limited ("RMA1") was incorporated as a wholly owned subsidiary of RLP on 24 October 2018. It holds some of RLP's previously originated long dated loans secured over freeholds and the ground rent cashflows from the underlying long-leases and has in turn issued time-tranched notes secured over those long dated ground rent loans back to RLP to be held by RLP in its matching and non-matching adjustment funds.

3.19 Rothesay MA No.2 Limited ("RMA2") was incorporated as a wholly owned subsidiary of RLP on 12 March 2019 and is currently dormant.

3.20 Rothesay MA No.3 Limited (“RMA3”) was incorporated as a wholly owned subsidiary of RLP on 6 November 2019. It holds certain euro-denominated residential mortgage assets (previously owned by Rothesay Life Plc). RMA3 has in turn issued notes secured over those assets back to RLP to be held in its matching and non-matching adjustment funds.

3.21 Rothesay MA No.4 Limited (“RMA4”) was incorporated as a wholly owned subsidiary of RLP on 6 November 2019 and is currently dormant.

3.22 Rothesay Foundation is the RL Group’s charitable entity, and is controlled by its trustees rather than the Group.

Business and Strategy

3.23 RLP is a wholesale annuity provider, sourcing business through three different channels:

- Bulk annuity business from pension schemes;
- Reinsurance of annuity portfolios followed by Part VII transfer; and
- Acquisition of other annuity providers.

3.24 RLP has previously completed successful transfers of annuity portfolios from Zurich Assurance Ltd and Scottish Equitable plc in a form substantially similar to that envisaged under this Scheme.

3.25 The Rothesay Group aims to protect regulatory surplus, minimise balance sheet volatility and achieve attractive risk-adjusted returns through de-risking the business by hedging longevity risk and adopting a cautious approach to investment.

Asset Strategy

3.26 RLP pursues an investment strategy that minimises risk in a number of ways:

- Investment in a diverse set of assets;
- Investment in low credit-risk asset classes such as government-guaranteed bonds and other highly-rated bonds;
- Investment in asset classes which contain significant structural mitigants to provide protection in the event of a counterparty defaulting;
- Prudent selection and monitoring of assets which create counterparty credit exposures; and
- Limiting outright credit risk, including using credit derivatives to hedge out credit risk.

3.27 RLP then further reduces its market risks through interest rate and inflation swaps contracts, to match closely with the tenor and type of the insurance liabilities, as well as active monitoring of assets and counterparties including assessing downgrade risk.

Reinsurance

3.28 RLP pursues a strategy that reduces its key demographic risks by hedging the majority of its longevity and related risks through collateralised longevity swap contracts. RLP makes extensive use of this market with approximately 71% of its longevity risk being transferred to the third-party reinsurance market. Note that this figure includes the effect of both the transferring and non-transferring liabilities, and the effect of the PAC Longevity Reinsurance, as RLP has the economic exposure to these.

Liabilities

3.29 Currently the majority of RLP’s existing direct insurance liabilities result from taking over risks associated with pension schemes, effected via longevity risk transfer, buy-in or buy-out (or equivalent mechanism, including directly acquiring blocks of business from other companies who have written these types of contracts). The remainder arise from taking on annuities written by insurance companies, namely Scottish Equitable plc and Zurich Assurance Ltd. The risks associated with the liabilities do not materially differ depending on the original source (i.e. pension scheme or insurance company), and RLP has significant experience in accepting and managing both types.

3.30 Generally the liabilities to policyholders are for the payment of guaranteed annuity amounts, where amounts may be pre-determined (i.e. level or increasing at a fixed rate) or linked wholly or partially to published indices such as the Retail Prices Index or the Consumer Prices Index; are payable on either an immediate or a deferred basis; and are payable either during the lifetime of the original pension scheme member/insurance company policyholder, or in some cases also to his or her dependant(s) on a contingent basis.

3.31 Where the trustee policyholders effect a buy-out of a pension scheme’s liabilities, these annuity benefits could potentially be secured by individual annuity policies directly with the member and/or dependant(s), rather than under a bulk annuity policy effected by the trustees. Individual deferred annuities may be surrendered (i.e. transferred to another registered pension scheme) in which case a transfer value would be payable on terms which have not been guaranteed but for which RLP has an established policy (i.e. payable on a broadly profit-neutral basis to RLP).

3.32 Three of RLP’s transactions are ‘unfunded’ (requiring a commitment on the part of the trustee policyholder to pay regular premiums to secure future benefits), while the other transactions have been ‘funded’ by way of upfront premiums payable by the trustee policyholders.

Non-standard existing RLP schemes / contracts features

3.33 In certain circumstances, certain trustee policyholders and reinsurance cedants may have the ability to surrender the entire bulk annuity policy for a surrender payment that would be made on a profit-neutral basis to RLP, unless this occurs due to a “default” by RLP (where “default” is defined by each relevant policy and would typically arise if the solvency cover falls below a trigger level which is relatively close to the statutory insolvency level). These trigger levels would not be breached as a result of the proposed Scheme.

3.34 In addition, under certain circumstances, some trustees may be able to surrender following a Part VII transfer of RLP’s business to another company without explicit trustee consent. As the proposed Scheme is a transfer of PAC liabilities into RLP, this has no impact in this case. I understand that none of the transferring PAC liabilities have such features.

3.35 I have considered the non-standard scheme/contract features and do not believe that there are any features that could have a detrimental impact on either the transferring PAC policies, or the current RLP policies, were the Scheme to go into effect as proposed.

Financial History

3.36 The following tables summarise the key financial metrics of RLP since the inception of Solvency II on 1 January 2016. Shown below is a simplified presentation which for example nets out derivatives as part of the net asset line and nets out reinsurance as part of the net technical provisions, rather than showing the asset and liabilities components separately, as this gives a clearer indication of the changes between reporting periods. Further information can be found in the latest Solvency and Financial Condition Report for RLP.

Table 3.1: Solvency II Pillar 1 financial position at prior annual reporting dates

Rothesay Life Plc £m	1 January 2016	31 December 2016	31 December 2017	31 December 2018	31 December 2019	31 December 2020
Net Assets	15,208	23,575	23,979	36,090	53,362	61,742
Technical Provisions	13,304	20,688	21,135	32,195	47,249	54,389
Own Funds	1,904	2,887	2,844	3,895	6,113	7,353
Solvency Capital Requirement	1,203	1,603	1,743	2,163	3,038	3,623
Surplus	701	1,284	1,101	1,732	3,075	3,730
SCR cover	158%	180%	163%	180%	201%	203%

Financial Strength Ratings

3.37 RLP has been reviewed by two recognised credit ratings agencies and given the following ratings:

- Moody's: Insurance Financial Strength rating of A3 "upper-medium grade and subject to low credit risk", with a positive outlook
- Fitch: Insurer Financial Strength rating of A+ "strong", with a stable outlook

Outline of the Scheme

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4.1 Further to the reinsurance of the PAC policies, the Boards of both RLP and PAC agreed to begin the process of a legal transfer of the PAC policies to RLP under Part VII of FSMA. The purpose of the proposed Scheme is to transfer the reinsured PAC policies from PAC to RLP. The types of liabilities to be transferred are materially the same as RLP's current liabilities as described in 3.29-3.32, with no materially new or different features. In particular, some of the transferring PAC policies are retail annuities written directly by an insurer, and some arise from insuring pension scheme liabilities.

4.2 I understand that the original motivation from PAC for the reinsurance and subsequent transfer was because it supports their strategic objectives to make efficient use of capital and to de-risk their business, and supported the demerger of M&G Prudential from Prudential plc. That demerger took effect on 21 October 2019 and PAC is now a subsidiary of M&G plc.

4.3 As described in Section 2, a small number of reinsured PAC policies will not transfer to RLP. These non-transferring policies will remain liabilities of PAC and are not in scope for the Scheme. They will continue to be reinsured by RLP under the existing reinsurance (appropriately amended).

4.4 The proposed Scheme is not intended to make any changes to existing RLP policy contracts. None of the liabilities due to RLP policyholders, nor commitments by RLP policyholders to make any subsequent premium payments to RLP, are being changed as a result of the proposed Scheme.

4.5 It is anticipated that the administration of the transferring policies will be performed by PAC on behalf of RLP under a separate Transitional Services Agreement, for a period of 6-12 months following the effective date of the Scheme. Therefore, there should be no material changes to the standards of service provided to the in-scope policyholders immediately following the transfer.

4.6 Compared to maintaining the reinsurance for the lifetime of the liabilities, a transfer under Part VII of FSMA is expected to have a number of benefits for RLP, including:

- Increased control over the quality of administration and data being provided;
- Simpler and clearer customer communication; and
- Removal of collateral ring-fencing requirements of the current reinsurance structure.

4.7 Under the proposed Scheme it is intended to transfer all of the reinsured liabilities of PAC to RLP, other than the non-transferring policies described in Section 2. No policies of PAC not already included in the reinsurance agreement are in scope of the Scheme. The associated PAC Longevity Reinsurance policies will also transfer to RLP, i.e. RLP will replace PAC as the cedant under those policies.

4.8 For current RLP policyholders all existing customer administration arrangements will remain in place and there will be no impact from the proposed transfer.

4.9 Certain potential liabilities associated with the original establishment of the PAC policies, particularly mis-selling risk, will not transfer to RLP and hence will be retained by PAC, these are described as Excluded Liabilities under the Scheme. Some residual mis-selling risk, which is expected to be negligible, has already been accepted by RLP under the original transaction documents and will be legally transferred to RLP under the Scheme. Mis-selling risk is the risk that a claim or similar action is made against PAC or one of their agents in relation to the sale or arrangement of some of the transferring policies, resulting in a payment, another form of settlement, or additional costs being incurred.

4.10 Other Excluded Liabilities defined by the Scheme are those related to the transferring PAC policies but which are not directly concerning the payment of policyholder benefits, for example in relation to tax affairs of PAC. These will remain the responsibility of PAC.

4.11 If the transfer does not take place then under certain circumstances PAC are able to terminate the reinsurance agreement. However, PAC may consider continuing with the reinsurance, depending on its view on the merits of termination compared with permanent reinsurance. I understand that PAC's view is that it would be likely to continue with the reinsurance.

Financial position post transfer

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Capital policy for Rothesay Life Plc

5.1 On 1 January 2016 the new solvency requirements prescribed under the Solvency II regime came into effect. Since this date, and continuously thereafter, RLP held surplus assets in excess of its regulatory capital requirement (the Solvency Capital Requirement or SCR). A summary of RLP's annual Solvency II balance sheets since the start of the regime are shown in Section 3.

5.2 Solvency II is a strong capital regime designed to provide a high level of policyholder security. Solvency II is a risk-based regime which means that insurers are required to hold capital commensurate with the level of risk that they operate with. Companies are expected to hold sufficient excess capital such that they can withstand adverse scenarios measured at the 99.5% confidence level over one year.

5.3 Following the UK's withdrawal from the EU, with effect from 1 January 2021 responsibility for the regulatory solvency framework applicable to UK insurance and reinsurance companies has reverted to the UK authorities. However, with the exception of some minor technical changes, the UK regulatory regime for insurance and reinsurance companies currently remains unchanged, and is still referred to as Solvency II.

5.4 On 23 July 2020 the UK Government announced that it would review certain features of the UK's implementation of Solvency II, and a call for evidence in relation to this review was published by HM Treasury on 19 October 2020. Therefore it is possible that the rules which apply to UK insurers may change in the future. This is true of all regulatory regimes, and indeed the EU version of Solvency II is also expected to change in the future. Given that it would be speculative to comment on future changes to the UK regulatory regime which applies to RLP, I have commented on the regime as it is currently implemented in the UK.

5.5 RLP's parent, Rothesay Limited, is also managed on a Solvency II basis. The Rothesay Group (as described in Section 3) is a simple one, with RLP being the only material active risk-carrying entity, and therefore there are no material residual risks outside of RLP which may affect the security of RLP's policyholders. For the remainder of this section I will therefore consider only RLP on a standalone basis, although given the simple structure of the Rothesay Group the conclusions reached are likely to hold for Rothesay Limited also.

5.6 RLP's capital management policy aims to maintain a solvency ratio of not less than 130% on a Solvency II Pillar 1 basis, that is, to have Own Funds to cover at least 130% of the SCR. RLP currently calculates its SCR using an internal model to calculate part of its SCR. This replaces some of the Standard Formula calculations (which are designed to be applicable to most insurers) with bespoke calculations which more accurately reflect the risk profile of Rothesay (e.g. the specific assets that it holds). The rest of the SCR is then calculated using the Standard Formula; the combination of internal model and Standard Formula is the partial internal model ("PIM"). RL's PIM covers two major risk categories, spread risk and counterparty default risk, with other risks being assessed using the Standard Formula. RL also currently holds capital in the form of a voluntary capital add-on to reflect a small number of risks that aren't reflected in the Standard Formula.

5.7 RLP is in the process of developing a full internal model ("FIM") which will cover the entire SCR calculation. It is expected that the application to use the FIM will be submitted in late 2021 with approval not until 2022. I am unable to comment on the potential impact of adopting the FIM. I expect that RLP will continue to maintain the same minimum target ratio of 130% once it calculates its capital requirements using the FIM.

5.8 Under Solvency II a firm is also obliged to consider the capital it believes that it needs in order to meet its own targets, a process known as the Own Risk and Solvency Assessment ("ORSA"). RLP's capital policy in relation to the ORSA is to hold sufficient excess capital such that RLP can withstand adverse scenarios measured at the 99.8% confidence level over one year, where the required capital is measured using RLP's own view of the risks it has rather than using the Standard Formula or the PIM. RLP would therefore seek to hold the greater of the capital calculated under the ORSA or 130% of the regulatory SCR, both of which give a high level of protection against adverse experience. In practice it is the Solvency II Pillar 1 basis which is the more onerous, and this is expected to continue to be the case for the foreseeable future, including once the capital is calculated using the FIM.

5.9 The Part VII transfer of the PAC policies to RLP will have no direct impact on the capital management policy. The capital policy will remain under regular review by the Board to ensure that it remains appropriate.

Solvency II capital position

5.10 The Solvency II position of RLP before and after the proposed transfer (as if it had been effective on 31 December 2020) is set out in Table 5.1, which is consistent with the presentation of prior positions shown in Table 3.1. As the policies in question are reinsured to RLP and the transaction was fully funded at the point of sale, with assets transferred to RLP, there is no change in the solvency position of RLP due to the Scheme. It is noted that the non-transferring policies described in Section 2 will not transfer under the Scheme and will remain reinsured by RLP and this is reflected in the post-transfer position. The SCR shown is calculated using the PIM basis that was in effect at the time.

Table 5.1: Solvency II Pillar 1 financial position (PIM) at 31 December 2020 before and after the proposed transfer (£m)

Rothesay Life Plc £m	31 December 2020 Pre-scheme	31 December 2020 Post-scheme
Net Assets	61,742	61,742
Net Technical Provisions	54,389	54,389
Own Funds	7,353	7,353
Solvency Capital Requirement	3,623	3,623
Surplus	3,730	3,730
SCR cover	203%	203%

5.11 The values of Technical Provisions shown above include the use of a matching adjustment in the valuation of the best estimate liability as approved by the PRA in November 2015. This involves the application of a spread to risk-free discount rates reflecting the liabilities being long-term and illiquid. The Scheme will not affect the ability of RLP to apply the matching adjustment.

5.12 In common with many other firms in the UK, RLP has been given approval by its prudential regulator the PRA to use a transitional adjustment to technical provisions. This reduces the technical provisions required in order to smooth the impact of moving to Solvency II. The transferring business is eligible for such treatment as it was written before the start of the Solvency II regime. Both sets of numbers above (i.e. pre- and post- transfer) reflect the use of this transitional adjustment. The Scheme will not affect the ability of RLP to apply this adjustment to technical provisions, and a recalculation of the adjustment is not required as a result of the Scheme since RLP has already accepted the economic risks associated with the liabilities through the reinsurance contract agreed with PAC.

5.13 It is noted that following the Scheme, RLP will have additional responsibilities and liabilities in relation to the transferring PAC policies compared to simply reinsuring them, in particular primary responsibility for administering the policies. RLP's Solvency II Standard Formula calculation (operational risk is not included in the existing PIM) increased the capital held for operational risk at the time that the reinsurance contract was effected.

5.14 Before the transfer, administration of the policies is being carried out by PAC, and the cost of this administration is covered by the reinsurance contract between RLP and PAC. After the transfer the administration will still be carried out by PAC on behalf of RLP under the TSA described earlier, before moving to a long-term administration provider of Rothesay's choice. There is not expected to be any material change in the cost of administration, nor in the risks associated with those costs, compared to those currently assumed by RLP as part of its reserving and capital calculations. Therefore, there is not expected to be a change in either the reserves held by RLP for expenses or in the capital held for those risks immediately following the scheme.

5.15 Before the transfer, some of the assets backing the reinsured liabilities are being held as collateral for PAC's benefit. There are some restrictions on the types of assets which can be held as part of this. After the transfer, these contractual restrictions relating to the transferring liabilities will be removed and RLP will have more investment freedom. However, RLP does not anticipate fundamentally changing the types of asset held immediately following the transfer. While there may be some economic benefits to RLP as a result of removing these restrictions, these are not reflected in the pro-forma position shown in Table 5.1.

5.16 The comparative figures for Rothesay Limited as at 31 December 2020 are 201% SCR cover pre-transfer and 201% SCR cover post-transfer. These are lower than the equivalent RLP values primarily due to a small amount of additional non-insurance liabilities at the Rothesay Limited level. There are no impacts of the Scheme to consider at the Rothesay Limited level beyond those considered at the RLP level.

5.17 As at the date of this report, the financial position of RLP, as measured on a Solvency II PIM basis, has not materially changed from the figures presented in Table 5.1.

5.18 In summary, I do not expect the proposed transfer to have any impact on the Solvency II capital position of RLP, and therefore no material impact on the security of RLP's current policyholders.

Solvency II ORSA

5.19 In addition to the results shown above, I have also considered the ORSA position of the business before and after the proposed transfer, as if the transfer had become effective on 31 December 2020. As the PAC policies are reinsured to RLP and the transaction was fully funded at the point of sale, with assets transferred to RLP, there is no change in the ORSA position of RLP due to the Scheme. It is noted that RLP will have additional operational responsibilities following the transfer and therefore the overall quantum of operational risk will be higher after the Scheme, but under RLP's ORSA all of the extra operational risk associated with the transfer was recognised from the point that the reinsurance agreement with PAC was effected. I am therefore comfortable that the extra risks are captured under RLP's ORSA and that therefore there should be no material reduction in the security of RLP's policyholders as a result of the Scheme.

Subsequent events and impact of COVID-19

5.20 This section sets out the events which have happened since the analysis above was performed, or which may happen between now and the effective date of the transfer. I will comment fully on any such events and their impact within my 2021 Supplementary Report.

5.21 Nothing has emerged since 31 December 2020 that would require any reconsideration of the analysis provided in this report.

5.22 While I do not expect the Scheme itself to have a significant impact on the financial position of RLP, there are a number of other potential management actions that could have an impact on RL's financial position. These include:

- Further new business may be written by RLP;
- RLP may invest in new assets;
- A dividend payment may be made either from RLP to Rothesay Limited, or Rothesay Limited to shareholders; and
- Further capital may be raised at either Rothesay Limited or RLP level.

5.23 In addition, market conditions have the potential to change between now and the effective date of the Scheme.

5.24 However, I do not consider it likely that any of these potential actions would cause me to revise my opinions, given that there is no material adverse effect for Rothesay's policyholders of the scheme going into effect.

5.25 I have also considered the impact of the on-going COVID-19 pandemic. At the time of writing the impact of the pandemic on day-to-day activities in the UK has significantly lessened, restrictions are being lifted and vaccines have been successfully rolled out to the majority of the UK population. While there remains uncertainty, including the future impact of the virus on health and the economy, I do not consider that the pandemic itself has any impact upon my conclusions. I also see no reason why the Scheme cannot be put into effect, for example I am comfortable that there are no material operational issues caused by COVID-19 on existing or proposed administration arrangements. Rothesay and their outsourced third-parties, including administrators, have been successfully working from home since the start of the pandemic and have proven their ability to continue business as usual with no impact on client service or customer satisfaction. Finally, the scheme is not projected to come into effect until late 2021, with the transfer of administration to Rothesay's provider of choice planned for 2022, when it is projected that the impact of the pandemic will have diminished further.

5.26 As noted earlier there are potential positive economic benefits for Rothesay that may arise following the completion of the Scheme, including being able to more efficiently manage the assets once the collateral associated with the transferring policies is removed and removing a number of other operational burdens. I have considered these potential benefits and while I have concluded that they are genuine and likely to arise, given that they are relatively small and uncertain in terms of amount and timing I have not taken them into account in my assessment of the impact of the Scheme. In particular, I have not taken into account any of the potential positive benefits when considering if there is any material adverse impact overall.

Impact of Scheme on existing RLP policyholders

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Impact on contractual terms applicable to existing RLP policyholders

6.1 There are no intended changes within the proposed Scheme to the contractual terms of any of the existing RLP policies.

6.2 The majority of the benefits payable under the existing RLP policies are fully defined, or vary only in relation to an external data source (e.g. the level of an inflation index). Where RLP has some discretion over payments to be made, for example in relation to the amount paid when a deferred annuity is transferred away from RLP or other types of commutations, there are no changes in the approach or basis to be used as a result of the scheme.

6.3 No changes are to be made to the collateral or security arrangements in place with certain trustee policyholders.

Impact on security of benefits applicable to existing RLP policyholders

6.4 As noted in Section 5 of this report, had the proposed Scheme been effective as at 31 December 2020, the capital impact to RLP (including the transferred-in assets and liabilities of PAC) would have been nil, and RLP would have continued to have capital in excess of the SCR, and in line with its capital management policy.

6.5 There would be negligible change in the security of benefits of RLP policyholders if the proposed Scheme were to be approved, as the reinsured PAC liabilities and associated assets are currently held on the RLP balance sheet and as such, the RLP policyholders are already exposed to the overall risks associated with the PAC policies.

6.6 The costs associated with the transfer will be borne in part by RLP and in part by PAC. No costs will be passed on to any RLP policyholders. These costs are not material in the context of the assets of RLP and will have no impact on the security of benefits for RLP's policyholders.

6.7 As well as the principal liabilities in relation to the transferring policies (i.e. the pension benefits), Rothesay has accepted, or committed to accepting this risk from a future date, certain mis-selling risks. These liabilities will either be transferred as part of the Scheme, or will be covered by an indemnity. The impact of this is expected to be negligible as it will have been several years since the policy was originally issued and any material exposure to these risks should already have been identified. In addition, for bulk transfers the trustees of the pension schemes involved are typically considered to be professional investors and make extensive use of professional advisers and so the risk of mis-selling is negligible. Therefore, I do not consider these additional liabilities create a material additional risk for RLP's existing policyholders. I also note that under both RLP's Standard Formula Solvency calculation and its ORSA calculation, the overall capital held for operational risk increased as a result of the original reinsurance arrangement.

6.8 Certain policyholders of RLP benefit from access to the Financial Services Compensation Scheme ("FSCS"), which acts to provide a safety net should a company be unable to pay claims or benefits due to policyholders. Generally the FSCS covers all individuals and some businesses. The Scheme will not impact the rights of any of RLP's current policyholders who are currently eligible to make a claim under the FSCS.

6.9 Upon completion of the Scheme, PAC will lose all security and recourse to any collateralised assets of RLP, save for any collateral required for the expected long-term reinsurance in respect of the non-transferring policies. This will provide a liquidity management benefit, give RLP more freedom to manage the assets appropriately, and give a small reduction in operational expense for RLP, therefore marginally improving the position for RLP and its policyholders compared to continuing with the reinsurance. Such benefits are not reflected in the pro-forma solvency position shown earlier.

6.10 The liabilities which are proposed to be transferred from PAC to RLP under the Scheme are materially the same types of liabilities which RLP currently manages. Upon completion of the Scheme, RLP will manage its affairs as a whole and in particular consider the security of all policyholders together, with no one set of policyholders being given preference. I do not expect any scenarios to arise where there would be a material divergence of interests between the current RLP policyholders and what would become the ex-PAC policyholders following the transfer.

Impact on administration applicable to existing RLP policyholders

6.11 There are no significant administrative changes that will adversely affect existing RLP policyholders as a result of the proposed Scheme. RLP outsources the majority of policyholder servicing activities and for existing RLP policyholders, members or dependants they will continue to be administered by the same outsourced providers, in the same way, and subject to the same service standards. After the transfer the administration of the transferring policies will continue to be performed by PAC on behalf of RLP under the TSA described earlier. Subsequent to the TSA RLP may use one of its current outsourced administration providers or a new administration provider. I have reviewed the plans for the migration of administration services and I am satisfied that in either case there would be no material impact on the administration arrangements for RLP's current policyholders.

Impact on PAC as a policyholder of RLP

6.12 When undertaking the reinsurance of the PAC policies, the objective of the reinsurance was as a precursor to a Part VII transfer to ultimately remove the liabilities from PAC's balance sheet. On completion of the Scheme, save in respect of the non-transferring policies, PAC will lose all security and recourse to any collateralised assets of RLP. Other than in respect of the non-transferring policies, all liabilities covered under the reinsurance agreement will also transfer and as such the security is no longer required. This is as intended by the terms of the agreement between PAC and RLP.

6.13 Following the transfer, PAC will no longer have primary responsibility for the administration of the transferring policies, thereby reducing the operational burden, noting that PAC has agreed to provide administration services to Rothesay under a TSA for a short period of time after the transfer. Responsibility for oversight of the associated reinsurance contracts will also switch to RLP.

6.14 In respect of the non-transferring policies, it is anticipated by RLP and PAC that they will remain reinsured by RLP under the existing reinsurance agreement (appropriately amended).

6.15 Therefore, the Scheme does not adversely affect PAC as a policyholder.

6.16 The implications for individual PAC policyholders will be considered in full in the PAC Chief Actuary's report, in the PAC With-Profits Actuary's report and in the Independent Expert's report.

Policyholder communications

6.17 As part of the original Part VII transfer process, RLP wrote to its existing policyholders (whose names and addresses were held on RLP's database just prior to the relevant mailing date) to inform them of the proposed transfer, providing an opportunity to comment or object. As at the date of this report 11 objections have been received. They related to the following matters:

- Policyholders who believed they should have been informed earlier of the proposed transfer;
- Policyholders who were concerned with the security of benefits following the transfer;
- Policyholders who are concerned that the proposed transfer will weaken Rothesay's financial strength in the long term;
- Policyholders who are concerned about the ongoing service standards that will apply to their policy following the transfer;
- Policyholders that are concerned they will have less control over the investment procedures as a result of the Scheme;
- Policyholders who believe that “no material adverse effect” is not sufficient reassurance and that that the proposed transfer should not have any adverse effect on policyholders;
- Policyholders who believe information is being withheld from them;
- Policyholders who do not wish their PAC policy to be transferred to RLP due to already having a policy with RLP and who wish to keep their policies with different companies in case one of the companies should become insolvent; and
- Policyholders who would like more information on the commercial reasons for the transfer.

6.18 All objections were shared with the Independent Expert. Summaries were provided to the PRA and FCA, and appropriate responses provided to all of the policyholders. I considered the issues raised by the objections and the responses provided. It is my opinion that none of the objections received provided any legitimate reasons why the Scheme should not go ahead and I continue to retain that view.

6.19 It is my understanding that these objections will continue to be treated as such, and provided to the Court when it considers the matter later in the year unless the policyholders ask for them to be withdrawn or amended. One of the original objections related to a policy that is no longer in force, and therefore is no longer considered to be an objection.

6.20 Rothesay will write to the remaining 10 policyholders who objected in 2019 to let them know that their previous objection will be resubmitted as part of this process unless they request otherwise and ask them to contact us if they want to change or amend their objection before submission.

6.21 Other than to those 10 policyholders, Rothesay does not intend to issue further direct communication to its individual policyholders, preferring instead to keep those individual policyholders informed via its website. Given that there is expected to be no material impact for Rothesay’s existing policyholders, and the possibility of causing alarm if any direct communication were to be misunderstood, I consider this approach to be reasonable.

6.22 Since the last communication exercise regarding the proposed transfer, Rothesay has written 26 new buy-in and buy-out arrangements. Rothesay also intends to write to the trustees of the schemes with new buy-in and buy-out policies who remain policyholders of Rothesay, informing them of the Scheme. While I understand that it is likely that these trustees were aware of the existence of the Scheme when they took out their policy, this is reasonable and proportionate.

Summary

6.23 Overall, in my opinion, the proposed Scheme and transfer of business is not likely to adversely affect the benefits, security or administrative arrangements applicable to existing RLP policyholders. Consequently, I do not consider that the proposed Scheme would mean that the principles to treat customers fairly and to manage conflicts of interest fairly are likely to be breached.

Simon Johnson, FIA
Chief Actuary, Rothesay Life Plc
13 July 2021

Compliance with actuarial standards

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7.1 The Financial Reporting Council ("FRC") sets Technical Actuarial Standards ("TASs") for members of the UK actuarial profession.

7.2 The TASs relevant to this work are:

- TAS 100: Principles for Technical Actuarial Work
- TAS 200: Insurance

7.3 I have considered the extent to which TAS 300: Pensions applies, and I have concluded that although some of the insurance policies in scope of the Scheme insure benefits provided by pension schemes (i.e. through buy-in policies) and therefore the Scheme could impact on the security of members' benefits, the Scheme and the associated reinsurance are in relation to insurance arrangements, and TAS 300 does not introduce any relevant additional requirements over and above TAS 100 and 200.

7.4 I have also taken into account guidance issued by the Institute and Faculty of Actuaries (IFoA) in relation to the TASs.

7.5 It is my assessment that this Report, and the underlying work, complies with the relevant TASs.

7.6 The IFoA issues Actuarial Professional Standards (APSs) which members must comply with. I have considered the requirements of APS X1: Applying Standards to Actuarial Work and APS L1: Duties and Responsibilities of Life Assurance Actuaries and applied them to the extent relevant.

7.7 This Report has been prepared in accordance with the Actuarial Professional Standard APS X2: Review of Actuarial Work. The drafting of this Report included an internal review by another actuary in the company, Andrew Stoker FIA, and I have taken his feedback into account when producing this Report. The Scheme is subject to independent review by the Independent Expert which provides a further review of the conclusions of this Report. I am satisfied that in the context of the Scheme and the purpose of this Report, that this is sufficient peer review.

Glossary of terms used

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Chief Actuary	The actuary appointed from time to time to carry out the duties set out in the Actuaries section of the PRA rulebook
Court	The High Court of Justice of England and Wales
Excluded Liabilities	Liabilities associated with the transferring PAC policies but which will not transfer from PAC to RLP under the Scheme, e.g. fines or similar losses arising from PAC activities before the transfer.
FRC	Financial Reporting Council
FCA	Financial Conduct Authority
FSCS	Financial Services Compensation Scheme
FSMA	Financial Services & Markets Act 2000
Independent Expert	The individual appointed to report on the terms of an insurance business transfer scheme and approved by the PRA and FCA pursuant to Section 109 of FSMA
ORSA	Own Risk and Solvency Assessment. An internal assessment a company makes of its own risk profile and hence the capital needed to allow for those risks
Own Funds	A company’s assets minus its liabilities, assessed on a Solvency II basis
PAC	The Prudential Assurance Company Limited
PAC Longevity Reinsurance	Longevity reinsurance contracts PAC had in place on some of the policies which are proposed to transfer to RLP. It is anticipated that these contracts will transfer to RLP as part of the overall insurance business transfer process.
PIM	Partial Internal Model, a type of internal model which may be used to calculate a company’s SCR, subject to regulatory approval. Some of the risks are modelled using a bespoke internal calculation, with the remaining risks using the Standard Formula approach
PRA	Prudential Regulation Authority
RLP	Rothesay Life Plc (formerly known as Rothesay Life Limited)
Rothesay Limited	Rothesay Limited, (formerly known as Rothesay HoldCo UK Limited) the parent company of RLP
Rothesay Group	The group of companies with Rothesay Limited as their ultimate parent
Scheme	The proposed insurance business transfer scheme relating to the transfer of the business of PAC to RLP
Scheme Report	The independent report required as part of the procedure for gaining approval of the Scheme by the Court
SCR	Solvency Capital Requirement under Solvency II
Standard Formula	A defined method for calculating a company’s SCR, using techniques and calibrations intended to be applicable for the majority of insurance companies
Supplementary Report	An update to the Scheme Report (or, if the context infers, to this Report), which may be required for the secondary Court hearing reflecting any material changes that have occurred in the businesses
Surplus	The excess of a firm’s Own Funds over its SCR
Technical Provisions	Solvency II base liability calculated as a sum of the Best Estimate Liability plus Risk Margin net of any transitional provisions