Rothesay

STEWARDSHIP REPORT 2021

ROTHESAY SUBMISSION TO THE FRC STEWARDSHIP CODE 2020

October 2022

Contents

Introduction

Rothesay is the UK's largest specialist pensions insurer, purpose-built to protect pension schemes and their members' pensions. Our singular focus is to secure pension annuities for the future, providing certainty as well as genuine service excellence for all our policyholders.

Our conservative investment strategy and prudent underwriting mean we are trusted to provide pension solutions by the pension schemes of some of the UK's best known companies, including Asda, British Airways, Cadbury's, the Civil Aviation Authority, National Grid, the Post Office and telent.

Underpinned by sophisticated risk management, our expert in-house investment team is continually developing new ways to drive predictable, dependable returns that minimise risk and create real security.

At year-end 2021, we managed over £62 billion in assets. We secure the pensions of over 837,000 people, and pay out, on average, over £200 million in pension payments each month. We are securing the future for every one of our clients and policyholders, and improving how pensions are delivered as we do it.

We are an asset owner with all assets managed in-house.

This document outlines Rothesay's approach to stewardship, defined by the Financial Reporting Council (FRC) as *'the responsible allocation, management and oversight of capital to create long-term value for clients and beneficiaries leading to sustainable benefits for the economy, the environment and society'*. This document is structured so as to align with the twelve principles detailed in The UK Stewardship Code 2020. All activities and data presented in this report refer to 2021, unless stated otherwise.

Message from the CEO

This is our first Stewardship Report, covering activities carried out in the year ending 31st December 2021, in line with the standards set out by the Financial Reporting Council's UK Stewardship Code 2020. Within it, we are pleased to detail how stewardship and sustainability decisions have influenced the management of our investment portfolio throughout the year.

At Rothesay, we understand the clear link between our core investment objectives and the need to consider stewardship principles alongside Environment, Social and Governance (ESG) risks in our strategy and decision making. I am proud that our approach to the management of these risks and broader considerations allows us to not only achieve our primary goal of providing pension security to our policyholders, but also provide wider benefits to our stakeholders, the environment and society.

We believe that an important part of our role is to exert influence by engaging on sustainability concerns with issuers, service providers and our industry peers. Through these engagements we seek to encourage transparent disclosures on ESG related risks and improved sustainability practices.

Our approach to stewardship is constantly evolving and we look forward to sharing the progress we have made in 2022 as part of next year's report.

Tom Pearce

Chief Executive Officer

I. Purpose, strategy and culture

Our purpose and culture

As the UK's largest specialist pensions insurer, our purpose is to protect pension schemes and the pensions of over 837,000 policyholders. We have always recognised the close link between ESG issues and more resilient long term performance. Embedding ESG principles enables us to deliver better outcomes for our policyholders, our people and our shareholders.

Rothesay's commitment to the highest standards of integrity, transparency and accountability is reflected in our cultural values, which are set out below and which are internally available on Rothesay's intranet along with the way in which those values translate into performance, behaviours and our everyday decisions and interactions:

1. **Original & Creative:** We are always looking for new ways to create security for our policyholders, manage risk and deliver reliable returns for our investors.

2. **Collaborative & Diverse:** We actively value difference, treating everyone as an individual with equal opportunity to thrive in their career. This helps us create a stronger, more dynamic business today and for the long term.

3. **Dedicated, Genuine & Accountable:** Our commitment to our policyholders is paramount and it guides us in all aspects of our business. For our work culture, we believe in taking personal ownership of the success of Rothesay, rewarding hard work, dedication and accountability.

4. **Meticulous & Fast-paced:** We are meticulous in everything we do and expect the highest standards from colleagues. We are always pushing ourselves to be at the forefront of our industry and will accept nothing but the best quality work.

Our business model

Underwrite the liabilities

In preparing to take on a new block of annuitant liabilities, we achieve maximum pre-deal certainty for trustees and pension scheme members through our meticulous underwriting and due diligence. We model the benefits of policyholders at an individual level and project these benefits to maturity. This means that we can accurately estimate the cost of providing the insured benefits and holding the necessary risk capital. We scrutinise all new business to minimise risk while aiming to achieve returns for our investors that are sustainable. Specifically, the company is managed over the long term with the goal of releasing sufficient capital each year, as policies run off, to achieve returns for investors and to be able to support the new business taken on.

Hedge the risks

We carefully assess all transactions before completion and put in place arrangements to match the liabilities we will take on with appropriate assets. This gives certainty to clients and protects our balance sheet. Alongside responsible asset selection, we are careful in our selection of derivative and reinsurance counterparties. We reinsure the majority of our exposure to longevity risk to mitigate losses should the life expectancies of our policyholders increase. In order that longevity risk and other hedged risks, such as interest rate and inflation risk, are not simply replaced by counterparty risk we make use of collateral arrangements, the management of which is an integral part of the Group's activities. We closely monitor collateral so that the value of our security is not compromised by market shifts.

Invest the assets

We seek to invest in assets: (i) where the cashflows that we receive in connection with that asset, match our liability cash flows (ii) which meet our ESG objectives, and (iii) which provide an appropriate risk-adjusted return. To achieve this, we invest in investment grade bonds and loans. Our investment portfolio is rated on average as AA and is made up of three diverse categories:

1. Supranational, Sovereign and Public Finance bonds.

2. Corporate Bonds and Infrastructure Lending.

3. Bonds and Loans Secured by Property.

To date this strategy has supported us in maintaining a stable portfolio that has avoided losses due to default, in building a strong capital surplus and in providing security to our policyholders and bondholders as recognised by our Fitch and Moody's long term issuer credit ratings of A+/A2 respectively.

Deliver the pension benefits

We have strategic partnerships with a number of well-established pension administrators including WTW, Mercer and Capita Employee Solutions. Working with these partners gives us scale and contingency capabilities. High levels of automation and sophisticated technology enable our partners to interact with our systems to eliminate discrepancies and deliver excellent customer service to our policyholders.

Our investment strategy

Our in-house team is responsible for the management of Rothesay's £62.5bn (at year end 2021) asset portfolio. Assets are sought which match our liability cash flows and provide an appropriate risk-adjusted return, as well as being in line with our Responsible Investment Policy. Rothesay operates a cautious investment strategy which seeks to diversify exposure and actively manages risk. We are constantly looking for new ways to reduce risk and achieve the dependable returns that create real security for people's pensions in the future. As a company Rothesay pursues a number of key investment objectives, defined as:

- **Policyholder security:** To ensure that liabilities to policyholders can be met in full and in a timely manner via conservative balance sheet and liquidity management;
- **Balance sheet stability:** To maintain financial strength and solvency capitalisation in order to produce stable cashflows from in-force business;
- **Value-driven investment:** To take a quantitative view of risk where possible and invest in a manner that enhances shareholder value on a risk-adjusted basis;
- **Focus on asset-liability management:** To invest assets in a manner appropriate to the permanent nature of the policyholder liabilities in order to reduce risk exposure and to take advantage of less liquid assets that offer higher returns than those exhibited by bonds that can be made readily available for sale; and
- **Knowing our borrowers:** To ensure that the investment process reflects Rothesay's governance principles and takes into account factors that are harder to quantify, such as ESG and reputational risks.

ESG and our investment strategy

As described in our investment objectives, Rothesay's investment decision-making seeks to take a quantitative view of risk where possible and invest in a manner that both maximises policyholder security and enhances shareholder value on a risk-adjusted basis. This ensures that our investment strategy is aligned with the best interests of our clients and beneficiaries. A key part of effective stewardship is the identification, assessment and monitoring of financially material ESG risks and opportunities.

There is a strong alignment of interest between measuring and managing ESG risks and our primary purpose of safeguarding our policyholders given that both require a complex measurement of the likelihood and extent of financial impacts caused by uncertain developments over extended (30 years and beyond) timeframes.

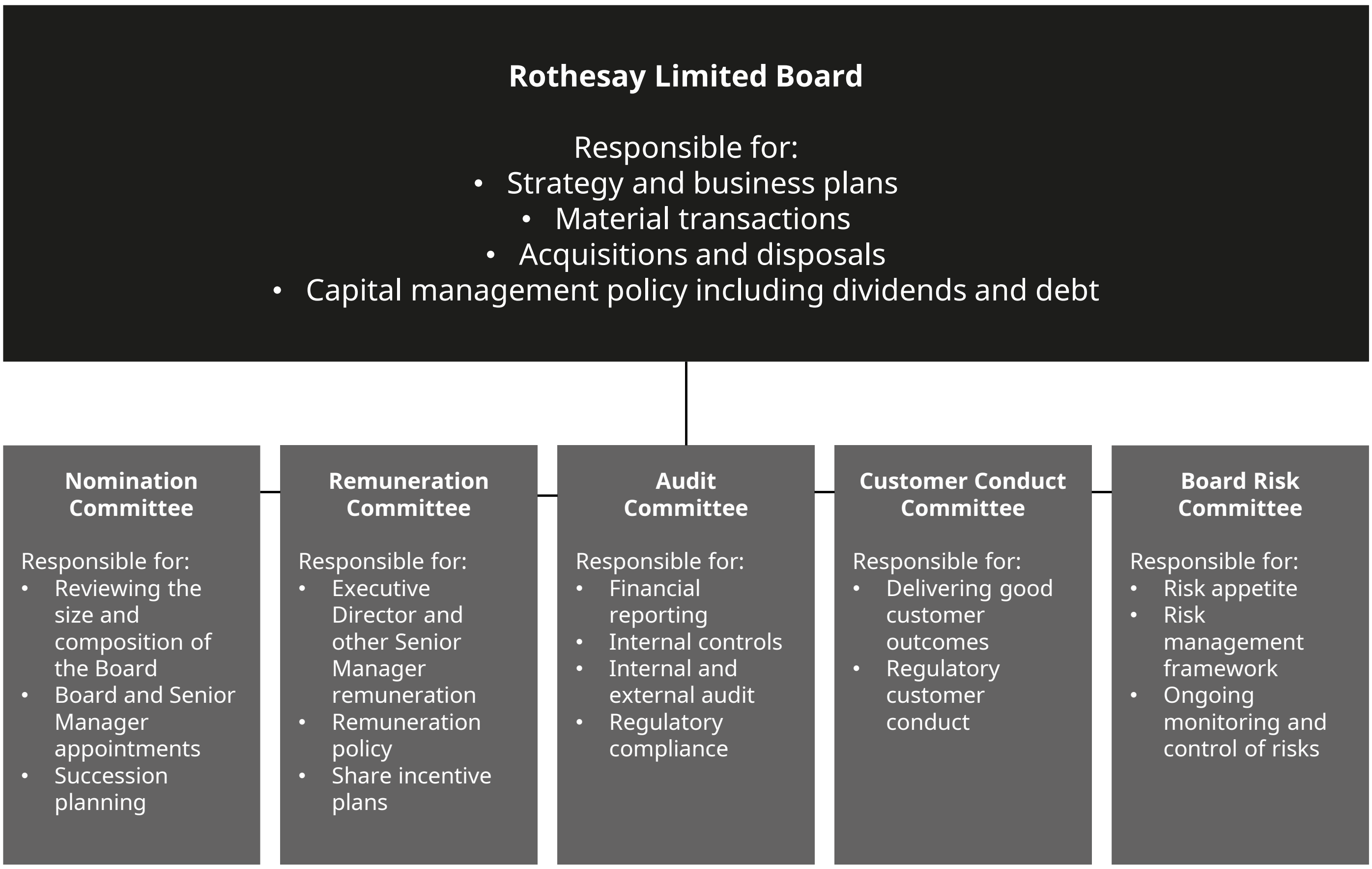
The in-house investment team considers financially material ESG factors as part of the investment process and these factors are formally documented in all committee papers for new investments in order to allow for educated discussion prior to an approval decision. We are aligning our investment portfolio with the Paris Agreement's goal to limit global warming to 1.5ºC above pre-industrial levels and are committed to supporting a low carbon economy in which the UK achieves carbon neutrality by 2050. Progress is tracked by measuring the Carbon Intensity, Financed Emissions and Temperature Alignment of the portion of our portfolio (90%, 73% and 15% respectively) for which we can obtain the corresponding emissions data or make estimates thereof.

II. Governance, resources and incentives

Structure

Effective stewardship of our assets begins with a strong governance framework to ensure that the interests of our policyholders are factored into every investment decision. At Rothesay, we structure our governance framework so that our strategy, purpose and values are clearly projected down from our Board and are understood and acted on throughout the business. This approach, alongside the processes and controls we have in place, means that we can effectively manage our risk profile and secure the future of every one of our policyholders.

The Board Committee structure is shown below:



Board Committee

The Board and Board Committees are comprised of a combination of Executives, Directors appointed by the shareholders of Rothesay Limited and Independent Non-Executive Directors (INEDs) and meet on a regular basis.

Rothesay applies all of our risk management, internal control systems and reporting procedures at a Group level (seeking to ensure that they are applied consistently across all entities in the Group) and also at an employee level.

Rothesay's governance structure means that decisions can be made quickly and efficiently whilst ensuring that there is robust oversight. The Board is supported by the Audit Committee, the Board Risk Committee (BRC), the Remuneration Committee and the Nomination Committee. Terms of reference for these Committees can be found at www.rothesay.com. In 2021, to streamline governance, the BRC became a committee of Rothesay Limited rather than of RLP. This aligns the structure with the reporting line of the Audit Committee. Prior to 2022 and therefore in the period covered by this report, the committee structure was slightly different in that a Customer and Conduct Committee served as a hybrid Board / Executive committee. We believe the elevation to full board committee, which was accompanied by removal of the conjunction from its title signifying a narrowing of conduct issues to those concerning customers, enhances our strong governance model, maintaining focus on providing excellent customer service as an essential element of our business model, brand and reputation. The Audit Committee now oversees matters related to conduct in all other areas such as market abuse and personal account dealing.

Fit and proper requirements

The FCA Handbook and PRA Rulebook requires firms to ensure that anyone performing a Senior Management Function or Certification Function is fit and proper for their role. This requirement also applies to Non-Executive Directors who are not Senior Managers.

Rothesay's Fit and Proper Policy was first approved by the Board in November 2015. It has since been updated regularly, and at least annually, to ensure ongoing compliance with the fitness and propriety requirements of Solvency II and the Senior Managers & Certification Regime (SMCR). The Policy identifies who is in scope, how fitness and propriety is assessed for both new starters and on an ongoing basis and the governance arrangements in relation to individuals being approved as being fit and proper, including Rothesay’s requirements concerning skills, knowledge and expertise applicable to persons who effectively run the business.

Rothesay’s assessments of individuals’ fitness and propriety reflect the SMCR fit and proper requirements, namely:

- Financial soundness;
- Honesty, integrity and reputation; and
- Competence and capability

In addition, the Nomination Committee ensures that the Boards collectively possess appropriate qualifications, experience and knowledge about at least:

- Insurance and financial markets;
- Business strategy and general management;
- Governance;
- Risk management;
- Financial and actuarial analysis; and
- Regulatory framework and requirements.

Rothesay employs the following procedures to assess fitness and propriety:

- Performance against the applicable PRA Conduct Standards and FCA Conduct Rules;
- Performance against internal policies and procedures;
- Disclosure and Barring Service checks;
- Credit checks;
- Social media checks;
- Review of regulatory references;
- Review of training completion;
- Directorship search;

- Annual performance reviews and assessments; and
- Self-attestation annually.

In addition, the Chairman and Chief Compliance Officer undertake individual review sessions with each of the Directors.

Resourcing of ESG and stewardship

The Board is responsible for overseeing the delivery of the overall strategy of the Group and, as part of this, is ultimately responsible for the business' approach to stewardship.

Since the presentation of the results of the 2019 PRA climate stress test, the topic of climate change has become a regular item at both BRC and Board meetings, with the material presented falling into three categories: general information designed to educate and ensure a broad understanding; Rothesay's climate related metrics (for business operations and the investment portfolio); and sector specific information that provides a guide to decision making at a granular asset by asset level. It should be noted that all materials taken to the Board, regardless of subject, will have been composed with due consideration given to Rothesay's ESG related policies, for example, assessment of alignment with our Responsible Investment policy.

At the heart of Rothesay's asset risk management are our Investment Committee, BRC and the Executive Risk Committee (ERC), which all consider and, if satisfied, approve new assets. Transactions presented in these forums are required to address ESG issues (including climate change) and these considerations are as important as other traditional credit matters.

The PRA requires that Senior Management Functions be nominated to take overall responsibility for identifying and managing the risks from climate change and Rothesay has selected to share that role, the Head of Asset & Liability Management and the Chief Risk Officer representing both business management and risk control.

Day-to-day responsibility for the implementation of Rothesay's climate change risk and ESG risk management framework has been delegated to the ESG Working Group (EWG), a sub-committee of the ERC. In line with Rothesay's philosophy of ensuring that ESG considerations are not confined to one team, the EWG draws membership from across the business and is chaired by the Head of Investment Strategy. This structure, encourages working group members to disseminate best practice within their departments.

The EWG discusses developments each week, meets formally once a month and is the forum at which all ESG related work is first discussed. Duties and responsibilities of the EWG include:

- Supporting the implementation of the ESG risk management framework.
- Acting as an internal knowledge centre on the financial implications of ESG, including monitoring of emerging risks and opportunities.
- Supporting the wider sustainability goals of Rothesay and its employees.
- Reviewing and monitoring ways to reduce our exposure to potential and emerging ESG issues.
- Supporting the development of Rothesay's approach to public disclosures and communications relating to ESG.

Recommendations from the EWG are subsequently presented for approval to the ERC and ultimately the BRC or the full Board.

In 2021, Rothesay also hired a dedicated ESG specialist into the Risk team to work alongside sector analysts to provide expertise and insight into the impact of ESG risk and facilitate enhancements required to governance processes and policies.

All new papers circulated to a committee in connection with the approval of a transaction have an ESG section in which the risks or opportunities relating to climate change, social welfare and the organisational structure of the potential borrower are examined.

Rothesay's corporate bond portfolio managers have immediate access to issuer emissions data in the same trading system that stores bond prices, yields and credit ratings. In this way Carbon Intensity has become a metric that is considered in the normal course of trading.

Incentivising and improving stewardship

At Rothesay, we believe that successful stewardship requires the support of all our employees to ensure that we can protect the financial security of our policyholders. We strive to provide all individuals with the encouragement and training required to consider the economy, environment and wider society when making business decisions. In 2021, in order to incentivise the implementation of effective stewardship, we introduced an assessment of each individual's alignment with, and contribution to, Rothesay's ESG objectives, which forms part of every employee's annual performance review.

As mentioned previously, one of the responsibilities of the EWG is to support the wider sustainability of Rothesay and its employees. Our team have hosted training sessions open to employees on the fundamentals of climate change and Rothesay's approach to ESG risk. A session on ESG is included in our quarterly induction sessions, which are attended by all new joiners.

We continue to assess our governance processes to ensure they remain appropriate and look for opportunities to strengthen our approach where necessary. For example, considering future resourcing requirements and training opportunities.

III. Conflicts of interest

Rothesay has adopted a policy that provides the business with guidance for identifying, avoiding, disclosing and managing circumstances which may give rise to conflicts of interest.

Our policy defines a conflict of interest as the following:

"A set of circumstances or situation where the Group and/or its employees are subject to multiple competing influences that could adversely impact decision-making and outcomes."

Potential conflicts arise in two ways:

1. Business conflicts: the competition of legitimate influences in the Group's business model, for example (i) between Rothesay's primary stakeholders; (ii) in the Group's third-party relationships; (iii) with a person linked by control; and (iv) with and between its clients or customers.
2. Personal conflicts: the competition between interests of an employee, the Group or its customers and potentially harmful influences rooted in personal interests or relationships. Examples include personal decisions driven by the prospect of financial gain or increased social status.

Rothesay operates a business model that includes a range of activities, including liability transactions in respect of bulk purchase annuities, funding arrangements with mortgage lenders and originators, real estate investments and other broader fixed income investment activities. These activities give rise to a number of potentially competing interests and therefore our activities must consider carefully the conflicts of interest they may present. Whilst the risk is identified as being low, Rothesay appreciates that there is the potential for conflicts of interest between traders' personal trading and trading activity undertaken on behalf of Rothesay. Therefore, we have implemented the following rules:

- The compliance department maintains a list of entities (the restricted list) for whom we know we are in possession of material non-public information (MNPI). Most of the entries on this list arise as a result of our liability dealings with corporate pension schemes but it is incumbent upon members of the asset management team to report occasions, such as new issue soundings, in which they take possession of MNPI.
- Prohibition of trading in securities of issuers who are on our restricted list.
- Approval required prior to trading in securities of issuers on our conflicts list for whom we hold confidential but not material non-public information.
- All employee personal account dealing in equity and corporate debt instruments must be submitted for pre-trade approval.

From time to time Rothesay's asset risk management function may wish to engage with issuers who are included in either the conflicts or restricted trading lists in order, for example, to obtain more detailed information about their carbon emissions or a potentially controversial activity that they are required to monitor. A conflict could arise if the bulk purchase annuity business development team believed such engagement would limit their ability to effectively negotiate a liability side transaction with the issuer's pension scheme. We mitigate this conflict by having a clear separation between the risk management teams (who are responsible for our issuer engagement activities and report to the CRO), and the Business Development Team (who report to the Managing Director)

Rothesay takes the following approach for all conflicts of interest:

1. Identification of potential/perceived conflicts of interest;
2. Avoid or manage the conflict of interest;
3. (Where necessary) disclose conflict of interest;
4. Review conflicts of interest.

The Executive Risk Committee, Business Controls Committee and Audit Committee are responsible for oversight of conflicts of interest.

Additional Conflicts of Interest examples:

It was identified that an employee was a member of a pension scheme that was the subject of a prospective bulk purchase annuity transaction. The conflict was disclosed and approved by relevant senior managers. It was confirmed that there was no ability for the employee to influence an outcome that was different to the outcome received by all other scheme members.

A Rothesay NED disclosed that they were also a NED for the corporate sponsor of a prospective client pension scheme. The NED stood down from their NED role at that company. However, in the event that the NED had not been able to take that action, Rothesay would have required the NED to recuse themselves from conversations relating to decisions with respect to that particular transaction and the client relationship.

IV. Promoting well-functioning markets

Risk management framework

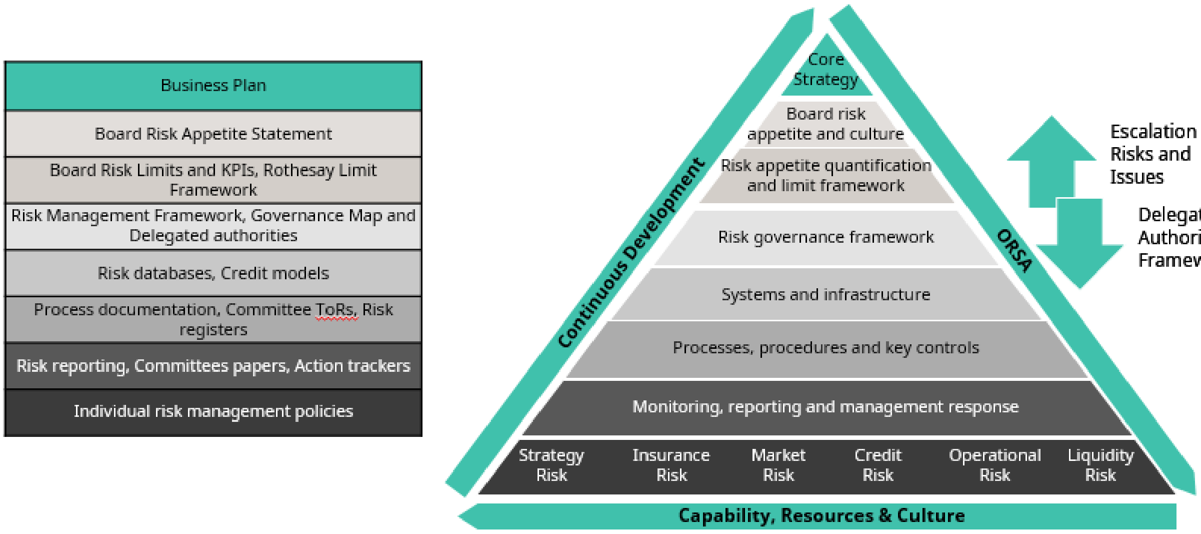
Rothesay has an embedded risk management framework (RMF) which is aligned to the 'three lines of defence model' and which ensures that every employee knows how they contribute to the effective identification, management, mitigation and monitoring of all types of risks.

- First line: Day-to-day risk management is delegated from the Board to the Chief Executive Officer (CEO) and, through a system of delegated authorities, to business managers. Rothesay also makes the distinction between:
    - the risk-taking functions, including investment and new business origination; and
    - the control functions, whose responsibility it is to ensure the integrity of Rothesay's operations and reporting. These include operations, finance and legal.

In 2021, a new committee (the Business Controls Committee), chaired by the CFO, was set up to focus on the control environment within Rothesay, the management of third party suppliers and the risks arising from new activities.

- Second line: Design and maintenance of the risk management framework as well as risk oversight is provided by the Chief Risk Officer (CRO), his team and risk management committees. The Chief Compliance Officer and his team report to the CRO. ERC is chaired by the CRO and consists of relevant senior managers working within a delegated risk management framework. This committee reviews all material new investment, hedging and liability transactions.
- Third line: Internal Audit provides the Board and Executive committees with comprehensive, independent, objective assurance over governance, risk management and internal control.

The RMF informs and is directed by Rothesay's business strategy. Risk management considerations are integral to setting business strategy, as we seek to optimise our risk-adjusted returns and create shareholder value whilst also meeting the expectations of our customers and other stakeholders. The RMF ensures both clear ownership and strong oversight of all of Rothesay's risks, both quantifiable and non-quantifiable.



Market-wide Risks

Rothesay's capital strength, embedded value, liquidity and profitability are all directly affected by changes in interest rates, currency rates and inflation often in a complex, interacting and non-linear fashion. We regard it as vital to know our sensitivity to these factors at all times and the firm's integrated pricing, capital and risk management system, inherited from Goldman Sachs and further developed in house, is our key competitive advantage in this regard. All assets and liabilities are captured within the system along with all the relevant real time market data. Each day comprehensive risk reports are computed allowing the traders immediately to execute trades of the correct size to maintain the sensitivity of our primary metrics in line with the course set by senior management. These trades are largely done in the market for interest rate and cross-currency swaps all of which are undertaken with Collateral Support Agreements which require us to manage our liquidity as carefully as our capital. To this end, where we are required to provide collateral to a counterparty, we have sought to agree arrangements which permit us to post as wide a selection of our assets as possible rather than being restricted to cash and Gilts.

The Rothesay Asset-Liability Committee meets each morning to discuss the behaviour of the markets and to decide upon any adjustments to our risk positions that may be warranted. This results in our dealings with the market having an incremental rather than a dominating impact on the flows experienced by our counterparties. We execute market trades in a manner that is respectful of our counterparties and indicative of our desire to be a long term participant with whom other institutions want to trade.

Systemic Risks - Examples

COVID-19

In March 2020 as the COVID-19 virus spread around the world, governments began to introduce national lockdowns which severely curtailed economic activity and threatened the viability of many companies, leading to a sharp fall in the price of corporate bonds. The Asset-Liability Committee had to decide whether this represented an opportunity to invest at higher yields or a risk that required a large scale liquidation. We conducted sector by sector downgrade and default scenario analysis as well as considering the impact of very low interest rates. We identified a few relatively small holdings such as airlines that appeared to be too risky to hold but satisfied ourselves that our capital position was strong enough to invest in return seeking assets. This decision was further supported by the action taken by government via the provision of support loans and furlough programs.

2021 continued to be dominated by the impact of COVID-19 on financial markets. Our market-leading risk management systems allowed us to protect our balance sheet during adverse and volatile market conditions. During 2021, there was considerable volatility in interest rates, exchange rates and inflation. At the same time, credit market conditions continued to improve, with credit markets being stronger than the levels seen at the end of 2019. Buoyant credit markets increased the risk that creditor protections were inappropriately weakened or that risk-adjusted returns were inadequate. Rothesay remained patient and cautious in making new investments over the year.

As a result of new business premiums, Rothesay had substantial cash and gilts to switch into longer-term assets. Tight credit spreads have meant that there were fewer opportunities to invest in assets providing an appropriate risk-adjusted return during 2021 but we made good progress in doing so, increasing our investment in Equity Release Mortgages (ERM) by £1.4bn and funding fixed-for-term mortgages for the first time. While both types of mortgage are secured on residential property, the risk profiles of ERMs and fixed-for-term mortgages are quite different. We continue to actively monitor and manage potential downgrade risk across the investment portfolio, particularly as sustained inflation and uncertain central bank monetary responses may drive macro and individual counterparty weakness.

The backdrop of market volatility and uncertainty over the future impact of COVID-19, has meant that Rothesay's proactive approach to risk management has continued to be crucial in delivering Rothesay's strategic objectives and ensuring continued financial security for our policyholders.

Climate change

The most significant influence that Rothesay has in helping to combat the effects of climate change is through directing the investment allocations in our asset portfolio.

Managing climate risk does not necessarily mean divesting from high emitters. In fact, we will invest in higher-emitting issuers in whom we have confidence that their emissions will decline in line with appropriate targets in the short and medium term. We have, however, reduced exposure to issuers where we have less confidence in the responsible stewardship of these risks. We also acknowledge the importance of a 'Just Transition[1]' in the way in which we manage ESG risks, making sure to consider the social consequences of withdrawing funding from one sector in favour of another. For example, giving greater support to issuers with clear exit strategies for coal generation, including issuers that have considered and clearly communicated plans well in advance to their local communities whose employment opportunities may be affected by the closure.

Our proactive management of these risks has resulted in a reduction in the carbon intensity of our corporate issuers by 17%, of which 7% was driven by the issuers themselves and 10% from active management of the portfolio. We acknowledge, however, that due to unusual factors resulting from COVID-19 restrictions, 2021's large decline may not be regularly repeated without substantive action being undertaken worldwide, even though this annual decline is of the order of what is required to limit warming to 1.5℃.

Rothesay continues to develop its approach to climate change stress testing, which forms a key component of our RMF. We use climate scenarios to further explore, understand and model how physical climate change and the energy transition to a low carbon economy could affect the future value of our asset portfolio. Conducting

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[1] As outlined in Paris Agreement, a Just Transition is defined as 'the movement towards an environmentally sustainable economy which is well managed and contributes to the goals of decent work for all, social inclusion and the eradication of poverty.'

scenario analysis allows us to validate and challenge the assessments of climate change risk that we conduct as part of our established risk management processes.

Although Rothesay is not one of the five life insurance companies that participated in the Bank of England's Climate Biennial Exploratory Scenario (CBES), we have chosen to align our scenario analysis with the three scenarios explored in this exercise (Early action, Late action, No additional action, based on a subset of the Network for Greening the Financial System climate scenarios), as we believe they reflect current industry and scientific consensus. We assessed our portfolio against the CBES scenarios by translating changes in the energy system, economy and physical environment into impacts on asset values, drawing selected data provided by Planetrics[2] (a McKinsey & Company solution) as part of their granular, bottom-up climate scenario model.

Although our modelling process continues to evolve, early outputs are being used to support our sector deep dives and help inform our investment strategy. We will now look to build on the good progress we have made this year and learn from the industry experience gained by participating in the CBES in order to refine our approach.

Many organisations and standards have been set up to help and encourage financial institutions to tackle the challenges presented by climate change. Rothesay have selected to join those that are very well established, make recommendations that are widely adopted and provide clear frameworks for their signatories to follow. We are a member of the UN-Convened Net-Zero Asset Owner Alliance (NZAOA) and a signatory to the UN Principles for Responsible Investment (PRI). We are also a supporter of the Financial Stability Board's Task Force on Climate-related Financial Disclosures (TCFD) and have disclosed in line with their recommendations as part of our annual reporting process since 2019. In 2021, Rothesay's then CEO sat as a member on the climate change committee for the ABI, helping to drive a co-ordinated strategy for the industry on climate change and sustainability.

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[2] We Rothesay are solely responsible for scenario selection, all assumptions underlying such selection, and all resulting findings, and conclusions and decisions. McKinsey & Company is not an investment adviser and has not provided any investment advice.

V. Review and assurance

Policy review

As set out in our Policy Framework, formal policies that sit within the BRC or Board are reviewed annually. This process is necessary to keep them aligned with our internal strategy, risk appetite, external standards and/or industry good practice; and regulatory requirements.

During 2021, we undertook a review of our RMF, Risk Appetite Statement, Risk Limit and Stress Testing Framework and Investment and Credit Policy, to formalise our approach to managing ESG risk. One of the conclusions of this exercise was to set a new Key Risk Indicator (KRI) relating to the climate risk of our investments, to be reported to the Executive Risk Committee and Board Risk Committee on a monthly basis. Market practice, regulatory expectations and policy, as well as our commitment to ESG-related initiatives, are evolving rapidly and we will continue to review and update our policies where necessary.

In 2021, in accordance with PRI recommendations, we published our Responsible Investment Policy confirming our commitment to implementing responsible investment objectives within our investment decision-making. Our Responsible Investment Policy provides an overview of Rothesay's approach to the integration of ESG within our investment and lending decisions. We aim to continue to build on this as we further develop and embed our ESG practices.

Furthermore, as required by the Modern Slavery Act 2015, we annually update and publish a Modern Slavery Statement on our website, this describes the steps taken by Rothesay to ensure that slavery and human trafficking is not taking place in any part of our business or in any of our supply chains.

In 2021 we formally committed to applying to the UK Stewardship Code, with this report being our first formal submission of alignment to the Code. The Rothesay Board approved our alignment to the Code's expectation that our purpose, belief, strategy and culture enable effective stewardship and the strategic development of our Responsible Investment Policy.

Internal/external assurance

In terms of our internal assurance, our governance structures provide mechanisms through which our ESG strategy and stewardship practices are reviewed and evaluated by senior members at Rothesay, including the Chief Risk Officer, Head of Asset and Liability Management and Head of Investment Strategy.

We have formalised our internal assurance approach such that a member of the Compliance team sits as a member of the EWG and Compliance undertakes regular reviews of our policies, commitments and practices. Rothesay's Internal Audit and Operational Risk functions review our investment and risk management processes and in 2021 performed an audit of the adequacy and effectiveness of the controls in place governing the ESG framework.

There is a significant level of internal oversight across the Group to provide assurance over our ESG investment policies and practices and the success with which they are being implemented. We have also engaged external consulting and legal support to provide independent assessments of our approach to ESG reporting.

The importance of high quality ESG reporting to ourselves and our stakeholders, means we intend to undertake formal external assurance on our carbon emissions data and methodology in the future.

VI. Client and beneficiary needs

Rothesay provides defined benefit payments both directly to individual policyholders and through bulk purchase annuities to the trustees of corporate pension schemes (Corporate Trustees). Together these classes of policyholder are made up of over 800,000 people who are almost entirely UK based. In order to meet its liabilities Rothesay invests in a portfolio of debt instruments with cashflows and maturities that match the required outflows. The policyholders are not exposed to the performance of the assets. Instead these risks are borne by Rothesay's shareholders and bondholders via the capital that they have contributed. As a consequence, policyholders have very little direct influence over investment policy and Corporate Trustees must instead decide, based upon our public disclosure, whether our approach suits their needs and is aligned with their principles.

While for individual policyholders our stewardship principles may be a matter of interest, Corporate Trustees are often required by their regulator to make their own climate related disclosures and therefore they rely on us to provide them with Rothesay's climate related disclosures. We report on our ESG investment strategy and risk management processes annually in both our financial statements and dedicated ESG report. We strive to produce accurate and granular information on our approach, in order to allow Corporate Trustees to ensure that Rothesay's approach meets the pension scheme's ESG objectives.

Rothesay also responds to a number of surveys from external consultants on our approach to stewardship, and following the publication of our ESG report we directly engage with a number of consultants responsible for advising Corporate Trustees. Through these actions, we have been able to understand Corporate Trustees' priorities and concerns, allowing us to develop and enhance our investment and risk management approach.

In addition, we conduct our own brand awareness surveys, alternating annually between the Corporate Trustees of our policyholders and external consultants. These provide an opportunity for some of our key stakeholders to provide feedback on their perception of Rothesay, including our approach to stewardship and management of ESG related risks.

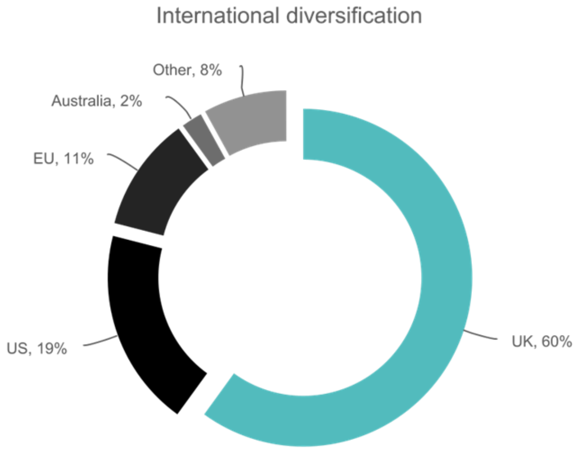
During 2021, Rothesay facilitated an initial workshop panel in partnership with mallowstreet, with membership comprising of Corporate Trustees from some of the UK's largest defined benefit pension schemes. The objective of the panel was to provide a forum for pension schemes to share ideas and discuss the challenges of producing ESG and climate-related disclosures.

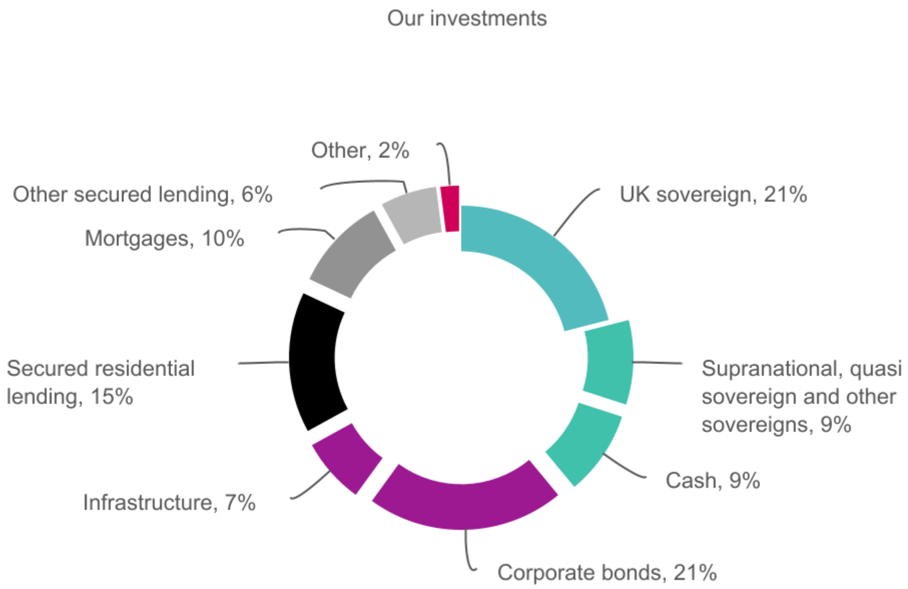
The average rating of Rothesay's investment portfolio is AA and the portfolio can be divided into three broad categories:

- **Supranational, Sovereign and Public Finance bonds –** This part of the portfolio includes assets that are available to meet collateral calls and cash requirements or may be awaiting redeployment into more productive sectors. It also includes assets that back some of our very long-dated cash flows.
- **Corporate bonds and infrastructure lending –** Given the scale of Rothesay's balance sheet, we invest in a diversified portfolio of corporate bonds, including regulated infrastructure such as water, energy and transportation.

- **Bonds and Loans secured by Property –** These assets are bonds and loans secured against property of various types. Included are different types of mortgages including ERMs and loans secured against commercial real estate. They are attractive because investors are rewarded for illiquidity rather than credit risk. Structural features such as collateral, covenants and other security features mean that recoveries in the event of default are maximised and credit risk minimised.

The charts below provide a breakdown of our investment portfolio at 31 December 2021 by sector and geography.





VII. Stewardship, investment and ESG integration

Identifying and managing risk

Our approach to the identification and management of risks during the investment process is guided by our RMF. Rothesay directly manages all its investments, allowing for an approach to managing risk that can be customised in detail. The treatment of ESG risk has been specifically embedded within existing frameworks, with heightened scrutiny triggered as ESG risk increases.

Prior to holding an asset, Rothesay will conduct various levels of scrutiny in order to gain comfort that it will be likely to generate an acceptable return for the risk taken, with risk being quantified according to our granular internal model for capital. In the case of corporate bonds this is dependent on credit ratings. Our risk identification process is designed to check whether the verdict of the relevant External Credit Assessment Institutions aligns with our internal risk assessment. One facet of our assessment is a determination of the degree of exposure of the asset to the risks (both physical and transition) associated with climate change.

In addition to this normal credit assessment, albeit enhanced by the investigation into the possible impact of climate change upon the issuing entity, we seek to understand the impact of the entity on climate change. We do this, in the first instance and as data allows, by measuring the Carbon Intensity per unit of revenue of the entity, the gross emissions we would be financing were we to buy the asset and the asset's temperature alignment. This helps us understand whether it is prudent to hold the asset given our public commitments to reduce the emissions associated with our portfolio. Gathering, aggregating and disclosing this information publicly allows Corporate Trustees of pension scheme clients to fulfil the disclosure requirements imposed upon them by their regulator.

All issuers are exposed to some form of climate risk. However, some issuers will have greater potential exposure to climate risk based on their activities, locations and regulation/policy focus. Acknowledging this, Rothesay has developed a climate screening approach to identify entities with elevated climate risk for which more detailed analysis is undertaken. The assignment of scores for comparison across our portfolio allows an additional lens to support our identification of priority issuers with which to engage.

This climate score supports our assessment of an issuer's exposure to transitional and physical climate impacts. It supplements the current (spot) Carbon Intensity measure and builds our understanding of the scale and effectiveness of an issuers transition strategy, and their likely contribution to real-world emission reductions. A score is allocated to all issuers within the portfolio based on our analysis of their level of climate risk. It provides a quick and easy way to understand climate exposure within the existing framework and is updated as performance of an issuer evolves.

An issuer is deemed to be exposed to elevated climate risk based on three factors: operating in a climate material sector; high Carbon Intensity and high physical risk exposure. The scores reflect factors such as current emissions and sector challenges, and overlays 'transition factors', which include issuer responses in terms of targets, track record and progress towards green technology.

As outlined above, due to their activities, some sectors are more likely to face elevated climate impacts. In order to identify and monitor these sectors, we undertake an annual review of Rothesay's portfolio in which we consider the concentration of emissions alongside analyst opinions of the industry concerned.

The sectors which Rothesay currently deems most climate material are:

- Automotive
- Aviation
- Construction
- Land Transport (Road)
- Mining & Metals
- Oil & Gas
- Shipping
- Steel
- Utilities

Rothesay's exposure here is relatively low with around 8% of the portfolio allocated a material climate score based on activity in one of these sectors, the largest of which by far being utilities. Initial trade screening identifies issuers which are exposed to ESG or climate risks. Those deemed material are subject to ongoing monitoring and should it appear that their transition plans are drifting we will first engage with them in an attempt to understand the problems they face. Strategies such as investing for shorter durations and high liquidity are considered for higher risk issuers to ensure we retain more flexibility to take action because ultimately we may conclude that the presence of an asset in the portfolio is no longer consistent with our climate related goals and that we therefore need to divest.

Example: Energy from Waste financing

In 2021, Rothesay was presented with a debt refinancing opportunity from a UK based Energy from Waste company. As part of the credit assessment process it was noted that the issuer carried increased climate risk due to the high Carbon Intensity activities it carried out. Although the issuer had stated intentions of reaching net-zero, it had no short-term targets and only shared limited details on its transition plan and how any changes would be financed. As in every investment opportunity, the identification of an ESG related risk was one of the many lenses that we used to assess our opinion of the deal. We declined to proceed in this case.

Wider ESG factors, such as involvement in controversies, are embedded in our credit analysis process because impacts from these factors are often current, event driven, result in public commentary and can lead to financial impact. Often an issue will be specific to a particular issuer and not necessarily a consideration for an industry sector as whole. This means that risk management is done on a case by case basis and constant monitoring of the news flow is required.

Currently, we have generally not sought many blanket policy bans on lending to entities within particular sectors or activities. Instead we undertake an assessment of the corresponding financial risks to issuers due to their involvement in potentially perceived controversial activities and then make case-by-case decisions on the most appropriate outcome.

Due diligence

Alongside the analysis undertaken by Credit and Trading, our Compliance team conducts "know your customer" style due diligence on borrowers new to the firm using a risk-based approach dependent on sector, jurisdiction and nature of the parties.

All due diligence includes the consideration of ESG factors, where this may either have a reputational impact or regulatory compliance implications. The factors considered depend on the sector concerned. We acknowledge that specific disclosure requirements relating to ESG are currently still in their infancy, with those surrounding climate change being the most developed while those on wider ESG themes are yet to be implemented in the UK. However, there are several areas of existing legislative and regulatory requirements that drive how we consider proposed investment opportunities from an ESG perspective, including the Modern Slavery Act 2015, various legal and regulatory requirements relating to Financial Crime, UN Guiding Principles on business and human rights and OECD guidelines.

Example: Due diligence for a blended finance project

Rothesay has reviewed a number of blended finance arrangements which, due to their scope and structure, can lead to the need to consider ESG implications in more detail.

The purpose of blended finance instruments is to incentivise greater private sector funding for infrastructure projects in emerging economies. Blended finance arrangements typically look to achieve this by placing the majority of the financial risk on the public sector funders, for example by structuring the public sector lenders in the first loss tranche, alongside the inclusion of guarantees to protect private sector financing in the event of default.

Typical questions of infrastructure projects where blended finance is proposed include:

- Weight of socio-economic benefits provided by the project against its impacts, including re-location of local communities and agriculture;
- Political stability and human rights record of the country whose public body was seeking funding;
- Financial Action Task Force (FATF) assessment of the adequacy of the country's anti-money laundering and terrorist financing controls; and
- Consideration of any mitigation in place to address specific risks, such as ESG due diligence reports and impact assessments.

A case in which Rothesay conducted a specific assessment was a proposed trade between private sector investors and a continental European government, relating to a loan to fund the re-development of a mine in an emerging economy. The mine was used to extract nickel and cobalt which are needed for the batteries used in green technology related products especially electric vehicles. Re-development of the mine was required to prolong its operating life beyond 2024. Whilst the project outcome is aligned with supporting green transition, the mining industry is considered high risk for bribery and corruption, particularly in the context of obtaining contracts and permits for mining projects in emerging economies. Therefore, as part of enhanced due diligence, an investigation into bribery and corruption was undertaken which examined:

- Local state investment in the mine (separate to the blended finance arrangement proposed) with a lack of transparency over the local government officials' involvement and allocation of Board seats; and
- High risk indicators for bribery and corruption that had been identified through compliance screening of the firm with significant control over the project.

In addition to this, compliance also raised concerns of greenwashing, namely the inclusion of both ESG assessments and details of a solar farm in the prospectus with no evidence provided either that the ESG assessments had been completed or that procurement processes for the solar farm had been started or would be covered by the loan being sought for the project.

The decision was made to not finance this project because we were unable to satisfactorily resolve our compliance concerns.

Portfolio surveillance

We manage our overall portfolio exposure to climate risk with reference to quantitative indices (e.g. the Carbon Intensity of the portfolio) and monitor this at portfolio, sector and individual issuer level. We also manage our climate risk exposure at the issuer level by assessing ongoing developments in their climate risk management strategy and performance against target metrics, including Carbon Intensity and emissions reductions. This aligns the risk management of our investments for the benefit of our policyholders, with real-world decarbonisation.

- The climate score for issuers will be regularly updated to reflect current climate commitments, as well as performance against these targets. This classification will also support our understanding of the level of climate risk within our portfolio, by analysing and reporting the distribution of issuers allocated each climate score to the Executive committees and BRC; and
- As part of our business as usual credit assessment processes, we continue to ensure that ESG driven events which may result in a credit rating change are assessed by analysts to understand any potential impacts.

Property related lending

We are aware of the potential materiality of both physical and transition risks to property-related sectors. Specific property screening for flood risk is undertaken as part of standard direct lending activities. Our financial exposure to climate risk due to property lending that passes our screening tests is estimated by conducting scenario analysis for both physical changes and changes to energy efficiency rules. The latter study assesses the cost to Rothesay for complying with a possible future regulation in which a property would be required to obtain an Energy Performance Certificate of at least grade C prior to sale. Where Rothesay funds the origination of mortgages in the UK, our lending criteria specify the type of properties that are acceptable, including factors such as construction, location and environmental perils such as flood risk.

VIII. Monitoring managers and service providers

The Business Controls Committee, which is chaired by the CFO, is responsible for the approval, implementation and monitoring of the Group's vendor management policy. The policy is designed to ensure that the legal, regulatory, information security, reputational, commercial, operational and financial risks associated with third party relationships are appropriately managed. Critical and strategic vendors are subject to periodic reviews, which consider the quality of service provided, operational performance, and financial risks, including ESG risk factors. Regular dialogue is maintained between the vendors and the Group's relevant business areas as part of the ongoing operation.

Rothesay does not employ any external asset managers except those who manage our cash which is held at banks or rapid access money market funds.

Our suppliers

Rothesay's procurement spend spans a wide range of companies and sectors, from professional services, marketing and goods such as IT systems and desktop hardware and software. Our spending generates a positive economic impact in the marketplace and supports the development and growth of our suppliers and companies that supply them.

We work closely with our suppliers to understand how materials are sourced, making sure they respect human rights, promote decent working conditions and improve sustainability across the supply chain.

As required annually by the Modern Slavery Act 2015, we published a statement on our website describing the steps taken by Rothesay to ensure that slavery and human trafficking is not taking place in any part of our business or in any of our supply chains.

The statement notes that we expect our suppliers to ensure fair employment practices. For example, we require our cleaning suppliers to pay their personnel, who work at our premises, a salary which is equivalent to (at least) the London Living Wage.

The Solvency II Directive (2009/138/EC) ("Solvency II") includes regulations in relation to the outsourcing of what it defines as "critical or important" functions. Rothesay classifies outsourced functions as "critical or important" if they are essential to the operation of the Group, i.e. the Group would be unable to deliver essential services to policyholders or other key external stakeholders without the function. Critical and important suppliers are subject to heightened approval processes and annual reviews which span not only their financial and operating performance, but look closely at areas such as cyber security to ensure our policyholders' data is protected. We also consider any environmental risks associated with the goods or services procured and look at supplier's emissions and climate targets.

Third Party Administrators

From the point of view of our policyholders, the companies in our supply chain with whom we are most closely entwined are those performing pension administration: Capita, Mercer and Willis Towers Watson. They make payments to pensioners, track life events that affect pensions (e.g. divorce, retirement and death) and are the first point of response to customer queries. We have taken reasonable steps to satisfy ourselves that these companies pursue ESG goals that are compatible with our own and have done so by analysing their Vigeo-Eiris assessments and by reading their public disclosure, bearing in mind that ESG scoring for these firms is largely a reflection of the comprehensiveness of their reporting.

Scope 1 and 2 emissions are not material in this sector but only Capita attempts a full reckoning of the Scope 3 emissions associated with its purchases of goods and services while WTW does not state its emissions. All three have net-zero commitments.

All our TPAs have clear codes of conduct, commitments against human trafficking and modern slavery as well as Anti Money Laundering policies. Mercer and WTW have received awards for their diversity and inclusion. All three state a commitment to protect client information but only Capita reports any relevant measures.

We monitor TPA governance procedures. Capita's board is 50% independent and undergoes regular third party evaluation with results and actions taken both disclosed. Mercer and WTW score less strongly on governance.

To the extent we are unable to source satisfactory information, the Rothesay team intends to engage directly with our contacts at the companies. In particular, we will seek information regarding the location of their data centres which will enable us to assess their vulnerability to possible physical manifestations of climate change such as flooding.

Monitoring our ESG service providers

In pursuance of our duties of stewardship, Rothesay utilises a number of third party data sources including Trucost (a subsidiary of S&P), CDP, Planetrics (a subsidiary of McKinsey) and Vigeo-Eiris (a subsidiary of Moody's).

We have worked with providers to establish a feed to our trading database and risk management system that automatically updates emissions data for corporate bonds as soon as it becomes available.

The ESG data universe is continuing to evolve, with better coverage, new metrics and improved methodologies. As part of this, we continue to review the third party data providers we use with reference to our own needs going forward. For example, whilst we do not currently utilise external ESG scores as a portfolio metric, due to significant industry variation dependent on provider, we continue to monitor this area for developments. We also understand that engagement is an important part of working with service providers, and look to provide feedback and have open conversations with all our ESG data providers.

One of the reasons for using multiple data providers is to check consistency. Where the numbers provided by one vendor exhibit material disagreement with those of another or with our independent research we bring it to the attention of the relevant third-party.

We have found that third-party data is not always updated in timely fashion which has led us to register complaints with the relevant vendors. Our ability to draw data from more than one source helps to prevent these delayed updates from becoming too serious a problem.

Example: Engaging with Planetrics on fixed income modelling

As mentioned in Section IV, Rothesay uses selected data provided by Planetrics, whose granular bottom-up climate scenario model helps us to study the possible impacts of climate change on our corporate bond portfolio. As part of the process of using the Planetrics platform we have provided feedback on the modelling of rating transition and credit spread changes for fixed income assets. We have regular meetings with the Planetrics team to discuss upcoming changes to the model and what improvements would be most beneficial.

Example: Data quality review of emissions data

To ensure the quality of our emissions data, we undertook a detailed verification review of our data provider Trucost. The aim of the exercise was to identify anomalies, especially for entities with elevated climate risk, where misstatements could have a significant impact on the accuracy of our reporting. The checks included extensive review across peer issuers, and analysis of material year on year changes in Carbon Intensity, a metric used to assess the carbon footprint of an investment portfolio, by verifying against the underlying source of data within issuer reports. This also helped us to further understand key drivers of change at the issuer level, which could be incorporated within our climate score.

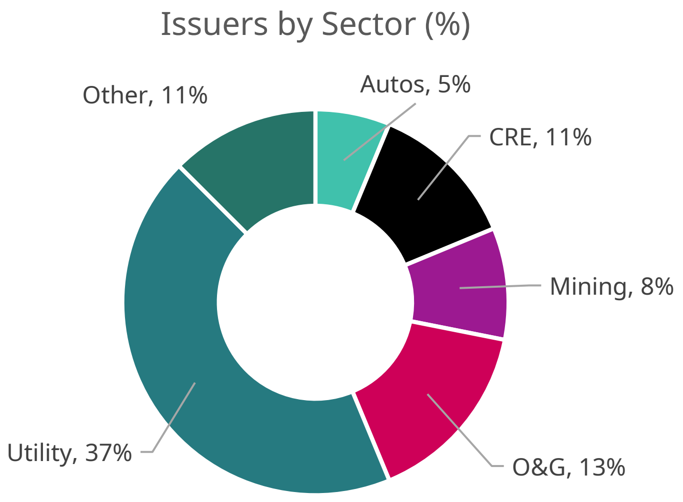
IX. Engagement

As part of our mission to provide security to our policyholders, engagement with issuers to encourage more sustainable practices that yield long-term financial returns is an important aspect of our approach to ESG management. We are dedicated to delivering positive outcomes for all our stakeholders and given the long-term nature of our business, we utilise engagement to ensure we maintain an appropriate understanding of risks to which our borrowers are exposed. In addition, as a signatory of both the PRI and NZAOA, Rothesay has committed to responsible engagement with firms in our portfolio.

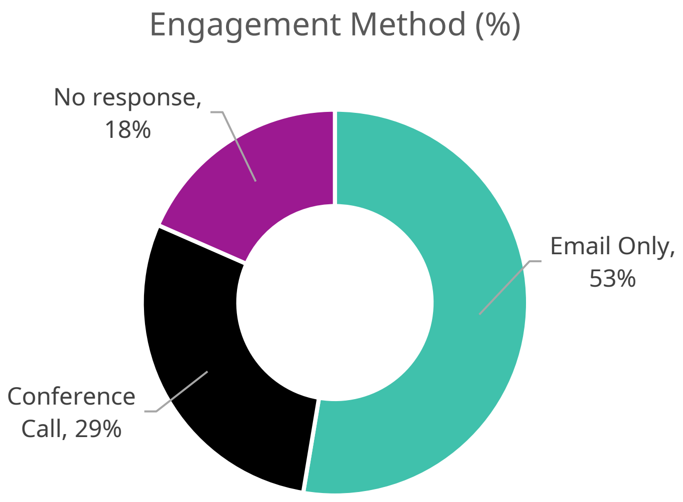
At the time of writing, our approach is predominantly focused on specific, direct engagement with the most material corporate issuers within our portfolio and we have a target to engage with at least 20 companies each year representing at least 65% of the emissions attributable to our corporate bond sub-portfolio. As we do not use external asset managers, all our engagement is coordinated by members of our Credit Risk and Asset Management teams. We have chosen to undertake this approach as it ensures our engagement efforts can be appropriately resourced, focused on material factors where we can have the most influence and support our specific climate strategy and broader ESG risk management approach.

In 2021, we recorded 38 specific engagements relating to ESG topics. These predominantly focused on climate interactions to align with our NZAOA commitment to engage with entities with the greatest climate relevance, and so 89% of engagements focused on environmental factors. Targeted entities were concentrated within the corporate universe given the particular importance of understanding climate risks in this sub-section of the portfolio. The majority of engagements occurred via email (53%), with almost one third (29%) having a follow-up conference call post email for additional information. Almost half (45%) of engagements were with members of the Investor Relations team, with 19% being with specialist ESG individuals. The lack of face-to-face engagement was driven by continued ramifications of the COVID-19 pandemic, however in future years we aim to utilise our attendance at industry conferences to further support our engagement approach.

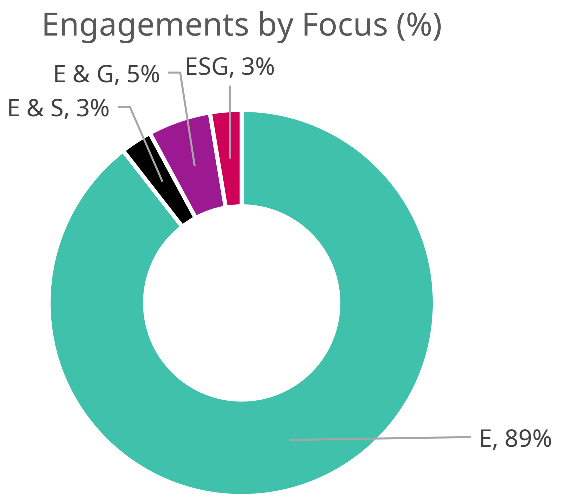
Our requests for engagement received an 82% response rate. We acknowledge that in the context of being a debt-only investor, our escalation approach is restricted by the more limited mechanisms and influence we can bring to bear with relevant issuers. In many cases, it can be challenging to accurately assess whether lack of responsiveness to our engagement reflects entity views on ESG issues or prioritisation of more material stakeholders. However, post our engagements on specific topics, such as coal exposure and coal plant exit strategies, a number of entities published updates to their plans to align more closely with our coal transition expectations. We have also on a number of occasions, successfully obtained additional disclosure from companies following our engagement. Whilst we cannot attribute this change to our engagement specifically, it indicates that our interactions on ESG-related topics may contribute to entity behaviour change and greater disclosure. We have a multi-year approach to reviewing behaviour change and responsiveness on a case-by-case basis. This includes giving consideration to how we may choose to escalate issues where we are faced with continued unresponsiveness in our original engagement channel.



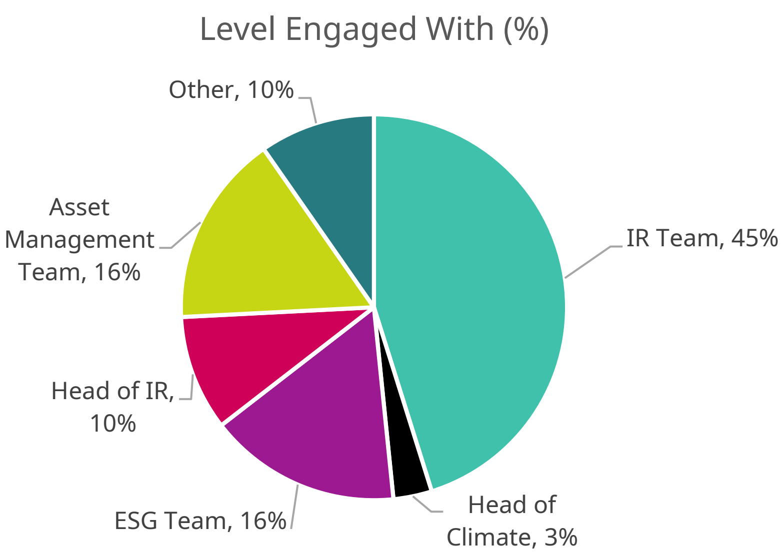
Issuers by Sector (%)
Other, 11%
Autos, 5%
CRE, 11%
Mining, 8%
O&G, 13%
Utility, 37%



Engagement Method (%)
No response, 18%
Email Only, 53%
Conference Call, 29%



Engagements by Focus (%)
E & G, 5%
ESG, 3%
E & S, 3%
E, 89%



As mentioned, our stewardship approach this year has focused on climate risk, given the unique challenges and forward-looking timeframe required to manage and mitigate this risk. We utilise a risk and impact-based approach to our engagement with issuers. For example, in our climate engagement, we identify those issuers with the highest Carbon Intensity, laggards within individual sectors, those with an elevated climate score and those without Paris aligned transition plans, in order to focus on engagement with issuers where it could make the most impact to the mitigation of climate change risks.

We continue to engage with those issuers identified in this way as we track their performance against the actions raised, along with the impact on their credit fundamentals. As our approach develops, where actions are not being closed or in the continued absence of clear improvement plans, we may further consider taking actions such as explicit requests for additional disclosure, inclusion of ESG covenants in bilateral loan positions or, ultimately, divestment.

Examples

Hard to Abate Sector Participant: Cement

- Engagement purpose: insight into transition plan and R&D activities

We identified an entity operating in a hard to abate sector with considerable emissions, where their management plan focused on the utilisation of a low-emission alternative solution. We sought engagement with this entity, to request additional clarity on the specific solution and to understand any reliance on market factors outside of their control, which could impact their ability to meet their ambitious targets. The engagement highlighted the importance and effective management of climate risk by the company and resulted in a strengthening of our internal view on the ability of the company to manage their high exposure to climate risks and credibility of their transition pathway. We therefore continue to hold this asset.

High Emissions Entity: Utilities

- Engagement purpose: improve ESG disclosures and clarity on transition plans

We engaged with a fossil fuel intensive utility within our portfolio, identified for additional review due to weaker disclosure in comparison to peers and high fossil fuel exposure. The purpose of the engagement was to gain additional clarity on their strategy to manage low-carbon transition and plans on reduction in fossil fuel exposure. The engagement resulted in better understanding of their management approach to addressable risks and the steps they planned to take to better manage and articulate their approach to these risks. We see engagement as a multi-year process, and will continue to monitor performance of this entity to ensure we remain comfortable with their approach.

Disclosure Support: Healthcare Provider

- Engagement purpose: improve ESG disclosures and clarity on transition plans

Through business as usual conversations with entities within the US Healthcare sector, we identified that whilst there was increasing appetite for discussion on sustainability issues with many entities, there was uncertainty about what expectations financial firms had for issuers. We therefore organised a bilateral conversation with one entity who did not provide detailed reporting on sustainability efforts within their disclosures and shared drivers for our interest in this area and some examples of potential best practice. We were pleased to see their most recent sustainability disclosures contained greater granularity on a number of themes.

X. Collaborative engagement

Along with our bilateral engagement approach, we occasionally seek to participate in collaborative engagement efforts where we determine there is relevance to our portfolio and that anti-trust concerns are absent. In particular, we are keen to join groups whose goal is to influence and assist sectors that are not yet mature in their sustainability reporting approaches and could benefit from combined industry experience to support better adoption.

While most of our engagement is achieved bilaterally, our participation in industry groups such as the Association of British Insurers, the PRI, the NZAOA and the Climate Financial Risk Forum allows us to remain alert to ideas for coordinated efforts. In addition, through these organisations we are able to consider, and where appropriate reflect, industry perspectives and recommendations when developing our own ESG approach.

Example - Reporting Standards: Social Housing Initiative

We were an early adopter, and are a continued supporter, of the Sustainable Reporting Standard for Social Housing. As part of this group, we have supported the process to create a common reporting standard for this sector to support better disclosure of data points needed to assess the sustainability of such entities. The outcome to date is that of the 63 housing providers that had adopted the Standard by the end of 2021, 49 produced a ESG Report using the SRS guidelines, supporting a significant uptick in disclosure within this sector. This in turn improved our own analysis of the sector and the accuracy of our disclosure.

XI. Escalation

As outlined in our response to Principle IX, we take a materiality-led approach to determine the prioritisation of issues to consider and escalate. As per our Responsible Investment Policy, our preferred approach where we identify sustainability related issues is for engagement rather than immediate divestment, to support behaviour improvement.

The most common issue that we escalate relates to the provision of data and in particular when an entity is less forthcoming in its disclosures than we have come to expect from their industry peers. As previously mentioned, we have on a number of occasions, successfully obtained additional disclosure from companies due to escalation in this area. In addition, we will escalate queries relating to any ambiguity within the business plan with regards to the issuer's transition to a low carbon economy. We are also quick to escalate our engagement upon the release of news surrounding a controversial activity or a change in business mix that threatens Rothesay's own climate commitments. For example, changes in fossil fuel involvement for a utility within our portfolio.

In the context of being a debt-only investor, our escalation approach is restricted by the more limited mechanisms and influence we can utilise with relevant issuers. While there are occasions when issuers are unresponsive to our attempts to engage with them, it is more common for our concerns to be addressed at least in part either in writing or via a call with management. It is often challenging to determine whether our activities alone result in a direct outcome or to accurately assess whether the lack of responsiveness to our engagement reflects an entity's own views on ESG issues or its prioritisation of more material stakeholders. In those cases, where our escalation receives no response from the issuer, we are not discouraged from making further attempts to engage in future years.

Example - Coal Exposure: Metals & Mining

After conducting a coal sector deep dive to establish our exposure to thermal coal within our portfolio, we established a public coal position statement within our Responsible Investment Policy. This includes a need for issuers to have clear plans to have minimal coal exposure by the commonly accepted coal exit timeframes of 2030 in the OECD. We identified a high thermal coal entity, which had not set plans to exit coal within these timeframes and sought to engage with them. The response from the issuer indicated intentions that were not aligned with our stance and so after internal discussion, we declined to increase our position and let our single short duration bond roll off. We no longer have exposure to this entity.

XII. Exercising rights and responsibilities

As outlined in our responses to previous principles, our business model is such that we do not use asset managers to exercise rights and responsibilities on our behalf and so this work is performed in house, generally under the auspices of the Waivers Committee. We note that, as a debt only investor, the occasions and degrees to which we are able to exercise rights and responsibilities are often limited.

For most corporate actions that require bondholder consent it is straightforward for the asset management team to determine the measures that offer the most favourable outcome in terms of asset value and hence value to Rothesay stakeholders. We will invariably vote to adopt those measures.

Occasionally our borrowers request covenant waivers to allow them to manage their business more efficiently. These requests are considered by the Waivers Committee and usually the interests of the borrower are sufficiently aligned with Rothesay's as lender that we acquiesce. We do sometimes use this opportunity, however, to impose new conditions on a borrower such as improved disclosure requirements. If the request for a waiver is clearly detrimental to Rothesay's interests, and hence those of our policyholders, we will refuse it and expect to negotiate an alternative route to avoid covenant breach.

As part of our trade due diligence for less liquid private placements and bilateral loans, we review prospectus and transaction documents to ensure all terms align with our investment principles and that relevant ESG themes are identified. This includes utilising both internal and external legal expertise to review structure and specific terms. Where applicable, we seek additional information and clarity and may do this either in writing or during investment calls with borrower management.

When documenting bilateral loans, we take the opportunity to include restrictive covenants that bolster Rothesay's financial security.

Example – Secured Lending

From time to time, Rothesay extends secured loans to banks. We aim to ensure that the collateral posted by the banks in support of the loans is sufficient according to valuation by Rothesay and fulfils prescribed eligibility requirements regarding its liquidity. We impose terms that give us confidence that, should these conditions be breached on any day and our calls for additional collateral go unheeded, our ability to enforce a default and sell collateral will be unfettered and successful.