Rothesaylife

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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Rothesay Life is an insurance company established in the UK and is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and Prudential Regulation Authority.

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Section 1 Introduction

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 ("RL"); and

- consider the implications of the proposed Scheme on the security and benefit expectations of existing RL policyholders and other beneficiaries of insurance policies issued by RL, 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 RL in my capacity as the Chief Actuary of RL.

1.3. In this report I address the effects of the Scheme on the security and benefit expectations of the existing RL 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 RL.

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 ("the Scheme Report") on the likely effect of the Scheme on the policyholders of both RL and PAC. The Prudential Regulation Authority ("PRA") has approved Mr Dumbreck as the Independent Expert following consultation with the Financial Conduct Authority ("FCA"). The Scheme 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 RL, 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 material information contained in 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 RL, including the most recent Annual Report and Accounts and Solvency and Financial Condition Report, which can be found on the RL website (RothesayLife.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.

Disclosures and reliances

1.10. 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 RL as Chief Actuary in April 2018, having previously been the Chief Actuary for Zurich Assurance Ltd, and I have over 15 years of experience working in the UK life assurance industry.

1.11. I do not hold any insurance policies issued by either RL or PAC, and have no direct financial interest in either company other than as an employee of the Rothesay Life group. There are no other potential conflicts of interest.

1.12. In preparing this report I have had access to all relevant financial information in relation to RL. In forming my conclusions I have relied upon work carried out by other RL 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

1.13. 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.

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

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Section 2 Executive summary

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 RL. These policies will be referred to as the "PAC policies". It is intended that the Part VII transfer considered in this report 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 RL. 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 RL 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 RL 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 RL, other than any non-transferring policies as described in 2.7.

2.7. A subset of the reinsured PAC policies (approximately 10% 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 would 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 RL under the existing reinsurance arrangement (appropriately amended).

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 00:01 on 26 June 2019, any policyholders or claimants in respect of the transferring PAC policies will be policyholders or claimants respectively of RL. Any policyholders or claimants in respect of the non-transferring policies will continue to be policyholders or claimants of PAC.

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2.11. Once the Scheme takes effect, some liabilities (or potential liabilities) not covered under the existing reinsurance will also have been transferred to RL. There are special arrangements in relation to the risk of potential claims in relation to the mis-selling of annuities; some risk will transfer to RL immediately following the Scheme, some will transfer to RL only after a further period of time has passed, and some will remain with PAC in perpetuity.

Impact of the Scheme on RL

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

2.13. Following the Scheme RL will also have responsibility for ensuring the policies are appropriately managed and administered. RL 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 RL for the transferring policyholders for a period of between 12 and 24 months after the effective date of the Scheme. Therefore following the Scheme RL would have additional primary responsibilities and also a new material outsourcing relationship to manage. A new long-term administrator will be appointed by RL to provide administration services after the TSA ends. This may be one of RL's existing third-party administrators or a new administration provider.

2.14. I have considered the impact of the potential residual mis-selling liabilities that will transfer to RL and which are not currently included as part of the reinsurance. While the impact of these liabilities is potentially large, 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 RL's existing policyholders as being very small.

2.15. I am not aware of any other expected or potential adverse impacts on RL or RL'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 RL 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 RL's ability to manage the asset portfolio, and provide a small reduction in operational expense for RL.

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

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Opinion of the Chief Actuary

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

- the security of the current policyholders of RL is not likely to be adversely affected as a result of the proposed transfer;
- the reasonable benefit expectations of the current policyholders of RL are not likely to be adversely affected as a result of the proposed transfer;
- the administrative arrangements applicable to the policyholders of RL 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.

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Section 3 Description of Rothesay Life Plc

History of Rothesay Life

3.1. RL was established on 26 February 2007 (initially under the name Hackremco (no. 2460) Limited until 14 March 2007, then under the name First Premium Company Limited until 16 May 2007) as a wholly-owned subsidiary of Rothesay Life (Cayman) Limited, which itself was a wholly-owned (indirect) subsidiary of its ultimate parent company, The Goldman Sachs Group LP. RL was established to provide solutions in the UK defined benefit pension risk transfer market.

3.2. RL 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.

3.3. RL 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 Life Group structure and history

3.4. As noted above, RL was established in 2007 as part of the Goldman Sachs Group. RL was deconsolidated from Goldman Sachs in December 2013, and Rothesay HoldCo UK Limited ("Rothesay HoldCo" or "RHUK") was introduced as a holding company between Rothesay Life (Cayman) Limited and Rothesay Life Limited. Three additional shareholders (in addition to Goldman Sachs) invested in Rothesay HoldCo, which is the sole parent of RL. Rothesay Life Limited became Rothesay Life Plc in March 2016.

3.5. During 2016, Rothesay HoldCo established an Employee Benefit Trust, Elian Employee Benefit Trustee Limited ("The Trust"). The Trust has been established to purchase and hold shares of Rothesay HoldCo for delivery to employees under employee share schemes.

3.6. In December 2017 Goldmans Sachs sold their remaining stake to the other three shareholders, namely The Blackstone Group L.P., GIC Private Limited, and MassMutual Financial Group.

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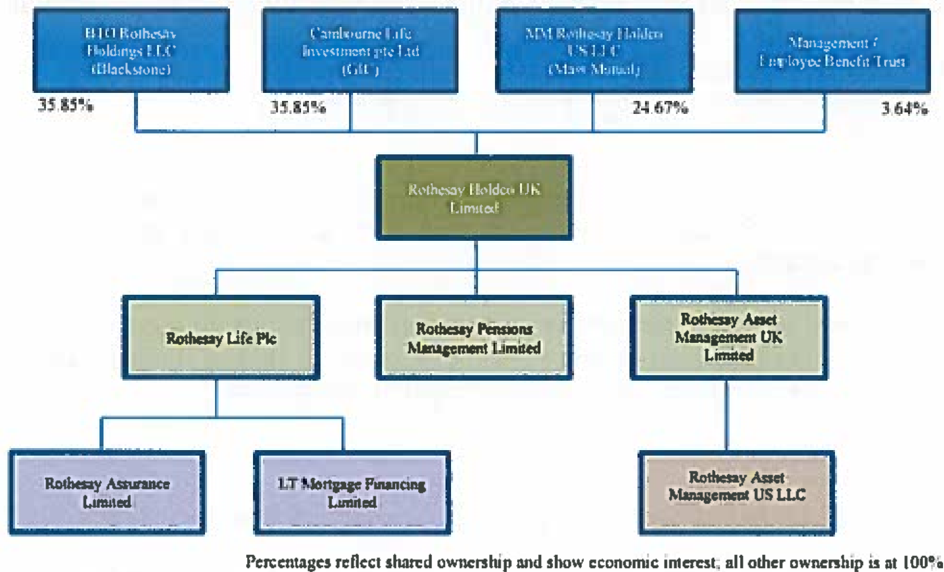
3.7. The ownership structure of RHUK and its subsidiaries (together 'the Group') is set out below as at 30 June 2018:



Percentages reflect shared ownership and show economic interest; all other ownership is at 100%

3.8. RHUK is the ultimate holding company with 6 wholly owned subsidiaries.

3.9. RLP is the Group's regulated insurance entity.

3.10. 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.

3.11. Rothesay Pensions Management Limited provides services to the other companies in the Group.

3.12. 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.

3.13. LT Mortgage Financing Limited was incorporated in 2015 and began trading in 2018.

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Business and Strategy

3.14. RL 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.

3.15. RL 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.

3.16. The 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

3.17. RL pursues an investment strategy that minimises risk in a number of ways:

- investment in low credit-risk asset classes such as government-guaranteed 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.

3.18. RL 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.

Reinsurance

3.19. RL pursues a strategy that reduces its key demographic risks by hedging the majority of its longevity and related risks through collateralised longevity swap contracts. RL makes extensive use of this market with approximately 70% of its longevity risk being transferred to the third-party reinsurance market.

Liabilities

3.20. Currently the majority of RL'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 RL is experienced in accepting and managing both types.

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3.21. 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 Average Weekly Earnings 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.

3.22. 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 RL has an established policy (i.e. payable on a broadly profit-neutral basis to RL).

3.23. Three of RL'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 RL Schemes / Contracts Features

3.24. 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 RL, unless this occurs due to a "default" by RL (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.

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

3.26. 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 RL policies.

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Financial History

3.27. The following tables summarise the key financial metrics of RL 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 RL.

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
Net Assets	15,208	23,575	23,979
Technical Provisions	13,304	20,688	21,135
Own Funds	1,904	2887	2,844
Solvency Capital Requirement	1,203	1603	1,743
Surplus	701	1284	1,101
SCR cover (%)	158	180	163

Financial Strength Ratings

3.28. RL 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"*
- Fitch: Insurer Financial Strength rating of A+ *"strong"*

Both ratings have a stable outlook. Both agencies considered the impact of the Prudential transaction (i.e. the initial reinsurance plus the anticipated business transfer) as part of their assessments.

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Section 4 Outline of the Scheme

4.1. Further to the reinsurance of the PAC policies, the Boards of both RL and PAC agreed to begin the process of a legal transfer of the PAC policies to RL under Part VII of FSMA. The purpose of the proposed Scheme is to transfer the reinsured PAC policies from PAC to RL. The types of liabilities to be transferred are materially the same as RL's current liabilities as described in 3.20-3.23, 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 PAC wish to do this because it supports their strategic objectives to make efficient use of capital and to de-risk their business, and supports the demerger of M&G Prudential from Prudential plc. PAC is a wholly-owned subsidiary of Prudential plc.

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

4.4. The proposed Scheme is not intended to make any changes to existing RL policy contracts. I do not anticipate that any of the liabilities due to RL policyholders, nor commitments by RL policyholders to make any subsequent premium payments to RL, 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 RL under a separate Transitional Services Agreement, for a period of 12-24 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 RL:

- 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 RL, 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.

4.8. From a current RL policyholder perspective, 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 RL and hence will be retained by PAC, these are described as Excluded Liabilities under the Scheme. For the avoidance of doubt some residual mis-selling risk will be transferred to RL under the

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Scheme, if they crystallise after a future defined date. 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 happen as expected, then under certain circumstances PAC are able to terminate the reinsurance agreement. However, PAC and RL may consider continuing with the reinsurance, depending on each company's view on the merits of termination compared with permanent reinsurance.

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Section 5 Financial position post transfer

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, RL held surplus assets in excess of its regulatory capital requirement (the Solvency Capital Requirement or SCR). A summary of RL'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. RL's parent, Rothesay Holdco UK Limited (RHUK), is also managed on a Solvency II basis. RHUK's Group (as described in Section 3) is a simple one, with RL being the only material active risk-carrying entity, and therefore there are no material residual risks outside of RL which may affect the security of RL's policyholders. For the remainder of this section I will therefore consider only RL on a standalone basis, although given the simple structure of RHUK the conclusions reached are likely to hold for RHUK also.

5.4. RL'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 surplus assets to cover at least 130% of the SCR. RL currently calculates its SCR using the Standard Formula, a defined approach under Solvency II intended to be appropriate for the majority of insurance companies across Europe. RL has applied to its prudential regulator the PRA for permission to use a partial internal model ("PIM") to calculate its SCR, in order to more accurately represent the specific risk profile of RL, and approval has been granted to use the PIM to calculate RL's SCR from 31 December 2018 onwards. RL's PIM covers two major risk categories, spread risk and counterparty default risk, with other risks being assessed using the Standard Formula.

5.5. RL will continue to maintain the same minimum target ratio of 130% once it calculates its capital requirements using the PIM.

5.6. 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"). RL's capital policy in relation to the ORSA is to hold sufficient excess capital such that RL can withstand adverse scenarios measured at the 99.8% confidence level over one year, where the required capital is measured using RL's own view of the risks it has rather than using the Standard Formula or the PIM. RL 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 PIM.

5.7. The Part VII transfer of the PAC policies to RL 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

5.8. The Solvency II position of RL before and after the proposed transfer (as if it had been effective on 30 June 2018) 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 RL and the transaction was fully funded at the point of sale, with assets transferred to RL, there is no change in the solvency position of RL 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 RL and this is reflected in the post-transfer position. The SCR shown is calculated using the Standard Formula basis that was in effect at the time. Analysis has been carried out which shows a similar impact if the pro-forma comparison was performed on a PIM basis instead.

Table 5.1: Solvency II Pillar 1 financial position (Standard Formula) at 30 June 2018 before and after the proposed transfer (£m)

Rothesay Life Plc	Actual pre transfer	Pro-forma post transfer
Net Assets	36,315	36,315
Technical Provisions	32,157	32,157
Own Funds	4,158	4,158
Solvency Capital Requirement	2,351	2,351
Surplus	1,807	1,807
SCR cover (%)	177	177

5.9. 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 RL to apply the matching adjustment.

5.10. In common with many other firms in the UK, RL 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 will be 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) allow for a recalculation of the transitional on 14 March 2018, the day the reinsurance transaction was effected between PAC and RL. The Scheme will not affect

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the ability of RL to apply this adjustment to technical provisions, and a recalculation of the adjustment is not required as a result of the Scheme since RL has already accepted the economic risks associated with the liabilities through the reinsurance contract agreed with PAC.

5.11. It is noted that following the Scheme, RL will have additional responsibilities and liabilities in relation to the transferring PAC policies compared to simply reinsuring them, in particular responsibility for administering the policies, and the additional potential residual mis-selling liabilities that will transfer to RL after a defined future date. RL's Solvency II Standard Formula calculation increased the capital held for operational risk at the time that the reinsurance contract was effected.

5.12. 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 RL and PAC. After the transfer the administration will still be carried out by PAC on behalf of RL under the TSA described earlier, before moving to a long-term administration provider. 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 RL as part of its reserving and capital calculations. Therefore there is not expected to be a change in either the reserves held by RL for expenses or in the capital held for those risks.

5.13. 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 RL will have more investment freedom. However RL does not anticipate fundamentally changing the types of asset held immediately following the transfer.

5.14. The comparative figures for RHUK as at 30 June 2018 are 157% SCR cover pre-transfer and 157% SCR cover post-transfer. These are lower than the equivalent RLP values due to the existence of loans of £500m which are not admissible at the Group level. There are no impacts of the Scheme to consider at the RHUK level beyond those considered at the RLP level.

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

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

Solvency II ORSA

5.17. 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 30 June 2018. As the PAC policies are reinsured to RL and the transaction was fully funded at the point of sale, with assets transferred to RL, there is no change in the ORSA position of RL due to the Scheme. It is noted that RL will have additional operational responsibilities following the transfer and therefore the overall quantum of operational risk will be higher after the Scheme, but under RL'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

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extra risks are captured under RL's ORSA and that therefore there should be no material reduction in the security of RL's policyholders as a result of the Scheme.

Subsequent events

5.18. 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 Supplementary Report.

5.19. As noted above RL has been granted approval to use a Partial Internal Model to calculate its SCR from 31 December 2018. Table 5.1 shows that the pro-forma impact on RL's Solvency II balance sheet as at 30 June 2018 is nil, and this would also be true if RL was using its proposed PIM as at that date. The PIM means that RL can better reflect its risk profile in its capital requirements and therefore improves the reliability of RL's balance sheet.

5.20. In September 2018 RL issued £350m of Restricted Tier 1 subordinated notes, which was used to pay a dividend to RHUK to repay bank debt. The values shown in this report do not reflect the impact of this debt but given the bank debt repayment this has not changed the level of solvency in RL and does not change any of my conclusions.

5.21. While I do not expect the Scheme itself to have a significant impact on the financial position of RL, 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 RL;
- RL may invest in new assets;
- a dividend payment may be made either from RL to Rothesay HoldCo, or Rothesay HoldCo to shareholders; and
- further capital may be raised at either Rothesay HoldCo or RL level.

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

Section 6 Impact of proposed Scheme on existing RL policyholders

Impact on contractual terms applicable to existing RL policyholders

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

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

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

Impact on security of benefits applicable to existing RL policyholders

6.4. As noted in Section 5 of this report, had the proposed Scheme been effective as at 30 June 2018, the capital impact to RL (including the transferred-in assets and liabilities of PAC) would have been nil, and RL 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 RL policyholders if the proposed Scheme were to be approved, as the reinsured PAC liabilities and associated assets are currently held on the RL balance sheet and as such, the RL 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 RL and in part by PAC. No costs will be passed on to any RL policyholders. These costs are not material in the context of the assets of RL and will have no impact on the security of benefits for RL's policyholders.

6.7. Either immediately following the Scheme or at a defined future date, some ancillary liabilities (in respect of the PAC policies) not reinsured from PAC to RL will transfer to RL, e.g. residual mis-selling risk. 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 schemes 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 RL's existing policyholders. I also note that under both RL'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 RL 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

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individuals and some businesses. The Scheme will not impact the rights of any of RL'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 RL, 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 RL more freedom to manage the assets appropriately, and give a small reduction in operational expense for RL, therefore marginally improving the position for RL and its policyholders compared to continuing with the reinsurance.

6.10. As noted earlier, the liabilities which are proposed to be transferred from PAC to RL under the Scheme are materially the same types of liabilities which RL currently manages. Upon completion of the Scheme, RL 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 RL policyholders and what would become the ex-PAC policyholders following the transfer.

Impact on administration applicable to existing RL policyholders

6.11. There are no significant administrative changes that will adversely affect existing RL policyholders as a result of the proposed Scheme. RL outsources the majority of policyholder servicing activities and for existing RL policyholders, members or dependents 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 RL under the TSA described earlier. Subsequent to the TSA RL may use one of its current outsourced administration providers or a new administration provider. In either case I do not anticipate this would have any material impact on the administration arrangements for RL's current policyholders.

Impact on PAC as a policyholder of RL

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 RL. 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 RL.

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

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

6.15. 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.

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Summary

6.16. 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 RL 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
21 January 2019

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Section 7 Compliance with actuarial standards

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 Acutaries (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.

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Glossary of terms used

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 RL 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 RL. It is anticipated that these contracts will transfer to RL 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
RL	Rothesay Life Plc (formerly known as Rothesay Life Limited)
RHUK	Rothesay HoldCo UK Limited, the parent company of RL
Scheme	The proposed insurance business transfer scheme relating to the transfer of the business of PAC to RL
Scheme Report	The independent report required as part of the procedure for gaining approval of the Scheme by the Court

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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

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