Rothesay Holdco UK Limited &

Rothesay Life Plc (formerly known as Rothesay Life Limited)

Interim Solvency and Financial Condition Report

31 December 2015

Risk Management | Investment | Innovation | Excellence

Rothesaylife

CONTENTS

I.	**Introduction**	1
II.	**Business and performance**	2
	A. Rothesay background and structure	2
	B. Regulator	4
	C. Auditors	4
	D. Shareholders	4
	E. Segmental analysis	5
	F. Underwriting and investment performance	5
III.	**System of Governance**	6
	A. Committee Structure	6
	B. Board of Directors	11
	C. Fit and proper requirements	11
	D. Risk management system	13
	E. Internal Control System	17
	F. Compliance	18
	G. Internal Audit function	18
	H. Actuarial function	20
	I. Outsourcing	20
	J. Adequacy of the System of Governance	21
IV.	**Risk Profile**	22
V.	**Valuation for solvency purposes**	27
	A. Assets	27
	B. Technical provisions	29
	C. Other assets and liabilities	34
VI.	**Capital Management**	36
	A. Own Funds	36
	1. Rothesay Life Limited	36
	2. The Group	37
	B. Capital position	38

Visit our Annual Report online www.rothesaylife.com

I. INTRODUCTION

Rothesay Life Limited (“RLL”) provides reinsurance to a number of insurance companies. Under the new Solvency II regime, insurers using the standard formula to calculate their capital requirements must base their counterparty risk capital on the reinsurer’s rating. Where the reinsurer is not rated, the counterparty risk capital is based on the solvency ratio reported by the reinsurer or, where no solvency ratio has been reported, a solvency ratio of 100%.

As RLL is unrated, we have prepared this interim Solvency and Financial Condition Report (“SFCR”) in order to allow the insurers to which RLL provides reinsurance to benefit from the company’s 158% solvency ratio when calculating counterparty risk exposure.

For commercial reasons, this document includes only a subset of the information that would be included in a full SFCR. Rothesay will, of course, publish a full SFCR as at 31 December 2016 during 2017.

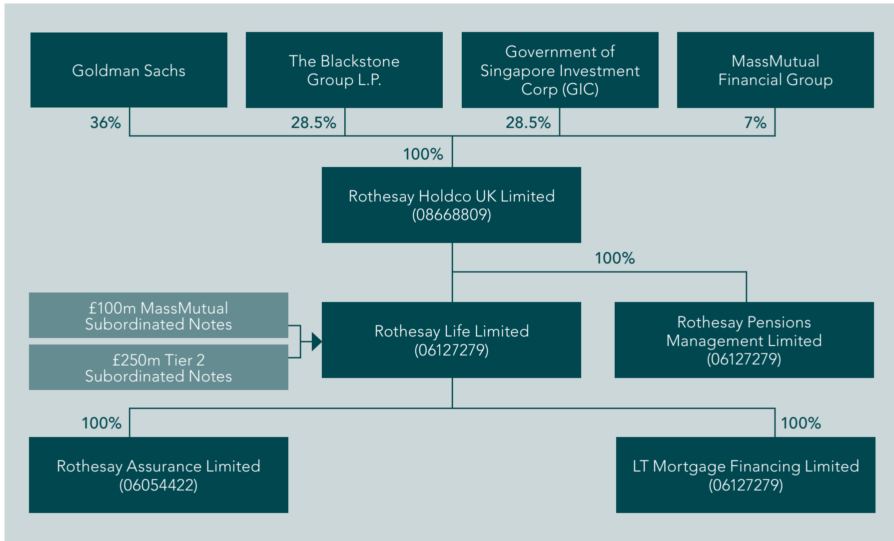
The document covers both RLL and Rothesay Holdco UK Limited and its subsidiaries.

II. BUSINESS AND PERFORMANCE

A. ROTHESAY BACKGROUND AND STRUCTURE

Rothesay Holdco UK Limited ("RHUK") is the ultimate holding company and is a UK Limited company with four wholly owned subsidiaries ("the Group").

The structure of the Group as at 31 December 2015 is as shown in the diagram below:



Group Undertakings	Country Of Incorporation	Primary business operation	Value at Cost £m	2015 % Equity interest	2014 % Equity interest
Rothesay Pensions Management Limited (RPML)	UK	Service company	–	100%	100%
Rothesay Life Limited (Rothesay Life Plc)	UK	Life insurance	383.7	100%	100%
Rothesay Assurance Limited (RAL)	UK	Life insurance	2.7	100%	100%
LT Mortgage Financing Limited	UK	Service company	–	100%	–

RLL is authorised by the Prudential Regulation Authority (PRA) and regulated to conduct life insurance business in the UK by the Financial Conduct Authority (FCA) and PRA.

II. BUSINESS AND PERFORMANCE CONTINUED

On 24 March 2016 Rothesay Life Limited became a public limited company and changed its name to Rothesay Life Plc. We will therefore use Rothesay Life Plc ("RLP" or "Rothesay") throughout this report.

Rothesay's strategy is to source longevity risk from pension schemes (or from other insurers with annuity blocks), with products tailored to meet the specific needs of corporate sponsors, trustees and pensions scheme members. It writes both single and regular premium business, and acts in the capacity of a principal, sourcing the longevity risk and hedging when favourable opportunities to reinsure are identified.

Rothesay then seeks investment opportunities in line with a high-security, low credit risk investment strategy, while extracting the optimum illiquidity premium from assets.

Each transaction entered into by Rothesay is a bespoke structured agreement, and the Group also enters into derivative and reinsurance contracts to fully or partially hedge both the risks assumed from the contracts with the schemes and from the investment of premiums received.

In addition to sourcing longevity risk directly from pension schemes, the Group has completed two acquisitions of insurance companies within the bulk purchase annuity sector: Paternoster UK Ltd in January 2011 and MetLife Assurance Limited (now Rothesay Assurance Limited or RAL) in May 2014. Both of these companies have only written insurance business consistent with the line of business written by Rothesay.

On 1 December 2015, the Board of RLP approved the transfer of the long-term insurance business of RAL to RLP, the immediate parent company. The transfer was effective from 1 December 2015. All of the assets, liabilities and reserves, with the exception of issued share capital within RAL's shareholder fund were transferred to the shareholder fund of RLP on the transfer date. Following the Part VII, RAL no longer writes insurance business. The Group has sought cancellation of all permissions from the PRA and the FCA.

Rothesy Pensions Management Limited ("RPML") provides services to other companies in the Group.

LT Mortgage Financing Limited ("LTMF") was incorporated as a wholly owned subsidiary of RLP on 17 February 2015. The Company has remained dormant during 2015.

II. BUSINESS AND PERFORMANCE CONTINUED

B. REGULATOR

The Group supervisor can be contacted as follows:

Prudential Regulatory Authority
Bank of England
20 Moorgate
London
EC2R 8AH
0207 601 4878

C. AUDITORS

The statutory accounts are audited by PricewaterhouseCoopers LLP who can be contacted as follows:

PricewaterhouseCoopers LLP
7 More London Riverside
London
SE1 2RT
0207 583 5000

D. SHAREHOLDERS

The specific shareholdings of each ultimate shareholder in Rothesay Holdco UK Limited as at 31 December 2015 are summarised below:

- The Goldman Sachs Group Inc.: 36.0%
- The Blackstone Group L.P.: 28.5%
- GIC Private Limited (formerly known as Government of Singapore Investment Corporation): 28.5%
- MassMutual Financial Group: 7.0%

II. BUSINESS AND PERFORMANCE CONTINUED

E. SEGMENTAL ANALYSIS

All of the Group's business risks and returns are within one business segment (i.e. long term insurance business). The Group's operations are materially within the United Kingdom. The split between regular premiums (payments of premium made regularly over the duration of the policy) and single premiums (single payment of premium which covers the life of the policy) is disclosed below:

	Regular premiums		Single premiums	
	Year ended 31 December 2015 £m	Year ended 31 December 2014 £m	Year ended 31 December 2015 £m	Year ended 31 December 2014 £m
Group pension bulk annuities	272.1	273.6	2,335.0	1,405.8
Assumed reinsurance premiums	–	–	1,156.6	–
Total Gross Premiums Written	272.1	273.6	3,491.5	1,405.8

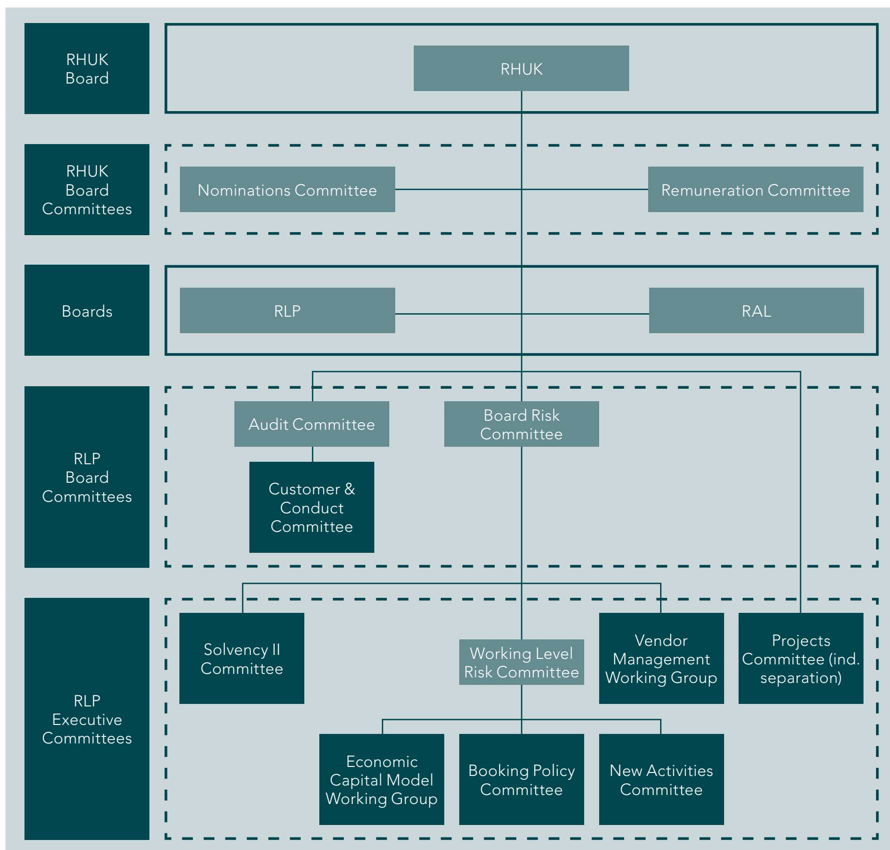
F. UNDERWRITING AND INVESTMENT PERFORMANCE

As this is the first SFCR focussed on the opening Solvency II balance sheet, we have not included details of underwriting and investment performance over the prior period.

III. SYSTEM OF GOVERNANCE

A. COMMITTEE STRUCTURE

The Rothesay Group Committee structure as at 31 December 2015 has been outlined below:



Terms of reference describe the structure, purpose and membership of each of the committees and working groups.

The Boards and Board level committees are comprised of a combination of executives, shareholder representatives and non-executive directors and meet on a regular basis, typically bi-monthly and not less than quarterly. The executive committees have balanced representation of business and control functions. Minutes document the discussions held in meetings and actions taken by members.

III. SYSTEM OF GOVERNANCE CONTINUED

New committees, sub-committees and working groups may be established on a permanent or temporary basis or dissolved, as deemed necessary by a Committee's Chairperson or Senior Management, except in the case of Board Committees where full Board approval is required. The creation of a Committee or Working Group is subject to the Policy on Committees. The document aims at ensuring the consistency of committees, the clarity of oversight and reporting lines and an appropriate and balanced representation of business and control functions.

Board Risk Committee

The Board Risk Committee (the "BRC") is authorised by the Board of Directors ("Board") with the purpose of assisting the Board in providing leadership, direction and oversight of the Group's risk appetite, tolerance, risk strategy and risk management framework and of the risk aspects of major investments and corporate transactions. Its primary function is the on-going monitoring and control of all financial and insurance risks associated with the activities of the Group, within the parameters set by the Board and as set out in the prevailing risk and investment policies of the Group. The BRC is also responsible for the oversight of the executive level Working Level Risk Committee ("WLRC").

The BRC membership includes both Independent Non-Executive Directors, who carry majority voting rights, and Non-Executive Directors. The Chairman is an Independent Non-executive Director, Naguib Kheraj. The Committee is responsible for:

Risk Framework

- Recommending the Group's overall risk appetite and tolerance to the Board for approval;
- Reviewing the Group's risk framework and approving risk policies, standards and limits within the overall appetite and tolerance approved by the Board;
- Reviewing the Group's processes for determining risk appetite tolerance, monitoring compliance with approved risk tolerance levels and policies and the resultant action in respect of policy breaches.
- Reviewing the Group's material risk exposures, including insurance, market, credit, operational, liquidity, reputational and economic and regulatory capital risks against the Group's risk methodologies and management's actions to monitor and control such exposures;
- Reviewing the Group's stress testing and monitoring management's response to the results;
- Receiving notification of material breaches of risk limits and approving the proposed remedial action where such cases are escalated to the Committee by the Chief Executive Officer or Chairman of the Working Level Risk Committee;

Strategy

- Reviewing and approving any new transaction to be executed by the Group which meets the criteria established by the Board and applicable policies;
- Advising the Board on the risk inherent in strategic transactions and business plans and the impact on the Group's risk appetite and tolerance;

III. SYSTEM OF GOVERNANCE CONTINUED

Risk Function

- Considering and approving the remit of the Group's risk function and ensuring it has adequate resources and appropriate access to information to enable it to perform its function with adequate independence;
- Reviewing promptly material reports on the Group from the Chairman of the WLRC and Chief Risk Officer;
- Reviewing and monitoring management's effectiveness in responding to the findings and recommendations of the Chief Risk Officer;

Capital

- Reviewing the key assumptions underlying the annual Individual Capital Assessment, Rothesay's Own Risk & Solvency Assessment ("ORSA") and other economic capital calculations; and
- Reviewing the results of the ORSA.

Working Level Risk Committee

The WLRC is responsible for the on-going monitoring and control of all financial risks, insurance risks and operational risks associated with the activities of the Group. The WLRC establishes, among other things, the limits for both financial risks (e.g. credit, interest rate and inflation risks) and insurance risks (e.g. pricing, underwriting and longevity risks), reviews stress tests and scenario analysis results, and establishes risk policies and procedures.

The WLRC is also responsible for recommending investment strategies to the BRC, for the on-going monitoring and control of the Group's existing asset and investment portfolio and for the review and approval of material new assets and investments of the Group. The WLRC acts within parameters established by the Board and any exceptions and changes are reviewed as appropriate by the BRC. The WLRC also reviews and monitors existing and any proposed hedging arrangements, including, but not limited to credit, interest rate, equity, inflation and longevity hedging transactions.

The WLRC is accountable for business standards and practices, including reputational risk management, within the scope of its mission.

The WLRC membership consists of 11 members. Two shareholder representatives have observer rights. The membership includes four control side members and two control side observers and is chaired by the Chief Financial Officer (CFO).

III. SYSTEM OF GOVERNANCE CONTINUED

Audit Committee

The Audit Committee is responsible for assisting the Board in fulfilling its oversight responsibilities for the financial reporting process, the system of internal control, the audit process, and the Group's process for monitoring compliance with laws and regulations and the business principles.

The Audit Committee membership consists of both shareholder representatives and Independent Non-Executive Directors. The Chairman is an Independent Non-executive Director, Bill Robertson. The Audit Committee carries out the duties below on behalf of the Board in respect of the Group:

Financial Reporting

The Audit Committee monitors the integrity of the financial statements of the Group, including its annual and half-yearly reports, any formal announcement relating to its financial performance, reviewing significant financial reporting issues and judgments which they contain.

Internal Controls

The Audit Committee keeps under review the effectiveness of the Group's internal controls and is responsible for understanding the scope of internal and external auditors' review of internal control over financial reporting, and obtaining reports on significant findings and recommendations, together with management's responses.

Internal Audit

The Audit Committee monitors and reviews the effectiveness of the Group internal audit function in the context of the Group's overall risk management system. The Audit Committee is responsible for appointing the Head of Internal Audit and any co-source internal audit arrangements. The Audit Committee is further responsible for reviewing and assessing the annual plan of internal audit activities for the Group, reviewing all internal audit reports and monitoring management's responsiveness to the findings and recommendations from Internal Audit.

External Audit

The Audit Committee considers and recommends to the Board the appointment, re-appointment and removal of the external auditors of the Group, and oversees the relationship with and between the external auditors. This includes approval of their remuneration, terms of engagement, assessing their independence and objectivity and ensuring co-ordination with the Group's Internal Audit function. The Audit Committee further reviews the findings of the audit with the external auditors, including discussing any major issues which arise during the audit, any accounting and audit judgements and the effectiveness of the audit.

Compliance

The Audit Committee reviews the effectiveness of the system for monitoring compliance with laws and regulations, the findings of any examinations by regulatory agencies and any auditor and the process for communicating the code of conduct/business principles to the Group's personnel as well as monitoring compliance.

III. SYSTEM OF GOVERNANCE CONTINUED

Whistleblowing
The Audit Committee reviews the Group's arrangements for its employees to raise concerns, in confidence, about possible wrongdoing in financial reporting or other matters. The Audit Committee ensures that these arrangements allow proportionate and independent investigation of such matters and appropriate follow-up action. The Chairman of the Audit Committee is also the Group Whistleblower's Champion.

Risk
The Audit Committee reviews the effectiveness of the system for risk governance and monitoring.

Remuneration Committee

The Remuneration Committee (the "RemCom") is responsible for reviewing and making recommendations to the Board regarding the Remuneration Policy of the Group, and for reviewing compliance with the policy in so far as it relates to senior managers and other employees. Within the context of the policy, the RemCom is specifically responsible for making recommendations for the remuneration packages of the Non-Executive Directors, Executive Directors and other senior managers of the Group.

The RemCom is further responsible for monitoring the level and structure of remuneration of the wider employees of the Group. The RemCom membership consists of both Executive and Non-Executive Directors and is chaired by the Chairman of the Board.

Nomination Committee

The Nominations Committee (the "NomCom") is responsible for monitoring the balance of the skills, knowledge, experience and diversity on the Board, recommending Board, board committee and senior management appointments to the Rothesay Boards, as appropriate and monitoring succession plans for the executive directors and the development plans of senior management within the Group. The responsibilities of the NomCom include reviewing the structure, size and composition of the Board, identifying and nomination candidates to fill Board vacancies as and when they arise, and approving any senior management appointments. The NomCom membership consists of Non-Executive Directors and the NomCom is chaired by the Chairman of the Board.

Related Party Transactions

During 2015 the Group entered into various transactions with fellow participating interests which are subject to common control from the same source, including Goldman Sachs International, Goldman Sachs and Co., The Goldman Sachs Group Inc., Goldman Sachs Asset Management Limited and RLP Limited (Cayman) Limited. All transactions are conducted within the normal course of business.

III. SYSTEM OF GOVERNANCE CONTINUED

The Group continues to develop fully independent infrastructure and computer systems. As of 1 September 2015 the Group fully migrated its middle office functions to an independent third party. Any services/support which remains provided by Goldman Sachs are provided on an arms-length basis under a Transition Services Agreement ('TSA').

B. BOARD OF DIRECTORS

The following were members of the RLP Board at 18 May 2016:

Director	Approved Function
Addy Loudiadis	SIMF 1 CEO 7 CF1 Director
Ray King	SIMF 9 Chairman SIMF 12 Chair of Remuneration Committee and Independent Non-executive Director
Naguib Kheraj	SIMF 10 Chair of Board Risk and Independent Non-executive Director
Bill Robertson	SIMF 11 Chair of Audit Committee and Independent Non-executive Director
Glenn Earle	SIMF 14 Senior Independent Director
Dermot McDonogh	SIMF 7 Group Entity Senior Manager & Non-Executive Director
Robin Jarratt	SIMF 7 Group Entity Senior Manager & CF1 Director
Qasim Abbas	SIMF 7 Group Entity Senior Manager & CF1 Director
Richard Berliand	Independent Non-executive Director
Charles Pickup	Independent Non-Executive Director

C. FIT AND PROPER REQUIREMENTS

The Fit and Proper Policy was approved by the Board in November 2015. It incorporates the changes required by the Senior Insurance Managers Regime (SIMR) and identifies who is in scope, how fitness and propriety will be assessed for both new starters and on an on-going 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).

III. SYSTEM OF GOVERNANCE CONTINUED

The Group's assessments of individuals' fitness and propriety reflects the SIMR fit and proper requirements, namely:

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

In addition, the Nominations Committee ensures that the Board collectively possesses appropriate qualifications, experience and knowledge about at least:

- insurance and financial markets
- business strategy and business model
- Solvency II requirements for the system of governance
- financial and actuarial analysis and
- regulatory framework and requirements.

The Group employs the following procedures to assess fitness and propriety:

1. Performance against the applicable PRA Conducts Standards and FCA Conduct Rules
2. Performance against internal policies and procedures
3. Disclosure and Barring Service (DBS) checks
4. Annual performance reviews and assessments
5. Self-attestation annually

In addition to the Directors listed in section IIIB above, the following officers have also been approved by the appropriate UK regulatory bodies as at 18 May 2016 and all are subject to the Groups Fit and Proper policy:

Approved Person	Approved Function
Andrew Stoker	SIMF 2 – Chief Finance Officer
Mark Foster	SIMF 4 – Chief Risk Officer
Emmeline Skerrett	SIMF 5 – Head of Internal Audit
Jeremy Nurse	SIMF 20 – Chief Actuary
James Dickson	CF10 – Compliance Oversight CF11 – Money Laundering Reporting Officer
Tom Pearce	CF29 – Significant Management – Managing Director
Jonathan Sarkar	CF29 – Significant Management – Chief Operating Officer
David Land	CF29 – Significant Management – Chief Investment Officer

III. SYSTEM OF GOVERNANCE CONTINUED

D. RISK MANAGEMENT SYSTEM

Risk Identification

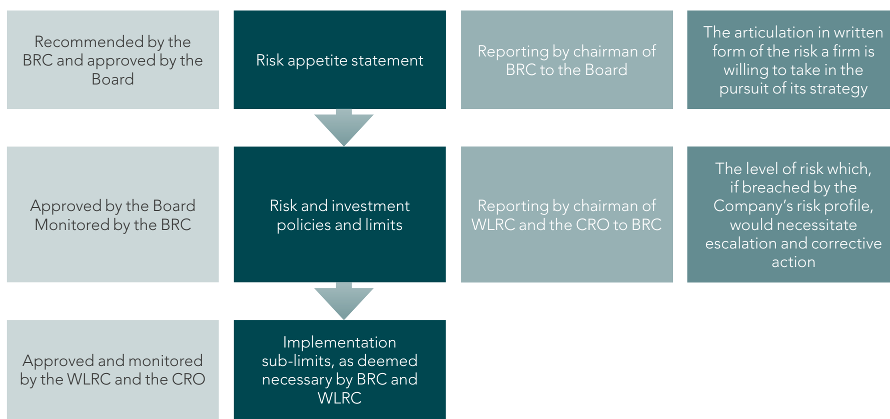
Rothesay assesses its underlying risk profile, its comfort with the risks taken and whether those are within the risk appetite on an on-going basis. Key risks and mitigating actions and controls in place to manage the identified risks are detailed in the central risk register, which is maintained by the risk function and is subject to an annual review, at a minimum.

Risk appetite, tolerances and limits

The risk appetite is articulated in the statement of risk appetite, which is a document owned by the Board and reviewed on a regular basis as new risks emerge, or at least annually.

The statement of risk appetite is translated into risk tolerances, which are in turn translated into the risk limits that are observed by the business. The risk limits are documented in key documents including the investment policy, risk management policy, liquidity policy, capital Policy and credit policy. Those documents and associated limits are approved by the Board on the recommendation of the BRC. They are maintained on an on-going basis and reviewed not less than annually.

The diagram below outlines Rothesay's risk management governance and responsibilities:



III. SYSTEM OF GOVERNANCE CONTINUED

Risk management and controls

The risk management framework is designed to identify measure, manage, monitor and report significant risks to the achievement of our business objectives. The core elements of our risk management framework are as follows:

Core elements	Description
Risk Appetite	Sets out our overall attitude to risk, the ranges and limits of acceptable risk taking
Risk Policies	Defines our approach to risk management and establishes the controls, procedures, limits and escalation to ensure that the risks are managed in line with the risk appetite: – Risk Management Policy, Capital Policy, Investment Policy, Liquidity Policy, Credit Policy, Outsourcing Policy, Underwriting Policy, Operational Risk Policy
Risk Assessment	Identifies and evaluates the risks to which the Group is exposed – Risk profile (Central Risk Register), ICA
Risk Oversight	Conducted by the following individuals and groups: – Risk Management function, Chief Risk Officer, Working Level Risk Committee, Compliance, Life Actuarial
Board Committees	Oversees the management of risks and challenges how the risk framework is functioning – Board Risk Committee, Audit Committee, Board of Directors

In addition, before the Group enters into activities which are substantially different from those in which we are experienced, a comprehensive risk assessment is performed. This includes an evaluation of our risk management capabilities, processes and systems for the new activity, which is presented to and approved by the New Activity Committee.

Rothesay has adopted a "three lines of defence approach". We also stress that the management of risk is the responsibility of each employee of Rothesay.

Prudent Person Principle

Article 132 of Solvency II defines the prudent person principle. We consider this as being as much a behavioural standard as an assessment of judgements and investment decisions. In line with this principle, and embedded within the investment policy all Rothesay employees consider a number of risk indicators before entering into new investments to ensure that:

- Investments are of a suitable quality and security to meet policyholder liabilities;
- Assets are only invested in which can be suitably modelled and valued;
- Consideration is given to the duration, currency and linkage of liabilities when making investment decisions;
- In the absence of Solvency I admissibility limits internal limitations are applied for assets classes and sectors.

III. SYSTEM OF GOVERNANCE CONTINUED

Rothesay does not use external investment managers; therefore these requirements need only be applied and monitored internally. The impact of new investments on a list of defined risk indicators, including stress tests, is captured within the investment memos presented to the Working Level Risk Committee. In addition, investments in new asset classes are considered first by the Rothesay New Activity Committee at which time it is ensured that the business, including the operational areas, have the ability to support the position, manage the associated risks and meet the regulatory obligations.

The Finance team must be comfortable that well defined and appropriate valuation methods have been developed for those instruments where external pricing information is not readily available. In addition to current admissibility rules, more onerous internal limits are placed on single counterparty and asset class exposures.

As such, we believe that the existing investment governance framework is consistent with the prudent person principle. Management intends to further enhance the framework though formalising a sign-off process through which the Working Level Risk Committee members confirm that the prudent person principle has been considered prior to approving investments in new issuers or asset classes.

Risk reporting

A key pillar of the risk management and reporting framework within Rothesay is the production of daily balance sheet valuations and movement explanations, for differing valuation measures. At this time daily IFRS P&L attribution reports are produced, in addition to daily Solvency II Balance Sheet reporting and monthly MCEV reports. As outlined in the Rothesay Risk Management policy, the Group's risk management framework is underpinned by a Fair Value measure which is also monitored and reported daily. Under this measure assets and liabilities are marked-to-market daily. In addition, reserves are held for all residual risks where it is believed that RLP would incur costs to fully hedge the position. Given such reserves, the Fair Value measure can be thought of as risk neutral as all risk is carried on the balance sheet at a price at which it could be readily transferred to a hedging counterparty. The RLP traders are aware of the risk limits in place and also headroom that exists beneath each, allowing them to act accordingly.

The Risk function monitors compliance with the various spot and stressed risk/scenario limits. The results of this monitoring exercise are captured within reporting packs that are provided to the business, including Senior Management, weekly. This weekly risk pack also forms a recurring agenda item at weekly WLRC meetings.

The Board receives a Management Information Pack on a monthly basis, which includes a risk section, extracts from the weekly risk pack and comments on key trends over the month.

The BRC is provided with a comprehensive risk update bi-monthly. Selected themes are then reported to the Board, which typically meets a few weeks after the BRC meetings.

III. SYSTEM OF GOVERNANCE CONTINUED

Internal credit assessment

External and internal credit assessments are both key inputs into our investment, risk or capital decisions. External and internal credit assessments were considered in all new asset transactions presented to the WLRC or brought to the credit team (which makes up part of the risk function and is headed by the Chief Credit Officer) for approval. The credit team typically performs an independent analysis on each new transaction, reviews external credit assessments if available and documents the independent credit view in the asset template. The credit team is responsible for the on-going surveillance of the asset portfolio, including the monitoring of changes in external credit assessments.

Own risk and solvency assessment

The EC Directive in Article 45 requires insurers, as part of their risk management system, to perform an own risk and solvency assessment (ORSA). This assessment requires Rothesay to properly determine its overall solvency needs to cover both short and long-term risks. The risk based approach requires, amongst other things, that Rothesay hold an amount of funds commensurate with the risks to which it may be exposed and thus the ORSA represents Rothesay's opinion and understanding of its risks, overall solvency needs and own funds held.

The intention of Rothesay's ORSA is to enhance awareness of the interrelationships between the risks Rothesay is currently exposed to, or may face in the long term, and the associated capital requirements. As a management tool it is designed to enhance risk awareness in Rothesay's culture and decision making processes, forming an integral part of the overall business strategy and to assist Rothesay to obtain a real and practical understanding of the risks it is assuming.

Rothesay's ORSA assessment helps to ensure that the Group can continuously meet its regulatory capital requirements, as well as the internal capital targets in the face of changes to our risk profile and business plans, as well as the impact of developments in the external environment. The ORSA is prepared on a Group basis. While other companies exist within the Group, all risk is housed within the insurance entities.

Similar to the Internal Capital Assessment required under the Solvency I regime, the ORSA process includes an assessment of our capital requirements over the next 12 months. A thorough risk identification exercise is performed to highlight those risks that should be captured within our economic capital model. The level of economic capital required is then derived using stresses consistent with the 99.5% confidence level movement over a 12 month timeframe. The instantaneous capital available to the Group is recalculated under the movement of each risk factor.

Dependencies between risk factors are derived, where possible consistent with observed correlations, and a multivariate distribution for the capital available to Rothesay created by combining the marginal distributions and the dependencies. A Monte-Carlo simulation is run with 100,000 scenarios and the capital available to Rothesay determined in each. The capital requirement is determined as the 99.5% confidence level adverse change.

III. SYSTEM OF GOVERNANCE CONTINUED

This analysis is supplemented by a suite of portfolio stress tests which target key risks present within the asset portfolio at any one time. As such, the stress tests performed will vary over time as the composition of the asset portfolio, and hence risk profile of Rothesay, changes. The results of the stress testing analysis form a key input to risk management and investment decisions.

A further important component of the ORSA process is the forward looking risk assessment. Here an analysis is performed which considers risks and extreme scenarios that could render the business model as non-viable. The analysis captures both quantitative and qualitative factors and provides a framework by which the impact of all identified events can be mapped to our business plan and capital requirements.

It is required that the ORSA includes consideration of the suitability of the Pillar 1 standard formula capital calculation versus those capital requirements derived from Rothesay's own view of risk. At this time Management believe that the component of the standard formula calculation which is least compatible with the highly secure asset portfolio held by Rothesay, is the spread risk module. For this reason, a partial internal model has been developed which allows security to be more appropriately reflected in capital calculations. The appropriateness of all aspects of the standard formula calculation will continue to be assessed over time and where appropriate, Management may explore the expansion of the internal model to capture additional risk factors.

While an annual ORSA report is produced, the ORSA process is continuous and helps inform our business strategy and capital requirements over time. The Boards of the Group are involved throughout the ORSA process, from setting the Group risk appetite, to discussing the suite of stresses that should be applied to our business model.

E. INTERNAL CONTROL SYSTEM

Rothesay's internal control system is designed to provide reasonable assurance that its financial reporting is reliable, it is compliant with applicable laws and regulations and its operations are effectively controlled. The Board is ultimately responsible for overseeing and maintaining the adequacy and effectiveness of the risk management and internal control systems. In practise the oversight and management of these systems necessarily involves participation of the Board, the Audit Committee, the Board Risk Committee, senior management, Risk, Finance, Compliance, Legal, business managers, various committees and Internal Audit.

Primary responsibility for ensuring day-to-day oversight of the internal control system lies with Rothesay's relevant Senior Insurance Manager Functions (SIMFs), Significant Influence Function (SIFs) holders and Key Function Holders. Rothesay promotes the importance of appropriate internal controls by: i) ensuring that all personnel are aware of their role in the internal control system as per the Governance Map and Fit and Proper Policy; ii) ensuring a

consistent implementation of the internal control systems across the Group; and iii) establishing monitoring and reporting mechanisms for decision making processes. Please see Risk Management and Controls section above for the brief description of the internal control systems relating to the risk function. Please also refer to the Compliance section below for the description of how the compliance function is implemented. Rothesay has a Reporting Policy, Risk Management Policy, Capital Management Policy, Internal Audit Policy, Outsourcing Policy, Internal Model Policy, Compliance Policy, Fit and Proper Policy and Governance Map which sets out its internal control systems in more detail.

F. COMPLIANCE

Compliance's missions are to:

i protect the Group's reputation and manage compliance risk by partnering with the business to develop commercially viable solutions that are in accordance with applicable laws, rules and regulations

ii demonstrate its commitment to the highest ethical standards in the conduct of its business and advance the Group's business

iii establish the framework for managing the Group's compliance risk.

The Chief Compliance Officer and Money Laundering Reporting Officer are classified by the FCA as a Significant Influence Function (CF10 and CF11) and these are required functions. The Group's Compliance function operates independently from the business and reports to the General Counsel. The Chief Compliance Officer (CCO) also has direct access to the Board and the Audit Committee, in order to assist with management of possible conflicts of interest.

Compliance interacts with regulatory bodies and authorities. Compliance monitors trends and changes in regulations and shares information and collaborates with regulators to manage reputational and compliance risks.

Compliance engages in a variety of activities and processes to identify, assess, control, measure, mitigate, monitor and report compliance risks across the Group as a part of its oversight and administration of the Compliance Plan.

G. INTERNAL AUDIT FUNCTION

The Internal Audit function has been established by the Audit Committee in order to assist the Audit Committee in fulfilling its oversight responsibilities.

Internal Audit's mission is to independently examine and evaluate the functioning, effectiveness and efficiency of the Group's internal control system and all other elements of the system of governance. Internal Audit's activities are designed to provide advice to management in improving the internal control environment, and monitor the implementation of strategic control initiatives and management's remediation activity.

III. SYSTEM OF GOVERNANCE CONTINUED

The Head of Internal Audit (HIA) reports to the Audit Committee and is responsible for supporting the Audit Committee and the Board in fulfilling their oversight responsibilities. The HIA also reports administratively to the CFO.

The Audit Committee will approve all decisions regarding the performance evaluation, appointment, or removal of the HIA. The RemCom will also review and approve the HIA's annual compensation and salary adjustment.

Rothesay's Internal Audit Policy states that Internal Audit activity will remain free from interference by any element of executive management, including matters of audit selection, scope, procedures, frequency, timing, or report opinion to permit maintenance of a necessary independent and objective mental attitude.

Internal auditors will have no direct operational responsibility or authority over any of the activities audited. Accordingly, they will not implement internal controls, develop procedures, install systems, prepare records, or engage in any other activity that may impair internal auditor's judgment. The Group's Internal Audit is independent from the business lines. Internal Audit may not be in a position where there is a possible conflict of interest between audit responsibilities and any other responsibilities.

Neither the HIA nor any Internal Audit staff shall perform any other control functions including the compliance, risk management and actuarial functions.

Audit staff will be rotated within Internal Audit as appropriate. The frequency of the rotation of Internal Audit staff will balance the need for developing expertise with that for maintaining adequate operational independence and also the size of the Audit Team. The Audit Committee has implemented a co-source Internal Audit approach using KPMG LLP. This relationship offers resource flexibility and rotation of Internal Audit staff assignment whenever appropriate and practicable to avoid any conflicts of interest.

Internal auditors that have been recruited internally will not audit activities or functions that they have performed in the last 12 months.

The co-source provider also manages conflicts of interest and will ensure where appropriate, staff are rotated. Where KPMG supplies non-Internal Audit services to Rothesay this will be approved by the Audit Committee. The co-source provider will ensure that no persons providing non-Internal Audit services subsequently work on the Internal Audit engagement and conflicts of interest are managed.

H. ACTUARIAL FUNCTION

Rothesay's Actuarial Function consists of six actuaries and actuarial students with the Chief Actuary role being outsourced to Jeremy Nurse at Willis Towers Watson. The Actuarial Function reports to the CFO. The Actuarial Function is provided information by actuaries within Operations, Pricing and Risk Function to assist the Actuarial Function in meeting its responsibilities.

The actuarial function is responsible, inter alia, for:

- Calculating the technical provisions, including:
  - Ensuring the appropriateness of methodologies, models and assumptions
  - Assessing the adequacy and quality of data used
  - Informing the Board of the reliability of the calculation
- Analysing the movement in technical provisions, including the comparison of best estimates against experience
- Opining on the underwriting policy and adequacy of reinsurance arrangements
- Contributing to the effective implementation of the risk management system, in particular to the modelling risk in respect of the ORSA and MCR/SCR calculations.

Each of these activities is undertaken on at least an annual basis. The additional responsibilities of the actuarial function do not create conflicts of interest.

I. OUTSOURCING

RPML employs all of the Group's management and staff and provides services to the other companies in the Group.

The Group has chosen to outsource some of its operational functions and activities in order to take advantage of economies of scale and external expertise. The following key functions and activities have been outsourced:

- Pensions administration to Jardine Lloyd Thomson and Willis Towers Watson
- The Chief Actuary role to Jeremy Nurse at Willis Towers Watson
- Middle office operational activity to Northern Trust
- Payroll and other HR services to Radius

All of these providers are located within the EU.

III. SYSTEM OF GOVERNANCE CONTINUED

The Group has adopted an Outsourcing Policy which is intended to establish a prudent risk management framework in relation to the management of the outsourcing arrangements and ensure compliance with the relevant regulatory requirements. The Policy covers the entire outsourcing lifecycle, from identifying the need for outsourcing through relationship management and oversight and provides processes to effectively manage risk associated with outsourcing relationships.

J. ADEQUACY OF THE SYSTEM OF GOVERNANCE

Reviews of the corporate governance and effectiveness of the boards and committees of Rothesay are carried out on a regular basis, taking into account the requirements of the Financial Reporting Council's Corporate Governance Code and recommendations from the PRA. Phase 1 of the most recent Board Effectiveness Review was completed in July 2015 and looked at the design of the governance structure and an update on matters arising was provided to the PRA at the end of the year. Phase 2 will be a more qualitative assessment of effectiveness of the governance structure and will be carried out during 2016.

IV. RISK PROFILE

The Group operates a low-risk business model that is supported by a robust risk management framework that ensures risks are well understood and controlled. This is facilitated by daily systematic quantification of all risks and a culture that promotes the importance of risk management. Integral to this is a thorough understanding and articulation of the Group's risk exposures. Determining the prevailing risk landscape within the Group allows Management, the Board Risk Committee and the Board to assess the appetite for each emerging risk and to ensure that all are quantifiable and managed consistently with our appetite to risk.

The Group's strategy is to acquire annuity liabilities from pension schemes and other insurance companies. Exposure to the market risks associated with annuities is significantly hedged with financial instruments, whilst the longevity risk sourced is partly ceded to reinsurers when favourable opportunities are identified. The Group seeks investment opportunities in line with a high security, low credit risk investment strategy and counterparty credit risk is managed through structural credit mitigants.

An overview of the principal risks associated with the business including an outline of how they are each managed is provided below.

Interest Rate Risk

The Group invests in fixed income securities in order to back its annuity obligations to policyholders. Interest rate exposure arises due to movements in future expectations of interest rates to the extent that the market value of assets is not sufficient to meet the present value of the annuity obligations.

The Group hedges its exposure on an IFRS basis, allowing for netting across its investment assets and insurance liabilities, by entering into a portfolio of interest rate swaps. The portfolio is constructed by analysing the sensitivity of all investment assets and insurance liabilities to movements in each of the underlying market instruments used to derive the swap curve. A portfolio of interest rate swaps can then be constructed which replicates these sensitivities. In this way, Rothesay can mitigate the risk to changes in the level, slope and curvature of the swap curve. Note, however that Rothesay's Solvency II balance sheet is still exposed to interest rate movements because technical provisions are more sensitive to interest rates that IFRS insurance liabilities. Monitoring and re-hedging occur on a daily basis.

Inflation Rate Risk

A proportion of the Group's annuity payments are linked to published inflation indices (e.g. UK RPI, UK CPI) and may be subject to caps and floors. Inflation rate exposure therefore arises due to movements in future expectations of inflation rates to the extent that the market value of assets is not sufficient to meet the present value of the annuity obligations.

IV. RISK PROFILE CONTINUED

The Group hedges its net exposure on an IFRS basis, by analysing the sensitivity of all investment assets and insurance liabilities to the movements in each of the underlying market instruments and constructing a portfolio of inflation swaps that replicate these sensitivities.

In this way, Rothesay can mitigate the risk to changes in the level, slope and curvature and volatility of the inflation swap curve. Note, however, that The Group's Solvency II balance sheet is still exposed to inflation rate movements because technical provisions are more sensitive to inflation rates than IFRS insurance liabilities. Monitoring and re-hedging occur on a daily basis.

Exchange Rate Risk

Although the Group principally operates in the UK with the vast majority of assets and liabilities denominated in GBP, a small proportion of the Group's pension obligations and investment assets are denominated in EUR, AUD or USD.

The Group hedges its net asset/liability currency exposure back to GBP by entering into a portfolio of exchange rate swaps which also match the term of the exposure. The portfolio is constructed by analysing the sensitivity of all investment assets and insurance liabilities to movements in the exchange rates between GBP and each of the currencies to which Rothesay is exposed. Monitoring and re-hedging occur on a daily basis.

Credit Default Risk

The Group seeks investment opportunities including government debt, government guaranteed debt, supranational debt, corporate debt, secured debt and secured loans. Therefore the Group is exposed to credit default risk.

The investment strategy pursued seeks to minimise credit default risk and lock in an illiquidity premium, which is achieved in a number of ways:

- Investing in low risk asset classes such as government guaranteed bonds;
- Investing in asset classes with security and other structural mitigation which protects Rothesay against loss in the event of borrower default, including over-collateralisation; and
- Limiting outright credit risk through the use of credit derivative hedges. The resulting asset and accompanying hedge package provide a residual rate of return with lower risk.

Our expertise is weighted toward structuring, legal and collateral management skills, which allows us to accumulate an asset base for which few fundamental credit assessments are required. Monitoring and re-hedging of the Group's credit exposure occurs on a daily basis. Sovereign and supranational debt represents 41% of the Group's investment portfolio.

Counterparty Default Risk

The Group utilises longevity reinsurance and Over-the-Counter (OTC) derivative transactions to manage efficiently risk across the portfolio. Reinsurance transactions are structured as unfunded longevity swaps. Examples of OTC derivatives use include the purchase of credit protection on bonds held in negative basis packages, interest rate and inflation delta hedging and also the hedging of inflation volatility risk. The Group is therefore exposed to the failure of these counterparties.

All such contracts are subject to daily margining requirements to ensure changes in their fair value are appropriately collateralised. Where there is residual gap risk, the value of each contract is adjusted to reflect their credit riskiness. Furthermore, we look to further reduce our exposure by diversifying counterparties and purchasing credit protection.

Insurance Risk

The projection of annuity obligations used for pricing and reserving requires a number of actuarial assumptions to be made. Similar to other bulk annuity providers, the performance of the Group's business will primarily depend on the actual experience of mortality rates and mortality trends. Systemic changes in mortality rates could arise, for example, from a cure for a major disease (e.g. cancer) being found in the near term. Such a cure may have a limited immediate impact on mortality rates, as time is required for a cure to be trialled, brought to market and widely adopted. However it could have significant impact on longer-term expectations of mortality rates.

These insurance risks are mitigated through strict underwriting criteria and the use of reinsurance when favourable opportunities are identified. Assumptions utilised in the projections are determined using recent historic experience, rating models or reinsurance pricing. Given the nature of the larger bulk annuities that the Group writes, the assumptions used can be derived specifically from the population under consideration.

To date, all reinsurance contracts entered into by the Group have been implemented through the use of unfunded longevity swaps where no initial premium outlay is required. Under a longevity swap, the reinsurer will pay the Group the actual experienced annuity obligations in exchange for a fixed fee schedule payable by the Group. 77% of longevity risk was hedged as at 31 December 2015.

Liquidity Risk

A lack of liquidity within the business may both prevent the Group from being able to pay annuity obligations as amounts fall due, and also may limit the Group's ability to satisfy collateral calls as they arise. Such outcomes will clearly limit the ability of Rothesay to continue as a going concern and write new business.

The Group's Liquidity Policy requires sufficiently liquid assets to be held in order to meet collateral outflows in extreme market conditions to ensure that sufficient liquid assets are held to satisfy collateral calls. Rothesay assumes severe instantaneous market shocks to a range of

parameters and measures both the impact on the value of assets held which may be used to satisfy collateral posting requirements and also movements in the value of derivatives which may require collateral to be posted to derivative counterparties (Maximum Liquidity Outflow or 'MLO'). The liquidity buffer exists; ongoing monitoring also allows mitigating actions to be taken at an early stage if required.

Operational Risk

The Group is exposed to operational risk, which is defined as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. In particular, this includes the failure of key outsourcing arrangements, business disruption, fraud and loss of key management.

This definition also includes legal risk and reputational risk, as the Group considers reputational risk critical to its franchise and therefore has adopted this broad definition of operational risk.

The process through which the Group's operational risk universe is determined and subsequent estimates of frequency and severity are assessed is captured in the Operational Risk Policy document. This process safeguards the ongoing improvement of the control environment and ensures that operational risk is identifiable and mitigated as the Group continues to grow.

The Group is reliant on the use of external parties to provide some services, for example policyholder administration for the bulk arrangements and annuitised schemes with JLT and Willis Towers Watson. As part of Goldman Sachs' divestment of 64% of the Group to Blackstone, GIC and MassMutual in 2013, the Group has been executing a separation project. Goldman Sachs still provides certain systems, services and process support under a service agreement. The Group is therefore exposed to the potential failure of these outsourcing partners. All risk management and high value functions are managed in-house in order to mitigate this risk and to ensure direct oversight.

Regulatory Risk

A change in the regulatory, legal or political environment may have consequences on the Group's Business Model, operations and financials. The Group is subject to financial regulation in the UK and the UK regulatory framework that applies to life insurance companies, in particular the Group is required to comply with capital adequacy requirements.

Although the Solvency II regime has now been implemented, it remains subject to future amendments to improve its operation and to better align approaches across Europe. In addition, Rothesay's application to use a partial internal model is dependent on PRA approval.

In 2015, the UK Government announced a number of regulatory changes in relation to the introduction of a secondary annuity market, allowing annuitants to sell their policies to third parties. Full implementation of the rules is expected by April 2017. Whilst this will have operational implications for Rothesay, sale of a policy does not impact the benefits provided.

IV. RISK PROFILE CONTINUED

The Group now has over 77,000 individual policyholders and is therefore exposed to conduct risk.

The Group maintains ongoing dialogue with the relevant regulators and industry bodies in order to ensure ongoing compliance and the ability to react quickly to any unanticipated changes.

Political Risk

In the event that the UK were to vote in favour of exiting the European Union, it is likely that there would be a period of increased market volatility. The negotiations surrounding any exit are likely to take a significant amount of time and it is then unclear what scope or appetite the UK government would have to amend the UK regulatory framework that applies to life insurance companies.

Conduct Risk

The FCA has outlined that firms need to ensure that they are putting customers and the integrity of markets at the heart of their business models and strategies.

This includes firms making strategic cultural changes which promote good conduct by establishing oversight around:

i. customers getting financial services and products that meet their needs from firms they can trust;
ii. markets and financial systems are sound, stable and resilient with transparent pricing information;
iii. firms compete effectively, with the interests of their customers and the integrity of markets at the heart of how they run their business.

Rothesay has therefore developed a Conduct Risk Register to measure the Group's conduct risks. This is an evolving document which aims to capture known conduct risks to the business and also mitigants in place to manage such risks. It is intended to incorporate the existing Conduct Risk Register into the Group's overall risk register during the first half of 2016. Conduct risk also forms an important element of any assessment of new products and activities.

Rothesay's Customer and Conduct Committee (CCC) is a sub-committee of the Audit Committee, meets six times a year and is chaired by Richard Berliand, an independent Non-executive Director. It helps ensure that the Group consistently delivers fair outcomes to consumers and that the Group and staff at all levels deliver the customer outcomes relevant to its business through establishing an appropriate culture. All employees receive compliance training on conduct risk and TCF.

Conduct risk means that all staff and not just the senior management have responsibility for getting things right.

V. VALUATION FOR SOLVENCY PURPOSES

A. ASSETS

The material classes of assets shown on the Group's Solvency II Balance sheet, the Solvency II values and values for the corresponding assets shown in the Group's financial statements, and the valuation methods used are summarised in the table below:

31 December 2015	Solvency II value £m	Solvency II valuation basis	Financial Statements value £m	Financial reporting valuation basis (Fair Value)
Collective investment schemes	470.4	Marked to Market	470.4	Marked to Market
Government and agency obligations	6,137.0	Marked to Market	6,137.0	Marked to Market
Corporate debt	5,792.9	Marked to Market	5,792.9	Marked to Market
Derivative assets	6,936.7	Marked to Market/Model	6,936.7	Marked to Market/Model
Collateralised agreements and financing	5,134.9	Marked to Market/Model	5,134.9	Marked to Market/Model
Certificate of deposits	119.7	Marked to market	119.7	Marked to market
Total Investments	**24,591.6**		**24,591.6**	
Property, Plant and equipment	2.0	Marked to Market (simplification)	2.0	Amortised Cost
Accrued interest and prepayments	165.0	Marked to Market	165.0	Marked to Market
Receivables	381.3	Marked to Market	381.3	Marked to Market
Cash and cash equivalents	98.5	Marked to Market	98.5	Marked to Market
	25,238.4		**25,238.4**	

The fair value of a financial instrument is the amount that would be received on sale of an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, i.e. the exit price. Financial investments are marked to bid prices and financial liabilities are marked to offer prices. Fair value measurements do not include transaction costs.

V. VALUATION FOR SOLVENCY PURPOSES
CONTINUED

The best evidence of fair value is a quoted price in an active market. If listed prices or quotations are not available, fair value is determined by reference to prices for similar instruments, quoted prices or recent transactions in less active markets, or internally developed models that primarily use, as inputs, market based or independently sourced parameters. Such parameters include, but are not limited to interest rates, volatilities, equity or debt prices, foreign exchange rates, credit curves and funding rates. The fair value of certain financial investments and financial liabilities require valuation adjustments for counterparty credit quality, funding risk, transfer restrictions, illiquidity and bid/offer inputs.

Cash instruments such as corporate debt securities, covered bonds, government and agency obligations and certain money market instruments are valued by verifying to quoted prices, recent trading activity for identical or similar instruments, broker or dealer quotations or alternative pricing sources with reasonable levels of price transparency. Consideration is given to the nature of the quotations (e.g. indicative or firm) and the relationship of recent market activity to the prices provided from alternative pricing sources. Valuation adjustments are typically made (i) if the cash instrument is subject to regulatory or contractual transfer restrictions and/or (ii) for other premiums and discounts that a market participant would require to arrive at fair value. Valuation adjustments are generally based on market evidence.

Certain cash instruments, including collateralised agreements and financing have one or more significant valuation inputs that are not observable. Absent evidence to the contrary, these instruments are initially valued at transaction price, which is considered to be the best initial estimate of fair value. When a pricing model is used, the model is adjusted so that the model value of the cash instrument at inception equals the transaction price. Subsequently, the Group uses other methodologies to determine fair value, which vary based on the type of instrument. Valuation inputs and assumptions are changed when corroborated by substantive observable evidence, including values realised on sales.

The Group's derivative contracts consist primarily of over the counter ('OTC') derivatives. OTC derivatives are generally valued using market transactions and other market evidence, including market based inputs to models, calibration to market clearing transactions, broker or dealer quotations or other alternative pricing sources with reasonable levels of price transparency. Consideration is given to the nature of the quotations (e.g. indicative or firm) and the relationship of recent market activity to the prices provided from alternative pricing sources.

Where models are used, the selection of a particular model to value an OTC derivative depends on the contractual terms of and specific risks inherent in the instrument, as well as the availability of pricing information in the market. Valuation models require a variety of inputs, including contractual terms, market prices, yield curves, credit curves, measures of volatility, prepayment rates, loss severity rates and correlations of such inputs. For OTC derivatives that trade in liquid markets, model selection does not involve significant management judgement because outputs of models can be calibrated to market clearing levels.

V. VALUATION FOR SOLVENCY PURPOSES CONTINUED

Certain OTC derivatives are valued using models which utilise inputs that can be observed in the market, as well as unobservable inputs. Unobservable inputs typically include certain correlations as well as credit spreads, that are long dated or derived from trading activity in inactive or less liquid markets. Subsequent to the initial valuation of such derivatives, the Group updates the observable inputs to reflect observable market changes. Unobservable inputs are changed when corroborated by evidence such as similar market transactions, third party pricing services and/or broker or dealer quotations or other empirical market data. In circumstances where the Group cannot verify the model value by reference to market transactions, it is possible that a different valuation model could produce a materially different estimate of fair value.

Fair value of our Financial Liabilities does not take account of changes in RLP's own credit risk on grounds of materiality and therefore there is no difference between the IFRS valuation and the Solvency II valuation.

B. TECHNICAL PROVISIONS

Technical provisions are valued in accordance with Article 77 of the Solvency II Directive which states that the value of technical provisions shall be equal to the sum of a best estimate and a risk margin.

Best estimate liabilities are calculated by discounting the projected cash flows based on our best estimate assumptions with regards to future demographic experience. When deriving demographic assumptions, RLP has always set these initially at a best estimate level and then added explicit prudential margins to meet the requirements of Solvency 1 INSPRU 1.2.13.R for Pillar 1 reserving. Hence, the demographic assumptions used for calculating best estimate liabilities simply release the explicit prudence present in our current reserving assumptions. As such, these assumptions are identical to those which RLP has historically used to calculate Solvency 1 Pillar 2 liabilities and MCEV, in particular for:

- Base mortality rates
- Mortality improvements
- Proportion with spouse/financial dependant
- Age of spouse/financial dependant
- Costs of Data/GMP equalisation risk
- Pension commencement lump sum ("PCLS") take-up.

Longevity

Recent mortality experience was analysed for each pension scheme (individually or grouped) at the end of 2015 and, where the data was considered statistically credible, the best estimate base mortality assumptions used in the valuation are based on this actual mortality experience. Where the data is not statistically credible, the RL Group has taken into account reinsurance prices and external and proprietary socio demographic models, based on postcode and other factors.

V. VALUATION FOR SOLVENCY PURPOSES CONTINUED

Mortality assumptions are set with reference to standard tables drawn up by the Continuous Mortality Investigation Bureau ('CMIB') of the Institute and Faculty of Actuaries. These tables are based on industry wide experience. During 2015 base mortality tables were updated to use the CMI S2 series of mortality tables (from the CMI S1 series of tables). The update was made to better reflect the shape of mortality and to update the base date from 2002 to 2007.

During 2015 the RL Group transacted funded reinsurance over a block of in payment Zurich Assurance annuities. The lives reinsured are reserved using the CMI 08 series of annuitant mortality tables rather than the S2 series of mortality tables used to value all other pension liabilities as the former is expected to better reflect the shape of mortality for an insured block.

Mortality assumptions are applied at a scheme or group of schemes level however the aggregate assumption is equivalent to valuing the whole book using 97.2% S2PXA.

Allowance is made for future improvements in annuitant mortality with reference to statistical analysis of historic rates of mortality improvements based on England and Wales population data, expert judgement of future changes in mortality improvements. The results are reviewed against industry benchmarking and reinsurance pricing. Longevity improvement assumptions are set using an advanced parameterisation of the Continuous Mortality Investigation 2014 projections model.

For all annuitant mortality bases covered by this paragraph, complete expectations of life on the valuation mortality basis have been calculated in years for males (weighted by the valuation of annuity benefits for each pension scheme), and are:

	Annuities in payment		Deferred annuities: life expectation at age 65	
31 December 2015	Age 65	Age 75	Age 45	Age 55
Male	23.0	13.9	25.7	24.4
Female	24.6	15.3	26.8	25.7

Unless reliable individual data is available, dependants' assumptions are set at a portfolio level with reference to historic experience, along with recent reinsurance pricing data, for proportion with spouse/financial dependant and age of spouse/financial dependant.

At retirement, a significant proportion of members are assumed to take part of their benefits immediately in the form of cash by commuting the maximum tax-free lump sum to which they are entitled, either through a pension commencement lump sum or a trivial commutation. A small take up is also assumed for the ability of deferred members to transfer the whole pension liability as a lump sum to an alternative pension provider pre-retirement. The assumptions reflect our best estimate of the conversion of deferred pension to a lump sum. In aggregate the assumption is equivalent to c. 25% of liability being taken as a lump sum.

No future management actions are assumed in the calculation of the technical provisions.

V. VALUATION FOR SOLVENCY PURPOSES CONTINUED

Assumptions used for the Financial Statements are entirely consistent with those detailed previously in this section with the exception that prudent margins are applied to reflect the fact that future experience for the schemes may differ from that assumed. On a Solvency II basis no margins are held in the best estimate liability.

Given that for the most material demographic assumptions, RLP has set assumptions with reference to pricing information obtained from reinsurance quotes, we consider that no correction is needed to these assumptions for any asymmetries around the mean assumptions derived, as by design, these would be included within the reinsurance pricing sourced.

One area of asymmetry which RLP makes an explicit allowance for in its modelling is pension payments which are inflation linked, but have increases which are capped or floored in absolute terms, i.e. LPI linked annuities. Here RLP explicitly allows for the asymmetry by marking the LPI annuities to market using a stochastic volatility model, which includes allowance for the convexity in inflation option pricing. As noted above, the principle of marking all assumptions to market where possible is the primary direction given for valuation of Assets and Liabilities in Article 10 of the Solvency II Directive, hence RLP's present approach is consistent with Solvency II regulations.

Cash flows included

RLP will project best estimate liabilities without inclusion of cash flows provided by reinsurance contracts. The value of reinsurance recoverables will then be separately included on the Solvency II balance sheet. The calculation of best estimate liabilities will include all contractual cash flows.

Future premiums are only payable to RLP on its unfunded longevity swap contracts and to a much smaller degree one future premium payment is due on a funded liability transaction. In all of these transactions, no unilateral right to cancel/reject the payment is available to either RLP or the pension scheme; hence all premiums and claims under these contracts will be included in the calculation of best estimate liabilities.

Reinsurance

Article 41 of the Delegated Acts outlines that reinsurance contracts should be considered/valued in a consistent way to insurance obligations. Under RLP's reinsurance contracts, all premiums and claims are again fully contractual; hence, these premiums and claims will be included in full in the valuation of the recoverables under these contracts.

RLP's reinsurance contracts all have a negative value to RLP on the Solvency II balance sheet, as the present value of the cash flows of the longevity swap on a best estimate basis is dominated by the fee which RLP will pay the reinsurer over the lifetime of the longevity swap. Further, even if future longevity outcomes caused these contracts to become an asset to RLP, these contracts are all subject to collateral requirements, with appropriate haircuts. Hence, the default adjustment on the base balance sheet for reinsurance trades is zero for RLP.

V. VALUATION FOR SOLVENCY PURPOSES CONTINUED

Discount rate

RLP uses Solvency II's basic risk-free term structure to discount the cash flows underlying all of the longevity swaps it has entered into, both with pension schemes and reinsurers, in accordance with Article 77 of the Solvency II Directive. All longevity swaps and associated reinsurance which are Matching Adjustment ("MA") ineligible are valued using the risk free curve.

As at the 31 December 2015 all of RLP's funded annuity liabilities and associated reinsurance are discounted using the basic risk-free rate plus a matching adjustment, as outlined in Article 77b of the Solvency II Directive and approved in November 2015 by the PRA.

As at the 31 December 2015 RLP does not utilise a volatility adjustment.

Expense assumptions

RLP's best estimate expense assumption framework includes allowance for all expense associated with managing its existing insurance obligations, namely:

- The cost of maintenance associated with existing insurance obligations (In house)
- The cost of administration associated with existing insurance obligations (outsourced)
- The cost of investment management expenses associated with existing insurance obligations.

The methodology required by the Solvency II Directive for derivation of an expense assumption is consistent with the expense analysis performed by RLP for its 31 December 2015 IFRS expense reserving. As such assumptions used for the financial statements are entirely consistent with those with those used for Solvency II with the exception that prudent margins are applied to reflect the fact that future experience for the schemes may differ from that assumed. On a Solvency II basis no margins are held in the best estimate liability.

The risk of expenses being above this level is capitalised in the SCR and the cost of capital associated with this non-hedgeable risk is further included in our risk margin calculation, as described in the subsequent section.

Consistent with IFRS expense provisioning, future acquisition expenses are not included as they are not related to the on-going administration of existing obligations.

Investment management expenses are allowed for within the matching adjustment calculation through a reduction to the yield on assets. This additional liability is principally to provide for the custodial fees for assets backing matching adjustment eligible liabilities, as well as outsourcing of Back and Middle office functions with Northern Trust, based on best estimate assumptions.

V. VALUATION FOR SOLVENCY PURPOSES
CONTINUED

Risk Margin

Article 37 of the Delegated Acts outlines the formula which should be used to calculate the risk margin. As detailed in the articles, only risk which cannot be readily hedged should be included in the calculation. For RLP, this calculation therefore includes the following risk modules:

- Life-Longevity;
- Life-Expense;
- Counterparty Default Risk (only the part associated with existing reinsurance);
- Operational risk, only incorporating the technical provisions component of operational risk requirements and not the new business premium contribution.

We have assumed no allowance for the loss-absorbing capacity of deferred taxes, in line with section (k) of Article 38.

EIOPA's guidelines on the valuation of technical provisions outline a hierarchy of simplifications for the calculation of the risk margin in Guideline 61. RLP makes use of method 2) detailed in this guideline, namely;

"To approximate the whole Solvency Capital Requirement for each future year as referred in Article 58 (a) of Commission Delegated Regulation 2015/35, inter alia by using the ratio of the best estimate at that future year to the best estimate at the valuation date".

RLP presently considers the method 1) calculation, which involves a full recalculation of the SCR into the future, inappropriate due to the disproportionate complexity and runtime of such a calculation compared to additional accuracy which may be obtained.

Transitional capital relief

As per Article 308d of the Solvency II Directive, approval has been granted by the PRA for use of Transitional Measures on Technical Provisions on the base Solvency II balance sheet.

Results

Total technical provisions net of transitional deductions were £13,304m as at 31 December 2015.

C. OTHER ASSETS AND LIABILITIES

Property, Plant and Equipment

The IFRS valuation of the Groups Property, Plant and Equipment is stated at cost less accumulated depreciation and accumulated impairment losses. The Directive states that Property, Plant and Equipment should be valued on a basis that reflects their fair value.

As part of the development of fully independent infrastructure and computer systems the Group moved into new premises during 2015. Property, Plant and Equipment held at

V. VALUATION FOR SOLVENCY PURPOSES
CONTINUED

31 December 2015 reflect the build out of the office following the move. As the fit out was only completed during 2015 the depreciated cost is deemed to be a materially fair approximation for fair market value.

Contingent liabilities

The IFRS valuation (prescribed by IAS 37) defines a contingent liability as;

a. A possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity; or
b. A present obligation that arises from past events but is not recognised because: (i) it is not probable that an outflow of resources embodying economic benefits will be required to settled the obligation; or (ii) the amount of the obligation cannot be measured with sufficient reliability.

A contingent liability will be disclosed under IFRS but not recognised. The Solvency II Directive states that Contingent Liabilities should be recognised if considered "material".

As at 31 December 2015 the Group has considered if it holds any Contingent Liabilities. The key options available to policyholder which would change the projected liability cash flows are PCLS take-ups and transfers. Experience has shown that neither has historically led to either a strain to RL or significant divergence from our assumed best estimate levels.

Further, in the vast majority of cases, RLP has discretion over the bases it uses to provide member options. Hence, we would not expect such options to represent any additional liability to the Group over that calculated on best estimate assumptions.

The Group will therefore not hold any Contingent Liabilities on its Solvency II balance sheet.

Goodwill/intangible assets

RL has no goodwill assets or any intangible assets on its Solvency II balance sheet.

Deferred Taxation

As previously noted the value of the assets held in accordance with the Solvency II Directive is identical to the value presently used for the purposes of our tax calculation.

However, the Solvency II technical provisions valued in accordance with the Solvency II Directive are calculated to be at a lower level than our present IFRS liabilities, which are used to calculate our tax position.

V. VALUATION FOR SOLVENCY PURPOSES CONTINUED

As a result, RLP has calculated an additional deferred tax liability, as the difference between IFRS liabilities and Solvency II technical provisions (after transitional measures) multiplied by the applicable tax rate and hold this additional liability on its base Solvency II balance sheet.

This liability will be broadly neutral from an aggregate surplus over SCR perspective, as, providing the deferred tax liability does not reach extremely high levels, the increase in the deferred tax liability will be released through the additional loss-absorbency capacity of deferred taxes in the SCR calculation, in accordance with Article 108 of the Solvency II Directive.

Aside from this adjustment, no further adjustment is made to the tax position from that presented in RLP's IFRS accounts.

Borrowings

Borrowings outstanding at 31 December 2015 include £100m of floating rate perpetual callable securities issued to an affiliate and £249m unsecured, subordinated loan notes.

The £100m of floating rate perpetual callable loan notes are callable at par on 21 December 2017 and every six months thereafter. They carry deferrable interest at six month sterling LIBOR plus 425bps per annum. The notes are unsecured and classified as qualifying dated Tier 2 securities for the purpose of the Group's regulatory capital requirements under both Solvency I and Solvency II. The notes are issued to an affiliate. The notes have a carrying value of £100m and a fair value of £100m. The repayment of the securities is subject to PRA consent.

On 22 October 2015, the Group issued £250m subordinated loan notes maturing in 2025 with a fixed 8% coupon paid annually in arrears. The notes are unsecured and classified as qualifying dated Tier 2 securities for the purpose of the Group's regulatory capital requirements under both Solvency I and Solvency II. The notes were issued and initially recognised at fair value of £248.7m being issue proceeds of £250m less capitalised issue costs of £1.3m. At 31 December 2015 the notes have a carrying value of £248.8m which is calculated on an amortised cost basis. The notes are issued through the public debt markets.

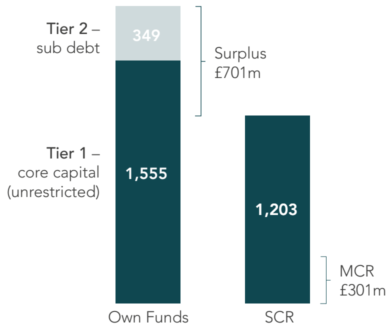
The Group has held these balances at amortised cost under IFRS and Solvency I reporting. Under Solvency II as per guideline 5 of the EIOPA guidelines on the valuation of assets and liabilities other than technical provisions the value of the liability will be updated to take account changes in the relevant risk free interest rate curve. For the 31 December 2015 this methodology would have led to a valuation of £247m. As this value is not materially different than the valuation used for Solvency I reporting a consistent valuation will be used between Solvency II and Solvency I. Use of the market value of the debt would not be appropriate for Solvency II valuation purposes, as this would incorporate market views and sentiment with regards to the Group's credit risk, which the EIOPA guidelines explicitly exclude from the valuation methodology for these borrowings.

VI. CAPITAL MANAGEMENT

A. OWN FUNDS

1. RLP

The Pillar 1 capital surplus (Own Funds) for RLP under Solvency II on 1 January 2016 is £1,904m giving a coverage ratio of 158%. The solvency position and breakdown of Own Funds is shown in the diagram below:



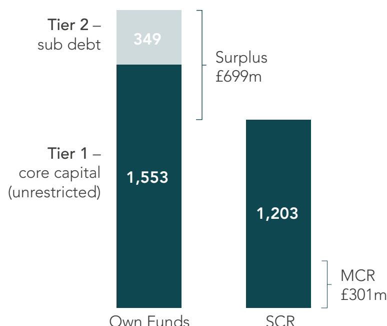
RLP's capital structure as at the 2015 year end consisted of the following capital instruments:

Capital Instrument	Details
Common Equity £1,555 Million	– Held by RHUK – Composed of share capital, share premium and other reserves
Hybrid Note £100 Million	– Issued to MassMutual in December 2012 from RLP – Qualifies as Tier 2 Capital under Solvency II – Callable on 21 December 2017 or any coupon payment date thereafter – Coupon = 6m£L + 425bps – Optional and mandatory deferral of coupons
Hybrid Note £249 Million	– Issued through public debt markets in October 2015 from RLP – Lower Tier 2 instrument – Qualifies as Tier 2 Capital under Solvency II – Coupon = 8% paid annually

VI. CAPITAL MANAGEMENT CONTINUED

2. The Group

The Pillar 1 capital surplus (Own Funds) for the Group under Solvency II on 1 January 2016 is £1,902m giving a coverage ratio of 158%. The solvency position and breakdown of Own Funds is shown in the diagram below:



The Group's capital structure as at the 2015 year end was the same as that of RLP (amended for intragroup transactions) except that the equity was privately held by shareholders rather than by RHUK.

Capital Instrument	Details
Common Equity £1,553 Million	– Privately held by shareholders – Composed of share capital, share premium and other reserves
Hybrid Note £100 Million	– Issued to MassMutual in December 2012 from RLP – Qualifies as Tier 2 Capital under Solvency II – Callable on 21 December 2017 or any coupon payment date thereafter – Coupon = 6m£L + 425bps – Optional and mandatory deferral of coupons
Hybrid Note £249 Million	– Issued through public debt markets in October 2015 from RLP – Lower Tier 2 instrument – Qualifies as Tier 2 Capital under Solvency II – Coupon = 8% paid annually

VI. CAPITAL MANAGEMENT CONTINUED

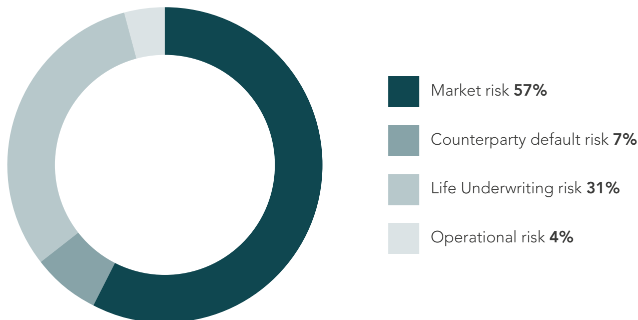
The consolidated SCR is calculated as set out in Article 336 of the Delegated Acts, i.e., as the sum of:

- The SCR on consolidated data for all wholly owned insurance subsidiaries of RHUK and all wholly owned service subsidiaries of RHUK (excluding ring-fenced funds that apply the matching adjustment);
- The notional SCR on each matching adjustment fund within the group; and
- Capital requirements with respect to other relevant undertakings (RPML) as defined in Article 336 of the SII Delegated Acts.

B. CAPITAL POSITION

The MCR and SCR in the diagrams above were calculated using the standard formula. The standard formula appropriateness has been assessed by Rothesay and a voluntary capital add-on has been agreed in discussions with the PRA.

The diagram below provides a breakdown of the SCR (pre diversification benefit between modules). Life underwriting relates mainly to longevity risk. Market risk is primarily by spread risk.



There have been no simplifications or undertaking specific parameters used in the calculation of the SCR results. No equity risk is held by RLP.

The biting MCR has been calculated as 25% of the SCR.

There have been no periods of non-compliance with the MCR or SCR.

Rothesay Life
Level 25
The Leadenhall Building
122 Leadenhall Street
London EC3V 4AB

www.rothesaylife.com

T: 020 7770 5300