Rothesaylife

Annual Report and Accounts 2014

Risk Management | Investment | Innovation | Excellence

Rothesaylife

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ROTHESAY LIFE WAS ESTABLISHED IN 2007 AND HAS BECOME ONE OF THE LEADING PROVIDERS OF REGULATED INSURANCE SOLUTIONS IN THE UK MARKET FOR PENSIONS DE-RISKING, WITH OVER £15 BILLION OF INSURANCE CONTRACTS EXECUTED.

Rothesay Life has been established on the core pillars of high-tech and sophisticated **Risk Management**, conservative **Investment** philosophy, continuous **Innovation** to meet clients' needs and **Excellence** in delivery.

Existing Rothesay Life clients include the pension schemes and members associated with such blue chip companies as British Airways, General Motors, GKN, InterContinental Hotels, Philips, Rank and RSA.

Visit our report online www.rothesaylife.com

"We have continued to focus on excellence in delivery to our clients, controlled underwriting, meticulous management of risk and maintained caution in investment markets."

2014 HIGHLIGHTS

Rothesay Life has delivered a strong performance in 2014 which included these key highlights:

- Generated IFRS profits of £244m and increased assets under management to £12.8bn
- Completed successful acquisition of MetLife Inc.'s £2.7bn UK bulk annuity business, MetLife Assurance Ltd.
- Originated total new business volume of £4.1bn including repeat transactions with a number of existing clients
- Maintained low-risk investment and longevity hedging strategy which, combined with disciplined underwriting, increased economic capital surplus by £321m to £802m
- Executed £2.8bn of longevity reinsurance hedges
- Issued over 36,000 individual annuity policies and >97% of customer survey respondents rated our service 'excellent' or 'good'

2014 FINANCIALS AT A GLANCE

ASSETS UNDER MANAGEMENT

£12.8bn

NUMBER OF LIVES INSURED

196,756

MARKET CONSISTENT EMBEDDED VALUE

£1,215m

IFRS PROFITS BEFORE TAX

£244m

2014 NEW BUSINESS VOLUME

£4.1bn

ECONOMIC CAPITAL

£1.6bn

CHAIRMAN'S STATEMENT

KEITH SATCHELL
CHAIRMAN

A CULTURE OF RISK MANAGEMENT LEADS TO DISCIPLINED GROWTH OF SHAREHOLDER VALUE AND THE LONG-TERM SECURITY OF OUR POLICYHOLDERS

I am delighted to introduce Rothesay Life's 2014 Annual Report. The Group[1] has delivered a very strong performance. We have continued to focus on excellence in delivery to our clients, prudent underwriting, meticulous management of risk and maintained caution in investment markets. This approach furthers our established track record of generating robust returns whilst limiting downside for our shareholders and providing security for our policyholders.

The Group has a clear and well defined strategy to grow by taking full advantage of the substantial opportunity in our sector but to do so in a manner that does not compromise prospective returns or take on unnecessary or unacceptable levels of risk. We acquire new business where we can best meet our return objectives, whether this is through organic growth or strategic acquisitions, and we protect accumulated value through minimising unrewarded financial risks.

Effective execution of our strategy requires a universal risk culture founded on discipline and responsibility. Dedication to this culture across the firm and its impact on the quality of the balance sheet and new business origination are testament to the excellent management team, led by our Chief Executive Officer, Addy Loudiadis.

Financial Performance

We believe close adherence to our strategy leads to sustainable growth and attractive financial returns. I am delighted to report that in 2014, the Group generated pre-tax IFRS profits for the year of £244m, up 33% on 2013. We have again proven our ability to execute successfully and integrate corporate acquisitions with the purchase of MetLife Inc's £2.7bn UK bulk annuity business which contributed to total new business volume of £4.1bn. This takes our assets under management to £12.8bn and total underlying policyholders to nearly 200,000. Market Consistent Embedded Value at year end was £1.2bn.

1 Rothesay Life, RL, the Company and the Group are used interchangeably throughout this report.

This strong set of results was generated against a challenging backdrop of historically low interest rates, tight fixed income spreads and increased levels of competition post the Budget. The team has achieved this through exhibiting creativity in writing new business and by remaining patient with investing new premiums to ensure we deploy funds into the best opportunities and do not simply chase tighter spreads and lower yields.

People

Rothesay Life prides itself on its premium brand. It is based on our reputation for delivery and demonstration of market-leading expertise and excellence in everything we do. We have achieved this by building one of the best teams in the industry through drawing from the most relevant talent across insurance, pensions, banking, asset management and technology. As we continue to grow we hire selectively but take care not to dilute the culture we have established.

We are committed to playing a strong role in the wider community. Not only do we make an important contribution in the broader economy through our investment and insurance activities, we are also proud to have established a relationship with Age UK, the UK's largest charity for older people.

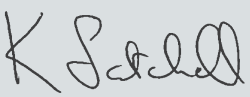
Board and Governance

During the year we took significant steps to strengthen the Board. Rothesay Life is a risk management business which needs a board with the relevant balance and level of expertise to provide both a channel for discussion and appropriate challenge to management. A strong board is key to maintaining the culture of the Group and with our shareholder representatives and Independent Non-Executives I believe we have assembled an outstanding team. To that end, I am delighted to welcome Richard Berliand, Glenn Earle, Naguib Kheraj, Ray King and our CFO Andrew Stoker to Rothesay Life as Directors and look forward to working with them to further the success of the business.

Confident Future

As we have grown the business, our approach to risk management has enabled us to recycle capital which has ensured we maintain a very strong balance sheet and substantial capital surplus. Rothesay Life ended 2014 with £1.6bn of economic capital[1]. This position offers the Group the financial resources to pursue both organic and strategic opportunities to grow, provides considerable support for policyholder promises and protects against impending regulatory change with the introduction of Solvency II.

While the UK economy has shown signs of improvement over 2014 and bulk annuity volumes reached another record, low interest rates continue to make the environment challenging for pension schemes. Against this backdrop, we will remain disciplined in assessing where we can best generate value for our shareholders and I remain confident that with our financial strength, creativity and ambition we are well positioned for continued success.



Keith Satchell
Chairman
25 March 2015

ASSETS UNDER MANAGEMENT

£12.8bn

NUMBER OF LIVES INSURED

196,756

1 Economic capital represents management's internal calculation of the capital resources available above best estimate liabilities to cover risk-based capital.

CHIEF EXECUTIVE OFFICER'S REPORT

ADDY LOUDIADIS
CHIEF EXECUTIVE OFFICER

EXCELLENT PERFORMANCE ACHIEVED THROUGH CREATIVITY AND DISCIPLINE IN ORIGINATION, UNDERPINNED BY OUR RELENTLESS FOCUS ON RISK CONTROL

I am pleased to report that 2014 has been a strong year for Rothesay Life. This has been achieved whilst being selective in pursuing only those growth opportunities which meet our strict return hurdles and avoiding unacceptable risks.

The Group operates in a structurally high growth market and, despite record low interest rates, the bulk annuity and pension buyout business has been strong. Our strategy is to be patient, disciplined and creative in underwriting which is critical in a market where levels of competition can vary. We do not chase volume and instead focus on value and risk.

Alongside core organic growth we have continued to pursue strategic acquisition opportunities which meet or exceed our return hurdles and where our approach to de-risking can generate excess value. In May we completed the successful purchase, integration and de-risking of MetLife Inc's £2.7bn specialist bulk annuity business in the UK, MetLife Assurance Limited ('MAL').

The origination approach we have adopted has resulted in healthy margins from new business which have contributed to a significant growth in embedded value during 2014 to £1,215m. Combining careful underwriting with our sophisticated and high-tech approach to risk management has also allowed us to recycle capital to fund further growth and protect the balance sheet of our in-force business. The Group finished the year with £802m of economic capital surplus, a £321m increase during the year despite having acquired £4.1bn of additional business.

Our History

JULY 2007
Rothesay Life Ltd. was founded as a subsidiary of Goldman Sachs. The company was authorised by the Financial Services Authority (now the PRA)

2008 – 2011
Total of £4.3bn pension scheme de-risking transactions completed including ground-breaking deals with the defined benefit pension schemes of British Airways and RSA Insurance Group plc

JANUARY 2011
Acquisition of specialist bulk annuity provider, Paternoster, with over £3.0bn in-force portfolio

2011 – 2013
£5.0bn of further pension scheme de-risking transactions completed, £323m of capital returned to shareholders, £100m sub-debt raised and sale of 64% of RL to Blackstone, GIC and MassMutual

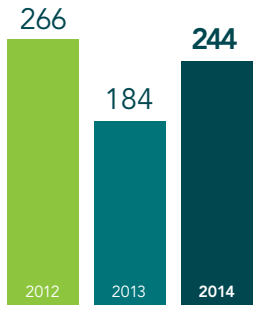
2014
Acquisition and integration of MetLife's UK bulk annuity business with £2.7bn in-force portfolio. The Group finished 2014 with £12.8bn assets under management plus a further £1.4bn pension scheme de-risking transactions

FINANCIAL AND OPERATIONAL EXCELLENCE

Group Performance

Group IFRS profits before tax for the year were £244.1m (2013: £183.5m), an increase of 33%. Profitability was primarily driven by high quality new bulk annuity business and the acquisition of MAL. Total operating profit before tax for the year (excluding market variances) was £277.1m. The small contribution attributable to economic variances (£0.6m) demonstrates the effectiveness of the Group's thorough approach to risk management and our distinguishing low-risk investment strategy.

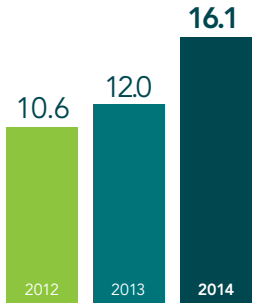
IFRS Profits before Tax (£m)[1]



Proven Capability in Organic and Strategic Growth

During the year, we acquired £4.1bn of new business including over £1.4bn of new bulk annuity transactions. Changes in the requirements for individuals to purchase annuities at retirement announced in the March Budget have altered the landscape for pension investment and resulted in some increase in competition, yet total market de-risking volumes were up significantly to a record £22.5bn and the barriers to entry remain high. I am delighted that the Group continued to demonstrate robust bulk annuity volumes and margins even against a backdrop of negative real interest rates and remain optimistic for strong future growth.

Cumulative Volume of New Business (£bn)



In May, the Group completed the acquisition of MAL in an all cash deal. Successful execution of this transaction required a number of areas of innovation to offer the vendor certainty and remove balance sheet volatility for Rothesay Life. We de-risked substantially all the investment risk and longevity risk in the business immediately on completion and finalised the integration within 2 months. The ability to handle a complex process in an expedited timeframe without introducing unacceptable risk is testament to the broad competences of the Group. More detailed highlights of the transaction are summarised in the case study on page 11.

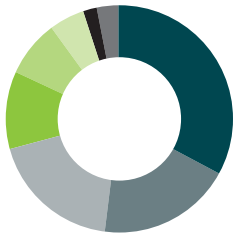
The Group now has 196,756 underlying insured policies (2013: 121,876) and makes annual pension payments of £700.6m (2013: £576.2m) to policyholders, making us one of the largest providers of annuity benefits in the UK.

Core Disciplines of Investment and Risk Management

During 2014, assets under management increased by £5.3bn to over £12.8bn (2013: £7.5bn). All assets are managed internally by a specialist team which implement a strategy distinct to the Group, aiming to mitigate credit risk and maximise the security and collateral we hold to back investments. This approach reduces our exposure to the performance of investment markets and, therefore, protects both shareholder returns and policyholder security.

During the year, Rothesay Life invested over £2bn in UK infrastructure including bridges, rail, airports and municipal transportation, many with explicit or implicit government support, and over £1bn in secured real estate. All of these investments offer Rothesay Life a low-risk asset base to back our annuity liabilities but also help bolster growth in the wider economy. Our strong capital position has afforded the Group the ability to be patient in investing premiums during the year to avoid chasing asset spreads tighter and ensure we maintain the high quality of the portfolio.

Assets Under Management (%)



UK Sovereign	33%
Secured Residential Lending	19%
Other Secured Lending	19%
Supranationals/Other Sovereign	11%
Infrastructure PFI	8%
UCITS Fund/Cash	5%
Negative Basis	2%
Other	3%

1 The 2012 profit before tax is as calculated under UK GAAP, but is expected to have been a similar figure if calculated under IFRS.

CHIEF EXECUTIVE OFFICER'S REPORT CONTINUED

Focus on Risk Management

We manage the combined risks in the business dynamically using proprietary integrated asset, liability and capital infrastructure which offers us live economic and regulatory balance sheet positions. This high-tech approach allows us to react quickly to changing market conditions and to be agile where investment or origination opportunities arise.

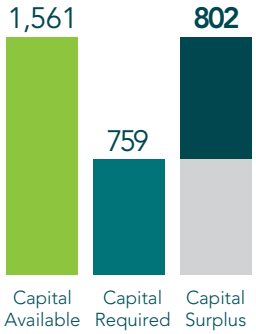
We reinsure more than 70% of the life expectancy risk associated with the business and in 2014 we completed 7 reinsurance transactions covering £2.8bn of pension benefits[1]. The arrangements we enter into cover only the longevity risk associated with the policies we write and the Group retains control of all investments.

Capital Management

The Group manages risk to its economic capital position. The economic capital requirement calculates our 1 year value-at-risk to a 99.8% confidence interval and offers a good measure of the effectiveness of the low-risk strategy. At 31 December 2014 the Group had economic capital of £1.6bn which was over double (206%) that necessary to cover the economic capital requirement, and an increase of 24% (2013: 182%). Given our low-risk balance sheet position, the statutory Insurance Groups Directive ('IGD') calculation remains the biting capital requirement where the Group had £366m of surplus and covered its Capital Resources Requirement ('CRR') by 177%.

During 2014 we have spent a significant amount of time and resources to prepare for Solvency II which is expected to be implemented from 1 January 2016.

Economic capital position
(£m, 2014YE)



We anticipate greater clarity around a number of areas to be provided by the relevant regulatory bodies during 2015, although the work we have done to-date combined with the Group's particularly strong economic capital position offers us confidence that our approach to risk management remains appropriate under the new regime.

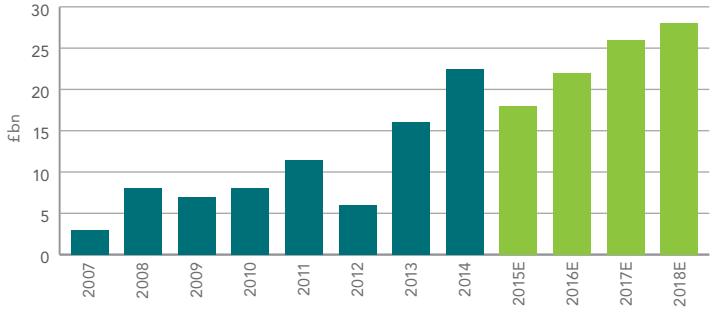
In the next section (pages 07-17), we have outlined our views on the market outlook and provided an overview of our unique business model.

I believe 2014 has further endorsed our ability to deliver attractive shareholder returns across the opportunity set in pensions and annuities. The Group is well positioned, both financially and operationally, to build on this achievement by pursuing further disciplined growth, whilst always ensuring continued policyholder security. I would like to thank our shareholders and my colleagues for their support and hard work as we look forward to another exciting year.

Addy Loudiadis
Chief Executive Officer
25 March 2015

1 £2.8bn represents the present value of the insurance cashflows that have been reinsured discounted using GBP LIBOR interest rates.

UK Pensions Risk Transfer Volumes



Source: Towers Watson; Lane, Clark & Peacock, Oliver Wyman.

Market Perspectives and Trading Outlook

We acquire bulk annuity liabilities both through our core buy-in and buy-out activity with pension schemes and also through reinsuring and/or acquiring existing annuities from other insurers.

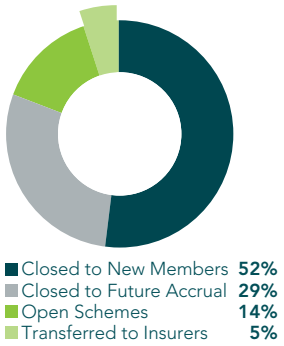
Core Market

The Pension Risk Transfer market continues to grow, driven by a number of key underlying structural features. 2014 was another record year for volumes despite dramatically falling interest rates challenging affordability for companies and scheme trustees.

Growth in bulk annuities and buy-outs is underpinned by fundamental change:

- More than 80% of defined benefit pension schemes are now closed and are no longer offered to new employees as a benefit
- Legislative change has meant that scheme trustees have greater powers to influence corporate activities and restrict flexibility
- Over £25bn per annum of deficit recovery contributions are made by scheme sponsors in order to meet funding targets which are being set closer to the cost of buying a bulk annuity or achieving a full buyout
- Equity market investors are increasingly discounting company stock valuations to embed the value of the pension scheme at a fair market value or at the cost of executing a full buy-out
- Trustee education and acknowledgement of longevity and market risks associated with their schemes have evolved as the advisor and broker industry for bulk annuity and full buy-out transactions has matured.

£1.8tn Defined Benefit Liabilities



These structural drivers have resulted in the majority of companies and trustees now recognising buy-out as a medium-term objective. Since 2007, volumes have grown at a CAGR of greater than 30% and by the end of 2014, 20% of FTSE 100 companies had completed a partial or full de-risking transaction. Despite this activity, only 5% of the total £1.8tn defined benefit pension liabilities in the UK has been transferred to the insurance sector to date[1].

Scheme Affordability

Given the substantial latent structural demand, the biggest driver of volumes becomes affordability for pension schemes. The primary determinant of affordability is the level of real interest rates. Despite real interest rates having been negative for most of 2014 and close to all-time lows, volumes still reached a record £22.5bn for the year (including longevity swaps) and industry experts predict the bulk annuity sector alone will reach in excess of £15bn pa within the next 2 to 3 years. A small increase in real interest rates is expected to add materially to these projections so we are optimistic about the future of the market and reassured by its robustness through the cycle.

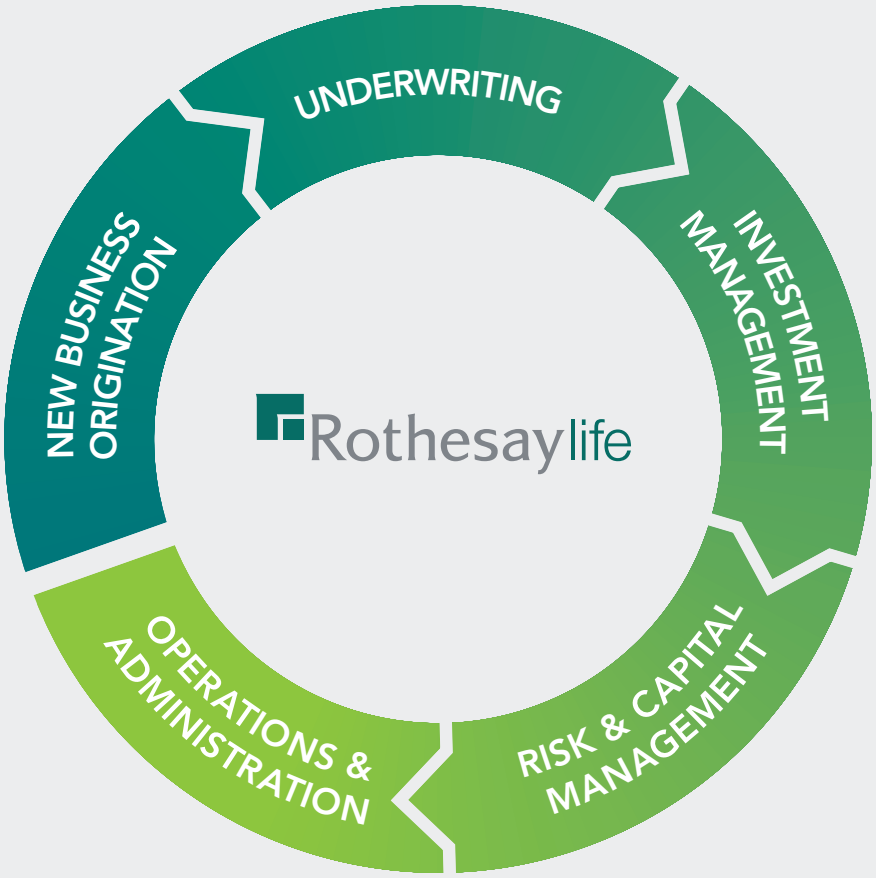
STRUCTURAL DRIVERS

Insured Annuities

The Group is also active in the market for blocks of annuities acquired through reinsurance or Part VII transfer and purchase of companies from other insurance groups. With the impending regulatory change (Solvency II), a number of annuity businesses have become non-core or capital constrained and may provide us with alternative growth opportunities similar to our acquisition of Paternoster in 2011 or MAL in 2014. Total value of in-force annuities in the UK is over £300bn.

1 Source: The Pension Regulator Purple Book 2014.

OUR BUSINESS MODEL



New Business Origination
Dedicated and experienced marketing and origination team sources new wholesale annuity business from across a broad opportunity set, ensure disciplined selection, promote the Group and maintain long-term relationships.

Underwriting
Cautious and controlled risk underwriting is combined with detailed legal and operational due diligence carried out by specialist Rothesay Life teams to achieve maximum pre-deal certainty.

Investment Management
Rothesay Life's investment team identify long-term investments which lock-in returns to back annuities while minimising the exposure of the business to credit and market risks.

Risk and Capital Management
Sophisticated systems ensure daily capital and risk reporting which allow the Rothesay Life trading team to manage all aspects of the balance sheet dynamically, react appropriately to evolving market conditions and maintain capital efficiency.

Operations and Administration
A high degree of automation and technology allows our out-sourced administration platforms to interact with our risk systems to minimise discrepancies and ensure the highest levels of customer service.

Our Strategy

1 Protect In-Force Balance Sheet

I. Conservative, economic-capital based approach to underwriting and risk management using integrated asset, liability, capital and risk infrastructure
II. Avoid unrewarded and unnecessary risks to protect the balance sheet and so ensuring surplus capital can be deployed to grow the business
III. A focus on risk results in robust solvency which safeguards policyholder security

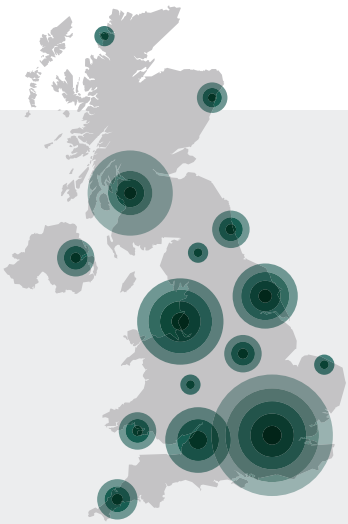
2 Grow Through Writing Value-Driven New Business

I. Origination driven by quality of business not volume of business
II. Focus on allocation of capital to new business opportunities that offer the most attractive risk-reward and maintain underwriting discipline
III. Pursue the full opportunity set of new business including core organic growth, secondary assets and strategic acquisitions

3 Safeguard Our Brand And Culture

I. Build our business on a foundation of stable long-term relationships and avoid short-term opportunism
II. Foster a solution driven culture which makes the company the trusted counterparty to major UK and global institutions
III. Maintain excellence in delivery to our customers, clients, counterparties and partners to protect our brand and ensure persisting success
IV. Recruit and retain the best and most relevant talent from across the financial services industry

NEW BUSINESS ORIGINATION



Locations of Rothesay Policy holders

We focus on selecting transactions that offer the most attractive returns taking into account the associated risks and capital required.

Markets, Customers and Size of Transactions

Rothesay Life's core business is in the UK wholesale bulk annuity market. We primarily offer 'buy-in' and 'buy-out' arrangements to defined benefit pension schemes in the £1.8tn UK market. These arrangements involve Rothesay Life providing bulk annuity insurance contracts which pay annuity benefits due to members of a pension scheme in exchange for upfront premiums. Total market volumes in this core business totalled £13bn in 2014 and has grown at a 30% CAGR since 2007. In addition to bulk annuities with pension schemes, we also source wholesale annuity business through reinsurance or acquisition from insurance companies who wish to de-risk their balance sheets. Much of the market is intermediated through Employee Benefit Consultants (EBCs) and other advisers who help facilitate transactions and advise trustees and corporate sponsors who wish to reduce or eliminate the risk associated with their pension obligations.

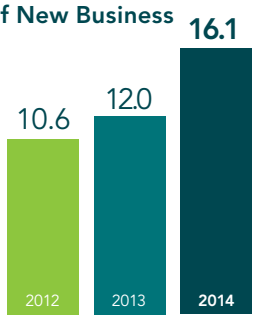
The Rothesay Life new business origination team comprises very experienced insurance and pensions professionals who are experts in their relevant fields. The team focuses on a solution driven approach which means the Group has been at the forefront of innovation and a market leader in execution of large transactions. While the Group has completed deals ranging in size from £60m to £3.1bn, 10 were over £400m including 2 successful acquisitions with greater than £2.5bn of assets each. The Group now directly or indirectly insures over 195,000 underlying policyholders.

Key Product Type	
The Group's wholesale annuity proposition encompasses 3 main structures:	
Pension buy-ins	Pension scheme acquires a bulk annuity policy from Rothesay Life which insures pension benefit payments due to a specified portion of members. The scheme holds the policy as an investment. This type of transaction is often a first step towards a pension buy-out.
Pension buy-outs	Pension scheme acquires a bulk annuity policy from Rothesay Life which insures all pension benefit payments due to all existing members and then subsequently dissolves the scheme entirely. The bulk annuity converts into individual policies for each underlying member and the pension scheme no longer exists.
Reinsurance	Insurance company enters into a reinsurance contract with Rothesay Life which insures a specified block of annuity obligations they have previously acquired. Reinsurance is often followed by a full legal transfer of the underlying annuities to Rothesay Life under a court-approved Part VII Transfer.

Selected Transactions

MetLife £2.7bn Acquisition May 2014	Vestey Foods Group £506m (cumulative) 2012-2014	PHILIPS £484m Buy-in August 2013	GKN £123m Buy-in January 2014
IHG InterContinental Hotels Group £440m Buy-out August 2013	BRITISH AIRWAYS £2.9bn (cumulative) Buy-in 2010-2013	GM £230m Buy-in October 2012	RSA £1.9bn Buy-in July 2009

Rothesay Life's Cumulative Volume of New Business (£bn)



OUR BUSINESS MODEL CONTINUED

UNDERWRITING

We adopt a meticulous approach to underwriting which involves evaluating and quantifying the key risks associated with acquiring pension annuity liabilities ahead of completion.

Our underwriting team comprises actuarial, pensions, operational, trading, investment and legal expertise, all of whom have extensive experience in their respective areas. We operate an integrated asset-liability risk model and benefit from sophisticated computer systems which allow all pension liability acquisitions to be assessed real time using prevailing market conditions and investment opportunities. This approach allows us to be opportunistic where we see value and reactive to client needs, but also protects the balance sheet by ensuring consistent quality of origination.

In addition to underwriting of financial risks, our specialist operations, administration and legal team conducts extensive due diligence consistent with the highest standards in the industry in advance of execution to both quantify and mitigate operational and data-related risks.

Core underwriting stages

Modelling Benefits: Each underlying policyholder is due a prescribed set of payments through time. We model and project these payments individually. Ensuring payments due are correct requires extensive legal and administration due diligence which we carry out upfront

Longevity Analysis: We carry out detailed demographic analysis using proprietary experience and projection models in conjunction with a substantial experience database. In many instances, we will also underwrite alongside our specialist life reinsurance partners to ensure consistency of analysis and to mitigate our risk

Investment Management: With accurate cashflow projections, we identify suitable available investment opportunities to deploy the premiums received which are consistent with our particular low-risk asset strategy. This appropriate investment will necessarily take into account the relevant projected term of the business acquired

Risk Management: Using the identified asset strategy, we review and evaluate the cost of hedging both market and demographic risks associated with the new business, assess residual risks in the context of our appetite and quantify reserves for any remaining unhedgeable risks

Capital Management: Combining the underlying new business characteristics with the intended investment and risk management strategy determines capital utilisation and also profitability and return metrics

Deal Assessment: Taking into account the risk-return characteristics identified in the underwriting steps, deals go through a rigorous approval process involving the senior executive, relevant committees and, if required, the Board. The company adopts disciplined risk-return hurdles for approval and is not motivated by volume

Due Diligence, Contracts & Execution: Additional confirmatory due diligence is completed as required and contracts agreed and executed by our specialist legal team. The Group prides itself in agreeing tight contractual terms to eliminate any future uncertainties.

CASE STUDY

ACQUISITION OF METLIFE ASSURANCE LIMITED

Key Facts

- Rothesay Life acquired MetLife Assurance Limited ('MAL'), a subsidiary of MetLife, Inc. on 16th May 2014 following regulatory approval
- MetLife Assurance was a well-regarded specialist bulk annuity pension provider with £3.1bn in assets under management, £2.7bn of liabilities and responsible for the pensions of 19,540 members across 100+ pension schemes
- Post the acquisition, Rothesay Life became the UK's largest dedicated provider of defined benefit de-risking solutions
- The transaction was accretive from a net asset value, capital and MCEV perspective to Rothesay Life.

£3.1bn
Assets under management

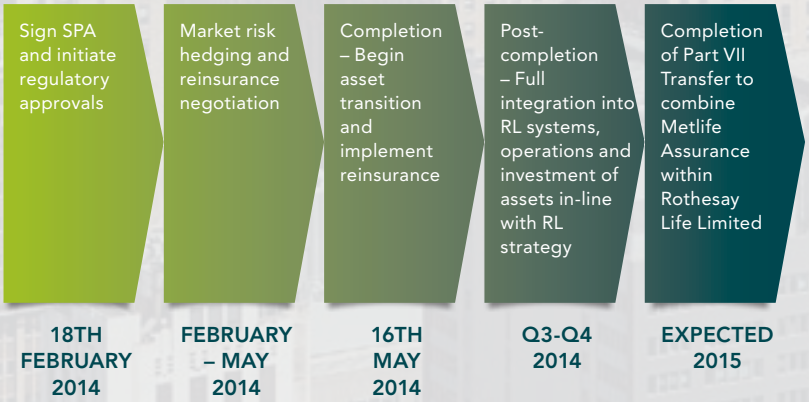
19,540
members

100+
schemes

The Transaction

- Rothesay Life implemented an acquisition structure which gave the vendor, MetLife Inc., certainty regarding commercial and economic terms during the extended period of regulatory approval
  - Prior to the acquisition, MetLife Assurance was invested in a portfolio of unsecured corporate bonds and had chosen to retain all of its life expectancy risk so the balance sheet was exposed to volatility
  - We intended to de-risk the company on completion of the acquisition but were unable to do this until all relevant approvals were obtained
  - Prior to entering into the Share Purchase Agreement, we set up the balance sheet in our proprietary risk systems so we could monitor the economic position and each relevant risk daily
  - We executed the Share Purchase Agreement in February with fixed commercial and economic terms and immediately overlaid a dynamic hedging strategy to immunise the volatility ahead of completion
- Following completion in May, we were able to de-risk the balance sheet. The hedging strategy allowed us to do this in an orderly manner and carefully transition assets to be in line with Rothesay Life's investment strategy
- MetLife Assurance has now been operationally integrated into Rothesay Life ahead of schedule and substantially de-risked including removing the majority of the longevity risk through reinsurance contracts
- We expect the Part VII transfer of the business into Rothesay Life to complete during 2015.

Timeline



OUR BUSINESS MODEL CONTINUED

INVESTMENT MANAGEMENT

Rothesay Life's £12.8bn asset portfolio is managed in-house by a specialist investment team whose primary objective is to earn secure returns by investing in low risk assets that benefit from collateral, hedging arrangements or other security and extract value from illiquidity. Investment management is integrated with underwriting, risk and capital management.

Distinct Investment Approach:

The Group invests in fixed income instruments which we use to match the long-term annuity liabilities they back. We aim to minimise credit default risk by investing in an optimal combination of liquid, low-risk government bonds, less liquid highly-secured or collateralised investments and cash:

- **Secured Investments:** 38% of the portfolio is invested in secured lending against property or other collateral. Many of these investments are bespoke where very high levels of collateral has been negotiated and returns are generated through liquidity premium
- **Infrastructure:** 8% of the portfolio is invested in regulated infrastructure such as water, energy and transportation. These investments are typically long-dated and backed by ring-fenced low-risk income streams
- **Government and Supranational Bonds:** 44% of the portfolio is invested in low risk government bonds, of which 96% is UK. This portion of the portfolio backs our very long-dated cashflows but is also available to meet collateral calls and cash requirements
- **Cash:** 5% of the portfolio is invested in immediately realisable cash investments

The Group adopts a market consistent approach to reserving for residual credit risks as they arise and adopts a dynamic strategy of monitoring and re-hedging these risks daily as they arise.

Collateral and Liquidity Management:

Given a large amount of the portfolio is highly secured but less liquid we need to both manage the collateral held against those investments and also hold substantial liquidity buffers at all times to protect the firm against potential liquidity calls. To achieve this, Rothesay Life operates a Maximum Liquidity Outflow ('MLO') framework which stress-tests and reports liquidity continually to ensure sufficient cash and liquid securities (primarily gilts) are available at all times to meet obligations. In addition, we stress test collateral backing investments to ensure security is not compromised due to market moves. These positions are overseen by dedicated treasury operations and a trading desk.

Industry Leading Expertise:

Given the nature of our approach, the Rothesay Life investment team consists of origination, structuring, legal, trading, risk, modelling, operations and capital expertise. We have built the team by hiring talent from the financial services industry to focus on core coverage areas of real estate, infrastructure, structured finance and government.

Operating the team in-house is critical to the success of the business given it ensures:

- Assets and liabilities are managed in an integrated manner
- Regulatory capital and risk are a dynamic consideration in decision making
- Investment opportunities feed into new business underwriting real-time which reduces uncertainty of anticipated returns

ROTHESAY LIFE'S KEY ASSET MANAGEMENT PRINCIPLES:

I. Integrate asset and liability management

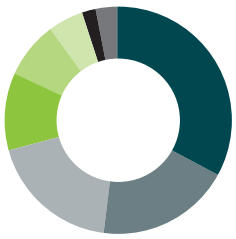
II. Minimise outright credit risk through collateral, credit protection or other structural security

III. Lock-in investment return and earn illiquidity premium

IV. Manage and mark collateral daily to minimise counterparty risks

V. Maintain sufficient liquidity buffer at all times

Assets Under Management (%)



UK Sovereign	33%
Secured Residential Lending	19%
Other Secured Lending	19%
Supranationals/Other Sovereign	11%
Infrastructure PFI	8%
UCITS Fund/Cash	5%
Negative Basis	2%
Other	3%

INVESTMENT CASE STUDIES

UK Infrastructure:
Mersey Gateway

The Mersey Gateway Project is an infrastructure initiative to construct a 2,130 metre long 6-lane toll bridge over the Mersey River in Liverpool. The bridge will bring about much needed traffic relief for the existing Silver Jubilee Bridge. The investment will create significant job growth and contribute to the economic prosperity of the area. The Mersey Gateway Project raised debt finance with the first publicly issued bond to benefit from the Infrastructure UK ('IUK') guarantee. IUK is a unit within Her Majesty's Treasury that works on the UK's long-term infrastructure priorities and secures private sector investment for infrastructure projects in the UK by guaranteeing qualifying infrastructure projects that wish to raise finance in the debt markets.

The Project raised £450m of debt for the construction and land assembly costs, with financing split between bank debt and publicly issued IUK guaranteed bonds. Rothesay Life was a lead investor in the bond issue.

Social Housing:
Affordable Housing Finance

Affordable Housing Finance (AHF) is a not-for-profit organisation that lends money to Registered Providers of social housing in the UK to support the development of new affordable housing. It is a subsidiary of The Housing Finance Corporation (THFC), a specialist organisation that makes loans to Housing Associations throughout the UK. AHF was created as a result of the Affordable Housing Guarantee Scheme, a programme introduced by the UK government's Department for Communities and Local Government (DCLG) to support the building of affordable homes in the UK. The DCLG's Affordable Housing Guarantee Scheme has allocated £3.5bn in initial support, which will be used for providing a government guarantee of AHF's debt.

During 2014, AHF launched its inaugural bond issue to lend to housing associations which will facilitate the construction of an estimated 2,200 affordable homes. Rothesay Life was a lead investor in the bond issue.

Commercial Real Estate:
Extra MSA Group

The Extra MSA Group is the property investment owner of 18 Motorway Service Areas ('MSAs') in the UK, each providing an average of around 300 jobs across a mix of retail and leisure operators, in aggregate serving more than 800,000 vehicles per week. The company owns sites which include Extra's M40 Beaconsfield and MSA's M25 Cobham, 2 of the newest and busiest Motorway Service Areas in the UK.

Towards the end of 2014, Extra MSA Group completed a £220m private bond issue to finance 9 of these MSA assets. The bond was secured on the portfolio of MSA assets. Rothesay Life was a lead investor in the bond issue.

Municipal Transportation:
Transport for London

Transport for London (TfL) is a statutory corporation and functional body of the Greater London Assembly which is responsible for managing London's public transport network. It plays an essential role in supporting London and the UK economy. There are 3 key sources of funding for TfL's operations and projects: revenue from sources such as transportation fares, grants from the Government and business rates, and borrowing from sources including the capital markets. Important ongoing TfL projects which rely on these funding sources include the construction of Crossrail, the Northern Line extension to Battersea and regular upgrades to the Tube lines and other key infrastructure.

During 2014, TfL issued an ultra-long bond to fund its key operations and projects. Rothesay Life was a lead investor in the bond issue.

OUR BUSINESS MODEL CONTINUED

RISK & CAPITAL MANAGEMENT

Rothesay Life's risk management principles are driven by the key objectives of the business: to make timely payments to policyholders over a very long-term, to produce stable IFRS earnings and dividend cashflows from in-force business, and to limit policyholders' and investors' downside risk.

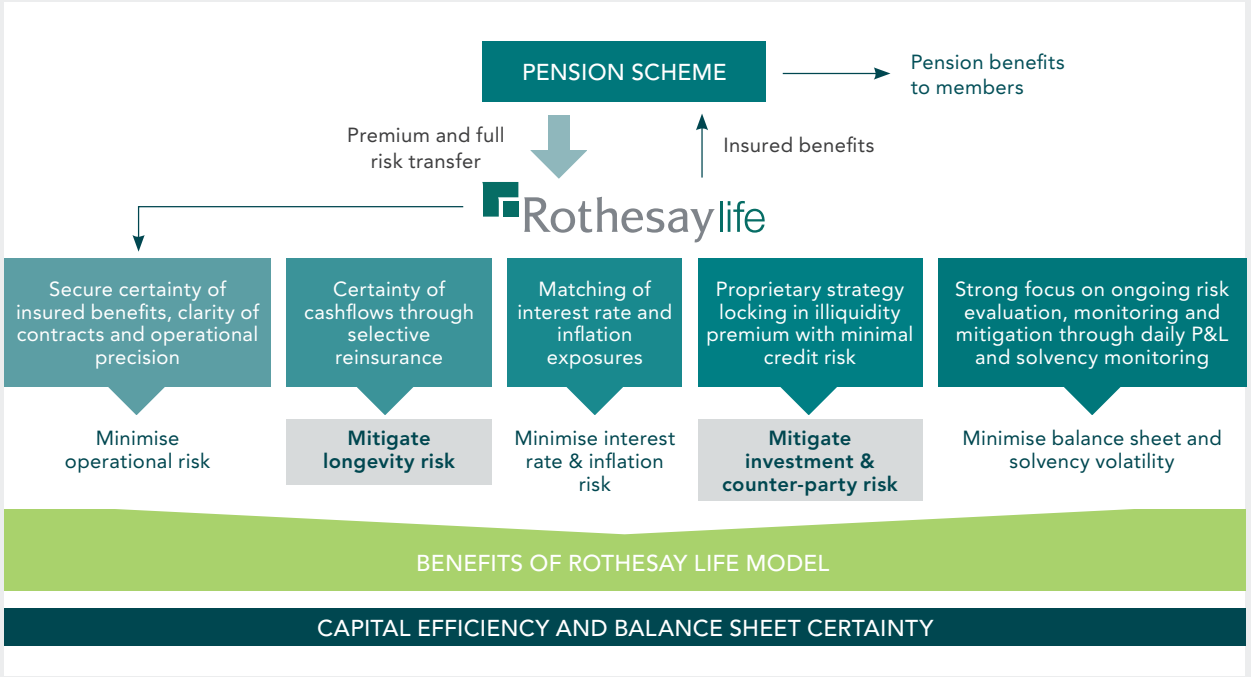
To best achieve these objectives, we adopt a low-risk approach to hedging and investment, which necessarily involves:

- **A daily mark-to-market valuation approach** for all assets and liabilities
- **A risk limit framework** which ensures the stability of the earnings and solvency position of the business. Limits exist in relation to market, counterparty, demographic and longevity risks and are sized with reference to our overall risk appetite and capital position
- **A reserving approach for un-hedged risks** which aims to ensure that reserves calibrate to the market price of hedging those risks. This enables management to dynamically risk hedge the portfolio based on early market indicators, without reducing expected investment returns.

Framework: The Group monitors and controls exposures through a robust risk and control framework which encompasses the management of both in-force business and new business underwriting:

- Integrated system infrastructure which captures all assets and liabilities centrally and provides us with the capability to report and monitor risk daily at both the portfolio and the individual transaction level
- Close co-ordination of underwriting, reinsurance, investment and risk hedging functions ensures risk management is central to all aspects of the business, and that new business pricing reflects latest market conditions, hedging costs, investment opportunities as well as comprehensive liability analysis
- An independent risk and capital management control function provides continuous monitoring of risk exposures and daily attribution of profit and loss, providing timely information to management and enabling dynamic risk based decision making.

Governance: The day-to-day risk management framework is overseen by the Working Level Risk Committee, consisting of relevant senior managers working within a delegated risk management framework. This committee reviews all material new investment, hedging or liability transactions.



The Board has overall responsibility for the management of the exposure to risks and is supported through the Audit Committee and the Board Risk Committee:

- The memberships of these committees consist of Non-Executive and Executive Directors
- These Committees ensure that the management of the business is conducted within the delegated risk framework from the main Board.

Risk Management in Practice

The Group's 2 primary risks are investment risk and longevity risk. In order to meet the objectives we set ourselves to produce stable earnings and limit downside risk to the in-force business, we adopt a conservative approach to both:

- **Investment Risk:** We undertake asset investment decisions with the primary objective of ensuring the projected returns that can be generated are secure and sustainable for the term of the policyholder reserves. When acquiring assets, we seek to minimise potential losses from default through the use of physical or structural security, or through implied or explicit sovereign support. In some instances credit hedging instruments are also used
- **Longevity Risk:** We mitigate the risk of life expectancy extending through extensive use of reinsurance. To achieve this, we work with a diversified group of global insurance counterparties and enter into highly collateralised arrangements which reduce the Group's exposure to longevity risk by ~71%.

Capital Management

We are required to hold sufficient capital in our subsidiaries to meet the higher of capital requirements calculated on the Pillar 1 statutory basis, which is based on EU Directives, and the Pillar 2 'Individual Capital Assessment'. We manage the business to our economic capital requirement which is consistent with the Individual Capital Assessment plus an additional buffer to achieve a lower probability of default. The conservative approach to risk management we adopt resulted in a particularly strong position where economic surplus at 2014 year-end was £802m. We ensure we maintain this strong position through optimising the balance between writing profitable new business, preserving capital and generating cash. Protecting the capital position backing the in-force business through active risk management ensures we both maintain a very high level of policyholder security and safeguard excess capital to support growth.

Focus on the economic capital position also means the Group is well positioned for the transition to Solvency II in January 2016. Solvency II is fundamentally an economic capital regime and we believe our substantial surplus on this basis helps distinguish us and protects against the remaining regulatory uncertainty.

CASE STUDY

LONGEVITY REINSURANCE

In the same way as we hedge interest rate and inflation risks in the capital markets, we work with our reinsurance partners to hedge a portion of our longevity risk.

Rothesay Life hedges longevity risk using longevity swaps, where we pay an agreed schedule of premiums in exchange for the reinsurer paying actual pension benefits as they arise. Longevity swaps involve no initial premium outlay and are collateralised for moves in projections of life expectancy. Using these arrangements, we retain management of all investment assets, but have hedged 71% of the life expectancy risk associated with the Group's underlying annuity contracts.

Key benefits of reinsuring longevity risk:

- Predictable obligations
- Stable earnings
- Capital efficiency
- Reserving assumptions validated by hedging market
- Better pricing controls

2014 was a record year for Rothesay Life's reinsurance activity:

- 7 longevity hedging transactions
- £2.8bn of longevity risk
- 70,000 lives
- 110 underlying pension schemes

UK Male Life Expectancy at Birth[1]

1 Sources: Stuart Basten, University of Oxford; ONS; World Bank.

OUR BUSINESS MODEL CONTINUED

OPERATIONS & ADMINISTRATION

Rothesay Life's primary obligation is to pay our policyholders. We adopt an outsourced pension administration model through key strategic partnerships and have made substantial investment in market-leading levels of automation to ensure exceptional client service and seamless processing.

Administration in wholesale and individual annuity business primarily requires timely payment of pension benefits but also efficient processing of events such as retirement. Our administration partners, Towers Watson, Jardine Lloyd Thomson (JLT) and Ensign are established pension administration providers with combined experience of 141 years. We pride ourselves on the level of service we provide to policyholders and our operations team exercise robust oversight and meticulous controls over these arrangements. The Group's service level standards are continually reviewed and are consistently above target.

We have made significant ongoing investment in our administration arrangements including developing extensive automation which protects administration standards, supports controls and ensures developments in our policyholder population are appropriately reflected back in the Group's risk systems as they occur.

Developments in 2014

Many of the Group's bulk annuity arrangements begin as a buy-in and evolve into a buy-out through time as Trustees take the necessary steps to wind-up their pension schemes. On completion of a buy-out, Rothesay Life issues individual policies to replace the original bulk annuity contract. During 2014, we:

- Issued over 36,000 individual policies and further developed our relationship with individual customers:
- Held a series of member forums nationwide where executives in our operations team present to individuals from schemes going through the transition to buy-out to give key information about their policies and about Rothesay Life
- Established a consolidator service to allow policyholders to be paid once from multiple sources
- Introduced extensive call reviews of our UK based call-centres to ensure consistently high service
- Established pro-active feedback process by issuing forms to policyholders as they go through key events (such as retirement) asking them to rate our service. In 2014 over 97% of our policyholders rated our service as 'Excellent' or 'Good'.[1]

In addition to ensuring the highest standard of ongoing service to our existing customers, Rothesay Life's operations team completed the functional and financial integration of MetLife Assurance ahead of schedule and without complication. Our administration model is scalable to accommodate significant growth ambitions without compromising the high levels of service we offer to policyholders.

EXCELLENT OR GOOD SERVICE

>97%

of survey respondents rated our service as 'Excellent' or 'Good'

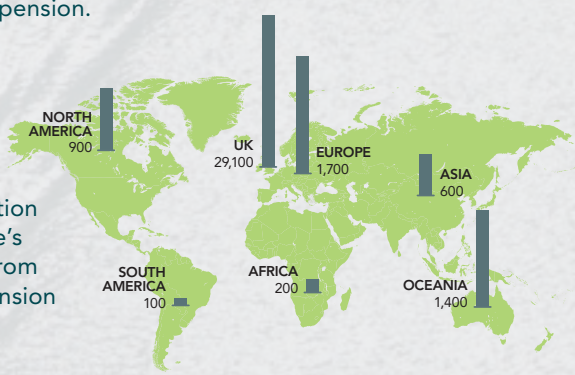
1 Based on over 9,000 policyholders surveyed during 2014.

CASE STUDY

MERCHANT NAVY OFFICERS PENSION FUND

KEY FACTS

- The Merchant Navy Officers Pension Fund ('MNOPF') is an industry-wide pension scheme established in 1937 to allow shipping companies to provide retirement and death benefits for their officers
- Rothesay Life entered into a £680m bulk annuity with the MNOPF in December 2012. The transaction covers approximately 34,000 policyholders, many of whom now reside overseas, and provides cover on an all-risks basis to indemnify the Trustee for all pension benefits due (a 'buy-in')
- The deal involved subsequently coordinating a joint project with the Trustee to wind-up a section of the Fund and streamline policy administration before issuing individual policies to all members in July 2014 and completing the 'buy-out'
- Residual assets were used to give all policyholders a 2.2% uplift to their total pension.



Global distribution of Rothesay Life's policyholders from the MNOPF pension scheme.

THE TRANSACTION

- Due to the complex and historical nature of this industry-wide pension scheme, the Trustee had limited funds to purchase the insurance policy and the target for the Rothesay team was to provide the insurance within this limited budget, leaving the Trustee with enough assets to meet their costs of winding-up and achieving a buy-out
- The Rothesay Life team completed approximately 500 hours of due diligence prior to pricing the transaction with the aim of eliminating unnecessary margins in the pricing data so that the target price could be met. Our preparedness to do this work was unique to our team and created the opportunity for a successful transaction
- Post the transaction, the team worked with the Trustee and another insurer to put in place a unique single payment model to aggregate policies held by individuals and therefore enhance their level of service. This arrangement was presented to the Fund members at a series of 10 UK wide roadshows
- By partnering with the Trustee and its advisors during the data cleanse and wind-up phase, the Rothesay team assisted the Trustee in optimising the required work, reduce costs and allowed them to generate a surplus which was used to provide all members with an additional 2.2% uplift to their pension.

34,000

individual policies issued across 82 countries within 6 months

FINANCIAL REVIEW

ANDREW STOKER
CHIEF FINANCIAL OFFICER

A CONTINUING ABILITY TO WRITE PROFITABLE NEW BUSINESS WHILST TAKING A CAUTIOUS APPROACH TO BALANCE SHEET MANAGEMENT

IFRS Financial Performance

£m	2014	2013
New business operating profit	60.8	56.7
Acquisition of MAL	210.2	N/A
Management of in-force book	50.8	150.9
Acquisition costs	(38.0)	(36.2)
Administration expenses	(13.2)	(4.4)
Experience variance	11.7	10.2
Other[1]	(5.2)	0.4
Operating profit before tax	277.1	177.6
Financing costs	(17.6)	(7.0)
Non-recurring and project expenditure	(14.8)	(0.2)
Investment and economic profits	(0.6)	13.1
Profit before tax	244.1	183.5

The Results of the Business

Our financial results demonstrate the Group's continuing ability to write profitable new business whilst taking a cautious approach to the management of our balance sheet.

The financial review describes the Group's financial performance and highlights the key drivers of the movements in the Group's consolidated statement of comprehensive income and consolidated statement of financial position.

Financial Performance

The Group achieved an operating profit before tax of £277.1m (2013: £177.6m) and a profit before tax of £244.1m (2013: £183.5m). The Group focuses on profit before tax as its primary measure of profitability because this metric includes recurring and non-recurring items as well as market fluctuations and has a direct impact on distributable reserves and capital.

The small below-the-line reduction in profit of £0.6m (2013: increase in profit of £13.1m) as a result of investment and economic profits demonstrates the effectiveness of the Group's risk management against the backdrop of significant movement in interest rates, inflation rates and credit spread over 2014.

New business operating profits were £271.0m in 2014 comprising £60.8m in relation to new pension bulk annuity business and £210.2m arising from the acquisition of MAL[2]. This compares to new business operating profits of £56.7m in 2013, with the increase in 2014 largely being driven by the acquisition of MAL.

Profits from the management of the in-force book fell from £150.9m in 2013 to £50.8m in 2014. Profits in 2013 were higher than in 2014 because they included the impact of investing some of the assets received as premiums during 2012. Similarly profits in 2014 were depressed by new business premiums received late in the year that remain undeployed at the year end.

1 The movements in this table are consistent with those shown in Note 31 of the Financial Statements which is based on statutory solvency. The 'other' line represents the differences between the results on an IFRS basis and the results on a statutory solvency basis.
2 The £210.2m profit from the acquisition of MAL is higher than the negative goodwill in Note 13 of the Financial Statements because it reflects the full impact of redeploying the assets acquired with MAL and of reinsuring the liabilities.

Income statement highlights

£m	2014	2013
Gross premiums written	**1,679.3**	1,628.1
Net premiums written	**1,244.2**	1,266.9
Investment return	**1,778.8**	(100.0)
Total revenue	**3,023.0**	1,166.9
Claims paid	**(291.3)**	(234.4)
Change in insurance liabilities	**(2,404.1)**	(701.0)
Operating expenses	**(66.0)**	(40.9)
Finance costs	**(17.6)**	(7.0)
Total claims and expenses	**(2,779.0)**	(983.3)
Profit before tax	**244.0**	183.6
Income tax	**(63.6)**	(34.7)
Profit after tax	**180.4**	148.9

The key line items in the consolidated statement of comprehensive income for the Group (shown above) can be explained as follows:

Gross Premiums Written

The Group's new business premiums increased from £1.4bn in 2013 to £4.1bn in 2014.

This is different from the gross premiums written as per the accounts (an increase from £1,628m in 2013 to £1,679m in 2014) because:

- The gross premiums written includes regular premiums of £273.6m (2013: £255.2m) generated on the in force inwards longevity reinsurance business written in prior years; and
- The gross premiums written excludes the £2.7bn of insurance liabilities acquired through the purchase of MAL. For accounting purposes, the assets and liabilities of MAL are consolidated into the Group's assets and liabilities and the difference between the consideration paid and the net assets received (negative goodwill) is included in investment returns for the year.

Net Premiums Written

Net premiums written represent the gross premiums written less the regular premiums ceded to reinsurers.

Net premiums written reduced slightly from £1,267m in 2013 to £1,244m in 2014 after allowing for an increase in reinsurance.

Investment Return

The investment return comprises interest received on financial assets, interest payable on financial liabilities and the net gains and losses on financial assets and liabilities.

Interest received on financial assets net of interest payable on financial liabilities increased from £168.9m in 2013 to £270.3m in 2014, reflecting the growth in the size of the business.

The net movement in the fair value of assets including realised gains was an increase of £1,508.6m in 2014 compared to a loss of £268.8m in 2013. The increase in the value of assets in 2014 was primarily due to the impact of falling interest rates which led to the offsetting increase in insurance liabilities, for example, a benchmark 30 years swap fell 1.16% in the period. This value also includes £56.4m, being the difference between the consideration paid for MAL and the net assets received.

Claims Paid

Claims paid represent the total payments due to policyholders during the year less the reinsurers' share of such claims.

Claims paid increased by £57.6m from £234.4m in 2013 to £291.3m in 2014, an increase reflecting the growth of the in force book.

Change in Insurance Liabilities

Change in insurance liabilities represents the change in the Group's gross insurance liabilities less the change in the value of the Group's reinsurance assets.

The change in insurance liabilities in 2014 was £2,404.1m compared to an increase in insurance liabilities of £701.0m in 2013. As mentioned above, this excludes the increase in Group liabilities from the acquisition of MAL (the net insurance liabilities for which were £2,709.2m at the end of 2014). The main drivers of the year-on-year increase compared to 2013 was the impact of interest rates on the in force net liabilities.

Acquisition Costs

Acquisition costs comprise the expenses associated with the origination of new business, including incentive payments made to employees. Acquisition costs increased from £36.2m in 2013 to £38.0m in 2014 as a result of the growth in new business.

Administration Expenses

Administration expenses represent the cost of administering the in force book of business. These increased from £4.4m in 2013 to £13.2m in 2014 in line with the growth of the business and the additional ongoing costs associated with being an independent standalone business.

Other Expenditure

Other expenditure amounted to £14.8m in 2014 (2013: £0.2m). This includes the cost of our Solvency II project, the costs associated with the project to separate our operations from Goldman Sachs to an independent standalone business and reinsurance fees required under IFRS to be categorised as expenses.

FINANCIAL REVIEW CONTINUED

Finance Costs
On 29 September 2014,Rothesay Holdco UK Ltd (RHUK) entered into a £125m 3-year term-loan agreement provided by a syndicate of third party banks. The loan is secured on the equity of RLL and RPML and the rate of interest is 6 month Sterling LIBOR plus 350bps per annum.

Finance costs mainly represent interest payable on borrowings and have increased from £7.0m in 2013 to £17.6m in 2014 as a result of the increase in borrowings as well as expenses in relation to the debt issuance.

Income tax
The Group's income tax charge increased from £34.7m in 2013 to £63.6m in 2014, largely as a result of the increase in profits.

Balance Sheet Highlights

£m	31 December 2014	31 December 2013
Financial investments	**20,989.4**	11,300.8
Reinsurance assets	**288.7**	164.3
Other assets	**605.4**	238.4
Total assets	**21,883.5**	11,703.5
Share capital and share premium	**267.5**	267.5
Capital contribution reserve	**4.5**	0.2
Retained earnings	**488.8**	308.4
Total equity	**760.8**	576.1
Insurance contract liabilities	**12,105.7**	6,953.3
Payables	**8,755.2**	4,051.8
Borrowings	**225.0**	100.0
Other	**36.8**	22.3
Total liabilities	**21,122.7**	11,127.4
Total equity and liabilities	**21,883.5**	11,703.5

The key line items in the consolidated statement of financial position for the Group (shown above) can be explained as follows:

Assets
Funds under management increased from £7.5bn as at 31 December 2013 to £12.8bn as at 31 December 2014 as a result of new business and the fall in interest rates.

These numbers can be derived from the table by taking the total assets of £21.9bn (2013: £11.7bn) and making the following adjustments:

- Deduct payables of £8.8bn (2013: £4.1bn) to net derivative assets against derivative liabilities and to net the assets and liabilities relating to collateralised financing; and
- Deduct reinsurance assets of £0.3bn (2013: £0.2bn).

Reinsurance assets have increased by £124.4m from £164.3m at 31 December 2013 to £288.7m at 31 December 2014 as a result of entering into additional reinsurance contracts during the year covering around £2.8bn of longevity risk. Reinsurance assets remain relatively low compared to insurance contract liabilities because the Group's reinsurance contracts are all longevity swap reinsurance under which the Group pays regular premiums in return for being entitled to make regular claims.

Total Equity
Total equity increased by £184.7m from £576.1m at 31 December 2013 to £760.8m at 31 December 2014, driven by the increase in retained earnings.

Liabilities
Insurance contract liabilities increased from £6.9bn at 31 December 2013 to £12.1bn at 31 December 2014, as a result of new business, the acquisition of MAL and the decrease in interest rates over the year.

Payables increased by £4.7bn from £4.1bn at 31 December 2013 to £8.8bn at 31 December 2014. Payables are dominated by derivative financial instruments and collateralised financing agreements. Derivatives are used to manage market and credit risk. The derivative liability as at 31 December 2014 of £5.6bn (2013: £2.3bn) largely nets off against the derivative assets of £5.8bn (2013: £2.4bn). The liabilities associated with collateralised financing agreements as at 31 December 2014 increased to £2.0bn (2013: £1.3bn) and can be partially netted off against the value of the associated collateralised financing assets of £3.4bn (2013: £2.9bn). Collateralised financing is used by the Group to enable investment in shorter term assets and to generate liquidity.

Borrowings have increased from £100m at 31 December 2013 to £225m at 31 December 2014 as discussed above.

Market Consistent Embedded Value

The Group's MCEV has increased to £1,215m at 31 December 2014. This is composed of value of in force of £470m and net assets of £973m less adjustments of £228m to allow for Group borrowings and other Group adjustments.

The value of new business written in 2014 was £299m comprising £71m in relation to new pension bulk annuity business and £228m arising from the acquisition of MAL.

As 2014 is first year MCEV has been published for external reporting, prior year comparatives have not been provided.

Capital Management under the Existing Solvency Regime

The Group is managed to the greater of the economic capital requirement (which is consistent with the individual capital assessment but using a lower probability of default) and the regulatory Pillar 1[1] position of its life companies. In practice, it is the Pillar 1 requirement which is more onerous and the Group aims to maintain 150% of the regulatory minimum requirement in its life insurance subsidiaries.

1 A fall in interest rates leads to a bigger increase in Pillar 1 technical provisions than best estimate liabilities because the former include prudent margins. Our approach to hedging means that if interest rates fall, the assets held to back the technical provisions increase in value by a similar amount to the increase in the technical provisions. Hence the difference in the change in technical provisions and the change in best estimate liabilities leads to an increase in economic capital surplus.

The Pillar 1 capital ratio has decreased slightly from 229% at 21 December 2013 (RLL only) to 204% at 31 December 2014 (RAL and RLL combined) due to the impact of new business and falling interest rates.

Economic capital has increased from £1.1bn at 31 December 2013 to £1.6bn as at 31 December 2014, giving an increase in the Group's economic capital coverage from 182% to 206%, an improvement of 24% over the year. Economic capital solvency improved as a result of the acquisition of MAL. It also improved over the year due to falling interest rates because we hedge closer to the Pillar 1 technical provisions than best estimate liabilities.

Solvency II

From 1 January 2016, the current solvency regime will be replaced by Solvency II. Similar to the existing regime, under Solvency II we are required to hold the greater of the capital required under the new Pillar 1 framework and the capital required under our own economic capital models, Pillar 2. We anticipate that the capital required for Rothesay Life under the new Pillar 1 will exceed that required under our own economic capital models, consistent with our current position.

Under Solvency II Pillar 1, we are required to hold sufficient assets to meet:

- The liabilities of the Group calculated on a best estimate basis (the 'BEL');
- The cost of transferring non-hedgeable risks (known as the risk margin); plus
- The capital required to meet a 1 in 200 year stress (calculated on a prescribed basis and known as the solvency capital requirement or 'SCR').

Matching adjustment

For most insurance business, the BEL must be discounted using a prescribed risk-free discount rate. However firms with illiquid liabilities such as annuity business can apply to discount these illiquid liabilities using the risk free rate plus what is known as the 'matching adjustment'. The matching adjustment is broadly equivalent to the liquidity premium that can be earned on the illiquid assets held to back illiquid liabilities.

Rothesay Life has participated in the matching adjustment pre-application process and intends to apply to use the matching adjustment for almost all of its business. We already closely match assets and liabilities and our investment strategy is consistent with the buy and hold requirements of Solvency II.

In order to use the matching adjustment, from 1 January 2016 we will be required to operate 2 separate funds within each life company – a matching adjustment fund and a non-matching adjustment fund. The matching adjustment fund will hold all of the single premium insurance business and sufficient qualifying assets to meet the associated BEL and risk margin. Regular premium business and all the remaining assets will be held in the non-matching adjustment fund.

Partial Internal Model

Under Solvency II, insurers have the option of calculating the SCR either using the prescribed basis (the 'standard formula') or applying to use their own internal model. Rothesay Life is in the process of applying to use its own model for calculating the SCR in relation to credit risk but intends using the standard formula for all other risks (a 'partial internal model').

We are applying to use a partial internal model because the capital requirements under the standard formula for credit spread risk depend on a somewhat arbitrary classification of structured and collateralised investments and rely on public credit ratings. Little relief is applied under Solvency II to unrated assets with strong security, collateral or other structural protection of the type in which Rothesay Life has specialised. Such assets are fundamental to our low risk business model, strong solvency and stable balance sheet position and hence we have developed a partial internal model which makes proper allowance for underlying security protection.

Results

Given there remains uncertainty about when we will obtain the relevant approvals and around some of the specific details and interpretation of the Solvency II regulations, we have decided not to publish solvency estimates in this report. Assuming that Rothesay Life receives the relevant approvals, we estimate that the impact of Solvency II will be relatively neutral for the Group given the capital required under Solvency II is similar to that required under Pillar 1 currently. However the risk remains that more capital is required under Solvency II than under the current regime.

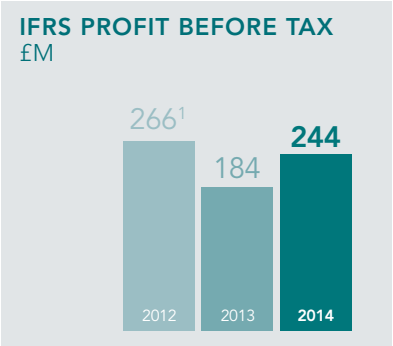
Contingency Plans and Transitional Solvency Relief

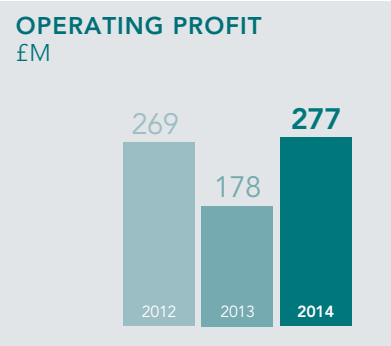
The Group's implementation programme is progressing well but we have developed contingency plans to address the situation that we do not receive the necessary approvals by 1 January 2016. Like most annuity providers, Rothesay Life's capital position under Solvency II is critically dependent on approval to use the matching adjustment. We are less dependent on approval to use a partial internal model but a delay in receiving approval would still have a negative impact on capital.

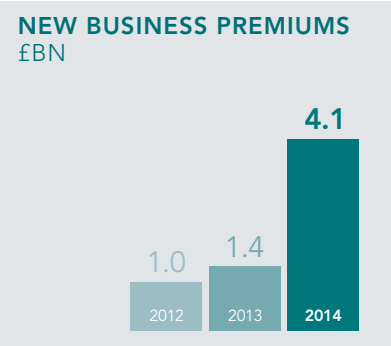
The dynamic and focussed approach of the business means that we will be able to rapidly address any issues raised by the PRA in relation to approvals. In addition, we will apply to use transitional solvency relief which will allow us to phase in the impact of Solvency II on our capital position over 16 years.

KEY PERFORMANCE INDICATORS

SET OUT BELOW ARE THE GROUP'S FINANCIAL KEY PERFORMANCE INDICATORS ('KPIS'). THE BOARD AND MANAGEMENT HAVE ADOPTED THE METRICS FOR MEASURING THE GROUP'S AGGREGATE PERFORMANCE AND SOLVENCY. THESE METRICS FORM AN IMPORTANT PART OF THE GROUP'S BUSINESS MODEL AND ONGOING FINANCIAL MANAGEMENT.







IFRS PROFIT BEFORE TAX

IFRS profit before tax is our primary measure of profitability, capturing all recurring and non-recurring items and in particular market fluctuations which have a direct impact on distributable reserves and capital.

IFRS profit before tax has increased by 33% to £244m, reflecting the strong performance in new business origination and cautious investment.

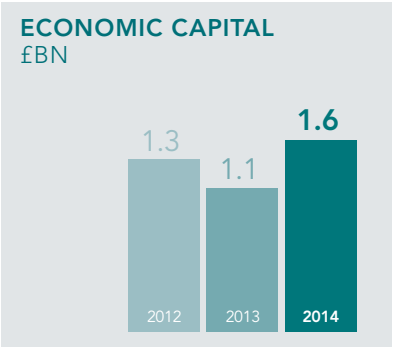
OPERATING PROFIT

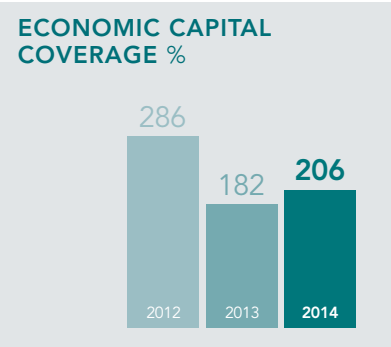
Operating Profit before tax is a measure of profitability capturing new business profit, in-force profit and assumption changes, but excluding market fluctuations and exceptional expenses.

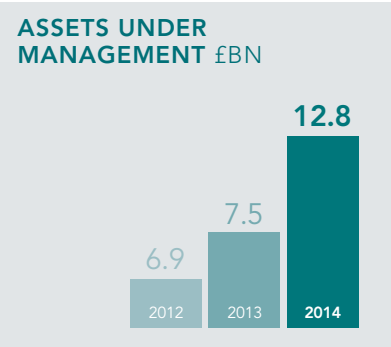
Operating profit increased by 68%, also reflecting our new business origination success.

NEW BUSINESS PREMIUMS

New business sales are a key indicator of the Group's growth and realisation of its strategic objectives. New business sales include premiums written as bulk annuities, reinsurance and liabilities acquired through acquisitions.







ECONOMIC CAPITAL

Economic capital represents management's internal calculation of the capital resources available to cover risk-based capital on a best estimate basis.

The Group holds capital resources of £1.6bn in excess of best estimate liabilities as at 31 December 2014, a £0.5bn increase since 2013.

ECONOMIC CAPITAL COVERAGE

Economic capital coverage represents management's internal risk-based calculation of the capital required to remain solvent for a 99.8% confidence level over a 1 year period.

The Group's economic capital coverage as at 31 December 2014 was 206%, an improvement of 24% over the year.

ASSETS UNDER MANAGEMENT

Assets Under Management ('AUM') measures the total financial investments, including cash.

As at 31 December 2014, the Group held assets of £12.8bn, an increase of c.£5.3bn.

1 The 2012 profit before tax is as calculated under UK GAAP, but is expected to have been a similar figure if calculated under IFRS.

PRINCIPAL RISKS AND UNCERTAINTIES

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.

Risks	Overview
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, allowing for netting across its investment assets and insurance liabilities, by entering into a portfolio of interest rates 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. 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. Rothesay hedges its net exposure 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, curvature and volatility of the inflation swap curve. Monitoring and re-hedging occur on a daily basis.

PRINCIPAL RISKS AND UNCERTAINTIES CONTINUED

Risks	Overview
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 or USD. Rothesay 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 rehedging 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 a 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 debt represents 35% of the Group's investment portfolio, of which 96% consists of UK Government bonds.
Counterparty Default Risk	The Group utilises longevity reinsurance and OTC derivative transactions to efficiently manage 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.

Risks	Overview
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 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. 71% longevity risk was hedged as at 31 December 2014.
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 conservative 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 position of Rothesay under such a stress is continually monitored. While a material liquidity buffer exists, ongoing monitoring also allows mitigating actions to be taken at an early stage if required.

PRINCIPAL RISKS AND UNCERTAINTIES CONTINUED

Risks	Overview
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, Towers Watson and Ensign. 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 and process support under a service agreement. 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. The European Union (EU) has developed a new regulatory regime for insurance companies known as Solvency II designed to ensure a common set of principles for supervision across the EU. The implementation of the directive has been delayed pending the clarification of certain aspects of the legislation will now come into force on 1 January 2016. A key aspect of Solvency II is the requirement to manage the business on an economic capital basis. Whilst the Group has the capability to operate under this framework and possesses a thorough understanding of the capital position under the upcoming Solvency II framework, there still remain areas of uncertainty regarding the appropriate interpretation of some aspects of the text, which are not expected to be finalised until late 2015. In 2014, the UK Government announced a number of regulatory changes in relation to the individual annuity sector; in particular the announcements made in the 2014 Budget whereby the compulsory purchase of annuities for new retirees would be removed. Although this has had a noticeable effect on the individual annuity sector, the impact on the bulk annuity sector has been negligible thus far. Full implementation of the rules is expected by April 2015. The Group now has over 36,000 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.

GOVERNANCE

ROTHESAY LIFE GROUP OF DIRECTORS

KEITH SATCHELL
CHAIRMAN OF ROTHESAY LIFE

Keith Satchell has been Chairman of Rothesay Life since it was founded in 2007. Keith is also chair of the Nomination and Remuneration committees. Keith was formerly CEO at Friends Provident plc (FP) from June 1997 to December 2006, and held various management positions within FP 1986-1997. Keith is a former Chairman of the Association of British Insurers and has previously served on Boards in Switzerland, Holland, Spain, Ireland, Italy and Portugal.

ANTIGONE (ADDY) LOUDIADIS
CEO OF ROTHESAY LIFE

Antigone (Addy) Loudiadis is the founder and Chief Executive Officer of Rothesay Life. Prior to establishing the business in 2007, Addy was a partner of Goldman Sachs and served as the co-head of the Investment Banking Division in Europe. Before moving to Investment Banking, Addy was head of European Fixed Income Sales at Goldman Sachs, having joined in 1994.

THOMAS (TOM) PEARCE
MANAGING DIRECTOR OF ROTHESAY LIFE

Tom Pearce is Managing Director and a co-founder of Rothesay Life, responsible for strategy and business development. Prior to the establishment of the Company in 2007, Tom was previously in the European Financing Group at Goldman Sachs responsible for UK Life insurance. Tom joined Goldman Sachs in 2000 in European Fixed Income.

ANDREW STOKER
CHIEF FINANCIAL OFFICER OF ROTHESAY LIFE

Andrew Stoker is the Chief Financial Officer of Rothesay Life following his appointment in 2014. At Rothesay Life, Andrew has responsibility for the finance, risk and actuarial functions. Andrew was previously a partner in EY's risk and actuarial practice and prior to that was Chief Actuary at Lucida plc. Andrew has also held roles at PwC, Tillinghast and Legal & General.

RICHARD BERLIAND
INDEPENDENT NON-EXECUTIVE DIRECTOR OF ROTHESAY LIFE

Richard Berliand is a member of the Supervisory Board of Deutsche Börse AG and its Eurex subsidiaries. Richard is also on the Board of Mako Europe, certain fund entities in the Renshaw Bay fund group and Chairman of ITRS Global Holdings. He is a member of the FCA Regulatory Decisions Committee and an advisor to the CFTC. He was previously with J.P.Morgan for 23 years, most recently as global head of the Cash Equities and Prime Services businesses.

GLENN EARLE
INDEPENDENT NON-EXECUTIVE DIRECTOR OF ROTHESAY LIFE

Glenn Earle is currently a Non-Executive Director of Fiat S.p.A., senior adviser at Affiliated Managers Group Limited and a Board Member and Trustee of the Royal National Theatre. In 2011, Glenn retired as Chief Operating Officer of Goldman Sachs in Europe where he also co-chaired the firm's Capital Committee. He also previously served as a Director of Rothesay Life during 2007-2011.

NAGUIB KHERAJ
INDEPENDENT NON-EXECUTIVE DIRECTOR OF ROTHESAY LIFE

Naguib is a Senior Advisor to the Aga Khan Development Network and serves on the Boards of various entities within Network. Naguib is also a Non-Executive Director of Standard Chartered and a member of the investment committee of Wellcome Trust. Naguib began his career at Salomon Brothers and went on to hold a number of senior positions at leading financial institutions. He served as Group Finance Director and Vice-Chairman and in various leadership positions at Barclays and was CEO of JP Morgan Cazenove.

RAYMOND (RAY) KING
INDEPENDENT NON-EXECUTIVE DIRECTOR OF ROTHESAY LIFE

Ray King is currently a Non-Executive Director and chairman of the audit and risk committees at Saga plc and of the audit committee at Infinis Energy plc He is also a reporting panel member at the CMA and a member of the FRC's Audit and Assurance Council. Previously he was CEO and Group Finance Director of BUPA and earlier in his career held senior management roles at Parity Group plc, Diageo/Guinness plc, Southern Water plc and ICI plc. Ray qualified as a Chartered Accountant with PWC. Ray is chair of the Rothesay Life Audit Committee.

DOUGLAS PATERSON
INDEPENDENT NON-EXECUTIVE DIRECTOR OF ROTHESAY LIFE

Douglas Paterson is a Non-Executive Director at Rothesay Life Limited and has served on the Board since July 2007. Douglas was previously a senior audit partner at PwC with considerable experience in financial service markets including insurance. Douglas is also a Non-Executive Director of Goldman Sachs International Bank and Close Brothers Group Limited.

CHARLES PICKUP
INDEPENDENT NON-EXECUTIVE DIRECTOR OF ROTHESAY LIFE

Charles Pickup is a Non-Executive Director of Rothesay Life Limited and has served on the Board since January 2012. Charles was previously a partner in the Risk Consulting and Software division of Towers Watson (formerly Tillinghast) and acted as AFH for Lucida plc, Countrywide and Blackrock. Prior to this Charles worked at Commercial Union and Prudential Bache Securities specialising in UK life insurance.

MICHAEL SHERWOOD
NON-EXECUTIVE DIRECTOR OF ROTHESAY HOLDCO

Michael Sherwood is a vice chairman of The Goldman Sachs Group, Inc. and co-chief executive officer of Goldman Sachs International. Michael is a member of the Management Committee, chairman of the Partnership Committee and co-chairman of the European Management Committee of Goldman Sachs. He joined Goldman Sachs in 1986 and became a partner in 1994.

DERMOT MCDONOGH
NON-EXECUTIVE DIRECTOR OF ROTHESAY LIFE

Dermot McDonogh is a managing director within the Finance Division of Goldman Sachs, is the firm's international controller and a member of the European Audit Committee. Dermot joined Goldman Sachs in 1994 in New York. Dermot has been a Director of Rothesay Life Limited since February 2009 and is chair of the Board Risk Committee.

CHAD PIKE
NON-EXECUTIVE DIRECTOR OF ROTHESAY HOLDCO

Chad R. Pike is a Senior Managing Director in the Tactical Opportunities Group and Vice Chairman of Blackstone Europe. Chad is currently a member of the Tactical Opportunities Investment Committee, the Real Estate Investment Committee, and Blackstone's Executive Committee. Since joining Blackstone in 1995, Chad has led a number of transformational initiatives at Blackstone.

QASIM ABBAS
NON-EXECUTIVE DIRECTOR OF ROTHESAY LIFE

Qasim Abbas is a Managing Director with Blackstone's Tactical Opportunities Group. Since joining Blackstone, Qasim has primarily focused on financial institutions across Europe. Prior to joining Blackstone in 2012, Qasim was a Portfolio Manager with Trafalgar Asset Managers where he was responsible for real estate and mortgage debt instruments.

ROBIN JARRATT
NON-EXECUTIVE DIRECTOR OF ROTHESAY LIFE

Robin Jarratt is a Senior Vice President of GIC Special Investments and head of the European direct investment group based in London. Robin is responsible for all direct private equity and mezzanine debt investments in Europe, Middle East and Africa (EMEA).

ELWIN CHAI
NON-EXECUTIVE DIRECTOR OF ROTHESAY HOLDCO

Elwin Chai is a Vice President of GIC Special Investments and a member of the European direct investment group based in London. He joined GIC SI in 2005 and had been part of the direct investment group in Asia.

TIMOTHY (TIM) CORBETT
NON-EXECUTIVE DIRECTOR OF ROTHESAY HOLDCO

Tim Corbett is Executive Vice President and Chief Investment Officer of Massachusetts Mutual Life Insurance Company (MassMutual). Tim is responsible for MassMutual's overall investment strategy and has oversight of the company's Investment Account. Prior to joining MassMutual in May 2011, Tim had been Chief Investment Officer and head of Pension Fund Management with the State of Connecticut Treasurer's Office since 2009.

BOARD COMMITTEES

A ROBUST BOARD WITH EFFECTIVE COMMITTEE STRUCTURE FACILITATES THE GOVERNANCE FRAMEWORK OF OUR GROUP

Board Risk Committee

The Board Risk Committee ('BRC') is authorised by the Board of Directors ('Board') with the purpose of assisting the Board in providing leadership, direction and oversight of Rothesay Life's (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.

The BRC membership includes both Independent Non-Executive Directors, who carry majority voting rights, and Non-Executive Directors. The Chairman is a Non-Executive Director, Dermot McDonogh.

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 risks inherent in strategic transactions and business plans and the impact on the Group's risk appetite and tolerance;

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 effectively. The Committee also ensures the risk function has adequate independence;
- reviewing promptly material reports on the Group from the Chairman of the Working Level Risk Committee 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 and other economic capital calculations; and
- reviewing any other major regulatory submissions involving capital.

Working Level Risk Committee

The Rothesay Life Working Level Risk Committee ('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 test and scenario analysis results, and establishes risk policies and procedures.

The WLRC is also responsible for recommending investment strategies to the Board Risk Committee, 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 Rothesay Life Board of Directors and any exceptions and changes are reviewed as appropriate by the Board Risk Committee. 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. 2 Non-Executive Directors have observer rights. The membership includes 4 control side members and 2 control side observers and is chaired by the Chief Financial Officer.

Audit Committee

The Rothesay Life Audit Committee ('Audit Committee') is responsible for assisting the Board of Directors 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 Non-Executive Directors and Independent Non-Executive Directors. The Audit Committee was chaired by the Chairman of the Board of Directors until 31 December 2015. Ray King was appointed chairman of the Committee on 1 January 2015. The Audit Committee carries out the duties below on behalf of the Board of Directors in respect of the Group:

a. 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 judgements which they contain.

b. 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.

BOARD COMMITTEES CONTINUED

c. 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.

d. External Audit
The Audit Committee considers and recommends to the Board the appointment, re-appointment and removal of the external auditors of the Group, 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 arose during the audit, any accounting and audit judgements and the effectiveness of the audit.

e. 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.

f. 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.

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

Remuneration Committee
The Remunerations Committee ('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 for 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 of Directors.

Nomination Committee
The Nominations Committee ('NomCom') is responsible for monitoring the balance of skills, knowledge, experience and diversity on the Board, recommending board, board committee and senior management appointments to the Rothesay Life Board, 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 of Directors, identifying and nominating candidates to fill Board vacancies as and when they arise, and approving any senior management appointments.
The NomCom membership consists of both Executive and Non-Executive Directors and NomCom is chaired by the Chairman of the Board of Directors.

REPORT OF THE DIRECTORS

The Directors present their Annual Report and the audited consolidated Financial Statements for Rothesay Holdco UK Limited, registered number 08668809, (the 'Company' or 'RHUK') for the year ended 31 December 2014. Comparative information has been presented for the year ended 31 December 2013.

1. Results

The Rothesay Holdco UK Limited ('the Group') results for the year are set out in the Consolidated Statement of Comprehensive Income on page 38.

2. Dividends

The Directors have recommended no payment of interim dividends during the year ended 31 December 2014 (2013: £290.6m). The Directors have recommended no final ordinary dividend in respect of the year (2013: £nil). Please refer to Note 28 in the Financial Statements for additional detail.

3. Directors

The Directors of the Company who served throughout the year and to the date of this report, except where noted, were:

Name	Appointed	Resigned
S Q Abbas		
R D A Berliand	1 October 2014	
T J Breedon		14 May 2014
E Chai		
M T Corbett		
R A De Beir Jarratt		
G Earle	1 January 2015	
R King	1 April 2014	
N Kheraj	1 October 2014	
A Loudiadis		
D McDonogh		
D G Paterson		
T Pearce		
C Pickup		
C Pike		
K Satchell		
M S Sherwood		
A M Stoker	17 November 2014	

4. Qualifying Third Party Indemnities

The Articles of Association of the Company provide for the Directors and officers of the Company to be indemnified in respect of liabilities incurred as a result of their office. The Company also provides certain protections for Group Directors and senior management against personal financial exposure that they may have incurred in their capacity as such. These include qualifying third party indemnity provisions (as defined under section 234 of the Companies Act 2006) in force for the benefit of the Directors of the Group during the year.

5. Going Concern Statement

The Directors are satisfied that the Company and the Group have adequate resources to continue in business and to meet their obligations for the foreseeable future. The Financial Statements have therefore been prepared on a going concern basis.

6. Transition to International Financial Reporting Statement ('IFRS')

The Consolidated Financial Statements of the Group and those of the Company have been prepared and approved by the Directors in accordance with IFRS as adopted by the European Union ('EU') and those parts of the Companies Act 2006 applicable to those reporting under IFRS. For all periods up to and including the year ended 31 December 2013, the Group prepared its Financial Statement in accordance with UK Generally Accepted Accounting Practice ('UK GAAP'). These Financial Statements for the year ended 31 December 2014 are the first the Group has prepared in accordance with IFRS. In preparing these Financial Statements the Group's opening Statement of Financial Position was prepared as at 1 January 2013, the Company's date of transition to IFRS. See Note 35 for information on how the Group adopted IFRS.

REPORT OF THE DIRECTORS CONTINUED

7. Disclosure of Information to Auditors

In the case of each of the persons who are Directors of the Company at the date when this report was approved:

- so far as each of the Directors is aware, there is no information relevant to the audit of which the Company's auditors are unaware; and
- each of the Directors has taken all the steps that he/she ought to have taken as a Director to make himself/herself aware of any information relevant to the audit and to establish that the Company's auditors are aware of that information.

8. Auditors

The Company has passed Elective Resolutions in accordance with the Companies Act 1985 to dispense with the holding of annual general meetings, the laying of accounts and reports before general meetings and the annual reappointment of auditors. PricewaterhouseCoopers LLP will, accordingly, continue in office as auditors of the Company pursuant to Section 487(2) of the Companies Act 2006 and paragraph 44 of Schedule 3 to the Companies Act 2006 (Commencement No. 3 Consequential Amendment, Transitional Provisions and Savings) Order 2007.

9. Statement of Directors' Responsibilities

The Directors are responsible for preparing the Strategic Report, Report of the Directors and the Financial Statements in accordance with applicable laws and regulations. Company law requires the Directors to prepare Financial Statements for each financial year. Under that law the Directors have prepared the Financial Statements in accordance with IFRSs as adopted by the EU. Under company law the Directors must not approve the Financial Statements unless they are satisfied that they give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period. In preparing these Financial Statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable IFRSs (as adopted by the EU) have been followed, subject to any material departures disclosed and explained in the Financial Statements; and
- prepare the Financial Statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the Financial Statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The Directors are responsible for the maintenance and integrity of the Company's website. Legislation in the United Kingdom governing the preparation and dissemination of Financial Statements may differ from legislation in other jurisdictions.

10. Date of Authorisation of Issue

The Financial Statements were authorised for issue by the Board of Directors on 25 March 2015.

On behalf Order of the Board

Addy Loudiadis
Chief Executive Officer
25 March 2015

INDEPENDENT AUDITORS' REPORT
TO THE MEMBERS OF ROTHESAY HOLDCO UK LIMITED

Report on the Financial Statements
Our Opinion
In our opinion, Rothesay Holdco UK Limited's Group Financial Statements and Parent Company Financial Statements ('the Financial Statements'):
- give a true and fair view of the state of the Group's and of the Parent Company's affairs as at 31 December 2014 and of the Group's profit and the Group's cash flows for the year then ended;
- the Group Financial Statements have been properly prepared in accordance with IFRSs as adopted by the EU; and as applied in accordance with the provisions of the Companies Act 2006; and
- the Financial Statements have been prepared in accordance with the requirements of the Companies Act 2006 and as regards the Group Financial Statements, Article 4 of the IAS regulation.

What we have audited
Rothesay Holdco UK Limited's Financial Statements comprise:
- the Consolidated and Company Statement of Financial Position as at 31 December 2014;
- the Consolidated Statement of Comprehensive Income for the year then ended;
- the Consolidated Statement of Cash Flow Statement for the year then ended;
- the Consolidated Statement of Changes in Equity for the year then ended; and
- the notes to the Financial Statements, which include a summary of significant accounting policies and other explanatory information.

The financial reporting framework that has been applied in their preparation of the Financial Statements is applicable law and IFRSs as adopted by the EU and, as regards the Parent Company Financial Statements, as applied in accordance with the provisions of the Companies Act 2006.

In applying the financial reporting framework, the Directors have made a number of subjective judgements, for example in respect of significant accounting estimates. In making such estimates, they have made assumptions and considered future events.

Opinion on Other Matters Prescribed by the Companies House Act 2006
In our opinion the information given in the Strategic Report and the Report of the Directors for the financial year for which the Financial Statements are prepared is consistent with the Financial Statements.

Other Matters on which we are required to Report by Exception
Adequacy of accounting records and information and explanations received
Under the Companies Act 2006 we are required to report to you if, in our opinion:
- we have not received all the information and explanations we require for our audit; or
- adequate accounting records have not been kept by the Parent Company, or returns adequate for our audit have not been received from branches not visited by us; or
- the Parent Company Financial Statements are not in agreement with the accounting records and returns.

We have no exceptions to report arising from this responsibility.

Directors' remuneration
Under the Companies Act 2006 we are required to report to you if, in our opinion, certain disclosures of Directors' remuneration specified by law are not made. We have no exceptions to report arising from this responsibility.

Responsibilities for the Financial Statements and the Audit
Our responsibilities and those of the Directors
As explained more fully in the Statement of Directors' Responsibilities set out on page 34, the Directors are responsible for the preparation of the Financial Statements and for being satisfied that they give a true and fair view.

Our responsibility is to audit and express an opinion on the Financial Statements in accordance with applicable law and International Standards on Auditing (UK and Ireland) ('ISAs (UK & Ireland)'). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

This report, including the opinions, has been prepared for and only for the Company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

INDEPENDENT AUDITORS' REPORT CONTINUED

What an audit of Financial Statements involves

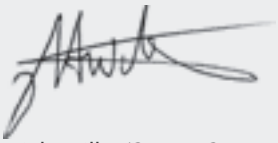
We conducted our audit in accordance with ISAs (UK & Ireland). An audit involves obtaining evidence about the amounts and disclosures in the Financial Statements sufficient to give reasonable assurance that the Financial Statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of:

- whether the accounting policies are appropriate to the Group's and the Parent Company's circumstances and have been consistently applied and adequately disclosed;
- the reasonableness of significant accounting estimates made by the Directors; and
- the overall presentation of the Financial Statements.

We primarily focus our work in these areas by assessing the Directors' judgements against available evidence, forming our own judgements, and evaluating the disclosures in the Financial Statements.

We test and examine information, using sampling and other auditing techniques, to the extent we consider necessary to provide a reasonable basis for us to draw conclusions. We obtain audit evidence through testing the effectiveness of controls, substantive procedures or a combination of both.

In addition, we read all the financial and non-financial information in the Annual Report and Accounts 2014 to identify material inconsistencies with the audited Financial Statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.



Nick Wilks (Senior Statutory Auditor)
For and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
London
25 March 2015

(a) The maintenance and integrity of the Rothesay Life website is the responsibility of the Directors; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the Financial Statements since they were initially presented on the website.
(b) Legislation in the United Kingdom governing the preparation and dissemination of Financial Statements may differ from legislation in other jurisdictions.

FINANCIAL STATEMENTS

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEAR ENDED 31 DECEMBER 2014

	Note	Year ended 31 December 2014 £000s	Year ended 31 December 2013 £000s
Income			
Gross premiums written	2	**1,679,335**	1,628,059
Premiums ceded to reinsurers		(435,179)	(361,208)
Net Premiums Written		1,244,156	1,266,851
Investment return	10	**1,778,882**	(99,950)
Total Revenue		**3,023,038**	1,166,901
Expenses			
Claims and change in insurance liabilities		**(3,228,526)**	(1,197,449)
Reinsurance recoveries		**533,182**	261,978
Net Claims and Change in Insurance Liabilities	4	**(2,695,344)**	(935,471)
Operating expenses	5	**(65,970)**	(40,851)
Finance costs	6	**(17,643)**	(7,033)
Total Operating Expenses		**(83,613)**	(47,884)
Profit Before Tax		**244,081**	183,546
Income tax expense	9	**(63,642)**	(34,659)
Profit for the Year		**180,439**	148,887

All income and expenses relate to continuing operations.

The Consolidated Statement of Comprehensive Income includes all income and expenses for the year. RHUK has no items required to be reported in other comprehensive income. Therefore a separate comprehensive income statement has not been presented.

Notes 1 – 35 form an integral part of these Financial Statements.

CONSOLIDATED STATEMENT OF FINANCIAL POSITION
AS AT 31 DECEMBER 2014

	Note	Year ended 31 December 2014 £000s	Year ended 31 December 2013 £000s	As at 1 January 2013 £000s
Assets				
Property, plant and equipment	15	**1,524**	–	–
Financial investments	16	**20,989,390**	11,300,849	9,146,260
Reinsurance assets	23	**288,654**	164,325	240,607
Deferred tax assets	19	**–**	–	827
Accrued interest and prepayments	20	**132,127**	77,863	70,383
Receivables	18	**360,156**	70,689	99,348
Cash and cash equivalents	21	**111,617**	89,827	54,468
Total Assets		**21,883,468**	11,703,553	9,611,893
Equity and Liabilities				
Share capital	26	**1,800**	1,800	1,800
Share premium	27	**265,710**	265,710	265,710
Capital contribution reserve	27	**4,520**	155	–
Other reserves	27	**488,826**	308,387	317,644
Total Equity		**760,856**	576,052	585,154
Liabilities				
Insurance contract liabilities	22	**12,105,682**	6,953,306	6,332,064
Payables and financial liabilities	24	**8,755,167**	4,051,846	2,472,888
Borrowings	25	**225,000**	100,000	205,000
Deferred tax liabilities	19	**3,429**	2,914	–
Accruals and deferred income		**33,334**	19,435	16,787
Total Equity and Liabilities		**21,883,468**	11,703,553	9,611,893

Please see Note 35 for further details of the IFRS transition and the Consolidated Statement of Financial Position as at 1 January 2014.

Notes 1 – 35 form an integral part of these Financial Statements.

The Financial Statements were approved by the Board of Directors on 25 March 2015 and signed on its behalf by

Addy Loudiadis
Chief Executive Officer
25 March 2015

Company number 08668809

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

FOR THE YEAR ENDED 31 DECEMBER 2014

	Share Capital £000s	Share Premium £000s	Capital Contribution Reserve £000s	Other reserves £000s	Total Equity £000s
As at 1 January 2014	1,800	265,710	155	308,387	576,052
Profit for the year	–	–	–	180,439	180,439
Capital contribution	–	–	4,365	–	4,365
As at 31 December 2014	1,800	265,710	4,520	488,826	760,856

FOR THE YEAR ENDED 31 DECEMBER 2013

	Share Capital £000s	Share Premium £000s	Capital Contribution Reserve £000s	Other reserves £000s	Total Equity £000s
As at 1 January 2013	1,800	265,710	–	317,644	585,154
Profit for the year	–	–	–	148,887	148,887
Dividends paid on ordinary shares	–	–	–	(290,554)	(290,554)
Group reorganisation	–	–	–	132,410	132,410
Capital contribution	–	–	155	–	155
As at 31 December 2013	1,800	265,710	155	308,387	576,052

The Group reorganisation relates to the incorporation of RHUK on 29 August 2013. On the 18 December 2013 the Company allotted 1,800,000 ordinary shares of £1 each. Group reorganisation led to an increase in other reserves of £132.4m reflecting the excess of consolidated net assets to the historical cost of investment in subsidiary entities.

CONSOLIDATED CASH FLOW STATEMENT
FOR THE YEAR ENDED 31 DECEMBER 2014

	Note	Year ended 31 December 2014 £000s	Year ended 31 December 2013 £000s
Cash Flows from Operating Activities			
Profit for the year		180,439	148,887
Adjustments for Non Cash Movements in Net Profit for the Year			
Share-based payments		4,365	–
Interest income		(270,267)	(168,891)
Interest expense		17,643	7,033
Other adjustments		7,988	–
Tax expense		63,642	34,659
Net Decrease/(Increase) in Operational Assets			
Financial investments		(6,649,323)	(2,154,589)
Reinsurance asset		(124,329)	76,282
Trade receivable		(287,815)	28,659
Net Increase in Operational Liabilities			
Insurance contracts		2,464,431	621,242
Other payables		592,181	270,405
Financial liabilities		4,026,346	1,280,527
Accruals		9,734	–
Cash generated in Operations		35,035	144,214
Interest paid		(16,921)	(4,385)
Interest received		277,747	161,411
Tax paid		(42,733)	(2,737)
Net Cash Inflow from Operating Activities		253,128	298,503
Cash Flows from Financing Activities			
Repayment of borrowings		–	(105,000)
Repayment of share capital		–	(90)
Proceeds from issuance of debt		125,000	–
Proceeds from issue of ordinary share capital (including share premium)		–	132,500
Dividends paid		–	(290,554)
Net Cash Inflows/(Outflows) from Financing Activities		125,000	(263,144)
Cash flows from Investing Activities			
Net acquisition of plant, equipment and intangibles		(1,524)	–
Acquisitions of subsidiaries (net of cash acquired)		(354,814)	–
Net Cash Outflows from Investing Activities		(356,338)	–
Net increase in cash and cash equivalents		21,790	35,359
Cash at bank and in hand at 1 January		89,827	54,468
Cash and Cash Equivalents at 31 December	21	111,617	89,827

COMPANY STATEMENT OF FINANCIAL POSITION
AS AT 31 DECEMBER 2014

	Note	Year ended 31 December 2014 £000s	Year ended 31 December 2013 £000s
Assets			
Investments in subsidiary undertakings	33	383,764	267,510
Accrued interest and prepayments		1,312	–
Receivables		3,939	–
Cash and cash equivalents		905	–
Total Assets		389,920	267,510
Equity			
Called up share capital		1,800	1,800
Share premium account		265,710	265,710
Retained earnings		(11,544)	–
Total Equity		255,966	267,510
Liabilities			
Other liabilities including derivatives		8,954	–
Borrowings		125,000	–
Total Equity and Liabilities		389,920	–

The Financial Statements were approved by the Board of Directors on 25 March 2015 and signed on its behalf by

Addy Loudiadis
Chief Executive Officer
25 March 2015

NOTES TO THE FINANCIAL STATEMENTS

Note 1 – Accounting Policies

(a) General Information

RHUK is the ultimate holding Company of the Rothesay group of companies. RHUK is a registered company incorporated in the United Kingdom. The Company's registered office and principal place of business is Level 25, The Leadenhall Building, 122 Leadenhall Street, London, EC3V 4AB.

(b) Basis of Preparation

The consolidated Financial Statements of the Group and those of the Company have been prepared and approved by the Directors in accordance with IFRSs as adopted by the EU and those parts of the Companies Act 2006 applicable to those reporting under IFRS. The Financial Statements have been prepared on a going concern basis as disclosed within Note 5 of the Report of the Directors.

For all periods up to and including the year ended 31 December 2013, the Group prepared its Financial Statements in accordance with UK GAAP. These Financial Statements for the year ended 31 December 2014 are the first the Group has prepared in accordance with IFRS. Accordingly, the Group has prepared Financial Statements which comply with IFRS applicable for periods beginning on or after 1 January 2014 as described in the accounting policies below. In preparing these Financial Statements the Group's opening Statement of Financial Position was prepared as at 1 January 2013, the Company's date of transition to IFRS. See Note 35 for information on how the Group adopted IFRS.

The consolidated and separate Financial Statements of the Company are presented in sterling (£) rounded to the nearest thousand (£000s) except where otherwise stated. The separate Statement of Financial Position of the Company is presented on page 42.

The Group presents its Statement of Financial Position broadly in order of liquidity. An analysis regarding recovery or settlement more than 12 months after the year end is presented in the notes.

Assets and liabilities are offset and the net amount reported in the Statement of Financial Position only when there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis, or to realise the assets and settle the liability simultaneously. Income and expenses are not offset in the income statement unless required or permitted by IFRS.

(i) Adoption of New or Amended Standards

The Group has adopted the following new standards and changes to existing standards which are relevant to the Group's operations, and became effective for financial years beginning on or after 1 January 2014:

IFRS 10 Consolidated Financial Statements

IFRS 10 establishes a new definition of 'control' to be applied when determining which entities must be consolidated. This definition is based on the concept of power, exposure or rights to variable returns and their linkage. This differs from the current definition in IAS 27 which is based on the power to determine financial and operating policies. The standard has no material impact on the Group's profit before tax for the year or equity. The standard has been endorsed by the EU.

IFRS 11 Joint Arrangements

IFRS 11 defines 2 types of joint arrangements – joint ventures and joint operations – based on how rights and obligations are shared by parties to the arrangements. The standard sets out the required accounting treatment for each type of joint arrangement. The standard has no material impact on the Group's profit before tax for the year or equity. The standard has been endorsed by the EU.

IFRS 12 Disclosures of Interests in Other Entities

IFRS 12 requires additional disclosure for investments in subsidiaries, joint arrangements, associates and structured entities. The standard is has an impact on the level of disclosure in respect of un-consolidated structured entities. The standard has been endorsed by the EU.

IAS 27 Separate Financial Statements

IAS 27 removes requirements superseded by IFRS 10. The standard has been endorsed by the EU.

Note 1 – Accounting Policies continued

IAS 28 Associates and Joint Ventures

This amendment brings joint ventures into the scope of IAS 28 and to require equity accounting for these entities. The amendment has no material impact on the Group's profit before tax for the year or equity. The amendment has been endorsed by the EU.

IAS 32 Financial Instruments – Presentation

This amendment clarifies the requirements for offsetting financial assets and financial liabilities on the Statement of Financial Position. The amendment has no material impact on the Group Financial Statements. The amendment has been endorsed by the EU.

IAS 36 Recoverable Amount Disclosures for Non-Financial Assets

This amendment reduces the circumstances in which the recoverable amount of assets is required to be disclosed and clarification and amendments to the disclosures required. The amendment has no material impact on the Group's Profit before Tax for the year or equity. The amendment has been endorsed by the EU.

IAS 39 Novation of Derivatives and Continuation of Hedge Accounting

This amendment clarifies the circumstances in which hedge accounting can be continued if derivatives are novated, to facilitate the novation of derivatives to a central counterparty. The amendment has no material impact on the Group's Profit before Tax for the year or equity. The amendment has been endorsed by the EU.

(ii) New or Revised Standard Not Yet Effective

The following new, revised standards, in issue, were not yet effective, or in some cases not yet endorsed by the EU. The Group has not early adopted any of these standards.

IFRS 9 Financial Instruments

IFRS 9, as issued in November 2009 and October 2010, reflects the first phase of the IASB's work on the replacement of IAS 39 and applies to classification and measurement of financial assets and financial liabilities respectively, as defined in IAS 39. The standard was initially effective for annual periods beginning on or after 1 January 2013, but amendments to IFRS 9 Mandatory Effective Date of IFRS 9 and Transition Disclosures, issued in December 2011, moved the mandatory effective date to 1 January 2015.

In November 2013, the IASB issued a new version of IFRS 9 (IFRS 9(2013)), which includes the hedge accounting requirements. IFRS 9 (2013) does not yet have a mandatory effective date, but entities may elect to early apply only the accounting requirements for gains and losses from own credit risk without applying the other requirements of IFRS 9 (2013) at the same time. These provisions require an entity to present in Other Comprehensive Income ('OCI'), the changes in the fair value of non-derivative financial liabilities designated at fair value through profit or loss that are attributable to the Company's own credit risk.

Previous versions of IFRS 9 (2009 and 2010) will be available for early application until all of the phases of IFRS 9 have been issued. A mandatory effective date will be set when the IASB completes the impairment phase of the project. The adoption of the first phase of IFRS 9 will have an effect on the classification and measurement of the Group's financial assets, but will not have an impact on classification and measurements of the Group's financial liabilities. The Group will quantify the effect in conjunction with the other phases, when the final standard including all phases is issued.

(iii) Annual Improvements 2010-2012 Cycle

These improvements are effective from 1 July 2014 and are not expected to have a material impact on the Group. They include: IFRS 2 Share Based Payments, IFRS 3 Business Combinations, IFRS 8 Operating Segments, IAS 16 Property, Plant and Equipment, IAS 38 Intangible Assets and IFRS 24 Related Party Disclosures.

(iv) Annual Improvements 2011-2013 Cycle

These improvements are effective from 1 July 2014 and are not expected to have a material impact on the Group. They include: IFRS 3 Business Combinations, IFRS 13 Fair Value Measurement, IAS 40 Investment Property, IFRS 15 Revenue from Contracts with customers, Amendments to IFRS 11 Joint Arrangements: Accounting for Acquisition of Interests, Amendments to IAS 16 and IAS 38: Clarification of Acceptable methods of depreciation and amortisation.

IFRS 15 Revenue from Contracts with Customers
IFRS 15, as issued in May 2014, establishes a new 5-step model that will apply to revenue earned from a contract with a customer, regardless of the type of revenue or industry. The principles in IFRS 15 provides a more structured approach to measuring and recognising revenue and will be applied using the following 5 steps:

1. Identify the contract(s) with a customer;
2. Identify the performance obligations in the contract;
3. Determine the transaction price;
4. Allocate the transaction price to the performance obligations in the contract;
5. Recognise revenue when (or as) the Company satisfies a performance obligation.

This new revenue standard, which is jointly issued by IASB and the United States Financial Accounting Standards Board (FASB), is applicable to all companies and will supersede the current revenue recognition requirements under IFRS. Either a full or modified retrospective application is required for annual periods beginning on or after 1 January 2017, but early adoption is permitted under IFRS. As the standard was recently issued, the Group is still currently assessing the impact on the companies within the Group.

Amendments to IFRS 11 Joint Arrangements: Accounting for Acquisitions of Interests
The amendments to IFRS 11 require that a joint operator accounting for the acquisition of an interest in a joint operation, in which the activity of the joint operation constitutes a business must apply the relevant IFRS 3 principles for business combinations accounting. The amendments also clarify that a previously held interest in a joint operation is not remeasured on the acquisition of an additional interest in the same joint operation while joint control is retained. In addition, a scope exclusion has been added to IFRS 11 to specify that the amendments do not apply when the parties sharing joint control, including the reporting entity, are under common control of the same ultimate controlling party.

The amendments apply to both the acquisition of the initial interest in a joint operation and the acquisition of any additional interests in the same joint operation and are prospectively effective for annual periods beginning on or after 1 January 2016, with early adoption permitted. This amendment is not expected to have any impact to the Group.

Amendments to IAS 16 and IAS 38: Clarification of Acceptable Methods of Depreciation and Amortisation
The amendments clarify the principle in IAS 16 and IAS 38 that revenue reflects a pattern of economic benefits that are generated from operating a business (of which the asset is part) rather than the economic benefits that are consumed through use of the asset. As a result, a revenue-based method cannot be used to depreciate property, plant and equipment and may only be used in very limited circumstances to amortise intangible assets. The amendments are effective prospectively for annual periods beginning on or after 1 January 2016, with early adoption permitted. These amendments are not expected to have any impact to the Group given that the Group has not used a revenue-based method to depreciate its non-current assets.

(c) Basis of Consolidation
The Consolidated Financial Statements comprise the Financial Statements of the Group as at 31 December each year.

Subsidiaries are fully consolidated from the date of acquisition, being the date on which the Group obtains control, and continue to be consolidated until the date when such control ceases. Assets, liabilities, income and expenses of a subsidiary acquired or disposed of during the year are included in the Statement of Comprehensive Income from the date the Group gains control until the date the Group ceases to control the subsidiary. The Financial Statements of the subsidiaries are prepared for the same reporting year as the parent company, using consistent accounting policies.

All intra-group balances, transactions, income and expenses and profits and losses resulting from intra-group transactions and dividends, are eliminated in full.

Control is achieved when the Group is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. Specifically, the Group controls an investee if and only if the Group has:

- Power over the investee (i.e. existing rights that give it the current ability to direct the relevant activities of the investee).
- Exposure, or rights, to variable returns from its involvement with the investee.
- The ability to use its power over the investee to affect its returns.

Note 1 – Accounting Policies continued

The Group re-assesses whether or not it controls an investee if facts and circumstances indicate that there are changes to 1 or more of the 3 elements of control.

(d) Contract Classification

The Group has classified all its policyholder contracts as insurance contracts in accordance with IFRS 4 Insurance Contracts. Insurance contracts are contracts which transfer significant insurance risk to the insurer at the inception of the contract.

As permitted by IFRS 4 Insurance Contracts, the assets and liabilities of the Group's insurance contracts are accounted for using generally accepted accounting principles within the industry. The Group applies the modified statutory solvency basis ('MSSB') of reporting as set out in the revised Statement of Recommended Practise (SORP) issued by the Association of British Insurers ('ABI') in November 2005 (amended in December 2006).

(i) Premiums

The Group writes both single and regular premium business, Single and regular premiums are recognised when they fall due and in accordance with the substance of the underlying contractual agreement.

(ii) Claims

Annuity payments are accounted for when they fall due for payment. Surrenders are accounted for when paid or, if earlier, on the date when the policy ceases to be included within the calculation of the long-term business provision. Death claims and all other claims are accounted for when notified.

(iii) Insurance Contract Liabilities

Insurance contract liabilities are determined by the Group's Directors using methods and assumptions recommended by the actuarial function holder of Rothesay Life Limited ('RLL') and Rothesay Assurance Limited ('RAL') and using recognised actuarial methods with due regard to the actuarial principles laid down in Directive 2002/83/EC. They are calculated using the statutory solvency basis required to comply with the reporting requirements under the Financial Services and Markets Act 2000 and in accordance with SORP on Accounting for Insurance Business issued by the ABI in December 2005 and revised in December 2006. The Group seeks to make prudent assumptions relating to expected future experience based on current market conditions and recent experience. The assumptions used incorporate prudent margins to reflect the inherent uncertainty that actual experience may be less favourable than would otherwise be assumed.

Insurance Contract Liabilities have been determined using the gross premium method of valuation. They are calculated as the discounted value of projected future claim payments (as determined by reference to the contractual arrangements with the insured schemes at an individual member level) adjusted for future administration costs and investment management expenses determined using prudent assumptions less the present value of future premiums (a schedule of agreed, guaranteed payments) received under the longevity swap arrangements. Projected future claim payments allow for the effects of mortality. Further details of valuation assumptions are produced in Note 22. The administration costs are reflective of recent costs and expenses budgeted for the future.

In accordance with the PRA valuation regulations set out in the Prudential Sourcebook for Insurers, the Group recognises negative mathematical reserves on its regular premium longevity risk transfer arrangements subject to the PRA's restrictions on the level of such reserves.

(e) Acquisition Costs

The costs of acquiring new business are expensed during the financial year in which they are incurred.

(f) Reinsurance

Long-term business is ceded to reinsurers under contracts to transfer part of the insurance risk associated with the underlying insurance contracts. Such contracts are accounted for as insurance contracts provided the risk transfer is significant.

The amounts that will be recoverable from reinsurers is estimated based upon the gross provisions, having due regard to collectability. The recoverability of reinsurance recoveries is assessed having regard to market data on the financial strength of the reinsurance company. The reinsurers' share of claims incurred, in the profit and loss account, reflects the amounts received or receivable from reinsurers in respect of claims paid or incurred during the year. Reinsurance liabilities are primarily premiums payable for reinsurance contracts and are recognised in the Statement of Comprehensive Income as 'Premiums Ceded to Reinsurers' when due.

Reinsurance assets are reviewed for impairment at each reporting date, or more frequently when an indication of impairment arises during the financial reporting year. Impairment occurs when there is objective evidence as a result of an event that occurred after initial recognition of the reinsurance asset that the Company may not receive all outstanding amounts due under the terms of the contract and the event has a reliably measurable impact on the amounts that the Company will receive from the reinsurer. Any impairment loss is recorded in the Statement of Comprehensive Income.

(g) Investment Income
Investment income comprises all investment income, realised investment gains and losses and movements in unrealised gains and losses.

Dividends on money market securities held in collective investment schemes are included as investment income on the date the units are created. Interest is accounted for on an accruals basis.

Realised gains and losses on investments carried at fair value are calculated as the difference between net sales proceeds and purchase price. Movements in unrealised gains and losses on investments represent the difference between the fair value at the Statement of Financial Position date and their purchase price.

(h) Finance Costs
Finance costs comprise finance costs and interest payable on financial liabilities. Expenses are accounted for on an accruals basis.

(i) Operating Leases
A lease is classified as an operating lease if it does not transfer substantially all the risk and rewards incidental to ownership.

Payments made under operating leases, net of any investments received from the lessor, are charged to profit and loss on a straight-line basis over the term of the lease. When the lease includes a rent free period, the lessee recognises the aggregate benefit of the incentive as a reduction of rental expense over the lease term on a systematic basis.

(j) Investments in Subsidiary Undertakings
Investments in subsidiary undertakings are stated at cost less provision for impairment in the Company's Financial Statements.

(k) Property, Plant and Equipment
Equipment is stated at cost less accumulated depreciation and accumulated impairment losses. Depreciation is calculated on a straight line basis over the useful life of the following classes of assets:

- Computer Equipment: 3 years
- Furniture and Fittings: 5 years

Note 1 – Accounting Policies continued

(l) Financial Investments

Financial Investments are classified, at initial recognition, as financial investments at fair value through profit or loss, with the exception of receivables, cash, and prepayments and accrued interest which are carried at amortised cost.

Financial Investments at Fair Value Through Profit and Loss

Financial Investments at fair value through profit or loss are both financial investments held for trading and financial investments designated upon initial recognition at fair value. Financial investments at fair value through profit or loss are carried in the Statement of Financial Position at fair value with net changes in fair value presented in investment income. Financial investments include collective investment schemes, government and agency obligations, derivative assets, corporate debt, and collateralised agreements and financing.

Derecognition

A financial Investment (or, where applicable, a part of a financial investment or part of a group of similar financial investments) is primarily derecognised (i.e. removed from the Group's Consolidated Statement of Financial Position) when:

- The rights to receive cash flows from the investment have expired; or
- The Group has transferred its rights to receive cash flows from the asset or has assumed an obligation to pay the received cash flows in full without material delay to a third party under a 'pass-through' arrangement; and either (a) the Group has transferred substantially all the risks and rewards of the asset, or (b) the Group has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the investment.

When the Group has transferred its rights to receive cash flows from an investment or has entered into a pass-through arrangement, it evaluates if and to what extent it has retained the risks and rewards of ownership. When it has neither transferred nor retained substantially all of the risks and rewards of the investment, nor transferred control of the investment, the Group continues to recognise the transferred investment to the extent of the Group's continuing involvement. In that case, the Group also recognises an associated liability. The transferred investment and the associated liability are measured on a basis that reflects the rights and obligations that the Group has retained.

Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of the original carrying amount of the asset and the maximum amount of consideration that the Group could be required to repay.

(m) Collateralised Agreements and Financing

Collateralised agreements (securities purchased under agreements to resell and deposits placed as collateral for stock borrowed) and collateralised financing (securities sold under agreements to repurchase and deposits received as collateral for stock loans) are treated as collateralised financing transactions and are carried at fair value through profit and loss under the fair value option. The collateral can be in the form of cash or securities. Cash collateral is recognised/derecognised when received/paid. Collateral posted by the Group in the form of securities is not derecognised from the Statement of Financial Position, whilst collateral received in the form of securities is not recognised on the Statement of Financial Position. If collateral received is subsequently sold, the obligation to return the collateral and the cash received are recognised in the Statement of Financial Position.

(n) Fair Value

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. Fair value gains or losses are included in Investment income.

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, including but 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 1 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.

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.

(o) Taxation

Current Income Tax

Income tax assets and liabilities for the current period and prior periods are measured at the amount expected to be recovered from or paid to the taxation authorities, or paid to or recovered from other group companies in respect of group relief surrendered or received. The tax rates and laws used to compute the amount are those that are enacted or substantively enacted by the financial statement date.

Deferred Income Tax

Deferred income tax is provided using the liability method on temporary differences at the financial statement date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes.

Note 1 – Accounting Policies continued

Deferred income tax and liabilities are recognised for all taxable temporary differences except:

- When the deferred income tax liability arises from the initial recognition of goodwill or of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit or loss nor taxable profit or loss; and
- In respect of taxable temporary differences associated with investments in subsidiary undertakings, associates and interests in joint ventures, when the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future.

Deferred income tax assets are recognised for all deductible temporary differences, carry forward of unused tax credits and unused tax losses, to the extent that it is probable that taxable profit will be available against which to offset them except:

- When the Deferred Income Tax asset relating to the deductible temporary difference arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit or loss nor the taxable profit or loss; and
- The carrying amount of Deferred Income Tax assets is reviewed at each financial reporting date and that reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the Deferred Tax Asset to be utilised. Unrecognised deferred income tax assets are reassessed at each financial reporting date and are recognised to the extent that it has become probable that future taxable profit will allow the deferred tax asset to be recovered.

Deferred income tax assets and liabilities are measured at the tax rates that are expected to apply to the year when the asset is realised or the liability settled, based on tax rates (and tax laws) that have been enacted or substantively enacted at the financial reporting date.

Deferred income tax assets and deferred tax liabilities are offset, if a legally enforceable right exists to set off current tax assets against current tax liabilities and the deferred income tax relate to the same taxable entity and the same taxation authority.

(p) Foreign Currencies

Transactions denominated in foreign currencies are translated into sterling at rates of exchange ruling on the date the transaction occurred. Monetary assets and liabilities denominated in foreign currencies are translated into sterling at rates of exchange ruling at the financial statement date. Gains and losses on exchange are recognised in Operating Expenses.

(q) Share-Based Payments

Prior to divestment, The Goldman Sachs Group Inc. issued awards in the form of restricted stock units ('RSUs') to its employees for services rendered to them. The cost of equity-based transactions with employees is measured based on the fair value of the award on grant date. Share-based awards that do not require future services (i.e. vesting awards, including awards granted to retired eligible employees) are expensed immediately. Share-based employee awards that require future service are amortised over the relevant service period. Expected forfeitures are included in determining share based employee compensation expense.

The Goldman Sachs Group, Inc. settles equity awards through delivery of its ordinary shares. The Goldman Sachs Group Inc. pays cash dividend equivalents on outstanding RSUs. The Group has also entered into a chargeback agreement with The Goldman Sachs Group Inc. under which it is committed to pay the market value at grant date, as well as subsequent movements in fair value of those awards, to the Group at the time of delivery to its employees.

Upon divestment, Rothesay Life (Cayman) Limited, an indirect shareholder of Rothesay Life Pensions Limited ('RPML') issued awards in the form of restricted stock units to the Group's employees for services rendered to the Group. The cost of equity-based transaction with employees is measured based on grant-date sale value. Share-based employee awards that require future services are amortised over the relevant service period. Expected forfeitures are included in determining share based employee compensation expense.

(r) Pension Costs

The Group operates a defined contribution pension scheme and contributions to the scheme are charged to the Statement of Comprehensive Income as they accrue.

NOTES TO THE FINANCIAL STATEMENTS CONTINUED

Note 2 – Segmental Analysis

All of the Group's business risks and returns are within 1 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 2014 £000s	Year ended 31 December 2013 £000s	**Year ended 31 December 2014 £000s**	Year ended 31 December 2013 £000s
Group pension bulk annuities	**273,567**	255,224	**1,405,768**	1,372,835
Total Gross Premiums Written	**273,567**	255,224	**1,405,768**	1,372,835

During 2014 premiums from 4 bulk annuity customers each made up more than 10% of the Group's total gross written premium (2013: 4 bulk annuity customers), generating premiums of £1,109.7m (2013: £1,371.9m).

Note 3 – Company Profit

The loss for the financial year of the Company was £11.5m (2013: £nil). As permitted by section 408 of the Companies Act 2006, the Company's Statement of Comprehensive Income has not been included in these Financial Statements.

Note 4 – Net Claims and Change in Insurance Contract Liabilities

	Year ended 31 December 2014 £000s	Year ended 31 December 2013 £000s
Claims Paid		
Gross claims paid	**(700,560)**	(576,207)
Reinsurance recoveries	**408,607**	338,260
Change in the provision for claims outstanding	**680**	3,520
	(291,273)	(234,427)
Change in Insurance Contract Liabilities		
Gross change in insurance contract liabilities	**(2,528,646)**	(624,762)
Reinsurance recoveries	**124,575**	(76,282)
	(2,404,071)	(701,044)
Net Claims and Change in Insurance Contract Liabilities	**(2,695,344)**	(935,471)

Note 5 – Operating Expenses

The note gives further details of items included in the Operating Expenses section of the Consolidated Statement of Comprehensive Income which have been included in arriving at the profit before tax:

	Year ended 31 December 2014 £000s	Year ended 31 December 2013 £000s
Acquisition costs	37,960	36,212
Administration expenses – recurring	13,234	4,393
Administration expenses – other	14,776	246
	65,970	40,851

The following items have been included in Administration expenses – other:

	Year ended 31 December 2014 £000s	Year ended 31 December 2013 £000s
Costs relating to separation project	4,558	–
Solvency II expenses	781	–
Part VII project	577	–
Acquisition of MAL	1,132	–
Reinsurance fees	7,728	246
	14,776	246

The following items have been included in Operating Expenses:

	Year ended 31 December 2014 £000s	Year ended 31 December 2013 £000s
Operating lease rental expense for office premises	420	–

Note 6 – Finance Costs

	Year ended 31 December 2014 £000s	Year ended 31 December 2013 £000s
Interest payable on collateral	1,511	676
Interest payable on overnight loans	23	66
Interest payable on borrowings from participating interest	–	1,292
Interest payable on third party borrowings	3,991	–
Interest payable on borrowings from affiliates	4,909	4,999
Debt issuance expenses	7,209	–
Net Finance Costs	17,643	7,033

Note 7 – Employee Information

	Year ended 31 December 2014	Year ended 31 December 2013
Average number of staff employed during the year	72	49
Employees by Department at Period End		
Management	7	6
Sales and marketing	9	11
Investment	15	16
Operations	21	13
Technology	6	6
Finance, Compliance and Legal	20	13
	78	65

NOTES TO THE FINANCIAL STATEMENTS CONTINUED

Note 7 – Employee Information continued

Group staff costs during the financial year (including Directors' salaries) are as follows:

	Year ended 31 December 2014 £000s	Year ended 31 December 2013 £000s
Wages and salaries	26,363	11,856
Social security costs	3,001	2,384
Pension costs	818	309
Total Employee Benefits Expense	30,182	14,549

During 2013 £12m of bonus payments were borne by a fellow participating interest as part of a long-term incentive arrangement.

	Year ended 31 December 2014 £000s	Year ended 31 December 2013 £000s
Directors' Remuneration		
Aggregate emoluments	4,204	643
Company pension contributions to money purchase schemes	36	4
	4,240	647
Highest Paid Director		
Total amount of emoluments	2,152	471
Company pension contributions to money purchase schemes	13	3
	2,165	474

In accordance with the Companies Act 2006, Directors' emoluments above represent the proportion of total emoluments paid or payable in respect of qualifying services. This total does not include the value of equity awards in accordance with the provisions of Schedule 5 of SI 2008/410.

During 2013 Directors also received emoluments for non-qualifying services which were not required to be disclosed.

No Directors have been granted shares in respect of long-term incentive schemes. No Directors have exercised options during the year.

Note 8 – Auditors' Remuneration

Fees paid and payable to the Company's auditors are as follows:

	Year ended 31 December 2014 £000s	Year ended 31 December 2013 £000s
Remuneration receivable by the Company's auditors for the audit of the consolidated and company financial statements	48	15
Remuneration receivable by the Company's auditors for the audit of the financial statements of the Company's subsidiaries	440	308
Audit related assurance services	147	62
Total Audit	635	385
Other assurance services	3	–
Total Fees	638	385

Note 9 – Taxation

The major components of income tax expense for the years ended 31 December 2014 and 2013 are:

(a) Tax charged in the income statement

	Year ended 31 December 2014 £000s	Year ended 31 December 2013 £000s
Current income tax		
UK corporation tax	57,479	30,902
Adjustments in respect of prior periods	6,557	16
Total Current Income Tax	64,036	30,918
Deferred tax		
Origination and reversal of temporary differences	(394)	3,277
Impact of changes in tax laws and rates	–	464
Total Deferred Tax	(394)	3,741
Total Expense in the Income Statement	63,642	34,659

(b) Reconciliation of the total tax charge

The tax expense in the Statement of Comprehensive Income for the year and the standard rate of corporation tax in the UK of 21.49% (2013: 23.25%) is reconciled below:

	Year ended 31 December 2014 £000s	Year ended 31 December 2013 £000s
Profit from continuing operations before tax	244,081	183,546
Tax calculated at UK standard rate of corporation tax of 21.49% (2013: 23.25%)	52,453	42,674
Income not subject to corporation tax	(12,102)	–
Expenses not deductible for tax purposes	14,290	–
Employee cost borne but not allowable by participating interest	–	(6,480)
Adjustment to tax charge in respect of prior periods	6,765	48
Tax losses on which deferred tax asset recognised	2,236	88
Impact of changes in tax laws and rates	–	(464)
Utilisation of previously unrecognised tax losses	–	(1,207)
Total Tax Expense Reported in the Statement of Comprehensive Income	63,642	34,659

Note 10 – Investment Return

Investment return includes fair value gains and losses. Interest is included on an accrual basis.

	Year ended 31 December 2014 £000s	Year ended 31 December 2013 £000s
Interest income on financial investments at fair value through profit and loss	270,267	168,891
Unrealised gains/(losses) on financial investments	895,260	(210,841)
Realised gains/(losses) on financial investments	564,189	(58,000)
Investment expenses	(7,247)	–
Gains on acquisition of subsidiary undertaking	56,413	–
Total Investment Return	1,778,882	(99,950)

Note 11 – Share-Based Payments

Stock Incentive Plan

Prior to 18 December 2013, the previous ultimate Parent Company of the Group, The Goldman Sachs Group, Inc., sponsored a stock incentive plan. The Goldman Sachs Amended and Restated Stock Incentive Plan ('the SIP'), which provided for, amongst others, grants of incentive stock options and restricted stock units ('RSUs').

The ultimate parent company issued RSUs to the employees under the SIP, primarily in connection with year-end compensation. RSUs were valued based on the closing price of the underlying shares at the date of grant after taking into account a liquidity discount for any applicable postvesting restrictions. Year end RSUs generally vest and deliver as outlined in the applicable RSU agreements. Employee RSU agreements generally provide that vesting is accelerated in certain circumstances, such as upon retirement, death and extended absence. Delivery of the underlying shares of common stock is conditional on the grantees satisfying certain vesting and other requirements outlined in the award agreements. The activity related to these RSUs is set forth below:

	31 December 2014 No. of RSUs		31 December 2013 No. of RSUs	
	No. future service requirement	Future service requirement	No. future service requirement	Future service requirement
Outstanding at the beginning of the period	–	–	1,958	977
Granted during the period	–	–	14,499	516
Forfeited during the period	–	–	(24,398)	(526)
Delivered during the period	–	–	–	(982)
Transferred in during the period	–	–	7,941	15
Outstanding at the End of the Period	–	–	–	–

The weighted average fair value of the equity instruments granted in relation to The Goldman Sachs Amended and Restated Stock Incentive Plan during the year ended 31 December 2013 was US$121.8. The fair value of the RSUs granted during the year ended 31 December 2013 included a liquidity discount of 13.62%, to reflect postvesting transfer restrictions of up to 4 years.

The RSUs were forfeited on 18 December 2013 following the Group reorganisation.

Rothesay Life (Cayman) Limited, an indirect shareholder of the Group, sponsors a stock incentive plan, The Rothesay Life (Cayman) Limited SARs plan ('the RLSIP'), which provides for grants of conditional rights over assets which are equivalent in value to certain equity rights of RHUK ('SARs').

The indirect shareholder issued SARs to the Group's employees under the RLSIP, primarily in connection with the sale of RHUK by The Goldman Sachs Group, Inc.. SARs were valued based on the sale price at the date of grant. The SARs vest in 3 equal instalments, on 31 December 2015, 31 December 2016 and 31 December 2017. Delivery of the underlying assets is conditional on the grantees satisfying certain vesting and other requirements outlined in the award agreements. The activity related to these SARs is set forth below:

	31 December 2014 No. of RSUs		31 December 2013 No. of RSUs	
	No. future service requirement	Future service requirement	No. future service requirement	Future service requirement
Outstanding at the beginning of the period	–	103,987	–	–
Granted during the period	–	–	–	103,987
Outstanding at the End of the Period	–	103,987	–	103,987

Expenses of £4.4m have been charged to the profit and loss account of the Group during the year in relation to the RLSIP.

In addition, RHUK sponsors a stock incentive plan, which provides for grants of conditional equity rights in RHUK. The rights vest conditionally on future events and employment conditions. The total value of the rights at year end is immaterial.

Note 12 – Pension Contributions

The Group operates a defined contribution pension scheme for its employees. Contributions to the scheme are recognised in the Statement of Comprehensive Income as they accrue. The amount charged for the financial year was £0.8m (2013: £0.3m). The outstanding contributions as at 31 December 2014 were £0.1m (2013: £nil) which were materially settled in January 2015.

Note 13 – Business Combinations

Acquisition of Rothesay Assurance Limited

On 16 May 2014, the Group acquired 100% of the ordinary shares of MetLife Assurance Limited for a cash consideration of £421.4m. MetLife Assurance Limited was the UK bulk annuity business of MetLife Inc. The acquisition was consistent with the Group's strategy to supplement organic growth. MetLife Assurance Limited was renamed Rothesay Assurance Limited on 23 June 2014.

	£000s
Cash and cash equivalent received	66,567
Cash paid as part of consideration	(421,381)
Net Cash Outflow	**(354,814)**

The fair value of the assets and liabilities at the date of acquisition was as follows:

	Fair value recognised on acquisition £000s	Previous carrying value £000s
Financial investments	3,039,214	3,039,214
Receivables	67,963	69,963
Cash and cash equivalents	66,567	66,567
	3,173,744	**3,175,744**
Insurance contract liabilities	(2,623,545)	(2,687,945)
Payables	(72,405)	(72,405)
	(2,695,950)	**(2,760,350)**
Total Identifiable Net Assets	**477,794**	**415,394**
Gain on bargain purchase arising on acquisition	(56,413)	
Total Consideration	**421,381**	

Note 14 – Investment in Unconsolidated Structured Entities

The Group has interests in investments which are classified under IFRS as unconsolidated structured entities. A structured entity is an entity that has been designed so that voting or similar rights are not the dominating factor in deciding who controls the entity, such as when voting rights might relate to administrative tasks only and the relevant activities are directed by means of contractual arrangement. Structured entities include those entities that have restricted activities or a narrow and well-defined objective. These structured entities have not been consolidated as the Group does not have the power to affect their returns.

As at 31 December 2014 our total interest in such entities, reflected on the Group's consolidated balance sheet and classified as financial investments held at fair value through profit or loss, was £1,156m (2013: £742m).

NOTES TO THE FINANCIAL STATEMENTS CONTINUED

Note 15 – Property, Plant and Equipment

	Furniture and Fittings £000s	Total £000s
Cost		
As at 1 January 2014	–	–
Additions	1,524	1,524
Disposals	–	–
As at 31 December 2014	1,524	1,524
Accumulated Depreciation		
As at 1 January 2014	–	–
Charge for the year	–	–
Disposals	–	–
As at 31 December 2014	–	–
Net Book Value		
As at 31 December 2014	1,524	1,524
As at 31 December 2014	–	–

As part of the development of fully independent infrastructure and computer systems the Group moved into new premises during early 2015. Furniture and Fittings additions reflect the build out of the office in preparation for the move. The fit out was completed during December 2014 and therefore no depreciation has been charged during the year.

Note 16 – Financial Investments

The Group's financial investments are grouped in a single category:

	31 December 2014 £000s	31 December 2013 £000s
Financial investments	20,989,390	11,300,849

This is made up of:

	Current Value		Cost	
	31 December 2014 £000s	31 December 2013 £000s	31 December 2014 £000s	31 December 2013 £000s
Collective investment schemes	726,307	425,237	419,112	217,873
Government and agency obligations	5,855,467	2,505,789	5,147,966	2,257,550
Corporate debt	5,076,291	3,083,115	4,576,895	3,198,847
Derivative assets	5,801,994	2,407,740	201,791	320,988
Collateralised agreements and financing	3,400,828	2,878,968	3,177,387	2,953,499
Certificate of deposits	128,503	–	93,671	–
	20,989,390	11,300,849	13,616,822	8,948,757

Note 17 – Fair Value

Determination of Fair Value and Fair Values Hierarchy

The Group uses the following hierarchy for determining and disclosing the fair value of Financial Instruments by valuation technique:

- Level 1: inputs are unadjusted quoted prices in active markets to which the Group had access at the measurement date for identical unrestricted assets and liabilities,
- Level 2: inputs to valuation techniques are observable either directly or indirectly,
- Level 3: 1 or more inputs to valuation techniques are significant and unobservable.

Financial Investments and liabilities measured using a valuation technique based on assumptions that are supported by prices from observable current market transactions are assets and liabilities for which pricing is obtained via pricing services, but where prices have not been determined in an active market, financial investments with fair values based on broker quotes and assets that are valued using the Group's own models whereby the majority of assumptions are market observable.

The following tables show an analysis of financial instruments recorded at fair value by level of the fair value hierarchy for 2014 and 2013:

31 December 2014

	Level 1 £000s	Level 2 £000s	Level 3 £000s	Total £000s
Financial Investments:				
Collective investment schemes	726,307	–	–	726,307
Government and agency obligations	3,390,645	2,464,822	–	5,855,467
Corporate debt	–	4,827,882	248,409	5,076,291
Derivative assets	–	5,800,209	1,785	5,801,994
Collateralised agreements and financing	–	3,400,828	–	3,400,828
Certificate of deposits	–	128,503	–	128,503
Total Financial Investments at Fair Value	4,116,952	16,622,244	250,194	20,989,390
Financial Liabilities:				
Derivative financial instruments	–	5,544,495	6,654	5,551,149
Collateralised financing agreements	–	2,022,430	–	2,022,430
Total Financial Liabilities at Fair Value	–	7,566,925	6,654	7,573,579

31 December 2013

	Level 1 £000s	Level 2 £000s	Level 3 £000s	Total £000s
Financial investments:				
Collective investment schemes	425,237	–	–	425,237
Government and agency obligations	941,533	1,564,256	–	2,505,789
Corporate debt	27,898	2,093,327	961,890	3,083,115
Derivative assets	–	2,403,762	3,978	2,407,740
Collateralised agreements and financing	–	2,326,201	552,767	2,878,968
Total Financial Investments at Fair Value	1,394,668	8,387,546	1,518,635	11,300,849
Financial liabilities:				
Derivative financial instruments	–	2,247,464	18,697	2,266,161
Collateralised financing agreements	–	1,281,069	–	1,281,069
Total Financial Liabilities at Fair Value	–	3,528,533	18,697	3,547,230

Around 1% (2013: 13%) of the total financial assets recorded at fair value, are based on estimates and recorded as Level 3 investments. Where estimates are used, these are based on a combination of independent third-party evidence and internally developed models, calibrated to market observable data where possible. While such valuations are sensitive to estimates, it is believed that changing 1 or more of the assumptions to reasonably possible alternative assumptions would not change the fair value significantly.

NOTES TO THE FINANCIAL STATEMENTS CONTINUED

Note 17 – Fair Value continued

The following table shows a reconciliation of the opening and closing recorded amounts in relation to the Level 3 Financial Instruments recorded at fair value:

	Corporate debt £000s	Collateralised agreements £000s	Derivatives £000s	Total £000s
At 1 January 2014	961,890	552,767	(14,719)	1,499,938
Acquisition at market value	6,942	–	7,474	14,416
Total gains in the Statement of Comprehensive Income:				
Unrealised gains	25,693	–	9,850	35,543
Transfer into level 3	24,511	–	–	24,511
Transfer out of level 3	(812,535)	(552,767)	(7,474)	(1,372,776)
Purchases/additions	41,908	–	–	41,908
At 31 December 2014	248,409	–	(4,869)	243,540
At 1 January 2013	10	543,606	183,829	727,445
Total gains in the Statement of Comprehensive Income:				
Unrealised gains	–	9,161	–	9,161
Transfer into level 3	44,660	–	–	44,660
Purchases/additions	917,220	–	3,977	921,197
Disposals	–	–	(202,525)	(202,525)
At 31 December 2013	961,890	552,767	(14,719)	1,499,938

There have been no transfers between Level 1 and Level 2 during the period.

During the year, the Group transferred certain financial instruments between Level 2 and Level 3 of the fair value hierarchy. The recorded amount of the total assets transferred from Level 2 to Level 3 is £24.5m (2013: £44.7m) and from Level 3 to Level 2 is £1,372.8m (2013: nil). The reason for the change is a change in the availability of observable market transactions or broker quotes for the same or similar instruments.

Sensitivity of Level 3 Financial Investments Measured at Fair Value to Changes in Key Assumptions

The following table shows the impact on the fair value of Level 3 instruments of using reasonably possible alternative assumptions by class of instrument:

			2014		
Impact on Financial Assets and Liabilities	Main Assumptions	Sensitivity	Current FV £000s	Decrease in FV £000s	Increase in FV £000s
Financial Assets					
Corporate debt	Discount rate	+/-50bps interest rate	248,409	(23,733)	23,733
Derivative assets	Expected defaults	+/-50bps credit spread	1,786	(472)	472
Financial Liabilities					
Derivative liabilities	Expected defaults	+/-50bps credit spread	(6,654)	(1,099)	1,099

			2014		
Impact on Profit Before Tax	Main Assumptions	Sensitivity	Current FV £000s	Decrease in FV £000s	Increase in FV £000s
Financial Assets					
Corporate debt	Discount rate	+/-50bps interest rate	248,409	(7,509)	7,509
Derivative assets	Expected defaults	+/-50bps credit spread	1,786	(472)	472
Financial Liabilities					
Derivative liabilities	Expected defaults	+/-50bps credit spread	(6,654)	(1,099)	1,099

Impact on Financial Assets and Liabilities	Main Assumptions	Sensitivity	2013 Current FV £000s	2013 Decrease in FV £000s	2013 Increase in FV £000s
Financial Assets					
Corporate debt	Discount rate	+/50bps interest rate	961,891	(48,521)	48,521
Derivative assets	Expected defaults	+/-50bps credit spread	3,977	(7,272)	7,272
Collateralised agreements and financing	Discount rate	+/-50bps interest rate	552,765	(7,699)	7,699
Financial Liabilities					
Derivative liabilities	Expected defaults	+/-50bps credit spread	(18,697)	(1,245)	1,245

Impact on Profit Before Tax	Main Assumptions	Sensitivity	2013 Current FV £000s	2013 Decrease in FV £000s	2013 Increase in FV £000s
Financial Assets					
Corporate debt	Discount rate	+/50bps interest rate	961,891	(16,206)	16,206
Derivative assets	Expected defaults	+/-50bps credit spread	3,977	(7,272)	7,272
Collateralised agreements and financing	Discount rate	+/-50bps interest rate	552,765	–	–
Financial Liabilities					
Derivative liabilities	Expected defaults	+/-50bps credit spread	(18,697)	(1,245)	1,245

The fair value recognised of certain debt securities classified as level 3 instruments is determined using inputs that are not based on observable market data. The valuation model discounts the future cash flows using interest rate swap curve in addition to a spread to reflect the associated credit and liquidity risk. The sensitivities shown above assume all other pricing inputs remain constant.

Note 18 – Receivables

	31 December 2014 £000s	31 December 2013 £000s
Deposits pledged as collateral to third parties	**349,273**	56,738
Amounts due from undertakings with participating interest	**1,979**	12,954
Tax receivable	**16**	141
Money market investments	**7,859**	1
Other receivables	**1,029**	855
	360,156	70,689

All receivables are due within 1 year. The fair value of receivables is £360.2m (2013: £70.7m).

The net exposure to certain OTC derivatives is collateralised through cash posted, as per the terms of the OTC contracts. At 31 December 2014, the total cash collateral posted was £349.3m (2013: £56.7m). Further details of the full extent of collateral usage can be found in the credit risk disclosure in Note 30.

NOTES TO THE FINANCIAL STATEMENTS CONTINUED

Note 19 – Deferred Taxation

Deferred tax balances comprise:

	31 December 2014 £000s	31 December 2013 £000s
Temporary differences between the Financial Statements and the tax deductions	(3,429)	(2,914)
	(3,429)	(2,914)

The movements in the deferred tax balances were as follows:

	31 December 2014 £000s	31 December 2013 £000s
At 1 January	(2,914)	827
Impact of tax rate change on opening balance	–	464
Tax losses utilised	–	(4,577)
Consolidation adjustment	(909)	
Capital allowances	(58)	–
Transitional adjustments	452	372
At 31 December	(3,429)	(2,914)

Deferred tax assets are only recognised to the extent that based on management's assessment, they are regarded as recoverable.

The Group has unrecognised deferred tax assets in respect:

	31 December 2014 £000s	31 December 2013 £000s
Timing differences in relation to equity-based compensation	2,338	130
	2,338	130

The movements in the unrecognised deferred tax balances were as follows:

	31 December 2014 £000s	31 December 2013 £000s
At 1 January	130	42
Temporary difference in relation to equity-based compensation	2,250	88
Reversal of prior year temporary difference	(42)	–
At 31 December	2,338	130

Note 20 – Accrued Interest and Prepayments

	31 December 2014 £000s	31 December 2013 £000s
Accrued interest	117,744	77,245
Prepaid expenses	14,383	618
Total	132,127	77,863

Note 21 – Cash and Cash Equivalents

The cash at bank and in hand of the Group at the year end is as follows:

	31 December 2014 £000s	31 December 2013 £000s
Cash at bank and in hand	111,617	89,827
	111,617	89,827

Note 22 – Insurance Contract Liabilities

Key Valuation Assumptions

This note details the assumptions with the greatest impact on the Group's insurance contract liability valuations.

(a) Mortality Assumptions

Mortality bases have been determined separately for each pension scheme. The resulting assumptions are equivalent to using the base mortality and improvement assumptions set out in the table below:

	31 December 2014		31 December 2013	
	Males	Females	Males	Females
Base mortality	101.8% S1PMA	101.8% S1PFA	95.7% S1PMA	95.7% S1PFA
Mortality improvements	CMI_2012_M[2.7%]	CMI_2012_F[2.2%]	CMI_2012_M[2.25%]	CMI_2012_F[1.85%]

Ultimate mortality has been used in all cases and mortality improvements are applied from 2002.

Recent mortality experience was analysed for each pension scheme at the end of 2014 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 Group has taken into account reinsurance prices and proprietary socio-demographic models, based on postcode and other factors.

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. For this year the mortality tables used were adjusted for the final scheme remaining on PCMA00 and PCFA00 standard tables to use a set percentage of the S1 suite of tables. All other schemes were converted during 2013.

Allowance is made for future improvements in annuitant mortality with reference to statistical analysis of historic rates of mortality improvements, expert judgement of future changes in mortality improvements, industry benchmarking and reinsurance pricing.

Prudent margins are then applied to the demographic basis to reflect the fact that future experience for the schemes may differ from that assumed. Since the previous valuation the shape of the prudent margins applied has been revised to be more reflective of reinsurance pricing.

(b) Valuation Rate of Interest

The valuation rate of interest used to discount the cash flows for the purpose of valuing insurance contract liabilities is based on the PRA Pillar 1 regulatory requirements, as modified by a waiver granted by the PRA in 2008 and renewed in 2013 to allow the Group to reflect the yield (internal rate of return) on the combined matching assets rather than an average yield based on market value weighted durations. It is determined based on the yield obtainable on the basket of assets matching the PRA Pillar 1 mathematical reserves at 31 December 2014.

The result is equivalent to using the valuation discount rate set out in the table below:

	31 December 2014	31 December 2013
Equivalent valuation discount rate	2.90%pa	4.02%pa

This reflects both the prescribed PRA 2.5% prudential margin applied to the risk adjusted internal rate of return obtained on the basket of matching assets and the allowance for investment management expenses of 3bps p.a. (2013: 3bps p.a).

The asset yield used to calculate the valuation discount rate has been reduced to reflect counterparty default risk; where applicable adjusted for the prudent expected recoveries in the event of default. This reduction in yield is determined separately for each individual asset reflecting the risk to the return being achieved on the asset.

Note 22 – Insurance Contract Liabilities continued

The table below shows the average yield deduction at 31 December 2014 and 31 December 2013 by asset category:

	Average yield reduction	
Asset Class	2014	2013
UK Government approved securities	**0bps**	0bps
Corporate bonds after allowance for covering credit default swaps	**0bps**	0bps
Secured Lending	**6bps**	8bps
Supranational/Other Sovereign	**18bps**	16bps
Secured Residential Lending	**33bps**	30bps
Infrastructure	**82bps**	79bps
Other	**31bps**	30bps
Overall	**18bps**	16bps

Overall, the deduction for counterparty default risk on the assets held by the Group are generally lower than the corresponding credit default deduction on a typical unsecured credit portfolio. This is due to the either the expectation of higher recovery in the event of default through collateralisation, recourse to specific assets, credit default swap protection or through a low probability of default due to government guarantees.

(c) Expenses

An allowance is made for future overhead maintenance expenses following an investigation into the total costs incurred by the Group during 2014 and the projected 2015 expenses. As part of this investigation, these costs have been split between acquisition and maintenance expenses. The long-term business provisions include an allowance to provide for the expenses payable under the Third Party Administration agreements ('TPA') together with the long-term business overhead expenses expressed as an amount per policy. An additional short-term maintenance expense overrun provision has been established to provide for expected project costs.

Within these expense provisions, an allowance for future expense inflation has been provided to cover the impact of both salary and price inflation. The future rate of expense inflation is assumed to be RPI (as implied by the RPI swap curve) plus an addition at each duration of 0.25% p.a. (2013: 0.25% p.a.) for the overhead maintenance expenses and an addition at each duration of 1.00% p.a. (2013: 1.00% p.a.) for the TPA expenses.

Other Assumptions

An important actuarial assumption relates to the future rate of escalation of certain benefits, but as the Company is holding appropriate matching assets (such as index-linked bonds and inflation-linked swaps), the impact on the overall financial position of the Company of actual or assumed changes in these rates is relatively small.

A number of other, less financially significant, actuarial assumptions are made in determining the provisions. These assumptions include, inter alia, the proportion of deferred and immediate annuitants assumed to have a dependant eligible for contingent benefits, dependant's age difference and the proportion of deferred annuitants opting to take a proportion of their benefit at retirement as a lump sum. When deferred annuitants have passed the scheme normal retirement date and have been subject to in depth tracing exercises and yet remain untraced, a prudent allowance has been made for the probability of them retiring in the future. All other individuals who have passed the scheme normal retirement date are assumed to retire immediately.

(d) Movements in Insurance Contract Liabilities

	31 December 2014			31 December 2013		
	Insurance Liabilities £000s	Reinsurance Assets £000s	Net Liabilities £000s	Insurance Liabilities £000s	Reinsurance Assets £000s	Net Liabilities £000s
Carrying amount at 1 January	6,953,306	164,325	6,788,981	6,323,645	240,607	6,083,038
RAL value at acquisition	2,623,545	–	2,623,545	–	–	–
Increase in respect of new business	1,282,942	56,225	1,226,717	1,322,798	8,185	1,314,613
Release of liabilities/liabilities discharged	(404,416)	20,099	(424,515)	(205,093)	18,089	223,182
Effect of non-economic assumption changes	30,708	(27,058)	57,766	(170,444)	(86,203)	(84,241)
Effect of economic assumption changes	1,629,421	75,063	1,554,358	(317,600)	(16,353)	(301,247)
Other	(9,824)	–	(9,824)	–	–	–
Closing Balance at 31 December	12,105,682	288,654	11,817,028	6,953,306	164,325	6,788,981

The table above details the change in the gross and net insurance liabilities over the period. The table below provides a further split of the net impact of the most significant assumption changes.

The release of liabilities line reflects claims paid, release of prudent margins and unwind of discounting over the period.

Effect of Changes in Assumptions and Estimates During the Year

The following table shows the impact on the Insurance Contact Liabilities of changes in the assumptions used:

Change in assumptions used	Net Increase/ (Decrease) in liabilities £000s
Valuation interest rates	1,787,053
Inflation	(232,695)
Demographics	50,602
Expenses	6,862
	1,611,822

As shown previously the valuation interest rate decreased by 1.12% over the year which led to the £1.8bn movement in the liability shown. This change was predominantly due to significant changes in interest rates for example a benchmark 30 year swap fell 1.16% in the period.

The movement in the demographic assumptions shown reflects the changes to mortality assumptions and prudent margins applied during the year leading to a £51m increase in liabilities.

(e) Sensitivity Analysis

The schedule below provides an analysis of the reasonably possible movements in key assumptions that would have a material impact on profit before tax, liabilities, and equity. The analysis is based on a change in a single assumption whilst holding all other assumptions constant.

2014	Change in Assumptions	Increase/ (decrease) on liabilities £000s	Increase/ (decrease) on PBT £000s	Impact on Equity £000s
Annuitant mortality	+%5qx	(96,999)	96,999	76,154
Annuitant mortality	-%5qx	102,408	(102,408)	(80,401)
Interest rate	+100bps	(1,755,204)	24,649	19,352
Interest rate	-100bps	2,279,806	879	690
Inflation	+100bps	840,470	12,726	9,991
Inflation	-100bps	(780,841)	63,088	49,530
Long-term credit default assumption	+10bps	729	(41,127)	(32,289)
Long-term credit default assumption	-10bps	(729)	42,706	33,529
Expenses	+10%	24,269	(24,269)	(19,054)

The sensitivities shown above capture non-linearity effects, which may be significant following large market movements. The credit default assumption sensitivity has been calculated assuming a change in the credit spreads on non risk free assets with no associated change in valuation interest rate.

Note 22 – Insurance Contract Liabilities continued

2014	Change in Assumptions	Increase/ (decrease) on Insurance Liability £000s	Increase/ (decrease) on Reinsurance Asset £000s	Net increase/ (decrease) on liabilities £000s
Annuitant mortality	+5% qx	(333,549)	236,550	(96,999)
Annuitant mortality	-5% qx	355,568	(253,159)	102,409

As can be seen from the table above the impact of the reinsurance is to reduce the sensitivity to mortality risk by 71%.

In the annuitant mortality stress it is assumed that in each year 5% more or fewer people survive to the end of each year than had previously been assumed.

The table below shows the discounted insurance liability cash flows, which are expected to arise during each period:

	31 December 2014			
	Less than 1 year £000s	1 to 5 years £000s	Over 5 years £000s	Total £000s
Insurance liability cash flows	486,363	1,850,609	9,768,710	12,105,682
Reinsurance asset cash flows	24,659	89,618	(402,931)	(288,654)
	511,022	1,940,227	9,365,779	11,817,028

	31 December 2013			
	Less than 1 year £000s	1 to 5 years £000s	Over 5 years £000s	Total £000s
Insurance liability cash flows	350,515	1,322,318	5,280,473	6,953,306
Reinsurance asset cash flows	17,254	51,839	(233,418)	(164,325)
	367,769	1,374,157	5,047,055	6,788,981

Note 23 – Reinsurance Assets

The reinsurers' share of the Insurance Contract Liabilities is as follows:

	31 December 2014 £000s	31 December 2013 £000s
Reinsurance of Insurance Contract Liabilities	288,654	164,325

Under the reinsurance contracts, the Company has committed to pay fixed cash flows to the reinsurer for each policy covered. In exchange, the reinsurers will pay cash flows that are linked to the actual life expectancy of the underlying policies. The contracts are collateralised for changes in longevity expectations and movements in market rates.

An analysis of the movement in Reinsurance of Insurance Contract Liabilities is included in Note 22.

At 31 December 2014 the Group conducted an impairment review of the reinsurance assets and found no impairment necessary.

Note 24 – Payables and Financial Liabilities

	31 December 2014 £000s	31 December 2013 £000s
Derivative financial instruments	5,551,149	2,266,161
Collateralised financing agreements	2,022,430	1,281,069
Deposits received as collateral from third parties	640,953	40,168
Deposits received as collateral for derivatives from participating interest	464,506	224,110
Amounts due to participating interests	6,453	1,391
Current tax payable	47,031	28,740
Other taxes and social security costs	4,913	29
Other payables	17,732	210,178
Total	8,755,167	4,051,846

The net exposures to certain OTC derivatives are collateralised through cash. As at 31 December 2014, the total cash collateral received was £1,105.5m (2013: £264.3m). Other OTC contracts are collateralised with fixed income securities which are not recognised on the Statement of Financial Position of the Group.

At 31 December 2013 Other payables included a £200m payable in relation to bonds purchased with settlement dates after the year end.

Note 25 – Borrowings

The Group's borrowings are as follows:

	31 December 2014 £000s	31 December 2013 £000s
Third party syndicated loan	125,000	–
Affiliate subordinated loan	100,000	100,000
Total	225,000	100,000

The amounts outstanding at 31 December 2014 include £100m of floating rate perpetual callable securities issued to an affiliate. In 2013 this was reflected in third party subordinated loans. The securities issued are unsecured and carry deferrable interest at 6 month sterling LIBOR plus 425bps per annum. These securities are callable at par on 21 December 2017 and every 6 months thereafter. The principal constitutes regulatory capital. The repayment of the securities is subject to PRA consent.

On 29 September 2014 the Company entered into a £125,000,000 3 year term loan agreement provided by a syndicate of third party banks. The loan is secured and the rate of interest is 6 month Sterling Libor plus 350bps per annum.

The fair value of the borrowings is £225m (2013: £100m).

Note 26 – Share Capital

At 31 December 2014 and 31 December 2013 share capital comprised

	31 December 2014		31 December 2013	
	No.	£000s	No.	£000s
Authorised share capital (ordinary shares of £1 each)	1,800,000	1,800	1,800,000	1,800

Note 27 – Share Premium Account and Reserve

	Share premium £000s	Capital contribution £000s	Other reserves £000s
At 1 January 2014	265,710	155	308,387
Profit for the financial year	–	–	180,439
Capital Contribution	–	4,365	–
At 31 December 2014	265,710	4,520	488,826

The capital contribution reserve arose as a result of the SARs granted in relation to the RLSIP (please see Note 11).

Note 28 – Dividends

	31 December 2014 £000s	31 December 2013 £000s
Interim Ordinary Share Dividends	–	290,554

The Directors have recommended that no interim ordinary dividend be paid (2013: 290.5m).

The Directors have recommended that no final ordinary dividend be paid in respect of the year (2013: £nil).

Note 29 – Derivatives

The Group utilises derivative financial instruments as part of its asset/liability risk management practice. It enters into derivative contracts to match the Insurance Contract Liabilities arising on Insurance Contracts that it issues.

The following table shows the fair value of derivative financial instruments, recorded as assets or liabilities, together with their notional amounts. The notional amount, recorded gross, is the amount of a derivative's underlying assets, reference rate or index and is the basis upon which changes in the value of derivatives are measured. The notional amounts indicate the volume of transactions outstanding at the year end and are indicative of neither the market risk nor the credit risk.

	31 December 2014			31 December 2013		
	Assets £000s	Liabilities £000s	Notional Amount £000s	Assets £000s	Liabilities £000s	Notional Amount £000s
Derivatives Held for Risk Management:						
Interest rate swap	4,641,488	(4,267,001)	75,617,910	2,029,005	(1,717,851)	51,708,091
Inflation swap	1,039,317	(1,077,421)	24,609,061	309,231	(473,342)	21,348,989
Currency swap	109,165	(120,689)	8,159,240	64,358	(29,133)	4,773,840
Credit derivative	11,923	(76,133)	3,449,834	5,103	(34,974)	695,974
Foreign currency forwards	101	(9,905)	946,626	43	(10,861)	397,712
	5,801,994	(5,551,149)	112,782,671	2,407,740	(2,266,161)	78,924,606

At their inception, derivatives often involve only a mutual exchange of promises, with little or no transfer of consideration. However, these instruments frequently involve a high degree of leverage and are very volatile. A relatively small movement in the value of the asset, rate or index underlying a derivative contract may have a significant impact on the profit or loss of the Group. Over-the-counter derivatives may expose the Group to the risks associated with the absence of an exchange market on which to close out an open position.

The Group's exposure under derivative contracts is closely monitored as part of the overall management of the Group's market risk (see also Note 30). As of 31 December 2014, the Group had positions in the following types of derivatives:

Interest rate swaps

Interest rate swaps are contractual agreements between 2 parties to exchange movements in interest rates. Typically, for an interest rate swap, a floating rate interest stream will be exchanged for a fixed rate or vice versa. The payment flows are usually netted against each other, with the difference being paid by 1 party to the other.

Inflation swaps

The Group uses inflation swaps and options to hedge the inflation linked benefits on the pension liabilities of the UK insurance business.

Currency swaps

In a currency swap, the Group pays a specified amount in 1 currency and receives a specified amount in another currency. Currency swaps are mostly gross–settled.

Credit derivatives

The Group uses credit derivatives to hedge counterparty risk of its assets in the event of default of corporate or sovereign bonds.

Forward and futures

Forwards and futures contracts are contractual agreements to buy or sell a specified financial instrument at a specific price and date in the future. Forwards are customised contracts traded in the over-the-counter market. Futures contracts are transacted in standardised amounts on regulated exchanges and are subject to daily cash margin requirements. The main differences in the risk associated with forward and futures contracts are credit risk and liquidity risk. The Group has credit exposure to the counterparties of forward contracts. The credit risk related to future contracts is considered minimal because the cash margin requirements of the exchange help ensure that these contracts are always honoured. Forward contracts are settled gross and are, therefore, considered to bear a higher liquidity risk than the futures contracts which are settled on a net basis. Both types of contracts result in market risk exposure.

Note 30 – Financial Risk Management

The Group is exposed to financial risk through its financial assets, financial liabilities and Insurance Contract Liabilities. These risks, described below, are managed in accordance with risk management policies and procedures established by the Group.

The Board Risk Committee advises and make recommendations to the Board of Directors to assist it in providing leadership, direction and oversight of the Group's risk appetite, risk strategy and risk management framework and of the risk aspects of major investments and corporate transactions. The Board Risk Committee has oversight of the Working Level Risk Committee, which is an executive committee and is assigned responsibility for the on-going monitoring and control of the financial and insurance risks associated with the activities of the Group.

In addition to the committees, independent functions such as Compliance, Finance (including Risk Management), Legal, Internal Audit and Operations, perform risk management functions, which include assessing, monitoring, reporting and evaluating risk.

Market Risk

Market risk is the risk of changes in the value of the Group's net asset position due to changes in market prices. Financial investments are accounted for at fair value and, therefore, fluctuate on a daily basis. Categories of market risk include the following:

- Interest rate risk arises from discounting cash flow mismatches across all future dates. Profits and losses are generated through changes in the level, slope and curvature of interest rate curves. The risk is hedged using interest rate swaps.
- Inflation rate risks results from mismatches in the index linkage of annuities and assets. Profits and losses are generated through changes to the level, slope and curvature of inflation curves. The risk is hedged using inflation swaps.
- Currency rate risk results from mismatches in the denomination of annuities and assets. Profits and losses are generated due to changes in the level of foreign exchange rates. The risk is hedged using spot foreign exchange and cross currency swaps.

The Group manages market risk by diversifying exposures, controlling position sizes and establishing economic hedges in related securities, derivatives and insurance liabilities.

This includes:

- Accurate and timely exposure information incorporating multiple risk metrics;
- A dynamic limit setting framework; and
- Constant communication between risk management and senior management.

The Group's Risk Function, which is independent of management and reports to the Chief Risk Officer, has responsibility for assessing, monitoring and managing market risk. Risks are monitored and controlled through strong oversight and independent control and support functions across the business.

Market risk limits are set by the Board Risk Committee and the Risk Function monitors exposures against those.

Senior management is responsible and accountable for managing market risks daily within prescribed limits. They have in depth knowledge of their positions, of markets and the instruments available to hedge their exposures.

Note 30 – Financial Risk Management continued

In addition to applying business judgement, management uses a number of quantitative tools to manage the exposure to market risk for 'Financial Investments' in the Financial Statements. These tools include scenario analyses, stress test and other analytical tools that measure the potential effects on the net revenues of various market events, including, but not limited to, a large widening of credit spreads, as well as volatility in interest, inflation and mortality rates.

Management and the Risk Function discuss market information, positions and estimated risk and loss scenarios on an ongoing basis.

Interest Rate Risk Sensitivity Analysis

Change in Variables	31 December 2014 Impact on PBT £000s	Impact on Equity Up to a Year £000s
(+) 1 basis point	125	98
(-) 1 basis point	(125)	(98)

Change in Variables	31 December 2013 Impact on PBT £000s	Impact on Equity Up to a Year £000s
(+) 1 basis point	295	226
(-) 1 basis point	(295)	(226)

There was no change in the method used for deriving sensitivity information and significant variables during the year.

Inflation rate risk sensitivity analysis

Change in Variables	31 December 2014 Impact on PBT £000s	Impact on Equity Up to a Year £000s
(+) 1 basis point	(357)	(280)
(-) 1 basis point	357	280

Change in Variables	31 December 2013 Impact on PBT £000s	Impact on Equity Up to a Year £000s
(+) 1 basis point	(46)	(35)
(-) 1 basis point	46	35

Credit Risk

Credit risk represents the potential for loss due to the default or deterioration in credit quality of a counterparty, e.g. an OTC derivatives counterparty or an issuer of corporate debt instruments. Credit risk also comes from cash placed with banks and collateralised financing transactions, (i.e. resale and repurchase agreements) and receivables from customers and counterparties.

The Board Risk Committee establishes and reviews credit policies and parameters. Policies authorised by the Board Risk Committee prescribe the level of formal approval required to assure credit exposure to a counterparty across all product areas are in line with the risk taking capacity and strategy, taking into account any enforceable netting provisions, collateral or other credit risk mitigants.

The Chief Credit Officer, who is independent of management and reports to the Chief Risk Officer, has responsibility for assessing and monitoring credit risk. Risks are monitored and controlled through strong oversight and independent control and support functions across the business.

Senior management is responsible and accountable for managing credit risks within prescribed limits. They have in depth knowledge of the credit positions, underlying models and the instruments available to hedge the credit exposures.

Effective management of credit risk requires accurate and timely information, a high level of communication and knowledge of customers, countries, industries and products. The process for managing credit risk includes:

- Assessing the likelihood that counterparty will default on its payment obligations;
- Measuring and modelling the Group's current and potential credit exposures and losses resulting from counterparty defaults;
- Approving credit risk generated by transactions and investments;
- Determining and reviewing the use of credit risk mitigants, including collateral and hedging;
- Establishing counterparty risk and concentration limits;
- Monitoring and communicating the utilisation of and compliance with established credit exposure limits;
- Identifying, monitoring and managing potential problem credits;
- Performing adequate stress tests to assess the Group's vulnerability to certain scenarios and risk concentrations; reporting and where necessary, escalating of credit exposures to senior management, the Working Level Risk Committee, the Board Risk Committee, and possibly the Board of Directors and regulators; and
- Communicating and collaborating with other independent control and support functions such as Operations, Legal and Compliance.

The credit risk management systems capture OTC credit derivative exposure to individual counterparties and on an aggregate basis to counterparties and their subsidiaries (economic groups). These systems also provide management with comprehensive aggregate credit risk by product, credit rating, industry, country and region. This is complemented by an additional platform for the measurement, monitoring, management and reporting of non-OTC credit exposures, including gross receivable exposures.

Risk Mitigants

To reduce the credit exposures on derivatives and collateralised agreement transactions, the Group enters into netting agreements with counterparties that permit it to offset receivables and payables with such counterparties that enable it to obtain collateral from them on an upfront or contingent basis and/or terminate transactions if the counterparty's credit rating falls below a specified level.

When the Group does not have sufficient visibility into a counterparty's financial strength or when it believes a counterparty requires support from its parent company, the Group may obtain third party guarantees of the counterparty's obligations. The Group also mitigates its credit risk using credit derivatives.

Credit Exposures

The Group's credit exposures are described further below.

Cash and Cash Equivalents. Cash and cash equivalents include both interest bearing and non-interest bearing deposits. To mitigate the risk of credit loss, the Group places its deposits with banks assigned minimum ratings in the single A rating category and central banks. Cash deposits with banks rated lower than the single A category are subject to approval by the Board Risk Committee, in line with Group's liquidity policy.

OTC Derivatives. Derivatives are reported at fair value on a gross by counterparty basis in the Group's Financial Statements unless the Group has current legal rights of set off and also intends to settle on a net basis. OTC derivatives are risk managed using the risk processes, measures and limits described above.

A waiver to INSPRU 3.2.5R(3) was granted in July 2010 and renewed in July 2013. This allowed the Group to treat a derivative contract with a pension scheme as an admissible asset. The purpose of the derivative contract is to provide a hedge for a specific pension scheme against market risk. The Group has hedged this risk with a derivative contract with an approved counterparty.

Collateralised Agreements. The Group bears credit risk related to resale agreement and securities borrowed only to the extent that cash advanced to the counterparty exceeds the value of the collateral received. Therefore, the Group's credit exposure on the transactions is significantly lower than the amounts recorded on the balance sheet (which represents fair values or contractual value before consideration of collateral received). The Group also has credit exposure on repurchase agreements and securities loaned, which are liabilities on its Statement of Financial Position, to the extent that the collateral pledged for these transactions exceeds the amount of cash received.

Note 30 – Financial Risk Management continued

Other Credit Exposures. The Group is exposed to credit risk from its receivables from customers and counter-parties. Receivables from counter-parties are generally comprised of collateralised receivables related to customer securities transactions and have minimal credit risk due to the value of the collateral received. In addition, the Group invests in highly rated assets or assets where there is underlying structural security in the event of a default. These assets include supranational sovereign bonds, sub-sovereign bonds and covered bonds.

The following table identifies the amounts covered by enforceable netting arrangements (netting under master netting agreements, cash collateral and security collateral) but do not qualify for netting under IAS32.

	31 December 2014				
		Related amounts not offset			
	Net amounts of financial assets presented in the statement of financial position £000s	Netting under master netting agreements £000s	Cash collateral £000s	Security collateral £000s	Net credit exposures £000s
Exposure to Credit Risk by Class					
Property, plant and equipment	1,524	–	–	–	1,524
Collective investment schemes	726,307	–	–	–	726,307
Government and agency obligations	5,855,467	–	–	–	5,855,467
Corporate debt	5,076,291	–	–	–	5,076,291
Derivative assets	5,801,994	(3,723,156)	(546,694)	(1,532,144)	–
Collateralised agreements and financing	3,400,828	–	(101,112)	(3,299,716)	–
Certificate of deposits	128,503	–	–	–	128,503
Reinsurance assets	288,654	–	–	–	288,654
Accrued income and prepayments	132,127	–	–	–	132,127
Receivables	360,156	–	–	–	360,156
Cash and cash equivalents	111,617	–	–	–	111,617
	21,883,468	(3,723,156)	(647,806)	(4,831,860)	12,680,646

	31 December 2013				
		Related amounts not offset			
	Net amounts of financial assets presented in the statement of financial position £000s	Netting under master netting agreements £000s	Cash collateral £000s	Security collateral £000s	Net credit exposures £000s
Exposure to Credit Risk by Class					
Collective investment schemes	425,237	–	–	–	425,237
Government and agency obligations	2,505,789	–	–	–	2,505,789
Corporate debt	3,083,115	–	–	–	3,083,115
Derivative assets	2,407,740	(1,374,084)	(248,470)	(785,186)	–
Collateralised agreements and financing	2,878,968	–	(15,808)	(2,863,160)	–
Reinsurance assets	164,325	–	–	–	164,325
Accrued income and prepayments	77,863	–	–	–	77,863
Receivables	70,689	–	–	–	70,689
Cash and cash equivalents	89,827	–	–	–	89,827
	11,703,553	(1,374,084)	(264,278)	(3,648,346)	6,416,845

Right of Offset

As described in the risk mitigants section of this note, the Group has the right of offset for certain financial assets and liabilities.

Netting under master netting agreements of £3,723m (2013: £1,374m) reflects the offsetting of derivative assets with liabilities for which the Group has a right to set off in the event of default. Cash and security collateral have been offset to the extent there are credit exposures on the balance sheet.

The Group has received total security collateral of £5,179.8m (2013: £4,291.6m) of which £4,831.9m (2013: £3,648.3m) has been applied against net exposure, leaving excess of £347.9m (2013: £643.3m). Security collateral exposes the Group to further market and credit risk. This is mitigated through the use of haircuts and over collateralisation.

Credit default swaps and total return swaps (which contain credit protection) have been purchased to protect the Group from default on corporate bonds. The table above does not reflect the protection provided. The Group calls margins, receivable in cash, against this exposure and other derivative positions.

In a distressed situation the value of collateral may vary depending on credit quality and interest rates. The effectiveness of collateral as a credit risk mitigant will depend on the operational expertise of the collateral manager and the ability to seize the collateral in a distressed scenario.

The table below shows the Group's gross and net credit exposure based on external ratings (lowest of Standard & Poor's, Moody's and Fitch ratings). In line with industry standards, Stability Ratings are used to rate the Money Market funds in which the Group invests.

£296.4m of the total net credit exposure relates to bonds held within negative basis packages, for which maturity matched credit default swap protection is held.

Net credit exposure is primarily in 'AAA' and 'AA' bonds. AAA assets include supranational bonds, sub sovereigns, covered bonds and certificates of deposit. 'AA' assets include Gilts. Other net credit exposures rated 'A' and 'BBB' include investments in regulated infrastructure assets and UK social housing bonds, which are secured on property assets.

As of current and prior year end there were no financial assets past due or impaired.

	31 December 2014				
		Related amounts not offset			
	Net amounts of financial assets presented in the statement of financial position £000s	Netting under master netting agreements £000s	Cash collateral £000s	Security collateral £000s	Net credit exposures £000s
Exposure to Credit Risk by Rating					
AAA	2,448,404	(46,272)	–	–	2,402,132
AA	8,155,173	(146,946)	–	(1,454,676)	6,553,551
A	7,408,877	(2,509,646)	(238,164)	(2,688,844)	1,972,223
BBB	2,416,223	(971,863)	(291,853)	(442,349)	710,158
BB	191,026	–	(1,600)	(106,018)	83,408
Unrated	1,263,765	(48,429)	(116,189)	(139,973)	959,174
	21,883,468	(3,723,156)	(647,806)	(4,831,860)	12,680,646

Note 30 – Financial Risk Management continued

The unrated financial assets of £1,263.8m (2013: £115.8m) reflect investments in issuers and issues that are not externally rated. During the year, the Group invested in unrated financial assets which are subject to very low credit risk.

	31 December 2013				
		Related amounts not offset			
	Net amounts of financial assets presented in the statement of financial position £000s	Netting under master netting agreements £000s	Cash collateral £000s	Security collateral £000s	Net credit exposures £000s
Exposure to Credit Risk by Rating					
AAA	1,777,652	–	–	–	1,777,652
AA	3,488,192	–	(10,030)	(709,529)	2,768,633
A	5,059,216	(1,374,084)	(241,841)	(2,324,554)	1,118,737
BBB	1,033,326	–	(9,861)	(387,397)	636,068
BB	229,412	–	(2,546)	(226,866)	–
Unrated	115,755	–	–	–	115,755
	11,703,553	(1,374,084)	(264,278)	(3,648,346)	6,416,845

Liquidity Risk

Liquidity risk arises where timing differences and/or uncertainties occur between cash inflows and cash outflows. The objective of liquidity management is to ensure that the Group is capable of honouring all cash flow commitments on both an ongoing basis and in a stressed scenario, without incurring significant cost or business disruption. The Group liquidity and funding policy is designed to ensure the availability of sufficient funds to meet cash flow requirements on a timely basis via:

- Maintenance of substantial excess liquidity. The Group seeks to enter into long-term, illiquid contracts that match its liabilities in order to maximise the value of the illiquidity premium. To mitigate residual liquidity risk the Group maintains substantial excess liquidity to meet a broad range of potential cash outflows in a stressed environment including financing obligations.
- Conservative asset-liability management. The Group seeks to maintain funding sources that are sufficiently long term in order to withstand a prolonged or severe liquidity stressed environment without having to rely on asset sales.

The Risk function which is independent of management and reports to the Chief Risk Officer, has primary responsibility for assessing, monitoring and managing liquidity risk. Risks are monitored and controlled through strong oversight and independent control and support functions across the business.

Senior management is responsible and accountable for managing liquidity risks within prescribed limits that are set by the Board and are overseen by the Board Risk Committee.

The following table details the Group's financial liabilities and assets by contractual maturity including interest that was accrued where the Group is entitled to repay the liability before its maturity. Other financial investments are presented at their fair value as this is consistent with the values used in the liquidity risk management of these instruments. The table excludes insurance liability cash flows and reinsurance asset cash flows which are included in note 22.

	31 December 2014			
	Less than 1 year £000s	1 to 5 years £000s	Over 5 years £000s	Total £000s
Financial Assets				
Financial investments	1,058,333	2,789,071	17,141,986	20,989,390
Accrued income and prepayments	132,127	–	–	132,127
Receivables	360,156	–	–	360,156
Cash and cash equivalents	111,617	–	–	111,617
	1,662,233	2,789,071	17,141,986	21,593,290
Financial Liabilities				
Payables and financial liabilities	1,618,242	1,388,232	5,748,693	8,755,167
Borrowings	–	–	225,000	225,000
Deferred tax liabilities	39	3,090	300	3,429
Accruals and deferred income	33,334	–	–	33,334
	1,651,615	1,391,322	5,973,993	9,016,930
Net	10,618	1,397,749	11,167,993	12,576,360

	31 December 2013			
	Less than 1 year £000s	1 to 5 years £000s	Over 5 years £000s	Total £000s
Financial Assets				
Financial investments	754,283	1,531,832	9,014,734	11,300,849
Accrued income and prepayments	77,863	–	–	77,863
Receivables	70,561	128	–	70,689
Cash and cash equivalents	89,827	–	–	89,827
	992,534	1,531,960	9,014,734	11,539,228
Financial Liabilities				
Payables and financial liabilities	560,193	591,837	2,899,816	4,051,846
Borrowings	–	–	100,000	100,000
Deferred tax liabilities	–	2,914	–	2,914
Accruals and deferred income	5,123	3,814	10,498	19,435
	565,316	598,565	3,010,314	4,174,195
Net	427,218	933,395	6,004,420	7,365,033

Collateralised Agreements

Assets are transferred under repurchase and securities lending agreements with other financial institutions. The nature and carrying amounts of the assets (all carried at fair value) subject to repurchase and securities lending.

	31 December 2014		31 December 2013	
	Asset £000s	Related Liability £000s	Asset £000s	Related Liability £000s
Government and agency obligations	2,273,450	1,973,732	496,746	480,190
Corporate debt	56,092	48,698	1,181,310	800,879
	2,329,542	2,022,430	1,678,056	1,281,069

As the substance of these transactions is secured borrowings and repurchase agreements the asset collateral continues to be recognised in full and the related liability reflecting the Group's obligations to repurchase the transferred assets at a future date is recognised in other liabilities. The Group remains exposed to interest rate risk and credit risk on these pledged instruments. The counterparty's recourse is not limited to the transferred assets.

Note 30 – Financial Risk Management continued

The net exposures to certain OTC derivatives are collateralised through cash. As at 31 December 2014, the total cash collateral received was £1,105.5m (2013: £264.3m). Other OTC contracts are collateralised with fixed income securities which are not recognised on the balance sheet of the Group.

Note 31 – Capital Management

The Group's capital resources are of critical importance. The Group's risk management procedures and governance and regulatory environment are described in the Strategic Report. The objectives in managing its capital are:

- To match the profile of its assets and liabilities, taking account of the risk inherent in the business;
- To maintain financial strength to support new business growth;
- To satisfy the requirements of its policyholders and regulators;
- To retain financial flexibility by maintaining strong liquidity; and
- To allocate capital efficiently to support growth.

As at 31 December 2014 the Group had sufficient capital available to meet its regulatory capital requirements. The Group holds both debt and equity to optimise its capital structure and improve shareholder return.

The Group is required to hold sufficient capital to meet the PRA's capital requirements calculated on the statutory basis, which is based on EU Directives. As is required with all regulated insurance businesses, the Group also monitors its Individual Capital Assessment ('ICA') which considers certain business risks not reflected in the statutory basis.

The available capital is subject to certain restrictions as to its availability to meet capital requirements. In particular, no transfers from the long-term fund can take place without an up to date actuarial valuation.

The capital held within the shareholders' fund is generally available to meet any requirements. It remains the intention of management to ensure that there is adequate capital to exceed the Company's regulatory requirements.

Total available capital resources at 31 December 2014 are £843.1m (2013: £640.1m) of which:

At 31 December 2014

	Long-Term Fund £000s	Shareholder's Funds £000s	Total £000s
Shareholders' funds outside long-term fund	–	230,776	230,776
Shareholders' funds held in long-term fund	530,080	–	530,080
Total shareholders' funds	530,080	230,776	760,856
Adjustments onto regulatory basis	(244,550)	326,802	82,252
Total Available Capital Resources	285,530	557,578	843,108

At 31 December 2013

	Long-Term Fund £000s	Shareholder's Funds £000s	Total £000s
Shareholders' funds outside long-term fund	–	284,374	284,374
Shareholders' funds held in long-term fund	291,678	–	291,678
Total shareholders' funds	291,678	284,374	576,052
Adjustments onto regulatory basis	(6,185)	70,223	64,038
Total Available Capital Resources	285,493	354,597	640,090

The Group does not write any with profits business. The Group has written an immaterial volume of unit linked business which is wholly reinsured.

The Group is required to hold sufficient capital to meet the Insurance Groups Directive ('IGD'). It is also required to ensure that its insurance company subsidiaries meet the higher of the Capital Resource Requirement ('CRR') determined in accordance with the PRA's regulatory rules and the ICA.

Note 31 – Capital Management continued

Management intends to maintain surplus capital in its insurance company subsidiaries in excess of the higher of the CRR and ICA to meet the PRA's total requirements, and to maintain an appropriate additional margin over this to absorb changes in capital requirements.

At 31 December 2014 the IGD cover was 177% (2013: 224%) of the capital requirement of £477.1m (2013: £285.5m).

Movements in Capital Resources

	31 December 2014 £000s	31 December 2013 £000s
Opening Balance	640,090	790,004
New business	60,800	56,745
Acquisition of RAL	210,203	–
Management of in force book	50,836	150,878
Expenses	(51,194)	(40,605)
Demographic experience variance	11,739	10,200
Other	(1,106)	2,119
Operating Surplus	921,368	969,341
Economic profits	(610)	13,200
Non-recurring expenses	(14,776)	(247)
Finance costs	(17,643)	(7,033)
Tax	(63,642)	(40,133)
Repayment of capital instrument	–	(132,500)
Capital contribution	4,365	–
Issue of ordinary share	–	132,500
Group regulatory adjustment	14,046	(14,038)
Dividend payment	–	(281,000)
Closing Balance	843,108	640,090

Capital Resource Sensitivities

The capital position is sensitive to changes in market conditions, due to changes in the value of the assets and the effect that changes in investment conditions may have on the value of the liabilities. The Group seeks to mitigate these risks through the use of derivative hedges and reinsurance. Management monitor these assumptions and market conditions and would take appropriate action if relevant.

The Group is exposed to changes in market conditions but controls its exposure to the various elements of this risk as follows:

- **Interest and Inflation Rates Risk:** A portfolio of interest and inflation swaps is structured such that each basis point movement in interest rates or inflation will change the value of assets and liabilities by a similar amounts.
- **Credit Risk:** As well as holding government bonds, government guaranteed bonds, supranational bonds and regulated covered bonds, the Group also holds corporate bonds with matching collateralised credit default swaps or total return swaps. Given this approach, the Group therefore has a reduced risk of reductions in regulatory capital resources caused by defaults on bonds. During 2014 the Group has continued to increase its exposure to other assets including social housing and infrastructure assets. The Group bears minimal credit risk under these arrangements unless the cash advanced to the counterparty exceeds the value of the collateral received.
- **Currency Risk:** The Company holds some Euro and US Dollar denominated corporate bonds. All foreign currency coupon and principal receipts are swapped for sterling cash flows thereby reducing the risk of volatility in regulatory capital resources due to exchange rate movements.

Management monitor market conditions and emerging longevity experience on a regular basis. As these conditions change, management will take remedial action such as adjustment of hedging strategies if appropriate.

Note 32 – Related Parties Disclosures

Ultimate Holding Companies

The ultimate holding companies of RHUK are:

- The Goldman Sachs Group, Inc.: 36.0%
- The Blackstone Group L.P.: 28.5%
- GIC Private Limited: 28.5%
- MassMutual Financial Group: 7.0%

Related Party Transactions

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 International, and Rothesay Life (Cayman) Limited.

Details of transactions and balances in respect of these transactions are as follows:

	31 December 2014 £000s	31 December 2013 £000s
Statement of Comprehensive Income		
Realised/Unrealised (losses) on financial assets and liabilities	(563,639)	(268,706)
Interest income on bank deposits	36	50
Income from money market securities held in collective investment schemes	2,890	2,169
Interest on collateralised agreements and financing	31,786	48,388
Service fee charges	(4,161)	(15,135)
Investment management charges	(7,077)	–
Finance costs	(2,679)	(6,159)
Statement of Financial Position		
Derivative financial assets and liabilities	(1,119,032)	(421,053)
Collateralised agreements and financing	1,440,880	1,089,774
Collective investments schemes	708,519	407,456
Accrued interest	241	–
Amounts payable to related party	(890)	(211,146)
Capital		
Ultimate parent company	267,510	267,510
Capital contribution	4,520	155
Dividends paid	–	290,554

During the year £4m (2013: £4m) of bonus payments were borne by a fellow participating interest, as part of a long-term incentive arrangement. The Group will not be charged for this expense.

The nominal value of derivatives contracts outstanding with related parties as at 31 December 2014 was £40,964.3m (2013: £52,078.2m).

The Group continues to develop fully independent infrastructure and computer system and to remove the need for infrastructure/systems support provided by Goldman Sachs. Any such services/support currently provided by Goldman Sachs are provided on an arm's length basis under a Transition Services Agreement ('TSA').

Key management personnel comprise the Directors of the Company, Directors of subsidiary undertakings and certain members of senior management.

There are no material transactions between the Group and its key management personnel other than transactions discussed below:

	31 December 2014 £000s	31 December 2013 £000s
Salaries, bonus and other employee benefits	7,800	5,125
Pension costs	151	149
	7,951	5,274

Transactions with Rothesay Pensions Management Limited

	31 December 2014 £000s	31 December 2013 £000s
Statement of Comprehensive Income		
Cost transfer	1	–
Statement of Financial Position		
Other receivables	3,939	–
Capital	10	10

Transactions with Rothesay Life Limited

	31 December 2014 £000s	31 December 2013 £000s
Statement of Comprehensive Income		
Finance costs	(60)	–
Cost transfer	(284)	–
Statement of Financial Position		
Other payables	5,015	–
Capital	383,754	267,500

Note 33 – Subsidiary Undertakings

Subsidiary Undertakings

The Financial Statements include the Financial Statements of RHUK and the subsidiaries listed in the following table:

Group Undertakings	Country of incorporation	Primary business operation	Value at cost £000s	2014 equity interest %	2013 equity interest %
Rothesay Pensions Management Limited	UK	Service Company	10	100%	100%
Rothesay Life Limited	UK	Life insurance	383,754	100%	100%
Rothesay Assurance Limited (formerly known as MetLife Assurance Limited)	UK	Life insurance	421,381	100%	–

The above subsidiary undertakings are registered in England and Wales.

On 16 May 2014, RLL acquired MetLife Assurance Limited, the UK bulk annuity business of MetLife Inc. MetLife Assurance Limited is now wholly owned by RLL. MetLife Assurance Limited was renamed Rothesay Assurance Limited on 23 June 2014.

Note 34 – Financial Commitments and Contingencies

Operating Lease Commitment

Operating lease rentals commitments arise where a Group company is the lessee in respect of non-cancellable operating lease agreements. Payments made under operating leases (net of any incentives received from the lessor) are charged to the profit and loss on a straight-line basis over the period of the lease.

The future aggregate minimum lease payments under non-cancellable operating leases are as follows:

	31 December 2014 £000s	31 December 2013 £000s
Not later than 1 year	420	–
Later than 1 year and no later than 5 years	3,358	–
Later than 5 years	3,779	–
Total Minimum Lease Payments	7,557	–

Other Commitments

During the year the Company executed transactions to purchase partly funded bonds. The Company expects to pay a further £197m within the next 5 years (2013: £123m), £nil of this being due within 12 months of the financial reporting date (2013: £197m).

	31 December 2014 £000s	31 December 2013 £000s
Not later than 1 year	–	25,000
Later than 1 year and no later than 5 years	197,000	49,000
Later than 5 years	–	49,000
Total Other Commitments	197,000	123,000

Note 35 – International Financial Reporting Standards ('IFRS') Transition

A1.1. Accounting Policies – Basis of Preparation

For all periods up to and including the year ended 31 December 2013, the Group prepared its Financial Statements in accordance with UK GAAP. These Financial Statements, for the year ended 31 December 2014, are the first the Group has prepared in accordance with IFRS.

Accordingly, the Group has prepared Financial Statements which comply with IFRS applicable for periods beginning on or after 1 January 2014 as described in the accounting policies. In preparing these Financial Statements, the Group's opening Statement of Financial Position was prepared as at 1 January 2013, the Group's date of transition to IFRS. This note explains the principal adjustments made by the Group in restating its UK GAAP Statement of Financial Position as at 1 January 2013 and its previously published UK GAAP Financial Statements for the year ended 31 December 2013. All adjustments are reclassifications of balances rather than valuation differences.

A1.2. Notes to the Financial Statements – First-time Adoption of IFRS *IFRS 1.22, 23*
IFRS has been applied retrospectively, except for certain optional and mandatory exemptions from full retrospective application, as provided for by IFRS 1 (Revised 2009) First–time Adoption of IFRSs, as detailed below.

Designation of financial assets and financial liabilities *IFRS 1. D19*
At the date of transition, the Group chose to designate according to the IFRS designation criteria, all of its existing financial assets as 'at fair value through profit or loss'.

Estimates
At the date of transition, the Group's estimates under IFRS are consistent with estimates previously made under UK GAAP.

IFRS classification changes
The principal classification changes at 1 January 2014 can be seen in the table below. They have no effect on equity.

1 January 2014

	UK GAAP £000s	Adjustments £000s	IFRS £000s
Assets			
Other financial investments	3,093,221	8,207,628	11,300,849
Assets held to cover linked liabilities	5,360,587	(5,360,587)	–
Reinsurers share of technical provisions	164,325	–	164,325
Accrued interest and prepayments	77,863	–	77,863
Other receivables	70,689	–	70,689
Cash at bank and in hand	89,827	–	89,827
Total Assets	8,856,512	2,847,041	11,703,553
Equity and Liabilities			
Share capital	1,800	–	1,800
Share premium	265,710	–	265,710
Capital contribution reserve	155	–	155
Retained earnings	308,387	–	308,387
Total Equity	576,052	–	576,052
Liabilities			
Long-term business provision/Insurance contract liabilities	1,439,582	5,513,724	6,953,306
Claims outstanding	4,899	(4,899)	–
Technical provision for linked liabilities	5,508,825	(5,508,825)	–
Borrowings	100,000	–	100,000
Other liabilities	1,204,805	2,847,041	4,051,846
Deferred tax liabilities	2,914	–	2,914
Accruals and deferred income	19,435	–	19,435
Total Equity and Liabilities	8,856,512	2,847,041	11,703,553

Note 35 – International Financial Reporting Standards ('IFRS') Transition continued

1 January 2014

	UK GAAP £000s	Adjustments £000s	IFRS £000s
Income			
Gross premiums written	1,628,059	–	1,628,059
Premiums ceded to reinsurers	(361,208)	–	(361,208)
Net Premiums Written	1,266,851	–	1,266,851
Investment income	209,575	(309,525)	(99,950)
Total Revenue, Net of Reinsurance	1,476,426	(309,525)	1,166,901
Gross claims and benefits paid	(576,207)	–	(576,207)
Outward reinsurers share of claims paid	338,260	–	338,260
Change in the provision for claims outstanding	3,520	–	3,520
Claims Incurred, Net of Reinsurance	(234,427)	–	(234,427)
Gross change in long-term business provision	230,661	(230,661)	–
Gross change in insurance contract liabilities	–	(624,762)	(624,762)
Reinsurers share of change in long-term business provisions	(76,282)	–	(76,282)
Changes in technical provisions, net of reinsurance	(855,423)	855,423	–
Change in Other Technical Provisions, Net of Reinsurance	(701,044)	–	(701,044)
Net operating expenses	(39,972)	(879)	(40,851)
Finance costs	(102,343)	95,310	(7,033)
Unrealised losses on investments	(210,841)	210,841	–
Balance on Long-Term Business Account Before Tax	187,799	(4,253)	183,546
Investment income	1,625	(1,625)	–
Net operating expenses	(879)	879	–
Finance costs	(4,999)	4,999	–
Profit on Ordinary Activities Before Tax	183,546	–	183,546
Tax on profit on ordinary activities	(34,659)	–	(34,659)
Profit on Ordinary Activities After Tax	148,887	–	148,887

Measurement Changes – Current and Deferred Tax

Under UK GAAP, provision is made for deferred tax assets and liabilities arising from timing differences between the recognition of gains and losses in the Financial Statements and their recognition in the income tax return. Under IAS 12 Income Taxes deferred tax is provided for temporary differences between the tax base of an asset or liability and the carrying value for financial reporting purposes at the period end.

No comparative Financial Statements have been prepared as there are no measurement adjustments between the UK GAAP and IFRS Financial Statements. The Statement of Financial Position as at 1 January 2013 is shown within the Statement of Financial Position within the primary Financial Statements.

SUPPLEMENTARY FINANCIAL STATEMENTS
MARKET CONSISTENT EMBEDDED VALUE

MARKET CONSISTENT EMBEDDED VALUE

Supplementary financial statements

Rothesay Life has prepared supplementary financial statements on a Market Consistent Embedded Value ('MCEV') basis. The results have been prepared in accordance with the European Insurance CFO Forum Market Consistent Embedded Value Principles ('MCEV Principles') (Copyright © Stichting CFO Forum Foundation 2008) which were published in 2008 and revised in October 2009. Rothesay Life considers that embedded value reporting provides investors with a useful measure of the future profit streams of the Group's in-force long-term business and is a valuable supplement to statutory accounts.

As the Group introduced this metric for external reporting purposes during 2014, 2013 Comparatives have not been provided.

GROUP STATEMENT OF FINANCIAL POSITION
AS AT 31 DECEMBER 2014

	Year ended 31 December 2014 £m
Assets	
Value of in-force business	469.7
Financial assets & equipment	20,990.9
Pre-payments and accrued income	132.1
Insurance and other receivables	648.8
Cash and cash equivalents	111.6
Total Assets	22,337.2
Total Equity	1,214.6
Liabilities	
Insurance liabilities	12,105.7
Other liabilities	8,755.2
Borrowings	225.0
Current tax liabilities	3.4
Insurance and other payables	33.3
Total Liabilities	21,122.6
Total Equity and Liabilities	22,337.2

The notes on pages 86 to 92 form an integral part of these supplementary financial statements.

RECONCILIATION OF SHAREHOLDERS' EQUITY ON IFRS BASIS TO SHAREHOLDERS' EQUITY ON MCEV BASIS

	Year ended 31 December 2014 £m
Shareholders' equity on IFRS basis	760.9
Value of in-force business	469.7
Reserving differences	(16.0)
Shareholders' equity on MCEV basis	1,214.6

	Year ended 31 December 2014 £m
Analysis of ordinary Shareholders' equity	
IFRS basis ordinary shareholders' equity	760.9
Additional retained profit on an MCEV basis	453.7
Shareholders' equity on MCEV basis	1,214.6

The value of in-force business ('VIF') component corresponds to the Operational Company VIF on page 89. The reserving differences reflects an additional closure reserve of £16m held on a Pillar 1 basis, which has been deducted from the adjusted net worth of the Operational Company. This reserve is not held on an IFRS basis and is therefore deducted from the VIF contribution in the above table.

Reconciliation of Rothesay Life available capital to shareholders' equity on IFRS basis

	Year ended 31 December 2014
RL Operational Co available capital	970.9
Inadmissible assets	1.7
IFRS reserving differences	16.0
Sub-Debt	(100.0)
Other group debt	(125.0)
Other group adjustments	(2.8)
Shareholders' equity on IFRS basis	760.9

The Rothesay Life available capital is consistent with the capital resources available set out in the Rothesay Life Ltd Annual PRA Returns for the year ended 31 December 2014. The shareholders' equity on an IFRS basis is consistent with the Total Equity in the consolidated statement of financial position in the primary financial statements set out on page 84.

NOTES TO THE MCEV SUPPLEMENTARY FINANCIAL STATEMENTS

1. Basis of presentation

The Group's primary financial statements have been prepared in accordance with International Financial Reporting Standards. The MCEV supplementary financial statements have been prepared in accordance with the European Insurance CFO Forum Market Consistent Embedded Value Principles ('MCEV Principles') (Copyright © Stichting CFO Forum Foundation 2008) which were published in 2008 and revised in October 2009. Non-compliance with the guidance has been noted below.

This is the first year that Rothesay Life has included supplementary financial statements, and as such, a comparative opening MCEV at 31 December 2013 has not been included. A number of items relating to the opening MCEV have therefore not been presented in the supplementary financial statements this year, namely:

- MCEV Income Statement;
- MCEV statement of changes in equity; and
- Covered business analysis of movement in MCEV (including associated operating variances and assumption changes).

These items will be included in our supplementary financial statements as at 31 December 2015 with the intention being that at that point the statements will be fully compliant.

a. Covered business

The covered business includes all business written by Rothesay Life and Rothesay Assurance Limited. This business falls under the definition of long-term insurance business for UK regulatory purposes.

b. New business

New business is defined as:
- premiums from the sale of new policies written throughout the year; and
- non-contractual increments on existing policies, transacted during the year.

Acquisitions are presented separately within the new business section. This covers the acquisition of MetLife Assurance Limited ('MAL') in May 2014, as described in the Strategic Report.

2. Methodology

The MCEV is the sum of the net worth of the Group companies plus the value of in-force business.

a. Net worth

The net worth is the market value of the shareholders' funds and the shareholders' interest in the surplus held in the long-term business funds, determined on a statutory solvency basis with inadmissible assets included.

The net worth consists of the required capital plus the free surplus of the company. Free surplus is defined as the assets over and above the level of required capital, described below.

b. Value of in-force

The value of in-force covered business (VIF) consists of the following components:

- present value of future profits;
- time value of financial options and guarantees;
- frictional costs of required capital; and
- cost of residual non-hedgeable risks.

c. Present value of future profits

The present value of future profits (PVFP) is the present value of the distributable profits to shareholders arising from the in-force covered business projected on a best estimate basis and discounted using the risk free rate adjusted (where applicable) for the liquidity premium.

d. Time value of financial options and guarantees

There are no material financial options and guarantees, and therefore the time value is nil.

The basis for policyholder options is generally set by the company to be profit-neutral. Where there are specific contractual clauses that diverge from this, these have been appropriately allowed for within the PVFP.

NOTES TO THE MCEV SUPPLEMENTARY FINANCIAL STATEMENTS CONTINUED

1. Basis of presentation continued

The company currently has no guaranteed surrender terms exercisable at the unilateral discretion of the pension schemes. Some counterparties are able to surrender conditional upon certain solvency events. However for the purposes of the MCEV, it is assumed that the company continues to meet these solvency requirements and hence no value is placed on these surrender rights.

e. Frictional costs of required capital

The additional costs to a shareholder of holding the assets backing required capital within an insurance company rather than directly in the market are known as frictional costs. The additional costs allowed for are the taxation costs and any additional investment expenses on the assets backing the required capital. These costs are explicitly deducted from the PVFP.

Frictional costs are calculated by projecting forwards the future levels of required capital. Tax on investment return and investment expenses are payable on the assets backing required capital, up until the point that they are assumed to be released to shareholders.

f. Cost of non-hedgeable risk

The cost of residual non-hedgeable risks (CNHR) covers risks not already allowed for in the time value of options and guarantees or in the PVFP. The allowance includes the impact of both non-hedgeable financial and non-financial risks. No allowance has been made within the CNHR for symmetric risks as these are diversifiable by investors.

The risks which contribute to the CNHR component of MCEV are:

- Counterparty default risk: the risk of losses following the failure of counterparties, for example for longevity reinsurance and over the counter derivative transactions.
- Expense risk: the risk that the amount of expenses incurred differs from current projections.
- Operational risk: the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events.

These are considered to be asymmetric risks, of which operational risk is the most material element. We have allowed for diversification benefits to the extent that these are identifiable.

The Group's demographic risks exhibit no material asymmetry. Appropriate allowance has been made within the PVFP for these risks; therefore no further allowance has been made in the CNHR.

The CNHR has been presented as an equivalent average cost of capital charge across all residual non hedgeable risks considered to be asymmetric (as defined above), after allowing for diversification between these risks. The capital charge has been calculated in line with Rothesay's Individual Capital Assessment ('ICA'). This capital requirement has been modelled as running off in line with the cashflow profile of the best estimate liabilities excluding the longevity swap cashflows.

The resulting annual capital charge is 3.0%.

g. Tax

The projected cash flows take into account all tax which the company expects to pay.

The government announced its intention to reduce the UK corporation tax rate from 21% to 20% from 1 April 2015 and the effect of this has been reflected in the Group MCEV.

	31 December 2014
2014	21.49%
2015	20.25%
2016 +	20.00%

h. Consolidation adjustments

Group entities have been incorporated at the market consistent value. This is equal to the IFRS net asset value.

The Group MCEV is net of external debt.

3. Assumptions

Economic assumptions

a. Reference rates

In setting the risk-free rate a mid-price swap yield curve provided by Goldman Sachs is used. A constant forward rate is applied after the 80 year point.

Term (years)	1	5	10	20	30
31 Dec 2014	0.74%	1.47%	1.89%	2.27%	2.31%

For annuity business, swap rates are adjusted for a 'liquidity premium' in deriving the reference rates. The liquidity premium is applied as a term specific addition to the swap curve set out above. The derivation uses a target investment mix and therefore aims to consider the types of investments in which the Company invests, but does not correspond exactly to the current assets holdings.

The liquidity premium is calculated on a daily basis and considers the spread over the risk-free rate observable for various asset classes. An appropriate deduction is made to the spread for credit risk. The deductions make reference to market observable credit risk information, and the resulting deduction is prudent relative to historical defaults.

The in-force liquidity premium adjustment as at 31 December 2014 was 80bps, after the deduction of investment management costs.

No liquidity premium is used in the valuation of longevity swap contracts.

The liquidity premium on new business is calculated at the point of sale and is determined using an approach consistent with that assumed for the in-force business.

b. Expenses

Expenses attributed to covered businesses have been included in the MCEV calculations. Future expense assumptions include an allowance for third party administration, investment management and maintenance expenses as well as project expenses.

No future productivity gains have been anticipated. Where subsidiary companies provide administration, investment management or other services to our life businesses, the value of profits or losses arising from these services have been included in the embedded value of new business.

c. Expense inflation

Internal and third party administration expenses are projected to increase at RPI, plus a margin where appropriate.

As at 31 December 2014 the assumed rate of future expense inflation is equivalent to 3.84%.

For internal service companies the fees charged to the life company reflect the underlying expenses incurred.

d. Exchange rates

The Group has a small amount of euro denominated liabilities. These cashflows have been converted to GBP using levels implied from cross currency swap quotes.

Non-Economic assumptions

e. Demographic assumptions

Assumed future mortality has been derived from analysis of experience with a view to giving a best estimate of future experience. Where appropriate this has been adjusted for anticipated future changes in experience, i.e. improvements in future policyholder longevity are allowed for.

Recent mortality experience has been analysed for each pension scheme at the end of 2014. Where the data was considered statistically credible, the mortality assumptions used in the valuation are based on this actual mortality experience. Where the data is not statistically credible, the Group has taken into account reinsurance quotes and proprietary socio-demographic models, based on postcode and other factors.

NOTES TO THE MCEV SUPPLEMENTARY FINANCIAL STATEMENTS CONTINUED

3. Assumptions continued

f. Non-hedgeable risk

For the balance sheet a charge of 3.0% has been applied to the group-diversified capital required on a 1-in-200 one-year basis over the remaining lifetime of in-force business. The capital levels used are projected to be sufficient to cover non-hedgeable risks at the 99.5% confidence. The level of the diversified capital requirement to which the charge is applied is £167m.

The resulting cost of non-hedgeable risks is £61.3m.

g. Required capital

The projected level of required capital to support the business is derived from the Group's capital management policy, which is to hold sufficient assets to meet the higher of:

- Prudent reserves plus 150% of Rothesay Life's long-term insurance capital requirement ('LTICR'), together with 150% of Rothesay Life's resilience capital requirement ('RCR'); and
- Best estimate liabilities plus the economic capital requirement.

The economic capital requirement calculates the 1 year value-at-risk to a 99.8% confidence interval. Historically the Group's capital requirement has been driven by 150% of Rothesay Life's LTICR and RCR. This continues to be the case at 31 December 2014.

h. Valuation of debt

Borrowings in the MCEV consolidated statement of financial position are valued at their market value. This is consistent with the Fair Value valuation as detailed on Note 25 of the primary financial statements.

At 31 December 2014 the value of the debt of the Group was £225m.

4. Group embedded value

Rothesay Life Group MCEV (£m)	Year ended 31 December 2014 £m
Adjusted net worth	972.6
Present value of future profits	598.8
Cost of capital	(67.8)
Cost of non hedgeable risks	(61.3)
Value of in-force business	469.7
Sub-debt	(100.0)
MCEV of Rothesay Life Limited	1,342.4
Net assets/(liabilities) of other Group companies	(127.8)
RL Group MCEV	1,214.6

5. Value of new business and acquisitions over 2014

The following table sets out the after-tax value of the new and acquired business for the financial year ended 31 December 2014, calculated at the point of sale:

	Year ended 31 December 2014 £m		
Rothesay Life Group MCEV (£m)	MAL acquisition	New business	Total new business and acquisition
Adjusted net worth	28.6	(100.4)	(71.9)
Present value of future profits	226.7	187.6	414.3
Cost of capital	(17.7)	(10.4)	(28.1)
Cost of non hedgeable risks	(10.0)	(5.5)	(15.5)
Debt and group adjustments	–	–	–
RL Group MCEV	227.6	71.3	298.9

£1,397m of new business premiums were written in 2014. This excludes regular premiums generated on the in-force inwards longevity reinsurance business written in prior years. The acquisition of MAL increased the Group's assets under management by £2,680m.

Economic and demographic assumptions have been used at the point of sale. The MCEV modelling assumptions for new business are consistent with those used for the inforce business, as has been described in the basis of preparation.

The Adjusted Net Worth does not reflect the impact of managing the new and acquired business, such as profits arising from investing assets received as premiums through the rest of the financial year. This results in a lower net worth than that shown in the Financial Review on pages 18-21. The effect of deployment has been allowed for in the PVFP.

The weighted average liquidity premia at point of sale for acquisitions and new business written during 2014 are as follows:

- MAL acquisition: 62bps
- New business: 70bps

These are lower than the total in-force assumption at the end of the year of 80bps due to the prevailing economic conditions at the point the business was written. Generally liquidity premium spreads have increased at the end of 2014.

6. Sensitivities

The following tables show the sensitivity of the total MCEV to:

- 1% increase and decrease in the risk-free rate of interest.
- 1% increase and decrease in inflation. The covers both expense inflation and benefit inflation.
- 10 basis point increase and decrease in long-term credit default assumptions with no change to liquidity premium. This stress has not been applied to UK government guaranteed debt or supranational bonds.
- 10 basis point increase and decrease in the liquidity premium, only affecting the liabilities. The market value of assets, swap curves or risk-free rate used are therefore unchanged under these sensitivities.
- Required capital equal to 100% of LTICR plus 100% of CRR.
- No sensitivity to equity or property has been shown as Rothesay Life does not directly invest in these asset classes.
- No sensitivity to swaption implied volatility has been shown as the company has no risk to swaption implied volatilities.
- Annuity base mortality 5% higher and lower than the central case (i.e. 105% and 95%, respectively, of the central mortality rates).
- Expenses 10% higher and lower than the central case (i.e. 110% and 90% of the central assumption). Maintenance, third party administration, investment management and project expenses have all been subjected to the stress. There is no change to expense inflation assumption.
- No sensitivity to lapse rates has been shown as Rothesay Life is not exposed to the lapse in future premiums.

	Impact on IFRS pre-tax profit	Tax	Adjusted Net Worth	VIF	Debt & group adjustments	MCEV
As reported on page 89 (£m)			972.6	469.7	(227.8)	1,214.6
Economic Assumptions						
Interest rates +1%	24.6	(5.3)	19.4	(93.8)	–	(74.4)
Interest rates -1%	0.9	(0.2)	0.7	135.2	–	135.9
Iinflation +1%	12.7	(2.7)	10.0	78.4	–	88.4
Inflation -1%	63.1	(13.6)	49.5	(64.3)	–	(14.7)
Credit default +10bps	(41.1)	8.8	(32.3)	(0.5)	–	(32.8)
Credit default -10bps	42.7	(9.2)	33.5	0.5	–	34.1
Illiquidity premium +10 bps	–	–	–	130.4	–	130.4
Illiquidity premium -10 bps	–	–	–	(134.0)	–	(134.0)
Required capital equal to 100% CRR	–	–	–	22.1	–	22.1
Non-economic assumptions						
Base mortality -5%	(102.4)	22.0	(80.4)	5.4	–	(75.0)
Base mortality +5%	97.0	(20.8)	76.2	(4.9)	–	71.2
Maintenance expenses +10%	(24.3)	5.2	(19.1)	3.3	–	(15.7)
Maintenance expenses -10%	24.3	(5.2)	19.1	(3.3)	–	15.7

NOTES TO THE MCEV SUPPLEMENTARY FINANCIAL STATEMENTS CONTINUED

6. Sensitivities continued

The impact on the MCEV, including new business, has been presented as follows:

- The impact on IFRS profit; consistent with the Note 22 of the financial statements as set out on page 62.
- The tax impact of the IFRS profit; taken by applying the current tax rate at 31 December 2014, of 21.49%, to the pre-tax profit figure.
- The impact on adjusted net worth; being the sum of the 2 previous items. A simplified approach has been taken to the treatment of any potential deferred tax asset created under the shock, as it has been assumed that losses have offset profit created in the current accounting period.
- The VIF component of the MCEV; which is the sum of the PVFP, CoC and CNHR.
- The sub-debt, and group adjustments, which are not affected by the sensitivities.

In each sensitivity calculation all other assumptions remain unchanged unless otherwise stated.

The sensitivities above include the new business written over the year. The risk profile of the new business written was materially similar to that of the in-force business. The impact of the sensitivities applied to new business in isolation can therefore be simplified as the same proportional impacts as those shown in the previous table.

STATEMENT OF DIRECTORS' RESPONSIBILITIES

In respect of the MCEV basis supplementary financial statements

When compliance with the MCEV Principles is stated, those principles require the Directors to prepare supplementary information in accordance with the methodology contained in the CFO Forum Principles and to disclose and explain any non-compliance with the guidance included in the CFO Forum Principles.

In preparing this supplementary information, the directors have done so in accordance with these CFO Forum Principles and have also fully complied with all the guidance included therein, except where highlighted above. Specifically, the directors have:

- determined assumptions on a realistic basis, having regard to past, current and expected future experience and to relevant external data, and then applied them consistently;
- made estimates that are reasonable and consistent; and,
- provided additional disclosures when compliance with the specific requirements of the CFO Forum Principles is insufficient to enable users to understand the impact of particular transactions, other events and conditions and the Group's financial position and financial performance.

The supplementary financial statements were approved by the Board of Directors in 25 March 2015 and were signed on its behalf by:

Andrew Stoker
Chief Financial Officer

INDEPENDENT REVIEW REPORT TO THE DIRECTORS OF ROTHESAY HOLDCO UK LIMITED ON THE SUPPLEMENTARY MCEV FINANCIAL STATEMENTS

Introduction

Rothesay HoldCo UK Limited has prepared supplementary MCEV financial statements for the financial year ending 31 December 2014 in accordance with the European Insurance CFO Forum Market Consistent Embedded Value Principles ('MCEV Principles') published in June 2008 and subsequently amended in October 2009. The supplementary MCEV financial statements are shown on pages 83 to 92.

We were engaged to review the supplementary MCEV financial statements, which comprise of the Group Statement of Financial Position and accompanying notes. This report is produced in accordance with our letter of engagement dated 11 August 2014.

Directors' responsibilities

The Directors are responsible for preparing the supplementary MCEV financial statements in accordance with the MCEV Principles using the methodologies and assumptions set out on pages 86 to 91.

Our responsibility

Our responsibility is to express a conclusion on the supplementary MCEV financial statements based on our review. This report, including our conclusion, has been prepared for and only for the Directors of Rothesay HoldCo UK Limited as a body in accordance with the agreement between us. We permit this report to be disclosed in the Rothesay HoldCo UK Limited 2014 Annual Report and Accounts to assist the Directors in responding to their governance responsibilities by obtaining an independent review in connection with the supplementary MCEV financial statements. We do not, in producing this report, accept or assume responsibility for any other purpose or to any other person other than the Board of Directors and Rothesay HoldCo UK Limited for our review, for this report, or for the conclusion we have formed, save where expressly agreed by our prior consent in writing.

Scope of review

We conducted our review in accordance with International Standard on Review Engagements (UK and Ireland) 2410, 'Review of Interim Financial Information Performed by the Independent Auditor of the Entity' issued by the Auditing Practices Board for use in the United Kingdom. A review of financial information consists of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing (UK and Ireland) and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

Our review included the following procedures:

- Obtained an understanding of the procedures adopted by the Directors and management to prepare the supplementary MCEV financial statements.
- Reviewed the methodologies and assumptions used by the Directors and management to calculate the MCEV results in the light of the requirements of the MCEV Principles.
- Performed analytical procedures to assess the reasonableness of the MCEV results relative to the proposed methodologies and assumptions.
- Reviewed the adequacy of the presentation of the supplementary MCEV financial statements in the light of the requirements of the MCEV Principles.

Our review did not include procedures on the models, processes and data sources and flows involved in the preparation of the supplementary MCEV financial statements.

Conclusion

Based on our review, nothing has come to our attention that causes us to believe that the supplementary MCEV financial statements for the financial year ending 31 December 2014 are not prepared, in all material respects, in accordance with the MCEV Principles using the methodologies and assumptions set out on pages 83 to 92.

PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP
Chartered accountants

London
25 March 2015

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

www.rothesaylife.com

T: 020 7770 5300