Rothesaylife

Rothesay Holdco UK Limited

Market Consistent Embedded Value Supplementary Financial Statements for the year ended 31 December 2018

Rothesay Life is one of the leading providers of regulated insurance solutions in the UK market for pensions de-risking. Established in 2007, Rothesay Life has grown to become one of the largest annuity providers in the UK market, with over £36bn of assets under management and insuring the annuities of over 770,000 individuals.

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Introduction

Rothesay Holdco UK Limited and its subsidiaries (the Group) have 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 and May 2016. These statements are intended to supplement the Annual Report and accounts for Rothesay Holdco UK Limited (RHUK) for the year ended 2018.

The Group 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.

Risks to the Group, including those related to Brexit, are included in our Annual Report and Accounts.

MCEV statements

Group statement of financial position

As at 31 December 2018

	2018 £m	2017 £m
Assets		
Value of in-force business	1,223	606
Financial investments and property, plant and equipment	49,176	37,304
Accrued interest and prepayments	497	312
Deferred tax asset	1	1
Reinsurance assets	43	168
Receivables	353	337
Cash and cash equivalents	163	251
Total assets	51,456	38,978
Total equity	3,441	2,301
Liabilities		
Reinsurance liabilities	673	231
Insurance contract liabilities	32,435	21,741
Payables and financial liabilities	13,849	13,965
Borrowings	1,000	703
Accruals and deferred income	58	37
Total liabilities	48,015	36,677
Total equity and liabilities	51,456	38,978

The notes on pages 5 to 11 form an integral part of these supplementary financial statements.

MCEV statements

Reconciliation of shareholders' equity on IFRS basis to shareholders' equity on MCEV basis

The shareholders' equity on an MCEV basis is consistent with the sum of the shareholders' equity on an IFRS basis, the value of in-force business (VIF) as shown on page 8 and any debt valuation differences as shown on page 7.

The debt valuation difference arises as a result of the market value approach under MCEV which differs from amortised cost valuation under IFRS.

Group MCEV analysis of earnings (net of tax)

For the year ended 31 December 2018

	Covered business (MCEV) £m	Non covered business (IFRS) £m	Total Group MCEV £m
Opening MCEV	2,201	100	2,301
Capital and dividend flows	450	(70)	380
Adjusted opening MCEV	2,651	30	2,681
Operating MCEV earnings	865	–	865
Non-operating MCEV earnings	(100)	(5)	(105)
Total MCEV earnings	765	(5)	760
Other movements in IFRS net equity	–	–	–
Closing MCEV	3,416	25	3,441

For the year ended 31 December 2017

	Covered business (MCEV) £m	Non covered business (IFRS) £m	Total Group MCEV £m
Opening MCEV	2,434	(261)	2,173
Capital and dividend flows	(370)	370	–
Adjusted opening MCEV	2,064	109	2,173
Operating MCEV earnings	149	–	149
Non-operating MCEV earnings	(12)	(9)	(21)
Total MCEV earnings	137	(9)	128
Other movements in IFRS net equity	–	–	–
Closing MCEV	2,201	100	2,301

Notes to the MCEV supplementary financial statements

1. Basis of preparation

Comparative information has been provided as at 31 December 2017.

Covered business

The covered business includes all business written by the Group's regulated insurer, Rothesay Life Plc (RLP). This business falls under the definition of long-term insurance business for UK regulatory purposes.

The adjustments applied to arrive at the Group MCEV are the market value of other entities within the Group.

New business

For MCEV purposes 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. For the dates shown there were no acquisitions.

Methodology

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

Net worth

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

a. Value of in-force (VIF)

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.

b. Present value of future profits (PVFP)

The PVFP reflects the profits, net of tax payable, calculated on an IFRS basis rather than on a Solvency II basis. The PVFP has not been updated to reflect Solvency II technical provisions to retain consistency with the payment of tax. Solvency II allowances are made through the definition of required capital and the associated frictional costs of required capital elements of the MCEV. The alternative presentation of calculating the PVFP on a Solvency II basis would not change the total MCEV however the constituents would differ, in particular, there would be a transfer from PVFP to free surplus.

c. Time value of financial options and guarantees (TVFOG)

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 Group to be profit-neutral. Where there are specific contractual clauses that diverge from this, these have been appropriately allowed for within the PVFP.

The Group 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 Group continues to meet these solvency requirements and hence no value is placed on these surrender rights.

d. Frictional costs of required capital

Frictional costs are calculated by projecting forwards the future levels of required capital as set out in the assumption section (g) on page 7. 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.

e. Cost of residual non-hedgeable risk (CNHR)

CNHR covers risks not already allowed for in the TVFOG or in the PVFP. 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.

Notes to the MCEV supplementary financial statements continued

1. Basis of preparation continued

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 Own Risk and Solvency Assessment (ORSA). This capital requirement has been modelled as running off in line with the cash flow profile of the best estimate liabilities excluding the longevity swap cash flows.

The resulting annual capital charge is 3.7% (31 December 2017: 3.6%).

f. Tax

The projected cash flows take into account all tax which the Group expects to pay using the following tax rates:

	2018	2017
2018	19.00%	19.00%
2019	19.00%	19.00%
2020	17.50%	17.50%
2021 +	17.00%	17.00%

g. Consolidation adjustments

Group entities have been incorporated at market value.

The Group MCEV is net of external debt.

Assumptions

Economic assumptions

a. Reference rates

In setting the risk-free rate a mid-price swap yield curve is used as shown in the table below:

Term (years)	1	5	10	20	30	50
31 December 2018	1.08%	1.31%	1.44%	1.56%	1.56%	1.48%
31 December 2017	0.65%	1.04%	1.29%	1.48%	1.44%	1.27%

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 Group invests, but does not correspond exactly to the current asset 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 were updated during 2018. These make reference to historical defaults and downgrades along with market observable credit risk information. The resulting deduction remains prudent relative to historical defaults. The change in methodology increased the total liquidity premium by 7bps which is mainly as a result of a reduction in the prudence previously held in the assumption.

The in-force liquidity premium adjustment as at 31 December 2018 was 115bps, after the deduction of investment management costs. The comparable liquidity premium adjustment as at 31 December 2017 was 104bps.

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. On average an allowance of £27 per policy per annum (31 December 2017: £32 per policy per annum) is made with additional allowances for short-term project costs and investment management expenses.

Notes to the MCEV supplementary financial statements continued

1. Basis of preparation continued

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 costs are anticipated to grow at a rate higher than RPI.

At 31 December 2018 the assumed rate of future expense inflation is equivalent to 3.64% (31 December 2017: 3.57%).

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 cash flows 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 an 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, that is improvements in future policyholder longevity are allowed for.

Recent mortality experience has been analysed for each pension scheme and reinsurance contract at the end of 2018. 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. A consistent approach has been used to derive the demographic assumptions used for new business written during 2018. The demographic assumptions are consistent with those used for the valuation of the insurance contract liabilities as described in section D2 of the Solvency and Financial Condition Report (SFCR).

f. Non-hedgeable risk

For the balance sheet a charge of 3.7% (3.6% at 31 December 2017) 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 £349m (£237m at 31 December 2017). The resulting CNHR is £124m (31 December 2017: £92m).

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:

- Solvency II Pillar 1 Technical Provisions (net of transitional measures) plus 130% of RLP's Solvency Capital Requirement (SCR).
- Best estimate liabilities plus the economic capital requirement.

The economic capital requirement calculates the one year value-at-risk to a 99.8% confidence interval. The Group's capital requirement is driven by 130% of RLP's SCR.

h. Valuation of debt

Borrowings in the MCEV consolidated statement of financial position are valued at their market value as determined by traded levels.

	2018 £m	2017 £m
Face value	650	650
Amortised costs	(3)	(3)
IFRS valuation	**647**	647
Face value	1,000	650
Effect of marking to market	–	53
Market value / fair value	**1,000**	703

During 2018 £350m of Restricted Tier 1 notes were issued by the Group. These notes are treated as equity under IFRS and debt under MCEV, and this drives the majority of the difference in valuation between MCEV and IFRS. For 2017 the debt valuation difference arose as a result of a market value approach being utilised under MCEV which differs from the amortised cost valuation method used under IFRS. During the prior year, the Group issued £300m of Tier 2 debt.

Notes to the MCEV supplementary financial statements continued

2. Group embedded value

	2018 £m	2017 £m
Net worth	3,193	2,298
Present value of future profits	1,474	826
Frictional cost of required capital	(127)	(128)
Cost of non-hedgeable risks	(124)	(92)
Value of in-force business	1,223	606
Sub-debt	(1,000)	(703)
MCEV of RLP	3,416	2,201
Debt	–	–
Net assets of other Group companies	25	100
Group MCEV	3,441	2,301

3. Covered business analysis of movement in embedded value (net of tax)

For the year ended 31 December 2018

	Net worth £m	VIF £m	Debt £m	MCEV impact £m	Group adjustments £m	MCEV £m
Opening MCEV	2,298	606	(703)	2,201	100	2,301
New business value	(369)	822	–	453	–	453
Management of in-force book	695	(255)	–	440	–	440
Expenses	(30)	–	–	(30)	–	(30)
Demographic experience variance	2	–	–	2	–	2
Operating MCEV earnings	298	567	–	865	–	865
Economic variances	(150)	44	53	(53)	–	(53)
Other non-operating variances	747	6	(350)	403	(75)	328
Total MCEV earnings	895	617	(297)	1,215	(75)	1,140
Closing MCEV	3,193	1,223	(1,000)	3,416	25	3,441

For the year ended 31 December 2017

	Net worth £m	VIF £m	Debt £m	MCEV impact £m	Group adjustments £m	MCEV £m
Opening MCEV	2,093	699	(358)	2,434	(261)	2,173
New business value	(79)	256	–	177	–	177
Management of in-force book	461	(420)	–	41	–	41
Expenses	(68)	–	–	(68)	–	(68)
Demographic experience variance	(1)	–	–	(1)	–	(1)
Operating MCEV earnings	313	(164)	–	149	–	149
Economic variances	14	73	(45)	42	–	42
Other non-operating variances	(122)	(2)	(300)	(424)	361	(63)
Total MCEV earnings	205	(93)	(345)	(233)	361	128
Closing MCEV	2,298	606	(703)	2,201	100	2,301

Notes to the MCEV supplementary financial statements continued

3. Covered business analysis of movement in embedded value (net of tax) continued

Commentary

The new business value shows the incremental MCEV, at the point of sale, from single premium bulk annuity transactions over 2018. For 2018 this is predominantly driven by the MCEV generated from the transaction to take on £12bn of annuities from Prudential.

The management of in-force book includes profits made through the year due to changes in assumptions, expected returns and demographic releases, data cleanse exercises and other data movements. Changes to assumptions are discussed previously. The impact of the change in allowance for credit defaults was to increase the MCEV by £225m and the change in demographic assumptions led to an increase in MCEV of £133m.

Expenses reflect the actual maintenance expenses. For 2018 all RLP acquisition expenses have been allocated against new business profits.

Demographic experience variance represents the impact on MCEV of actual experience during the year relative to the expected assumptions at the start of the year.

Economic variances arise from market movements in credit spreads, illiquidity premium, interest rates and inflation compared to expectations. IFRS losses were experienced during the year due to credit spread widening. In line with this general trend across the market, the cost to repay the RLP debt also fell, increasing the MCEV.

Other non-operating variances net worth includes £380m of equity capital injected as part of the Prudential transaction and the issuance of £350m of RT1 notes. In addition, the movement in net worth from non-operating variances also reflects debt financing costs and non-recurring expenses net of tax.

4. Value of new business over the year ended 31 December 2018

The following table sets out the after-tax value of new business for the year ended 31 December 2018, calculated at the point of sale:

	2018 £m	2017 £m
Net worth	(369)	(79)
Present value of future profits	899	261
Frictional cost of required capital	(35)	(5)
Cost of non-hedgeable risks	(42)	–
Group MCEV for new business	**453**	**177**

£13.2bn of new business premiums were written in the year ending 31 December 2018 (31 December 2017: £1.2bn). This excludes regular premiums generated on the in-force inwards longevity reinsurance business written in prior years.

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 in-force business, as described in the basis of preparation.

The net worth is calculated at the point of sale and 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 current or future financial year.

The weighted average liquidity premium at point of sale for new business written during the year ending 31 December 2018 was 91bps (31 December 2017: 109bps). This is lower than the total in-force assumption at 31 December 2018 due to changes in market conditions and assumptions during the year.

Notes to the MCEV supplementary financial statements continued

5. Sensitivities

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

- 1% increase and decrease in the risk-free rate of interest. No floor has been applied to the risk-free rate of interest in these sensitivities. The impact of dynamic hedging is allowed for as interest rates change.
- 1% increase and decrease in inflation. This covers both expense inflation and benefit inflation.
- 10 basis point increase in IFRS credit default assumptions, along with associated spread widening. This stress has not been applied to risk free assets or, for 2018, any assets included under the property stress.
- 10% decrease in property prices. While the group has no direct exposure to property, a sensitivity to property is shown reflecting the collateral underlying certain assets. As with IFRS reporting this stress is included for the first time during 2018 due to increased sensitivity of the portfolio to property risk.
- Required capital equal to 100% of SCR.
- 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 than the central case (i.e. 110% 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.

The following sensitivities have not been shown:

- Swaption implied volatility due to materiality.
- Equity as the Group does not directly invest in this asset class.
- Lapse rates as the Group is not exposed to the lapse of future premiums.

In calculating the change in Solvency II capital required in each scenario it assumed that the transitional has been recalculated.

For 2018 the 10 basis point decrease in credit default assumptions has been removed for the consistency with the SFCR where no credit spread reduction sensitivity is shown.

Sensitivities at 31 December 2018

	Net worth £m	VIF £m	Debt & group adjustments £m	MCEV £m
As reported	3,193	1,223	(975)	3,441
Economic assumptions				
Interest rates +1%	21	(205)	38	(146)
Interest rates –1%	236	318	(41)	514
Inflation +1%	21	113	–	134
Inflation –1%	66	(116)	–	(50)
Credit default +10bps	(167)	60	–	(107)
Property Prices –10%	(68)	12	–	(56)
Required capital equal to 100% of SCR	–	36	–	36
Non-economic assumptions				
Base mortality –5%	(145)	31	–	(115)
Base mortality +5%	139	(28)	–	110
Expenses +10%	(77)	24		(53)

Sensitivities at 31 December 2017

	Net worth £m	VIF £m	Debt & group adjustments £m	MCEV £m
As reported	2,298	606	(603)	2,301
Economic assumptions				
Interest rates +1%	(20)	(41)	18	(43)
Interest rates –1%	277	121	(19)	379
Inflation +1%	52	62	–	114
Inflation –1%	69	(87)	–	(18)
Credit default +10bps	(90)	1	–	(89)
Credit default –10bps	90	–	–	90
Required capital equal to 100% of SCR	–	30	–	30
Non-economic assumptions				
Base mortality –5%	(88)	9	–	(79)
Base mortality +5%	84	(8)	–	76
Expenses +10%	(54)	16	–	(38)

Notes to the MCEV supplementary financial statements continued

5. Sensitivities continued

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

- The net worth is calculated based on the impact on IFRS profit and is consistent with the note 23 of the Group's report and accounts net of tax. The tax on IFRS profit is determined by applying the current tax rate at 31 December 2018, of 19%, to the pre-tax profit figure. 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, Frictional Cost of Capital and Cost of Non-hedgeable Risk.
- The debt and Group adjustments include the effect of marking all debt to market in the interest 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.

MCEV statements

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. 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.
- 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.
- Prepared the consolidated supplementary financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.
- Established internal controls as they determine is necessary to enable the preparation of consolidated supplementary financial statements that are free from material misstatement, whether due to fraud or error.

The supplementary financial statements were approved by the Board of Directors on 27 March 2019 and were signed on its behalf by:

Andrew Stoker
Chief Financial Officer

27 March 2019

Independent auditors' report

to the Directors of Rothesay Holdco UK Limited on the Market Consistent Embedded Value consolidated supplementary financial statements

Report on the audit of the Market Consistent Embedded Value supplementary financial statements

Opinion

In our opinion, the Rothesay Holdco UK Limited's Market Consistent Embedded Value ("MCEV") supplementary financial statements for the year ended 31 December 2018 have been prepared, in all material respects, in accordance with the MCEV Principles issued in June 2008 as amended in October 2009 and May 2016 ("CFO Forum Principles") and the Basis of preparation set out on pages 5 to 7.

We have audited the MCEV supplementary financial statements of Rothesay Holdco UK Limited ("the Group") for the year ended 31 December 2018 which comprise the Group statement of financial position, the Reconciliation of shareholders' equity on IFRS basis to shareholders' equity on MCEV basis, the Group MCEV analysis of earnings (net of tax), and the Notes to the MCEV supplementary financial statements, which have been prepared in accordance with the European Insurance CFO Forum MCEV Principles issued in June 2008 as amended in October 2009 and May 2016 ("CFO Forum Principles") and the Basis of preparation set out on pages 5 to 7.

The information contained in the MCEV supplementary financial statements should be read in conjunction with the Rothesay Holdco UK Limited's consolidated financial statements.

Basis of opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ('ISAs (UK)'), including ISA (UK) 800, and applicable law. Our responsibilities under ISAs (UK) are further described in the Auditors' responsibilities for the audit of the MCEV supplementary financial statements section of our report. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Independence

We remained independent of the Group in accordance with the ethical requirements that are relevant to our audit of the MCEV supplementary financial statements in the UK, which includes the FRC's Ethical Standard as applicable to public interest entities and we have fulfilled our other ethical responsibilities in accordance with these requirements.

Emphasis matter – Basis of preparation

In forming our opinion on the MCEV supplementary financial statements, which is not modified, we draw attention to the Basis of preparation on pages 5 to 7. The MCEV supplementary financial statements are prepared by the Group in accordance with this special purpose framework because the Group believes that embedded value reporting provides investors with a useful measure of the future profit streams of the Group's in-force long-term business. As a result, the MCEV supplementary financial statements may not be suitable for another purpose.

Conclusions relating to going concern

ISAs (UK) require us to report to you when:

- the Directors' use of the going concern basis of accounting in the preparation of the MCEV supplementary financial statements is not appropriate; or
- the Directors have not disclosed in the MCEV supplementary financial statements any identified material uncertainties that may cast significant doubt about the Group's ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the MCEV supplementary financial statements are authorised for issue.

We have nothing to report in respect of the above matters.

However, because not all future events or conditions can be predicted, this statement is not a guarantee as to the Group's ability to continue as a going concern. For example, the terms on which the United Kingdom may withdraw from the European Union are not clear, and it is difficult to evaluate all of the potential implications on the Group's trade, customers, suppliers, and the wider economy.

Reporting on other information

The other information comprises all of the information in the document containing the MCEV supplementary financial statements other than the MCEV financial statements and our auditors' report thereon. The Directors are responsible for the other information. Our opinion on the MCEV supplementary financial statements does not cover the other information and, accordingly, we do not express an audit opinion or any form of assurance thereon.

In connection with our audit of the MCEV supplementary financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the MCEV supplementary financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If we identify an apparent material inconsistency or material misstatement, we are required to perform procedures to conclude whether there is a material misstatement of the MCEV supplementary financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report based on these responsibilities.

Independent auditors' report continued

to the Directors of Rothesay Holdco UK Limited on the Market Consistent Embedded Value consolidated supplementary financial statements

Responsibilities for the supplementary financial statements and the audit

Responsibilities of the Directors for the supplementary financial statements

As explained more fully in the Statement of Directors' responsibilities in relation to the Market Consistent Embedded Value basis supplementary information, the Directors are responsible for the preparation of MCEV supplementary financial statements in accordance with the MCEV basis set out in the basis of preparation on pages 5 to 7. The Directors are also responsible for such internal control as they determine is necessary to enable the preparation of MCEV supplementary financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the MCEV supplementary financial statements, the Directors are responsible for assessing the Group's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless the Directors either intend to liquidate the Group or to cease operations, or have no realistic alternative but to do so.

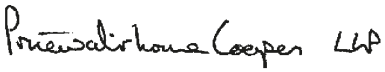
Auditors' responsibilities for the audit of the supplementary financial statements

Our objectives are to obtain reasonable assurance about whether the MCEV supplementary financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these MCEV supplementary financial statements.

A further description of our responsibilities for the audit of the MCEV supplementary financial statements is located on the Financial Reporting Council's website at: www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditors' report.

Use of this report

This report, including the opinion, has been prepared for and only for the Group's Directors as a body for management purposes in accordance with our engagement letter dated 16 July 2018 and variation letter dated 7 March 2019, and for no other purpose. We do not, in giving this opinion, 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, including without limitation under any contractual obligations of the Group, save where expressly agreed by our prior consent in writing.



PricewaterhouseCoopers LLP
Chartered Accountants

London
27 March 2019

MCEV statements

Glossary of terms

Administration expenses	Administration costs represent the cost of administering the in-force book of business.
Annuity	A series of regular payments made to an individual until their death. Payments may be indexed.
Best estimate liability (BEL)	The liabilities of the Group calculated on a best estimate basis under Solvency II, i.e. where all the assumptions made in the calculation are best estimate.
Bulk annuity	A bulk annuity, sometimes referred to as a bulk purchase annuity, is a contract between a defined benefit pension scheme and an insurance company, whereby an insurance company insures some or all of the annuities being paid by the pension scheme.
Credit risk	The risk of loss or of adverse change in the financial situation resulting from fluctuations in the credit standing of issuers of securities, counterparties and any debtors.
Demographics	Statistical data relating to the population and particular groups within it.
Economic capital	Represents management's internal risk-based calculation of the capital required to remain solvent for a 99.8% confidence level over a one-year period.
Fair value	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.
Frictional costs of required capital	Additional costs to a shareholder, on an MCEV basis, of holding the assets backing required capital within an insurance company rather than directly in the market. The additional costs allowed for are the tax costs and any additional investment expenses on the assets backing the required capital. These costs are explicitly deducted from the present value of future premiums.
In-force	An insurance policy or contract reflected on records that has not expired, matured or otherwise been surrendered or terminated.
Investment return	Comprises all interest income on financial investments at fair value through profit and loss, realised investment gains and losses and movements in unrealised gains and losses, as well as expenses directly related to investments executed during the year.
Liquidity premium	An addition to the risk-free rate used when projecting investment returns and discounting cash flows on certain types of contracts where the liabilities are illiquid and have cash flows that are predictable.
Management of in-force book	Profits or losses generated on the in-force book of business.
Market consistent embedded value (MCEV)	Provides an indication of the value of business written by measuring the risk-adjusted value of the in-force business, allowing for the unwind of margins.
Net worth	The market value of the shareholders' funds and the shareholders' interest in the surplus held in the long-term business funds, determined on an IFRS basis at 31 December 2018.
New business	New insurance contracts and reinsurance inwards sold during the period.
New business premium	Premium paid on new business transacted during the period.
Non-hedgeable risk	Under MCEV, risks not already allowed for in the time value of options and guarantees or 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.
Operational risk	The risk arising from inadequate or failed internal processes, personnel or systems, or from external events.
Pillar I	Under Solvency II, represents the solvency capital requirement calculated using a standard formula, or (partial) internal model.
Present value of future profits (PVFP)	Present value of the profits to shareholders, in MCEV arising from the in-force covered business projected on a best estimate basis and discounted during the risk free rate adjusted for the liquidity premium.
Regular premiums	Payments of premium made regularly over the duration of the policy.
Reinsurance	Protection sold to or purchased from another insurance company.
RHUK	Rothesay Holdco UK Limited.
RLP	Rothesay Life Plc, the Group's regulated life company.

Glossary of terms continued

Solvency capital requirement (SCR)	Under Solvency II, capital requirement to withstand a 1-in-200 year event.
Solvency II	The solvency regime applicable from 1 January 2016. Under Solvency II, the Group is required to hold the greater of the capital required under the new Solvency II Pillar 1 framework and the capital required under our own economic capital models Solvency II Pillar 2.
Surrender	The termination of a life insurance policy or annuity contract at the request of the policyholder after which the policyholder receives the cash surrender value, if any, of the contract.
Third party administration (TPA) agreement	Contract with pensions administrator to process claims and payroll on behalf of RLP.
TVFOG	Time value of financial options and guarantees in MCEV.
Value of in force business	Consists of the following components, in MCEV; present value of future profits, time value of financial options and guarantees, frictional costs of required capital and cost of residual non-hedgeable risks.
Yield	A measure of the income received from an investment compared to the price paid for the investment. Normally expressed as a percentage.

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