

**SCOTTISH RE (DUBLIN) DAC**

**SOLVENCY AND FINANCIAL CONDITION REPORT**

**Covering the Period 01 January 2016 to 31 December 2016**

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## Summary

### Overview of Company

Scottish Re (Dublin) dac (“Company”, “SRD”) which is a limited liability company incorporated and domiciled in the Republic of Ireland (“Ireland”) since December 2000, has principal activity of reinsurance of life assurance business.

Effective 1 October 2009, SRD entered into a modified coinsurance reinsurance agreement with Scottish Re (U.S.), Inc (“SRUS”) for the reinsurance of business originally ceded to SRUS by Penn Mutual Life Insurance Company (Harbourton) (“Penn Mutual Life”). Under this agreement certain individual single premium deferred annuities, as well as individual flexible premium deferred annuities are reinsured by SRUS. SRUS cedes 90% of the above Penn Mutual Life treaty on a modified coinsurance basis to SRD.

In 2012, SRUS began the recapture of its excess retrocession business up to a \$3 million retention on the 2000 through 2004 pool years as the business crossed its ten year policy anniversary dates. All the business subject to the National Association of Insurance Commissioners (“NAIC”) Valuation of Life Insurance Regulation, commonly referred to as Valuation of Life Insurance Policies Regulation reserving requirements, written by SRUS between 1 January 2004 and 31 December 2004, was ceded to the Orkney Re II plc (“Orkney Re II”) Special Purpose Vehicle (below a transaction maximum retention limit of \$0.5 million). SRUS retained liability for individual exposures above the Orkney Re II transaction retention limit up to SRUS’ then current maximum retention of \$2 million, with all individual exposures above this retention limit ceded to third party excess retrocessionaires.

In 2014, SRUS created an internal excess retrocession agreement with SRD for the recaptured excess retrocession business on the treaties ceded to Orkney Re II for individual exposures between the old and revised retention limits (i.e., for individual exposures between \$2 million and \$3 million). The 2004 excess retrocession pool was originally ceded to six retrocessionaires. The internal excess retrocession is on consistent terms as the external excess retrocession business.

The business consists of fifty-seven (57) underlying treaties of business written by SRUS between 1 January 2004 and 31 December 2004. The business primarily is comprised of guaranteed level premium term life insurance which is subject to the statutory reserve requirements of Valuation of Life Insurance Policies Regulation. The defined block of business is a closed block of business.

The business was recaptured on the policy anniversary and was immediately ceded to SRD.

SRD also has in place the following intra-group agreements:

- Access to Collateral Support Agreement dated 1 January 2001 between Scottish Annuity & Life Insurance Company (Cayman) Ltd. (“SALIC”) and SRD;
- Net Worth Maintenance (“NWM”) Agreement dated 1 January 2002 between SALIC and SRD (as amended);
- Support Service Agreement dated 1 January 2002 between SRUS and SRD; and
- Support Service Agreement dated 1 January 2003 between Scottish Holdings, Inc. (“SHI”) and SRD.

Pursuant to a 2008 agreement, SALIC agreed to limit any fees payable to it in respect of the Collateral Support Agreement and the NWM Agreement. There is also a waiver letter from SRUS, SHI, and SRGL waiving the fees to which they would otherwise be entitled pursuant to the three service agreements referred to above. These waiver letters were signed during 2008 and were for an indefinite time period. In December 2015, SRD received notice that fees for the three service agreements would be charged from 1 January 2016. Fees under the NWM Agreement were reinstated with SRD's agreement beginning 1 January 2016.

The Company reports under FRS 101 and Solvency II.

SRD is required by the Central Bank of Ireland (the "Central Bank") to maintain a minimum level of paid up share capital. The Central Bank has put certain restrictions in place on the ability of SRD to make dividend payments from profits available for distribution within the meaning of the Act.

As is allowed under FRS101, the Company reclassified its capital contributions to the retained loss account, creating a revenue reserve account. With effect from 13 December 2016, based on the approval letter obtained from the Central Bank, SRD transferred all of the capital contributions made to date, US\$ 533,699,585.18 to the retained earnings account, creating a positive revenue reserve account of US\$ 9,987,408. This enabled SRD to declare a distribution by way of return on capital to its parent company and sole shareholder (as the above meets the criteria for distributable profits under the Act), SALIC, of US\$7 million. The distribution to owner of US\$7 million was approved by the Central Bank on 13 December 2016 which was completed on 20 January 2017.

#### Approval

This document was approved by the board on May 16<sup>th</sup> 2017.

## **Section A: Business & Performance**

### **A1. Business**

SRD is incorporated in the Republic of Ireland and is a company limited by shares.

The address of the registered office is:

2 Grand Canal Square  
Dublin 2  
Ireland

This Solvency and Financial Condition Report (“SFCR”) covers SRD on a solo basis.

Under Solvency II, the group supervisor of SRD is the Central Bank of Ireland (“CBI”).

Central Bank of Ireland Desk Officer of the Company is:

Eamonn Henry  
Central Bank of Ireland  
3 Upper Mayor Street  
Dublin 2  
Ireland

The External auditors of the Company are:

EY  
Harcourt Centre  
Harcourt Street  
Dublin 2  
Ireland

The signing Partner in EY is Dargan Fitzgerald

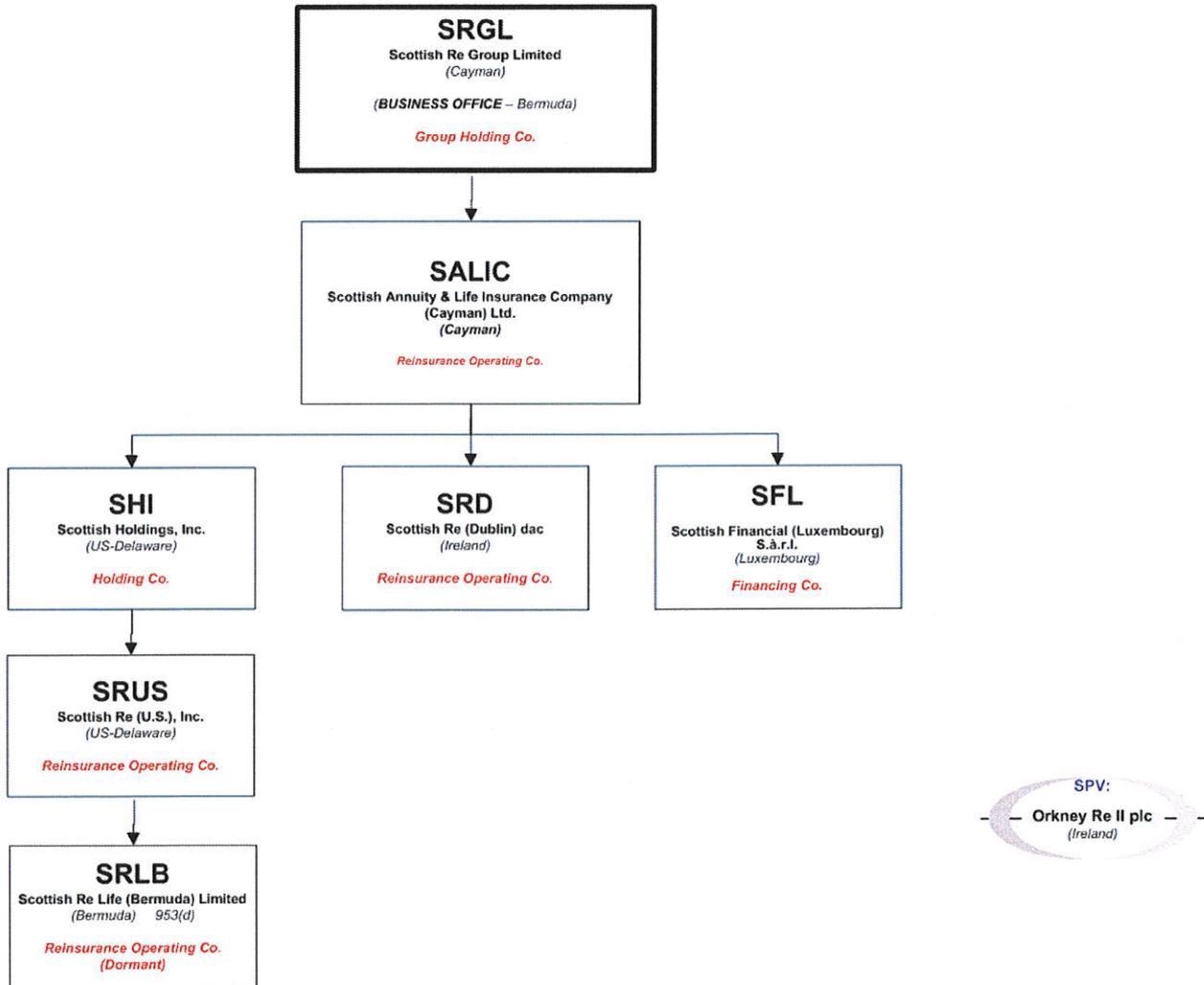
The Legal advisors of the Company are:

William Fry  
2 Grand Canal Square  
Dublin 2  
Ireland

The Company's immediate parent company is Scottish Annuity & Life Insurance Company (Cayman) Ltd. ("SALIC"), a company incorporated in the Cayman Islands.

The Company's ultimate parent is Scottish Re Group Limited ("SRGL"), a company incorporated in the Cayman Islands, which is not an EEA State

The chart below shows the structure of Scottish Re Group Limited:



Orkney Re II Plc is a special purpose vehicle (orphan company) which is consolidated into the SRGL Financial Statements.

## A2. Underwriting performance

The table below shows a breakout of the Net Technical reserves under FRS 101.

<b>SRD IRISH RESERVES AS OF 31 DECEMBER 2016 (\$000S):</b>			
<b>SRUS Treaties</b>	<b>2016</b>	<b>2015</b>	<b>Movement</b>
Account Value	3,867	3,719	148
Additional Guarantee	1,650	1,287	363
<b>Total (Penn Mutual)</b>	<b>5,517</b>	<b>5,006</b>	<b>511</b>
Unearned Premium Reserve	1,594	1,504	91
Incurred But Not Reported Reserve	669	476	193
Pending Claims	1,676	175	1,501
<b>Total (Guaranteed Level Premium Term Life Treaty)</b>	<b>3,940</b>	<b>2,155</b>	<b>1,785</b>
<b>Grand Total</b>	<b>9,457</b>	<b>7,161</b>	<b>2,296</b>

## A3. Investment performance

### *Investment income*

Investment income is comprised of interest and realised gains. Realised losses are included in investment expenses and charges. Realised gains and losses on sale or maturity of investments are determined by specific identification as the difference between the proceeds and carrying value of the investment. Unrealised gains and losses are separately disclosed and included in the income statement, and are determined by specific identification as the difference between cost and market value.

Below is a summary of the investment income and expense for the year: (US\$, 000):

	<u>2016 US\$</u>	<u>2015 US\$</u>
Interest on financial investments	554	346
Interest credited on deposits with cedant companies	(147)	(143)
Investment Management Charges	(20)	(17)
Unrealised losses on investments	(55)	(65)
Loss on embedded derivative	(12)	(72)

Below is a summary of the Investment Portfolio in (US\$, 000):

Asset Class	Market Value	% of Total	Market Yield	Effective Duration	Average Life
<b>Cash &amp; Cash Equivalents</b>	<b>\$2.6</b>	<b>16%</b>	<b>0.0%</b>	<b>0.0</b>	<b>0.0</b>
<b>Non-Structured</b>	<b>\$11.0</b>	<b>68%</b>	<b>3.3%</b>	<b>4.4</b>	<b>5.1</b>
Governments	0.3	2%	1.6%	3.4	3.6
Corporates	10.7	66%	3.4%	4.4	5.1
<b>Structured</b>	<b>\$2.6</b>	<b>16%</b>	<b>4.3%</b>	<b>3.1</b>	<b>5.1</b>
Agency MBS	0.1	0%	1.8%	2.0	2.3
Commercial MBS	0.8	5%	4.5%	6.5	7.7
CLO	0.8	5%	4.0%	0.2	5.2
Asset Backed Securities	0.9	6%	4.1%	2.5	3.0
<b>Non-Structured + Structured</b>	<b>\$13.5</b>	<b>84%</b>	<b>3.5%</b>	<b>4.1</b>	<b>5.1</b>
<b>Q4 2016 Total</b>	<b>\$16.1</b>	<b>100%</b>	<b>3.0%</b>	<b>3.4</b>	<b>4.2</b>

#### A4. Performance of other activities

Operating expenses for the year totalled US\$958,910 (US\$560,727); the increase was as a result of charges such as inter-company fees, net worth maintenance fees, and actuarial fees for the implementation of Solvency II.

#### A5. Any other information

The Company's key financial and other performance indicators during the year were as follows (US\$, 000):

:

	<u>2016 US\$</u>	<u>2015 US\$</u>
Gross premium written	3,248	3,052
(Loss)/profits on ordinary activities	(34)	1,887
Deposits with ceding undertakings	3,867	3,719
Financial investments at fair value	5,611	5,279,
Available for sale financial assets	10,512	8,485
Net technical provisions	9,457	7,161

In December 2016, the Company and the CBI approved a return of capital to the parent, SALIC, of US\$7 million. The assets were returned on 20 January 2017.

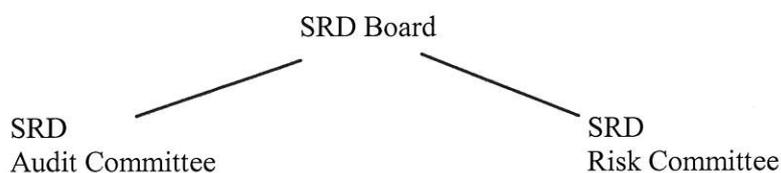
## Section B: System of Governance

### B1. General information on the system of governance

The Board of Directors (“Board”) has the responsibility to ensure that the principles of sound uncompromising good governance are observed.

The Company recognises the importance of strong corporate governance and has established a well-defined governance framework, system of control and committee structure.

#### Overview of the Board and sub-committees



The Corporate Governance Code for Credit Institutions and Insurance Undertakings (2015) (the “Code”) requires the Company to provide evidence of fitness and probity of all Directors and key management. All Directors and key management of the Company have previously completed appropriate questionnaires regarding their qualifications for the positions to which they have been appointed and have been approved by the Central Bank. New Directors and senior managers will complete the Fit and Proper Individual Questionnaire for approval by the Central Bank as required by the Fit and Proper Requirements paper.

The Company must have sufficient resources within Ireland to set strategic direction, and have the ability for decision-making, control, and accountability. The Company currently has a strong and active Board, which include Jim Ruane and Alex Tully as independent non-executive directors, Gregg Klingenberg (Chief Executive Officer (“CEO”) of SRGL), TJ Keller (Executive Vice President, Chief Financial Officer of SRGL), and Karina Lynch (CEO of SRD). Karina Lynch also acts as Compliance Officer of the Company and is based in Ireland.

The Company has appointed Mark Harris (Vice President, Finance Manager of SRGL) as its Chief Risk Officer, and Head of Internal Audit.

Jim Ruane and Alex Tully are considered Independent Non-Executive Directors (“INEDs”) and satisfy all defined requirements of INEDs in Ireland. The Company’s corporate governance guidelines require at least one INED to be present at any Board meeting in order to meet a quorum.

From time to time, the Directors consider the composition and size of the Board as it relates to the ability to adequately oversee Company operations.

Each Board member has agreed to defined time commitments required to fulfill their responsibilities. Jim Ruane was appointed as Chairman of the Board on 3 November 2015.

The Directors, with the assistance of management, continually monitor and approve the targeted minimum solvency level. The Company set a solvency target at 175% under Solvency II in 2016. The retrocession strategy for the Company is also reviewed periodically and approved by the Directors. Human resource policies covering appointment, disciplinary procedures, and dismissal of senior management (including remuneration) have been adopted by the Board. The Company has defined contribution pension scheme in place with an annual contribution rate of 15% of eligible pensionable earnings.

The Company utilises support from other SRGL affiliates in the U.S. and Bermuda, primarily in the form of information technology, actuarial and accounting support services. With this support, management of the Company oversees the daily operations, provides the Board with recommendations for review and approval on objectives, strategy, business plans, and major policies, and provides the Board with comprehensive, relevant, and timely information to fulfill their responsibilities.

All material contracts entered into by the Company are reviewed by the SRGL legal department pursuant to the support services agreement and by local Irish counsel as necessary. Investment management is outsourced with oversight by the Board, who receive regular investment reports.

The Company has established effective internal controls and systems to communicate information between management and the Board.

The Board will continue to monitor the Company's corporate governance structures, particularly in the context of any new business underwritten by the Company, to ensure that it has levels of oversight in operation that are consistent with and proportionate to the size and complexity of its business and to ensure that it has internal governance mechanisms in place which are commensurate with the standards of the Central Bank's corporate governance guidelines and in compliance with the Code.

## **B2. Fitness and proper requirements**

Requirements for skills, knowledge and expertise

The Company ensures that all persons who effectively run the Company or have other key functions are fit to provide sound and prudent management through their professional qualifications, knowledge and experience and are proper by being of good repute and integrity.

In order to ensure that Senior Managers / Company Directors of the Company are fit, they are recruited giving due regard to interview requirements, referencing, relevant skills, personal and professional background and other checks as required and relevant to the role to be undertaken.

In order to ensure that Senior Managers / Company Directors are proper, they are subjected to a variety of checks at the commencement of their assessment.

### **B3. Risk management system including the own risk and solvency assessment**

The Company is aligned with the Group's risk management system. The Group's risk management system is articulated in a number of policies and frameworks, overarched by the Enterprise Risk Management Framework ("ERM Framework").

The Company has developed a comprehensive set of risk policies, frameworks and guidelines to ensure that adequate processes and procedures are in place to manage all types of risk. These documents are aligned with the current regulatory requirements under the Solvency II regime and adopted by the CBI.

The Group adopts the 'three lines of defense' governance model:

#### **The 1st Line of Defense – Business Management**

Business management makes up the first line of defense. Overall, the first line of defense is responsible for the day to day management of risk and control within the business operations as well as delivering the strategy and optimising business performance within an agreed governance and risk framework.

#### **The 2nd Line of Defense – Oversight**

The second line of defense functions comprise of the risk management function and the compliance function. These are independent functions that provide limited assurance to the Board with regards to the adequacy and effectiveness of the overall risk management system. These functions have the authority to communicate with any employee and obtain timely access to any records required to carry out its responsibilities.

#### **The 3rd Line of Defense – Assurance**

The third line of defense comprises of the Company's independent assurance functions, i.e. internal and external audit, that provide an independent and balanced view of the effectiveness of the first and second line functions as defined above.

#### **Own Risk and Solvency Assessment ("ORSA")**

The ORSA is required under Article 45 of Directive 2009/138/EC of the European Parliament and of the Council on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II) (the "Solvency II Directive"). The Solvency II Directive requires that insurance and reinsurance undertakings shall perform the ORSA regularly, at least annually, and without any delay following any significant change in their risk profile.

The Company performed an ad-hoc ORSA on 1 December 2016, to consider the potential return of capital and/or novation of one of the Company's treaties.

This ad-hoc ORSA only addressed the additional considerations related to the potential return of capital and/or novation of one of the Company's treaties and needs to be considered in conjunction with annual ORSA process approved by the Board on 20 October 2016.

The Board of Directors of the Company retains responsibility in respect of the ORSA process and has an active role steering the process and challenging the results.

#### **B4. Internal control system**

The Company maintains a financial control framework that governs financial and regulatory reporting in the company. This framework aims to ensure that:

- All the risks that pertain to the preparation and fair presentation of the financial statements in accordance with the applicable financial reporting framework have been identified and documented;
- There are controls (manual and automated) in place to address these risks and they are adequately designed to prevent or detect material misstatements in the financial statements and disclosures; and
- The controls identified operate as they are supposed to and are appropriately evidenced.

The financial control framework is subject to annual review of the appropriateness and effectiveness of the controls. This review is conducted by the Internal Audit function and the results submitted to the Audit Committee.

The FRS 101 financial statements are also subject to rigorous controls in the production and review leading up to publishing. The actuarial liabilities are produced using best practice actuarial practices that are subject to review by the Risk Committee. The statements are also subject to internal review and external audit review. They are presented to the Audit Committee and Board for sign-off prior to publishing.

#### **B5. Internal audit system**

The internal audit function is part of the third line of defense in the Company.

The internal audit function of the Company is managed by the Head of Internal Audit who is an employee of the group and reports into the chair of the Audit Committee, which is a Non-Executive Director role. This reporting structure ensures independence of the internal audit function.

The Internal audit in the Company is implemented through the following process:

An audit plan is created on an annual basis and ensures sufficient evidence will be obtained to evaluate the effectiveness of the risk management and control processes across the business. The plan includes a review of the major risk management processes operating across the business and a selection of the key risks identified from those processes. The audit plan also gives special consideration to those operations most affected by recent or expected changes. The proposed plan is flexible so that adjustments can be made during the year as a result of changes in management strategies, external conditions, major risk areas, or revised expectations in respect of achieving the business' objectives. Any proposed changes or update in the plan are reported to the Audit Committee for their review and agreement before they are incorporated into ongoing work. The Audit Committee review and approve the plan at least annually.

Based on the annual plan, the internal audit activity evaluates the adequacy and effectiveness of controls encompassing the business' governance, operations, and information systems. This includes:

- Reliability and integrity of financial and operational information;
- Effectiveness and efficiency of operations;
- Safeguarding of assets; and
- Compliance with laws, regulations, and contracts.

In determining the proposed audit plan, the Head of Internal Audit considers relevant work that will be performed by other areas, e.g. Compliance Assurance, External Audit. To minimise duplication of effort and inefficiencies the work planned, or recently completed, by management in its assessments of the risk management process, controls and quality improvement processes, as well as the work planned by the external auditors, are considered in determining the expected coverage of the audit plan for the coming year.

The Audit Committee and the Board requires that the Head of Internal Audit performs sufficient audit work and gathers other available information during the year so as to form a judgement regarding the adequacy and effectiveness of the risk management and control processes. The Head of Internal Audit communicates overall judgement regarding the Company's risk management process and system of controls to the Audit Committee Board of Directors.

#### **B6. Actuarial function**

The Company provides for an Actuarial Function as specified in the CBI Solvency II guidance.

The position of Head of the Actuarial Function is held by Padraic O'Malley of Milliman Limited ("Milliman") who has a wealth of experience in the Irish reinsurance industry.

Padraic O'Malley is a Fellow of the Society of Actuaries in Ireland and has complied continuously with the specific professional obligations this requires. He is an Approved Person under the regime.

The Head of the Actuarial Function is supported by staff in the Scottish Re Group and colleagues within Milliman.

#### **B7. Outsourcing**

Outsourcing is the use of a third party (either an affiliated entity within the same group or an external entity) to perform activities on a continuing basis that would normally be undertaken by the Company. The third party to whom an activity is outsourced is a 'service provider'.

The Board ensures that any outsourcing arrangement does not diminish the Company's ability to fulfill its obligations to customers or its regulator, nor impede effective supervision by its regulator.

Fundamental responsibilities such as the setting of strategies and policies, the oversight of the operation of the Company's processes, and the final responsibility for customers, shall not be outsourced.

The Board approves all outsourcing and considers outsourcing where they believe that there is an advantage to the Company and customer by using a service provider e.g. access to specialist resource, provision of services in the same jurisdiction as the customer, cost benefits.

***SRD Outsourcing***

<b>Service Provider</b>	<b>Services Provided</b>	<b>Jurisdiction Located</b>
Milliman	Actuarial Services	Ireland
PWC	Tax Consulting Services	Ireland
William Fry	Legal Services	Ireland
Wilton Secretarial	Company Secretary	Ireland
Aon Hewitt	Payroll Services	Ireland
Scottish Re Group	Underwriting, Legal, Tax, HR	USA/Bermuda/Grand Cayman

**B8. Any other information**

There is no other information on its general corporate governance of the Company which the Company believes needs to be disclosed at this time.

## Section C: Risk Profile

The Company accepts reinsurance treaties from within the Scottish Re Group and is open to accepting further business from within the Scottish Re Group.

There are two reinsurance treaties on the balance sheet as at end 2016, both treaties are with the Scottish Re Group. Under the Penn Mutual treaty the Company shares in the risk associated with a block of single premium and flexible premium deferred annuities. Under the second treaty the Company shares in the risk associated with a block of US term insurance business. The second treaty is written on a yearly renewable basis and is referred to as the yearly renewable term (“YRT”) treaty.

The Company sets out its risk appetite in its risk appetite statement. The Company has set a solvency ratio at 175% on a Solvency II basis.

In addition, the Company has a parental guarantee with SALIC which ensures that it will meet its reinsurance obligations and maintain its target solvency ratio. The amount of capital currently held by the Company is in excess of this level.

The Risk Appetite will be reviewed prior to writing any new treaties to ensure that the Company is comfortable with the risks presented by the new treaty.

### C1. Underwriting risk

#### C1.1 Risk exposure

The Company is exposed to the following underwriting risks:

- Lapse risk
- Expense risk
- Mortality risk, including catastrophe risk
- Longevity risk

The following table summarises the capital requirements in respect of these risks, at year-end 2016 and year-end 2015. The figures are calculated on a standard formula basis.

Life Underwriting Risk (\$'000)	2016	2015
Lapse Risk	3,598	4,072
Mortality Risk	2,590	2,791
Expense Risk	866	937
Catastrophe Risk	1,246	1,309
Longevity Risk	104	59
Diversification	(2,863)	(3,064)
<b>Total Life Underwriting Risk</b>	<b>5,540</b>	<b>6,104</b>

Underwriting risks are assessed using a number of different methodologies, including:

- Sensitivities
- Capital Requirements and own solvency needs assessments
- Scenario testing

#### *Mortality Risk*

There is significant mortality risk attaching to the YRT Treaty, as this is pure term insurance business and the development of future mortality rates will determine the profitability of the treaty. There is also risk arising from variability of claims experience given the number of lives covered and this risk is reflected through the catastrophe SCR.

There is limited mortality risk on the Penn Mutual Treaty as the death benefit is equal to the account value.

#### *Persistency Risk*

The Company has a significant exposure to lapse risk because the future profits embedded in the Best Estimate Liability (“BEL”) calculation are dependent upon the number of underlying policies that remain inforce.

#### *Expense Risk*

Expense risk represents the risk that expenses are higher than expected and that expense inflation increases more than projected. This is a relatively material risk for the Company given the scale of the inforce business.

#### *Longevity Risk*

The Company has a limited amount of longevity exposure associated with the Penn Mutual treaty. The longevity risk arises because if the underlying policyholders live longer than expected then the cost of the guarantees will increase accordingly.

### **C1.2 Risk concentration**

The Company has some exposure to mortality risk concentration given the number of lives covered under the YRT treaty and the potential for large claims arising from a number of deaths.

### **C1.3 Risk mitigation**

Mortality risk is mitigated through the high profitability attaching to the YRT treaty and the parental guarantee that is in place, which ensures that the Company will hold sufficient capital to meet its target solvency ratio.

### **C1.4 Risk sensitivity**

The sensitivity of the life underwriting risks can be seen in the results of the SCR shocks, the results of which are detailed above. Lapse risk is the most significant life underwriting risk and an increase in lapses (as per the standard formula shock) would result in the future profits embedded in the inforce business falling by almost \$3.6 million.

The assumptions and methodology used for these risk sensitivities are consistent with those outlined in Section D2.

## **C2. Market risk**

### **C2.1 Risk exposure**

The Company is exposed to the following market risks:

- Spread risk
- Currency risk
- Interest rate risk
- Concentration risk

The following table summarises the capital requirements in respect of these risks, at year-end 2016 and year-end 2015. The figures are calculated on a standard formula basis.

Market Risk (\$'000)	2016	2015
Spread Risk	1,658	1,514
Currency Risk	957	1,119
Interest Rate Risk	460	517
Concentration Risk	199	20
Diversification	<b>(1,053)</b>	<b>(946)</b>
<b>Total Market Risk</b>	<b>2,220</b>	<b>2,224</b>

Underwriting risks are assessed using a number of different methodologies, including:

- Sensitivities
- Capital Requirements and own solvency needs assessments
- Scenario testing

#### *Interest Rate Risk*

There is interest rate risk associated with the Penn Mutual Treaty because there is an investment guarantee associated with the underlying business. The underlying policies minimum guaranteed rate of 4% per annum. There is a risk that the Company will not be able to cover the guarantee from the yields available in the market. The current low interest environment means that it is likely that the 4% guaranteed level will not be achieved in the short to medium term.

There is also market risk associated with the other investments of the Company. The Company invests in bonds and asset backed securities so that a movement in interest rates will result in the market value of assets moving accordingly.

### *Foreign Exchange Risk*

The Company has some limited currency risk. Most of the Company's income, liabilities and assets are denominated in USD. Most of the Company's expenses are denominated in Euros, which leads to a small amount of currency risk.

### *Credit Risk*

The Company assumes a certain amount of credit spread exposure through investment in bonds and asset backed securities. Any increase in spreads would result in the market value of the assets held declining.

## **C2.2 Risk concentration**

The Company does not have any material risk concentrations in relation to market risk, as assets are diversified across a wide range of issuers and asset-types.

## **C2.3 Risk mitigation**

Market risks are mitigated through diversification and ongoing monitoring of the investments.

The Board of Directors are responsible for monitoring the investment performance and the Risk Committee is responsible for monitoring the associated risks arising from investments.

Assets are invested in accordance with the prudent person principle, based on the Company's Investment policy.

## **C2.4 Risk sensitivity**

The sensitivity of the market risks can be seen in the results of the SCR shocks, the results of which are detailed above. Spread risk is the most significant of the risks and a significant movement in spreads would result in the Company's assets declining in value.

The assumptions and methodology used for these risk sensitivities are consistent with those outlined in Section D2.

## **C3. Credit risk**

### **C3.1 Risk Exposure**

Counterparty risk primarily arises in relation to the deposits with banks and reinsurance receivables, noting that risks arising from credit spreads are covered under market risk. The Company has a significant amount of cash holdings. The Company had approximately \$2.5 million cash as at 31 December 2016 and a reinsurance receivable of \$140k. The Company is exposed to the risk of default on these holdings.

The following table summarises the capital requirements in respect of these risks, at year-end 2016 and 2015.

Counterparty Risk \$'000	2016	2015
Type 1	126	148
Type 2	0	0
Diversification	.0	0
<b>Total Counterparty Risk</b>	<b>126</b>	<b>148</b>

### **C3.2 Risk concentration**

The Company does not have any material risk concentrations in relation to counterparty risk.

### **C3.3 Risk mitigation**

Counterparty risks are mitigated through diversification and ongoing monitoring of the investments.

### **C3.4 Risk sensitivity**

The counterparty default SCR illustrates the low level of risk arising from counterparty risk.

## **C4. Liquidity risk**

### **C4.1 Risk exposure**

Liquidity risk refers to the risk that undertakings are unable to realise investments and other assets in order to settle their financial obligations when they fall due. The Company qualitatively assesses its exposure to liquidity risk as “Low” because of the high quality liquid assets held.

There has been no material change in the liquidity exposure of the Company over the past year.

Liquidity risks are assessed using a number of different methodologies, including:

- Sensitivities
- Key Risk Indicators
- Scenario testing

The Company has a negative BEL but does not rely upon this negative liability to offset any positive liability, so does not consider that any liquidity risk arises from this source.

### **C4.2 Risk concentration**

The Company does not have any material risk concentrations in relation to liquidity risk.

### **C4.3 Risk mitigation**

Liquidity risks are mitigated through the nature and sufficiency of assets held to match the liabilities.

Liquidity risks are mitigated through the nature and sufficiency of assets held to match the liabilities.

The Expected Profits in Future Premiums (“EPIFP”) equals \$8.1 million.

#### **C4.4 Risk sensitivity**

As part of the ORSA process, the Company considers scenarios that could potentially result in liquidity difficulties. These scenarios have never resulted in any funding difficulties for the Company.

### **C5. Operational risk**

#### **C5.1 Risk exposure**

Operational risk refers to the risk of loss arising from inadequate or failed internal processes, or from personnel and systems, or from external events.

The Company qualitatively assesses its exposure to operational risk as “Low” because of the limited number of transactions undertaken.

The Company is exposed to a range of operational risks, including:

- Key person risk
- Fraud
- IT risk
- Data security / cyber risk
- Regulatory and compliance risk
- Administration risk

Regulatory risk includes risks relating to the existing solvency position and the Company’s compliance with the existing legislation. It also includes potential changes to the regulatory framework, both in Ireland and in the U.S., which could impact upon the Company’s business model.

It is expected that the Company will not be liable for Irish corporation tax in the medium term due to significant historical tax losses. Financial projections of the business assume that no tax will be payable during the projection time horizon.

The following table summarises the capital requirements in respect of these risks, at year-end 2016 and 2015.

Operational Risk \$'000	2016	2015
<b>Total Operational Risk</b>	<b>136</b>	<b>129</b>

#### **C5.2 Risk concentration**

The Company does have some risk concentration given the reliance on certain key persons. The Company has considered these exposures and how best to manage the risks.

#### **C5.3 Risk mitigation**

The Company has a number of mitigants in place in relation to operational risk, including control activities, internal and external audit and contingency plans.

#### **C5.4 Risk sensitivity**

Given the nature of operational risks, the Company does not calculate any quantitative risk sensitivities. However operational risk is considered qualitatively in both the ORSA and the regular Risk Updates provided to the Risk Committee.

#### **C6. Other material risks**

Given the scale of the Company, there are some exposures to the group, which is relied upon for various support services. The two treaties are also within the group, so that the exposure to the group is an important risk consideration.

#### **C7. Any other information**

There is no other information on the Companies Risk Profile to disclosure at this time.

### **Section D: Valuation for Solvency Purposes**

#### **D1. Assets**

The following table outlines the main categories of assets and their value as at 31 December 2016 in \$'000:

<b>Asset Category</b>	<b>31/12/2016</b>
Investments	16,123
Deposits with cedants	3,867
Reinsurance Receivables	511
Cash and Cash Equivalents	134
Other Assets	269
<b>Total Assets</b>	<b>20,904</b>

Financial assets measured at fair value are valued based on market prices at the valuation date, where a market price is available. Where a market price is not available then these assets are valued using observable inputs. The Company does not have any financial assets in this category that are valued using significant unobservable inputs.

The Company considers whether a market can be considered active taking into consideration a number of factors including:

- quoted prices readily and regularly available
- those prices represent actual and regularly occurring market transactions on an arm's length basis
- Whether it is possible to trade without affecting the price

Receivables and Other assets are generally valued at face value. Deposits with banks are valued at face value.

Deposits with cedants represents funds held by Scottish Re US in relation to the Penn Mutual Treaty. There are no material differences between the valuation bases, methods or assumptions used to value assets on a Solvency II basis and those used for FRS 101 purposes.

There is no retrocession in place, and hence no reinsurance asset.

There are no leasing arrangements or investments in related undertakings.

The Company does not account for a deferred tax assets.

No changes were made to the recognition and valuation bases or estimations used during the period.

## D2. Technical provision

The table below outlines the technical provisions as at 31 December 2016 in \$'000s:

Technical Provisions	31/12/2016
Unit Liability	3,867
Best Estimate Liability	(4,102)
Risk Margin	1,994
<b>Gross Technical Provisions</b>	<b>1,759</b>

In the valuation of technical provisions, unit-linked liabilities are unbundled and the unit liability is calculated as “technical provisions calculated as a whole”. The value of the unit-linked liability is set equal to the value of the matching assets.

The Best Estimate Liability (“BEL”) is calculated by projecting forward the future income and outgo on the unit-linked policies and discounting the cashflows back to the valuation date. A deterministic projection is used for the YRT treaty and the BEL for the Penn Mutual treaty is evaluated through the use of a number of deterministic scenarios to which probabilities are attached to reflect the possibility of varying market conditions.

The risk margin is calculated using the cost of capital approach set out in the Directive. The steps involved in this calculation are set out below.

- Firstly, the Solvency II capital requirement relating to non-hedgeable risks is projected for each future year (until the expiry of all contracts).
- The SCR in each future year is then multiplied by the prescribed cost of capital rate (6% p.a.) to get the cost of holding the Solvency II capital requirement in each future year.
- These cost-of-capital figures are then discounted to a single present value using the risk-free yield curve to determine the overall risk margin.

This projection involves the use of risk drivers to estimate the SCR for different risk sub-modules at each future time period rather than performing a full recalculation of the SCR for each sub-module at each point.

The main assumptions required to calculate the BEL are those relating to policyholder lapses and mortality. The mortality assumption is determined based on an investigation of the Company's experience over the past number of years. Lapse assumptions are determined based on group investigations of surrender experience.

No assumptions regarding future management actions are made in the calculation of the technical provisions.

The Company does not apply the matching adjustment, volatility adjustment or any transitional provisions.

There is no retrocession in place and hence no reinsurance asset or liability.

The company has not used any significant simplified methods to calculate technical provisions.

### Uncertainty of Technical Provisions

Uncertainty arises primarily in relation to the key assumptions specified above and the development of experience against these assumptions. This uncertainty can be seen in the SCR amounts required in respect of lapse and mortality risk.

### Material Differences with the Financial Statements

The table below outlines the technical provisions included in the Solvency II balance sheet relative to those included in the financial statements as at 31 December 2016 in \$'000's:

	Solvency II		Financial Statements
Unit Liability	3,867	Unit Liability	3,867
Best Estimate Liability	(4,102)	Technical Provisions	5,577
Risk Margin	1,994		
<b>Total Technical Provisions</b>	<b>1,759</b>	<b>Total Technical Provisions</b>	<b>9,444</b>

There are significant differences in the technical provisions held. In the financial statements an Unearned Premium Reserve ("UPR") is held in respect of the YRT treaty, whereas under Solvency II the BEL for this treaty reflects the profits expected to emerge in the future and a negative liability is held. No risk margin is held within the financial statements.

The assumptions are generally consistent between financial statements and Solvency II, with the financial statement assumptions containing some additional margins for prudence that are not included in the Solvency II best estimate assumptions.

### D3. Other liabilities

The other liabilities of the Company, excluding technical provisions, are shown in the following table as at 31 December 2016 in \$'000s. The table also shows the value of other liabilities shown in the financial statements.

	Solvency II		Financial Statements
Other Liabilities	7,000	Other Liabilities	7,000
Reinsurance Payables	141	Reinsurance Payables	141
Trade Payables	72	Trade Payables	72
<b>Total Other Liabilities</b>	<b>7,213</b>	<b>Total Other Liabilities</b>	<b>7,213</b>

Reinsurance and trade payables represent the face value of the amount owed to creditors and there are no differences compared to the values in the financial statements.

Other Liabilities represents a return of capital that was declared but not yet paid at year-end 2016.

No Deferred Tax Liability (“DTL”) is recognised given the historic tax losses available to offset any taxes arising on future profits.

There are no liabilities in respect of leasing arrangements or employee benefits.

There were no changes to the recognition and valuation bases used or on estimations during the reporting period.

There are not any material assumptions or judgements made in relation to the recognition or valuation of the “Other Liabilities”.

### D4. Alternate methods for valuation

The Company does not use any alternative methods for valuation of its assets

### D5. Any other information

The Company does not have any other material information on the valuation of assets or liabilities.

## Section E: Capital Management

### E1. Own funds

The following table outlines the Company's own funds as at 31 December 2016 in \$'000:

Own Fund Item	31/12/2016
Ordinary Share Capital	1,250
Reconciliation Reserve	10,682
Other items approved by Supervisor	0
<b>Total Own Funds</b>	<b>11,932</b>

The Company only holds Tier 1 basic own funds. Therefore, the eligible amount of own funds to cover the SCR and MCR is \$11.9 million. The item approved by the Supervisory authorities was a number of capital contributions. There are no own fund items subject to transitional arrangements and no deductions from own funds or restrictions affecting the availability of own funds.

The items approved by the Supervisor reduced by \$7 million during 2016, as \$7 million in capital was returned to the parent, SALIC.

The objective of own funds management is to maintain, at all times, sufficient own funds to cover the SCR and MCR with an appropriate buffer. These should be of sufficient quality to meet the eligibility requirements in Article 82 of the Delegated Regulation. The Company holds regular meetings of senior management, which are at least quarterly, in which the ratio of eligible own funds over SCR and MCR are reviewed.

The following table reconciles the Solvency II own funds to the shareholder equity shown in the financial statements:

Reconciliation	\$'000's
Share Capital	1,250
Capital Contribution	533,700
Retained Earnings	(523,678)
Return of capital	(7,000)
<b>Shareholder Equity Financial Statements</b>	<b>4,235</b>
Remove FS technical provisions	9,444
Add SII Technical provisions	(1,759)
<b>Solvency II Own Funds</b>	<b>11,932</b>

The reconciliation reserve is effectively equal to the retained earnings in the financial statements plus all of the adjustments outlined above in moving from financial statements to own funds under Solvency II.

## E2. Solvency capital requirement & minimum capital requirements (“MCR”)

### Solvency Capital Requirement

The SCR and MCR figures at year-end 2016 in \$'000's are as follows:

Capital requirements	31 Dec 2016
SCR	6,638
MCR	3,795

The SCR is calculated using the standard formula and the split of the SCR by risk module is as follows:

Capital requirements (\$'000's)	31 Dec 2016
Market Risk	2,220
Underwriting risk	5,540
Counterparty risk	126
Operational	136
Diversification	(1,384)
Loss Adjusting Capacity Deferred Tax	0
<b>SCR</b>	<b>6,638</b>

The Company does not use any simplified calculations or any Company specific parameters in the calculation of the SCR. There are currently no capital add-ons applied by the regulator.

No loss absorbing capacity of deferred tax is recognised when calculating the capital requirements.

### MCR Inputs

The inputs used in the calculation of the MCR are as follows:

- The technical provisions (excluding the risk margin) is US\$5,577,339.
- The total capital at risk US\$850,306,942.
- SCR amount as calculated for the Company. Details of the SCR amounts are set out above. The MCR is capped and floored at 25% and 45% of the SCR.
- The absolute floor of €3.6 million.

The absolute floor of €3.6 million, or \$3.8 million, applies as at end 2016.

### Material Movements in MCR and SCR over the year

The SCR reduced slightly over the year driven by a reduction in underwriting risk. The MCR didn't change over the year in euro's as the absolute floor applied at both points, but currency movements resulted in a slight movement in US dollars.

**E3. Use of the duration based equity risk sub-module in the calculation of the Solvency Capital Requirements**

The Company does not use duration based equity risk sub-module in the calculation of the SCR.

**E4. Difference between the standard formula and any internal model used**

The Company does not use an internal model for its Solvency II calculations.

**E5. Non-compliance with MRC and significant non-compliance with the SCR**

There has been no non-compliance with the MCR or SCR during the year ending 31 December 2016.

**E6. Any other information**

There are no other material disclosures under capital management.