



Case Study

SPRING/FALL 2018

Strategic Decision Making Exam

EXAM CFE SDM

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Disclaimer

The companies and events depicted in this Case Study are fictitious. Any similarity to any event, corporation, organization and person living or dead is merely coincidental. With the exception of Appendix 3A Exhibit 4 which consists of real press releases related to the airline industry, some narrative material utilizes real locations and real news organizations to make the Case Study seem real. The Associated Press, Wall Street Journal, Standard & Poor's, A.M. Best and others used in this context have never actually commented on any of the fictitious companies.

RPPC Dynasty Corporation: A BOX FULL OF GROWTH

1 RPPC Dynasty Corporation

1.1 Introduction

The leaves rustled as Julia and Emmanuel walked down the trail that surrounded Frenz Corporation's home office. The autumn air was refreshingly cool and awakened the senses and mind after an exhilarating and exhausting two weeks. "I appreciate all you've done the past couple of months," and handing Julia a box, Emmanuel said, "I thought this would be appropriate given the words of wisdom you shared at the beginning of this trip." She unwrapped the gift to find a box of gourmet chocolates – one of the many products Frenz sold.

Just two weeks earlier on October 6, 2012, she was with eleven others waiting at the airport, part of two Corporate Planning Teams assigned to visit management at RPPC Dynasty's major businesses and review their 3-year plans. Others had asked what she expected from all the people they would meet. "Hmmm ... my favorite movie is Forrest Gump. Forrest's maxim was, 'Life is like a box of chocolates you never know what you're going to get.'" Everyone chuckled as they recounted their favorite Forrest Gump scenes.

Julia's team had been on a whirlwind tour to Russia, Ontario, Texas, and their final stop in Antwerp, Belgium to talk apparel, tires, airlines and coffee. She looked at her watch. The other team was already in the air on their way back from New Mexico to Dynasty's headquarters in Luxembourg.

Harry looked out the window and could see the Atlantic coastline in the distance. His team had covered the financial businesses – life insurance, banking and P&C insurance. On his left sat Olivia and Sophie. Olivia was full of energy talking about all the people they had met and the opportunities that had been discussed over the past two weeks. There was a lot to do in the next month before next year's plans were finalized in mid-December - a lot of proposals and alternatives to evaluate. Of course there were questions and issues to resolve - products, markets, distribution, investment strategies and impending regulatory and accounting changes. Some thought they should grow cautiously until the recovery was further along. They felt that selling insurance products and making bank loans in this environment squeezed out any margins and added too much additional risk. She thought the opportunities were now and that RPPC couldn't move fast enough. She recalled that Winston Churchill always favored action - the time to act is now. Harry said, "In any case the financial and risk management areas are going to be busy the next 8 weeks. Remember what happened during the Redeploy Project last year."

Julia thought herself lucky to have been given this opportunity – a chance to shine in a prominent role, a chance to really make a difference. The Risk Management function at RPPC had only been established in 2010. In reality RPPC Dynasty was lucky to have her. She worked long hours in preparation. She had read report after report, countless management memos, policies and

process documents and had looked at numbers, metrics, market intelligence analyses and even more numbers. She preferred meeting in small groups. Julia was known as the “Friendly Interrogator”. You couldn’t survive a meeting unless you’d done your homework and had thought through the issues. She helped you be at your best.

Julia had been the CRO’s right hand and was just appointed as CRO recently. Her risk management team was earning the reputation of being business savvy. Her CERA studies had been useful but she was glad she had taken the Corporate Finance & ERM Track in getting her Fellowship in 2008. The material covered in the Strategic Decision Making exam gave her a solid business foundation, strategic mindset and sharpened her critical thinking skills. By continuing to read business and strategy books, mixed in with first-hand experience, her communication skills and business acumen had been noticed. Life was indeed a box of chocolates.

RPPC Dynasty Corporation History

RPPC Dynasty (also referred to as RPPC or Dynasty) was established in 2000 with head offices in Luxembourg by four founding partners. The corporation’s name is derived from the four founder’s surnames - Ruiz, Putin, Patel and Chan. They had ambitious goals to grow the corporation to become its namesake – a business dynasty respected throughout the world. From the beginning, and still to this day, the focus has been to meet the needs of a globally mobile clientele. The corporation holds a diverse group of businesses. Luxembourg was chosen due to its being a European low tax jurisdiction.

The business roots began in 1985. Mr. Ruiz won a \$700,000 lottery. With his winnings and his \$20,000 savings, he started a coffee shop business. His \$720,000 initial investment in his business had growth steadily into billion dollar company today.

The apparel shop began in 1995, also family owned and operated by the Chan family.

In 2000, Mr. Ruiz and Ms. Chan formed a partnership. Soon thereafter two other entrepreneurs were brought in to expand the brand.

In 2001, with the guidance of Mr. Patel, a Bank group was formed.

In 2005, with the influence of the mariner background of Mrs. Putin, a P&C Insurer corporation was acquired. The P&C group were leaders in personal and commercial marine insurance.

In 2009, the financial crisis presented an opportunity to acquire a life insurance group to expand the wealth management capabilities of the bank operations.

In 2010, an Airline was bought to appeal to the growing global mobility of the group’s clientele. The Airline has been put through a restructuring initiative to be fitted into the group’s vision.

RPPC Dynasty's growing empire consists of nearly two dozen companies spanning a variety of industries and services.

Mission

Provide high quality and uniquely tailored service to families or businesses that are globally active.

Our family is your family, come experience our difference that is so familiar to you!!

Vision

We provide our customer the comfort of a family friend when they are away from home. We are your family away from home!!

Executive Team

The Executive Team included:

CEO – Mr. Gilroy Clyde (since inception)

CFO – Mr. Houben Huang (5 years)

CRO – Ms. Julia Reich (recently appointed)

COO – Ms. Jane Mulrone (since incorporation, previously performed CRO functions)

Selling a Success Story

Mr. Houben Huang looked out his window. The trees were bare and the silhouettes against the morning sun always left an impression. December was always a busy month – final business decisions to bring the year to a close, planning always went into overdrive, holiday gatherings and parties, school concerts and plays.

On his desk were materials for a debt rating review session with the Trusty Rating Agency on January 6. Much of the material would be used for the upcoming investor analysts' meeting and excerpts would form the theme in the 2012 Annual Report to shareholders. But the upcoming debt issuance was paramount to their growth plans. Later this morning he would be meeting for most of the day with Gilroy, Jane and Julia. Within the past few weeks, the Boards of Dynasty and its many businesses had adopted many of Management's recommendations. The Board had also sent a few proposals back for further analysis and consideration. The Corporate Planning Teams had been invaluable working with the businesses and their planning teams.

The Trusty Presentation Materials highlighted the Dynasty story - main messages and points Management wished to articulate. Some of the content was done and some needed to be updated or revised. Houben had scribbled some notes – how did the material convey and package the following themes?

Business Strategies

| | |
|----------------|----------------------------------------------------------|
| <i>Airline</i> | <i>new management with a focus on customer</i> |
| <i>Tire</i> | <i>niche market, need new investment or will be sold</i> |
| <i>Coffee</i> | <i>market leader, growth focused</i> |

| | |
|------------------|----------------------------------------------------------------------------------------------------------------------------|
| <i>P&C</i> | <i>cash cow, niche market (Marine (UK), Pet (Canada), Liability, Commercial, Catastrophic) looking to expand to the US</i> |
| <i>Bank</i> | <i>customer oriented wealth management focus, growth by M&A integration</i> |
| <i>Insurance</i> | <i>long term interest risk (VA, LCOI)</i> |
| <i>Apparel</i> | <i>boutique fast follower, seasonal volatility</i> |

Trusty would hammer management on challenges, struggles and missteps. There were a few headaches but the biggest message to sell was the Dynasty success story. There were tremendous opportunities in their major businesses and the acquisition team had several new attractive prospects under consideration. Dynasty was well positioned to grow.

Trusty Presentation Materials also included an executive summary of the global market outlook (see Exhibit 1A). This outlook helps the company in strategizing its global expansion plan. It identifies areas that the company has capitalized on from these global market changes.

1.2 Governance and Risk Management Overview

Governance

RPPC has the following Executive Committees:

1. Operation's Committee
2. Audit Committee
3. Finance Committee
4. Risk Committee
5. Compliance & Legal Committee

RPPC Risk Management Framework

Vision Statement

We are exposed to a variety of risks that are inherent in carrying out our business activities. *Having an integrated and disciplined approach to risk management is key to the success of our business.* In order to achieve prudent and measured risk-taking that aligns with our business strategy, we are guided by a risk management framework that is embedded in our daily business activities and planning process.

Strengths and Value Drivers

- A Risk Appetite that shapes business strategies and is integrated into our decision-making processes. Risk management is considered a profit generating activity. We believe preventing our organisation from experiencing loss is as beneficial as creating new profit streams from new arenas.
- A unified and strong risk culture that is embedded across the enterprise means that there is consensus opinion on the value and purpose of risk management.

Challenge

- Continued volatility in global economic conditions, causing heightened marketplace uncertainty. This is both a risk as well as an opportunity.

Our Priority

- Broaden and strengthen risk capabilities, including enhancing our stress testing functions to deliver better *insights* to both our risk and business groups. We believe strongly in assessing risk through a variety of lenses, not simply looking at past performance.

Our Path to Differentiation

- Within our independent oversight framework and the limits of our risk appetite, contribute to the enterprise's customer focus.
- Ensure that risk awareness is pervasive throughout the organisation, at all levels, and all functions, and that the risk for reward trade-off is applied effectively and consistently in all levels of decision-making.

Key Objectives and Recent Achievements

A key objective is to continue embedding our strong risk culture across the enterprise, including newly acquired businesses:

- Emphasize and ensure that at RPPC Dynasty risk management is a process of continual improvement.
- Reinforce our risk independence and our three-lines-of-defense approach to managing risk across the enterprise.

Recent Achievements

RPPC achieved the roll-out of our five step message on our value based approach to enterprise risk management:

- Understand and manage
- Protect our reputation
- Diversify. Limit tail risk
- Maintain strong capital and liquidity
- Optimise Risk Return

RPPC established and formalised the role of **Risk Champion** to ensure strengthened engagement between the office of the CRO and Business operating groups.

Value-Based Enterprise Risk Framework

RPPC risk governance has three pillars.

- I The first line of defense at RPPC is the Business operating group, which are responsible for ensuring that products and services adhere to the approval process and profit guidelines of their business. Their mandate is to pursue suitable business opportunities within the Risk Appetite, and to adopt strategies and practices to

optimize return on capital employed. They accomplish this by using complicated models of risk, reward and economic capital. RPPC officers must act within delegated risk taking authority, and must have effective processes and controls in place to enable it to operate within its delegated risk authorities and limits.

- II The second line of defense is the office of the CRO, along with Enterprise Risk Officers (ERO's) and Subject Matter Experts (SME's) as assigned for specific risk categories or sub categories, which provide oversight, challenge and independent assessment of risk. These risk officers have a significant influence in the level of risk that the company takes, and utilizes its risk assessments in major strategic decisions.
- III The third line of defense is the Corporate Audit Division, which in conducting the internal audit process will provide assessment as to the effectiveness of internal control including control, risk management and governance processes that support the Enterprise, its objectives and the Board of Directors' discharge of its responsibilities. The audit process includes assessment of the underwriting processes, claims management, and other processes that result in significant risks for the company.

The CEO is responsible for the business operating groups. This is known as the first line of defense. The second line is made up of risk officers (ERO's and SME's) who work collaboratively with the business operating groups and are engaged through corporate policies that support ERM & Portfolio Management (EPM). These risk officers are governed by the CRO and the risk management committee. The second line has a direct line to the Board and therefore meets "in camera"¹ with the Board. The third line, the Audit officers, also has an "in camera" with the Board.

| RPPC Board | | | | |
|---------------------------------------------------------------------------------------------------------------------------------|-------------------------|---------------------------------------|------------------------|------------------------------|
| Board Risk Committee | CEO | | | Board Audit Committee |
| <i>Risk Management Committee</i> | <i>Operating Groups</i> | <i>ERM & Portfolio Management</i> | <i>ERO's and SME's</i> | <i>Corporate Audit Group</i> |
| <ul style="list-style-type: none"> • Capital Management • Reputational Risk • Operational Risk | 1st line of defense | 2nd line of defense | 2nd line of defense | 3rd line of defense |

Risk Culture

Every employee is responsible for risk management at RPPC. The three lines of defense model promote engagement and dialogue between the Business Operating Groups (first line) and the risk office (second line) within the protocols of the Corporate policies that support EPM. The key facilitator of this engagement process is the Risk Champion. The role of the Risk Champion is critical to ensuring that there is buy-in to the process among both business managers and risk officers alike, and ultimately the success of enterprise risk management (ERM). This engagement

¹ In camera is a legal term that means in private.

is central to a value based ERM approach as it promotes understanding and alignment with our risk appetite leading to sound decision making.

In support of an overarching goal of continual improvement, the company has two human resource corporate policies that improve risk management: (1) two-way rotation policy TWRP: allowing employees to rotate between risk roles and business management roles; (2) continued professional development policy CPDP, obligating employees to attend training on risk management principles and techniques at least once every two years.

Risk Principles

All material risks to which the enterprise is exposed are identified, measured, managed, monitored and reported. Risk awareness must be demonstrated to drive all decision-making within the enterprise. For any risk, a risk based approach is used to calculate its reported Economic capital. Economic Capital is used to measure and aggregate all risks.

Risk Appetite

The Risk appetite is at the centre of our value-based enterprise risk management approach. The clear communication of risk appetite at all levels within each line of business is critical to effective risk-taking in decision making. This is achieved with business specific risk appetite statements that are aligned with the RPPC risk appetite statement approved by our Board of Directors.

The following RPPC Risk Appetite Statement is a clear articulation of the value creation principles of RPPC. The Board of Directors of RPPC and its executive officers declare that the business operating groups with the support of risk officers:

- Do not take risks that are opaque, not well understood or that cannot be well managed.
- Identify and quantify low probability tail events.
- Limit exposure to low probability tail event risks that could jeopardize RPPC's credit rating, capital position or reputation.
- Subject all new products or services to a rigorous review and approval process.
- Ensure that the performance management system incorporates risk measures.
- Protect and enhance the RPPC brand by exceeding expectation in the products and services that we deliver to our clients.
- Promote focused differentiation on products and services that leverage RPPC's core competencies to build client trust and to surpass expectations.
- Maintain strong capital and liquidity and funding positions that exceed regulatory requirements.
- Maintain compliance standards, controls and practices that prevent regulatory exposures that could adversely affect our reputation.

Incentive Compensation and Risk Appetite

The business management of RPPC is governed by Key Performance Indicators (KPI) and Key Risk Indicators (KRI). All officers of the company will have their compensation dependent on the following:

- For any risk, the return on its economic capital must exceed the cost of the capital acquired to fund that risk. The CEO of each business operating group must identify and report KPI that indicate that this requirement is being met.
- The payback period on capital invested in a business operating group must not exceed 10 years from the date that capital is first employed. Each operating group CEO must report KRI that indicate for the aggregate of all risk underwritten, that if the business group were to suffer a 1-in-100 year tail event that the capital thereafter would still be able to withstand another 1-in-100 year event. This is referred to as redundant capital. This is critical to RPPC's market discipline, because client relationship management and sustainability is promoted over price leadership.
- Through the identification of KPI and KRI, business management indicates whether the risk being underwritten is within the group's risk appetite. The KPI and KRI are recommended by the business CEO and are approved by a Risk Appetite Consensus Meeting that includes the business executives, CRO, the appropriate risk and business Subject Matter Experts (SME's).

When reporting business plans and KPI, the financial projection must be based on a complete business cycle inclusive of severe market conditions rather than simply best estimate assumptions.

When reporting KRI, scenario results and any stress testing must be demonstrated in the context of the business and directly related to its business driver. Such KRI value based results must be reported, well understood and action-ed at all levels of management within each business group and in all risk decision-making. Scenarios and stress tests are based on transparent deterministic scenarios recommended by the Business and approved by the Risk team.

Only actual past events are deemed relevant in communicating the financial impact of a KRI. Severity is assessed when economic events or business impact are greater than three standard deviations from the average.

Risk Review and Approval Policy

This policy outlines the procedures for the development, review, and procedures for the approval of new products and services within the RPPC conglomerate. The policy is important because it balances the goal of delivering new products in a timely and efficient manner with the need to manage pricing and product development risk. Pricing and product development risk is the risk of financial and/or reputational loss as a result of the unexpected performance of a product or where the costs incurred are greater than those assumed in the pricing of the product.

This policy requires the establishment of product pricing guidelines that describe profit targets for RPPC and performance metrics that must be calculated for all new products and services. This policy also requires the establishment of a product pricing committee that meets periodically to

examine the profitability of current and future sales as compared to the product pricing guidelines.

The Role of Risk Champion

The Risk Champion is a critical role which facilitates the Risk Review and Approval Process (RRAP). The Risk Champion is responsible for identifying the relevant business managers, risk managers and SME's which are needed to complete the required risk assessment and risk analysis. In this way, the Risk Champion serves the role of arbitrator for finding the appropriate forum to resolve areas of dispute between the business and the risk review. The purpose of fostering dialogue and collaboration is to build and maintain the buy-in of all stakeholders throughout the RRAP. The Risk Champion is the key communication bridge between the first line and the second line of defense in the risk framework.

This policy involves the following stages:

Feasibility – For all new products and services, a report assessing the feasibility of the new product or service must be created. This report will provide high-level business rationale and risk assessment for the product or service, and must be presented to the product pricing committee before any further development is undertaken. In this phase, all key stakeholders must be identified and interviewed, and any key issues would be identified and further information may be required before proceeding with development.

Product Assessment – All aspects of the product design must be assessed including the marketing analysis and supporting research, the distribution plan, pricing estimates, sales projections, risk adjusted return on capital, and tax implications.

Risk Assessment – All aspects of the risks of the product or service must be assessed, including exposures and ratings as compared to the risk appetite statement. The assessment should also include a summary of the appropriate procedures and controls to be implemented, or already in place, that are required to manage the new product or service once it is launched.

Sign-off and Approval – Sign-off and approval of the new product or service is required by the office of the CRO, the product pricing committee, and the operational head of the business unit. This approval is gained through initial feasibility study and the product and risk assessments and any resulting subsequent discussion and analysis.

Documentation – An official record must be kept of the feasibility study, product and risk assessments, and the approval and sign-off forms. These could be reviewed by the internal audit function, external auditors, or regulators as evidence of appropriate due diligence and compliance with internal procedures, as well as providing the rationale for the assessments and decision making.

Risk Monitoring

There are three disciplines to the risk monitoring approach:

- Post implementation review
- Risk based capital assessment
- Stress testing

Post implementation review is the core discipline within the engagement approach that embodies our three lines of defense model. Whenever a business operating group has launched an initiative, the group business managers are obligated to develop and report Key Performance Indicators (KPI) and Key Risk Indicators (KRI) that are specifically related to the initiative and that speak directly to the risk appetite of the enterprise.

The assessment of risk based capital within an Economic Capital framework is one of the key metrics in the measurement and communication of any risk taken on. Economic capital is determined by the Risk Management Committee and is underpinned by the Redundant Capital philosophy. Capital is determined to withstand a 1-in-100 year event, after which the capital position is still sufficient to meet another 1-in-100 year event. Economic capital is also compared with regulatory capital to ensure compliance

Allied with the Economic Capital framework, strong risk management and good business management relies on identifying “what-ifs”. Stress testing is the use of historical extreme economic events and/or periods of poor market conditions to quantify and to communicate the impact on the financial results of a given business operation. Scenarios based on historical events are easy to communicate and to get engagement when assessing value based impact.

On an on-going basis, key risk factors are identified on a global basis by the Risk Management Committee. These key risk factors are developed from on-going global market research and outlook studies which identify global market trends and areas of emerging risks. Exhibit 1 provides an executive summary of the recent global market outlook completed by the Risk Management Committee.

Operations Committee

In an effort to create a more holistic risk oversight structure, the CRO in conjunction with the Risk Champion want to better understand the commonality and interaction of risks between individual business operating groups.

A new initiative this year is to establish a CRO sponsored Operations committee. The Operations committee will meet on a quarterly basis, separate from the risk committee, to assess ongoing risk in RPPC. Amongst their goals, the committee seeks to understand the risks being taken throughout the company, discuss different risk policies and issues, and strengthen governance. One of the major mandates of the Operations committee will be to explore in depth the risk of different operating functions.

The members of this committee are the COO, CEO, CRO, Risk Champion, and a human resource representative from RPPC. Other guest attendees are invited on an as-needed basis from the various business groups depending on the agenda of the meeting.

Risk Modelling

Julia, CRO, has recently hired a risk consultant group, FAST Analytics, to propose a quantitative framework in measuring and managing RPPC corporation's risks due to the diversity of its investment and business ventures. Mr. Otto, principal of FAST Analytics, has drafted a proposal naming "*Managing Risks with Fast Actuarial Simulation Technology*" as shown on Exhibit 2.

1.3 New Venture

On November 12, 2015, Robert Sigurdson, one of RPPC's Board members, was contacted by Myhotel's president, Randy Smith, to discuss some of Myhotel's recent marketing activities. Randy, a close friend of Robert, is excited about the recent expansion of his hotel chain into the time sharing vacation area. However, this expansion has caused some financial strain to its company. In addition, Myhotel's loyalty program has caused some volatility to Myhotel's financial results in recent years.

The loyalty program was established in 1999 due to a short term need to market the Myhotel brand more broadly and to increase customer sales in a new market segment at that time. Over the years, this loyalty program has grown significantly and thus Randy set up a new subsidiary to take over this program a year ago. However, with this new subsidiary being set up and the recent expansion plan, Myhotel's capital position is strained. Thus Randy is willing to look at converting the subsidiary into a joint venture or outright selling this subsidiary for some upfront cash.

Robert has taken note of the potential risk exposure of this loyalty business during their discussion. He thinks this business may be a good fit to RPPC's current business lines. Thus he is considering a proposal to Randy to acquire this subsidiary as a new line of business for RPPC. Randy appears to be enthusiastic about the potential sale and has agreed to give RPPC access to the financial data required to assess the company.

Robert returned to RPPC and discussed with the Executive team which includes Gilroy (CEO), Houben (CFO), Julia (CRO) and Jane (COO) regarding this opportunity to test the waters before approaching other Board members. The following is the discussion that takes place in the meeting on November 30, 2015:

"Hey Gilroy, I met with my friend Randy the other day and see a potential opportunity for us at RPPC. Randy's hotel chain currently has a subsidiary that offers a loyalty program to his hotel chain which helps them in increasing the hotel's market share. However, due to the recent expansion of his business in other areas, Randy is thinking of partnering with a financial

conglomerate like us ideally but would also consider a sale offer if the price is right. What do you think of this opportunity?” Robert begins.

“Loyalty company hmmm, I am not sure Rob. We just started to consider the Blue Jay Air loyalty program not too long ago and went into some new challenges with the cut in interchange fees² and increased burn-to-earn ratio³. I am a bit worried of going full-blown into the loyalty business and its strain on our capital. Besides, I think AIMCO, a publicly traded loyalty company, has taken a nose dive in their share price recently because of future earnings strain due to reduced interchange fees and reduced margins caused by increased costs of redemption. Bad combination! Julia, any insights into the risk exposures of this type of business?” replies Gilroy.

Gilroy handed out an article on AIMCO which is displayed in Exhibit 3.

Julia replies: “I agree with you Gilroy. We have seen significant uncertainty in our consideration of Blue Jay Air loyalty program but we think our program may help to smooth Blue Jay Air’s capacity demand and earnings volatility. If we get into the loyalty business on its own, the risk is probably similar to an insurance program which may tie up some of our capital. However, since this business is not regulated, the margin may be more lucrative than insurance if the price and product features are set up properly.”

Jane joins in: “But we may have to worry about competition if the margin becomes too lucrative unless we have managed to become an oligopoly, which is impossible due to low barrier of entry!”

Gilroy concludes: “I believe we need to obtain the financial and product data from Randy first and compare with our airline loyalty program before drawing any conclusion. We also need a market study of this type of loyalty program to consider the potential competition. Julia, please contact Randy and Jane, I want a preliminary market analysis from you. Let’s regroup after a month.”

Thanks Gilroy!” replies Robert.

² Interchange fees are the fees that help the credit card issuers to cover the various costs including the costs of loyalty programs. Typically the drop in these fees will impact the price paid per mile by credit card issuers to the loyalty program company if the loyalty program agreement permits the drop in fees to be passed through.

³ Burn-to-earn ratio is the ratio of the amount of redemptions over the amount of air miles sales.

1A RPPC Dynasty Corporation Exhibits

Exhibit 1 Global Market Outlook

Key factors for the global market outlook are summarized as follows:

1. Change in demographics
 - a. World population is growing by around 2.0 billion every 15 years. About 95% of this growth is accounted for by developing countries while 5% by developed countries.
 - b. The world population is also aging, mainly due to greater life expectancy and to declining birth rates. Life expectancy doubled from 30 to 60 years in the 20th century. At the same time, the global average age has risen from 23 years to 30 years.
 - c. Increasing global migration flows where people are migrating from south to north and between developed countries. Industrialized countries are reliant on immigrants to maintain their economy and competing with one another.
2. Increasing complexity and accelerating globalization
 - a. Increasingly complex and international trade flows. The increase in global movements of goods has been 2.0 times and the increase in capital transactions is three times the increase of global GDP.
 - b. Increasing value chains. Multinational companies are on the rise, from 7,000 in the 1990s and to some 65,000 parent companies today, with 85,000 foreign subsidiaries.
 - c. Increasing the degree of complexity where the complexity is measured by number of parties involved and all of their connections, stability of connections, networking of systems etc. These measures increase significantly as globalization process fasten in the 1990s.
 - d. Transport and travel are expanding. Increasing risk of pandemic risk.
3. Growing demand in micro-insurance
 - a. About 3 billion of the world population are in the target group for micro-insurance, mostly in the South Asia, east Asia and pacific regions.
 - b. Premium volume is currently in range of USD \$1 to \$2 billion and the market is estimated to have potential up to \$60 billion in premium.

- c. Micro-insurance is strongly supported by government of developing countries and emerging countries, aids agencies and NGOs as a means to tackle poverty.
4. Advancing climate change
- a. Rising number of weather-related natural catastrophes
 - b. Changes in the availability of fresh water
 - c. Higher losses from weather-related natural catastrophes
 - d. Accelerated climate change could lead to a significant decline in the global GDP level.

Exhibit 2

Managing Risks with Fast Actuarial Simulation Technology (FAST)

In recent years, stochastic simulation has become the standard tool used for measuring and managing complex risks. Compared to deterministic tools, stochastic simulation provides a full distribution of results instead of a single best-estimate result. Thus, risk can be measured by applying risk measures on the distribution. On a micro level, companies may use stochastic simulation to generate risk profiles for individual products and businesses. This is commonly done for the pricing and valuation of individual products. The effectiveness of risk management strategies can also be tested with stochastic simulations. On a macro level, companies may be interested in knowing the total capital requirements in the future and the associated costs of holding capital. Stochastic simulation can be used in this case to project the corporation's future balance sheets under a range of scenarios.

Despite its usefulness, implementing stochastic simulation could become complex with many IT systems and manual processes. Further, stochastic simulation may require a significant investment in computational power despite the numerical techniques available. Fast Actuarial Simulation Technology (FAST) is a high-performance actuarial simulation platform that enables companies to efficiently manage risks using stochastic simulations. FAST implements stochastic simulation in a robust 5-step process that eliminates the discontinuity between systems and enables efficient risk aggregation.

FAST Simulations

Stochastic simulation is used in many situations where simple formulas are not available. FAST implements stochastic simulation in an integrated 5-step process:

- 1) Identify the risk factors related to the product/business

This first step is critical. Real world results would be significantly different if an important risk factor or economic variable are left out of the simulation. FAST identifies the important risk factors by re-computing results by varying risk factor levels. The factors associated with the most variations in results are kept. This is a model-free sensitivity or Greeks computation. Greeks are hugely important for risk management. The ability to look to at Greeks before any risk aggregation makes sure that the model is realistic and no important risk factors are missing. FAST considers all common risk factors.

2) Specify appropriate stochastic equations and correlations for modeling the risk factors

Choosing the right model is very much linked to its calibration. An inappropriate model choice would limit the possible distributions it could generate. For example, if the desired distribution of a risk factor has a fat tail, then it would not be possible for a Normal model to model the tail realistically regardless of the calibration procedure. The same can be said about correlation structure. The classical Pearson's linear correlation may not be the best choice for many risks that have been shown to have non-linear relationships. A copula is likely to be more suitable for modeling RRPC's complex portfolio of businesses. FAST recommends the appropriate models based on the historical data specified by the user.

3) Calibrate the parameters to statistical distributions

Depending on the application, the parameters can be calibrated to either risk-neutral distributions or real-world distributions. For pricing and valuation of liquid traded instruments, the parameters are calibrated to the risk-neutral distribution implied from the market prices of related instruments. On the other hand, real-world distributions are usually obtained from historical data. By using models calibrated to real-world distributions, we assume that the statistical properties in the past will continue to be valid in the future. In practice, one needs both risk-neutral and real-world calibrations (see next step). Because of this, FAST calibrates the model to both distributions. The two distributions are further linked by a variable called risk premium to ensure consistency. FAST is compatible with leading market data providers.

4) Run Monte Carlo simulations using the calibrated model

Once the model is calibrated, we generate random scenarios for all risk factors for a certain time horizon. The cash flows are re-calculated under each scenario. The cash flows may include only liabilities (in the case of pricing) or both assets and liabilities (in the case of hedging or asset liability management). The simplest type of simulation is so-called time-0 simulation where all the cash flows calculations are based on the current point in time.

Increasingly common in risk management is the use of nested stochastic simulations. Nested stochastic simulation projects the value of assets and liabilities for each scenario in the future by recalculating the value of real-world cash flows at future point in time.

The projection of cash flows at a future time is a repeat of the time-0 simulation but assumes the then evolved (risk-neutral or real-world) distributions for the risk factors. One of the applications of nested stochastic simulation is the valuation of American options. Another application is to measure the effectiveness of hedging strategies. In some cases where pricing or valuation is the goal, Least-squares Monte Carlo can be used to eliminate the need for brute-force nested stochastic simulations.

This is the most computationally time-consuming step. Depending on the number of simulation paths and the complexity of the model, computation time could be hours or days even with a grid of computers. FAST utilizes the power of graphic processing units (GPUs) to reduce computation time up to 100 times. Because of this technology, users are able to view results near real-time.

5) Analyze results

The last step is to extract information from the data we have produced from the stochastic simulation. For individual products, for example, we may calculate the expected net profit of a business, the average payoff of an option, or the profit and loss of a hedging strategy. For enterprise risk management, we can measure the risk by computing the VaR or the Expected Shortfall (Tail Expectation) from the resulting distribution. Due to the huge data output from the previous step, this is not as easy as it seems. Fortunately, FAST is designed to work with big data. Information can be instantly extracted from huge databases without the constraint of spreadsheet size limits.

FAST Solutions

FAST provides solutions for corporations looking to integrate stochastic simulations into their risk management systems. FAST can be used in many parts of RRPC's business to improve business-level risk management. A few examples include:

- Evaluate commodity price risk and the potential impact of a hedge program to mitigate the risk (Blue Jay Tire Co)
- Estimate the fair value of the loyalty program (Blue Jay Air)
- Evaluate the possible worst outcomes of the loyalty program related to the economic risks (Blue Jay Air)
- Valuation of real options embedded in the business especially when the payoff is path-dependent or the exercise time is flexible. (All subsidiaries)

- Use catastrophe models to simulate the worst-case scenarios and the solvency capital required (Blue Ocean P&C)
- Monitor foreign exchange risk in-house by simulating FX rates (Big Ben Bank)
- Aggregate and report all risks e.g. credit risk, market risk, liquidity risk, operational risk (Big Ben Bank)
- Price secondary guarantees and evaluate the hedging of such guarantees (Darwin Life)

On the corporate level, FAST can be used to provide the following solutions:

- Incorporate simulation-based internal modeling into economic capital calculation
- Establish a risk aggregation framework across the enterprise
- Satisfy regulatory guidelines and produce forward-looking risk and capital reports for the banking and insurance divisions
- Evaluate and compare subsidiary performance on a risk-adjusted return basis, i.e. return adjusted for the cost of capital

Stochastic simulation plays an important role in these applications. A major challenge in implementing stochastic simulation is to make sure the system is able to produce results in a timely manner, especially during times of stress. Due to the large number of scenarios that need to be generated, RRPC needs to balance between accuracy and speed (as a consequence of computational power). The market-leading performance of FAST enables the company to deal with the most complex situation efficiently. Instead of waiting for the system to finish computation, the user can be focused on business problems and receive real-time risk statistics. Additionally, FAST is a transparent system. Auditors and regulators may look at the details of the models and coding if so desired.

Grosso Bank used to rely on in-house ad hoc systems to compute its portfolio risks. The models were run overnight to obtain risk statistics. With the introduction of Basel III, the bank is further required to provide long term risk estimates. Combined with the timely reporting principle, the existing infrastructure was clearly inadequate. After switching to FAST, Grosso Bank was able to reduce the run time to 10 minutes and automate the processes. As a result, the bank not only enhanced its reporting capabilities but also reduced its overall overhead expenses.

In conclusion, FAST provides a streamlined 5-step process that eliminates the need for many separate systems and improves productivity. The high performance of the system enables the company to achieve the goal of efficient risk management and timely reporting.

Exhibit 3

AIMCO News Excerpt

Uncertainty in AIMCO from lower interchange fees and smaller-than-expected international earnings – Is AIMCO taking off?

Source from Bloomberg and Globe and Mail

The share price of the Canadian loyalty program company, AIMCO, an initial public offering (IPO) last year, has taken a nosedive from C\$17 to C\$10 per share due to not meeting analysts' earnings expectation. During an IPO last year, AIMCO completed a transaction with a major credit card company to offer air miles to the credit card company's existing customers. At that time, AIMCO greatly enhanced the benefits to its air mile members by negotiating an increase in available seats with a major commercial airline company. However, the increased availability has put upward pressure on costs for AIMCO. At the same time, AIMCO was only able to secure a marginal increase in price per mile paid by the credit card company.

There is a timing issue associated with the new deal. As air miles members can now as a whole use many more miles that they earn due to the increased availability, this puts significant pressure on AIMCO's earnings. AIMCO must now spend an increasing amount to satisfy redemptions even as it may be selling fewer miles to the credit-card issuers. This is expressed as a "burn-to-earn" ratio. This ratio is now working against AIMCO.

During the past year, competition has been fierce as other credit card companies started their own self-insured programs which added the flexibility of reimbursing their members with the costs of any air travel seats. As competitions intensified, the interchange fee, which are the fees that help card issuers cover the various costs including the costs of loyalty programs, have decreased from 2% to 1.5% for the next five years. AIMCO and the analysts expect card issuers to absorb the blow by cutting the amount they will pay for the air miles. This decrease in interchange fees have called into question AIMCO's estimates of free cash flow as the AIMCO's agreement with the credit card company allows AIMCO to "share the pain" of an interchange cut. AIMCO estimates about C\$100 million of gross billing may be at risk if 100% of the cut in interchange fees are passed through to AIMCO. With a 50% share, the target estimate will result in C\$50 million of lost free cash flow.

In addition, the currency exchange may also present an issue for AIMCO which operates internationally. The recent decline in the Canadian dollar puts huge cost pressures on AIMCO's US operation, which locked in their pricing exchange rate last year without hedging their pricing exchange rate.

All of the above factors have resulted in the earnings estimate to drop from the C\$17 to C\$10 target, with a negative outlook if existing competition and drops in the Canadian currency exchange rate continue to persist. Investors should expect AIMCO to sit on the runway for some time before any potential takeoff.

2 Blue Jay Air

Other services are customer-oriented. The airline industry is increasingly anti-consumer. It's become a real hassle to travel. That is our opportunity - as long as we are given a chance to compete fairly.

John Feather, CEO of Blue Jay Air, was sitting in his newly renovated executive office and pondering the future strategic direction of his company. Blue Jay Air had undergone a major corporate reorganization two years ago. With a newly appointed Board and a total replacement of the senior management the company had a completely new face. It was time to rebuild its image and reposition itself in the highly competitive local airline market and reconsider expanding into the international arena.

Blue Jay Air has made substantial investments that included major infrastructure. Change couldn't come fast enough for John. Every aspect of service and operations needed to get better. It was the only way. Changing infrastructure was hard up to a point. Changing attitudes and behavior and winning customers – that was hard. How fast and how hard should he push? Some wanted reams of data to move forward. Stay local? Go international? Which routes? Which planes? Remodel or new? Did they have enough capital? Access the capital markets? Sell Blue Jay Tire? He had a good team. He recalled one of Warren Buffett's comments he applied to his management style, "Give a person or a nation a fine reputation to live up to and they will live up to it." John was establishing Blue Jay Air's reputation. He was confident his team would meet the challenge.

2.1 Background

Blue Jay Air was originally incorporated in the United States in the early 1970s. It was a small local commercial passenger carrier, operating only in the Eastern region of the United States. Its target market was high-end business clientele located in major cities along the east coast of the United States. Since then, Blue Jay had gone through three mergers and two significant acquisitions over the last 40 years. The company had been transformed from a focused high-end regional company to an expanded price-competitive commercial carrier, covering the full geographical region of United States as well as major cities in Canada.

During the past 40 years, the airline industry had gone through several significant cyclical business cycles, with each earning cycle trending lower than the preceding cycle, which resulted in significant pressure on the business margins and profits. In addition, with the deregulation in the airline industry during the Reagan administration, the number of commercial carriers had exploded exponentially, thereby had materially decreased consumer prices and also reduced the service level of the airline industry. Due to reduced margins, most companies had severely curbed operating costs by reducing staff level or restraining salary increases. As a result, labour disputes and disruptions had become a major concern in the industry. The negative impact on the industry was compounded with an aging workforce and insufficient training for the new staff especially for the pilots. Frequency of accident occurrences had trended upwards due to lack of qualified manpower and insufficient compensation level.

Despite all the perils in the industry, Blue Jay Air was resilient in surfing the destructive waves through different reorganization and restructuring efforts. The latest acquisition by RPPC was viewed positively by shareholders and investors. In 2010, the Wall Journal quoted that “the takeover is a step forward for Blue Jay Air.” John Feather, who has over 20 years of airline experience, is viewed as a “turnaround” CEO by the industry. Thus the parent company has high expectation in John’s new strategic vision.

2.2 Strategies

Blue Jay Air’s new strategic vision is to become the most customer-oriented airline company in the world, providing the best services to the marketplace. Comfort, punctuality and safety are the three important virtues that the company has adopted. Thus the number one priority for Blue Jay is to rebrand the company and image. In order to successfully rebrand the company, the company has done an extensive study on its customer base and identified its customers. John believes that understanding and knowing the customers is an important step to improve profitability for the company in the long run.

Based on the customer base study, the company found that more than 55% of its customers are travelling for business reasons. This percentage is significantly above industry norm which is generally around 20%. This finding could stem from the fact that the company was originally a commercial passenger carrier catering to business travelers and so its relationship with the business community was deep-rooted and unique compared to its competitors. In fact, the expansion to leisure travel over the last 15 years did not increase its market share and profit margin as the number of business travelers declined from over 80% to 55% due to reduced services. The rebranding and the change of business model may regain the company’s marketability and improve profitability over time.

At the time of acquisition, the company reconsidered its market operations including the expansion to international operations due to increased demand for international travel caused by globalization of the business world. In order to make this strategy possible, the company has been negotiating with several international airport authorities in several European and Asian financial centres and major cities over the last two years to secure a boarding space. Some of these negotiations are close to fruition.

Cost control is a key element in this industry. Labour relationship management is a key cost control element for Blue Jay Air as the labour force is not currently unionized, which is very rare in the industry. In order to maintain this niche, Blue Jay requires an effective management team to foster a cultural change without damaging the relationship with the employees and ensure that their needs are addressed to reduce the desire to unionize. In the past few decades, the company had implemented profit sharing schemes, regular salary scale and benefit reviews, frequent employee networking events, employee suggestion boxes and an employee diversity team to foster communication and pay equity between management and regular staff. These efforts have been working as unionization has not materialized. Thus the company would like to maintain its current employee relationship strategy. The only caveat is that in order to stay competitive, the company has to continue taking further significant expense control measures particularly in the areas of staff

count, staff expenses and information technology expenditures. As a result the company has started to cut back on most training programs except the current pilot and safety training programs in order to foster our vision of being the “safest” airline in the industry. The company also imposes tougher standards to qualify for the “top-scaled commercial pilot” category in order to ensure Blue Jay pilots are of the highest quality.

Another expansion option available today is to serve more customers through code-share agreement (CSA), which has been widely used by many airlines. Blue Jay Air’s executive team is actively looking into the option. More details about CSA are described in Exhibit 8.

2.3 Risk Management

As a highly-leveraged capital-intensive company, ability to raise debt and servicing the debts are crucial to Blue Jay Air. Thus a key risk management objective is to maintain the credit rating of the company within the investment grade categories, i.e., BBB- or higher.

As Blue Jay Air has significant pension liabilities for its existing labour force, ability to fund the pension liabilities has become a crucial issue for the company, especially in today’s low interest rate environment. Blue Jay Air has increased exposure to interest rate volatility due to the significant amount of long-term debt and finance leases that it has entered into since incorporation.

Since being acquired by RPPC Dynasty, Blue Jay Air has established a risk management committee headed by a well-known risk manager, Jim Peters. Jim was formerly the Chief Risk Officer (CRO) of a major Canadian bank and he was recruited by John under the recommendation from Howard Creston, former CRO of RPPC Dynasty. Jim was a hedge fund manager before he became the CRO of the bank and thus he has extensive knowledge in implementing risk management strategies. Over the last two years, Jim has put together a dynamically hedged portfolio that handles the commodity exposures that the company has been facing as well as the interest rate risks.

In addition, Jim has established a Treasury role under the risk management committee to centralize the long-term and short-term fund raising activities of the company and deal with the liquidity and credit risks of the company. This role is headed by Elaine Saunders who was a former Treasurer of a New York based investment bank. Elaine has a significant network with venture capitalists, pension fund managers as well as private equity fund managers. Elaine has also worked in the Investor Relations area of a major US Commercial Bank and thus has dealt with credit rating agencies such as Standard & Poor’s, Moody’s, A.M. Best and Fitch. Over the last two years, she has implemented a liquidity model and a credit model to monitor the company’s ongoing liquidity and credit needs.

The Risk Management roles and functions are still in the progress of refinement and adjustments. The staffing requirement in these areas is highly specialized and will take time to establish a full staff complement. As a result, the staff workload is currently intensive and turnover rate is slightly higher than the other areas.

2.4 Operations

Planes

It has been 10 years since Blue Jay Air purchased the current fleet of planes. The current fleet of planes is starting to age. Limited passenger capacity renders most of the fleet as unsuitable for international flights. In order to implement an international expansion strategy, the company will have to order or refurbish some larger planes with updated features such as Wi-Fi, expanded business classes, flat beds, bars, and stronger engines with additional safety features to be delivered over the next few years. The new planes are catered for added comfort, safety and shorter flight time which are ideal for international travel. However, the costs of these new planes and refurbishments are significant and will require capital injection or debt guarantees from RPPC Dynasty as Blue Jay Air alone cannot bear these costs without jeopardizing the credit rating of the company.

Even for the short haul planes, the current fleet requires updates such as Wi-Fi capability, individual TV screens and stronger engines to provide additional comfort for business travelers.

This will also require additional funding and support from RPPC Dynasty.

Given the current business needs, the majority of aircrafts owned by Blue Jay Air are X730 manufactured by Xolar Aircraft. X730 is a twin-engine short- to medium-range wide body jet airliner which can typically seat 280 passengers in a two-class layout, with a maximum range of 8000 km when fully loaded. Other than Blue Jay Air, only five airlines possess this type of aircraft. Four of them use X730 as well for short to medium distance. The remaining ones use S999 manufactured by Skylite Aircraft for medium distance. S999 is a twin-engine medium-range wide body jet airliner which is comparable to X730. Xolar Aircraft has a very long history and is more famous than Skylite Aircraft. As of today, the stock price for Skylite Aircraft is substantially depressed due to its high book-to-market value.

Blue Jay Air is considering acquiring one of the two aircraft manufacturers above in order to extend the presence into another stage of the industry chain. They will not have enough cash for either of the companies, therefore they need to bring in new investors or sell Blue Jay Tire in order to complete the acquisition. Rebecca Gibbs, VP of Operations, submitted the following information and considerations for both Aircraft manufacturers.

- Xolar Aircraft is a United states-based corporation with a very long history that designs, manufactures and sells fixed-wing aircraft. The company produces the X730 which is among the most recognizable aircraft in the air for many years. X730 was involved in 27 accidents in 40 years of services, including a very famous incident named the 306 Air Disaster. Xolar has been profitable for over 10 years until last year, where they lost a number of new orders to competitor Skylite Aircraft which resulted in an unprofitable position. Considering the result of the past 10 years, Rebecca believes that last year was just a one-off bad experience and Xolar will perform at its normal level again next year. In particular, Xolar aircraft is having a cost-cutting campaign and expects to see some positive trends in cost control.

Rebecca believes that the campaign will be effective. Therefore she included some cost reduction in her forecast, the result being that Xolar Aircraft would turn a profit next year.

- Skylite Aircraft is an aircraft manufacturing subsidiary of a global aerospace and defense corporation. The company produces and markets the S999 which has been a direct competitor of the X730 in the last 20 years. The S999 was only involved in 11 accidents in this period. Rebecca is in favour of Skylite for safety reasons since safety is very important to airlines. On the other hand, due to its substantial operations, Skylite has had significant cost overrun issues. Thus the company has not been profitable for a 5 year period. However, last year Skylite engineered a turnaround due to a new marketing strategy which led to a number of new orders during the year. Using the newest data collected over last year, Rebecca forecasted a profitable position for Skylite Aircraft in the coming years.

Loyalty Program

As part of Blue Jay Air's rebranding strategy, a business travel loyalty program is being considered to encourage frequent business travels. Blue Jay Air is considering progressive bonus point systems as flight frequency increases over a short period of time. In addition, Blue Jay Air would like to expand its reward systems by partnering with other business partners and its affiliated companies. This will substantially increase the incentive of business travels by business executives.

For example, Blue Jay Air is partnering the loyalty card with Big Ben Bank's credit and debit cards to introduce a combined credit card with an "enhanced air points reward system." This partnership should further increase the value of the loyalty program.

A modification to the existing application form is required to accommodate the expansion of this new enhanced loyalty program. The current application is an online form which is an electronic version of a paper form. The paper form is currently five pages long with 30 different questions related to the customers' personal information and preferences. The customer data is crucial for current and future marketing analysis. However, the current completion rate is much lower than the target rate due to the extensive information required to be filled out.

Travel Insurance Program

In addition to the travel loyalty program, Blue Jay Air is also exploring an opportunity to offer travel insurance to the airline's customers. As part of their commitment to become the most customer-oriented airline, the proposed solution envisions a fully customizable coverage package that allows each traveler to choose what best fits their needs.

Blue Jay Air has identified Blue Ocean as the ideal strategic partner to successfully execute this venture, and CEOs John Feather and Edward Blue have eagerly prepared a business case to bring forward to the RPPC Board. They are very excited about the potential synergies this initiative can realize for RPPC Dynasty.

As part of the proposal, the risk functions from both companies have collaborated on a preliminary risk review, and have identified some concerns with the initiative.

An email thread discussing some of the key issues of this new proposal are shown in Section 2A Exhibit 1.

Booking System enhancements

With the technological advancements over the last few decades, Blue Jay Air is considering revamping its booking system to enhance its internet booking capability as well as introducing different mobile phone apps for the major mobile phone systems.

The new system will automatically link up with the loyalty and credit cards for ease of use of loyalty points. It will include tracking of flight schedules, weather systems, time zones and other pertinent information. It will incorporate many added features that will make business travel enjoyable.

Business Lounges

Blue Jay Air will renovate all of its business lounges in major cities to enhance its business travel strategy to stay competitive. New business lounges will offer free Wi-Fi, free internet access and amenities such as gourmet French coffee and specialty teas, snacks, massage chairs with music selection and flat beds. The goal is to make business travelers as comfortable as possible while waiting for their flights.

Baggage and Baggage Systems

Blue Jay Air will incorporate a charge for each piece of luggage being checked-in since most business travelers do not check-in their luggage and in response to their competitors' pricing. Free luggage check-in is no longer available except for international flights for which Blue Jay Air will reduce its free luggage check-in policy from two pieces to one piece with no change to the current weight limit. The current Baggage Tracking system seems to be adequate and Blue Jay Air has no plan to upgrade its systems.

Other Cost Measures

Blue Jay Air has decided to discontinue its travel agency programs with different travel agencies as part of the continuing effort to keep the company as cost efficient as possible. Instead the company will establish direct business relationships with its business client base. Blue Jay Air will negotiate direct contractual arrangements with its business clients in order to customize client needs and leverage long-term client business relationships.

A referral program will also be offered to its business clients in order to expand its customer base in the most direct and efficient manner. This referral program will be combined with the loyalty program to optimize value for existing customers.

Financial Statements

Detailed financial statements are shown in the Section 2A Exhibits 2 to 4.

Recent News on Competitors

Recently, several airline companies have appeared in the headlines in both the US and Canada as shown in Exhibit 5.

Balanced Scorecard

In order to clarify Blue Jay Air's vision and strategies and to enhance execution of these strategies, the business operations team has established a balanced scorecard for Blue Jay Air.

The intent of this balanced scorecard is to provide senior management with feedback on both the internal business processes and external outcomes, which allows for continuous improvement of strategic performance and results. The balanced scorecard framework is shown in Exhibit 6.

2.5 Loyalty Program Proposal

Blue Jay Air has promoted a marketing campaign for the past two years for its primary customer segment, the business traveler. This campaign, named the Lucky 7 program, offered 1 free one-way business class flight for every 7 one-way business class segments purchased (a round-trip is equivalent to two one-way segments). The program has been very successful according to the results presented by the BJA CEO, John Feather, at a recent RPPC Board meeting.

Excerpts from the executive summary

- Business Travelers now account for 57% of the total one-way flight segments with BJA.
- Business Travelers now provide 71% of the airline's total revenue.
- The marketing cost of the lucky 7 program for the two years was 12% below budgeted cost for the selected routes.
- In the two years prior to the lucky 7 program, their marketing campaigns achieved 23% lower sales revenue.
- The introduction of the lucky 7 program has increased both the number of one-way flight segments and the average revenue per one-way segment.
- Purchases of business class one-way segments were up 13% in period over period comparatives due to the 30% increase in the routes with the Lucky 7 program.
- Much of these gains were attributed to the ability of the lucky 7 promotion to overcome the higher than usual staff turnover in both air crew staff and the operational management team.
- The retirement of several long serving staff resulted in several employment promotions being offered to internal candidates and the operations have transitioned effectively to new leadership. In fact, in the year end employee survey, the morale, energy, and commitment to the team showed a dramatic improvement in period over period comparatives.
- The BJA client persona has also changed due to the lucky 7 program. The average age of the client, average number of business class round-trips per client, and the amount of ancillary service purchases per stay were all up period over period in the routes with the program. On these routes the BJA client is now more likely to be an Executive Vice President and/or member of the C-suite rather than from middle management.
- The lucky 7 program was only offered on the Toronto to New York and subsequently Chicago to New York. But the research team believes similar results can be achieved in other BJA routes, especially the 8 other commercial centers with population greater than 1 million in the USA across the carrier network.

Marketing research committee discussion notes

The BJA CEO formed a research committee to assess the feasibility of expanding the lucky 7 program into a company-wide loyalty program.

The marketing research committee has concluded that the loyalty program is a \$69m value-added project on an NPV basis. They estimate that if the increased revenue from business class purchases of 30% from the lucky 7 program can be achieved across the network then the BJA gross margin will improve from 8.10% to 8.73% of annual revenues of \$1,215m.

The marketing research committee has estimated that the loyalty program can be funded from within the existing operational margins; therefore, the current marketing budget is expected to remain the same as the past 4 years, approximately 10% of revenue. The estimated IT system development work to launch the loyalty program, USD \$17m, will be repaid in 3 years due to the anticipated revenue increases.

The additional cost of annual administration of a loyalty card program will be funded by the anticipated continuation of the 12% marketing cost savings achieved by the lucky 7 program, namely, the development of promotional materials, management of a new customer relationship management (CRM) system and maintenance of a mobile app for customer engagement. No new staff is anticipated to be required because the loyalty program will leverage the expertise developed from recently promoted managers of the lucky 7 program. Cross-regional training programs are proposed which will be managed by Human Resources. The committee anticipates this will go smoothly at relatively low cost because the staff who manage other flying routes are very experienced and highly competent.

Also, the committee strongly believes that the proposed loyalty program will not require a contingency fund in support of the loyalty points system. The marketing research committee believes that being disciplined about applying the same structure and parameters of the lucky 7 promotion is the best form of risk management for the loyalty program. Therefore, for example, the committee proposes a loyalty points system that mirrors the 1 for 7 promotion: namely each one-way business class segment earns 100 points and a 700 point redemption is needed to claim 1 free business class one-way segment. However, to appease economy class passengers the loyalty program will also offer 25 points earned for each purchased one-way economy class segment and a 300 point redemption is needed to claim 1 free economy class one-way segment. The 10 year historical data of flights on BJA indicates that no client has ever purchased 12 economy class one-way flight segments in any one calendar year, so this economy class loyalty benefit is estimated to have no cost.

The research committee understands that this is not a risk that was trialed within the lucky 7 promotion but they are confident that the economy class passengers are a low risk because this passenger class is a small customer segment for BJA. They point to the statistic that economy class passengers are not as likely to be repeat travelers within a given calendar year. The committee proposes that all loyalty points will have a fixed duration for redemption.

The research committee also points out that their proposed approach will be a cost savings over the alternative of joining an existing loyalty Alliance. The committee estimates that an Alliance approach might save administrative development cost and ongoing operational maintenance. But the Alliance approach requires as part of its fee a contribution to build a contingency reserve fund that provides backing for the loyalty obligations. The market research committee believes this contingency reserve is overkill and that the Alliance fee at 9% revenue is not economical given that the Alliance fee plus staff cost will result in a budget overrun for the Marketing department. The research committee believes that the 9% is too high because it uses up 90% of their total marketing budget.

The committee is aware of another North American airline, Air Canada, that had an in-house loyalty program (Aeroplan) that ultimately was spun-off into its own company, AIMIA. The committee closely studied key excerpts from their Management Discussion Notes from their Annual filings. These are provided for reference.

AIMIA does hold a contingency fund for their Aeroplan loyalty points. The committee points out that the AIMIA contingency fund is not estimated using Actuarial principles and in the estimation of the committee this fund appears to be simply a cashflow management tool rather than a contingent point redemption liability reserve.

CRO and CFO correspondence emails

In a series of emails the CRO, Jim Peters, has been discussing the merits of the proposal with the CFO. A senior actuary, Richard Smith, working for the CRO has been asked to summarise this exchange of concerns and positives for the proposal from these emails.

To: Jim Peters
From: Richard Smith
Cc:
Subject:

Hi Jim

I hope you are well. Sorry for the delay on this. I have reviewed all of our email discussion on this and I have summarized the findings below.

Business objective

- CFO is comfortable with the growth objective in the business traveler segment, which is in keeping with their overall commitment to the RPPC Board in their 2016-2020 Strategic Plan.
- CRO pleased that the proposal seeks to activate and leverage a very successful pilot project that contains very useful customer data and market behavior insight. There is strong adherence to the risk appetite of BJA for the high-end market.
- Financial metrics of the lucky 7 pilot are impressive. To successfully extend this performance to other routes would result in a financially stable BJA after years of sub-par performance. This is a critical objective of the RPPC Board.

Financial Objectives

- Marketing cost effectiveness and sales performance within the lucky 7 promotion are noteworthy.
- CFO agrees that this level of operational effectiveness can support a viable and profitable business.
- Operations have managed well within the existing budget, but what happens to cost as the young team gains in seniority (wage inflation)?
- CFO is concerned about scalability because the pilot was conducted on the most busy flying routes

- CFO would benefit from more research on the drivers of sales/marketing costs and staff resource needs (e.g. seasonality, general economy, business cycle, size of client market, competitors)

Risk Objectives

- CRO is concerned that the sales mix is held to be one of the critical success factors but what if this proves to be different in other flying routes? How much market share of the C-suite travelers is needed to sustain success?
- CRO points out that the cost estimate comparison is apples vs oranges – (a) approach with no contingency fund, no business diversification, versus, (b) the Alliance which includes a contingency fund, diversity among various carriers and geographies.
- CRO suggests that even using a simple Multi-normal sales & marketing distribution model for economy class passengers and business class passengers could be insightful about the tail risk in recession periods or contagion risks.
- CRO also points out that the improvement in sales for business class travel might have had nothing to do with the lucky 7 promotion but simply good macro-economic conditions and a positive business climate.

CRO and CFO proposed the following areas for Future research and analysis work to be done.

1. Gather the historical data for sales, marketing, seat vacancy rates and client profiles for the last 10 years (namely a complete business cycle).
2. Also gather data on potential business drivers such as macro-economics and industry statistics – compare and model against sales.
3. Research and apply the actuarial practices for estimation of the loyalty points contingency fund (or liability reserve).
4. Consider whether behavioural economics could impact actual performance of the loyalty points incentives.

Regards
Richard

Excerpts from the Air Canada Annual Report

FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

SUMMARY OF FUEL AND OTHER DERIVATIVES

The following is a summary of fuel and other derivatives included in non-operating income (expense) on Air Canada's consolidated statement of operations for the periods indicated:

| IN MILLIONS | FORTH QUARTER | | FULL YEAR | |
|--------------------------------------------|---------------|-------------|----------------|---------------|
| | 2015 | 2014 | 2015 | 2014 |
| Fuel derivatives | \$ - | \$ (18) | \$ (11) | \$ (36) |
| Share forward contracts | \$ (4) | \$ 24 | \$ (9) | \$ 31 |
| Prepayment options on senior secured notes | \$ 1 | \$ 2 | \$ 1 | \$ 2 |
| Interest rate swaps | \$ - | \$ 1 | \$ 2 | \$ 2 |
| TOTAL FUEL AND OTHER DERIVATIVES | \$ (3) | \$ 9 | \$ (17) | \$ (1) |

RISK MANAGEMENT

Under its risk management policy, Air Canada manages its fuel price risk, foreign exchange risk and interest rate risk through the use of various financial derivative instruments. Air Canada uses these instruments solely for risk management purposes, not for generating trading profit. As such, any change in cash flows associated with derivative instruments is designed to be offset by changes in cash flows of the relevant risk being hedged.

As noted below, Air Canada uses derivative instruments to provide economic hedges to mitigate various risks. The fair values of these instruments represent the amount of the consideration that could be exchanged in an arm's length transaction between willing parties who are under no compulsion to act. The fair value of these derivatives is determined using prices in active markets, where available. When no such market is available, valuation techniques are applied such as discounted cash flow analysis. The valuation technique incorporates all factors that would be considered in setting a price, including Air Canada's own credit risk, as well as the credit risk of the counterparty.

FUEL PRICE RISK MANAGEMENT

Fuel price risk is the risk that future cash flows will fluctuate because of changes in jet fuel prices. In order to manage its exposure to jet fuel prices and to help mitigate volatility in operating cash flows, Air Canada enters into derivative contracts with financial intermediaries. Air Canada may use derivative contracts based on jet fuel, heating oil and crude oil. Air Canada's policy permits hedging of up to 75% of the projected jet fuel purchases for the next 12 months, 50% for the next 13 to 24 months and 25% for the next 25 to 36 months. These are maximum (but not mandated) limits.

There is no minimum monthly hedging requirement. There are regular reviews to adjust the strategy in light of market conditions.

In 2015:

- Air Canada recorded a loss of \$11 million in fuel and other derivatives on Air Canada’s consolidated statement of operations related to fuel derivatives (a loss of \$36 million in 2014). These derivatives were not designated as hedges for accounting purposes.
- Air Canada purchased crude oil call options covering a portion of 2015 and 2016 fuel exposures. The cash premium related to these contracts was \$39 million (\$44 million in 2014 for 2014 and 2015 exposures).
- Fuel derivative contracts cash settled with a net fair value of \$1 million (\$24 million in favour of Air Canada in 2014).

Air Canada applied fuel hedge accounting for certain designated fuel derivatives prospectively from April 1, 2015. In 2015, the fair value decrease of \$21 million for derivatives under hedge accounting was deferred as a cost of the hedged item in other comprehensive income and will be reclassified to aircraft fuel expense when the underlying hedged jet fuel is used. Fuel hedging loss of \$10 million was reclassified from other comprehensive income to aircraft fuel expense in 2015.

A summary of amounts related to fuel derivatives designated as hedging instruments at December 31, 2015 is presented below.

| | CARRYING AMOUNT OF THE HEDGE INSTRUMENT | | CONSOLIDATED STATEMENT OF FINANCIAL POSITION CLASSIFICATION | CHANGES IN FAIR VALUE USED FOR CALCULATING HEDGE INEFFECTIVENESS |
|----------------------------------|-------------------------------------------------------|--------------|-------------------------------------------------------------|------------------------------------------------------------------|
| | NOMINAL AMOUNT OF THE HEDGING INSTRUMENT (IN BARRELS) | ASSETS | | |
| CASH FLOW HEDGE | | | | |
| Fuel price risk option contracts | - 5,646,000 | \$10 million | \$ - | prepaid expenses and other current assets \$ - |

As of December 31, 2015, approximately 18% of Air Canada’s anticipated purchases of jet fuel for 2016 was hedged at an average West Texas Intermediate (“WTI”) equivalent capped price of US\$48 per barrel for WTI prices up to US\$51 per barrel and an average equivalent capped price of US\$51 per barrel for WTI prices above US\$53 per barrel. Air Canada’s contracts to hedge anticipated jet fuel purchases over the 2016 period are comprised of call options with notional volumes of 5,646,000 barrels. The fair value of the fuel derivatives portfolio at December 31, 2015 was \$10 million in favour of Air Canada (2014 – \$4 million in favour of Air Canada) and is recorded within prepaid expenses and other current assets on Air Canada’s consolidated statement of financial condition.

INTEREST RATE RISK MANAGEMENT

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates.

Air Canada enters into both fixed and floating rate debt and leases certain assets where the rental amount fluctuates based on changes in short-term interest rates. Air Canada manages interest rate risk on a portfolio basis and seeks financing terms in individual arrangements that are most advantageous taking into account all relevant factors, including credit margin, term and basis. The risk management objective is to minimize the potential for changes in interest rates to cause adverse changes in cash flows to Air Canada. The cash and short-term investment portfolio, which earns a floating rate of return, is an economic hedge for a portion of the floating rate debt.

The ratio of fixed to floating rate obligations outstanding is designed to maintain flexibility in Air Canada's capital structure and is based upon a long-term objective of 60% fixed and 40% floating but allows the flexibility in the short-term to adjust to prevailing market conditions. The ratio at December 31, 2015, was 79% fixed and 21% floating, including the effects of interest rate swap positions (75% and 25%, respectively, as at December 31, 2014).

CRITICAL ACCOUNTING ESTIMATES

Critical accounting estimates are those that are most important to the portrayal of Air Canada's financial condition and results of operations. They require management's most difficult, subjective or complex judgments, often because of the need to make estimates about the effect of matters that are inherently uncertain. Actual results could differ from those estimates under different assumptions or conditions.

Air Canada has identified the following areas that contain critical accounting estimates utilized in the preparation of its consolidated financial statements.

EMPLOYEE FUTURE BENEFITS

Air Canada maintains several defined benefit plans providing pension, other retirement and post-employment benefits to its employees. The cost and related liabilities of Air Canada's pensions, other post-retirement and post-employment benefit programs are determined using actuarial valuations. The actuarial valuations involve assumptions, including discount rates, future salary increases, mortality rates and future benefit increases. Also, due to the long-term nature of these programs, such estimates are subject to significant uncertainty.

ASSUMPTIONS

Management is required to make significant estimates about actuarial and financial assumptions to determine the cost and related liabilities of Air Canada's employee future benefits.

Financial Assumptions

Discount Rate

The discount rate used to determine the pension obligation was determined by reference to market interest rates on corporate bonds rated "AA" or better with cash flows that approximate the timing and amount of expected benefit payments.

Future increases in compensation are based upon the current compensation policies, labour agreements and economic forecasts.

The significant weighted average assumptions used to determine Air Canada's accrued benefit obligations and cost are as follows:

| | PENSION BENEFITS | | OTHER | EMPLOYEE |
|---------------------------------------------------------------------------|------------------|------|-----------------|----------|
| | 2015 | 2014 | FUTURE BENEFITS | 2014 |
| DISCOUNT RATE USED TO DETERMINE: | | | | |
| Net interest on the net benefit obligation for the year ended December 31 | 4.0% | 4.9% | 3.9% | 4.8% |
| Service cost for the year ended December 31 | 4.2% | 4.9% | 4.1% | 4.8% |
| Accrued benefit obligation as at December 31 | 4.1% | 4.0% | 4.1% | 3.9% |
| RATE OF FUTURE INCREASES IN COMPENSATION USED TO DETERMINE: | | | | |
| Accrued benefit cost for the year ended December 31 | 2.5% | 2.5% | N/A | N/A |
| Accrued benefit obligation as at December 31 | 2.5% | 2.5% | N/A | N/A |

SENSITIVITY ANALYSIS

Sensitivity analysis is based on changing one assumption while holding all other assumptions constant. In practice, this may be unlikely to occur, and changes in some of the assumptions may be correlated. When calculating the sensitivity of the defined benefit obligation to variations in significant actuarial assumptions, the same method (present value of the defined benefit obligation calculated with the projected unit credit method at the end of the reporting period) has been applied as that used for calculating the liability recognized in the consolidated statement of financial position.

Sensitivity analysis on 2015 pension expense and net financing expense relating to pension benefit liabilities, based on different actuarial assumptions with respect to discount rate is set out below. The effects on each pension plan of a change in an assumption are weighted proportionately to the total plan obligation to determine the total impact for each assumption presented.

| | 0.25 PERCENTAGE POINT | |
|---------------------------------------------------------------|-----------------------|----------|
| | DECREASE | INCREASE |
| DISCOUNT RATE ON OBLIGATION ASSUMPTION | | |
| Pension expense | \$ 19 | \$ (18) |
| Net financing expense relating to pension benefit liabilities | \$ 17 | \$ (13) |
| TOTAL | \$ 36 | \$ (31) |
| INCREASE (DECREASE) IN PENSION OBLIGATION | \$ 639 | \$ (618) |

The increase (decrease) in the pension obligation for a 0.25 percentage point change in the discount rate relates to the gross amount of the pension liabilities and is before the impact of any change in plan assets. As at December 31, 2015, approximately 75% of Air Canada's pension liabilities were matched with fixed income products to mitigate a significant portion of the interest rate (discount rate) risk.

An increase of one year life expectancy would increase the pension benefit obligation by \$445 million.

Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plans. A 5.5% annual rate of increase in the per capita cost of covered health care benefits was assumed for 2015 (2014 – 5.5%). The rate is assumed to decrease to 5% by 2019. A one percentage point increase in assumed health care trend rates would have increased the total of current service and interest costs by \$4 million and the obligation by \$64 million. A one percentage point decrease in assumed health care trend rates would have decreased the total of current service and interest costs by \$4 million and the obligation by \$62 million.

A 0.25 percentage point decrease in discount rate would have increased the total of current and interest costs by \$1 million and the obligation by \$51 million. A 0.25 percentage point increase in discount rate would have decreased the total of current and interest costs by \$1 million and the obligation by \$40 million.

IMPAIRMENT CONSIDERATIONS OF LONG-LIVED ASSETS

Long-lived assets include property and equipment, definite lived intangible assets, indefinite lived intangible assets and goodwill. Assets that have an indefinite useful life, including goodwill, are tested annually for impairment or when events or circumstances indicate that the carrying value may not be recoverable. Assets that are subject to depreciation or amortization are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. When required, an impairment test is performed by comparing the carrying amount of the asset or cash generating unit to their recoverable amount. Recoverable amount is calculated as the higher of an asset's or cash-generating unit's fair value less costs to dispose and its value in use. For the purpose of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units or CGUs). Management has determined that the appropriate level for assessing impairments in accordance with IFRS is at the North American and international fleet levels for aircraft and related assets supporting the operating fleet. Parked aircraft not used in operations and aircraft leased or subleased to third parties are assessed for impairment at the individual asset level. Value in use is calculated based upon a discounted cash flow analysis, which requires management to make a number of significant assumptions including assumptions relating to future operating plans, discount rates and future growth rates. An impairment loss is recognized for the amount by which the asset's carrying amount exceeds its recoverable amount.

DEPRECIATION AND AMORTIZATION PERIOD FOR LONG-LIVED ASSETS

Air Canada makes estimates about the expected useful lives of long-lived assets and the expected residual values of the assets based on the estimated current fair value of the assets, Air Canada's fleet plans and the cash flows they generate. Changes to these estimates, which can be significant, could be caused by a variety of factors, including changes to maintenance programs, changes in jet fuel prices and other operating costs, changes in utilization of the aircraft, and changing market prices for new and used aircraft of the same or similar types. Estimates and assumptions are evaluated at least annually. Generally, these adjustments are accounted for on a prospective basis, through depreciation and amortization expense. For the purposes of sensitivity analysis on these

estimates, a 50% reduction to residual values on aircraft with remaining useful lives greater than five years results in an increase of \$15 million to annual depreciation expense. For aircraft with shorter remaining useful lives, the residual values are not expected to change significantly.

MAINTENANCE PROVISIONS

The recording of maintenance provisions related to return conditions on aircraft leases requires management to make estimates of the future costs associated with the maintenance events required under the lease return condition and estimates of the expected future maintenance condition of the aircraft at the time of lease expiry. These estimates take into account current costs of these maintenance events, estimates of inflation surrounding these costs as well as assumptions surrounding utilization of the related aircraft. Any difference in the actual maintenance cost incurred and the amount of the provision is recorded in maintenance expense in the period. The effect of any changes in estimates, including changes in discount rates, inflation assumptions, cost estimates or lease expiries, is also recognized in maintenance expense in the period. Assuming the aggregate cost for return conditions increases by 5%, holding all other factors constant, there would be a cumulative balance sheet adjustment to increase the provision by \$44 million at December 31, 2015 and an increase to maintenance expense in 2016 of approximately \$7 million. For illustrative purposes, if the discount rates were to increase by 1%, holding all other factors constant, there would be a cumulative balance sheet adjustment to decrease the provision by \$19 million at December 31, 2015. Due to low market rates of interest, a 1% decrease in discount rates was not considered a reasonable scenario.

INCOME TAXES

Deferred income tax assets are recognized only to the extent that it is probable that future taxable income will be available to realize them. In making this assessment, consideration is given to available positive and negative evidence and relevant assumptions. Consideration is given to, among other things, future projections of taxable income, overall business environment, historical financial results, and industrywide trends and outlooks. At December 31, 2015, no deferred income tax assets have been recorded.

Excerpts from AIMIA AUDITED CONSOLIDATED FINANCIAL STATEMENTS

RISKS AND UNCERTAINTIES AFFECTING THE BUSINESS

The results of operations and financial condition of Aimia are subject to a number of risks and uncertainties, and are affected by a number of factors outside of the control of Management. The following section summarizes certain of the major risks and uncertainties that could materially affect our future business results going forward. The risks described below may not be the only risks faced by Aimia. Other risks which currently do not exist or which are deemed immaterial may surface and have a material adverse impact on Aimia's results of operations and financial condition.

RISKS RELATED TO THE BUSINESS AND THE INDUSTRY

Dependency on significant Accumulation Partners and Clients

Aimia's top four Accumulation Partners were responsible for approximately 53% of Gross Billings for the year ended December 31, 2015. A decrease in sales of Loyalty Units to these partners or to any other significant Accumulation Partner, for any reason, including a decrease in pricing or activity, or a decision to either utilize another service provider or to no longer outsource some or all of the services provided, could have a material adverse effect on Gross Billings and revenue. The success of our coalition programs is dependent to a large extent on our relationships with certain key anchor partners. There is no assurance that contracts with Aimia's principal Accumulation Partners, including anchor partners, will be renewed on similar terms, or at all when they expire.

The Aeroplan Program derives a significant portion of its Gross Billings from its agreements with TD, CIBC, Air Canada.

On January 1, 2014, ten-year financial credit card agreements between Aimia and each of TD and CIBC (the "New Credit Card Agreements") became effective. Under the New Credit Card Agreements, TD became Aeroplan's primary financial services partner and credit card issuer, while CIBC also continues to be an issuer of the Aeroplan credit cards. In connection with the New Credit Card Agreements, on December 27, 2013 TD acquired approximately half of the Aeroplan card portfolio and CIBC retained the balance, comprised of Aeroplan cardholders with broader banking relationships with CIBC. The terms of the New Credit Card Agreements are materially different from the previous agreement with CIBC (the "Old CIBC Agreement") which expired on December 31, 2013, pursuant to which CIBC administered various Visa and other products through which Aeroplan members could accumulate Aeroplan Miles from the credit cards and other spending. There can be no assurance that the New Credit Card Agreements will provide, over the course of the term of the New Credit Card Agreements, a financial contribution to Aimia similar to the historical contribution of the Old CIBC Agreement and/or similar to the contribution from the first year of the term during which there was substantial bonusing activity as well as card acquisition incentives. In the event the New Credit Card Agreements provide, over the course of the term of the New Credit Card Agreements, a lesser financial contribution to Aimia as compared to the historical contribution of the Old CIBC Agreement or as compared to the first year of the term, there would be an adverse effect on our Gross Billings, revenue, redemption costs and profitability. The New Credit Card Agreement with CIBC also includes an option for either party to terminate the

agreement after its third year if certain conditions related to the migration of Aeroplan credit cards in CIBC's retained portfolio to other CIBC credit cards are met. In the event the termination option is exercised under the New Credit Card Agreement with CIBC, there can be no assurance that CIBC Aeroplan cardholders would migrate to TD or what level of cardholder migration, if any, may occur at that time. Consequently, the exercise of such termination option could have an adverse effect on Aimia's Gross Billings and revenues.

The CPSA between Aeroplan and Air Canada expires on June 29, 2020, subject to four automatic renewals of five years each, unless either party provides written notice to the other of its intention not to renew at least 12 months prior to the expiry of the initial term or the then current renewal term. See "Supply and Capacity Costs" below. Subject to the minimum number of Aeroplan Miles to be purchased by Air Canada under the CPSA, Air Canada can change the number of Aeroplan Miles awarded per flight without Aeroplan's consent, which could lead to a significant reduction in Gross Billings.

The Nectar Program derives a significant portion of its Gross Billings from its founding coalition partner, Sainsbury's. The commercial agreements governing the participation of Sainsbury's as an Accumulation Partner and Redemption Partner in the Nectar Program expire in 2019, unless renewed by the parties. On October 13, 2014, Aimia announced that Nectar members will earn one point for every £1 spent in stores or online with Sainsbury's starting in April of 2015, compared with the existing two points per £1, with greater emphasis being placed on bonus offers and increased personalized points offers. While these changes are intended to drive increased engagement and activity with more frequent and targeted bonusing, there can be no assurance that the new accumulation program will be successful in doing so and instead may lead to decreases in member engagement with the Nectar Program generally. Any material decrease in member engagement with the Nectar Program could have an adverse effect on Aimia's Gross Billings and revenues.

Aimia's proprietary loyalty services clients are generally able to reduce marketing spending or cancel projects on short notice at their discretion. It is possible that such clients could reduce spending in comparison with historical patterns, or they could reduce future spending. A significant reduction in marketing spending by Aimia's largest proprietary loyalty services clients, or the loss of several large clients, if not replaced by new accounts or an increase in business from other clients, could adversely affect our proprietary loyalty service revenues and impact Aimia's results of operations and financial condition.

Failure to Safeguard Databases, Cyber Security and Consumer Privacy

As part of our coalition and proprietary loyalty programs and in connection with the activities of Aimia's proprietary loyalty and loyalty analytics businesses, member databases are maintained for our programs and those of our clients. These databases contain member information including account transactions. Although we and third parties providing services to us have established rigorous physical and cyber security procedures, the databases may be vulnerable to potential unauthorized access to, or use or disclosure of member data. If we or our service providers were to experience a security breach, our reputation may be negatively affected and an increased number of members in our loyalty programs may opt out from receiving marketing materials or

resist providing their personal data. The use of loyalty marketing services by partners and clients could decline in the event any compromise of security occurred. Any public perception that we released consumer information without authorization could subject our businesses to complaints and investigation by the applicable privacy regulatory bodies and adversely affect relationships with members, clients and partners. In addition, any unauthorized release of member information, or any public perception that member information was released without authorization, could lead to complaints from consumers and by the applicable privacy regulatory bodies and adversely affect relationships with members and Commercial Partners and expose us to litigation (including class action litigation) and other enforcement proceedings, material fines, remediation costs and other compensatory damages, any of which could adversely affect our results of operations and financial condition.

Changes to the Aeroplan Program

Aimia implemented significant changes to the Aeroplan Program on January 1, 2014, including: new Market Fare Flight Rewards which replaced ClassicPlus Flight Rewards, offering members significantly improved value; the launch of Distinction, a new tiered recognition program that rewards top accumulating members with preferential mileage levels for redemption; and the cancellation of the seven-year mileage redemption policy, with miles no longer expiring for members active in the program each year. The ongoing implementation of the enhanced Aeroplan Program on a financially successful basis is partially dependent on expectations of increased engagement by current Aeroplan members and the attraction of new members to the Aeroplan Program. There can be no assurance that the changes to the Aeroplan Program will result in the increased member engagement and/or the attraction of new Aeroplan members at the levels expected by Aimia, which may have an adverse effect on Aimia's Gross Billings and revenue. In addition, there can be no assurance that the actual level of redemption activity and/or anticipated costs of rewards will be achieved at the levels expected by Aimia. Higher than expected redemption activity and/or costs may have an adverse impact on Aimia's profitability.

Reliance on Redemption Partners

We rely on third party Redemption Partners to provide air travel and other rewards to members upon redemption of Loyalty Units. Our profitability could be adversely impacted if they fail to fulfill their obligations. The failure of our Redemption Partners to deliver products and services in sufficient quantities and in a timely manner could adversely affect our business. If we were unable to renew our existing contracts with our significant Redemption Partners, we might not be able to replace the related product or service at the same cost which would negatively impact our profitability.

Conflicts of Interest

Aimia's businesses provide services to a number of clients who are competitors in various industries. Our ability to retain existing, and attract new, Accumulation Partners and clients may be limited by perceptions of conflicts of interest arising out of other relationships. If we are unable to

adequately manage multiple client relationships and avoid potential conflicts of interests, there could be an impact on our results of operations and financial condition.

Greater Than Expected Redemptions for Rewards

A significant portion of our profitability is based on estimates of the number of Loyalty Units that will never be redeemed by the member base. The percentage of Loyalty Units that are not expected to be redeemed is known as "Breakage" in the loyalty industry. Breakage is estimated by Management based on the terms and conditions of membership and historical accumulation and redemption patterns, as adjusted for changes to any terms and conditions that may affect members' future redemption practices. Management, assisted by an independent expert, developed an econometric model that takes into account historical activity, and expected member behaviour, projected on a going concern basis. This tool is used by Aimia to estimate and monitor the appropriate Breakage estimates of several programs it operates on a regular basis. The consolidated weighted average Breakage estimate at December 31, 2015 is 12% (December 31, 2014: 12%). The consolidated weighted average Breakage estimate is calculated based on the total Loyalty Units outstanding under the Corporation's loyalty programs. This Breakage estimate is based on the results of the application of the model in 2015. The amount of revenue recognized related to Breakage is based on the number of Loyalty Units redeemed in a period in relation to the total number expected to be redeemed, which factors in the Corporation's estimate for Breakage. Breakage for the Aeroplan and Nectar Programs may decrease as such programs grow and a greater diversity of rewards becomes available. If actual redemptions are greater than current estimates, profitability could be adversely affected due to the cost of the excess redemptions. Furthermore, the actual mix of redemptions between air and non-air rewards could adversely affect profitability. Management believes that the estimates, methodologies, judgments and assumptions made in the preparation of the Corporation's financial statements, including those relating to the treatment of Breakage, are reasonable based upon the information available and reliance on subject matter experts. However, there can be no assurance that applicable tax or other regulatory authorities will agree with such estimates, judgments and assumptions.

Regulatory Matters

Aimia's businesses are subject to several types of regulation, including legislation relating to privacy, telemarketing, consumer protection, competition, advertising and sales, and lotteries, gaming and publicity contests. In addition, an increasing number of laws and regulations pertain to the Internet, including in relation to liability for information retrieved from or transmitted over the Internet and online content regulation. Moreover, the applicability to the Internet to existing laws governing personal privacy, intellectual property ownership and infringement and other issues continues to be uncertain and is developing. There is also the possibility that additional laws and regulations are adopted to specifically regulate the loyalty industry, or portions thereof. Aimia closely monitors and regularly participates in dialogues with the appropriate governmental departments to ensure that we are constantly apprised of the current status of global regulatory matters that could have a material impact on Aimia's business in the short or long term, including the following:

A. Privacy

In Canada, we are subject to laws and regulations relating to consumer privacy and/or marketing, including: (i) the Privacy Act, (ii) the Personal Information Protection and Electronic Documents Act which sets out rules for how private sector organizations may collect, use or disclose personal information in the course of commercial activities; (iii) the Safeguarding Canadians' Personal Information Act which includes provisions regarding individuals' consent to the collection, use or disclosure of their personal information; and (iv) Canada's anti-spam legislation which prohibits the sending of a commercial electronic message to a recipient without prior consent, and prescribes form and content requirements. Failure to comply with the provisions of applicable consumer privacy and/or marketing laws and regulations may result in monetary penalties that could have an impact on Aimia's results of operation and financial condition.

The enactment of new, or amendments to existing, legislation or industry regulations relating to consumer privacy issues and/or marketing, in Canada or in any of the markets where Aimia conducts business, may materially impact our relationships with members and our Commercial Partners. Any such legislation or industry regulations could also place restrictions upon the collection and use of information and could adversely affect our ability to deliver loyalty marketing services.

B. Payments in Canada

The voluntary Code of Conduct for the Credit and Debit Industry in Canada was introduced by the Federal Minister of Finance in 2010 in response to calls for greater transparency in respect of the fees associated with accepting electronic payments at the point of sale, specifically the costs incurred by merchants when accepting "premium" card products vs "standard" card products. On February 11, 2014, as part of the 2014/2015 federal budget, the then Minister of Finance announced that the Government would continue to work with stakeholders to promote fair and transparent practices and to help lower credit card acceptance costs, while encouraging merchants to lower prices to consumers. In order to attain these objectives, the Government stated that it intended to strengthen the voluntary Code of Conduct for the credit and debit card industry, in consultation with stakeholders.

Aimia actively participated in numerous stakeholder discussions and meetings, including with the then-Minister and his staff. Consistent with past consultations, Aimia provided information and our views, to ensure that the impacts on Aimia that could arise due to changes in the Canadian payments eco-system were thoroughly understood and considered by the Canadian Government.

On November 4, 2014, Visa and MasterCard submitted separate and individual voluntary undertakings to reduce their credit card fees to an average effective rate of 1.50% for the next five years. As stated by the Canadian Minister of Finance, the two commitments represent a reduction in credit card fees of approximately 10%. Aimia worked with TD and CIBC to develop a satisfactory outcome for the parties.

Any further changes to the current payments system, including further changes to the system for setting interchange rates of credit cards, could affect revenue for credit card companies and, as a result, could have an adverse effect on our Gross Billings.

Retail Market/Economic Conditions

The markets for the services that Aimia's businesses offer may contract or continue to contract and this could negatively impact growth and profitability. Loyalty and database marketing strategies are relatively new to retailers, and there can be no guarantee that merchants will continue to use these types of marketing strategies. In addition, Gross Billings and marketing revenues are dependent on levels of consumer spend with Accumulation Partners and clients, and any slowdown or reduction in consumer activity may have an impact on our business.

Industry Competition

Competition in the loyalty marketing industry is intense. New and existing competitors may target Accumulation Partners, clients and members, as well as draw rewards from Redemption Partners. The continued attractiveness of Aimia's businesses will depend in large part on their ability to remain affiliated with existing Commercial Partners and clients or add new partners, that are desirable to consumers and to offer rewards that are both attainable and attractive to consumers. Many of our current competitors may have greater financial, technical, marketing and other resources. We cannot ensure that we will be able to compete successfully against current and potential competitors, including in connection with technological advancements by such competitors.

Air Canada Liquidity Issues or Air Travel Industry Disruptions

Aeroplan members' strong demand for air travel creates a significant dependency on Air Canada in particular and the airline industry in general.

In the past, Air Canada has sustained significant losses and may sustain significant losses in the future. In its public filings, Air Canada has indicated that it is faced with a variety of risks, including risks related to leverage, the need for additional capital and liquidity, foreign exchange rates, economic and geopolitical conditions, volatility in fuel costs and other expenses, competition, labour issues, pension plan funding, low gross profit margins and high fixed costs, as well as risks relating to restrictive terms under its financing agreements.

Air Canada has, and is expected to continue to have and incur, a significant amount of indebtedness, and as a result of any challenging economic or other conditions affecting Air Canada, Air Canada may incur greater levels of indebtedness. The amount of indebtedness that Air Canada has and which it may incur in the future could have a material adverse effect on Air Canada. There can be no assurance that Air Canada will at all times be able to generate sufficient cash from its operations to pay its debts and lease obligations or to obtain, on a timely basis, sufficient funds to provide adequate liquidity if cash flows from operations and cash on hand are insufficient. If Air Canada is unable to meet its financial liabilities and other contractual obligations as they become

due, or to conclude arrangements to secure additional liquidity should it be unable to do so, it may be required to commence proceedings under applicable creditor protection legislation.

The bankruptcy or insolvency of Air Canada could lead to a termination or renegotiation of the CPSA. Upon such a renegotiation, Aimia may be required to pay more for seat capacity from Air Canada than the currently negotiated rates under the CPSA. If the CPSA is terminated, Aimia would have to purchase seat capacity from other airlines. Seat capacity from other airlines could be more expensive than comparable seat capacity under the CPSA, and the routes offered by the other airlines may be inconvenient or undesirable to the redeeming members. As a result, Aimia would experience higher air travel redemption costs, while at the same time member satisfaction with the Aeroplan Program may be adversely affected by requiring travel on other carriers.

The bankruptcy or insolvency of Air Canada could also lead certain Accumulation Partners to attempt to renegotiate certain terms of their commercial relationships with Aeroplan. Depending on the results of any such negotiation, Aimia's gross proceeds from the sale of Aeroplan Miles could be negatively affected.

Any disruptions or other material adverse changes in the airline industry, whether domestic or international, affecting Air Canada or a Star Alliance member airline, could have a material adverse impact on the business. This could manifest itself in Aeroplan's inability to fulfill member's flight redemption requests or to provide sufficient accumulation opportunities. As a result of airline or travel services industry disruption or delays, including those which may result from terrorist attacks or terrorist activity, accidents or disasters involving an aircraft, political instability, acts or war, epidemic diseases, environmental conditions and factors, such as those arising from volcanic eruptions or other natural phenomena, or from increasingly restrictive security measures, such as restrictions on the content of carry-on baggage, passenger identification document requirements, and passenger screening procedures, too much uncertainty could result in the minds of the traveling public and have a material adverse effect on passenger demand for air travel and on the number of passengers traveling on Air Canada's flights. Consequently, members might forego redeeming miles for air travel and therefore might not participate in the Aeroplan Program to the extent they previously did which could adversely affect revenue from the Aeroplan Program. A reduction in member use of the Aeroplan Program could impact Aeroplan's ability to retain its current Commercial Partners and members and to attract new Commercial Partners and members.

Airline Industry Changes and Increased Airline Costs

Air travel rewards remain the most desirable reward for consumers under the Aeroplan Program. An increase in low cost carriers and the airline industry trend which has major airlines offering low cost fares may negatively impact the incentive for consumers of air travel services to book flights with Air Canada or participate in the Aeroplan Program. Similarly, any change which would see the benefits of Star Alliance reduced either through Air Canada's, or, to a lesser extent, another airline's withdrawal from Star Alliance, or the dissolution of Star Alliance, could also have a negative impact since Aeroplan's members would lose access to the existing portfolio of international reward travel. In addition, the growth or emergence of other airline alliance groups could have a negative impact on Aeroplan by reducing traffic on Air Canada and Star Alliance member airlines.

The airline industry has been subject to a number of increasing costs over the last several years, including increases in the cost of fuel, insurance, airport user fees and air navigation fees. In addition, new and proposed legislation have been considered or adopted concerning carbon emissions emanating from the airline industry, including the setting of emissions allowances and charging aircraft operators for a certain percentage of these allowances. These increased costs may be passed on to consumers, increasing the cost of redeeming Aeroplan Miles for air travel rewards. This may negatively impact consumer incentive to participate in the Aeroplan Program.

Supply and Capacity Costs

Costs may increase as a result of supply arrangements with Air Canada and other suppliers for our coalition loyalty programs. Aeroplan may not be able to satisfy its members if the seating capacity made available to Aeroplan by Air Canada and Star Alliance member airlines or other non-air rewards from other suppliers are inadequate to meet their redemption demands at specific prices.

If, upon the expiry of the CPSA, Aeroplan is unable to negotiate a replacement agreement with Air Canada on similarly favourable terms, or if Air Canada sharply reduces its seat capacity, Aeroplan may be required to pay more for seat capacity from Air Canada than the currently negotiated rates under the CPSA or to purchase seat capacity from other airlines. Seat capacity from other airlines could be more expensive than comparable seat capacity under the CPSA, and the routes offered by the other airlines may be inconvenient or undesirable to the redeeming members. As a result, Aeroplan would experience higher air travel redemption costs, while at the same time member satisfaction with the Aeroplan Program may be adversely affected by requiring travel on other carriers on certain routes.

Unfunded Future Redemption Costs

In the coalition loyalty program model, Gross Billings are derived from the sale of Loyalty Units to Accumulation Partners. The earnings process is not complete at the time a Loyalty Unit is sold as most of the costs are incurred on the redemption thereof. Based on historical data, the estimated period between the issuance of a Loyalty Unit and its redemption is currently approximately 30 months for the Aeroplan Program and 15 months for the Nectar Program; however, Aeroplan and Nectar have no control over the timing of the redemption or the number of units redeemed. Aeroplan and Nectar currently use proceeds from Gross Billings (which are deferred for accounting purposes) in the fiscal year from the issuance of the unit to pay for the redemption costs incurred in the year. As a result, if Aeroplan or Nectar were to cease to carry on business, or if redemption costs incurred in a given year were in excess of the revenues received in the year from the issuance of the Loyalty Units, they would face unfunded Future Redemption Costs, which could increase the need for working capital and, consequently, affect the payment of dividends to Shareholders.

Changes to Coalition Loyalty Programs

From time to time we may make changes to our coalition loyalty programs that may not be well received by certain segments of the membership and may affect their level of engagement. In

addition, these members may choose to seek such legal and other recourses as available to them, which if successful, could have a negative impact on results of operations and /or reputation.

Seasonal Nature of the Business, Other Factors and Prior Performance

Aeroplan has historically experienced lower Gross Billings from the sale of Aeroplan Miles in the first and second quarters of the calendar year and higher Gross Billings from the sale of Aeroplan Miles in the third and fourth quarters of the calendar year. In addition, Aeroplan has historically experienced greater redemptions and therefore costs for rewards, in the first and second quarters of the calendar year and lower redemptions and related costs for rewards in the third and fourth quarters of the calendar year. This pattern results in significantly higher operating cash flow and margins in the third and fourth quarters for each calendar year compared to the first and second quarters. This pattern may however vary in future years as the degree of seasonality evolves over time.

Nectar's Gross Billings from the Nectar Program are seasonal with fourth quarter gross billings typically higher than the preceding quarters, as a result of the impact of Christmas shopping. Gross Billings for the other quarters are broadly similar. Redemption activity in the Nectar Program is more seasonal than Gross Billings. More than 40% of all redemptions for the Nectar Program in the last three years have taken place during the fourth quarter, as a result of members redeeming for gifts and other rewards prior to Christmas. Consequently, operating results for any one quarter may not be necessarily indicative of operating results for an entire year.

Demand for travel rewards is also affected by factors such as economic conditions, war or the threat of war, fare levels and weather conditions. Due to these and other factors, operating results for an interim period are not necessarily indicative of operating results for an entire year, and operating results for a historical period are not necessarily indicative of operating results for a future period.

The proprietary loyalty business also fluctuates seasonally, with award redemptions typically higher around the Christmas shopping season, and business loyalty events typically occurring during the spring and fall.

Foreign Operations

A significant portion of Aimia's Gross Billings is generated outside Canada. We expect Gross Billings from outside Canada to continue to represent a significant portion of Aimia's consolidated Gross Billings in the foreseeable future. As a result, we are subject to the risks of doing business internationally, including changes in foreign laws and regulations and general changes in economic and geopolitical conditions.

Legal Proceedings

From time to time, Aimia becomes involved in various claims and litigation as a result of carrying on its business. Please see "Provisions, Contingent Liabilities and Guarantees". Our businesses are

susceptible to various claims and litigation, including class action claims, arising in the course of operating our business or with respect to the interpretation of existing agreements. Any future claims or litigation could also have a material adverse effect on our business and results from operations.

Reliance on Key Personnel

Aimia's success depends on the abilities, experience, industry knowledge and personal efforts of senior Management and other key employees, including the ability to retain and attract skilled employees. The loss of the services of such key personnel could have a material adverse effect on our business, financial condition or future prospects. Aimia's growth plans may also put additional strain and demand on senior Management and key employees and produce risks in both productivity and retention levels. In addition, we may not be able to attract and retain additional qualified Management as needed in the future.

Labour Relations

Aeroplan's contact center employees are unionized. The collective agreement for these employees expired on November 14, 2015. Aimia and the contact center employees' union are currently in negotiations for a renewal of the collective agreement. No strikes or lock-outs may lawfully occur during the term of the collective agreement, nor during the negotiations of its renewal until a number of pre-conditions have been satisfied. There can be no assurance that the collective agreement will be renewed without labour conflict or action or that there will not be a labour conflict that could lead to a dispute or to an interruption or stoppage in Aeroplan's contact center service or otherwise adversely affect the ability of Aeroplan to conduct its operations, any of which could have an adverse effect on our business, operations and financial condition.

Pension Liability

The transfer of over 800 contact centre employees from Air Canada to Aeroplan was fully effected on June 14, 2009. As part of the transfer of the employees, Aeroplan agreed to recognize the transferred employees' seniority and assume any excess pension obligation arising from the accumulation of service years post termination with Air Canada until retirement from Aeroplan.

On June 8, 2012, Aeroplan entered into an agreement with Air Canada through which Air Canada will transfer to the Aeroplan defined benefit pension plan all the pension plan assets and obligations related to pension benefits accrued by employees who were Air Canada customer sales & service agents prior to 2009 and who were transferred to Aeroplan in 2009. The transfer was subject to regulatory approval from the Office of the Superintendent of Financial Institutions ("OSFI"), which was received on May 29, 2014. As a result, all the defined benefit pension plan assets and liabilities were transferred to Aeroplan.

The funding requirements of the defined benefit pension plan resulting from valuations of its assets and liabilities, depends on a number of factors, including actual returns on pension plan assets, long-term interest rates, plan demographic and pension regulations. Changes in these factors could

cause actual future contributions to significantly differ from our current estimates and could require us to make contributions in the future and, therefore, could have a negative effect on our liquidity and results of operations.

Technological Disruptions and Inability to use Third-Party Software and Outsourcing

Aimia's ability to protect the data and contact centres of our coalition loyalty programs and those of our clients that are within our control against damage from fire, power loss, telecommunications failure and other disasters is critical. In order to provide many of our services, we must be able to store, retrieve, process and manage large databases and periodically expand and upgrade their capabilities. While we have in place, and continue to invest in, technology security initiatives and disaster recovery plans, these measures may not be adequate or implemented properly. Any damage to data and contact centres, any failure of telecommunication links that interrupts operations or any impairment of the ability to use licensed software could adversely affect our ability to meet our Commercial Partners', clients' and members' needs and their confidence in utilizing our services or programs in the future. In addition, proper implementation and operation of technology initiatives is fundamental to the ability to operate a profitable business. We continuously invest in new technology initiatives to remain competitive, and our continued ability to invest sufficient amounts to enhance technology will affect our ability to operate successfully.

In order to achieve cost and operational efficiencies and to have access to leading processes and solutions, specialized expertise and innovation, we outsource to third-party vendors many of the computer systems and other services that are integral to the operations of our global businesses. A failure to adequately manage our third-party service providers or to monitor our third party service providers' compliance with regulatory or legal requirements could result in economic and reputational harm to us. There is also a risk the confidentiality, privacy and/or security of data held by third parties or communicated over third party networks or platforms could become compromised, which could significantly harm our business even if the attack or breach does not impact our systems. In addition, the management of multiple third-party vendors increases our operational complexity and decreases our control.

Failure to Protect Intellectual Property Rights

Third parties may infringe or misappropriate our trademarks or other intellectual property rights or may challenge the validity of trademarks or other intellectual property rights, which could have a material adverse effect on our business, financial condition or operating results. The actions that are taken to protect trademarks and other proprietary rights may not be adequate. Litigation may be necessary to enforce or protect intellectual property rights, trade secrets or determine the validity and scope of the proprietary rights of others. Aimia cannot ensure that we will be able to prevent infringement of intellectual property rights or misappropriation of proprietary information. Any infringement or misappropriation could harm any competitive advantage that we currently derive or may derive from proprietary rights. Third parties may assert infringement claims against our businesses. Any such claims and any resulting litigation could result in significant liability for damages. An adverse determination in any litigation of this type could require us to design around a third party's patent or to license alternative technology from another party. In addition, litigation

may be time-consuming and expensive and could result in the diversion of time and resources. Any claims from third parties may also result in limitations on the ability to use the intellectual property subject to these claims.

RISKS RELATED TO AIMIA

Interest Rate and Currency Fluctuations

Aimia may be exposed to fluctuations in interest rates under its borrowings. Increases in interest rates may have an adverse effect on the earnings.

Aimia's results are sensitive to fluctuations in the Canada/U.S. dollar exchange rate and to the exchange rate from pound sterling (GBP) to Canadian dollars. Aeroplan incurs expenses in U.S. dollars for such items as air, car rental and hotel rewards issued to redeeming Aeroplan members, while a substantial portion of its revenues are generated in Canadian dollars. A significant deterioration of the Canadian dollar relative to the U.S. dollar would increase the costs of Aimia. Substantially all of Aimia EMEA Limited's revenues and expenses are denominated in pounds sterling (GBP) rendering its results and their impact on Aimia's consolidated statements sensitive to fluctuations in the Canadian dollar exchange rate. Aimia US & APAC's activities are located in the United States and the Asia Pacific region. Financial results are sensitive to the changing value of the Canadian dollar and foreign operations are sensitive to the fluctuations of other currencies, including the United States dollar, British pound sterling and the Australian dollar.

Leverage and Restrictive Covenants in Current and Future Indebtedness

The ability of Aimia to pay dividends, make distributions or make other payments or advances is subject to applicable laws and contractual restrictions contained in the instruments governing any indebtedness (including the credit facilities). The degree to which Aimia is leveraged has important consequences to Shareholders, including: (i) Aimia's ability to obtain additional financing for working capital, capital expenditures or acquisitions in the future may be limited; (ii) a significant portion of cash flow from operations may be dedicated to the payment of the principal of and interest on its indebtedness, thereby reducing funds available for future operations; (iii) certain borrowings will be at variable rates of interest, which exposes Aimia to the risk of increased interest rates; and (iv) Aimia may be more vulnerable to economic downturns and be limited in its ability to withstand competitive pressures.

In addition, the credit facilities contain a number of financial and other restrictive covenants that require Aimia to meet certain financial ratios and financial condition tests and limit the ability to enter into certain transactions. A failure to comply with the obligations in the credit facilities could result in a default which, if not cured or waived, could permit acceleration of the relevant indebtedness. If the indebtedness under the credit facilities, including any possible hedge contracts with the lenders, were to be accelerated, there can be no assurance that the assets of Aimia would be sufficient to repay in full that indebtedness.

Aimia may need to refinance its available credit facilities or other debt and there can be no assurance that it will be able to do so or be able to do so on terms as favourable as those presently in place. If Aimia is unable to refinance these credit facilities or other debt, or is only able to refinance these credit facilities or other debt on less favourable and/or more restrictive terms, this may have a material adverse effect on Aimia's financial position, which may result in a reduction or suspension of payments of dividends to Shareholders. In addition, the terms of any new credit facility or debt may be less favourable or more restrictive than the terms of the existing credit facilities or other debt, which may indirectly limit or negatively impact the ability of Aimia to pay dividends.

Uncertainty of Dividend Payments

Payment of dividends are dependent upon operating cash flows generated by Subsidiaries of Aimia, financial requirements of Aimia and the satisfaction of solvency tests on the payment of dividends pursuant to the Canada Business Corporations Act.

Managing Growth

We regularly review potential acquisitions of businesses we believe may be complementary to ours. As part of any acquisition we conduct customary due diligence with the goal of identifying and evaluating material risks. Notwithstanding our review, we may be unsuccessful in identifying all such risks or realizing the intended synergies of any given acquisition and our results of operations and financial condition could be adversely impacted. In addition, our inability to effectively manage growth could have a material adverse impact on our business, operations and prospects.

Credit Ratings

Aimia has been assigned issuer credit ratings of BBB with a stable trend by DBRS and BBB- by S&P. The Notes have also been assigned credit ratings of BBB with a stable trend by DBRS and BBB- by S&P. There can be no assurance that the credit ratings assigned to Aimia and the Notes will remain in effect for any given period of time or that the ratings will not be withdrawn or revised by either or both of the rating agencies at any time. The interest rate payable pursuant to Aimia's credit facilities and the Notes will be subject to adjustment from time to time if any of DBRS or S&P downgrade (or subsequently upgrade) their ratings. Additionally, Aimia's access to capital markets could be adversely affected by changes to the debt credit ratings assigned by independent rating agencies such as DBRS and S&P.

Audits by Tax Authorities

In the ordinary course of business, the Corporation is subject to ongoing audits by tax authorities. While Aimia believes that its tax filing positions are appropriate and supportable, from time to time, certain matters are reviewed and challenged by the tax authorities. We regularly review the potential for adverse outcomes in respect of tax matters and believe that any ultimate disposition of a reassessment will not have a material adverse impact on our liquidity, consolidated financial

position or results of operations due to adequate provisioning for these tax matters. Should an outcome materially differ from existing provisions, the Corporation's effective tax rate, its earnings, and its liquidity and working capital position could be affected positively or negatively in the period in which matters are resolved.

MEASURING OUR PERFORMANCE AGAINST 2015 GUIDANCE

On February 27, 2015, Aimia issued guidance for the year ending December 31, 2015, which was updated on August 14, 2015 and November 13, 2015. A comparison of Aimia's actual reported results for the year ended December 31, 2015 against the guidance issued and updated for such year is presented below:

| Guidance Issued February 27, 2015, as Updated | Comparison to Actual Results |
|--------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Consolidated Guidance for the Year Ending December 31, 2015 | |
| Gross Billings between <u>\$2,400 million and \$2,460 million</u> | Gross Billings were <u>\$2,469 million</u> . |
| Adjusted EBITDA ¹ margin of approximately <u>9%</u> | Adjusted EBITDA ¹ margin of <u>9.5%</u> |
| Free Cash Flow before dividends paid ² between <u>\$180 million and \$190 million</u> | Free Cash Flow before dividends paid ² was <u>\$207 million</u> , which was higher than the top end of the range due to timing of cash receipts from some of our larger clients in our US and EMEA businesses and lower fourth quarter redemptions than expected in our Nectar Program. |
| Capital expenditures to approximate <u>\$80 million to \$90 million</u> . | Capital expenditures were reported at <u>\$94 million</u> , which was higher than the top end of the range due to expenditures associated with client delivery of platforms and the further weakening of the Canadian dollar. |

Notes:

1. The 2015 guidance and reported results exclude the \$45.7 million favourable adjustment related to the Card Migration Provision and restructuring expenses of \$15.7 million related to the organizational change from a geographical structure to a line of business structure.
2. The 2015 guidance and reported results exclude severance payments of \$4.5 million related to the organizational change from a geographical structure to a line of business structure.

2A Blue Jay Air Exhibits

EXHIBIT 1

Email thread discussing the Travel Insurance program issues

From: Jim Peters
Sent: August 28th, 2015 9:00pm
To: Geoff Olive
cc: John Feather, Edward Blue
Subject: Travel Insurance Risk Review

Hi Geoff,

Has your team reviewed the pricing on the travel insurance proposal? I'm not comfortable that the tail risk is being picked up here. Isn't it possible that a tail event like a plane crash can affect multiple travel insurance policies?

Thanks,
Jim Peters
Head of Risk Management Committee, Blue Jay Air

=====

From: Geoff Olive
Sent: August 29th, 2015 8:45am
To: Jim Peters
cc: John Feather, Edward Blue
Subject: RE: Travel Insurance Risk Review

Hi Jim,

I'm worried the tail risk is actually too high for us to retain. As we all know, RPPC wants to limit its exposure to tail event risks. We should sit down and discuss some risk transfer options.

Thanks,
Geoff Olive
CRO, Blue Ocean Inc.

=====

From: Jim Peters
Sent: August 29th, 2015 10:30am
To: Geoff Olive
cc: John Feather, Edward Blue
Subject: RE: RE: Travel Insurance Risk Review

I think that's worth exploring. I also have a few suggestions on the economic capital model you've been using for pricing. We'll need to ensure that tail dependence is properly modeled. I'll send you some of our work on this.

Jim

=====

Exhibit 2
Blue Jay Air Corporation
NON-CONSOLIDATED STATEMENTS OF OPERATIONS
(US Dollars in millions)

| Fiscal Year Ended | Dec 31, 2015 | Dec 31, 2014 | Dec 31, 2013 |
|------------------------------------------------------|--------------|--------------|--------------|
| Operating revenues: | | | |
| Passenger | 1,544 | 1,235 | 1,074 |
| Other | 291 | 242 | 207 |
| Total revenues | 1,835 | 1,477 | 1,281 |
| Operating expenses: | | | |
| Aircraft fuel | 574 | 462 | 401 |
| Wages, salaries and benefits | 359 | 289 | 251 |
| Capacity purchase agreements | 172 | 138 | 120 |
| Airport and navigation fees | 158 | 127 | 110 |
| Depreciation, amortization & impairment | 96 | 77 | 67 |
| Aircraft maintenance | 110 | 89 | 77 |
| Sales & Distribution costs | 73 | 59 | 51 |
| Aircraft rent | 49 | 39 | 34 |
| Food, beverages and supplies | 42 | 33 | 29 |
| Communications and Information technology | 33 | 27 | 23 |
| Other | 19 | 15 | 13 |
| Total operating expenses | 1,684 | 1,356 | 1,176 |
| Net Operating income | 150 | 121 | 105 |
| Non-operating income (expenses) | | | |
| Foreign exchange gain(loss) | 15 | 10 | (29) |
| Interest income | 5 | 5 | 5 |
| Interest expense | (44) | (36) | (31) |
| Interest capitalized | 2 | 1 | (5) |
| Net financing expense relating to employee benefits | (2) | (2) | (15) |
| Loss on financial instruments recorded at fair value | (3) | (7) | (33) |
| Other | (1) | (2) | (19) |
| Total non-operating expense | (28) | (31) | (127) |
| Income (loss) before income taxes | 122 | 90 | (22) |
| Income taxes | (43) | (32) | 8 |
| Net income (loss) | 79 | 59 | (14) |

EXHIBIT 3
Blue Jay Air Corporation
NON-CONSOLIDATED STATEMENT OF FINANCIAL POSITION
(US Dollars in millions)

| Fiscal Year Ended | Dec 31, 2015 | Dec 31, 2014 | Dec 31, 2013 |
|----------------------------------------------------|--------------|--------------|--------------|
| ASSETS | | | |
| Current: | | | |
| Cash and Cash equivalents | 150 | 140 | 136 |
| Short-term investments | 210 | 182 | 83 |
| Total cash & Short-term investments | 360 | 322 | 219 |
| Restricted cash | 15 | 15 | 15 |
| Accounts receivable | 200 | 160 | 127 |
| Aircraft fuel inventory | 91 | 63 | 48 |
| Spare parts and supplies inventory | 120 | 80 | 33 |
| Prepaid expenses & other current assets | 150 | 100 | 70 |
| Total current assets | 576 | 418 | 293 |
| Property and equipment | 545 | 509 | 474 |
| Intangible assets | 21 | 21 | 21 |
| Goodwill | 31 | 31 | 31 |
| Deposit and other assets | 9 | 7 | 1 |
| Total assets | 1,542 | 1,308 | 1,039 |
| LIABILITIES | | | |
| Current: | | | |
| Account payable & accrued liabilities | 150 | 107 | 70 |
| Advance ticket sales | 310 | 250 | 181 |
| Current portion of long-term debt & finance leases | 110 | 80 | 61 |
| Total current liabilities | 570 | 437 | 312 |
| Long-term debt and finance leases | 470 | 450 | 320 |
| Pension & other benefit liabilities | 545 | 556 | 580 |
| Maintenance provisions | 60 | 55 | 60 |
| Other long-term liabilities | 50 | 48 | 43 |
| Total liabilities | 1,695 | 1,546 | 1,315 |
| EQUITY | | | |
| Shareholders' equity | | | |
| Share capital | 90 | 90 | 90 |
| Contributed surplus | 30 | 25 | 45 |
| Deficit | (273) | (352) | (411) |
| Total shareholders' equity | (153) | (238) | (276) |
| Total liabilities & equity | 1,542 | 1,308 | 1,039 |

EXHIBIT 4
Blue Jay Air Corporation
NON-CONSOLIDATED STATEMENT OF CASH FLOW
(US Dollars in millions)

| Fiscal Year Ended | Dec 31, 2015 | Dec 31, 2014 | Dec 31, 2013 |
|-------------------------------------------------------------------------------------------------------------|---------------------|---------------------|---------------------|
| Cash Flows from (used for) | | | |
| Operating: | | | |
| Net income (loss) | 79 | 59 | (14) |
| Adjustments to reconcile to net cash from operations: | | | |
| Adjust for non-cash items: | | | |
| Depreciation, amortization & impairment | 96 | 77 | 67 |
| Fuel & other derivatives | (20) | (11) | 14 |
| Adjust for Changes in non-cash working capital items: | | | |
| Change in inventories | (68) | (62) | (32) |
| Change in account receivable | (40) | (33) | (59) |
| Change in Account Payable | 43 | 37 | (37) |
| Change in advance ticket sales | 60 | 69 | 57 |
| Change in pension & other benefit liabilities | (11) | (24) | 24 |
| Change in maintenance provisions | 5 | (5) | 5 |
| Other | (50) | (30) | (20) |
| Net cash flow from operating activities | 95 | 77 | 5 |
| Financing | | | |
| Proceeds from borrowings | 150 | 100 | 125 |
| Reduction of long-term debt obligations | (63) | 64 | (104) |
| Reduction of finance lease obligations & Distributions related to aircraft special purpose leasing entities | (35) | (10) | (74) |
| Contributed Surplus | 6 | (20) | 35 |
| Net cash flows used in financing activities | 58 | 134 | (18) |
| Investing | | | |
| Short-term investments | (28) | (99) | (8) |
| Additions to property, equipment & intangible assets | (136) | (114) | (36) |
| Proceeds from sale of assets | 4 | 2 | 4 |
| Foreign exchange gain(loss) | (4) | (3) | 7 |
| Other | 2 | (1) | 0 |
| Net cash flows used in investing activities | (162) | (214) | (33) |
| Decrease in cash & cash equivalents | (10) | (4) | (46) |
| Cash & cash equivalents, beginning of year | 155 | 151 | 105 |
| Cash & cash equivalents, end of year | 165 | 155 | 151 |

EXHIBIT 5

Headline News Excerpts on Competitors

5.1 Southwest Airlines

Key Revenue Measure Is Flat for Southwest Airlines

DALLAS -- Southwest Airlines Co. said Friday that a key revenue measure was flat in March, another sign that airlines are struggling to sell more high-fare tickets.

Southwest, which owns AirTran Airways, said that traffic on the two carriers rose 4 percent last month compared with a year earlier, as passengers flew 9.44 billion miles.

Despite the increase in traffic, Southwest said that passenger revenue for each seat flying one mile was unchanged from March 2012. That statistic is a closely watched indicator of pricing power in the airline business.

Airlines are leaving fewer empty seats on their planes _ occupancy is at levels not seen since 1945 _ but they appear to be selling fewer seats at the highest fares or discounting more tickets.

Earlier this week, Delta Air Lines Inc. and US Airways Group Inc. reported weaker-than-expected figures for the same revenue-per-mile statistic and said that last-minute bookings were disappointing. That's important because passengers usually must pay more for last-minute tickets.

Delta and US Airways blamed the weakness in late bookings on automatic federal spending cuts, which presumably would result in less travel by government employees.

Dallas-based Southwest, the nation's fourth-largest airline, raised passenger-carrying capacity in March by 3.8 percent. Airlines can increase capacity by adding flights or making longer trips, which Southwest did.

With traffic rising slightly faster than capacity, planes were a bit more full. Southwest said average occupancy was 82 percent, up from 81.8 percent in March 2012.

In late morning trading, shares of Southwest fell 16 cents, or 1.3 percent, to \$12.64 _ about double the rate of decline in the Standard & Poor's 500 index.

5.2 Virgin America

Virgin America: More Elite Fliers Wanted

In a bid to attract coveted elite frequent fliers from other airlines, Virgin America on Tuesday extended its status match program.

Virgin America first introduced the program last November. Certain American and **United** road warriors holding elite status were matched to Virgin's Silver or Gold Elevate status. (*Read more: **Virgin America Woos Elite American, United Fliers***)

The program was scheduled to end April 30. But Virgin has extended it until June 30 and is inviting **Southwest Airlines** elites to participate.

Travelers who fly at least 25,000 miles annually on American or United will be matched to Virgin America Elevate Silver status. Those who fly 75,000 miles or more on United—or 100,000 miles or more on American—will be given Elevate Gold status. (*Read more: **How Flying, Just For the Miles, Can Pay Off***)

For **Southwest** fliers, those who hold A-List or A-List Preferred status—25 or 50 qualifying one-way flights annually—will be matched to Elevate Silver status. Southwest Companion Pass holders—100 or more one-way flights annually—will be given Elevate Gold Status.

The matched status upgrade will be valid until June 30. Travelers can extend their status through the end of 2013 by accumulating either 8,000 status points for Silver, or 12,000 status points for Gold by June 30, 2013.

...

5.3 Air Canada & Westjet

A new set of headwinds for Air Canada & Westjet

By Brenda Bouw, The Globe and Mail

Airline stocks have hit some recent turbulence amid concerns over slowing global economic growth and the Ebola outbreak, but some investors see a buying opportunity, especially as lower fuel prices cut operating costs.

Shares of Canada's two major airlines, WestJet Airlines Ltd. and Air Canada, have dipped in recent weeks, even as both report steady traffic increases and expect to receive extra revenue from newly introduced baggage fees.

A lower Canadian dollar is a headwind for the airlines, since they make major purchases in U.S. dollars, such as fuel, which makes up about 25 per cent to 35 per cent of an airline's cost base. Some analysts say that should be offset by the drop in the price of the commodity produced from oil.

Benchmark Gulf Coast jet fuel prices have fallen to about \$2.40 (U.S.) per gallon, down almost 20 per cent from \$2.95 in June.

"The dramatic drop in fuel prices recently does, in our view, provide significant cost relief that should benefit everyone in the industry," said Ben Cherniavsky, an analyst at Raymond James Ltd., in a recent note.

Still, he discourages investors from viewing airline stocks as a way to play falling oil prices, saying GDP growth has a greater impact on airline profits. "It doesn't matter what fuel costs if the seats are empty," Mr. Cherniavsky said.

He has a "strong buy" on WestJet, calling it the carrier with the lower costs, and recently upgraded Air Canada to "market perform" (similar to a hold) from "underperform" (similar to a

sell), citing lower fuel prices and its underperformance compared with the overall sector and the S&P/TSX composite index.

Air Canada shares have fallen about 25 per cent from a six-year high of \$10.90 (Canadian) reached in June. WestJet shares hit an all-time high of \$33.33 in mid-September, but have fallen about 7 per cent since. (Both stocks have recovered in the past couple of days alongside the broader markets.)

Both stocks have been affected by concerns about the impact on traffic from a downturn in the global economy, the spread of the Ebola virus and competition from other, smaller carriers.

Konark Gupta, an analyst at Macquarie Capital Markets, said Air Canada has been harder hit than WestJet and over a longer period because of its thinner margins and greater exposure to international markets, including the weakening European economy.

Mr. Gupta also doesn't believe investors should bet on lower fuel prices to lower costs long-term.

"Fuel is uncertain. What we are seeing with fuel prices right now is likely a temporary shift. [Prices] could rebound," said Mr. Gupta, who has a "buy" on WestJet and a "hold" on Air Canada.

Bruce Campbell, president and portfolio manager at Campbell Lee & Ross, said his firm doesn't own airline stocks because the industry's costs are mainly fuel and labour, both of which they have little control over.

However, if the stocks were hit by a rebound in fuel prices he might consider them as a short-term play given what he calls the "fragile psyche of the market" today.

"We don't like the long-term business, but if they got hit a lot then you might have to look and say, 'There's so much value here we have to do it.' If we did do that it would be new for us," he said.

BMO Nesbitt Burns analyst Fadi Chamoun said steep sell-offs in airline stocks have proven to be a buying opportunities in the past, with the exception of recessions.

"We do not sense the demand environment has deteriorated and we remain positive on the outlook for passenger traffic," Mr. Chamoun said in a note. He has an "outperform" on both Air Canada and WestJet.

Canaccord Genuity analyst David Tyerman believes it's a good time to buy airline stocks, but said the "wild card" is the health of the North American economy.

"At this point, the Canadian and U.S. economic outlook remains supportive for airline demand," Mr. Tyerman said in a note.

Air Canada confirms novel financing for new planes

By Ross Marowits, THE CANADIAN PRESS

MONTREAL — Air Canada confirmed Wednesday that it plans to tap into a novel way — at least in Canada — of financing the purchase of five new Boeing 777 aircraft. The Montreal-based airline announced the private offering of three tranches of enhanced equipment trust certificates (EETC) worth US\$714.5 million.

The aircraft are scheduled for delivery between June 2013 and February 2014.

Loxley Aviation Ltd. has been created to facilitate Air Canada's inaugural offering, Moody's Investors Service said in assigning ratings of Baa3 to tranche A, B1 to tranche B and B3 to tranche C.

The aircraft, configured with 458 seats in economy, premium economy and premium classes, will be used as collateral. Air Canada (TSX:ACB) uses the largest planes in its fleet on long-haul routes.

...

Chris Murray of PI Financial Corp. had predicted the carrier would become the first Canadian airline to tap into a new way to finance aircraft purchases that reduces interest rates. Ottawa's approval in December of an aircraft protocol opens the doors effective April 1 to the EETC trust market that has been used by U.S. carriers for nearly 20 years. Murray added in a report last week that Air Canada may also consider the same financing arrangement for its new Boeing 787 planes set to begin delivery next year.

...

Air Canada's poor punctuality could cost customers, expert warns

Carrier ranked last of 28 major international airlines

CBC News

Air Canada has the worst on-time arrival performance of any major international airline, a CBC *Marketplace* investigation has found.

Numbers from travel information group FlightStats showed just 60.89 per cent of the Canadian carrier's flights landed on time in 2012, the worst on-time performance record of 28 international airlines.

Air Canada's record worsens on the popular Vancouver-Toronto corridor where only 55 per cent of flights arrived on time in 2012. Air Canada competitor WestJet landed on time 70 per cent of the time on that same route.

The airline's performance is "not good," says Anming Zhang, professor of air transportation at the University of British Columbia. He speculates that the airline's poor punctuality will cost it customers.

“If you can arrive on time, it is considered by passengers as a quality of service,” he said. “Unhappy customers are not willing to take your flight if there's a competitor flight [that's on time].”

Zhang says many factors can cause late flights, including poor weather and international connections.

He points out that WestJet has the advantage of being a largely domestic airline, while Air Canada flies to Europe and Asia, long-haul flights that are more prone to delays.

He also says Air Canada's fleet could be a problem, since the variety of aircraft types can slow maintenance and repairs.

“If the airline works with a single aircraft type, it's much easier, you know the aircraft inside and out,” he told *Marketplace* co-host Erica Johnson. “Once you mix with different aircraft types and parts, there will be more complicated operations.”

WestJet uses just one aircraft type.

“[Using one model] is much simpler,” he said. “If you have seven or eight aircraft types, versus just one aircraft type, the parts are uniform and mechanics know exactly what happened. It's much faster.”

Top-ranked Japan Airlines, which lands more than 90 per cent of flights on time, has 10 different aircraft types.

Air Canada responded to *Marketplace's* investigation with a written statement saying, in part, “Air Canada is now engaged in a company-wide, on-time-performance initiative that is resulting in continuous improvement in this area.”

Starting April 10, Air Canada will require customers on most flights to check their bags 45 minutes before departure time, instead of the current 30 minutes.

Zhang says checking bags earlier is a positive step that should save time, but he also encourages Air Canada to be more transparent about its delays.

“Customers pay for this service and they have the right the right to consume the product as the company has advertised,” he said. “They have a scheduled departure time [and] a scheduled arrival time, and they are entitled to see why there is a deviation from the product you provide and the product you declared in terms of quality aspects.”

5.4 Porter Airline

Porter aims to become Canada's 3rd national airline

CBC News

Porter Airlines confirmed today it plans to buy up to 30 CS100 jets from Montreal-based Bombardier, which would expand the regional carrier's reach from coast to coast, and take direct aim at Air Canada and WestJet.

"We believe it is time to spread our wings," president and CEO Bob Deluce said at a news conference at Billy Bishop Toronto City Airport, where Porter is based. "And so I present to you our vision for the future of Porter Airlines — a vision with service to destinations across North America, from Calgary and Vancouver, to Los Angeles, Miami and Orlando."

The move pushes Porter into direct competition with Air Canada and WestJet as a national carrier, while setting up a potential political standoff over expansion of the island airport in downtown Toronto.

'We believe the CS100 is the perfect aircraft for the next stage of our growth for many reasons, not the least of which is that it is the quietest commercial jet in production.'—Bob Deluce, Porter CEO

The conditional deal is to buy 12 Bombardier CS100s, with options on 18 more.

The deal also includes purchase rights for six of Bombardier's Q400 turboprop aircraft, currently the mainstay of the Porter fleet.

The total purchase could reach \$2.29 billion US if all the options and purchase rights are exercised.

Delivery of the first jet, which has seating for 107 passengers, is expected in 2016.

The conditional purchase agreement signed on Tuesday is a coup for Bombardier, and ushers in a change in Canadian aviation. That's because the CSeries jets can fly 5,400 km without refuelling, much farther than the current fleet of Q400 turboprop planes that Porter flies to connect 19 cities across Eastern Canada and the U.S.

The airline said the expansion could mean 1,000 new employees, which would bring the total to 2,400.

Potential price war

Joseph D'Cruz, a University of Toronto business professor and aviation expert, said the move could be good news for consumers.

The announcement could lead to a political dispute over the airport, which is near residents on the island and the city's heavily populated downtown. (Marivel Taruc/CBC)

"It's going to be interesting to watch how WestJet and Air Canada react once Porter starts biting into their business," he told CBC News. "They're going to retaliate, and the only way they can retaliate is lower prices."

"This may trigger a vicious price war," D'Cruz said.

Air Canada said that before it takes a position on further investment at the island airport, it wants assurance that takeoff and landing slots will become available for other airlines that have been seeking increased access.

Canada's largest airline currently has only enough landing and takeoff slots to offer service between Montreal and the airport on the Toronto waterfront.

WestJet Airlines did not directly address Porter's plans, but said it remains focused on keeping its own business.

"We expect competition to increase and are preparing accordingly," WestJet spokesman Robert Palmer said in a statement.

...

In a separate interview with The Canadian Press, Kokonis noted that Porter's planes have been flying less full while load factors at WestJet and Air Canada have been improving.

"In a zero sum game where they're all sort of chasing the same passenger, it does give one pause for concern that Porter might be struggling in some areas."

Despite the expansion, Deluce said taking the privately held airline public and raising money through an initial public offering is not a priority right now.

The company had planned to issue shares on the public markets in the past, but shelved them for various reasons.

"We've not thought about an IPO in most recent times," Deluce said. "Sometime in the future it's a possibility."

5.5 Orange Sky Airline

Orange Sky Troubled Past Finally Emerging From Bankruptcy

Excerpt Adaptation from 3rd Edition of Organizational Behavior: A Strategic Approach by Hitt, Michael, Miller, C. Chet, and Colella, John Wiley & Sons

Orange Sky Airlines finally emerged from bankruptcy on April 1, 2014 after 3 years and 51 days of internal conflicts and deteriorated management- labor relations, which led to falling stock prices and increasingly dissatisfied customers. The long-dated labour problem dated back at least to 2001 when the company's different union groups (pilots, mechanics flight attendants) were at odds with the company and with each other. The company was able to obtain agreement with the pilots' and the mechanics' union members to reduce their pay in exchange for 25% and 20% of company's stock respectively and 10% to non-union employees. However, this exchange was not endorsed by the flight attendants' union which ended in dispute among the different unions. As a result, the customer services were impacted and flight delays occurred more frequently than other airlines. In addition, management was blaming the unions for all the dilemmas resulted, whereas the unions felt management was making poor decisions, ignoring their input and top executives were still receiving excessive compensation; thereby leading to toxic management-labour relations. As time progressed, Orange Sky experienced more losses caused by substantial

reduction in flight sales especially during the 2008 financial crisis, mis-management and inability of Orange Sky to obtain loan of almost \$1.5 billion from Air Transportation Stabilization Board (ATSB) to cover its debt in early 2009. As a condition of such loan, Orange Sky would have to make more cutbacks and reduction in wages and benefits. For this to occur, all unions would have to agree to pay cuts. Orange Sky management was unable to reach consensus with the unions. As a result, Orange Sky Airline filed for bankruptcy in early 2011 in order to settle with the different unions and creditors. Today, Orange Sky stock dropped to less than US \$1 per share.

5.6 Recent Airline Incidents

British Airways plane catches fire at Las Vegas airport

The Guardian

A British Airways jet has caught fire at Las Vegas airport, sending smoke billowing into the air, after suffering what the pilot described as a “catastrophic failure” of the left engine.

Fire officials said 14 people were taken to Sunrise hospital to be treated for minor injuries, including cuts and bruises, most a result of sliding down the inflatable chutes to escape.

All 157 passengers and 13 crew – including three pilots – on board were evacuated, and the fire was swiftly put out by around 50 firefighters. An airport spokeswoman told reporters: “All passengers were evacuated quickly and safely and taken by bus to the terminal.

“We cannot express enough gratitude to the emergency response crews, as well as the British Airways crew.”

The National Transportation Safety Board was investigating the incident, she added.

The plane aborted take-off shortly before the fire broke out. The Federal Aviation Administration (FAA) said the Boeing’s 777 left engine – manufactured by General Electric – burst into flames.

Dramatic images of flight BA2276 were shared on social media by members of the public at the airport, which is five miles south of downtown Las Vegas.

Guardian reporter Jacob Steinberg was on the plane and tweeted about the evacuation: “Just evacuated on a British Airways flight at Las Vegas airport after an engine caught fire. Don’t think anyone hurt.

“Was asleep as the plane took off. Came to a crashing halt. Smell of smoke. Initially told to stay seated, then shout of evacuate. Could smell and see smoke but was on other side of plane. One person said fire melted a couple of windows.”

The Crash of Delta 1086: Typical!

The Economist

MOST aviation accidents aren't like the disappearance of Malaysia Airlines Flight 370 last year. The crash of Delta Air Lines Flight 1086 at New York's LaGuardia airport last week is far more typical. Delta 1086, a McDonnell Douglas MD-80, was landing at LaGuardia in a snowstorm when it skidded off the runway and into an earthen berm that separates the airport from Flushing Bay. Three people were hospitalised, but no one was killed and all passengers were successfully evacuated.

This is as close to a prototypical airline accident as you can get. It was survivable, happened during takeoff or landing, and didn't result in the total loss of the plane. Many planes get into trouble because of bad weather, which certainly could have been a contributing factor in this case (the National Transportation Safety Board is still investigating). It is also not clear whether pilot error played any role, but the crew of the plane certainly deserve credit for managing a quick and complete evacuation, especially since the aircraft was leaking fuel. The Associated Press has a good roundup of possible causes the NTSB will investigate.

As Dennis Mersereau notes over at *Gawker*, one of the lessons here is that travellers should resist complaining to the airlines about bad weather. It is totally outside of their control, and poor conditions make flying significantly more dangerous. American airports have, in recent decades, struck a good balance between remaining open when it is safe to do so and closing when it's not. And when you think about aeroplane accidents, remember: you're incredibly unlikely to be in one. But if you are, it'll probably be more like Delta 1086 than MH370.

EXHIBIT 6

Blue Jay Air Corporation's Balanced Scorecard Framework

Blue Jay Airlines' Balanced Scorecard Framework

| | Objectives | Measurements | Targets | Initiative |
|--------------------------------|---------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------|----------------------|
| Financial | Revenue Growth Frequent Business Travels Expense Reduction Asset Utilization | Total Revenues Business Class Load Factor Total Operating Expense Higher Tangible Asset | 35% Annual Growth 95% 2% Annual Decrease Increase Service Capacity | Refurbish / Purchase |
| Customer | Frequent Business Travels Enhance Loyalty Program Rebranding / Image | % Business Traveler Number of Participants Business Traveler Ranking | 85% 25% Annual Growth # 1 | |
| Internal | Booking System Enhancements Enhance Comfort and Service Turnaround | Utilization Internet, Mobile Increase Business Class Capacity On Time Departure | 50% Annual Growth 80% of Fleet 85% | |
| Innovation and Learning | Labor Relationship Management Labor Efficiencies Safety | Employee Satisfaction Decrease Staff Expenses JACDEC Safety Index, Rank | Top 10% of Industry 10% Decline over next 5 years # 1 | |

EXHIBIT 7

JACDEC 2014 Aviation Safety Review

From: Jim Peters
Sent: December 1, 2015 9:00am
To: John Feather
Subject: JACDEC 2014 Aviation Safety Review

John –

My team has reviewed results of the 2014 Aviation Safety Review and summarized as follows. Please let me know if you would like to discuss changes to any of our programs based on the results of this report.

- Jim

In 2014 the world's death toll in commercial air transport has risen nearly four times over the 2013 numbers. Spectacular accidents crippled the unprecedented safety record of last year.

"This is the second highest in the past ten years," writes Jan-Arwed Richter, founder of the Hamburg Aircraft Accident office, called "Jet Airliner Crash Data Evaluation Centre" (JACDEC). The number lies almost four times higher than in the previous year, when only 251 people were killed in aviation accidents killed Richter explained in a previously published paper for the aviation magazine "Aero International".

About half of the fatalities came from the Asia-Pacific region. Although flying remains the safest way of travelling, 2014 marks an atypical year compared to a series of years with falling numbers of victims.

2014 also whirled through the JACDEC security list of the 60 largest airlines.

The world's new leading airline in terms of its safety record, is **Cathay Pacific** from Hong Kong, followed by **Emirates**, **EVA Air** of Taiwan and **Air Canada**. The safest airline in Europe is therefore now the Dutch **KLM** in fifth, ahead of **Air New Zealand** and **Qantas** of Australia.

Two major disasters affected **Malaysia Airlines**, which fell from 34th to 57th place.

Lufthansa remains unchanged and claimed 12th place. Germany's second largest airline **Air Berlin** climbed from 26th to 20th place.

“From the observed 60 largest airlines more than half a dozen lost one of their aircraft“, it says in the article. The JACDEC safety score is primarily calculated by the revenue traffic performance of an airline in relation to the number of serious incidents and total losses it experienced up to 30 years back.

The safest regions were North America and Eurasia (including Russia plus all GUS⁴ States east of Ukraine): There was not a single flight accident death.

For Latin America, the analyst came to 10 deaths mostly on flights with vintage machines on non-scheduled operations. The Middle East and Central Asia remained at 57.

Africa was once again a point of focus; it experienced 18 aircraft losses and 134 fatalities, although the total was exceeded by Europe. Including the disaster of the Malaysian Boeing 777 over eastern Ukraine, the region had a total number of 300 fatalities and came in 2nd last place.

The most deaths occurred in the Asia-Pacific region, where half of all fatalities occurred in the past year.

From: John Feather
Sent: December 1, 2015 9:05am
To: Jim Peters
Subject: RE: JACDEC 2014 Aviation Safety Review

Jim –

Budget for improvements is limited, but interested in improving our rank. Please advise.

JF

⁴ GUS States are members of the Commonwealth of Independent States which is a regional organization formed during the dissolution of the Soviet Union.

EXHIBIT 8

Code-Share Agreement

A code-share agreement is an aviation business arrangement where two or more airlines share the same flight. Sharing, in this sense, means that each airline publishes and markets the flight under its own airline designator and flight number as part of its published timetable or schedule. A seat can be purchased on each airline's designator and flight number, but is operated by only one of these cooperating airlines, commonly called the operating carrier. The carrier marketing the flight under its own code is commonly called the marketing carrier. The number of marketing carriers for one flight technically is not limited.

In certain situations, an operating carrier does not also act as a marketing carrier. These types of carriers primarily consist of smaller, regional airlines doing business as another marketing carrier or subsidiary thereof. For instance, a flight may be listed as operated by Endeavor Air DBA Delta Connection. It is often the case that these carriers do not have a sound infrastructure in place to market and sell seats to the consumer directly. These flights may also involve more than one marketing carrier.

Airlines are motivated to enter into code-sharing agreements primarily to expand the number of offerings an individual airline can offer its customers. These additional offerings may take the form of additional routes and/or additional flight timings. In addition, the marketing carrier is able to avoid the additional costs and difficulties in obtaining additional equipment and gate access necessary to add an additional flight on its own. Code-share agreements do involve significant costs, however, due to the initial setup and continuing negotiations, as well as ever-changing contracts between airlines in dealing with how seats are exchanged between them.

Furthermore, the marketing carrier must be confident that the operating carrier offers a safe and suitable product when the marketing carrier's passengers board the other's planes. Likewise, the operating carrier must rely upon the marketing carrier's service and systems to bring them to their planes in a reliable manner. Moreover, the systems of all associated parties must reliably interact and provide the appropriate information to each other.

Membership in one of the three major Airline Alliances (Star Alliance, SkyTeam, and oneworld) is distinguishable from code-share agreements, though alliance members often enter into CSAs. In fact, one alliance requires CSAs to become a member of the alliance. The mutual obligations among the members of an alliance are outside of the CSAs, and alliance membership does not dictate the agreement details.

One of the basic provisions of a code-share agreement is 'The Inventory Control Procedure', which specifies how booking classes are to be mapped among the parties and how access to the seat inventory will be provided to the marketing carrier by the operating carrier. Generally, booking classes (sometimes known as fare classes) refer to the type of fare (e.g. flexible or non-

refundable) and/or type of traffic (e.g. a flight with a long-haul connection.) Revenue differs according to each booking class. Seat inventory can be provided as one of the following:

- Freesale arrangement – The marketing carrier(s) and operating carrier both sell tickets from the same inventory of seats and booking classes for each carrier are directly mapped to each other.
- Hard Block Space arrangement – The marketing carrier pre-arranges with the operator to set aside a given number of seats for the marketing carrier to sell. The marketing operator will purchase these seats from the operator at an agreed upon prices.
- Soft Block Space arrangement – Similar to a Hard Block Space arrangement, but with an option to return some of the seats at an agreed upon number of days prior to departure.

Additional provisions of code-share agreements are as follows.

- List of routes
- Marketing and product display
- In-flight product and quality monitoring
- Technical and operational requirements
- Safety and security
- Passenger handling and airport procedures
- Pricing, revenue management, ticketing, commission payments and financial settlement
- Taxes
- Liability, indemnification, and insurance
- Exclusivity – The code-share agreement is exclusive for the parties entering into the agreement and those parties will not be able to enter into further code-share agreements with other carriers in certain markets.

In addition to the basic provisions of a code-share agreement, separate, parallel agreements between the parties involved may be established. The most common of these parallel agreements are Special Prorate Agreements (SPAs) and revenue settlement agreements.

The SPA will specify how revenue will be divided among the carriers in the case when a leg(s) of a total passenger's journey is operated by the operating carrier and a leg(s) is operated by the marketing carrier. SPAs may be "gross" or "net," as defined below.

- Gross SPAs – the SPA specifies a straight-rate proration among the operating carrier and marketing carrier(s)

- Net SPAs – the SPA specifies the amount to be paid to the airline carrying the passenger on a specific leg; the amount also depends on the booking class to which the passenger is booked

A revenue settlement agreement is similar to the SPA, but possesses a broader scope. Provisions for the allotment of revenues and the payment of code-share commissions, as well as the settlement procedures are likely included in such agreements.

Code-share agreements are also subject to further regulatory scrutiny. Governments are concerned if entering into the agreement creates an unfair market position for any of the airlines involved. For instance, in 1999, the Department of Transportation in the US demanded that a CSA between Continental and Northwest could not include flights between each airline's hub airports. Additionally, regulatory authorities will closely watch airlines with existing CSAs to make sure no collusion or other anti-competitive practices exist as a result.

3 Blue Jay Tire Co

“Who said any publicity is good publicity,” wondered Pierre Beaudry, CEO of Blue Jay Tire Co (BJT). He further reflected that it was paradoxical that leaders who live during severe crises get the most press and thus the highest rankings from historians and the popular public – ministers, presidents, mayors and civil leaders. BJT was experiencing both publicity and a crisis. Pierre was confident his team would navigate the recall crisis successfully. It was not the first challenge they had faced nor would it be the last.

“How many major strategic issues can pile on at once?” thought Pierre. “We have a tire recall and union negotiations at the same time that oil prices are decreasing and minimum wage is increasing.”

Decreasing oil prices have proven to be a positive for tire sales as both consumer and commercial vehicle usage was on the rise. The industry was rife with growth, but production plants in the southern states were near capacity. BJT needs to expand their production capacity soon to support its growth. This and other labor concerns would need to be discussed with the union representatives for the new contracts. Even though the tire recall had only caused a small ripple in consumer sentiment so far, Pierre remained weary. Best to tread gently in light of recent events.

In light of the recall, Pierre knew the press would show no mercy. He knew the Board would demand change. What went wrong? They had risk governance policies, they had risk dashboards, they performed policy audits, they had training programs and they had a well-staffed risk management function. How would the crisis alter their plans and growth strategies? Before the crisis they had tough choices to make. Now the choices would be even tougher. How should he reshape their plans?

3.1 Background

Early History

The Durable Tire Corporation (also referred to as Durable) has been operating in Canada since 1920. The company has a small and loyal customer base in rural areas. The high quality product proved to be very well suited to the rugged Canadian frontier. Durable built tires for farming-related vehicles and small planes intended to be used on dirt roads or off-road on farms and small community towns. The company founders, the Eastern family, were also farmers. Durable also manufactured specialty tires sold in niche markets. The Easterns always focused on providing the best quality tires that would live up to the family name and brand.

When the family patriarch passed away in 2000, the family decided to sell its interest in the company. The company was acquired by Blue Jays Air (BJA). BJA had been one of Durable’s clients for specialty tires in small aircrafts that flew in the Northern reaches of Canada.

Under BJA Since 2001

Under BJA management, Durable Tire was re-branded for broader appeal. The BJA group felt that it could leverage the capabilities of the manufacturing process to develop a broader range of tires. The tire company re-branded within the BJA group to become Blue Jay Tire (BJT). In 2001, the BJA team initiated a 5 year plan to expand sales and its distribution reach into commercial vehicles across the USA.

The BJA management team increased its focus and oversight towards the BJT venture and its ever-improving financial results as Blue Jay's struggles worsened due to increased competition and squeezed margins.

In 2006, having successfully met and surpassed the 5 year plan objectives set out in 2001, the BJA board directed the Eagle Tire division to pursue an even more ambitious growth strategy . With funding, BJT purchased two manufacturing plants in the southern USA and re-fitted the operation with direction from their Canadian operations. An executive team under the banner of Blue Jay Tire USA (BJT-USA) was setup by the BJA board. This company operated with oversight from its Canadian head office. BJT-USA engineers were asked to set targets at double their pre-acquisition production levels or about triple the level of the Canadian manufacturing plant. At the same time, BJT introduced a tire warranty program that helped to enhance the tire sales and establish the tire brand. With a premium of about 50% of the tire costs, the warranty program provides free tire replacement for seven years from purchase date of every tire. Since inception, this tire warranty program was well received. The warranty program is currently maintained on a pay-as-you-go basis.

BJT-USA surpassed its sale targets each and every year from 2006-2015. BJT-USA, despite its size, achieved a 3rd place market position in tire sales for compact cars and small SUV vehicles in the southern U.S.A. By 2008 BJT dominated the earnings of the Blue Jays Air group. BJT in early 2014 accounted for 20% of the revenue and an astounding 43% of the profit of the Airline group. BJT management was heralded by the executive team, the board and its shareholders as the "star" of the Airline group.

Although BJT had received increased focus and scrutiny from BJA since acquisition, BJA has more recently found that disconnects continue to exist between the two companies. Consequently, BJA has prioritized additional oversight and communication towards BJT management and operations. Additionally, it is expected that BJT adopt and act in accordance with BJA's corporate vision and risk culture. BJA fully supports all BJT teams and has affected a new cultural directive to promote teamwork among the combined organization.

Financials

Detailed 4 year financial statements are shown in Appendix 3A Exhibits 1 to 3.

3.2 Risk Factors

The following risk factor excerpts are taken from the 2015 Annual Report.

Commodity Risk

Although there is a large amount of synthetic rubber used in the manufacturing process, the company still depends a great deal on natural rubber. Typically that is sourced in countries somewhat less stable than the developed world. Natural rubber production is subject to weather related risks. In the Tire Industry rubber represents 52% of total manufacturing purchases. A \$0.10 per kilogram increase in natural rubber prices would lead to an estimated \$0.5M increase in manufacturing costs.

BJT has maintained the same supplier for over 30 years. The relationship is very strong and BJT benefits from stable pricing. In the past decade BJT has achieved the lowest prices on its commodity purchases because its growth strategy has also benefited the supplier. Volume discounts have been passed on to BJT in the form of better pricing. For BJT rubber now represents only 48% of company purchases down from 60% at the start of the millennium.

Commodity risk is considered to be lower for BJT than its competitors.

Manufacturing Risk

The process of making tires involves chemicals and flammable ingredients. This poses concerns for the workers and the risk of fire is large. In addition, the size of the finished product increases the risk of worker disabilities.

A lost-time injury is defined as an occurrence that resulted in a fatality, permanent disability or time lost from work of one day/shift or more. The Lost Time Injury Frequency Rate (LTIFR), the number of lost-time injuries per million hours worked, is calculated as:

$$LTIFR = \frac{\text{Number of lost – time injuries} \times 1,000,000}{\text{Total hours worked in accounting period}}$$

Overall, the BJT manufacturing plants have reported a LTIFR of between 2.16 and 2.69 in recent years. This compares reasonably well to the industry average of 2.38. In particular, the LTIFR for the Canadian BJT plant has had best in class safety records at less than 2.0 since inter-company surveys began. In comparison, the U.S. plants have been between 2.56 to 2.99 since being acquired by BJT.

The manufacturing process had been established by the company founders and has had proven success over many decades. The same process and standards are used in both Canadian and U.S. plants. The core competences for quality assurance are in the people who manage the process and the culture of quality management is passed on within the operations team from experienced staff to new associates. Quality management is considered by Executive Management to be a grass-roots competence of the company.

Manufacturing risk is currently considered to be medium for BJT. Management's recent focus has been to return to the historical Canadian operational level of 1.92. A program recently implemented invites retired Canadian and former BJT plant operators to conduct quality management training for existing staff.

Labor Risk

Tire manufacturing plants typically have unionized labor forces. The company might face contentious labor issues in a number of manufacturing plants with unionized labor.

Historically the Canadian operation has not had unionized labor. However, 50% of the employees working in the two U.S. plants are Union members. The current Union contract expires in 2016. After normalizing for standard of living differentials and exchange rates between geographical locations, the labor cost in the Canadian operation is 35% lower than similar operations in the U.S.

There has not been any disruption in the workforce at any plants. Labor risk is currently considered by Executive Management to be low. However, the number of staff that elect for Union representation has been increasing.

Legal Risk

The possibility of class-action lawsuits exists, particularly in the US. A large risk stems from the chances of paying out large claims and/or having wide-spread product recalls. BJT has not experienced any litigation action in its history.

Distributor Risk

BJT sells almost all its tires through independent distributors. BJT has long standing relationships with several Canadian car dealerships as their sole or primary tire supplier.

Insurance Risk

The key risks in a tire operation are product liability and product recall. Some companies use a captive insurance company to handle this exposure. Historically BJT has retained its risks. The board has requested a feasibility report to examine the solution to effectively mitigate this exposure.

Environmental Risk

Tires are an easy target for environmental groups. Billions of tires are produced each year and billions are discarded. The materials to produce tires and the manufacturing process can be the subject of environmental concerns. BJT maintains a recycling plant for the rubber in its discarded tires. This plant is only able to support operations in Canada due partly to subsidies available from the Canadian government. Efforts in the U.S. for a similar plant are not likely to be economical. Environmental risk is considered to be low due to operation size and overall market share.

Economic Risk

The number of miles driven has a large impact on the demand for tires. The state of the world economy has a direct impact on the company’s ability to grow and expand. BJT has chosen to target compact cars and small SUVs which experienced increased sales during the financial crisis (2008 – 2010). It was anticipated that the increased gasoline prices would continue the trend towards the small vehicles. This strategy was proven to be effective as a counter-cyclical impact on sales. BJT experienced market share growth from 5% to 8% during the financial crisis. However, with recent volatility in gasoline prices, it is difficult to anticipate whether such trend will continue.

Overall, economic risk for BJT is considered medium.

Reputational Risk

One of the company’s primary strengths is its brand name. BJT must constantly assure that its products are of the highest quality and invest in research & development to continually improve its products. BJT has growing brand awareness within the U.S. market. BJT uses social media monitoring tools to assess its brand awareness. Brand awareness is considered to be a critical determinant of BJT’s growing presence in its chosen target market. BJT monitors 5 media channels (e.g. newspapers, television stations and websites) for their positive/negative ratio.

| Media channel | Positive/negative ratio |
|--------------------------------|--------------------------------|
| Blog | 1.5 |
| Internet Forum | 2.7 |
| Newspaper | 1.9 |
| Online newspaper | 1.7 |
| Associated Press (AP) Newswire | 3.2 |
| All media combined | 2.2 |

If the outlier of 3.2 corresponding to the AP Newswire is omitted, then the average positive/negative ratio is 2.0 with a standard deviation of 0.4. Pro-BJT information is generally about twice as persuasive as con-BJT messages. The ratio has grown from 1.8 to 2.2 since BJT began monitoring its brand. This is held to be a sign of BJT’s growing reputation in its chosen market. Reputational risk is considered to be low.

Political Risk

The company is exposed to political risk through import/export quotas and price controls. The North American Free Trade Agreement (NAFTA) between U.S.A., Canada and Mexico gave birth to the U.S. operations of BJT. BJT is exposed to future changes in this agreement. During the crisis, U.S. interest lobby groups demanded stronger nationalist policies. There continues to be strong political support for NAFTA, in the current US administration. However, when political leadership is to change in the U.S. and the poor economic growth to persist, NAFTA might be revisited.

The supply chain is also exposed to political risk due to the geographical location of the suppliers which are primarily in Malaysia.

In addition, BJT faces the risk that states within the U.S. may repeal right-to-work laws (see section 3.5.) As of 2016, a right-to-work law exists in Alabama and Georgia, but does not exist in the state of New York.

Political risk is considered a medium risk for BJT as a small Canadian firm operating in the U.S..

Currency Risk

Manufacturing costs and the revenue generated are in different currencies resulting in a possible loss. BJT Canadian operations and sales are in Canadian dollars and the U.S. operations and sales are in U.S. dollars. 85% of the raw materials are sourced from Malaysia.

3.3 Recall

Recent Tire Recall Issue

Below are the headline news and a series of emails uncovered by the investigative journalist that led to the recent tire recall.

Blue Jay Tire quality or quantity, you decide by Jennifer Truth

Smallville, Arizona (Associated Press – August 2nd 2015): The Blue Jay Tire Co (BJT) reported in May 2015 that a tire defect which caused a single car accident was an isolated incident. Pierre Beaudry, CEO, issued a statement saying “Blue Jay Tire has a long history of manufacturing excellence but on behalf of our employees we extend our condolences to the Franklin family for their loss. We regret that a BJT tire was responsible for this accident. On behalf of our engineers, line managers and production team, I can assure the Franklin and any family in the USA that we do everything in our power to ensure our tires are the highest quality on the road”.

The tire involved on the day in May, was the RU42WD model. Over 40 million of these tires have been sold in the USA. The official report on the accident disclosed that the defective tires exploded causing a sudden loss of driver control.

In July, this reporter uncovered a number of email record related to RU42WD tires in BJT’s manufacturing process.

In an email dated Aug 8th 2013, the BJT (Canada) head engineer, Paul Gosling indicated reservation with the speed of the production line resulting in uneven rubber density to a BJT (USA) executive, Jack Tavares. The follow up responses indicate that some corrective action was taken to redress the situation. When contacted, the BJT (USA) head engineer, Chris Carpenter, at the time reported to this paper: “The production process always ran within its design limits. But

we did notice tire density variations. We never did test the possible impact of low density tires on automobiles travelling at speed. Instead we relied on the fact that the tire thread wear tests were always within the tolerances commonly used by all tire companies at the time". Chris Carpenter now works for a rival firm.

BJT (USA) refused to comment when contacted about these internal memos and the comments of Mr. Carpenter.

Below are series of emails that were uncovered by AP journalists:

From: Paul Gosling
To: Jack Tavares
Date: August 8, 2013
Subject: Sticky valves and rubber density on tires

Jack –

After visiting ET-USA plant, I did not feel that enough Quality Assurance is in place. In general, I think production is too fast to match demand and not enough checks are being made. Specifically, I have noticed two items: sticky valves on model RU42WR and uneven rubber density on RU42WD. I recommend the line managers to monitor these issues more closely and to tighten the allowed defects – even though this may slow production – so as to correct these issues. Although the valve is more of a nuisance, the density is more of a safety issue, but to be clear, the low density areas are still within prescribed density limits – there are just some noticeable variations within the tires.

I will keep you posted.

Paul Gosling
Head Engineer
Blue Jay Tire (Canada)

From: Jack Tavares
To: Paul Gosling
Date: August 12, 2013
Subject: RE: Sticky valves and rubber density on tires

Paul

Good catch – I will follow up with Chris regarding both RU42WR and RU42WD.
Hope you enjoyed your visit!

Jack Tavares
Chief Risk Officer
Blue Jay Tire (USA)

From: Chris Carpenter

To: Jack Tavares
Date: September 9, 2013
Subject: Tire production

Jack

This is to summarize our calls over the past month.

I think we have both issues solved: as I mentioned on the phone, the sticky values on RU42WR were easily fixed by increasing the lubricant on the silicon machine. RU42WD required more effort and took longer. We discovered a small inconsistency on the centrifuge console. My staff recalibrated it and we have eliminated the density issue. We also increased our spec inspections from 1 in 200 to 1 in 20 until we were confident the fix took.

We are back up to regular production levels again. We are actually considering increasing the product speed.

Thanks again,

Chris Carpenter
Head Engineer
Blue Jay Tire (USA)

3.4 Production Expansion Committee

The Production Expansion Committee was formed in 2006 by BJA as a part of Eagle Tire's ambitious growth strategy. The team has consisted of the same five members since inception, all of whom are employees of BJT-USA. Oversight of the committee became the responsibility of the president of Eagle Tire, since the division was most affected by the committee's decisions. The reporting structure has also not changed since inception, and there remains no direct tie between the committee and BJA.

The committee experienced quick success as it was able to select and purchase the two manufacturing plants, and initiate and transfer the re-fitting process to the Canadian operations. During the selection period, Jack Tavares immediately became their natural leader, and the other four team members found it comfortable to get behind his direction in order to expand Eagle Tire's production capabilities. Moreover, after the acquisition of the first plant in Montgomery, Alabama, the committee found themselves engaging in a very cohesive manner. The purchase of the second plant in Macon, Georgia occurred within a few months of the first.

Since the early successes, the committee had more of a monitoring type of role, meeting only on occasion. They have been responsible observing, from a high level, whether the two plants have met the needs of BJT-USA as anticipated. Overall, the plants have operated without major incident and have yet to reach capacity. More importantly, the committee is responsible for

monitoring potential plants available for purchase or lease that would be a good fit for BJT, should the need arise. Overall, the amount of work contributed by the committee has been limited, thus the need for more infrequent meetings. However, these meetings have eventually begun to be dominated by Jack Tavares. For the past three years, Jack has set the committee's agenda, has individually interpreted the information supplied by the other team members, and has essentially dictated the leading potential plants to the rest of the team. The other team members have shown no real resistance to this, because they have felt great and sincere respect for him, and they credit him with making the two early plant purchases successful. Senior Management of Eagle Tire has shown no concern for these developments.

In October of 2015, the Production Expansion Committee received word that a third plant was to be purchased and re-fitted by the first quarter of 2017. This plant would be used by Eagle Tire as well as other divisions within BJT, but production out of this plant was expected to be very limited in the first year or two. The committee quickly expanded the due diligence work on their top two prospective plants, one in Mobile, Alabama and one in Buffalo, New York. Either would be for purchase.

3.5 Right-To-Work Law

Right-to-work laws are laws in many U.S. states intended to provide employees the right to work without an obligation of joining a union and without an obligation to pay for any portion of the cost of union representation. Although such laws have not been listed under U.S. labor and employment laws, they have been operational with local employment hearing judges for many years. Moreover, these laws are allowed under the 1947 federal Taft-Hartley Act. A distinction may exist within these laws between those persons employed by state and municipal governments and those employed in the private sector, and whether or not the law shall apply to both groups.

Right-to-work laws or constitutional provisions currently exist in 26 U.S. states, mostly in southern, western, and certain Midwestern states. These include Georgia and Alabama in the south, Nevada and Arizona in the west, and Indiana and Iowa in the Midwest. Business interests represented by the United States Chamber of Commerce have lobbied considerably to bring about right-to-work legislation.

3A Blue Jay Tire Exhibits

EXHIBIT 1

Blue Jay Tire Corporation

NON-CONSOLIDATED STATEMENTS OF OPERATIONS (US Dollars in millions)

| FISCAL YEAR ending 12/31/YYYY | 2015 | 2014 | 2013 | 2012 |
|------------------------------------------------------------|------------|------------|------------|------------|
| Total Gross Sales | 277 | 259 | 242 | 230 |
| Cost of Sales (1) | | | | |
| Cost of Raw Materials | (14) | (13) | (12) | (12) |
| Production Costs (2) | (28) | (26) | (24) | (23) |
| Depreciation & Amortization | (20) | (20) | (20) | (5) |
| Shipping Costs | (5) | (4) | (3) | (3) |
| Other | (6) | (7) | (8) | (4) |
| Total Costs of Sales | (73) | (70) | (67) | (47) |
| Net Revenue | 204 | 189 | 175 | 183 |
| Operating Expenses | | | | |
| Research Development | 22 | 23 | 24 | 25 |
| Selling General & Administrative (3) | 43 | 40 | 37 | 35 |
| Non-Recurring (4) | 66 | 23 | 27 | 17 |
| Foreign Exchange Gain(Loss) | (8) | (10) | 20 | 14 |
| Other (5) | 50 | 80 | 27 | 10 |
| Total Operating Expenses | 173 | 156 | 135 | 101 |
| Operating Income or Loss | 31 | 33 | 40 | 82 |
| Income from Other Revenue and Continuing Operations | | | | |
| Other Revenue – Warranty program | 69 | 65 | 61 | 58 |
| Other Revenue – Book Sales | 9 | 8 | 7 | 5 |
| Tire Replacement Expenses | (35) | (32) | (30) | (29) |
| Total Other Income/Expenses Net (6) | 43 | 41 | 38 | 34 |
| Earnings Before Interest & Taxes | 74 | 74 | 78 | 116 |
| Interest Expenses | 28 | 28 | 24 | 18 |
| Income Before Taxes | 46 | 46 | 54 | 98 |
| Income Taxes | 9 | 9 | 11 | 20 |
| Net Income from Continuing Ops | 37 | 37 | 43 | 78 |

Notes:

- (1) Includes cost of material & production with overhead
- (2) Includes salaries & overheads directly related to production
- (3) Includes salaries other than production related
- (4) Includes operational process upgrades
- (5) Predominantly injury claims
- (6) Performance of the tire warranty program and Sales from travel & restaurant guide books

EXHIBIT 2

Blue Jay Tire Corporation

NON-CONSOLIDATED STATEMENT OF FINANCIAL POSITION (US Dollars in millions)

| FISCAL YEAR ending 12/31/YYYY | 2015 | 2014 | 2013 | 2012 |
|-------------------------------------|--------------|--------------|--------------|--------------|
| ASSETS | | | | |
| Current Assets | | | | |
| Cash and Cash Equivalents | 50 | 57 | 52 | 49 |
| Short Term Investments | 80 | 84 | 89 | 111 |
| Receivables | 23 | 11 | 9 | 4 |
| Inventory | 53 | 58 | 48 | 37 |
| Total Current Assets | 206 | 210 | 198 | 201 |
| Long Term Investments | 1,100 | 1,109 | 1,004 | 940 |
| Property Plant and Equipment | 140 | 160 | 180 | 50 |
| Accumulated Amortization | 40 | - | - | - |
| Intangible Assets | 25 | 25 | 25 | 5 |
| Other Assets | 68 | 42 | 33 | 53 |
| TOTAL ASSETS | 1,579 | 1,546 | 1,440 | 1,249 |
| LIABILITIES and EQUITY | | | | |
| Current Liabilities | | | | |
| Accounts payable | 4 | 4 | 2 | 2 |
| Short/Current Term Debt | 5 | 5 | 5 | - |
| Other Current Liabilities | 4 | 3 | 3 | 2 |
| Total Current Liabilities | 13 | 12 | 10 | 4 |
| Long Term Debt | 457 | 465 | 380 | 250 |
| Other Liabilities | 35 | 32 | 30 | 18 |
| TOTAL LIABILITIES | 505 | 509 | 420 | 272 |
| Equity | | | | |
| Retained Earnings | 1,044 | 1007 | 970 | 927 |
| Capital | 50 | 50 | 50 | 50 |
| TOTAL EQUITY | 1,094 | 1,057 | 1,020 | 977 |
| TOTAL LIABILITIES and EQUITY | 1,579 | 1,546 | 1,440 | 1,249 |

EXHIBIT 3
Blue Jay Tire Corporation
NON-CONSOLIDATED STATEMENT OF CASH FLOW (US Dollars in millions)

| FISCAL YEAR ending 12/31/YYYY | 2015 | 2014 | 2013 | 2012 |
|----------------------------------------------------------------|-------------|--------------|--------------|--------------|
| Net Income | 37 | 37 | 43 | 78 |
| Operating Activities, Cash Flows Provided By or Used In | | | | |
| Depreciation | 20 | 20 | 20 | 5 |
| Amortization of deferred expenses | 20 | 0 | 0 | 0 |
| Adjustments To Net Income: | | | | |
| Changes In Accounts Receivables | (12) | (2) | (5) | (1) |
| Changes In Liabilities/Account Payables | 1 | 1 | 1 | (4) |
| Changes In Inventories | 4 | (9) | (11) | 3 |
| Changes In Other Operating Activities | (60) | 0 | 0 | 0 |
| Total Cash Flow From Operating Activities | 10 | 47 | 48 | 81 |
| Investing Activities, Cash Flows Provided By or Used In | | | | |
| Capital Expenditures | 0 | 0 | (170) | (10) |
| Investments | 3 | 6 | 22 | (91) |
| Foreign exchange gain(loss) | 0 | 0 | 0 | (2) |
| Other Cash flows from Investing Activities | (17) | (114) | (44) | 0 |
| Total Cash Flow From Investing Activities | (14) | (108) | (192) | (103) |
| Financing Activities, Cash Flows Provided By or Used In | | | | |
| Dividends Paid | 0 | 0 | 0 | 0 |
| Sale Purchase of Stock | 0 | 0 | 0 | 0 |
| Net Borrowings | (8) | 85 | 135 | 22 |
| Other Cash Flows from Financing Activities | 5 | 2 | 14 | 5 |
| Total Cash Flow From Financing Activities | (3) | 87 | 149 | 27 |
| Cash & cash equivalents, beginning of year | 57 | 52 | 49 | 42 |
| Cash & cash equivalents, end of year | 50 | 57 | 52 | 49 |
| Change In Cash and Cash Equivalents | -7 | 5 | 3 | 7 |

4 Frenz Corporation

David Gillet, CEO, was looking forward to seeing the traveling show *Les Misérables* in a few weeks. He associated the musical and its worldwide success with the success of Frenz and his own career. He had first seen the musical a few months after it opened on the West End in 1985 shortly after joining Frenz. David recalled, “In our early days what we we're doing was new - specialty coffee for the worker on the move. We've always been in front of the curve – we were early pioneers of store Wi-Fi. Our customers were on the move via the internet. With each passing year competition gets fiercer. Each success is copied. We are expanding globally and expanding product lines but our competition is moving into our markets.”

David wanted to accelerate Frenz's expansion. His perspective on future growth was global. How well did Frenz's advantages travel globally? What was the best way to grow especially in the emerging markets? Frenz had an opportunity to secure its supply of coffee beans to fuel its growth. He wanted to increase the rate of new store openings and entered new countries. He was concerned about which geographic regions, whether stores should be franchisee developed or company owned. He wanted to expand product offerings. Frenz had a number of products in trial markets and cities. Which products should be expanded within a country, a region or globally? How many variations? Should they be the same globally or customized for local tastes? He wanted to increase brand recognition and increase customer traffic especially in recently entered countries. What was the most effective means of marketing and how should marketing costs be allocated? How should Frenz leverage its relationship with other sister companies in promoting its brand through other channels?

Existing stores generated cash. Opening new stores was capital intensive. How would Frenz fund growth? What were the risks associated with franchising? How do Frenz manage the licensees? Could Frenz continue to be choosy about site selection and new managers? Would corporate support and quality or service suffer with rapid expansion and new locales? New products had lower profit margins. Should they have promotional sales discounts upon introduction? Would new products sabotage sales of higher margin products? High unemployment and high gas prices had hindered sales and growth. Was this the new norm? The competitors were offering products at lower price points. How should Frenz respond? With expansion of the digital world, how would Frenz tackle this new market? Should Frenz expand and invest in its digital technology which would take away resources and capital from its core business? The parent company, RPPC Dynasty wanted a global risk management framework for all its subsidiaries. How did Frenz fit in this framework? Was the current global funding allocation from RPPC Dynasty adequate for the future growth of Frenz? Should Frenz continue to rely on debt to fund its growth or request more equity investment from RPPC? Would capital be an issue with Frenz's expansion plan?

4.1 Background

Frenz Corporation (also referred to as Frenz) is a wholly owned subsidiary of RPPC Dynasty, incorporated in Belgium. It is a global premier roaster, marketer and retailer of specialty coffee in the European and American countries. It has operations in most major cities of Europe and America, including all developed countries and some developing countries. Other than company-operated stores, Frenz also sells a variety of coffee and tea products and licenses its trademarks through many other channels such as franchises, groceries, private clubs, hotels, cruise ships and national foodservice accounts.

Frenz is one of the most recognized and respected brand in the “premier” coffee houses as well as household brand in the developed world. Its main competitors in the coffee houses market include Starbucks, McDonald’s, Douwe Egberts, Delta Cafés, Genovese Coffee and Markus Coffee. Its household brand’s main competitors include Nescafé, Folgers, Maxwell House, Jacobs, Douwe Egberts and Starbucks. Two aspects of its main objective is to maintain its competitive standing and to continue its disciplined expansion of the store base, primarily focused on growth in developing countries.

Mission Statement

Frenz’s mission statement is:

One person, one cup, one community, one world. We care about our family.

This mission statement focuses on our objective of being the most recognizable coffee brand in the world.

Board of Directors

Frenz’s Board consists of eight members. Three board members are Chief Executive Officers or Board Chairmen in leading public companies in Belgium, two are Board members of RPPC Dynasty and the remaining Board members are executive officers of Frenz.

In recent years RPPC Dynasty has adopted a global company risk management mandate in order to ensure consistent and unified risk management policies, strategies and processes among the conglomerate groups of companies. In response to the new risk management strategy, Frenz’s Board hired an experienced Chief Risk Officer, Robert Kaplan, to develop the risk management strategies for Frenz and to ensure that these strategies fit in RPPC Dynasty’s global risk management mandate. Robert Kaplan’s responsibilities include proper integration of risk management strategies and policies with the global strategies and policies, smooth and controlled implementation of these strategies and cultivation of an acceptable risk management culture for Frenz facilitating its ultimate goal of becoming the top coffee company in the world.

With this new mandate the Board members have some disagreements as to which Board Committee should be given the responsibility of overseeing the work of Robert Kaplan. Some Board members believe that the Audit Committee’s role should be expanded to oversee this new risk management mandate. Some Board Committee members believe that this new mandate involves significant strategic changes and should be the Executive Committee’s role. Some

believe that it should be the role of Related Party and Conduct Review Committee Role's as the strategies will involve significant related party transactions. The Board of Directors has requested Robert Kaplan consult with Ms. Julia Reich – RPPC Dynasty CRO and provide a recommendation.

Market Strategies

Frenz is dominant in the high-end specialty coffee market especially through its premier coffee house outlets which have over a 40% market share in Europe. However, its market shares in North America, Latin America, developing countries and household coffee constitute only about 18%, 11%, 5% and 16% respectively. There is significant growth potential in these countries where the customer base is still expanding and represents a chance to increase market share without the pressure to take customers from competitors. Frenz's current market strategies are as follows:

- Continue its dominant market position in the coffee houses by organic expansion of its company-operated coffee houses in the developed countries through building more of these company-operated coffee houses in financial districts and high socio-economic areas;
- Further nurture relationships with and loyalty from other distributors such as high-end hotels, private clubs, universities, cruise-liners and upscale grocery and retail outlets such as bookstores and department stores;
- Expand into more developing countries through acquisition of local coffee house chains, franchising and organic growth into more cities and financial districts of the developing countries especially the fast growing Asian market;
- Target local advertising in certain countries to expand its household brand recognition as well as more endorsements with certain significant events such as the World Cup, the Olympics, the World Exhibition and events of regional significance;
- Maintain a significant budget devoted to Frenz's renowned marketing capability which due to investments over many years has achieved significant economies of scale;
- Further enhance the company's ability to quickly develop and roll out new and innovative products which helps defend against potential coffee substitutes as well as serving to further differentiate Frenz from its competitors;
- Expand and build the brand's digital presence and enhance analytics to better understand customer preferences and profiles.

Frenz is also exploring vertical integration by owning and controlling its sources of key ingredients such as coffee beans plantations and tea plantations in order to enhance its quality control as well as developing its own niche products.

Risk Profiles

Frenz faces significant supply-chain risks such as commodity price risks and shipping costs and demand risks such as significant competitive pressures and change in consumer markets. It also faces operation risks, litigation and reputational risks and other market risks which include foreign currency exchange risk, equity security prices, and interest rates. It also faces staff

turnover, litigation and reputational risks. Each of these risks is described in detail in Appendix 4A.

Financial Statements

Detailed financial statements are shown in Exhibits 1 and 2.

4.2 Growth

Growth is never easy as the following examples of external and internal growth pains illustrated.

External Challenges

During the financial crisis in 2008 Frenz suffered significant losses due to reduced market demand as well as significant investment losses. Some Board members were unhappy with the geographical market concentration which caused Frenz's losses.

Today, the Marketing Vice President, Anthony Pirot, is being empowered to implement the recent market strategic goals set by the Board. Anthony Pirot's first priority is to expand into the fast growing Asian market. Anthony Pirot currently leads a team of twenty experienced and mature marketing staff whose experience is predominantly targeting the higher socio-economic clientele in the developed countries in Europe and United States.

This expansion strategy will require significant capital. The new Chief Risk Officer, Robert Kaplan, is uneasy with the expansion strategy as cash flow in Frenz will greatly be strained without additional debt financing which in turn increases the Company's leverage ratio above the conglomerate mandated threshold.

In addition Anthony is expanding its product lines such as the super-premium coffee market and bubble teas and specialty fruit and mixed coffee and tea drinks that have given Frenz a reputation as a product innovator in the market. To this end Frenz is exploring offering coffee made from exotic coffee beans and special tea leaves. There are very few areas that can produce such high-quality premium coffee beans. The best coffee beans are from Costa Rica - the *Finca Palmilera* but they are very expensive.

Digital Strategy

Frenz is dedicated to maintaining its renowned marketing capabilities, and reputation as an innovator in the industry. Given the increasing prevalence of technology as a preferred medium for communication and commerce, Frenz has launched a Digital Strategy Group (DSG) with the goals of:

- Building the brand's digital presence
- Using analytics to understand customer preferences
- Enhancing customer experience with technology

- Reaffirming Frenz’s origins as the “specialty coffee for the worker on the move”

A Frenz smartphone app is under development, with the following features under consideration:

- GPS-enabled search to find the closest Frenz Coffee House. The DSG is contemplating a partnership with an existing GPS location provider (e.g., Google Maps) and would overlay a Frenz-branded interface. Users can check-in to a particular location and share through various social media platforms.
- Full menu browsing complete with pricing and nutritional information.
- Payment capabilities both through prepaid digital gift cards and charging a stored credit card directly. With respect to charging a credit card, the DSG is contemplating leveraging existing digital payment options (e.g., Apple Pay) or storing credit card information directly within the app.
- Purchase history automatically recorded when in-app payment is used. Users can share recent purchases through various social media platforms.
- Loyalty program to reward frequent customers with exclusive promotions (e.g., every 10th coffee is free). Additional loyalty reward points would be credited for other activities (e.g., signing up a friend to the app).

An app of this scope is not currently being offered by any of Frenz’s competitors; however, various features described above have been rolled-out by other market participants.

The DSG is particularly interested in the customer data that will be collected through this app. The data architecture and information security is being developed, and Frenz recently hired Bill Arima, an acclaimed data scientist from Silicon Valley, to get their predictive modeling capabilities up and running as soon as possible. Bill’s team has already demonstrated promising results using data collected from beta versions of the app. Frenz is currently seeking a Chief Data Officer to ensure proper data governance.

This strategy is a costly undertaking for Frenz and will be diverting capital away from its core business.

Overhead Allocation

Jeff Bemowski, Frenz Division head of Non-Coffee Product Marketing slunk down in the guest chair in the office of Kitty Dunn, Frenz’s Chief Accounting Officer.

“You are killing me with your overhead,” Bemowski begins.

“I’m not sure what you mean,” replies Dunn. “Our policy for allocating corporate overhead is pretty straight forward and hasn’t changed in several years. Overhead costs such as corporate advertising, executive salaries, the rent on this home office building, and so on are accumulated. Then that bucket of corporate overhead is spread over all sales on a uniform basis.”

“That’s exactly the problem!” retorts Bemowski. “I think we need to change and we need to change it now before.....”

“Wait a minute,” says Dunn. “We have worked very hard to keep our overall corporate overhead under control. In fact, corporate overhead has increased at only a 5% rate per year over the last five years. That’s at a time when the company has grown by over 250% in those same five years. Every summer, we review the overhead allocation ratio and, well, with all our growth, it has gone down every year.”

“I know that,” responds Bemowski. “What I’m talking about is HOW corporate overhead is allocated. Look, a big part of my bonus is dependent on the profitability of Frenz’ non-coffee products. You know, the music CDs, greeting cards, coffee cups, etc. that we sell. I’ve been pushing our store managers to move these products but your allocation method for corporate overhead disguises the true profitability of my part of the operation.”

“Well it is a zero sum game. The overhead is the overhead and it all has to be allocated somewhere,” replied Dunn.

“Yeah but a CD costs more than a cup of coffee,” argued Bemowski. “When Frenz does something like run a commercial, we are advertising the whole brand. We want to get customers to come into our stores to have the whole Frenz experience. We get them to come in to our store regularly for coffee. Eventually, they may buy our other products in addition to their coffee. Why should the one CD be saddled with more overhead than all those cups of coffee? It just feels wrong to me!”

“Again,” began Dunn, “each product gets an allocation of corporate overhead based on its standard price. That keeps it the same from market to market, where prices might be different and it negates the impact of sales and discounts on items. That seems like a fair system to me but if you don’t want to do it that way, what would you suggest?”

“Well I believe our model is that each store is a profit center,” says Bemowski. We tell our store managers that corporate supports them but once they are part of the Frenz family, they can make their shop as profitable as they want it to be. The upside is unlimited, their hard work will pay off.”

“Wait,” interjects Dunn. “There are rules for how the stores must be set up and how the product is displayed. Not to mention quality...”

“I know all that,” Bemowski cut in. “But we are allocating overhead in a way that punishes our most successful store managers. Take that corporate overhead and allocate it as \$X per store. Corporate supports the store; the store manager is the one who determines how much business the store does.” Better yet, allocate Corporate overhead to each store based on smoothed, budget amounts. That way each store manager knows just how much Corporate overhead he has to cover in his store at the start of the year.”

“I suppose we could look at it,” concedes Dunn. “We have most of the data and we could collect some.....”

“You financial-types always want more data. You are afraid to make a decision! It is obvious, change and you are going to get a better look at what stores are on top and which are on the bottom,” sputtered Bemowski. “And you will see how important my non-coffee products are to making those top stores, top stores. I can feel it in my bones; you need to get on board or get out of the way.”

“We are most certainly not going to change anything without studying it first,” responded Dunn calmly, “and there are channels to go through making any expense allocation change. We need to weigh the pros and cons.”

“You can’t save your way to greatness,” said Bemowski getting up and heading toward the door. “Call me when this company is serious about making real money.”

And with that, Bemowski was gone. Dunn rubbed her temples. “Marketing,” she murmured under her breath.

4.3 Market Trend

Specialty brews boost coffee sales in Canada

Coffee, Canada’s go-to drink, has become a multi-billion-dollar industry spurred on by increasingly adventurous consumers looking for new taste challenges

Innovation is driving the growth of Canada’s \$6.2-billion coffee industry with specialty coffees, new preparation methods and technology helping lift sales to new heights, according to Lesya Balych-Cooper, president of the Coffee Association of Canada (CAC).

The most popular beverage among adult Canadians, who drink an average 3.2 cups of coffee a day, the sector is a favourite with that most desirable demographic, the millennials.

Ms. Balych-Cooper says the 2016 CAC Coffee Trends survey shows the number of 18- to 24-year-olds who said they drank coffee ‘yesterday’ is up from 38 per cent in 2008 to 58 per cent in 2016.

“That’s 20 points: it’s huge,” she adds.

While traditional or brewed coffee is most likely to be consumed by people between 65 and 79 years old, sales of specialty coffee have grown from 13 per cent in 2013 to 19 per cent in 2016.

“Those six points are a very relevant growth indicator,” says Ms. Balych-Cooper. “It’s attributable mainly to millennials. According to our surveys, we know that more and more [18- to 34-year-olds] drink espresso, iced, frozen and branded coffee drinks than those people who are 35 and older.”

The numbers also show a 3 per cent increase, from 2015 to 2016, of cold speciality coffee compared to hot specialty coffee. Nitro brewing, an innovative preparation method that infuses

cold brewed coffee with tasteless, odourless nitrogen gas to produce a smooth beverage with a creamy texture, is a trendsetter in this category.

While Canada recorded the fastest sustained growth of the traditional importing markets for coffee (North America, Europe and Japan) over the past decade, sustaining and boosting the industry requires that companies understand their consumers. “Many millennials will make choices about where they go in terms of how they can experience their coffee, and even when they choose a traditional way of experiencing coffee, they may want to have a coffee that is grown in a fair trade environment.

“Today’s consumers are engaged in a conversation about ethics, technology and sustainability. It’s a much more intellectual conversation about a cup of coffee that overlays the drinking of the coffee,” says Ms. Balych-Cooper.

Historically the industry has understood the journey from the farm gate to the consumers’ lips.

“That aperture has been widened now. People want to know more than just the farm gate. They want to know what’s happening on the farm. What is it doing to the people that work there? What is it doing to the environment? They don’t just want to know what it tastes like,” she adds.

Ms. Balych-Cooper says almost a quarter of the people surveyed say that they want to know that the coffee beans are grown on farms that treat their workers well. They also want to know if the companies buying the beans support the communities where the coffee is grown.

“These are all things that might make millennials, or anybody for that matter, choose a particular coffee experience. Some might buy just to support growers in certain countries. It’s a much deeper conversation.”

Meanwhile, innovation is also increasing sales of coffee in grocery stores, says Robert Carter, executive director, foodservice at market research firm NPD Group.

While the CAC Coffee Trends survey showed that seven out of 10 cups of coffee are consumed at home, Mr. Carter says the once ubiquitous drip coffee maker is being challenged by the single-cup pod system coffee machines. He says this trend is fuelling the purchase of pods, a more expensive option than traditional packaged coffee.

Mr. Carter says convenience is the major reason Canadians are embracing the system.

“It’s more convenient to brew a single cup rather than brew a whole pot of coffee. The easier you make a process the more consumers will respond,” he adds. The selection and variety of coffee available in pods is also boosting sales.

“But the millennial cohort is very concerned about their food and beverages, and the pods are not recyclable. The industry will have to deal with this barrier to growth, and I anticipate that in the next 24 months they will have resolved it,” he says.

And while the pods, with their higher price point than traditional packaged coffee, are also good news for grocery stores, they face a challenge from that great disruptor, the Internet.

“The pods are easy to deliver, so buying them online is an attractive and less expensive option,” Mr. Carter points out.

The CAC notes that coffee in the food service industry (any place where coffee outside the home is served) is worth \$4.8 billion a year.

Restaurants may have been ahead of the trend in the specialty coffee category with their decades-old menu offerings of post-dinner drinks like Irish Coffee and Café Amaretto. Ian Tostenson, president and CEO of the BC Restaurant and Food Services Association, says fine

dining restaurants in particular have the opportunity to benefit from the growing appetite for specialty coffee. “It is a good profit centre for restaurants; it absolutely ups the average check,” he adds.

Ms. Balych-Cooper says a break to enjoy a cup of coffee is one of the simpler pleasures in a busy day. “Whether you want to call it an indulgence or just a rest, it gives that little moment of pleasure. It’s wonderful to have that pause to enjoy it.”

Smart coffee

Canadians drink a lot of coffee – two thirds of adults consume at least one cup a day – but despite the proliferation of coffee shops across the country, seven out of 10 cups are enjoyed at home, according to the Coffee Association of Canada. And now coffee just got a whole lot smarter: you can create and brew your favourite drink via a Bluetooth connected app on your tablet or smartphone.

More than 30 years ago, Italy-based Saeco introduced the first fully automatic coffee machine, and now the company has rolled out another industry leader with the first consumer Bluetooth espresso machine.

“The GranBaristo Avanti and its app offer an easy way for consumers to customize every detail of their drink,” says Nadège Vergura, senior marketing manager, Saeco, Philips Canada. She says Saeco continually invests in research and development to improve its technology and designs, and the Saeco GranBaristo Avanti is the company’s most high-tech coffee machine.

“It gives you the ability to make espresso-based drinks and long American coffee by automatically lowering the pressure from 15 bars to two bars depending on the drink you choose. Every drink can be fully customized through the user interface or through its app. We are putting the power in the hands of the consumer,” she says.

There are many variables to making that perfect cup of coffee. Exceptional beans and pure water are essential. Fair trade, organic or other certifications from growers often impact the choice of coffee beans.

“The Saeco Adapting System ensures that any Saeco machine will continuously learn and adapt to the bean the consumer chooses, ensuring the perfect espresso and the perfect crema every time,” says Ms. Vergura.

Coffee connoisseurs also consider the coarseness of the grind, the temperature of the coffee and the froth of the milk when making latte macchiato and other speciality espresso-based drinks like a cappuccino.

The GranBaristo Avanti enables all these choices and can store preferences for six different drinks, memorizing length, strength and temperature for each. The Latte Perfetto technology adds that extra luxury touch: the milk carafe froths the milk twice, then pours a creamy layer into the cup.

“The app is fun when you’re entertaining. You can see the drink you are making and adjust the amount of milk and coffee. Your guests can choose from 18 drinks and place an ‘order’ right in the app, allowing each guest to customize their own coffee. The app will queue them for you. It’s very visual and fun to play with the coffee and milk levels and see your coffee right on your screen,” adds Ms. Vergura.

The GranBaristo Avanti has been completely redesigned to present a much smaller footprint than traditional Saeco coffee machines, and the new brew group is easier to clean.

“It has a stainless steel finish and a contemporary design that looks beautiful in any kitchen, and we test every single machine before it is packaged and shipped, to ensure top quality,” says Ms. Vergura.

Innovation, quality and customer experience

When it comes to serving coffee, Starbucks keeps human connection at the forefront when making business decisions. With 1,400 stores across the country, Starbucks is one of Canada’s most familiar brands, but its success is driven by far more than its size, says Peter Furnish, vice president of marketing and category, Starbucks Canada.

In a rapidly evolving market, maintaining a competitive edge takes more than simply expanding the market.

“Our ability to deliver leading coffee and digital innovation, utmost quality and a remarkable customer experience is unmatched,” he says. “We strive to create a space of warmth for our customers as they’re welcomed by an engaging barista skilled in making handcrafted customized beverages, which creates a really special experience.”

For example, Starbucks’ latest offering, Blonde Espresso Roast launched this week, provides Canadian customers with two distinct choices of espresso for the first time.

Blonde Espresso is a lighter roasted blend with a smooth and sweet flavour profile that is truly differentiated from Espresso Roast, explains Mr. Furnish.

“Blonde Espresso Roast, with its complexity and depth of flavour, will provide a new option to our current espresso customers and bring along a new generation of coffee drinkers as they adopt less- sweet, more coffee-forward beverages,” he says. “It also unlocks endless possibilities for customers to experience their favourite beverages in a new way.”

Blonde Espresso Roast especially shines in iced espresso beverages, creating smooth, balanced beverage creations that will continue to support the rapid growth of iced coffee and espresso at Starbucks, he adds.

“In our eyes, unmatched innovation inspired by customer and partner feedback, our ability to constantly explore new ideas around the world and our capacity to be coffee and tea forward make our approach special,” says Mr. Furnish. “We’ve always believed in buying and serving the best coffee possible. And it’s our goal for all our coffee to be grown under the highest standards of quality, using ethical sourcing and responsible growing practices. We think it’s a better cup of coffee that also helps create a better future for farmers and a more stable climate for the planet.”

Innovation was also behind the opening last November in Ottawa of Starbucks’ first experiential Starbucks Reserve coffee bar in Canada.

“When Starbucks opened its first Reserve Roastery in Seattle in 2014, it created an immersive coffee destination unlike any other, where the theatre of coffee takes centre stage,” says Mr. Furnish. “Experiential Starbucks Reserve coffee bars offer a similar immersive coffee experience. We know our customers are more curious about coffee than ever before, and this new experience places coffee craft at the centre of the conversation.”

Starbucks Reserve small-lot coffees are featured, and the beverages are crafted with a variety of brewing methods, including Siphon, Clover, Pour Over and Nitro Cold Brew taps. The company plans to open more Reserve coffee bars across Canada.

4A Frenz Corporation Exhibits

EXHIBIT 1 Board of Directors

Felix Hermans is the Chief Executive Officer of Genie Bank of Belgium. He holds a Master of Science in Business Econometrics/Operations Research degree from Tilburg University and has completed professional programs at the Netherlands Institute for Banking, Amsterdam Institute of Finance, Oxford University and INSEAD. He is currently the Chairman of the Frenz's Board and has been a director since 2005.

Fred Coppens is the Chief Executive Officer of Vedegu Chocolate, which is a chocolate manufacturer in Belgium. He holds a Master of Science degree in automation engineering and has been a director since 2009.

Abram Lemaire is a Vice Chairman, Chief Executive Officer, Managing Director and a Member of Management Board at VESET Group SA, an affiliate of Ora Construction Industries Company. He has been a director since 2000.

Gilroy Clyde is the Chief Executive Officer of RPPC, the holding Company of Frenz. He has been director since 2000.

Olivier Collignon is the Deputy Chairman of the Board of RPPC. He has been director since 2000.

Julien Jacobs joined Frenz in April 2000 and has served as Chief Executive Officer since October 2005. He was the CEO of Frenz US, which a subsidiary of Frenz from April 2003 to October 2005. He has been director since 2003.

David Gillet is the Chief Executive Officer of Frenz US since 2005 and has served as president, Frenz China and Asia Pacific, which a subsidiary of Frenz since November 2003. He has been director since 2005.

Vincent Jansen is the Chief Financial Officer of Frenz Corporation and has been a director since 2005.

There are no family relationships among any directors or executive officers. The mandate of the Board was established at the time of incorporation to supervise management of the business and affairs of the Corporation on a broad scale rather than daily management. Its responsibility includes approving strategic goals and objectives, review of operations, disclosure and communication policies, oversight of financial reporting and other internal controls, corporate governance, Director orientation and education, senior management compensation and oversight, and Director nomination, compensation and assessment.

In order to ensure that the responsibility is carried out on a cohesive manner, the Board has established the sub-committees to aid in carrying out its responsibilities.

Executive Committee

The Executive Committee has and may exercise all or any of the powers vested in and exercisable by the Board, including approval of the annual strategic plan. Currently the Executive Board comprises of 5 board members with the Chairman of the Board, Felix Hermans also acts as Chairman of this Committee and the following Board members:

- Fred Coppens
- Olivier Collignon
- Abram Lemaire
- Julien Jacobs

Audit Committee

The primary mandate of the Audit Committee is to review the financial statements of the Corporation and public disclosure documents containing financial information and to report on such review to the Board, to be satisfied that adequate procedures are in place for the review of the Corporation's public disclosure documents that contain financial information, to oversee the work and review the independence of the external auditors, and to review any evaluation of the Corporation's internal control over financial reporting.

The Audit Committee comprises of 4 Board members with Vincent Jansen, the CFO of Frenz acting as the Chair of this Committee and the following Board members:

- Gilroy Clyde
- Abram Lemaire
- David Gillet

Compensation Committee

The primary mandate of the Compensation Committee is to approve compensation policies and guidelines for employees of the Corporation, to approve compensation arrangements for executives of the Corporation, to recommend to the Board compensation arrangements for the Directors and to oversee the management of incentive compensation plans, and to review succession plans for senior management. The current Chair of this Committee is Gilroy Clyde with the following 3 Board members:

- Felix Hermans
- Abram Lemaire
- Olivier Collignon

Related Party and Conduct Review Committee

The primary mandate of the Related Party and Conduct Review Committee is to recommend to the Board procedures for the consideration and approval of transactions with related parties of the Corporation and to review and, if deemed appropriate, to approve such transactions. Fred Coppens is the Chair of this Committee with the following 3 Board members:

- Olivier Collignon
- David Gillet
- Vincent Jansen

Governance and Nominating Committee

The primary mandate of the Governance and Nominating Committee is to oversee the Corporation's approach to governance issues, to recommend to the Board corporate governance practices consistent with the Corporation's commitment to high standards of corporate governance, to assess the effectiveness of the Board of Directors, of Committees of the Board and of the Directors, and to recommend to the Board candidates for election as Directors and for appointment to Board Committees. This Committee is also responsible in recommending the Board on the "Code of Business Conduct and Ethics" policies to ensure and maintain a culture of integrity throughout the Corporation. This Code is applicable to Directors, officers and employees of the Corporation.

Julien Jacobs, the current CEO of Frenz is the Chair of this Committee and the Committee is comprised of the following Board members.

- Olivier Collignon
- Gilroy Clyde
- David Gillet

EXHIBIT 2

Risk Profiles

Supply-Chain Risks

Commodity price risk is the primary supply-chain risk for Frenz. Price volatility of key ingredients such as green coffee, tea leaves and dairy products, etc. presents a substantial exposure to the stability of the product prices as well as profit margins. This is mitigated somewhat by the ability to keep coffee and tea for long periods of time, thus reducing storage costs.

In addition, oil prices also have a direct impact on shipping costs. Frenz incurs substantial shipping costs in transporting the key ingredients to its worldwide retail outlets. Therefore, oil price increases over recent years has eroded Frenz profit margin.

Supply and price can be affected by multiple factors in the producing countries, including weather, political and economic conditions. Price for coffee is also impacted by trading activities in the Arabica coffee futures market, including hedge funds and commodity index funds.

Furthermore, green coffee prices may be affected by actions of certain organizations and associations that have historically attempted to influence prices of green coffee through agreements establishing export quotas, increased tariffs, embargoes, customs restrictions or by restricting coffee supplies. Similar influence also exists for prices of tea leaves.

Relationships with the producers (coffee, tea & dairy), outside trading companies, suppliers and exporters are also pertinent in assessing the risk of non-delivery on purchase commitments and quality of ingredients delivered.

Demand Risks

Competition can be fierce as the capital required to enter the industry is low. The company is facing competition not only from the specialty beverage shops such as Starbucks, Timothy's, Second Cup etc., but also from quick-service restaurants such as McDonald's, donut shops such as Tim Hortons, dessert shops, high-end restaurants and other specialty retailers, etc. Thus the need for the company to keep expanding and differentiating its product lines and venture into unfamiliar territories is being inevitable.

Customer loyalty is pertinent in this trade. As a result, the company will continue to expand its popular loyalty card program, which has been effective in preventing other companies from stealing away Frenz's customers, to include products from other sister companies in the conglomerate group.

Adverse economic conditions may cause declines in general consumer demands for these high-end products, driving the increase in costs and pressure for reduced quality of products, which in turn, may increase impacts from negative publicity.

Adverse impacts resulting negative publicity regarding business practices or health effects of consuming products, etc., may lead to reduction in demand and profitability and increase in litigation.

Operational Risks

As the company is facing expansion, risks are associated with each expansion plan that the company is exploring and implementation of these plans can be very challenging and risky as these plans are disruptions to the ongoing business.

Delays in store openings for reasons beyond control, exposure to increased construction costs associated with new store openings and lack of desirable real estate locations availability would also negatively impact the net revenues and profit margins.

The degree to which the company enters into, maintains, develops, and is able to negotiate appropriate terms and conditions and to which it can enforce, commercial and other agreements could have significant impact on company financing and operation.

Loss of key personnel, difficulties in recruiting and retaining qualified personnel, labour discord, political instability and natural disasters could cause significant business interruption which, in turn, adversely impacts the business and financial results.

Adverse public or medical opinions about health effects, food tampering, food contamination, regional or global health pandemic could severely and adversely impact the company's business.

As the company relies heavily on information technology, any material failure, inadequacy, interruption or security failure of the technology could harm the ability to effectively operate the business.

Litigation and Reputation Risks

Success depends substantially on the value of the brands especially in the specialty business. Thus the company has to maintain quality of product and be able to consistently deliver positive consumer experience and engage in corporate social responsibility programs to enhance the company reputation. Brand value is based on in part consumer perceptions on a variety of subjective qualities. Thus even isolated business incidents that erode consumer trust, such as contaminated food or privacy breaches can significantly reduce brand value, particularly if the incidents receive considerable publicity or result in litigation.

Reputation may be harmed by actions taken by third parties that are outside of the company's control. Third parties may include business partners, licensee and partnership relationships, suppliers, vendors and any business associates that the company has engaged in past or current dealings.

Proper handling of customers' complaints is very important in protecting the company's reputation and preventing potential litigation.

Foreign Currency Risk

Frenz has operations in many different countries. Frenz has currency exchange risk because currencies generated from revenues are different from currencies used for expenses. Currency volatility has caused significant costs in operation due to timing differences.

Real Estate Risk

Frenz has significant exposure in real estate markets due to investments in commercial properties and operation plants.

Interest Rate Risk

Frenz has debt issuances and fluctuation in interest rates could result in significant impacts on refinancing costs.

Capital Risk

In order to maintain the company's growth rate, Frenz is facing increasing capital risks.

EXHIBIT 3

Financial Statements and Supplementary Data

Frenz Corporation Ltd.

CONSOLIDATED STATEMENTS OF EARNINGS (In millions, except per share data)

| Fiscal Year Ended | Dec 31, 2014 | Dec 31, 2013 | Dec 31, 2012 | Dec 31, 2011 | Dec 31, 2010 | Dec 31, 2009 | Dec 31, 2008 |
|-----------------------------------------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|
| Net revenues: | | | | | | | |
| Company-operated stores | \$1,214 | \$1,056 | \$ 960 | \$ 890 | \$ 650 | \$ 400 | \$1,360 |
| Licensed stores | 127 | 110 | 100 | 85 | 50 | 45 | 200 |
| CPG, foodservice and other | 134 | 117 | 106 | 88 | 60 | 100 | 100 |
| Total net revenues | 1,475 | 1,283 | 1,166 | 1,063 | 760 | 545 | 1,660 |
| Cost of sales including occupancy costs | 583 | 535 | 495 | 445 | 375 | 255 | 760 |
| Store operating expenses | 423 | 393 | 366 | 355 | 320 | 300 | 400 |
| Other operating expenses | 49 | 45 | 40 | 29 | 25 | 20 | 100 |
| Depreciation/ amortization expenses | 58 | 55 | 52 | 51 | 50 | 50 | 50 |
| General & administrative expenses | 75 | 70 | 65 | 56 | 30 | 28 | 80 |
| Restructuring charges | 0 | 0 | 0 | 53 | 100 | 200 | 0 |
| Total operating expenses | 1,188 | 1,098 | 1,018 | 989 | 900 | 853 | 1,390 |
| Gain on sale of properties | 112 | 55 | 30 | 0 | 0 | 0 | 0 |
| Income from equity investments | 33 | 22 | 18 | 15 | 10 | (175) | 125 |
| Operating income | 320 | 207 | 196 | 89 | (130) | (483) | 395 |
| Interest income and other, net | 15 | 14 | 11 | 5 | 5 | 4 | 10 |
| Interest expense | (5) | (3) | (3) | (3) | (3) | (3) | (4) |
| Earnings before income taxes | 330 | 218 | 204 | 91 | (128) | (482) | 401 |
| Income taxes | (73) | (54) | (63) | (28) | 14 | 144 | (121) |
| Net earnings (loss) | \$258 | \$163 | \$141 | \$63 | \$(114) | \$(338) | \$280 |
| Earnings per share—basic | \$0.52 | \$0.33 | \$0.28 | \$0.13 | \$(0.07) | \$(0.68) | \$0.56 |
| Cash dividends declared per share | \$0.005 | \$0.005 | \$0.005 | \$0.000 | \$0.000 | \$0.000 | \$0.01 |
| Cash Dividends Paid | \$2.50 | \$2.50 | \$2.52 | \$0.00 | \$0.00 | \$0.00 | \$5.00 |

EXHIBIT 4
Frenz Corporation Ltd.
CONSOLIDATED BALANCE SHEETS
(In millions, except per share data)

| Fiscal Year Ended Dec 31, YYYY | 2014 | 2013 | 2012 | 2011 | 2010 | 2009 | 2008 |
|------------------------------------------------------------------------|----------------|----------------|--------------|--------------|--------------|--------------|--------------|
| ASSETS | | | | | | | |
| Current assets: | | | | | | | |
| Cash and cash equivalents | \$187 | \$159 | \$138 | \$116 | \$90 | \$20 | \$200 |
| Short-term investments —available-for-sale securities | 115 | 98 | 85 | 24 | 15 | 5 | 100 |
| Short-term investments —trading securities | 35 | 22 | 25 | 15 | 5 | 5 | 15 |
| Accounts receivable, net | 53 | 40 | 84 | 30 | 35 | 60 | 40 |
| Inventories | 102 | 98 | 45 | 44 | 67 | 143 | 95 |
| Prepaid expenses & current assets | 35 | 28 | 45 | 16 | 20 | 16 | 30 |
| Deferred income taxes, net | 20 | 21 | 25 | 30 | 35 | 23 | 50 |
| Total current assets | 548 | 465 | 447 | 275 | 267 | 272 | 530 |
| Long-term investments —available-for-sale securities | 95 | 66 | 10 | 19 | 10 | 5 | 30 |
| Equity and cost investments | 138 | 88 | 37 | 34 | 15 | 8 | 50 |
| Property, plant and equipment, net | 450 | 300 | 235 | 245 | 205 | 200 | 300 |
| Goodwill | 25 | 25 | 25 | 25 | 25 | 25 | 35 |
| Other intangible assets | 10 | 10 | 5 | 5 | 5 | 5 | 15 |
| Other assets | 56 | 48 | 20 | 23 | 5 | 25 | 30 |
| Total Assets | \$1,322 | \$1,003 | \$779 | \$626 | \$532 | \$540 | \$990 |
| LIABILITIES AND EQUITY | | | | | | | |
| Current liabilities: | | | | | | | |
| Accounts payable | \$45 | \$33 | \$24 | \$28 | \$35 | \$40 | \$50 |
| Accrued compensation & related cost | 42 | 39 | 36 | 40 | 35 | 10 | 50 |
| Accrued occupancy costs | 17 | 13 | 15 | 17 | 20 | 15 | 20 |
| Accrued taxes | 10 | 10 | 10 | 10 | 5 | 2 | 10 |
| Insurance reserves | 15 | 15 | 15 | 15 | 15 | 15 | 15 |
| Other accrued liabilities | 28 | 30 | 32 | 26 | 22 | 15 | 25 |
| Deferred revenue | 42 | 49 | 43 | 41 | 40 | 25 | 60 |
| Total current liabilities | 199 | 189 | 175 | 177 | 172 | 122 | 230 |
| Long-term debt | 177 | 140 | 120 | 110 | 95 | 55 | 55 |
| Other long-term liabilities | 71 | 62 | 52 | 45 | 38 | 22 | 92 |
| Total liabilities | \$447 | \$391 | \$347 | \$332 | \$305 | \$199 | \$377 |
| Shareholders' equity: | | | | | | | |
| Common stock (\$0.001 par value) —authorized, 500 shares; issued & o/s | \$0.5 | \$0.5 | \$0.5 | \$0.5 | \$0.5 | \$0.5 | \$0.5 |
| Additional paid-in capital | 44.8 | 44.8 | 44.8 | 44.8 | 44.8 | 44.8 | 0.3 |
| Other additional paid-in-capital | 55 | 50 | 34 | 34 | 34 | 34 | 4 |
| Retained earnings | 763 | 508 | 347 | 209 | 146 | 260 | 598 |
| Accum. other comprehensive income | 11 | 8 | 5 | 6 | 2 | 2 | 10 |
| Total shareholders' equity | \$875 | \$612 | \$432 | \$294 | \$227 | \$341 | \$613 |
| TOTAL LIABILITIES AND EQUITY | \$1,322 | \$1,003 | \$779 | \$626 | \$532 | \$540 | \$990 |

EXHIBIT 5
Vietombia Statistics

| INFRASTRUCTURE | |
|------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------|
| Economy | |
| GDP (2014) | USD 70.1 billion |
| % exports (2014) | USD 62.9 billion FOB 89.73% |
| Population and employment | |
| Total population | 86 million |
| Total employment in the coffee industry | 600,000 coffee growers |
| % adult literacy | 30% |
| Average school level for workers in the coffee industry (farms) | Grade 6 |
| % of workers who are landowners | n/a |
| Number of workers associated to a cooperative | 20,000 |
| % workers with permanent contract | 5% |
| Forms of workers representation | |
| Association of coffee providers | None |
| % of employees who are part of a trade union | None |
| Geographical aspects | |
| Total area of production (hectares) | Cultivated area: 506,000 ha |
| Number of farms | 300,000 |
| History of the coffee industry | |
| Date of creation | First coffee plantation in 1857 in French colony |
| Management system/style | n/a |
| Number of owned farms | n/a |
| Number of owned thresher | n/a |
| Economic indicators of coffee industry (net profit, sales, etc.) | Total production: 57.6 million bags (2014) Total exports: 53.8 million bags (2014) |
| Exports (total exports, % exports against total production) | Total production 961 million tons (2014) Total export 897 million tons (2014) % participation of exports in total production: 93.34% |

5 Blue Ocean P&C Company

Ruth Green, Chief Actuary, was watching the year in review shows frequently broadcast as the year came to a close. She watched the replays of the national hero at the Games. Mo Farah took gold in both the 5000 and 10,000 metres. Mo was fast, Usain Bolt was faster but Blue Ocean moved with greater speed. Blue Ocean had been built on innovation and speed to opportunity and speed to market because they view product development as a long-term strategy. They saw a niche and filled it. Everyone looked at the same information. Not everyone saw the same things. Others saw only dots. They made connections. This was the benefit of having cross-functional teams across the organization that have a common understanding of the company's mission, strategy, goals, marketing, sales, and logistics.

There were always questions. Other companies choked from paralysis. Blue Ocean underwriters didn't just sit on ideas ignored by management too busy to be persuaded. Instead management asked what action to take. Management supports the new product development process. Ruth keeps an open channel of communication for new product development ideas, which recently resulted in several new ideas coming across her desk. How could she make it happen? How would they underwrite and manage the risks? Which segments should they target? Would these most recent niche offerings add value? Why might Blue Ocean fail? What should she do to remove or mitigate those risks? How will she balance the number of projects with available resources?

5.1 Background

Mission and Strategic Plan

Our mission is to strengthen the brand identity as a dominant innovator in the UK market and maximize sustainable long-term growth in shareholder value. Our strategic plan is to capitalize on arenas with new opportunities.

History

RPPC Dynasty acquired Blue Ocean, the 5th largest property and casualty insurance company in the United Kingdom (UK), in 2005. This acquisition gave Parent Company access to Blue Ocean's lucrative insurance market in UK and continental Europe. Products include marine, property catastrophe and retrocession. Since then, Blue Ocean continued to expand and develop its insurance businesses worldwide. In September 2011, Blue Ocean began writing Pet and Travel insurance business in North America. As of the beginning of 2015, the capital base stands at \$3 billion.

Rating

Guided by experienced management and backed by an impressive team of underwriters, actuaries and catastrophe risk modelers, Blue Ocean earned an A.M. Best rating of A (Excellent) and quickly established itself as a market leader.

Management Team

CEO

Edward Blue

CFO

Michael Tan

Chief Actuary

Ruth Green

CLO

Jerome Black

CRO

Geoff Olive

Business Ops

Andrew Grey

CAO

Michelle Rouge

Strategy

The traditional business arena for Blue Ocean has been the marine insurance market. This focus has been very successful in the company's traditional geographical market, the United Kingdom. With the expansion into a new region, company management decided to expand its focus into Pet and Travel Insurance. In keeping with its mission to be an innovative leader the executive team is considering an offering within the emerging Renewable Energy sector. Blue Ocean has an ongoing initiative to identify new opportunities and can redirect the strategic plan in real-time to respond to market forces and new technologies such as conducting a feasibility study on whether to offer Solar Personal Energy Insurance to homeowners that have purchased solar panels to produce their own power.

Within the Pet and Travel insurance lines, the goal is to establish a dominant market share in this relatively young insurance field. The financial goals are to generate as much profit and premium from this new risk arena as currently generated in the core Marine business.

Other innovative ideas have also come through the Chief Actuary's e-mail which have been related to insurance opportunities in the Online Peer-to-Peer Commerce space, also known as the "Sharing Economy".

Travel Insurance

Travel insurers faced steep revenue declines during the recession. The recession from 2008 to 2009 caused consumer discretionary spending and, therefore, consumer spending on travel to plummet. However, since 2010 industry revenues have grown. The recession and associated turmoil in the international airline industry boosted demand for travel insurance: consumers were more sensitive to protecting their investments in travel expenditures due to higher risk of flight cancellations and delays. The industry is expected to continue growing over the next five years and expand into niche markets catering to students and business travelers. The Travel Insurance industry has a low level of market share concentration.

In order for Blue Ocean to compete in this industry, it offers a comprehensive travel insurance program to its customers. The insurance program includes life and accidental death and dismemberment insurance, trip cancellation and trip interruption insurance, baggage loss insurance, medical and hospitalization insurance, etc. It even offers ambulance and air transportation coverage in case of medical emergencies occurred within the first 60 days of travel. The insurance can be purchased on a per trip basis or on an annual basis for frequent flyers. Unbundling of some benefits are also available.

In order to facilitate this wide range of services, Blue Ocean has established partnership with travel agencies to recover the salvage value of all cancelled trips by offering deep discounts in the last minute travel markets. In addition, it has established partnership with some hotel chains and air ambulance service companies in accommodating its customers in case of emergencies or airline delays. These partnerships are means of reducing the overall costs of the program. Despite its short history in this industry, Blue Ocean has already made significant inroads into the business relationships with its business partners. These relationships have become its competitive advantage in the travel industry.

Pet Insurance

While pet insurance remains a relatively underdeveloped product in North America, with less than 1% of all pets being insured, European levels of insured pets range from 12% to 50%. In many European countries insuring your pet is just as common as insuring your home or car. It's second nature. The UK pet insurance industry is a mature industry. 50% of dogs and 30% of cats are insured with a population estimated at 8.3 million dogs and 11.9 million cats.

The industry is diverse and provides consumers with a multitude of choice in terms of products and types of cover available. Three clear strategies have appeared. The first is the 'menu-based' proposition, where customers are provided with the standard 'vet fees' only product and allowed to choose various coverage options to produce a product that meets their needs. The second option, which the majority of providers offer, is a 'multiple cover' offering, where customers are able to choose products based on set coverage limits. These types of products are often displayed as 'bronze, silver or gold', reflecting the levels of cover offered. The third option is a 'one size fits all' product that offers a static veterinary fees limit and does not allow for flexibility to increase or decrease this limit.

In continental Europe there are 120 million dogs and cats. The percent insured varies by country. For example, in Sweden 55% and 35% of dogs and cats are insured respectively. The U.S. pet insurance industry is in its infancy. Approximately 1% of a population of 155 million cats and dogs is insured. The U.S. industry has grown 18% compounded annually on a premium basis since 2003.

Pet Insurance is coverage for Veterinary Medical Expenses – so the underlying inherent risk is a health risk similar to medical expenses in humans. Although pet insurance is primarily a health risk, in the US it is regulated as a P&C product, since in most states pets are considered property under the law. Typically, they are regulated under the Inland-Marine line of business.

Pet Insurance is characterized by traits associated with really low risk.

- Low Severity (\$230/claim)
- High Frequency (1.3 claims per policy/year)
- Ultra-Short-Tail
 - 95% of claims are paid out within 3 months of the loss
 - 99.9% are paid out in 12 months

Because of the ultra-short tail properties there is very little opportunity to earn investment on reserves.

| | 2015 Premium Income* | 2015 Reported profit* |
|--------|----------------------|-----------------------|
| Marine | 1,600 | 120 |
| Pet | 400 | 25 |
| Travel | 300 | 30 |

* (millions)

5.2 Opportunity

Renewable Energy Insurance Business profile

Renewable energy and its associated technologies are an emerging industry. There are considerable uncertainties for companies operating in this industry to predict their income generation capabilities. There are two key sources of uncertainty: 1) the productivity of a given technology to generate given units of energy, and 2) market price of selling units. The intended focus of our insurance solution for this industry is to offer protection on the income generated by energy suppliers.

The renewable energy lines of business segments include: 1) Solar, 2) Wind and 3) Water for both commercial and personal.

Overview of Solar Personal Energy Insurance

The target homeowner for this insurance program has over 1,000 sq. ft. available roof space for mounting solar panels. The typical client has purchased solar panels that can generate between 7,000 to 12,000 kwh of energy per year and depending on the cost of the panels can be enticed into a fixed contract to sell the energy generated for between 30c to 60c per kwh (c = cents). A solar personal contract would either guarantee the number of units that are generated (7000 kwh), or the sale price per unit (30-60c), or both (4000 kwh sold at 40c). In exchange Blue Ocean would receive the actual units of energy generated and would sell them in the energy market via electrical companies. Some of the electric companies would be either privately owned or government regulated or run by the state department.

There is a trend in North America for families to purchase their own personal solar grids. Our five year plan is to become the face of the insurance to this group.

Blue Ocean Feasibility Study – 2015 Initiative

Blue Ocean hired *Able Energy Consulting Group*. Exhibit 1 provides *Market Data* on the number of detached homes in the U.S., energy production per solar panel and electric company seasonal prices and volatilities. As expected with all new product development projects, Blue Ocean takes a concept and product, and consistently conducts market testing to determine if the project should be undertaken by the company.

Below is an excerpt from the business plan pro-forma that was created to gain funding approval to enter this line of business.

| | 2016 | 2017 | 2018 | 2019 | 2020 |
|-------------------------------------|-------|--------|--------|--------|--------|
| No. of homes insured | 1,200 | 2,600 | 4,200 | 6,000 | 8,000 |
| No of electric co contracts | 5 | 11 | 17 | 25 | 33 |
| Energy (kwh) gen per home | 9,000 | 13,500 | 20,250 | 30,375 | 45,563 |
| Fees paid per kwh (cents) | 60 | 50 | 40 | 30 | 20 |
| Energy Co resale rate (cents) | 80 | 70 | 60 | 50 | 40 |
| Contingency liability (in millions) | 1.08 | 1.62 | 2.43 | 3.65 | 5.47 |
| Target capital (in millions) | 2.16 | 7.02 | 17.01 | 36.45 | 72.9 |

Reserve methodology

Below is an email thread discussing the reserve methodology for the renewable energy business.

From: Michael Tan
Sent: March 28th, 2015 9:00pm
To: Ruth Green
Subject: Risk capital

Hi Ruth,
How are you? Thanks for sending me the draft plan. I have reviewed the high level financial projections. I noticed that the contingency liability increases faster than the fee income line. Can we have a meeting to discuss the results?
I am reviewing the corporate level capital figures. I would also like to discuss capital for this line of business.

Thanks,
Michael Tan
CFO, Blue Ocean Inc.

=====
From: Ruth Green
Sent: March 28th, 2015 9:08pm
To: Michael Tan
Subject: Re: Risk Capital

Hi Michael,
I am doing well. Hope all is well with you.
Thanks for your note. I am also reviewing these figures in more detail and recently engaged with an external actuarial firm. I will set up a meeting as soon as this review is completed.
Thank you,
Ruth Green
Chief Actuary,, Blue Ocean Inc.

=====
From: Edward Blue
Sent: March 28th, 2015 12:01pm
To: Geoff Olive
cc: Ruth Green
Subject: Risk factors
Remind me the risk factors within capital calculation

=====
From: Geoff Olive
Sent: March 29th, 2015 7:05am
To: Edward Blue
cc: Ruth Green
Subject: Re: Risk factors

Here is the list of risk factors:

- Weather
- Mechanics
- Default rate
- Energy conversion ratio
- Counterparty

Market update: A new dawn for solar energy

China's advancement in solar-technology production has reduced prices to a point that allows a worldwide scale-up of green energy

The assembly lines at Jinko Solar whirl with the precise efficiency of a high-tech Chinese factory. Workers and robots work side by side, tending machines that take wafer-thin squares of black silicon, imprint and infuse them with chemicals before placing them onto large frames. Far from here, the completed modules will be erected in empty fields and atop buildings, facing the sun and pumping out electrons.

There is nothing particularly revolutionary in this. The first patent for solar electricity from silicon is now more than six decades old. The revolution lies in what factories like this one in Haining, China, have accomplished: they have made solar power cheap.

Once among the most expensive ways to produce power, the cost of solar cells has, after a year of extraordinary price declines, now come tantalizing close to a threshold where it is cheaper to generate electricity from the sun than coal, even without government subsidies. That threshold, known in the industry as grid parity, has long been an unattainable fantasy, even as the cost of new solar installations gradually eroded.

In 2016, that cost for solar tumbled an astonishing 27 per cent, enough to now tip some countries into a place where solar projects are winning open-bid electricity contracts over other forms of power.

In 2016, however, that cost tumbled an astonishing 27 per cent, enough to now tip some countries into a place where solar projects are winning open-bid electricity contracts over other forms of power. “To put it bluntly, we’ve seen pockets of countries, and pockets of markets, that I would say have reached quasi grid parity,” where “solar has outbid other technology competitors,” said Gurpreet Gujral, a Macquarie analyst who covers solar stocks. Solar prices, he said, have become “incredibly competitive.”

Solar power, of course, has a number of disadvantages. Outside a revolution in electrical storage, solar’s obvious inability to generate power in the dark will keep it from ever dominating entire electrical systems the way coal, natural gas, nuclear and even hydro do to supply base-load power. In a high-latitude country like Canada, solar faces an even greater disadvantage in winter months.

But in a growing number of places, costs have dipped to a level that stands to allow the sun’s energy to provide a much larger percentage of the electrons on global grids, a milestone that has underpinned a series of seemingly incredible claims from visionaries and tech companies in recent months.

In November, Elon Musk, the billionaire promoting a vision of solar-powered houses and electric cars, said he expects solar roofs will soon be as cheap as existing roofs, in addition to generating electricity. Google intends to be fully powered by renewable energy next year. Industry leaders in Spain have said their country will one day run entirely on green power. “I think people are going to tell me we’re crazy but I’m pretty sure we’ll arrive at 100 per cent,” Miguel Ezpeleta, director of Renewable Energy Control Centre at Spanish clean-power giant ACCIONA Energy SA, told Australian media earlier this year.

Deutsche Bank says solar power is becoming price-competitive in 80 per cent of countries. In bidding wars around the world, the declining cost of solar electricity is already making it “an unfair fight” that other forms of electricity can’t win, said Tim Buckley, director of energy-finance studies at the Institute for Energy Economics and Financial Analysis in Sydney, Australia. “2016 marked a massive globalization of where grid parity is rapidly approaching, if we haven’t already exceeded it.” The cost of solar electricity is heavily dependent on factors outside the technology itself, including labour and land costs for installation. For that reason, solar will remain an expensive alternative in countries such as Japan for a long time to come. In Canada, too, solar panels make up less than a quarter of the total outlay for large industrial projects, muting the impact of even a dramatic reduction in technology costs.

Still, for a country with a government keen on slashing carbon emissions, it’s a shift with sweeping potential benefits. Ottawa is already banking on cheap renewable power to underpin its greenhouse gas reduction plan. “Wind and solar are becoming as competitive as more traditional sources of power,” Environment Minister Catherine McKenna said in a recent interview.

But even among climate skeptics, the price of harvesting energy from the sun has fallen so precipitously that it is likely to be a major energy source regardless of national policy. U.S. President Donald Trump has pledged to end tax breaks for renewable energy, which he called “so expensive,” in favour of reviving the coal industry. The math is unlikely to be on his side.

In the next five years, the U.S. Energy Information Administration has calculated, new solar installations in the United States will become nearly 40-per-cent cheaper for every megawatt-hour than the cost of a new coal plant built to modern requirements, including carbon capture and storage.

Similar numbers are already being seen elsewhere. In recent bidding rounds in South Africa, new solar installations have come in 40-per-cent cheaper than coal. In Mexico, the cost of building solar power fell by a fifth between two bidding rounds this year alone; it’s now competitive with natural gas-fired electricity. In Chile, a solar project won a bid earlier this year at a price half that of a competing coal plant. Chile is building such cheap solar power that the government has promised to cut electricity prices for families and small businesses by 20 per cent over the next five years.

“Because these technologies now are ever more cost-effective, the market is playing a much larger role in their rollout, as opposed to purely subsidies, government programs or even pollution-reduction efforts,” said Anders Hove, Beijing research director for the think tank Paulson Institute. With the cost of new solar, “we are way below some of the wildest dreams” from only a few years ago. “It is very dramatic what’s happened in the last six months alone.”

In some regions, particularly South America, governments have given solar bidders a slight boost by pricing contracts in U.S. dollars, which allows bidders to access U.S.-denominated financing at better rates. But in places as disparate as Ontario and India, manufacturers are installing their own solar panels in parking lots and on rooftops, knowing they can make homegrown juice cheaper than what comes in from the transmission towers. Tenders in the Middle East, meanwhile, are setting new records. “We are talking about 2.4 cents a kilowatt-hour for the United Arab Emirates. The average American retail price of electricity, which is one of the lowest in the world, sits at 12 to 14 cents,” said Mr. Buckley.

Most of the responsibility for tilting the playing field belongs to China, and in particular its sprawling industrial plants like the one in Haining run by Jinko Solar, a giant in an industry dominated by Chinese firms. Here, in a cluster of hulking factory buildings that sit next to a small research and development centre, Jinko is using smarter manufacturing techniques, faster machines and greater output volumes to steadily chip away at costs.

It is a game of inches. This year, the Haining plant will churn out a completed solar cell every 1.8 seconds. Next year, it aims for one every 1.6 seconds. More robots mean the work force will be 8-per-cent smaller in a year. And the year after that will, again, bring more advances advances like it – incremental steps, but they add up. Three years ago, a single production in Haining might pump out 1,600 solar cells an hour. Today, it has topped 4,000.

“We have fewer and fewer workers, and the automation is improving,” says Wang Pan, the company’s director of production.

“Put it together and it’s a big change,” Jinko chief scientist Hao Jin says.

It’s a turnaround for an industry that, just four years ago, was in the midst of an ugly reckoning. In the wake of the financial crisis, places like Spain dramatically cut generous power rates guaranteed for solar producers, gutting the local industry. Chinese solar companies defaulted on bonds and so many went bankrupt that trade media maintained death lists. In 2013, the Wharton School released a public-policy document entitled “Why Is the Sun Setting on China’s Solar Power Industry?” The sector, it said, “is reeling, dogged by too much capacity, too little demand and punitive trade tariffs.” Solar stocks, such as Canadian Solar and First Solar plunged and have gone through wild swings since then.

Many Ontario renewable-energy companies, such as Osborne Solar Solution, are finding they can get by without subsidies, thanks to lowered costs.

Now Canadian Solar, founded by a former Ontario Hydro research scientist, tells investors it expects solar power to go from 0.5 per cent of world electricity today to more than 10 per cent by 2030. Canadian Solar has posted an annual profit each year since 2013.

Jinko – already the world’s largest manufacturer of solar modules – has cleared a sprawling field for expansion next to its existing factory in Haining. Its third-quarter revenues were up 39 per cent, enough for a small profit.

The Chinese industry owes its new footing to an explosion in demand, a fortuitous drop in the price of a key raw material – and relentless innovation.

Every year, the efficiency of solar cells improves by roughly half a percentage point, meaning each new generation of panels squeezes out more electrons from the same surface area. But Jinko is also using better-quality silicon that is easier to handle. It has tweaked machines to level of productivity not even their makers thought possible. It has imported techniques from the semiconductor industry, like an ultra-clean manufacturing environment and new chemical treatments for silicon. “We just borrow the idea,” says Mr. Hao.

Cheaper materials – prices for polysilicon, the main ingredient in solar cells, have cratered – and roaring demand haven’t hurt, either.

The industry will install 76 gigawatts of solar capacity across the world this year, Mercom Capital Group estimates. That’s equivalent to more than half the entire capacity of the Canadian electrical sector, and up by half over the year before. The sheer increase in volume has been a major contributor to manufacturing efficiency.

Here, too, China plays a singular role. Not only are its factories slashing costs, but its energy companies will install fully 40 per cent of the global total this year.

There is a downside to this. China may be enabling seemingly impossible pricing – but it has done it at a steep price, which has fuelled irrational exuberance. Its 30 gigawatts of expected solar construction this year have little to do with market economics and everything to do with subsidies. A national feed-in-tariff program has made China among the more expensive places on earth for solar power – but among the most lucrative markets for companies generating it.

It has led to a bizarre situation, where firms using Chinese-made solar panels are bidding 2.4 cents a kilowatt-hour for projects in the Middle East, while at home the Chinese government is paying 12 cents.

The program has led to vast amounts of excess power, particularly in China’s sunny but sparsely-populated far west, where a solar construction spree has not been matched by adequate transmission capacity. So much renewable energy has been built so quickly that in some months, 70 per cent of potential wind and solar power goes to waste.

Relying on Chinese subsidies has made the entire industry vulnerable. China is trimming the price it is willing to pay for solar power this year, raising questions about the pace of future installations. In November, First Solar Inc. said it would cut a quarter of its work force.

And subsidies aren’t just a Chinese problem. In an industry report last year, market research firm IHS said market competitiveness remains “a very minor driver of growth,” estimating that of all the solar installed in 2015, just 2 per cent was unsubsidized. Even by 2018, the firm predicted then, “only 6 per cent of total global solar installations will be done without any incentives at all. Given the pace of price declines witnessed in the solar industry and the widespread hype regarding grid-parity, this is remarkably low.”

China, too, has been accused of dumping by authorities around the world, and hit with tariffs on its solar products.

But it may also be worth giving China thanks. Without the demand it created, it’s doubtful solar prices would have fallen to current levels. And rather than taper that demand, Beijing is working to raise it to even greater levels. Earlier this year, Chinese authorities said they intend to spend more than \$470-billion on renewable energy between now and 2020. It’s a project of staggering size even by Chinese standards (equivalent to some two-thirds the cost of building the U.S. Interstate system, a project that spanned four decades), and one with global implications.

“By its very aggressive policies to scale up solar energy, China has effectively subsidized the scale-up of green energy worldwide,” Mr. Hove said.

Of course, there are limits to that influence. In Canada, solar installations remain dependent primarily on public subsidies through government-set rates – first in Ontario, which is halting that program, and in future in Alberta, which is embarking on its own project to get rid of coal.

But solar will only be able to truly compete with coal or natural gas when the combined cost of panels and electrical storage reaches a competitive price – and that remains a distant prospect.

Coal has environmental issues. But it “does deliver a reliable, cost-effective solution,” said Dave Jesty, the managing director of project finance and infrastructure at Manulife, one of Canada’s largest backers and investors in solar projects.

Solar, by comparison, is expensive to install, a distinct disadvantage in a country like Canada where labour is pricey. Even a modestly-sized solar installation requires thousands of holes in the ground to support a blanket of precision panels, Mr. Jesty said. The actual cost of solar panels might make up 23 or 24 per cent of a project; the remainder are transmission towers, land acquisition and installation and interest costs, legal fees and the like.

Solar faces potent competition in a Canadian electrical system that gets more than half its energy from cheap, clean hydro power. And there are financial obstacles, too, to building solar projects that compete on a purely commercial basis. Without a fixed government contract, there is simply too much risk to finance installation of a long-life solar project, Mr. Jesty said. “Typically what is required is a defined cash-flow stream,” he said. “For us to invest there has to be an off-take contract in place.”

Still, the cost revolution in Chinese factories has reached Canadian shores. In Ontario, companies are beginning to discover that they can erect their own solar installations “subsidy-free,” said Thomas Timmins, a lawyer who leads the renewable energy group at Gowling WLG.

“I get calls every day from people who are operating manufacturing plants who are saying, we have a parking lot, we have a roof,” he said. Their intent is to feed their own operations, rather than the grid, in order to reduce peak daytime electricity charges. And, Mr. Timmins said, “12 months from now, if you can put solar on your roof or in your backyard at your cottage, you will shave electricity costs,” he said.

India, meanwhile, has become among the world’s most eager solar adopters. It wants to build 100 gigawatts of solar capacity by 2022, equivalent to a third of the expected 2016 global total. KPMG has estimated that Indian solar projects will be 10-per-cent cheaper than coal, currently its largest source of power, by 2020. The country’s government has said it has already reached that point.

“I think a new coal plant would give you costlier power than a solar plant,” Indian energy minister Piyush Goyal said this spring.

Prices have fallen so low that industrial and commercial users can today generate their own solar power for 30-per-cent less than what they pay from the grid, Pramod Deo, former chair of the country’s Central Electricity Regulatory Commission, said in an interview. “It is very attractive for them – and even for residential consumers who have large rooftops,” he said. “It is because of the crash in solar prices.”

And industry believes there is more to come. IHS predicts another decline in solar pricing of 14 to 38 per cent this year, saying that by 2020, solar prices are likely to be half what they are today. Individual solar companies have made similar predictions. That may prove overoptimistic.

“I wouldn’t say it’s a slam dunk,” said Mr. Gujral, the Macquarie analyst. “These numbers are not definite. They’re aspirations and targets,” and based heavily on an expectation that polysilicon will continue to get cheaper. Mr. Gujral is not convinced that will happen.

What prices are unlikely to do, however, is rise again, which suggests that, at the very least, the gains made on Jinko’s factory floor are here to stay.

“Once it goes down, it never goes back,” said Mr. Hao, the chief scientist. And, he added, in university labs and his company’s own engineering offices, they are working to bring next year’s prices down even further. “We still have room for the technology to play,” he said.

5A Blue Ocean P&C Company Exhibits

| SOLAR ENERGY STATISTICS (SOUTHERN USA) | Year | | | | | | | | | | |
|-----------------------------------------------------------------|--------|--------|--------|--------|---------|---------|---------|---------|---------|---------|---------|
| | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 |
| Weather Related | | | | | | | | | | | |
| Number of Rainy days | 71 | 84 | 79 | 67 | 76 | 97 | 84 | 83 | 79 | 81 | 77 |
| Number of severe weather (storms) | 19 | 27 | 9 | 29 | 31 | 67 | 39 | 14 | 37 | 40 | 35 |
| Political Support | | | | | | | | | | | |
| States with energy rebate programs | 1 | 1 | 1 | 2 | 2 | 3 | 3 | 6 | 6 | 7 | 7 |
| % of voters considered candidates record on environmental issue | 1% | 1% | 2% | 3% | 5% | 10% | 12% | 13% | 15% | 17% | 20% |
| Manufacturing Base | | | | | | | | | | | |
| Number of panel provider companies | 0 | 1 | 4 | 8 | 10 | 15 | 20 | 22 | 23 | 25 | 27 |
| Number of panel manufacturers | 1 | 1 | 2 | 3 | 3 | 4 | 5 | 5 | 5 | 6 | 7 |
| Cost of photovoltaic cells (key component) | 113 | 103 | 90 | 70 | 66 | 63 | 62 | 50 | 49 | 47 | 45 |
| Energy production capacity 10sq.ft.panel (KwH) | 426 | 679 | 893 | 951 | 1235 | 1678 | 1931 | 2391 | 2538 | 2897 | 3256 |
| Components reported defective as rate per active units | 10% | 10% | 9% | 8% | 10% | 7% | 6% | 8% | 6% | 5% | 4% |
| Consumer Reports | | | | | | | | | | | |
| Cost of 10kwh panel system (USD 000's) | 125 | 110 | 105 | 95 | 90 | 85 | 80 | 75 | 70 | 65 | 60 |
| Number of homes with more than 1000 sq. ft. roof | 45,129 | 55,891 | 67,901 | 75,462 | 105,087 | 129,971 | 145,923 | 170,798 | 189,321 | 190,908 | 195,133 |
| Electric Company Solar energy usage | | | | | | | | | | | |
| Average purchase rate for solar energy per kwh (cents) | 70 | 85 | 57 | 87 | 80 | 105 | 88 | 65 | 81 | 85 | 77 |
| % of Total grid energy that is Solar powered | 1% | 2% | 1% | 3% | 3% | 5% | 5% | 5% | 6% | 6% | 7% |

Able Energy Consulting Group copyright 2015

6 Big Ben Bank

Maggie Crawley, Chief Risk Officer, looked across the table. She wondered when to bring the intense ongoing debate to a close. Such forthcoming dialogue was a sought after dimension in the risk management process. However, unless the management team came up with successful ideas and effective market positions, opportunities would fade away like the morning dew. Sophisticated products and services need considerable time for development and securing commitment from partners.

Was Big Ben identifying the right risk metrics? How should the risk profile behave and evolving over time? Were they simply monitoring business intelligence or was risk information forming their decisions? How could they leverage the expertise of their insurance group, Darwin? How could they cross sell to Dynasty's high-end clientele? New regulations and scrutiny seemed never-ending.

6.1 Overview

The banking group was formed in 2001 under the directorship of Mr. Saleen Patel. Mr. Patel gained his wealth as a self-directed fund manager using fundamental asset selection and key insights into the business models of his investments. The initial focus of Mr. Patel's banking group was finding best in class funds for its high net worth (HNW) clients. Mr. Patel's fund management business was formed in 1990 and its success was primarily built within European financial centres.

A key growth differentiator, in the initial years, was Big Ben's Private Banking division, which offered exclusive concierge services to its HNW clients. Another competitive advantage that Big Ben enjoyed, was Mr. Patel's network of connections, that included many members of NYC, London, and Zurich high society. Mr. Patel's reputed fund management, and tax management, prowess also contributed to the success of Big Ben.

However, the financial crisis presented some unexpected challenges. The AUM fell dramatically and some of the investors experienced hardships in their own businesses. The fund performance was dramatically negative and the subsequent increase in redemptions severely impacted overall AUM and forced a revision in the strategic approach.

Products / Services

Since inception the critical profit driver has been the excess of the MER (management expense ratio) charged on the AUM over the operational costs of fulfilling the fund management mandate. Big Ben Bank is a world leader in the exchange-traded fund (ETF) market, and has a strong brand and a loyal investor base. But MERs for ETF's are coming under increased downward pressure as more competitors come into this fund arena.

Traditional personal and commercial banking has been a smaller, but significant, component of the revenue pie. The operational model of the personal banking division is primarily online, rather than physical branches. This approach was meant to meet the needs of a globally mobile clientele. Fund transfer and foreign exchange transactions were once the majority of transactions but the travellers' cheque business is slowing. Transfers and transactions are now dominated by an ultra-high limit VISA card program. Foreign exchange transactions and "best rates" are an attractive feature of the VISA program.

The physical distribution model is almost non-existent and cannot support broad-based banking, but expertise exists on emerging technologies and connectivity with a time-critical customer base.

Revised strategy

The executive group, following strong direction from the four partners, has been asked to re-engineer the business focus, by lowering the minimum investable assets requirement for participation in the services traditionally offered, exclusively, to the Bank's (HNW) customers, and by offering more holistic wealth management and financial planning services. As a result, RPPC decided to acquire Darwin Life insurance group in 2008.

Mr. Patel articulated Big Ben's revised strategy in the following excerpt from a recent speech: "Our vision is to be the wealth management solutions provider of choice, and to expand the Bank's clientele-base by expanding our retail banking, wealth management, and insurance division. We will also build new global platforms, to support this new growth. Our path to differentiation is to deliver a personalised and unique financial planning experience to our clients, and by building a culture of innovation."

Risk Management

Big Ben Bank has from the beginning prided itself on a strong risk culture and has had an active risk management function. During the 2008 Financial crises, the bank capital was somewhat strained, but Big Ben has regained a good capital position, in recent years.

With a greater focus on innovation-based solutions and wealth management solutions intertwined with the Insurance group, the risk management function will need to evolve and adapt its strengths to a more agile environment.

The Executive mindset has been to increase focus on the financial planning sales approach, to leverage the wealth management capabilities within insurance contracts and to formulate a one-stop shopping interface to our globally mobile clientele.

Big Ben Bank uses various models to manage market risks as well as providing insight into decision making. The three most important ones are as follows:

- i) A model to capture the correlation between mortgage prepayment rate and interest rates using statistical best fit techniques
- ii) Black-Scholes option pricing model based on the underlying asset price, the strike price and assumptions on asset price distributions, etc. in the hedging program
- iii) Short-cut bond price model based on assumptions about yield movements to provide some quick estimates

Big Ben Bank use frequency tests to validate VaR risk models based on the number of losses exceeding VaR and a significance level.

Big Ben conforms with the documentation standards of RPPC's model risk management framework.

The key is still our private club; our brand; our family!!

Regulatory Challenges

In December 2010, the Basel Committee issued the Basel III rules text, which presents the details of global regulatory standards on bank capital adequacy and liquidity agreed by the Governors and Heads of Supervision, and endorsed by the G20 Leaders at their November 2010 Seoul summit.

The rules text presents the details of the Basel III Framework, which covers both micro-prudential and macro-prudential elements. The Framework sets out higher and better-quality capital, better risk coverage, the introduction of a leverage ratio as a backstop to the risk-based requirement, measures to promote the build-up of capital that can be drawn down in periods of stress, and the introduction of two global liquidity standards.

Through authorities provided in the Dodd-Frank Act, the Federal Reserve Board (FRB) regulates at the holding company level a number of companies that are primarily life insurers. The Dodd-Frank Act also authorized the FRB to supervise nonbank financial companies designated as systemically important by the Financial Stability Oversight Council (FSOC), some of which may be insurers. In addition, Section 171 (the Collins Amendment) of the Dodd-Frank Act authorizes the FRB to establish capital standards for these insurance companies.

The FRB exercised these new authorities on June 7, 2012, issuing three proposed rules which collectively implement Basel III capital standards and Section 171 of the Dodd-Frank Act.

Capital Management

Big Ben Bank is committed to maintaining a strong capital base to support the risks associated with its businesses. Strength in capital management contributes to safety for the Big Ben's customers, fosters investor confidence and supports high credit ratings, while allowing the bank to take advantage of

growth opportunities as they arise and to enhance shareholder returns through increased dividends and share repurchases.

Big Ben's capital management framework includes a comprehensive Internal Capital Adequacy Assessment Process (ICAAP), aimed at ensuring that the bank's capital is adequate to meet current and future risks and achieve its strategic objectives. Key components of the bank's ICAAP include sound corporate governance; creating a comprehensive risk appetite of the Bank; managing and monitoring capital, both currently and prospectively; and utilizing appropriate financial metrics which relate risk to capital, including economic and regulatory capital measures.

The following are the core principles that govern the Capital Management of the bank:

- Manage capital within the framework set by the regulators, monitor capital based on planned changes in the Bank's strategy, and identify changes in its operating environment or changes in its risk profile.
- Ensure appropriate governance and oversight, including clear delineation of roles and responsibilities.
- Establish a capital management framework that focuses on the interrelationship of risk appetite, risk profile, and capital capacity.
- Implement a sound risk management process that ensures management identifies and stress tests all material risks, understands the nature and level of risk taken by the Bank and how this risk relates to capital adequacy.
- Ensure a robust capital adequacy assessment process that is supported by appropriate governance, oversight and internal control review.
- Ensure adequate systems, resources, processes and controls are in place to support the planning, forecasting, monitoring and reporting of capital both internally to Executive Management and the Board of Directors (the Board) and externally to the regulators.

Risk Appetite

- a. Common Equity Tier 1 (CET1) Ratio – Internal Target of 9.5%
- b. Tier 1 and Total Capital Ratios – Internal Target of 11.5% and 13.5%
- c. Economic Capital – For economic capital, the internal target within the Bank's 2016 Risk Appetite Statement is based on the Bank's long term definition of available capital, which is mainly common shareholders' equity. For the Bank's medium term internal target, common shareholder's equity should be at least 100% of required economic capital; however, in the short term, it may be as low as 95% of required economic capital and supported by preferred shares
- d. Leverage Ratio – include an operating buffer of 1% over minimum leverage ratio requirement of 3.0%.

6A Big Ben Bank Exhibits

EXHIBIT 1 Big Ben Bank Financial Data

I. Year End Balance Sheet

Big Ben Balance Sheet

| | 2015 \$million | 2014 \$million | Increase/ (Decrease) \$million | Increase/ (Decrease) % |
|-----------------------------------------------------------------|-------------------|-------------------|--------------------------------------|------------------------------|
| Assets | | | | |
| Advances and investments | | | | |
| Cash and balances at central banks | 4,736 | 3,272 | 1,464 | 45% |
| Loans and advances to banks | 6,598 | 5,206 | 1,392 | 27% |
| Loans and advances to customers | 2,638 | 2,436 | 202 | 8% |
| Investment securities held at amortised cost | 549 | 483 | 66 | 14% |
| | 14,521 | 11,397 | 3,125 | 27% |
| Assets held at fair value | | | | |
| Investment securities held available-for-sale | 7,979 | 7,097 | 882 | 12% |
| Financial assets held at fair value through profit or loss | 2,483 | 2,702 | (219) | (8)% |
| Derivative financial instruments | 6,793 | 4,786 | 2,007 | 42% |
| | 17,255 | 14,585 | 2,670 | 18% |
| Other assets | 4,392 | 4,074 | 317 | 8% |
| Total assets | 36,168 | 30,056 | 6,112 | 20% |
| Liabilities | | | | |
| Deposits and debt securities in issue | | | | |
| Deposits by banks | 6,548 | 5,037 | 1,511 | 30% |
| Customer accounts | 3,758 | 3,699 | 58 | 2% |
| Debt securities in issue | 6,128 | 4,085 | 2,043 | 50% |
| | 16,434 | 12,822 | 3,612 | 28% |
| Liabilities held at fair value | | | | |
| Financial liabilities held at fair value through profit or loss | 2,160 | 2,268 | (108) | (5)% |
| Derivative financial instruments | 6,893 | 4,713 | 2,179 | 46% |
| | 9,053 | 6,981 | 2,071 | 30% |
| Subordinated liabilities and other borrowed funds | 3,272 | 3,116 | 156 | 5% |
| Other liabilities | 5,152 | 4,938 | 214 | 4% |
| Total liabilities | 33,910 | 27,857 | 6,053 | 22% |
| Equity | 2,258 | 2,199 | 59 | 3% |
| Total liabilities and shareholders' funds | 36,168 | 30,056 | 6,112 | 20% |

II. Liquidity Risk Policy

The following data are the 3 liquidity measures the bank had used to monitor their liquidity exposures for the past 5 years (mm denotes millions).

| Measure | 2011 | 2012 | 2013 | 2014 | 2015 |
|----------------------|-------------|-------------|-------------|-------------|-------------|
| Liquidity Index (%) | 82% | 88% | 89% | 90% | 90% |
| Financing Gap (\$mm) | \$1,050mm | \$813mm | \$1,392mm | \$750mm | -\$850mm |
| Net Liquidity (\$mm) | -\$750mm | \$1,187mm | \$608mm | \$1,250mm | -\$800mm |

The bank also has a liquidity crisis plan that outlined the roles and responsibilities of each executive during a liquidity crisis. Furthermore, the plan also defined a mandatory decision-making process and communications that need to take place during the crisis. The plan also defined the criteria to trigger the liquidity crisis plan. These are the only measures or tools the bank used to manage and monitor their liquidity risk up to this point.

The bank came out from 2008 financial crisis unscratched. The bank stayed solvent and did not have severe liquidity problem and the executives of the bank are very happy with the performance of the bank after looking at these historical measures and comfortable with the current liquidity risk mitigation policy.

III. Investment Limits and triggers

| Criteria | Instructions | Limit per issuer |
|----------------------|---------------------|-------------------------------|
| Fixed Income | Permitted | 20% of portfolio Market Value |
| Real Estates | Permitted | 10% of portfolio Market Value |
| Equities | Permitted | 20% of portfolio Market Value |
| Derivatives * | Permitted | 15% of portfolio Market Value |

| FI Category | Limit (% of portfolio Market Value) |
|------------------------------------|--------------------------------------------|
| Treasury / Agency | 100% |
| Sovereign Treasury | 100% |
| Corporate / Credit <= B+ | 10% |
| Corporate / Credit > B+ | 50% |

*Derivative Financial Instruments written:

- Forward Contract
- Interest swap
- Currency Swap
- Put/Call options

EXHIBIT 2

Big Ben Bank Internal Capital Adequacy Assessment

The adequacy of the capital is assessed against the current risk profile of the consolidated Bank, as well as its future expected and/or possible profile based on strategic initiatives and objectives, including the results of the bank's enterprise stress testing program. Capital adequacy is also assessed against current and prospective regulatory requirements and internal capital adequacy targets.

Principles

- Maintain a sound ICAAP to periodically evaluate the adequacy of both economic and regulatory capital in relation to the Bank's risk profile and risk appetite.
- Ensure Executive Management assesses the adequacy of capital in the context of its current position, as well as various potential stress scenarios. A forward looking capital adequacy assessment includes consideration of the results of appropriate stress testing.
- Report the outcome of the capital adequacy assessment to the Board and ensure it is appropriately incorporated in the Bank's capital planning.
- Ensure periodic review of differences between regulatory and economic capital.

Methods

- Documented ICAAP procedures and methodologies have been formalized and are reviewed on a periodic basis.
- Executive Management continuously monitors its regulatory and economic capital in relation to its risk profile and risk appetite and internal capital adequacy targets.
- A comprehensive capital adequacy assessment is completed at least annually, and monitored on an ongoing basis.
- The comprehensive capital adequacy assessment is closely integrated with the Bank's annual capital planning process.
- The capital adequacy assessment includes forecasts of various scenarios of capital generation and growth in risk-weighted assets, both through organic growth and acquisitions for current and future periods.
- The results of the Enterprise Wide Stress Testing Program are incorporated in the overall assessment of the adequacy of capital.
- The results of the capital adequacy assessment are reported to the Board and incorporated, as relevant, in the Bank's capital planning.
- The executive management regularly reviews and documents the differences between regulatory and economic capital computations to determine the impact, if any, on the adequacy of capital. Where differences cannot be supported, consideration is given to changing either the economic or the regulatory capital models to align treatment of risk and capital measurements.
- An annual self-assessment of the effectiveness of the ICAAP is performed.

Assessment of Risk

The Assessment of Risks is owned by Enterprise Risk, Global Risk Management (GRM) and is updated annually in consultation with relevant management for each risk type. It is an integral part of the Bank's Internal Capital Adequacy Assessment Process (ICAAP) conducted by Capital Management, E.O. Finance. The Assessment of Risks is reviewed and approved by the ICAAP Oversight Committee (IOC), which reviews, objectively challenge and approves the inclusion and exclusion of risks per this document.

1. Outcomes

The outcome of the assessment for a given risk may be any of the following:

- included in economic capital;
- excluded from economic capital;
- excluded from economic capital, but included as part of internal capital considerations.

2. Criteria for Inclusion

This section describes the definition for the Materiality of Risk, and the criteria for inclusion in Economic Capital or Internal Capital.

2.1 Materiality of Risk

Criteria used for evaluating whether a risk is considered material to the Bank include any one or a combination of:

- pervasiveness of the risk across multiple business lines of the Bank;
- significance of the risk to a specific business line;
- likelihood and potential impact of the risk, i.e., whether the risk may cause unexpected losses in income or value of portfolios up to a given confidence level over a specified time horizon;
- evolving and emerging risks;
- other qualitative considerations such as strategic, economic, or environmental factors.

2.2 Relevance to Economic Capital

Criteria for evaluating whether a material risk is considered relevant for economic capital include any one or a combination of:

- whether holding economic capital would mitigate the risk;
- other qualitative considerations such as strategic, economic, or environmental factors.

2.3 Inclusion in Economic Capital Model

Criteria used to assess whether a material and relevant risk should be included in the economic capital model include any one or a combination of:

- is the risk reliably quantifiable, either through a model or scenario-based process? Risks that are not quantifiable should not be included in the economic capital model;
- has the risk been captured as part of another risk that is quantified for economic capital? A risk should not be included in the economic capital model if the risk is already captured by another risk already quantified in the model;

- the amount of economic capital to include should be based on the remaining risk after consideration of existing mitigants and controls;
- risks that are estimated to have maximum loss level which is not material in relation to the financial statements may be excluded; and
- other qualitative considerations such as strategic, economic, or environmental factors.

Inclusion in Internal Capital Adequacy Assessment

Definition

Internal Capital / Economic Capital

- o The Bank measures and reports its Internal Capital (IC) measures and capital adequacy to Basel's Pillar II requirements.
- o The Bank's IC measures are based on its economic capital (EC) framework and methodologies, adjusted for certain regulatory requirements. EC is a single metric used to measure multiple risks. All material risks to which the Bank is exposed are quantified and aggregated to determine the EC of the Bank.
- o EC measures the risk of unexpected losses in income or value of portfolios up to a given confidence level (99.95%) over a one year time horizon. It assumes that expected losses are a cost of doing business and are already reflected in loan loss provisions and product pricing.

7 Darwin Life Insurance Company

Darwin Life had tremendous top line growth in its Term, Universal Life (UL) and Variable Annuities (VA) over the past 5 years. Life sales had grown at a 30% rate in an industry with flat life sales. VA sales for the industry had rebounded since the financial crisis. Darwin had not been a player pre-crisis. But since the crisis VAs became attractive and reasonable. Pre-crisis, insurance companies had aggressively priced products with rich benefits by, in the view of many, by taking on too much risk. The crisis had resulted in many companies exiting or greatly reducing the benefits.

Since 2011 the executive team had been in overdrive working on a few large initiatives. 2015 seemed to pose even more challenges. The external environment created headwinds from low interest rates to new regulations and accounting requirements to less consumer disposable income to fierce competition. Since the crisis, companies had been continuing to exit product lines and markets and shedding distribution capacity. Were they doing enough? Did the front line have enough authority and resources to do the little things? How could Darwin continue its extraordinary growth? What would be the limits of that growth? How could the company take advantage of its position to extend its reach?

Or, were they doing too much? Every time you turned around the Wall Street Journal's front-page seemed to cover yet another high-risk meltdown. No industry, especially the financial sector, was immune. Darwin had aggressive plans. Did they have a handle on the risks they were taking? One thing he did know, standing still was a risk he wasn't going to take. Brandon needed the front-line business managers to see and grab opportunities, opportunities that weren't planned for or one of their objectives at the beginning of the year.

Background

Darwin Life is a mid-size life insurer headquartered in Albuquerque, New Mexico with an increasing presence in the domestic U.S. market. Life sales are distributed primarily through an agency system and annuity sales are distributed primarily through financial institutional channels (e.g., banks and broker-dealers). Darwin has experienced an era of success since embarking on a new strategic direction under new leadership ten years ago, measured by growth in earnings, revenue and distribution capacity. Recent growth has been fueled by core competencies - distribution relationships and product/service development.

Prior to the strategic change, Darwin lacked focus with little to no differentiation, high costs and stagnant sales. Prior management's view was that the customer was the agent not the policy holders. There was no focus on profitability or growth. Operations lacked discipline with frequent exceptions to administrative and underwriting standards. Products included traditional whole life, level term and current assumption Universal Life (UL). Although Darwin offered fixed and variable annuities there was no focus on asset accumulation products or distribution capacity within the financial institutional markets.

Ten years ago, new management shifted strategy to be focused on wealth management and a customer focus targeting middle to upper income individuals, professionals and small business owners with estate planning, tax-deferred accumulation, traditional income preservation and retirement income protection needs.

This strategic focus and management's solid execution through the early 2000's caught the eye of RPPC Dynasty. Dynasty thought Darwin was an attractive property and it became affordable when the market and financial industry stocks in particular, nose-dived. In hindsight the acquisition was a bargain. At the time there had been much heated debate. Darwin's focus on wealth management was a great strategic fit with RPPC's financial division – products and distribution

Core product segments are universal life, high cash value traditional life and variable annuities. Non-core segments include group annuities, individual fixed annuities and term life. Darwin enhanced its universal life products to better suit the consumers' insurance, estate and business planning needs and also introduced UL with secondary guarantees.

Darwin has pursued an aggressive organic growth strategy focusing on individual life and individual variable annuities through expanding and enhancing distribution channel. Today Darwin distributes life insurance primarily through career agents, banks, and direct marketing channels. The traditional agency channel utilizes a variable cost structure with compensation incentives which promotes persistency. Bank-owned life insurance (BOLI) products are marketed through independent marketing organizations that specialize in the BOLI market. In 2009 they expanded annuity distribution into financial institutions. It aims to add major new outlets, penetrate existing outlets and expand the agency distribution by 2-3 regional offices per year. Both the agent and institutional distribution expansions required a significant investment.

Agent service remains important. Customer focus creates a change in perspective that is critical in administrative and underwriting practices which translate into consumer value and expected higher profits. A disciplined operation strategy was split into separate operational strategies for pricing, underwriting, investments, financial reporting, claims, reinsurance, technology, corporate governance and risk management.

Over the past decade Darwin had become an innovator in service - providing wealth management solutions to individuals - including expertise in design and distribution of tax-sheltered or tax minimizing strategies such as estate planning and small business owner succession planning. Darwin invested in technology and staff to service both the customer and distribution channels such as new administrative and reporting platforms, implemented an imaging and automated workflow system, and established a team so that a client service representative answers the phone within four rings 95% of the time. This attention on customer focus and attention to service sets them apart from their peer group and supports an aggressive organic growth strategy.

Darwin offers a broad array of competitive products with customization for specific distribution channels. Darwin has not pursued a first to market strategy but has developed competency to be a fast follower and replicate new product designs in the market. Darwin sometimes lacks the expertise to replicate

processes and infrastructure. They have invested heavily in front end distributing, issuing and processing of new business. They have built strong relationships with the agency and institutional distribution channels.

Darwin has had high costs partly due to misaligned resources. Legacy products and systems have drained resources. As a result not enough resources have been devoted to infrastructure or in force management. Resources are devoted to new products and new business and priority placed on customer service and growth in distributions. Dedicated resources to manage in force business have been insufficient. Darwin was slow relative to its peer group in actively managing its spread compression due to low interest rates. Time constraints and lack of expertise in some cutting edge product areas resulted in less than effective back end areas including risk mitigation and management operational monitoring and reporting. Greater speed is needed to respond to business problems including risk monitoring and escalation. Operational areas are silo-based resulting in less effective collaboration and cross-functional continuous improvement processes. Darwin is moving towards a disciplined operational focus in underwriting, investments and diversified competitive products.

Darwin has solid ratings from every major rating agency – A.M. Best, Standard and Poor’s, Moody’s, Fitch, and Insight Ratings.

Financial Analysis

Darwin has outperformed the industry over the past 10 years regarding growth in life sales, annuity sales, equity, assets, and distribution capacity. Relative to the industry and similarly rated companies, Darwin unfavorably has higher leverage, lower interest coverage and lower liquidity and favorably has higher return on capital and lower expenses. Relative to its peer group, Darwin has had a lower operating income margin and a lower net income margin, a higher investment yield, a higher expense ratio, higher growth in life insurance in force, higher growth in equity, and average mortality and persistency.

The Industry

The 55-75 age group has \$7 trillion in investable assets and within a decade the 401 (k)/IRA rollover market will exceed \$1 trillion per year. The shift from life protection to pre-retirement accumulation to post-retirement income protection and retirement asset management will accelerate.

As protection moves from pre-mature death to protection from longevity there are opportunities for companies with product, distribution, and service (trust, process and advice). Variable deferred annuities have transformed from tax-deferred mutual fund investments to guaranteed retirement vehicles. Protection is the differentiator versus other financial services (e.g., 85% of all variable annuity sales have living benefit riders).

Successful companies will have well positioned defensible market positions, pricing power, advanced technology and systems to enhance service and process and lower costs, operational efficiencies, experienced management, high-quality financial reporting and corporate governance, strong asset-liability management, investment and risk management, a focused and balanced growth strategy, the ability to innovate products and distribution by partnering with other services (financial planners, estate attorneys, tax experts, and healthcare advisors), and the ability to build customer relationships.

Risk Management

Darwin formalized its risk management function with the creation of an ERM Committee in 2007 followed by a new a CRO position and a Risk Management department in 2008. The Committee meets quarterly. Its purpose is to build sustainable competitive advantages by fully integrating risk management into daily business activities and strategic planning. Excerpts from its Charter charge the Committee to:

- Increase the enterprise's value through promotion of robust risk management framework/processes.
- Align risk preferences, appetite and tolerances with strategy
- Monitor Darwin's overall risk exposure and ensure risks are measured and well-managed.
- Anticipate risk exposure and recommend action where exposures are deemed excessive or where opportunities exist for competitive advantages.

The Charter also specifies the Committee's Composition, Authority, Meetings and Responsibilities.

Darwin's risk appetite statement is:

- I. Capital The probability of a 15 percent loss of Statutory equity in one year is less than 0.5 percent.
- II. Earnings The probability of negative GAAP earnings in one year is less than 5 percent.
- III. Ratings Maintain an AA financial strength rating. Maintain capital 10% above minimum AA capital requirements. Maintain an A rating on senior unsecured debt.

Risk tolerances are based on the estimated impact of quantified risks on statutory capital since the core mission is policyholder protection. Market risk, credit risk, underwriting risk, operational risk, strategic and liquidity risks are quantified using a variety of metrics to capture multiple perspectives.

Investment Policy and Strategy

The investment department manages the general account investments. The Chief Investment Officer (CIO) reports to the CFO. Investment policy and strategy is reviewed and approved by an internal management committee consisting of the CEO, CFO, CIO, and SVPs (or VPs) of its major business lines. Internal management committee decisions are subject to review by the board's investment committee. The internal management committee meets quarterly and is responsible for reviewing investment results and approving the use of new investment instruments. Day-to-day decision-making authority is delegated to the CIO, up to specified limits. The CIO may delegate approval authority to his or her subordinates. Transactions in excess of the CIO's approval limit require approval by the CEO and CFO.

The company's general account is invested primarily in fixed-income assets. Within the general account there are separate investment portfolios for each of the main product lines. Variable annuity investment accounts are held in a separate (segregated) account and are managed by a third-party investment advisor.

A New Way to Reach Customers

Brandon Kaladin, CEO was up late thinking about potential strategies to present at an upcoming quarterly Board meeting. He knew there were opportunities to win market share from competitors as

well as to sell to markets no other companies were reaching. He knew the Board was looking for bold ideas that would ensure the company could grow for years to come.

One idea that kept coming back to him was whether a direct marketing distribution channel could work at Darwin. This would involve Darwin selling financial products directly to their customers, most likely over the Internet. This would allow Darwin to reach millions of new customers, potentially reduce commission expenses and allow for a sales process that could appeal to a large section of the population, especially amongst millennials who Brandon found were particularly disengaged in traditional channels.

This idea had been around for a while and Brandon had been warned by his direct reports that this wouldn't be a good strategy for Darwin. They were concerned that Darwin didn't have the technical expertise to develop a seamless direct marketing sales process. They also worried that the existing career agency force would view any attempt to replace them with a website as hostile to their livelihood and any online gains would be wiped out.

Brandon understood the risks that kept his direct reports apprehensive but he still felt it was time to start investigating direct marketing. He knew that the insurance industry had been around for hundreds of years and sooner or later every industry gets disrupted. He wants to make sure that it was Darwin doing the disrupting and not some other company like Google or Amazon.

Risks

Credit Risk

Darwin invests in investment grade quality bonds (S&P at or above BBB-). Fixed-income securities in the general account have exposure limits at individual obligor (issuer) and sector levels. Obligor-level limits vary according to asset type and credit quality, as determined by external rating agencies. The investment department monitors compliance of the exposure limits.

For each portfolio, there are weighted average credit quality targets. Portfolio credit quality is measured by converting each asset's external credit rating into a numerical score. Scores are a linear function of credit ratings (AAA = 1, AA = 2, etc.). Sub-category ratings (i.e. + or -) are ignored in the scale. The company prefers to maintain a score above 3.5 for each line of business.

Market Risk

Semi-annually within each block of business, Darwin measures the effective duration of the assets and liabilities. If the asset and liability durations are further apart than 0.5, the asset portfolio is rebalanced such that its new effective duration equals that of the liabilities.

The VA hedging program uses a semi-static hedge updated for market factors weekly and for in force changes monthly. The key risk measures are the market greeks. Darwin currently hedges delta and rho. The program purchases derivatives so that at least 90% of liability delta and 50% rho are hedged. Existing hedges are not sold if the hedge ratio exceeds these thresholds. Gamma, vega and cross greeks are self-insured due to system complexity, the cost of hedges, the tendency of equity volatility to mean revert and other factors. US GAAP and Statutory reserves, in and of themselves, are not hedged. There is risk that this may result in insufficient protection on GAAP and Statutory bases.

The hedge program has not yet been integrated into the main legacy system as there is a backlog in getting back-end risk reporting on the system. Currently it is run separately by Tim Ballmer and his risk management team who develop the necessary assumptions for the hedging models. There has been an effort to integrate the assumption-setting process across product development, financial reporting and risk management, but it is only in the planning stages, as the company culture of silo-based operations has been hard to overcome. The only assumption currently shared across functions is the static policyholder behavior assumption. While hedges are updated weekly, hedge effectiveness, liability attribution, and risk factor calculation are only tested quarterly.

Market risk on group annuities with separate accounts and interest rate risk on general account products is currently unhedged. A small portion of the group annuity block has guaranteed minimum death benefits (GMDB) and guaranteed minimum income benefits (GMIB), exposing Darwin to a small amount of unhedged equity risk. However, the risk management team has determined that the capital at risk is within acceptable risk tolerances.

Liquidity Risk

The liquidity policy requires Darwin to hold sufficient liquid assets to meet demands for cash in a liquidity crisis. One scenario considers a reputational liquidity crisis where markets continue to operate normally and the liquidity crunch affects only the company. The liquidity stress test anticipates situations where the company's ability to sell assets to meet cash needs from its liability products is hindered by the market taking advantage of the company during the crisis. Another scenario considers a crisis in which the entire market is not able to sell assets at a reasonable value.

Operational Risk

The CRO is responsible for collecting and disseminating risk information. A report is prepared monthly and distributed to executive management.

Stress Testing

Stochastic testing is supplemented with deterministic scenario-based stress tests, performed annually. Each test is applied as shocks to the model assumptions (for example, mortality, lapse and market assumptions). Interest rates have a floor of 0.10%

Additional risk factors are described in Appendix 7 Exhibit 3.

Liquidity and capital

Vin Atium's PC beeped as a new e-mail arrived. It was the agenda for tomorrow's 10 a.m. - 12 p.m. meeting. Vin was a new member of the Liquidity and Capital Committee and it would be her first meeting. A recently adopted ERM policy charged the committee with an annual review of Darwin's Liquidity Plan and Capital Plan. The recent financial crisis taught the importance of liquidity and capital - managing in normal conditions is one thing, managing in a crisis is another!

Like many companies during the crisis Darwin responded by building large cash balances far exceeding pre-crisis maximum cash limits per Darwin's Investment Policy. At its peak cash represented 10% of general account assets. Management and the Board wanted to demonstrate financial strength to policyholders, rating agencies and analysts that under no conditions would they need to sell assets at the sale prices.

Darwin had historically used standard accounting liquidity ratios to measure liquidity and a maturity ladder to analyze their ability to fund cash outflows over time. RBC was the primary capital measure.

Various stress scenarios were tested although until the financial crisis the focus was on the liability side and some event such a downgrade resulting in high surrender rates. The business and financial forecasts provided by the Actuarial Reporting and Accounting departments were key tools in managing appropriate levels.

In 2008-09 she had always wondered what was the right cash level. Darwin had stopped buying new investments until its cash levels were extraordinarily high (she felt too high). However it was better that no analyst could question whether it was enough. No company wanted to be downgraded. Protecting the policyholders and Darwin's ratings was worth the cost. But if resources had been marshaled and the models had produced better information, could Darwin have demonstrated a lower cash level was sufficient? Holding cash was a costly drag on earnings due to the foregone investment income. Earnings represented future capital. Today's capital problems were created by yesterday's solution to liquidity.

In reviewing the Liquidity Plan and Capital Plan and how they were put into practice, she asked,

Were the timeframe dimensions being appropriately addressed?

Were all sources and uses of liquidity identified?

Were they using the right metrics to measure of liquidity position?

In a liquidity crisis were responsibilities, possible actions and action criteria clearly defined?

Were capital allocations and returns on capital appropriately risk-adjusted? RBC was a constraint but what was the right capital measure? Economic capital?

Were they considering the appropriate stress and what-if scenarios?

She thought Darwin's liquidity and capital management was good but could be better. However she was hesitant to ask any questions during the meeting. Being a team player meant not asking questions. Her role would be to carry out any marching orders. The Committee was evaluating a number of initiatives to improve Darwin's liquidity and capital position.

To improve liquidity and capital the agenda items included:

- Securitizing redundant term and ULSG reserves,
- Reinsuring 20 and 30 year level term
- Modifying and expanding lines of credit and other credit facilities
- Becoming a member of the Federal Loan System which provided an alternative to banks
- Changing product designs and to improve liquidity
- Revisiting capital intensive products including 15/20/30 year term, ULSG, fixed annuities and VAs - reduce Guarantees and increase Rates.
- Hedging un-hedged liabilities
- Implementing renewal/replacement product strategies

As she looked over the Agenda, she reflected:

This is a good list ... Securitizations are complicated and expensive. She had to find a Memo and White Paper – it had a high level view of redundant reserves, securitization flows, costs, risks.

With no firsthand experience Darwin lacked expertise. They would have to put together the right team, a team that could identify and work through the issues ... timely. What would the curve be? It would take resources from many departments to pull that off

Reinsurance was a good way to manage capital but what would the earnings trade-off be?

How do we determine the right levels for credit facilities – stress tests? Stochastic tests – what CTE?

Capital intensive products? That pretty much covers everything we sell except whole life – did they leave anything out - marketing will be super receptive ...

I wonder what liabilities and hedging they have in mind?

I wonder what product strategies they are considering?

The committee wouldn't be able to push everything through the initiative and budget process. She wondered if they would only discuss what needed to be done or if they would also discuss how to make things happen.

A New Product

Anne Kofsky, VP Life Insurance Division had made a proposal to expand the offering of life insurance product into Universal Life with Secondary Guarantees (ULSG) to appeal to the middle to upper income clientele. The proposed product introduced a market value adjustment (MVA). Initial product development efforts indicated that the product will produce a Statutory internal rate of return (IRR) at 15% which is above the hurdle rate set by the holding company. The new product design reflects general account investment supported by a portfolio of investment grade corporate bonds supplemented by interest derivatives and credit default swaps (CDS) to manage the interest and credit risk, competitive pricing in the guaranteed provisions as well as moderate assumptions in shadow account projections and a financial reinsurance agreement to reduce the onerous capital requirement.

Below is an e-mail excerpt from the CEO.

From: Brandon Kaladin, CEO
Sent: Monday, March 25 2015 7:36 PM
To: Josie Brennan, CRO
cc: Anne Kofsky, VP
Subject: Re: ULSGMVA

Anne's report on the proposed ULSG with MVA looks very promising both in terms of revenue and profit. I see the actuaries used new stochastic models with multiple interest scenarios and dynamic consumer behavior. Josie, I know your team has been involved and is still reviewing. As aggressive as our 3-year UL sales growth are I don't want to have a misfire on launching a UL product like ABC Life and XYZ which withdrew products from the market within a year after introduction. Their agents were not happy. Could you perform a more comprehensive review than usual to evaluate if the models are adequate to capture all the major risk categories and if the additional risk-taking is aligned with our risk appetite? Have you settled on new risk metrics and what will be on the risk dashboard? The target launch is still June 17.

Rating agency preparation

Senior VP and Chief Corporate Actuary Roger Heilman conducted the weekly meeting for the Corporate Department. Towards the end of the meeting Roger said, “Today I received the agenda and discussion points from Insight Ratings. They always ask for a lot. You never know what will end up being discussed so we need to be over prepared. They might not cover everything on the list but you never know. What they do discuss they grill you on so we need to be prepared. And our preparation for Insight last year was of tremendous value when Dynasty folks visited us last fall. This will be similar to last year – we need to anticipate and be able to answer 99% of what they could ask. In addition to the discussion points we will use the list I developed of additional or follow-up questions they could ask. Any questions? Good, I’d like to see everything in two weeks.”

On the way back to their desks Becky and Stanley groaned. “Becky, last year's list had over 100 extremely detailed analysis items, for which none of the data was readily available.” “Yeah, Stanley, nor do we have decent analytical tools to analyze the data. It’s all manually intensive. The data is not standardized, it has inconsistent formatting and scattered across the four corners of the building. Last year Roger said he was going to make quality data for analysis and decision making a priority for management.” He said, “well garbage in and garbage – oh we need to get something useful out.” She said “we could take the resources and time spent on developing a footnote to a footnote that is buried in a file cabinet or running from crisis to crisis and devote them to material issues that would make a difference/impact.”

Excerpts from Insight Ratings email and Discussion Points are in Appendix 7A Exhibit 1.

Capital Management

Darwin does not currently calculate economic capital. Darwin has been working with the consulting firm Consultants R Us (CRS) on capital measurement and management strategies. Under current consideration is a “risk and capital” model that would aid management in gauging the adequacy of overall capitalization of the company and in allocating resultant capital to target lines of business or niche business segments. Darwin wishes to gauge the risk adjusted return on capital (RAROC) by segment to aid in its business planning. In essence, Darwin’s goal is to improve its ability to better manage capital and return. Underlying this goal, CRS advises on three underlying themes:

- Capital Productivity
- Capital Protection
- Capital Adequacy

Thought leadership focuses on the notion that there is a trade-off between having enough capital to minimize insurance company failures and having the minimum amount of capital so capital can be deployed. As such, CRS recommended using a risk adjusted return on required capital (RAROC) approach. In essence, this approach considers both how much Darwin is earning on the capital that is

committed to the business and how much capital is needed to ensure that policyholders are paid in the event of a stress scenario. CRS argues that RAROC addresses the aforementioned trade-off between capital productivity and capital adequacy. To set a target or requirement for the amount of capital that should be held by an insurance company or group requires a clear vision of the purposes for which capital is held. Effectively defined capital requirements serve several purposes, including, but not limited to:

- Providing funds so Darwin is able to honor its obligations during adverse contingent events.
- Motivating a company to avoid undesirable levels of risk
- Promoting a risk management culture to the extent that capital requirements are a function of actual economic risk

Economic capital will be what Darwin requires for ongoing operations and what it must hold in order to gain the necessary confidence of the marketplace, its policyholders, its investors, and its regulatory supervisors. At the same time, the operations of Darwin, after the net effect of all the inherent risks, must yield a rate of return deemed reasonable by the providers of the insurer's capital.

7A Darwin Life Insurance Company Exhibits

EXHIBIT 1 Rating Agency

Insight Ratings

1 Insight Drive, Capital City phone 123/555-6500

www.InsightRatings.com

March 7, 2015

Roger Heilman
Senior VP and Chief Corporate Actuary
Darwin Life Insurance Co
123 Main Street
Albuquerque, NM

Dear Roger:

The following are a list of items that we would like to discuss for our upcoming 9 am – 4 pm April 12th, 2015 meeting. An item of particular concern that we will spend time on will be your investment portfolio and your capital levels. With the current low interest rate environment, our rating committee is examining closely investment portfolios and the effect investment performance has and will have on earnings and capital.

As part of our year round rating process, we will look to determine the rating for the company shortly after the completion of the rating meeting and the management discussions that will follow. As a result, we would appreciate a comprehensive response to the items noted in the attachment.

If you have any questions regarding our request please call me. Please supplement this request with any additional information that you feel would be helpful to our review. In order for us to fully review your information, submit two copies of this information at least one week prior to the meeting date to allow time to review the material.

I look forward to meeting you and the management team.

Regards,

Morgan Hubbard
Financial Analyst
Life/Health Division

Below are excerpts from the Insight Ratings Discussion Points attachment.

Meeting Agenda

- Strategy Overview
- Corporate Governance and Audit Committee Update
- Business Line Review
- Individual Life
- Individual Annuities
- Distribution
- Financial Projections (split by product and by distribution)
- Investments
- Asset/Liability Management and Liquidity Investments
- Capital Management
- Enterprise Risk Management

Information Requests

- Audited (if available) 2014 Statutory and GAAP Financial Statements
- 3-year Plan: Statutory and GAAP statements
- Updated bank facility agreements
- Cash flow testing summary
- Product brochure and illustration for top selling life products, VA and fixed annuity.
- LIMRA sales information on different products; also show persistency
- Holding company only IS and BS that shows asset details
- Business with Big Ben Bank: life insurance in-force and life and annuity sales
- Profitability measures
- Retail fixed annuity and variable annuity flow information including net sales and spreads

Questions

Overview

- Review Darwin's Corporate Strategy and capital allocation in the organization.
- Review the most recent Board of Directors presentation materials.
- Discuss the synergies of Darwin's current business segments.
- Provide updates on any recent/potential acquisitions, sales or strategic affiliations.
- Discuss ventures with Big Ben Bank.
- Discuss plans for maintaining long-term top line growth (i.e. revenue) as well as plans to improve operating performance (specifically statutory earnings performance) and your capital and surplus position.
- How will Darwin maintain its competitive advantage in the market place?

Corporate Governance and Audit Committee Update

- Discuss audit report issued by Harmon & Strauss, LLP (see details in Exhibit 8)
- Discuss any issues raised in the Corporate Governance and Audit Committee

Business line review

- Review marketing/business plan for the company including changes in product, market, or geographic focus/expansion.
- Discuss current business plans by line of business including current product development plans and how trends in product design and technology are incorporated.
- Discuss the impact of the current interest rate environment on your core business lines.
- Review your claims experience versus pricing assumptions.
- Discuss the company's use of mortality reinsurance.
- Discuss the pricing on fixed annuity and life products. Quantify target pricing spreads; quantify annuity gross and net spreads – historical and projected.

Distribution

- Discuss agent retention statistics
- Discuss sales promotions - quantify costs and impact on sales
- Discuss competition in the UL and VA markets
- Review your distribution channel strategy and growth plans.

Financial Projections

- Discuss any material variances including margins, direct and net premiums, expenses, benefits and commission levels.
- Provide a by-line analysis of performance/profitability including the sources of earnings.
- Discuss the company's different products including profit targets, anticipated emergence of statutory earnings, acquisition costs and sensitivities to different risk factors such as expense, interest rate, equity markets, mortality and lapse.

Investments

- Provide impairments in 2014 and 2015 YTD.
- Provide current portfolio yields and new money rates in aggregate and for different classes.
- Discuss any changes to the investment strategy.
- Review alternative assets and sub-prime mortgage / alt-A and CMBS exposures.
- Discuss developments in portfolio credit quality and expected investment related realized and unrealized losses.
- Provide your investment policies and a narrative on investment strategies. Discuss your investment strategy and any expected changes in the near term.

ALM

- Review of asset/liability management, cash flow testing/sensitivity analysis. Were there any changes to pricing assumptions because of investment performance?
- Describe the VA hedging strategy and the risks being hedged. Which risks are not hedged?

Capital Management

- Quantify the impact of redundant reserves in term (XXX) and UL (AXXX). How does the company intend to deal with the reserve strain?

- What was the reserve impact of AG 38 in 2015? Any product changes?
- Discuss securitization plans.
- Discuss the company's use of reinsurance. Any changes in reinsurance program/retention?
- Discuss capital adequacy as measured by the company and future access to capital.

Enterprise Risk Management

... several bullet points

Miscellaneous

- Update and summary of outstanding litigation, market conduct and/or compliance issues.
- Discuss any expense control initiatives.

... several additional bullet points

EXHIBIT 2

Business Intelligence

Product Comparisons

Darwin tracks market position within each business segment. Considerations include premiums paid, benefits, features, credited rates and guarantee period, other guarantees, fees, surrender charges, service, and policy cash values over time (under current assumptions and under guarantees). Competitors tracked vary by segment and product.

Distribution Capacity

Darwin tracks Agency distribution growth by number of agents, by geographic penetration, total sales by agents, sales over prior year sales for same agents banded by years of service, retention rates and training costs. Darwin tracks Institutional distribution growth by distributor count, number of wholesalers, number of appointed representatives, ranking within each partner, change in percentage share and dollar volume within each partner and number of appointed Reps.

Financial Growth

Darwin measures financial growth using the following KPIs: GAAP earnings, Statutory equity, total assets under management, life insurance sales (first year premium), variable annuity sales and fixed annuity sales, RBC ratio and debt ratio.

Darwin vs. Industry vs. Peer Group

Darwin uses the following to benchmark itself.

1. NAIC Risk Based Capital (RBC) Ratio
2. Capital Growth Sharpe Ratio
3. Financial Leverage
4. Earning Interest Coverage
5. Cash Flow Interest Coverage
6. Return on Capital
7. Expense Ratio
8. Liquidity Ratio
9. Individual Life Premium as a % of Total

EXHIBIT 3

Risk Factors

In addition to the risks outlined in the Background material in Section 7 numerous other risks include:

Risk Factors

Economic conditions may materially adversely affect our business and results of operations. The Company's strategies for mitigating risks arising from its day-to-day operations may prove ineffective resulting in a material adverse effect on its operational results and financial condition.

The development and maintenance of our various distribution systems are critical to growth in product sales and profits.

A ratings downgrade or other negative action by a rating agency could materially and negatively affect our business, financial condition and results of operations.

The Company's results and financial condition may be negatively affected should actual experience differ from management's assumptions and estimates.

The Company could be forced to sell investments at a loss to cover policyholder withdrawals

Interest rate fluctuations or significant and sustained periods of low interest rates could negatively affect the Company's interest earnings and spread income or otherwise impact its business.

Equity market volatility could negatively impact the Company's business.

The Company's use of derivative financial instruments within its risk management strategy may not be effective or sufficient.

The use of reinsurance introduces variability in the Company's statements of income.

The Company is highly regulated and subject to numerous legal restrictions and regulations. Changes in regulation may reduce our profitability and growth.

New accounting rules, changes to existing accounting rules, or the grant of permitted accounting practices to competitors could negatively impact the Company.

Financial services companies are frequently the targets of legal proceedings, including class action litigation, which could result in substantial judgments.

Changes to tax law or interpretations of existing tax law could increase our tax costs.

Companies in the financial services industry are sometimes the target of law enforcement investigations and the focus of increased regulatory scrutiny.

Litigation could result in substantial judgments against us or our affiliates.

The Company's ability to maintain competitive unit costs is dependent upon the level of new sales and persistency of existing business.

The Company's investments are subject to market and credit risks. These risks could be heightened during periods of extreme volatility or disruption in financial and credit markets.

The Company's reinsurers could fail to meet assumed obligations, increase rates, or be subject to adverse developments that could affect the Company.

Adverse capital and credit market conditions may significantly affect our ability to meet liquidity and financing needs or access capital, as well as affect our cost of capital.

The Company could be adversely affected by an inability to access its credit facility

The amount of statutory capital that the Company has and the amount of statutory capital that it must hold to maintain its ratings and meet other requirements can vary significantly from time to time and is sensitive to a number of factors outside of the Company's control.

The Company's ability to grow depends in large part upon the continued availability of capital.

The occurrence of computer viruses, network security breaches, disasters, or other unanticipated events could affect the data processing systems of Darwin or its affiliates and could damage our business and adversely affect our financial condition and results of operations.

EXHIBIT 4
Financial Data: GAAP Income Statements (in 000s)

| Total | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 |
|--------------------------------------|------------------|------------------|------------------|------------------|------------------|------------------|
| REVENUES | | | | | | |
| Premium - First Year | 784,780 | 911,720 | 1,077,880 | 1,289,710 | 1,594,260 | 2,090,450 |
| Premium - Renewal | 222,890 | 255,630 | 293,230 | 329,160 | 365,520 | 401,560 |
| Total Premiums | 1,007,670 | 1,167,350 | 1,371,110 | 1,618,870 | 1,959,780 | 2,492,010 |
| Net Investment Income | 597,270 | 595,330 | 606,450 | 624,430 | 647,770 | 685,240 |
| Other income | 42,050 | 51,360 | 61,150 | 73,190 | 85,850 | 103,940 |
| Total Revenues | 1,646,990 | 1,814,040 | 2,038,710 | 2,316,490 | 2,693,400 | 3,281,190 |
| BENEFITS AND EXPENSES | | | | | | |
| Claims | 100,500 | 129,890 | 143,730 | 168,890 | 198,370 | 235,170 |
| Surrender and other benefits | 601,710 | 659,910 | 722,420 | 726,080 | 791,210 | 863,940 |
| Inc. in reserves & S/A Transfers | 588,460 | 695,250 | 835,020 | 1,052,600 | 1,320,810 | 1,776,940 |
| Total Benefits | 1,290,670 | 1,485,050 | 1,701,170 | 1,947,570 | 2,310,390 | 2,876,050 |
| Field Compensation | 83,650 | 100,920 | 119,100 | 138,800 | 161,100 | 193,200 |
| Change in DAC | (49,100) | (63,270) | (75,070) | (87,090) | (100,330) | (120,350) |
| Total Acquisition Costs | 34,550 | 37,650 | 44,030 | 51,710 | 60,770 | 72,850 |
| Total Administrative Expenses | 69,280 | 77,220 | 84,090 | 91,700 | 99,740 | 107,750 |
| Total Benefits and Expenses | 1,394,500 | 1,599,920 | 1,829,290 | 2,090,980 | 2,470,900 | 3,056,650 |
| EBIT | 252,490 | 214,120 | 209,420 | 225,510 | 222,500 | 224,540 |
| Interest | 18,000 | 18,000 | 18,000 | 18,000 | 18,000 | 7,375 |
| Tax | 82,100 | 68,600 | 67,000 | 72,600 | 71,600 | 76,000 |
| Net Income | 170,390 | 145,520 | 142,420 | 152,910 | 150,900 | 148,540 |
| Variable Annuities | | | | | | |
| | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 |
| REVENUES | | | | | | |
| Premium - First Year | 561,000 | 669,800 | 812,600 | 1,000,000 | 1,280,000 | 1,750,000 |
| Premium - Renewal | - | - | - | - | - | - |
| Total Premiums | 561,000 | 669,800 | 812,600 | 1,000,000 | 1,280,000 | 1,750,000 |
| Net Investment Income | 73,700 | 85,000 | 98,000 | 119,000 | 142,000 | 175,000 |
| Other income | 25,800 | 33,400 | 40,600 | 50,500 | 61,600 | 76,500 |
| Total Revenues | 660,500 | 788,200 | 951,200 | 1,169,500 | 1,483,600 | 2,001,500 |
| BENEFITS AND EXPENSES | | | | | | |
| Claims | 16,200 | 28,800 | 36,000 | 46,600 | 59,200 | 75,100 |
| Surrender and other benefits | 114,650 | 161,100 | 193,650 | 228,100 | 276,450 | 315,700 |
| Inc. in reserves & S/A Transfers | 474,250 | 536,300 | 649,250 | 807,400 | 1,038,000 | 1,464,500 |

| | | | | | | |
|------------------------------------|----------------|----------------|----------------|------------------|------------------|------------------|
| Total Benefits | 605,100 | 726,200 | 878,900 | 1,082,100 | 1,373,650 | 1,855,300 |
| Field Compensation | 30,200 | 38,300 | 46,400 | 56,100 | 69,000 | 90,800 |
| Change in DAC | (13,400) | (20,900) | (24,300) | (28,500) | (36,900) | (52,300) |
| Total Acquisition Costs | 16,800 | 17,400 | 22,100 | 27,600 | 32,100 | 38,500 |
| Total Administrative Expenses | 14,300 | 17,400 | 20,200 | 24,100 | 28,200 | 32,800 |
| Total Benefits and Expenses | 636,200 | 761,000 | 921,200 | 1,133,800 | 1,433,950 | 1,926,600 |

| | | | | | | |
|-------------------|---------------|---------------|---------------|---------------|---------------|---------------|
| EBIT | 24,300 | 27,200 | 30,000 | 35,700 | 49,650 | 74,900 |
| Interest | | | | | | |
| Tax | 8,500 | 9,500 | 10,500 | 12,500 | 17,400 | 26,200 |
| Net Income | 15,800 | 17,700 | 19,500 | 23,200 | 32,250 | 48,700 |

| | | | | | | |
|-----------------------|-------------|-------------|-------------|-------------|-------------|-------------|
| Universal Life | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 |
|-----------------------|-------------|-------------|-------------|-------------|-------------|-------------|

| | | | | | | |
|-----------------|--|--|--|--|--|--|
| REVENUES | | | | | | |
|-----------------|--|--|--|--|--|--|

| | | | | | | |
|-----------------------|----------------|----------------|----------------|----------------|----------------|----------------|
| Premium - First Year | 58,780 | 72,420 | 89,480 | 106,810 | 125,360 | 145,650 |
| Premium - Renewal | 47,590 | 64,730 | 82,030 | 96,460 | 111,020 | 125,060 |
| Total Premiums | 106,370 | 137,150 | 171,510 | 203,270 | 236,380 | 270,710 |
| Net Investment Income | 110,770 | 106,530 | 105,850 | 109,730 | 114,170 | 121,040 |
| Other income | 5,850 | 6,760 | 8,450 | 9,490 | 9,750 | 11,440 |
| Total Revenues | 222,990 | 250,440 | 285,810 | 322,490 | 360,300 | 403,190 |

| | | | | | | |
|------------------------------------|----------------|----------------|----------------|----------------|----------------|----------------|
| BENEFITS AND EXPENSES | 0.36 | 0.35 | 0.36 | 0.36 | 0.36 | 0.36 |
| Claims | 27,300 | 35,290 | 33,930 | 38,090 | 42,770 | 47,970 |
| Surrender and other benefits | 32,760 | 32,110 | 36,270 | 41,080 | 45,760 | 51,740 |
| Increase in reserves | 92,310 | 120,250 | 152,270 | 182,600 | 214,410 | 246,440 |
| Total Benefits | 152,370 | 187,650 | 222,470 | 261,770 | 302,940 | 346,150 |
| Field Compensation | 21,450 | 25,220 | 32,200 | 38,500 | 45,100 | 52,400 |
| Change in DAC | (13,000) | (16,770) | (24,670) | (31,790) | (36,830) | (41,350) |
| Total Acquisition Costs | 8,450 | 8,450 | 7,530 | 6,710 | 8,270 | 11,050 |
| Total Administrative Expenses | 13,780 | 14,820 | 15,990 | 16,900 | 17,940 | 18,850 |
| Total Benefits and Expenses | 174,600 | 210,920 | 245,990 | 285,380 | 329,150 | 376,050 |

| | | | | | | |
|-------------------|---------------|---------------|---------------|---------------|---------------|---------------|
| EBIT | 48,390 | 39,520 | 39,820 | 37,110 | 31,150 | 27,140 |
| Interest | - | - | - | - | - | - |
| Tax | 16,900 | 13,800 | 13,900 | 13,000 | 10,900 | 9,500 |
| Net Income | 31,490 | 25,720 | 25,920 | 24,110 | 20,250 | 17,640 |

| Traditional Life | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 |
|-------------------------|----------------|----------------|----------------|----------------|----------------|----------------|
| REVENUES | | | | | | |
| Premium - First Year | 34,000 | 34,000 | 36,400 | 38,500 | 40,200 | 41,700 |
| Premium - Renewal | 54,900 | 63,100 | 71,200 | 80,000 | 89,300 | 98,600 |
| Total Premiums | 88,900 | 97,100 | 107,600 | 118,500 | 129,500 | 140,300 |
| Net Investment Income | 51,200 | 50,500 | 51,700 | 53,000 | 54,500 | 56,700 |
| Other income | - | - | - | - | - | - |
| Total Revenues | 140,100 | 147,600 | 159,300 | 171,500 | 184,000 | 197,000 |

| | | | | | | |
|------------------------------------|----------------|----------------|----------------|----------------|----------------|----------------|
| BENEFITS AND EXPENSES | | | | | | |
| Claims | 15,800 | 15,800 | 17,200 | 18,800 | 20,500 | 22,300 |
| Surrender and other benefits | 31,900 | 29,800 | 31,200 | 33,000 | 34,900 | 36,800 |
| Increase in reserves | 34,400 | 45,400 | 51,300 | 58,300 | 64,800 | 71,300 |
| Total Benefits | 82,100 | 91,000 | 99,700 | 110,100 | 120,200 | 130,400 |
| Field Compensation | 18,100 | 20,500 | 22,500 | 25,100 | 27,500 | 30,000 |
| Change in DAC | (9,300) | (11,200) | (11,700) | (12,600) | (13,200) | (13,800) |
| Total Acquisition Costs | 8,800 | 9,300 | 10,800 | 12,500 | 14,300 | 16,200 |
| Total Administrative Expenses | 9,200 | 10,300 | 10,900 | 11,500 | 12,200 | 12,700 |
| Total Benefits and Expenses | 100,100 | 110,600 | 121,400 | 134,100 | 146,700 | 159,300 |

| | | | | | | |
|-------------------|---------------|---------------|---------------|---------------|---------------|---------------|
| EBIT | 40,000 | 37,000 | 37,900 | 37,400 | 37,300 | 37,700 |
| Interest | - | - | - | - | - | - |
| Tax | 14,000 | 13,000 | 13,300 | 13,100 | 13,100 | 13,200 |
| Net Income | 26,000 | 24,000 | 24,600 | 24,300 | 24,200 | 24,500 |

| Term | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 |
|-----------------------|---------------|---------------|----------------|----------------|----------------|----------------|
| REVENUES | | | | | | |
| Premium - First Year | 14,300 | 17,500 | 19,400 | 21,400 | 22,700 | 24,100 |
| Premium - Renewal | 44,700 | 52,800 | 63,000 | 73,700 | 84,200 | 93,900 |
| Total Premiums | 59,000 | 70,300 | 82,400 | 95,100 | 106,900 | 118,000 |
| Net Investment Income | 20,400 | 20,500 | 22,000 | 24,100 | 26,800 | 30,100 |
| Other income | - | - | - | - | - | - |
| Total Revenues | 79,400 | 90,800 | 104,400 | 119,200 | 133,700 | 148,100 |

| | | | | | | |
|------------------------------|---------------|---------------|---------------|---------------|---------------|---------------|
| BENEFITS AND EXPENSES | | | | | | |
| Claims | 22,900 | 28,600 | 35,900 | 44,200 | 53,000 | 65,200 |
| Surrender and other benefits | 400 | 500 | 500 | 500 | 500 | 500 |
| Increase in reserves | 10,800 | 11,100 | 12,000 | 13,200 | 14,600 | 15,100 |
| Total Benefits | 34,100 | 40,200 | 48,400 | 57,900 | 68,100 | 80,800 |
| Field Compensation | 8,200 | 10,800 | 11,700 | 12,600 | 12,900 | 13,100 |
| Change in DAC | (11,200) | (12,300) | (12,600) | (12,600) | (12,000) | (11,500) |

| | | | | | | |
|------------------------------------|----------------|----------------|---------------|---------------|---------------|----------------|
| Total Acquisition Costs | (3,000) | (1,500) | (900) | - | 900 | 1,600 |
| Total Administrative Expenses | 21,200 | 23,100 | 24,800 | 26,500 | 28,000 | 29,500 |
| Total Benefits and Expenses | 52,300 | 61,800 | 72,300 | 84,400 | 97,000 | 111,900 |

| | | | | | | |
|-------------------|---------------|---------------|---------------|---------------|---------------|---------------|
| EBIT | 27,100 | 29,000 | 32,100 | 34,800 | 36,700 | 36,200 |
| Interest | - | - | - | - | - | - |
| Tax | 9,500 | 10,200 | 11,200 | 12,200 | 12,800 | 12,700 |
| Net Income | 17,600 | 18,800 | 20,900 | 22,600 | 23,900 | 23,500 |

Other **2014** **2015** **2016** **2017** **2018** **2019**

REVENUES

| | | | | | | |
|-----------------------|----------------|----------------|----------------|----------------|----------------|----------------|
| Premium - First Year | 116,700 | 118,000 | 120,000 | 123,000 | 126,000 | 129,000 |
| Premium - Renewal | 75,700 | 75,000 | 77,000 | 79,000 | 81,000 | 84,000 |
| Total Premiums | 192,400 | 193,000 | 197,000 | 202,000 | 207,000 | 213,000 |
| Net Investment Income | 341,200 | 332,800 | 328,900 | 318,600 | 310,300 | 302,400 |
| Other income | 10,400 | 11,200 | 12,100 | 13,200 | 14,500 | 16,000 |
| Total Revenues | 544,000 | 537,000 | 538,000 | 533,800 | 531,800 | 531,400 |

BENEFITS AND EXPENSES

| | | | | | | |
|------------------------------------|----------------|----------------|----------------|----------------|----------------|----------------|
| Claims | 18,300 | 21,400 | 20,700 | 21,200 | 22,900 | 24,600 |
| Surrender and other benefits | 422,000 | 436,400 | 460,800 | 423,400 | 433,600 | 459,200 |
| Increase in reserves | (23,300) | (17,800) | (29,800) | (8,900) | (11,000) | (20,400) |
| Total Benefits | 417,000 | 440,000 | 451,700 | 435,700 | 445,500 | 463,400 |
| Field Compensation | 5,700 | 6,100 | 6,300 | 6,500 | 6,600 | 6,900 |
| Change in DAC | (2,200) | (2,100) | (1,800) | (1,600) | (1,400) | (1,400) |
| Total Acquisition Costs | 3,500 | 4,000 | 4,500 | 4,900 | 5,200 | 5,500 |
| Total Administrative Expenses | 10,800 | 11,600 | 12,200 | 12,700 | 13,400 | 13,900 |
| Total Benefits and Expenses | 431,300 | 455,600 | 468,400 | 453,300 | 464,100 | 482,800 |

| | | | | | | |
|-------------------|----------------|---------------|---------------|---------------|---------------|---------------|
| EBIT | 112,700 | 81,400 | 69,600 | 80,500 | 67,700 | 48,600 |
| Interest | - | - | - | - | - | - |
| Tax | 39,400 | 28,500 | 24,400 | 28,200 | 23,700 | 17,000 |
| Net Income | 73,300 | 52,900 | 45,200 | 52,300 | 44,000 | 31,600 |

EXHIBIT 5
Financial Data: Statutory Balance Sheets (in 000s) and Debt

| Total | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 |
|----------------------------------|-------------------|-------------------|-------------------|-------------------|-------------------|-------------------|
| Cash | 1,022,230 | 1,046,640 | 1,067,190 | 1,100,600 | 1,140,470 | 1,172,530 |
| Bonds | 6,133,380 | 6,279,840 | 6,403,140 | 6,603,600 | 6,842,820 | 7,035,180 |
| Mortgages | 3,066,690 | 3,139,920 | 3,201,570 | 3,301,800 | 3,421,410 | 3,517,590 |
| Subtotal: Cash & Invested Assets | 10,222,300 | 10,466,400 | 10,671,900 | 11,006,000 | 11,404,700 | 11,725,300 |
| Separate Account Assets | 1,878,100 | 2,128,200 | 2,515,900 | 3,057,800 | 3,777,900 | 4,872,200 |
| Deferred Tax Asset | - | - | - | - | - | - |
| Total Assets | 12,100,400 | 12,594,600 | 13,187,800 | 14,063,800 | 15,182,600 | 16,597,500 |
| Statutory Reserves | 11,231,200 | 11,716,000 | 12,299,000 | 13,160,200 | 14,280,300 | 15,856,500 |
| Debt | 225,000 | 225,000 | 225,000 | 225,000 | 225,000 | 75,000 |
| Total Liabilities | 11,456,200 | 11,941,000 | 12,524,000 | 13,385,200 | 14,505,300 | 15,931,500 |
| Statutory Equity | 644,200 | 653,600 | 663,800 | 678,600 | 677,300 | 666,000 |
| RBC | 338% | 333% | 324% | 312% | 306% | 287% |
| Debt Ratio | 35% | 34% | 34% | 33% | 33% | 11% |
| Variable Annuity | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 |
| Cash, Invested and Other Assets | 365,100 | 457,300 | 459,700 | 532,900 | 608,800 | 687,600 |
| Separate Account Assets | 1,878,100 | 2,128,200 | 2,515,900 | 3,057,800 | 3,777,900 | 4,872,200 |
| Deferred Tax Asset | - | - | - | - | - | - |
| Total Assets | 2,243,200 | 2,585,500 | 2,975,600 | 3,590,700 | 4,386,700 | 5,559,800 |
| Statutory Reserves | 2,086,200 | 2,417,400 | 2,797,100 | 3,398,700 | 4,198,300 | 5,385,700 |
| Total Liabilities | 2,086,200 | 2,417,400 | 2,797,100 | 3,398,700 | 4,198,300 | 5,385,700 |
| Statutory Equity | 157,000 | 168,100 | 178,500 | 192,000 | 188,400 | 174,100 |
| Universal Life | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 |
| Cash, Invested and Other Assets | 1,929,200 | 2,001,900 | 2,102,300 | 2,237,100 | 2,406,800 | 2,617,100 |
| Deferred Tax Asset | - | - | - | - | - | - |
| Total Assets | 1,929,200 | 2,001,900 | 2,102,300 | 2,237,100 | 2,406,800 | 2,617,100 |
| Statutory Reserves | 1,820,000 | 1,897,500 | 2,002,200 | 2,140,700 | 2,314,200 | 2,528,600 |

| | | | | | | |
|--------------------------|-----------|-----------|-----------|-----------|-----------|-----------|
| Total Liabilities | 1,820,000 | 1,897,500 | 2,002,200 | 2,140,700 | 2,314,200 | 2,528,600 |
| Statutory Equity | 109,200 | 104,400 | 100,100 | 96,400 | 92,600 | 88,500 |

| Traditional Life | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 |
|---------------------------------|-------------|-------------|-------------|-------------|-------------|-------------|
| Cash, Invested and Other Assets | 936,000 | 966,100 | 1,005,700 | 1,050,500 | 1,101,500 | 1,158,100 |
| Deferred Tax Asset | - | - | - | - | - | - |
| Total Assets | 936,000 | 966,100 | 1,005,700 | 1,050,500 | 1,101,500 | 1,158,100 |
| Statutory Reserves | 900,000 | 928,900 | 967,000 | 1,010,100 | 1,059,100 | 1,113,500 |
| Total Liabilities | 900,000 | 928,900 | 967,000 | 1,010,100 | 1,059,100 | 1,113,500 |
| Statutory Equity | 36,000 | 37,200 | 38,700 | 40,400 | 42,400 | 44,600 |

| Term | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 |
|---------------------------------|-------------|-------------|-------------|-------------|-------------|-------------|
| Cash, Invested and Other Assets | 442,000 | 478,800 | 530,000 | 598,600 | 687,600 | 798,700 |
| Deferred Tax Asset | - | - | - | - | - | - |
| Total Assets | 442,000 | 478,800 | 530,000 | 598,600 | 687,600 | 798,700 |
| Statutory Reserves | 425,000 | 460,400 | 509,600 | 575,500 | 661,100 | 768,000 |
| Total Liabilities | 425,000 | 460,400 | 509,600 | 575,500 | 661,100 | 768,000 |
| Statutory Equity | 17,000 | 18,400 | 20,400 | 23,100 | 26,500 | 30,700 |

| Other | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 |
|---------------------------------|-------------|-------------|-------------|-------------|-------------|-------------|
| Cash, Invested and Other Assets | 6,300,000 | 6,312,300 | 6,324,200 | 6,336,900 | 6,350,000 | 6,363,800 |
| Deferred Tax Asset | - | - | - | - | - | - |
| Total Assets | 6,300,000 | 6,312,300 | 6,324,200 | 6,336,900 | 6,350,000 | 6,363,800 |
| Statutory Reserves | 6,000,000 | 6,011,800 | 6,023,100 | 6,035,200 | 6,047,600 | 6,060,700 |
| Total Liabilities | 6,000,000 | 6,011,800 | 6,023,100 | 6,035,200 | 6,047,600 | 6,060,700 |
| Statutory Equity | 300,000 | 300,500 | 301,100 | 301,700 | 302,400 | 303,100 |

| | | | | | | |
|-------------|---------|---------|---------|---------|---------|---------|
| Corp | 250,000 | 250,000 | 250,000 | 250,000 | 250,000 | 100,000 |
|-------------|---------|---------|---------|---------|---------|---------|

Asset Durations (as of Dec 31, 2014)

Cash Bonds Mortgages

| | | | |
|----------------------|---|------|------|
| Duration | 0 | 10 | 6 |
| Market to Book Ratio | 1 | 1.08 | 1.04 |

Debt Issuance

| Issue | Issue Date | Maturity Date | Rate | Face Amount |
|--------------------|-------------------|----------------------|-------------|--------------------|
| Senior notes issue | 1 Mar 2000 | 1 Mar 2015 | 8.50% | 150,000 |
| Senior notes issue | 15 Jun 2010 | 15 Jun 2030 | 7.00% | 75,000 |

EXHIBIT 6 Sensitivity Tests

Term Sensitivities (in 000s)

| Baseline | 2015 | 2016 | 2017 | 2018 | 2019 |
|-----------------------------|-------------|-------------|-------------|-------------|-------------|
| Sales | 21,400 | 22,700 | 24,100 | 25,600 | 27,200 |
| GAAP Earnings: In force | 7,100 | 6,900 | 7,100 | 6,300 | 5,100 |
| GAAP Earnings: New Business | 15,500 | 17,000 | 16,400 | 26,200 | 28,000 |
| GAAP Total Earnings | 22,600 | 23,900 | 23,500 | 32,500 | 33,100 |
| Statutory Capital | 23,100 | 26,500 | 30,700 | 33,765 | 34,294 |
| Lapse Up 15% | | | | | |
| Sales | 21,400 | 22,700 | 24,100 | 25,600 | 27,200 |
| GAAP Earnings: In force | 7,455 | 7,935 | 8,875 | 8,505 | 7,395 |
| GAAP Earnings: New Business | 15,190 | 15,470 | 13,776 | 20,174 | 19,600 |
| GAAP Total Earnings | 22,645 | 23,405 | 22,651 | 28,679 | 26,995 |
| Statutory Capital | 22,638 | 25,175 | 27,630 | 28,363 | 26,749 |
| Lapse Down 15% | | | | | |
| Sales | 21,400 | 22,700 | 24,100 | 25,600 | 27,200 |
| GAAP Earnings: In force | 7,455 | 5,865 | 4,615 | 2,835 | 1,275 |
| GAAP Earnings: New Business | 15,190 | 16,830 | 16,400 | 26,462 | 28,560 |
| GAAP Total Earnings | 22,645 | 22,695 | 21,015 | 29,297 | 29,835 |
| Statutory Capital | 23,793 | 28,090 | 33,463 | 38,154 | 40,124 |
| Sales Up 15% | | | | | |
| Sales | 24,610 | 26,105 | 27,715 | 29,440 | 31,280 |
| GAAP Earnings: In force | 7,100 | 6,900 | 7,100 | 6,300 | 5,100 |
| GAAP Earnings: New Business | 17,825 | 19,550 | 18,860 | 30,130 | 32,200 |
| GAAP Total Earnings | 24,925 | 26,450 | 25,960 | 36,430 | 37,300 |
| Statutory Capital | 23,562 | 28,090 | 33,770 | 38,830 | 40,810 |
| Sales Down 15% | | | | | |
| Sales | 18,190 | 19,295 | 20,485 | 21,760 | 23,120 |
| GAAP Earnings: In force | 7,100 | 6,900 | 7,100 | 6,300 | 5,100 |
| GAAP Earnings: New Business | 13,175 | 14,450 | 13,940 | 22,270 | 23,800 |
| GAAP Total Earnings | 20,275 | 21,350 | 21,040 | 28,570 | 28,900 |
| Statutory Capital | 22,638 | 25,175 | 27,630 | 28,363 | 26,749 |

Variable Annuity Sensitivities (in 000s)

| Baseline | 2015 | 2016 | 2017 | 2018 | 2019 |
|-----------------------------|-------------|-------------|-------------|-------------|-------------|
| Sales | 1,000,000 | 1,280,000 | 1,750,000 | 2,100,000 | 2,520,000 |
| GAAP Earnings: In force | 17,400 | 17,900 | 18,200 | 18,900 | 19,200 |
| GAAP Earnings: New Business | 5,800 | 14,350 | 30,500 | 39,500 | 50,900 |
| GAAP Total Earnings | 23,200 | 32,250 | 48,700 | 58,400 | 70,100 |
| Statutory Capital | 192,000 | 188,400 | 174,100 | 178,300 | 181,900 |

Market Up 15% at 31 Dec 2014

| | | | | | |
|-----------------------------|-----------|-----------|-----------|-----------|-----------|
| Sales | 1,000,000 | 1,280,000 | 1,750,000 | 2,100,000 | 2,520,000 |
| GAAP Earnings: In force | 24,000 | 25,000 | 25,900 | 27,200 | 28,200 |
| GAAP Earnings: New Business | 5,800 | 14,350 | 30,500 | 39,500 | 50,900 |
| GAAP Total Earnings | 29,800 | 39,350 | 56,400 | 66,700 | 79,100 |
| Statutory Capital | 232,000 | 230,400 | 218,200 | 224,600 | 230,500 |

Market Down 15% at 31 Dec 2014

| | | | | | |
|-----------------------------|-----------|-----------|-----------|-----------|-----------|
| Sales | 1,000,000 | 1,280,000 | 1,750,000 | 2,100,000 | 2,520,000 |
| GAAP Earnings: In force | 10,800 | 10,800 | 10,500 | 10,600 | 10,200 |
| GAAP Earnings: New Business | 5,800 | 14,350 | 30,500 | 39,500 | 50,900 |
| GAAP Total Earnings | 16,600 | 25,150 | 41,000 | 50,100 | 61,100 |
| Statutory Capital | 112,000 | 104,400 | 85,900 | 85,700 | 84,700 |

Sales Up 15%

| | | | | | |
|-----------------------------|-----------|-----------|-----------|-----------|-----------|
| Sales | 1,150,000 | 1,472,000 | 2,012,500 | 2,415,000 | 2,898,000 |
| GAAP Earnings: In force | 17,400 | 17,900 | 18,200 | 18,900 | 19,200 |
| GAAP Earnings: New Business | 26,700 | 37,100 | 56,000 | 67,200 | 80,600 |
| GAAP Total Earnings | 44,100 | 55,000 | 74,200 | 86,100 | 99,800 |
| Statutory Capital | 190,500 | 184,980 | 168,055 | 169,105 | 168,925 |

Sales Down 15%

| | | | | | |
|-----------------------------|---------|-----------|-----------|-----------|-----------|
| Sales | 850,000 | 1,088,000 | 1,487,500 | 1,785,000 | 2,142,000 |
| GAAP Earnings: In force | 17,400 | 17,900 | 18,200 | 18,900 | 19,200 |
| GAAP Earnings: New Business | 19,720 | 27,413 | 41,395 | 49,640 | 59,585 |
| GAAP Total Earnings | 37,120 | 45,313 | 59,595 | 68,540 | 78,785 |
| Statutory Capital | 193,500 | 191,820 | 180,145 | 187,495 | 194,875 |

EXHIBIT 7
Financial Data: Inforce Statistics

| Total | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 |
|----------------------------------|-------------|-------------|-------------|-------------|-------------|-------------|
| Death Benefit Inforce (in 000's) | 103,119,763 | 105,583,877 | 108,447,334 | 120,000,000 | 127,697,000 | 134,299,000 |
| Policy Contract Count | 303,125 | 332,458 | 364,656 | 400,000 | 420,400 | 441,844 |

Variable Annuity

| | | | | | | |
|----------------------------------|------------|------------|------------|------------|------------|------------|
| Death Benefit Inforce (in 000's) | 12,355,000 | 11,843,000 | 11,519,000 | 18,000,000 | 17,297,000 | 18,055,000 |
| Policy Contract Count | 30,053 | 33,058 | 36,364 | 40,000 | 42,000 | 44,100 |

Universal Life

| | | | | | | |
|----------------------------------|------------|------------|------------|------------|------------|------------|
| Death Benefit Inforce (in 000's) | 51,830,256 | 54,421,769 | 57,142,857 | 60,000,000 | 64,800,000 | 69,984,000 |
| Policy Contract Count | 32,652 | 34,938 | 37,383 | 40,000 | 42,400 | 44,944 |

Traditional Life

| | | | | | | |
|----------------------------------|------------|------------|------------|------------|------------|------------|
| Death Benefit Inforce (in 000's) | 28,571,000 | 28,571,000 | 28,571,000 | 30,000,000 | 32,400,000 | 32,400,000 |
| Policy Contract Count | 75,131 | 82,645 | 90,909 | 100,000 | 105,000 | 110,250 |

Term

| | | | | | | |
|----------------------------------|-----------|-----------|-----------|-----------|-----------|-----------|
| Death Benefit Inforce (in 000's) | 4,807,507 | 5,192,108 | 5,607,477 | 6,000,000 | 6,600,000 | 7,260,000 |
| Policy Contract Count | 150,263 | 165,289 | 181,818 | 200,000 | 210,000 | 220,500 |

Other

| | | | | | | |
|----------------------------------|-----------|-----------|-----------|-----------|-----------|-----------|
| Death Benefit Inforce (in 000's) | 5,556,000 | 5,556,000 | 5,607,000 | 6,000,000 | 6,600,000 | 6,600,000 |
| Policy Contract Count | 15,026 | 16,529 | 18,182 | 20,000 | 21,000 | 22,050 |

EXHIBIT 8

Audit Report Issued by Harmon & Strauss, LLP

Background on Auditing Firm

Harmon & Strauss, LLP is a highly sought after audit firm, and has been auditing VA and Life companies for 10 years now. They have built up a reputation as an expert in auditing these companies, and a superior review from Harmon & Strauss, LLP will greatly please Darwin's stockholders, and make them comfortable that proper controls are in place.

Scope

The scope of the audit performed on Darwin by Harmon & Strauss, LLP Audit Firm was the following:

- Ensure proper checks in place to verify policy count and account value matches between modeling inforce files and the administration system.
- Model & assumption changes reviewed and approved by an independent model committee.
- Adequate analysis & trending is performed to get comfortable with results.
- At least 5 controls are documented and performed on a quarterly basis.

Methodology of Audit

Harmon & Strauss, LLP asked for a copy of Darwin's quarterly control binder for the previous quarter. This binder includes the controls and trending performed during the valuation process that feeds into the Statutory and GAAP financial statements. After reviewing the binder, members of the audit team met with Darwin employees to gather additional feedback and dig into the processes. From there, Harmon & Strauss, LLP was able to summarize and put together flowcharts of the necessary controls. Once all data was gathered, the audit team scored Darwin on each of the items noted as part of the scope of the audit. A score was determined for each block of business and item in scope, and then averaged to get an overall score. A score of 1 indicates severe operational risks and lack of controls, a score of 5 indicates excellent controls and low operational risks. The overall score was provided to senior management for their consideration.

Data Gathering

Prior to the end of quarter, Darwin's modeling team provides documentation for any intended model changes or assumption updates. The model oversight team reviews this documentation to ensure the changes make sense. They also ask the modeling team to place a copy of their models into a test folder for their review. A comparison is done between the current quarter's model and the previous quarter to ensure all updates were communicated. The model integrity team then provides signoff. This signoff is printed and included in the documentation binder.

The administration system of Darwin stores all of the policy level detail for its products. A separate system/platform is used for the life products verses the annuities. For both products, an extract gets created with policy level information, which is then used in putting together the inforce file. The code in the extract calculates the various fields needed, such as account value, surrender value, etc. As part of the extract process, a summary report is also generated that shows total policy count and account value. The summary report is

then compared to the policy level extract to ensure nothing got missed during the load process. The comparison is completed for policy count and account value in total for all but two VA products (for which only the AV is being compared).

The inforce files are then loaded to the models. For both VA and Life, the results are highly dependent on demographics of the policyholder – i.e. gender, age, etc, that are input via the inforce file process. Since total policy count and account value are tied out between the admin system and the inforce file, the modelers feel comfortable that the inforce file is complete and accurate – without the need for separate checks of the remaining inforce file fields. The results from the models get imported into several spreadsheets and later imported into a database in order to calculate final reserves. Once the database has been run, results are copied into a workbook. This workbook gathers data from the model results, as well as any manual adjustments, and summarizes it to send to accounting in order to book to the ledger.

Once reserves have been booked to the ledger, some trending is performed. Policy counts, account value, and reserves are compared to the past few quarters to verify reasonability at the total Life and Annuity levels. The comparison is done as a visual check by a product expert. No formal thresholds are set to determine if something looks incorrect, as it would just be obvious to the product owner.

Model changes and assumptions updates, inforce file tie-outs, and trending files are all included within the quarterly control binder.

Audit Findings/Risk Scoring

| Control | Score | Rationale |
|----------------------------------------------------------------------|-------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Inforce file matches administration system | 3 | Two policies were found to be missing in the inforce file compared to the summary report, along with \$1m in AV. |
| Model changes & assumption updates approved by independent committee | 5 | Proper approvals are being obtained from an independent committee. |
| Analysis & Trending performed | 3 | Formal thresholds should be set, comparison should be done in the file, better documentation is needed in case the product expert is not available to perform the analysis |
| Number of Controls Documented | 3 | Only three controls are included in the documentation binder. |
| Overall Average Score | 3.5 | |