Rothesay life

ANNUAL REPORT AND ACCOUNTS

2019

Who we are

Rothesay Life is one of the UK's largest pension insurers.

Our purpose

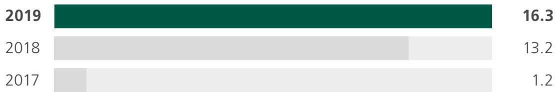
To provide pension security for our policyholders and value to our shareholders and other stakeholders over the long term.

Rothesay Life refers to Rothesay Holdco UK Limited (RHUK) and its subsidiaries, together the Group.

Highlights

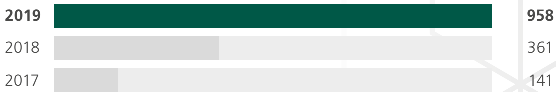
New business premium (APM)[1] (£bn)

£16.3bn



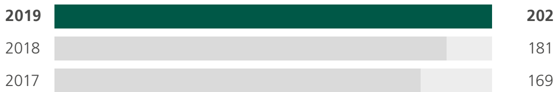
New business profit[2] **(IFRS) (APM)** (£m)

£958m



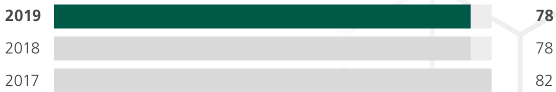
Group SCR coverage (APM) (%)

202%



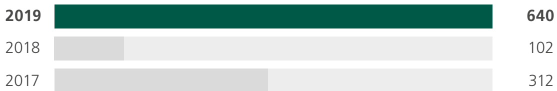
Percent reinsured (APM) (%)

78%



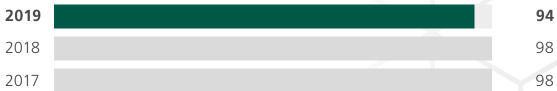
IFRS profit before tax (£m)

£640m



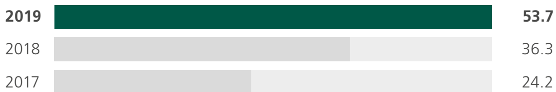
Customer satisfaction[3] **(APM)** (%)

94%



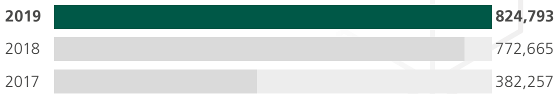
Assets under management (APM) (£bn)

£53.7bn



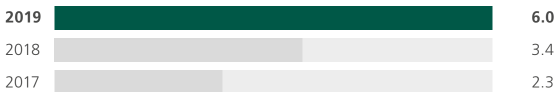
Number of policies (number)

824,793



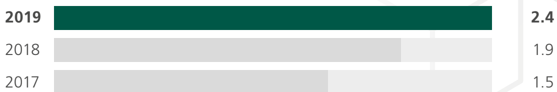
Market consistent embedded value (APM) (£bn)

£6.0bn



Paid to policyholders in the year (£bn)

£2.4bn



Rating of Rothesay Life Plc (RLP)

A3 Moody's Investor Service and A+ by Fitch Ratings

1 APM – Alternative Performance Measure, please see page 125 for further details.
2 With assets invested
3 Note that we no longer issue satisfaction surveys in relation to bulk exercises and hence this result is not comparable to prior years.

At a glance

About us and what we do

About us

Established in 2007, we think originally and work diligently to help pension schemes and insurance companies to de-risk. Our cautious investment strategy and sophisticated approach to risk management is focused on providing long-term pension security for our policyholders.

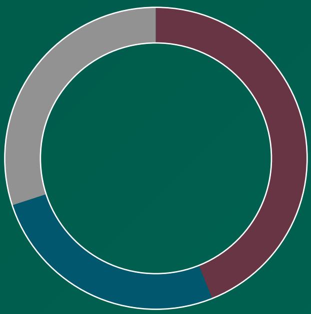
What we do

Our strategy is designed to provide pension security for our policyholders and to generate sustainable shareholder value.

We **protect the security of policyholder benefits** by matching assets and liabilities, hedging risk where it makes sense economically using derivatives and by reinsuring against the risk that policyholders live longer than expected. We back the liabilities with a diversified portfolio of assets with an average credit rating of AA.

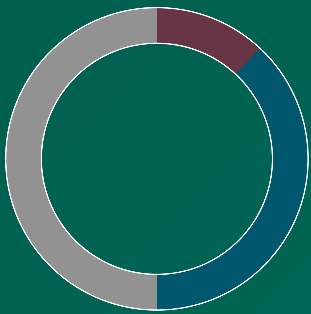
We **aim to grow by writing value-driven new business.** Meticulous underwriting is intended to bring pre-deal certainty about the liabilities and risks that we are taking on. Our integrated approach to pricing involves all relevant parts of the business and helps ensure that new business achieves our target return thresholds. Our ability to source pensions through the core bulk annuity market as well as from other insurance companies, combined with the support of our investors, means that we can take advantage of opportunities to grow the business when they arise.

Our assets



Government securities & cash	**44%**
Corporate bonds & infrastructure	**26%**
Secured lending & ERMs	**30%**

Our liabilities



Insurance company acquisitions	**12%**
Backbook acquisitions	**38%**
Pension Buy-in/Buy-out	**50%**

We **safeguard our brand and culture** by working hard to ensure that our customers receive a high quality service. This is achieved through a robust IT-enabled control environment and a close partnership with our third party administrators. Our people are critical to the Group's long-term success and we have built a multi-disciplinary team of highly skilled and focused individuals.

See page 14
for more on strategy

Our locations

London – During 2019 we moved to The Post Building. Our new office means that all 246 of our UK-based employees are located on one floor, facilitating our multi-disciplinary approach to running the business. An absence of functional silos means that all parts of the business contribute to decision making.

New York – We now employ six people in our asset origination subsidiary, Rothesay Asset Management US LLC which has helped us source $1.7bn of US investments to date.

What drives us

By meeting the needs of our clients, our own success will follow. We do the right things in the right way through:

1. Intellectual curiosity

We blend talent, intellect and technology to deliver success and security for policyholders – The Group's market-leading technology provides us with a comprehensive understanding of the drivers of performance and enables us to risk manage the balance sheet in real time.

2. Providing certainty

We aim for certainty of business outcome in order to deliver security and predictability – The Group focuses on protecting the balance sheet through preserving and recycling capital, to not only ensure that we meet our promises to policyholders, but also protect shareholder equity.

3. Focusing together

We are a team that is driven in what we do, aiming to spend our time and efforts focused on creating value and managing risk. An absence of functional silos mean that all parts of the business contribute to decision making and helps to ensure that all angles are considered in order to create solutions that meet the needs of our policyholders.

4. Delivering success

We aim to be entrepreneurial and agile in order to deliver successful outcomes for all stakeholders – Lack of hierarchy, hard-working teams and focus means that decisions can be taken quickly, and execution certainty can be provided to our policyholders.

Our new UK offices.

Rothesay Life has been established on the core pillars of high-tech and sophisticated risk management, relatively conservative investment philosophy, continuous innovation to meet our clients' needs and excellence in delivery.

Strategic report

Chairman’s statement

Review of 2019
and looking ahead

A record year for new business

"With £16bn of new business in 2019, Rothesay Life is now the third largest annuity provider in the UK."

Assets under management **(APM)**:

£53.7bn

2018: £36.3bn | **+48%**

Number of people insured:

824,793

2018: 772,665 | **+7%**

I am pleased to introduce Rothesay Life's annual report for 2019. The past year saw Rothesay Life continue to grow and develop rapidly. It was a record year for the pension risk transfer market as a whole and within that we were able to achieve over £16bn of new business **(APM)**. We also had a record year of IFRS earnings, posting pre-tax profits of £640m.

Rothesay Life is now recognised in the pensions and annuity sectors as one of a handful of specialists which is able to handle large, complex risk transfer transactions in a well-controlled and timely manner.

We are very grateful to the trustees, sponsors and advisers who have demonstrated their confidence in our ability to deliver risk transfer solutions which enable them to focus their business and capital on risks they wish to retain.

We have been very conscious to ensure that we only take on new business if we are sure we will be able to maintain both our high standards of policyholder service and support and our strong capital position.

We have been fortunate to have strong support from shareholders, banks, bondholders, longevity risk reinsurance providers and our operational partners who are our interface with policyholders through this period of exceptional growth. This has enabled us to grow whilst staying well capitalised and has allowed us to scale up our operational capacity in line with the growth of the liabilities we have taken on.

Chairman's statement

CONTINUED

Our policyholders

We are now responsible for paying annuities for over 800,000 individuals and are the third largest provider in the UK. We take this responsibility seriously and pride ourselves on having one of the best records in the industry for policyholder service. Monitoring service standards closely is a high priority for the Board and Senior Management.

In March we sold our €140m (£125m) portfolio of Irish annuities to Laguna Life DAC in order to ensure that these customers continue to receive their pensions post-Brexit. The transaction is structured initially as a reinsurance contract with Monument Re Limited (part of the Laguna Life Group) and we are now seeking approval for a Part VII transfer of the business.

A record year for new business

The Prudential transaction

In 2018 Rothesay Life and the Prudential Assurance Company Limited (Prudential) entered into a reinsurance transaction covering a £12bn portfolio of annuities, with the expectation that this would be followed by an insurance business transfer. The terms of the proposed transfer were reviewed by an independent expert, who was appointed to report to the High Court, and who concluded that the transfer would not result in any material adverse effect on policyholders' security or benefits. Additionally, neither the Prudential Regulation Authority (PRA) nor the Financial Conduct Authority (FCA) objected to the transfer.

Unfortunately, in August the High Court declined to sanction the transfer. Rothesay Life and Prudential were immediately granted leave to appeal by the High Court and have elected to do so, with the appeal due to be heard in 2020. If the transfer is not approved then the reinsurance agreement will remain in place so the underlying economic risk transfer would be unaffected, but the policyholders covered by the agreement would continue to be serviced by Prudential.

Our investment approach

As we have taken on new liabilities it has also been important to develop our capacity to invest in appropriate assets and we have expanded our capabilities in liquid credit markets as well as in specialised longer term secured real estate backed assets both in the UK and internationally and are a major provider of finance to the social housing sector in the UK.

Our investors
We have three substantial and very engaged institutional shareholders. Not only have they supported the Group by injecting a further £700m of new equity capital in 2019, they each provide the Group with significant access to their networks of relationships and expertise which are of considerable value to our business.

The additional equity invested by our shareholders together with a further £800m of subordinated debt we raised in the capital markets enabled us to stay well capitalised. Our dynamic hedging programme protected our capital position through turbulent markets in which there were significant movements in UK interest and currency rates and we ended the year with a solvency ratio of 202% **(APM)**.

Charitable activity
Rothesay Life's chosen charity is Age UK, the UK's largest charity dedicated to helping everyone make the most of later life. The charity helps more than six million people every year, providing companionship, advice and support for older people who need it most. We are delighted to be supporting Age UK's vital work through a range of sponsorships.

During 2019 the Group established the Rothesay Life Foundation, with the aim of supporting charities that seek to improve the quality of life for older people, helping them to live their lives in a happy, safe and fulfilling way.

In addition, on an annual basis we choose a charity of the year which has a special significance to one of our people. In 2019 our charity of the year was Kids, an organisation dedicated to providing an extensive range of services to disabled children and young people, irrespective of their impairment or condition.

Our people
Our people managed to handle the exceptional volume of new business through excellent teamwork; we have added to capacity, particularly in the area of technology development and our employees show a tremendous degree of loyalty and engagement. We provide a dynamic and entrepreneurial yet highly disciplined work environment that enables us to attract and retain top talent.

Our Board also remains highly engaged; the level of new business activity necessitated a number of additional Board meetings during the year and the level of attendance and contributions was very high. Richard Berliand who had served us well as an independent Non Executive Director for four and a half years left the Board as he took on a new Chairmanship elsewhere; we are pleased to have had Simon Morris join the Board as an independent Non Executive Director; Simon brings a wealth of financial markets experience to the Board.

As we look forward, Rothesay Life is well placed to continue to assist companies and pension funds to manage their exposures and to provide reliable and efficient services to our policyholders.

Naguib Kheraj
Chairman
13 February 2020

Case study

Age UK

"Age UK is extremely grateful for the continued support of Rothesay Life. Our aim is to be there for older people when they need us most, and with over 2.5 million older people feeling they have no one to turn to for help and support, Rothesay Life's support has never been more needed.

Rothesay Life's sponsorship of Age UK's annual celebrity carol concert, Love Christmas, made it possible for us to hold a very special festive celebration at St Marylebone Parish Church for over 600 older beneficiaries and supporters, helping us raise vital funds and awareness for our cause.

Not only do Rothesay Life support Age UK at Christmas but throughout the year too. In 2019 funding from Rothesay Life allowed Age UK to produce thousands of copies of our information guide on bereavement and update our scams prevention guide helping older people to identify and avoid scams.

Our long running partnership is testament to Rothesay Life's commitment to ensuring a better future for older people in the UK."

Our markets

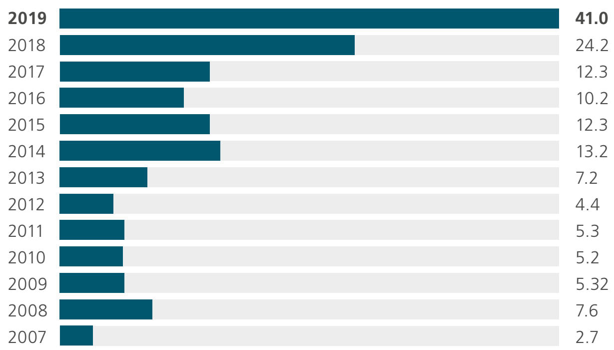
The Group's core market is growing strongly

The Group focuses on the pension risk transfer market, specifically bulk annuities where pension schemes transfer responsibility for paying pensions to us in return for payment of an insurance premium. This can be structured as a buy-in, where the insurance policy remains an asset of the scheme, or a buy-out, where individual Rothesay Life pension annuity policies are issued to members of the pension scheme.

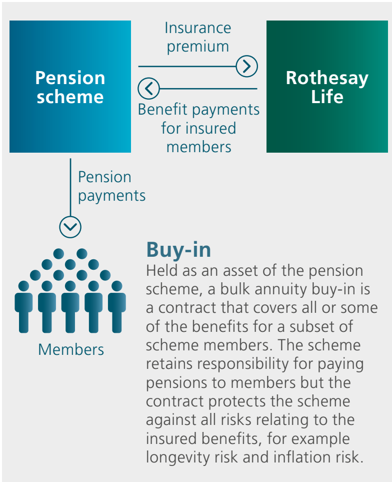
Almost 90% of UK defined benefit pension schemes are now closed and defined benefit pensions are no longer offered to new employees. As a result, companies and trustees are increasingly wanting to de-risk the pension scheme liabilities with many considering and actively working towards pension risk transfer.

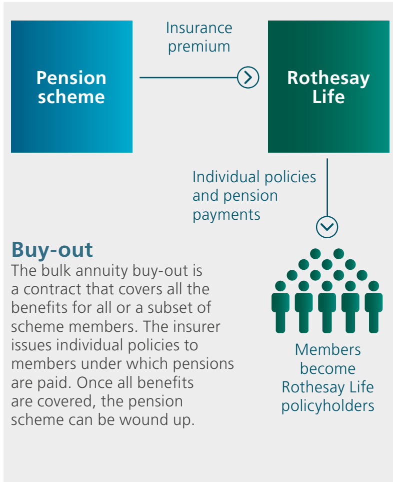
The chart on the right shows that the growth in pensions risk transfer volumes since 2007 though market penetration is still only around 7% of the £2.1 trillion of UK defined benefit pension liabilities. 2019 has been a record year for pension risk transfers and the pipeline for 2020 and beyond is strong.

Market volume (£bn)



2019 data sourced from Aon. Prior year data sourced from LCP and Hymans Robertson market reports.





Wholesale annuity market

As well as focusing on the pension risk transfer market, the Group looks to acquire back-books of annuities from insurance companies, either through the acquisition of companies or through the acquisition of blocks of business.

Acquisition of a block of business normally starts as a reinsurance transaction between Rothesay Life and the insurer selling the block.

This is then ideally followed by a Court-sanctioned transfer of the business approximately 18 months later to Rothesay Life. During the reinsurance phase, responsibility for administration typically remains with the selling insurer but Rothesay Life has full economic exposure.

The outlook for back-book transactions remains positive. A number of UK insurance companies have exited the individual annuity market which means that their annuity portfolios are no longer core and the Group has extensive experience in the wholesale annuity market.

	Transaction	Size of transaction	Number of policies (000s)	Type of business
2011	Acquisition of Paternoster	£3bn	42	Bulk annuities
2014	Acquisition of MetLife Assurance Limited	£3bn	24	Bulk annuities
2015	Purchase of annuity portfolio from Zurich UK Life (reinsurance followed by Court-approved transfer), with three follow on transactions	£1bn	28	Mixture of individual and bulk annuities
2016	Purchase of annuity portfolio from Aegon UK (reinsurance followed by Court-approved transfer)	£6bn	187	Mixture of individual and bulk annuities
2018	Purchase of annuity portfolio from Prudential (reinsurance followed by proposed transfer)	£12bn	400	Mixture of individual and bulk annuities

Case study

telent

We secured the benefits of the c.39,000 members of the G.E.C. 1972 Pension Plan (the Plan) with a £4.7bn bulk annuity, the largest pension fund (as of September 2019) to secure a buy-out.

Over the last decade, given the asymmetry between the size of the sponsor and the size of the Plan, the trustee of the Plan had worked to de-risk the assets, hedge rates and inflation and try to improve the funding level of the Plan. Having significantly improved their funding level and completed initial feasibility analysis, in 2019 the trustee and the corporate sponsor, telent, came to market with a clear set of objectives as to what was required for the buy-out to take place. This direct articulation allowed us to focus our resources on creating tailored solutions to meet the needs of the Plan. The premium for transferring the risks to Rothesay Life was converted into a subset of the Plan's assets, giving the trustee and employer increased certainty regarding the economics of the transaction. Our ability to offer price certainty and mitigate execution risk during volatile markets made us an attractive partner for the trustee.

£4.7bn

Bulk annuity

Our business model

Our strengths

1 High-tech and sophisticated risk management

The Group's market-leading technology provides us with a comprehensive understanding of the drivers of performance and allows us to risk manage the balance sheet in real time as well as ensuring that policyholders are paid the right benefits.

2 Attention to detail and multi-disciplinary expertise

We look to blend multi-disciplinary talent and experience with technology to deliver granular analysis and appropriate attention to detail. Our strategic outsourcing model facilitates excellent customer service.

3 Efficient and effective decision making

An absence of functional silos means that all parts of the business contribute to decision making and helps ensure that all angles are considered in order to create solutions that meet the needs of our policyholders.

The Group's governance structures mean that decisions can be made quickly and efficiently whilst ensuring that there is robust oversight.

4 Financial strength and access to capital

The Group's proven approach to capital management is intended to ensure financial strength in adverse conditions. By preserving and recycling capital, we not only ensure that we meet our promises to policyholders but also protect shareholder equity.

In addition, supportive shareholders have repeatedly demonstrated a willingness to provide equity to support the growth of the business. We have also been successful in raising debt in the bond markets.

Sophisticated risk management systems and a low-risk investment strategy allow the Group to operate a capital-efficient business model

Business model

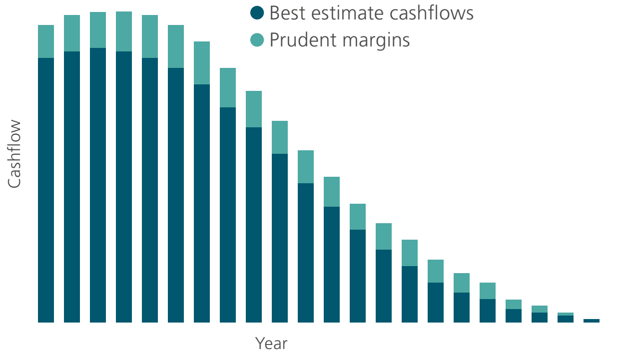
1 Underwrite the liabilities

Our meticulous approach to underwriting and due diligence achieves maximum pre-deal certainty about the profile of the liabilities that we are taking on.

This involves modelling the benefits of every individual policyholder and projecting them to maturity on best estimate and prudent assumptions. From this, we then determine our estimate of the cost of providing the benefits to be insured along with the cost of holding the associated risk capital.

We are disciplined in new business pricing – all new business must achieve our return thresholds without the need to take excessive investment risk.

Illustrative projection of scheme cashflows



2 Hedge the risks

Our capital-efficient business model involves hedging risk where possible so we use derivatives and other assets to hedge interest rate and inflation risk. See the principal risks table on page 31.

The Group's risk management systems allow us to assess and monitor the impact of transactions in advance of completion. This means that we can provide certainty of pricing for clients by locking-in the economics of a transaction, which also protects the Group's balance sheet by allowing us to hedge risks appropriately as soon as new business is written.

We also use reinsurance to hedge longevity risk and have currently reinsured 78% (APM) of our exposure. Hedging risk with reinsurers has the added benefit of ensuring pricing discipline as the reinsurance process provides us with an independent third party view on the appropriate mortality basis to use.

The use of derivatives to hedge market risk, combined with our use of collateral to mitigate credit and counterparty risk, means that collateral management forms an integral part of the Group's activities. We monitor collateral closely to ensure security is not compromised due to market moves.

3 Invest the assets to back the liabilities

Our in-house team is responsible for the management of the Group's £76bn asset portfolio. Assets are sought which match the liability cash flows and which provide an appropriate risk-adjusted return. The average rating of the Group's investment portfolio is AA and the portfolio can be divided into three broad categories:

- **Cash and government bonds –** This part of the portfolio is available for future investment and to meet collateral calls and cash requirements and also backs some of our very long-dated cash flows.
- **Corporate bonds and infrastructure –** Given the scale of the Group's balance sheet, we also invest in a diversified portfolio of more liquid corporate bonds, including 4% of the portfolio in regulated infrastructure such as water, energy and transportation.
- **Secure, illiquid assets –** These assets include loans secured against property, equity release mortgages (ERMs) and loans secured against other collateral. They are attractive because investors are rewarded for illiquidity rather than credit risk. Structural features such as collateral, covenants and other security features mean that recoveries in the event of default are maximised and credit risk mitigated.

Cash	**10%**
UK sovereign	**22%**
Supranational, quasi sovereign and other sovereign	**11%**
Other	**4%**
Corporate bonds	**14%**
Infrastructure	**9%**
Other secured lending	**11%**
Secured residential lending	**14%**
ERM	**5%**

4 Deliver excellent customer service through our strategic business partners

We follow a strategic outsourcing model for the provision of administration services. Key to the delivery of excellent customer service is our robust oversight and working relationship with our third party administrators, Willis Towers Watson, JLT Employee Benefits and Capita Employee Solutions, all of whom are well established pension administrators. Our three strategic partnerships provide us with both scale and contingency capabilities.

High levels of automation and use of technology allow our outsourced administration platforms to interact with our risk management systems to minimise discrepancies and ensure the highest levels of customer service.

Generating value for all our stakeholders

Trustees and policyholders

Our experience, approach and business model mean that clients can be confident that transactions will be executed quickly and efficiently.

Once transactions are executed, we look to provide excellent customer service, ensuring that we pay policyholders and trustees accurately and on time and that we meet demanding target service levels, resulting in low levels of complaints and high levels of customer satisfaction.

Our financial strength means that policyholders can have confidence in the long term security of their pensions.

Employees

Our success in the market and our business model help ensure that Rothesay Life is a rewarding place to work for all our people.

Strategic business partners

Given our strategic outsourcing model, as we grow so do our long-term strategic partners.

Our approach to working with reinsurers is similar to that of working with clients. Reinsurers can be confident in our quick and efficient execution.

Shareholders and bondholders

As the business runs-off, we generate returns on the assets being held to back the liabilities and to release surplus capital backing the liabilities.

These investment returns and capital releases are first used to cover:

- any adverse experience such as investment defaults or the cost of pensioners living longer than assumed;
- the expenses of running the business including financing costs; and
- the costs of hedging, including reinsurance fees.

Amounts in excess of this are then used to back new business or, if not otherwise required, returned as dividends to shareholders. No dividends were paid to shareholders in 2019 (2018: Nil).

Our strategy and key performance indicators

Delivering on our commitments

Our strategy is designed to provide pension security for our policyholders and value to our shareholders and other stakeholders over the long term.

1
Protect the security of policyholder benefits

We apply a conservative, risk capital-based approach to managing our balance sheet.

The Group aims to maintain SCR coverage in the range of 130% to 150%. Surplus above 150% is available to write new business or pay dividends.

Progress in 2019:
- Maintained a robust solvency position.
- Obtained approval to amend the Partial Internal Model (PIM) to include Dutch residential mortgages and to make additional model refinements.
- Raised £400m of Tier 3 debt, £400m of Tier 2 debt and £700m of equity, ensuring that the Group remained appropriately capitalised despite record new business.
- Reinsured £12bn of liabilities, ensuring that our reinsurance coverage remained at 78% **(APM)**.

How we measure performance

RLP SCR coverage 201% (2018: 180%) **(APM)**	Assets under management £53.7bn (2018: £36.3bn) **(APM)**	Rating
SCR coverage shows the way in which RLP is capitalised compared to the regulatory requirement, demonstrating its capital strength.	Assets under management provide a useful measure of the size of the business. Increased scale gives greater resilience and ability to withstand risk events.	A3 Moody's Investors Service A+ Fitch Ratings The external ratings of RLP provide an alternative, external view of the financial strength of the Group.

Opportunities in 2020 and beyond:
- The Group's sophisticated risk management systems and real-time reporting enable us to maintain a robust solvency position.
- The size and experience of our risk function means that we can continue to develop our approach to the identification and management of emerging risks such as the financial risk of climate change.
- We continue to invest in our capital models, extending the PIM to cover other risks, facilitating investment in new asset classes and ensuring that capital models are aligned to the risks to which the Group is exposed.
- The strength of our trading and reinsurance teams means that we can diversify our counterparty exposure and investment portfolio.
- We will also continue to optimise our capital structure through an appropriate mix of equity and debt.

2
Growth through writing value-driven new business

We pursue growth by focusing on high-quality new business which meets our return thresholds and risk tolerance. We remain disciplined in our approach, which benefits from proven execution capabilities across pensions and insurance company acquisitions.

Progress in 2019:

- Successfully invested all of the assets received from the Prudential transaction according to our long-term investment strategy at the yields assumed in pricing the deal and managed to do so more quickly than planned. This helped contribute to the Group's IFRS profit before tax of £640m.
- Assisted ten pension schemes to de-risk their liabilities, generating record new business volumes, and remained disciplined in new business pricing.

How we measure performance

New business premiums £16.3bn (2018: £13.2bn) (APM)	IFRS profit before tax £640m (2018: £102m)	MCEV £6.0bn (2018: £3.4bn) (APM)	MCEV new business profit £1,612m (2018: £453m) (APM)
New business premiums are a key indicator of the Group's growth and realisation of our strategic objectives.	IFRS profit before tax is our primary measure of profitability, capturing all recurring and non-recurring items.	The MCEV provides an indication of the value of the business by measuring the risk-adjusted value of the in-force business, allowing for the unwind of margins.	MCEV new business profit provides a useful indication of the value generated by new business.

Opportunities in 2020 and beyond:

- As a leading insurer in the UK pension risk transfer market, pension schemes and their advisors will usually approach Rothesay Life with new business opportunities. Having visibility of a wide range of opportunities allows us to target new business which meets our return thresholds and risk tolerance both in our core bulk annuity market and in the wholesale market.
- This is helped by our investors again demonstrating their willingness to provide new equity and debt to support the business.
- Rothesay Asset Management US LLC is building the Group's profile as an investor in the US and our track record in the UK means that we have visibility of a wide range of investment opportunities. This will allow us to continue to diversify the Group's investments as we invest assets according to the Group's long-term investment strategy.

3
Safeguard our brand and culture

We have built our business on the foundation of long-term relationships and avoided short-term opportunism. We focus on recruiting and retaining the best and most relevant people to protect this culture and ensure we can maintain excellence in delivery to policyholders, counterparties and partners.

Progress in 2019:

- 95% of all policyholder requests were dealt with within our demanding target service levels.
- Maintained low complaint rates and high customer satisfaction despite significant growth of the business.
- Implemented a Corporate Social Responsibility policy intended to ensure the sustainability of the Group's business model.
- Recruited 60 talented individuals across all areas of the Group, including for our new US operation.
- Maintained high levels of employee engagement.
- Established the Rothesay Life Foundation, to support charities that seek to improve the quality of life for older people, helping them to live their lives in a happy, safe and fulfilling way.

How we measure performance

Customer satisfaction 94% (2018: 98%) (APM)	Complaints received and upheld (per 1000 customers) 0.70 and 0.36 (2018: 0.76 and 0.23) (APM)	Employee engagement 87% of employees are proud to work at Rothesay Life[2]
We pride ourselves on the quality of service that our policyholders receive and are pleased that 94% of policyholders responding to feedback surveys rate the service as excellent or good for the year 2019[1].	Complaints provide another useful indication of customer satisfaction and can provide information that can be used to make improvements.	We undertake regular employee surveys in order to understand levels of employee engagement and where improvements can be made.

Opportunities in 2020 and beyond:

- Continue to focus on the provision of excellent customer service.
- Further recruit to continue to grow our asset origination and in-house IT capabilities.
- Ensure seamless execution of new business.
- If the appeal in relation to the transfer of Prudential business is successful, we will work towards transferring policyholder administration of the Prudential book to a long-term administration partner.
- Work to strengthen the Group's operational resilience.

1 Note that we no longer issue satisfaction surveys in relation to bulk exercises and hence this result is not comparable to prior years.
2 Differences in survey methodology between 2018 and 2019 mean that the 2019 result is not comparable to the 2018 result and hence no comparative is provided.

Chief Executive's statement

I am delighted to announce our results for 2019, which has been a record year for us.

Financial strength and security for the long term

"We are now responsible for paying the pensions of over 800,000 policyholders in the UK."

We executed over £16bn of new bulk annuity business **(APM)** over the course of the year – a record for the market and an increase of 24% over our previous best year. We also successfully invested the assets we received as part of the £12bn transaction we executed with Prudential in 2018 in accordance with our long-term investment strategy.

Notwithstanding the volume of business we have written during 2019, we are not driven by new business volumes. We strive to execute transactions that meet our financial return metrics, rather than aim for specific volume targets. 2019 began with a flurry of activity in the market, with some of the business transacted by our competitors being written at pricing levels that would not have met our return thresholds. Hence, we remained patient and selective. That patience was justified as during the second half of 2019, we were fortunate enough to have the opportunity to execute four benchmark and ground-breaking deals with Allied Domecq, Asda Group Pension Plan, National Grid and G.E.C. 1972 Plan (telent). Not only was each of these transactions noteworthy in and of their own right, they also enabled us to exhibit our strength in execution, ability to raise substantial amounts of capital efficiently and quickly, and deliver on the promises we made to the pension scheme trustees in providing an outcome that protected the financial future of their policyholders.

Our capital position remains robust with Group SCR coverage of 202% (2018: 181%) **(APM)** and RLP SCR coverage of 201% (2018: 180%) **(APM)**. We aim to maintain SCR coverage in the range of 130% to 150%, so our capital position provides significant surplus capital for new business and potential future dividends. We were very pleased to have successfully raised £800m in aggregate across two new subordinated bond issuances (£400m Tier 3 and £400m Tier 2) over the summer. Our shareholders also backed the ongoing growth in the business by injecting a further £700m to support the business. The combined £1.5bn of capital we raised is testament to the strength of our franchise and a strong endorsement from our stakeholders of their continuing support.

New business premium **(APM)**:

£16.3bn

2018: £13.2bn | **+23%**

Group SCR coverage **(APM)**:

202%

2018: 181% | **+12%**

In total, we helped ten pension schemes to de-risk their liabilities during 2019, generating new business premium for the year of £16.3bn **(APM)**, taking our total assets under management to over £53bn **(APM)** and making us the third largest annuity provider in the UK. We are proud of our achievements over the past decade and we remain focused primarily on ensuring we provide the greatest level of security and service to over 800,000 individuals whose future pension payments we insure.

During the year, Fitch Ratings and Moody's Investor Service maintained their A+ and A3 ratings respectively, providing an independent assessment of the strength and long-term viability of our business and our business model. Both the agencies highlight our risk, capital and asset management capabilities as strong positive drivers of the ratings.

We are now focused on investing the premiums received according to our long-term investment strategy. With assets under management of £53.7bn **(APM)**, the Group has increased its exposure to corporate bonds, managing the portfolio in house. We are now one of the UK's largest investors in social housing loans and other UK infrastructure.

Chief Executive's statement

CONTINUED

The Group's US subsidiary, Rothesay Asset Management US LLC, which was set up at the end of 2017, continues to source assets consistent with our investment strategy in the United States. We have grown the team and now have a broad set of skills and capabilities there to access a range of attractive investment opportunities for our growing business, including commercial real estate loans and asset-backed financing.

Our equity release mortgage origination business is also performing well. We have now funded £2.7bn of equity release mortgages, having entered the market at the end of 2016. By providing funding to back equity release mortgages through a number of strategic partners, the Group is helping older people to access the equity in their homes, without the need for them to move. This is potentially an extremely important and convenient source of liquidity for people in later life. Mortgages are written with a no negative equity guarantee, which means that borrowers don't have to worry about the liability growing above the value of the house.

Group performance

In 2018, a combination of the de-risking we undertook post the completion of the Prudential transaction and widening credit markets resulted in dampening our IFRS profit before tax to £102m. During 2019, we were successful in investing the remaining assets from the Prudential transaction which was one of the main drivers of our record profit before tax of £640m. Continued focus on value and risk in underwriting led to 75% MCEV growth **(APM)**, up £2.6bn to £6.0bn including £0.7bn of new equity (2018: £3.4bn). More details can be found on our financial performance in the Financial review on page 20.

The market outlook

Over £40bn of bulk annuity transactions were completed during 2019 – making it a record year in terms of volume of transactions. Many larger pension schemes are in a position to undertake bulk annuity transactions almost regardless of macroeconomic market conditions given they are well hedged against interest rate, credit and other risks. We have also seen, as in the case of the Asda Group Pension Plan transaction, that parent companies are willing to contribute significant amounts of funding to improve the solvency position of pension schemes to enable a de-risking transaction to be executed successfully. As such, we have seen a year with record volume of transactions despite falling interest rates and the volatility in the wider UK market due to concerns around Brexit.

Low real interest rates will remain a challenge both for pension schemes, as well as for insurance companies looking to invest safely whilst generating commensurate returns. The macro-economic environment remains volatile given tensions in the Middle East, uncertainty about the UK's long-term trading relationship with the European Union and the US election later in 2020. Despite this, market commentators forecast that the next five to ten years will see robust bulk annuity volumes and we are excited about the opportunities that this presents.

Financial strength and security for the long term

The outlook for back-book transactions also looks positive. Many UK insurance companies have exited the individual annuity market, which means that their annuity portfolios are no longer core. As a result, we believe that there are likely to be a number of opportunities to acquire back-books of annuities over the next few years once the current uncertainty about the Part VII transfer mechanism is resolved. Our successful experience with the Aegon and Zurich transactions, along with our acquisitions of MetLife's bulk annuity business and Paternoster, puts us in a leading position to execute future transactions.

Risk and capital management

The wider macroeconomic environment in the UK as well as globally has been challenging during 2019. The year has again seen significant volatility in interest rates and credit markets and this is likely to continue in 2020.

Our market-leading risk management systems provide us with a strong advantage and allow us to be proactive and to navigate even the most difficult markets. In the midst of significant market volatility, having detailed real-time information is critical for the successful and efficient operation of any insurance business. Continued investment in the systems and people to manage the risks we assume on behalf of our policyholders is a key part of our strategy.

Our risk and capital management framework is intended to ensure that we identify and understand all of the inherent risks in the liabilities we insure and manage them in the most efficient and effective manner. This involves matching liabilities with assets and hedging market risks, such as interest rate, currency and inflation, using derivatives and hedging longevity risk using reinsurance, where we have reinsured 78% **(APM)** of our exposure. The framework also covers the risks associated with the assets in which we invest, including the possible financial impact of climate change.

We believe that it is prudent to hedge market and longevity risk exposures, as long as this is done with robust collateral provisions to mitigate counterparty risk.

Corporate Social Responsibility

During 2019, we published our Corporate Social Responsibility policy which describes the way in which we aim to engage positively with all of our stakeholders. The policy also describes the way in which we take financially material environmental, social and governance factors, including climate change, into account in our investment process.

We also established the Rothesay Life Foundation with the aim of supporting charities that seek to improve the quality of life for older people, helping them to live their lives in a happy, safe and fulfilling way.

Our policyholders

Providing over 800,000 policyholders with a safe and secure pension is at the heart of what we do. We take pride in the quality of the service we provide and are proud to be the first insurance company to have gained Accreditation by the Pensions Administration Standards Association (PASA), an independent body dedicated to improving standards in pensions administration. The quality of service we provide to our policyholders is also reflected in consistent low levels of upheld complaints and the high level of customer satisfaction.

Rothesay Life's in-house operations team works closely with our administration partners to automate processes and minimise the risk of errors. The close integration of our administration systems and risk management systems helps to ensure accuracy of payments to policyholders as well as making sure risks are actively managed.

We were disappointed not to receive approval for the transfer of business from Prudential to Rothesay Life. As we do not believe that a long-term reinsurance arrangement is in the best interest of our stakeholders, we are planning to appeal the Court's decision.

Our shareholders

We are fortunate to have continued strong support from our three shareholders – Blackstone, GIC and MassMutual. The long-term support from our shareholders allows us to provide clients with a full range of solutions on a large scale, as well as taking advantage of strategic opportunities as they arise.

Our people

At the end of 2019, the Group had 252 employees, an increase of 20% from 2018.

Our team has delivered a great set of results for the year. Close coordination between all the areas of the firm and our relentless attention to detail ensured that all of the business written in 2019 was meticulously executed.

The high level of engagement of our people and the breadth of the expertise within the team across insurance, pensions, actuarial, investment management, operations, legal, finance and technology is the defining factor in our success. I would like to take this opportunity to thank our people and our administration partners for their efforts during the year.

Our capital strength, risk management practices and overall business model are all designed with the primary objective of providing the highest level of security to our policyholders whilst ensuring we remain a successful and profitable business. This is a matter of pride to us and should be of great comfort to our stakeholders. I look forward to 2020 and beyond with optimism and excitement about what the future holds for Rothesay Life and our customers.

Addy Loudiadis
Chief Executive Officer
13 February 2020

Financial review

Record new business volumes in 2019 were accompanied by record IFRS profits and record growth in MCEV.

Record IFRS profits

IFRS profit before tax:

£640m

2018: £102m | **+527%**

MCEV **(APM)**:

£6.0bn

2018: £3.4bn | **+76%**

The financial review describes the financial performance of Rothesay Holdco UK Limited and its subsidiaries (the Group) and highlights the key drivers of the movements in the Group's consolidated statement of comprehensive income and consolidated statement of financial position. It also describes the Group's capital position.

IFRS financial performance

The Group achieved a profit before tax of £640m (2018: £102m) and an operating profit before tax of £507m (2018: £355m) **(APM)**.

By the middle of 2019, we had successfully invested the assets received as part of the Prudential transaction in 2018 according to our long-term business strategy. This was achieved more quickly than assumed in pricing the deal and at the yields assumed.

The second half of 2019 was dominated by record new business volumes, with new business premiums for the year of £16.3bn (2018: £13.2bn) **(APM)**. This took the Group's assets under management to £53.7bn (2018: £36.3bn) **(APM)**.

Although we have made good progress with investing the assets received as new premiums, we are patient in asset origination and anticipate further longer-term IFRS gains as the new business premiums are invested according to the Group's long-term business strategy.

The financial performance analysis shown in the table below is intended to provide an explanation of the way in which profits have been generated. More explanation of the line items can be found in the notes on alternative performance measures.

New business profits in the analysis are calculated assuming full investment of premiums and the short-term impact of any under-investment is reported separately in the table. New business profit for the year assuming full investment of premiums was £958m (2018: £361m) **(APM)**. The analysis has been prepared assuming that once fully invested, the risk adjusted yield on the assets held increases to 1.90% compared to the 1.78% being achieved at 31 December 2019 (2.50% compared to the 2.44% being achieved at 31 December 2018).

The temporary impact of the delay in investing assets according to our long term strategy was a reduction in profits of £909m (2018: a reduction of £273m) **(APM)**. We anticipate that this will reverse as assets are invested. Profits for 2019 include the profits of £273m generated on investment of the Prudential assets in the first half of the year (2018: Nil) **(APM)**.

Profits generated on the in-force book were £299m (2018: £302m) **(APM)**. The impact of the change to demographic and expense assumptions (see note E.2) was an increase in profit of £46m (2018: a profit of £106m). Demographic assumption changes in 2019 were driven by experience analysis and recent longevity reinsurance transactions and these were partially offset by an increase in expense provisions.

The Group made economic profits of £244m (2018: a loss of £178m) **(APM)** as a result of falling interest rates, rising bond prices and the fall in the value of sterling. Economic profits represent the change in value of assets from changes in economic conditions less the change in value of liabilities from those changes.

Financial performance (Alternative analysis of profit generation) (APM)	**2019 £m**	2018 £m
New business profit (assuming assets fully invested)	**958**	361
Impact of temporary investment delay	**(909)**	(273)
Investment profit from prior year	**273**	–
Performance of in-force book	**299**	302
Non-economic assumption changes	**46**	106
Acquisition and Group costs	**(112)**	(105)
Administration expenses	**(48)**	(36)
Operating profit before tax	**507**	355
Borrowing costs	**(87)**	(55)
Project and other one-off expenses	**(24)**	(20)
Economic profits/(losses)	**244**	(178)
IFRS profit before tax	**640**	102

Financial review

CONTINUED

Income statement highlights	2019 £m	2018 (Restated)[1] £m	Commentary
Gross premiums written	**16,606**	13,424	Gross written premiums are made up of record new business of £16.3bn (2018: £13.2bn) and regular premiums of £0.3bn (2018: £0.3bn) generated on the inwards longevity reinsurance business written in prior years.
Net premiums written	**15,361**	12,310	Net premiums written represent the gross premiums written less the £1,245m (2018: £1,114m) of regular premiums ceded to reinsurers.
Investment return	**2,295**	141	Large positive investment returns arose from the growth in the value of assets due to falling interest rates and rising bond prices.
Total revenue	**17,656**	12,451	
Net Claims paid	**(1,396)**	(856)	Claims paid represent the total payments due to policyholders during the year of £2.4bn (2018: £1.9bn) less the reinsurers' share of such claims £1.0bn (2018: £1.0bn).
Change in net insurance liabilities	**(15,327)**	(11,261)	The change in insurance liabilities in 2019 was largely as a result of new business.
Operating expenses	**(184)**	(161)	Operating expenses consist of £48m (2018: £36m) of administration expenses, £112m (2018: £105m) of acquisition expenses and £24m (2018: £20m) of non-recurring and project expenditure.
Finance costs	**(109)**	(71)	Finance costs mainly represent interest payable on borrowings and have increased as the Group's borrowings have increased.
Total claims and expenses	**(17,016)**	(12,349)	
Profit before tax	**640**	102	
Income tax	**(124)**	(17)	The Group's effective tax rate is 19.3% (2018: 18.4%).
Profit after tax	**516**	85	

1 Please see note A5 for details of the prior year restatement.

Alternative Performance Measures

The Group's strategy is focused on protecting the security of policyholder benefits, growth through writing value-driven new business and, ultimately, delivering sustainable shareholder value.

In the opinion of the Directors, the prescribed IFRS results and disclosures do not capture long-term value creation or changes to capital requirements and therefore do not fully reflect the performance of the Group.

The Group therefore uses a number of Alternative Performance Measures (APMs) which focus on value generation and capital strength. Further information on the Group's APMs can be found on page 125, including definitions, why the measure is used and, if applicable, how the APM can be reconciled to the nearest GAAP measure. The Group uses the symbol **APM** to highlight APMs throughout the financial statements

IFRS balance sheet highlights

The key line items in the consolidated statement of financial position for the Group are summarised in the table below:

line items in the consolidated statement of financial position for the Group are summarised in the table below:

Balance sheet highlights	2019 £m	2018 (Restated)[1] £m
Financial investments	**73,742**	49,174
Reinsurance assets	**388**	43
Other assets	**1,971**	1,016
Total assets	**76,101**	50,233
Share capital and share premium	**1,518**	829
Tier 1 notes	**347**	347
Capital contribution reserve	**17**	10
Other reserves	**1,894**	1,385
Total equity	**3,776**	2,571
Insurance contract liabilities	**47,932**	32,559
Reinsurance liabilities	**848**	549
Payables and financial liabilities	**21,999**	13,849
Borrowings	**1,427**	647
Other	**119**	58
Total liabilities	**72,325**	47,662
Total equity and liabilities	**76,101**	50,233

Assets

Total assets increased from £50.2bn as at 31 December 2018 to £76.1bn as at 31 December 2019. These aggregate numbers include derivative assets which net off against derivative liabilities.

Assets under management increased from £36.3bn as at 31 December 2018 to £53.7bn (APM) as at 31 December 2019, largely as a result of new business. These numbers can be derived from the table below by adjusting for reinsurance, derivatives and collateralised financing:

Assets under management (APM)	2019 £m	2018 £m
Total assets	**76,101**	50,233
Less reinsurance assets	**(388)**	(43)
Less payables and financial liabilities	**(21,999)**	(13,849)
Assets under management	**53,714**	36,341

Reinsurance assets/liabilities

Although some of the Group's reinsurance is an asset on an IFRS basis because projected claims exceed the regular premiums due on some longevity reinsurance contracts, overall the reinsurance represents a net liability of £460m (2018: net liability of £506m). The impact of the reinsurance associated with the new business written in 2019 was largely offset by the change in longevity assumptions.

Total equity

The increase in total equity (an increase of £1,205m from £2,571m at 31 December 2018 to £3,776m at 31 December 2019) was driven by the £700m of new equity injected by our institutional shareholders to support new business and the increase in retained earnings during 2019.

Liabilities

Insurance contract liabilities increased from £32.6bn at 31 December 2018 to £47.9bn at 31 December 2019, largely as a result of the new business written in 2019 (see note E.2).

Payables increased by £8.1bn from £13.9bn at 31 December 2018 to £22.0bn at 31 December 2019 largely as a result of the changes in economic conditions. Payables are dominated by derivative financial instruments and collateralised financing agreements. Derivatives are used to manage market and credit risk. The derivative liability as at 31 December 2019 of £19.9bn (2018: £11.8bn) nets off against the derivative assets of £19.5bn (2018: £11.5bn).

Borrowings have increased over the year because of the issuance of £300m of Tier 3 bonds on 12 July 2019 (plus a further £100m of Tier 3 bonds on 19 November 2019) and of £400m of Tier 2 bonds on 17 September 2019.

Changes to accounting standards

The International Accounting Standards Board has announced that, subject to due process, the implementation of IFRS 17, the accounting standard for insurance contracts, will be delayed until 1 January 2022. The standard will have a significant impact on the way the Group's results are reported and work will continue during 2020 to prepare for implementation.

The Group has taken the deferral option in relation to IFRS 9 and will adopt the standard on the effective date of the new insurance contract standard.

Less material is the new standard on leases, IFRS 16. We have now adopted the new standard, which has seen assets and liabilities increasing by a similar amount to reflect the value of leases entered into by the Group (see note I.5 Leases and note A.4 Adoption of new or amended standards). As the lease on The Post Building was signed in May 2019 there is no change to 2018 comparatives.

Market consistent embedded value (APM)

The Group prepares supplementary information on an MCEV basis because we consider that embedded value reporting provides investors with a useful measure of the future profit streams of the Group's in-force long-term business. The Group's MCEV has increased by 75% from £3,441m at 31 December 2018 to £6,032m at 31 December 2019, largely as a result of new business and the associated equity. The MCEV is summarised in the table below.

Market consistent embedded value	2019 £m	2018 £m
Net worth of RLP	**5,181**	3,193
Value of in-force business	**2,757**	1,222
Less: debt and Group adjustments	**(1,906)**	(974)
MCEV	**6,032**	3,441

Adjustments allow for Group borrowings and other Group adjustments.

The value on an MCEV basis of new business written in 2019 was £1,612m (2018: £453m).

Financial review

CONTINUED

Capital management

The Group's capital resources are of critical importance. The Group's capital management framework is designed to meet the following objectives:

- to maintain financial strength in adverse conditions;
- to give customers long-term confidence in the Group;
- to satisfy our regulatory obligations;
- to match the profile of our assets and liabilities, taking account of the risk inherent in the business;
- to allocate capital efficiently to support new business growth;
- to retain financial flexibility by maintaining strong liquidity; and
- to provide an appropriate return to shareholders.

Under the Solvency II regime, the Group and its insurance company subsidiary, RLP, are required to hold the greater of the capital required under the new Solvency II Pillar 1 framework and the capital required under its own economic capital models, Solvency II Pillar 2.

In practice, it is the Pillar 1 requirement which is more onerous and which has a direct impact on the Group's ability to pay dividends. The Group aims to maintain solvency coverage in the range of 130% to 150% of the regulatory minimum requirement. As at 31 December 2019, the Group had an SCR coverage ratio of 202% (31 December 2018: 181%) **(APM)**, giving surplus capital for new business opportunities or future dividends.

The Group has implemented a dynamic capital management framework which uses interest rate and other hedging to target stability of the IFRS balance sheet under normal conditions and seeks to manage both the IFRS and solvency balance sheets as conditions deteriorate.

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

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

Firms with illiquid liabilities such as annuity business can discount these illiquid liabilities using the risk-free rate plus what is known as the 'matching adjustment'. The matching adjustment is broadly equivalent to the illiquidity premium that can be earned on the illiquid assets held to back illiquid liabilities. The Group applies the matching adjustment in calculating the BEL for almost all of its single premium insurance business. The remaining liabilities are discounted at the risk-free rate.

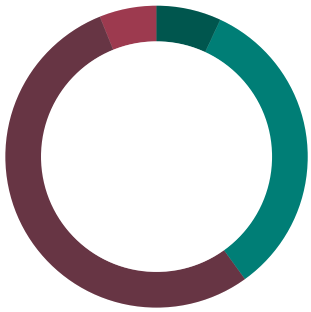
Assets in excess of those required to meet the technical provisions are known as Own Funds.

As part of the transitional arrangements in relation to the introduction of Solvency II, the Group is permitted to take credit for transitional solvency relief which amortises linearly to zero, falling by 1/16th on 1 January 2017 and again each year thereafter. An application can be made to re-calculate the amount of transitional solvency relief that can be taken if the risk profile of the Group changes materially. The Group was required to recalculate the transitional on 31 December 2019 (we are required to do so every two years). The impact of recalculation increased the transitional to £1,138m net of the associated impact of tax on Own Funds and allowing for amortisation of 4/16ths (2018: £609m allowing for amortisation of 3/16ths). Transitional solvency relief is now 52% of the risk margin (2018: 40%).

The Group's SCR is calculated using a PIM approved for use from 31 December 2019. The PIM means that the Group's bespoke models are used for calculation of credit and counterparty risk capital and ensures that the allocation of capital to investment is consistent with the risk inherent in the types of highly secured and collateralised investments which are core to the Group's investment strategy. The PIM was updated during 2019 to reflect feedback received from the PRA and to cover investment in Dutch mortgages. The standard formula is used to calculate the SCR for all other risk components and for aggregation across risk components.

The diagram below provides a breakdown of the SCR post-diversification benefit between modules. Life underwriting risk relates mainly to longevity risk. Market risk is primarily spread risk, i.e. the risk that credit spreads widen.

RHUK SCR 31 December 2019



Operational Risk	**7%**
Life Underwriting Risk	**33%**
Market Risk	**54%**
Counterparty Risk	**6%**

The solvency positions of the Group and RLP are summarised in the table below. Group SCR coverage increased from 181% at 31 December 2018 to 202% **(APM)** at 31 December 2019 and SCR coverage at RLP increased from 180% to 201% **(APM)**.

Solvency position of the Group and RLP	Group 2019 £m	Group 2018 £m	RLP 2019 £m	RLP 2018 £m
Tier 1 capital	**4,677**	3,260	**4,658**	3,236
Tier 2 capital	**1,059**	658	**1,059**	658
Tier 3 capital	**396**	–	**396**	–
Own funds available to meet SCR	**6,132**	3,918	**6,113**	3,894
SCR	**3,038**	2,163	**3,038**	2,163
Surplus above SCR	**3,094**	1,755	**3,075**	1,731
SCR coverage (APM)	**202%**	181%	**201%**	180%
SCR coverage without transitional solvency relief	**153%**	153%	**152%**	152%

An analysis of the change in Own Funds and SCR is shown below. Own Funds have increased from £3,918m to £6,132m after allowing for amortisation of 1/16th of transitional solvency relief on 1 January 2019. The biggest drivers of this change were the impact of new business (and associated new equity and debt) and the change in economic conditions.

The Group's SCR increased from £2,163m to £3,038m largely as a result of falling interest rates, new business and the impact of investing in more capital-efficient assets. All numbers are shown net of tax impacts and allow, where relevant, for changes in transitional solvency relief.

Change in Own Funds and SCR (APM)	2019 Change in Own Funds £m	2019 Change in SCR £m	2018 Change in Own Funds £m	2018 Change in SCR £m
Opening position	**3,918**	**2,163**	2,944	1,745
Amortisation of 1/16th of transitional on 1 January	**(43)**	**–**	(67)	–
New business (on a fully invested basis)	**1,338**	**1,170**	659	880
Short term impact of delayed investment	**(1,212)**	**(420)**	(271)	(41)
Investment impact from prior year	**271**	**41**	–	–
Performance of in-force book	**124**	**(265)**	616	96
Non-economic assumption changes	**35**	**(4)**	93	21
Acquisition costs and administration expenses	**(160)**	**–**	(120)	–
Borrowing Costs	**(86)**	**–**	(48)	–
Non-recurring and project expenditure	**(24)**	**–**	(20)	–
Economic conditions	**446**	**307**	(217)	(127)
New capital issuance	**1,479**	**–**	730	–
Changes to internal model	**46**	**46**	(381)	(411)
Closing position	**6,132**	**3,038**	3,918	2,163

Differences between IFRS accounting standards and Solvency II mean that management actions and changes in economic conditions can have very different impacts on the two bases.

Further information on the Group's solvency position can be found in the 2019 Solvency and Financial Condition Report when it is published.

Risk management

Central to our success

The Group's risk management principles are driven by the key objectives of the business:

- To ensure that our liabilities to policyholders can be met in a full and timely manner.
- To maintain our financial strength and capitalisation.
- To produce stable earnings from our in-force business.
- To protect and increase the value of our shareholders' investment.
- To safeguard Rothesay Life's reputation.

The risk management framework is intended to ensure that we identify and understand all of the risks inherent in the business. Where appropriate, longevity reinsurance, asset liability matching and hedging strategies are used to manage that risk and to optimise use of capital. We also look to mitigate credit risk through investing in assets that benefit from collateral and structural protections.

The management of risk is central to the success of the business. Every employee knows that they are responsible for the identification and management of risk.

Throughout 2019 the Group continued to invest in the risk functions to meet the needs of the Group and to be able to respond robustly to the changing nature of the uncertainties facing the Group.

Risk management framework
The Group has an embedded risk management framework (RMF) which ensures that every employee knows how they contribute to the effective management of all types of risks.

Further detail on the components of our RMF is provided below. The RMF informs and is directed by the Group's business strategy. Risk management considerations are integral to setting business strategy, as we seek to optimise our risk-adjusted returns and create shareholder value whilst also meeting the expectations of our customers and other stakeholders. The RMF ensures both clear ownership and strong oversight of all of the Group's risks, both quantifiable and non-quantifiable.

Board risk appetite and culture
Rothesay Life's risk appetite expresses the types of risk that the Group is willing to be exposed to in pursuing strategic objectives. The Board's risk appetite sets the tone for the culture of risk management throughout the organisation.

Our strategic approach is to de-risk our business in order to achieve attractive risk-adjusted returns. We aim to protect regulatory surplus and minimise balance sheet volatility by hedging longevity risk and adopting a cautious approach to investment.

Risk taking is therefore limited to circumstances where we believe that we fully understand the inherent and residual risks, where we are able to manage them within prudent, observable levels and where incurring the risks provides sufficient value to our stakeholders.

We aim to substantially mitigate the financial risks in our portfolio in order to protect policyholders, lock in value and to safeguard capital surplus such that excess capital may be invested into attractive risk-adjusted new business opportunities where the Group believes it has a comparative advantage.

"The risk management framework is intended to ensure that we identify and understand all of the risks inherent in the business."

Risk management

CONTINUED

Our risk appetite statement sets out the types of risk that we are willing to be exposed to in order to meet our strategic objectives. They are categorised as:

- Desired – risks that are core to the business model;
- Tolerated – risks that we incur as a result of the business model but try to mitigate or manage in some way; or
- Undesired – risks that we will seek to avoid or fully eliminate where possible.

All possible risks are considered as part of defining the overall risk universe for the Group, with each risk categorised as above and assigned an executive risk owner.

Risk appetite quantification and limit framework

The risk limit framework is intended to ensure the stability of earnings and solvency position of the business. Risk appetite is translated into quantifiable limits and early warning triggers that prompt management action to avoid our risk exposures breaching the Board's risk appetite. Limits exist in relation to market, credit, counterparty, liquidity, demographic and longevity risks and are sized with reference to our overall risk appetite and capital position. Limits are constantly reviewed and regularly reported against.

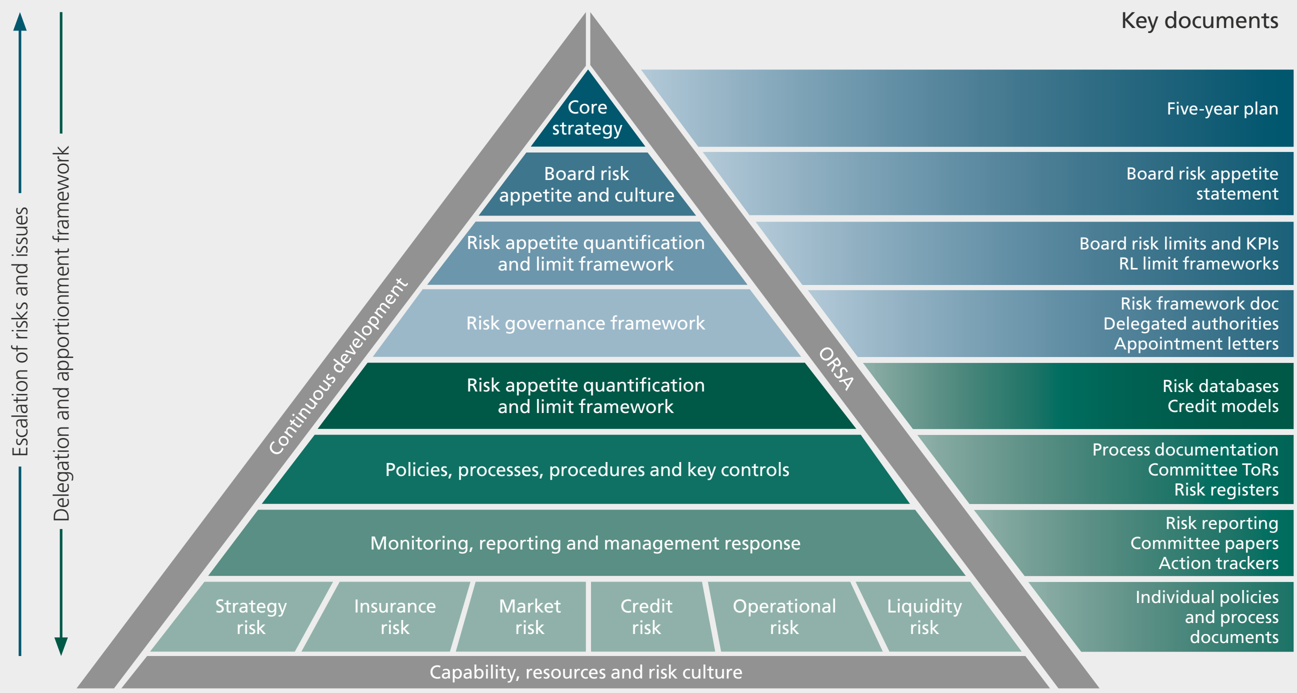
Risk governance framework

Rothesay Life's risk governance arrangements strengthen the risk-taking and risk management of the business by adding challenge, oversight and independent assurance. This framework is part of our commitment to compliance with the Senior Managers and Certification Regime (SMCR).

Rothesay Life adopts the principles of a 'three lines of defence' model for effective risk management that provides a consistent, transparent and clearly documented allocation of accountability and segregation of functional responsibilities.

- **First line:** Day-to-day risk management is delegated from the Board to the Chief Executive Officer (CEO) and, through a system of delegated authorities, to business managers. The Group also makes the distinction between:
  - the risk-taking functions, including investment and new business origination; and
  - the control functions, whose responsibility it is to ensure the integrity of the Group's operations and reporting. These include operations, finance and legal.
- **Second line:** Risk oversight is provided by the Chief Risk Officer (CRO), his team and risk management committees. The executive-level Working Level Risk Committee (WLRC) is chaired by the CRO and consists of relevant senior managers working within a delegated risk management framework. This Committee, and its sub-committees, review all material new investment, hedging or liability transactions, and is supported by a number of other committees which focus on risks arising from new activities, methodology and assumptions underlying our financial modelling and the management of third party suppliers.
- **Third line:** Internal audit provides the Board and Executive with comprehensive, independent, objective assurance over governance, risk management and internal control.

Risk management framework



Risk type	Definition	Risk Preference: Undesired	Risk Preference: Tolerated	Risk Preference: Desired
STRATEGY RISK	The risk of loss in future earnings and capital arising from changes in the competitive, economic, legal or political environment, changing customer behaviour, or a failure to select appropriate strategic or long-term business plans.			●
INSURANCE RISK	The risk of loss or of adverse change in the value of insurance liabilities, due to inadequate pricing and provisioning assumptions, or changes in longevity or other expectations.			●
MARKET RISK	The risk of loss or of adverse change resulting, directly or indirectly, from fluctuations in the level and in the volatility of market prices of assets, liabilities and financial instruments.		●	
CREDIT RISK	The risk of loss or of adverse change in the financial situation, resulting from fluctuations in the credit standing of issuers of securities, counterparties and any debtors.			●
LIQUIDITY RISK	The risk of being unable to realise investments and other assets in order to settle financial obligations when they fall due.	●		
OPERATIONAL RISK	The risk arising from inadequate or failed internal processes, personnel or systems, or from external events. This includes conduct risk.	●		

The Board has overall responsibility for the management of the exposure to risks and is supported by the Board Risk Committee (BRC) whose membership consists entirely of Non-Executive Directors and looks to ensure that the management of the business is conducted within the delegated risk framework from the main Board.

Systems and infrastructure

The Group operates an integrated system infrastructure which captures all assets and liabilities centrally and provides us with the capability to report and monitor risk daily at both the portfolio and the individual transaction level. Close coordination of underwriting, reinsurance, investment and risk hedging functions ensures risk management is central to all aspects of the business, and that new business pricing reflects latest market conditions, hedging costs, investment opportunities as well as comprehensive liability analysis.

Policies, processes, procedures and key controls

Our risks are grouped into one of six categories: strategy, insurance, market, credit, operational and liquidity risk. Rothesay Life has developed appropriate processes and documented procedures, appropriate controls and other risk mitigation techniques in order to manage them effectively. The Group policy framework ensures that an appropriate suite of risk management policies is maintained which set out the principles and standards for risk identification, measurement, mitigation, control and monitoring.

Monitoring, reporting and management response

We monitor our risk exposures against risk appetite as well as management actions on a continuous basis to confirm that our risk mitigations are effective. We then report our monitoring to oversight committees and individuals with responsibility for risk management in order to inform business decisions. Monitoring considers both those risks to which the Group is currently exposed, in addition to emerging risks that may impact the Group in the future.

Capability, resources and risk culture

Rothesay Life seeks to attract and retain the highest quality talent in the industry. The effectiveness of our risk management depends upon the high quality of our people and the strong risk culture and risk management practices. Consequently, training is conducted so that everyone understands their role in how to manage risk effectively and risk management is considered as part of all performance reviews.

Risk management

CONTINUED

Own Risk and Solvency Assessment (ORSA)

The ORSA is undertaken at least annually and involves an assessment of the risks to which the business is exposed as well as solvency forecasting in a range of scenarios, including consideration of the stresses that could jeopardise the Group's business plans. The ORSA is an important input to the Group's strategic planning cycle.

The Group also runs a number of stress tests on a weekly basis. The stresses have been developed so as to provide coverage over the key risks implicit within the portfolio at the time. Examples of stresses currently applied to the portfolio include issuer default stresses, property stresses, credit spread widening, credit downgrades and market risk stresses on liquidity outflows.

Continuous development

The way we think of and manage risk is constantly evolving. The CRO is responsible for developing the RMF to ensure that risk management remains effective.

Changes in the Group's risk profile and emerging risks

2019 saw the Group continue to grow, writing record volumes of new business. The Group now manages assets of over £53bn and insures the pensions of over 800,000 individuals.

The Group has continued its strategy of investment in a diverse range of assets, including low loan-to-value commercial real estate loans and infrastructure. The Group has continued to fund equity release mortgages and has recently started to invest in Dutch mortgages. The Group sources assets globally in order to achieve its target risk-adjusted returns, and has increased its capabilities in the US market while also enhancing its expertise in the domestic corporate debt markets.

This evolving investment strategy, together with the backdrop of political uncertainty, market volatility and uncertainty over future life expectancy, has meant that the Group's proactive approach to risk management has continued to be crucial in delivering the Group's strategic objectives and ensuring continued financial security for our policyholders.

The Group has continued to strengthen its control functions and the risk function, bringing in additional experts in credit risk. We have also strengthened our in-house internal audit capabilities.

There continue to be changes in accounting regulation, asset trading markets, pensions and tax, the effects of which are highly uncertain.

Transition from LIBOR

The interest rate benchmark LIBOR is expected to cease after the end of 2021. The Group closely monitors its exposure to the basis between LIBOR and SONIA swaps and has taken action to mitigate this risk. In addition, during 2019 the risk function has overseen the project which aims to ensure that the Group is ready to transition to alternative rates.

Brexit

As a UK insurer serving the domestic market, the Group's business model is largely unaffected by the UK's decision to leave the EU. However, the Group does have a small portfolio of Irish annuities which we sold to Laguna Life in March 2019. The transaction is structured initially as a reinsurance contract with Monument Re Limited (part of the Laguna Life Group) and we are now seeking approval for a Part VII transfer of the business. We also have a number of ex-pat policyholders based outside the UK. In the unlikely event that we are prevented from making payments to such policyholders we will look to take alternative steps to ensure continuity of pension payments.

The Group has reviewed its investment portfolio, suppliers and counterparties in the context of a "hard" Brexit and taken action to minimise any impact and ensure contract continuity.

The continued uncertainty over the UK's future political and financial relationship with the EU and the potential implications for financial markets, provide investment challenges for all UK insurers. A hard Brexit could have adverse financial impact on the Group but regular stress testing of the balance sheet ensures that the financial and solvency impact of such an exit is within our risk tolerances. Further information on sensitivities can be found in note D.1 (financial investments), note E.2 (insurance contract liabilities) and note F.2.2 (market risk).

Longer term

The Group has identified a number of emerging risks that could impact the business over the medium to long term. Geopolitical risk continues to be high across Europe and the US, driven by changes in government or evolving global relationships.

Over the longer term there are risks relating to climate change and how this could impact the Group's investments, as well as emerging or changing drivers of population mortality, including antimicrobial resistance, new screening technologies, dementia management and scope for pharmacological breakthroughs. The Group's investment policy requires consideration of the potential impact of climate change on new investments.

The Group continues to manage its affairs prudently such that it is not over-exposed to one particular risk and so that it only accepts risks which it understands and where it is adequately rewarded for accepting the risk.

Principal risks and uncertainties facing the Group

The Group's principal risks are credit, insurance, liquidity and market related. An overview of these and other risks associated with the business, including an outline of how each is mitigated and how the risk has changed from last year, is provided in the table below next page. Our risk exposures generally increase with the size of the balance sheet; in the table below we have only shown an increasing trend where the increase has been out of line with this.

More details can be found in sections E and F of the financial statements.

Risks and uncertainties	Description	Mitigation	Strategic priority	Change from last year
CREDIT RISK – THE RISK THAT AN INVESTMENT COUNTERPARTY'S CREDIT WORTHINESS DETERIORATES OR THAT THE COUNTERPARTY DEFAULTS	The Group is exposed to the credit worthiness of its investment counterparties. Our financial and/or capital position could be adversely impacted by downgrades, credit spread widening or defaults.	The Group carefully selects the investments it makes in order to generate an adequate risk-adjusted return, has a preference for investments with structured protection such as collateral, and may purchase external credit protection to mitigate the impact of any defaults. The Group also carefully manages its counterparty exposures and works with a range of third parties. The Group maintains a highly experienced market-facing team as well as a second-line internal credit risk team who regularly monitor and assess the credit risk associated with its investments. Where assets are unrated, the credit risk team also makes an independent assessment of the appropriate internal credit rating.	1,2	↑ This risk has increased as the balance sheet has grown, particularly because with the growth of the balance sheet, we have a higher weighting of corporate bonds.
COUNTERPARTY DEFAULT RISK- – THE RISK THAT A FINANCIAL COUNTERPARTY'S CREDIT WORTHINESS DETERIORATES OR THAT A COUNTERPARTY DEFAULTS	The Group is exposed to the credit worthiness of its financial counterparties. Our financial and/or capital position could be adversely impacted by downgrades, credit spread widening or defaults.	The Group prefers to work with highly rated and stable counterparties, and to diversify counterparty exposures where appropriate. Derivative and reinsurance contracts are subject to margining requirements to ensure exposures are appropriately collateralised. The Group actively monitors counterparties for downgrade risk, and may also purchase credit protection to mitigate specific exposures.	1,2	→ This risk has grown with the balance sheet.
INSURANCE RISK – THE RISK THAT DEMOGRAPHIC EXPERIENCE IS DIFFERENT FROM EXPECTED	As the pensions insured by the Group are guaranteed, our financial and/or capital position could be adversely impacted if, for example, policyholders live longer than expected or if more of them have dependants than expected.	The Group invests in both people and modelling capabilities to understand its longevity experience and to help predict what could happen in the future. The Group aims to reinsure a majority of its longevity exposure. As at 31 December 2019, the Group had reinsured 78% of its longevity risk (2018: 78%) **(APM)**.	1,2	→ This risk has grown with the balance sheet. Longevity in 2019 has improved by more than expected and, given lower improvements in prior years, the outlook remains uncertain.

Risk management

CONTINUED

Risks and uncertainties	Description	Mitigation	Strategic priority	Change from last year
MARKET RISK – THE RISK OF ADVERSE MOVEMENTS IN INTEREST RATES, INFLATION OR CURRENCY	The Group's financial and/or capital position could be adversely impacted by market movements to the extent that assets and liabilities are mismatched.	The Group monitors interest rate risk and foreign exchange risk closely, and uses derivatives to hedge the risks. We also undertake regular scenario testing, for example in relation to Brexit, to understand the impact of potential combinations of stresses. Assets and liabilities are matched as closely as possible, including using inflation-linked assets to meet inflation-linked liabilities.	1,2	→ Volatile market conditions have persisted in 2019
PROPERTY RISK – THE RISK OF A FALL IN THE VALUE OF PROPERTY	Through its investments secured on property, the Group's financial and/or capital position could be adversely impacted by falls in the value of property.	Residential property risk is reduced through strict underwriting criteria, covering for example the quality of the underlying property and loan-to-value limits by age of borrower. We have also established prudent reserves covering the potential cost of the no negative equity guarantee on equity release mortgages. Exposure to commercial real estate is reduced by ensuring that loans have a low loan to value ratio, that there are appropriate covenants and that properties have strong tenants.	1,2,3	→ This risk has grown with the balance sheet through the Group's continuing investment in equity release mortgages and commercial real estate loans and new investments in Dutch residential mortgages
LIQUIDITY RISK – THE RISK OF BEING UNABLE TO REALISE INVESTMENTS AND OTHER ASSETS IN ORDER TO SETTLE FINANCIAL OBLIGATIONS WHEN THEY FALL DUE.	Given our holding of illiquid assets, there is a risk that we are unable to meet payments or collateral calls as they fall due in adverse circumstances.	The Group has a comprehensive liquidity management framework that ensures sufficient liquidity is held to meet collateral outflows as well as projected expenses and other outflows, in extreme market conditions.	1,3	↓ With the growth of the balance sheet, the Group's pool of liquid investments has increased
CLIMATE CHANGE – THE RISK OF CLIMATE CHANGE	The Group's assets are exposed to the potential impact of climate change. Such risks include: Physical risks such as increasing frequency and severity of flooding; and Transition risks which can arise from the process of adjustment towards a low-carbon economy.	The Group's in-house team is responsible for the selection and management of all of the Group's assets. The team considers climate-related risk as part of the investment process. In addition, the Group considers flood risk as part of its lending policies.	1,2,3	NEW There is some evidence of acceleration of climate change and the UK's commitment to carbon neutrality by 2050 may increase transition risk.

Risks and uncertainties	Description	Mitigation	Strategic priority	Change from last year
OPERATIONAL RISK – THE RISK OF OPERATIONAL FAILURE, INCLUDING CONDUCT FAILURES	The Group is exposed to the risk of operational failure as a result of failure of a strategic business partner or of its own systems and processes. This could lead to reputational damage and increased costs.	The Group has no appetite for material operational risk losses, and has a strong control environment to limit these risks as far as possible. The Customer and Conduct Committee is responsible for ensuring that stakeholders are treated fairly by the Group and its strategic business partners. Scenario analysis covering a variety of potential operational risk events is regularly carried out. The Group seeks to mitigate cyber risk through robust processes and controls including data protection, penetration testing and staff training, and maintains ISO 27001 and ISO 22301 accreditation. Where the Group outsources some of its responsibilities, we undertake thorough due diligence in advance of appointment and then have a strong programme of oversight.	2, 3	↑ The Group continues to grow through writing new business and the number of staff employed is expected to increase in the short term as a result. Our investment in equity release mortgages increases conduct risk, through the Group's involvement in product design. Cyber and financial crime risk continue to be heightened. Focus on the management of operational risk has continued in 2019.

Risk management

CONTINUED

Risks and uncertainties	Description	Mitigation	Strategic priority	Change from last year
STRATEGIC, POLITICAL AND REGULATORY RISK – THE RISK OF ADVERSE CHANGES TO THE REGULATORY OR POLITICAL ENVIRONMENT	The Group's strategy, financial or capital position could be adversely affected by the impact of regulatory or political change.	The Group continues to actively monitor the political landscape. Where appropriate, the Group carries out lobbying activities or responds to consultations which may directly impact it. Strategic decisions take into account the overall political landscape. The Group's potential exposure to leasehold reform is mitigated by structural protections in the loans advanced. The Group seeks to have a regular dialogue with regulators in order to ensure compliance, as well as the ability to react quickly to any unanticipated developments. The Group seeks to have an open and transparent relationship with regulators at all times. The Group is a member of the Confederation of British Industry and the Association of British Insurers and it participates in consultations to ensure that its interests are protected for the benefit of its stakeholders.	1,2	→ The focus remains on the UK's post-Brexit relationship with the EU and the associated uncertainty, but there are continued political risks globally. The government's planned reform of the leasehold market could have an adverse impact on the Group's loans secured on ground rents. The emergence of defined benefit consolidator schemes could prove a threat to the pension de-risking market if consolidator schemes become a viable alternative means of de-risking pension liabilities for well-funded pension schemes or companies.

Strategic priorities:
1. Protect the security of policyholder benefits
2. Grow through writing value-driven new business
3. Safeguard our brand and culture

Viability statement

The Board of Directors has assessed the prospects for the Group over a longer period than the 12 months required by the 'going concern' provision. In making this assessment the Directors have considered the current liquidity and solvency position, ensuring long-term pension security for our policyholders and stakeholder reward as well as the potential risks, the mitigation of these and the impact these could have on liquidity and solvency.

The Board of Directors conducted this review for a period of five years, which is consistent with the Group's ORSA. As noted above, the Group's own views of risk and associated capital requirements have been investigated through the ORSA process, including considering how future changes to the Group's risk profile and also external influences may impact on our solvency needs and ability to execute the business plan.

The ORSA includes a number of forward-looking scenarios intended to test the impact of a number of stresses and scenarios that may impact Rothesay's ability to execute the business plan. Scenarios considered include a replay of the Global Financial Crisis, in addition to shocks to new business volume and profitability. The ORSA demonstrates the robustness of the Group's solvency and the way in which the business plan would need to be adapted to respond to adverse conditions. Management and the Board believe that the Group is well capitalised on both a regulatory and economic capital basis.

Given the dynamic nature of the market and the Group, the Group's strategic business plan is based on a shorter period of three years and is prepared on a rolling basis and reviewed and approved annually by the Board. The business plan is refreshed if there are material changes in the business model or market environment. The strategic business plan is centred around the Group's projected new business targets, with assumptions about pricing, reinsurance, revenue generation, expenses and leverage based on the Group's existing business and target operating model. In certain scenarios where there is very material new business growth, the plan also assumes that new equity would be issued. IFRS pre-tax profits are driven by two key sources: new business profitability and profit emergence of the Group's back-book.

Based on the results of this analysis, the Board of Directors has a reasonable expectation that the Group will be able to continue in operation and meet its liabilities and obligations as they fall due over the five-year period of the assessment.

Stakeholder engagement

The Group's purpose

As well as policyholders and shareholders, the Group has responsibility to a number of other stakeholders, including our suppliers, our people, our community, the environment and our bondholders.

Section 172 (1) statement
s172 Companies Act 2006
At each Board meeting, the Board considers the impact on stakeholders and the requirements of s172 of the Companies Act 2006 when making decisions. The Company Secretary sets out the text of s172 on every Board agenda.

Given the long-term nature of our business, the Board is very focused on the likely long-term consequences of decisions and believes that it has acted in a way that promotes the success of the Group. Our Corporate Social Responsibility policy describes the way in which the Group aims to engage positively with all our stakeholders – a key concern of the Board.

Stakeholder engagement is described in the following pages.

The Group's purpose is to provide pension security for our policyholders and value to our shareholders and other stakeholders over the long term.

Our customers

We provide benefits to over 800,000 individuals either direct (through individual policies) or through policies purchased by pension scheme trustees or insurance companies.

Read more on **page 38**

Our people

The Group now employs 252 people in London and New York.

Read more on **page 42**

Our environment

The Group recognises the need to protect the environment and aims to reduce our impact through a commitment to continual improvement and by working with our partners to reduce their impact.

Read more on **page 44**

Our community

We invest over £30.5bn in the UK economy and make a significant tax contribution in the UK.

We also contribute to the community through our charitable activities.

Read more on **page 46**

Our strategic partners

We continue to follow a strategic outsourcing model for middle office services and the provision of administration services so strong relationships with our suppliers are crucial to providing our customers with the level of service they expect.

Where possible we hedge longevity risk in the reinsurance market so we actively work with our reinsurance counterparties to maintain good relationships and to ensure that robust controls are in place.

Read more on **page 48**

Our investors

The Group appreciates the support and commitment provided by our three, long-term institutional shareholders and also by our bondholders.

Read more on **page 49**

Stakeholder engagement

CONTINUED

HAVE YOUR SAY

EDITED BY KATE PALMER

Thanks for honest annuity

Could I just say a huge thank you to the insurer Rothesay Life for behaving so honestly and honourably regarding paying out cash for small annuities?

Not only does a real person answer the phone (almost unheard of these days), but whoever you speak to is knowledgeable and helpful.

The company deserves a pat on the back – unlike some others that I hesitate to name . . .

You know who you are!

LS, Kennington, London

Positive feedback in The Sunday Times

Our customers

Over 800,000 individuals depend on Rothesay Life for the payment of their pensions, so providing long-term pension security is at the heart of what we do.

We pride ourselves on providing a high quality customer service. We were the first insurance company to have gained Accreditation by the Pensions Administration Standards Association (PASA), an independent body dedicated to improving standards in pensions administration, highlighting the strength of our controls and oversight of our administrators.

As noted earlier, we follow a strategic outsourcing model for the provision of administration and payroll services. Each administrator has dedicated teams supporting Rothesay Life, with all calls and policyholder interaction carried out in the UK.

Policyholder

Buy in	**19%**
Buy out	**11%**
Re-insurance	**47%**
Individual policyholders	**23%**

A high degree of automation and technology means that our outsourced administration platforms interact with our risk management systems to minimise discrepancies and ensure that we pay policyholders accurately and on time. During 2019 we continued to invest in automation and efficiency projects to ensure we have a robust control environment to manage existing and future business without compromising our high service levels and our continued commitment to our policyholders.

In order to ensure that customer service wouldn't be adversely impacted by the record new business volumes in 2019, the Operations team spent time with all our administrators to understand their capacity to take on additional work and this analysis was provided to the Board. The Group assigns new third party contracts in a way which is intended to deliver a high quality customer service and takes into account factors such as transaction timing, scheme complexity, membership size, potential business pipeline, ongoing projects and cost.

We manage the administrators through a series of robust and established processes, including service level agreements which are amongst the most challenging in the industry. This ensures we maintain excellent customer service levels across case work and call handling (with 95% of targets being met). Our complaint levels continue to be low with just 0.70 complaints received per 1,000 policyholders, of which only 0.36 complaints per 1,000 policyholder were upheld **(APM)**. Our administrators escalate all complaints to the in-house Operations team immediately for review and sign-off of the response. Where policyholders express dissatisfaction or make complaints then we undertake a full root cause analysis. All complaints are reported to our Customer and Conduct Committee, which is chaired by Terry Miller, an Independent Non-Executive Director.

Customer satisfaction levels remain high with excellent customer feedback and 94% of policyholders responding to our surveys rating our service as 'Excellent' or 'Good'.

Vulnerable customers

Rothesay Life is proud of the fact that all of our policyholders are treated as individuals and we have strong governance in place to help ensure we follow best practice in this area. We are actively engaged with the Association of British Insurers (ABI) and are a member of their Vulnerable Customers Working Group. Our contact centre administrators are trained on how to identify and deal with vulnerable customers and over the past 12 months we have proactively supported a number of initiatives to promote better outcomes for vulnerable customers. For example, as part of October's Customer Service Week, we sponsored a Vulnerable Customer Award with our contact centre and administration teams.

Rothesay Life has recently joined the Death Notification Service. This is a free customer-facing service that is intended to make death notification process easier during what is a difficult time..

Small pots

In 2018, we initiated a "small pots" initiative under which pensioners with relatively small annuities (benefit value of less than £10,000) were offered a one-off opportunity to take a lump sum payment and this initiative has continued throughout 2019. We believe that, where possible, our policyholders should be offered the opportunity to take a lump sum because some of them were obliged to purchase an annuity on retirement and may have preferred to take cash. We are actively engaging with the FCA on this project, which was overseen by our Customer and Conduct Committee to ensure fair treatment of our customers.

Our Irish customers

On 27 March 2019 the Group sold its €140m portfolio of around 400 Irish annuities to Laguna Life DAC in order to ensure that these customers continue to receive their pensions post-Brexit. The transaction is structured initially as a reinsurance contract and it is expected, subject to High Court approval, that this would be followed by an insurance business transfer under Part VII of the Financial Services and Markets Act 2000.

"The service is absolutely five star! It's a great service thanks very much."

"I was greatly impressed with the professional way my enquiry was dealt with, nothing was too much trouble. Thank you very much."

Stakeholder engagement

CONTINUED

> "The service side is highly important to us and our experience has been excellent."

A pension trustee

> "From the first buy-in this has been a positive relationship; what stands out is their professionalism, and clear and determined decision making."

A pension trustee

The Group provides pension de-risking solutions to the trustees of over 180 pension schemes.

Rothesay Life is a Technical Partner of PensionChair, a leading industry network for pension scheme Trustee Chairs. In this role, we provide expert insight to the PensionChair membership. We are also a premier sponsor of the Association of Member Nominated Trustees – a body that provides training and support to member-nominated trustees.

There are a number of phases to a bulk annuity transaction. Through a well-managed and collaborative implementation, data cleanse and transition process, the optimal member outcome can be achieved. We aim to deliver certainty to trustees and members by:

- Ensuring that the Group is strongly capitalised to give confidence in our ability to provide long-term pension security for our policyholders
- Performing detailed due diligence up front so that all parties are clear as to the risks that are being insured or bought out
- Working with the trustees and their administrators to make the data cleaning process and conversion from buy-in to buy-out as seamless as possible
- Providing excellent customer service into the future

The Group undertakes a regular survey of trustees. Individual trustees are asked a series of questions by an independent facilitator who then produces a report summarising the results. This report and the Group's planned actions in response to the feedback are discussed at the Board.

In addition, Directors and management of the Group have ad hoc meetings with pension scheme trustees throughout the year.

> "Their due diligence was of the highest order and they carried it out without any issues. They are not pushovers when you are negotiating, but they are very professional. They are tough commercially. My view is that they are the best in the market and I would have no trouble saying so."

A pension trustee

Pension trustees

Case study

nationalgrid

We completed a £2.8bn pensioner buy-in with National Grid UK Pension Scheme (the 'Scheme'), which has assets and liabilities of around £20bn.

Over a period of three months, from the point the Scheme approached the market to the completion of the bulk annuity, we demonstrated our ability to react quickly, allowing the Scheme to benefit from favourable pricing and market conditions. We were also able to provide additional security in a volatile market from our offer of a highly bespoke price lock based on a portfolio of the Scheme's assets, and the Scheme was able to pay the premium by simply transferring this portfolio to Rothesay Life. This transaction was the first insurance solution used by the Scheme to help reduce its exposure to both longevity risks and financial risks, such as interest rate and inflation changes, and provides extra protection of the funding position of the Scheme.

£2.8bn

Pensioner buy-in

Stakeholder engagement

CONTINUED

Average employee turnover

7.4%

(2018: 11.8%) | **-4.4%**

Building the team that builds our business

To meet the demands of a growing business, we have continued to recruit, with headcount increasing from 210 at the end of 2018 to 252 at the end of 2019. Hiring in 2019 has been focused on four main areas:

- Investment – to help us to deliver the Group's long-term investment strategy. This includes further growth of our New York office.
- Operations – to meet the demands of increasing policyholder numbers and maintain robust controls.
- Technology – to manage the re-platforming of our market-leading technology and to ensure we continue to be at the leading edge of automation.
- Internal Audit – to reduce our reliance on our co-sourcing partner and ensure a robust 'third line of defence.'

Year-on-year increases in graduate numbers have also strengthened our capability pipeline for the future.

Investing in our people

In 2019 we delivered a comprehensive learning and development agenda, designed to support an environment where our employees can thrive and fulfil their career ambitions. With our strategic objectives and company drivers in mind, our people are encouraged to own their career development and select their learning activities from the programmes which have been tailored to Rothesay Life's requirements.

We continue to invest in partnerships with suppliers to deliver onsite training and learning platforms that augment the technical skills and soft skills of our people.

The Group supports employees in gaining a range of professional qualifications and in 2019 we sponsored our first apprentice. During 2019 we became a member of Cityparents, an award-winning network providing quality content aimed at all City professionals.

We also continue to invest in the health and wellbeing of our employees and their families. Health benefits include private healthcare for employees and their families, subsidised gym memberships, subsidised health assessments, free flu jabs and comprehensive online resources.

Engaging our employees

In 2019, we continued to focus on strengthening our internal communications capability and building a central hub for information. This has been key to helping new hires become part of the team. We have ensured that there is regular communication from all parts of the business and have increased the frequency of all-employee town halls.

Our new offices at The Post Building mean that all our UK-based employees are now working together on one floor, facilitates the absence of functional silos – an integral part of the Rothesay Life culture. In addition, the CEO has regular lunches to meet employees. The Chairman also has frequent, informal interaction with the Group's employees.

Our people

In 2019 we repeated the employee engagement survey using an external consultancy in order that we can use benchmarking data to better interpret the results. We are delighted that the results demonstrate an engaged workforce and that our top three responses were:

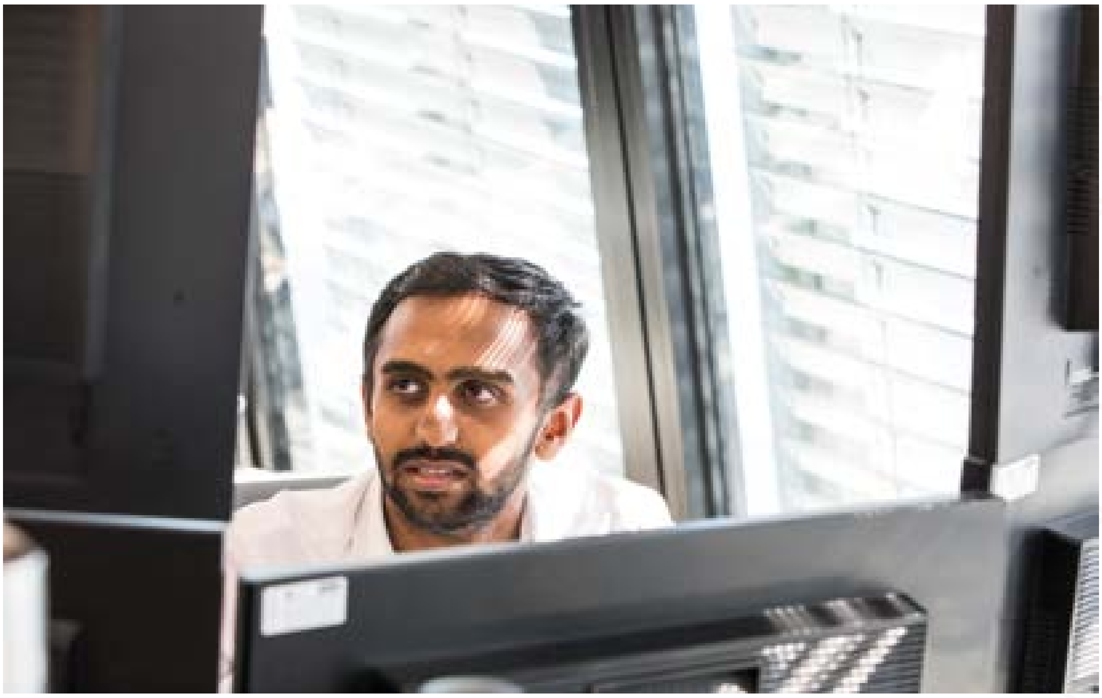
- I am proud to work at Rothesay – 87%
- My manager gives me freedom to express my opinions even though they might contradict their views – 86%
- Senior leadership makes me excited about the future of the organisation – 82%

The survey has also helped us identify areas where we can do better and this will be a focus for 2020.

Diversity and inclusion

The Group is committed to promoting equality and diversity, and a culture that actively values difference. We recognise that people from different backgrounds and experiences can bring valuable insights to the workplace and enhance the way we work. In 2019, Terry Miller, one of the Non-Executive Directors, met with senior female managers to discuss actions that might be taken to improve inclusivity, one outcome of which was the decision to become a member of Cityparents.

During 2019 all our managers received training on what it means to be an inclusive company and in September 2019 we joined an ABI initiative aimed at ensuring transparent, easily accessible information on parental leave and pay policies. We also increased paid paternity leave entitlement from two weeks to four weeks.



Stakeholder engagement
CONTINUED

Our environment

Responsible investment
We believe that investing sustainably is consistent with our long-term investment objectives and sound risk management. In particular, we believe that climate change could pose a systematic, long-term material financial risk to the value of assets.

Our in-house team is responsible for the selection and management of almost all of the Group's assets. By taking financially material environmental, social and governance (ESG) factors, including climate change, into account in our investment process, we believe that the Group better manages risk and is better positioned to deliver our long-term investment objectives.

The following table shows the way in which we manage the risks associated with climate change.

The Group recognises the need to protect the environment and will endeavour to reduce our impact through a commitment to continual improvement and by working with our partners to reduce their impact.

Our new London office has a BREEAM 'Excellent' rating and has been designed to support cycling to work through provision of 439 cycle spaces and a cycle workshop.

Climate-related risk management

GOVERNANCE

Climate-related risks are incorporated in the Group's risk management framework, which is overseen by the BRC.

The Group's in-house team is responsible for the selection and management of all of the Group's assets. The team considers climate-related risk as part of the investment process and is required to document this as part of committee approval papers for new investments.

The CRO and Head of Asset and Liability Management are jointly responsible for the management of climate-related financial risks.

STRATEGY

Given the Group's focus on annuity business, we believe that climate-related risks and opportunities mainly impact our investment strategy and that they have a limited impact on our business model. The long-term nature of the Group's investments means that the Group is exposed to financial risks from climate change.

By taking such risks into account as part of the investment process, the Group aims to ensure that climate change will not impact the long-term pension security of our policyholders.

The Group's dynamic investment strategy means that we are well placed to take advantage of any climate-related investment opportunities.

RISK MANAGEMENT

Climate-related risks are incorporated in the Group's risk management framework (as described in the risk management section).

The in-house investment team considers climate-related risk as part of the investment process and this assessment is reviewed and challenged by the second line risk function.

In 2019 the Group was asked to participate in the PRA's insurance stress testing which included climate change scenarios. We are now in the process of developing a series of climate-related stress tests that can be regularly undertaken in order to understand the potential impact of climate change on the Group's balance sheet and to mitigate this appropriately, primarily through investment selection and lending policies.

METRICS AND TARGETS

Climate-related financial risks are summarised in the principal risks and uncertainties facing the Group (see page 32).

The Group focuses on the capital impact of climate-related risks by considering potential climate change scenarios and the possible impact on the Group's assets and liabilities. This includes the development of appropriate metrics to help manage climate-related risk exposures.

As with other financial risks, the Group aims to ensure that we can withstand reasonably plausible risk scenarios which have been calibrated with input from industry forums and expert research.

During 2019 the Group invested in CPI-linked Ørsted bonds

Stakeholder engagement

CONTINUED

Invested in the UK economy

£30.5bn

2018: £21.5bn | **+42%**

Rothesay Life has invested in projects in education and social housing.

Investment in the UK economy

The Group has invested £30.5bn (2018:£21.5bn) in projects that benefit the UK such as transport, infrastructure, education and social housing.

In addition, by providing funding to back equity release mortgages, the Group is helping older people access the equity in their houses, without the need for them to move. Mortgages are written with a no negative equity guarantee which means that borrowers don't have to worry about the liability growing above the value of the house.

Taxation

The Group's tax strategy is designed to ensure compliance with the tax laws of those countries in which the Group operates (primarily the UK). Any tax planning undertaken has commercial and economic substance and has regard to the Group's corporate responsibilities and brand and the potential impact on shareholders, policyholders and other stakeholders. We do not undertake planning that is contrived or artificial. The Group has zero tolerance for tax evasion of any kind.

The Group makes a significant tax contribution in the UK, with £223m remitted to UK tax authorities in 2019 (2018: £183m). The Group has an effective corporation tax rate of 19.3% during 2019 (2018: 18.4%). Other taxes include property taxes, employer payroll taxes and irrecoverable indirect taxes.

Taxes paid	2019 £m	2018 £m
Corporation tax	**59**	38
Other taxes	**12**	10
Taxes collected	**152**	135
Total remitted	**233**	183

Giving back

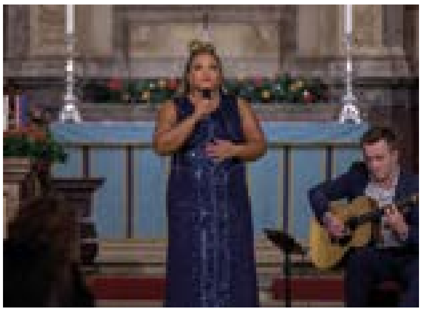
Rothesay Life's chosen charity is Age UK, the UK's largest charity dedicated to helping everyone make the most of later life. The charity helps more than six million people very year, providing companionship, advice and support for older people who need it most (see p9). We sponsor Age UK's Avoiding Scams booklet which provides useful information on how to protect people from scams and we also continue to sponsor and issue their Bereavement Guide.

Our community

Rothesay Life also supports Tax Help for Older People, a charity service providing free, independent and expert help and advice for older people on lower incomes who cannot afford to pay for professional tax advice.

On an annual basis we choose an employee-nominated charity of the year. In 2019 our charity of the year was Kids, an organisation dedicated to providing an extensive range of services to disabled children and young people, irrespective of their impairment or condition. We support a number of other charities and encourage our employees to support charities personal to them through our matched giving policy, which gives everyone an annual matched allowance of £1,000. We are proud that so many people have engaged in fundraising and social events designed to give back to the community.

During 2019 the Group established the Rothesay Life Foundation, to support charities that seek to improve the quality of life for older people, helping them to live their lives in a happy, safe and fulfilling way.



Rothesay Life sponsors Age UK's annual celebrity carol concert, Love Christmas (photographer: Graham Lacdao).

52 employees took part in the JP Morgan Corporate Challenge, an event which seeks to raise money for charity and to promote health and fitness in the workplace

Stakeholder engagement

CONTINUED

Outsourcing model

As noted previously, we follow a strategic outsourcing model for the provision of administration services and middle office functions. Key to delivery of excellent customer service is our close working relationship with our third party administrators, Willis Towers Watson, JLT Employee Benefits and Capita Employee Solutions.

The record volume of new business in 2019 has meant that we have been in close dialogue with each of our administration partners about their capacity and appetite for taking on new business. We also continue to prepare for the potential transfer of business from Prudential should our appeal be successful.

During 2018 members of the Board made site visits to our three strategic administration partners and in 2019 they visited Northern Trust in Dublin, meeting with the respective management teams.

Other suppliers

Oversight

The Third Party Oversight Committee, a sub-committee of the Working Level Risk Committee, is responsible for the oversight of third party relationships. Its objective is to ensure that the legal, regulatory, information security, reputational, commercial, operational and financial risks associated with third party relationships are appropriately managed.

Prompt payment code

The Group's finance team aims to pay suppliers promptly, with the average time taken to pay invoices in 2019 being 13 days and 95% being paid within 30 days.

Modern slavery

As required by the Modern Slavery Act 2015, on 4 June 2019 a statement was published on the Group's website describing the steps taken by the Group to ensure that slavery and human trafficking is not taking place in any part of our business or in any of our supply chains.

The statement also notes that we expect our suppliers to ensure fair employment practices. For example, we require our cleaning suppliers to pay their personnel, who work at our premises, a salary which is equivalent to (at least) the London Living Wage.

Reinsurers

As previously noted, we have reinsured the new business written in 2019, maintaining 78% reinsurance coverage **(APM)** and this has led to us entering into seven reinsurance contracts with existing counterparties and one contract with a new reinsurance counterparty.

The long-term nature of these reinsurance agreements means that developing a strong working relationship with our reinsurance counterparts is important and we look to provide our reinsurance counterparties with the same quick and efficient execution that we target for client transactions. During 2019 we have developed a new internal reinsurance administration system which will facilitate this.

Our strategic business partners

Our investors

Shareholders

We are fortunate in having a long-term stable shareholder base consisting of three institutional shareholders. Based on the percentage nominal share capital owned, their holdings are as follows:

- The Blackstone Group L.P. – 35%
- GIC Private Limited – 35%
- MassMutual Financial Group – 24%

Each of the shareholders has appointed a Non-Executive Director. The shareholder Directors attend Board and other Board Committee meetings, providing an important contribution to the effectiveness of the Board and to the overall performance of the Group. The shareholders receive regular management information and their teams also interact directly with management.

The shareholders support the Group in other ways, for example assisting in the sourcing and evaluation of investments, providing debt financing and providing longevity reinsurance.

Bondholders

We were pleased with the debt markets' response to our Tier 2 and Tier 3 bond issuance during 2019:

- On 12 July, RLP issued a seven-year £300m Tier 3 bond with a fixed 3.375% coupon.
- On 17 September, RLP issued a 10-year £400m Tier 2 bond with a fixed 5.5% coupon.
- On 19 November, RLP issued a further £100m of the seven-year Tier 3 bonds with the same terms and conditions as the July issuance.

Senior management meets with debt investors on a regular basis and makes presentations to groups of investors and analysts.

The Group also has a regular dialogue with its relationship banks.

Credit ratings agencies

The Group's life company has credit ratings from Moody's Investor Service and Fitch Ratings and the Group's outstanding public bonds have all been rated by Fitch Ratings. The Group meets with the ratings agencies at least once per year and updates them on material events.

Rating of RLP:

A3

Moody's Investor service

A+

Fitch Ratings

The Board, together with management, is responsible for ensuring the security of our policyholders' pensions and generating and delivering sustainable shareholder value through the management of the Group's business.

Governance Report

Chairman's introduction

Naguib Kheraj Chairman

Robust corporate governance

The Group's governance structure means that decisions can be made quickly and efficiently whilst ensuring that there is robust oversight.

The Board

A strong Board with an effective committee structure facilitates the governance framework of our Group.

The Board comprises 13 Directors – the Chairman, three shareholder Directors, six independent Non-Executive Directors and three Executive Directors.

As noted previously, on 28 February 2019, Richard Berliand stepped down from the Board. Simon Morris was appointed as an independent Non-Executive Director on 14 February 2019. There were no other changes to the Board during 2019.

Shareholders

Based on the percentage of nominal capital, the ultimate shareholders of RHUK are:

- The Blackstone Group L.P. 35%
- GIC Private Limited 35%
- MassMutual Financial Group 24%

The shareholder Directors provide an important contribution to the Board and the overall performance of the Group.

The Shareholder Agreement sets out a number of reserved matters, including:

- Changes to the rights of shareholders.
- Issuance of new equity or debt.
- Material changes to the business strategy of the Group.
- Material acquisitions or disposals.

How the Board operates

The Board is led by the Chairman, Naguib Kheraj. Naguib was appointed to the Board on 1 October 2014 and became Chairman on 18 December 2017.

Day-to-day management of the Group is led by Addy Loudiadis, the Chief Executive Officer, and Tom Pearce, the Managing Director.

The Board is responsible to shareholders, policyholders, the regulators, employees and other stakeholders for the overall performance of the Group. More information on stakeholder engagement can be found on p36. The Board's role is to provide oversight and direction to the senior management team and to ensure that there is an appropriate risk and control framework for the Group.

The Board has a schedule of matters reserved for its consideration and approval, including:

- Group strategy and business plans.
- Material new investments and new insurance transactions.
- Acquisitions and disposals.
- The constitution of Board Committees.
- Capital management policy including dividend policy.
- Other key Group policies.

The Board is supported by the Audit Committee, the Board Risk Committee, the Remuneration Committee and the Nomination Committee. Terms of reference for these Committees can be found at www.rothesaylife.com. In the following sections of the governance report, the chairs of these Committees provide a report on activity in the year.

How the Board spent its time in 2019

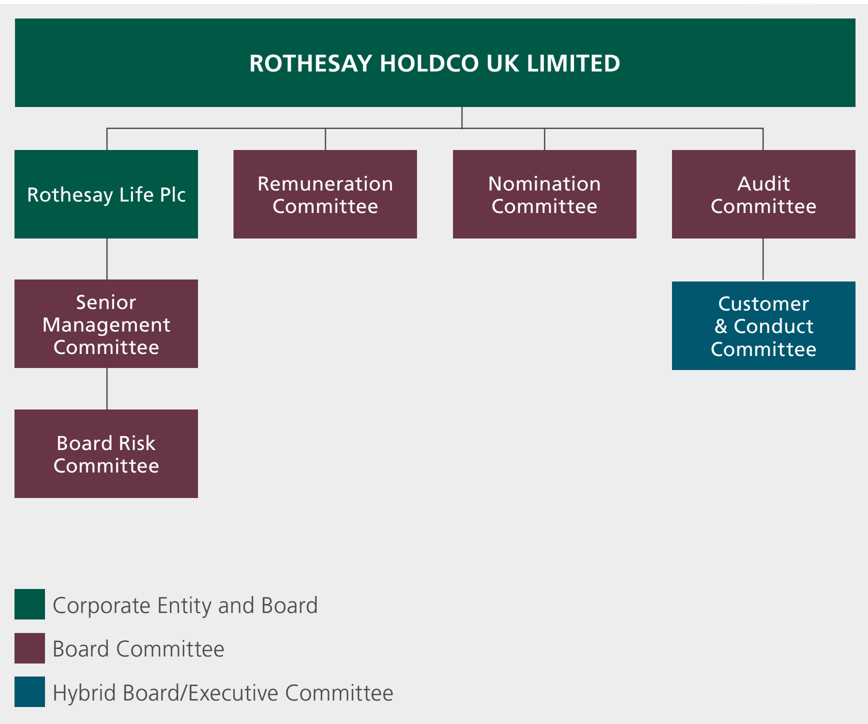
The Board met formally six times during 2019, in addition to meeting on a number of other occasions on an ad hoc basis to discuss, amongst other things, material transactions and the issuance of the Tier 2 and Tier 3 bonds.

The Board agenda is set by the Chairman and generally includes:

- An update from the CEO on business performance.
- Reports from sub-committee chairs.
- An update on the Group's financial performance.
- Updates from the risk and compliance functions.
- Discussion on material new investments and liability transactions.
- Discussion of key initiatives such as development of the partial internal model, the Part VII transfer and the re-platforming of the Group's risk and capital management system.
- Board legal and governance update.

The Board held a strategy off-site event during the year outside of the formal Board meeting schedule. This event focused on:

- Strategic growth opportunities for the Group over the next few years in light of the new business pipeline for bulk annuities.
- Development of a Corporate Social Responsibility policy, including the impact of ESG considerations on the Group's investment strategy.
- Succession planning.



Chairman's introduction

CONTINUED

The Board spent time in formal meetings as well as a separate session discussing updates to the Group's partial internal model and approved the changes to the model for submission. This included incorporation of the modelling of Dutch mortgages.

The Board considered the progress made by management in response to the 2018 employee engagement survey. Later in the year, the Board reviewed the results of the 2019 employee engagement survey and discussed management's proposed response.

Board performance and effectiveness

The Board recognises that the continuous development of Directors is important to the Board's performance and effectiveness.

During the year, the following development activities took place:

- One-to-one briefing sessions for independent Non-Executive Directors on the report and accounts.
- Training sessions on the Group's approach to managing cyber risk, the Senior Managers & Certification Regime, Solvency II and an update on accounting and regulatory developments.

An externally facilitated review of Board effectiveness was undertaken during the year. This consisted of face-to-face discussions with each member of the Board using a pre-completed questionnaire to structure discussions. The external facilitator attended the May Board meeting as an observer, interviewed a number of other senior executives and presented the results at a subsequent Board meeting. In addition the Chairman meets annually with all directors individually to discuss their feedback on board performance and their individual contribution.

The review led to small number of recommendations which will be addressed over 2020. As part of the review, feedback was obtained on individual members of the Board so individual members of the Board also had the opportunity to discuss their own performance with the external facilitators.

Corporate governance highlights

- Review and approval of the larger new bulk annuity contracts and of the associated reinsurance.
- Review and approval of the issuance of T2 and T3 bonds by RLP and of the new equity issued by RHUK.
- Review and approval of the Group's Corporate Social Responsibility policy.
- Review and approval of the creation of the Rothesay Life Foundation.
- Review of the results of the 2019 employee engagement survey and discussion of management's planned response.

The Wates Corporate Governance Principles

The Board has decided to apply the Wates Corporate Governance Principles for Large Private Companies ("the Wates Principles"). A review by management suggested that the Group was already broadly compliant with the principles and we have taken action to ensure full compliance.

Information can be found on our approach to compliance in the strategic report and in this governance report.

Principle	Where further information can be found
1: Purpose and Leadership – An effective board develops and promotes the purpose of a company and ensures that its values, strategy and culture align with that purpose.	The Group's purpose is to provide pension security for our policyholders and value to our shareholders over the long term. The Group's strategic objectives are discussed on page 14. More information can be found on the Group's culture on page 15.
2: Board Composition – Effective board composition requires an effective chair and a balance of skills, backgrounds, experience and knowledge, with individual directors having sufficient capacity to make a valuable contribution. The size of a board should be guided by the scale and complexity of the company.	Board effectiveness is described above under "Board performance and effectiveness". Board composition is described on page 56. The Nomination Committee is responsible for ensuring that the Group's Board and management team have the appropriate mix of expertise and experience. See page 67.
3: Board Responsibilities – The board and individual directors should have a clear understanding of their accountability and responsibilities. The board's policies and procedures should support effective decision-making and independent challenge.	Board governance is described on page 52. The Audit Committee is responsible for overseeing the systems and controls that ensure the reliability of information provided to the Board See page 58.
4: Opportunity and Risk – A board should promote the long-term sustainable success of the company by identifying opportunities to create and preserve value and establishing oversight for the identification and mitigation of risks.	The Board has overall responsibility for identifying opportunities to create and preserve value and this is discussed above under "How the Board spent its time in 2019". The Board Risk Committee is responsible for the operation of the Group's risk management framework. The framework is described on page 26 and more can be found on the BRC on page 62. Risks and opportunities are also highlighted as part of the description of strategic objectives on page 14.
5: Remuneration – A board should promote executive remuneration structures aligned to the long-term sustainable success of a company, taking into account pay and conditions elsewhere in the company.	The Remuneration Committee is responsible for ensuring that the Group's remuneration policy appropriately rewards and incentivises our people. See page 64.
6: Stakeholder Relationships and Engagement – Directors should foster effective stakeholder relationships aligned to the company's purpose. The board is responsible for overseeing meaningful engagement with stakeholders, including the workforce, and having regard to their views when taking decisions.	The Group's purpose is to provide pension security for our policyholders and value to our shareholders over the long-term. The Group has responsibility to a number of other stakeholders, including our suppliers, our people, our community, the environment and our bondholders. Further information on stakeholder engagement can be found on page 36.

Board of Directors

NAGUIB KHERAJ

INDEPENDENT NON-EXECUTIVE DIRECTOR AND CHAIRMAN

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

ANTIGONE (ADDY) LOUDIADIS

CEO

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

THOMAS (TOM) PEARCE

MANAGING DIRECTOR

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

ANDREW STOKER

CHIEF FINANCIAL OFFICER

Andrew Stoker is the Chief Financial Officer of Rothesay Life following his appointment in 2014. At Rothesay Life, Andrew has responsibility for the finance, actuarial and HR functions. Andrew was previously a partner in EY's risk and actuarial practice and prior to that was Chief Actuary at Lucida plc. Andrew has also held roles at PwC, Tillinghast (now Willis Towers Watson) and Legal & General. Andrew is a member of the Association of British Insurer's Long-Term Savings Committee and chairs the ABI's Life CEO and Executives Forum.

CONSTANT (STAN) BECKERS

INDEPENDENT NON-EXECUTIVE DIRECTOR

Stan retired from his role as Chief Executive Officer of NN Investment Partners B.V. in 2017, having previously been Co-Head of BlackRock Solutions at BlackRock Advisors (UK) Limited and, prior to that, had spent six years with Barclays Global Investors Ltd, most recently as Chief Investment Officer, Scientific Active Equity Europe. Stan started his career at BARRA (now MSCI BARRA) where, over a 20-year period, he established and managed its non-US operations. Stan was previously a non-executive director of Robeco N.V. and a non-executive director of Kas Bank N.V.

RAYMOND (RAY) KING

INDEPENDENT NON-EXECUTIVE DIRECTOR

Ray King is currently a non-executive director and audit chair of Saga plc and is a Non-Executive Director of Rothesay Life, having stepped down as Chairman in December 2017. Ray ended his executive career as Group CEO of Bupa, having previously been Finance Director. Earlier in his career he held senior management roles at Diageo/Guinness plc, Southern Water plc and ICI plc.

THERESE (TERRY) MILLER

INDEPENDENT NON-EXECUTIVE DIRECTOR

Terry Miller is a non-executive director and the Senior Independent Director of Galliford Try Plc, a non-executive director of Goldman Sachs International Bank and Goldman Sachs International, and has been a director and trustee of the Invictus Games Foundation. She was previously General Counsel of the London Organising Committee of the Olympic and Paralympic Games (LOCOG) and a non-executive director of the British Olympic Association. Prior to her LOCOG appointment, she was a partner of Goldman Sachs, most recently as International General Counsel.

SIMON MORRIS

INDEPENDENT NON-EXECUTIVE DIRECTOR

Simon Morris is the CEO of Boltons Place Capital Management, a private investment fund, and a non-executive director of Goldman Sachs Bank USA. He was previously a partner at Goldman Sachs, where he was Head of International Credit Trading and European Mortgage Trading. Simon served on the Securities Division Executive Committee, Firmwide Risk Committee and was co-head of Goldman Sachs International Risk Committee. Simon retired from Goldman Sachs in 2017 after 17 years. Prior to Goldman Sachs, Simon was at JP Morgan in Credit Trading.

CHARLES PICKUP

INDEPENDENT NON-EXECUTIVE DIRECTOR

Charles Pickup was previously a partner in the Risk Consulting and Software division of Towers Watson (formerly Tillinghast) and acted as Actuarial Function Holder (AFH) for Lucida plc, Countrywide and BlackRock. Prior to this, Charles worked at Commercial Union and Prudential Bache Securities specialising in UK life insurance.

WILLIAM (BILL) ROBERTSON

INDEPENDENT NON-EXECUTIVE DIRECTOR

Bill Robertson was previously the Global Life Chief Risk Officer and Global Life Chief Actuary for Zurich Financial Services and also held various senior positions at Aegon. Prior to this, Bill was a partner at Hymans Robertson and Head of Actuarial at Scottish Amicable

QASIM ABBAS

NON-EXECUTIVE DIRECTOR

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

M. TIMOTHY (TIM) CORBETT

NON-EXECUTIVE DIRECTOR

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

ROBIN JARRATT

NON-EXECUTIVE DIRECTOR

Robin Jarratt is Head of the Global Private Credit group at GIC. Robin has responsibility for all private credit investment by the firm in the US, Europe and Asia. Robin is a member of GIC Private Equity's Management and Investment Committees.

Audit Committee report

Bill Robertson Chairman of the Audit Committee

Audit Committee

The Audit Committee plays a key role in monitoring the robustness of the Group's systems and controls.

Committee members

Bill Robertson (Chair)
Terry Miller
Robin Jarratt
Ray King
Charles Pickup

I am pleased to present the Audit Committee's report for the year ended 31 December 2019. I became Chairman of the Committee during 2016.

The Committee is responsible for assisting the Board in fulfilling its oversight responsibilities for the financial reporting process, the system of internal control, the internal and external audit processes and the Group's process for monitoring compliance with laws and regulations and the business principles. The Committee also receives reports from the Customer and Conduct Committee.

The Committee has unrestricted access to management and external advisors to help discharge its duties. It is satisfied that in 2019 it received adequate, reliable and timely information to perform its responsibilities effectively.

Committee membership and attendance

The Committee has a majority of independent Non-Executive Directors with an appropriate mix of expertise and experience.

The Committee met on six occasions in 2019 at appropriate times in the financial and regulatory reporting audit cycle. The Chairman of the Board, CEO, Managing Director, CFO, CRO, Chief Actuary, Chief Auditor, Chief Compliance Officer and representatives of PwC regularly attended Committee meetings. Other members of senior management were also invited to attend as appropriate to present reports. During the year the Committee held regular private sessions with the Chief Auditor, Chief Compliance Officer and PwC without management present.

A number of Committee members are also members of, or regular attendees at, the Board Risk Committee. This ensures effective coordination across the two committees.

As Chairman of the Committee, I report on matters dealt with at each Committee meeting to the subsequent scheduled Board meeting.

Committee activities during 2019

The work of the Committee during 2019 fell under five main areas: financial statements and accounting policies, internal control, regulatory compliance, oversight of the Internal Audit function and oversight of the external audit. In addition, the Committee received reports from the Customer and Conduct Committee.

Financial statements and accounting policies

The Committee reviewed the Group's financial announcements, the annual report and accounts, the half-year results and the going concern assumptions in relation to the annual report and accounts.

An important focus of the Committee is assisting the Board in ensuring that the annual report and accounts, taken as a whole, are fair, balanced and understandable and provide the information necessary for shareholders to assess the Group's position and performance, business model and strategy. For 2019 the Committee has also focused on ensuring compliance with the Companies (Miscellaneous Reporting) Regulations 2018 and that there is appropriate disclosure on compliance with the Wates Corporate Governance Principles.

The Committee reviewed the relevant Solvency II disclosures including the SFCR and the RSR. This included oversight of the Group's use of transitional solvency relief during the year, including re-calculation as at 31 December 2019.

The Committee reviewed the key assumptions used in calculating both the long-term insurance liabilities and the MCEV. Key assumptions included the annuity mortality assumptions, the credit default allowance on the investment portfolio and the prudence requirements around the IFRS assumptions. For MCEV, the illiquidity premium is also a key assumption. The table below provides more detail on significant accounting issues considered by the Committee.

The Committee reviewed the Group's tax policy, strategy statement and reporting on payment practices and performance under regulations made under Section 3 of the Small Business, Enterprise and Employment Act 2015.

The Committee receives reports from the Chief Actuary on areas including the reliability and adequacy of technical provisions, the quality of data, underwriting policy and reinsurance arrangements.

Significant accounting issues considered by the Committee

Issue	Committee's response
Longevity and credit default assumptions used to determine the valuation of insurance liabilities The inherent uncertainty involved in setting the assumptions used to determine the insurance liabilities for the Group, particularly in relation to longevity and credit defaults, represent the most significant area of judgement due to the potential impact these assumptions have on the financial statements.	The Committee focused on assumptions made in relation to new assets and liabilities and on management's proposed changes to reserving assumptions, particularly in relation to longevity and credit default. **Longevity assumptions**: The Committee reviewed available data illustrating recent trends in longevity experience in the UK population, the longevity experience on different blocks of business, industry benchmarking data and reinsurer pricing. **Credit default assumptions:** The Committee reviewed the methodology used to determine credit default assumptions and considered available industry benchmarking data. The Committee recognises that the deduction for counterparty default risk on many of the assets held by the Group is generally lower than the corresponding credit default deduction on a typical unsecured credit portfolio but considers this is appropriate due to the low probability of default and the expectation of higher recover through collateralisation. The Committee concluded that the assumptions used are appropriate for the determination of the insurance liabilities. As 78% of the longevity risk is reinsured the Group has visibility over pricing for the majority of its liabilities.
Valuation of investments classified as Level 3 under IFRS 13 The valuation of Level 3 assets is based on either inputs into a valuation model or observable prices for proxy positions. This is inherently complex and requires the use of significant management judgement. Furthermore, the balances are material to the financial statements.	The Committee has reviewed and approved the Group's valuation policy. The Committee also receives and reviews a report from the finance function setting out the way in which all Level 3 assets have been valued and the range of plausible valuations. The Committee concluded that there are appropriate controls surrounding the valuation of Level 3 assets and that they are valued appropriately for inclusion in the financial statements.

Audit Committee report

CONTINUED

Internal control

Alongside the Board Risk Committee, the Committee seeks to ensure that the Group operates within a framework of prudent and effective controls and that the Board and its committees receive reliable information.

During 2019 the Committee reviewed the robustness of the controls over the Group's technology infrastructure.

The Committee is supported in its oversight of the control framework by regular reports from the Internal Audit function (see below).

Regulatory compliance

The Committee received regular compliance updates, including:

- from the Compliance function on whistleblowing and the way in which Rothesay Life ensures compliance with relevant laws and regulations, including anti-money laundering and anti-bribery, and on the implications of changes;
- on compliance with the General Data Protection Regulation (GDPR) including data subject access requests;
- updates on Solvency II compliance including the operation of the matching adjustment fund and calculation of transitional capital relief;
- the results of the reviews undertaken by the Compliance function; and
- on contingency planning for Brexit, in particular in relation to the Group's Irish policyholders.

The Committee approved the interim arrangements for managing the Compliance function following the resignation of the Chief Compliance Officer.

The Customer and Conduct Committee

The Customer and Conduct Committee is responsible for ensuring that customers, clients and counterparties are treated fairly by the Group and its strategic business partners. The Committee also oversees the Group's approach to regulatory conduct. The Committee is chaired by an Independent Non-Executive Director, Terry Miller. Another independent Non-Executive Director, Charles Pickup, is a member of the Committee and the Chairman of the Board also regularly attends.

During 2019, the Customer and Conduct Committee received regular reports from the Compliance function on regulatory conduct and from the Operations team on customer satisfaction, complaints and the performance of the Group's third party administrators.

The Customer and Conduct Committee also considered:

- the "small pots" initiative under which annuitants with relatively small annuities were offered the opportunity to cash them in for a lump sum payment;
- non-standard member options; and
- operating guidelines in relation to equity release mortgages.

Internal Audit

The Internal Audit function assists the Committee in fulfilling its oversight responsibilities. The Internal Audit Charter sets out the objectives, scope and responsibilities of the Internal Audit function and how it maintains independence from the first and second line management of the Group. The Committee reviews, and approves, the Internal Audit Charter annually.

The Chief Auditor reports directly to the Chairman of the Committee and her remuneration is approved by the Remuneration Committee. The Group operates a co-sourcing approach to internal audit using external advisors to supplement the in-house Internal Audit team. During 2016, the Group re-tendered these services with the result that EY was appointed.

During 2019 the Committee has overseen the strengthening of the Internal Audit function as the Chief Auditor has continued to build the in-house team.

The internal audit plan for 2019 was reviewed and approved by the Committee, with internal audits being planned and prioritised following a risk-based assessment of the business. The reviews undertaken included audits of:

- the internal processes in relation to equity release mortgages, including migration of the book of mortgages acquired from UK Asset Resolution Limited;
- processes and controls in place to ensure ongoing compliance with SM&CR requirements;
- oversight of the middle office services provided by Northern Trust;
- payroll and payroll taxes;
- collateral management;
- the operation of the matching adjustment fund and of the PIM; and
- the oversight of Willis Towers Watson, one of the Group's third party administrators.

Internal Audit also closely monitored the projects to relocate to The Post Building and to re-platform the Group's risk management systems.

The Committee received regular reports from Internal Audit on the audits that have been carried out, management's response to findings and progress in addressing identified issues.

During the year, the Committee assessed whether the Internal Audit function was effective and concluded it was. This included the Committee satisfying itself that the Internal Audit function has access to appropriate resources.

In December, the Committee considered and approved the internal audit plan for 2020.

External audit

The Committee ran a competitive tender process during 2016 and reappointed PwC as its auditors from the 2017 year end. Under European Law the external audit contract must be put out for tender again no later than for the 2027 year end, at which time the Group will not be permitted to reappoint PwC.

Lee Clarke became the Group's external audit partner from the 2015 year end. Under the revised Ethical Standard, Engagement Partners are required to rotate every five years and so 2019 will be the last year that Lee is the audit partner. As Chairman of the Audit Committee, I am leading the process to select Lee's successor.

During 2019 the Committee performed its annual review of the independence, effectiveness and objectivity of the auditor by evaluating the auditor against a range of criteria.

The Committee has approved an External Auditor Policy (which was reviewed during the year) which aims to:

- preserve the independence and objectivity of the external auditors in performing the statutory audits;
- ensure the effectiveness of the external auditors; and
- avoid any conflict of interest by outlining both the types of services that the external auditors can and cannot undertake and the considerations that should be applied in assessing potential conflicts of interest.

The fees paid to PwC for the year ended 31 December 2019 are summarised in the table below:

	2019 £'000s	2018 £'000s
Audit of the financial statements of the Group and its subsidiaries	**1,163**	714
Total audit	**1,163**	714
Required by regulation	**126**	120
Audit-related assurance services	**158**	151
Other assurance services	**167**	196
Non-audit services	**75**	—
Total fees	**1,689**	1,181

Other assurance services provided in 2019 include work in relation to the issuance of the Tier 2 and Tier 3 bonds and assurance in relation to the Group's solvency disclosures. These services are all in compliance with applicable independence rules and the Group felt that the external auditor was best placed to provide these services because of their understanding of the Group.

Committee performance and effectiveness

The externally facilitated Board effectiveness review considered the effectiveness of both the Audit Committee and the Customer and Conduct Committee.

Board Risk Committee report

Stan Beckers Chairman of the Board Risk Committee

Board Risk Committee

The Board Risk Committee is responsible for the operation of the Group's risk management framework.

Committee members

Stan Beckers (Chair)
Qasim Abbas
Naguib Kheraj
Ray King
Simon Morris
Charles Pickup
Bill Robertson

I am pleased to present the Board Risk Committee's report for the year ended 31 December 2019. I took over chairing the Committee at the end of 2017.

The Committee's primary responsibilities are the ongoing monitoring and control of all risks associated with the activities of the Group, within the parameters set by the Board and as set out in the risk and investment policies of the Group.

The Committee is also responsible for the oversight of the executive level Working Level Risk Committee, and its sub-committees, which are responsible for the ongoing monitoring and control of all financial risks, insurance risks and operational risks associated with the activities of the Group. The WLRC membership consists of 14 members and is chaired by the CRO.

Committee membership and attendance

The Committee has a majority of independent Non-Executive Directors with an appropriate mix of expertise and experience.

The Committee met for six scheduled meetings during 2019 in addition to reviewing risk limit changes via email.

The CEO, Managing Director, CRO, Chief Financial Officer (CFO), Head of Asset and Liability Management, General Counsel and other Non-Executive Directors regularly attended Committee meetings. Other members of senior management were also invited to attend as appropriate to present reports.

Committee activities during 2019

Risk appetite monitoring

The Committee received regular, detailed reports on key risk exposures and the drivers of risk throughout the Group.

The Committee monitored the Group's exposure against the Group's overall risk appetite.

Risk management and governance

The Committee received regular reports from the WLRC and the CRO. This allowed the Committee to monitor the way in which risk was being managed by the Group. Regular reporting includes:

- investment activity;
- compliance with risk limits, including in relation to liquidity;
- stress testing and potential impact of emerging risks;
- market risk exposures;
- operational risk events;
- assessment and monitoring of cyber risk;
- economic capital coverage; and
- the results of the regular risk and control self-assessment.

The Committee received ad hoc reports on specific sectors in which the Group invests, such as social housing, utilities and commercial real estate loans. The Committee also reviewed the Group's approach to market risk hedging.

During 2019, the Committee reviewed the Group's risk appetite statement, a number of risk-related policies, the Group's risk management framework and the Group's ORSA.

The Committee oversaw the Group's approach to origination of equity release mortgages and to the Group's entry into the Dutch mortgage market.

The Committee continued to monitor the potential impact of the UK leaving the EU and associated contingency planning. It also considered the potential impact of the planned reform of leasehold on the Group's loans secured on ground rents.

The Committee reviewed the Group's preparations for mandatory clearing of derivatives and in response to Interbank Offered Rates (IBOR) reform.

The Committee considered the Group's approach to cyber risk.

Climate change

The Committee reviewed the Group's plans in response to Supervisory Statement SS3/19 Enhancing banks' and insurers' approaches to managing the financial risks from climate change. The Committee agreed that these risks should be managed through the existing risk management framework.

The Committee will monitor progress in this area during 2020.

New transactions

The Committee reviewed the underwriting assumptions made in relation to the large bulk annuity transactions undertaken and proposed. This included consideration of the Group's asset investment approach and associated limits, including the changes in risk limits as the balance sheet grew.

The Committee reviewed a number of proposed commercial real estate loans.

The Committee also considered the implications of the issuance of T2 and T3 bonds by RLP.

Internal model

The Committee oversaw the model validation work done in relation to the proposed changes to the Group's PIM by the Risk function.

The Committee also oversaw the ongoing work being undertaken to construct the Group's full internal model.

Committee performance and effectiveness

The externally facilitated Board effectiveness review considered the effectiveness of the Board Risk Committee.

Remuneration Committee report

Naguib Kheraj Chairman of the Remuneration Committee

Setting remuneration policy

The Remuneration Committee is responsible for ensuring that the Group's remuneration policy appropriately rewards and incentivises our people.

Committee members

- Naguib Kheraj (Chair)
- Qasim Abbas
- Stan Beckers
- Tim Corbett
- Robin Jarratt
- Terry Miller

I am pleased to present the Remuneration Committee's report for the year ended 31 December 2019. I became Chairman of the Committee at the end of 2017.

Committee membership and attendance

The Committee is composed solely of Non-Executive Directors with an appropriate mix of expertise and experience. Membership includes representation from the Group's three shareholders in order to ensure that remuneration structures have their support. The independent Non-Executive Directors form a majority given the Chairman's casting vote.

The Committee met on two occasions in 2019 in addition to reviewing remuneration issues via email and ad hoc telephone calls. The CEO, Managing Director and the CFO also regularly attended part of Committee meetings as appropriate and relevant. The Committee has also appointed an independent advisor to provide benchmarking and industry insights and he regularly attends meetings.

Committee responsibilities

The Committee is responsible for reviewing and making recommendations to the Board regarding the remuneration policy of the Group and for reviewing compliance with the policy in so far as it relates to senior managers and other employees. Within the context of the policy the Committee is specifically responsible for making recommendations for the remuneration packages of the independent Non-Executive Directors, Executive Directors and other senior managers of the Group. The Committee is further responsible for monitoring the level and structure of remuneration for the wider employees of the Group.

The Group's remuneration policy is intended to:

- promote sound and effective risk management;
- align individuals' incentives with multi-year performance;
- discourage excessive or concentrated risk-taking;
- allow the Group to attract and retain proven talent; and
- align aggregate remuneration with the performance of the Group as a whole and encourage teamwork.

This is achieved by ensuring that variable remuneration is linked to the Group's KPIs, adjusted for current and future risks. The CRO provides input to the annual appraisal process and financial metrics are ignored when evaluating the performance of second and third-line staff. Remuneration packages combine a base salary, cash bonuses and a long-term share-based incentive plan (the RHUK SIP).

A summary of the components of remuneration of Executive Directors and senior management can be found in the table opposite.

Committee activities during 2019

The Committee made recommendations for the remuneration packages of senior managers of the Group. It also reviewed the recommendations of management in relation to the compensation for employees of the wider Group and in relation to leavers from the Group.

The Committee reviewed the composition of the material risk taker population four times this year and their individual performance was discussed at year end. The Committee also considered the fitness and propriety of senior management and Directors.

The Committee approved the creation of a new Schedule 2 Share Incentive Plan in 2020 in order that all employees can be awarded shares, thereby ensuring that all employees benefit from the success of the Group.

Committee performance and effectiveness

As noted earlier, the Group undertook a formal Board effectiveness review during 2019 which considered the effectiveness of the Remuneration Committee.

Component of remuneration

Component	Rationale
Salary	Salaries are set at a level which is intended to reflect the individual's responsibility, skill, competence and contribution to the Group's objectives, whilst at the same time taking note of the external value placed on the job in the market generally.
Bonus	The annual bonus rewards the achievement of strategic objectives and is linked to the Group's KPIs adjusted for current and future risks. Part of the cash bonus may be deferred.
Long-term share-based incentive	Part of the annual bonus is awarded as equity. The RHUK SIP ensures that stock vests and is delivered over several years. In 2019 the creation of a new Schedule 2 Share Incentive Plan will mean that all UK employees will be offered shares which will not vest for at least three years.
Benefits	Executive Directors and senior management are entitled to benefits in line with those provided to all employees.
Pension	The Group operates a defined contribution scheme. Executive Directors and senior management are entitled to membership of the scheme and receive contributions in line with those paid for all employees.
Equity	Executive Directors and senior management hold equity as a result of historic awards and annual vestings. Management has also been awarded H shares which are intended to align the interests of management and shareholders.
Shareholding guidelines	As the Company is not quoted, Executive Directors and senior management are unable to sell shares except as approved by the Remuneration Committee.
Malus and clawback	Any bonus that has been deferred is capable of a downwards adjustment or forfeiture and the rules of the RHUK SIP ensure that equity can be clawed back even after vesting.

Nomination Committee report

Naguib Kheraj Chairman of the Nomination Committee

Appointing new talent

The Nomination Committee is responsible for ensuring that the Group's Board and management team have the appropriate mix of expertise and experience.

Committee members

Naguib Kheraj (Chair)
Qasim Abbas
Tim Corbett
Robin Jarratt
Ray King

I am pleased to present the Nomination Committee's report for the year ended 31 December 2019. I became Chairman of the Committee at the end of 2017.

The Nomination Committee is responsible for monitoring the balance of skills, knowledge, experience, independence and diversity on the Board, identifying and recommending Board, Board committee and senior management appointments to the Boards of the various Group entities, as appropriate, and monitoring succession plans for the Executive Directors and the development plans of senior management within the Group.

The responsibilities of the Committee include reviewing the structure, size and composition of the Board of Directors, identifying and nominating candidates to fill Board vacancies as and when they arise and approving senior management appointments.

A summary of the Board's mix of experience is provided in the table on the next page.

Committee membership and attendance

The Committee is composed of Non-Executive Directors with an appropriate mix of expertise and experience. The CEO, Managing Director and General Counsel also regularly attended Committee meetings.

Committee activities during 2019

The Committee approved the appointment of Simon Morris to the Board and Board Risk Committee following the resignation of Richard Berliand. It also approved the re-appointment of Bill Robertson to the Board.

The Committee reviewed the composition of the various Board committees following Richard's departure. This led to the appointment of Terry Miller as Chair of the Customer and Conduct Committee and also to her appointment to the Nomination Committee.

The Committee also decided that it was appropriate to appoint a second independent Non-Executive Director to the Customer and Conduct Committee, which led to the appointment of Charles Pickup to that committee.

Committee performance and effectiveness

As noted earlier, the Group undertook a formal Board effectiveness review during 2019 which considered the effectiveness of the Nomination Committee.

	Naguib Kheraj	Addy Loudiadis	Tom Pearce	Andrew Stoker	Stan Beckers	Ray King	Terry Miller	Simon Morris	Charles Pickup	Bill Robertson	Qasim Abbas	Tim Corbett	Robin Jarratt
General management	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
Insurance industry		✓	✓	✓		✓			✓	✓	✓	✓	
Investment	✓	✓	✓		✓			✓		✓	✓	✓	✓
Technology/operations				✓	✓								
Financial industry	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
Accounting/actuarial	✓			✓		✓			✓	✓		✓	
Risk management	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
International business	✓	✓			✓	✓	✓	✓		✓	✓	✓	✓
Strategy development	✓	✓	✓	✓	✓	✓				✓	✓	✓	✓
Mergers & acquisitions	✓	✓	✓	✓		✓			✓	✓	✓	✓	✓
Retail customers	✓					✓	✓	✓	✓	✓			
Legal/regulatory				✓			✓	✓	✓				✓
Corporate governance	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
Human resources	✓	✓	✓	✓	✓	✓	✓	✓					

The financial statements set out the consolidated results for Rothesay Holdco UK Limited and its subsidiaries for the year ended 31 December 2019.

Financial Statements

Report of the Directors

The Directors present their annual report and the audited consolidated financial statements for Rothesay Holdco UK Limited, registered number 08668809, (the Company or RHUK) for the year ended 31 December 2019. Comparative information has been presented for the year ended 31 December 2018.

1. General information

RHUK is the ultimate holding company of the Rothesay group of companies. RHUK is a registered limited company incorporated and domiciled in the United Kingdom.

All accounting policies, where relevant, have been included within the specific note disclosures.

2. Results

The consolidated results for RHUK and its subsidiaries (the Group) for the year are set out in the consolidated statement of comprehensive income on page 78.

3. Dividends

The Directors have recommended no payment of interim dividends during the year ended 31 December 2019 (2018: £nil). The Directors have recommended no final ordinary dividend in respect of the year ended 31 December 2019 (2018: £nil).

4. Registered office

The financial statements include the financial results of RHUK and its subsidiaries: Rothesay Pensions Management Limited, Rothesay Life Plc, Rothesay Assurance Limited, LT Mortgage Financing Limited, Rothesay Asset Management UK Limited, Rothesay MA No.1 Limited, Rothesay MA No.2 Limited, Rothesay MA No.3 Limited, Rothesay MA No.4 Limited, Rothesay Life Foundation and Rothesay Asset Management US LLC.

The Company and all subsidiary undertakings, with the exception of Rothesay Asset Management US LLC, are registered in the United Kingdom. The registered office and principal place of business for RHUK and its UK subsidiary undertakings is The Post Building, 100 Museum Street, London WC1A 1PB. The registered office for Rothesay Asset Management US LLC is Corporate Trust Center, 1209 Orange Street, Wilmington, Delaware 19801, New Castle County.

Copies of the annual accounts of subsidiary undertakings are publicly available on the Companies House website or can be obtained from the Company Secretary, The Post Building, 100 Museum Street, London WC1A 1PB.

5. Directors

The membership of the Board of Directors of the Company is given within the corporate governance report on pages 56 to 57, which is incorporated by reference in this report.

During 2019 and up to the date of this report, the following changes to the Board took place:

- Simon Morris was appointed to the Board on 14 February 2019; and
- Richard Berliand resigned from the Board on 28 February 2019.

6. Qualifying third party indemnities

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

7. Disclosure of information to auditors

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

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

8. Auditors

PricewaterhouseCoopers LLP will continue in office as auditors of the Company pursuant to Section 487(2) of the Companies Act. Resolutions to reappoint PricewaterhouseCoopers LLP as auditor to the Group and to authorise the Directors to determine their remuneration are proposed.

9. Statement of Directors' responsibilities

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

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

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

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

10. Internal control and risk management systems

The Group has established internal control and risk management systems in relation to the process for preparing consolidated financial statements. The key features of these internal control and risk management systems are:

- management ensures that processes are appropriately followed, documented and controlled;
- the Risk function and management conduct checks on internal controls half yearly;
- the Internal Audit function reviews and assesses controls on an ongoing basis;
- management regularly monitors and considers developments in accounting regulations and best practice in financial reporting and, where appropriate, reflects developments in the consolidated financial statements. The Audit Committee is kept appraised of such developments;
- the Group's results are subject to various levels of review by management; and
- the Audit Committee and the Board review the draft consolidated financial statements, strategic report and report of the Directors. The Audit Committee receives reports from management and the external auditors on significant judgements, changes in accounting policies, changes in accounting estimates and other pertinent matters relating to the consolidated financial statements.

11. Date of authorisation of issue

The financial statements were authorised for issue by the Board of Directors on 13 February 2020.

ON BEHALF OF THE BOARD

A. Loudiadis
Chief Executive Officer
13 February 2020

Independent auditors' report to the members of Rothesay Holdco UK Limited

REPORT ON THE AUDIT OF THE FINANCIAL STATEMENTS

Opinion

In our opinion, Rothesay Holdco UK Limited's Group financial statements and Company financial statements (the financial statements):

- give a true and fair view of the state of the Group's and of the Company's affairs as at 31 December 2019 and of the Group's profit and the Group's and the Company's cash flows for the year then ended;
- have been properly prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union and, as regards the Company's financial statements, as applied in accordance with the provisions of the Companies Act 2006; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

We have audited the financial statements, included within the annual report and accounts 2019 (the Annual Report), which comprise: the Consolidated and Company statements of financial position as at 31 December 2019; the Consolidated statement of comprehensive income, the Consolidated and Company cash flow statements, and the Consolidated and Company statements of changes in equity for the year then ended; the accounting policies; and the notes to the financial statements.

Our opinion is consistent with our reporting to the Audit Committee.

Basis for opinion

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

Independence

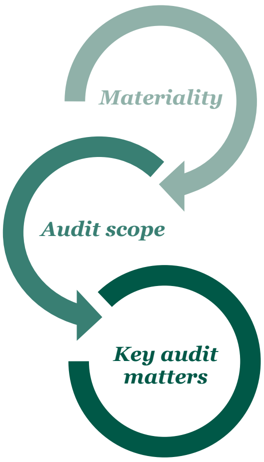
We remained independent of the Group in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, which includes the FRC's Ethical Standard, as applicable to public interest entities, and we have fulfilled our other ethical responsibilities in accordance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

To the best of our knowledge and belief, we declare that non-audit services prohibited by the FRC's Ethical Standard were not provided to the Group or the Company.

Other than those disclosed in note B.7 to the financial statements, we have provided no non-audit services to the Group or the Company in the period from 1 January 2019 to 31 December 2019.

Our audit approach

Overview



Overall Group materiality: £52.8 million (2018: £40 million), equates to 1.4% of Total equity.

Overall Company materiality: £25.1 million (2018: £18.2 million), based on 1% of total assets.

The Group consists of 12 legal entities. We performed a full scope audit of the Group's financial statements in accordance with our materiality and risk assessment.

This assessment identified two full scope components; Rothesay Life Plc and Rothesay Holdco UK Limited (Company).

- Valuation of insurance contract liabilities, specifically;
  - Longevity Assumptions;
  - Credit Default Risk Assumptions.
- Valuation of investments classified as Level 3 under IFRS 13. There are no Key Audit Matters to report for the Company.

The scope of our audit

As part of designing our audit, we determined materiality and assessed the risks of material misstatement in the financial statements.

Capability of the audit in detecting irregularities, including fraud

Based on our understanding of the Group and industry, we identified that the principal risks of non-compliance with laws and regulations related to breaches of UK and European regulatory principles, such as those governed by the Prudential Regulation Authority and the Financial Conduct Authority (see page 31 of the Annual Report), and we considered the extent to which non-compliance might have a material effect on the financial statements of the Group and Company. We also considered those laws and regulations that have a direct impact on the financial statements of the Group and Company such as the Companies Act 2006, the Prudential Regulation Authority's regulations, the Pensions Regulator legislation, the UK tax legislation, and we considered the extent to which non-compliance might have a material effect on the financial statements. We evaluated management's incentive and opportunities for fraudulent manipulation of the financial statements (including the risk of override of controls), and determined that the principal risks were related to posting inappropriate journal entries, such as increasing revenue or the capital position of the Group and Company, management bias in accounting estimates and judgemental areas of the financial statements such as the valuation of life insurance contract liabilities and the valuation of investments classified as Level 3 under IFRS 13. The Group engagement team shared this risk assessment with the component auditors so that they could include appropriate audit procedures in response to such risks in their work. Audit procedures performed by the Group engagement team and/or component auditors included:

- Discussions with the Board, management, Internal Audit, senior management involved in the Risk and Compliance functions and the Group's and Company's legal function, including consideration of known or suspected instances of non-compliance with laws and regulation and fraud;
- Assessment of matters reported on the Group's and Company's whistleblowing register and the results of management's investigation of such matters;
- Reading key correspondence with the Prudential Regulation Authority and the Financial Conduct Authority in relation to compliance with laws and regulations;
- Reviewing relevant meeting minutes including those of the Risk Committee;
- Reviewing data regarding policyholder complaints, the Group's and Company's register of litigation and claims, Internal Audit reports, Compliance reports in so far as they related to non-compliance with laws and regulations and fraud;
- Procedures relating to the valuation of life insurance contract liabilities, in particular longevity and credit default risk assumptions, and the valuation of investments classified as Level 3 under IFRS 13 described in the related key audit matter below;
- Identifying and testing journal entries; and
- Designing audit procedures to incorporate unpredictability around the nature, timing or extent of our testing.

There are inherent limitations in the audit procedures described above and the further removed non-compliance with laws and regulations is from events and transactions reflected in the financial statements, the less likely we would become aware of it. Also, the risk of not detecting a material misstatement due to fraud is higher than the risk of not detecting one arising from error, as fraud may involve deliberate concealment by, for example, forgery or intentional misrepresentations, or through collusion.

Key audit matters

Key audit matters are those matters that, in the auditors' professional judgement, were of most significance in the audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) identified by the auditors, including those which had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team. These matters, and any comments we make on the results of our procedures thereon, were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. This is not a complete list of all risks identified by our audit.

Independent auditors' report to the members of Rothesay Holdco UK Limited

REPORT ON THE AUDIT OF THE FINANCIAL STATEMENTS CONTINUED

Key audit matter	How our audit addressed the key audit matter
Valuation of insurance contract liabilities *Refer to note A.1 Basis of preparation and E.2 Insurance contract liabilities* The inherent uncertainty involved in setting the assumptions used to determine the insurance liabilities represents a significant area of management judgement for which small changes in assumptions can result in material impacts to the valuation of these liabilities. As part of our consideration of the entire set of assumptions we focused particularly on longevity assumptions and credit default risk assumptions given they are the most significant and judgemental assumptions.	The work to address the valuation of the insurance contract liabilities included the following procedures: • Understood the processes and tested controls in place around policyholder data used in the valuation of insurance contract liabilities; • For a sample of schemes, reconciled the data used in the model to the data provided by scheme administrators; • Understood and tested the governance process in place to determine the insurance contract liabilities, • Using our actuarial specialist team members, we applied our industry knowledge and experience to assess the appropriateness of the methodology, models and assumptions used against recognised actuarial practices; • Assessed whether the impact of the High Court ruling in relation to the Prudential transaction had been appropriately reflected in the valuation of insurance contract liabilities; • Tested the key judgements involved in the preparation of the manually calculated components of the liability and accuracy of the calculation, on a sample basis. • Used the results of an independent PwC annual benchmarking survey of assumptions to further challenge the assumption setting process by comparing certain assumptions used relative to the Group and Company's industry peers; and • Assessed the disclosures in the financial statements. Further testing was also conducted on the longevity and credit default assumptions as set out below. **From the evidence obtained, we consider the valuation of insurance contract liabilities to be reasonable.**
Longevity Assumptions Annuitant mortality and specifically longevity improvement continues to be an area of judgement, especially given recent trends in the UK market which suggest for certain populations a slowing in the rate of mortality improvement. Management utilise the Group's own historic experience and available market data in the calculation of the appropriate assumptions. For the rate of mortality improvement, this includes the latest model and datasets from the Continuous Mortality Investigation (CMI) bureau, CMI2018. Whilst the Group manages the extent of its exposure to longevity risk through reinsurance, we consider the longevity assumptions underpinning gross insurance contract liabilities to be a key audit matter, especially given the mono-line nature of the Group's insurance business.	In addition to the procedures above, in respect of the longevity assumptions we: • Tested the methodology, implementation and results of the annual experience studies, including those in relation to new liability trades; • Assessed the appropriateness of expert judgements used in the development of the mortality improvement assumptions. For example, choice of base mortality assumptions, the selection and parameterisation of the CMI model including the calibration of parameters (e.g. smoothing parameter, long-term rate) and prudential margin; • Compared the longevity assumptions selected by the Group against those used by their peers; and • Assessed the disclosure of the longevity assumptions and the commentary to support the profit arising from changes in these assumptions over 2019. **From the evidence obtained, we found the assumptions and methodology to be appropriate.**

Key audit matter	How our audit addressed the key audit matter
Credit Default Risk Assumptions The Group has significant holdings in complex and illiquid investments. The deduction from the valuation rate of interest for credit default risk for these assets is judgemental and is generally lower than the corresponding credit default risk deduction on a typical unsecured credit portfolio. This reflects the Group's view of the security held against the asset class which in itself is an area of judgement.	In addition to the procedures above, in respect of the credit default assumptions we: • Assessed the methodologies used to derive the assumptions (including prudential margin) with reference to relevant rules and actuarial guidance; and by applying our industry knowledge and experience. This included the methodologies used for new asset classes purchased during 2019; • Tested controls performed by management over the approval and implementation of credit default assumptions (to the extent available); • Validated significant assumptions used by management against market observable data (to the extent available and relevant) and our experience of market practices; • Compared the assumptions selected against those adopted by peers using our annual survey of the market (to the extent available); • Tested the analysis of the movement in credit default risk assumption prepared by management for each asset class based on current market data and developments in the asset portfolio; and • Assessed the disclosure of the credit default risk assumptions and the commentary to support the profit arising from changes in these assumptions over 2019. **From the evidence obtained, we found the assumptions and methodology to be appropriate.**
Valuation of investments classified as Level 3 under IFRS 13 *Refer to note A.1 Basis of preparation and note D.1 financial investments* The investments classified as Level 3 are a material balance and comprise investments in commercial mortgage loans, ground rents and equity release mortgages. The equity release mortgage portfolio has increased significantly in the current year following the acquisition of the UK Asset Resolution portfolio as well as continued new originations. The valuations of Level 3 investments is typically based on either inputs into a valuation model or observable prices for proxy positions. This is inherently complex and requires the use of significant management judgement.	The work to address the valuation of investments included the following procedures: • Understood and validated the design adequacy and operating effectiveness of management's controls, including the monthly price verification process and controls over the accuracy of data inputs; • Understood the valuation models used by management; • Reviewed management's methodology and assumptions, including yield curves, discounted cash flows, property growth rates, longevity assumptions and liquidity premiums a relevant to each asset class; • Engaged our relevant experts to assess the reasonableness and appropriateness of management's methodology; • Independently revalued a sample of investments; • Tested inputs into the valuation to external sources, where possible; and • Assessed the disclosures in the financial statements. **From the evidence obtained, we consider the assumptions and methodology used to be appropriate.**

We determined that there were no key audit matters applicable to the Company to communicate in our report.

Independent auditors' report to the members of Rothesay Holdco UK Limited

REPORT ON THE AUDIT OF THE FINANCIAL STATEMENTS CONTINUED

How we tailored the audit scope

We tailored the scope of our audit to ensure that we performed enough work to be able to give an opinion on the financial statements as a whole, taking into account the structure of the Group and the Company, the accounting processes and controls, and the industry in which they operate.

The Group consists of eleven subsidiary companies and the parent Company; Rothesay Holdco UK Limited. Of the eleven subsidiary companies in the Group, the most significant component is Rothesay Life Plc, which conducts all insurance business on behalf of the Group.

We determined the remaining entities to be immaterial to the Rothesay Group financial statements. For the audit of the Group, Rothesay Life Plc and Rothesay Holdco UK Limited (Company) are considered full scope components and results in 96% coverage of total assets and 99% of consolidated profit before tax.

Materiality

The scope of our audit was influenced by our application of materiality. We set certain quantitative thresholds for materiality. These, together with qualitative considerations, helped us to determine the scope of our audit and the nature, timing and extent of our audit procedures on the individual financial statement line items and disclosures and in evaluating the effect of misstatements, both individually and in aggregate on the financial statements as a whole.

Based on our professional judgement, we determined materiality for the financial statements as a whole as follows:

	Group financial statements	Company financial statements
Overall materiality	£52.8 million (2018: £40 million).	£25.1 million (2018: £18.2 million).
How we determined it	1.4% of total equity.	1% of total assets.
Rationale for benchmark applied	We consider total equity to be the most appropriate benchmark as it represents the residual interest that can be ascribed to shareholders after policyholder assets and corresponding liabilities have been accounted for. We compared our materiality against other relevant benchmarks, such as total assets, total revenue and profit before tax to ensure the materiality selected was appropriate for our audit.	We consider that total assets is the primary measure used by the shareholders in assessing the performance of the entity and is a generally accepted auditing benchmark for the purpose of the Company financial statements.

For each component in the scope of our Group audit, we allocated a materiality that is less than our overall Group materiality. The range of materiality allocated to the two components was between £25.1 million and £50 million.

We agreed with the Audit Committee that we would report to them misstatements identified during our audit above £2.6 million (Group audit) (2018: £2 million) and £1.3 million (Company audit) (2018: £0.9 million) as well as misstatements below those amounts that, in our view, warranted reporting for qualitative reasons.

Conclusions relating to going concern

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

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

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

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

Reporting on other information
The other information comprises all of the information in the Annual Report other than the financial statements and our auditors' report thereon. The Directors are responsible for the other information. Our opinion on the financial statements does not cover the other information and, accordingly, we do not express an audit opinion or, except to the extent otherwise explicitly stated in this report, and form of assurance thereon.

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

With respect to the Strategic Report and Report of the Directors, we also considered whether the disclosures required by the UK Companies Act 2006 have been included.

Based on the responsibilities described above and our work undertaken in the course of the audit, ISAs (UK) require us also to report certain opinions and matters as described below.

Strategic Report and Report of the Directors
In our opinion, based on the work undertaken in the course of the audit, the information given in the Strategic Report and Report of the Directors for the year ended 31 December 2019 is consistent with the financial statements and has been prepared in accordance with applicable legal requirements.

In light of the knowledge and understanding of the Group and Company and their environment obtained in the course of the audit, we did not identify any material misstatements in the Strategic Report and Report of the Directors.

Responsibilities for the financial statements and the audit

Responsibilities of the Directors for the financial statements
As explained more fully in the Statement of Directors' responsibilities, the Directors are responsible for the preparation of the financial statements in accordance with the applicable framework and for being satisfied that they give a true and fair view. The Directors are also responsible for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

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

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

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

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

Other required reporting
Companies Act 2006 exception reporting
Under the Companies Act 2006 we are required to report to you if, in our opinion:

- we have not received all the information and explanations we require for our audit; or
- adequate accounting records have not been kept by the Company, or returns adequate for our audit have not been received from branches not visited by us; or
- certain disclosures of directors' remuneration specified by law are not made; or
- the Company financial statements are not in agreement with the accounting records and returns.

We have no exceptions to report arising from this responsibility.

Appointment
Following the recommendation of the Audit Committee, we were appointed by the directors on 26 February 2007 to audit the financial statements for the year ended 30 November 2007 and subsequent financial periods. There was a competitive tender process conducted by the Audit Committee during 2016 and we were reappointed as auditors for the year ended 31 December 2017. The period of total uninterrupted engagement is 13 years, covering the years ended 30 November 2007 to 31 December 2019.

Lee Clarke (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
London
13 February 2020

Consolidated statement of comprehensive income

FOR THE YEAR ENDED 31 DECEMBER 2019

	Note	2019 £m	2018 restated[1] £m
Income			
Gross premiums written	B.1	**16,606**	13,424
Premiums ceded to reinsurers		**(1,245)**	(1,114)
Net premiums written		**15,361**	12,310
Investment return	B.2	**2,295**	141
Total revenue		**17,656**	12,451
Expenses			
Policyholder claims		**(2,442)**	(1,876)
Reinsurance recoveries		**1,046**	1,020
Change in insurance contract liabilities	E.2	**(15,373)**	(10,818)
Change in the reinsurers' share of insurance contract liabilities	E.2	**46**	(443)
Net claims and change in insurance liabilities		**(16,723)**	(12,117)
Acquisition and administration expenses	B.3	**(184)**	(161)
Finance costs	B.4	**(109)**	(71)
Total expenses		**(17,016)**	(12,349)
Profit before tax		**640**	102
Income tax expense	B.8	**(124)**	(17)
Profit for the year		**516**	85

1 Please see note A5 for details of the prior year restatement.

All income and expenses are related to continuing operations.

The consolidated statement of comprehensive income includes all income and expenses for the year. The Company has no items required to be reported in other comprehensive income, therefore a separate comprehensive income statement has not been presented.

Notes A – I, the Alternative Performance Measures and Glossary of terms form an integral part of these financial statements.

Consolidated statement of financial position

AS AT 31 DECEMBER 2019

	Note	2019 £m	2018 restated[1] £m
Assets			
Property, plant and equipment		**9**	2
Lease – right of use asset	I.5	**37**	–
Financial investments	D.1	**73,742**	49,174
Deferred tax asset	G.1	**2**	1
Reinsurance assets	E.1	**388**	43
Accrued interest and prepayments	D.3	**755**	497
Receivables	D.4	**905**	353
Cash and cash equivalents	D.5	**263**	163
Total assets		**76,101**	50,233
Equity and liabilities			
Share capital	C.1	**3**	3
Tier 1 notes	C.2	**347**	347
Employee benefit trust	C.3	**(30)**	(19)
Share premium	C.3	**1,545**	845
Capital contribution reserve	C.3	**17**	10
Other reserves	C.3	**1,894**	1,385
Total equity		**3,776**	2,571
Liabilities			
Reinsurance liabilities	E.1	**848**	549
Insurance contract liabilities	E.2	**47,932**	32,559
Payables and financial liabilities	D.6	**21,999**	13,849
Leasehold liabilities	I.5	**39**	–
Borrowings	D.7	**1,427**	647
Accruals and deferred income		**80**	58
Total liabilities		**72,325**	47,662
Total equity and liabilities		**76,101**	50,233

1 Please see note A5 for details of the prior year restatement.

Notes A – I, the Alternative Performance Measures and Glossary of terms form an integral part of these financial statements.

The financial statements were approved by the Board of Directors on 13 February 2020 and signed on its behalf by:

A. Loudiadis
Chief Executive Officer
13 February 2020

Company number 08668809

Consolidated statement of changes in equity

FOR THE YEAR ENDED 31 DECEMBER 2019

	Share capital £m	Share premium £m	Tier 1 notes £m	Capital contribution reserve £m	Profit and loss reserve £m	Reorganisation reserve £m	Employee scheme treasure shares £m	Total equity £m
As at 1 January 2019	**3**	**845**	**347**	**10**	**1,253**	**132**	**(19)**	**2,571**
Profit for the financial year	**–**	**–**	**–**	**–**	**516**	**–**	**–**	**516**
Retrospective restatement due to change in accounting treatment	**–**	**–**	**–**	**–**	**(7)**	**–**	**–**	**(7)**
Share issuance	**–**	**700**	**–**	**–**	**–**	**–**	**–**	**700**
Employee benefit trust	**–**	**–**	**–**	**–**	**–**	**–**	**(11)**	**(11)**
Capital contribution	**–**	**–**	**–**	**7**	**–**	**–**	**–**	**7**
As at 31 December 2019	**3**	**1,545**	**347**	**17**	**1,762**	**132**	**(30)**	**3,776**

FOR THE YEAR ENDED 31 DECEMBER 2018

	Share capital £m	Share premium £m	Tier 1 notes £m	Capital contribution reserve £m	Profit and loss reserve £m	Reorganisation reserve £m	Employee scheme treasure shares £m	Total equity £m
As at 1 January 2018	2	466	–	5	1,168	132	(20)	1,753
Profit for the financial year	–	–	–	–	85	–	–	85
Share issuance	1	379	–	–	–	–	–	380
Vesting of stock appreciation plan	–	–	–	(2)	–	–	–	(2)
Tier 1 note issuance	–	–	347	–	–	–	–	347
Employee benefit trust	–	–	–	–	–	–	1	1
Capital contribution	–	–	–	7	–	–	–	7
As at 31 December 2018	3	845	347	10	1,253	132	(19)	2,571

Consolidated cash flow statement

FOR THE YEAR ENDED 31 DECEMBER 2019

	Note	2019 £m	2018 restated[1] £m
Cash flows from operating activities			
Profit for the financial year		**516**	85
Adjustments for non-cash movements in net profit for the year			
Retrospective restatement due to change in accounting treatment	B.4	**(7)**	–
Fixed asset write off		**1**	–
Depreciation		**1**	1
Amortisation of debt costs	B.4	**1**	3
Leasehold depreciation	I.5	**2**	–
Financing charge on leasehold	I.5	**1**	–
Share-based payments		**(3)**	8
Interest income	B.2	**(1,125)**	(956)
Interest expense	B.4	**105**	71
Income tax expense	B.8	**125**	17
Net (increase)/decrease in operational assets			
Financial investments		**(24,568)**	(11,861)
Deferred tax	G.1	**(1)**	–
Reinsurance asset		**(344)**	124
Receivables		**(552)**	(16)
Prepayment		**(205)**	(83)
Net increase/(decrease) in operational liabilities			
Insurance contract liabilities		**15,373**	10,818
Reinsurance liabilities		**299**	319
Financial liabilities		**8,051**	(1)
Other payables		**33**	(95)
Accruals and deferred income		**1**	20
Net cash flows used in operating activities		**(2,296)**	(1,546)
Interest paid		**(84)**	(73)
Interest received		**1,071**	844
Tax paid		**(59)**	(38)
Cash flows used in operating activities		**(1,368)**	(813)
Cash flows from financing activities			
Repayment of borrowings	D.7	**–**	(500)
Proceeds from issuance of debt (net of issuance costs)	D.7	**778**	–
Proceeds from borrowings	D.7	**–**	498
Proceeds from issuance of Tier 1 notes (net of issuance costs)	C.2	**–**	347
Proceeds from issuance of ordinary share capital (including share premium)	C.1	**700**	380
Net cash inflows from financing activities		**1,478**	725
Cash outflows from investing activities			
Acquisition of property, plant and equipment		**(9)**	–
Cash flow on leasehold		**(1)**	–
Net cash outflows from investing activities		**(10)**	–
Net increase/(decrease) in cash and cash equivalents		**100**	(88)
Cash and cash equivalents at 1 January		**163**	251
Cash and cash equivalents at 31 December	D.5	**263**	163

1 Please see note A5 for details of the prior year restatement.

Company statement of financial position

AS AT 31 DECEMBER 2019

	Note	2019 £m	2018 £m
Assets			
Investment in subsidiary undertakings	H.2	**2,491**	1,780
Financial investments		**1**	11
Receivables		**44**	30
Total assets		**2,536**	1,821
Equity and liabilities			
Share capital	C.1	**3**	3
Share premium	C.3	**1,545**	845
Capital contribution reserve		**22**	11
Retained earnings		**941**	948
Total equity		**2,511**	1,807
Liabilities			
Other payables		**25**	14
Total liabilities		**25**	14
Total equity and liabilities		**2,536**	1,821

Notes A – I, the Alternative Performance Measures and Glossary of terms form an integral part of these financial statements.

The loss for the financial year of the Company was £7m (2018: loss of £13m). As permitted by Section 408 of the Companies Act 2006, the Company's statement of comprehensive income has not been included in these financial statements.

The financial statements were approved by the Board of Directors on 13 February 2020 and signed on its behalf by:

A. Loudiadis
Chief Executive Officer
13 February 2020

Company number 08668809

Company statement of changes in equity

FOR THE YEAR ENDED 31 DECEMBER 2019

	Share capital £m	Share premium £m	Capital contribution reserve £m	Profit and loss reserve £m	Total equity £m
As at 1 January 2019	**3**	**845**	**11**	**948**	**1,807**
Loss for the financial year	**–**	**–**	**–**	**(7)**	**(7)**
Capital contribution	**–**	**–**	**11**	**–**	**11**
Share issuance	**–**	**700**	**–**	**–**	**700**
As at 31 December 2019	**3**	**1,545**	**22**	**941**	**2,511**

FOR THE YEAR ENDED 31 DECEMBER 2018

	Share capital £m	Share premium £m	Capital contribution reserve £m	Profit and loss reserve £m	Total equity £m
As at 1 January 2018	2	466	5	461	934
Loss for the financial year	–	–	–	(13)	(13)
Dividends	–	–	–	500	500
Capital contribution	–	–	8	–	8
Vesting of stock appreciation rights	–	–	(2)	–	(2)
Share issuance	1	379	–	–	380
As at 31 December 2018	3	845	11	948	1,807

Company cash flow statement

FOR THE YEAR ENDED 31 DECEMBER 2019

	Note	2019 £m	2018 £m
Cash flows from operating activities			
Loss for the year	I.1	**(7)**	(13)
Adjustments for non-cash movements in net loss for the year			
Amortisation of debt cost		**1**	2
Interest expense		**2**	10
Net decrease/(increase) in operational assets			
Financial investments		**10**	(11)
Receivables		**(14)**	–
Net increase/(decrease) in operational liabilities			
Other payables		**10**	4
Accruals and deferred income		**–**	(5)
Net cash flows used in operating activities		**2**	(13)
Interest paid		**(2)**	(10)
Cash flows used in operating activities		**–**	(23)
Cash flows used in financing activities			
Repayment of borrowings	D.7	**–**	(500)
Dividends received		**–**	500
Proceeds from borrowings	D.7	**–**	498
Proceeds from issuance of ordinary share capital	C.1	**700**	380
Net cash flows used in financing activities		**700**	878
Cash outflows from investing activities			
Investment in subsidiaries	H.2	**(700)**	(955)
Net cash outflows from investing activities		**(700)**	(955)
Net decrease in cash and cash equivalents		**–**	(100)
Cash and cash equivalents at 1 January		**–**	100
Cash and cash equivalents at 31 December		**–**	–

Notes to the financial statements

Note A – Significant accounting policies

A.1 Basis of preparation and consolidation

The consolidated financial statements of the Group and those of the Company have been prepared and approved by the Directors in accordance with IFRSs as adopted by the EU and those parts of the Companies Act 2006 applicable to those reporting under IFRS. The accounting policies have been applied consistently. The financial statements have been prepared on a going concern basis as disclosed within the strategic report.

The consolidated and separate financial statements of the Company are presented in sterling (£) rounded to the nearest million (£m) except where otherwise stated. The separate Company statement of financial position is presented on page 82.

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

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

The consolidated financial statements comprise the financial statements of the Group as at 31 December each year.

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

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

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

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

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

During the preparation of the consolidated financial statements the Group selects accounting policies and makes estimates and assumptions that impact on the items reported and their presentation. The Audit Committee reviews the reasonableness of these judgements and assumptions as well as the appropriateness of the accounting policies applied.

Judgements are decisions which management has made in the process of applying the Group's accounting policies. Matters of significant judgement are considered to be:

- The assessment of whether the Group controls underlying entities and investments (see note H.1).
- Assessment of the significance of insurance risk transferred to the Group in determining whether a contract should be accounted for as an insurance or investment contract (see note A.2).

Estimates are based on evidence available at the accounting date and opinions provided by subject matter experts. Actual results may vary from the estimates provided. As new facts become available estimates will be updated. Items considered particularly susceptible to changes in estimates are noted below:

- Fair value of financial investments where quoted market prices are not available (see note D.1).
- Measurement of insurance contract liabilities (see note E.2).

Notes to the financial statements

CONTINUED

Note A – Significant accounting policies (continued)

A.1 Basis of preparation and consolidation (continued)

In accordance with IAS 1 and published FRC guidance, within each of the relevant notes the Group has included the following information:

- the assumptions made and the uncertainties around these;
- how sensitive the assets and liabilities are to these assumptions;
- expected resolution of the uncertainty and the range of possible outcomes for the financial year ending 31 December 2020; and
- explanation of any changes made to past assumptions if the uncertainty is unresolved.

A.2 Contract classification

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

As permitted by IFRS 4 Insurance contracts, the liabilities of the Group's insurance contracts are accounted for using generally accepted accounting principles within the UK industry. The Group applies the modified historic statutory solvency basis (MSSB) of reporting as set out in the revised Statement of Recommended Practice (SORP) issued by the Association of British Insurers (ABI) in November 2005 (amended in December 2006). The SORP was withdrawn with effect for accounting periods beginning on or after 1 January 2015 but the Group continues to apply the principles.

A.3 Foreign currencies

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

A.4 Adoption of new or amended standards

The Group has considered the following new standards and changes to existing standards which are relevant to the Group's operations, and became effective for financial years beginning on or after 1 January 2019. These amendments have all been endorsed by the EU.

IFRS 16 Leases

The Group adopted IFRS 16 on 1 January 2019. IFRS 16 replaces the guidance in IAS 17. IFRS 16 requires lessees to recognise a lease liability reflecting future lease payments and a 'right of use asset' for virtually all lease contracts. The Group has recognised a 'right of use asset' in relation to a lease executed during May 2019 in relation to new premises. The Group has not restated comparatives for the 2018 reporting period, as permitted under the specific transition provisions in IFRS 16. The reclassifications and the adjustments arising from the new leasing rules are therefore recognised in the opening balance sheet on 1 January 2019.

Amendments to IFRS 9 Financial instruments – prepayments features with negative compensation

The amendment covers two issues:

- What financial assets may be measured at amortised cost. The amendment permits more assets to be measured at amortised cost than under the previous version.
- How to account for the modification of a financial liability. The amendment confirms that most such modifications will result in immediate recognition of a gain or loss.

The Group has taken the deferral option included in the IFRS 4 Insurance contract amendment and will adopt the standard on the effective date of the new insurance contract standard, now expected to be 1 January 2022. The Group does not expect the amendment to have a material impact. The Group will therefore continue to apply IAS 39, Financial Instruments: Recognition and measurement, instead of adopting IFRS 9.

The exemption applies to the Group because its activities are 'predominantly connected with insurance'. The assessment of whether activities are predominantly connected with insurance was initially performed at the annual reporting date immediately preceding 1 April 2016. There are two tests which an insurer needs to pass before it can consider its activities predominantly connected with insurance:

1) Assess whether the carrying amount of liabilities arising from contracts within IFRS 4's scope is significant, compared to the total carrying amount of all its liabilities.
2) Compare the total carrying amount of all liabilities connected with insurance with the total carrying amount of all its liabilities. As at 31 December 2015, Rothesay Life Plc's liabilities connected with insurance exceeded 90% of its total liabilities.

Note A – Significant accounting policies (continued)

A.4 Adoption of new or amended standards (continued)

The exemption remains applicable at 31 December 2019. The temporary exemption allows the Group to avoid the temporary volatility that may result from adopting IFRS 9 before the forthcoming new insurance contracts standard. The Group has made an initial assessment of the impact of IFRS 9 and does not expect there to be a material impact on the measurement of financial assets and liabilities.

Note that the deferral option is only applicable to Rothesay Life Plc and therefore all other group entities have adopted IFRS 9 (but are not impacted by the amendment).

The Group holds all financial investments at fair value through profit and loss; please see note D.1 for disclosure of fair values. Financial assets including accrued interest and prepayments which are not held at fair value are deemed to be held at a value which is a reasonable approximation of its fair value and therefore no further disclosures have been provided. Information on credit risk exposure is provided in note F.2.1 Credit risk.

Amendments to IAS 28 – Investments in associates

Investors could have long-term interests in an associate or joint venture that form part of the net investment in the associate or joint venture. The International Accounting Standards Board (IASB) was asked to clarify whether these long-term interests are within the scope of IFRS 9, and whether IFRS 9 impairment requirements are applicable.

The IASB issued a narrow scope amendment to IAS 28 that clarified that these long-term interests in an associate or joint venture to which the equity method is not applied should be accounted for using IFRS 9. This includes the impairment requirements in IFRS 9. The Group has not been impacted by the IAS 28 amendment.

Amendments to IAS 19 – Employee benefits

This amendment requires a company:

- to use updated assumptions to determine current service cost and net interest for the remainder of the period after a plan amendment, curtailment or settlement; and
- to recognise profit or loss as part of past service cost, or a gain or loss on settlement, any reduction in a surplus, even if that surplus was not previously recognised because of the impact of the asset ceiling.

The amendments will affect any entity that changes the terms or the membership of a defined benefit plan such that there is a past service cost or a gain or loss on settlement. The Group has not been impacted by the amendment because it does not operate such a plan.

Annual improvements 2015-2017 cycles

These improvements are effective from 1 January 2019 and are not applicable to the Group. They include: Amendments to IFRS 3, Business combinations (clarifies that obtaining control of a business that is a joint operation, is a business combination achieved in stages), IFRS 11 Joint arrangements (clarifies that the party obtaining joint control of a business that is a joint operation should not re-measure its previously held interest in a joint operation), IAS 12 income tax (clarifies that the income tax consequences of dividends on financial instruments classified as equity should be recognised according to where past transactions or events that generated distributable profits were recognised), and IAS 23 Borrowing costs (clarifies that if a specific borrowing cost remains outstanding after the related qualifying asset is ready for its intended use or sale, it becomes part of general borrowings).

IFRIC 23 – Uncertainty over income tax

This interpretation clarifies how the recognition and measurement requirements of IAS 12- income taxes, are applied where there is uncertainty over income tax treatments. The Group has not been impacted by the interpretation.

New or revised standards not yet effective

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

Amendments to IFRS 3 Business combinations

The amendment is expected to be effective for periods beginning on or after 1 January 2020. To be considered a business, an acquisition would have to include an input and a substantive process that together significantly contributes to the ability to create outputs. The new guidance provides a framework to evaluation when an input and a substantive process are present (including for early stage companies that have not generated outputs). To be a business without outputs, there will now need to be an organised workforce.

The changes to the definition of a business will likely result in more acquisitions being accounted for as asset acquisitions across all industries. The Group is not expected to be impacted by this change.

Notes to the financial statements

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Note A – Significant accounting policies (continued)

A.4 Adoption of new or amended standards (continued)

Amendments to IAS 1 Presentation of financial statements and IAS 8 Definition of material

The amendment is expected to be effective for periods beginning on or after 1 January 2020. The amendments use a consistent definition of materiality throughout the IFRSs and the Conceptual Framework for Financial Reporting, clarify the explanation of the definition of material and incorporate some of the guidance in IAS 1 about immaterial information.

The amendments clarify the definition of material and make IFRSs more consistent, but are not expected to have a significant impact on the preparation of the Group's financial statements.

Amendments to the conceptual framework

The IASB has revised its conceptual framework. This will not result in any immediate change to IFRS, but the Board and Interpretations Committee will use the revised framework in setting future standards.

IFRS 17 Insurance contracts

The standard is expected to be effective for the first interim period within annual reporting periods beginning on or after 1 January 2022, subject to IASB deliberations. Earlier application is permitted. Once effective, IFRS 17 replaces IFRS 4 Insurance contracts that was issued in 2005. The overall objective of IFRS 17 is to provide a more useful and consistent accounting model for insurance contracts across entities issuing insurance contracts globally. The IFRS 17 model combines a current balance sheet measurement of insurance contract liabilities with the recognition of profit over the period that services are provided. Certain changes in the estimates of future cash flows and the risk adjustment are also recognised over the period that services are provided. Entities will have the option to present the effect of changes in discount rates either in profit and loss or in other comprehensive income. The standard will have a material impact on the way in which insurance company results are reported and the Group has set up a project to consider how to interpret the standard, assess the impact and determine how best to implement it.

A.5 Accounting treatment of reinsurance

For 2019 we have changed the way in which we present reinsurance and have re-stated the 2018 results accordingly. This has not impacted profit before tax or net equity. We are now showing insurance liabilities excluding third party reinsurance arrangements. This has led to the following changes:

Consolidated statement of comprehensive income and consolidated cash flow statement

The 2018 change in insurance contract liabilities has increased from £10,694m to £10,818m and the change in reinsurers' share of insurance contract liabilities has decreased from £567m to £443m. The net change in insurance contract liabilities is unchanged. These changes have also been reflected in the consolidated cash flow statement.

2018 premiums ceded to reinsurers have reduced from £1,369m to £1,114m and reinsurance recoveries have reduced from £1,275m to £1,020m.

Consolidated statement of financial position

2018 reinsurance contract liabilities have decreased from £673m to £549m and insurance contract liabilities have increased from £32,435m to £32,559m. Net insurance contract liabilities are unchanged.

Note B – Income statement notes

B.1 Segmental analysis

Segmental information is presented on the same basis as internal financial information used by the Group to evaluate operating performance. An operating segment is a component of the Group that engages in business activities from which it earns revenues and incurs expenses. Minor operating segments are combined to derive the Group's reportable segments in accordance with the requirements of IFRS 8.

The Group writes both single and regular premium business. Single (single payment of premium which covers the life of the policy) and regular premiums (payments of premium made regularly over the duration of the policy) are recognised when they fall due.

All of the Group's business risks and returns are within one business segment (i.e. long-term insurance business). This includes the premiums generated on inwards reinsurance contracts. The Group's operations are materially within the United Kingdom. The split between regular premiums and single premiums is shown below:

	Regular premiums		Single premiums	
	2019 £m	2018 £m	**2019 £m**	2018 £m
Group pension bulk annuities	**263**	263	**16,343**	928
Assumed reinsurance premiums	**–**	–	**–**	12,233
Total gross premiums written	**263**	263	**16,343**	13,161

Regular premiums are paid over the term of the longevity-only insurance policies written by the Group. Single premiums are one-off payments relating to bulk annuity contracts and inwards reinsurance.

The Group conducts a relatively small number of individual transactions each year. These transactions are one-off in nature and the Group's business plans do not anticipate conducting a significant amount of repeat business. The assumed reinsurance premiums for 2018 mainly relate to the Prudential transaction.

B.2 Investment return

Investment return comprises all interest income on financial investments at fair value through profit and loss, realised investment gains and losses and movements in unrealised gains and losses, as well as expenses directly related to investments executed during the year.

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

Realised gains and losses on investments carried at fair value are calculated as the difference between net sales proceeds and purchase price. Movements in unrealised gains and losses on investments represent the difference between the fair value of investments held at the statement of financial position date of each financial year and their purchase price or previous financial date.

	2019 £m	2018 £m
Interest income on financial investments at fair value through profit and loss	**1,125**	956
Unrealised profit/(loss) on financial investments	**900**	(686)
Realised gains/(losses) on financial investments	**316**	(93)
Investment management expenses	**(46)**	(36)
Total investment return	**2,295**	141

Interest income has increased due to the growth in assets under management. The profit on financial investments during the period were due to the more favourable market conditions than prior year, with tightening credit spreads, and lower interest rates.

The increase in investment management expenses reflects the growing size of the Group's investment activity.

Notes to the financial statements

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Note B – Income statement notes (continued)

B.3 Acquisition and administration expenses

The costs of acquiring new business are expensed during the financial year in which the premium is written and the costs incurred.

This note gives further details of items included in the acquisition and administration expenses section of the consolidated statement of comprehensive income which have been included in arriving at the profit before tax:

	2019 £m	2018 £m
Acquisition and Group costs	112	105
Administration expenses – recurring	48	36
Administration expenses – projects and other one-off expenses	24	20
Total operating expenses	**184**	161

The following items have been included in administration expenses – projects and other one-off expenses:

	2019 £m	2018 £m
Solvency II costs	4	1
Reinsurance fees	3	8
Other	17	11
	24	20

The following items have been included in operating expenses:

	2019 £m	2018 £m
Depreciation	1	1
Operating lease rental expense for office premises	–	2
	1	3

B.4 Finance costs

Finance costs consist of finance costs and interest payable on financial liabilities. Finance costs are accounted for on an accruals basis.

	2019 £m	2018 £m
Interest payable on collateral	9	7
Interest payable on collateralised agreements and financing	13	9
Total interest payable on collateral and collateralised agreements	**22**	16
Interest payable on borrowings from participating interest	26	25
Interest payable on third party borrowings	60	30
Financing charge on leasehold asset	1	–
Total borrowing costs	**87**	55
Net finance costs	**109**	71

Debt issuance expenses associated with the issue of subordinated loans are recognised over the term of the loan within interest payable.

Interest expense on the Tier 1 note is included in interest payable on third party borrowings following a change to the legislation of regulatory capital instruments from 1 January 2019. A prior year restatement in relation to this of £7m has been made.

Note B – Income statement notes (continued)
B.5 Employee information

	2019 No.	2018 Restated No.
Average number of staff employed during the year	**231**	195
Employees by department at year end		
Management	**19**	16
New business origination	**17**	17
Investments	**40**	35
Technology	**44**	21
Finance, legal and HR	**53**	50
Operations and project management	**47**	42
Risk and Internal Audit	**32**	29
	252	210

During the year the Group has amended the department structure. 2018 comparatives have been restated to reflect the change.

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

	2019 £m	2018 £m
Wages and salaries	**77**	58
Social security costs	**11**	8
Other pension costs	**2**	2
Total employee benefits expense	**90**	68

The key management personnel who have the authority and responsibility for planning, directing and controlling the activities of the Group include its Directors.

Directors' emoluments in respect of qualifying services to the Group were as follows:

	2019 £m	2018 £m
Directors' remuneration		
Aggregate emoluments	**9**	9
Company pension contributions to money purchase schemes	**–**	–
Total Directors' remuneration	**9**	9
Highest paid Director		
Total amount of emoluments	**4**	4
Company pension contributions to money purchase schemes	**–**	–
Total highest paid Director	**4**	4

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

During 2019 Directors received no emoluments for non-qualifying services which are required to be disclosed. Three Directors have been granted shares in RHUK in respect of long-term incentive schemes. No Directors have exercised options during the year.

Notes to the financial statements

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Note B – Income statement notes (continued)

B.6 Pension contributions

The Group operates a defined contribution pension scheme, sponsored by Rothesay Pensions Management Limited and contributions to the scheme are charged to the consolidated statement of comprehensive income as they accrue.

The amount charged for the financial year was £2m (2018: £2m). There were no outstanding contributions as at 31 December 2019 (2018: £nil).

B.7 Auditors' remuneration

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

	2019 £000s	2018 £000s
Remuneration receivable by the Company's auditors for the audit of the consolidated and Company financial statements	29	28
Remuneration receivable by the Company's auditors for the audit of the financial statements of the Company's subsidiaries	1,134	686
Total audit	**1,163**	714
Required by regulation	126	120
Audit-related assurance services	158	151
Other assurance services	167	196
Non-audit services	75	–
Total fees	**1,689**	1,181

The increase in total audit fees has been driven by new business written during the year. Other assurance services provided in 2019 include work in relation to the issuance of notes during the year. These and the other non-audit services are all in compliance with applicable independence rules and the Group considered that the external auditor was best placed to provide these services because of their understanding of the Group and their expertise.

B.8 Income tax expense

Income tax assets and liabilities for the current year and prior years are measured at the amount expected to be recovered from or paid to the taxation authorities. The tax rates and laws used to compute the amount are those that are enacted or substantively enacted by the financial statement date. Management uses previous experience and the advice of professional firms when assessing tax risks.

The major components of income tax expense for the years ended 31 December 2019 and 2018 are:

(a) Tax charged in the statement of comprehensive income

	2019 £m	2018 £m
Current income tax:		
UK corporation tax	120	19
Adjustment in respect of prior period	5	(2)
Total current income tax	**125**	17
Deferred tax:		
Origination and reversal of temporary differences	(1)	–
Total deferred tax	**(1)**	–
Total tax expense in the consolidated statement of comprehensive income	**124**	17

Note B – Income statement notes (continued)

B.8 Income tax expense (continued)

Reconciliation of the total tax charge

The tax expense in the consolidated statement of comprehensive income for the year and the standard rate of corporation tax in the UK of 19% (2018: 19%) is reconciled below:

	2019 £m	2018 £m
Profit on ordinary activities before taxation	**640**	102
Tax calculated at UK standard rate of corporation tax of 19% (2018: 19%)	**122**	20
Difference in Accounting and tax valuation basis	**(4)**	(1)
Adjustment in respect of prior period	**5**	(2)
Temporary differences	**1**	–
Total tax expense reported in the consolidated statement of comprehensive income	**124**	17

Note C – Equity

C.1 Share capital

At 31 December 2019 and 31 December 2018 share capital comprised:

	2019		2018	
	No.	£m	No.	£m
Ordinary share capital of £0.001 each	**–**	**–**	1,214,827,671	1.2
Ordinary share capital of £0.002 each	**1,547,867,964**	**3.1**	–	–
Preference share capital of £0.001 each	**–**	**–**	1,214,827,671	1.2
Restricted shares of £0.001 each	**90,000,000**	**0.1**	70,000,000	0.1
Authorised and issued share capital	**1,637,867,964**	**3.2**	2,499,655,342	2.5

With effect from 3 April 2019, the previous 943,519,813 A stapled shares (comprising one A ordinary share of £0.001 and the related preference share of £0.001), 44,159,475 B stapled shares (comprising one B ordinary share of £0.001 and the related preference share of £0.001) and 227,148,383 C stapled shares (comprising one C ordinary share of £0.001 and the related preference share of £0.001) were consolidated and reclassified respectively into 943,519,813 new A ordinary shares (of £0.002 each), 44,159,475 new B ordinary shares (of £0.002 each) and 227,148,383 new C ordinary shares (of £0.002 each).

On 20 June 2019, the Group issued 20,000,000 restricted H shares to the employee benefit trust for total cash consideration of £0.02m.

During September 2019, in order to ensure that the Group would remain appropriately capitalised given the new business pipeline, the Group allocated shares to existing institutional shareholders:

- On 11 September 2019 for total cash consideration of £500m, reflecting share premium of £499m the Group allotted 191,728,179 new A ordinary shares of £0.002 each and 46,157,744 new C ordinary shares of £0.002 each; and
- On 26 September 2019 for total cash consideration of £200m, reflecting share premium of £199m the Group allotted 76,691,273 new A ordinary shares of £0.002 each and 18,463,097 new C ordinary shares of £0.002 each.

During the prior year, in order to ensure that the Group remained appropriately capitalised following the Prudential transaction, on 14 March 2018 the Company allotted the following shares to existing institutional shareholders for total cash consideration of £380m, reflecting share premium of £379m:

- 145,713,416 A ordinary shares of £0.001 each
- 35,079,886 C ordinary shares of £0.001 each
- 180,793,302 preference shares of £0.001 each

The restricted shares are not entitled to participate in dividends but are entitled to receive a proportion of shareholder returns in excess of agreed hurdles in the event of a material change of control. All classes of shares have been fully paid.

Notes to the financial statements

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Note C – Equity (continued)

C.1 Share capital (continued)

The ordinary shares issued are analysed into the following categories:

	2019		2018	
	No.	£m	No.	£m
A £0.001 Ordinary	–	–	943,519,813	0.9
B £0.001 Ordinary	–	–	44,159,475	0.1
C £0.001 Ordinary	–	–	227,148,383	0.2
New A £0.002 ordinary	1,211,939,265	2.4	–	–
New B £0.002 ordinary	44,159,475	0.1	–	–
New C £0.002 ordinary	291,769,224	0.6	–	–
Total	**1,547,867,964**	**3.1**	1,214,827,671	1.2

The A, B and C ordinary shares entitle the holder to participate in dividends. All ordinary shares entitle the holder to share in the proceeds of winding up of the Company in proportion to the number of and amounts paid on the shares held. Only the A shares have full voting rights. The other classes of shares have limited voting rights.

The table below provides an analysis of the movement in the number of shares:

Number of shares	2019 No.	2018 No.
At 1 January	**2,499,655,342**	2,138,068,738
Ordinary share issuance	333,040,293	180,793,302
Preference share issuance	–	180,793,302
Preference share collapse into new ordinary shares	(1,214,827,671)	–
Restricted share issuance	20,000,000	–
At 31 December	**1,637,867,964**	2,499,655,342

Employee benefit trust

On 6 January 2016, the Company established an employee benefit trust, The Rothesay Employee Share Trust (the Trust). The Trust was established to purchase and hold shares of the Company for delivery of employee share schemes. Shares owned by the Trust are included at cost in the consolidated statements of financial position and are shown as a deduction from shareholders' equity. They are disclosed as employee scheme shares until they vest.

The table below provides an analysis of the movement in the number of B ordinary shares held by the Trust.

Number of shares	2019 No.	2018 No.
At 1 January	**11,733,106**	12,783,445
Shares acquired from employees	4,101,242	42,849
Shares issued to employees as RSUs vest	(2,414,552)	(1,093,188)
At 31 December	**13,419,796**	11,733,106

On 4 April 2019, the Trust purchased 3,116,366 new B ordinary shares for consideration of £8.8m. A further 984,876 B shares (stapled pre-consolidation, new post-consolidation) were acquired by the Trust during the year from employees leaving employment.

As noted above, on 20 June 2019, RHUK issued and allotted to the Trust 20,000,000 H shares and the beneficial interest was sold to eight employees of the Group immediately thereafter.

Note C – Equity (continued)
C.2 Restricted Tier 1 notes

Under IFRS the RT1 notes meet the definition of equity and are therefore recognised as such. Following a change to the legislation of regulatory capital instruments from 1 January 2019, the coupon payments are recognised as interest payable on third party borrowings.

	2019 £m	2018 £m
Loan notes issued through public debt markets	**347**	347

On 5 September 2018, the Group issued £350m of RT1 notes with a fixed 6.875% coupon payable semi-annually in arrears. The notes were issued through the public debt markets. The notes were initially recognised at the fair value of the consideration received less transaction costs directly attributable to the issuance.

The notes are callable on or after 5 September 2028. If the notes are not repaid on that date, a fixed rate of interest per annum will be reset. The notes are direct, unsecured and subordinated obligations of the issuer.

The Group has the option to cancel the coupon payment which becomes mandatory upon breach or non-compliance with RLP's SCR, a breach of the minimum capital requirement (MCR) or where the Group has insufficient distributable reserves.

The full principal amount of each note is irrevocably and automatically reduced to zero on a permanent basis if RLP determines at any time that:

(i) eligible Own Fund items are less than or equal to 75% of the SCR;
(ii) eligible Own Fund items are less than or equal to 100% of the MCR; or
(iii) a breach of the SCR has occurred and has not been remedied within three months.

C.3 Share premium account and reserve

	Share premium £m	Capital contribution reserve £m	Employee scheme treasury shares £m	Profit and loss reserve £m	Reorganisation reserve £m
1 January 2019	**845**	**10**	**(19)**	**1,253**	**132**
Profit for the financial year	–	–	–	**516**	–
Retrospective restatement due to change in accounting treatment	–	–	–	**(7)**	–
Share issuance	**700**	–	–	–	–
Employee benefit trust	–	–	**(11)**	–	–
Capital contribution	–	**7**	–	–	–
31 December 2019	**1,545**	**17**	**(30)**	**1,762**	**132**

	Share premium £m	Capital contribution reserve £m	Employee scheme treasury shares £m	Profit and loss reserve £m	Reorganisation reserve £m
1 January 2018	466	5	(20)	1,168	132
Profit for the financial year	–	–	–	85	–
Share issuance	379	–	–	–	–
Vesting of stock appreciation rights	–	(2)	–	–	–
Employee benefit trust	–	–	1	–	–
Capital contribution	–	7	–	–	–
31 December 2018	845	10	(19)	1,253	132

The capital contribution reserve arose as a result of a historic stock appreciation rights plan.

Notes to the financial statements

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Note D – Financial assets and liabilities

D.1 Financial investments

Financial investments are classified, at initial recognition, as financial investments at fair value through profit or loss, with the exception of receivables, cash and accrued interest, which are carried at amortised cost. Fair value is considered consistent with the risk management of the portfolio.

Financial investments at fair value through profit or loss are both financial investments held for trading and financial investments designated upon initial recognition at fair value. Such investments are carried in the consolidated statement of financial position at fair value with net changes in fair value presented in investment income. Transaction costs, which are incremental costs that are directly attributable to the acquisition of a financial asset, are expensed. Financial investments include collective investment schemes, government, sub sovereign and agency obligations, derivative assets, corporate bonds and other corporate debt, certificates of deposit, loans secured on property, equity release mortgages and collateralised agreements and financing.

The fair value of a financial instrument is the amount that would be received on the sale of an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, i.e. the exit price. Financial investments are marked to bid prices and financial liabilities are marked to offer prices. Fair value gains or losses are included in investment income.

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

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

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

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

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

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

Note D – Financial assets and liabilities (continued)

D.1 Financial investments (continued)

Derecognition

A financial investment (or, where applicable, a part of a financial investment or part of a group of similar financial investments) is primarily derecognised (i.e. removed from the Group's statement of financial position) when i) the rights to receive cash flows from the investment have expired; or ii) the Group has transferred its rights to receive cash flows from the asset or has assumed an obligation to pay the received cash flows in full without material delay to a third party under a 'pass-through' arrangement; and either (a) the Group has transferred substantially all the risks and rewards of the asset, or (b) the Group has transferred control of the investment.

When the Group has transferred its rights to receive cash flows from an investment or has entered into a pass-through arrangement, it evaluates if and to what extent it has retained the risks and rewards of ownership. When it has neither transferred all of the risks and rewards of the investment nor transferred control of the investment, the Group continues to recognise the transferred investment to the extent of the Group's continuing involvement. In that case, the Group also recognises an associated liability. The transferred investment and the associated liability are measured on a basis that reflects the rights and obligations that the Group has retained. Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of the original carrying amount of the asset and the maximum amount of consideration that the Group could be required to repay.

Collateralised agreements and financing

Collateralised agreements (securities purchased under agreements to re-sell and deposits placed as collateral for stock borrowed) and collateralised financing (securities sold under agreements to repurchase and deposits received as collateral for stock loans) are treated as collateralised financing transactions and are carried at fair value through profit and loss under the fair value option, as the securities are managed on a fair value basis. The collateral can be in the form of cash or securities.

Cash collateral is recognised/derecognised when received/paid. Collateral posted by the Group in the form of securities is not derecognised from the consolidated statement of financial position, whilst collateral received in the form of securities is not recognised on the consolidated statement of financial position. If collateral received is subsequently sold, the obligation to return the collateral and the cash received are recognised in the consolidated statement of financial position.

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

	2019 £m	2018 £m
Financial investments carried at fair value through profit and loss, designated at initial recognition	**73,742**	49,174

Determination of fair value and fair value hierarchy

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

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

The fair value of certain debt securities classified as Level 3 instruments is determined using inputs that are not based on observable market data. One of the most significant inputs is liquidity premiums. The valuation model discounts future cash flows using interest rate swap curves in addition to a spread to reflect the associated credit risk and liquidity premiums.

Notes to the financial statements

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Note D – Financial assets and liabilities (continued)

D.1 Financial investments (continued)

The following tables show an analysis of financial investments recorded at fair value by level of the fair value hierarchy for 2019 and 2018 (please refer to note D.6 for financial liabilities):

31 December 2019	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Collective investment schemes	5,330	–	–	5,330
Government sub sovereign and agency obligations	7,951	10,005	–	17,956
Corporate bonds and other corporate debt	–	19,073	1,088	20,161
Derivative assets (see note D.2)	–	19,508	–	19,508
Collateralised agreements and financing	–	1,875	–	1,875
Loans secured on property	–	–	6,063	6,063
Equity release mortgages	–	–	2,669	2,669
Certificate of deposits	–	180	–	180
Total financial investments at fair value	**13,281**	**50,641**	**9,820**	**73,742**

31 December 2018	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Collective investment schemes	1,390	–	–	1,390
Government sub sovereign and agency obligations	4,694	10,989	364	16,047
Corporate bonds and other corporate debt	–	11,732	1,091	12,823
Derivative assets (see note D.2)	–	11,450	1	11,451
Collateralised agreements and financing	–	2,028	–	2,028
Loans secured on property	–	–	3,376	3,376
Equity release mortgages	–	–	1,897	1,897
Certificate of deposits	–	162	–	162
Total financial investments at fair value	6,084	36,361	6,729	49,174

Collective investment schemes represent money market funds with same-day liquidity.

Approximately 13% (2018: 14%) of the total financial assets recorded at fair value are valued based on estimates and recorded as Level 3 investments. Where estimates are used, these are based on a combination of independent third party evidence and internally developed models, calibrated to market observable data where possible.

The following table shows a reconciliation of the opening and closing recorded amounts in relation to the Level 3 financial instruments recorded at fair value (excluding equity release mortgages which are discussed in the equity release mortgages section of note D.1):

	Government sub sovereign and agency obligations £m	Corporate debt £m	Loans secured on property £m	Derivatives £m	Total £m
At 1 January 2019	**364**	**1,091**	**3,376**	**1**	**4,832**
Total gains in the statement of comprehensive income:					
Unrealised gains	6	60	156	13	235
Transfer out of Level 3	(412)	(395)	–	(21)	(828)
Net purchases/additions	42	332	2,531	7	2,912
At 31 December 2019	**–**	**1,088**	**6,063**	**–**	**7,151**
At 1 January 2018	–	685	3,409	–	4,094
Total gains in the statement of comprehensive income:					
Unrealised (losses)/gains	–	(15)	(87)	1	(101)
Net purchases/additions	364	421	54	–	839
At 31 December 2018	364	1,091	3,376	1	4,832

Please see note D.6 for details of Level 3 derivative liabilities.

Note D – Financial assets and liabilities (continued)

D.1 Financial investments (continued)

The Group's policy is to determine the relevant categorisation of financial assets and liabilities at least annually and, where availability of inputs has changed, transfers will be made between levels. The recorded amount of the total financial assets transferred from Level 3 to Level 2 is £828m (2018: £nil). There were no transfers of financial instruments from Level 2 to Level 3 (2018: £nil).

Equity release mortgages

Equity release mortgages allow the borrowers to take equity from their homes either as a lump sum or in smaller, regular amounts. The total amount, capital plus interest, is repaid when the borrower dies or moves into long-term care. All equity release mortgage loans provide a 'no-negative equity guarantee' (NNEG), which means that the mortgage repayment amounts (loan principal plus interest on redemption) are subject to a maximum of the sale proceeds of the property on which the loan is secured.

Equity release mortgages are valued using a discounted cash flow model by projecting future net cash flows on a closed form basis allowing for demographic assumptions, consistent with those used for insurance contracts adjusted for transfer to long-term care, prepayment rates, future expenses and potential cost of providing the NNEG. Cash flows are then discounted at a risk-free rate plus illiquidity premium inferred from market observed levels.

The NNEG can be thought of as a series of options written by the Group which allow the equity release mortgage holders to extinguish their loan by selling their property back to the Group at the current market value and at the point at which the mortgage must be redeemed (typically on death or transfer to long-term care), even when property values are lower than the outstanding loan balance.

Sensitivities to interest rates and house prices are shown later in this note as these are the most material assumptions given the way in which the potential cost of the no-negative guarantee is derived.

Given the various assumptions used in valuing the equity release mortgages, the instruments are recorded as Level 3 assets. The table below provides an analysis of the movement in the value of equity release mortgages. New business includes both the acquisition of back-books of equity release mortgages and new origination through our strategic partners. The change in economic assumptions includes the impact of changes in interest rates and property prices. The change in demographic assumptions includes the impact of changes in pre-payment rates and assumed mortality.

	2019 £m	2018 £m
Carrying amount at 1 January	**1,897**	539
Increase in respect of new business	**694**	1,380
Redemptions/repayments	**(142)**	(76)
Accrued interest for the year	**109**	50
Change in economic assumptions	**111**	3
Change in demographic assumptions	**–**	1
Closing balance at 31 December	**2,669**	1,897

The table below provides a summary of the cash flows arising from the equity release mortgage portfolio based on the above assumptions:

	2019 £m	2018 £m
Less than one year	**176**	135
One to five years	**624**	471
Over five years	**1,869**	1,291
	2,669	1,897

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Note D – Financial assets and liabilities (continued)

D.1 Financial investments (continued)

Collateralised agreements

Assets are transferred under repurchase and securities lending agreements with other financial institutions. The nature and carrying amounts of the assets (all carried at fair value) subject to repurchase and securities lending agreements, as well as their related liabilities, are as follows:

	2019		2018	
	Asset £m	Related liability £m	Asset £m	Related liability £m
Government and agency obligations	**822**	**676**	965	779
Total collateralised agreements	**822**	**676**	965	779

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

The net exposure to certain OTC derivatives is collateralised through cash. As at 31 December 2019, the total cash collateral received was £1,193m (2018: £1,128m). Other OTC contracts are collateralised with fixed income securities which are not recognised on the balance sheet of the Group.

Sensitivity of Level 3 financial investments measured at fair value to changes in key assumptions

The following table shows the impact on the fair value (FV) of Level 3 instruments of using reasonably possible alternative assumptions by class of instrument. Since part of any spread movement is likely to be included in the derivation of the valuation rate of interest, changes in fair value of assets also impact liabilities. The table below also shows the potential impact on profit before tax (PBT) of the same alternative assumptions, assuming that all other pricing inputs remain constant:

			2019		
Impact on financial assets and PBT	Main assumptions	Changes in assumptions	Current FV £m	(Decrease)/ Increase in FV £m	(Decrease)/ Increase in PBT £m
Financial assets					
Corporate bonds and other corporate debt	Discount rate	+50bps yield to maturity	**1,088**	**(38)**	**(4)**
		-50bps yield to maturity	**1,088**	**41**	**4**
Government sub sovereign and agency obligations	Discount rate	+50bps yield to maturity	**–**	**–**	**–**
		-50bps yield to maturity	**–**	**–**	**–**
Loans secured on property	Liquidity premium	+25bps yield to maturity	**6,063**	**(250)**	**–**
		-25bps yield to maturity	**6,063**	**271**	**–**
Loans secured on property	Property prices	+10% change in property prices	**6,063**	**10**	**17**
		-10% change in property prices	**6,063**	**(16)**	**(42)**
Equity release mortgages	Liquidity premium	+50bps yield to maturity	**2,669**	**(144)**	**–**
		-50bps yield to maturity	**2,669**	**157**	**–**
Equity release mortgages	House prices	+10% change in house prices	**2,669**	**49**	**56**
		-10% change in house prices	**2,669**	**(62)**	**(71)**
Derivative assets	Expected defaults	+50bps credit default spread	**–**	**–**	**–**
		-50bps credit default spread	**–**	**–**	**–**

The following table shows the impact on the fair value (FV) of Level 3 instruments of using reasonably possible alternative assumptions by class of instrument. Since part of any spread movement is likely to be included in the derivation of the valuation rate of interest, changes in fair value of assets also impact liabilities.

Note D – Financial assets and liabilities (continued)
D.1 Financial investments (continued)
Sensitivity of Level 3 financial investments measured at fair value to changes in key assumptions (continued)

Impact on financial assets and PBT	Main assumptions	Changes in assumptions	2018 Current FV £m	2018 (Decrease)/ Increase in FV £m	2018 (Decrease)/ Increase in PBT £m
Financial assets					
Corporate bonds and other		+50bps yield to maturity	1,091	(58)	(18)
corporate debt	Discount rate	-50bps yield to maturity	1,091	63	20
Government sub sovereign and		+50bps yield to maturity	364	(11)	(2)
agency obligations	Discount rate	-50bps yield to maturity	364	12	2
Loans secured on property		+25bps yield to maturity	3,376	(187)	–
	Liquidity premium	-25bps yield to maturity	3,376	206	–
		+10% change in property prices	3,376	10	14
Loans secured on property	Property prices	-10% change in property prices	3,376	(19)	(28)
		+25bps yield to maturity	1,897	(94)	–
Equity release mortgages	Liquidity premium	-25bps yield to maturity	1,897	102	–
		+10% change in house prices	1,897	39	44
Equity release mortgages	House prices	-10% change in house prices	1,897	(50)	(56)
		+50bps credit default spread	1	–	–
Derivative assets	Expected defaults	-50bps credit default spread	1	–	–

D.2 Derivatives
The Group uses derivative financial instruments as part of its risk management strategy and to hedge its solvency position. The objectives include managing exposure to market, foreign currency, inflation and interest rate risks on assets and liabilities (see also note F.2.2). The total net fair value of the Group's derivative assets and liabilities as at 31 December 2019 is a liability of £436m (2018: a liability of £339m).

The following table shows the fair value of derivative financial instruments, recorded as assets or liabilities, together with their notional amounts.

	2019			2018		
	Assets £m	**Liabilities £m**	**Notional amount £m**	Assets £m	Liabilities £m	Notional amount £m
Derivatives held for risk management						
Interest rate swap	**14,843**	**(15,167)**	**350,352**	9,356	(9,532)	200,403
Inflation swap	**3,816**	**(3,981)**	**49,029**	1,570	(1,620)	34,871
Currency swap	**481**	**(427)**	**46,889**	497	(597)	37,889
Credit derivative	**286**	**(332)**	**15,024**	22	(34)	2,049
Forwards	**82**	**(37)**	**4,345**	6	(7)	2,073
Total	**19,508**	**(19,944)**	**465,639**	11,451	(11,790)	277,285

Derivatives are used solely for efficient portfolio management and risk management purposes, allowing market risks to be hedged in line with our risk appetite. The notional amount shown reflects the gross notional of derivative contracts. Under IFRS certain restrictions apply in relation to the offset of assets and liabilities. The Group does not consider that it meets these restrictions and therefore presentation is gross. Hence multiple derivative contracts which generate offsetting risk positions inflate the size of the notional amount reported, but do not increase our risk exposure. As such, the notional amount should not be considered as an indicator of the market risk exposure generated by the derivative portfolio. Derivatives where the fair value is positive are recognised as an asset and where the fair value is negative they are recognised as a liability.

The Group's exposure under derivative contracts is closely monitored as part of the overall management of the Group's market risk (see also note F.2.2).

Notes to the financial statements

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Note D – Financial assets and liabilities (continued)

D.3 Accrued interest and prepayments

	2019 £m	2018 £m
Accrued interest	**399**	346
Prepaid expenses	**356**	151
Total accrued interest and prepayments	**755**	497

D.4 Receivables

	2019 £m	2018 £m
Deposits pledged as collateral to third parties	**688**	333
Other receivables	**217**	20
Total receivables	**905**	353

All receivables are due within one year. The fair value of receivables is £905m (2018: £353m).

The net exposure to certain OTC derivatives is collateralised through cash posted, as per the terms of the OTC contracts. At 31 December 2019, the total cash collateral posted was £688m (2018: £333m). Further details of the full extent of collateral usage can be found in the credit risk disclosure in note F.2.1.

D.5 Cash and cash equivalents

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

	2019 £m	2018 £m
Cash at bank and in hand	**263**	163
Total cash and cash equivalents	**263**	163

D.6 Payables and financial liabilities

	2019 £m	2018 £m
Derivative financial instruments	**19,944**	11,790
Collateralised financing agreements	**676**	779
Total financial liabilities	**20,620**	12,569
Deposits received as collateral from third parties	**1,193**	1,128
Current tax payable	**82**	17
Other taxes and social security costs	**9**	8
Other payables	**95**	127
Total payables	**1,379**	1,280
Total payables and financial liabilities	**21,999**	13,849

Financial liabilities are recorded at fair value (see note D.1 for accounting policy), of which £0.9m are valued using Level 3 techniques (2018: £0.5m). The remainder are valued using Level 2 techniques.

Payables and financial liabilities of £1,660m (2018: £1,569m) are all due within one year.

The net exposures to certain OTC derivatives are collateralised through cash. As at 31 December 2019, the total cash collateral received was £1,193m (2018: £1,128m). Other OTC contracts are collateralised with fixed income securities which are not recognised on the consolidated statement of financial position for the Group.

Note D – Financial assets and liabilities (continued)
D.7 Borrowings

Borrowings are recognised initially at fair value, net of transaction costs incurred. Borrowings are subsequently stated at amortised cost; any difference between the proceeds (net of transaction costs) and the redemption value is recognised in the income statement over the period of the borrowings using the effective interest method. Transaction costs are amortised over the period of the borrowings.

The Group's borrowings are as follows:

	2019 £m	2018 £m
Subordinated loans from participating interests	**398**	398
Subordinated loan notes	**1,029**	249
Total borrowed	**1,427**	647

On 12 July 2019 RLP issued £300m of Tier 3 bonds with maturity on 12 July 2026 and a fixed 3.375% coupon payable annually in arrears. On 19 November 2019 RLP issued a further £100m of the Tier 3 bonds with the same maturity and coupon as the original issuance. On 17 September 2019 RLP issued £400m of Tier 2 bonds with maturity on 17 September 2029 and a fixed 5.5% coupon payable annual in arrears. The Tier 2 bonds are callable on 17 September 2024.

In March 2018, the Group entered into a £500m three-year term loan facility with a syndicate of third party banks. On 10 October 2018, £350m of this facility was repaid using the proceeds of the RT1 note issuance in RLP. On 12 December 2018 the remaining £150m of the facility was repaid using the proceeds from a dividend from RLP.

The £300m revolving credit facility entered into in March 2017 was renegotiated in July 2019 and increased to £420m and remains effective but undrawn.

The carrying amounts, fair values and features of the Group's borrowings are summarised in the table below:

					Carrying amount		Fair value	
Notional amount	Issue date	Redemption date	Callable at par at the option of the Group from	Coupon	2019 £m	2018 £m	2019 £m	2018 £m
Subordinated loans from participating interests								
£100m	21 December 2012	Lender has option to convert to equity from 21 December 2022	21 December 2017 and every six months thereafter	6m£L plus 4.25%	**100**	100	**97**	93
£300m	19 September 2017	19 September 2028	19 September 2023 and annually thereafter	3m£L plus 5.95%	**298**	298	**302**	287
Subordinated loans								
£250m	22 October 2015	22 October 2025	No call option	8%	**249**	249	**306**	283
£400m	12 July 2019	12 July 2026	No call option	3.375%	**386**	–	**403**	–
£400m	17 September 2019	17 September 2029	17 September 2024	5.5%	**394**	–	**434**	–

For the period ended 31 December 2019, an interest expense of £62m (2018: £55m) was recognised in the consolidated statement of comprehensive income in respect of these borrowings.

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Note D – Financial assets and liabilities (continued)

D.7 Borrowings (continued)

Reconciliation of borrowings

The table below provides a reconciliation between opening and closing balances in the statement of financial position for liabilities arising from financing activity:

	31 December 2018 £m	Cash flows £m	Non-cash flows £m	31 December 2019 £m
Subordinated loans from participating interest	398	–	–	398
Subordinated loan notes	249	778	2	1,029
Total borrowings	**647**	**778**	**2**	**1,427**

	31 December 2017 £m	Cash flows £m	Non-cash flows £m	31 December 2018 £m
Subordinated loans from participating interest	398	–	–	398
Subordinated loan notes	249	–	–	249
Total borrowings	647	–	–	647

Note E – Insurance contracts and reinsurance

E.1 Reinsurance assets/liabilities

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

The amounts that will be recoverable from reinsurers are estimated based upon the gross provisions, having due regard to collectability. The recoverability of reinsurance recoveries is assessed having regard to market data on the financial strength of the reinsurance company. The reinsurers' share of claims incurred in the profit and loss account reflects the amounts received or receivable from reinsurers in respect of claims paid or incurred during the year. Reinsurance assets/liabilities represent the discounted value of the premiums payable under the reinsurance contracts less the discounted value of the reinsurance claims payable. Premiums are recognised in the consolidated statement of comprehensive income as 'Premiums ceded to reinsurers' when due.

Collateral received on reinsurance assets is accounted for in line with collateral received on financial investments.

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

The reinsurers' share of the insurance contract liabilities is as follows:

	2019 £m	2018 restated[1] £m
Reinsurance assets	388	43
Reinsurance liabilities	(848)	(549)
Total reinsurance of insurance contract liabilities	**(460)**	(506)

1 Please see note A5 for details of the prior year restatement.

Reinsurance assets have increased partly as a result of the Group selling its €140m portfolio of Irish annuities to Laguna Life DAC, owned by Monument Re. This transaction is structured initially as a reinsurance contract with Monument Re Limited and covers around 400 policyholders who will remain RLP's customers until the effective date of a Part VII transfer to Laguna Life, at which point the reinsurance agreement will also transfer to Laguna Life.

Note E – Insurance contracts and reinsurance (continued)

E.1 Reinsurance assets/liabilities (continued)

With the exception of the reinsurance agreement with Monument Re Limited (noted on the previous page), under the outward reinsurance contracts, the Group has committed to pay fixed cash flows to the reinsurer for each policy covered. In exchange, the reinsurers will pay cash flows that are linked to the actual longevity of the underlying policies. The contracts are generally collateralised for changes in longevity expectations and movements in market rates. Where a contract is collateralised no additional reserves are held, as part of the insurance contract liabilities, as the expected loss on default would be expected to be covered by the collateral. For the contracts where no collateral is held, an additional counterparty default allowance is held as part of the insurance contract liabilities to reflect the risk of loss on default. The calculation of the allowance considers the probability of default of the counterparty along with the expected level of collateral available to be reclaimed in the event of default. Longevity reinsurance contracts are valued as the net position comparing the discounted value of the fixed leg payable with the floating leg received from the reinsurer.

The value of the reinsurance liability has increased due to a combination of changes in demographic assumptions and changes in economic conditions. Overall, the proportion of the insurance liability reinsured has remained constant over the period due to reinsurance taken out on new business. The total amount of reinsurance held over the period has increased.

At 31 December 2019 and 31 December 2018, the Group conducted an impairment review of the reinsurance assets and found no impairment necessary.

E.2 Insurance contract liabilities

Insurance contract liabilities are determined by the Group's actuaries using methods and assumptions recommended by the actuarial function of RLP and approved by the Board. They are calculated using the historic statutory solvency basis required to comply with the reporting requirements under the Financial Services and Markets Act 2000 and in accordance with the SORP on Accounting for Insurance Business issued by the ABI in December 2005 and revised in December 2006. The SORP has been withdrawn with effect for accounting periods beginning on or after 1 January 2015 but the Group continues to apply the principles. The Group seeks to make prudent assumptions relating to expected future experience based on current market conditions and recent experience. The assumptions used incorporate prudent margins to reflect the inherent uncertainty that actual experience may be less favourable than our best estimate.

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

In accordance with the previous solvency basis, where applicable the Group recognises negative mathematical reserves on its regular premium longevity risk transfer arrangements.

Key valuation assumptions

This note details the assumptions with the greatest impact on the Group's insurance contract liability valuations. Note that insurance contract liabilities include reinsurance inwards, i.e. where the Group has reinsured a third party insurer.

(a) Mortality assumptions

Mortality assumptions have been determined separately for each insurance contract. The resulting assumptions are equivalent to using the base mortality assumptions set out in the table below:

	2019		2018	
	Pensions originated	**Insurance originated**	Pensions originated	Insurance originated
Males	**94.7% S2PMA**	**90.8% S2PMA**[1]	94.8% S2PMA	100.2% PMA08
Females	**94.7% S2PFA**	**90.8% S2PFA**[1]	94.8% S2PFA	100.2% PFA08

1 Previously these had been expressed for reporting purposes as an equivalent to the PXA08 series tables. For 31 December 2019 the assumptions are equivalent to 99.8% PXA08. The disclosure basis has been updated as the CMI S2 tables reflect a better fit to the liabilities.

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Note E – Insurance contracts and reinsurance (continued)

E.2 Insurance contract liabilities (continued)

For pension scheme originated business, ultimate mortality has been used in all cases. For insurance originated business, the stated base mortality basis incorporates the effect of selection adjustments for relevant policies. Past mortality improvements are applied assuming the base mortality rates are as at 2007.

Recent mortality experience is analysed annually for each pension scheme and for insurance originated business. The last review was carried out during 2019. The best estimate base mortality assumptions used in the valuation are based on this actual mortality experience. Mortality assumptions are generally set with reference to a Rothesay specific suite of mortality tables. These have been expressed for reporting purposes as a single adjustment equivalent to the CMI S2 series of mortality tables drawn up by the Continuous Mortality Investigation (CMI) of the Institute and Faculty of Actuaries. The S2 tables are based on industry-wide experience.

The changes to the single equivalent rates over 2019 reflect the inclusion of new business, differences from expected mortality in recent years and the introduction of additional prudence in the base mortality assumption. The additional prudence on base mortality has been offset by a reduction in prudence in mortality improvements to provide a better reflection of the risk.

Allowance is made for future improvements in annuitant mortality with reference to statistical analysis of historical rates of mortality improvements, expert judgement of future changes in mortality improvements, industry benchmarking and reinsurance pricing. In 2019, mortality improvement assumptions were updated to reflect recent mortality improvements including adoption of the CMI 2018 improvement model. For both 2018 and 2019 an advanced calibration of the model has been used. The chosen long-term improvement rate assumption varies by age using a bespoke calibration that tapers non-linearly from age 70 to 0% at age 120. The best estimate long-term rates have remained unchanged from 2017. Assumed initial rates of improvements were increased over the period. The new initial adjustment parameter introduced in the CMI 2018 model has not been adopted, with adjustment to the initial rate of mortality improvements continuing to be made through the Sk parameter.

Improvements are equivalent to those shown in the table below:

	Future mortality improvements (including margins)	
	2019	2018
Males	**CMI_2018_M [2.4%; Sk=7.9]**	CMI_2017_M [3.0%; Sk=7.5]
Females	**CMI_2018_F [2.4%; Sk=7.9]**	CMI_2017_F [3.0%; Sk=7.5]

Prudent margins are applied to the demographic basis, through the base table multiplier, Sk factor and the long-term rate to reflect the fact that future experience may differ from that assumed. Prudent margins have been reshaped during 2019 with increased prudence being applied to base mortality and reduced prudence applied to initial improvement rates and a reduction in the long-term prudent margin. This better reflects both market practice and reinsurance pricing. The increase in prudent margin in the base mortality, offset by a reduction in prudence in mortality improvements has led to a net reduction in the overall level of prudence (see Section (e)).

(b) Economic assumptions including valuation rate of interest

The valuation rate of interest used to discount the cash flows for the purpose of valuing insurance contract liabilities is based on the yield obtainable on the basket of assets matching the applicable insurance contract liabilities at 31 December 2019. For the purposes of this calculation, any assets held by LT Mortgage Financing Limited or Rothesay MA No.1 Limited are treated as if they were held directly and intercompany arrangements ignored.

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

	2019	2018
Equivalent rate of interest	**1.78% p.a.**	2.44% p.a.

This reflects a 2.5% prudential margin applied to the risk-adjusted internal rate of return obtained on the basket of matching assets and an allowance for investment management expenses of 3bps p.a. (2018: 3bps p.a.).

The asset yield used to calculate the valuation rate of interest has been reduced to reflect credit default risk, where applicable adjusted for the prudent expected recoveries in the event of default and, for some asset classes, the cost of rebalancing the portfolio following a downgrade. This deduction in yield is determined separately for each individual asset, reflecting the risk to the return being achieved on the asset. The equivalent rate of interest shown includes allowance for the yield deduction shown in the table on the following page.

Note E – Insurance contracts and reinsurance (continued)

E.2 Insurance contract liabilities (continued)

The table below shows the average yield deduction before the application of the 2.5% prudential margin at 31 December 2019 and 31 December 2018 by asset category:

Asset class	Average yield deduction 2019	Average yield deduction 2018 (Grouping restated)
UK government approved securities	**0 bps**	0 bps
Secured lending	**24 bps**	17 bps
Supranational/other sovereign	**17 bps**	24 bps
Secured residential lending	**28 bps**	28 bps
Corporate bonds (without covering credit default swaps)	**56 bps**	63 bps
Infrastructure	**63 bps**	75 bps
Equity release mortgages	**125 bps**	146 bps
Other	**36 bps**	39 bps
Overall yield reduction	**31 bps**	31 bps

The average yield reduction is unchanged, this is due to an increase as a result of the change in asset mix offset by the reduction in default allowance associated with credit spread tightening during the period.

Allowance is made for the risks associated with equity release mortgages through the valuation of the NNEG and this is included in the overall yield deduction above. The calculation of the NNEG is described in note D.1 and is calculated on a prudent basis allowing for future property price growth at a rate equivalent to 1.14% net of dilapidation costs and cost of sale (2018: 1.59%) and house price volatility equivalent to 13% (2018: 13%). The reduction in the yield deduction for equity release mortgages over the year has been driven by origination of lower risk mortgages, offset slightly by the change in assumed property price growth rate over the period.

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

(c) Expense assumption

An allowance is made for future overhead maintenance expenses following an investigation into the total costs incurred by the Group during 2019 and the projected 2020 expenses. As part of this investigation, these costs have been split between acquisition and maintenance expenses. The long-term business provisions include an allowance to provide for the expenses payable under the third party administration agreements together with the long-term business overhead expenses expressed as an amount per policy. Although expense provisions as a proportion of total liabilities fell between 2018 and 2019, the high average policy size of the new business written in 2019 means that the average per policy allowance has increased to £36 per policy per annum (2018: £30 per policy per annum). Additional allowances are then made for short-term project costs and investment management expenses.

Within these expense provisions, an allowance for future expense inflation has been provided to cover the impact of both salary and price inflation. The future rate of expense inflation is assumed to be RPI (as implied by the RPI swap curve) plus an addition at each duration of 0.25% p.a. for all expenses (2018: 0.25% p.a.).

(d) Member option and dependants assumptions

A number of other, less financially significant, actuarial assumptions are made in determining the provisions. These assumptions include, inter alia, the proportion of deferred and immediate annuitants assumed to have a dependant eligible for contingent benefits, dependant's age difference and the proportion of deferred annuitants opting to take a proportion or all of their benefit as a lump sum.

The modelling of member options allows for the probability that deferred annuitants choose to transfer their benefits each year. The cash flow profile resulting from the assumed take-up of member options impacts the composition of the basket of assets used to derive the valuation rate of interest (see E.2(b) on the previous page).

When deferred annuitants have passed the scheme normal retirement date and have been subject to an in-depth tracing exercise and yet remain untraced, a prudent allowance has been made for the probability of them taking their benefits in the future. All other individuals who have passed the scheme normal retirement date are assumed to start receiving pension payments immediately.

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Note E – Insurance contracts and reinsurance (continued)

E.2 Insurance contract liabilities (continued)

(e) Movement in insurance contract liabilities

The table below details the change in the insurance contract liabilities, net of reinsurance, over the year. The release of liabilities line reflects claims paid, release of prudent margins and unwind of discounting over the year.

	2019 £m	2018 £m
Carrying amount at 1 January	**33,065**	21,804
Increase in respect of new business	**16,362**	12,933
Release of liabilities	**(2,028)**	(1,162)
Effect of assumption changes	**985**	(517)
Other	**8**	7
Closing balance at 31 December	**48,392**	33,065

The following table shows the impact on the insurance contract liabilities, net of reinsurance, of changes in the assumptions used:

Net increase/(decrease) in liabilities	2019 £m	2018 £m
Change in assumptions used		
Valuation rate of interest	**1,747**	(401)
Inflation	**(716)**	(10)
Effect of economic assumption changes	**1,031**	(411)
Demographics	**(212)**	(133)
Member options	**(10)**	(20)
Expenses	**176**	47
Effect of non-economic assumption changes	**(46)**	(106)
Total effect of assumption changes	**985**	(517)

As shown previously, the valuation rate of interest decreased by 66bps over the year, which led to the £1.7bn increase in the net liability shown. This was partially offset by the impact of the fall in future rate of inflation.

The movement in the demographic assumptions shown reflects the changes to base mortality, mortality improvement and other demographic assumption changes applied during the year, leading to a £212m decrease in net liabilities. The change in the assumptions are shown in section (a).

Additional expense reserves set up to support new business as set up at the point of sale have been reflected through the increase in net insurance liabilities in respect of new business. Expense assumptions were strengthened further during the second half of 2019, increasing the net liabilities by £176m, including changes to ongoing maintenance and investment costs and changes to the allowance for project provisions.

(f) Sensitivity analysis

The schedule on the next page provides an analysis of the reasonably possible movements in key assumptions that would have a material impact on liabilities (net of reinsurance), profit before tax (PBT) and equity. The analysis is based on a change in a single assumption whilst holding all other assumptions constant. The analysis assumes an instantaneous shock to the assumptions other than for the interest rate sensitivity where the impact of dynamic hedging is allowed for as interest rates change. The interest rate sensitivities have increased by more than the increase in the size of the balance sheet because of the long duration of the new business. However the risk remains closely monitored and hedged as seen through the impact of the sensitivity on equity. Inflation sensitivities have increased from 2018 to 2019 because all of the schemes insured in 2019 have inflation-linked benefits.

Note E – Insurance contracts and reinsurance (continued)

E.2 Insurance contract liabilities (continued)

2019	Change in assumptions	(Decrease)/ increase in net liabilities £m	Increase/ (decrease) in PBT £m	Impact on equity £m
Annuitant mortality	**+5% qx**	**(228)**	**225**	**182**
Annuitant mortality	**-5% qx**	**240**	**(237)**	**(192)**
Interest rate	**+100bps**	**(6,149)**	**241**	**195**
Interest rate	**-100bps**	**7,719**	**(85)**	**(69)**
Inflation	**+100bps**	**3,234**	**(242)**	**(196)**
Inflation	**-100bps**	**(2,968)**	**382**	**309**
Credit default assumption	**+10bps**	**(508)**	**(310)**	**(251)**
Credit default assumption	**-10bps**	**523**	**319**	**259**
Change in property prices	**+10%**	**(14)**	**72**	**59**
Change in property prices	**-10%**	**35**	**(113)**	**(91)**
Expenses	**+10%**	**134**	**(134)**	**(108)**

2018	Change in assumptions	(Decrease)/ increase in net liabilities £m	Increase/ (decrease) in PBT £m	Impact on equity £m
Annuitant mortality	+5% qx	(172)	171	139
Annuitant mortality	-5% qx	181	(179)	(145)
Interest rate	+100bps	(3,752)	26	21
Interest rate	-100bps	4,661	292	236
Inflation	+100bps	1,320	26	21
Inflation	-100bps	(1,256)	82	66
Credit default assumption	+10bps	(320)	(206)	(167)
Credit default assumption	-10bps	329	209	170
Change in property prices	+10%	(9)	59	47
Change in property prices	-10%	15	(84)	(68)
Expenses	+10%	95	(95)	(77)

The sensitivities shown capture non-linearity effects, which may be significant following large market movements. The risk management strategy adopted can result in the Group being immunised to market movements in either direction.

Given current interest rates, the -100bps interest rate sensitivity means that interest rates are assumed to fall below zero for eight years (2018: did not fall below zero).

The impact of reinsurance on the sensitivity to morality risk is a reduction of 78% (2018: 78%).

The annuitant mortality sensitivity is defined in terms of a qx stress where qx represents the probability of a life dying during the year. As such, in the annuitant mortality stress it is assumed that in each year 5% more or fewer people survive to the end of each year than had previously been assumed.

(g) Timing of cash flows

The table below shows the discounted insurance liability cash flows, net of reinsurance, which are expected to arise during each year:

	2019			
	Less than 1 year £m	**1 to 5 years £m**	**Over 5 years £m**	**Total £m**
Insurance contract cash flows net of reinsurance	**2,440**	**9,057**	**36,895**	**48,392**

	2018			
	Less than 1 year £m	1 to 5 years £m	Over 5 years £m	Total £m
Insurance contract cash flows net of reinsurance	1,988	6,990	24,087	33,065

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Note F – Risk and capital management

F.1 Capital management

The Group's capital resources are of critical importance. The Group's capital management framework is designed to meet the following objectives:

- to maintain financial strength in adverse conditions;
- to give customers long-term confidence in the Group;
- to satisfy our regulatory obligations;
- to match the profile of our assets and liabilities, taking account of the risk inherent in the business;
- to allocate capital efficiently to support new business growth;
- to retain financial flexibility by maintaining strong liquidity; and
- to provide an appropriate return to shareholders.

From 1 January 2016, the Group was required to operate under the new Solvency II regime. The Group had sufficient capital available to meet its regulatory capital requirements at all times during the year ended 31 December 2019.

Under the Solvency II regime, the Group is required to hold sufficient assets to meet:

- The Group's technical provisions, being:
  - the liabilities of the Group calculated on a best estimate basis (the BEL); plus
  - the risk margin; less
  - available transitional solvency relief.
- The capital required to meet a 1-in-200-year stress (known as the solvency capital requirement or SCR).

Transitional solvency relief was re-calculated as at both 31 December 2018 and 31 December 2019 and amortises by 1/16th each year from 1 January 2017. As at 31 December 2019, solvency estimates allow for amortisation of 3/16^{ths} of transitional solvency relief (2018: 2/16th).

The Group received approval to use a PIM from 31 December 2018 so from that date the SCR relating to credit and counterparty risk is calculated using the Group's bespoke models and the standard formula is used to calculate the SCR for all other risk components and for aggregation across risk components.

Capital in excess of that required to meet the technical provisions is known as Own Funds. As at 31 December 2019, Own Funds for the Group were £6,132m (2018: £3,918m) made up as follows:

	2019 £m	2018 £m
Total IFRS equity	3,776	2,571
Liability valuation differences and other regulatory adjustments	901	689
Total Tier 1	**4,677**	3,260
Tier 2 debt valuation	1,059	658
Tier 3 debt valuation	396	–
Own Funds	**6,132**	3,918

The Group holds both debt and equity to optimise its capital structure and improve shareholder return. During 2019, £700m of equity, £400m of Tier 2 debt and £400m of Tier 3 debt were issued by the Group. During the prior year, £380m of equity and £350m of RT1 notes were issued by the Group.

The capital position is sensitive to changes in market conditions, due to changes in the value of the assets and the effect that changes in investment conditions may have on the value of the liabilities. The Group seeks to mitigate these risks through the close matching of asset and liability cash flows, and through the use of derivative hedges and reinsurance. Management monitors market conditions and emerging longevity experience on a regular basis. As these conditions change, management will take remedial action such as adjustment of hedging strategies and re-investment of assets as appropriate.

Note F – Risk and capital management (continued)

F.2 Risk management and analysis

The Group is exposed to credit, market and liquidity risk through its financial assets and financial liabilities. The Group is exposed to insurance risk through its insurance liabilities and to operational risk as a result of its activities. These risks are described below and are managed in accordance with risk management policies and procedures established by the Group. Please see pages 26 to 34 of the strategic review for further detail on risk management arrangements and the governance framework within the Group.

F.2.1 Credit risk

Credit risk represents the potential for loss, or solvency deterioration, due to the default or deterioration in credit quality of a counterparty or an investment we hold. Credit risk also arises from cash placed with banks or money market funds, collateralised financing transactions (i.e. resale and repurchase agreements) and receivables from third parties.

Management is responsible and accountable for managing credit risks within prescribed limits. Effective management of credit risk requires disciplined underwriting, accurate and timely information, strong collateral management, a high level of communication and knowledge of customers, countries, industries and products.

The independent risk function, led by the CRO, has responsibility for ensuring an appropriate framework is in place for assessing and monitoring credit risk. All credit exposures are actively monitored by the risk function, including the use of regular sector and position reviews and a number of early warning indicators, resulting in regular reporting to the investment team and key governance bodies such as the BRC.

Risk mitigants

The Group manages credit risk in its investment portfolio by diversifying exposures across and within sectors, controlling position sizes through limits, and regular monitoring and oversight of investments.

To mitigate the credit exposures on derivatives and collateralised agreement transactions, the Group obtains collateral from counterparties on an upfront or contingent basis. The Group also enters into netting agreements with counterparties that permit it to offset receivables and payables with such counterparties for transaction settlements and upon a counterparty default.

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

Credit exposures

The Group is exposed to credit risk from its receivables from third parties. Receivables from counterparties are generally comprised of collateralised receivables related to derivatives or collateralised agreements transactions and have minimal credit risk due to the value of the collateral received. In addition, the Group invests in assets that are typically highly rated, or assets where there is underlying structural security in the event of a default. These assets include supranationals, sovereign bonds, sub sovereign bonds, covered bonds, higher education bonds, infrastructure assets, unsecured corporate bonds and secured residential lending.

Further information is provided below:

Cash and cash equivalents. Cash and cash equivalents include both interest bearing and non-interest bearing deposits and investment in money market funds. To mitigate the risk of credit loss, the Group diversifies its exposure and places its deposits with multiple banks, typically with minimum ratings in the 'A' rating category. The Group only invests in 'AAA' rated money market funds.

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

Collateralised agreements. Collateralised agreements are reported at fair value or contractual value before consideration of collateral received on the balance sheet. The Group bears credit risk related to sale and repurchase agreements and securities borrowing only to the extent that cash advanced to the counterparty exceeds the value of the collateral received or charges over assets. Therefore, the Group's credit exposure on the transactions is significantly lower than the amounts recorded on the balance sheet. The Group also has credit exposure on repurchase agreements and securities loaned, which are liabilities on its consolidated statement of financial position, to the extent that the collateral pledged for these transactions exceeds the amount of cash received.

Notes to the financial statements

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Note F – Risk and capital management (continued)
F.2 Risk management and analysis (continued)
F.2.1 Credit risk (continued)

Reinsurance. Long-term business is ceded to reinsurers under collateralised contracts to transfer part of the insurance risk associated with the underlying insurance contracts. The amounts that will be recoverable from reinsurers is estimated based upon the gross provisions, having due regard to collectability. The recoverability of reinsurance recoveries is assessed having regard to market data on the financial strength of the reinsurance company.

The following table identifies the amounts covered by enforceable netting arrangements (netting under master netting agreements, cash collateral and security collateral) which do not qualify for netting under IAS 32.

	2019				
		Related amounts not offset			
	Net amount of financial assets presented in the statement of financial position £m	Netting under master netting agreements £m	Cash collateral £m	Security collateral and charges £m	Net credit exposures £m
Property, plant and equipment	9	–	–	–	9
Collective investment schemes	5,330	–	–	–	5,330
Lease- right of use	37	–	–	–	37
Government sub sovereign and agency obligations	17,956	–	–	–	17,956
Corporate bonds and other corporate debt	20,161	–	–	–	20,161
Derivative assets	19,508	(16,000)	(529)	(2,960)	19
Collateralised agreements and financing	1,875	–	(33)	(1,842)	–
Loans secured on property	6,063	–	–	(6,063)	–
Equity release mortgages	2,669	–	–	(2,669)	–
Certificate of deposits	180	–	–	–	180
Reinsurance assets	388	–	(3)	(126)	259
Deferred tax assets	2	–	–	–	2
Accrued income and prepayments	755	–	–	(106)	649
Receivables	905	–	–	–	905
Cash and cash equivalents	263	–	–	–	263
Total	**76,101**	**(16,000)**	**(565)**	**(13,766)**	**45,770**
Derivative liabilities	(19,944)	16,000	351	3,216	(377)
Collateralised financing agreements	(676)	–	–	676	–
Total	**(20,620)**	**16,000**	**351**	**3,892**	**(377)**

Note F – Risk and capital management (continued)
F.2 Risk management and analysis (continued)
F.2.1 Credit risk (continued)

	2018	Related amounts not offset			
	Net amount of financial assets presented in the statement of financial position £m	Netting under master netting agreements £m	Cash collateral £m	Security collateral and charges £m	Net credit exposures £m
Property, plant and equipment	2	–	–	–	2
Collective investment schemes	1,390	–	–	–	1,390
Government sub sovereign and agency obligations	16,047	–	–	–	16,047
Corporate bonds and other corporate debt	12,823	–	–	–	12,823
Derivative assets	11,451	(8,149)	(567)	(2,731)	4
Collateralised agreements and financing	2,028	–	(13)	(2,015)	–
Loans secured on property	3,376	–	–	(3,376)	–
Equity release mortgages	1,897	–	–	(1,897)	–
Certificate of deposits	162	–	–	–	162
Reinsurance assets	43	–	–	–	43
Deferred tax assets	1	–	–	–	1
Accrued income and prepayments	497	–	–	–	497
Receivables	353	–	–	–	353
Cash and cash equivalents	163	–	–	–	163
Total	50,233	(8,149)	(580)	(10,019)	31,485
Derivative liabilities	(11,790)	8,149	315	3,105	(221)
Collateralised financing agreements	(779)	–	–	779	–
Total	(12,569)	8,149	315	3,884	(221)

Within the above table, derivative liabilities are only included to the extent they net against derivative assets. Therefore, the amount of derivative assets shown after offsetting netting arrangements does not represent our overall derivative exposure. Our overall exposure can be seen in note D.2.

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Note F – Risk and capital management (continued)
F.2 Risk management and analysis (continued)
F.2.1 Credit risk (continued)
Right of offset
The Group has the right of offset for certain financial assets and liabilities.

Netting under master netting agreements of £16,000m (2018: £8,149m) reflects the offsetting of derivative assets with liabilities for which the Group has a right to set off in the event of default. Cash and security collateral have been offset to the extent there are credit exposures on the balance sheet.

The Group has received total security collateral and charges of £14,219m (2018: £10,570m) of which £13,766m (2018: £10,019m) has been applied against net exposure, leaving excess of £453m (2018: £551m). Security collateral exposes the Group to further market and credit risk. This is mitigated through the use of haircuts and over-collateralisation.

Credit default swaps have been purchased to protect the Group from the default of some of its counterparties. The table on the previous page does not reflect the protection provided. The Group calls margins, receivable in cash and gilt instruments, against this exposure and other derivative positions.

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

The table below shows the Group's gross and net credit exposure based on external and internal ratings to be consistent with management's view of credit. 2018 comparatives have been restated accordingly. The external rating is generally based on the median of the ratings assigned by Standard & Poor's, Moody's and Fitch. For the purpose of Solvency II, certain assets are internally rated by the Group's independent credit risk function under a framework which has been externally validated.

Net credit exposure is predominately arising from strong investment grade assets. AAA rated assets include supranational bonds, sub sovereigns, covered bonds, US not-for-profit private universities and certificates of deposit. AA rated assets include gilts. Other net credit exposures rated A and BBB include investments in regulated infrastructure assets and commercial real estate loans, as well as unsecured corporate bonds.

A vast majority of the unrated assets relate to residential mortgages that are not individually rated.

	2019 Related amounts not offset				
	Net amount of financial assets presented in the statement of financial position £m	Netting under master netting agreements £m	Cash collateral £m	Security collateral and charges £m	Net credit exposures £m
Exposure to credit risk by rating					
AAA	**14,727**	**–**	**–**	**(2,660)**	**12,067**
AA	**20,296**	**(1,855)**	**(49)**	**(2,046)**	**16,346**
A	**28,386**	**(13,738)**	**(490)**	**(2,285)**	**11,873**
BBB	**9,254**	**(407)**	**(23)**	**(3,762)**	**5,062**
BB	**–**	**–**	**–**	**–**	**–**
B	**–**	**–**	**–**	**–**	**–**
Unrated	**3,438**	**–**	**(3)**	**(3,013)**	**422**
Total	**76,101**	**(16,000)**	**(565)**	**(13,766)**	**45,770**

Note F – Risk and capital management (continued)
F.2 Risk management and analysis (continued)
F.2.1 Credit risk (continued)

	2018 restated Related amounts not offset				
	Amounts of financial assets presented in the statement of financial position £m	Netting under master netting agreements £m	Cash collateral £m	Security collateral and charges £m	Net credit exposures £m
Exposure to credit risk by rating					
AAA	10,402	–	–	(2,646)	7,756
AA	15,558	(891)	(13)	(1,780)	12,874
A	15,190	(6,319)	(389)	(644)	7,838
BBB	6,937	(939)	(178)	(2,975)	2,845
BB	–	–	–	–	–
B	–	–	–	–	–
Unrated	2,146	–	–	(1,974)	172
Total	50,233	(8,149)	(580)	(10,019)	31,485

Other than a small number of equity release mortgages, as of the current and prior year end there were no financial assets past due.

F.2.2 Market risk
Market risk is the risk of changes in the value of the Group's net position due to changes in market prices. Financial investments are accounted for at fair value and, therefore, fluctuate on a daily basis. Certain liabilities are also exposed to market risk. Categories of market risk include the following:

- Interest rate risk arises from discounting cash flow mismatches across all future dates. Profits and losses are generated through changes in the level, slope and curvature of interest rate curves. The risk is hedged closely by matching assets and liabilities and by using interest rate swaps. Consideration is given to both the Group's IFRS and solvency risk positions when determining the appropriate hedging strategy.
- Inflation rate risk results from mismatches in the index linkage of liabilities and assets. Profits and losses are generated through changes to the level, slope and curvature of inflation curves. The risk is hedged by closely matching assets and liabilities and by using inflation swaps.
- Currency rate risk results from mismatches in the denomination of liabilities and assets. Profits and losses are generated due to changes in the level of foreign exchange rates. The risk is hedged using spot foreign exchange and cross currency swaps.
- Property risk results from investments that are secured on commercial or residential properties. Profits and losses may be generated by material movements in spot or forward property prices. This risk is mitigated through strict underwriting criteria, aggregated risk monitoring and low loan-to-value limits. Where the property risk becomes more material then prudent allowance is made for this within the credit risk adjustment.

The Group manages market risk by diversifying exposures, controlling position sizes through limits and regular stress and scenario testing and establishing economic hedges in related securities, derivatives and insurance liabilities.

Sensitivities to market risk are shown in note E.2 (f).

Notes to the financial statements

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Note F – Risk and capital management (continued)
F.2 Risk management and analysis (continued)
F.2.3 Liquidity risk

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

The Group liquidity policy is designed to ensure the availability of sufficient funds to meet cash flow requirements on a timely basis via:

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

The liquidity management framework is designed to ensure that a prudent level of liquidity is maintained on a spot basis, but also under stressed market conditions at which time liquidity may leave the Group through collateral outflows and ongoing business obligations such as expenses and undrawn investments. A suite of market stresses are considered as part of the liquidity management framework, against which limits are applied by the Board.

The risk function has primary responsibility for ensuring an appropriate framework is in place for assessing, monitoring and managing liquidity risk. The liquidity risk management framework requires liquid assets to be held to meet a wide range of stressed market conditions which consider all material sources of liquidity risk present on the balance sheet. Liquidity is managed for the Group as a whole, in addition to at a Solvency II fund level. Risks are monitored and controlled through strong oversight and independent control and support functions across the business.

Management is responsible and accountable for managing liquidity risks within prescribed limits that are set by the Board and are overseen by the BRC.

The following table details the Group's financial liabilities and assets by contractual maturity including interest that was accrued where the Group is entitled to repay the liability before its maturity. Financial assets and liabilities are presented at their fair value (with the exception of receivables, cash, accrued interest and borrowings) as this is consistent with the values used in the liquidity risk management of these instruments. The table excludes insurance liability and reinsurance cash flows which are included in note E.2. The table also excludes equity release mortgage cash flows which are included in note D.1 and leasehold cash flows which are included in note I.5.

	2019			
	Less than 1 year £m	1 to 5 years £m	Over 5 years £m	Total £m
Financial assets				
Financial investments	6,589	6,183	58,301	71,073
Accrued income and prepayments	755	–	–	755
Receivables	905	–	–	905
Cash and cash equivalents	263	–	–	263
	8,512	6,183	58,301	72,996
Financial liabilities				
Financial liabilities	(281)	(1,499)	(18,840)	(20,620)
Payables	(1,379)	–	–	(1,379)
Borrowings	(100)	–	(1,327)	(1,427)
Accruals and deferred income	(80)	–	–	(80)
	(1,840)	(1,499)	(20,167)	(23,506)
Net	6,672	4,684	38,134	49,490

Note F – Risk and capital management (continued)
F.2 Risk management and analysis (continued)
F.2.3 Liquidity risk (continued)

	2018			
	Less than 1 year £m	1 to 5 years £m	Over 5 years £m	Total £m
Financial assets				
Financial investments	3,525	5,174	38,578	47,277
Accrued income and prepayments	497	–	–	497
Receivables	353	–	–	353
Cash and cash equivalents	163	–	–	163
	4,538	5,174	38,578	48,290
Financial liabilities				
Financial liabilities	(289)	(950)	(11,330)	(12,569)
Payables	(1,280)	–	–	(1,280)
Borrowings	(100)	–	(547)	(647)
Accruals and deferred income	(58)	–	–	(58)
	(1,727)	(950)	(11,877)	(14,554)
Net	2,811	4,224	26,701	33,736

F.2.4 Operational risk

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. The Group manages operational risk through the development and maintenance of an effective risk management framework which ensures that a comprehensive internal control environment is in place. This is supported by regular risk and control self-assessments coordinated, challenged and reported by the second line, which allow risk levels to be measured and control enhancements to be developed in line with the Group's risk appetite.

The Group also uses scenario analysis to explore key areas of operational risk, ensuring that the implications of adverse operational risk events crystallising are well understood and that, where appropriate, additional controls or contingency plans are introduced to improve operational resilience.

The Group has significant outsourcing arrangements in place, which are subject to extensive due diligence at the point of entering into them, but also to ongoing review, with oversight provided by the Third Party Oversight Committee. Oversight of these arrangements considers the information security risk that the Group is exposed to, the performance of the third party with respect to service level agreements, and other relevant information (e.g. their ongoing creditworthiness, and where relevant their readiness to accommodate the Group's growth).

Operational risk also includes the risk of conduct failure – a risk that is managed by the Compliance function and overseen by the Customer and Conduct Committee.

F.2.5 Insurance risk

Insurance risk is the risk of changes in the value of the Group's net position due to changes in the insurance contract liabilities. Insurance risk may occur either through changes in actual demographic experience or revised expectations of future experience. The main categories of insurance risk include the following:

- Demographic risk arises from current mortality or spouse experience being lighter than that assumed. The risk is hedged by external reinsurance.
- Longevity improvement risk represents the risk of future mortality rates improving at a faster rate than assumed. The risk is hedged by external reinsurance.
- Expense risk results from future expenses required to maintain the business being higher than expected. This risk is managed through budgeting and robust expense management.

As at 31 December 2019 78% of longevity risk was reinsured (2018: 78%). Risks are monitored and controlled by the actuarial function and overseen by the Chief Actuary and risk function.

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Note G – Other statement of consolidated position notes

G.1 Deferred tax assets

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

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

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

The carrying amount of deferred income tax assets is reviewed at each financial reporting date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilised. Unrecognised deferred income tax assets are reassessed at each financial reporting date and are recognised to the extent that it has become probable that future taxable profit will allow the deferred tax asset to be recovered.

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

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

Deferred tax balances comprise:

	2019 £m	2018 £m
Temporary differences between the financial statements and the tax deductions	2	1
Total temporary differences	**2**	1

The movements in the deferred tax balances were as follows:

	2019 £m	2018 £m
At 1 January	1	1
Timing difference	1	–
At 31 December	**2**	1

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

Note H – Interests in subsidiaries and associates

H.1 Investment in unconsolidated structured entities

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

The Group has interests in unconsolidated structured entities as described below:

- loans granted to and notes issued by special purpose vehicles (SPVs) secured by the assets held by the SPV such as commercial or residential real estate;
- debt securities issued by SPVs secured by financial receivables; and
- loans granted to SPVs secured by financial receivables.

Note H – Interests in subsidiaries and associates (continued)

H.1 Investment in unconsolidated structured entities (continued)

As at 31 December 2019, our total interest in such entities, reflected on the Group's statement of financial position and classified as financial investments held at fair value through profit or loss, was £7,555m (2018: £4,825m). The recorded fair value represents the Group's maximum loss exposure to these unconsolidated structured entities. The £2,730m increase in the balance was predominantly driven by new investments in commercial real-estate loans and mark-to-market gains on existing positions.

A summary of the Group's interest in unconsolidated structured entities is provided below:

	2019 £m	2018 £m
Government sub sovereign and agency obligations	63	75
Corporate bonds and other corporate debt	1,545	1,319
Loans secured on property	5,947	3,431
Total	**7,555**	4,825

H.2 Investments in subsidiaries

Investments in subsidiary undertakings are stated at cost less provision for impairment in the Company's financial statements.

The financial statements include the financial statements of RHUK and the subsidiaries listed in the following table:

Group undertakings	Country of incorporation	Primary business operation	2019 £m	2018 £m	2019 % equity interest	2018 % equity interest
Rothesay Pensions Management Limited	UK	Service company	22	11	100%	100%
Rothesay Life Plc (formerly known as Rothesay Life Limited)	UK	Life insurance	2,464	1,764	100%	100%
Rothesay Assurance Limited (formerly known as MetLife Assurance Limited)	UK	Service company	–	–	100%	100%
LT Mortgage Financing Limited	UK	Service company	5	1	100%	100%
Rothesay MA No.1 Limited	UK	Service company	5	–	100%	100%
Rothesay MA No.2 Limited	UK	Service company	–	–	100%	–
Rothesay MA No.3 Limited	UK	Service company	–	–	100%	–
Rothesay MA No.4 Limited	UK	Service company	–	–	100%	–
Rothesay Asset Management UK Limited	UK	Service company	5	5	100%	100%
Rothesay Asset Management US LLC	US	Service company	5	5	100%	100%
Rothesay Life Foundation	UK	Charitable foundation	–	–	100%	–

Subsidiaries are held at the lower of cost and net realisable value.

The above subsidiary undertakings, with the exception of Rothesay Asset Management US LLC, are registered in the United Kingdom. The registered office and principal place of business for all UK subsidiary undertakings is The Post Building, 100 Museum Street, London WC1A 1PB.

Rothesay Asset Management US LLC is registered in Delaware, United States of America. The registered office is Corporate Trust Center, 1209 Orange Street, Wilmington, Delaware 19801, New Castle County.

Rothesay MA No.2 Limited was incorporated during March 2019. Rothesay MA No.3 Limited and Rothesay MA No.4 Limited were incorporated during November 2019. All three entities remain dormant.

During October 2019 Rothesay established a charitable foundation, Rothesay Life Foundation.

On 3 October 2016, the PRA granted an application to cancel the permissions of Rothesay Assurance Limited. As it is now no longer needed, steps have been taken to remove it from the Group, and the company was placed into members' voluntary liquidation on 4 June 2019. The company will be dissolved once the liquidation is completed.

Notes to the financial statements

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Note I – Other notes

I.1 Company loss

The loss for the financial year of the Company was £7m (2018: loss of £13m). As permitted by Section 408 of the Companies Act 2006, the Company's statement of comprehensive income has not been included in these financial statements.

I.2 Share-based payments

The cost of equity-based transactions with employees is measured based on grant-date sale value. Share-based employee awards that require future services are amortised over the relevant service period. Expected forfeitures are included in determining share-based employee compensation expenses.

The fair value is determined at grant date and expensed on a straight-line basis over the vesting period in profit and loss. At each reporting date the Group revises its estimate of the number of shares that are expected to be issued and recognises the impact of the revision of original estimates.

In the case of shares, the fair value is assumed to be the market price and the Group revises the value at each reporting date.

During the year ended 31 December 2015, RHUK created a stock incentive plan, the Long Term Stock Incentive Plan (RHUK SIP) which provided for grants of restricted stock units (RSUs).

The Group issued RSUs to the employees under the RHUK SIP, primarily in connection with year-end compensation. These RSUs vest and deliver as outlined in the applicable RSU agreements. Vesting is subject to the recipient not having left employment or having left employment as a result of death, permanent illness or redundancy. Delivery of the RSUs is in the form of shares or an equivalent amount of cash (determined at the absolute discretion of the Remuneration Committee). All RSUs have a future service requirement. The activity related to these RSUs is set out below:

	2019 No. of RSUs	2018 No. of RSUs
Outstanding at the beginning of the year	**15,452,083**	12,468,328
Forfeited during the year	**(329,612)**	(156,417)
Vested during the year	**(4,553,187)**	(2,062,675)
Granted during the year	**4,552,902**	5,202,847
Outstanding at the end of the year	**15,122,186**	15,452,083

The fair value of the RSUs is determined by taking 100% of the Group MCEV and dividing by the number of ordinary shares. The weighted average fair value of the RSUs at 31 December 2019 was £3.90 (31 December 2018: £2.83). Expenses of £10.4m (2018: £7.7m) have been charged to the profit and loss of the Group during the year in relation to the RHUK SIP.

I.3 Related parties disclosures

Ultimate holding companies

Based on the percentage nominal share capital owned, the shareholdings of the Group's institutional investors are as follows:

- The Blackstone Group L.P.: 35%
- GIC Private Limited: 35%
- MassMutual Financial Group: 24%

The remaining percentage is owned by the Directors, management, employees and the Trust (see note C.1).

Note I – Other notes (continued)

I.3 Related parties disclosures (continued)

Related party transactions

The Group entered into various transactions with fellow participating interests which are subject to common control from the same source.

	2019 £m	2018 £m
Statement of comprehensive income		
Change in the reinsurers' share of insurance contract liabilities and reinsurance recoveries	**(2)**	(3)
Finance costs	**(26)**	(25)
Operating expenses	**(8)**	(1)
Statement of financial position		
Reinsurance liabilities	**6**	4
Borrowings	**398**	398
Capital	**937**	513

Transactions with key management personnel

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

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

	2019 £m	2018 £m
Salaries, bonus and other employee benefits	**21**	20
Equity-based compensation payments	**6**	4
Total transactions	**27**	24

On 4 April 2019 members of key management personnel and their families sold new B ordinary shares to the Employee Benefit Trust for consideration of £7.8m.

The tables below represent transactions between RHUK and its subsidiaries RPML and RLP.

Transactions with RPML	2019 £m	2018 £m
Statement of financial position		
Other receivables	**8**	8
Other payables	**3**	–
Capital	**22**	11

Transactions with RLP	2019 £m	2018 £m
Statement of comprehensive income		
Cost transfer	**(5)**	(3)
Statement of financial position		
Other payables	**13**	6
Capital	**2,464**	1,764
Dividends	**–**	500

Transactions with Rothesay Asset Management UK	2019 £m	2018 £m
Capital	**5**	5

Notes to the financial statements

CONTINUED

Note I – Other notes (continued)

I.3 Related parties disclosures (continued)

Transactions with LTMF

During December 2018, £1.3bn of the equity release mortgage loans were transferred from RLP to its subsidiary LT Mortgage Financing Limited (LTMF). During June 2019 and September 2019, a further £0.4bn and £0.2bn respectively were transferred from RLP to LTMF. LTMF became the beneficial owner in the equity release mortgage loans in exchange for the issue of loan notes. These transactions took place on an arm's length basis using the fair value of the equity release mortgages. Under IAS 39 the loans cannot be derecognised from the Company as RLP effectively maintains all the risk and rewards and control of the mortgages after the securitisations through the loan notes. For the purposes of determining the valuation rate of interest under IFRS 4, this securitisation is ignored.

Transactions with Rothesay MA No.1 Limited

During December 2018, £778m of ground rent loans were transferred from RLP to its subsidiary Rothesay MA No.1 Limited (RMA1). RMA1 became the beneficial owner in the ground rent loans in exchange for the issue of loan notes. These transactions took place on an arm's length basis using the fair value of the ground rent loans. Under IAS 39 the loans cannot be derecognised from the Company as RLP effectively maintains all the risk and rewards and control of the loans after the securitisations through the loan notes. For the purposes of determining the valuation rate of interest under IFRS 4, this securitisation is ignored.

I.4 Financial commitments and contingencies

Lease commitment

From 1 January 2019, IFRS 16 Leases became effective. IFRS 16 replaced the guidance in IAS 17. Under IAS 17, lessees were required to make a distinction between a finance lease (on balance sheet) and an operating lease (off balance sheet).

IFRS 16 now requires lessees to recognise a lease liability reflecting future lease payments and a right of use asset for virtually all lease contracts (see note I.5). The new standard has affected the balance sheet and related ratios.

The Group relocated its UK-based operations to The Post Building during the second half of 2019 in order to accommodate the growth of the business. As a result:

- The Group has entered into a lease for space in The Post Building, which will be accounted for under IFRS 16 (see note I.5).
- The Group has exercised its break clause under the lease for Level 25 of The Leadenhall Building. The cash flows for 2019 have therefore been accounted for on a cash flow basis. There will be no future cash flows in relation to this lease.
- The Group has identified a new tenant for Level 32 of The Leadenhall Building and therefore has terminated the lease. The cash flows for 2019 have therefore been accounted for a on a cash flow basis. There will be no future cash flows in relation to this lease.

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

	2019 £m	2018 £m
Not later than one year	–	2
Later than one year and no later than five years	–	18
Later than five years	–	37
Total minimum lease payments	–	57

Other commitments

During previous years the Group executed transactions to purchase partly funded bonds and forward settling bonds. During 2019 the Group purchased additional partly funded bonds and forward settling bonds. The Group also signed up to a number of multi-year contracts. The Group expects to pay a further £1,043m within the next five years (2018: £258m), £436m of this being due within 12 months of the financial reporting date (2018: £90m).

	2019 £m	2018 £m
Not later than one year	**436**	90
Later than one year and no later than five years	**607**	168
Later than five years	–	–
Total other commitments	**1,043**	258

Note I – Other notes (continued)
I.5 Leases
(a) Amounts included in the statement of financial position
On adoption of IFRS 16, the Group recognised lease liabilities on the lease on the new premises entered into during May 2019, which would previously have been classified as 'operating leases' under the principles of IAS 17 Leases.

Assets and liabilities arising from a lease are initially measured on a present value basis. Lease liabilities include the net present value of the following lease payments:

- fixed payments, less any lease incentives receivable;
- amounts expected to be payable by the Group under residual value guarantees;
- payments of penalties for terminating the lease; and
- lease payments to be made under reasonably certain extension options.

Lease payments are discounted using the Group's incremental borrowing rate as at 31 December 2019. The weighted average lessee's incremental borrowing rate applied to the lease liabilities is 3.374%. The incremental borrowing rate represents the cost of funding to the Group at that date.

Lease payments are allocated between principal and finance cost. The finance cost is charged to the statement of income over the lease period so as to produce a constant rate of interest on the remaining balance of the liability for each period.

Right of use assets are measured at cost comprising the following:

- amount of any initial measurement of lease liability;
- leased payments made before the commencement date less any lease incentives received;
- initial direct costs; and
- restoration costs.

Right of use assets are depreciated over the lease term on a straight-line basis.

The Group did not have any leases previously classified as finance leases that would be impacted by measurement adjustments for adoption of IFRS 16.

Additions to the right of use asset recognised by the Group relate to the lease on the new UK office which was executed in May 2019, therefore there was a nil balance at 1 January 2019. The lease for The Post Building has a duration of 17 years with a break clause at 12 years which we have assumed is exercised. The Group's right of use asset also includes a lease on our US office which was executed in May 2019. The Group was not a lessor during the period.

Right of use asset

	2019 £m
Right of use asset	**37**
Right of use asset – property	
Balance at 1 January	**–**
Depreciation charge for the period	**(2)**
Additions	**39**
Closing balance at statement of financial position date	**37**

Notes to the financial statements

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Note I – Other notes (continued)

I.5 Leases (continued)

Lease liabilities

	2019 £m
Lease liability	39
Maturity analysis undiscounted liabilities	
Current liabilities	
Less than one year	–
Non-current liabilities	
One to five years	16
More than five years	33
Total undiscounted lease liabilities	**49**

Comparative information has not been provided as the Group has taken the modified retrospective approach.

(b) Amounts recognised in the statement of comprehensive income

	2019 £m
Depreciation charge of right of use assets – property	2
Financing charge on lease liabilities (included in note B.4 Finance costs)	1

(c) Amount recognised in statement of cash flows

	2019 £m
Depreciation charge of right of use assets – property	2
Financing charge on lease liabilities	1
Total cash flows for leases	1

Alternative Performance Measures

As noted on page 22, throughout the financial statements the Group has used a variety of measures to provide stakeholders with the necessary information on the performance and financial position of the Group. Some of these measures are not consistent with IFRS and therefore are explained in the table below.

Alternative Performance Measure	Definition	Why is this meaningful	Reconciliation to IFRS
Assets under management	Assets adjusted for reinsurance, derivatives and collateralised financing.	By netting down the derivative gross up the Group provides a more meaningful value for the assets managed and a useful measure of the size of the business.	A full reconciliation is provided in the financial review on page 23.
Market Consistent Embedded Value (MCEV)	The risk-adjusted value of the in-force business, allowing for the unwind of IFRS margins and cost of capital.	The Group considers that embedded value reporting provides investors with a useful measure of the future profit streams of the Group's long-term business.	The shareholders' equity on an MCEV basis is consistent with the sum of the shareholders' equity on an IFRS basis plus the value of in-force business reduced by debt valuation on an MCEV basis.
New business premiums	Premiums paid on new business transacted during the period and adjustments to new business premiums from prior periods.	New business premiums are a key indicator of the growth of the business.	New business premiums are a subset of gross written premiums and are made up of premiums paid on new business transacted in the period and premium adjustments from prior periods.
Own Funds	Available capital under the Solvency II regime.	Provides a measure of regulatory capital.	A reconciliation of Own Funds to IFRS equity is provided in note F.1.
Solvency Capital Requirement (SCR)	Under Solvency II, capital requirement to withstand a 1-in-200-year event.	Provides a measure of risk exposure of the Group.	It would not be possible to reconcile the SCR to the IFRS financial statements.
SCR coverage %	Own Funds (capital in excess of technical provisions) divided by the SCR and expressed as a percentage.	Provides a measure of the financial strength of the Group.	It would not be possible to reconcile the SCR to the IFRS Financial statements.
Longevity reinsurance %	The longevity reinsurance percentage provides an indication of the extent to which the Group is protected from fluctuations in longevity through reinsurance.	Demonstrates how the Group has mitigated exposure is to longevity fluctuations through reinsurance.	The longevity reinsurance percentage is derived from the IFRS sensitivity to changes in assumed longevity.
Customer satisfaction	Policyholder feedback surveys are sent to all policyholders following interaction with them (apart from complaints and bereavement).	The Group prides itself on the quality of the service that it provides and this APM provides a measure of the quality of that service.	It would not be possible to reconcile to the IFRS financial statements.
Complaints received and upheld	The number of complaints received and upheld per 1,000 policyholders.	Complaints provide a useful indication of customer (dis)satisfaction.	It would not be possible to reconcile to the IFRS financial statements.

Alternative Performance Measures

CONTINUED

Alternative Performance Measure	Definition	Why is this meaningful	Reconciliation to IFRS
Operating profit before tax	Gross IFRS profit less the impact of market fluctuations, exceptional expenses and financing costs.	Measure of longer-term profitability designed to remove the distorting impact of market fluctuations and exceptional expenses.	The operating profit before tax measure involves apportioning the items in the income statement across the various drivers of profit. When taken together with the other items in the alternative analysis of profit generation, the items can be reconciled to the IFRS financial statements.
New business profit	IFRS new business profit projected to be realised once the premium is invested according to the Group's long-term investment strategy, before release of IFRS margins.	This is one of the metrics used by the Group when underwriting new business.	New business profit is calculated on an IFRS basis by comparing the premium received with the insurance liabilities taken on. The discount rate used in calculating the insurance liabilities assumes full investment of premiums according to the Group's long-term investment strategy. When taken together with the other items in the alternative analysis of profit generation, the items can be reconciled to the IFRS financial statements.
Impact of temporary investment delay	The difference between new business profit on a fully invested basis and the new business profit actually achieved by the reporting date.	When taken with the new business profit, this provides an indication of new business profit achieved by the reporting date.	Impact of temporary investment delay is calculated on an IFRS basis by comparing new business profit with the new business profit calculated using the discount rate derived from the investments held. When taken together with the other items in the alternative analysis of profit generation, the items can be reconciled to the IFRS financial statements.
Investment profit from prior year	IFRS profits from investment of prior year premiums.	Shows the extent to which prior year temporary investment delays have been reversed.	Calculated by considering profits generated from investment of assets received as premiums in prior years as a result of the impact on the discount rate. Any profits made from investment in excess of those disclosed in prior years as the impact of temporary investment delay would offset the current year's impact of temporary investment delay (if applicable).

Alternative Performance Measure	Definition	Why is this meaningful	Reconciliation to IFRS
Performance of in-force book	Profits or losses generated on the in-force book of business.	Provides more granular analysis of financial performance.	Calculated by considering the impact on the assets and liabilities that can be attributed to the expected release of prudent margins, actual experience versus assumptions and the investment return on surplus assets. When taken together with the other items in the alternative analysis of profit generation, the items can be reconciled to the IFRS financial statements.
Non-economic assumption changes and model refinement	Profits or losses generated as a result of non-economic assumption changes and model refinement.	Provides more granular analysis of financial performance.	See note E.2.
Economic profits	Profits or losses generated as a result of changes in economic conditions.	Provides a more granular analysis of financial performance.	Calculated by considering the change in assets and liabilities attributable to changes in economic conditions allowing for the cost of hedging. The release of credit default allowances over time is included in the management of in-force book. When taken together with the other items in the alternative analysis of profit generation, the items can be reconciled to the IFRS financial statements.
Value of new business on an MCEV basis	The risk-adjusted value of the business written in the period, allowing for the unwind of margins and cost of capital.	This provides a measure of the profitability of new business once all margins have been released.	It is not possible to reconcile to the IFRS financial statements.

Glossary of terms

Acquisition costs	Acquisition costs comprise the expenses associated with the origination of new business, including annual compensation for employees.
Administration expenses – recurring	Administration costs (shown in note B.3) represent the cost of administering the in-force book of business. They include both outsourcing costs and other costs incurred by the Group.
Annuity	A series of regular payments made to an individual until their death. Payments may be indexed.
Assets under management	See Alternative Performance Measures.
Assumed reinsurance premiums	Premiums received by the Group in respect of reinsurance inwards, i.e. a policy where RLP is acting as the reinsurer.
Best estimate liability (BEL)	The liabilities of the Group calculated on a best estimate basis under Solvency II, i.e. where all the assumptions made in the calculation are best estimate.
Bid price	A bid price is the price a buyer is willing to pay for a security.
Borrowing costs	Interest payable on borrowings. This is a subset of the finance costs shown in note B.4.
BREEAM excellent rating	BREEAM is the world's longest established method of assessing, rating and certifying the sustainability of buildings. Excellent is the highest rating.
Brexit	The UK's planned exit from the European Union.
Bulk annuity	A bulk annuity, sometimes referred to as a bulk purchase annuity, is a contract between a defined benefit pension scheme and an insurance company, whereby an insurance company insures some or all of the annuities being paid by the pension scheme.
Buy-in	Held as an asset of the pension scheme, a bulk annuity buy-in is a contract that covers all or some of the benefits for a subset of scheme members. The scheme retains responsibility for paying pensions to members but the contract protects the scheme against all risks relating to the insured benefits, for example longevity risk and inflation risk.
Buy-out	The bulk annuity buy-out is a contract that covers all of the benefits for all or a subset of scheme members. The insurer issues individual policies to members under which pensions are paid. Once all benefits are covered, the pension scheme can be wound up.
Capital contribution reserve	The capital contribution reserve arose as a result of the stock appreciation rights granted in relation to the Rothesay Life share incentive plan.
Collateralised agreements/ investments	Loans secured on property or other collateral.
Collective investment schemes	A way of investing money alongside other investors.
Corporate bonds and other corporate debt	These are debt securities issued by corporations which are not guaranteed by governments.
Covered bonds	Covered bonds are debt securities issued by a bank or mortgage institution and collateralised against a pool of assets.
Credit risk	The risk of loss or of adverse change in the financial situation resulting from fluctuations in the credit standing of issuers of securities, counterparties and any debtors.
Currency rate risk	The risk that asset or liability values, cash flows, income or expenses will be affected by changes in exchange rates. Also referred to as foreign exchange risk.
Customer satisfaction	See Alternative Performance Measures.
Deferred annuities	Annuities or pensions due to be paid from a future date or when the policyholder reaches a specified age.
Demographics	Statistical data relating to the population and particular groups within it.
Investment profit from prior year	See Alternative Performance Measures.
Distributable profits	A company's profits available for distribution are its accumulated realised profits.
Economic capital	Represents management's internal risk-based calculation of the capital required to remain solvent for a 99.8% confidence level over a one-year period.
Economic profits	See Alternative Performance Measures.

Employee benefit trust (EBT)	A trust established to purchase and hold shares of the Company for delivery under employee share schemes.
Equity-based compensation	Share-based transactions awarded under incentive plans.
Equity release mortgages	Mortgages extended to older customers (aged 55 and over) against their residential property at low loan-to-value percentage. Unlike a typical residential mortgage, no interest is paid monthly by the customer. Instead, the interest is simply added to the principal loan amount with the loan only repayable on death or entry into long-term care of the last remaining homeowner.
Fair value	Amount that would be received on sale of an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.
Finance costs	Represent interest payable on borrowings.
Government, sub sovereign and agency obligations	A bond issued by a country's government or corporate debt which is guaranteed by a government to repay borrowed money at a specific time.
Gross premiums written	Premiums received by RLP on new business and generated through regular premiums.
In-force	An insurance policy or contract reflected on records that has not expired, matured or otherwise been surrendered or terminated.
Infrastructure	Investments in infrastructure such as water, energy and transportation.
Insurance risk	The risk of loss or of adverse change in the value of insurance liabilities, due to inadequate pricing and provisioning assumptions.
International Financial Reporting Standards (IFRS)	Accounting standards that are applied in preparing the Group's consolidated financial statements.
Investment return	Comprises all interest income on financial investments at fair value through profit and loss, realised investment gains and losses and movements in unrealised gains and losses, as well as expenses directly related to investments executed during the year.
Liquidity premium	An addition to the risk-free rate used when projecting investment returns and discounting cash flows on certain types of contracts where the liabilities are illiquid and have cash flows that are predictable.
Liquidity premium adjustment	In calculating the MCEV, liabilities are discounted using the risk-free rate plus a liquidity premium adjustment, designed to capture the component of yield on a portfolio of assets that is attributable to liquidity rather than credit risk.
Liquidity risk	The risk of being unable to realise investments and other assets in order to settle financial obligations when they fall due.
LTMF	LT Mortgage Financing Limited.
Longevity reinsurance (%)	See Alternative Performance Measures.
Longevity risk	The risk that a company could be exposed to a higher payout as a result of increasing life expectancy.
Market consistent embedded value (MCEV)	See Alternative Performance Measures.
Market risk	The risk of loss or of adverse change resulting, directly or indirectly, from fluctuations in the level and in the volatility of market prices of assets, liabilities and financial instruments.
Matching adjustment	The matching adjustment, a concept in Solvency II, is broadly equivalent to the illiquidity premium that can be earned on the illiquid assets held to back illiquid liabilities.
Mortality tables	A table which shows for each age, what the probability is that a person of that age and gender will die before their next birthday.
Net premiums	Life insurance premiums, net of reinsurance premiums paid to third party reinsurers.
Net worth	Under MCEV, the value of equity plus the value of borrowings on an IFRS basis.
New business	New insurance contracts and reinsurance inwards sold during the period. Includes business acquired through purchase of companies.
New business premium	See Alternative Performance Measures.
New business profit	See Alternative Performance Measures.

Glossary of terms

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Non-hedgeable risk	Under MCEV, risks not already allowed for in the time value of options and guarantees or PVFP. The allowance includes the impact of both non-hedgeable financial and non-financial risks. No allowance has been made within the CNHR for symmetric risks as these are diversifiable by investors.
Non-recurring and project expenditure	Administration – project and other one-off expenses (see note B.3).
Offer price	Price at which a market maker is prepared to sell a specific security.
Operating profit before tax	See Alternative Performance Measures.
Operational risk	The risk arising from inadequate or failed internal processes, personnel or systems, or from external events.
Own Funds	See Alternative Performance Measures.
Own risk and solvency assessment (ORSA)	An assessment of the risk to which the business is exposed as well as solvency forecasting in a range of scenarios, including consideration of the stresses that could jeopardise the Group's business plans.
Partial internal model	Under Solvency II, insurer's own model used to calculate the solvency capital requirement in relation to particular risks approved by the PRA.
Part VII transfers	Court-approved transfer of a portfolio of contracts from one entity to another.
Performance of in force book	See Alternative Performance Measures.
Pillar I	Under Solvency II, represents the solvency capital requirement calculated using a standard formula or (partial) internal model.
Policyholders	The Group generally uses the term policyholder to refer to the individual annuitants whose benefits are insured by the Group regardless of whether the insurance is provided under a bulk annuity (where the contract is with the pension scheme) or a reinsurance policy (where the contract is with the insurance company).
Prudential Regulation Authority (PRA)	The PRA is a UK regulatory body responsible for prudential regulation and supervision of banks, building societies, credit unions, insurers and major investment firms.
qx	qx is actuarial notation used to represent the probability of a life aged x dying during the year.
RAL	Rothesay Assurance Limited. Now being wound up.
Regular premiums	Payments of premium made regularly over the duration of the policy.
Reinsurance	Protection sold to or purchased from another insurance company.
Reorganisation reserve	Reflects the impact of the Group reorganisation in 2013 which led to an increase in reserves of £132m, reflecting the excess of consolidated net assets to the historical cost of investment in subsidiary entities.
RHUK	Rothesay Holdco UK Limited.
Risk margin	Under Solvency II, the cost of transferring non-hedgeable risks.
RLP	Rothesay Life Plc, the Group's regulated life company.
RMA1	Rothesay MA No.1 Limited.
RMA2	Rothesay MA No.2 Limited.
RMA3	Rothesay MA No.3 Limited.
RMA4	Rothesay MA No.4 Limited.
RPML	Rothesay Pensions Management Limited, the Group's service company.
Secured investments	Bespoke investments where very high levels of collateral have been negotiated and returns are generated through illiquidity premium.
Single premiums	Single premium policies of insurance are those that require only a single lump sum payment from the policyholder.
Solvency capital requirement (SCR)	See Alternative Performance Measures.

SCR coverage %	See Alternative Performance Measures.
Solvency II	The solvency regime applicable from 1 January 2016. Under Solvency II, the Group is required to hold the greater of the capital required under the new Solvency II Pillar 1 framework and the capital required under our own economic capital models Solvency II Pillar 2.
Stock appreciation rights (SARs)	Method for companies to give their management or employees a bonus if the company performs well. SARs resemble employee stock options in that the employee benefits from an increase in stock price.
Strategy risk	The risk of loss in future earnings and capital arising from changes in the competitive, economic, legal or political environment, changing customer behaviour, or a failure to select appropriate strategic or long-term business plans.
Subordinated loan	A fixed interest issue or debt that ranks below other debt in order of priority for repayment if the issuer is liquidated. Holders are compensated for added risk through higher rates of interest. Under EU insurance regulation, subordinated debt is not treated as a liability and counts towards the coverage of the required minimum margin of solvency with limitations.
Surrender	The termination of a life insurance policy or annuity contract at the request of the policyholder after which the policyholder receives the cash surrender value, if any, of the contract.
Third party administration (TPA) agreement	Contract with pensions administrator to process claims and payroll on behalf of RLP.
Unconsolidated structured entities	A structured entity is an entity that has been designed so that voting or similar rights are not the dominating factor in deciding who controls the entity. These structured entities have not been consolidated as the Group does not have the power to affect their returns.
Value of in-force business	See Alternative Performance Measures.
Yield	A measure of the income received from an investment compared to the price paid for the investment. Normally expressed as a percentage.

Notes

Rothesay Holdco UK Limited
The Post Building
100 Museum Street
London WC1A 1PB

www.rothesaylife.com
T: 020 7770 5300