ROTHESAY LIFE PLC
INTERIM CONDENSED FINANCIAL STATEMENTS
FOR THE SIX MONTHS ENDED 30 JUNE

2020

Who we are

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

Our purpose

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

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Rothesay Life (Rothesay) refers to Rothesay Life Plc (RLP).

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Highlights

Key statistics

	HY2020	HY2019	FY2019
New business premium APM[1]	**£0.7bn**	£0.7bn	£16.3bn
New business profit (IFRS) APM[2]	**£57m**	£25m	£958m
SCR coverage APM	**189%**	176%	201%
Percent reinsured APM	**83%**	76%	78%
IFRS profit before tax	**£811m**	£404m	£640m
Customer satisfaction APM[3]	**93%**	96%	94%
Assets under management APM	**£55.9bn**	£37.8bn	£53.7bn
Number of policies	**831,661**	778,415	824,793
Paid to policyholders in the period	**£1.3bn**	£1.2bn	£2.4bn
Rating of Rothesay Life Plc	**A3 Moody's Investor Service and A+ by Fitch Ratings**		

1 APM – Alternative Performance Measure, please see page 39 for further details.
2 With assets invested.
3 Note that we no longer issue satisfaction surveys in relation to bulk annuities and hence HY2020 and FY FY2019 results are not comparable to HY2019.

Chief Executive's statement

"I am proud of the way in which our people have responded to the COVID-19 pandemic."

Addy Loudiadis, Chief Executive Officer

The rapid spread of COVID-19 has impacted all of our lives in ways we could not have imagined at the beginning of 2020. The human cost of the pandemic has been both shocking and saddening. As the scale of the crisis became clear, and governments took action in response, the impact on financial markets has been severe.

Rothesay responded quickly to ensure that any impact on our business was minimised. Our immediate priorities have been the health and safety of our people and ensuring that our policyholders continued to receive their pensions as normal. Almost all of our people have been working from home since the middle of March and I am pleased to say that the transition to home working has been seamless. Our third party administrators have also responded well, enabling us to continue to provide our policyholders and clients with industry-leading levels of customer service.

This seamless transition to working from home, along with our market-leading risk management systems and meticulous approach to underwriting, has allowed us to protect our balance sheet during these adverse conditions. It has also allowed us to continue to invest the premiums we received in 2019 and conduct new business. Indeed, despite a depressed market, I am pleased to report that Rothesay has assisted four pension schemes to de-risk their liabilities in the first half of this year, all successfully completed while working remotely.

Risk and capital management

The first half of 2020 has seen very volatile markets and falling interest rates. The duration of our liabilities means that Rothesay's balance sheet is particularly sensitive to long-term interest rates and our sophisticated risk management systems have again proved advantageous in managing this and responding rapidly to a challenging economic environment. In the midst of significant market volatility, having detailed real-time information is critical for the successful and efficient operation of any insurance business.

Our investment portfolio has an average rating of AA and is focussed on assets with high quality collateral. This, combined with active monitoring and management of our credit portfolio, means that we are well positioned to withstand adverse credit markets as seen in the first half and any potential future market deterioration.

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. We started the year with significant capital surplus above our target operating range available to write new business. Our balance sheet remains strong with Own Funds of £6.9bn (HY2019: £4.1bn, FY2019: £6.1bn) and solvency capital requirement (SCR) ratio **(APM)** of 189% (HY2019: 176%, FY2019: 201%), giving us additional resilience in the face of exceptional market volatility as well as capital to write new business. Rothesay's liquidity has also remained robust throughout the market turmoil and we continue to hold significant liquidity buffers.

Financial results

Although much of our focus in the first half of 2020 has been on protecting the balance sheet in adverse conditions, we have continued to invest the premiums received in 2019 according to our long-term investment strategy. As a result, we have generated IFRS pre tax profits of £811m (HY2019: £404m, FY2019: £640m) despite deteriorating financial conditions.

New business

Whilst new business activity levels have been depressed by the impact of COVID-19, transactions are being completed and this is being achieved with all parties working remotely. Even under these difficult working conditions, we continue to apply a rigorous approach to underwriting and due diligence.

We remain disciplined in new business pricing, all new business must achieve our return thresholds without the need to take excessive investment risk. During the first half of 2020, we have assisted four pension schemes to de-risk their liabilities, resulting in new business premiums **(APM)** £0.7bn (HY2019: £0.7bn, FY2019: £16.3bn). Since 30 June 2020, we have also written another £1.6bn of new business.

Our policyholders

Our priority throughout the COVID-19 crisis has been ensuring that we continue to provide our policyholders with the service they expect. With the help of our third party administration partners, I am delighted to say that this has been achieved with service levels being met consistently (including in response to telephone calls).

Our customer service statistics remain strong. In surveys, over 93% (HY2019: 96%, FY2019: 94%) of customers rated the quality of service received as good or excellent in the first half of 2020. We received complaints at an annual rate of 0.65 per 1,000 policyholders **(APM)** (HY2019 0.72 per 1,000, FY2019: 0.70 per 1,000). We take all complaints extremely seriously and after thorough investigation just 0.33 complaints per 1,000 policyholders **(APM)** (HY2019 0.29 per 1,000, FY2019: 0.36 per 1,000) were upheld.

Our people

Our people are a key strength of Rothesay and I am proud of the way in which they responded to the COVID-19 pandemic. It is a testament to the team that even though almost all of our employees are now working from home, the business has continued to operate normally.

We have also continued to recruit, which has led to us on-boarding new employees remotely. As at 30 June, the number of employees within the Rothesay Life Group had increased to 280 (HY2019: 227, FY2019: 252).

As the business started to work remotely, we have been focussed on the well-being of our people, ensuring regular check-ins and providing additional support where necessary. We have supported our people in additional volunteering and have also offered triple matched funding of charitable contributions.

During this period, we have seen increased public debate in the US and UK on the subjects of race and inclusivity. Rothesay is committed to promoting equality and diversity, and a culture that actively values difference. We have a clear equal employment opportunity policy and we recognise that people from different backgrounds and experiences can bring valuable insights to the workplace and enhance the way we work. We will continue to engage with our people, and the businesses we partner with, to promote working environments where everyone feels valued.

Corporate responsibility

The establishment at the end of 2019 of the Rothesay Life Foundation (the Foundation) means that in 2020 the Foundation has started 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.

Over the first half of 2020, we have contributed over £3.5m to charitable causes. This includes making a significant contribution to the COVID-19 Support Fund, the UK insurance industry's initiative to help some of the people hardest hit by the COVID-19 crisis.

Looking forward

We enter the second half of the year confident in our financial and operational resilience. Our balance sheet remains strong with capital available both to withstand further deterioration in financial markets and to write new business.

The bulk annuity pipeline remains healthy despite the impact of COVID-19 and Brexit with commentators predicting a total bulk annuity market size for 2020 of £25bn. In addition, the capital strain of low interest rates may present strategic opportunities in the insurance market through back-book transactions as other insurers re-think their own future plans. Turbulent financial markets may yield attractive investment opportunities. We are still in the process of investing the premiums received in 2019 and this, combined with the strength of our investment team, means that we are well placed should such opportunities arise.

Finally, I would like to take this opportunity to thank our people and our administration partners for their outstanding efforts through these difficult times. Thanks to them I am confident that Rothesay will continue to thrive, providing pension security for our policyholders and value to our shareholders over the long term.

Addy Loudiadis
Chief Executive Officer
13 August 2020

New business premium **(APM)**:

£0.7bn

HY2019 £0.7bn

SCR coverage **(APM)**:

189%

HY2019: 176% +13%

Business review

COVID-19

Almost all of our employees transitioned to remote working early giving time to ensure that everyone was well equipped for working from home. This, combined with our cloud-based infrastructure, meant that there has been no obvious impact on our operations with productivity remaining at a good level. None of our employees have been furloughed.

Our third party administrators and other outsourcing partners have also taken steps to ensure that operations have been disrupted as little as possible. As a result, our customers have continued to receive excellent customer service despite the disruption caused by COVID-19.

Rothesay's real-time risk management systems proved invaluable in assisting us to protect the balance sheet in the adverse and volatile markets of the first half of 2020. This volatility is likely to continue over the rest of the year and, as well as monitoring the live solvency and financial position of Rothesay, regular stress testing allows us to take action in response to the changing dynamics of economic markets.

We will continue to monitor and follow government advice regarding any transition to moving back to office-based working. Given the high level of productivity being maintained through remote working, we will be prudent in terms of the timing and extent of any transition back to the office and our primary focus will continue to be the health and welfare of our employees.

New business

As noted above in the Chief Executive's report, during the first half of 2020, we have assisted four pension schemes to de-risk their liabilities, resulting in new business premiums **(APM)** of £0.7bn (HY2019: £0.7bn, FY2019: £16.3bn) Since 30 June 2020, we have also written another £1.6bn of new business.

We are in the process of reinsuring some of the longevity risk associated with 2020 new business. The percentage of longevity risk reinsured across the whole business is around 83% (HY2019: 76%, FY2019: 78%).

The bulk annuity pipeline remains healthy despite the impact of COVID-19 with commentators predicting a total bulk annuity market size for 2020 of £25bn.

Investment activity

Rothesay operates a cautious investment strategy and actively manages risk. Our investment portfolio is AA rated on average with a high allocation to secured investment.

At the end of 2019, Rothesay had substantial cash and gilts to deploy into longer-term assets due to the record amount of new business written in that year. During the first half of 2020, the focus has been on investing those assets according to Rothesay's long-term investment strategy. Good progress has been made and we have succeeded in investing assets more quickly than envisaged when the business was originally underwritten and at better risk-adjusted returns. Around £3bn of assets remain to be invested.

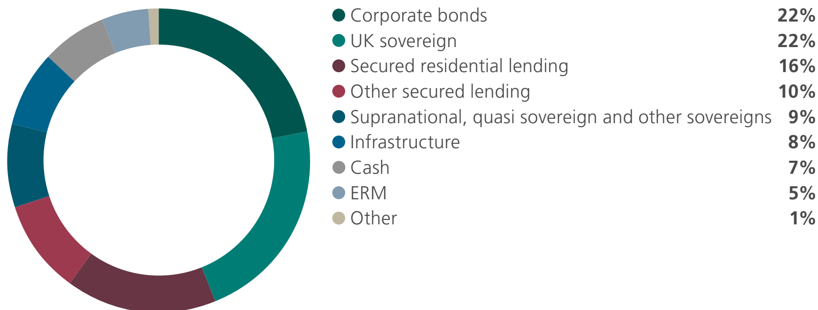
Given recent market conditions, there have been fewer opportunities to invest in more illiquid assets so many of the new investments have been in more liquid, highly rated corporate bonds, including US universities and healthcare providers, as well as in loans issued by well managed, real estate investment trusts, particularly those focused on industrials.

We took the decision to slow down origination of equity release mortgages and Dutch mortgages given the practical difficulties associated with property underwriting in the second quarter of 2020 and have been gradually re-starting origination as COVID-19 restrictions are lifted.

We have remained disciplined and cautious about making investments and have been very selective in the investment decisions made. A systematic review of our investment portfolio led to the identification of sectors most likely to be adversely impacted by COVID-19 and of assets most at risk of downgrading to sub-investment grade. Where possible, we have opportunistically switched assets accordingly. This analysis is also used in stress and scenario testing.

The chart on the next page provides a breakdown of our investment portfolio.

Investment mix of total assets



The average rating of Rothesay's investment portfolio is AA. Of our £18bn holding of corporate bonds and infrastructure, around 30% (or 9% of total assets) is rated BBB and of those only £0.1bn is rated BBB-. Rothesay has experienced no defaults and only one downgrade to sub-investment grade during the year to date with an immaterial impact on solvency.

Prudential transaction update

At the recent Directions Hearing, the Court indicated that the appeal of the original judgement in relation to our application to transfer business from Prudential to Rothesay Life will be held in October 2020. We do not expect a decision immediately after the hearing but anticipate this will follow some time later in 2020 or early in 2021.

If the appeal is successful, there will be a further hearing at the High Court to decide whether the proposed transfer should be approved or not. In the event that the transfer is not approved then the reinsurance agreement with Prudential 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.

Brexit

As a result of Rothesay's acquisition of MetLife Assurance Limited in 2014, we acquired a small portfolio of Irish annuities. We took the decision to sell the portfolio to the Monument Life Group. The transaction was initially structured as a reinsurance contract with Monument Re Limited but we have now received Court approval to transfer the policies to Monument Life Insurance DAC with an effective date of 7 September 2020. As the transfer is not effective until that date, the impact of the transfer is not allowed for in the results. Had the transfer happened on 30 June 2020 then reinsurance assets would be reduced by around £125m and insurance liabilities would reduce by a similar amount.

We foresee no other operational issues as a result of Brexit and the latest guidance confirms that we can continue to pay annuities which were written in the UK but where the policyholder has since moved to the EU.

We are of course exposed to the impact on the finance markets of a 'hard' Brexit and continue to manage and monitor the investment portfolio accordingly. Stress testing is regularly undertaken and includes Brexit scenarios, the results from which show that we would remain within our target operating solvency range post stress.

LIBOR reform

The London Interbank Offered Rate (LIBOR) is due to be phased out by the end of 2021. Rothesay closely monitors its exposure to the difference between LIBOR and Sterling Overnight Interbank Average rate (SONIA) swaps and has taken action to mitigate this risk. New derivative transactions are now based on SONIA rather than LIBOR where possible and the project to prepare for the transition from LIBOR is on track.

Some uncertainty remains regarding the approach the European Insurance and Occupational Pension Authority (EIOPA) will take to updating certain inputs to the Solvency II balance sheet following LIBOR reform, including the risk free rate, but Rothesay has evaluated a number of scenarios which indicate that the impact is likely to be immaterial.

Financial review

"Good progress has been made with investing the assets received as premiums in 2019 despite the COVID-19 pandemic."

Andrew Stoker, Chief Financial Officer

In the period to 30 June 2020, Rothesay made a profit before tax of £811m (HY2019: £404m, FY2019: £640m). Profits largely arose as a result of investing the assets received from the £16.3bn new business executed throughout 2019. The impact of widening credit markets was offset by the impact of falling interest rates.

The financial performance analysis shown in the table on the next page 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 **(APM)** 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 **(APM)** for the period assuming full investment of premiums was £57m (HY2019: £25m, FY2019: £958m) **(APM)**. The analysis has been prepared assuming that once fully invested, the risk adjusted yield on the assets held increases by 4bps compared to the 1.47% yield being achieved at 30 June 2020 (HY2019: an increase of 2bps, FY2019: an increase of 12bps).

The temporary impact of the delay in investing assets received as 2020 new business premiums according to our long-term strategy was a reduction in profits of £146m (HY2019: a reduction of £85m) **(APM)**. We anticipate that this will reverse as assets are invested. Profits for the first half include profits of £782m generated on investment of the assets received as premiums last year (HY2019: $269m) **(APM)**.

Profits generated on the in-force book were £258m (HY2019: £168m) **(APM)**. These profits mainly arose from the release of prudent margins as the business runs off and as members exercise their options.

Rothesay made economic profits of £6m (HY2019: £127m) **(APM)**. IFRS gains from falling interest rates were largely offset by the impact of increases in credit default allowances (as credit spreads widened) and cautious assumptions about potential falls in property values as a result of COVID-19. Economic profits **(APM)** represent the change in value of assets from changes in economic conditions less the change in value of liabilities from those changes.

Alternative Performance Measures

Rothesay'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 Rothesay. Rothesay therefore uses a number of Alternative Performance Measures (APMs) which focus on value generation and capital strength. Further information on the Company's APMs can be found on page 39, including definitions, why the measure is used and, if applicable, how the APM can be reconciled to the nearest GAAP measure. Rothesay uses the symbol **APM** *to highlight APMs throughout the financial statements.*

IFRS profit before tax:

£811m

HY2019: £404m + 101%

Assets under management **(APM)**:

£55.9bn

FY2019: £53.7bn +4%

IFRS financial performance

Financial performance (Alternative analysis of profit generation) (APM)	HY2020 £m	HY2019 £m	FY2019 £m
New business profit (assuming assets fully invested)	**57**	25	958
Impact of temporary investment delay	**(146)**	(85)	(909)
Investment profit from prior year	**782**	269	273
Performance of in-force book	**258**	168	293
Non-economic assumption changes	**–**	10	46
Acquisition costs	**(50)**	(40)	(108)
Administration expenses	**(25)**	(20)	(48)
Operating profit before tax	**876**	327	505
Borrowing costs	**(54)**	(34)	(85)
Project and other one-off expenses	**(17)**	(16)	(24)
Economic profits	**6**	127	244
IFRS profit before tax	**811**	404	640

Total assets increased from £76.1bn as at 31 December 2019 to £93.5bn as at 30 June 2020 primarily as a result of the significant change in market conditions. Assets under management **(APM)** increased from £53.7bn as at 31 December 2019 to £55.9bn as at 30 June 2020. Assets under management can be derived by adjusting total assets for reinsurance, payables, derivatives and collateralised financing as shown in the table on the next page.

IFRS balance sheet highlights

Balance sheet highlights	HY2020 £m	HY2019 restated[1] £m	FY2019 £m
Financial investments	**90,831**	55,775	73,741
Reinsurance assets	**475**	180	388
Other assets	**2,176**	1,035	1,993
Total assets	**93,482**	56,990	76,122
Share capital and share premium	**2,463**	1,763	2,463
Tier 1 notes	**347**	347	347
Reserves	**1,606**	756	946
Total equity	**4,416**	2,866	3,756
Insurance contract liabilities	**49,399**	33,837	47,932
Reinsurance liabilities	**938**	540	848
Payables and financial liabilities	**37,101**	18,986	22,010
Borrowings	**1,425**	647	1,427
Other	**203**	114	149
Total liabilities	**89,066**	54,124	72,366
Total equity and liabilities	**93,482**	56,990	76,122

1 Please see note A.3 for details of the prior period restatement.

Insurance contract liabilities increased from £47.9bn as at 31 December 2019 to £49.4bn as at 30 June 2020 largely as a result of falling interest rates.

Financial review

CONTINUED

COVID-19

Reduced trading activity as a result of COVID-19 means that there is increased uncertainty as to the fair value of our financial investments. Where possible, we have continued to use observable market prices but where assets have been valued using techniques where inputs are unobservable, we have considered whether adjustments need to be made. For example, in valuing loans secured on commercial real estate, we have adjusted underlying property values on a property by property basis and, in calculating the impact of the no negative equity guarantee of ERMs on the valuation rate of interest, house prices are assumed to have fallen by 5% with no offsetting change in assumed future house price growth.

It is also unclear as to whether COVID-19 will materially impact our longevity assumptions. In valuing our insurance and reinsurance assets and liabilities, we have allowed for reported deaths but we have not made any changes to our longevity assumptions as it is still too early to know what the long-term impact of COVID-19 might be on longevity.

Assets under management

Assets under management (APM)	HY2020 £m	HY2019 £m	FY2019 £m
Total assets	**93,482**	56,990	76,122
Less reinsurance assets	**(475)**	(180)	(388)
Less payables and financial liabilities	**(37,101)**	(18,986)	(22,010)
Assets under management	**55,906**	37,824	53,724

Risk and capital management

Rothesay'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.

Rothesay's liquidity position has remained robust throughout the market turmoil and we continue to hold significant liquidity buffers.

Rothesay continues to hedge a large proportion of the longevity risk associated with our business and we were 83% reinsured **(APM)** on 30 June 2020 (HY2019: 76%, FY2019: 78%).

Following their periodic reviews, RLP's insurance financial strength ratings have been re-affirmed as A3 by Moody's Investors Service and A+ by Fitch Ratings.

On 19 May 2020, we issued £100m of Tier 3 bonds with the same maturity and coupon date as the Tier 3 bonds issued in 2019. The proceeds were used to repay the floating rate Tier 2 loan issued on 21 December 2012.

The principal risks remain unchanged from the year ended 31 December 2019, albeit that COVID-19 has significantly increased financial risks in the near term and has introduced new operational risks from remote working.

Capital management

Rothesay aims to maintain solvency coverage in the range of 130% to 150% of the regulatory minimum requirement. Rothesay's solvency position has remained robust throughout the period despite considerable market volatility and falling interest rates. We started the year with significant capital surplus above our target operating range available to write new business. As at 30 June 2020 Rothesay had an SCR coverage ratio **(APM)** of 189% (HY2019: 176%, FY2019: 201%), giving us additional resilience in the face of exceptional market volatility as well as capital to write new business. The solvency position of RLP is summarised in the table below.

Rothesay operates 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. This is facilitated by our access to real-time solvency information.

	RLP		
Solvency position of RLP	**HY2020 £m**	HY2019 £m	FY2019 £m
Tier 1 capital	**5,438**	3,401	4,658
Tier 2 capital	**968**	665	1,059
Tier 3 capital	**502**	–	396
Own Funds available to meet SCR	**6,908**	4,066	6,113
SCR	**3,654**	2,310	3,038
Surplus above SCR	**3,254**	1,756	3,075
SCR coverage	**189%**	176%	201%

The value of transitional solvency relief was last recalculated on 31 December 2019 as Rothesay is required to recalculate every two years. We estimate that recalculating transitional solvency relief as at 30 June 2020 would not have a material impact on solvency coverage.

Rothesay's SCR is calculated using a Partial Internal Model (PIM). The PIM means that Rothesay'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 Rothesay's investment strategy. The PIM was originally approved for use from 31 December 2018 and updated during 2019 to reflect feedback received from the Prudential Regulation Authority (PRA) and to cover investments in Dutch mortgages. Work continues on extending the model to cover other risk components but for now the standard formula is used to calculate the SCR for all other risk components and for aggregation across risk components.

Risk and capital management

CONTINUED

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 dominated by spread risk, i.e. the risk that credit spreads widen. Market risk has increased from 54% of the SCR at the end of 2019 to 64% of the SCR due to changes in economic conditions and investment of assets in the first half of 2020.

RLP SCR 30 June 2020

An analysis of the change in Own Funds **(APM)** and SCR is shown in the table below. Own Funds **(APM)** have increased from £6,113m to £6,908m after allowing for amortisation of 1/16th of transitional solvency relief on 1 January 2020. The biggest drivers of this change were changes in economic conditions (particularly falling interest rates and inflation) and the impact of investing assets according to our longer term investment strategy. As can be seen in the table, the increase in SCR from new investment has been less than envisaged when the new business was originally underwritten, i.e. investment has been more capital efficient than assumed. The SCR **(APM)** increased from £3,038m to £3,654m largely as a result of falling interest rates and the impact of investing assets. The increase was partially offset by a realignment of hedges between funds. All numbers are shown net of tax impacts and allow, where relevant, for changes in transitional solvency relief.

	HY2020		HY2019		FY2019	
Change in Own Funds and SCR (APM)	**Change in Own Funds (£m)**	**Change in SCR (£m)**	Change in Own Funds (£m)	Change in SCR (£m)	Change in Own Funds (£m)	Change in SCR (£m)
Opening position	**6,113**	**3,038**	3,894	2,163	3,894	2,163
Amortisation of 1/16th of transitional on 1 January	**(88)**	**18**	(43)	–	(43)	–
New business (on a fully invested basis)	**36**	**75**	23	63	732	1,170
Short term impact of delayed investment	**(18)**	**(2)**	(46)	(84)	(606)	(420)
Investment impact from prior year	**606**	**116**	124	(9)	271	41
Performance of in-force book	**167**	**(48)**	133	(33)	124	(265)
Non-economic assumption changes	**–**	**–**	6	–	35	(4)
Acquisition costs and administration expenses	**(76)**	**–**	(49)	–	(156)	–
Borrowing costs	**(54)**	**–**	(30)	–	(85)	–
Non-recurring and project expenditure	**(17)**	**–**	(15)	–	(24)	–
Economic conditions	**239**	**457**	69	210	446	307
New capital issuance	**–**	**–**	–	–	1,479	–
Changes to internal model	**–**	**–**	–	–	46	46
Closing position	**6,908**	**3,654**	4,066	2,310	6,113	3,038

In the table above, we have amended the 2019 movement analysis (compared to that provided in the 2019 annual report and accounts) to remove the impact of writing new business on the financial resources requirement limit when recalculating transitional solvency relief as we believe that this impact distorts the analysis. This has led to a £606m reduction in the impact of writing new business (on a fully invested basis) and a corresponding reduction in the short-term impact of delayed deployment compared to that shown in the 2019 annual report and accounts.

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.

Report of the Directors

The Directors present their condensed financial statements for Rothesay Life Plc, registered number 06127279, (the Company or RLP) for the period ended 30 June 2020. RLP is a registered public limited company incorporated and domiciled in the United Kingdom.

Comparative information has been presented for the period ended 30 June 2019 and the year ended 31 December 2019.

The Directors of Rothesay confirm that to the best of their knowledge these interim condensed financial statements have been prepared in accordance with International Accounting Standard 34, 'Interim Financial Reporting' as adopted by the EU and that the interim financial report includes a fair review of the information namely:

- An indication of important events that have occurred during the six months ended 30 June 2020 and their impact on the condensed set of financial statements, and a description of the principal risks and uncertainties for the remaining six months of the financial year; and
- Material related-party transactions in the six months ended 30 June 2020 and any material changes in the related-party transactions described in the last Annual Report.

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

ON BEHALF OF THE BOARD

Addy Loudiadis
Chief Executive Officer
13 August 2020

Rothesay Life Plc
Board of Directors
Chairman
Naguib Kheraj

Executive Directors
Addy Loudiadis
Tom Pearce
Andrew Stoker

Shareholder Non-Executive Directors
Qasim Abbas
Tim Corbett
Robin Jarratt

Independent Non-Executive Directors
Stan Beckers
Ray King
Terry Miller
Simon Morris
Charles Pickup
Bill Robertson

Condensed statement of comprehensive income

FOR THE PERIOD ENDED 30 JUNE 2020

	Note	**HY2020 £m**	HY2019 restated[1] £m	FY2019 £m
Income				
Gross premiums written	B.1	**851**	852	16,606
Premiums ceded to reinsurers		**(713)**	(663)	(1,245)
Net premiums written		**138**	189	15,361
Investment return	B.2	**2,974**	2,127	2,289
Total revenue		**3,112**	2,316	17,650
Expenses				
Policyholder claims		**(1,346)**	(1,163)	(2,442)
Less: reinsurance recoveries		**670**	504	1,046
Change in insurance contract liabilities	E.2	**(1,467)**	(1,405)	(15,373)
Change in the reinsurers' share of insurance contract liabilities	E.1	**(3)**	270	46
Net claims and change in insurance liabilities		**(2,146)**	(1,794)	(16,723)
Acquisition and administration expenses	B.3	**(92)**	(76)	(180)
Finance costs	B.4	**(63)**	(42)	(107)
Total expenses		**(2,301)**	(1,912)	(17,010)
Profit before tax		**811**	404	640
Income tax expense	B.5	**(151)**	(76)	(122)
Profit for the period/financial year		**660**	328	518

1 Please see note A.3 for details of the prior period restatement.

All income and expenses are related to continuing operations.

The condensed statement of comprehensive income includes all income and expenses for the period. 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 form an integral part of these financial statements.

Condensed statement of financial position

AS AT 30 JUNE 2020

	Note	**HY2020 £m**	HY2019 restated[1] £m	FY2019 £m
Assets				
Investment in subsidiaries	H.1	**11**	1	11
Property, plant and equipment		**8**	2	9
Lease – right of use asset	I.3	**35**	36	37
Financial investments	D.1	**90,831**	55,775	73,741
Reinsurance assets	E.1	**475**	180	388
Accrued interest and prepayments		**545**	405	755
Receivables		**1,326**	453	947
Cash and cash equivalents		**251**	138	234
Total assets		**93,482**	56,990	76,122
Equity and liabilities				
Equity				
Share capital	C.1	**510**	410	510
Tier 1 notes	C.2	**347**	347	347
Share premium	C.3	**1,953**	1,353	1,953
Retained earnings	C.3	**1,606**	756	946
Total equity		**4,416**	2,866	3,756
Liabilities				
Reinsurance liabilities	E.1	**938**	540	848
Insurance contract liabilities	E.2	**49,399**	33,837	47,932
Payables and financial liabilities	D.2	**37,101**	18,986	22,010
Leasehold liabilities	I.3	**39**	36	39
Borrowings	D.3	**1,425**	647	1,427
Deferred tax liabilities	G.1	**57**	2	31
Accruals and deferred income		**107**	76	79
Total liabilities		**89,066**	54,124	72,366
Total equity and liabilities		**93,482**	56,990	76,122

1 Please see note A.3 for details of the prior period restatement.

Notes A–I form an integral part of these financial statements.

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

Addy Loudiadis
Chief Executive Officer
13 August 2020

Company number 06127279

Condensed statement of changes in equity

FOR THE PERIOD ENDED 30 JUNE 2020

	Share capital £m	**Share premium £m**	**Tier 1 notes £m**	**Retained earnings £m**	**Total equity £m**
As at 1 January 2020	**510**	**1,953**	**347**	**946**	**3,756**
Profit for the period	**–**	**–**	**–**	**660**	**660**
As at 30 June 2020	**510**	**1,953**	**347**	**1,606**	**4,416**

FOR THE PERIOD ENDED 30 JUNE 2019

	Share capital £m	Share premium £m	Tier 1 notes £m	Retained earnings £m	Total equity £m
As at 1 January 2019	410	1,353	347	435	2,545
Retrospective restatement due to change in accounting treatment	–	–	–	(7)	(7)
Profit for the financial year	–	–	–	328	328
As at 30 June 2019	410	1,353	347	756	2,866

FOR THE YEAR ENDED 31 DECEMBER 2019

	Share capital £m	Share premium £m	Tier 1 notes £m	Retained earnings £m	Total equity £m
As at 1 January 2019	410	1,353	347	435	2,545
Profit for the financial year	–	–	–	518	518
Retrospective restatement due to change in accounting treatment	–	–	–	(7)	(7)
Share issuance	100	600	–	–	700
As at 31 December 2019	510	1,953	347	946	3,756

Condensed cash flow statement

FOR THE PERIOD ENDED 30 JUNE 2020

	Note	HY2020 £m	HY2019 restated[1] £m	FY2019 £m
Cash flows from operating activities				
Profit for the period/financial year		**660**	328	518
Adjustments for non-cash movements in net profit for the period/financial year				
Retrospective restatement due to change in accounting treatment		**–**	(7)	(7)
Fixed asset write-off		**–**	–	1
Depreciation		**1**	2	1
Amortisation of debt costs	B.4	**2**	–	2
Leasehold depreciation	I.3	**2**	–	1
Financing charge on leasehold	I.3	**1**	–	1
Interest income	B.2	**(690)**	(527)	(1,125)
Interest expense	B.4	**61**	42	105
Income tax expense	B.5	**151**	76	122
Net (increase)/decrease in operational assets				
Financial investments		**(17,090)**	(6,612)	(24,578)
Reinsurance asset		**(87)**	(137)	(344)
Receivables		**(379)**	(97)	(590)
Prepayment		**159**	17	(204)
Net increase/(decrease) in operational liabilities				
Insurance contract liabilities		**1,466**	1,402	15,373
Reinsurance liabilities		**90**	(133)	299
Financial liabilities		**14,323**	5,068	8,051
Other payables		**758**	5	40
Deferred tax	G.1	**26**	–	30
Accruals and deferred income		**(1)**	–	–
Cash flows used in operating activities		**(547)**	(573)	(2,304)
Interest paid		**(31)**	(22)	(83)
Interest received		**740**	602	1,071
Tax paid		**(141)**	(19)	(59)
Net cash flows from/(used) in operating activities		**21**	(12)	(1,375)
Cash flows from financing activities				
Proceeds from issuance of debt (net of issuance costs)	D.3	**96**	–	778
Repayment of borrowings	D.3	**(100)**	–	–
Proceeds from issuance of ordinary share capital (including share premium)	C.1	**–**	–	700
Net cash outflows from financing activities		**(4)**	–	1,478
Cash outflows from investing activities				
Net acquisition of property, plant and equipment		**–**	(1)	(9)
Investment in subsidiary	H.1	**–**	–	(10)
Cash flow on leasehold	I.3	**–**	–	(1)
Net cash outflows from investing activities		**–**	(1)	(20)
Net increase/(decrease) in cash and cash equivalents		**17**	(13)	83
Cash and cash equivalents at 1 January		**234**	151	151
Cash and cash equivalents at the statement of financial position date		**251**	138	234

1 Please see note A.3 for details of the prior period restatement

Notes to the financial statements

Note A – Significant accounting policies

A.1 Basis of preparation and consolidation

The condensed interim financial statements for the six month period ended 30 June 2020 have been prepared and approved by the Directors in accordance with IAS 34, 'Interim Financial Reporting', as adopted by the EU. The condensed interim financial statements should be read in conjunction with the annual financial statements for the year ended 31 December 2019, which have been prepared in accordance with IFRSs as adopted by the EU.

The condensed financial statements of RLP are presented in sterling (£) rounded to the nearest million (£m) except where otherwise stated.

The Company presents its statement of financial position broadly in order of liquidity.

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.

There is no seasonality or cyclicality in the Company's business operations.

A.2 Accounting policies and change in accounting policies

The accounting policies adopted are consistent with those of the previous financial year. The Company has not adopted any new standards or any changes to existing standards, including matters of significant judgement and use of estimates. Accounting policies of the Company can be found in the 2019 Annual Report.

A.3 Accounting treatment of reinsurance

At year end 2019 we changed the way in which we present reinsurance and have re-stated the June 2019 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:

Statement of comprehensive income and cash flow statement

The June 2019 change in insurance contract liabilities has increased from £1,274m to £1,405m and the change in reinsurers' share of insurance contract liabilities has increased from £139m to £270m. The net change in insurance contract liabilities is unchanged. These changes have also been reflected in the cash flow statement.

2019 premiums ceded to reinsurers have reduced from £780m to £663m and reinsurance recoveries have reduced from £621m to £504m.

Statement of financial position

June 2019 reinsurance contract liabilities have decreased from £671m to £540m and insurance contract liabilities have increased from £33,706m to £33,837m. Net insurance contract liabilities are unchanged.

Note B – Income statement notes

B.1 Segmental analysis

All of Rothesay'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. Rothesay's insurance operations are within the United Kingdom. The split between regular premiums and single premiums is shown below:

	Regular premiums			Single premiums		
	HY2020 £m	HY2019 £m	FY2019 £m	**HY2020 £m**	HY2019 £m	FY2019 £m
Group pension bulk annuities	**130**	132	263	**721**	720	16,343
Total gross premiums written	**130**	132	263	**721**	720	16,343

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

Rothesay conducts a relatively small number of individual transactions each year. These transactions are one-off in nature and Rothesay's business plans do not anticipate conducting a significant amount of repeat business.

B.2 Investment return

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

	HY2020 £m	HY2019 £m	FY2019 £m
Interest income on financial investments at fair value through profit and loss	**690**	527	1,125
Unrealised gain on financial investments	**2,351**	1,384	900
Realised (losses)/gains on financial investments	**(44)**	237	316
Investment management expenses	**(23)**	(21)	(52)
Total investment return	**2,974**	2,127	2,289

Interest income has increased due to the growth in assets under management. The profit on financial investments was due to the significant reduction in interest rates in the first half of the year.

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

B.3 Acquisition and administration expenses

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

	HY2020 £m	HY2019 £m	FY2019 £m
Acquisition costs	**50**	40	108
Administration expenses – recurring	**25**	20	48
Administration expenses – projects and other one-off expenses	**17**	16	24
Total operating expenses	**92**	76	180

One off expenses include charitable donations of £3.5m in HY2020.

Notes to the financial statements

CONTINUED

Note B – Income statement notes (continued)

B.4 Finance costs

	HY2020 £m	HY2019 £m	FY2019 £m
Interest payable on collateral	3	4	9
Interest payable on collateralised agreements and financing	6	4	13
Total interest payable on collateral and collateralised agreements	9	8	22
Interest payable on borrowings from participating interest	12	13	26
Interest payable on third party borrowings	42	21	58
Financing charge on leasehold asset	–	–	1
Total borrowing costs	54	34	85
Net finance costs	63	42	107

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.

B.5 Income tax expense

The major components of income tax expense for the six month period ended 30 June 2020 and 30 June 2019 and the financial year ended 31 December 2019 are:

(a) Tax charged in the statement of comprehensive income

	HY2020 £m	HY2019 £m	FY2019 £m
Current income tax:			
UK corporation tax	125	76	87
Adjustment in respect of prior period	–	–	6
Total current income tax	125	76	93
Deferred tax:			
Origination and reversal of temporary differences	26	–	29
Total deferred tax	26	–	29
Total tax expense in the condensed statement of comprehensive income	151	76	122

(b) Reconciliation of the total tax charge

The tax expense in the condensed statement of comprehensive income for the period and the standard rate of corporation tax in the UK of 19% (HY2019: 19%, FY2019: 19%) is reconciled below:

	HY2020 £m	HY2019 £m	FY2019 £m
Profit on ordinary activities before taxation	811	404	640
Tax calculated at UK standard rate of corporation tax of 19% (2019: 19%)	154	77	122
Adjustment in respect of prior period	–	–	5
Difference in accounting and tax valuation basis	28	(19)	34
Permanent differences	(28)	–	(38)
Utilisation of losses surrendered by group undertakings	(3)	18	(1)
Total tax expense reported in the condensed statement of comprehensive income	151	76	122

Note C – Equity

C.1 Share capital

At 30 June 2020, 30 June 2019 and 31 December 2019 share capital comprised:

	HY2020		HY2019		FY2019	
	No.	**£m**	No.	£m	No.	£m
Authorised share capital (ordinary shares of £1 each)	**510,528,696**	**510**	410,322,557	410	510,528,696	510

During September 2019, in order to ensure the Company would remain appropriately capitalised given the new business pipeline, the Company allotted 100,206,139 shares to RHUK for total cash consideration of £700m, reflecting share premium of £600m.

C.2 Restricted Tier 1 notes

	HY2020 £m	HY2019 £m	FY2019 £m
Loan notes issued through public debt markets	**347**	347	347

On 5 September 2018, Rothesay issued £350m of Restricted Tier 1 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 Company has the option to cancel the coupon payment which becomes mandatory upon breach or non-compliance with the Company SCR, a breach of the minimum capital requirement (MCR) or where the Company 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	**Retained earnings £m**
1 January 2020	**1,953**	**946**
Profit for the financial year	**–**	**660**
30 June 2020	**1,953**	**1,606**

	Share premium £m	Retained earnings £m
1 January 2019	1,353	435
Profit for the financial year	–	328
Retrospective restatement due to change in accounting treatment	–	(7)
30 June 2019	1,353	756

	Share premium £m	Retained earnings £m
1 January 2019	1,353	435
Profit for the financial year	–	518
Retrospective restatement due to change in accounting treatment	–	(7)
Share issuance	600	–
31 December 2019	1,953	946

C.4 Dividends on ordinary shares

The Directors have recommended no payment of interim dividends during the year ended 30 June 2020 (HY2019: £nil).

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 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, Rothesay 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.

Rothesay uses derivative contracts for the purposes of efficient portfolio management and to mitigate the risk of adverse market movements. Rothesay'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, Rothesay 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 Rothesay 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 Rothesay's statement of financial position) when i) the rights to receive cash flows from the investment have expired; or ii) Rothesay 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) Rothesay has transferred substantially all the risks and rewards of the asset, or (b) Rothesay has transferred control of the investment.

When Rothesay 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, Rothesay continues to recognise the transferred investment to the extent of Rothesay's continuing involvement. In that case, Rothesay also recognises an associated liability. The transferred investment and the associated liability are measured on a basis that reflects the rights and obligations that Rothesay 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 Rothesay 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 Rothesay in the form of securities is not derecognised from the statement of financial position, whilst collateral received in the form of securities is not recognised on the statement of financial position. If collateral received is subsequently sold, the obligation to return the collateral and the cash received are recognised in the statement of financial position.

Rothesay's financial investments are grouped in a single category:

	HY2020 £m	HY2019 £m	FY2019 £m
Financial investments carried at fair value through profit and loss, designated at initial recognition	**90,831**	55,775	73,741

Determination of fair value and fair value hierarchy

Rothesay 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 Rothesay 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.

COVID-19

Reduced trading activity in the market as a result of COVID-19 means that there is increased uncertainty as to the fair value of our financial investments. Where possible, we have continued to use observable market prices but where assets have been valued using techniques where inputs are unobservable, we have considered whether adjustments need to be made. For example, in valuing loans secured on commercial real estate, we have adjusted underlying property values on a property by property basis. Sensitivities to the value of the inputs can be found at the end of this note.

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 HY2020, HY2019 and FY2019 (please refer to note D.2 for financial liabilities):

30 June 2020	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Collective investment schemes	**3,467**	**–**	**–**	**3,467**
Government sub sovereign and agency obligations	**6,673**	**10,477**	**–**	**17,150**
Corporate bonds and other corporate debt	**–**	**24,550**	**1,172**	**25,722**
Derivative assets	**–**	**32,599**	**1**	**32,600**
Collateralised agreements and financing	**–**	**2,145**	**–**	**2,145**
Loans secured on property	**–**	**–**	**6,483**	**6,483**
Equity release mortgages	**–**	**–**	**3,054**	**3,054**
Certificate of deposits	**–**	**210**	**–**	**210**
Total financial investments at fair value	**10,140**	**69,981**	**10,710**	**90,831**

30 June 2019	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Collective investment schemes	2,119	–	–	2,119
Government sub sovereign and agency obligations	2,927	9,538	412	12,877
Corporate bonds and other corporate debt	–	13,914	1,086	15,000
Derivative assets	–	15,565	21	15,586
Collateralised agreements and financing	–	2,762	–	2,762
Loans secured on property	–	–	4,961	4,961
Equity release mortgages	–	–	2,284	2,284
Certificate of deposits	–	186	–	186
Total financial investments at fair value	5,046	41,965	8,764	55,775

31 December 2019	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Collective investment schemes	5,329	–	–	5,329
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	–	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	13,280	50,641	9,820	73,741

Note D – Financial assets and liabilities (continued)

D.1 Financial investments (continued)

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

Approximately 12% (HY2019: 16%, FY2019: 13%) 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 below):

	Government sub sovereign and agency obligations £m	Corporate debt £m	Loans secured on property £m	Derivatives £m	Total £m
At 1 January 2020	**–**	**1,088**	**6,063**	**–**	**7,151**
Total gains in the statement of comprehensive income:					
Unrealised gains	**–**	**2**	**64**	**–**	**66**
Realised gains	**–**	**–**	**12**	**–**	**12**
Transfer into Level 3	**–**	**90**	**–**	**1**	**91**
Transfer out of Level 3	**–**	**(17)**	**–**	**–**	**(17)**
Net purchases/additions	**–**	**9**	**344**	**–**	**353**
At 30 June 2020	**–**	**1,172**	**6,483**	**1**	**7,656**
At 1 January 2019	364	1,091	3,376	1	4,832
Total gains in the statement of comprehensive income:					
Unrealised gains	6	182	235	13	436
Transfer out of Level 3	–	(205)	–	–	(205)
Net purchases/additions	42	18	1,350	7	1,417
At 30 June 2019	412	1,086	4,961	21	6,480
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

Please see note D.2 for details of Level 3 derivative liabilities.

Rothesay'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 £17m (HY2019: £205m, FY2019: £828m). There were £91m (HY2019: £nil, FY2019: £nil) of financial investments transferred from Level 2 to Level 3.

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Note D – Financial assets and liabilities (continued)

D.1 Financial investments (continued)

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 liquidity premium inferred from market observed levels.

The NNEG can be thought of as a series of options written by Rothesay which allow the equity release mortgage holders to extinguish their loan by selling their property back to Rothesay 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.

Underlying house prices have been updated in line with the latest available data. 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. No change has been made to demographic assumptions.

	HY2020 £m	HY2019 £m	FY2019 £m
Carrying amount at 1 January	**2,669**	1,897	1,897
Increase in respect of new business	**314**	363	694
Redemptions/repayments	**(56)**	(70)	(142)
Accrued interest for the year	**59**	53	109
Change in economic assumptions	**68**	41	111
Closing balance at the statement of financial position date	**3,054**	2,284	2,669

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

	HY2020 £m	HY2019 £m	FY2019 £m
Less than one year	**110**	169	176
One to five years	**682**	551	624
Over five years	**2,262**	1,564	1,869
	3,054	2,284	2,669

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

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. Changes are made in isolation so, for example, no change is made to property price inflation in the property price sensitivities. 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:

			HY2020		
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	**1,172**	**(44)**	**(7)**
		-50bps yield to maturity	**1,172**	**47**	**7**
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	**6,483**	**(264)**	**–**
		-25bps yield to maturity	**6,483**	**283**	**–**
Loans secured on property	Property prices	+10% change in property prices	**6,483**	**16**	**34**
		-10% change in property prices	**6,483**	**(20)**	**(74)**
Equity release mortgages	Liquidity premium	+50bps yield to maturity	**3,054**	**(171)**	**–**
		-50bps yield to maturity	**3,054**	**187**	**–**
Equity release mortgages	House prices	+10% change in house prices	**3,054**	**65**	**65**
		-10% change in house prices	**3,054**	**(81)**	**(82)**
Derivative assets	Expected defaults	+50bps credit default spread	**1**	**(1)**	**(1)**
		-50bps credit default spread	**1**	**1**	**1**

			HY2019		
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	1,086	(40)	(10)
		-50bps yield to maturity	1,086	43	10
Government sub sovereign and agency obligations	Discount rate	+50bps yield to maturity	412	(13)	(2)
		-50bps yield to maturity	412	14	3
Loans secured on property	Liquidity premium	+25bps yield to maturity	4,961	(227)	–
		-25bps yield to maturity	4,961	249	–
Loans secured on property	Property prices	+10% change in property prices	4,961	14	20
		-10% change in property prices	4,961	(26)	(36)
Equity release mortgages	Liquidity premium	+50bps yield to maturity	2,284	(117)	–
		-50bps yield to maturity	2,284	128	–
Equity release mortgages	House prices	+10% change in house prices	2,284	46	52
		-10% change in house prices	2,284	(58)	(65)
Derivative assets	Expected defaults	+50bps credit default spread	21	(23)	(9)
		-50bps credit default spread	21	26	10

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Note D – Financial assets and liabilities (continued)

D.1 Financial investment (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	FY2019 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	–	–	–

D.2 Payables and financial liabilities

	HY2020 £m	HY2019 £m	FY2019 £m
Derivative financial instruments	**33,485**	16,054	19,944
Collateralised financing agreements	**1,448**	828	676
Government, sub sovereign and agency obligations	**10**	756	–
Total financial liabilities	**34,943**	17,638	20,620
Deposits received as collateral from third parties	**1,869**	1,166	1,193
Amounts due to group undertakings	**31**	36	70
Current tax payable	**91**	74	81
Other payables	**167**	72	46
Total payables	**2,158**	1,348	1,390
Total payables and financial liabilities	**37,101**	18,986	22,010

Financial liabilities are recorded at fair value (see note D.1 for accounting policy), of which £2.9m are valued using Level 3 techniques (HY2019: £0.5m, FY2019: £0.9m). The remainder are valued using Level 2 techniques at each financial statement date excluding £756m at HY2019 which were valued using Level 1 techniques.

D.3 Borrowings

Rothesay's borrowings are as follows:

	HY2020 £m	HY2019 £m	FY2019 £m
Subordinated loans from participating interests	**298**	398	398
Subordinated loan notes	**1,127**	249	1,029
Total borrowed	**1,425**	647	1,427

On 19 May 2020 RLP issued a further £100m of Tier 3 bonds with maturity on 12 July 2026 and a fixed 3.375% coupon payable annually in arrears. On 27 May 2020 RLP used the proceeds from the Tier 3 issuance to repay £100m of subordinated loans from participating interests.

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.

Note D – Financial assets and liabilities (continued)

D.3 Borrowings (continued)

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

Notional amount	Issue date	Redemption date	Callable at par at the option of the Company from	Coupon	Carrying amount HY2020 £m	Carrying amount HY2019 £m	Carrying amount FY2019 £m	Fair value HY2020 £m	Fair value HY2019 £m	Fair value FY2019 £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	**–**	95	97
£300m	19 September 2017	19 September 2028	19 September 2023 and annually thereafter	3m£L plus 5.95%	**298**	298	298	**292**	296	302
Subordinated loans										
£250m	22 October 2015	22 October 2025	No call option	8%	**249**	249	249	**295**	282	306
£500m	12 July 2019	12 July 2026	No call option	3.375%	**486**	–	386	**496**	–	403
£400m	17 September 2019	17 September 2029	17 September 2024	5.5%	**394**	–	394	**422**	–	434

For the period ended 30 June 2020, an interest expense of £42m (HY2019: £23m, FY2019: £62m) was recognised in the condensed statement of comprehensive income in respect of these borrowings.

Reconciliation of borrowings

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

	31 December 2019 £m	**Cash flows £m**	**Non-cash flows £m**	**30 June 2020 £m**
Subordinated loans from participating interest	**398**	**(100)**	**–**	**298**
Subordinated loan notes	**1,029**	**96**	**2**	**1,127**
Total borrowings	**1,427**	**(4)**	**2**	**1,425**

	31 December 2018 £m	Cash flows £m	Non-cash flows £m	30 June 2019 £m
Subordinated loans from participating interest	398	–	–	398
Subordinated loan notes	249	–	–	249
Total borrowings	647	–	–	647

	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

Notes to the financial statements

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Note E – Insurance contracts and reinsurance

E.1 Reinsurance assets/liabilities

Insurance contract liabilities, net and gross of reinsurance, are as follows:

	HY2020 £m	HY2019 restated[1] £m	FY2019 £m
Insurance contract liabilities	**49,399**	33,837	47,932
Reinsurance assets	**(475)**	(180)	(388)
Reinsurance liabilities	**938**	540	848
Insurance contract liabilities, net of reinsurance	**49,862**	34,197	48,392

1 Please see note A.3 for details of the prior period restatement.

Reinsurance assets include the reinsurance of our €140m portfolio of Irish annuities. 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 7 September 2020 when the liabilities will transfer to Monument Life Insurance DAC (formerly Laguna Life DAC and part of the Monument Re Group).

As noted previously, it is unclear as to whether COVID-19 will materially impact our longevity assumptions. In valuing the reinsurance assets and liabilities (and consistent with the valuation of insurance contract liabilities), we have allowed for reported deaths but we have not made any changes to our longevity assumptions as it is still too early to know what the long term impact of COVID-19 might be on longevity.

With the exception of the reinsurance agreement with Monument Re Limited (noted above), under the outward reinsurance contracts, Rothesay 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 changes in economic conditions. No additional reinsurance has been transacted over the period.

At 30 June 2020, 30 June 2019 and 31 December 2019, Rothesay conducted an impairment review of the reinsurance assets and found no impairment necessary.

E.2 Insurance contract liabilities

Key valuation assumptions

This note details the assumptions with the greatest impact on Rothesay's insurance contract liability valuations. Note that insurance contract liabilities include reinsurance inwards, i.e. where Rothesay 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:

	HY2020		HY2019		FY2019	
	Pensions originated	**Insurance originated**	Pensions originated	Insurance originated	Pensions originated	Insurance originated
Males	**94.7% S2PMA**	**90.8% S2PMA**	94.8% S2PMA	100.2% PMA08	94.7% S2PMA	90.8% S2PMA[1]
Females	**94.7% S2PFA**	**90.8% S2PFA**	94.8% S2PFA	100.2% PFA08	94.7% S2PFA	90.8% S2PFA[1]

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.

Note E – Insurance contracts and reinsurance (continued)

E.2 Insurance contract liabilities (continued)

(a) Mortality assumptions (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 and no adjustments have been made to reflect the potential impact of COVID-19. 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. No changes have been made during 2020.

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. For FY2019, mortality improvement assumptions were updated to reflect recent mortality improvements including adoption of the CMI 2018 improvement model. For both 2020 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 through 2019 and 2020. Assumed initial rates of improvements were increased for full year 2019, and were unchanged for 2020. 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)		
	HY2020	HY2019	FY2019
Males	**CMI_2018_M[2.4%; Sk=7.9]**	CMI_2017_M[3.0%; Sk=7.5]	CMI_2018_M[2.4%; Sk=7.9]
Females	**CMI_2018_F[2.4%; Sk=7.9]**	CMI_2017_F[3.0%; Sk=7.5]	CMI_2018_F[2.4%; Sk=7.9]

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 were reshaped for full year 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) below).

(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 30 June 2020. 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 inter-company arrangements ignored.

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

	HY2020	HY2019	FY2019
Equivalent rate of interest	**1.47% p.a.**	2.10% p.a.	1.78% 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. (HY2019: 3bps p.a., FY2019: 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 following table.

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Note E – Insurance contracts and reinsurance (continued)
E.2 Insurance contract liabilities (continued)
(b) Economic assumptions including valuation rate of interest (continued)
The table below shows the average yield deduction by asset class before the application of the 2.5% prudential margin at 30 June 2020, 30 June 2019 and 31 December 2019:

	Average yield deduction		
Asset class	**HY2020**	HY2019 (grouping restated)	FY2019
UK government approved securities	**0 bps**	0 bps	0 bps
Secured lending	**36 bps**	15 bps	24 bps
Supranational/other sovereign	**30 bps**	26 bps	17 bps
Secured residential lending	**30 bps**	27 bps	28 bps
Corporate bonds (without covering credit default swaps)	**74 bps**	55 bps	56 bps
Infrastructure	**77 bps**	65 bps	63 bps
Equity release mortgages	**137 bps**	137 bps	125 bps
Other	**50 bps**	38 bps	36 bps
Overall yield reduction	**41 bps**	32 bps	31 bps

Since the end of 2019, the average yield deduction has increased for all asset classes and in aggregate. This is as a result of an increase in default allowance associated with credit spread widening during the period along with, for some asset classes and for the aggregate deduction, the change in asset mix. Our approach to deriving credit default assumptions was modified at the start of the period to better reflect the relative riskiness of individual assets.

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 for the valuation rate of interest is calculated on a prudent basis allowing for future property price growth at a rate equivalent to 0.88% net of dilapidation costs and cost of sale (HY2019: 1.22%, FY2019: 1.14%) and house price volatility equivalent to 13% (HY2019: 13%, FY2019: 13%). Given the lack of recent housing transaction data, in calculating the value of the NNEG allowed for in the yield deduction above, house prices are assumed to have fallen by 5% with no offsetting change in assumed future house price growth. The increase in the yield deduction for equity release mortgages over the period has been driven by the assumed fall in house prices and the reduction in assumed property price growth rate over the period partially offset by origination of lower risk mortgages.

An important actuarial assumption relates to the future rate of escalation of certain annuity benefits, but as Rothesay 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 Rothesay 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 Rothesay 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. Average per policy allowance is unchanged from FY2019 at £36 per policy per annum (HY2019: £30 per policy per annum, FY2019: £36 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 (HY2019: 0.25% p.a., FY2019: 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.

Note E – Insurance contracts and reinsurance (continued)

E.2 Insurance contract liabilities (continued)

(e) Movement in insurance contract liabilities, net of reinsurance

The table below details the change in 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.

	HY2020 £m	HY2019 £m	FY2019 £m
Carrying amount at 1 January	**48,392**	33,065	33,065
Increase in respect of new business	**856**	696	16,362
Release of liabilities	**(1,111)**	(1,001)	(2,028)
Effect of assumption changes	**1,721**	1,442	985
Other	**4**	(5)	8
Closing balance at statement of financial position date	**49,862**	34,197	48,392

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	HY2020 £m	HY2019 £m	FY2019 £m
Change in assumptions used			
Valuation rate of interest	**2,298**	1,499	1,747
Inflation	**(577)**	(47)	(716)
Effect of economic assumption changes	**1,721**	1,452	1,031
Demographics	**–**	(10)	(212)
Member options	**–**	–	(10)
Expenses	**–**	–	176
Effect of non-economic assumption changes	**–**	(10)	(46)
Total effect of assumption changes	**1,721**	1,442	985

As shown previously, the valuation rate of interest decreased by 31bps over the year, which led to the £2.3bn increase in the net liability shown. This was partially offset by the impact of the fall in future rate of inflation.

There were no changes made to the non-economic assumptions during the period.

(f) Sensitivity analysis

The schedule below provides an analysis of the reasonably possible movements in key assumptions that would have a material impact on liabilities (net of reinsurance), 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 sensitivity of liabilities to interest rates and inflation increased during 2019 as a result of writing significant amounts of long duration new business. The risk remains closely monitored and hedged as seen through the impact of the sensitivity on equity. Changes in the directional sensitivity of equity to interest rates reflect adjustments to hedging strategy as interest rates fell in the first half of 2020. When stressing credit default assumptions, the total spread on corporate bonds is assumed to move by approximately 30bps.

HY2020	Change in assumptions	(Decrease)/ increase in net liabilities £m	Increase/ (decrease) in PBT £m	Impact on equity £m
Annuitant mortality	**+5% qx**	**(195)**	**192**	**155**
Annuitant mortality	**-5% qx**	**203**	**(200)**	**(162)**
Interest rate	**+100bps**	**(6,459)**	**(237)**	**(192)**
Interest rate	**-100bps**	**8,076**	**619**	**502**
Inflation	**+100bps**	**3,535**	**(207)**	**(167)**
Inflation	**-100bps**	**(3,203)**	**366**	**297**
Credit default assumption	**+10bps**	**(656)**	**(440)**	**(357)**
Credit default assumption	**-10bps**	**679**	**451**	**365**
Change in property prices	**+10%**	**(18)**	**99**	**80**
Change in property prices	**-10%**	**56**	**(156)**	**(127)**
Expenses	**+10%**	**127**	**(127)**	**(103)**

Notes to the financial statements

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Note E – Insurance contracts and reinsurance (continued)

E.2 Insurance contract liabilities (continued)

(f) Sensitivity analysis (continued)

HY2019	Change in assumptions	(Decrease)/ increase in net liabilities £m	Increase/ (decrease) in PBT £m	Impact on equity £m
Annuitant mortality	+5% qx	(200)	199	161
Annuitant mortality	-5% qx	210	(209)	(170)
Interest rate	+100bps	(3,961)	(61)	(49)
Interest rate	-100bps	4,937	340	275
Inflation	+100bps	1,472	21	17
Inflation	-100bps	(1,391)	97	79
Credit default assumption	+10bps	(419)	(231)	(187)
Credit default assumption	-10bps	400	231	187
Change in property prices	+10%	(11)	73	59
Change in property prices	-10%	17	(98)	(79)
Expenses	+10%	97	(97)	(79)

FY2019	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)

The sensitivities shown capture non-linearity effects, which may be significant following large market movements. The risk management strategy adopted can result in Rothesay 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 at all durations (HY2019: did not fall below zero, FY2019: fell below zero for eight years).

The impact of reinsurance on the sensitivity to mortality risk is a reduction of 83% (HY2019: 76%, FY2019: 78%). The impact of reinsurance has changed because of changes in the discount rates used in valuing reinsurance and insurance respectively.

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.

Note F – Risk and capital management

F.1 Capital management

Rothesay's capital resources are of critical importance. Rothesay'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 Rothesay;
- 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, Rothesay was required to operate under the new Solvency II regime. Rothesay had sufficient capital available to meet its regulatory capital requirements at all times during the period ended 30 June 2020.

Under the Solvency II regime, Rothesay is required to hold sufficient assets to meet:

- Rothesay's technical provisions, being:
  - the liabilities of Rothesay 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).

Rothesay 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 Rothesay'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 30 June 2020, Own Funds for the Company were £6,908m (HY2019: £4,066m, FY2019: £6,113m) made up as follows:

	HY2020 £m	HY2019 £m	FY2019 £m
Total IFRS equity	**4,416**	2,866	3,756
Liability valuation differences and other regulatory adjustments	**1,022**	535	902
Total Tier 1	**5,438**	3,401	4,658
Tier 2 debt valuation	**968**	665	1,059
Tier 3 debt valuation	**502**	–	396
Own Funds	**6,908**	4,066	6,113

On 19 May 2020, RLP issued £100m of Tier 3 bonds with the same maturity and coupon date as the Tier 3 bonds issued in 2019. The proceeds were used to repay the floating rate Tier 2 loan interest issued by RLP on 21 December 2012.

Rothesay holds both debt and equity to optimise its capital structure and improve shareholder return. During the prior year, £700m of equity, £400m of Tier 2 debt and £400m of Tier 3 debt were issued by Rothesay.

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. Rothesay 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.

Notes to the financial statements

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Note G – Other statement of financial position notes

G.1 Deferred tax liabilities

Deferred tax balances comprise:

	HY2020 £m	HY2019 £m	FY2019 £m
Temporary differences between the financial statements and the tax deductions	**(57)**	(2)	(31)
Total temporary differences	**(57)**	(2)	(31)

The movements in the deferred tax balances were as follows:

	HY2020 £m	HY2019 £m	FY2019 £m
At 1 January	**(31)**	(2)	(2)
Timing difference	**(26)**	–	(29)
At statement of financial position date	**(57)**	(2)	(31)

Note H – Interests in subsidiaries and associates

H.1 Investments in subsidiaries

RLP holds investments in the subsidiaries listed in the following table:

Group undertakings	Country of incorporation	Primary business operation	HY2020 £m	HY2019 £m	FY2019 £m	HY2020 % equity interest	HY2019 % equity interest	FY2019 % equity interest
Rothesay Assurance Limited (formerly known as MetLife Assurance Limited)	UK	Service company	**–**	–	–	**100%**	100%	100%
LT Mortgage Financing Limited (LTMF)	UK	Service company	**6**	1	6	**100%**	100%	100%
Rothesay MA No.1 Limited (RMA1)	UK	Service company	**5**	–	5	**100%**	100%	100%
Rothesay MA No.2 Limited	UK	Service company	**–**	–	–	**100%**	100%	100%
Rothesay MA No.3 Limited	UK	Service company	**–**	–	–	**100%**	–	100%
Rothesay MA No.4 Limited	UK	Service company	**–**	–	–	**100%**	–	100%

Subsidiaries are held at the lower of cost and net realisable value.

The above subsidiary undertakings, 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 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.

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.

Note I – Other notes

I.1 Related parties disclosures

Ultimate holding company

At the financial statement date, the immediate and ultimate parent company was RHUK, which is incorporated in the United Kingdom. Group financial statements are prepared for RHUK, copies of which can be obtained from the Company Secretary, The Post Building, 100 Museum Street, London WC1A 1PB.

Related party transactions

The Company entered into various transactions with fellow participating interests which are subject to common control from the same source.

	HY2020 £m	HY2019 £m	FY2019 restated[1] £m
Statement of comprehensive income			
Change in the reinsurers' share of insurance contract liabilities and reinsurance recoveries	**14**	(2)	48
Finance costs	**(12)**	(13)	(26)
Operating expenses	**(5)**	–	(8)
Statement of financial position			
Reinsurance liabilities	**58**	3	44
Borrowings	**298**	398	398
Capital	**2,463**	1,763	2,463

1 FY2019 both change in the reinsurers share of insurance contract liabilities and reinsurance liabilities have been restated to reflect the correct position due to omission of a contract during the prior period. The change in reinsurer share has changed from a charge of £2m to a credit of £48m. The reinsurance liabilities have increased from £6m to £58m.

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 Company and its key management personnel other than transactions discussed below:

	HY2020 £m	HY2019 £m	FY2019 £m
Salaries, bonus and other employee benefits	**3**	3	21
Equity-based compensation payments	**4**	3	6
Total transactions	**7**	6	27

On 19 March 2020 members of key management personnel and their families sold new B ordinary shares to the Employment Benefit Trust for consideration of £8.1m.

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 RLP, its parent RHUK, its subsidiaries LTMF and RMA1 and other group companies RPML and Rothesay Asset Management US LLC.

Transactions with RHUK	**HY2020 £m**	HY2019 £m	FY2019 £m
Statement of comprehensive income			
Cost transfer	**3**	2	5
Statement of financial position			
Other receivables	**25**	9	13
Capital	**2,463**	1,764	2,463

Notes to the financial statements

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Note I – Other notes (continued)

I.1 Related parties disclosures (continued)

Transactions with LTMF	HY2020 £m	HY2019 £m	FY2019 £m
Statement of financial position			
Other receivables	**43**	–	11
Capital	**6**	–	6

Transactions with Rothesay MA No.1 Limited	HY2020 £m	HY2019 £m	FY2019 £m
Statement of financial position			
Other receivables	**14**	–	8
Capital	**5**	–	5

Transactions with RPML	HY2020 £m	HY2019 £m	FY2019 £m
Statement of comprehensive income			
Cost transfer	**44**	(35)	(86)
Statement of financial position			
Other payables	**30**	33	66

Transactions with Rothesay Asset Management US LLC	HY2020 £m	HY2019 £m	FY2019 £m
Statement of comprehensive income			
Transaction fee	**(1)**	(3)	(4)
Service fee	**(2)**	(1)	(1)
Statement of financial position			
Other receivables	**1**	–	–
Other payables	**–**	3	4

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. During April 2020, a further £0.2bn of loans 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.

Note I – Other notes (continued)

I.2 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.3). The new standard has affected the balance sheet and related ratios.

The Company 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 Company has entered into a lease for space in The Post Building, which have been accounted for under IFRS 16 (see note I.3).
- The Company has exercised its break clause under the lease for Level 25 of The Leadenhall Building. The cash flows for 2019 were therefore accounted for on a cash flow basis. There will be no future cash flows in relation to this lease.
- The Company identified a new tenant for Level 32 of The Leadenhall Building and therefore terminated the lease. The cash flows for 2019 were 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 are as follows:

	HY2020 £m	HY2019 £m	FY2019 £m
Not later than one year	**–**	2	–
Later than one year and no later than five years	**–**	–	–
Later than five years	**–**	–	–
Total minimum lease payments	**–**	2	–

Other commitments

During previous years Rothesay executed transactions to purchase partly funded bonds and forward settling bonds. During the first half of 2020 the Company purchased additional partly funded bonds and forward settling bonds. Rothesay also signed up to a number of multi-year contracts. Rothesay expects to pay a further £1,424m within the next five years (HY2019: £653m, FY219: £1,043m), £802m of this being due within 12 months of the financial reporting date (HY2019: £285m, FY2019: £436m).

	HY2020 £m	HY2019 £m	FY2019 £m
Not later than one year	**802**	285	436
Later than one year and no later than five years	**622**	368	607
Later than five years	**–**	–	–
Total other commitments	**1,424**	653	1,043

I.3 Leases

(a) Amounts included in the statement of financial position

On adoption of IFRS 16, the Company 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 Company 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 Company's incremental borrowing rate. 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 Company 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.

Notes to the financial statements

CONTINUED

Note I – Other notes (continued)

I.3 Leases (continued)

(a) Amounts included in the statement of financial position (continued)

Right of use assets are depreciated over the lease term on a straight-line basis.

The Company 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 Company in prior year 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 Company was not a lessor during the period.

Right of use assets

	HY2020 £m	HY2019 £m	FY2019 £m
Right of use asset	**35**	36	37
Right of use asset – property			
Balance at 1 January	**37**	–	–
Depreciation charge for the period	**(2)**	–	(2)
Additions	**–**	36	39
Closing balance at statement of financial position date	**35**	36	37

Lease liabilities

	HY2020 £m	HY2019 £m	FY2019 £m
Lease liability	**39**	36	39
Maturity analysis undiscounted liabilities			
Current liabilities			
Less than one year	**–**	1	–
Non-current liabilities			
One to five years	**23**	13	16
More than five years	**25**	36	33
Total undiscounted lease liabilities	**48**	50	49

(b) Amounts recognised in the statement of comprehensive income

	HY2020 £m	HY2019 £m	FY2019 £m
Depreciation charge of right of use assets – property	**2**	–	2
Financing charge on lease liabilities (included in note B.4 Finance costs)	**–**	–	1

(c) Amounts recognised in statement of cash flows

	HY2020 £m	HY2019 £m	FY2019 £m
Depreciation charge of right of use assets – property	**2**	–	2
Financing charge on lease liabilities	**–**	–	1
Total cash flows for leases	**2**	–	1

Alternative Performance Measures

As noted on page 6, throughout the financial statements the Company has used a variety of measures to provide stakeholders with the necessary information on the performance and financial position of the Company. 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 Company 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 strategic review on page 8.
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 exposures of the Company.	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 Company.	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 Company is protected from fluctuations in longevity through reinsurance.	Demonstrates how the Company has mitigated exposure 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 Company 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.
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.

Alternative Performance Measures

CONTINUED

Alternative Performance Measure	Definition	Why is this meaningful	Reconciliation to IFRS
New business profit	IFRS new business profit projected to be realised once the premium is invested according to Rothesay's long-term investment strategy, before release of IFRS margins.	This is one of the metrics used by Rothesay 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 Rothesay'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).
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 net movement in assets and liabilities that can be attributed to: • the release of prudent margins as the business runs off (including credit default allowances and expense reserves) and as members exercise their options; • the impact of actual demographic 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 net change in assets and liabilities attributable to changes in economic conditions allowing for the cost of hedging. Changes in economic conditions include movements in interest rates, inflation, exchange rates, credit spreads, credit default allowances, actual defaults and property prices. The release of credit default allowances over time is included in the performance 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.

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 Company.
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 Company in respect of reinsurance inwards, i.e. a policy where RLP is acting as the reinsurer.
Best estimate liability (BEL)	The liabilities of the Company 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.
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.
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.
Distributable profits	A company's profits available for distribution are its accumulated realised profits.

Glossary of terms

CONTINUED

Economic profits	See Alternative Performance Measures.
Equity-based compensation	Share-based transactions awarded under incentive plans.
Equity release mortgages (ERMs)	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 Company's financial statements.
Investment profit from prior year	See Alternative Performance Measures.
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 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 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.

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.
No negative equity guarantee (NNEG)	ERMs provide what is known as a NNEG, which means that the mortgage repayment amount (loan principal plus interest on redemption) cannot exceed the sale proceeds of the property on which the loan is secured.
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 Company'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 Company generally uses the term policyholder to refer to the individual annuitants whose benefits are insured by the Company 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.
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.

Glossary of terms

CONTINUED

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 Company is 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.
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 Company does not have the power to affect their returns.
Yield	A measure of the income received from an investment compared to the price paid for the investment. Normally expressed as a percentage.

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