Rothesay life

ANNUAL REPORT AND ACCOUNTS OF ROTHESAY LIFE PLC

2019

Who we are

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

RLP's purpose

To provide pension security for its policyholders and value to the Company's shareholders and other stakeholders over the long term.

STRATEGIC REPORT	**1-18**
Strategic report	01
Review of the year and looking ahead	02
RLP's strategy and key performance indicators	07
Financial review	09
Risk management	11
Viability statement	18
FINANCIAL STATEMENTS	**19-67**
Report of the Directors	19
Independent auditors' report	21
Statement of comprehensive income	27
Statement of financial position	28
Statement of changes in equity	29
Cash flow statement	30
Notes to the financial statements	31
ALTERNATIVE PERFORMANCE MEASURES	**68**
GLOSSARY OF TERMS	**69-71**

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Strategic report

About us

Established in 2007, RLP thinks originally and works diligently to help pension schemes and insurance companies to de-risk. The Company's cautious investment strategy and sophisticated approach to risk management is focused on providing long-term pension security for its policyholders.

The Directors present their Annual Report and the audited financial statements for Rothesay Life Plc, registered number 06127279 (RLP or the Company), for the year ended 31 December 2019. Comparative information has been presented for the year ended 31 December 2018.

The Company operates as part of the Rothesay Holdco UK Limited Group (RHUK or the Group).

Principal activities

RLP's business model has been established on the core pillars of high-tech and sophisticated risk management, relatively conservative investment philosophy, continuous innovation to meet its clients' needs and excellence in delivery.

RLP provides tailored solutions for clients seeking to mitigate financial and longevity risk, aiming to create structures that are tailor-made to suit the needs of scheme members, trustees and corporates.

RLP is a leading provider of regulated insurance solutions in the UK market for pensions de-risking. Established in 2007, the Company has grown to become the third largest annuity provider in the UK market, with over £53bn of assets under management **(APM)**[1] and insuring the annuities of over 800,000 individuals. RLP's business strategy is focused around three key areas:

i) Protect the security of policyholder benefits.
ii) Grow through writing value-driven new business.
iii) Safeguard its brand and culture.

Operational highlights

RLP has delivered a strong performance in 2019, which included these key highlights:

- **New business:** During the year the Company wrote £16.3bn of new business **(APM)**, assisting ten pension schemes to de-risk their liabilities, a record for the Company and the market (2018: £13.2bn).
- **IFRS pre-tax profit:** During 2019, RLP was successful in investing the remaining assets from the 2018 Prudential transaction, which was one of the main drivers of RLP's record profits of £640m (2018: £114m).
- **Assets under management:** The Company's assets under management increased by 48% to £53.7bn (2018: £36.3bn) **(APM)**, driven by new business volumes.
- **Solvency position:** Following the new business written during the year, £700m of new equity has been provided by the Rothesay Group's institutional shareholders to help finance the transactions. In addition, RLP issued £400m of Tier 3 bonds and £400m of Tier 2 bonds. This has helped ensure the solvency position of the Company has remained strong with SCR coverage of 201% (2018: 180%) **(APM)**.
- **Credit rating:** RLP has maintained an insurance financial strength rating of A3 by Moody's Investors Service and A+ by Fitch Ratings.

The statement of financial position is set out on page 28.

1 APM – Alternative Performance Measure, please see page 68 for further details.

Review of the year and looking ahead

2019 has been a record year for RLP. The Company executed over £16bn of new bulk annuity business **(APM)** over the course of the year – a record for the market and an increase of 24% over RLP's previous best year. RLP also successfully invested the assets it received as part of the £12bn transaction it executed with Prudential in 2018 in accordance with its long-term investment strategy.

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

In total, RLP helped ten pension schemes to de-risk their liabilities during 2019, generating new business premium for the year of £16.3bn **(APM)**, taking it's total assets under management to over £53bn **(APM)** and making it the third largest annuity provider in the UK. RLP is proud of it's achievements over the past decade and it remains focused primarily on ensuring the Company provides the greatest level of security and service to the over 800,000 individuals whose future pension payments it insures.

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

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

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

Performance

In 2018, a combination of the de-risking RLP undertook post the completion of the Prudential transaction and widening credit markets resulted in dampening the IFRS profit before tax to £114m. During 2019, RLP has been very successful in investing the remaining assets from the Prudential transaction which was one of the main drivers of RLP's record profit before tax of £640m.

The market outlook

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

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

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

Risk, capital and asset management

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

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

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

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

Policyholders

Providing over 800,000 policyholders with a safe and secure pension is at the heart of what RLP does. The Company takes pride in the quality of the service it provides and is proud to be the first insurance company to have gained Accreditation by the Pensions Administration Standards Association (PASA), an independent body dedicated to improving standards in pensions administration. The quality of service the Company provides to it's policyholders is also reflected in the consistently low levels of upheld complaints and high level of customer satisfaction.

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

RLP was disappointed not to receive approval for the transfer of business from Prudential to RLP. RLP and Prudential were immediately granted leave to appeal by the High Court and have elected to do so, with the appeal due to be heard in 2020. If the transfer is not approved then the reinsurance agreement will remain in place so the underlying economic risk transfer would be unaffected, but the policyholders covered by the agreement would continue to be serviced by Prudential.

RLP's people

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

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

The high level of engagement of RLP's people and the breadth of the expertise within the team across insurance, pensions, actuarial, investment management, operations, legal, finance and technology is the defining factor in the Company's success.

Section 172 (1) statement

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

Given the long-term nature of RLP's business, the Board is very focused on the likely long-term consequences of decisions and believes that it has acted in a way that promotes the success of the Company.

The Company operates under the governance framework of the RHUK Group and an explanation of how the RHUK Group board has considered the matters set out in s172 is detailed within the Stakeholder engagement section of the RHUK Group annual report (which does not form part of this report).

Review of the year and looking ahead

CONTINUED

RLP's business model

Our strengths

1. High-tech and sophisticated risk management

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

2. Attention to detail and multi-disciplinary expertise

The Company looks to blend multi-disciplinary talent and experience with technology to deliver granular analysis and appropriate attention to detail. RLP's strategic outsourcing model facilitates excellent customer service.

3. Efficient and effective decision making

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

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

4. Financial strength and access to capital

The Company's proven approach to capital management is intended to ensure financial strength in adverse conditions. By preserving and recycling capital, RLP not only ensures that it meets its promises to policyholders but also protects RHUK's shareholder equity.

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

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

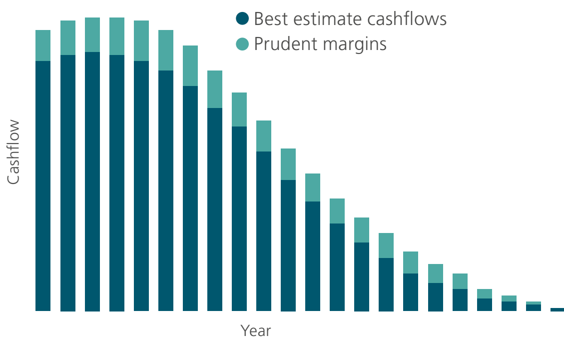
1. Underwrite the liabilities

RLP's meticulous approach to underwriting and due diligence achieves maximum pre-deal certainty about the profile of the liabilities that it is taking on.

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

RLP is disciplined in new business pricing – all new business must achieve it's return thresholds without the need to take excessive investment risk.

Illustrative projection of scheme cashflows



2. Hedge the risks

The Company's capital-efficient business model involves hedging risk where possible so it uses derivatives and other assets to hedge interest rate and inflation risk. See principal risk table on page 14.

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

RLP also uses reinsurance to hedge longevity risk and has currently reinsured 78% **(APM)** of it's exposure. Hedging risk with reinsurers has the added benefit of ensuring pricing discipline as the reinsurance process provides the Company with an independent third party view on the appropriate mortality basis to use.

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

3. Invest the assets to back the liabilities

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

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

Review of the year and looking ahead

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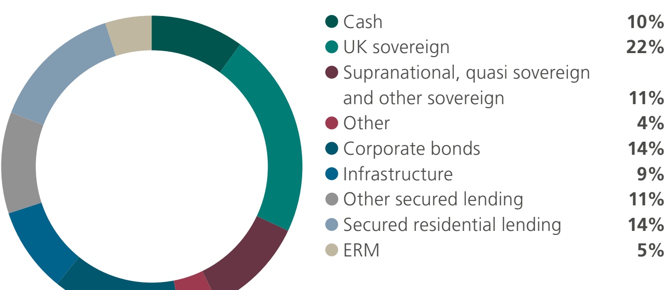
Investments



4. Deliver excellent customer service through RLP's strategic business partners

RLP follows a strategic outsourcing model for the provision of administration services. Key to the delivery of excellent customer service is it's robust oversight and working relationship with it's third party administrators, Willis Towers Watson, JLT Employee Benefits and Capita Employee Solutions, all of whom are well established pension administrators. The three strategic partnerships provides RLP with both scale and contingency capabilities.

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

Generating value for all RLP's stakeholder

- **Trustees and policyholders**

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

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

  The Company's financial strength means that policyholders can have confidence in the long-term security of their pensions.

- **Employees**

  RLP's success in the market and its business model helps ensure that Rothesay Life is a rewarding place to work for all it's people.

- **Strategic business partners**

  Given RLP's strategic outsourcing model, as the Company grows so does it's long-term strategic partners.

  RLP's approach to working with reinsurers is similar to that of working with clients. Reinsurers can be confident in the Company's quick and efficient execution.

- **RHUK Group shareholders and RLP's bondholders**

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

  These investment returns and capital releases are first used to cover:
  - any adverse experience such as investment defaults or the cost of pensioners living longer than assumed;
  - the expenses of running the business including financing costs; and
  - the costs of hedging, including reinsurance fees.

  Amounts in excess of this are then used to back new business or, if not otherwise required, returned as dividends to shareholders. No dividends were paid to RHUK or to the Group's shareholders in 2019 (2018: £500m paid to RHUK).

RLP's strategy and key performance indicators

Delivering on RLP's commitments

The Company's strategy is designed to provide pension security for its policyholders and value to the Group's shareholders and other stakeholders over the long term.

1. Protect the security of policyholder benefits

RLP applies a conservative, risk capital-based approach to managing its balance sheet.

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

Progress in 2019:

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

How RLP measures performance

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

Opportunities in 2020 and beyond:

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

RLP's strategy and key performance indicators

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2. Growth through writing value-driven new business

The Company pursues growth by focusing on high-quality new business which meets its return thresholds and risk tolerance. RLP remains disciplined in its approach, which benefits from proven execution capabilities across pensions and insurance company acquisitions.

Progress in 2019:

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

How RLP measures performance

New business premiums £16.3bn (2018: £13.2bn) (APM)
New business premiums are a key indicator of the Company's growth and realisation of its strategic objectives.

IFRS profit before tax £640m (2018: £114m)
IFRS profit before tax is the Company's primary measure of profitability, capturing all recurring and non-recurring items.

Opportunities in 2020 and beyond:

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

3. Safeguard RLP's brand and culture

The Company has built its business on the foundation of long-term relationships and avoided short-term opportunism. RLP has focused on recruiting and retaining the best and most relevant people to protect this culture and ensured it can maintain excellence in delivery to policyholders, counterparties and partners.

Progress in 2019:

- 95% of all policyholder requests were dealt with within RLP's demanding target service levels.
- Maintained low complaint rates and high customer satisfaction despite significant growth of the business.
- Implemented a Corporate Social Responsibility policy intended to ensure the sustainability of the Company's business model.
- Recruited 60 talented individuals across all areas of the Company, including for the RHUK Group's new US operation.
- Maintained high levels of employee engagement.

How RLP measures performance

Customer satisfaction
94% (2018: 98%) (APM)
RLP prides itself on the quality of service that its policyholders receive and is pleased that 94% of policyholders responding to feedback surveys rate the service as excellent or good for the year 2019[1].

Complaints received and upheld (per 1,000 customers)
0.70 and 0.36 (2018: 0.76 and 0.23) (APM)
Complaints provide another useful indication of customer satisfaction and can provide information that can be used to make improvements.

Employee engagement
87% of employees are proud to work at Rothesay Life[2]
The Company undertakes regular employee surveys in order to understand levels of employee engagement and where improvements can be made.

Opportunities in 2020 and beyond:

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

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

Financial review

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

IFRS financial performance

RLP achieved a profit before tax of £640m (2018: £114m).

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

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

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

IFRS profits were also impacted by changes to demographic and expense assumptions, falling interest rates, rising bond prices and falls in the value of sterling.

Alternative performance measures

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

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

The Company 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 68, including definitions, why the measure is used and, if applicable, how the APM can be reconciled to the nearest GAAP measures. The Company uses the symbol **APM** *to highlight APM throughout the financial statements.*

Assets

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

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

Assets under management (APM)	2019 £m	2018 £m
Total assets	**76,122**	50,214
Less reinsurance assets	**(388)**	(43)
Less payables and financial liabilities	**(22,010)**	(13,855)
Assets under management	**53,724**	36,316

Financial review

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Changes to accounting standards

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

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

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

Capital management

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

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

Under the Solvency II regime, the 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.

In practice, it is the Pillar 1 requirement which is more onerous and which has a direct impact on the Company's ability to pay dividends. The Company aims to maintain solvency coverage in the range of 130% to 150% of the regulatory minimum requirement. As at 31 December 2019, the Company had an SCR coverage ratio of 201% (31 December 2018: 180%) **(APM)**, giving surplus capital for new business opportunities or future dividends.

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

Risk management

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

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

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

The risk management framework is intended to ensure that RLP identifies and understands 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. RLP also looks to mitigate credit risk through investing in assets that benefit from collateral and structural protections.

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

Risk management framework

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

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

Board risk appetite and culture

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

RLP's strategic approach is to de-risk its business in order to achieve attractive risk adjusted returns. RLP aims to protect regulatory surplus and minimise balance sheet volatility by hedging longevity risk and adopting a cautious approach to investment.

Risk taking is therefore limited to circumstances where the Company believes that it fully understands the inherent and residual risks, where it is able to manage them within prudent, observable levels and where incurring the risks provides sufficient value to its stakeholders.

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

The risk appetite statement sets out the types of risk that the Company is willing to be exposed to in order to meet its strategic objectives. They are categorised as:

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

Risk management

CONTINUED

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

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

Risk appetite quantification and limit framework

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

Risk governance framework

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

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

- **First line:** Day-to-day risk management is delegated from the Board to the Chief Executive Officer (CEO) and, through a system of delegated authorities, to business managers. RLP also makes the distinction between:
  - the risk-taking functions, including investment and new business origination; and
  - the control functions, whose responsibility it is to ensure the integrity of the Company's operations and reporting. These include operations, finance and legal.

- **Second line:** Risk oversight is provided by the Chief Risk Officer (CRO), his team and risk management committees. The executive-level Working Level Risk Committee (WLRC) is chaired by the CRO and consists of relevant senior managers working within a delegated risk management framework. This Committee, and its sub-committees, review all material new investment, hedging or liability transactions, and is supported by a number of other committees which focus on risks arising from new activities, methodology and assumptions underlying RLP's financial modelling and the management of third party suppliers.

- **Third line:** Internal audit provides the Board and Executive with comprehensive, independent, objective assurance over governance, risk management and internal control.

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

Systems and infrastructure

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

Policies, processes, procedures and key controls

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

Monitoring, reporting and management response

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

Capability, resources and risk culture

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

Own Risk and Solvency Assessment (ORSA)

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

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

Continuous development

The way RLP thinks of and manages risk is constantly evolving. The CRO is responsible for developing the RMF to ensure that risk management remains effective.

Changes in the Company's risk profile and emerging risks

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

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

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

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

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

Transition from LIBOR

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

Risk management

CONTINUED

Brexit

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

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

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

Longer term

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

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

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

Principal risks and uncertainties facing the Company

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

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

Risks and uncertainties	Description	Mitigation	Strategic priority	Change from last year
CREDIT RISK – THE RISK THAT AN INVESTMENT COUNTERPARTY'S CREDIT WORTHINESS DETERIORATES OR THAT THE COUNTERPARTY DEFAULTS	The Company is exposed to the credit worthiness of its investment counterparties. The Company's financial and/or capital position could be adversely impacted by downgrades, credit spread widening or defaults.	The Company carefully selects the investments it makes in order to generate an adequate risk-adjusted return, has a preference for investments with structured protection such as collateral, and may purchase external credit protection to mitigate the impact of any defaults. The Company also carefully manages its counterparty exposures and works with a range of third parties. The Company maintains a highly experienced market-facing team as well as a second-line internal credit risk team who regularly monitor and assess the credit risk associated with its investments. Where assets are unrated, the credit risk team also makes an independent assessment of the appropriate internal credit rating.	1,2	↑ This risk has increased as the balance sheet has grown, particularly because with the growth of the balance sheet, we have a higher weighting of corporate bonds.

Risks and uncertainties	Description	Mitigation	Strategic priority	Change from last year
COUNTERPARTY DEFAULT RISK – THE RISK THAT A FINANCIAL COUNTERPARTY'S CREDIT WORTHINESS DETERIORATES OR THAT A COUNTERPARTY DEFAULTS	The Company is exposed to the credit worthiness of its financial counterparties. Its financial and/or capital position could be adversely impacted by downgrades, credit spread widening or defaults.	The Company prefers to work with highly rated and stable counterparties, and to diversify counterparty exposures where appropriate. Derivative and reinsurance contracts are subject to margining requirements to ensure exposures are appropriately collateralised. The Company actively monitors counterparties for downgrade risk, and may also purchase credit protection to mitigate specific exposures.	1,2	→ This risk has grown with the balance sheet.
INSURANCE RISK – THE RISK THAT DEMOGRAPHIC EXPERIENCE IS DIFFERENT FROM EXPECTED	As the pensions insured by the Company are guaranteed, its financial and/or capital position could be adversely impacted if, for example, policyholders live longer than expected or if more of them have dependants than expected.	The Company invests in both people and modelling capabilities to understand its longevity experience and to help predict what could happen in the future. The Company aims to reinsure a majority of its longevity exposure. As at 31 December 2019, the Company had reinsured 78% of its longevity risk (2018: 78%). (APM)	1,2	→ This risk has grown with the balance sheet. Longevity in 2019 has improved by more than expected and, given lower improvements in prior years, the outlook remains uncertain.
MARKET RISK – THE RISK OF ADVERSE MOVEMENTS IN INTEREST RATES, INFLATION OR CURRENCY	The Company's financial and/or capital position could be adversely impacted by market movements to the extent that assets and liabilities are mismatched.	The Company monitors interest rate risk and foreign exchange risk closely, and uses derivatives to hedge the risks. It also undertakes regular scenario testing, for example in relation to Brexit, to understand the impact of potential combinations of stresses. Assets and liabilities are matched as closely as possible, including using inflation-linked assets to meet inflation-linked liabilities.	1,2	→ Volatile market conditions have persisted in 2019
PROPERTY RISK – THE RISK OF A FALL IN THE VALUE OF PROPERTY	Through its investments secured on property, the Company's financial and/or capital position could be adversely impacted by falls in the value of property.	Residential property risk is reduced through strict underwriting criteria, covering, for example, the quality of the underlying property and loan-to-value limits by age of borrower. The Company has also established prudent reserves covering the potential cost of the no-negative equity guarantee on equity release mortgages. Exposure to commercial real estate is reduced by ensuring that loans have a low loan to value ratio, that there are appropriate covenants and that properties have strong tenants.	1,2,3	→ This risk has grown with the balance sheet through the Company's continuing investment in equity release mortgages and commercial real estate loans, and new investments in Dutch residential mortgages.
LIQUIDITY RISK – THE RISK OF BEING UNABLE TO REALISE INVESTMENTS AND OTHER ASSETS IN ORDER TO SETTLE FINANCIAL OBLIGATIONS WHEN THEY FALL DUE	Given the Company's holding of illiquid assets, there is a risk that it is unable to meet payments or collateral calls as they fall due in adverse circumstances.	The Company has a comprehensive liquidity management framework that ensures sufficient liquidity is held to meet collateral outflows as well as projected expenses and other outflows, in extreme market conditions.	1,3	↓ With the growth of the balance sheet, the Company's pool of liquid investments has increased.

Risk management
CONTINUED

Risks and uncertainties	Description	Mitigation	Strategic priority	Change from last year
CLIMATE CHANGE – THE RISK OF CLIMATE CHANGE	The Company's assets are exposed to the potential impact of climate change. Such risks include: • Physical risks such as increasing frequency and severity of flooding; and • Transition risks which can arise from the process of adjustment towards a low-carbon economy.	The Company's in-house team is responsible for the selection and management of all of the Company's assets. The team considers climate-related risk as part of the investment process. In addition, the Company considers flood risk as part of its lending policies.	1,2,3	**New** There is some evidence of acceleration of climate change and the UK's commitment to carbon neutrality by 2050 may increase transition risk.
OPERATIONAL RISK – THE RISK OF OPERATIONAL FAILURE INCLUDING CONDUCT FAILURES.	The Company is exposed to the risk of operational failure as a result of failure of a strategic business partner or of its own systems and processes. This could lead to reputational damage and increased cost.	The Company has no appetite for material operational risk losses, and has a strong control environment to limit these risks as far as possible. The Customer and Conduct Committee is responsible for ensuring that stakeholders are treated fairly by the Company and its strategic business partners. Scenario analysis covering a variety of potential operational risk events is regularly carried out. The Company seeks to mitigate cyber risk through robust processes and controls including data protection, penetration testing and staff training, and maintains ISO 27001 and ISO 22301 accreditation. Where the Company outsources some of its responsibilities, it undertakes thorough due diligence in advance of appointment and then has a strong programme of oversight.	2, 3	↑ The Company continues to grow through writing new business and the number of staff employed is expected to increase in the short term as a result. The investment in equity release mortgages increases conduct risk, through the Company's involvement in product design. Cyber and financial crime risk continue to be heightened. Focus on the management of operational risk has continued in 2019.

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

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

Viability statement

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

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

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

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

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

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

A.M. Stoker
Chief Financial Officer
13 February 2020

Report of the Directors

The Directors present their annual report and the audited financial statements for Rothesay Life Plc, registered number 06127279, (the Company or RLP) for the year ended 31 December 2019. Comparative information has been presented for the year ended 31 December 2018.

1. General information

RLP is a registered public limited company incorporated and domiciled in the United Kingdom. All accounting policies, where relevant, have been included within the specific note disclosures.

2. Results

The results for RLP for the year are set out in the statement of comprehensive income on page 27.

3. Dividends

The Directors have recommended no payment of interim dividends during the year ended 31 December 2019 (2018: £500m). The Directors have recommended no payment of final ordinary dividend in respect of the year ended 31 December 2019 (2018: £nil). Please refer to note C.4 to the financial statements for additional detail of the prior year dividend.

4. Registered office

RLP is registered in the United Kingdom. The registered office and principal place of business is The Post Building, 100 Museum Street, London WC1A 1PB.

5. Directors

The Directors of the Company who served throughout the year and to the date of this report, except where noted were:

Name	Appointed	Resigned
S. Q. Abbas		
C. Beckers		
R. D. A. Berliand		25 February 2019
M. T. Corbett		
R. A. De Beir Jarratt		
N. Kheraj		
R. King		
A. Loudiadis		
T. L. Miller		
S.P. Morris	14 February 2019	
T. J. Pearce		
C. D. Pickup		
W. J. Robertson		
A. M. Stoker		

6. Qualifying third party indemnities

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

7. Disclosure of information to auditors

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

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

Report of the Directors

CONTINUED

8. Auditors

The Company has passed elective resolutions in accordance with the Companies Act 1985 to dispense with the holding of annual general meetings, the laying of accounts and reports before general meetings and the annual reappointment of auditors. PricewaterhouseCoopers LLP will, accordingly, continue in office as auditors of the Company pursuant to Section 487(2) of the Companies Act 2006.

9. Statement of Directors' responsibilities

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

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

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

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

10. Internal control and risk management systems

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

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

11. Stakeholder statement

The Company operates under the governance framework of the RHUK Group and an explanation of how the RHUK Group board has considered the matters set out in s172 is detailed within the Stakeholder engagement section of the RHUK Group annual report (which does not form part of this report). The RLP Board of Directors has also considered relevant matters where appropriate.

12. Date of authorisation of issue

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

ON BEHALF OF THE BOARD

A.M. Stoker
Chief Financial Officer
13 February 2020

Independent auditors' report to the members of Rothesay Life Plc

REPORT ON THE AUDIT OF THE FINANCIAL STATEMENTS

Opinion

In our opinion, Rothesay Life Plc's financial statements:

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

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

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

Basis for opinion

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

Independence

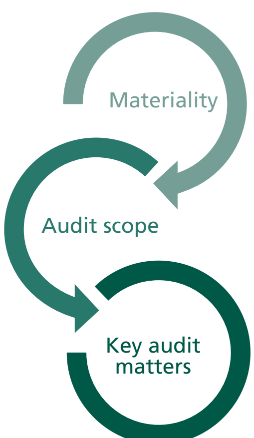
We remained independent of the Company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, which includes the FRC's Ethical Standard, as applicable to listed public interest entities, and we have fulfilled our other ethical responsibilities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

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

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

Our audit approach

Overview



Overall Company materiality: £50 million (2018: £35 million), equates to 1.33% of Total Equity.

The Company is a UK based legal entity, and we performed a full scope audit of the Company's financial statements.

Valuation of Insurance Contract Liabilities, specifically;

- Longevity Assumptions;
- Credit Default Risk Assumptions.

Valuation of investments classified as Level 3 under IFRS 13.

The scope of our audit

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

Independent auditors' report to the members of Rothesay Life Plc

REPORT ON THE AUDIT OF THE FINANCIAL STATEMENTS CONTINUED

Capability of the audit in detecting irregularities, including fraud

Based on our understanding of the Company and its industry, we identified that the principal risks of non-compliance with laws and regulations related to breaches of UK and European regulatory principles, such as those governed by the Prudential Regulation Authority and the Financial Conduct Authority (see page 14 of the Annual Report), and we considered the extent to which non-compliance might have a material effect on the financial statements. We also considered those laws and regulations that have a direct impact on the preparation of the financial statements of the Company such as the Companies Act 2006, the Prudential Regulation Authority's regulations, the Pensions Regulator legislation and UK tax legislation.

We also evaluated management's incentives and opportunities for fraudulent manipulation of the financial statements (including the risk of override of controls), and determined that the principal risks were related to posting inappropriate journal entries, such as increasing revenue or the capital position of the Company, management bias in accounting estimates and judgemental areas of the financial statements such as the valuation of life insurance contract liabilities and the valuation of investments classified as Level 3 under IFRS 13. Audit procedures performed by the engagement team included:

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

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

Key audit matters

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

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

Independent auditors' report to the members of Rothesay Life Plc

REPORT ON THE AUDIT OF THE FINANCIAL STATEMENTS CONTINUED

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

How we tailored the audit scope

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

The Company is a regulated insurance Company. A number of activities are outsourced to third party providers including claims administration, investment administration, payroll and hosting of the information technology infrastructure.

In order to gain appropriate audit evidence, we performed a combination of testing the internal controls over financial reporting and testing transactions and balances to supporting evidence. In respect of the outsourced service providers we were able to gain appropriate audit evidence through a combination of evaluating the providers' published assurance reports on internal control, performing our own testing at the administrators and testing controls operated by the Company that monitor the procedures carried out by the service providers. This gave us the evidence we needed for our opinion on the Rothesay Life plc financial statements as a whole.

Materiality

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

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

Overall materiality	£50million (2018: £35 million).
How we determined it	1.33% of total equity.
Rationale for benchmark applied	We consider total equity to be the most appropriate benchmark as it represents the residual interest that can be ascribed to shareholders after policyholder assets and corresponding liabilities have been accounted for. We compared our materiality against other relevant benchmarks, such as total assets, total revenue and profit before tax to ensure the materiality selected was appropriate for our audit.

We agreed with the Audit Committee that we would report to them misstatements identified during our audit above £2.5 million (2018: £1.75 million) as well as misstatements below those amounts that, in our view, warranted reporting for qualitative reasons.

Conclusions relating to going concern

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

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

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

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

Reporting on other information

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

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

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

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

Strategic Report and Report of the Directors

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

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

Independent auditors' report to the members of Rothesay Life Plc

REPORT ON THE AUDIT OF THE FINANCIAL STATEMENTS CONTINUED

Responsibilities for the financial statements and the audit

Responsibilities of the Directors for the financial statements

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

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

Auditors' responsibilities for the audit of the financial statements

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

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

Use of this report

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

Other required reporting

Companies Act 2006 exception reporting

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

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

We have no exceptions to report arising from this responsibility.

Appointment

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

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

Statement of comprehensive income

FOR THE YEAR ENDED 31 DECEMBER 2019

	Note	2019 £m	2018 restated[1] £m
Income			
Gross premiums written	B.1	**16,606**	13,424
Premiums ceded to reinsurers		**(1,245)**	(1,114)
Net premiums written		**15,361**	12,310
Investment return	B.2	**2,289**	140
Total revenue		**17,650**	12,450
Expenses			
Policyholder claims		**(2,442)**	(1,876)
Reinsurance recoveries		**1,046**	1,020
Change in insurance contract liabilities	E.2	**(15,373)**	(10,818)
Change in the reinsurers' share of insurance contract liabilities	E.2	**46**	(443)
Net claims and change in insurance liabilities		**(16,723**	(12,117)
Acquisition and administration expenses	B.3	**(180)**	(158)
Finance costs	B.4	**(107)**	(61)
Total expenses		**(17,010)**	(12,336)
Profit before tax		**640**	114
Income tax expense	B.8	**(122)**	(17)
Profit for the year		**518**	97

All income and expenses are related to continuing operations.

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

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

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

Statement of financial position

AS AT 31 DECEMBER 2019

	Note	2019 £m	2018 restated[1] £m
Assets			
Investment in subsidiaries	H.2	**11**	1
Property, plant and equipment		**9**	2
Lease – right of use asset	I.4	**37**	–
Financial investments	D.1	**73,741**	49,163
Reinsurance assets	E.1	**388**	43
Accrued interest and prepayments	D.3	**755**	497
Receivables	D.4	**947**	357
Cash and cash equivalents	D.5	**234**	151
Total assets		**76,122**	50,214
Equity and liabilities			
Share capital	C.1	**510**	410
Tier 1 notes	C.2	**347**	347
Share premium	C.3	**1,953**	1,353
Retained earnings	C.3	**946**	435
Total equity		**3,756**	2,545
Liabilities			
Reinsurance liabilities	E.1	**848**	549
Insurance contract liabilities	E.2	**47,932**	32,559
Payables and financial liabilities	D.6	**22,010**	13,855
Leasehold liabilities	I.4	**39**	–
Borrowings	D.7	**1,427**	647
Deferred tax liabilities	G.1	**31**	2
Accruals and deferred income		**79**	57
Total liabilities		**72,366**	47,669
Total equity and liabilities		**76,122**	50,214

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

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

A.M. Stoker
Chief Financial Officer
13 February 2020

Company number 06127279

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

Statement of changes in equity

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**

FOR THE YEAR ENDED 31 DECEMBER 2018

	Share capital £m	Share premium £m	Tier 1 notes £m	Retained earnings £m	Total equity £m
As at 1 January 2018	264	549	–	838	1,651
Tier 1 note issuance	–	–	347	–	347
Share issuance	146	804	–	–	950
Profit for the financial year	–	–	–	97	97
Dividends paid	–	–	–	(500)	(500)
As at 31 December 2018	410	1,353	347	435	2,545

Cash flow statement

FOR THE YEAR ENDED 31 DECEMBER 2019

	Note	2019 £m	2018 restated[1] £m
Cash flows from operating activities			
Profit for the financial year		**518**	97
Adjustments for non-cash movements in net profit for the year			
Retrospective restatement due to change in accounting treatment	B.4	**(7)**	–
Fixed asset write-off		**1**	–
Depreciation		**1**	1
Amortisation of debt costs		**1**	–
Leasehold depreciation	I.4	**2**	–
Financing charge on leasehold	I.4	**1**	–
Interest income	B.2	**(1,125)**	(956)
Interest expense	B.4	**105**	61
Income tax expense	B.8	**122**	17
Net (increase)/decrease in operational assets			
Financial investments		**(24,578)**	(11,849)
Reinsurance asset		**(344)**	124
Receivables		**(590)**	(19)
Prepayment		**(204)**	(83)
Net increase/(decrease) in operational liabilities			
Insurance contract liabilities		**15,373**	10,818
Reinsurance liabilities		**299**	319
Financial liabilities		**8,051**	(1)
Other payables		**40**	(82)
Deferred tax	G.1	**30**	–
Accruals and deferred income		**–**	23
Net cash flows used in operating activities		**(2,304)**	(1,530)
Interest paid		**(83)**	(62)
Interest received		**1,071**	843
Tax paid		**(59)**	(38)
Cash flows used in operating activities		**(1,375)**	(787)
Cash flows from financing activities			
Proceeds from issuance of debt (net of issuance costs)	D.7	**778**	–
Proceeds from issuance of Tier 1 notes (net of issuance costs)	C.2	**–**	347
Proceeds from issuance of ordinary share capital (including share premium)	C.1	**700**	950
Dividends paid	C.4	**–**	(500)
Net cash inflows from financing activities		**1,478**	797
Cash outflows from investing activities			
Acquisition of property, plant and equipment		**(9)**	–
Investment in subsidiary	H.2	**(10)**	(1)
Cash flow on leasehold	I.4	**(1)**	–
Net cash outflows from investing activities		**(20)**	(1)
Net increase in cash and cash equivalents		**83**	9
Cash and cash equivalents at 1 January		**151**	142
Cash and cash equivalents at 31 December	D.5	**234**	151

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

Notes to the financial statements

Note A – Significant accounting policies

A.1 Basis of preparation

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

RLP has taken an exemption from the requirement to prepare consolidated group accounts under section 405 of the Companies Act as the consolidation of the Company's subsidiaries is not considered to be material for the purpose of giving a true and fair view.

The financial statements of the Company are presented in sterling (£) rounded to the nearest million (£m) except where otherwise stated. The Company statement of financial position is presented on page 28.

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

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

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

- The assessment of whether the Company controls underlying entities and investments (see note H.1).
- Assessment of the significance of insurance risk transferred to the Company in determining whether a contract should be accounted for as an insurance or investment contract (see note A.2).
- The assessment of whether the Company has transferred the risk and rewards of ownership of financial assets during securitisations (see note I.1).

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

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

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

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

A.2 Contract classification

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

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

A.3 Foreign currencies

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

Notes to the financial statements

CONTINUED

Note A – Significant accounting policies (continued)

A.4 Adoption of new or amended standards

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

IFRS 16 Leases

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

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

The amendment covers two issues:

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

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

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

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

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

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

Information on credit risk exposure is provided in note F.2.1 Credit risk

Amendments to IAS 28 – Investments in associates

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

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

Note A – Significant accounting policies (continued)

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

Amendments to IAS 19 – Employee benefits

This amendment requires a company:

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

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

Annual improvements 2015-2017 cycles

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

IFRIC 23 – Uncertainty over income tax

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

New or revised standards not yet effective

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

Amendments to IFRS 3 Business combinations

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

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

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

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

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

Amendments to the conceptual framework

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

Notes to the financial statements

CONTINUED

Note A – Significant accounting policies (continued)

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

IFRS 17 Insurance contracts

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

A.5 Accounting treatment of reinsurance

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

Statement of comprehensive income and cash flow statement

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

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

Statement of financial position

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

Note B – Income statement notes

B.1 Segmental analysis

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

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

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

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

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

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

Note B – Income statement notes (continued)

B.2 Investment return

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

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

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

	2019 £m	2018 £m
Interest income on financial investments at fair value through profit and loss	**1,125**	956
Unrealised profit/(loss) on financial investments	**900**	(686)
Realised gains/(losses) on financial investments	**316**	(93)
Investment management expenses	**(52)**	(37)
Total investment return	**2,289**	140

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

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

B.3 Acquisition and administration expenses

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

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

	2019 £m	2018 £m
Acquisition costs	**108**	102
Administration expenses – recurring	**48**	36
Administration expenses – projects and other one-off expenses	**24**	20
Total operating expenses	**180**	158

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

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

The following items have been included in operating expenses:

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

Notes to the financial statements

CONTINUED

Note B – Income statement notes (continued)

B.4 Finance costs

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

	2019 £m	2018 £m
Interest payable on collateral	**9**	7
Interest payable on collateralised agreements and financing	**13**	9
Total interest payable on collateral and collateralised agreements	**22**	16
Interest payable on borrowings from participating interest	**26**	25
Interest payable on third party borrowings	**58**	20
Financing charge on leasehold asset	**1**	–
Total borrowing costs	**85**	45
Net finance costs	**107**	61

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

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

B.5 Employee information

All persons involved in the Company's operations are employed by a wider group undertaking, Rothesay Pensions Management Limited (RPML). The charges made by RPML for all the services provided (personnel and other) to the Company are included in the management fees charged by group undertakings. Details of the Group's employees are as follows:

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

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

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

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

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

Note B – Income statement notes (continued)

B.5 Employee information (continued)

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

	2019 £m	2018 £m
Directors' remuneration		
Aggregate emoluments	**4**	4
Company pension contributions to money purchase schemes	**–**	–
Total Directors' remuneration	**4**	4
Highest paid Director		
Total amount of emoluments	**2**	2
Company pension contributions to money purchase schemes	**–**	–
Total highest paid Director	**2**	2

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

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

B.6 Pension contributions

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

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

B.7 Auditors' remuneration

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

	2019 £000s	2018 £000s
Remuneration receivable by the Company's auditors for the audit of the Company financial statements	**1,060**	661
Remuneration receivable by the Company's auditors for the audit of the financial statements of the Company's subsidiaries	**47**	–
Total audit	**1,107**	661
Required by regulation	**126**	120
Audit-related assurance services	**158**	79
Other assurance services	**167**	196
Non-audit services	**75**	–
Total fees	**1,633**	1,056

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

Notes to the financial statements

CONTINUED

Note B – Income statement notes (continued)

B.8 Income tax expense

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

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

(a) Tax charged in the statement of comprehensive income

	2019 £m	2018 £m
Current income tax:		
UK corporation tax	87	19
Adjustment in respect of prior period	6	(2)
Total current income tax	**93**	17
Deferred tax:		
Origination and reversal of temporary differences	29	–
Total deferred tax	**29**	–
Total tax expense in the statement of comprehensive income	**122**	17

(b) Reconciliation of the total tax charge

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

	2019 £m	2018 £m
Profit on ordinary activities before taxation	640	114
Tax calculated at UK standard rate of corporation tax of 19% (2018: 19%)	122	22
Adjustment in respect of prior period	5	(2)
Difference in accounting and tax valuation basis	34	5
Permanent differences	(38)	–
Utilisation of losses surrendered by group undertakings	(1)	(8)
Total tax expense reported in the statement of comprehensive income	**122**	17

Note C – Equity

C.1 Share capital

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

	2019		2018	
	No.	£m	No.	£m
Authorised share capital (ordinary shares of £1 each)	510,528,696	510	410,322,557	410

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.

During prior year in order to ensure that RLP remained appropriately capitalised following the Prudential transaction, on 14 March 2018 the Company allotted 145,941,747 shares to RHUK for total cash consideration of £950m, reflecting share premium of £804m.

Note C – Equity (continued)

C.2 Restricted Tier 1 notes

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

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

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

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

The 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 2019	**1,353**	**435**
Profit for the financial year	**–**	**518**
Retrospective restatement due to change in accounting treatment	**–**	**(7)**
Share issuance	**600**	**–**
Dividends paid	**–**	**–**
31 December 2019	**1,953**	**946**

	Share premium £m	Retained earnings £m
1 January 2018	549	838
Profit for the financial year	–	97
Share issuance	804	–
Dividends paid	–	(500)
31 December 2018	1,353	435

C.4 Dividends paid

Final dividends are recognised when they are approved by the shareholders. Interim dividends are recognised in the year that they are paid. These dividends are debited directly to equity.

	2019 £m	2018 £m
Interim ordinary share dividends	**–**	500
	–	500

Notes to the financial statements

CONTINUED

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, the Company uses other methodologies to determine fair value, which vary based on the type of instrument. Valuation inputs and assumptions are changed when corroborated by substantive observable evidence, including values realised on sales.

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

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

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

Note D – Financial assets and liabilities (continued)
D.1 Financial investments (continued)

Derecognition

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

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

Collateralised agreements and financing

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

Cash collateral is recognised/derecognised when received/paid. Collateral posted by the Company 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.

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

	2019 £m	2018 £m
Financial investments carried at fair value through profit and loss, designated at initial recognition	**73,741**	49,163

Determination of fair value and fair value hierarchy

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

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

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

Notes to the financial statements

CONTINUED

Note D – Financial assets and liabilities (continued)

D.1 Financial investments (continued)

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

31 December 2019	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Collective investment schemes	**5,329**	**–**	**–**	**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 (see note D.2)	**–**	**19,508**	**–**	**19,508**
Collateralised agreements and financing	**–**	**1,875**	**–**	**1,875**
Loans secured on property	**–**	**–**	**6,063**	**6,063**
Equity release mortgages	**–**	**–**	**2,669**	**2,669**
Certificate of deposits	**–**	**180**	**–**	**180**
Total financial investments at fair value	**13,280**	**50,641**	**9,820**	**73,741**

31 December 2018	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Collective investment schemes	1,379	–	–	1,379
Government sub sovereign and agency obligations	4,694	10,989	364	16,047
Corporate bonds and other corporate debt	–	11,732	1,091	12,823
Derivative assets (see note D.2)	–	11,450	1	11,451
Collateralised agreements and financing	–	2,028	–	2,028
Loans secured on property	–	–	3,376	3,376
Equity release mortgages	–	–	1,897	1,897
Certificate of deposits	–	162	–	162
Total financial investments at fair value	6,073	36,361	6,729	49,163

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

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

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

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

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

Note D – Financial assets and liabilities (continued)

D.1 Financial investments (continued)

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

Equity release mortgages

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

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

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

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

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

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

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

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

Notes to the financial statements

CONTINUED

Note D – Financial assets and liabilities (continued)

D.1 Financial investments (continued)

Collateralised agreements

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Notes to the financial statements

CONTINUED

Note D – Financial assets and liabilities (continued)

D.3 Accrued interest and prepayments

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

D.4 Receivables

	2019 £m	2018 £m
Deposits pledged as collateral to third parties	**688**	333
Amounts due from group undertakings	**43**	6
Other receivables	**216**	18
Total receivables	**947**	357

All receivables are due within one year. The fair value of receivables is £947m (2018: £357m).

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

D.5 Cash and cash equivalents

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

	2019 £m	2018 £m
Cash at bank and in hand	**234**	151
Total cash and cash equivalents	**234**	151

D.6 Payables and financial liabilities

	2019 £m	2018 £m
Derivative financial instruments	**19,944**	11,790
Collateralised financing agreements	**676**	779
Total financial liabilities	**20,620**	12,569
Deposits received as collateral from third parties	**1,193**	1,128
Amounts due to group undertakings	**70**	50
Current tax payable	**81**	17
Other payables	**46**	91
Total payables	**1,390**	1,286
Total payables and financial liabilities	**22,010**	13,855

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

Payables and financial liabilities of £1,671m (2018: £1,575m) are all due within one year.

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

Note D – Financial assets and liabilities (continued)

D.7 Borrowings

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

The Company's borrowings are as follows:

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

On 12 July 2019 the Company 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 the Company 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.

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

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

For the period ended 31 December 2019, an interest expense of £60m (2018: £45m) was recognised in the 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 statement of financial position for liabilities arising from financing activity:

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

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

Notes to the financial statements

CONTINUED

Note E – Insurance contracts and reinsurance

E.1 Reinsurance assets/liabilities

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

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

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

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

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

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

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

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

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

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

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

Note E – Insurance contracts and reinsurance (continued)
E.2 Insurance contract liabilities

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

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

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

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

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

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

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

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

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

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

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

Notes to the financial statements

CONTINUED

Note E – Insurance contracts and reinsurance (continued)

E.2 Insurance contract liabilities (continued)

Improvements are equivalent to those shown in the table below:

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

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

(b) Economic assumptions including valuation rate of interest

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

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

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

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

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

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

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

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

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

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

Note E – Insurance contracts and reinsurance (continued)

E.2 Insurance contract liabilities (continued)

(c) Expense assumption

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

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

(d) Member option and dependants assumptions

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

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

When deferred annuitants have passed the scheme normal retirement date and have been subject to an in-depth tracing exercises 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.

e) Movement in insurance contract liabilities

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.

	2019 £m	2018 £m
Carrying amount at 1 January	**33,065**	21,804
Increase in respect of new business	**16,362**	12,933
Release of liabilities	**(2,028)**	(1,162)
Effect of assumption changes	**985**	(517)
Other	**8**	7
Closing balance at 31 December	**48,392**	33,065

The following table shows the impact on the insurance contract liabilities, net of reinsurance, of changes in the assumptions used:

Net increase/(decrease) in liabilities	**2019 £m**	2018 £m
Change in assumptions used		
Valuation rate of interest	**1,747**	(401)
Inflation	**(716)**	(10)
Effect of economic assumption changes	**1,031**	(411)
Demographics	**(212)**	(133)
Member options	**(10)**	(20)
Expenses	**176**	47
Effect of non-economic assumption changes	**(46)**	(106)
Total effect of assumption changes	**985**	(517)

As shown previously, the valuation rate of interest decreased by 66bps over the year, which led to the £1.7bn increase in the net liability shown. This was partially offset by the impact of the fall in future rate of inflation.

Notes to the financial statements

CONTINUED

Note E – Insurance contracts and reinsurance (continued)

E.2 Insurance contract liabilities (continued)

The movement in the demographic assumptions shown reflects the changes to base mortality, mortality improvement and other demographic assumption changes applied during the year, leading to a £212m decrease in net liabilities. The change in the assumptions are shown in section (a).

Additional expense reserves set up to support new business as set up at the point of sale have been reflected through the increase in net insurance liabilities in respect of new business. Expense assumptions were strengthened further during the second half of 2019, increasing the net liabilities by £176m, including changes to ongoing maintenance and investment costs and changes to the allowance for project provisions.

(f) Sensitivity analysis

The schedule below provides an analysis of the reasonably possible movements in key assumptions that would have a material impact on liabilities (net of reinsurance), profit before tax (PBT) and equity. The analysis is based on a change in a single assumption whilst holding all other assumptions constant. The analysis assumes an instantaneous shock to the assumptions other than for the interest rate sensitivity where the impact of dynamic hedging is allowed for as interest rates change. The interest rate sensitivities have increased by more than the increase in the size of the balance sheet because of the long duration of the new business. However the risk remains closely monitored and hedged as seen through the impact of the sensitivity on equity. Inflation sensitivities have increased from 2018 to 2019 because all of schemes insured in 2019 have inflation-linked benefits.

2019	Change in assumptions	(Decrease)/ increase in net liabilities £m	Increase/ (decrease) in PBT £m	Impact on equity £m
Annuitant mortality	**+5% qx**	**(228)**	**225**	**182**
Annuitant mortality	**-5% qx**	**240**	**(237)**	**(192)**
Interest rate	**+100bps**	**(6,149)**	**241**	**195**
Interest rate	**-100bps**	**7,719**	**(85)**	**(69)**
Inflation	**+100bps**	**3,234**	**(242)**	**(196)**
Inflation	**-100bps**	**(2,968)**	**382**	**309**
Credit default assumption	**+10bps**	**(508)**	**(310)**	**(251)**
Credit default assumption	**-10bps**	**523**	**319**	**259**
Change in property prices	**+10%**	**(14)**	**72**	**59**
Change in property prices	**-10%**	**35**	**(113)**	**(91)**
Expenses	**+10%**	**134**	**(134)**	**(108)**

2018	Change in assumptions	(Decrease)/ increase in net liabilities £m	Increase/ (decrease) in PBT £m	Impact on equity £m
Annuitant mortality	+5% qx	(172)	171	139
Annuitant mortality	-5% qx	181	(179)	(145)
Interest rate	+100bps	(3,752)	26	21
Interest rate	-100bps	4,661	292	236
Inflation	+100bps	1,320	26	21
Inflation	-100bps	(1,256)	82	66
Credit default assumption	+10bps	(320)	(206)	(167)
Credit default assumption	-10bps	329	209	170
Change in property prices	+10%	(9)	59	47
Change in property prices	-10%	15	(84)	(68)
Expenses	+10%	95	(95)	(77)

The sensitivities shown capture non-linearity effects, which may be significant following large market movements. The risk management strategy adopted can result in the Company being immunised to market movements in either direction.

Given current interest rates, the -100bps interest rate sensitivity means that interest rates are assumed to fall below zero for eight years (2018: did not fall below zero).

Note E – Insurance contracts and reinsurance (continued)

E.2 Insurance contract liabilities (continued)

The impact of reinsurance on the sensitivity to mortality risk is a reduction of 78% (2018: 78%).

The annuitant mortality sensitivity is defined in terms of a qx stress where qx represents the probability of a life dying during the year. As such, in the annuitant mortality stress it is assumed that in each year 5% more or fewer people survive to the end of each year than had previously been assumed.

(g) Timing of cash flows

The table below shows the discounted value of insurance liability cash flows, net of reinsurance, which are expected to arise during each year:

	2019			
	Less than 1 year £m	**1 to 5 years £m**	**Over 5 years £m**	**Total £m**
Insurance contract cash flows net of reinsurance	**2,440**	**9,057**	**36,895**	**48,392**

	2018			
	Less than 1 year £m	1 to 5 years £m	Over 5 years £m	Total £m
Insurance contract cash flows net of reinsurance	1,988	6,990	24,087	33,065

Note F – Risk and capital management

F.1 Capital management

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

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

From 1 January 2016, the Company was required to operate under the new Solvency II regime. The Company had sufficient capital available to meet its regulatory capital requirements at all times during the year ended 31 December 2019.

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

- The Company's technical provisions, being:
  - the liabilities of the Company calculated on a best estimate basis (the BEL); plus
  - the risk margin; less
  - available transitional solvency relief.
- The capital required to meet a 1-in-200-year stress (known as the solvency capital requirement or SCR).

Transitional solvency relief was re-calculated as at both 31 December 2018 and 31 December 2019 and amortises by $1/16^{th}$ each year from 1 January 2017. As at 31 December 2019, solvency estimates allow for amortisation of $3/16^{ths}$ of transitional solvency relief (2018: $2/16^{th}$).

The Company 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 Company's bespoke models and the standard formula is used to calculate the SCR for all other risk components and for aggregation across risk components.

Notes to the financial statements

CONTINUED

Note F – Risk and capital management (continued)

F.1 Capital management (continued)

Capital in excess of that required to meet the technical provisions is known as Own Funds. As at 31 December 2019, Own Funds for the Company were £6,113m (2018: £3,894m) made up as follows:

	2019 £m	2018 £m
Total IFRS equity	3,756	2,545
Liability valuation differences and other regulatory adjustments	902	691
Total Tier 1	4,658	3,236
Tier 2 debt valuation	1,059	658
Tier 3 debt valuation	396	–
Own Funds	6,113	3,894

The Company holds both debt and equity to optimise its capital structure and improve shareholder return. During 2019, £700m of equity, £400m of Tier 2 debt and £400m of Tier 3 debt were issued by the Company. During the prior year, £950m of equity and £350m of RT1 notes were issued by the Company.

The capital position is sensitive to changes in market conditions, due to changes in the value of the assets and the effect that changes in investment conditions may have on the value of the liabilities. The Company 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.

F.2 Risk management and analysis

The Company is exposed to credit, market and liquidity risk through its financial assets and financial liabilities. The Company is exposed to insurance risk through its insurance liabilities and to operational risk as a result of its activities. These risks are described below and are managed in accordance with risk management policies and procedures established by the Company. Please see pages 11 to 17 of the strategic review for further detail on risk management arrangements and the governance framework within the Company.

F.2.1 Credit risk

Credit risk represents the potential for loss, or solvency deterioration, due to the default or deterioration in credit quality of a counterparty or an investment RLP holds. Credit risk also arises from cash placed with banks or money market funds, collateralised financing transactions (i.e. resale and repurchase agreements) and receivables from third parties.

Management is responsible and accountable for managing credit risks within prescribed limits. Effective management of credit risk requires disciplined underwriting, accurate and timely information, strong collateral management, a high level of communication and knowledge of customers, countries, industries and products.

The independent risk function, led by the CRO, has responsibility for ensuring an appropriate framework is in place for assessing and monitoring credit risk. All credit exposures are actively monitored by the risk function, including the use of regular sector and position reviews and a number of early warning indicators, resulting in regular reporting to the investment team and key governance bodies such as the BRC.

Risk mitigants

The Company manages credit risk in its investment portfolio by diversifying exposures across and within sectors, controlling position sizes through limits, and regular monitoring and oversight of investments.

To mitigate the credit exposures on derivatives and collateralised agreement transactions, the Company obtains collateral from counterparties on an upfront or contingent basis. The Company also enters into netting agreements with counterparties that permit it to offset receivables and payables with such counterparties for transaction settlements and upon a counterparty default.

When the Company does not have sufficient visibility into a counterparty's financial strength, or when it believes a counterparty requires support from its parent company, the Company may obtain third party guarantees of the counterparty's obligations. The Company also mitigates its investment and counterparty credit risk using credit derivatives.

Note F – Risk and capital management (continued)

F.2 Risk management and analysis (continued)

F.2.1 Credit risk (continued)

Credit exposures

The Company is exposed to credit risk from its receivables from third parties. Receivables from counterparties are generally comprised of collateralised receivables related to derivatives or collateralised agreements transactions and have minimal credit risk due to the value of the collateral received. In addition, the Company invests in assets that are typically highly rated, or assets where there is underlying structural security in the event of a default. These assets include supranationals, sovereign bonds, sub sovereign bonds, covered bonds, higher education bonds, infrastructure assets, unsecured corporate bonds and secured residential lending.

Further information is provided below:

Cash and cash equivalents. Cash and cash equivalents include both interest bearing and non-interest bearing deposits and investment in money market funds. To mitigate the risk of credit loss, the Company diversifies its exposure and places its deposits with multiple banks, typically with minimum ratings in the 'A' rating category. The Company only invests in 'AAA' rated money market funds.

Derivatives. Derivatives are reported at fair value on a gross basis by counterparty in the Company's financial statements unless the Company has current legal rights of set-off and also intends to settle on a net basis. Derivatives are risk managed through the processes, risk mitigating measures and limits described above.

Collateralised agreements. Collateralised agreements are reported at fair value or contractual value before consideration of collateral received on the balance sheet. The Company bears credit risk related to sale and repurchase agreements and securities borrowing only to the extent that cash advanced to the counterparty exceeds the value of the collateral received or charges over assets. Therefore, the Company's credit exposure on the transactions is significantly lower than the amounts recorded on the balance sheet. The Company also has credit exposure on repurchase agreements and securities loaned, which are liabilities on its statement of financial position, to the extent that the collateral pledged for these transactions exceeds the amount of cash received.

Reinsurance. Long-term business is ceded to reinsurers under collateralised contracts to transfer part of the insurance risk associated with the underlying insurance contracts. The amounts that will be recoverable from reinsurers is estimated based upon the gross provisions, having due regard to collectability. The recoverability of reinsurance recoveries is assessed having regard to market data on the financial strength of the reinsurance company.

Notes to the financial statements

CONTINUED

Note F – Risk and capital management (continued)

F.2 Risk management and analysis (continued)

F.2.1 Credit risk (continued)

The following table identifies the amounts covered by enforceable netting arrangements (netting under master netting agreements, cash collateral and security collateral) which do not qualify for netting under IAS 32.

	2019	Related amounts not offset			
	Net amount of financial assets presented in the statement of financial position £m	Netting under master netting agreements £m	Cash collateral £m	Security collateral and charges £m	Net credit exposures £m
Investment in subsidiary undertaking	11	–	–	–	11
Property, plant and equipment	9	–	–	–	9
Lease – right of use	37	–	–	–	37
Collective investment schemes	5,329	–	–	–	5,329
Government sub sovereign and agency obligations	17,956	–	–	–	17,956
Corporate bonds and other corporate debt	20,161	–	–	–	20,161
Derivative assets	19,508	(16,000)	(529)	(2,960)	19
Collateralised agreements and financing	1,875	–	(33)	(1,842)	–
Loans secured on property	6,063	–	–	(6,063)	–
Equity release mortgages	2,669	–	–	(2,669)	–
Certificate of deposits	180	–	–	–	180
Reinsurance assets	388	–	(3)	(126)	259
Accrued income and prepayments	755	–	–	(106)	649
Receivables	947	–	–	–	947
Cash and cash equivalents	234	–	–	–	234
Total	**76,122**	**(16,000)**	**(565)**	**(13,766)**	**45,791**
Derivative liabilities	(19,944)	16,000	351	3,216	(377)
Collateralised financing agreements	(676)	–	–	676	–
Total	**(20,620)**	**16,000**	**351**	**3,892**	**(377)**

Note F – Risk and capital management (continued)
F.2 Risk management and analysis (continued)
F.2.1 Credit risk (continued)

	2018 Related amounts not offset				
	Net amount of financial assets presented in the statement of financial position £m	Netting under master netting agreements £m	Cash collateral £m	Security collateral and charges £m	Net credit exposures £m
Investment in subsidiaries	1				1
Property, plant and equipment	2	–	–	–	2
Collective investment schemes	1,379	–	–	–	1,379
Government sub sovereign and agency obligations	16,047	–	–	–	16,047
Corporate bonds and other corporate debt	12,823	–	–	–	12,823
Derivative assets	11,451	(8,149)	(567)	(2,731)	4
Collateralised agreements and financing	2,028	–	(13)	(2,015)	–
Loans secured on property	3,376	–	–	(3,376)	–
Equity release mortgages	1,897	–	–	(1,897)	–
Certificate of deposits	162	–	–	–	162
Reinsurance assets	43	–	–	–	43
Accrued income and prepayments	497	–	–	–	497
Receivables	357	–	–	–	357
Cash and cash equivalents	151	–	–	–	151
Total	50,214	(8,149)	(580)	(10,019)	31,466
Derivative liabilities	(11,790)	8,149	315	3,105	(221)
Collateralised financing agreements	(779)	–	–	779	–
Total	(12,569)	8,149	315	3,884	(221)

Within the above table, derivative liabilities are only included to the extent they net against derivative assets. Therefore, the amount of derivative assets shown after offsetting netting arrangements does not represent the Company's overall derivative exposure. The Company's overall exposure can be seen in note D.2.

Right of offset

The Company has the right of offset for certain financial assets and liabilities.

Netting under master netting agreements of £16,000m (2018: £8,149m) reflects the offsetting of derivative assets with liabilities for which the Company has a right to set off in the event of default. Cash and security collateral have been offset to the extent there are credit exposures on the balance sheet.

The Company has received total security collateral and charges of £14,219m (2018: £10,570m) of which £13,766m (2018: £10,019m) has been applied against net exposure, leaving excess of £453m (2018: £551m). Security collateral exposes the Company to further market and credit risk. This is mitigated through the use of haircuts and over-collateralisation.

Credit default swaps have been purchased to protect the Company from the default of some of its counterparties. The table on the previous page does not reflect the protection provided. The Company calls margins, receivable in cash and gilt instruments, against this exposure and other derivative positions.

In a distressed situation the value of collateral may vary depending on credit quality and interest rates. The effectiveness of collateral as a credit risk mitigant will depend on the operational expertise of the collateral manager and the ability to seize, value and sell the collateral in a distressed scenario.

The table on the next page shows the Company's gross and net credit exposure based on external and internal ratings to be consistent with management's view of credit. 2018 comparatives have been restated accordingly. The external rating is generally based on the median of the ratings assigned by Standard & Poor's, Moody's and Fitch. For the purpose of Solvency II, certain assets are internally rated by the Company's independent credit risk function under a framework which has been externally validated.

Notes to the financial statements

CONTINUED

Note F – Risk and capital management (continued)

F.2 Risk management and analysis (continued)

F.2.1 Credit risk (continued)

Net credit exposure is predominately arising from strong investment grade assets. AAA rated assets include supranational bonds, sub sovereigns, covered bonds, US not-for-profit private universities and certificates of deposit. AA rated assets include gilts. Other net credit exposures rated A and BBB include investments in regulated infrastructure assets and commercial real estate loans, as well as unsecured corporate bonds.

A vast majority of the unrated assets relate to residential mortgages that are not individually rated.

	2019 Related amounts not offset				
	Net amount of financial assets presented in the statement of financial position £m	**Netting under master netting agreements £m**	**Cash collateral £m**	**Security collateral and charges £m**	**Net credit exposures £m**
Exposure to credit risk by rating					
AAA	**14,726**	**–**	**–**	**(2,660)**	**12,066**
AA	**20,249**	**(1,855)**	**(49)**	**(2,046)**	**16,299**
A	**28,372**	**(13,738)**	**(490)**	**(2,285)**	**11,859**
BBB	**9,254**	**(407)**	**(23)**	**(3,762)**	**5,062**
BB	**–**	**–**	**–**	**–**	**–**
B	**–**	**–**	**–**	**–**	**–**
Unrated	**3,521**	**–**	**(3)**	**(3,013)**	**505**
Total	**76,122**	**(16,000)**	**(565)**	**(13,766)**	**45,791**

	2018 Related amounts not offset				
	Amounts of financial assets presented in the statement of financial position £m	Netting under master netting agreements £m	Cash collateral £m	Security collateral and charges £m	Net credit exposures £m
Exposure to credit risk by rating					
AAA	10,391	–	–	(2,646)	7,745
AA	15,553	(891)	(13)	(1,780)	12,869
A	15,183	(6,319)	(389)	(644)	7,831
BBB	6,937	(939)	(178)	(2,975)	2,845
BB	–	–	–	–	–
B	–	–	–	–	–
Unrated	2,150	–	–	(1,974)	176
Total	50,214	(8,149)	(580)	(10,019)	31,466

Other than a small number of equity release mortgages, as of the current and prior year end there were no financial assets past due.

Note F – Risk and capital management (continued)

F.2 Risk management and analysis (continued)

F.2.2 Market risk

Market risk is the risk of changes in the value of the Company's net position due to changes in market prices. Financial investments are accounted for at fair value and, therefore, fluctuate on a daily basis. Certain liabilities are also exposed to market risk. Categories of market risk include the following:

- Interest rate risk arises from discounting cash flow mismatches across all future dates. Profits and losses are generated through changes in the level, slope and curvature of interest rate curves. The risk is hedged closely by matching assets and liabilities and by using interest rate swaps. Consideration is given to both the Company's IFRS and solvency risk positions when determining the appropriate hedging strategy.
- Inflation rate risk results from mismatches in the index linkage of liabilities and assets. Profits and losses are generated through changes to the level, slope and curvature of inflation curves. The risk is hedged by closely matching assets and liabilities and by using inflation swaps.
- Currency rate risk results from mismatches in the denomination of liabilities and assets. Profits and losses are generated due to changes in the level of foreign exchange rates. The risk is hedged using spot foreign exchange and cross currency swaps.
- Property risk results from investments that are secured on commercial or residential properties. Profits and losses may be generated by material movements in spot or forward property prices. This risk is mitigated through strict underwriting criteria, aggregated risk monitoring and low loan-to-value limits. Where the property risk becomes more material then prudent allowance is made for this within the credit risk adjustment.

The Company manages market risk by diversifying exposures, controlling position sizes through limits and regular stress and scenario testing and establishing economic hedges in related securities, derivatives and insurance liabilities.

Sensitivities to market risk are shown in note E.2 (f).

F.2.3 Liquidity risk

Liquidity risk arises where timing differences and/or uncertainties occur between cash inflows and cash outflows. The objective of liquidity management is to ensure that the Company is capable of honouring all cash flow commitments on both an ongoing basis and in a stressed scenario, without incurring significant cost or business disruption.

The Company liquidity policy is designed to ensure the availability of sufficient funds to meet cash flow requirements on a timely basis via:

- Maintenance of substantial excess liquidity. The Company seeks to enter into long-term, illiquid investments that match its liabilities in order to maximise the value of the illiquidity premium. To mitigate residual liquidity risk, the Company maintains substantial excess liquidity to meet a broad range of potential cash outflows in a stressed environment including collateral outflows and financing obligations.
- Conservative asset/liability management. The Company seeks to maintain funding sources that are sufficiently long-term in order to withstand a prolonged or severe liquidity-stressed environment without having to rely on asset sales.

The liquidity management framework is designed to ensure that a prudent level of liquidity is maintained on a spot basis, but also under stressed market conditions at which time liquidity may leave the Company through collateral outflows and ongoing business obligations such as expenses and undrawn investments. A suite of market stresses are considered as part of the liquidity management framework, against which limits are applied by the Board.

The risk function has primary responsibility for ensuring an appropriate framework is in place for assessing, monitoring and managing liquidity risk. The liquidity risk management framework requires liquid assets to be held to meet a wide range of stressed market conditions which consider all material sources of liquidity risk present on the balance sheet. Liquidity is managed for the Company as a whole, in addition to at a Solvency II fund level. Risks are monitored and controlled through strong oversight and independent control and support functions across the business.

Management is responsible and accountable for managing liquidity risks within prescribed limits that are set by the Board and are overseen by the BRC.

Notes to the financial statements

CONTINUED

Note F – Risk and capital management (continued)

F.2 Risk management and analysis (continued)

F.2.3 Liquidity risk (continued)

The following table details the Company's financial liabilities and assets by contractual maturity including interest that was accrued where the Company is entitled to repay the liability before its maturity. Financial assets and liabilities are presented at their fair value (with the exception of receivables, cash, accrued interest and borrowings) as this is consistent with the values used in the liquidity risk management of these instruments. The table excludes insurance liability and reinsurance cash flows which are included in note E.2. The table also excludes equity release mortgage cash flows which are included in note D.1 and leasehold cashflows which are included in note I.4.

	2019			
	Less than 1 year £m	**1 to 5 years £m**	**Over 5 years £m**	**Total £m**
Financial assets				
Financial investments	**6,588**	**6,183**	**58,301**	**71,072**
Accrued income and prepayments	**755**	**–**	**–**	**755**
Receivables	**947**	**–**	**–**	**947**
Cash and cash equivalents	**234**	**–**	**–**	**234**
	8,524	**6,183**	**58,301**	**73,008**
Financial liabilities				
Financial liabilities	**(281)**	**(1,499)**	**(18,840)**	**(20,620)**
Payables	**(1,390)**	**–**	**–**	**(1,390)**
Borrowings	**(100)**	**–**	**(1,327)**	**(1,427)**
Accruals and deferred income	**(79)**	**–**	**–**	**(79)**
	(1,850)	**(1,499)**	**(20,167)**	**(23,516)**
Net	**6,674**	**4,684**	**38,134**	**49,492**

	2018			
	Less than 1 year £m	1 to 5 years £m	Over 5 years £m	Total £m
Financial assets				
Financial investments	3,514	5,174	38,578	47,266
Accrued income and prepayments	497	–	–	497
Receivables	357	–	–	357
Cash and cash equivalents	151	–	–	151
	4,519	5,174	38,578	48,271
Financial liabilities				
Financial liabilities	(289)	(950)	(11,330)	(12,569)
Payables	(1,286)	–	–	(1,286)
Borrowings	(100)	–	(547)	(647)
Accruals and deferred income	(57)	–	–	(57)
	(1,732)	(950)	(11,877)	(14,559)
Net	2,787	4,224	26,701	33,712

Note F – Risk and capital management (continued)

F.2 Risk management and analysis (continued)

F.2.4 Operational risk

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. The Company manages operational risk through the development and maintenance of an effective risk management framework which ensures that a comprehensive internal control environment is in place. This is supported by regular risk and control self-assessments coordinated, challenged and reported by the second line, which allow risk levels to be measured and control enhancements to be developed in line with the Company's risk appetite.

The Company also uses scenario analysis to explore key areas of operational risk, ensuring that the implications of adverse operational risk events crystallising are well understood and that, where appropriate, additional controls or contingency plans are introduced to improve operational resilience.

The Company has significant outsourcing arrangements in place, which are subject to extensive due diligence at the point of entering into them, but also to ongoing review, with oversight provided by the Third Party Oversight Committee. Oversight of these arrangements considers the information security risk that the Company is exposed to, the performance of the third party with respect to service level agreements, and other relevant information (e.g. their ongoing creditworthiness, and where relevant their readiness to accommodate the Company's growth).

Operational risk also includes the risk of conduct failure – a risk that is managed by the Compliance function and overseen by the Customer and Conduct Committee.

F.2.5 Insurance risk

Insurance risk is the risk of changes in the value of the Company's net position due to changes in the insurance contract liabilities. Insurance risk may occur either through changes in actual demographic experience or revised expectations of future experience. The main categories of insurance risk include the following:

- Demographic risk arises from current mortality or spouse experience being lighter than that assumed. The risk is hedged by external reinsurance.
- Longevity improvement risk represents the risk of future mortality rates improving at a faster rate than assumed. The risk is hedged by external reinsurance.
- Expense risk results from future expenses required to maintain the business being higher than expected. This risk is managed through budgeting and robust expense management.

As at 31 December 2019 78% of longevity risk was reinsured (2018: 78%). Risks are monitored and controlled by the actuarial function and overseen by the Chief Actuary and risk function.

Note G – Other statement of position notes

G.1 Deferred tax liabilities

Deferred income tax is provided using the liability method on temporary differences at the financial statement date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes.

Deferred income tax and liabilities are recognised for all taxable temporary differences except:

- *when the deferred income tax liability arises from the initial recognition of goodwill or from an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit or loss nor taxable profit or loss; and*
- *in respect of taxable temporary differences associated with investments in subsidiary undertakings, associates and interests in joint ventures, when the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future.*

The carrying amount of deferred income tax assets is reviewed at each financial reporting date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilised. Unrecognised deferred income tax assets are reassessed at each financial reporting date and are recognised to the extent that it has become probable that future taxable profit will allow the deferred tax asset to be recovered.

Deferred income tax assets and liabilities are measured at the tax rates that are expected to apply to the year when the asset is realised or the liability settled, based on tax rates (and tax laws) that have been enacted or substantively enacted at the financial reporting date.

Deferred income tax assets and deferred tax liabilities are offset if a legally enforceable right exists to set off current tax assets against current tax liabilities and the deferred income tax relates to the same taxable entity and the same taxation authority.

Notes to the financial statements

CONTINUED

Note G – Other statement of position notes (continued)

G.1 Deferred tax liabilities (continued)

Deferred tax balances comprise:

	2019 £m	2018 £m
Temporary differences between the financial statements and the tax deductions	**(31)**	(2)
Total temporary differences	**(31)**	(2)

The movements in the deferred tax balances were as follows:

	2019 £m	2018 £m
At 1 January	**(2)**	(2)
Temporary difference between amortised cost and fair value basis	**(29)**	–
At 31 December	**(31)**	(2)

Deferred tax assets are only recognised to the extent that, based on management's assessment, they are regarded as recoverable.

Unrecognised deferred tax balances

	2019 £m	2018 £m
Timing differences	**–**	4
	–	4

The movements in the unrecognised deferred tax balances were as follows:

	2019 £m	2018 £m
At 1 January	**4**	–
Recognition of previously unrecognised deferred tax	**(4)**	–
Timing differences	**–**	4
At 31 December	**–**	4

Note H – Interests in subsidiaries and associates

H.1 Investment in unconsolidated structured entities

The Company has interests in investments which are classified under IFRS as unconsolidated structured entities. A structured entity is an entity that has been designed so that voting or similar rights are not the dominating factor in deciding who controls the entity, such as when voting rights might relate to administrative tasks only and the relevant activities are directed by means of contractual arrangement. Structured entities include those entities that have restricted activities or a narrow and well-defined objective. These structured entities have not been consolidated as the Company does not have the power to affect their returns.

The Company has interests in unconsolidated structured entities as described below:

- loans granted to and notes issued by special purpose vehicles (SPVs) secured by the assets held by the SPV such as commercial or residential real estate;
- debt securities issued by SPVs secured by financial receivables; and
- loans granted to SPVs secured by financial receivables.

As at 31 December 2019, the Company's total interest in such entities, reflected on the Company's statement of financial position and classified as financial investments held at fair value through profit or loss, was £7,555m (2018: £4,825m). The recorded fair value represents the Company's maximum loss exposure to these unconsolidated structured entities. The £2,730m increase in the balance was predominantly driven by new investments in commercial real-estate loans and mark-to-market gains on existing positions.

Note H – Interests in subsidiaries and associates (continued)

H.1 Investment in unconsolidated structured entities (continued)

A summary of the Company's interest in unconsolidated structured entities is provided below:

	2019 £m	2018 £m
Government sub sovereign and agency obligations	**63**	75
Corporate bonds and other corporate debt	**1,545**	1,319
Loans secured on property	**5,947**	3,431
Total	**7,555**	4,825

H.2 Investments in subsidiaries

Investments in subsidiary undertakings are stated at cost less provision for impairment in the Company's financial statements.

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

Company undertakings	Country of incorporation	Primary business operation	2019 £m	2018 £m	2019 % equity interest	2018 % equity interest
Rothesay Assurance Limited (formerly known as MetLife Assurance Limited)	UK	Service company	**–**	–	**100%**	100%
LT Mortgage Financing Limited	UK	Service company	**6**	1	**100%**	100%
Rothesay MA No.1 Limited	UK	Service company	**5**	–	**100%**	100%
Rothesay MA No.2 Limited	UK	Service company	**–**	–	**100%**	–
Rothesay MA No.3 Limited	UK	Service company	**–**	–	**100%**	–
Rothesay MA No.4 Limited	UK	Service company	**–**	–	**100%**	–

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.

	2019 £m	2018 £m
Statement of comprehensive income		
Change in the reinsurers' share of insurance contract liabilities and reinsurance recoveries	**(2)**	(3)
Finance costs	**(26)**	(25)
Operating expenses	**(8)**	(1)
Statement of financial position		
Reinsurance liabilities	**6**	4
Borrowings	**398**	398
Capital	**2,463**	1,763

Notes to the financial statements

CONTINUED

Note I – Other notes (continued)

I.1 Related parties disclosures (continued)

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:

	2019 £m	2018 £m
Salaries, bonus and other employee benefits	21	20
Equity-based compensation payments	6	4
Total transactions	**27**	24

On 4 April 2019 members of key management personnel and their families sold new B ordinary shares to the Employee Benefit Trust for consideration of £7.8m.

The tables below represent transactions between RLP its parent RHUK, its subsidiaries LTMF and RMA1 and other group companies RPML and Rothesay Asset Management US LLC.

Transactions with RHUK	2019 £m	2018 £m
Statement of comprehensive income		
Cost transfer	5	3
Statement of financial position		
Other receivables	13	6
Capital	2,464	1,764
Dividends	–	500

Transactions with LTMF	2019 £m	2018 £m
Statement of financial position		
Other receivables	11	–
Capital	6	–

Transactions with Rothesay MA No.1 Limited	2019 £m	2018 £m
Statement of financial position		
Other receivables	8	–
Capital	5	–

Transactions with RPML	2019 £m	2018 £m
Statement of comprehensive income		
Cost transfer	(86)	(68)
Statement of financial position		
Other payables	66	47

Transactions with Rothesay Asset Management US LLC	2019 £m	2018 £m
Statement of comprehensive income		
Transaction fee	(4)	(1)
Service fee	(1)	(2)
Statement of financial position		
Other payables	4	3

Note I – Other notes (continued)

I.1 Related parties disclosures (continued)

Transactions with LTMF

During December 2018, £1.3bn of the equity release mortgage loans were transferred from RLP to its subsidiary LT Mortgage Financing Limited (LTMF). During June 2019 and September 2019, a further £0.4bn and £0.2bn respectively were transferred from RLP to LTMF. LTMF became the beneficial owner in the equity release mortgage loans in exchange for the issue of loan notes. These transactions took place on an arm's length basis using the fair value of the equity release mortgages. Under IAS 39 the loans cannot be derecognised from the Company as RLP effectively maintains all the risk and rewards and control of the mortgages after the securitisations through the loan notes. For the purposes of determining the valuation rate of interest under IFRS 4, this securitisation is ignored.

Transactions with Rothesay MA No.1 Limited

During December 2018, £778m of ground rent loans were transferred from RLP to its subsidiary Rothesay MA No.1 Limited (RMA1). RMA1 became the beneficial owner in the ground rent loans in exchange for the issue of loan notes. These transactions took place on an arm's length basis using the fair value of the ground rent loans. Under IAS 39 the loans cannot be derecognised from the Company as RLP effectively maintains all the risk and rewards and control of the loans after the securitisations through the loan notes. For the purposes of determining the valuation rate of interest under IFRS 4, this securitisation is ignored.

I.2 Share based payments

The cost of equity-based transactions with employees is measured based on grant-date sale value. Share-based employee awards that require future services are amortised over the relevant service period. Expected forfeitures are included in determining share-based employee compensation expenses.

The fair value is determined at grant date and expensed on a straight-line basis over the vesting period in profit and loss. At each reporting date the RHUK Group revises its estimate of the number of shares that are expected to be issued and recognises the impact of the revision of original estimates.

In the case of shares, the fair value is assumed to be the market price and RHUK revises the value at each reporting date.

During the year ended 31 December 2015, RHUK created a stock incentive plan, the Long Term Stock Incentive Plan (RHUK SIP) which provided for grants of restricted stock units (RSUs).

RHUK issued RSUs to the employees under the RHUK SIP, primarily in connection with year-end compensation. These RSUs vest and deliver as outlined in the applicable RSU agreements. Vesting is subject to the recipient not having left employment or having left employment as a result of death, permanent illness or redundancy. Delivery of the RSUs is in the form of RHUK shares or an equivalent amount of cash (determined at the absolute discretion of the Remuneration Committee). All RSUs have a future service requirement.

The activity related to these RSUs is set out below:

	2019 No. of RSUs	2018 No. of RSUs
Outstanding at the beginning of the year	**15,452,083**	12,468,328
Forfeited during the year	**(329,612)**	(156,417)
Vested during the year	**(4,553,187)**	(2,062,675)
Granted during the year	**4,552,902**	5,202,847
Outstanding at the end of the year	**15,122,186**	15,452,083

The fair value of the RSUs is determined by taking 100% of the Group Market Consistent Embedded Value (MCEV) and dividing by the number of ordinary shares in RHUK. The weighted average fair value of the RSUs at 31 December 2019 was £3.90 (31 December 2018: £2.83). Expenses of £10.4m (2018: £7.7m) have been charged to the profit and loss of the Group during the year in relation to the RHUK SIP.

Notes to the financial statements

CONTINUED

Note I – Other notes (continued)

I.3 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.4). The new standard has affected the balance sheet and related ratios.

The Company has 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 will be accounted for under IFRS 16 (see note I.4).
- The Company has exercised its break clause under the lease for Level 25 of The Leadenhall Building. The cash flows for 2019 have therefore been accounted for on a cash flow basis. There will be no future cash flows in relation to this lease.
- The Company has identified a new tenant for Level 32 of The Leadenhall Building and therefore has terminated the lease. The cash flows for 2019 have therefore been accounted for a on a cash flow basis. There will be no future cash flows in relation to this lease.

The future aggregate minimum lease payments under non-cancellable operating leases are as follows:

	2019 £m	2018 £m
Not later than one year	–	2
Later than one year and no later than five years	–	18
Later than five years	–	37
Total minimum lease payments	–	57

Other commitments

During previous years the Company executed transactions to purchase partly funded bonds and forward settling bonds. During 2019 the Company purchased additional partly funded bonds and forward settling bonds. The Company also signed up to a number of multi-year contracts. The Company expects to pay a further £1,043m within the next five years (2018: £258m), £436m of this being due within 12 months of the financial reporting date (2018: £90m).

	2019 £m	2018 £m
Not later than one year	**436**	90
Later than one year and no later than five years	**607**	168
Later than five years	–	–
Total other commitments	**1,043**	258

I.4 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 as 31 December 2019. The weighted average lessee's incremental borrowing rate applied to the lease liabilities is 3.374%. The incremental borrowing rate represents the cost of funding to the 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.

Note I – Other notes (continued)

I.4 Leases (continued)

Right of use assets are measured at cost comprising the following:

- amount of any initial measurement of lease liability;
- leased payments made before the commencement date less any lease incentives received;
- initial direct costs; and
- restoration costs.

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

The 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 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 asset

	2019 £m
Right of use asset	37
Right of use asset – property	
Balance at 1 January	–
Depreciation charge for the period	(2)
Additions	39
Closing balance at statement of financial position date	**37**

Lease liabilities

	2019 £m
Lease liability	39
Maturity analysis undiscounted liabilities	
Current liabilities	
Less than one year	–
Non-current liabilities	
One to five years	16
More than five years	33
Total undiscounted lease liabilities	**49**

Comparative information has not been provided as the Company has taken the modified retrospective approach.

(b) Amounts recognised in the statement of comprehensive income

	2019 £m
Depreciation charge of right of use assets – property	2
Financing charge on lease liabilities (included in note B.4 Finance costs)	1

(c) Amount recognised in statement of cash flows

	2019 £m
Depreciation charge of right of use assets – property	2
Financing charge on lease liabilities	1
Total cash flows for leases	1

Alternative Performance Measures

Alternative Performance Measures

As noted on page 9, 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 9.
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 is to longevity fluctuations through reinsurance.	The longevity reinsurance percentage is derived from the IFRS sensitivity to changes in assumed longevity.
Customer satisfaction	Policyholder feedback surveys are sent to all policyholders following interaction with them (apart from complaints and bereavement).	The 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.

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.
Economic capital	Represents management's internal risk-based calculation of the capital required to remain solvent for a 99.8% confidence level over a one-year period.
Equity-based compensation	Share-based transactions awarded under incentive plans.
Equity release mortgages	Mortgages extended to older customers (aged 55 and over) against their residential property at low loan-to-value percentage. Unlike a typical residential mortgage, no interest is paid monthly by the customer. Instead, the interest is simply added to the principal loan amount with the loan only repayable on death or entry into long-term care of the last remaining homeowner.
Fair value	Amount that would be received on sale of an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

Glossary of terms

CONTINUED

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 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 consistent embedded value (MCEV)	The risk-adjusted value of the in-force business, allowing for the unwind of IFRS margins and cost of capital.
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.
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.
Operational risk	The risk arising from inadequate or failed internal processes, personnel or systems, or from external events.
Own Funds	Available capital under the Solvency II regime.
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.
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.
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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