Rothesay Life Plc
Annual report and accounts 2020

Our purpose

We are dedicated to securing the future for every one of our policyholders.

Rothesay refers to Rothesay Life Plc (RLP).

Overview

Strategic report

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Performance at a glance

New business premium APM[1]

2020: £7.0bn
2019: £16.3bn
2018: £13.2bn

£7.0bn

Percent reinsured APM

2020: 87%
2019: 78%
2018: 78%

87%

Number of policies

2020: 847,839
2019: 824,793
2018: 772,665

847,839

SCR coverage APM

2020: 203%
2019: 201%
2018: 180%

203%

Paid to policyholders in the year

2020: £2.8bn
2019: £2.4bn
2018: £1.9bn

£2.8bn

Customer satisfaction APM

2020: 95%
2019: 94%
2018: 98%[2]

95%

1 APM – Alternative Performance Measure; please see page 28 for further details.
2 Since 2019 Rothesay no longer issues satisfaction surveys in relation to bulk annuity exercises and hence the 2018 result is not comparable.

IFRS profit before tax

2020: £1,474m
2019: £640m
2018: £114m

£1,474m

Own funds

2020: £7,353m
2019: £6,113m
2018: £3,894m

£7,353m

Assets under management APM

2020: £62.2bn
2019: £53.7bn
2018: £36.3bn

£62.2bn

Who we are

Purpose-built to protect pension schemes and their members' pensions

Rothesay is the UK's largest pensions insurance specialist, purpose-built to protect pension schemes and their members' pensions. Our singular focus is to secure pension annuities for the future, providing certainty as well as genuine service excellence for every policyholder we look after.

Our conservative investment strategy and prudent underwriting mean we are trusted by some of the UK's best known companies to provide pension solutions, including Allied Domecq, Asda, British Airways, Cadbury's, the Civil Aviation Authority, National Grid, the Post Office, Prudential and telent.

Underpinned by sophisticated risk management, our expert team never stops developing new ways to drive predictable, dependable returns that minimise risk and create real security.

Today, we manage over £60 billion in assets, secure the pensions of over 800,000 people, and pay out, on average, over £200 million in pension payments each month. We are securing the future for every one of our clients and policyholders, and improving how pensions are delivered as we do it.

What we deliver

Real financial security
We are obsessed about effectively managing risk – we measure every asset and liability every day, so we can react in the moment as the world changes.

Genuine service excellence
We are focused on every detail, to provide genuine service excellence for every one of our policyholders and trustees.

1st
insurance company to be PASA Accredited for customer experience[1]

95%
of policyholders surveyed rate our service 'good' or 'excellent'

203%
regulatory capital coverage

AA
average asset rating

A+
Fitch Ratings credit rating

A3
Moody's credit rating

1 In 2020 our Accreditation was renewed by the Pensions Administration Standards Association (PASA), an independent body dedicated to improving standards in pensions administration.

Section

2

Strategic report

Every strategic decision that we make is informed by our conservative investment philosophy, cautious approach to risk management and sophisticated technology platform. We challenge ourselves every single day to think creatively so that our business model is best placed to meet our clients' needs.

This year, more than ever, we have seen the value of the purpose-built risk management infrastructure that we have developed to protect policyholders' pensions.

Addy Loudiadis
Chief Executive Officer

Chief Executive's statement

The rapid spread of COVID-19 has impacted all of our lives in ways we could not have imagined at the beginning of 2020.

The human cost of the pandemic has been both shocking and saddening and I would like to take this opportunity to extend my sympathies to all those who have been affected by the disease and the economic crisis it has created.

Rothesay responded quickly to ensure that any impact on our business and our stakeholders was minimised. Our immediate priorities were the health and welfare of our people and ensuring our policyholders continued to receive their pensions as normal. We transitioned to remote working in early March, even before the UK lockdown measures were implemented. This enabled us to fully test our remote IT systems and operational infrastructure to ensure we were able to provide a seamless continuation of all business functions and the same level of market-leading customer service to our policyholders. Credit and thanks are due to our employees and third party administrators for going above and beyond to ensure that Rothesay remained fully operational.

Our purpose-built risk management systems proved invaluable in supporting us to protect the balance sheet in the adverse and volatile market conditions experienced in the immediate aftermath of lockdown. Regular stress testing and live monitoring of the financial and solvency position of Rothesay has allowed us to respond dynamically as market conditions have evolved throughout the year, ensuring that we ended 2020 with a robust SCR coverage ratio of 203% (2019: 201%).

Performance

Although much of our focus in 2020 has been on protecting the balance sheet, we have successfully completed the investment of premiums received in 2019 according to our long-term investment strategy. During 2020, we have invested almost £10bn of assets and this has helped generate record IFRS pre-tax profit of £1,474m (2019: £640m) despite volatile market conditions.

Our investment portfolio has an average rating of AA and is focused on assets with high-quality collateral.

New business volumes during 2020 have held up well, with Rothesay's new business in 2020 being the third highest in our history even though many transactions were executed entirely remotely. This shows the strong sense of cooperation and collaboration between trustees, consultants, legal advisers and insurers working together in the interests of pension scheme members. With the help of our counterparties, we have continued to apply rigorous underwriting and due diligence despite remote working and have assisted 12 pension schemes to de-risk during 2020, generating £7.0bn of new business premiums (2019: £16.3bn). Assets under management increased to £62.2bn from £53.7bn at the end of 2019.

Risk and capital management

The macroeconomic environment worldwide has been extremely challenging during 2020, with significant volatility in interest rates and credit markets. Low real interest rates will remain a challenge for all pension providers and the macroeconomic environment remains volatile given the long-term impact of the actions taken by governments in response to COVID-19 and continuing geopolitical tensions.

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

Our balance sheet remains strong with Own Funds of £7.4bn (2019: £6.1bn) and an SCR coverage ratio of 203% (2019: 201%), well above our target operating range and giving us significant surplus capital to write new business. This has been achieved without the need for new capital and is after allowing for the capital strain from writing £7.0bn of new business. Rothesay's liquidity has also remained robust throughout the market turmoil and we continue to hold large liquidity buffers.

Chief Executive's statement
continued

We continue to hedge market and longevity risk exposures, using robust collateral provisions to mitigate counterparty risk. We entered into six new reinsurance agreements in 2020, leading to reinsurance of 87% of our longevity exposure (2019: 78%). As well as reinsuring the larger new business transactions written in 2020, we also reinsured longevity risk on some of our existing liabilities.

Our policyholders
Providing over 800,000 policyholders with a safe and secure pension is at the heart of what we do. We pride ourselves on the quality of the service we provide. This year we were reaccredited by the Pensions Administration Standards Association (PASA), an independent body dedicated to improving standards in pensions administration. We are also members of the Institute of Customer Service, an independent, professional body for customer service.

This year, more than ever, we have been focused on ensuring that our policyholders received excellent service and I am pleased to say that thanks to the outstanding effort of our administration partners this has been achieved, with service levels being met consistently (including in response to telephone calls) despite the challenges of working remotely.

During 2020 we have also updated our brand, introducing a new look and feel for the Company which we believe is a better reflection of who we are.

As part of Rothesay's preparations for Brexit, we concluded that it was necessary to transfer approximately 400 Irish annuity policies to an EU-regulated insurance company. This transfer took place in September and was required to ensure that payments under the affected policies can continue to be lawfully paid following the end of the Brexit implementation period.

In December the Court of Appeal found in favour of Rothesay and Prudential regarding the proposed transfer of a portfolio of annuities business from Prudential, providing clarity for us and the sector as a whole about the operation of Part VII transfers. In 2021, we plan to seek approval for the transfer of the Prudential annuity business to Rothesay as envisaged in the original transaction and will focus on ensuring that any transition is as smooth as possible for policyholders.

Rothesay's ultimate shareholders
In December, GIC and MassMutual acquired the shares held by Blackstone in Rothesay Limited, in a transaction that valued the Group at £5.75bn. This was a strong expression of confidence in the Rothesay Group and provides the business with exceptional support from two of the world's leading institutional investors and a long-term platform for growth in the future.

Our people
Our people are a key strength of Rothesay. The team has delivered a great set of results despite the challenges of home-schooling, remote working and lockdown. Close coordination between all the areas of the firm and our relentless attention to detail ensured that all of the business written in 2020 was meticulously executed and I am proud of the way in which our people responded to the COVID-19 pandemic. It is a testament to the team that even though almost all of our employees have been working from home since March, the business has continued to operate normally.

We received an outstanding response to our 2020 employee engagement survey, with 95% of employees participating (2019: 81%) and with 92% of employees saying that they were proud to work at Rothesay (2019: 87%).

During 2020 we have continued to recruit, particularly to strengthen our control functions and to support development of our IT platform. We have honoured all of our pre-COVID-19 job offer commitments and on-boarded many new employees remotely. At the end of 2020, Rothesay had 305 employees, including seven in Rothesay Asset Management US, an increase of 21% from 2019.

This year we have seen increased public debate on the subjects of race and inclusivity. Racism and other forms of discrimination have no place at Rothesay. Rothesay is committed to promoting equality and diversity, and a culture that actively values difference. We have a clear equal opportunity policy and we recognise that people from different backgrounds and experiences can bring valuable insights to the workplace and enhance the way we work. We will continue to engage with our people, and the businesses we partner with, to promote working environments where everyone feels valued.

Corporate Social Responsibility

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

Rothesay is determined to play its part in combating climate change and global warming. We are in the process of aligning our investment portfolio with the goal of the Paris Accord to limit global warming to 1.5ºC above pre-industrial levels and are committed to supporting a low carbon economy in which the UK achieves carbon neutrality by 2050. We are also a signatory to the UN Principles for Responsible Investing, a supporter of the Task Force on Climate-Related Financial Disclosures and an early adopter of the Sustainability Reporting Standard for Social Housing.

In 2019 we established the Rothesay Foundation with the aim of supporting charities that seek to improve the quality of life for older people, helping them to live their lives in a happy, safe and fulfilling way. The Foundation has now started to support these charities, many of whom had financial difficulties due to the COVID-19 crisis.

During 2020, we have contributed over £4.1m to charitable causes. This includes making a significant contribution to the COVID-19 Support Fund, the UK insurance industry's initiative to help some of the people hardest hit by the COVID-19 crisis. We also encouraged our employees to donate towards charitable causes through various matching incentive programmes which were widely utilised.

Looking forward

Our market opportunity remains strong and attractive. Total market volumes for 2020 have exceeded £30bn, despite the impact of COVID-19, making 2020 the second highest volume year for pension risk transfers in history. This follows on from the £40bn of transactions that were executed during 2019, providing clear evidence of the depth and resilience of the sector. Market forecasts estimate annual market volumes under normal conditions of £40bn+ p.a. and 2021 is shaping up to be another busy year. Our strong capital position and supportive shareholders ensure we are well positioned to pursue strategic opportunities as well as pension risk transfer business. As always, we will remain disciplined and selective when underwriting new business.

Rothesay is designed to protect pensions even through the most difficult times. It is a matter of great pride to us, and comfort to our stakeholders, that every pension we provide is as secure now as it was before the start of the COVID-19 pandemic. As we emerge from the challenges of COVID-19, I am confident in Rothesay's financial and operational resilience and I look forward to 2021 with optimism and excitement about what the future holds for Rothesay, our customers and our other stakeholders.

Finally, I would like to take this opportunity to give huge thanks to our people and our administration partners for their truly outstanding efforts through the year.

Addy Loudiadis
Chief Executive Officer
11 February 2021

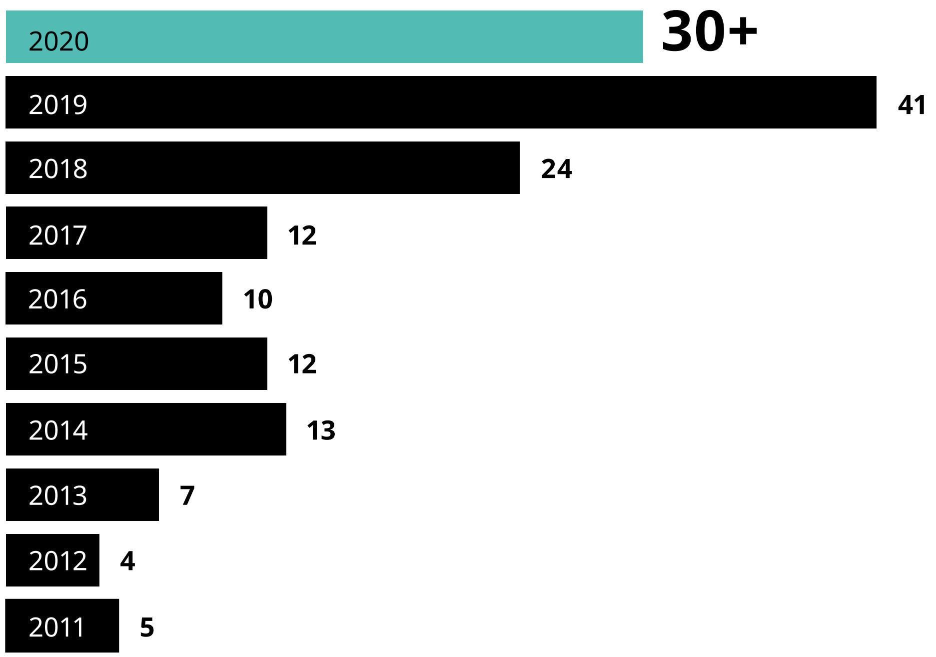
Our markets

1. Pension risk transfer

Rothesay's core market is growing strongly
Rothesay's core market is in pension risk transfer. Market volume has grown considerably in the last few years, but total market penetration is still only 8% of the £2.1 trillion UK market.

Almost 90% of UK defined benefit pension schemes are now closed and such benefits are no longer offered to new employees. This means companies and trustees want to de-risk their pension scheme liabilities. This is where we step in, either with a buy-in or full buy-out.

Growing pension risk transfer market (£bn)



Showing UK pension risk transfers completed per year. 2020 and 2019 data sourced from Aon.
Prior year data sourced from LCP and Hymans Robertson market reports.

Securing UK pension schemes
For many of our clients, pension scheme protection is a two-step process, starting with bespoke insurance, leading to a complete transfer of members into our care.

Buy-in
Bespoke insurance to bring immediate financial security to your pension scheme.

In a buy-in, the scheme purchases a bulk annuity insurance policy which is held as an asset of the scheme.

This makes Rothesay responsible for all the risks relating to the insured benefits e.g. longevity risk, market risk, interest rate and inflation.

The scheme is still responsible for paying pensions to its members – Rothesay has no direct relationship with the scheme members.

Buy-out
Full transition of your scheme and members into Rothesay's care, for total protection.

In a buy-out, Rothesay takes full responsibility for the pension scheme and the employer's obligations to its members.

The pension scheme is wound up and the assets move over to Rothesay. The scheme members become Rothesay policyholders and receive new individual policies.

Our markets
continued

2. Wholesale annuity

Our second source of business is in acquiring back-books of annuities from insurance companies, either through acquisition of companies or blocks of business.

The opportunity to acquire back-books looks positive; many companies are wishing to leave the individual annuity market and we are able to help with our extensive experience in the sector.

Acquisition of companies
Traditional company acquisition, where we take on all of the company's assets, liabilities and obligations, including the economic exposure and administration of their annuities.

Acquisition of blocks of business
1. Reinsurance transaction between Rothesay and the insurer selling the block. During this step, the insurer is responsible for administration but Rothesay has full economic exposure.
2. Approximately 18 months later, the goal is a Court-sanctioned transfer of the business to Rothesay. Now, we take over the administration as well as the economic exposure.

Wholesale annuity transaction timeline

	2011	2014
Transaction	Acquisition of Paternoster	Acquisition of MetLife Assurance Limited
Size of transaction	£3bn	£3bn
Number of policies (000s)	42	24
Type of business	Bulk annuities	Bulk annuities

2015	2016	2018
Purchase of annuity portfolio from Zurich UK Life (reinsurance followed by Court-approved transfer), with three follow on transactions	Purchase of annuity portfolio from Aegon UK (reinsurance followed by Court-approved transfer)	Purchase of annuity portfolio from Prudential (reinsurance followed by proposed transfer)
£1bn	**£6bn**	**£12bn**
28	**187**	**400**
Individual and bulk annuities	Individual and bulk annuities	Individual and bulk annuities

Our business model: Security for the long term

Underwrite the liabilities

We achieve maximum pre-deal certainty about the profile of the liabilities we are taking on through our meticulous underwriting and due diligence.

We model the benefits of every single policyholder and project them to maturity. This means we can accurately estimate the cost of providing the insured benefits and holding the risk capital.

We scrutinise all new business to ensure we minimise risk and will be able to achieve our return threshold.

Hedge the risks

We assess the risk impact of transactions before completion so we can lock in the economics. This gives certainty to clients and protects our balance sheet. You can see our full risk breakdown on page 35.

We reinsure the majority of our exposure to longevity risk. This process also gives independent third party price verification.

Collateral management is an integral part of the Company's activities. We closely monitor collateral so that our security is not compromised by market shifts.

Invest the assets

We seek assets which match our liability cash flows and provide an appropriate risk-adjusted return.

Our portfolio is rated on average as AA and is made up of three diverse categories:

1. Cash and government bonds.

2. Infrastructure and other corporate bonds.

3. Secure, illiquid assets.

Deliver the pension benefits

We have strategic partnerships with well established pension administrators – Willis Towers Watson, Mercer and Capita Employee solutions.

Working with these partners gives us scale and contingency capabilities. High levels of automation and sophisticated technology enable our partners to interact with our risk management systems to eliminate discrepancies and optimise policyholder service.

Our investments

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

We have remained disciplined and cautious about making investments during 2020 and have been very selective in the investment decisions made. A systematic review of our investment portfolio led to the identification of sectors most likely to be adversely impacted by COVID-19 and of assets most at risk of downgrading to sub-investment grade. Where possible, we have proactively switched assets accordingly.

Our in-house team is responsible for the management of Rothesay's £62.2bn asset portfolio. Assets are sought which match our liability cash flows and which provide an appropriate risk-adjusted return. Rothesay operates a cautious investment strategy which seeks to diversify exposure and actively manages risk. We are constantly looking for new ways to reduce risk and achieve the dependable returns that create real security for people's pensions in the future.

At the end of 2019, Rothesay had substantial cash and gilts to deploy into longer-term assets due to the record amount of new business written in that year. Much of 2020 has been focused on investing those assets according to Rothesay's long-term investment strategy. We have succeeded in investing almost £10bn of assets more quickly than envisaged when the business was originally underwritten and at better risk-adjusted returns.

The in-house team considers financially material environmental, social and governance (ESG) factors as part of the investment process and these factors are formally documented in all committee approval papers for new investments in order to ensure that appropriate account is taken of them. We are aligning our investment portfolio with the goal of the Paris Accord to limit global warming to 1.5ºC above pre-industrial levels and are committed to supporting a low carbon economy in which the UK achieves carbon neutrality by 2050. For more information please refer to our Corporate Social Responsibility report, which will be published later in 2021.

The average rating of Rothesay's investment portfolio is AA and the portfolio can be divided into three broad categories:

- **Cash and government bonds** – This part of the portfolio is available for future investment and to meet collateral calls and cash requirements and also backs some of our very long-dated cash flows.
- **Corporate bonds and infrastructure** – Given the scale of Rothesay's balance sheet, we also invest in a diversified portfolio of corporate bonds, including 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 minimised.

The charts on the next pages provide a breakdown of our investment portfolio at 31 December 2020 by sector and geography.

Corporate bonds and infrastructure

Given recent market conditions, there have been fewer opportunities to invest in more illiquid assets in 2020, so many of the new investments have been in more liquid, highly rated corporate bonds, including US universities and healthcare providers, as well as in loans issued by conservatively managed and leveraged real estate investment trusts (REITs), particularly those focused on industrials. These include a number of private placements. Over time, we may look to switch out of the more liquid positions into other assets.

The table below provides a summary by sector of our corporate bond and infrastructure holding:

Sector	Percentage
Infrastructure	27
Real estate	14
Banking & insurance	14
Education	9
Consumer goods & services	7
Communications & media	7
Technology & electronics	5
Healthcare	5
Industrial & energy	5
Automotive & transportation	3
Retail	2
Other	2

Of our £19bn holding of corporate bonds and infrastructure, around 30% (or 9% of total assets) is rated BBB and of those only £0.2bn is rated BBB-. Rothesay holds no sub-investment grade bonds.

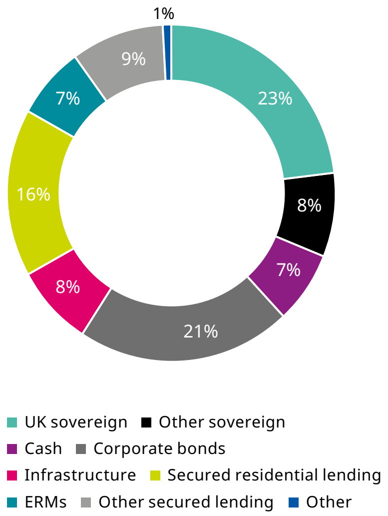
A breakdown of the investment portfolio by rating can be found in note F.2.1.

Mortgages

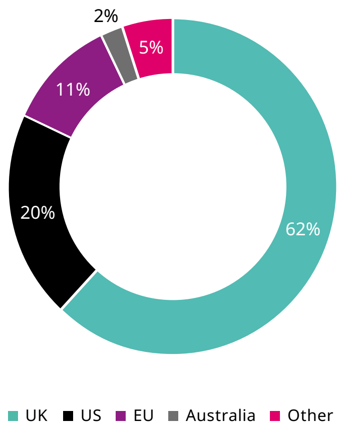
We took the decision to slow down origination of ERMs and Dutch mortgages given the practical difficulties associated with property underwriting in the second quarter of 2020 and gradually re-started origination as COVID-19 restrictions were lifted and as market practise has evolved.

By the end of 2020, our total ERM portfolio had increased to £4.2bn (2019: £2.7bn) or 7% of assets under management (2019: 5%).

Our investments



International diversification



Why we are successful

Rothesay is a purpose-built specialist business, with a unique culture and set of capabilities that continue to drive our growth and leadership.

Purpose-built

We were founded with a single purpose: to secure UK pensions at scale, exceptionally well and within a robust regulatory environment.

We are designed from the ground up with modern systems, structures and capabilities to protect and deliver pensions more securely and effectively.

Financial strength

We have an extremely strong capital position with an absolute focus on maintaining solvency. Our safety-first approach to writing business means we rigorously analyse every risk and would rather invest in no business than risky business.

Unique integration

Our governance is robust yet agile, and our team think diversely but operate as one, blending actuarial rigour with investment expertise.

Every decision is a product of our multi-disciplinary management team who are experts across investments, underwriting and risk management.

Sophisticated technology

Our industry-leading, purpose-built technology platform underpins the whole business, so that we are always informed and can adapt in real time to market changes.

Our engineers drive its evolution so that our platform grows with the industry.

Original thinking

We continuously bring creative and innovative ways of delivering for our clients, and develop bespoke solutions for every pension scheme.

Our original thinking has led to several pioneering firsts, including our rapid response times and our dynamic technology-focused approach.

Service excellence

We support clients through every step of the process and don’t leave a stone unturned from pitch to buy-in to buy-out. And once policies are issued, we provide excellent customer service. Our straightforward and straight-talking approach helps us build clarity and trust in every interaction.

Our strategy and KPIs: Measuring success

Financial security

	2019	2020
RLP SCR coverage Indicates capital strength through comparing how RLP is capitalised relative to the regulatory requirement (APM)	201%	**203%**
External ratings Impartial indicators of our financial strength	**A3** Moody's Investors Service	**A+** Fitch Ratings

2020 progress:

- Maintained a robust solvency position against a volatile economic backdrop.
- Raised £100m Tier 3 debt in order to repay £100m of hybrid capital.
- Reinsured £7.4bn of liabilities giving effective reinsurance coverage of 87%, including reinsurance with two new counterparties.
- Made good progress in the development of the full internal model (FIM).
- MassMutual and GIC acquired Blackstone's stake in the Rothesay Limited business, ensuring Rothesay has two long-term, sophisticated strategic investors.

Opportunities in 2021 and beyond:

- Continue to maintain a robust solvency position.
- Expand our risk function to better identify and manage emerging risks including climate change.
- Invest in capital models, extending the partial internal model (PIM) to a FIM covering all risks.
- Continue to optimise our capital structure through appropriate levels of equity and debt.

Steady growth

	2019	2020
New business premiums Signals Rothesay's growth (APM)	£16.3bn	**£7.0bn**
Assets under management Measures business size to indicate resilience (APM)	£53.7bn	**£62.2bn**

2020 progress:

- De-risked the liabilities of 12 pension schemes, which generated £7.0bn of new business.
- Grew the Rothesay team by 53 talented individuals across the whole Rothesay Group.

Opportunities in 2021 and beyond:

- Continue to seek appropriate new business opportunities, with a view to growing our market share.
- Focus on recruitment in asset origination to continue diversifying our investment portfolio.
- Continue to strengthen our in-house IT capabilities to continue developing our IT platform.
- Strengthen Rothesay's profile as an investor overseas, particularly in the US, to allow us to continue to diversify investments.

Our strategy and KPIs: Measuring success

continued

Service excellence

	2019	2020
Service quality Measures the number of policyholders who rate our service 'good' or 'excellent' (APM)	94%	**95%**
Complaints Measures satisfaction through number of complaints upheld per 1,000 customers (APM)	0.36	**0.42**

2020 progress:

- Performance throughout the year above our stringent benchmarks across all TPAs.
- Maintained low complaint rates and high satisfaction despite the challenges of COVID-19.
- By leveraging our TPAs' existing functionality we are now able to offer an online service to our policyholders.

Opportunities in 2021 and beyond:

- Continue to excel in customer service.
- Prepare for a potential transfer of the Prudential portfolio should our application for approval be successful.

Reliable performance

	2019	2020
IFRS profit before tax Measures profitability, by capturing all recurring and non-recurring items	£640m	**£1,474m**
Employee engagement Measures the number of employees who say they are proud to work at Rothesay	87%	**92%**

2020 progress:

- Invested all assets received from 2019 new business more quickly and at better yields than planned, contributing to an increased IFRS profit.
- Maintained high levels of employee engagement despite COVID-19.
- Committed to ambitious environmental targets to ensure a sustainable business model.

Opportunities in 2021 and beyond:

- Increase our market penetration – the total market volume has grown considerably in the last few years, but penetration is still only 8% of the £2.1 trillion UK market.
- Maintain employee engagement despite ongoing restrictions from COVID-19.
- Make progress towards our ambitious environmental targets.

Record IFRS profits driven by investment of the assets received as premiums in 2019.

Andrew Stoker
Chief Financial Officer

Financial review

IFRS financial performance

Rothesay made a profit before tax of £1,474m (2019: £640m). The large increase in profits was largely as a result of investing the assets received from the £16.3bn new business executed throughout 2019 and as such is unlikely to be repeated in 2021.

The financial performance analysis shown in the table on the next page provides an explanation of the way in which profits have been generated. Further explanation of the line items can be found in the notes on Alternative Performance Measures on page 108.

New business profits (APM) in the analysis are calculated assuming full investment of premiums and the short-term impact of any under-investment is reported separately in the table. New business profit (APM) for the year was £449m (2019: £958m)) (APM). The analysis has been prepared assuming that once fully invested, the risk-adjusted yield on the assets held increases by 7bps compared to the 1.32% yield being achieved at 31 December 2020 (2019: an increase of 12bps).

As most of the new business written in 2020 was written in the second half of the year, there is a temporary reduction in profits from the delay in investing assets received as new business premiums of £547m (2019: a reduction of £909m) (APM). We anticipate that this will reverse as assets are invested according to our long-term strategy. Profits for the year include profits of £909m generated on investment of the assets received as premiums last year (2019: £273m) (APM).

Profits generated on the in-force book were £476m (2019: £293m) (APM). These profits mainly arose from increased longevity reinsurance and the release of prudent margins as the business runs off and as members exercise their options.

The impact of the change to non-economic assumptions, a gain of £284m (2019: a gain of £46m) (APM) was largely as a result of the £296m impact of a change in estimating approach to marking assets and liabilities which increase with limited price indexation (LPI). In previous years, we have projected LPI using future assumed rates derived from the LPI swap market. However, over time this market has become highly illiquid and all but a very small number of banks have withdrawn from the market, leading to rates which are out of line with the LPI rates actually realised. For 2020, in valuing our liabilities, we have therefore projected rates using LPI models based on realised LPI and other market inputs. The impact of the change to non-economic assumptions also includes an increase in expense provisions for 2020 that was largely offset by demographic assumption changes (see note E.2).

Rothesay made economic profits of £212m (2019: £244m) (APM). Economic profits (APM) represent the change in value of assets from changes in economic conditions less the change in value of liabilities from those changes. Economic profits in 2020 include gains from credit spread tightening and other market movements.

Financial review
continued

Financial performance (Alternative analysis of profit generation) (APM)	2020 £m	2019 £m
New business profit (assuming assets fully invested)	**449**	958
Impact of temporary investment delay	**(547)**	(909)
Investment profit from prior year	**909**	273
Performance of in-force book	**476**	293
Non-economic assumption changes and model refinement	**284**	46
Acquisition costs	**(114)**	(108)
Administration expenses	**(53)**	(48)
Operating profit before tax	**1,404**	505
Borrowing costs	**(108)**	(85)
Project and other one-off expenses	**(34)**	(24)
Economic profits	**212**	244
IFRS profit before tax	**1,474**	640

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

It is unclear as to whether COVID-19 will materially impact future mortality. In valuing our insurance and reinsurance assets and liabilities, we have allowed for reported deaths but we have not made any changes to our mortality assumptions to allow for the impact of COVID-19 as we believe it is still too early to know what this might be and scenario analysis suggests a wide range of possible outcomes.

Alternative Performance Measures
Rothesay's strategy is focused on protecting the security of policyholder benefits, growth through writing value-driven new business and, ultimately, delivering sustainable shareholder value. In the opinion of the Directors, the prescribed IFRS results and disclosures do not capture long-term value creation or changes to capital requirements and therefore do not fully reflect the performance of Rothesay. Rothesay therefore uses a number of Alternative Performance Measures (APMs) which focus on value generation and capital strength. Further information on the Company's APMs can be found on page 108, including definitions, why the measure is used and, if applicable, how the APM can be reconciled to the nearest GAAP measure. Rothesay uses the symbol APM to highlight APMs throughout the financial statements.

IFRS income statement highlights

The key line items in the statement of comprehensive income for Rothesay are summarised in the table below:

Income statement highlights	2020 £m	2019 £m	Commentary
Gross premiums written	**7,281**	16,606	Gross written premiums are made up of new business of £7.0bn (2019: £16.3bn) and regular premiums of £0.3bn (2019: £0.3bn) generated on the inwards longevity reinsurance business written in prior years.
Net premiums written	**5,869**	15,361	Net premiums written represent the gross premiums written less the £1,412m (2019: £1,245m) of regular premiums ceded to reinsurers.
Investment return	**4,648**	2,289	Large positive investment returns arose from the growth in the value of assets due to falling interest rates and rising bond prices in the second half of the year.
Total revenue	**10,517**	17,650	
Net claims paid	**(1,491)**	(1,396)	Claims paid represent the total payments due to policyholders during the year of £2.8bn (2019: £2.4bn) less the reinsurers' share of such claims £1.3bn (2019: £1.0bn).
Change in net insurance liabilities	**(7,232)**	(15,327)	The change in insurance liabilities in 2020 was largely as a result of new business and change in market conditions (predominantly the reduction in interest rates) partly offset by the run off of liabilities.
Operating expenses	**(201)**	(180)	Operating expenses consist of £53m (2019: £48m) of administration expenses, £114m (2019: £108m) of acquisition expenses and £34m (2019: £24m) of non-recurring and project expenditure.
Finance costs	**(119)**	(107)	Finance costs mainly represent interest payable on borrowings and have increased as the Rothesay's borrowings have increased.
Total claims and expenses	**(9,043)**	(17,010)	
Profit before tax	**1,474**	640	
Income tax	**(280)**	(122)	Rothesay's effective tax rate is 18.8% (2019: 19.3%).
Profit after tax	**1,194**	518	

Financial review
continued

IFRS balance sheet highlights
The key line items in the statement of financial position for Rothesay are summarised in the table below:

Balance sheet highlights	2020 £m	2019 £m
Financial investments	**93,712**	73,741
Reinsurance assets	**616**	388
Other assets	**2,027**	1,993
Total assets	**96,355**	76,122
Share capital and share premium	**2,463**	2,463
Tier 1 notes	**347**	347
Reserves	**2,140**	946
Total equity	**4,950**	3,756
Insurance contract liabilities	**55,247**	47,932
Reinsurance liabilities	**993**	848
Payables and financial liabilities	**33,547**	22,010
Borrowings	**1,426**	1,427
Other	**192**	149
Total liabilities	**91,405**	72,366
Total equity and liabilities	**96,355**	76,122

Assets under management
Total assets increased from £76.1bn as at 31 December 2019 to £96.3bn as at 31 December 2020 primarily as a result of new business and the change in market conditions. Assets under management (APM) increased from £53.7bn as at 31 December 2019 to £62.2bn as at 31 December 2020. Assets under management can be derived by adjusting total assets for reinsurance, payables, derivatives and collateralised financing as shown in the table below.

Payables and financial liabilities increased from £22.0bn at 31 December 2019 to £33.5bn at 31 December 2020 largely as a result of the changes in economic conditions. Payables are dominated by derivative financial instruments and collateralised financing agreements. Derivatives are used to manage market and credit risk. The derivative liability as at 31 December 2020 of £30.4bn (2019: £19.7bn) is largely offset by derivative assets of £30.7bn (2019: £19.5bn).

Assets under management (APM)	2020 £m	2019 £m
Total assets	**96,355**	76,122
Less reinsurance assets	**(616)**	(388)
Less payables and financial liabilities	**(33,547)**	(22,010)
Assets under management	**62,192**	53,724

Reinsurance

Reinsurance assets fell by €140m as a result of the Part VII transfer of the Irish portfolio to Monument Life. At the same time, insurance liabilities fell by a similar amount.

During 2020 we entered into six new reinsurance contracts covering around £7.4bn of longevity risk in relation to both new and existing business. Some of Rothesay's reinsurance is an asset on an IFRS basis because projected claims exceed the regular premiums due on some longevity reinsurance contracts but overall the reinsurance represents a net liability of £377m (2019: net liability of £460m).

Total equity

The increase in total equity (an increase of £1,194m from £3,756m at 31 December 2019 to £4,950m at 31 December 2020) was driven by the increase in retained earnings during 2020.

Insurance liabilities

Insurance contract liabilities increased from £47.9bn as at 31 December 2019 to £55.2bn as at 31 December 2020 largely as a result of the new business written in 2020 and falling interest rates (see note E.2).

Borrowings

On 22 May 2020, RLP issued a further £100m of Tier 3 bonds. The proceeds of the Tier 3 issuance were used to repay £100m of loans from participating interests leaving overall borrowings unchanged.

As part of our LIBOR transition programme, with effect from 19 December 2020 the subordinated loan from participating interests, was converted from a floating rate loan to a fixed rate loan. The fair value of the loan was unchanged as a result of the conversion.

Changes to accounting standards

The International Accounting Standards Board has announced that the implementation of IFRS 17, the accounting standard for insurance contracts, will be further delayed until 1 January 2023. The standard will have a big impact on the way Rothesay's results are reported because the standard rebuilds performance measurement from the ground up in areas ranging from a new definition of insurance revenue to the elimination of upfront profits and spreading of profit across the lifetime of the contract. As a result, IFRS profits that have been declared in the past (and up to 31 December 2022) will be re-calculated and the opening balance sheet adjusted accordingly. We do not envisage that the change in accounting will have a material impact on the way in which Rothesay is run.

During 2020 the IFRS 17 project team has continued to make progress. An initial assessment has now been completed on the potential impact of IFRS 17 and work will continue during 2021 on detailed implementation. The IFRS 17 project is being overseen by the Audit Committee.

Rothesay 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. However, IFRS 9 is expected to have relatively little impact on Rothesay as assets are already fair valued.

Capital management

Rothesay's capital position has remained robust throughout 2020.

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

Rothesay aims to maintain solvency coverage in the range of 130% to 150% of the regulatory minimum solvency capital requirement (SCR), so our capital position provides significant surplus capital for new business and potential future dividends. We operate a dynamic capital management framework which uses interest rate and other hedging to target stability of the IFRS balance sheet under normal conditions and seeks to manage both the IFRS and solvency balance sheets as conditions deteriorate. This is facilitated by our access to real-time solvency information.

Rothesay's solvency position has remained robust throughout the period despite considerable market volatility and falling interest rates. We started the year with capital surplus well above our target operating range. As at 31 December 2020, Rothesay had an SCR coverage ratio (APM) of 203% (2019: 201%), giving us significant excess capital to write new business. The solvency position of RLP is summarised in the table below.

	RLP	
Solvency position of RLP	**2020 £m**	2019 £m
Tier 1 capital	**5,857**	4,658
Tier 2 capital	**984**	1,059
Tier 3 capital	**512**	396
Own Funds (APM) available to meet SCR	**7,353**	6,113
SCR	**3,623**	3,038
Surplus above SCR	**3,730**	3,075
SCR coverage (APM)	**203%**	201%
SCR coverage without transitional solvency relief	**154%**	152%

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

As part of the transitional arrangements in relation to the introduction of Solvency II, Rothesay is permitted to take credit for transitional solvency relief which amortises linearly to zero, falling by 1/16th on 1 January 2017 and again each year thereafter. Given the large fall in interest rates over 2020, the value of transitional solvency relief has been re-calculated as at 31 December 2020. The impact of re-calculation was to increase the transitional to £1,298m net of the associated impact of tax on Own Funds and allowing for amortisation of 4/16ths (2019: £1,138m allowing for amortisation of 3/16ths). Transitional solvency relief now covers 57% of the risk margin (2019: 52%).

Rothesay's SCR is calculated using a partial internal model (PIM). The PIM means that Rothesay's bespoke models are used for calculation of credit and counterparty risk capital and ensures that the allocation of capital to investment is consistent with the risk inherent in the types of highly secured and collateralised investments which are core to Rothesay's investment strategy. The PIM was originally approved for use from 31 December 2018 and updated during 2019 to reflect feedback received from the Prudential Regulation Authority (PRA) and to cover investments in Dutch mortgages.

Work continues on a Full Internal Model (FIM), extending the PIM to cover other risk components but for now the standard formula is used to calculate the SCR for all other risk components and for aggregation across risk components.

The table below provides a breakdown of the SCR post-diversification benefit between modules. Insurance risk relates mainly to longevity risk. Market risk is dominated by spread risk, i.e. the risk that credit spreads widen. The proportion of insurance risk capital has decreased during the period due to additional reinsurance transacted. The market risk proportion has increased from 54% of the SCR at the end of 2019 to 64% of the SCR, due to changes in economic conditions, investment of assets in 2020 and the reduction in insurance risk.

	2020 %	2019 %
Market risk	**64**	54
Insurance risk	**24**	33
Operational risk	**6**	7
Counterparty risk	**6**	6

An analysis of the change in Own Funds (APM) and SCR is shown in the table below. Own Funds (APM) have increased from £6,113m to £7,353m after allowing for amortisation of 1/16th of transitional solvency relief on 1 January 2020. The biggest drivers of this change were changes in economic conditions (particularly falling interest rates and inflation), increased longevity reinsurance and the impact of investing assets according to our longer-term investment strategy. The increase in SCR from this new investment was less than envisaged when the new business was originally underwritten, i.e. investment has been more capital efficient than assumed. The SCR (APM) increased from £3,038m to £3,623m, largely as a result of falling interest rates and the impact of investing assets. The increase was partially offset by a realignment of hedges between funds. All numbers are shown net of tax impacts and allow, where relevant, for changes in transitional solvency relief.

In the table below, we have amended the 2019 movement analysis (compared to that provided in the 2019 annual report and accounts) to remove the impact of writing new business on the financial resources requirement limit when re-calculating transitional solvency relief as we believe that this impact distorts the analysis. This has led to a £606m reduction in the impact of writing new business (on a fully invested basis) and a corresponding reduction in the short-term impact of delayed deployment compared to that shown in the 2019 annual report and accounts. Differences between IFRS accounting standards and Solvency II mean that management actions and changes in economic conditions can have very different impacts on the two bases.

	2020		2019	
Change in Own Funds and SCR (APM)	**Change in Own Funds £m**	**Change in SCR £m**	Change in Own Funds £m	Change in SCR £m
Opening position	**6,113**	**3,038**	3,894	2,163
Amortisation of 1/16th of transitional on 1 January	**(88)**	**18**	(43)	—
New business (on a fully invested basis)	**5**	**455**	732	1,170
Short-term impact of delayed investment	**(218)**	**(294)**	(606)	(420)
Investment impact from prior year	**606**	**304**	271	41
Performance of in-force book	**631**	**(298)**	124	(265)
Non-economic assumption changes	**192**	**(54)**	35	(4)
Acquisition costs and administration expenses	**(167)**	**—**	(156)	—
Borrowing costs	**(108)**	**—**	(85)	—
Non-recurring and project expenditure	**(34)**	**—**	(24)	—
Economic conditions	**421**	**454**	446	307
New capital issuance	**—**	**—**	1,479	—
Changes to internal model	**—**	**—**	46	46
Closing position	**7,353**	**3,623**	6,113	3,038

"A year like 2020 demonstrates the importance of having a robust risk management framework."

Peter Shepherd
Chief Risk Officer

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.

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

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

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

Throughout 2020 Rothesay continued to invest in the risk function, increasing headcount across the function including in relation to compliance, to meet the needs of Rothesay and to be able to respond robustly to the changing nature of the uncertainties facing Rothesay.

Risk management framework

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

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

Board risk appetite and culture

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

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

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

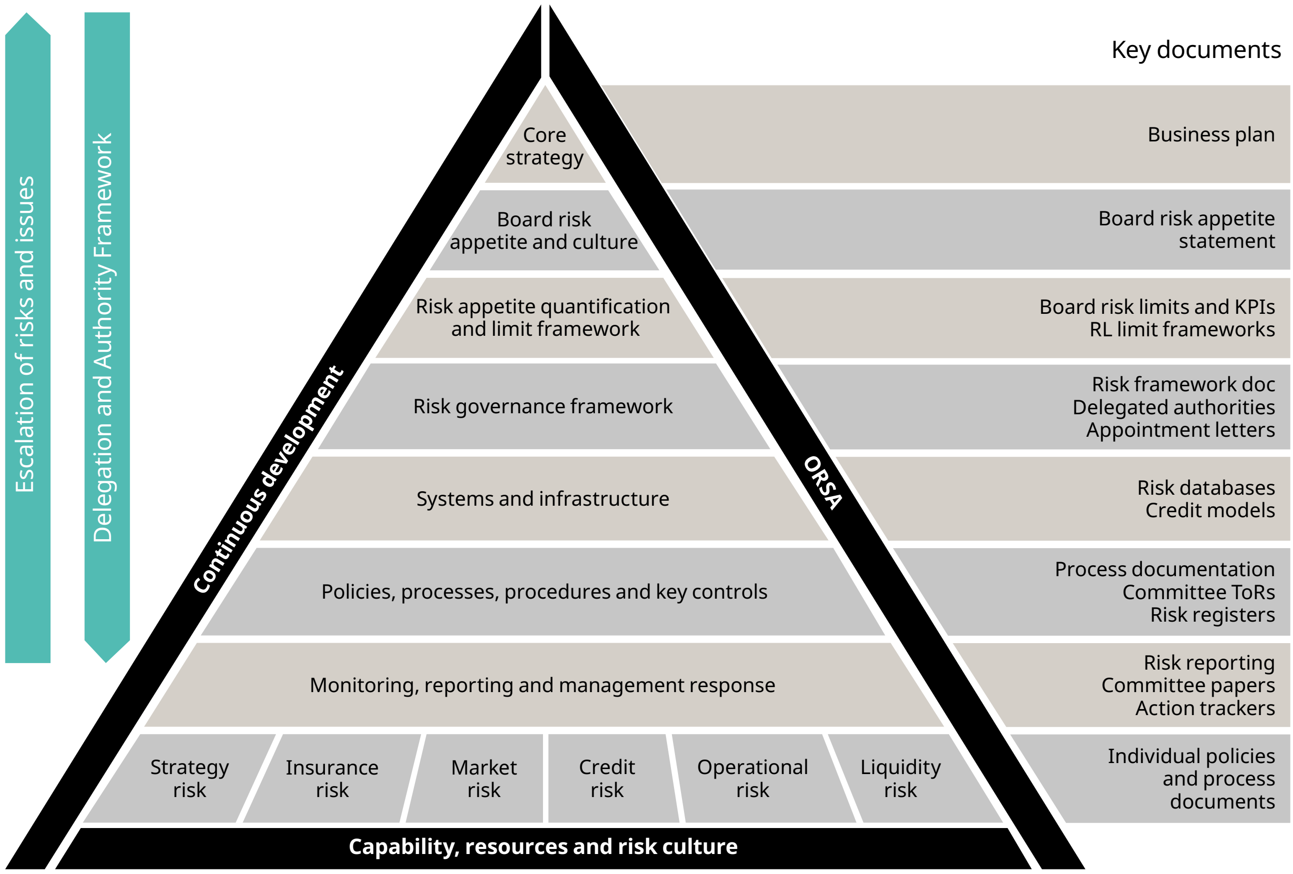
We aim to substantially mitigate the financial risks in our portfolio in order to protect policyholders, lock in value and to safeguard capital surplus such that excess capital may be invested into attractive risk-adjusted new business opportunities where Rothesay believes it has a comparative advantage.

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

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

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

Risk management
continued



Risk appetite quantification and limit framework

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

Risk governance framework

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

Rothesay 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. Rothesay 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 Rothesay's operations and reporting. These include operations, finance and legal.

- **Second line:** Risk oversight is provided by the Chief

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

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

Risk 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 and IT security risk.	●		

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

Systems and infrastructure

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

Policies, processes, procedures and key controls

Our risks are grouped into one of six categories: strategy, insurance, market, credit, operational and liquidity risk. Rothesay has developed appropriate processes and documented procedures, appropriate controls and other risk mitigation techniques in order to manage them effectively. The 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.

Risk management
continued

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

Capability, resources and risk culture
Rothesay seeks to attract and retain the highest quality talent in the industry. The effectiveness of our risk management depends upon the high quality of our people and the strong risk culture and risk management practices.

We are committed to maintaining the highest standards of integrity, transparency and accountability. Good conduct is fundamental to our purpose, strategy and how we operate and is also good business practice. A good culture is one where people do the right thing, feel empowered to speak up if something doesn't look right and know they can rely on support from management. Training is conducted so that everyone understands Rothesay's culture and the part they play in maintaining standards and in managing risk effectively.

Risk management and conduct are an integral part of Rothesay's performance review process.

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 Rothesay's business plans. The ORSA is an important input to Rothesay's strategic planning cycle.

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

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

Changes in the Rothesay's risk profile and emerging risks
2020 was dominated by the impact of COVID-19 on our business operations and on financial markets.

Our market-leading risk management systems have allowed us to protect our balance sheet during adverse and volatile market conditions. By the end of 2020, market conditions had improved, with credit markets being close to the levels seen at the end of 2019, although we believe that there is heightened risk of corporate downgrades in 2021 as the impact of COVID-19 restrictions continue to be felt.

As noted earlier, the transition to home working was seamless and our third party administrators also responded well. As a result, there has been no obvious impact on our operations, with productivity remaining at a good level and risk controls continuing to work effectively. Despite COVID-19, Rothesay continued to grow in 2020, writing £7bn of new business. Rothesay now manages assets of over £62bn and insures the pensions of over 800,000 individuals.

We entered into six new reinsurance contracts in 2020 covering both new and existing business and taking our reinsurance coverage up to 87% (2019: 78%). Longevity reinsurance reduces the capital intensity of new business and allows the release of capital held against existing business.

Rothesay has continued its strategy of investment in a diverse range of assets, but given market conditions in 2020, there have been fewer opportunities to invest in more illiquid assets so many of the new investments have been in more liquid, highly rated corporate bonds, including US universities and healthcare providers, as well as in loans issued by conservatively managed and leveraged real estate investment trusts, particularly those focused on industrials. A systematic review of our investment portfolio led to the identification of sectors most likely to be adversely impacted by COVID-19 and of assets most at risk of downgrading to sub-investment grade. Where possible, we have proactively switched assets accordingly. This analysis is also used in stress and scenario testing.

The long-term impact of COVID-19 is still unclear. The long-term effectiveness of vaccination programmes is uncertain and governments continue to advise that it may be some time before life returns to normal. Rothesay's evolving investment strategy, together with the backdrop of market volatility and uncertainty over the future impact of COVID-19, has meant that Rothesay's proactive approach to risk management has continued to be crucial in delivering Rothesay's strategic objectives and ensuring continued financial security for our policyholders.

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

There continue to be changes in accounting regulation, asset trading markets, pensions and tax, the effects of which are highly uncertain. The government's proposed reform of the leasehold market could have an adverse impact on Rothesay's loans secured on ground rents. In addition, the Treasury is consulting on changes to prudential regulation now that the UK is outside the EU which could impact Rothesay's regulatory balance sheet. Potential changes include a reduction in the risk margin and a relaxation of matching adjustment rules.

Transition from LIBOR

The interest rate London Interbank Offer Rate (LIBOR) benchmark is expected to cease after the end of 2021. During 2020 the risk function has been overseeing the project which aims to ensure that Rothesay is ready to transition to alternative rates.

Rothesay closely monitors its exposure to the basis between LIBOR and Sterling Overnight Index Average (SONIA) swaps and has taken action to mitigate this risk. Most new trades are SONIA-based and during 2020 we have been converting existing contracts to be SONIA-based. In addition, we have converted our own floating rate bond to a fixed rate (on a fair value neutral basis).

We are now using SONIA as the basis for setting the risk free rate under IFRS. The PRA is now consulting on the changes required under Solvency II (Consultation paper CP1/21 – "Solvency II: Deep, liquid and transparent assessments, and GBP transition to SONIA"). Scenario analysis shows that whatever the change required, the impact on our solvency position is likely to be small.

RPI reform

In November, it was announced that the UK's Retail Price Index (RPI) inflation measure will be aligned with the Consumer Price Index including housing costs (CPIH) from 2030, with no compensation for holders of index-linked gilts. Rothesay closely hedges its inflation exposure and does not use RPI-linked assets to hedge CPI-linked liabilities, so the change in the value of index-linked gilts and RPI-linked derivatives as a result of RPI reform was largely matched by a change in the value of liabilities.

Brexit

As a UK insurer serving the domestic market, Rothesay's business model is largely unaffected by the UK's withdrawal from the EU.

The successful Part VII transfer of our small portfolio of Irish annuities to Monument Life Insurance DAC (formerly Laguna Life) in September 2020 means that none of the remaining business was written under passporting. We do have a number of ex-pat policyholders based outside the UK. In the unlikely event that we are prevented from making payments to such policyholders we will look to take alternative steps to ensure continuity of pension payments. We have asked all who may be affected to contact their banks for clarification on the measures they plan to take.

Rothesay has reviewed its investment portfolio, suppliers and counterparties and taken action to ensure contract continuity. We have also taken steps to ensure that our EU employees continue to have the right to work in the UK.

Longer term

Rothesay 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 Asia, driven by changes in government, evolving global relationships and unexpected fallout from Brexit.

Over the longer term there are risks relating to climate change and how this could impact Rothesay'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. Rothesay's investment policy requires consideration of the potential impact of climate change on new investments.

Rothesay continues to manage its affairs prudently such that we are not over-exposed to one particular risk and so that we only accept risks which we understand and where we are adequately rewarded for accepting them.

Risk management
continued

Principal risks and uncertainties facing Rothesay

Rothesay'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. Our risk exposures generally increase with the size of the balance sheet; in the table below we have only shown an increasing trend where the increase has been out of line with this.

In the table, strategic priorities 1 to 4 refer to:
1. Financial security
2. Steady growth
3. Service excellence
4. Reliable performance

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

Risk	Mitigation	Strategic priority	Change from last year
Credit risk The risk that an investment counterparty's credit worthiness deteriorates or that the counterparty defaults. Our financial and/or capital position could be adversely impacted by downgrades, credit spread widening or defaults.	Rothesay 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. Rothesay 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.	1,4	This risk has increased as a result of the impact of COVID-19 restrictions and as the balance sheet has grown.
Counterparty default risk The risk that a financial counterparty's credit worthiness deteriorates or that a counterparty defaults. Our financial and/or capital position could be adversely impacted by downgrades, credit spread widening or defaults.	Rothesay 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. Rothesay actively monitors counterparties for downgrade risk, and may also purchase credit protection to mitigate specific exposures.	1,4	This risk has increased as a result of the impact of COVID-19 on our counterparties.
Insurance risk The risk that demographic experience is different from expected. As the pensions insured by Rothesay are guaranteed, our financial and/or capital position could be adversely impacted if, for example, policyholders live longer than expected.	Rothesay invests in both people and modelling capabilities to understand its longevity experience and to help predict what could happen in the future. Rothesay aims to reinsure a majority of its longevity exposure. As at 31 December 2020, Rothesay had reinsured 87% of its longevity risk (2019: 78%) (APM).	1,4	Although we are now more reinsured, the balance sheet has also grown. The impact of COVID-19 on future longevity remains uncertain.

Risk	Mitigation	Strategic priority	Change from last year
Market risk The risk of adverse movements in interest rates, inflation or currency. Rothesay's financial and/or capital position could be adversely impacted by market movements to the extent that assets and liabilities are mismatched.	Rothesay monitors interest rate risk and foreign exchange risk closely, and uses derivatives to hedge the risks. We also undertake regular scenario testing, for example in relation to a UK downgrade, 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.	1,4	Volatile market conditions have persisted in 2020.
Property risk The risk of a fall in the value of property. Through its investments secured on property, Rothesay'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, flood risk and loan-to-value limits by age of borrower. We have also established prudent reserves covering the potential cost of the no negative equity guarantee on equity release mortgages. Exposure to commercial real estate is reduced by ensuring that loans have a low loan to value ratio, that there are appropriate covenants and that properties have strong tenants.	1,4	The long-term impact of COVID-19 restrictions on property prices remains unclear, heightening this risk.
Liquidity risk The risk of being unable to realise investments and other assets in order to settle financial obligations when they fall due. Given our holding of illiquid assets, there is a risk that we are unable to meet payments or collateral calls as they fall due in adverse circumstances.	Rothesay 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.	1,4	Market movements in 2020 led to large collateral calls. However Rothesay's liquidity position has remained robust throughout.
Climate change Rothesay'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.	Rothesay has established a Climate Change Working Group to focus on improving the way in which we manage this risk. Our in-house investment team is responsible for the selection and management of all of Rothesay's assets. The team considers climate-related risk as part of the investment process. In addition, Rothesay considers flood risk as part of its lending policies.	1,4	Rothesay has committed to supporting the UK in achieving carbon neutrality by 2050 and to aligning our investment with the aims of the Paris Accord.

Risk management
continued

Risk	Mitigation	Strategic priority	Change from last year
Operational risk The risk of operational failure, including conduct failures. Rothesay is exposed to the risk of operational failure as a result of failure of a strategic business partner or of its own systems and processes. This could lead to reputational damage and increased costs.	Rothesay 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 Rothesay and its strategic business partners. Scenario analysis covering a variety of potential operational risk events is regularly carried out. Rothesay 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 Rothesay outsources some of its responsibilities, we undertake thorough due diligence in advance of appointment and then have a strong programme of oversight.	3,4	Through the COVID-19 pandemic, Rothesay and our business partners have demonstrated operational resilience. Cyber and financial crime risk continue to be heightened.
Strategic, political and regulatory risk The risk of adverse changes to the regulatory or political environment. Rothesay's strategy, financial or capital position could be adversely affected by the impact of regulatory or political change.	Rothesay continues to actively monitor the political landscape. Where appropriate, Rothesay carries out lobbying activities or responds to consultations which may directly impact it. Strategic decisions take into account the overall political landscape. Rothesay's potential exposure to leasehold reform is mitigated by structural protections in the loans advanced. Rothesay 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. Rothesay seeks to have an open and transparent relationship with regulators at all times. Rothesay is a member of the Confederation of British Industry and the Association of British Insurers and we participate in consultations to ensure that our interests are protected for the benefit of our stakeholders.	1,2,4	There are continued political risks globally. The government's planned reform of the leasehold market could have an adverse impact on Rothesay'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.

Viability statement

Rothesay viability statement

Rothesay's strategy and business model, which are detailed in the strategic report, both centre around long-term pension security for our policyholders. This focus leads both management and the Board to consider the viability of Rothesay on an ongoing basis. The viability of Rothesay is linked to our ability to generate profits and maintain solvency and liquidity over a period of time.

Why we assess viability

The Board's assessment of viability is a central process within our risk management and strategic planning framework. Rothesay has been purpose-built to protect pensions and ensuring the Company remains viable is critical to protecting our policyholders' pensions.

The period we assess

Making a viability assessment requires the principal risks (pages 40 to 42) of the Company to be thoroughly understood and regularly updated for changes.

Rothesay's own views of risk and associated capital requirements have been investigated through the ORSA, including consideration of the way in which future changes to Rothesay's risk profile and also external influences may impact on Rothesay's solvency needs and ability to execute the business plan. The ORSA, approved by the Board in December 2020, considers risks across a five-year time horizon and therefore it is felt appropriate for the viability assessment to be considered across the same time horizon. Rothesay recognises that the Company has policyholder liabilities which extend beyond the five-year horizon but considers that year by year projections beyond the five-year period are likely to be unreliable given everything that might happen in that time. However, given the projected financial position of the Company in five years' time on a range of scenarios, the Board do not consider there to be any going concern or viability issues beyond this time frame.

How we assess viability

The ORSA includes a number of forward-looking scenarios intended to test the impact of stresses and scenarios that may impact Rothesay's ability to execute the business plan. Scenarios considered include shocks to new business (up and down), liquidity, financial markets (including the global financial crisis) and longevity. More details can be found in notes E and F of the financial statements. The results demonstrate the robustness of Rothesay's solvency and provide insight into the way in which the business plan would need to be adapted to respond to adverse conditions. Management and the Board believe Rothesay is well capitalised on both a regulatory and economic capital basis.

Given the dynamic nature of the market, the 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 last business plan was reviewed and approved in July 2020 and has not been impacted by the change in ownership of Rothesay, and remains appropriate. The business plan is refreshed if there are material changes to the business model or market environment. The business plan is centred around Rothesay's projected new business targets, with assumptions about pricing, reinsurance, investment strategy, revenue generation, expenses and leverage based on Rothesay'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 provided by our shareholders. IFRS pre-tax profits are driven by two key sources: new business profitability and profit emergence on the Rothesay back-book.

COVID-19

Scenario analysis has helped inform the Board's assessment of the future potential impact of COVID-19 on Rothesay's financial position. The results of this analysis combined with Rothesay's continuing operational and financial resilience throughout 2020 mean that the Board is confident that COVID-19 will not impact Rothesay's long term viability.

Our assessment of viability and going concern

Based on the results of this analysis, the Board has a reasonable expectation that Rothesay 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.

The same analysis also informs the Board's assessment of Rothesay's ability to continue to adopt the going concern basis of accounting.

Section

3

Financial statements

Report of the Directors

The Directors present their annual report and the audited financial statements for Rothesay Life Plc, registered number 06127279, (the Company, Rothesay or RLP) for the period ended 31 December 2020. Comparative information has been presented for the year ended 31 December 2019.

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 61.

3. Registered office
RLP is a registered public limited company incorporated and domiciled in the United Kingdom. The registered office and principal place of business is The Post Building, 100 Museum Street, London WC1A 1PB.

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

4. 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.

5. Disclosure of information to auditors
In the case of each Director in office at the date the Directors' report is approved:
- so far as the Director is aware, there is no relevant audit information of which the Company's auditors are unaware; and
- they have taken all the steps that they ought to have taken as a Director in order to make themselves aware of any relevant audit information and to establish that the Company's auditors are aware of that information.

6. 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.

7. Statement of Directors' responsibilities
The Directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable law and regulation. 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 accounting standards in conformity with the requirements of the Companies Act 2006. 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 period. In preparing these financial statements, the Directors are required to:
- select suitable accounting policies and then apply them consistently;
- state whether applicable international accounting standards in conformity with the requirements of the Companies Act 2006 have been followed, subject to any material departures disclosed and explained in the financial statements;
- make judgements and estimates that are reasonable and prudent; 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 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 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. The Directors are responsible for the maintenance and integrity of the Company's financial statements published on the ultimate parent Company's website.

Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

8. 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 include:

- 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 Remuneration Committee reviews the remuneration disclosures. 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.

9. Stakeholder statement

The Company operates under the governance framework of the Rothesay Group and an explanation of how the Rothesay Group board has considered the matters set out in s.172 is detailed within the Stakeholder engagement section of the Rothesay Limited Group annual report (which does not form part of this report but which can be obtained from the Company Secretary, The Post Building, 100 Museum Street, London WC1A 1PB). The RLP Board of Directors has also considered relevant matters where appropriate.

10. Streamlined Energy and Carbon Reporting

Rothesay Limited has prepared Streamlined Energy and Carbon Reporting (SECR) for the Rothesay Group. The Rothesay Limited Group SECR can be found in the Stakeholder engagement section of the Rothesay Limited Group annual report (which does not form part of this report but which can be obtained from the Company Secretary, The Post Building, 100 Museum Street, London WC1A 1BP).

11. Changes in Directors

- With the change of control of the Rothesay Limited Group, Qasim Abbas resigned with effect from 1 December 2020.
- Jane Hanson was appointed as an independent Non-Executive Director with effect from 1 January 2021.
- Edward Giera was appointed as an independent Non-Executive Director with effect from 25 January 2021.

12. Date of authorisation of issue

The financial statements were authorised for issue by the Board of Directors on 11 February 2021.

ON BEHALF OF THE BOARD

Addy Loudiadis
Chief Executive Officer
11 February 2021

Rothesay Life Plc

Board of Directors
Chairman
Naguib Kheraj

Executive Directors
Addy Loudiadis
Tom Pearce
Andrew Stoker

Shareholder Non-Executive Directors
Tim Corbett
Robin Jarratt

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

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 2020 and of its profit and cash flows for the year then ended;
- have been properly prepared in accordance with international accounting standards in conformity with the requirements of the Companies Act 2006; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

We have audited the financial statements, included within the Annual report and accounts 2020 (the “Annual Report”), which comprise: the Statement of financial position as at 31 December 2020; the Statement of comprehensive income, the Cash flow statement, and the Statement of changes in equity for the year then ended; and the notes to the financial statements, which include a description of the significant accounting policies.

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

Separate opinion in relation to international financial reporting standards adopted pursuant to Regulation (EC) No 1606/2002 as it applies in the European Union

As explained in note A.1 to the financial statements, the Company, in addition to applying international accounting standards in conformity with the requirements of the Companies Act 2006, has also applied international financial reporting standards adopted pursuant to Regulation (EC) No 1606/2002 as it applies in the European Union.

In our opinion, the Company financial statements have been properly prepared in accordance with international financial reporting standards adopted pursuant to Regulation (EC) No 1606/2002 as it applies in the European Union.

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 Group headed by Rothesay Limited, of which the Company is a member.

Other than those disclosed in note B.7 to the financial statements, we have provided no non-audit services to the group in the period under audit.

Our audit approach

Overview

Audit scope

- Our audit scope has been determined to provide coverage of all material financial statement line items.
- We have performed audit procedures that have assessed the extent of the impact of COVID-19, in particular on the valuation of insurance contract liabilities, ability to continue meeting regulatory solvency capital requirements, and financial performance, as well the ability of the Company to continue as a going concern.

Key audit matters

- Valuation of insurance contract liabilities – Longevity Methodology and Assumptions
- Valuation of insurance contract liabilities – Credit Default Risk Methodology and Assumptions
- Valuation of insurance contract liabilities – Methodology and Assumptions to derive the Limited Price Indexation (LPI)
- Valuation of investments classified as Level 3 under IFRS 13
- Impact of COVID-19

Materiality

- Overall materiality: £50,000,000 (2019: £50,000,000) based on a materiality value that is equivalent of 1.0% of Total Equity.
- Performance materiality: £35,000,000.

The scope of our audit

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

Capability of the audit in detecting irregularities, including fraud

Irregularities, including fraud, are instances of non-compliance with laws and regulations. We design procedures in line with our responsibilities, outlined in the Auditors' responsibilities for the audit of the financial statements section, to detect material misstatements in respect of irregularities, including fraud. The extent to which our procedures are capable of detecting irregularities, including fraud, is detailed below.

Based on our understanding of the Company and industry, we identified that the principal risks of non-compliance with laws and regulations related to breaches of UK regulatory principles, such as those governed by the Prudential Regulation Authority, the Financial Conduct Authority, and UK tax legislation, 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 such as the Companies Act 2006. We 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 instance of non-compliance with laws and regulation and fraud.
- Assessment of any 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 and attending all Audit Committees.

Independent auditors' report to the members of Rothesay Life Plc

continued

- Reviewing data regarding policyholder complaints, the Company's register of litigation and claims, Internal Audit reports, and 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, credit default risk assumptions and Limited Price Indexation 'LPI', and the valuation of investments classified as Level 3 under IFRS 13 described in the related key audit matters below. In addition we consider whether there are indications of management bias.
- Identifying risk criteria relating to the posting of journals that is susceptible to fraud and analysing the entire population of journals to assess those that meet this criteria.
- Designing audit procedures that incorporated unpredictability around the nature, timing or extent of our testing to material and immaterial financial statement line items, as well as validating the accuracy of member data from outsourced service providers to underlying evidence.

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 resulting 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.

The "Impact of COVID-19" and "Valuation of insurance contract liabilities – Methodology and Assumptions to derive the Limited Price Indexation (LPI)" are new key audit matters this year. The key audit matter titled "Insurance contract liabilities", which was a key audit matter last year, is no longer included because of its constituent components being split out into the "Valuation of insurance contract liabilities – Longevity Methodology and Assumptions", and "Valuation of insurance contract liabilities – Credit Default Risk Methodology and Assumptions" key audit matters. Otherwise, the key audit matters below are consistent with last year.

Key audit matter	How our audit addressed the key audit matter
Valuation of insurance contract liabilities – Longevity Methodology and Assumptions	
As disclosed in notes A.1 Basis of preparation and E.2 Insurance contract liabilities	The procedures to assess the appropriateness of the longevity assumptions used in the valuation of insurance contract liabilities includes the following:
Annuitant mortality and specifically longevity improvement is inherently uncertain and continues to be an area of judgement. The potential impact of the ongoing COVID-19 pandemic on longevity also involves significant expert judgement.	• Understood and tested the governance process in place to determine the longevity assumptions;

Key audit matter	How our audit addressed the key audit matter
Management utilises 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, CMI 2019.	• Assessed the appropriateness of expert judgements used in the development of the mortality assumptions. For example, the derivation of the 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;
Whilst the Company manages the extent of its exposure to longevity risk through reinsurance, we consider the longevity assumptions underpinning insurance contract liabilities to be a key audit matter, especially given the mono-line nature of the Company's insurance business.	• Compared the longevity assumptions selected by the Company against those used by their peers; and • Assessed the disclosure of the longevity assumptions and the associated financial impact on the liabilities arising from changes in these assumptions over 2020. Based on the audit procedures performed and evidence obtained, we consider the longevity assumptions used in the valuation of Insurance contract liabilities to be appropriate.
Valuation of insurance contract liabilities – Longevity Methodology and Assumptions	
As disclosed in notes A.1 Basis of preparation and E.2 Insurance contract liabilities	The procedures to assess the appropriateness of the longevity assumptions used in the valuation of insurance contract liabilities includes the following:
Annuitant mortality and specifically longevity improvement is inherently uncertain and continues to be an area of judgement. The potential impact of the ongoing COVID-19 pandemic on longevity also involves significant expert judgement.	• Understood and tested the governance process in place to determine the longevity assumptions;
Management utilises 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, CMI 2019.	• Assessed the appropriateness of expert judgements used in the development of the mortality assumptions. For example, the derivation of the 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;
Whilst the Company manages the extent of its exposure to longevity risk through reinsurance, we consider the longevity assumptions underpinning insurance contract liabilities to be a key audit matter, especially given the mono-line nature of the Company's insurance business.	• Compared the longevity assumptions selected by the Company against those used by their peers; and • Assessed the disclosure of the longevity assumptions and the associated financial impact on the liabilities arising from changes in these assumptions over 2020. Based on the audit procedures performed and evidence obtained, we consider the longevity assumptions used in the valuation of Insurance contract liabilities to be appropriate.

Independent auditors' report to the members of Rothesay Life Plc

continued

Key audit matter	How our audit addressed the key audit matter
Valuation of insurance contract liabilities – Credit Default Risk Methodology and Assumptions	
As disclosed in notes A.1 Basis of preparation and E.2 Insurance contract liabilities	The procedures to assess the appropriateness of the credit default assumptions used in the valuation of insurance contract liabilities included the following:
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.	• 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 reflects the Company's view of the security held against the asset class which in itself is an area of judgement. The challenging economic environment caused by the COVID-19 pandemic has increased the uncertainty in relation to the credit default assumptions made.	• 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 associated financial impact on the liabilities from changes in these assumptions over 2020. Based on the audit procedures performed and evidence obtained we consider the methodology and assumptions for Credit Default used in the valuation of Insurance contract liabilities to be appropriate.
Valuation of insurance contract liabilities – Methodology and Assumptions to derive the Limited Price Indexation (LPI)	
As disclosed in notes A.1 Basis of preparation and E.2 Insurance contract liabilities	The procedures to assess the appropriateness of the LPI methodology and assumptions used for the valuation of Insurance contract liabilities include the following:
Due to the nature of the Company's insurance business, there are significant insurance contract liabilities which relate to bulk pension annuities that are valued with reference to IFRS 4.	• Considered the liquidity of the LPI market in relation to assessing the relevance of the market quotes that are available and the rationale to moving to an internally developed model;

Key audit matter	How our audit addressed the key audit matter
A significant proportion of these liabilities are contractually inflated over time by LPI. This exposure has also increased materially in recent years (particularly 2019) following large transactions. Therefore, the assumptions as to how LPI will behave in the future are significant inputs to the valuation of these liabilities.	• Assessed the appropriateness of the timing of this methodology change, with regards to the evolution of Rothesay's LPI exposure over time and in light of new information received over 2020;
Management have adopted a new approach to the determination of this assumption as at 31 December 2020, calculating it using an internally developed model, where previously this was based on quotes obtained from the market.	• Assessed the methodologies used to derive the LPI assumptions (including the LPI spread, LPI volatility and prudential margin) with reference to relevant IFRS 4 accounting standards and academic literature; and by applying our industry knowledge and experience; • Tested controls performed by management over the approval and implementation of LPI assumptions (to the extent available); • Assessed the appropriateness of expert judgements used in the development of the LPI model. For example, the selection and parameterisation of the LPI model including the calibration of parameters and prudential margin. We have reviewed relevant academic literature and historic market data to support these judgements; • Assessed the appropriateness of the output of the LPI model against the related liquid interest rate market and historic LPI data; • Compared the assumptions determined against those adopted by peers using our independent benchmarking survey of the pensions market; and • Assessed the disclosure of the LPI assumptions and the commentary to support the profit arising from changes in these assumptions over 2020. Based on the procedures performed and evidence obtained, we consider the methodology and assumptions used to derive the LPI for the valuation of Insurance contract liabilities to be appropriate.
Valuation of investments classified as Level 3 under IFRS 13	
As disclosed in notes A.1 Basis of preparation, D.1 Financial Investments, D.2 Derivatives, and D.3 Payables and Financial Liabilities	The procedures to assess the appropriateness of the valuation of investments classified as Level 3 included the following:
The investments classified as Level 3 under the IFRS 13 fair value hierarchy is a material balance and comprise investments in commercial mortgage loans, ground rents, Dutch residential mortgages (DRM), equity release mortgages (ERM) and LPI derivatives.	• 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 significant data inputs;

Independent auditors' report to the members of Rothesay Life Plc

continued

Key audit matter	How our audit addressed the key audit matter
The ERM portfolio has increased significantly in the current year following the acquisition of a new ERM backbook portfolio as well as continued new originations.	• Reviewed management's methodology and assumptions, including yield curves, discounted cash flows, property growth rates, longevity assumptions and liquidity premiums relevant to each asset class;
In addition, the Company holds a material portfolio of derivatives used to hedge LPI exposure within the insurance contract liabilities. These financial investments have been transferred from IFRS 13 fair value hierarchy Level 2 into Level 3 as at 31 December 2020 due to the use of significant unobservable inputs in the valuation techniques.	• Understood the valuation models used by management and obtained evidence to support the model's operation is in line with methodology;
The valuations of Level 3 investments are 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.	• Engaged our relevant experts to assess the appropriateness of management's methodology; • Independently revalued a sample of investments, including revaluation of the ERM portfolio during the year using an independent model; • Tested significant inputs into the valuation of Level 3 financial investments to external sources, where possible; • Considered the appropriateness of the spreads that represent the unobservable input to the valuation of the LPI derivative portfolio; • With consideration of the impacts of the pandemic, identified sectors at higher risk and obtained evidence of management's credit risk assessments for relevant illiquid assets, including corroboration to external evidence; and • Assessed the adequacy of disclosures in the financial statements. Based on the procedures performed and evidence obtained, we consider the valuation of Level 3 financial investments to be appropriate.
Impact of COVID-19	
As disclosed in the Strategic report and notes A.1 Basis of preparation, D.1 Financial Investments, E.1 Reinsurance assets/liabilities, E.2 Insurance contract liabilities	In assessing management's consideration of the impact of COVID-19 on the Company we have performed the following procedures:
The impacts of the global pandemic due to the Coronavirus COVID-19 continue to cause significant social and economic disruption up to the date of reporting. In our audit we have identified the following key impacts of COVID-19:	
Ability of the entity to continue as a going concern.	

Key audit matter	How our audit addressed the key audit matter
There are a number of potential matters in relation to COVID-19 which could impact on the going concern status of the Company. Using downside scenarios driven by the required Own Risk and Solvency Assessment (ORSA) process, the Directors have considered the ability of the Company to remain solvent with sufficient liquidity to meet future obligations. The Directors have also considered its requirements in respect of regulatory capital under Solvency II and the potential operational impacts on the business arising from remote working.	• Obtained management's updated going concern assessment and challenged the rationale for the downside scenarios adopted and material assumptions made using our knowledge of Rothesay's business performance, review of regulatory correspondence and obtaining further corroborating evidence;
The Directors' have concluded that the Company are a going concern.	• Considered information obtained during the course of the audit and publicly available market information to identify any evidence that would contradict management's assessment of the impact of COVID-19; and • Inquired and understood the actions taken by management to mitigate the impacts of COVID-19, including review of Board Risk Committee minutes and attendance of all Audit Committees. We agree with the Director's conclusions in respect of going concern.
Impact on Estimation Uncertainty in the Financial Statements	
The pandemic has increased the level of estimation uncertainty in the financial statements. The Directors have therefore considered how COVID-19 has impacted the key estimates that determine the valuation of material balances, particularly the Insurance Contract Liabilities and Level 3 Financial Investments.	• Considered whether there has been any impacts from remote working on the design and operating effectiveness of key controls impacting the preparation of financial statement information; • Challenged the judgements applied by management to derive the longevity and credit default assumptions, used to determine the insurance contract liabilities, in light of the emerging COVID-19 experience and by comparing these relative to the Company's industry peers; and • With consideration of the impacts of the pandemic, identified sectors at higher risk and obtained evidence of management's credit risk assessments for relevant illiquid assets, including corroboration to external evidence. We have audited the balances impacted by estimation uncertainty and believe the values presented in the Financial Statements to be reasonable.

Independent auditors' report to the members of Rothesay Life Plc

continued

Key audit matter	How our audit addressed the key audit matter
Qualitative Disclosures in the Annual Report and Financial Statements	
In addition, the Directors have considered the qualitative disclosures included in the Annual Report and Accounts in respect of COVID-19 and the impact that the pandemic has had, and continues to have, on the Company.	• Reviewed the appropriateness of disclosures within the Annual report and accounts with respect to COVID-19 and, where relevant, considered the material consistency of this other information to the audited financial statements and the information obtained in the audit. Based on the procedures performed and evidence obtained, we consider the disclosure of COVID 19 in the financial statements 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 Company materiality	£50,000,000 (2019: £50,000,000).
How we determined it	a materiality value that is equivalent of 1.0% of Total Equity.
Rationale for benchmark applied	We determine a materiality value that reflects the context of business performance and benchmarks which represent the key performance indicators considered important to the users of the financial statements. Based on the benchmarks used in the financial statements, 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 and the financial strength of the Company for the holders of listed debt issued. We have presented the materiality value as a percentage of Total Equity, but have also compared the materiality value against other relevant benchmarks, such as total assets, total revenue and profit before tax, to ensure the materiality selected was appropriate for our audit. We consider that total assets is the primary measure used by the shareholders in assessing the performance of the entity and is a generally accepted auditing benchmark for the purpose of the Company financial statements.

We use performance materiality to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements exceeds overall materiality. Specifically, we use performance materiality in determining the scope of our audit and the nature and extent of our testing of account balances, classes of transactions and disclosures, for example in determining sample sizes. Our performance materiality was 75% of overall materiality, amounting to £35,000,000 for the Company financial statements.

In determining the performance materiality, we considered a number of factors – the history of misstatements, risk assessment and aggregation risk and the effectiveness of controls – and concluded that an amount at the upper end of our normal range was appropriate.

We agreed with the Audit Committee that we would report to them misstatements identified during our audit above £2,500,000 (2019: £2,500,000) as well as misstatements below that amount that, in our view, warranted reporting for qualitative reasons.

Independent auditors' report to the members of Rothesay Life Plc

continued

Conclusions relating to going concern

Our evaluation of the Directors' assessment of the Company's ability to continue to adopt the going concern basis of accounting included:

- Obtained management's updated going concern assessment and challenged the rationale for the downside scenarios adopted and material assumptions made using our knowledge of Rothesay's business performance, review of regulatory correspondence and obtaining further corroborating evidence;
- Considered management's assessment of the regulatory Solvency coverage and liquidity position in the forward looking scenarios considered which have been driven from Rothesay's ORSA;
- Considered information obtained during the course of the audit and publicly available market information to identify any evidence that would contradict management's assessment of going concern (including the impacts of COVID-19); and
- Inquired and understood the actions taken by management to mitigate the impacts of COVID-19, including review of Board Risk Committee minutes and attendance of all Audit Committees.

Based on the work we have performed, we have not identified any material uncertainties relating to events or conditions that, individually or collectively, may cast significant doubt on the Company's ability to continue as a going concern for a period of at least twelve months from when the financial statements are authorised for issue.

In auditing the financial statements, we have concluded that the Directors' use of the going concern basis of accounting in the preparation of the financial statements is appropriate.

However, because not all future events or conditions can be predicted, this conclusion is not a guarantee as to the Company's ability to continue as a going concern.

Our responsibilities and the responsibilities of the Directors with respect to going concern are described in the relevant sections of this report.

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 our work undertaken in the course of the audit, the Companies Act 2006 requires 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 2020 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.

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.

Our audit testing might include testing complete populations of certain transactions and balances, possibly using data auditing techniques. However, it typically involves selecting a limited number of items for testing, rather than testing complete populations. We will often seek to target particular items for testing based on their size or risk characteristics. In other cases, we will use audit sampling to enable us to draw a conclusion about the population from which the sample is selected.

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.

Independent auditors' report to the members of Rothesay Life Plc

continued

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 obtained 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

We were appointed by the members on 26 February 2007 to audit the financial statements for the year ended 30 November 2007 and subsequent financial periods. The period of total uninterrupted engagement is 14 years, covering the years ended 30 November 2007 to 31 December 2020.

Sue Morling (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
Bristol
11 February 2021

Statement of comprehensive income

FOR THE YEAR ENDED 31 DECEMBER 2020

	Note	2020 £m	2019 £m
Income			
Gross premiums written	B.1	**7,281**	16,606
Premiums ceded to reinsurers		**(1,412)**	(1,245)
Net premiums written		**5,869**	15,361
Investment return	B.2	**4,648**	2,289
Total revenue		**10,517**	17,650
Expenses			
Policyholder claims		**(2,798)**	(2,442)
Less: reinsurance recoveries		**1,307**	1,046
Change in insurance contract liabilities	E.2	**(7,315)**	(15,373)
Change in the reinsurers' share of insurance contract liabilities	E.1	**83**	46
Net claims and change in insurance liabilities		**(8,723)**	(16,723)
Acquisition and administration expenses	B.3	**(201)**	(180)
Finance costs	B.4	**(119)**	(107)
Total expenses		**(9,043)**	(17,010)
Profit before tax		**1,474**	640
Income tax expense	B.8	**(280)**	(122)
Profit for the year		**1,194**	518

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 form an integral part of these financial statements.

Statement of financial position

AS AT 31 DECEMBER 2020

	Note	**2020 £m**	2019 £m
Assets			
Investment in subsidiaries	H.2	**13**	11
Property, plant and equipment		**7**	9
Lease – right of use asset	I.4	**34**	37
Financial investments	D.1	**93,712**	73,741
Reinsurance assets	E.1	**616**	388
Accrued interest and prepayments	D.3	**663**	755
Receivables	D.4	**1,124**	947
Cash and cash equivalents	D.5	**186**	234
Total assets		**96,355**	76,122
Equity and liabilities			
Equity			
Share capital	C.1	**510**	510
Tier 1 notes	C.2	**347**	347
Share premium	C.3	**1,953**	1,953
Retained earnings	C.3	**2,140**	946
Total equity		**4,950**	3,756
Liabilities			
Reinsurance liabilities	E.1	**993**	848
Insurance contract liabilities	E.2	**55,247**	47,932
Payables and financial liabilities	D.6	**33,547**	22,010
Leasehold liabilities	I.4	**40**	39
Borrowings	D.7	**1,426**	1,427
Deferred tax liabilities	G.1	**82**	31
Accruals and deferred income		**70**	79
Total liabilities		**91,405**	72,366
Total equity and liabilities		**96,355**	76,122

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

The financial statements were approved by the Board of Directors on 11 February 2021 and signed on its behalf by:

Addy Loudiadis
Chief Executive Officer
11 February 2021

Company number 06127279

Statement of changes in equity

FOR THE YEAR ENDED 31 DECEMBER 2020

	Share capital £m	Share premium £m	Tier 1 notes £m	Retained earnings £m	Total equity £m
As at 1 January 2020	**510**	**1,953**	**347**	**946**	**3,756**
Profit for the financial year	**—**	**—**	**—**	**1,194**	**1,194**
As at 31 December 2020	**510**	**1,953**	**347**	**2,140**	**4,950**

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

Cash flow statement

FOR THE YEAR ENDED 31 DECEMBER 2020

	Note	2020 £m	2019 £m
Cash flows from operating activities			
Profit for the financial year		**1,194**	518
Adjustments for non-cash movements in net profit for the financial year			
Retrospective restatement due to change in accounting treatment		**—**	(7)
Fixed asset write-off		**—**	1
Depreciation		**2**	1
Amortisation of debt costs	B.4	**3**	1
Leasehold depreciation	I.4	**3**	2
Financing charge on leasehold	I.4	**1**	1
Interest income	B.2	**(1,400)**	(1,125)
Interest expense	B.4	**115**	105
Income tax expense	B.8	**230**	122
Net (increase)/decrease in operational assets			
Financial investments	D.1	**(19,971)**	(24,578)
Reinsurance asset	E.1	**(228)**	(344)
Receivables	D.4	**(177)**	(590)
Prepayment	D.3	**126**	(204)
Net increase/(decrease) in operational liabilities			
Insurance contract liabilities	E.2	**7,315**	15,373
Reinsurance liabilities	E.1	**145**	299
Financial liabilities	D.6	**10,632**	8,051
Other payables	D.6	**969**	40
Deferred tax	G.1	**51**	30
Accruals and deferred income		**(7)**	—
Cash flows used in operating activities		**(997)**	(2,304)
Interest paid		**(115)**	(83)
Interest received		**1,366**	1,071
Tax paid		**(295)**	(59)
Net cash flows used in operating activities		**(41)**	(1,375)
Cash flows (used in)/from financing activities			
Proceeds from issuance of debt (net of issuance costs)	D.7	**96**	778
Repayment of borrowings	D.7	**(100)**	—
Proceeds from issuance of ordinary share capital (including share premium)	C.1	**—**	700
Net cash (used in)/from financing activities		**(4)**	1,478
Cash outflows from investing activities			
Net acquisition of property, plant and equipment		**(1)**	(9)
Investment in subsidiaries	H.2	**(2)**	(10)
Cash flow on leasehold	I.4	**—**	(1)
Net cash outflows from investing activities		**(3)**	(20)
Net (decrease)/increase in cash and cash equivalents		**(48)**	83
Cash and cash equivalents at 1 January		**234**	151
Cash and cash equivalents at 31 December	D.5	**186**	234

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 international accounting standards in conformity with the requirements of the Companies Act 2006 and international financial reporting standards adopted pursuant to Regulation (EC) No 1606/2002 as it applies in the European Union. 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 62.

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.

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

Judgements are decisions which management has made in the process of applying Rothesay's accounting policies. Matters of significant judgement are considered to be:
- The assessment of whether Rothesay controls underlying entities and investments (see note H.1).
- Assessment of the significance of insurance risk transferred to Rothesay 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.2).

Estimates are based on evidence available at the accounting date and opinions provided by subject matter experts. Actual results may vary from the estimates provided. As new facts become available estimates will be updated. Items considered particularly susceptible to changes in estimates are noted below:
- Fair value of financial investments where quoted market prices are not available (see note D.1).
- Measurement of net insurance contract liabilities (see notes E.1 and E.2).

During 2020, we have changed our approach to setting the rate of limited price indexation (LPI). Over time the LPI market has become highly illiquid and all but a very small number of banks have withdrawn from the market, leading to rates which are out of line with the LPI rates actually realised. In calculating the insurance liabilities, for 2020, we have therefore projected rates using LPI models based on realised LPI and other market inputs. This change has led to a reduction in insurance liabilities of £456m which was partly offset by a reduction in the estimated value of LPI linked derivatives of £160m. As this is a change in accounting estimate we have not restated prior year comparatives.

Notes to the financial statements
continued

Note A – Significant accounting policies (continued)
A.1 Basis of preparation (continued)
In accordance with IAS 1 and published FRC guidance, within each of the relevant notes Rothesay 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 2021; and
- explanation of any changes made to past assumptions if the uncertainty is unresolved.

A.2 Contract classification
Rothesay 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 Rothesay's insurance contracts are accounted for using generally accepted accounting principles within the UK industry. Rothesay 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 Rothesay continues to apply the principles.

A.3 Foreign currencies
Transactions denominated in foreign currencies are translated into sterling at rates of exchange ruling on the date the transaction occurred. Monetary assets and liabilities denominated in foreign currencies are translated into sterling at rates of exchange ruling at the financial statement date. Gains and losses on exchange are recognised in operating expenses.

A.4 Adoption of new or amended standards
Rothesay has considered the following new standards and changes to existing standards which are relevant to Rothesay's operations, and became effective for financial years beginning on or after 1 January 2020. These amendments have all been endorsed by the EU.

Amendments to IFRS 9 — Financial instruments, IAS 39 — Financial instruments, and IFRS 7 — Financial instruments: disclosures — Interest rate benchmark reform:
Following the financial crisis, the replacement of benchmark interest rates such as LIBOR and other interbank offered rates (IBORS) has become a priority for global regulators. Many uncertainties remain but the route to replacement is becoming clearer. Given the pervasive nature of IBOR-based contracts among both financial institutions and corporates, there are significant potential impacts of these changes on financial reporting under IFRS.

The phase 1 amendments provide temporary relief from applying specific hedge accounting requirements to hedging relationships directly affected by IBOR reform. Rothesay does not apply hedge accounting and therefore has not been impacted by the amendments.

Amendments to IAS 1 — Presentation of financial statements and IAS 8 — Accounting policies, changes in accounting estimates and errors — Definition of material:
The amendments to IAS 1 and IAS 8 and consequential amendments to other IFRSs i) use a consistent definition of materiality throughout IFRSs and the Conceptual Framework for Financial Reporting; ii) clarify the explanation of the definition of material; and iii) incorporate some of the guidance in IAS about immaterial information.

Note A – Significant accounting policies (continued)

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

The amended definition is ‘Information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that the primary users of general purpose financial statements make on the basis of those financial statements, which provide financial information about a specific reporting entity’.

The amendment clarifies that the reference to obscure information addresses situations in which the effect is similar to omitting or misstating that information. It also states that an entity assesses materiality in the context of the financial statements as a whole. The amendments clarify the definition of material but have not impacted on the preparation of Rothesay’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. The revised Framework has not impacted Rothesay’s financial statements but will be used to understand the concepts in the Framework and the potential ways in which future guidance might be impacted.

Amendments to IFRS 3 Business combinations — Definition of a business:

This amendment has not been adopted by the EU but early adoption is permitted. To be considered a business, an acquisition would have to include an input and a substantive process that together significantly contribute to the ability to create outputs. The new guidance provides a framework to evaluate when an input and a substantive process are present. To be a business without outputs, there will now need to be an organised workforce. The changes to the definition of a business will not impact Rothesay in the current year.

Amendments to IAS 1 ‘Presentation of financial statements’, on classification of liabilities

The amendment is expected to be effective for periods beginning on or after 1 January 2022. The IASB issued a narrow-scope amendment to IAS 1 to clarify that liabilities are classified as either current or non-current, depending on the rights that exist at the end of the reporting period. All entities should reconsider their existing classification in the light of the amendment and determine whether any changes are required. The changes are not expected to impact the classification of Rothesay’s liabilities.

Amendment to IFRS 16, Leases — COVID-19 related rent concessions

As a result of the coronavirus pandemic, rent concessions have been granted to lessees. Such concessions might take a variety of forms, including payment holidays and deferral of lease payments. On 28 May 2020, the IASB published an amendment to IFRS 16 that provides an optional practical expedient for lessees from assessing whether a rent concession related to COVID-19 is a lease modification. Lessees can elect to account for such rent concessions in the same way as they would if they were not lease modifications. Rothesay has not received any concessions and therefore this amendment is not relevant to the Company.

IFRS 17 Insurance contracts

The International Accounting Standards Board has announced that the implementation of IFRS 17, the accounting standard for insurance contracts, will be further delayed until 1 January 2023. The standard will have a big impact on the way Rothesay’s results are reported because the standard rebuilds performance measurement from the ground up in areas ranging from a new definition of insurance revenue to the elimination of upfront profits and spreading of profit across the lifetime of the contract. As a result, IFRS profits that have been declared in the past (and up to 31 December 2022) will be re-calculated and the opening balance sheet adjusted accordingly.

During 2020 the IFRS 17 project team has continued to make progress. An initial assessment has now been completed on the potential impact of IFRS 17 and work will continue during 2021 on detailed implementation. The IFRS 17 project is being overseen by the Audit Committee.

Notes to the financial statements
continued

Note A – Significant accounting policies (continued)
A.4 Adoption of new or amended standards (continued)
Rothesay 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. However IFRS 9 is expected to have relatively little impact on Rothesay as assets are already fair valued.

The following standards have not yet been endorsed and are effective for annual periods on or after 1 January 2022:

Amendment to IFRS 3 'Business combinations'
The amendments update a reference in IFRS 3 to the Conceptual Framework for Financial Reporting without changing the accounting requirements for business combinations.

Amendments to IAS 16 Property, plant and equipment
The amendment prohibits a company from deducting from the cost of property, plant and equipment amounts received from selling items produced while the Company is preparing the asset for its intended use. Instead, a Company will recognise such sales proceeds and related costs in profit or loss. This is not expected to apply to Rothesay.

Amendments to IAS 37, Provisions, contingent liabilities and contingent assets
The amendments specify which costs a company includes when assessing whether a contract will be loss-making. This is not expected to apply to Rothesay.

Annual improvements
Annual improvements make minor amendments to IFRS 1, First-time Adoption of IFRS, IFRS 9, Financial instruments, IAS 41, Agriculture and the illustrative Examples accompanying IFRS 16, Leases. None of the amendments are expected to impact Rothesay.

Note B – Income statement notes

B.1 Segmental analysis

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

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

	Regular premiums		Single premiums	
	2020 £m	2019 £m	**2020 £m**	2019 £m
Pension bulk annuities	**260**	263	**7,021**	16,343
Total gross premiums written	**260**	263	**7,021**	16,343

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

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

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.

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

	2020 £m	2019 £m
Interest income on financial investments at fair value through profit and loss	**1,400**	1,125
Unrealised gain on financial investments	**2,745**	900
Realised gains on financial investments	**561**	316
Investment management expenses	**(58)**	(52)
Total investment return	**4,648**	2,289

Notes to the financial statements
continued

Note B – Income statement notes (continued)
B.2 Investment return (continued)

Interest income has increased due to the growth in assets under management. The gains on financial investments were largely driven by the reduction in interest rates over the year.

The increase in investment management expenses reflects the growth in Rothesay'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.

Acquisition and administration expenses can be broken down as follows:

	2020 £m	2019 £m
Acquisition costs	**114**	108
Administration expenses – recurring	**53**	48
Administration expenses – projects and other one-off expenses	**34**	24
Total operating expenses	**201**	180

The following items have been included in operating expenses:

	2020 £m	2019 £m
Depreciation	**2**	1
Operating lease rental expense for office premises	**4**	—
	6	1

Project and other one off expenses include reinsurance fees and charitable contributions. Projects include the development of the full internal model, the development of our IT platform and development activity by our third party administrators.

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.

	2020 £m	2019 £m
Interest payable on collateral	**3**	9
Interest payable on collateralised agreements and financing	**8**	13
Total interest payable on collateral and collateralised agreements	**11**	22
Interest payable on borrowings from participating interest	**21**	26
Interest payable on third party borrowings	**86**	58
Financing charge on leasehold asset	**1**	1
Total borrowing costs	**108**	85
Net finance costs	**119**	107

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

Interest expense on the Tier 1 note is included in interest payable on third party borrowings.

Note B – Income statement notes (continued)

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 Rothesay's employees are as follows:

	2020 No.	2019 No.
Average number of staff employed during the year	**279**	231
Employees by department at year end		
Management	**25**	19
New business origination	**17**	17
Investments	**46**	40
Technology	**57**	44
Finance, legal and HR	**58**	53
Operations and project management	**65**	47
Risk and Internal Audit	**37**	32
	305	252

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

	2020 £m	2019 £m
Wages and salaries	**85**	77
Social security costs	**13**	11
Other pension costs	**3**	2
Total employee benefits expense	**101**	90

The key management personnel who have the authority and responsibility for planning, directing and controlling the activities of Rothesay include its Directors. Further details of key management personnel transactions are included in note I.2.

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

	2020 £m	2019 £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	**1**	2
Company pension contributions to money purchase schemes	**—**	—
Total highest paid Director	**1**	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 2020 Directors received no emoluments for non-qualifying services which are required to be disclosed. Four Directors have been granted shares in Rothesay Limited in respect of long-term incentive schemes. No Directors have exercised options during the year.

Notes to the financial statements
continued

Note B – Income statement notes (continued)
B.6 Pension contributions

Rothesay 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 £3m (2019: £2m). There were no outstanding contributions as at 31 December 2020 (2019: £nil).

B.7 Auditors' remuneration

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

	2020 £000s	2019 £000s
Remuneration receivable by the Company's auditors for the audit of the Company financial statements	**1,323**	1,060
Remuneration receivable by the Company's auditors for the audit of the financial statements of the Company's subsidiaries	**94**	47
Total audit	**1,417**	1,107
Required by regulation	**145**	126
Audit-related assurance services	**198**	158
Other assurance services	**222**	167
Non-audit services	**40**	75
Total fees	**2,022**	1,633

Other assurance services provided in 2020 include work in relation to the issuance of Tier 3 bonds and in relation to Rothesay's financial controls. These and the other non-audit services are all in compliance with applicable independence rules and Rothesay considered that the external auditor was best placed to provide these services because of their expertise and their understanding of Rothesay.

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 2020 and 31 December 2019 are:

	2020 £m	2019 £m
Current income tax:		
UK corporation tax	**230**	87
Adjustment in respect of prior period	**(1)**	6
Total current income tax	**229**	93
Deferred tax:		
Origination and reversal of temporary differences	**51**	29
Total deferred tax	**51**	29
Total tax expense in the statement of comprehensive income	**280**	122

The tax expense in the statement of comprehensive income for the year and the standard rate of corporation tax in the UK of 19% (2019: 19%) is reconciled below:

	2020 £m	2019 £m
Profit on ordinary activities before taxation	**1,474**	640
Tax calculated at UK standard rate of corporation tax of 19% (2019: 19%)	**280**	122
Adjustment in respect of prior period	**(1)**	5
Difference in accounting and tax valuation basis	**52**	34
Change in tax rates	**2**	—
Permanent differences	**(51)**	(38)
Utilisation of losses surrendered by group undertakings	**(2)**	(1)
Total tax expense reported in the statement of comprehensive income	**280**	122

Notes to the financial statements
continued

Note C – Equity
C.1 Share capital
At 31 December 2020 and 31 December 2019 share capital comprised:

	2020		2019	
	No.	£m	No.	£m
Authorised share capital (ordinary shares of £1 each)	**510,528,696**	**510**	510,528,696	510

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

C.2 Restricted Tier 1 notes
Under IFRS the Restricted Tier 1 notes (RT1) 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.

	2020 £m	2019 £m
Loan notes issued through public debt markets	**347**	347

On 5 September 2018, Rothesay issued £350m of Restricted Tier 1 notes with a fixed 6.875% coupon payable semi-annually in arrears. The notes were issued through the public debt markets. The notes were initially recognised at the fair value of the consideration received less transaction costs directly attributable to the issuance.

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

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

The full principal amount of each note is irrevocably and automatically reduced to zero on a permanent basis if RLP determines at any time that:
(i) eligible Own Fund items are less than or equal to 75% of the SCR;
(ii) eligible Own Fund items are less than or equal to 100% of the MCR; or
(iii) a breach of the SCR has occurred and has not been remedied within three months.

Note C – Equity (continued)
C.3 Share premium account and reserve

	Share premium £m	Retained earnings £m
1 January 2020	**1,953**	**946**
Profit for the financial year	**—**	**1,194**
31 December 2020	**1,953**	**2,140**

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

C.4 Dividends paid
The Directors have recommended no payment of interim dividends during the year ended 31 December 2020 (2019: £nil). The Directors have recommended no final ordinary dividend in respect of the year ended 31 December 2020 (2019: £nil).

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

Rothesay uses derivative contracts for the purposes of efficient portfolio management and to mitigate the risk of adverse market movements. Rothesay's derivative contracts consist primarily of over the counter (OTC) derivatives. Rothesay measures the derivative assets and liabilities on the basis of our net exposure to the relevant risk and the fair value is the price paid to transfer the net long or short position at the balance sheet date. 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 and the relationship of recent market activity to the prices provided from alternative pricing sources.

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

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. In circumstances where Rothesay cannot verify the model value by reference to market transactions, it is possible that a different valuation model could produce a materially different estimate of fair value.

Derecognition

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

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

Collateralised agreements and financing

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

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

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

	2020 £m	2019 £m
Financial investments carried at fair value through profit and loss, designated at initial recognition	**93,712**	73,741

Notes to the financial statements
continued

Note D – Financial assets and liabilities (continued)
D.1 Financial investments (continued)
Determination of fair value and fair value hierarchy
Rothesay uses the following hierarchy for determining and disclosing the fair value of financial instruments by valuation technique:
- Level 1: inputs are unadjusted quoted prices in active markets to which Rothesay had access at the measurement date for identical unrestricted assets and liabilities;
- Level 2: inputs to valuation techniques are observable either directly or indirectly; and
- Level 3: one or more inputs to valuation techniques are significant and unobservable.

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

COVID-19
The continued economic disruption a result of COVID-19 has impacted the fair value of our financial investments. Where possible, we have continued to use observable market prices. Where assets have been valued using techniques with unobservable inputs, we have considered whether adjustments need to be made. For example, in valuing loans secured on commercial real estate, we have adjusted underlying property values on a property-by-property basis. Sensitivities to the value of the inputs can be found at the end of this note.

The following tables show an analysis of financial investments recorded at fair value by level of the fair value hierarchy for 2020 and 2019 (please refer to note D.6 for financial liabilities):

31 December 2020	**Level 1 £m**	**Level 2 £m**	**Level 3 £m**	**Total £m**
Collective investment schemes	**4,286**	**—**	**—**	**4,286**
Government sub sovereign and agency obligations	**8,900**	**9,971**	**—**	**18,871**
Corporate bonds and other corporate debt	**—**	**25,986**	**1,186**	**27,172**
Derivative assets (see note D.2)	**—**	**27,145**	**3,555**	**30,700**
Collateralised agreements and financing	**—**	**1,727**	**—**	**1,727**
Loans secured on property	**—**	**—**	**6,523**	**6,523**
Equity release mortgages	**—**	**—**	**4,222**	**4,222**
Certificate of deposits	**—**	**211**	**—**	**211**
Total financial investments at fair value	**13,186**	**65,040**	**15,486**	**93,712**

31 December 2019	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Collective investment schemes	5,329	—	—	5,329
Government sub sovereign and agency obligations	7,951	10,005	—	17,956
Corporate bonds and other corporate debt	—	19,073	1,088	20,161
Derivative assets	—	19,508	—	19,508
Collateralised agreements and financing	—	1,875	—	1,875
Loans secured on property	—	—	6,063	6,063
Equity release mortgages	—	—	2,669	2,669
Certificate of deposits	—	180	—	180
Total financial investments at fair value	13,280	50,641	9,820	73,741

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

Approximately 17% (2019: 13%) of the total financial assets recorded at fair value are valued based on estimates and recorded as Level 3 investments.

Note D – Financial assets and liabilities (continued)
D.1 Financial investments (continued)
COVID-19 (continued)

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

	Government sub sovereign and agency obligations £m	Corporate debt £m	Loans secured on property £m	Derivative assets £m	Total £m
At 1 January 2020	**—**	**1,088**	**6,063**	**—**	**7,151**
Total gains in the statement of comprehensive income:					
Unrealised gains/(losses)	**—**	**33**	**(93)**	**—**	**(60)**
Realised gains	**—**	**—**	**12**	**—**	**12**
Transfer into Level 3	**—**	**90**	**—**	**3,555**	**3,645**
Transfer out of Level 3	**—**	**(47)**	**—**	**—**	**(47)**
Net purchases/additions	**—**	**22**	**541**	**—**	**563**
At 31 December 2020	**—**	**1,186**	**6,523**	**3,555**	**11,264**
At 1 January 2019	364	1,091	3,376	1	4,832
Total gains in the statement of comprehensive income:					
Unrealised gains	6	60	156	13	235
Transfer out of Level 3	(412)	(395)	—	(21)	(828)
Net purchases/additions	42	332	2,531	7	2,912
At 31 December 2019	—	1,088	6,063	—	7,151

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

Rothesay's policy is to determine the relevant categorisation of financial assets and liabilities at least annually and, where availability of inputs has changed, transfers will be made between levels. The recorded amount of the total financial assets and investments transferred from Level 3 to Level 2 is £47m (2019: £828m). The increase in Level 3 derivative assets was driven by the transfer of LPI linked derivatives from Level 2 to Level 3 as a result of the assessment that the market for LPI swaps is illiquid. There were £90m of corporate debts transferred from Level 2 to Level 3 due to the lack of market pricing colour.

Equity release mortgages

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

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

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

Notes to the financial statements
continued

Note D – Financial assets and liabilities (continued)
D.1 Financial investments (continued)
Equity release mortgages (continued)
Underlying house prices have been updated in line with the latest available data. Sensitivities to interest rates and house prices are shown later in this note as these are the most material assumptions given the way in which the potential cost of the no negative equity 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.

	2020 £m	2019 £m
Carrying amount at 1 January	**2,669**	1,897
Increase in respect of new business	**1,444**	694
Redemptions/repayments	**(145)**	(142)
Accrued interest for the year	**126**	109
Change in economic assumptions	**128**	111
Change in demographic assumptions	**—**	—
Closing balance at 31 December 2020	**4,222**	2,669

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

	2020 £m	2019 £m
Less than one year	**249**	176
One to five years	**913**	624
Over five years	**3,060**	1,869
	4,222	2,669

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:

	2020		2019 restated[1]	
	Asset £m	**Related liability £m**	Asset £m	Related liability £m
Government and agency obligations	**1,102**	**894**	1,020	879
Total collateralised agreements	**1,102**	**894**	1,020	879

1 As at 31 December 2019 we have reclassified a financial liability of £203m from derivative financial instruments to collateralised financing agreements following a review of the classification of derivative contracts.

The asset collateral continues to be recognised in full and the related liability reflecting Rothesay's obligations to repurchase the transferred assets at a future date is recognised in other liabilities. Rothesay 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 2020, the total cash collateral received was £2,063m (2019: £1,193m). Other OTC contracts are collateralised with fixed income securities which are not recognised on the balance sheet of Rothesay.

Note D – Financial assets and liabilities (continued)

D.1 Financial investments (continued)

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

The following table shows the impact on the fair value (FV) of Level 3 instruments of using reasonably possible alternative assumptions by class of instrument. Changes are made in isolation so, for example, no change is made to property price inflation in the property price sensitivities. Since part of any spread movement is likely to be included in the derivation of the valuation rate of interest, changes in fair value of assets also impact liabilities. The table below also shows the potential impact on profit before tax (PBT) of the same alternative assumptions, assuming that all other pricing inputs remain constant.

			2020		
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	+25bps yield to maturity	**1,186**	**(21)**	**(3)**
		-25bps yield to maturity	**1,186**	**22**	**4**
Loans secured on property	Liquidity premium	+25bps yield to maturity	**6,523**	**(258)**	**—**
		-25bps yield to maturity	**6,523**	**280**	**—**
Loans secured on property	Property prices	+10% change in property prices	**6,523**	**19**	**41**
		-10% change in property prices	**6,523**	**(28)**	**(76)**
Equity release mortgages	Liquidity premium	+25bps yield to maturity	**4,222**	**(125)**	**—**
		-25bps yield to maturity	**4,222**	**131**	**—**
Equity release mortgages	House prices	+10% change in house prices	**4,222**	**80**	**81**
		-10% change in house prices	**4,222**	**(101)**	**(103)**
Derivative assets	LPI bid-mid spread	+15bps LPI bid-mid spread	**3,555**	**(39)**	**(39)**
		-15bps LPI bid-mid spread	**3,555**	**39**	**39**
Financial liabilities					
Derivative liabilities	LPI bid-mid spread	+15bps LPI bid-mid spread	**4,518**	**217**	**217**
		-15bps LPI bid-mid spread	**4,518**	**(217)**	**(217)**
Collateralised financing agreements	Liquidity Premium	+25bps yield to maturity	**219**	**14**	**14**
		-25bps yield to maturity	**219**	**(14)**	**(14)**

			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
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	—	—	—

No comparatives are shown for financial liabilities because Level 3 financial liabilities were immaterial in 2019.

Notes to the financial statements

continued

Note D – Financial assets and liabilities (continued)

D.2 Derivatives

Rothesay uses derivative financial instruments as part of its risk management strategy and to hedge its solvency position. 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 Rothesay's derivative assets and liabilities as at 31 December 2020 is an asset of £341m (2019: a liability of £233m).

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

	2020			2019 restated[1]		
	Assets £m	**Liabilities £m**	**Notional amount £m**	Assets £m	Liabilities £m	Notional amount £m
Derivatives held for risk management						
Interest rate swap	**21,769**	**(21,288)**	**393,911**	14,463	(14,527)	332,733
Inflation swap	**5,546**	**(6,042)**	**56,801**	3,816	(3,981)	49,029
Currency swap	**3,081**	**(2,741)**	**91,372**	861	(864)	64,363
Credit derivative	**143**	**(271)**	**18,939**	286	(332)	15,024
Forwards	**161**	**(17)**	**3,374**	82	(37)	4,345
Total	**30,700**	**(30,359)**	**564,397**	19,508	(19,741)	465,494

1 Following a review of derivative contracts, Rothesay has reclassified a number of swaps from interest rate swaps to currency swaps. The impact of the restatement is a reclassification of £380m fair value derivative assets and £437m fair value derivative liabilities and £17bn in notional value. In addition, we have reclassified a derivative liability of £203m fair value and £145m notional from interest rate swaps to collateralised financing agreements.

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

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

D.3 Accrued interest and prepayments

	2020 £m	2019 £m
Accrued interest	**433**	399
Prepaid expenses	**230**	356
Total accrued interest and prepayments	**663**	755

D.4 Receivables

	2020 £m	2019 £m
Deposits pledged as collateral to third parties	**891**	688
Amounts due from group undertakings	**122**	43
Other receivables	**111**	216
Total receivables	**1,124**	947

All receivables are due within one year. The fair value of receivables is £1,124m (2019: £947m).

The net exposure to certain OTC derivatives is collateralised through cash posted, as per the terms of the OTC contracts. At 31 December 2020, the total cash collateral posted was £891m (2019: £688m). Further details of the full extent of collateral usage can be found in the credit risk disclosure in note F.2.1.

Note D – Financial assets and liabilities (continued)

D.5 Cash and cash equivalents

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

	2020 £m	2019 £m
Cash at bank and in hand	**186**	234
Total cash and cash equivalents	**186**	234

D.6 Payables and financial liabilities

	2020 £m	2019 restated[1] £m
Derivative financial instruments	**30,359**	19,741
Collateralised financing agreements	**894**	879
Total financial liabilities	**31,253**	20,620
Deposits received as collateral from third parties	**2,063**	1,193
Amounts due to group undertakings	**66**	70
Current tax payable	**65**	81
Other payables	**100**	46
Total payables	**2,294**	1,390
Total payables and financial liabilities	**33,547**	22,010

1 As at 31 December 2019 we have reclassified a financial liability of £203m from derivative financial instruments to collateralised financing agreements following a review of the classification of derivative contracts.

Financial liabilities are recorded at fair value (see note D.1 for accounting policy), of which £4,737m are valued using Level 3 techniques (2019: £1m). The remainder are valued using Level 2 techniques. The impact on the fair value of Level 3 financial liabilities of using reasonably possible alternative assumptions is included in Note D.1.

£4,731m (2019: £nil) of Level 3 derivative and other liabilities were transferred into Level 3 from Level 2 predominantly as a result of the decrease in observability of market inputs for LPI linked derivatives. The remaining movement of Level 3 financial liabilities were due to changes in economic conditions.

Payables and financial liabilities of £3,189m (2019: £1,671m) are all due within one year.

The net exposures to certain OTC derivatives are collateralised through cash. As at 31 December 2020, the total cash collateral received was £2,063m (2019: £1,193m). Other OTC contracts are collateralised with fixed income securities which are not recognised on the statement of financial position for Rothesay.

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:

	2020 £m	2019 £m
Subordinated loans from participating interests	**298**	398
Subordinated loan notes	**1,128**	1,029
Total borrowed	**1,426**	1,427

On 22 May 2020 RLP issued a further £100m of Tier 3 bonds with maturity on 12 July 2026 and a fixed 3.375% coupon payable annually in arrears. On 27 May 2020 RLP used the proceeds from the Tier 3 issuance to repay £100m of subordinated loans from participating interests.

Notes to the financial statements
continued

Note D – Financial assets and liabilities (continued)
D.7 Borrowings (continued)
As part of our LIBOR transition programme, with effect from 19 December 2020, the subordinated loan from participating interests was converted from a floating rate loan to a fixed rate loan with the coupon fixed at 6.05%. The fair value of the loan was unchanged as a result of the conversion.

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

The carrying amounts, fair values and features of the Rothesay'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	**2020 £m**	2019 £m	**2020 £m**	2019 £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 LIBOR plus 4.25%	**—**	100	**—**	97
£300m	19 September 2017	19 September 2028	19 September 2023 and annually thereafter	6.05%	**298**	298	**317**	302
Subordinated loans								
£250m	22 October 2015	22 October 2025	No call option	8%	**249**	249	**317**	306
£500m	12 July 2019	12 July 2026	No call option	3.375%	**485**	386	**533**	403
£400m	17 September 2019	17 September 2029	17 September 2024	5.5%	**394**	394	**447**	434

Prior to 19 December 2020, the subordinated loan from participating interests had a coupon of 3m LIBOR plus 5.95%.

For the year ended 31 December 2020, an interest expense of £83m (2019: £60m) as 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:

	1 January 2020 £m	**Cash flows £m**	**Non-cash flows £m**	**31 December 2020 £m**
Subordinated loans from participating interests	**398**	**(100)**	**—**	**298**
Subordinated loan notes	**1,029**	**96**	**3**	**1,128**
Total borrowings	**1,427**	**(4)**	**3**	**1,426**

	1 January 2019 £m	Cash flows £m	Non-cash flows £m	31 December 2019 £m
Subordinated loans from participating interests	398	—	—	398
Subordinated loan notes	249	778	2	1,029
Total borrowings	647	778	2	1,427

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. Reinsurance inwards (i.e. where Rothesay is the reinsurer) is included in insurance contract liabilities.

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.

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 Rothesay 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 Rothesay will receive from the reinsurer. Any impairment loss is recorded in the statement of comprehensive income.

	2020 £m	2019 £m
Insurance contract liabilities	**55,247**	47,932
Reinsurance assets	**(616)**	(388)
Reinsurance liabilities	**993**	848
Insurance contract liabilities, net of reinsurance	**55,624**	48,392

Reinsurance assets in 2019 included the reinsurance of our €140m portfolio of Irish annuities. This transaction was structured initially as a reinsurance contract with Monument Re Limited and covered around 400 policyholders who remained RLP's customers until 7 September 2020, when the liabilities transferred to Monument Life Insurance DAC (formerly Laguna Life DAC and part of the Monument Re Group). Reinsurance assets (and insurance liabilities) reduced by £126m as a result of the transfer.

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

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

The value of the reinsurance liability has increased due to changes in economic conditions. Additional reinsurance has been transacted over the period covering both new business and business held at 31 December 2019. The additional reinsurance has increased the reinsurance asset.

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

Notes to the financial statements
continued

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

Insurance contract liabilities are determined by Rothesay'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 Rothesay continues to apply the principles. Rothesay seeks to make prudent assumptions relating to expected future experience based on current market conditions and recent experience. The assumptions used incorporate prudent margins to reflect the inherent uncertainty that actual experience may be less favourable than our best estimate.

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

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

Note that insurance contract liabilities include reinsurance inwards, i.e. where Rothesay has reinsured a third party insurer. Where such contracts benefit from third party reinsurance, the insurance contract liabilities are shown net of those reinsurance arrangements.

Key valuation assumptions
This note details the assumptions with the greatest impact on Rothesay's insurance contract liability valuations.

(a) Mortality assumptions
In what follows, we have changed the presentation of the mortality assumptions compared with prior years to improve clarity of disclosure.

Best estimate 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:

	2020		2019	
	Pensions originated	**Insurance originated**	Pensions originated	Insurance originated
Males	**100.5% S2PMA**	**95.6% S2PMA**	97.9% S2PMA	92.9% S2PMA
Females	**100.5% S2PFA**	**95.6% S2PFA**	97.9% S2PFA	92.9% S2PFA

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 2020 and no adjustments have been made to reflect the potential impact of COVID-19 given the ongoing uncertainty. 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.

Note E – Insurance contracts and reinsurance (continued)
E.2 Insurance contract liabilities (continued)
(a) Mortality assumptions (continued)
The changes to the single equivalent rates over 2020 reflect the inclusion of new business, differences from expected mortality in recent years, updates to reflect the view of reinsurers (via reinsurance quotations) and the impact of updating the mortality improvements used to roll the base tables forward to the current date.

Allowance is made for future improvements in annuitant mortality with reference to statistical analysis of historical rates of mortality improvements, expert judgement of future changes in mortality improvements, industry benchmarking and reinsurance pricing. For 2020, mortality improvement assumptions were updated to reflect recent mortality improvements including adoption of the CMI 2019 improvement model. No allowance has been made for the potential impact of COVID-19 given the uncertainty of its long term impact. For both 2020 and 2019 an advanced calibration of the model has been used. The chosen long-term improvement rate assumption varies by age using a bespoke calibration that tapers non-linearly from age 70 to 0% at age 120. The long-term rates in the table below are expressed as core CMI model long term rates and are equivalent on a present value basis to the actual long-term rate adopted. The best estimate long-term rates have remained unchanged through 2019 and 2020. We have increased the assumed initial rates of improvements for full year 2020. The new initial adjustment parameter introduced in the CMI 2018 model has not been adopted, with adjustment to the initial rate of mortality improvements continuing to be made through the Sk parameter. As part of the adoption of the CMI 2019 model, the calibration ages have been amended to improve the shape of initial improvement rates by age.

Best estimate improvements are equivalent to those shown in the table below:

	Future mortality improvements (excluding margins)	
	2020	2019
Males	**CMI_2019*_M[1.7%; Sκ=7.5]**	CMI_2018_M[1.7%; Sκ=7.3]
Females	**CMI_2019*_F[1.7%; Sκ=7.5]**	CMI_2018_F[1.7%; Sκ=7.3]

* Calibration ages 20-90

Prudent margins are then applied to both the base mortality assumptions and improvements to reflect the fact that future experience may differ from that assumed. The impact of the margins applied leads to an increase in assumed life expectancy for a 65 year old of 1.6 years (2019: 1.6 years). No changes have been made to prudent margins during 2020.

(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 risk adjusted yield obtainable on the basket of assets matching the applicable insurance contract liabilities at 31 December 2020. For the purposes of this calculation, any assets held by LTMF, RMA1 and RMA3 are treated as if they were held directly and inter-company arrangements ignored. Where assets are assumed to be re-invested, we now assume that they achieve a yield of SONIA (2019: a yield of LIBOR less 12.5bps).

A 2.5% prudential margin is then applied to the risk-adjusted internal rate of return obtained on the basket of matching assets and an allowance made for investment management expenses of 3bps p.a. (2019: 3bps p.a.).

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

	2020	2019
Equivalent rate of interest	**1.32% p.a.**	1.78% p.a.

In determining the risk adjusted yield on assets a deduction is made 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.

Notes to the financial statements
continued

Note E – Insurance contracts and reinsurance (continued)
E.2 Insurance contract liabilities (continued)
Key valuation assumptions (continued)
(b) Economic assumptions including valuation rate of interest (continued)

The table below shows the average yield deduction by asset class before the application of the 2.5% prudential margin at 31 December 2020 and 31 December 2019.

	Average yield deduction	
Asset class	**2020**	2019
UK government approved securities	**0 bps**	0 bps
Secured lending	**35 bps**	24 bps
Supranational/other sovereign	**27 bps**	17 bps
Secured residential lending	**27 bps**	28 bps
Corporate bonds (without covering credit default swaps)	**60 bps**	56 bps
Infrastructure	**67 bps**	63 bps
Equity release mortgages	**112 bps**	125 bps
Other	**43 bps**	36 bps
Overall yield reduction	**35 bps**	31 bps

Since the end of 2019, the average yield deduction has increased in aggregate. The change in default allowance is mainly due to the change in asset mix during the period. Our approach to deriving credit default assumptions was modified at the start of 2020 to better reflect the relative riskiness of individual assets.

Allowance is made for the risks associated with equity release mortgages through the valuation of the NNEG and this is included in the overall yield deduction above. The calculation of the NNEG is described in note D.1 and for the valuation rate of interest is calculated on a prudent basis allowing for future property price growth at a rate equivalent to 0.97% net of dilapidation costs and cost of sale (2019: 1.14%) and house price volatility equivalent to 13% (2019: 13%). Given the potential short term distortion in the housing market from the stamp duty holiday, in calculating the value of the NNEG allowed for in the yield deduction above, house prices are assumed to have fallen by 5% with no offsetting change in assumed future house price growth. The decrease in the yield deduction for equity release mortgages over the period has been driven by origination of lower-risk mortgages partially offset by the assumed fall in house prices and the reduction in assumed property price growth rate over the period.

An important actuarial assumption relates to the future rate of escalation of certain annuity benefits. Where possible such rates are derived from inflation swap markets. Whilst that is still the case for more liquid inflation rates, in 2020 we have changed our approach to setting the rate of limited price indexation (LPI). Over time the LPI market has become highly illiquid and all but a very small number of banks have withdrawn from the market, leading to rates which are out of line with the LPI rates actually realised. For 2020, we have therefore projected rates using LPI models based on realised LPI and other market inputs. This change has led to a reduction in insurance liabilities of £456m which was partly offset by a reduction in the estimated value of LPI linked assets of £160m.

(c) Expense assumption

The allowance made for future overhead maintenance expenses has been updated following an investigation into the total costs incurred by Rothesay during 2020 and the projected 2021 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. The average per policy allowance is £40 per policy per annum (2019: £36 per policy per annum). Additional allowances are then made for short-term project costs and investment management expenses.

Within these expense provisions, an allowance for future expense inflation has been made 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 (2019: 0.25% p.a.).

Note E – Insurance contracts and reinsurance (continued)
E.2 Insurance contract liabilities (continued)
Key valuation assumptions (continued)
(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, the dependant's age difference and the proportion of deferred annuitants opting to take a proportion or all of their benefit as a lump sum.

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

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

(e) Movement in insurance contract liabilities, net of reinsurance
The table below details the change in insurance contract liabilities, net of reinsurance, over the year. The release of liabilities line reflects claims paid, release of prudent margins and unwind of discounting over the year.

	2020 £m	2019 £m
Carrying amount at 1 January	**48,392**	33,065
Increase in respect of new business	**7,142**	16,362
Release of liabilities	**(2,498)**	(2,028)
Effect of assumption changes	**2,579**	985
Other	**9**	8
Closing balance at 31 December	**55,624**	48,392

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

Net increase/(decrease) in liabilities	**2020 £m**	2019 £m
Change in assumptions used		
Valuation rate of interest	**3,435**	1,747
Inflation	**(412)**	(716)
Effect of economic assumption changes	**3,023**	1,031
Demographics	**(46)**	(212)
Member options	**(12)**	(10)
Expenses	**70**	176
LPI model refinement	**(456)**	—
Effect of non-economic assumption changes and model refinement	**(444)**	(46)
Total effect of assumption changes	**2,579**	985

As shown previously, the valuation rate of interest decreased by 46bps over the year, which led to the £3.4bn increase in the net liability shown. This was partially offset by the impact of the fall in future rate of inflation.

Updates were made to the non-economic assumptions and modelling refinement during the period as described in section E.2 (a) for demographic assumptions, E.2 (b) for LPI model refinement and E.2.(c) for expenses. Note that the reduction in liabilities as a result of the change in approach to modelling LPI was partly offset by a reduction in the estimated value of LPI linked assets of £160m.

Notes to the financial statements
continued

Note E – Insurance contracts and reinsurance (continued)
E.2 Insurance contract liabilities (continued)
Key valuation assumptions (continued)
(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 and inflation sensitivities where the impact of dynamic hedging is allowed for as market conditions change. The sensitivity of liabilities to interest rates and inflation increased during 2020 as a result of the growth in net insurance liabilities. The change in the impact of interest rate moves on PBT and equity is partly due to us being more focussed on hedging the solvency balance sheet than at the end of 2019. When stressing credit default assumptions, the total spread on corporate bonds is assumed to move by approximately 30bps.

2020	**Change in assumptions**	**(Decrease)/ increase in net liabilities £m**	**Increase/ (decrease) in PBT £m**	**Impact on equity £m**
Annuitant mortality	**+5% qx**	**(154)**	**149**	**120**
Annuitant mortality	**-5% qx**	**159**	**(154)**	**(125)**
Interest rate	**+100bps**	**(7,120)**	**(169)**	**(137)**
Interest rate	**-100bps**	**8,852**	**549**	**445**
Inflation	**+100bps**	**3,507**	**(48)**	**(39)**
Inflation	**-100bps**	**(3,111)**	**173**	**140**
Credit default assumption	**+10bps**	**(713)**	**(447)**	**(362)**
Credit default assumption	**-10bps**	**735**	**460**	**372**
Change in property prices	**+10%**	**(22)**	**121**	**98**
Change in property prices	**-10%**	**50**	**(179)**	**(145)**
Expenses	**+10%**	**142**	**(142)**	**(115)**

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)

Note E – Insurance contracts and reinsurance (continued)
E.2 Insurance contract liabilities (continued)
Key valuation assumptions (continued)
(f) Sensitivity analysis (continued)
The sensitivities shown capture non-linearity effects, which may be significant following large market movements. The risk management strategy adopted can result in Rothesay being immunised to market movements in either direction.

Given current interest rates, the -100bps interest rate sensitivity means that interest rates are assumed to fall below zero at all durations (2019: fall below zero for eight years).

The impact of reinsurance on the sensitivity to mortality risk is a reduction of 87% (2019: 78%). The impact of reinsurance has changed due to additional reinsurance transacted through the period.

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:

	2020			
	Less than 1 year £m	**1 to 5 years £m**	**Over 5 years £m**	**Total £m**
Insurance contract cash flows net of reinsurance	**2,726**	**10,235**	**42,663**	**55,624**

	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

Notes to the financial statements

continued

Note F – Risk and capital management

F.1 Capital management

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

- to maintain financial strength in adverse conditions;
- to give customers long-term confidence in Rothesay;
- to satisfy 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, Rothesay was required to operate under the new Solvency II regime. Rothesay had sufficient capital available to meet its regulatory capital requirements at all times during the period ended 31 December 2020.

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

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

Transitional solvency relief has been re-calculated as at 31 December 2020 and amortises by 1/16th each year from 1 January 2017. As at 31 December 2020, solvency estimates allow for amortisation of 4/16ths of transitional solvency relief (2019: 3/16ths).

Rothesay received approval to use a PIM from 31 December 2018, so from that date the SCR relating to credit and counterparty risk is calculated using the Rothesay's bespoke models and the standard formula is used to calculate the SCR for all other risk components and for aggregation across risk components.

Capital in excess of that required to meet the technical provisions is known as Own Funds. As at 31 December 2020, Own Funds for Rothesay were £7,353m (2019: £6,113m) made up as follows:

	2020 £m	2019 £m
Total IFRS equity	**4,950**	3,756
Liability valuation differences and other regulatory adjustments	**907**	902
Total Tier 1	**5,857**	4,658
Tier 2 debt valuation	**984**	1,059
Tier 3 debt valuation	**512**	396
Own Funds	**7,353**	6,113

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

The capital position is sensitive to changes in market conditions, due to changes in the value of the assets and the effect that changes in investment conditions may have on the value of the liabilities. Rothesay seeks to mitigate these risks through the close matching of asset and liability cash flows, and through the use of derivative hedges and reinsurance. Management monitors market conditions and emerging longevity experience on a regular basis. As these conditions change, management will take remedial action such as adjustment of hedging strategies and re-investment of assets as appropriate.

Note F – Risk and capital management (continued)

F.2 Risk management and analysis

Rothesay is exposed to credit, market and liquidity risk through its financial assets and financial liabilities. Rothesay 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 Rothesay. Please see pages 34 to 42 of the strategic review for further detail on risk management arrangements and the governance framework within Rothesay.

F.2.1 Credit risk

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

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

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

Risk mitigants

Rothesay 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, Rothesay obtains collateral from counterparties on an upfront or contingent basis. Rothesay 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 Rothesay does not have sufficient visibility into a counterparty's financial strength, or when it believes a counterparty requires support from its parent company, Rothesay may obtain third party guarantees of the counterparty's obligations. Rothesay also mitigates its investment and counterparty credit risk using credit derivatives.

Credit exposures

Rothesay 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, Rothesay 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, Rothesay diversifies its exposure and places its deposits with multiple banks, typically with minimum ratings in the 'A' rating category. Rothesay only invests in 'AAA' rated money market funds.

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 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.

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)

Credit exposures (continued)

Collateralised agreements. Collateralised agreements are reported at fair value or contractual value before consideration of collateral received on the balance sheet. Rothesay 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, Rothesay's credit exposure on the transactions is significantly lower than the amounts recorded on the balance sheet. Rothesay 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.

The following table identifies derivatives and collateralised agreements covered by enforceable netting arrangements (netting under master netting agreements, cash collateral and security collateral) which do not qualify for netting under IAS 32. We have excluded all other assets as we feel the presentation below increases clarity of the disclosure. 2019 comparatives have been restated accordingly.

		2020 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**
Derivative assets	**30,700**	**(26,173)**	**(865)**	**(3,595)**	**67**
Collateralised agreements and financing	**1,727**	**—**	**(104)**	**(1,623)**	**—**
Total	**32,427**	**(26,173)**	**(969)**	**(5,218)**	**67**
Derivative liabilities	**(30,359)**	**26,173**	**306**	**3,913**	**33**
Collateralised financing agreements	**(894)**	**—**	**—**	**894**	**—**
Total	**(31,253)**	**26,173**	**306**	**4,807**	**33**

		2019 restated[1] Related amounts not offset			
	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
Derivative assets	19,508	(16,000)	(529)	(2,960)	19
Collateralised agreements and financing	1,875	—	(33)	(1,842)	—
Total	21,383	(16,000)	(562)	(4,802)	19
Derivative liabilities	(19,741)	16,000	351	3,216	(174)
Collateralised financing agreements	(879)	—	—	879	—
Total	(20,620)	16,000	351	4,095	(174)

1 As at 31 December 2019 we have reclassified a financial liability of £203m from derivative financial instruments to collateralised financing agreements following a review of the classification of derivative contracts.

Note F – Risk and capital management (continued)
F.2 Risk management and analysis (continued)
F.2.1 Credit risk (continued)
Credit exposures (continued)
Credit default swaps have been purchased to protect Rothesay from the default of some of its counterparties. The table above does not reflect the protection provided. Rothesay 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.

Rothesay has the right of offset for certain financial assets and liabilities. Netting under master netting agreements of £26,173m (2019: £16,000m) reflects the offsetting of derivative assets with liabilities for which Rothesay 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.

Credit ratings
The table below shows Rothesay's credit exposure from financial investments (excluding derivatives), receivables and cash based on external and internal ratings, consistent with management's view of credit risk. 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, unrated assets are internally rated by Rothesay's independent credit risk function under a framework which has been externally validated. 2019 comparatives have been restated.

	AAA £m	AA £m	A £m	BBB £m	BB £m	Unrated £m	Grand total £m
2020	**12,892**	**21,476**	**17,462**	**6,960**	**314**	**5,217**	**64,322**
2019	14,598	17,867	13,991	5,905	—	3,053	55,414

We have excluded derivatives and other assets in the table as the derivatives are collateralised and we feel the presentation above increases clarity of the disclosure and corresponds more closely to the way in which we measure the credit risk. The difference between the total assets shown in the tables above and the assets under management (APM) is:
- derivative assets of £30,700m (2019: £19,508m); and
- other assets of £717m (2019: £812m); less
- payables and financial liabilities of £33,547m (2019: 22,010).

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 and corporate bonds. 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. One commercial real estate loan has been downgraded by Rothesay's credit risk team to BB under their cautious approach to internal ratings.

Unrated assets are UK and Dutch residential mortgages that are not individually rated.

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

Notes to the financial statements

continued

Note F – Risk and capital management (continued)

F.2.2 Market risk

Market risk is the risk of changes in the value of Rothesay's net financial 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 Rothesay'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.

Rothesay 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 Rothesay is capable of honouring all cash flow commitments on both an ongoing basis and in highly stressed scenarios, without incurring significant cost or business disruption.

Rothesay's 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. Rothesay 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, Rothesay 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. Rothesay seeks to maintain funding sources that are sufficiently long-term in order to withstand a prolonged or severe liquidity-stressed environment. Only the most liquid assets held on Rothesay's balance sheet are assumed to be available to meet potential stressed liquidity requirements.
- Maintenance of a comprehensive liquidity contingency plan.

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 Rothesay through collateral outflows and ongoing business obligations such as expenses and undrawn investments. A comprehensive analysis of all sources of liquidity risk to which the Company is exposed is maintained. Based upon this analysis, an extensive suite of stresses is considered as part of the liquidity management framework, including onerous market shocks, against which limits are applied by the Board.

Management is responsible and accountable for managing liquidity risks within prescribed limits that are set by the Board and are overseen by the BRC. The second line Risk function ensures that an appropriate framework is in place for assessing, monitoring and managing liquidity risk. Liquidity is managed for Rothesay 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.

Note F – Risk and capital management (continued)

F.2.3 Liquidity risk (continued)

The following table details Rothesay's financial liabilities and assets by contractual maturity including interest that was accrued where Rothesay 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, totals of 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.

	2020			
	Less than 1 year £m	**1 to 5 years £m**	**Over 5 years £m**	**Total £m**
Financial assets				
Financial investments	**5,641**	**5,947**	**77,902**	**89,490**
Accrued income and prepayments	**663**	**—**	**—**	**663**
Receivables	**1,109**	**15**	**—**	**1,124**
Cash and cash equivalents	**186**	**—**	**—**	**186**
	7,599	**5,962**	**77,902**	**91,463**
Financial liabilities				
Financial liabilities	**(895)**	**(1,554)**	**(28,804)**	**(31,253)**
Payables	**(2,294)**	**—**	**—**	**(2,294)**
Borrowings	**—**	**(249)**	**(1,177)**	**(1,426)**
Accruals and deferred income	**(70)**	**—**	**—**	**(70)**
	(3,259)	**(1,803)**	**(29,981)**	**(35,043)**
Net	**4,340**	**4,159**	**47,921**	**56,420**

	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

Notes to the financial statements
continued

Note F – Risk and capital management (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. Rothesay 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 Rothesay's risk appetite.

Rothesay 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.

Rothesay has important 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 Rothesay 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 Rothesay's growth).

The management of the operational risk associated with Brexit, the COVID-19 pandemic and the transition from LIBOR is discussed in the risk management section of the Strategic Report.

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 Rothesay'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 2020 87% of longevity risk was reinsured (2019: 78%). Risks are monitored and controlled by the actuarial function and overseen by the Chief Actuary and the risk function.

Note G – Other statement of financial 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.

Deferred tax balances comprise:

	2020 £m	2019 £m
Temporary differences between the financial statements and the tax deductions	**(82)**	(31)
Total temporary differences	**(82)**	(31)

The movements in the deferred tax balances were as follows:

	2020 £m	2019 £m
At 1 January	**(31)**	(2)
Timing difference	**(51)**	(29)
At 31 December	**(82)**	(31)

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

Notes to the financial statements
continued

Note H – Interests in subsidiaries and associates
H.1 Investment in unconsolidated structured entities
Rothesay 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 Rothesay does not have the power to affect their returns.

Rothesay 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 2020, our total interest in such entities, reflected on Rothesay's statement of financial position and classified as financial investments held at fair value through profit or loss, was £7,314m (2019: £7,555m). The recorded fair value represents Rothesay's maximum loss exposure to these unconsolidated structured entities. The £241m decrease in the balance was predominantly driven by a loan prepayment.

The interest income recognised in relation to these investments was £184m (2019: £153m).

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

	2020 £m	2019 £m
Government sub sovereign and agency obligations	**53**	63
Corporate bonds and other corporate debt	**1,503**	1,545
Loans secured on property	**5,758**	5,947
Total	**7,314**	7,555

H.2 Investment in subsidiaries
RLP holds investments in the subsidiaries listed in the following table:

Company undertakings	Country of incorporation	Primary business operation	**2020 £m**	2019 £m	**2020 % equity interest**	2019 % equity interest
Rothesay Assurance Limited (formerly known as MetLife Assurance Limited)	UK	Service company	**—**	—	**100%**	100%
LT Mortgage Financing Limited (LTMF)	UK	Service company	**6**	6	**100%**	100%
Rothesay MA No.1 Limited (RMA1)	UK	Service company	**5**	5	**100%**	100%
Rothesay MA No.2 Limited (RMA2)	UK	Service company	**—**	—	**100%**	100%
Rothesay MA No.3 Limited (RMA3)	UK	Service company	**2**	—	**100%**	100%
Rothesay MA No.4 Limited (RMA4)	UK	Service company	**—**	—	**100%**	100%

Subsidiaries are held at the lower of cost and net realisable value. The above subsidiary undertakings, are registered in the United Kingdom. The registered office and principal place of business for all UK subsidiary undertakings, except Rothesay Assurance Limited, is The Post Building, 100 Museum Street, London WC1A 1PB. The registered address of Rothesay Assurance Limited is 55 Baker Street, London W1U 7EU.

Rothesay MA No.2 Limited was incorporated during March 2019. Rothesay MA No.4 Limited was incorporated during November 2019. Both entities remain dormant.

Rothesay MA No.3 Limited was incorporated during November 2019 and began trading in December 2020.

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 Rothesay, 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 Share based payments

Historically the cost of equity-based transactions with employees has been measured based on grant-date sale value.

The fair value was determined at grant date and expensed on a straight-line basis over the vesting period in profit and loss. At each reporting date Rothesay revised its estimate of the number of shares that were expected to be issued and recognised the impact of the revision of original estimates.

During December 2020, Rothesay amended its remuneration policy in relation to the deferred equity award plan (previously known as the Long Term Stock Incentive Plan) to give employees the choice of receiving cash or equity for vestings from December 2021 onwards. For these awards, the fair value of the grant will now be reassessed at each reporting period and any change charged to the profit and loss.

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.

During the year ended 31 December 2015, Rothesay created a stock incentive plan, now known as the deferred equity award plan which provided for grants of restricted stock units (RSUs).

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

The activity related to the deferred equity award plan RSUs is set out below:

	2020 No. of RSUs	2019 No. of RSUs
Outstanding at the beginning of the year	**15,122,186**	15,452,083
Forfeited during the year	**(23,030)**	(329,612)
Vested during the year	**(5,211,453)**	(4,553,187)
Granted during the year	**4,159,213**	4,552,902
Outstanding at the end of the year	**14,046,916**	15,122,186

On 3 March 2020, the Company established a new HMRC-approved employee share plan known as the Employee Share Incentive Plan (ESIP). Under the ESIP, Rothesay offered shares to all eligible UK employees as part of year-end compensation. The rules governing withdrawal of the shares from the ESIP Trust and subsequent tax treatment are set by HMRC. They are disclosed as employee scheme shares until they are withdrawn. The ability to withdraw shares is generally subject to the recipient not having left employment before three years from grant date.

Notes to the financial statements
continued

Note I – Other notes (continued)
I.1 Share based payments (continued)
The activity related to the ESIP RSUs is set out below:

	2020 No. of RSUs	2019 No. of RSUs
Outstanding at the beginning of the year	**—**	—
Forfeited during the year	**(3,600)**	—
Vested during the year	**—**	—
Granted during the year	**226,800**	—
Outstanding at the end of the year	**223,200**	—

Historically the fair value of RSUs was determined by taking 100% of Rothesay's MCEV and dividing by the number of ordinary shares. The weighted average fair value of the RSUs at 31 December 2019 was £3.90. During 2020 the methodology for calculating the fair value of the RSUs was amended to be consistent with the price paid by MassMutual and GIC for Blackstone's shareholding of Rothesay Limited. The weighted average fair value of the RSUs at 31 December 2020 was £4.00.

Share appreciation plan
During December 2020 a new long-term share appreciation plan (the SARs plan) was created which provides for grants of cash-settled share appreciation rights (SARs). The SARs provide the right to receive the upside on a fixed proportion of an agreed value of Rothesay shares over a defined time horizon, paid out in cash, subject to achievement of returns above an agreed hurdle. The SARs will be awarded for the first time during 2021 and vest and deliver as outlined in the applicable agreement. Vesting is subject to the recipient not having left employment or having left employment as a result of death, permanent illness or redundancy. All SARs have a future service requirement.

The valuation of the SARs will be based on an option pricing model.

Expenses in relation to share-based payment schemes
Expenses of £15m (2019: £10m) have been charged to the profit and loss of Rothesay during the year in relation to the various share-based payment schemes. The year-on-year increase includes £2m which arises from the change in remuneration policy and associated change in accounting.

I.2 Related parties disclosures
Ultimate holding company
At the financial statement date, the immediate and ultimate parent company was Rothesay Limited, which is incorporated in the United Kingdom. Group financial statements are prepared for Rothesay Limited, copies of which can be obtained from the Company Secretary, The Post Building, 100 Museum Street, London WC1A 1PB.

Note I – Other notes (continued)
I.2 Related parties disclosures (continued)
Related party transactions

The Company entered into various transactions with fellow participating interests which are subject to common control from the same source. No changes to the table below are required as a result of the change in ownership of Rothesay Limited.

	2020 £m	2019 restated[1] £m
Statement of comprehensive income		
Change in the reinsurers' share of insurance contract liabilities and reinsurance recoveries	**115**	48
Finance costs	**(21)**	(26)
Operating expenses	**(8)**	(8)
Statement of financial position		
Reinsurance liabilities	**159**	44
Borrowings	**298**	398
Capital	**2,463**	2,463

1 As at 31 December 2019, both change in reinsurers' share of insurance contract liabilities and reinsurance liabilities have been restated to reflect the correct position due to omission of a contract during the prior period. The change in reinsurers' share has changed from a charge of £2m to a credit of £48m. The reinsurance liabilities have increased from £6m to £44m.

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

	2020 £m	2019 restated[1] £m
Salaries, bonus and other employee benefits	**20**	23
Equity-based compensation payments	**8**	6
Total transactions	**28**	29

1 As at 31 December 2019 key management personnel has been restated to include independent Non-Executive Directors in line with our definition of Directors being key management personnel. This resulted in an increase in 2019 salaries from £21m to £23m.

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

On 1 December 2020, members of key management personnel and their families sold 18,766,215 new B ordinary shares to GIC, MassMutual and the Employment Benefit Trust for consideration of £69.7m, £25.3m of which is deferred for one year. They also sold 73,500,000 H shares to GIC and MassMutual for consideration of £176.2m, £88.4m of which is payable over three years from 2021 to 2023.

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 Rothesay Limited, its subsidiaries LTMF, RMA1 and RMA3 and other group companies RPML and Rothesay Asset Management US LLC.

Notes to the financial statements
continued

Note I – Other notes (continued)
I.2 Related parties disclosures (continued)
Related party transactions (continued)

Transactions with RL	2020 £m	2019 £m
Statement of comprehensive income		
Cost transfer	**5**	5
Statement of financial position		
Other receivables	**41**	13
Capital	**2,464**	2,464

Transactions with LTMF	2020 £m	2019 £m
Statement of financial position		
Other receivables	**66**	11
Capital	**6**	6

Transactions with Rothesay MA No.1 Limited	2020 £m	2019 £m
Statement of financial position		
Other receivables	**12**	8
Capital	**5**	5

Transactions with Rothesay MA No.3 Limited	2020 £m	2019 £m
Statement of financial position		
Other receivables	**1**	—
Capital	**2**	—

Transactions with RPML	2020 £m	2019 £m
Statement of comprehensive income		
Cost transfer	**(99)**	(86)
Statement of financial position		
Other payables	**63**	66

Transactions with Rothesay Asset Management US LLC	2020 £m	2019 £m
Statement of comprehensive income		
Transaction fee	**—**	(4)
Service fee	**(6)**	(1)
Statement of financial position		
Other payables	**3**	4

Transactions with LTMF
In 2018, £1.3bn of ERMs were transferred from RLP to its subsidiary LT Mortgage Financing Limited (LTMF). During 2019 and 2020, a further £0.6bn and £1.2bn respectively of ERMs were transferred. In each case, LTMF became the beneficial owner in the ERMs 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, these securitisations are ignored.

Note I – Other notes (continued)
I.2 Related parties disclosures (continued)
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.

Transactions with Rothesay MA No.3 Limited
During December 2020, €0.5bn of Dutch mortgage loans were transferred from RLP to its subsidiary Rothesay MA No.3 Limited (RMA3). RMA3 became the beneficial owner in the Dutch 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 Dutch 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.

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.

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

Other commitments
During previous years Rothesay executed transactions to purchase partly funded bonds and forward settling bonds. During 2020 the Company purchased additional partly funded bonds and forward settling bonds. Rothesay also signed up to a number of multi-year contracts. Rothesay expects to pay a further £999m within the next five years (2019: £1,043m), £561m of this being due within 12 months of the financial reporting date (2019: £436m).

	2020 £m	2019 £m
Not later than one year	**561**	436
Later than one year and no later than five years	**438**	607
Later than five years	**—**	—
Total other commitments	**999**	1,043

Notes to the financial statements
continued

Note I – Other notes (continued)
I.4 Leases
(a) Amounts included in the statement of financial position
On adoption of IFRS 16, Rothesay 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 Rothesay 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 Rothesay's incremental borrowing rate of 3.374%. The incremental borrowing rate represents the cost of funding to Rothesay at the date that the lease was entered into.

Lease payments are allocated between principal and finance cost. The finance cost is charged to the statement of income over the lease period so as to produce a constant rate of interest on the remaining balance of the liability for each period.

Right of use assets are measured at cost comprising the following:
- amount of any initial measurement of lease liability;
- leased payments made before the commencement date less any lease incentives received;
- initial direct costs; and
- restoration costs.

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

Rothesay 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 Rothesay in prior year relate to the lease on the new UK office which was executed in May 2019, therefore there was a nil balance at 1 January 2019. The lease for The Post Building has a duration of 17 years with a break clause at 12 years which we have assumed is exercised.

Rothesay's right of use asset also includes a lease on our US office which was executed in May 2019. Rothesay was not a lessor during the period.

Right of use assets

	2020 £m	2019 £m
Right of use asset	**34**	37
Right of use asset – property		
Balance at 1 January	**37**	—
Depreciation charge for the period	**(3)**	(2)
Additions	**—**	39
Closing balance at 31 December	**34**	37

Note I – Other notes (continued)
I.4 Leases (continued)
(a) Amounts included in the statement of financial position (continued)
Lease liabilities

	2020 £m	2019 £m
Lease liability	**40**	39
Maturity analysis undiscounted liabilities		
Current liabilities		
Less than one year	**—**	—
Non-current liabilities		
One to five years	**22**	16
More than five years	**20**	33
Total undiscounted lease liabilities	**42**	49

(b) Amounts recognised in the statement of comprehensive income

	2020 £m	2019 £m
Depreciation charge of right of use assets – property	**3**	2
Financing charge on lease liabilities (included in note B.4 Finance costs)	**1**	1

(c) Amounts recognised in statement of cash flows

	2020 £m	2019 £m
Depreciation charge of right of use assets – property	**3**	2
Financing charge on lease liabilities	**1**	1
Total cash flows for leases	**—**	1

Alternative Performance Measures (unaudited)

As noted on page 28, throughout the financial statements Rothesay has used a variety of measures to provide stakeholders with the necessary information on the performance and financial position of Rothesay. Where it is possible to reconcile to the financial statements this has been referenced, however some of these measures are not on a consistent basis with IFRS and therefore the methodology is explained in the table below. Where relevant, we have used accounting policies and assumptions that are consistent with the IFRS financial statements.

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 30.
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 provided in note B.1.
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 Rothesay.	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 Rothesay is protected from fluctuations in longevity through reinsurance.	Demonstrates how Rothesay has mitigated exposure to longevity fluctuations through reinsurance.	The longevity reinsurance percentage is derived from the IFRS sensitivity (see note E.2.f) to changes in assumed longevity.

Alternative Performance Measure	Definition	Why is this meaningful	Reconciliation to IFRS
Customer satisfaction	Policyholder feedback surveys are sent to all policyholders following interaction with them (apart from complaints and bereavement).	Rothesay prides itself on the quality of the service that it provides and this APM provides a measure of the quality of that service.	It would not be possible to reconcile to the IFRS financial statements.
Complaints received and upheld	The number of complaints received and upheld per 1,000 policyholders.	Complaints provide a useful indication of customer (dis)satisfaction.	It would not be possible to reconcile to the IFRS financial statements.
Operating profit before tax	Gross IFRS profit less the impact of market fluctuations, exceptional expenses and financing costs.	Measure of longer-term profitability designed to remove the distorting impact of market fluctuations and exceptional expenses.	The operating profit before tax measure involves apportioning the items in the income statement across the various drivers of profit. When taken together with the other items in the alternative analysis of profit generation, the items can be reconciled to the IFRS financial statements (see page 28).
New business profit	IFRS new business profit projected to be realised once the premium is invested according to Rothesay's long-term investment strategy, before release of IFRS margins.	This is one of the metrics used by Rothesay when underwriting new business.	New business profit is calculated on an IFRS basis by comparing the premium received with the insurance liabilities taken on. The discount rate used in calculating the insurance liabilities assumes full investment of premiums according to the Rothesay's long-term investment strategy. When taken together with the other items in the alternative analysis of profit generation, the items can be reconciled to the IFRS financial statements (see page 28).

Alternative Performance Measures (unaudited)
continued

Alternative Performance Measure	Definition	Why is this meaningful	Reconciliation to IFRS
Impact of temporary investment delay	The difference between new business profit on a fully invested basis and the new business profit actually achieved by the reporting date.	When taken with the new business profit, this provides an indication of new business profit achieved by the reporting date.	Impact of temporary investment delay is calculated on an IFRS basis by comparing new business profit with the new business profit calculated using the discount rate derived from the investments held. When taken together with the other items in the alternative analysis of profit generation, the items can be reconciled to the IFRS financial statements (see page 28).
Investment profit from prior year	IFRS profits from investment of prior year premiums.	Shows the extent to which prior year temporary investment delays have been reversed.	Calculated by considering profits generated from investment of assets received as premiums in prior years as a result of the impact on the discount rate. Any profits made from investment in excess of those disclosed in prior years as the impact of temporary investment delay would offset the current year's impact of temporary investment delay (if applicable) (see page 28).

Alternative Performance Measure	Definition	Why is this meaningful	Reconciliation to IFRS
Performance of in-force book	Profits or losses generated on the in-force book of business.	Provides more granular analysis of financial performance.	Calculated by considering the net movement in assets and liabilities that can be attributed to: • the release of prudent margins as the business runs off (including credit default allowances and expense reserves) and as members exercise their options; • the impact of actual demographic experience versus assumptions; and • the investment return on surplus assets. When taken together with the other items in the alternative analysis of profit generation, the items can be reconciled to the IFRS financial statements (see page 28).
Non-economic assumption changes and model refinement	Profits or losses generated as a result of non-economic assumption changes and model refinement.	Provides a more granular analysis of financial performance.	See note E.2.

Alternative Performance Measures (unaudited)
continued

Alternative Performance Measure	Definition	Why is this meaningful	Reconciliation to IFRS
Economic profits	Profits or losses generated as a result of changes in economic conditions.	Provides a more granular analysis of financial performance.	Calculated by considering the net change in assets and liabilities attributable to changes in economic conditions allowing for the cost of hedging. Changes in economic conditions include movements in interest rates, inflation, exchange rates, credit spreads, credit default allowances, actual defaults and property prices. The release of credit default allowances over time is included in the performance of the in-force book. When taken together with the other items in the alternative analysis of profit generation, the items can be reconciled to the IFRS financial statements (see page 28).

Glossary of terms (unaudited)

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.
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 withdrawal 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.

Glossary of terms (unaudited)
continued

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 profits	See Alternative Performance Measures.
Employee Share Incentive Plan (ESIP) Trust	A trust established to purchase and hold shares of the Company for delivery under a HMRC-approved employee share schemes.
Employment Benefit trust (EBT)	A trust established to purchase and hold shares of the Company for delivery under employee share schemes.
Equity-based compensation	Share-based transactions awarded under incentive plans.
Equity release mortgages (ERMs)	Mortgages extended to older customers (aged 55 and over) against their residential property at low loan-to-value percentage. Unlike a typical residential mortgage, no interest is paid monthly by the customer. Instead, the interest is simply added to the principal loan amount with the loan only repayable on death or entry into long-term care of the last remaining homeowner.
Fair value	Amount that would be received on sale of an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.
Finance costs	Represent interest payable on borrowings.
Full 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.
Government, sub sovereign and agency obligations	A bond issued by a country's government or corporate debt which is guaranteed by a government to repay borrowed money at a specific time.
Gross premiums written	Premiums received by RLP on new business and generated through regular premiums.
In-force	An insurance policy or contract reflected on records that has not expired, matured or otherwise been surrendered or terminated.
Infrastructure	Investments in infrastructure such as water, energy and transportation.
Insurance risk	The risk of loss or of adverse change in the value of insurance liabilities, due to inadequate pricing and provisioning assumptions.

International Financial Reporting Standards (IFRS)	Accounting standards that are applied in preparing the Company's financial statements.
Investment profit from prior year	See Alternative Performance Measures.
Investment return	Comprises all interest income on financial investments at fair value through profit and loss, realised investment gains and losses and movements in unrealised gains and losses, as well as expenses directly related to investments executed during the year.
LIBOR	LIBOR, the acronym for London Interbank Offer Rate, is the global reference rate for unsecured short-term borrowing in the interbank market and is due to be phased out at the end of 2021.
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.
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.
LTMF	LT Mortgage Financing Limited.
Market risk	The risk of loss or of adverse change resulting, directly or indirectly, from fluctuations in the level and in the volatility of market prices of assets, liabilities and financial instruments.
Matching adjustment	The matching adjustment, a concept in Solvency II, is broadly equivalent to the illiquidity premium that can be earned on the illiquid assets held to back illiquid liabilities.
Mortality tables	A table which shows for each age, what the probability is that a person of that age and gender will die before their next birthday.
Net premiums	Life insurance premiums, net of reinsurance premiums paid to third party reinsurers.
New business	New insurance contracts and reinsurance inwards sold during the period. Includes business acquired through purchase of companies.
New business premium	See Alternative Performance Measures.
New business profit	See Alternative Performance Measures.
No negative equity guarantee (NNEG)	ERMs provide what is known as a NNEG, which means that the mortgage repayment amount (loan principal plus interest on redemption) cannot exceed the sale proceeds of the property on which the loan is secured.

Glossary of terms (unaudited)

continued

Non-recurring and project expenditure	Administration – project and other one-off expenses (see note B.3).
Offer price	Price at which a market maker is prepared to sell a specific security.
Operating profit before tax	See Alternative Performance Measures.
Operational risk	The risk arising from inadequate or failed internal processes, personnel or systems, or from external events.
Own Funds	See Alternative Performance Measures.
Own risk and solvency assessment (ORSA)	An assessment of the risk to which the business is exposed as well as solvency forecasting in a range of scenarios, including consideration of the stresses that could jeopardise the Company's business plans.
Partial internal model	Under Solvency II, insurer's own model used to calculate the solvency capital requirement in relation to particular risks approved by the PRA.
Part VII transfers	Court-approved transfer of a portfolio of contracts from one entity to another.
Performance of in force book	See Alternative Performance Measures.
Pillar I	Under Solvency II, represents the solvency capital requirement calculated using a standard formula or (partial) internal model.
Policyholders	The Company generally uses the term policyholder to refer to the individual immediate and deferred 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 the 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.
Risk margin	Under Solvency II, the cost of transferring non-hedgeable risks.
RL	Rothesay Limited.
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.
RSUs	Restricted share units.
SARs	Stock appreciation rights.
SCR coverage %	See Alternative Performance Measures.
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.
Sk	Smoothing parameter in CMI longevity improvement modelling determining the weighting on recent experience. Given recent improvements, a higher Sk will generally lead to a higher initial assumed rate of mortality improvement.
Solvency capital requirement (SCR)	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.
SONIA	The Sterling Overnight Index Average, abbreviated SONIA, is the effective overnight interest rate paid by banks for unsecured transactions in the British sterling market.
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.

Glossary of terms (unaudited)

continued

Third party administration (TPA) agreement	Contract with pensions administrator to process claims and payroll on behalf of Rothesay.
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.

Rothesay

Rothesay Life Plc
The Post Building
100 Museum Street
London WC1A 1PB

www.rothesay.com
T: 020 7770 5300