Innovating to secure the future

Rothesaylife

Rothesay Life Plc

Interim condensed financial statements for the six months ended 30 June 2018

What we do

Rothesay Life is a leading provider of regulated insurance solutions in the UK market for pensions de-risking. Established in 2007, Rothesay Life has grown to become one of the largest annuity providers in the UK market, with over £36bn of assets under management and insuring the annuities of over 770,000 individuals.

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For more information
www.rothesaylife.com

Strategic report

The Directors present the interim condensed financial statements for Rothesay Life Plc, registered number 06127279, (RLP or the Company) for the six month period ended 30 June 2018. Comparative information has been presented for the six month period ended 30 June 2017 and the year ended 31 December 2017.

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

Principal activities

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

RLP is a leading provider of regulated insurance solutions in the UK market for pensions de-risking. Established in 2007, RLP has grown to become one of the largest annuity providers in the UK market, with over £36bn of assets under management and insuring the annuities of over 770,000 individuals.

RLP's business strategy is focused around three key areas:

i) Protect our in-force balance sheet to ensure that our obligations to policyholders can be met.
ii) Grow through writing value-driven new business.
iii) Safeguard our brand and culture.

2018 year to date business highlights

- **Purchase of £12bn of annuities:** The Company successfully completed the reinsurance of a £12bn block of in-force annuity business from Prudential plc (the 'Prudential transaction'). This was the largest transaction of its type in the UK and increased the number of lives insured by the Company by approximately 400,000.
- **New business:** In addition to the Prudential transaction, the Company insured the defined benefit liabilities of the Toshiba Pension and Assurance Scheme taking new business premiums to £12.4bn (HY2017: £0.6bn and FY2017: £1.2bn).
- **Assets under management:** The Company's assets under management increased by 52% to £36.6bn (HY2017: £23.9bn and FY2017: £24.1bn).
- **Solvency position:** A continued focus on pro-active risk management and a cautious investment strategy maintained a robust solvency position. As at 30 June 2018, RLP's SCR coverage was 177% (HY2017: 171% and FY2017: 163%).
- **Credit rating:** Rothesay Life Plc was assigned an insurance financial strength rating of A3 by Moody's Investors Service and A+ by Fitch Ratings.
- **IFRS pre-tax losses:** Following completion of the Prudential transaction, we have chosen to de-risk the underlying assets and continue to be cautious about reinvesting the premium given market conditions. Given this approach, we have generated new business strain resulting in first half pre-tax losses (as anticipated when underwriting the transaction). First half pre-tax losses were £253m (HY2017: a pre-tax profit of £111m and FY2017: a pre-tax profit of £330m). As we invest the assets received from the Prudential transaction in line with our long-term investment strategy we expect to reverse this position and to generate significant IFRS profits.

Strategic report continued

The condensed statement of financial position is set out on page 9. RLP has assets under management of £36,624m (HY2017: £23,869m and FY2017: £24,138m). These numbers can be derived from the condensed statement of financial position by adjusting for reinsurance, payables, derivatives and collateralised financing as shown in the table below.

Assets under management

£m	HY2018	HY2017	FY2017
Total assets	**52,114**	38,498	38,266
Less reinsurance assets	**(72)**	(394)	(168)
Less payables and financial liabilities	**(15,418)**	(14,235)	(13,960)
Assets under management	**36,624**	23,869	24,138

Review of the business

Market backdrop

The first six months of the year saw considerable political uncertainty as a result of the continuing negotiations in relation to the UK's exit from the European Union (EU) and the changes in global relations. Long-term interest rates have increased and credit spreads have widened over the half year and this has been accompanied by continuing volatility from week to week.

We anticipate that the market uncertainty and volatility will increase through the remainder of 2018 and into 2019 as the political process of negotiating and finalising the details of the UK's proposed exit from the EU is completed, global tensions play out and quantitative easing is unwound. As a result, we remain cautious in investment markets and have sold a substantial proportion of the corporate bonds received as part of the premium for the Prudential transaction.

Demand for pension scheme de-risking remains strong and our bulk annuity pipeline suggests that 2018 will be a record year for the market. However, some of this business is likely to be, and has already been, written at levels which do not meet our return targets, so we will continue to exercise our strict business selection procedures.

Performance

On 14 March 2018, the Company acquired a £12bn portfolio of annuities from Prudential plc. The transaction is structured initially as a reinsurance contract and covers approximately 400,000 policyholders who will remain customers of Prudential and continue to be serviced by Prudential until the effective date of the Part VII transfer. The premium was paid by transfer of a portfolio of gilts and other government guaranteed bonds, cash, infrastructure bonds, social housing bonds and corporate bonds. Mainly as a result of the Prudential transaction and the associated capital injection, RLP's assets under management grew to £36.6bn at 30 June 2018 (HY2017: £23.9bn and FY2017: £24.1bn).

RLP also insured the defined benefit liabilities of the Toshiba Pension and Assurance Scheme taking new business premiums for the first half of 2018 to £12.4bn (HY2017: £0.6bn and FY2017: £1.2bn).

In order to ensure that RLP was appropriately capitalised post the Prudential transaction, RHUK, RLP's parent company borrowed £500m from a syndicate of banks and injected the proceeds into RLP as equity along with £70m of cash held by RHUK. RHUK's institutional shareholders also injected £380m of new equity with all three contributing in proportion to their existing investment. As a result, solvency coverage at RLP was 177% at 30 June 2018 (HY2017: 171% and FY2017: 163%).

Over the first half of 2018, the Company generated IFRS losses before tax of £253m (HY2017: a pre-tax profit of £111m and FY2017: a pre-tax profit of £330m). Losses largely arose from the new business strain associated with the Prudential transaction and the actions taken by the Company to reduce investment risk. As noted above, we have sold a substantial proportion of the corporate bonds received as part of the premium for the Prudential transaction and used the proceeds to purchase gilts. We have also reduced the duration of the assets held that are not required to back liabilities on a best estimate basis. Both of these actions have adversely impacted the IFRS balance sheet because both have led to a reduction in the rate used to discount the insurance liabilities. As we invest the assets received as part of the Prudential transaction in line with our long-term investment strategy we expect to reverse these losses and to generate significant IFRS profits.

As a result of our investment caution, we remain overweight in cash, gilts and US treasuries while we continue to seek investment opportunities in the UK and overseas. Areas we have invested in actively include financing the provision of equity release mortgages to older borrowers. By providing funding to back equity release mortgages, the Company is helping the over 55s to access the equity in their houses, without the need for them to move. Such mortgages also provide an attractive risk adjusted return to back our annuity business and we anticipate continuing to expand our activity in this area. We have also continued to selectively make low loan-to-value loans secured against prime commercial property both in the UK and the US.

Our policyholders

We pride ourselves on the quality of the service we provide and this is borne out by our customer service statistics. In surveys, over 98% of customers rate the quality of service received as good or excellent and in the first half of 2018 we received complaints at an annual rate of 0.66 per 1,000 policyholders of which only 0.14 complaints per 1,000 policyholders were upheld.

The Prudential transaction means that once the Part VII transfer has been approved, the Company will be responsible for over 770,000 individual policyholders so a key focus over the next 12 months will be ensuring that the transition from Prudential to RLP is seamless.

Risk, capital and asset management

The Company manages the risks associated with our annuity business in order to protect policyholder security and provide shareholders with a stable return. We look to use surplus capital to fund growth opportunities which we assess with a disciplined approach to risk and return.

Residual risk exposures and the Company's capital position are reported and monitored daily using a sophisticated and fully integrated risk management system, which allows the Company to manage its financial exposures dynamically in changing market conditions. New business is accretive to shareholder returns once assets are invested according to the Company's long-term investment strategy and helps the business achieve economies of scale.

Strategic report continued

The Company continues to hedge a large proportion of the longevity risk associated with our business and we were 76% reinsured on 30 June 2018 (HY2017: 83% and FY2017: 82%). Around 70% of the annuities acquired from Prudential are reinsured and the associated reinsurance agreements will transfer to the Company at the same time as the Part VII transfer is approved.

In July, the Prudential Regulation Authority (PRA) published consultation paper CP13/18 'Solvency II: equity release mortgages'. We do not believe that the outcome of the consultation will have a material impact on RLP's financial position or prospects, assuming that the final policy statement is consistent with such proposals. Equity release mortgage business is written on terms and assumptions that allow us to comply with the proposals as set out in CP13/18.

The Company makes use of its passporting rights to service customers situated in member states of the European Union (other than the United Kingdom). While it is anticipated that transitional arrangements in relation to Brexit will ensure that more permanent arrangements can be made for the servicing of customers situated in member states of the European Union (other than the United Kingdom), it is possible that no such arrangements are agreed. The Company is, therefore, in the process of developing contingency plans.

Despite the significant growth in the business over the first half of 2018, the principal risks remain unchanged from the year ended 31 December 2017.

Looking forward

The Company has a track record of being patient and adapting to market conditions both in asset and liability origination. Our large holding of cash and gilts should allow us to take advantage of investment opportunities as they arise, including those sourced by RHUK's new subsidiary, Rothesay Asset Management US LLC. Our sophisticated risk management systems facilitate a rapid response to new prospects.

In addition, the Prudential transaction demonstrated the willingness of RHUK's institutional shareholders to provide new equity to support strategic opportunities for growing the business as and when such opportunities arise.

Capital management

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

- to maintain financial strength in adverse conditions;
- to give customers long-term confidence in the Company;
- to satisfy 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; and
- to retain financial flexibility by maintaining strong liquidity.

Under the Solvency II regime, the Company is required to hold the greater of the capital required under the Solvency II Pillar 1 framework and the capital required under its own economic capital models, Solvency II Pillar 2.

The Company is capitalised to the greater of the economic capital requirement and the regulatory Pillar 1 position. In practice, it is the Pillar 1 requirement which is more onerous and the Company aims to maintain at least 130% of the regulatory minimum requirement in RLP. As at 30 June 2018, RLP had an SCR coverage ratio of 177% (HY2017: 171% and FY2017: 163%).

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

The solvency position of the Company is summarised in the table below. Company SCR coverage increased from 163% at 31 December 2017 to 177% at 30 June 2018 as a result of equity injected into RLP.

Solvency position of RLP

£m	HY2018	HY2017	FY2017
Tier 1 capital	3,496	2,348	2,180
Tier 2 capital	662	361	664
Own Funds available to meet SCR	4,158	2,709	2,844
SCR	2,351	1,584	1,743
Surplus above SCR	1,807	1,125	1,101
SCR coverage	177%	171%	163%

The value of transitional solvency relief was last recalculated on 14 March 2018 at the time of the Prudential transaction as all of the annuities acquired were written before 1 January 2016 and are eligible for transitional solvency relief. We estimate that the impact of recalculating transitional solvency relief as at 30 June 2018 would be to reduce solvency coverage by 7.5% as a result of changes in economic conditions and the application of the financial resources requirement test.

The SCR is calculated using the standard formula. The Company has recently made a formal application to the PRA to use its own model for calculating the SCR in relation to spread and counterparty risk but intends using the standard formula for all other risks (a 'partial internal model'). The Company has applied for approval to use a partial internal model to ensure that the allocation of capital to investments is consistent with the low risk inherent in the types of highly collateralised investments which are core to the Company's investment strategy. Approval of the partial internal model would also allow the Company to restructure our holding of equity release mortgages to make them eligible for inclusion in the matching adjustment fund.

Report of the Directors

The Directors present their condensed financial statements for Rothesay Life Plc, registered number 06127279, (the Company or RLP) for the period ended 30 June 2018. Comparative information has been presented for the period ended 30 June 2017 and year ended 31 December 2017.

1. Results

The results for RLP for the period are set out in the condensed statement of comprehensive income on page 8.

2. Dividends

The Directors have recommended no payment of interim dividends during the period ended 30 June 2018 (HY2017: £nil).

3. Registered office

The financial statements include the financial statements of RLP. The Company is registered in the United Kingdom. The registered office and principal place of business for RLP is Level 25, The Leadenhall Building, 122 Leadenhall Street, London, EC3V 4AB.

4. Post balance sheet event

On 5 September RLP issued £350m of Restricted Tier 1 bonds with a fixed 6.875% coupon payable semi-annually in arrears. The notes were issued through the public debt markets. The proceeds will be paid from RLP to RHUK as a dividend in order to partially repay the bank debt held at RHUK.

5. Directors

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

Name	Appointed	Resigned
S. Q. Abbas		
C. Beckers		
R. D. A. Berliand		
M. T. Corbett		
R. A. De Beir Jarratt		
G. P. J. Earle		10 January 2018
N. Kheraj		
R. King		
A. Loudiadis		
T. L. Miller		
T. J. Pearce		
C. D. Pickup		
W. J. Robertson		
A. M. Stoker		

6. Statement of Directors' responsibilities

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

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

7. Date of authorisation of issue

The financial statements were authorised for issue by the Board of Directors on 24 September 2018.

On behalf of the Board

Addy Loudiadis
Chief Executive Officer
24 September 2018

Condensed statement of comprehensive income

For the period ended 30 June 2018

	Note	HY2018 £m	HY2017 £m	FY2017 £m
Income				
Gross premiums written	2	**12,489**	742	1,447
Less: premiums ceded to reinsurers		**(519)**	(327)	(781)
Net premiums written		**11,970**	415	666
Investment return	3	**(131)**	238	773
Total revenue		**11,839**	653	1,439
Expenses				
Policyholder claims		**(757)**	(751)	(1,479)
Less: reinsurance recoveries		**492**	306	736
Change in insurance contract liabilities		**(11,341)**	40	330
Change in the reinsurers' share of insurance contract liabilities		**(364)**	(43)	(500)
Net claims and change in insurance contract liabilities		**(11,970)**	(448)	(913)
Acquisition and administration expenses	4	**(96)**	(76)	(146)
Finance costs	5	**(26)**	(18)	(50)
Total operating expenses		**(122)**	(94)	(196)
(Loss)/profit before tax		**(253)**	111	330
Income tax credit/(expense)	6	**48**	(20)	(53)
(Loss)/profit for the period/financial year		**(205)**	91	277

All income and expenses relate to continuing operations.

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

Notes 1 – 20 form an integral part of these financial statements.

Condensed statement of financial position

As at 30 June 2018

	Note	HY2018 £m	HY2017 £m	FY2017 £m
Assets				
Investment in subsidiaries	18	–	2	–
Property, plant and equipment		3	4	3
Financial investments	7	50,737	37,138	37,302
Reinsurance assets	8	72	394	168
Accrued interest and prepayments		443	241	312
Receivables		458	553	339
Cash and cash equivalents		401	166	142
Total assets		52,114	38,498	38,266
Equity and liabilities				
Equity				
Share capital	14	410	264	264
Share premium	15	1,353	549	549
Retained earnings	15	633	1,022	838
Total equity		2,396	1,835	1,651
Liabilities				
Reinsurance liabilities	8	500	–	231
Insurance contract liabilities	9	33,083	22,036	21,741
Payables and financial liabilities	10	15,418	14,235	13,960
Borrowings	11	647	349	647
Deferred tax liabilities	13	2	2	2
Accruals and deferred income		68	41	34
Total liabilities		49,718	36,663	36,615
Total equity and liabilities		52,114	38,498	38,266

Notes 1 – 20 form an integral part of these financial statements.

The financial statements were approved by the Board of Directors on 24 September 2018 and signed on its behalf by:

Addy Loudiadis
Chief Executive Officer
24 September 2018
Company number 06127279

Condensed statement of changes in equity

For the period ended 30 June 2018

	Share capital £m	Share premium £m	Retained earnings £m	Total equity £m
As at 1 January 2018	264	549	838	1,651
Loss for the period	–	–	(205)	(205)
Share issuance	146	804	–	950
As at 30 June 2018	410	1,353	633	2,396

For the period ended 30 June 2017

	Share capital £m	Share premium £m	Retained earnings £m	Total equity £m
As at 1 January 2017	264	549	931	1,744
Profit for the period	–	–	91	91
As at 30 June 2017	264	549	1,022	1,835

For the year ended 31 December 2017

	Share capital £m	Share premium £m	Retained earnings £m	Total equity £m
As at 1 January 2017	264	549	931	1,744
Profit for the period	–	–	277	277
Dividends paid	–	–	(370)	(370)
As at 31 December 2017	264	549	838	1,651

Condensed cash flow statement

For the period ended 30 June 2018

	HY2018 £m	HY2017 £m	FY2017 £m
Cash flows from operating activities			
(Loss)/profit for the period/financial year	(205)	91	277
Adjustments for non cash movements in net (loss)/profit for the period/financial year			
Depreciation	1	1	1
Amortisation of debt costs	–	–	(2)
Interest income	(420)	(291)	(649)
Interest expense	26	18	50
Income tax expense	(48)	20	53
Net (increase)/decrease in operational assets			
Financial investments	(13,435)	1,204	1,041
Reinsurance asset	96	43	269
Receivables	(71)	(31)	182
Net increase/(decrease) in operational liabilities			
Insurance contract liabilities	11,342	(39)	(330)
Claims outstanding	–	4	1
Reinsurance liabilities	269	–	231
Financial liabilities	1,229	(1,196)	(1,387)
Other payables	267	(70)	(172)
Accruals and deferred income	22	–	3
Net cash flows used in operating activities	(927)	(246)	(432)
Interest paid	(15)	(7)	(48)
Interest received	289	323	610
Tax paid	(38)	(46)	(62)
Cash flows from operating activities	(691)	24	68
Cash outflows from financing activities			
Proceeds from issuance of debt	–	–	300
Proceeds from issue of ordinary share capital (including share premium)	950	–	–
Dividends	–	–	(370)
Net cash flows from financing activities	950	–	(70)
Cash flows from investing activities			
Net acquisition of property, plant and equipment	–	(1)	(1)
Repayment of investment in subsidiary	–	–	2
Net cash flows from investing activities	–	(1)	1
Net increase/(decrease) in cash and cash equivalents	259	23	(1)
Cash and cash equivalents at 1 January	142	143	143
Cash and cash equivalents at the statement of financial position date	401	166	142

Notes to the financial statements

Note 1 – General information and basis of preparation

(a) General information

RLP is a registered public limited company incorporated and domiciled in the United Kingdom. The Company's registered office and principal place of business is Level 25, The Leadenhall Building, 122 Leadenhall Street, London, EC3V 4AB.

(b) Basis of preparation

The condensed interim financial statements for the six month period ended 30 June 2018 have been prepared and approved by the Directors in accordance with IAS 34, 'Interim Financial Reporting', as adopted by the EU. The condensed interim financial statements should be read in conjunction with the annual financial statements for the year ended 31 December 2017, which have been prepared in accordance with IFRSs as adopted by the EU.

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

RLP presents its statement of financial position broadly in order of liquidity.

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

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

(c) Accounting policies

The accounting policies adopted are consistent with those of the previous financial year. RLP has not adopted any new standards or changes to existing standards, including matters of significant judgement and use of estimates. Accounting policies of the Company can be found in the 2017 Annual Report.

Note 2 – Segmental analysis

All of RLP's business risks and returns are within one business segment (i.e. long-term insurance business). This includes the premium generated on inwards reinsurance contracts. RLP's operations are materially within the United Kingdom. The split between regular premiums (payments of premium made regularly over the duration of the policy) and single premiums (single payment of premium which covers the life of the policy) is shown below:

	Regular premiums			Single premiums		
	HY2018 £m	HY2017 £m	FY2017 £m	**HY2018 £m**	HY2017 £m	FY2017 £m
Group pension bulk annuities	**132**	132	263	**175**	406	978
Assumed reinsurance premiums	**–**	–	–	**12,182**	204	206
Total gross premiums written	**132**	132	263	**12,357**	610	1,184

Note 2 – Segmental analysis continued

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

Note 3 – Investment return

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

	HY2018 £m	HY2017 £m	FY2017 £m
Interest income on financial investments at fair value through profit and loss	420	291	649
Unrealised (losses)/gains on financial investments	(721)	(128)	14
Realised gains on financial investments	187	83	131
Investment expenses	(17)	(8)	(21)
Total investment return	(131)	238	773

The main driver for the increase in the interest income is due to the bonds received as part of the Prudential transaction premium.

The unrealised losses during the six month period were due to the impact of rising interest rates.

Note 4 – Acquisition and administration expenses

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

	HY2018 £m	HY2017 £m	FY2017 £m
Acquisition costs	64	43	83
Administration expenses – recurring	14	9	21
Administration expenses – project and other one off expenses	18	24	42
Total operating expenses	96	76	146

Notes to the financial statements continued

Note 5 – Finance costs

	HY2018 £m	HY2017 £m	FY2017 £m
Interest payable on collateral	3	1	3
Interest payable on collateralised agreements and financing	1	5	17
Interest payable on collateral and collateralised agreements	4	6	20
Interest payable on third party borrowings	10	10	20
Interest payable on borrowings from participating interest	12	–	10
Interest payable on borrowing from affiliates	–	2	–
Total borrowing costs	22	12	30
Net finance costs	26	18	50

Debt issuance expenses associated with the issue of subordinated loans will be recognised over the term of the loan.

As a result of the recapitalisation of the Group, the affiliate was reclassified as a participating interest.

Note 6 – Income tax expense

The major components of the income tax expense for the six month period ended 30 June 2018 and 30 June 2017 and the financial year ended 31 December 2017 are:

(a) Tax charged in the income statement

	HY2018 £m	HY2017 £m	FY2017 £m
Current income tax:			
UK corporation tax	(48)	21	54
Total current income tax	(48)	21	54
Deferred tax:			
Origination and reversal of temporary differences	–	(1)	(1)
Total deferred tax	–	(1)	(1)
Total (credit)/expense in the condensed statement of comprehensive income	(48)	20	53

Note 6 – Income tax expense continued

(b) Reconciliation of the total tax charge

The tax expense in the condensed statement of comprehensive income for the period and the standard rate of corporation tax in the UK of 19.00% (HY2017 and FY2017: 19.25%) is reconciled below:

	HY2018 £m	HY2017 £m	FY2017 £m
(Loss)/profit on ordinary activities before taxation	(253)	111	330
Tax calculated at UK standard rate of corporation tax of 19.00% (HY2017 and FY2017: 19.25%)	(48)	21	63
Utilisation of losses surrendered by Group undertakings	–	(1)	(10)
Total tax (credit)/expense reported in the condensed statement of comprehensive income	(48)	20	53

Note 7 – Fair value

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 measurements do not include transaction costs. 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 and bid/offer inputs.

Financial instruments such as corporate debt securities, covered bonds, government, sub sovereign and agency obligations, 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. Valuation adjustments are generally based on market evidence.

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

Notes to the financial statements continued

Note 7 – Fair value continued

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

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

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

Determination of fair value and fair values hierarchy

RLP 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 RLP 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 the future cash flows using interest rate swap curves in addition to a spread to reflect the associated credit risk and liquidity premiums.

The tables on the next page show an analysis of financial instruments recorded at fair value by level of the fair value hierarchy for 30 June 2018, 30 June 2017 and 31 December 2017.

Note 7 – Fair value continued

HY2018	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Collective investment schemes	1,837	–	–	1,837
Government, sub sovereign and agency obligations	7,092	12,258	–	19,350
Corporate bonds and other corporate debt	–	11,036	877	11,913
Derivative assets	–	11,169	–	11,169
Collateralised agreements and financing	–	2,368	–	2,368
Loans secured on property	–	–	3,942	3,942
Certificate of deposits	–	158	–	158
Total financial investments at fair value	**8,929**	**36,989**	**4,819**	**50,737**
Derivative financial instruments	–	11,649	5	11,654
Collateralised financing agreements	–	2,145	–	2,145
Total financial liabilities at fair value	**–**	**13,794**	**5**	**13,799**

HY2017	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Collective investment schemes	1,034	–	–	1,034
Government, sub sovereign and agency obligations	5,793	6,974	–	12,767
Corporate bonds and other corporate debt	–	5,965	539	6,504
Derivative assets	–	10,649	–	10,649
Collateralised agreements and financing[1]	–	2,753	–	2,753
Loans secured on property[1]	–	–	3,279	3,279
Certificate of deposits	–	152	–	152
Total financial investments at fair value	6,827	26,493	3,818	37,138
Derivative financial instruments	–	10,860	–	10,860
Collateralised financing agreements	–	1,901	–	1,901
Total financial liabilities at fair value	–	12,761	–	12,761

FY2017	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Collective investment schemes	1,028	–	–	1,028
Government, sub sovereign and agency obligations	4,044	7,975	–	12,019
Corporate bonds and other corporate debt	–	6,334	685	7,019
Derivative assets	–	10,735	–	10,735
Collateralised agreements and financing	–	2,402	–	2,402
Loans secured on property	–	–	3,938	3,938
Certificate of deposits	–	161	–	161
Total financial investments at fair value	5,072	27,607	4,623	37,302
Derivative financial instruments	–	11,164	1	11,165
Collateralised financing agreements	–	1,405	–	1,405
Total financial liabilities at fair value	–	12,569	1	12,570

1 £3.3bn of investments, that include loans secured on residential and commercial properties, as at 30 June 2017 which were categorised as collateralised agreements and financing have been separately identified as loans secured on property to reflect the substance of these investments.

Notes to the financial statements continued

Note 7 – Fair value continued

Approximately 9% (HY2017: 10% and FY2017: 12%) of the total financial assets recorded at fair value are based on estimates and recorded as Level 3 investments. Where estimates are used, these are based on a combination of independent third party evidence and internally developed models, calibrated to market observable data where possible.

The following table shows a reconciliation of the opening and closing recorded amounts in relation to the Level 3 financial instruments recorded at fair value:

	Corporate bonds and other corporate debt £m	Loans secured on property £m	Derivatives £m	Total £m
At 1 January 2018	**685**	**3,938**	**(1)**	**4,622**
Total gains in the statement of comprehensive income:				
Unrealised losses	**(15)**	**(193)**	**–**	**(208)**
Transfer into Level 3	**–**	**–**	**(4)**	**(4)**
Purchase/additions	**207**	**197**	**–**	**404**
At 30 June 2018	**877**	**3,942**	**(5)**	**4,814**

	Corporate bonds and other corporate debt £m	Loans secured on property £m	Derivatives £m	Total £m
At 1 January 2017	338	2,911	(1)	3,248
Total gains in the statement of comprehensive income:				
Unrealised gains/(losses)	15	(151)	1	(135)
Transfer into Level 3	159	195	–	354
Purchases/additions	27	324	–	351
At 30 June 2017	539	3,279	–	3,818

	Corporate bonds and other corporate debt £m	Loans secured on property £m	Derivatives £m	Total £m
At 1 January 2017	338	2,911	(1)	3,248
Total gains in the statement of comprehensive income:				
Unrealised gains	26	79	–	105
Transfer into Level 3	160	197	–	357
Purchases/additions	161	751	–	912
At 31 December 2017	685	3,938	(1)	4,622

Note 7 – Fair value continued

There have been no transfers between Level 1 and Level 2 during the period.

During the previous period, RLP transferred certain financial instruments between Level 2 and Level 3 of the fair value hierarchy.

The recorded amount of the total assets transferred from Level 2 to Level 3 is £nil (HY2017: £354m, FY2017: £357m), total liabilities is £4m (HY2017: £nil, FY2017: £nil). The reason for the transfer is a change in the availability of observable market transactions for the same or similar instruments. There were £nil movements from Level 3 to Level 2 (HY2017: £nil, FY2017: £nil).

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

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

			HY2018		
Impact on financial assets, liabilities and PBT	Main assumptions	Sensitivity	Current FV £m	(Decrease)/ increase in FV £m	(Decrease)/ increase in PBT £m
Financial assets					
Corporate bonds and other corporate debt	Discount rate	+50bps interest rate	877	(41)	(14)
		-50bps interest rate	877	45	15
Loans secured on property	Discount rate	+25bps interest rate	3,942	(223)	(25)
		-25bps interest rate	3,942	245	28
Loans secured on property	House price	+10% change in house price	3,942	5	5
		-10% change in house price	3,942	(6)	(6)
Financial liabilities					
Derivative liabilities	Expected defaults	+50bps credit default spread	5	2	2
		-50bps credit default spread	5	(2)	(2)

Notes to the financial statements continued

Note 7 – Fair value continued

Impact on financial assets, liabilities and PBT	Main assumptions	Sensitivity	HY2017 Current FV £m	HY2017 (Decrease)/ increase in FV £m	HY2017 (Decrease)/ increase in PBT £m
Financial assets					
Corporate bonds and other corporate debt	Discount rate	+50bps interest rate	539	(33)	(9)
		-50bps interest rate	539	37	10
Loans secured on property	Discount rate	+25bps interest rate	3,279	(189)	(16)
		-25bps interest rate	3,279	208	18
Loans secured on property	House price	+10% change in house price	3,279	1	1
		-10% change in house price	3,279	(1)	(1)
Financial liabilities					
Derivative liabilities	Expected defaults	+50bps credit default spread	–	–	–
		-50bps credit default spread	–	–	–

Impact on financial assets, liabilities and PBT	Main assumptions	Sensitivity	FY2017 Current FV £m	FY2017 (Decrease)/ increase in FV £m	FY2017 (Decrease)/ increase in PBT £m
Financial assets					
Corporate bonds and other corporate debt	Discount rate	+50bps interest rate	685	(34)	(11)
		-50bps interest rate	685	38	12
Loans secured on property	Discount rate	+25bps interest rate	3,938	(220)	(21)
		-25bps interest rate	3,938	242	23
Loans secured on property	House price	+10% change in house price	3,938	5	5
		-10% change in house price	3,938	(3)	(3)
Financial liabilities					
Derivative liabilities	Expected defaults	+50bps credit default spread	1	1	1
		-50bps credit default spread	1	(1)	(1)

Note 8 – Reinsurance assets/(liabilities)

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

	HY2018 £m	HY2017 £m	FY2017 £m
Reinsurance assets	72	394	168
Reinsurance liabilities	(500)	–	(231)
Total reinsurance of insurance contract liabilities	(428)	394	(63)

Under the outward reinsurance contracts, RLP 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 collateralised generally 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.

An analysis of the movement in reinsurance of insurance contract liabilities is included in Note 9. Some reinsurance contracts have moved from being reinsurance assets to reinsurance liabilities during prior year, with some additional contracts moving to become reinsurance liabilities during 2018. This is due to the change in the mortality assumptions detailed in Note 9. Reinsurance contracts are valued as the net position comparing the discounted value of a fixed leg being paid to a floating leg moving with expected prudent mortality being received. As the mortality assumptions have been adjusted such that the underlying lives are not expected to live as long, the floating leg being received has become less valuable. This affects all contracts including those that have remained as reinsurance assets.

At 30 June 2018, 30 June 2017 and 31 December 2017 the Company conducted an impairment review of the reinsurance assets and found no impairment necessary.

Note 9 – Insurance contract liabilities

Key valuation assumptions

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

(a) Mortality assumptions

Mortality bases have been determined separately for each insurance contract. The resulting assumptions are equivalent to using the base mortality and improvement assumptions set out in the table on the next page.

Notes to the financial statements continued

Note 9 – Insurance contract liabilities continued

	Base mortality					
	HY2018		HY2017		FY2017	
	Pensions originated	Insurance originated	Pensions originated	Insurance originated	Pensions originated	Insurance originated
Males	97.1% S2PMA	103.8% PMA08	97.4% S2PMA	104.4% PMA08	96.1% S2PMA	104.3% PMA08
Females	97.1% S2PFA	103.8% PFA08	97.4% S2PFA	104.4% PFA08	96.1% S2PFA	104.3% PFA08

	Mortality improvements		
	HY2018	HY2017	FY2017
Males	CMI_2017_M[3.4%; Sκ=7.75]	CMI_2014_M[2.4%]	CMI_2016_M[3.5%; Sκ=7.75]
Females	CMI_2017_F[3.4%; Sκ=7.75]	CMI_2014_F[2.4%]	CMI_2016_F[3.5%; Sκ=7.75]

There were no changes to the base mortality assumptions at 30 June 2018 from those used at 31 December 2017. The last review was carried out during 2017 except for new business which was assessed during 2018. Changes shown in the tables are as a result of the impact of new business on the average mortality assumption for the portfolio as a whole.

For pension scheme originated business, ultimate mortality has been used in all cases and mortality improvements are applied assuming mortality rates are as at 2007. Mortality assumptions are generally set with reference to a RLP specific suite of mortality tables. These have been expressed for reporting purposes as an 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.

For insurance originated annuities, bespoke mortality tables and the CMI 08 series of annuitant mortality tables are used to value the liabilities. These have been expressed for reporting purposes as an equivalent to the CMI 08 series tables. These incorporate the effect of selection adjustments for relevant policies and mortality improvements are applied assuming mortality rates are at 2008.

Allowance is made for future improvements in annuitant mortality with reference to statistical analysis of historical rates of mortality improvements, expert judgement of future changes in mortality improvements, industry benchmarking and reinsurance pricing. In 2017, mortality improvement assumptions were updated to reflect CMI_2016 and in HY2018 assumptions have been further updated to reflect the latest mortality improvement model as released by the CMI, CMI_2017. This model allows the user to choose the level of smoothing applied to historic mortality improvements (Sκ parameter). A value of Sκ=7.75 has been chosen as a reasonable level of smoothing given recent changes to population level mortality improvements and the inherent uncertainty in mortality improvements by socio economic class. The chosen long-term improvement rate assumption varies by age using a bespoke calibration that tapers non-linearly from age 67 to 0% at age 120. These rates have remained unchanged from 2017, although the equivalent single long-term rate as applied to the core model has changed slightly as a result of new business. The impact of the change to CMI_2017 led to a reduction in net liability of £64m. Prudent margins are applied to the demographic basis to reflect the fact that future experience for the schemes may differ from that assumed. There are no changes to the prudent margins at 30 June 2018.

Note 9 – Insurance contract liabilities continued

(b) Valuation rate of interest

The valuation rate of interest used to discount the cash flows for the purpose of valuing insurance contract liabilities is based on the yield obtained on the basket of assets matching the applicable insurance contract liabilities at 30 June 2018.

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

	HY2018	HY2017	FY2017
Equivalent valuation discount rate	2.30% p.a.	2.39% p.a.	2.32% p.a.

This reflects a 2.5% prudential margin applied to the risk adjusted internal rate of return obtained on the basket of matching assets and an allowance for investment management expenses of 3bps p.a. (30 June 2017: 3bps p.a. and 31 December 2017: 3bps p.a.).

The asset yield used to calculate the valuation discount rate has been reduced to reflect counterparty default risk; where applicable adjusted for the prudent expected recoveries in the event of default. This reduction in yield is determined separately for each individual asset reflecting the risk to the return being achieved on the asset.

The table below shows the average yield deduction at 30 June 2018, 30 June 2017 and 31 December 2017 by asset category:

	Average yield reduction		
Asset class	HY2018	HY2017	FY2017
UK Government approved securities	0bps	0bps	0bps
Corporate bonds after allowance for covering credit default swaps	0bps	0bps	0bps
Secured lending	6bps	7bps	5bps
Supranational/other sovereign	26bps	21bps	21bps
Secured residential lending	32bps	21bps	24bps
Corporate bonds (without covering credit default swaps)	52bps	48bps	46bps
Infrastructure	70bps	76bps	73bps
Other	35bps	41bps	41bps
Overall yield reduction	26bps	17bps	19bps

There have been no changes made to the methodology used to derive the credit default yield deduction over the period. The increase in the credit deduction has arisen from a combination of market movements and change in asset mix.

Notes to the financial statements continued

Note 9 – Insurance contract liabilities continued

Overall, the deduction for counterparty default risk on the assets held by RLP is generally lower than the corresponding credit default deduction on a typical unsecured credit portfolio. This is due to a significant proportion of the portfolio being invested in assets with either a low probability of default due to government guarantees or expectation of higher recovery in the event of default through collateralisation, recourse to specific assets and credit default swap protection.

(c) Expenses

An allowance is made for future overhead maintenance expenses following an investigation into the total costs incurred by the Company during 2017 and the projected 2018 expenses. The investigation was last updated for the 31 December 2017 valuation and was reassessed for 30 June 2018 valuation as a result of new business. 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 (TPA) agreements together with the long-term business overhead expenses expressed as an amount per policy. On average an allowance of £24 per policy per annum (p.a.) (HY2017: £29 per policy p.a. and FY2017: £35 per policy p.a.) is made with additional allowances for short-term project costs and investment management expenses. The overall expense allowance has increased materially since 31 December 2017 but the average per policy expense allowance has reduced due to the number of policies more than doubling over the period and new business incurring a lower marginal per policy cost than existing business.

Within these expense provisions, an allowance for future expense inflation has been provided to cover the impact of both salary and price inflation. The future rate of expense inflation is assumed to be RPI (as implied by the RPI swap curve) plus an addition at each duration of 0.25% p.a. for all expenses (HY2017: 0.25% p.a. and FY2017: 0.25% p.a.).

(d) Other assumptions

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

A number of other, less financially significant, actuarial assumptions are made in determining the provisions. These assumptions include, inter alia, the proportion of deferred and immediate annuitants assumed to have a dependant eligible for contingent benefits, dependant's age difference and the proportion of deferred annuitants opting to take a proportion or all of their benefit as a lump sum. The assumptions are modelled to reflect a proportion of the maximum pension commencement lump sum that a member can choose to take tax free when reaching retirement, along with the probability of the whole pension being converted to a lump sum prior to retirement. The main impact of the assumption is to change the profile of the cash flows assumed to be paid as the value of the lump sums reflect a discounted value of the same cash flows as projected using the assumptions to value the liability as an annuity.

When deferred annuitants have passed the scheme normal retirement date and have been subject to an in depth tracing exercises and yet remain untraced, a prudent allowance has been made for the probability of them retiring in the future. All other individuals who have passed the scheme normal retirement date are assumed to retire immediately.

Note 9 – Insurance contract liabilities continued

(e) Movements in insurance contract liabilities

	HY2018		
	Insurance liabilities £m	Reinsurance liabilities £m	Net liabilities £m
Carrying amount at 1 January	**21,741**	**(63)**	**21,804**
Increase in respect of new business	**12,378**	**(94)**	**12,472**
Release of liabilities/liabilities discharged	**(401)**	**(7)**	**(394)**
Effect of non-economic assumption changes	**(221)**	**(157)**	**(64)**
Effect of economic assumption changes	**(416)**	**(106)**	**(310)**
Other	**2**	**(1)**	**3**
Closing balance at 30 June	**33,083**	**(428)**	**33,511**

	HY2017		
	Insurance liabilities £m	Reinsurance assets £m	Net liabilities £m
Carrying amount at 1 January	22,071	437	21,634
Increase in respect of new business	558	6	552
Release of liabilities/liabilities discharged	(592)	(3)	(589)
Effect of economic assumption changes	34	(45)	79
Other	(35)	(1)	(34)
Closing balance at 30 June	22,036	394	21,642

	FY2017		
	Insurance liabilities £m	Reinsurance assets/ (liabilities) £m	Net liabilities £m
Carrying amount at 1 January	22,071	437	21,634
Increase in respect of new business	1,040	6	1,034
Release of liabilities/liabilities discharged	(960)	5	(965)
Effect of non-economic assumption changes	(589)	(464)	(125)
Effect of economic assumption changes	182	(47)	229
Other	(3)	–	(3)
Closing balance at 31 December	21,741	(63)	21,804

The table above details the change in the gross and net insurance liabilities over the period. The table on the next page provides a further split of the net impact of the most significant assumption changes.

The release of liabilities line reflects claims paid, release of prudent margins and unwind of discounting over the period.

Notes to the financial statements continued

Note 9 – Insurance contract liabilities continued

Effect of changes in assumptions and estimates during the period

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

Net increase in net liabilities

Change in assumptions used	HY2018 £m	HY2017 £m	FY2017 £m
Valuation rate of interest	(103)	159	325
Inflation	(207)	(80)	(96)
Effect of economic assumption changes	(310)	79	229
Demographics	(64)	–	(160)
Expenses	–	–	35
Effect of non-economic assumption changes	(64)	–	(125)
Total change in assumptions used	(374)	79	104

As shown previously the valuation rate of interest decreased by 2bps over the period, which would imply an increase to the liability valuation. However, this reduction in yield was in part driven by the assets received during the year as new business premiums. This effect is included in the increase in liabilities in respect of new business. Market impacts led to the £103m decrease in the liability shown, this was mainly due to interest rates increasing offset by spreads on government guaranteed assets reducing.

The movement in the demographic assumptions shown reflects the changes to mortality improvement assumptions applied during the period leading to a £64m decrease in net liabilities.

There were no changes to the expense assumptions during the period except as a result of new business. Additional expense reserves set up to support new business have been reflected through the increase in respect of new business.

(f) Sensitivity analysis

The schedule on the next page provides an analysis of the reasonably possible movements in key assumptions that would have a material impact on liabilities (net of reinsurance), profit before tax (PBT), and equity. The analysis is based on a change in a single assumption whilst holding all other assumptions constant. The analysis assumes an instantaneous shock to the assumptions, other than for the interest rate sensitivities where the impact of dynamic hedging is allowed for as an interest rate change.

Note 9 – Insurance contract liabilities continued

HY2018	Change in assumptions	(Decrease)/ increase on liabilities £m	Increase/ (decrease) on PBT £m	Impact on equity £m
Annuitant mortality	+5% qx	(187)	187	151
Annuitant mortality	-5% qx	197	(197)	(160)
Interest rate	+100bps	(3,830)	119	97
Interest rate	-100bps	4,775	238	193
Inflation	+100bps	1,296	45	36
Inflation	-100bps	(1,248)	119	96
Credit default assumption	+10bps	(145)	(174)	(141)
Credit default assumption	-10bps	110	216	175
Expenses	+10%	92	(92)	(74)

HY2017	Change in assumptions	(Decrease)/ increase on liabilities £m	Increase/ (decrease) on PBT £m	Impact on equity £m
Annuitant mortality	+5% qx	(96)	96	78
Annuitant mortality	-5% qx	101	(101)	(82)
Interest rate	+100bps	(2,656)	10	8
Interest rate	-100bps	3,375	219	177
Inflation	+100bps	1,046	73	59
Inflation	-100bps	(1,010)	62	50
Credit default assumption	+10bps	(116)	(104)	(84)
Credit default assumption	-10bps	119	105	85
Expenses	+10%	56	(56)	(45)

FY2017	Change in assumptions	Decrease/ (increase) on liabilities £m	Increase/ (decrease) on PBT £m	Impact on equity £m
Annuitant mortality	+5% qx	(104)	104	84
Annuitant mortality	-5% qx	109	(109)	(88)
Interest rate	+100bps	(2,723)	(25)	(20)
Interest rate	-100bps	3,476	343	277
Inflation	+100bps	1,157	65	52
Inflation	-100bps	(1,110)	85	69
Credit default assumption	+10bps	(114)	(112)	(90)
Credit default assumption	-10bps	117	111	90
Expenses	+10%	66	(66)	(54)

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

The -100bps interest rate sensitivity assumes interest rates fall below zero for the period up to one year at 30 June 2018 (five years HY2017 and four years FY2017).

Notes to the financial statements continued

Note 9 – Insurance contract liabilities continued

The credit default assumption sensitivity has been calculated assuming a change in the credit spreads on non risk free assets with no associated change in the valuation rate of interest.

The table below shows the impact of reinsurance on the sensitivity to mortality risk, a reduction of 76% (HY2017: 83% and FY2017: 82%). The reduction in the impact of reinsurance is mainly due to new business written being less reinsured than business in force at 31 December 2017.

HY2018	Change in assumptions	(Decrease)/ increase on insurance liabilities £m	Increase/ (decrease) on reinsurance asset £m	Net (decrease)/ increase on liabilities net of reinsurance £m
Annuitant mortality	+5% qx	(786)	599	(187)
Annuitant mortality	-5% qx	839	(642)	197

HY2017	Change in assumptions	(Decrease)/ increase on insurance liabilities £m	Increase/ (decrease) on reinsurance asset £m	Net (decrease)/ increase on liabilities net of reinsurance £m
Annuitant mortality	+5% qx	(567)	471	(96)
Annuitant mortality	-5% qx	607	(506)	101

FY2017	Change in assumptions	(Decrease)/ increase on insurance liabilities £m	Increase/ (decrease) on reinsurance asset £m	Net (decrease)/ increase on liabilities net of reinsurance £m
Annuitant mortality	+5% qx	(578)	474	(104)
Annuitant mortality	-5% qx	619	(510)	109

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

Note 10 – Payables and financial liabilities

	HY2018 £m	HY2017 £m	FY2017 £m
Derivative financial instruments	11,654	10,860	11,165
Collateralised financing agreements	2,145	1,901	1,405
Deposits received as collateral from third parties	1,235	763	1,264
Deposits received as collateral for derivatives from participating interest	–	626	–
Amounts due to Group undertakings	37	18	33
Current tax payable	–	20	38
Other payables	347	47	55
Total payables and financial liabilities	15,418	14,235	13,960

Note 11 – Borrowings

RLP's borrowings are as follows:

	HY2018 £m	HY2017 £m	FY2017 £m
Affiliate subordinated loan	–	100	–
Subordinated loans from participating interest	398	–	398
Subordinated loan notes	249	249	249
Total borrowed	647	349	647

Note that the affiliate subordinated loan of £100m has been reclassified as subordinated loan notes from a participating interest following the recapitalisation on 18 December 2017.

Notes to the financial statements continued

Note 11 – Borrowings continued

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

Notional amount	Issue date	Redemption date	Callable at par at option of the Company from	Coupon	Carrying amount HY2018 £m	Carrying amount HY2017 £m	Carrying amount FY2017 £m	Fair value HY2018 £m	Fair value HY2017 £m	Fair value FY2017 £m
Subordinated loans from participating interest										
£100m	21 December 2012	Lender has option to convert to equity from 21 December 2022	21 December 2017 and every six months thereafter	6m£L plus 4.25%	**100**	100	100	**94**	100	95
£300m	19 September 2017	19 September 2028	19 September 2023 and annually thereafter	3m£L plus 5.95%	**298**	–	298	**301**	–	305
Subordinated loans										
£250m	22 October 2015	22 October 2025	22 October 2025	8.00%	**249**	249	249	**294**	279	303

For the period ended 30 June 2018, an interest expense of £22m (HY2017: £12m and FY2017: £30m) was recognised in the condensed statement of comprehensive income in respect of these borrowings.

Note 12 – Reconciliation of borrowings

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

	1 January 2018 £m	Cash flows £m	Non cash flows £m	30 June 2018 £m
Subordinated loans from participating interest	398	–	–	398
Subordinated loan notes	249	–	–	249
Total borrowings	647	–	–	647

	1 January 2017 £m	Cash flows £m	Non cash flows £m	31 December 2017 £m
Affiliate subordinated loan	100	–	(100)	–
Subordinated loans from participating interest	–	300	98	398
Subordinated loan notes	249	–	–	249
Total borrowings	349	300	(2)	647

Note 13 – Deferred taxation liabilities

Deferred tax balances comprise:

	HY2018 £m	HY2017 £m	FY2017 £m
Temporary differences between the financial statements and the tax deductions	(2)	(2)	(2)
Total temporary differences	(2)	(2)	(2)

The movements in the deferred tax balances were as follows:

	HY2018 £m	HY2017 £m	FY2017 £m
At 1 January	(2)	(3)	(3)
Capital allowances	–	1	1
At statement of financial position date	(2)	(2)	(2)

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

Note 14 – Share capital

At 30 June 2018, 30 June 2017 and 31 December 2017 share capital comprised:

	HY2018		HY2017		FY2017	
	No.	£m	No.	£m	No.	£m
Authorised share capital (ordinary shares of £1 each)	410,322,556	410	264,380,809	264	264,380,809	264

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

Notes to the financial statements continued

Note 15 – Share premium account and reserve

	Share premium £m	Retained earnings £m
At 1 January 2018	549	838
Loss for the period	–	(205)
Share issuance	804	–
At 30 June 2018	1,353	633

	Share premium £m	Retained earnings £m
At 1 January 2017	549	931
Profit for the period	–	91
At 30 June 2017	549	1,022

	Share premium £m	Retained earnings £m
At 1 January 2017	549	931
Profit for the period	–	277
Dividends paid	–	(370)
At 31 December 2017	549	838

Note 16 – Capital management

RLP's capital resources are of critical importance. The Company's objectives in managing its capital are:

- to maintain financial strength in adverse conditions;
- to give customers long-term confidence in the Company;
- 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; and
- to retain financial flexibility by maintaining strong liquidity.

From 1 January 2016, the Company was required to operate under the new Solvency II regime. The Company had sufficient capital available to meet its regulatory capital requirements at all times during the period ended 30 June 2018.

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

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

Note 16 – Capital management continued

Capital in excess of that required to meet the technical provisions is known as Own Funds. As at 30 June 2018, Own Funds for RLP are £4,158m (HY2017: £2,709m and FY2017: £2,844m) made up as follows:

	HY2018 £m	HY2017 £m	FY2017 £m
Total IFRS equity	2,396	1,835	1,651
Assumed payment to RHUK	–	(262)	–
Liability valuation differences and other adjustments	1,100	775	529
Total tier 1	3,496	2,348	2,180
Solvency II debt valuation	662	361	664
Total tier 2	662	361	664
Own Funds	4,158	2,709	2,844

RLP holds both debt and equity to optimise its capital structure and improve shareholder return. During 2018, £950m of equity was issued by the Company. During the prior year, the Company issued £300m of tier 2 debt.

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. RLP seeks to mitigate these risks 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 redeployment of assets as appropriate.

Note 17 – Related parties disclosures

Ultimate holding company

At the balance sheet date, the immediate and ultimate parent company was RHUK, which is incorporated in the United Kingdom. Company financial statements are prepared for RHUK, copies of which can be obtained from the Company Secretary, Level 25, The Leadenhall Building, 122 Leadenhall Street, London, EC3V 4AB.

Related party transactions

Prior to the acquisition of Goldman Sachs' shareholding by MassMutual, Blackstone and GIC the Company entered into various transactions with fellow former participating interests all within the Goldman Sachs Group, including Goldman Sachs International, Goldman Sachs and Co, the Goldman Sachs Group Inc., Goldman Sachs Asset Management International, and Rothesay Life (Cayman) Limited.

Notes to the financial statements continued

Note 17 – Related parties disclosures continued

Details of such transactions are as follows. Closing balances in respect of these transactions are only shown for 30 June 2017.

	HY2018 £m	HY2017 £m	FY2017 £m
Statement of comprehensive income			
Realised/unrealised gains/(losses) on financial assets and liabilities	–	216	(131)
Income from money market securities held in collective investment schemes	–	1	1
Interest on collateralised agreements and financing	–	15	34
Service fee charges	–	(3)	(11)
Investment management charges	–	–	(7)
Statement of financial position			
Derivative financial assets and liabilities	–	(1,841)	–
Collateralised agreements and financing	–	924	–
Collective investments schemes	–	1,033	–
Accrued interest	–	8	–
Amounts payable to related party	–	(626)	–
Capital			
Ultimate parent company	–	264	–

The notional value of derivatives contracts outstanding with related parties as at 30 June 2018 was £nil (HY2017: £42,652m and FY2017: £nil).

RLP entered into various transactions with fellow participating interests which are subject to common control from the same source. The table below includes a transaction with an affiliate that became a related party as a result of the recapitalisation in December 2017. The affiliate was not a related party at 30 June 2017 and therefore transactions and balances have not been included at that date.

	HY2018 £m	FY2017 £m
Statement of comprehensive income		
Change in the reinsurers' share of insurance contract liabilities and reinsurance recoveries	(2)	(1)
Finance costs	(12)	(10)
Operating expenses	(1)	–
Statement of financial position		
Reinsurance liabilities	3	1
Borrowings	398	398

Transactions with key management personnel

Key management personnel comprise the Directors of the Company, Directors of subsidiary undertakings and certain members of senior management.

Note 17 – Related parties disclosures continued

There are no material transactions between RLP and its key management personnel other than transactions discussed below.

	HY2018 £m	HY2017 £m	FY2017 £m
Salaries, bonus and other employee benefits	2	2	15
Equity based compensation payments	1	1	2
Total transactions	3	3	17

The table below represents transactions between RLP and its subsidiary Rothesay Assurance Limited (RAL), its parent RHUK and other group companies Rothesay Pensions Management Limited (RPML) and Rothesay Asset Management US LLC.

Transactions with RPML	HY2018 £m	HY2017 £m	FY2017 £m
Statement of comprehensive income			
Cost transfer	(40)	(24)	(55)
Statement of financial position			
Other payables	36	18	33

Transactions with RAL	HY2018 £m	HY2017 £m	FY2017 £m
Statement of financial position			
Investment in subsidiary undertaking	–	2	–

Transactions with RHUK	HY2018 £m	HY2017 £m	FY2017 £m
Statement of comprehensive income			
Interest income	–	1	4
Cost transfer	2	–	3
Statement of financial position			
Other receivables	5	272	3
Capital	1,763	814	815
Dividends	–	–	370

Transactions with Rothesay Asset Management US LLC	HY2018 £m	HY2017 £m	FY2017 £m
Statement of comprehensive income			
Transaction fee	(2)	–	–
Statement of financial position			
Other payables	2	–	–

Notes to the financial statements continued

Note 18 – Investment in subsidiaries

The subsidiaries of RLP are listed in the following table:

Subsidiary undertakings	Country of incorporation	Primary business operation	HY2018 £m	HY2017 £m	FY2017 £m	HY2018 % equity interest	HY2017 % equity interest	FY2017 % equity interest
Rothesay Assurance Limited (RAL)	UK	Dormant Company	–	2	–	100%	100%	100%
LT Mortgage Financing Limited (LTMF)	UK	Dormant Company	–	–	–	100%	100%	100%

Subsidiaries are held at 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 subsidiary undertakings is Level 25, The Leadenhall Building, 122 Leadenhall Street, London, EC3V 4AB.

LT Mortgage Financing has remained dormant during 2018.

On 3 October 2016, the Prudential Regulation Authority (PRA) granted an application to cancel the permissions of Rothesay Assurance Limited (RAL). As it is now no longer needed the Company has begun proceedings to voluntarily liquidate RAL.

Note 19 – Financial commitments and contingencies

Operating lease commitments

Operating lease rentals commitments arise where a company is the lessee in respect of non-cancellable operating lease agreements. Payments made under operating leases (net of any incentives received from the lessor) are charged to the profit and loss on a straight line basis over the period of the lease.

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

	HY2018 £m	HY2017 £m	FY2017 £m
Not later than one year	2	2	2
Later than one year and no later than five years	10	9	8
Later than five years	2	3	4
Total minimum lease payments	14	14	14

Note 19 – Financial commitments and contingencies continued

Other commitments

RLP has executed a number of transactions to purchase partly funded bonds. As a result of these transactions RLP expects to pay a further £261m within the next five years (HY2017: £210m and FY2017: £153m), £82m of this being due within 12 months of the financial reporting date (HY2017: £74m and FY2017: £46m).

	HY2018 £m	HY2017 £m	FY2017 £m
Not later than one year	82	74	46
Later than one year and no later than five years	179	136	107
Later than five years	–	–	–
Total other commitments	261	210	153

Note 20 – Post balance sheet events

On 5 September RLP issued £350m of Restricted Tier 1 bonds with a fixed 6.875% coupon payable semi-annually in arrears. The notes were issued through the public debt markets. The proceeds will be paid from RLP to RHUK as a dividend in order to partially repay the bank debt held at RHUK.

Glossary of terms

Acquisition costs	Acquisition costs comprise the expenses associated with the origination of new business, including incentive payments made to employees.
Administration expenses	Administration costs represent the cost of administering the in-force book of business.
Annuity	A series of regular payments made to an individual until their death. Payments may be indexed.
Assets under management	Assets being managed by the Company. Can be derived by taking total assets and adjusting for reinsurance assets, payables, derivative liabilities and collateralised liabilities.
Assumed reinsurance premiums	Premiums received by RLP in respect of reinsurance inwards, i.e. a policy where RLP is acting as the reinsurer.
Best estimate liability (BEL)	The liabilities of the Company calculated on a best estimate basis, under Solvency II, i.e. where all the assumptions made in the calculation are best estimate.
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.
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.
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.
Demographics	Statistical data relating to the population and particular groups within it.
Equity release mortgages	Mortgages extended to older customers (aged 55 and over) against their residential property at low loan to value percentage. Unlike a typical residential mortgage, no interest is paid monthly by the customer. Instead, the interest is simply added to the principal loan amount with the loan only repayable on death or entry into long-term care of the last remaining homeowner.

Fair value	Amount that would be received on sale of an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.
Finance costs	Represent interest payable on borrowings.
Government, sub sovereign and agency obligations	A bond issued by a country's government or corporate debt which is guaranteed by a government to repay borrowed money at a specific time.
Gross premiums written	Premiums received by RLP on new business and generated through regular premiums.
In force	An insurance policy or contract reflected on records that has not expired, matured or otherwise been surrendered or terminated.
Infrastructure	Investments in infrastructure such as water, energy and transportation.
International Financial Reporting Standards (IFRS)	Accounting standards that are applied in preparing the Company's financial statements.
Investment return	Comprises all interest income on financial investments at fair value through profit and loss, realised investment gains and losses and movements in unrealised gains and losses, as well as expenses directly related to investments executed during the year.
Liquidity premium	An addition to the risk-free rate used when projecting investment returns and discounting cash flows on certain types of contracts where the liabilities are illiquid and have cash flows that are predictable.
Longevity risk	The risk that a company could be exposed to a higher pay out as a result of increasing life expectancy.
LTMF	LT Mortgage Financing Limited. Currently dormant.
Management of in-force book	Profits or losses generated on the in-force book of business.
Matching adjustment	The matching adjustment is broadly equivalent to the illiquidity premium that can be earned on the illiquid assets held to back illiquid liabilities.
Mortality tables	A table which shows for each age, what the probability is that a person of that age and gender will die before his or her next birthday.
Net premiums	Life insurance premiums, net of reinsurance premiums paid to third-party reinsurers.

Glossary of terms continued

New business	New insurance contracts and reinsurance inwards sold during the period. Includes business acquired through purchase of companies.
New business premium	Premium paid on new business transacted during the period and (from 2018 onwards) adjustments to new business premiums from prior periods.
Own Funds	Available capital under the Solvency II regime.
Part VII transfers	Court-approved transfer of a portfolio of contracts from one entity to another.
Pillar I	Under Solvency II, represents the solvency capital requirement calculated using a standard formula, or (partial) internal model.
Prudential Regulation Authority (PRA)	The PRA is a UK regulatory body responsible for prudential regulation and supervision of banks, building societies, credit unions, insurers and major investment firms.
qx	qx is actuarial notation used to represent the probability of a life aged x dying during the year.
RAL	Rothesay Assurance Limited.
Regular premiums	Payments of premium made regularly over the duration of the policy.
Reinsurance	Protection sold to or purchased from another insurance company.
RHUK	Rothesay Holdco UK Limited.
Risk margin	Under Solvency II, the cost of transferring non-hedgeable risks.
RLP	Rothesay Life Plc.
RPML	Rothesay Pensions Management Limited, the Group's service company.

Single premiums	Single premium policies of insurance are those that require only a single lump sum payment from the policyholder.
SCR coverage ratio	Own Funds divided by SCR. Measure of surplus above capital requirement.
Solvency capital requirement (SCR)	Under Solvency II, capital requirement to withstand a 1-in-200 year event.
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 our own economic capital models Solvency II Pillar 2.
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.
Third party administration (TPA) agreements	Contract with pensions administrator to process claims and payroll on behalf of RLP.
Yield	A measure of the income received from an investment compared to the price paid for the investment. Normally expressed as a percentage.

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Rothesay Life Plc,
Level 25, The Leadenhall Building,
122 Leadenhall Street, London,
EC3V 4AB

www.rothesaylife.com

T: 020 7770 5300