Rothesay Holdco UK Limited

Interim Consolidated Financial Statements

For the six months ended 30 June 2016

Risk Management | Investment | Innovation | Excellence

Rothesay life

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STRATEGIC REPORT

The Directors present their Interim Condensed Consolidated Financial Statements for Rothesay Holdco UK Limited, registered number 08668809, (the 'Company' or 'RHUK') for the six-month period ended 30 June 2016. Comparative information has been presented for the six-month period ended 30 June 2015 and the year ended 31 December 2015. All information (unless otherwise specified) has been provided on a consolidated basis for the whole Rothesay Life Group (the 'Group').

PRINCIPAL ACTIVITIES

The Group provides bulk annuity and other bespoke pension insurance solutions tailored to meet the specific needs of our clients which include defined benefit pension plans and individual annuity providers. The Group is authorised to write long-term insurance business by the Prudential Regulation Authority (the 'PRA') and is regulated by the PRA and the Financial Conduct Authority (the 'FCA'). RHUK is the ultimate holding company of the Group.

FINANCIAL HIGHLIGHTS (FIRST HALF OF 2016)

- **New business volume:** The Group successfully completed the reinsurance of a £6.4bn block of in-force individual annuities business from Aegon N.V. (the 'Aegon Transaction') This represents the single largest transaction executed by the Group and increased the number of lives insured by 187,013. (New business volume period ended 30 June 2015: £1.8bn).
- **IFRS pre-tax profit:** The Group generated interim IFRS pre-tax profits of £100m (period ended 30 June 2015: £175m), driven mainly through a combination of continued new business volumes and continued robust management of our risk and capital positions on the in-force business despite significant market volatility experienced over the period, particularly around the referendum held in the United Kingdom regarding the potential exit from the European Union ("EU Referendum").
- **Operating profit before tax:** The Group's first half operating profit was £125m (period ended 30 June 2015: £186m). This profit was generated despite the impact of being overweight in gilts and cash at 30 June 2016 due to the Aegon Transaction.
- **Assets under management:** The Group's assets under management increased to £23.9bn, up 55% from £15.4bn at the end of 2015. This was driven primarily by the Aegon Transaction and interest rate movements. The Group retains a significant proportion of undeployed gilts and cash which will enhance returns and profitability once they have been invested in suitable assets.
- **Capital position:** The capital position of the Group and its insurance company subsidiary, Rothesay Life Plc ("RLP") remains robust under both Solvency II and economic capital. As at 30 June 2016, RLP had SCR coverage of 162%[1] (1 January 2016: 158%) and economic capital coverage of 378% (31 December 2015: 191%). The Board of Directors are satisfied that the Group has successfully navigated the turmoil caused by the EU Referendum and remain confident of maintaining a strong solvency position heading into the second half of the year.
- **Market Consistent Embedded Value ("MCEV"):** The Group's MCEV has increased by 42% to £2,055m (YE2015: £1,445m), driven largely by the Aegon Transaction and additional new equity of £200m.

1 After allowing for the impact of recalculation of transitional capital relief and removing excess hedges (see page 7 capital and solvency management).

REVIEW OF THE BUSINESS

Background

The Group manages the risks associated with its in-force portfolio of annuities 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.

The primary risks transferred to the Group through wholesale annuity contracts are longevity risk, interest rate risk, inflation risk and investment risk. The Group adopts a conservative approach to managing each of these risks:

- Hedging substantially all interest rate and inflation risk with collateralised swaps.
- Entering into longevity reinsurance contracts to mitigate life expectancy risk and offer future cash flow certainty.
- Locking in returns in long-dated liability matching investments by investing in low-risk assets which benefit from security, seniority and/or structural protection.

Residual risks and capital position are reported and monitored daily using a sophisticated and fully integrated risk management system, which allows the Group to manage the financial exposures dynamically in changing market conditions. This has proved invaluable to the Group during the macroeconomic turmoil observed during the period immediately following the EU Referendum. By reducing the risk inherent in the in-force portfolio, the Group is able to protect its surplus capital, ensure policyholders have certainty and deploy excess resources to acquire new business where it meets our strict underwriting criteria. New business is accretive to shareholder returns and helps the business achieve economies of scale. We have considered the risk of Brexit detailed on page 10. All other principal risks remain unchanged from the year ended 31 December 2015.

New Business

New business opportunities during the first half of 2016 have been relatively muted due to the political uncertainties and economic volatility around the EU Referendum. Interest rates in particular have been near a historical low which has resulted in most pension schemes experiencing worsening funding deficits. This may have reduced affordability of full buy-outs for some pension schemes.

Against this backdrop, the Group has been able to capitalise on its ability to acquire annuities via three different routes – defined benefit bulk annuities, strategic acquisitions and reinsurance transactions. The Aegon Transaction is an example of this flexibility and demonstrates our ability to underwrite new business even in challenging market conditions. The Aegon Transaction involved underwriting a £6.4bn portfolio, more than two-thirds of Aegon's in-force annuities. This is initially a reinsurance transaction with Aegon N.V. which will be followed by a Part VII transfer of all relevant assets and liabilities from Aegon N.V. to RLP, including the longevity reinsurance agreements that Aegon already has in place to cover the annuity portfolio. The transfer process is expected to complete in 2017. The Aegon Transaction represents our single largest transaction in any form.

REVIEW OF THE BUSINESS CONTINUED

Investment

During the first half of 2016, the Group has been active in reinvesting some of the premiums received from new business into low-risk, highly-secure asset opportunities consistent with the business model and risk management philosophy of the Group.

The Group continues to pursue innovative transactions that demonstrate the Group's ability to diversify our investment base whilst preserving the core principle of achieving high security from assets whilst generating attractive returns. The run-up to the EU Referendum saw a period of significant market volatility, and the uncertainty from the aftermath is expected to last an extended period of time. However, the Group retains a significant amount of liquid assets and remains in a strong position to deploy those into attractive opportunities.

FINANCIAL REVIEW

Performance in the first half of the year was dominated by the Aegon Transaction.

In the period to 30 June 2016, the Group achieved an operating profit before tax (measure of profitability, capturing new business profit, in-force profit and assumption changes, but excluding market fluctuations, financing costs and exceptional expenses) of £125m (HY2015: £186m) and a profit before tax of £100m (HY2015: £175m). The Group focuses on profit before tax as our primary measure of profitability because this metric includes recurring and non-recurring items as well as market fluctuations and has a direct impact on distributable reserves and capital.

New business premiums for the half year, mainly as a result of the Aegon Transaction, were £6.4bn (HY2015: £1.8bn) leading to new business profits of £410m (HY2015: £88m).

Losses of £242m (HY2015: profit of £123m) from the management of the in-force book arose from being overweight in gilts and cash during the half year as the premiums received in the Aegon Transaction have yet to be fully deployed. The Group will generate profits on these assets as it invests them according to our long-term investment strategy.

IFRS Financial Performance

	H1 2016 £m	H1 2015 £m	FY 2015 £m
New business operating profit	410	88	174
Management of in-force book	(242)	123	259
Acquisition costs	(37)	(25)	(52)
Administration expenses	(6)	(6)	(14)
Experience variance	(1)	2	10
Other	1	4	7
Operating profit before tax	125	186	384
Financing costs	(15)	(7)	(16)
Non-recurring and project expenditure	(14)	(4)	(15)
Investment and economic profits	4	–	(6)
Profit before tax	**100**	**175**	**347**

As discussed below under Capital and Solvency Management, immediately post the EU Referendum, the Group moved towards hedging the solvency balance sheet rather than the IFRS balance sheet. Whilst the relatively small below-the-line increase in profit of £4m (HY2015: £nil) as a result of investment and economic profits demonstrates the effectiveness of the Group's risk management over the period to the EU Referendum the result conceals the gain from interest rate movements immediately following the EU Referendum as this was partially offset by credit losses in the same period.

FINANCIAL REVIEW CONTINUED

Total assets increased from £25.5bn as at 31 December 2015 to £44.0bn as at 30 June 2016 as a result of the Aegon Transaction and the fall in interest rates. Assets under management increased from £15.4bn as at 31 December 2015 to £23.9bn as at 30 June 2016. These numbers can be derived from the Consolidated Statement of Financial Position by adjusting for reinsurance, derivatives and collateralised financing as shown in the table below.

Balance Sheet Highlights

	30 Jun 2016 £m	31 Dec 2015 £m
Financial investments	42,023	24,592
Reinsurance assets	525	274
Other assets	1,454	646
Total assets	**44,002**	**25,512**
Share capital and share premium	448	268
Capital contribution reserve	6	5
Retained earnings	849	769
Total equity	**1,303**	**1,042**
Insurance contract liabilities	22,487	14,207
Payables	19,557	9,884
Borrowings	587	349
Other	68	30
Total liabilities	**42,699**	**24,470**
Total equity and liabilities	**44,002**	**25,512**

Assets Under Management

	30 Jun 2016 £m	31 Dec 2015 £m
Total assets	44,002	25,512
Less reinsurance assets	(525)	(274)
Less payables and financial liabilities	(19,557)	(9,884)
Assets under management	**23,920**	**15,354**

In order to maintain financial strength in anticipation of the Aegon Transaction, the Group raised £200m of new equity capital from its existing shareholders. This led to an increase in share capital (including the Employee Benefit Trust) and share premium from £268m as at 31 December 2015 to £448m as at 30 June 2016. The Group also borrowed £240m from a syndicate of banks increasing borrowings from £349m as at 31 December 2015 to £587m as at 30 June 2016. £430m of the funds raised were subsequently injected into RLP as equity.

Insurance contract liabilities increased from £14.2bn as at 31 December 2015 to £22.5bn as at 30 June 2016 as a result of the Aegon Transaction and the fall in interest rates.

MCEV has increased by 42% from £1,445m at 31 December 2015 to £2,055m at 30 June 2016. This is summarised in the table below. Adjustments allow for Group borrowings and other Group adjustments.

The half year MCEV allows for the changes required as a result of Solvency II (£36m reduction, see page 41). Net assets include the impact of the additional £200m of equity during the half year (HY2015: £nil).

MCEV (£m)

The value on an MCEV basis of new business written in the first half of 2016 was £322m (HY2015: £91m).

	30 Jun 2016 £m	31 Dec 2015 £m
Net assets	1,906	1,370
Value of in-force	752	435
Less Group adjustments	(603)	(360)
MCEV	**2,055**	**1,445**

Capital and Solvency Management

Under the new solvency regime (Solvency II), the Group is required to hold the greater of the capital required under the new Solvency II Pillar 1 framework and the capital required under our own economic capital models, Solvency II Pillar 2. As expected, the capital required for Rothesay Life under Pillar 1 exceeds that required under our own economic capital models, consistent with our position under the previous solvency regime. Whereas under the previous solvency regime, the solvency and IFRS balance sheets were closely aligned, under the new regime, the solvency balance sheet is far more sensitive to interest rates and inflation than the IFRS balance sheet.

The Group also ensures that its insurance company subsidiary, RLP, is capitalised to the greater of the economic capital requirement (which is consistent with the individual capital assessment but using a lower probability of default) and the regulatory Pillar 1 position. In practice, it is the Pillar 1 requirement which is more onerous and the Group aims to maintain at least 130% of the regulatory minimum requirement in RLP.

The Group has implemented a solvency management framework which targets stability of the IFRS balance sheet under normal conditions and progressively shifts towards managing the stability of the solvency balance sheet under more stressed conditions. For this reason, in the immediate aftermath of the EU Referendum, the Group moved towards hedging the solvency balance sheet. This involved the use of additional interest rate hedges and deliberate exposure to the US Dollar as a macro-economic hedge. Given the market volatility and continuing uncertainty, these hedges remained in place as at 30 June 2016. Following the appointment of a new UK Prime Minister on 14 July 2016 the currency hedges were unwound removing the exposure to a strengthening of Sterling against the US Dollar. Until economic conditions stabilise and the Group removes the additional interest rate hedges, the IFRS balance sheet will be exposed to an increase in interest rates.

FINANCIAL REVIEW CONTINUED

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

- The Group's technical provisions being:
  - the liabilities of the Group calculated on a best estimate basis (the 'BEL'); plus
  - the cost of transferring non-hedgeable risks (known as 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').

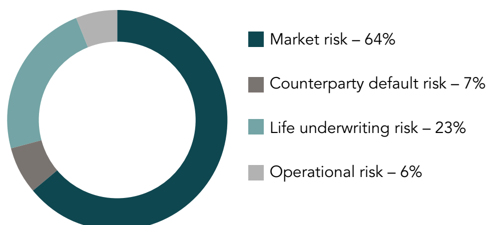
Capital in excess of that required to meet the technical provisions is known as Own Funds.

Insurers have the option of calculating the SCR either using the prescribed basis (the 'standard formula') or applying to use their own internal model. The Group is in the process of applying to use its own model for calculating the SCR in relation to credit and counterparty risk but intends using the standard formula for all other risks (a 'partial internal model'). The Group is applying to use a partial internal model to ensure that the allocation of capital to investment is consistent with the low risk inherent in the types of highly secured and collateralised investments which are core to the Group's investment strategy.

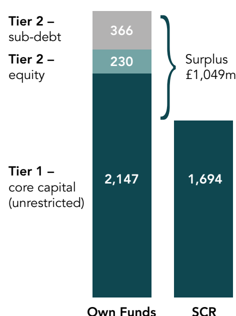
As at 30 June 2016, the Group's SCR calculated using the standard formula was £1,694m (1 January 2016: £1,203m) after allowing for the impact of removing interest rate and currency hedges in excess of those required to match the BEL[1]. The diagram below provides a breakdown of the SCR pre-diversification benefit between modules. Life underwriting relates mainly to longevity risk. Market risk is primarily spread risk, i.e. the risk that credit spreads widen.

Approval of the Group's partial internal model is not expected until 2017 and is unlikely to significantly change the SCR but will ensure that the Group's capital position evolves appropriately under Solvency II as the Group makes new investments.

RLP SCR 30 June 2016



Own Funds in RLP by Capital Tier at 30 June 2016 (£m)



1 The impact of removing the excess hedges is a 2.3% reduction in SCR.

As part of the transitional arrangements in relation to the introduction of Solvency II, the Group is permitted to take credit for transitional solvency relief in relation to business that was written prior to the introduction of Solvency II which amortises to zero over the next 16 years. Recalculating the transitional solvency relief as at 30 June 2016, results in an increase in the amount of solvency relief to reflect the change in economic conditions over the half year and to allow for the additional liabilities taken on as a result of the reinsurance agreement with Aegon (since the Aegon policies were written prior to the introduction of Solvency II).

After allowing for the recalculation of transitionals, the total available Pillar 1 capital surplus (Own Funds) for RLP on 30 June 2016 is £2,743m (1 January 2016: £1,904m) giving a coverage ratio of 162% (1 January 2016: 158%). The solvency position and breakdown of Own Funds for RLP is shown in the diagram opposite.

In order to ensure that RLP remained appropriately capitalised following the reinsurance transaction with Aegon, RHUK borrowed £240m from a syndicate of banks, and issued a further £200m of equity to existing shareholders, £430m of which was injected into RLP as equity. The £240m debt does not contribute towards the Group's Own Funds and the associated equity is treated as Tier 2 capital in RLP. On 30 June 2016, the Group's Own Funds amounted to £2,486m (1 January 2016: £1,902m) giving a coverage ratio of 147% (1 January 2016: 158%).

As noted above, the transitional solvency relief amortises over 16 years. Over the same period, the risk margin associated with business in-force on 31 December 2015 is also projected to reduce. Projections show that the amortisation of the transitional solvency relief will be met from the reduction in the risk margin and the release of the associated Solvency II capital requirement over the same period.

Even without transitional solvency relief, the Group would be able to cover its Solvency II capital requirements.

Where applicable, new business is being priced to allow for the capital requirements under the Solvency II regime.

Matching Adjustment

For most insurance business, the BEL must be discounted using a prescribed risk-free discount rate. However firms with illiquid liabilities such as annuity business can apply to discount these illiquid liabilities using the risk-free rate plus what is known as the 'matching adjustment'. The matching adjustment is broadly equivalent to the liquidity premium that can be earned on the illiquid assets held to back illiquid liabilities.

Rothesay Life has approval from the PRA to use the matching adjustment and credit has been taken for the matching adjustment in the BEL numbers shown above. From 1 January 2016, RLP is operating two separate funds – a matching adjustment fund and a non-matching adjustment fund. The matching adjustment fund holds almost all of the single premium insurance business and sufficient qualifying assets to meet the associated BEL and risk margin. Regular premium business, the remaining single premium business and all the remaining assets are held in the non-matching adjustment fund.

BUSINESS OUTLOOK

Given that the in-force portfolio is overweight in gilts and cash following the Aegon Transaction, the second half of 2016 will be focused on deploying these assets into assets consistent with the Group's long-term investment strategy. The Group expects to generate profits upon the deployment of these assets. Following the outcome of the EU Referendum, the Group expects a prolonged period of uncertainty and increased market volatility. However, the Board expect markets post the EU Referendum to provide additional opportunities to source appropriate investments.

Rothesay's capital position has been resilient to market stress and the Group's solvency coverage ratio post-referendum is only a few percentage points lower than before the referendum. Management will continue to actively manage the Group's IFRS and Solvency II positions in line with the Group's risk management strategy. Despite this economic backdrop, our pipeline for pension buy-ins and buy-outs in the medium term remains strong, comprising many larger prospective transactions.

The Group will continue to target new business opportunities from defined benefit pension schemes, insurance companies with annuity portfolios and through acquisition, and the Group will continue to apply its strict business selection criteria to underwriting to ensure that we meet or exceed target return metrics. Flexibility to transact across structures and sources, combined with risk management will enable the Group to be competitive and take advantage of particular market opportunities that may arise. The Group chooses to write both small and large transactions depending on where the economics offer the most attractive returns. The Group's management team expects the reinsurance followed by Part VII transfer of annuity portfolios to become more prevalent over the next few years as larger, composite insurance groups look to release encumbered capital from legacy, non-core business units to redeploy in higher growth areas. Rothesay Life, as an annuity specialist, believes it can manage such liabilities with greater capital and operational efficiency. However, the Group does not expect to write significant volumes of additional new business in the second half of 2016.

The Group is based in the UK and conducts its business in the UK. As such, the Group considers that the vote to leave the EU will have no material operational impact on the Group. As such, the Group considers that the vote to leave the EU is unlikely to have a material operational impact on the Group. Until then, the Group will continue to operate under the Solvency II capital regime and other EU regulations.

DIRECTORS' RESPONSIBILITIES STATEMENT

The Directors of the Group confirm that these Condensed Consolidated Financial Statements have been prepared in accordance with International Accounting Standard 34, 'Interim Financial Reporting' as adopted by the European Union ('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.

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		
R D A. Berliand		
M T Corbett		
R A De Beir Jarratt		
G Earle		
N Kheraj		
R King		
A Loudiadis		
D McDonogh		
V Nagarajan		20 May 2016
T Pearce		
C D Pickup		
C Pike		20 May 2016
W J Robertson	1 January 2016	
K Satchell		30 March 2016
M S Sherwood		20 May 2016
A M Stoker		

On behalf of the Board

Addy Loudiadis
Chief Executive Officer
21 September 2016

CONDENSED CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

FOR THE PERIOD ENDED 30 JUNE 2016

	Note	Period ended 30 Jun 2016 £m	Period ended 30 Jun 2015 £m	Year ended 31 Dec 2015 £m
Income				
Gross premiums written	2	6,638	1,868	3,764
Premiums ceded to reinsurers		(317)	(252)	(562)
Net premiums written		**6,321**	**1,616**	**3,202**
Investment return	3	2,233	(132)	(115)
Total revenue		**8,554**	**1,484**	**3,087**
Expenses				
Claims and change in insurance liabilities	4	(8,851)	(1,500)	(3,199)
Reinsurance recoveries	4	469	233	557
Net claims and change in insurance liabilities		**(8,382)**	**(1,267)**	**(2,642)**
Operating expenses	5	(57)	(35)	(81)
Finance costs	6	(15)	(7)	(17)
Total operating expenses		**(72)**	**(42)**	**(98)**
profit before tax		**100**	**175**	**347**
Income tax expense	7	(20)	(36)	(71)
Profit for the period/year		**80**	**139**	**276**

All income and expenses relate to continuing operations.

The Consolidated Statement of Comprehensive Income includes all income and expenses for the period. RHUK has no items required to be reported in other comprehensive income. Therefore a separate comprehensive income statement has not been presented.

Notes 1–21 form an integral part of these Financial Statements.

CONDENSED CONSOLIDATED STATEMENT OF FINANCIAL POSITION

AS AT 30 JUNE 2016

	Note	Period ended 30 Jun 2016 £m	Period ended 30 Jun 2015 £m	Year ended 31 Dec 2015 £m
Assets				
Property, plant and equipment	9	2	2	2
Financial investments	10	42,023	21,784	24,592
Reinsurance assets	12	525	285	274
Accrued interest and prepayments		232	90	165
Receivables		1,015	188	381
Cash and cash equivalents		205	119	98
Total assets		**44,002**	**22,468**	**25,512**
Equity and liabilities				
Share capital	16	2	2	2
Employee Benefit Trust	16	(20)	–	–
Share premium	17	466	266	266
Capital contribution reserve	17	6	7	5
Other reserves	17	849	628	769
Total equity		**1,303**	**903**	**1,042**
Liabilities				
Insurance contract liabilities	13	22,487	13,213	14,207
Payables and financial liabilities	14	19,557	8,091	9,884
Borrowings	15	587	225	349
Deferred tax liabilities	11	3	3	3
Accruals and deferred income		65	33	27
Total equity and liabilities		**44,002**	**22,468**	**25,512**

Notes 1–21 form an integral part of these Financial Statements.

The Financial Statements were approved by the Board of Directors on 21 September 2016 and signed on its behalf by:

Addy Loudiadis
Chief Executive Officer
21 September 2016
Company number 08668809

CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

FOR THE PERIOD ENDED 30 JUNE 2016

	Share capital £m	Share premium £m	Employee Benefit Trust £m	Capital contribution reserve £m	Other reserves £m	Total equity £m
As at 1 January 2016	2	266	–	5	769	1,042
Profit for the period	–	–	–	–	80	80
Share issuance	–	200	–	–	–	200
Employee Benefit Trust	–	–	(20)	–	–	(20)
Capital contribution	–	–	–	1	–	1
As at 30 June 2016	**2**	**466**	**(20)**	**6**	**849**	**1,303**

FOR THE PERIOD ENDED 30 JUNE 2015

	Share capital £m	Share premium £m	Capital contribution reserve £m	Other reserves £m	Total equity £m
As at 1 January 2015	2	266	5	489	762
Profit for the period	–	–	–	139	139
Capital contribution	–	–	2	–	2
As at 30 June 2015	**2**	**266**	**7**	**628**	**903**

FOR THE PERIOD ENDED 31 DECEMBER 2015

	Share capital £m	Share premium £m	Capital contribution reserve £m	Other reserves £m	Total equity £m
As at 1 January 2015	2	266	5	489	762
Profit for the year	–	–	–	276	276
Vesting of stock appreciation plan	–	–	(4)	4	–
Capital contribution	–	–	4	–	4
As at 31 December 2015	**2**	**266**	**5**	**769**	**1,042**

CONDENSED CONSOLIDATED CASH FLOW STATEMENT
FOR THE PERIOD ENDED 30 JUNE 2015

	Period ended 30 Jun 2016 £m	Period ended 30 Jun 2015 £m	Year ended 31 Dec 2015 £m
Cash flows from operating activities			
Profit for the period	80	139	276
Adjustments for non-cash movements in net profit for the period			
Share-based payments	2	2	4
Interest income	(208)	(177)	(351)
Interest expense	15	7	17
Depreciation	–	–	–
Tax expense	20	36	71
Net increase/(decrease) in operational assets			
Financial investments	(17,431)	(795)	(3,602)
Reinsurance asset	(251)	3	15
Receivable	(634)	172	(22)
Net increase/(decrease) in operational liabilities			
Insurance contracts liabilities	8,280	1,107	2,102
Other payables	917	(406)	(106)
Financial liabilities	8,788	(247)	1,230
Accruals	9	–	(11)
Cash used in operations	**(413)**	**(159)**	**(377)**
Interest paid	(11)	(7)	(11)
Interest received	145	221	318
Tax paid	(52)	(47)	(66)
Net cash flows from operating activities	(331)	8	(136)
Cash flows from financing activities			
Repayment of borrowings	–	–	(125)
Proceeds from issue of Ordinary Share capital	200	–	–
Proceeds from issuance of debt	238	–	248
Net cash inflows from financing activities	**438**	**–**	**123**
Cash flows from investing activities			
Net acquisition of plant, equipment and intangibles	–	(1)	(1)
Net cash outflows from investing activities	**–**	(1)	(1)
Net increase/(decrease) in cash and cash equivalents	107	7	(14)
Cash at bank and in hand at 1 January	98	112	112
Cash and cash equivalents at the Statement of Financial Position date	**205**	**119**	**98**

NOTES TO THE FINANCIAL STATEMENTS

Note 1 – Accounting Policies

(a) General Information

RHUK is the ultimate holding Company of the Rothesay group of companies. RHUK is a registered company incorporated in the UK. 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 Consolidated Interim Financial Statements for the six-month period ended 30 June 2016 have been prepared in accordance with IAS 34, 'Interim Financial Reporting', as adopted by the EU. The Condensed Consolidated Interim Financial Statements should be read in conjunction with the Annual Financial Statements for the year ended 31 December 2015, which has been prepared in accordance with IFRS as adopted by the EU.

The Consolidated Financial Statements of the Group are presented in Sterling (£) rounded to the nearest million (£m) except where otherwise stated.

The Group presents its Consolidated Statement of Financial Position broadly in order of liquidity.

Assets and liabilities are offset and the net amount reported in the Consolidated 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.

(c) Accounting Policies

The accounting policies adopted are consistent with those of the previous financial year. The Group has not adopted any new standards or made any changes to existing standards.

Note 2 – Segmental Analysis

All of the Group's business risks and returns are within one business segment (i.e. long-term insurance business). The Group's operations are materially within the UK. 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		
	Period ended 30 Jun 2016 £m	Period ended 30 Jun 2015 £m	Year ended 31 Dec 2015 £m	Period ended 30 Jun 2016 £m	Period ended 30 Jun 2015 £m	Year ended 31 Dec 2015 £m
Group pension bulk annuities	134	137	272	12	660	2,335
Assumed reinsurance premiums	–	–	–	6,492	1,071	1,157
Total gross premiums Written	**134**	**137**	**272**	**6,504**	**1,731**	**3,492**

Note 3 – Investment Return

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

	Period ended 30 Jun 2016 £m	Period ended 30 Jun 2015 £m	Year ended 31 Dec 2015 £m
Interest income on financial investments at fair value through profit and loss	208	177	351
Unrealised gains/(losses) on financial investments	2,009	(658)	(925)
Realised gains on financial investments	16	352	462
Investment expenses	–	(3)	(3)
Total investment return	**2,233**	**(132)**	**(115)**

The unrealised gains during the six-month period were due the impact of falling interest rates (which led to an offsetting increase in insurance liabilities).

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Note 4 – Net Claims and Change in Insurance Contract Liabilities

	Period ended 30 Jun 2016 £m	Period ended 30 Jun 2015 £m	Year ended 31 Dec 2015 £m
Claims paid			
Gross claims paid	(652)	(394)	(1,056)
Reinsurance recoveries	298	237	531
Change in the provision for claims outstanding	–	1	–
Total claims paid	**(354)**	**(156)**	**(525)**
Change in insurance contract liabilities			
Gross change in insurance contract liabilities	(8,199)	(1,107)	(2,143)
Reinsurance recoveries	171	(4)	26
Total change in insurance contract liabilities	**(8,028)**	**(1,111)**	**(2,117)**
Net claims and change in insurance contract liabilities	**(8,382)**	**(1,267)**	**(2,642)**

Note 5 – Operating Expenses

The note gives further details of items included in the operating expenses section of the Consolidated Statement of Comprehensive Income which have been included in arriving at the profit before tax:

	Period ended 30 Jun 2016 £m	Period ended 30 Jun 2015 £m	Year ended 31 Dec 2015 £m
Acquisition costs	37	25	52
Administration expenses – recurring	6	6	14
Administration expenses – projects and other one-off expenses	14	4	15
Total operating expenses	**57**	**35**	**81**

Note 6 – Finance Costs

	Period ended 30 Jun 2016 £m	Period ended 30 Jun 2015 £m	Year ended 31 Dec 2015 £m
Interest payable on collateral	2	2	4
Interest payable on third-party borrowings	11	5	8
Interest payable on borrowings from affiliates	2	–	5
Net finance costs	**15**	**7**	**17**

Note 7 – Taxation

The major components of income tax expense for the period ended 30 June 2016, 30 June 2015 and 31 December 2015 are:

(a) Tax Charged in the Income Statement

	Period ended 30 Jun 2016 £m	Period ended 30 Jun 2015 £m	Year ended 31 Dec 2015 £m
Current income tax:			
UK corporation tax	20	36	72
Total current income tax	**20**	**36**	**72**
Deferred tax:			
Origination and reversal of temporary differences	–	–	(1)
Total deferred tax	**–**	**–**	**(1)**
Total expense in the income statement	**20**	**36**	**71**

(b) Reconciliation of the Total Tax Charge

The tax expense in the Statement of Comprehensive Income for the half year and the standard rate of corporation tax in the UK of 20% (30 June 2015: 20.25 % and 31 December 2015: 20.25%) is reconciled below:

	Period ended 30 Jun 2016 £m	Period ended 30 Jun 2015 £m	Year ended 31 Dec 2015 £m
Profit before tax	100	175	347
Tax calculated at UK standard rate of corporation tax	20	35	70
Tax losses on which deferred tax asset recognised	–	1	1
Total tax expense reported in the Consolidated Statement of Comprehensive Income	**20**	**36**	**71**

Note 8 – Investment in Unconsolidated Structured Entities

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

As at 30 June 2016, our total interest in such entities, reflected on the Group's consolidated balance sheet and classified as financial investments held at fair value through profit or loss, was £3,317m (30 June 2015: £1,782m and 31 December 2015: £2,892m).

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Note 9 – Property, Plant and Equipment

	Computer equipment £m	Furniture and fittings £m	Total £m
Cost			
As at 1 January 2016	0.2	2.2	2.4
Additions	–	0.1	0.1
Disposals	–	–	–
As at 30 June 2016	**0.2**	**2.3**	**2.5**
Accumulated depreciation			
As at 1 January 2016	0.1	0.4	0.5
Charge for the half year	–	0.2	0.2
Disposals	–	–	–
As at 30 June 2016	**0.1**	**0.6**	**0.7**
Net book value			
As at 30 June 2016	**0.1**	**1.7**	**1.8**
As at 31 December 2015	0.1	1.8	1.9
As at 30 June 2015	0.2	1.9	2.1

Note 10 – Fair Value

Determination of Fair Value and Fair Values Hierarchy

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

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

Financial investments and liabilities measured using a valuation technique based on assumptions that are supported by prices from observable current market transactions are assets and liabilities for which pricing is obtained via pricing services, but where prices have not been determined in an active market, financial investments with fair values based on broker quotes and assets that are valued using the Group's own models whereby the majority of assumptions are market observable.

Note 10 – Fair Value continued

The following tables show an analysis of financial instruments recorded at fair value by level of the fair value hierarchy for 30 June 2016, 30 June 2015 and 31 December 2015:

30 Jun 2016	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Financial investments:				
Collective investment schemes	893	–	–	893
Government and agency obligations	6,418	4,358	–	10,776
Corporate debt	–	8,883	265	9,148
Derivative assets	–	15,298	–	15,298
Collateralised agreements and financing	–	3,364	2,380	5,744
Certificate of deposits	–	164	–	164
Total financial investments at fair value	**7,311**	**32,067**	**2,645**	**42,023**
Financial liabilities:				
Derivative financial instruments	–	15,706	–	15,706
Collateralised financing agreements	–	1,885	–	1,885
Total financial liabilities at fair value	**–**	**17,591**	**–**	**17,591**

30 Jun 2015	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Financial investments:				
Collective investment schemes	790	–	–	790
Government and agency obligations	2,802	2,845	–	5,647
Corporate debt	–	4,973	438	5,411
Derivative assets	–	5,738	2	5,740
Collateralised agreements and financing	–	4,085	–	4,085
Certificate of deposits	–	111	–	111
Total financial investments at fair value	**3,592**	**17,752**	**440**	**21,784**
Financial liabilities:				
Derivative financial instrument	–	5,381	12	5,393
Collateralised financing agreements	–	1,933	–	1,933
Total financial liabilities at fair value	**–**	**7,314**	**12**	**7,326**

NOTES TO THE FINANCIAL STATEMENTS CONTINUED

Note 10 – Fair Value continued

31 Dec 2015	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Financial investments:				
Collective investment schemes	470	–	–	470
Government and agency obligations	3,242	2,896	–	6,138
Corporate debt	–	5,610	182	5,792
Derivative assets	–	6,934	3	6,937
Collateralised agreements and financing	–	3,196	1,939	5,135
Certificate of deposits	–	120	–	120
Total financial investments at fair value	**3,712**	**18,756**	**2,124**	**24,592**
Financial liabilities:				
Derivative financial instruments	–	6,906	11	6,917
Collateralised financing agreements	–	1,886	–	1,886
Total financial liabilities at fair value	**–**	**8,792**	**11**	**8,803**

Approximately 6% (30 June 2015: 2% and 31 December 2015: 9%) 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. While such valuations are sensitive to estimates, it is believed that changing one or more of the assumptions to reasonably possible alternative assumptions would not change the fair value significantly.

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 debt £m	Collateralised agreements £m	Derivatives £m	Total £m
At 1 January 2016	**182**	**1,939**	**(8)**	**2,113**
Total gains in the Statement of Comprehensive Income:				
Unrealised gains	83	346	–	429
Realised gains	–	–	–	–
Transfer out of Level 3	–	–	8	8
Purchase	–	95	–	95
At 30 June 2016	**265**	**2,380**	**–**	**2,645**

Note 10 – Fair Value continued

	Corporate debt £m	Collateralised agreements £m	Derivatives £m	Total £m
At 1 January 2015	**248**	**–**	**(5)**	**243**
Total gains in the Statement of Comprehensive Income:				
Unrealised gains/(losses)	(11)	–	(5)	(16)
Realised gains	–	–	–	–
Transfer into Level 3	213	–	–	213
Transfer out of Level 3	–	–		–
Purchases/additions	(12)	–	–	(12)
At 30 June 2015	**438**	**–**	**(10)**	**428**

	Corporate debt £m	Collateralised agreements £m	Derivatives £m	Total £m
At 1 January 2015	**248**	**–**	**(5)**	**243**
Total gains in the Statement of Comprehensive Income:				
Unrealised gains/(losses)	2	–	(3)	(1)
Realised gains	1	–	–	1
Transfer into Level 3	–	456	–	456
Transfer out of Level 3	(137)	–		(137)
Purchases/additions	68	1,483	–	1,551
At 31 December 2015	**182**	**1,939**	**(8)**	**2,113**

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

During the period, the Group 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 (31 December 2015: £213.1m) and from Level 3 to Level 2 is £8m (full year 2015: £nil). The reason for the change is a change in the availability of observable market transactions for the same or similar instruments.

Note 11 – Deferred Taxation

Deferred tax balances comprise:

	Period ended 30 Jun 2016 £m	Period ended 30 Jun 2015 £m	Year ended 31 Dec 2015 £m
Temporary differences between the Financial Statements and the tax deductions	(3)	(3)	(3)
Total temporary differences	**(3)**	**(3)**	**(3)**

NOTES TO THE FINANCIAL STATEMENTS CONTINUED

Note 11 – Deferred Taxation continued

The movements in the deferred tax balances were as follows:

	Period ended 30 Jun 2016 £m	Period ended 30 Jun 2015 £m	Year ended 31 Dec 2015 £m
At 1 January	(3)	(3)	(3)
Capital allowances	–	–	–
At Statement of Financial Position date	(3)	(3)	(3)

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

The Group has unrecognised deferred tax assets in respect:

	Period ended 30 Jun 2016 £m	Period ended 30 Jun 2015 £m	Year ended 31 Dec 2015 £m
Timing differences in relation to equity-based compensation	3	2	3
Total timing differences	3	2	3

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

	Period ended 30 Jun 2016 £m	Period ended 30 Jun 2015 £m	Year ended 31 Dec 2015 £m
At 1 January	3	2	3
Temporary difference in relation to equity-based compensation	–	–	–
At Statement of Financial Position date	3	2	3

Further reductions to the UK corporation tax rate were announced in the March 2016 Budget. The changes propose to reduce the rates to 17% by 1 April 2020. The changes had not been substantively enacted at the balance sheet date and therefore, are not recognised in these Financial Statements. Had they been substantively enacted they would reduce the deferred tax asset at the 30 June 2016 by £0.07m.

Note 12 – Reinsurance Assets

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

	Period ended 30 Jun 2016 £m	Period ended 30 Jun 2015 £m	Year ended 31 Dec 2015 £m
Reinsurance of insurance contract liabilities	525	285	274
Total reinsurance of insurance contract liabilities	525	285	274

Note 12 – Reinsurance Assets continued

Under the outward reinsurance contracts, the Group has committed to pay fixed cash flows to the reinsurer for each policy covered. In exchange, the reinsurers will pay cash flows that are linked to the actual longevity of the underlying policies. The contracts are collateralised for changes in longevity expectations and movements in market rates.

An analysis of the movement in reinsurance of insurance contract liabilities is included in Note 13.

At 30 June 2016, 30 June 2015 and 31 December 2015, the Group conducted an impairment review of the reinsurance assets and found no impairment necessary.

Note 13 – Insurance Contract Liabilities

Key Valuation Assumptions

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

(a) Mortality Assumptions

Mortality 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 below:

	Base mortality			
	30 Jun 2016		30 Jun 2015	31 Dec 2015
	Pensions originated	Insurance originated	All	All
Males	94.6% S2PMA	110.9% PMA08	101.0% S1PMA	97.2% S2PMA
Females	94.6% S2PFA	110.9% PFA08	101.0% S1PFA	97.2% S2PFA

	Mortality improvements		
	30 Jun 2016	30 Jun 2015	31 Dec 2015
Males	CMI_2014_M[2.7%]	CMI_2012_M[2.7%]	CMI_2014_M[2.7%]
Females	CMI_2014_F[2.2%]	CMI_2012_F[2.2%]	CMI_2014_F[2.2%]

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Note 13 – Insurance Contract Liabilities continued

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. For insurance originated business select adjustments are applied to the above basis for certain policies and mortality improvements are applied assuming mortality rates are as at 2008.

Recent mortality experience is analysed annually for each pension scheme (individually or grouped). The last review was carried out as at the end of 2015. Where the data is considered statistically credible, the best estimate base mortality assumptions used in the valuation are based on this actual mortality experience. Where the data is not statistically credible, the Group takes into account reinsurance prices, and external and proprietary socio-demographic models, based on postcode and other factors.

For pension scheme business mortality assumptions are generally set with reference to the CMI S2 series of mortality tables drawn up by the Continuous Mortality Investigation Bureau ('CMIB') of the Institute and Faculty of Actuaries. These tables are based on industry-wide experience.

For the reinsured blocks of in payment Zurich Assurance annuities and most of the reinsured block of in payment Aegon annuities, the CMI 08 series of annuitant mortality tables are used to value the pension liabilities. These are expected to better reflect the shape of mortality for insured blocks.

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.

Prudent margins are then 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 2016.

(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 (internal rate of return) on the combined matching assets. It is determined based on the yield obtainable on the basket of assets matching the applicable Insurance Contract Liabilities at 30 June 2016.

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

	30 Jun 2016	30 Jun 2015	31 Dec 2015
Equivalent valuation discount rate	2.3% p.a.	3.1% p.a.	3.21% 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 the allowance for investment management expenses of 3bps p.a. (30 June 2015: 3bps p.a. and 31 December 2015: 3bps p.a.).

Note 13 – Insurance Contract Liabilities continued

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 2016, 30 June 2015 and 30 December 2015 by asset category:

	Average yield reduction		
Asset Class	30 Jun 2016	30 Jun 2015	31 Dec 2015
UK government approved securities	0 bps	0 bps	0 bps
Corporate bonds after allowance for covering credit default swaps	0 bps	0 bps	0 bps
Secured lending	7 bps	6 bps	6 bps
Supranational/other sovereign	22 bps	19 bps	15 bps
Secured residential lending	28 bps	26 bps	24 bps
Corporate bonds	75 bps	N/A	N/A
Infrastructure	91 bps	83 bps	83 bps
Other	83 bps	36 bps	56 bps
Overall yield reduction	**23 bps**	**17 bps**	**18 bps**

Overall, the deduction for counterparty default risk on the assets held by the Group is generally lower than the corresponding credit default deduction on a typical unsecured credit portfolio. This is due to 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 Group during 2015 and the projected 2016 expenses. The investigation was updated during the period to allow for the additional expected future costs as a result of the Aegon Transaction. 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. An additional short term maintenance expense overrun provision has been established to provide for expected project costs. The results of the investigation continue to be used for production of the 30 June 2016 insurance liabilities.

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. (30 June 2015: 0.25% p.a. and 31 December 2015: 0.25% p.a.) or 1.00% p.a (30 June 2015: 1.00% p.a. and 31 December 2015: 1.00% p.a.) for the TPA expenses depending on the TPA provider.

NOTES TO THE FINANCIAL STATEMENTS CONTINUED

Note 13 – Insurance Contract Liabilities continued

Other Assumptions

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

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 of their benefit at retirement as a lump sum. When deferred annuitants have passed the scheme normal retirement date and have been subject to 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.

(d) Movements in Insurance Contract Liabilities

	30 Jun 2016		
	Insurance liabilities £m	Reinsurance assets £m	Net liabilities £m
Carrying amount at 1 January	14,207	274	**13,933**
Increase in respect of new business	6,210	116	**6,094**
Release of liabilities/liabilities discharged	(518)	4	**(522)**
Effect of non-economic assumption changes	–	–	**–**
Effect of economic assumption changes	2,588	131	**2,457**
Other	–	–	**–**
Closing balance at 30 June	**22,487**	**525**	**21,962**

	31 Dec 2015		
	Insurance liabilities £m	Reinsurance assets £m	Net liabilities £m
Carrying amount at 1 January	12,106	289	**11,817**
Increase in respect of new business	3,320	9	**3,311**
Release of liabilities/liabilities discharged	(617)	2	**(619)**
Effect of non-economic assumption changes	(83)	(103)	**20**
Effect of economic assumption changes	(520)	77	**(597)**
Other	1	–	**1**
Closing balance at 31 December	**14,207**	**274**	**13,933**

Note 13 – Insurance Contract Liabilities continued

The table above details the change in the gross and net insurance liabilities over the period. The table below 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.

Effect of Changes in Assumptions and Estimates during the Period

The following table shows the impact on the Insurance Contract Liabilities of changes in the assumptions used:

Net Increase/(Decrease) in liabilities

Change in assumptions used	30 Jun 2016 £m	31 Dec 2015 £m
Valuation interest rates	2,700	(441)
Inflation	(243)	(156)
Demographics	–	(24)
Expenses	–	44
Total change in assumptions used	**2,457**	**(577)**

As shown previously the valuation interest rate decreased by 0.9% over the period which led to the £2.7bn movement in the liability shown. This change was predominantly through movements in LIBOR with 30-year rates falling close to 100bps over the period.

There were no changes to the demographic or expense assumptions during the period.

(e) Sensitivity Analysis

The schedule below provides an analysis of the reasonably possible movements in key assumptions that would have a material impact on liabilities, profit before tax ('PBT'), and equity.

The analysis is based on a change in a single assumption whilst holding all other assumptions constant.

30 Jun 2016	Change in assumptions	Increase/ (decrease) on liabilities £m	Increase/ (decrease) on PBT £m	Impact on equity £m
Annuitant mortality	+%5 qx	(97)	97	78
Annuitant mortality	–%5 qx	101	(101)	(81)
Interest rate	+100bps	(2,961)	(74)	(59)
Interest rate	–100bps	3,777	180	144
Inflation	+100bps	1,235	(25)	(20)
Inflation	–100bps	(1,107)	101	80
Long-term credit default assumption	+10bps	1	(92)	(73)
Long-term credit default assumption	–10bps	(1)	91	73
Expenses	+10%	45	(45)	(36)

NOTES TO THE FINANCIAL STATEMENTS
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Note 13 – Insurance Contract Liabilities continued

31 Dec 2015	Change in assumptions	Increase/ (decrease) on liabilities £m	Increase/ (decrease) on PBT £m	Impact on equity £m
Annuitant mortality	+%5 qx	(86)	86	68
Annuitant mortality	–%5 qx	90	(90)	(72)
Interest rate	+100bps	(1,934)	29	23
Interest rate	–100bps	2,474	65	52
Inflation	+100bps	912	11	9
Inflation	–100bps	(845)	59	47
Long-term credit default assumption	+10bps	1	(53)	(42)
Long-term credit default assumption	–10bps	(1)	54	43
Expenses	+10%	29	(29)	(23)

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 Group being immunised to market movements in either direction.

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 valuation interest rate.

The table below shows the impact of the reinsurance on the sensitivity to mortality risk, a reduction of 83% (31 December 2015: 77%) compared to the sensitivity of the gross insurance liability.

30 Jun 2016	Change in assumptions	Increase/ (decrease) on insurance liability £000s	Increase/ (decrease) on reinsurance asset £000s	Net increase/ (decrease) on liabilities £000s
Annuitant mortality	+5% qx	(576)	479	(97)
Annuitant mortality	–5% qx	616	(515)	101

31 Dec 2015	Change in assumptions	Increase/ (decrease) on insurance liability £000s	Increase/ (decrease) on reinsurance asset £000s	Net increase/ (decrease) on liabilities £000s
Annuitant mortality	+5% qx	(378)	292	(86)
Annuitant mortality	–5% qx	403	(314)	89

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 14 – Payables and Financial Liabilities

	Period ended 30 Jun 2016 £m	Period ended 30 Jun 2015 £m	Year ended 31 Dec 2015 £m
Derivative financial instruments	15,706	5,393	6,917
Collateralised financing agreements	1,885	1,933	1,886
Deposits received as collateral from third parties	1,248	381	753
Deposits received as collateral for derivatives from participating interest	455	327	227
Amounts due to participating interests	–	1	–
Current tax payable	20	37	52
Other taxes and social security costs	–	3	7
Other payables	243	16	42
Total payables and financial liabilities	**19,557**	**8,091**	**9,884**

Note 15 – Borrowings

The Group's borrowings are as follows:

	Period ended 30 Jun 2016 £m	Period ended 30 Jun 2015 £m	Year ended 31 Dec 2015 £m
Third-party syndicated loan	238	125	–
Affiliate subordinated loan	100	100	100
Subordinated loan notes	249	–	249
Total borrowed	**587**	**225**	**349**

The amounts outstanding at 30 June 2016 include £100m of floating rate perpetual callable loan notes, £249m unsecured, subordinated loan notes and £238m of third-party syndicated loan notes.

On 4 April 2016, the Company entered into a £240m three year term loan facility agreement provided by a syndicate of third-party banks. The loan is secured and the rate of interest is six-month Sterling LIBOR plus 250bps p.a. The loan has been drawn down in three phases – £125m on 7 April 2016, £75m on 12 April 2016 and the remaining £40m on 29 June 2016. The notes were issued and initially recognised at fair value of £238m being issue proceeds of £240m less capitalised issue cost of £2m. At 30 June 2016, the notes have a carrying value of £238m which is calculated based on an amortised cost basis and a fair value of £240m.

The £100m of floating rate perpetual callable loan notes are callable at par on 21 December 2017 and every six months thereafter. They carry deferrable interest at six-month Sterling LIBOR plus 425bps p.a. The notes are unsecured and classified as qualifying dated Tier 2 securities for the purpose of the RL Group's regulatory capital requirements. The notes are issued to an affiliate. The notes have a carrying value of £100m and a fair value of £100m (2015: £100m).

NOTES TO THE FINANCIAL STATEMENTS
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Note 15 – Borrowings continued

The £250m subordinated loan notes mature in 2025 with a fixed 8% coupon paid annually in arrears. The notes are unsecured and classified as qualifying dated Tier 2 securities for the purpose of the RL Group's regulatory capital requirements. The notes were issued and initially recognised at fair value of £249m being issue proceeds of £250m less capitalised issue costs of £1m.

At 30 June 2016, the notes have a carrying value of £249m which is calculated based on an amortised cost basis, and a fair value of £248m (31 December 2015: £258m), as determined by traded levels. The notes are issued through the public debt markets.

For the period ended 30 June 2016, an interest expense of £13m was recognised in the Consolidated Statement of Comprehensive Income in respect of these borrowings.

Note 16 – Share Capital

On 5 April, the Company converted the A, B and C £1.00 Ordinary Shares into shares with a nominal value of £0.001. In the tables below for ease of comparison, the 31 December 2015 numbers have been adjusted to allow for this conversion. At 30 June 2016 and 31 December 2015, share capital comprised:

	30 Jun 2016		31 Dec 2015 (adjusted for 1,000 for 1 conversion)	
		£m		£m
Ordinary Share capital of £1.00 each	30,001	–	1	–
Ordinary Share capital of £0.001 each	1,034,034,369	1.0	1,000,000,000	1.0
Preference Share capital of £0.001 each	1,034,034,369	1.0	800,000,000	0.8
Authorised share capital	**2,068,098,739**	**2.0**	**1,800,000,001**	**1.8**

On 28 January 2016, the Company issued 30,000 £1.00 Ordinary D Shares to an existing shareholder. The total cash consideration received was £30,000.

On 5 April 2016, the 200m £0.001 B Ordinary Shares were converted into 81.4m new B Ordinary Shares, 81.4m Preference Shares and 37.1m Deferred Shares. The Deferred Shares were bought back by the Company on 6 April 2016 for £59.

On 7 April 2016, the Company allotted 152,607,000 Ordinary Shares of £0.001 each and 152,607,000 Preference Shares of £0.001 each to existing shareholders. The total cash consideration received was £200m, reflecting share premium of £199.7m.

Note 16 – Share Capital continued

The Ordinary Shares issued are analysed into the following categories:

	30 Jun 2016		31 Dec 2015 (adjusted for 1000 for 1 conversion)	
		£m		£m
A £0.001 Ordinary	789,429,000	0.8	762,666,000	0.8
B £0.001 Ordinary	–	–	200,000,000	0.2
B £0.001 new Ordinary	81,427,369	0.1	–	–
C £0.001 Ordinary	76,426,000	0.1	37,334,000	–
D £1.00 Ordinary	30,001	–	1	–
E £0.001 Ordinary	49,798,000	–	–	–
F £0.001 Ordinary	36,954,000	–	–	–
Total	**1,034,064,370**	**1.0**	**1,000,000,001**	**1.0**

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

Employee Benefit Trust

On 6 January 2016, the Company established an Employee Benefit Trust, Elian Employee Benefit Trustee Limited ('The Trust'). The Trust has been established to purchase and hold shares of the Company for delivery to employees under employee share schemes. Shares owned by The Trust are included at cost in the Consolidated Statements of Financial Position and are shown as a deduction from shareholders equity. They are disclosed as employee scheme shares until they vest to employees.

On 19 February 2016, The Trust purchased 29,530 of the £1.00 B Ordinary Shares for consideration of £20.3m from management and employees. On 5 April, these were converted to 29,530,000 £0.001 B Ordinary Shares and then converted to 13,209,560 £0.001 new B Ordinary Shares, 13,209,560 £0.001 Preference Shares and 3,110,880 Deferred Shares. As noted above, the Deferred Shares were brought back by the Company on 6 April 2016.

Note 17 – Share Premium Account and Reserve

	Share premium £m	Employee Benefit Trust £m	Capital contribution £m	Other reserves £m
At 1 January 2016	266	–	5	769
Profit for the period	–	–	–	80
Share issuance	200	–	–	–
Employee based trust	–	(20)	–	–
Capital contribution	–	–	1	–
At 30 June 2016	**466**	**(20)**	**6**	**849**

NOTES TO THE FINANCIAL STATEMENTS
CONTINUED

Note 18 – Capital Management

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

- to satisfy the requirements of its policyholders and regulators;
- to match the profile of its assets and liabilities, taking account of the risk inherent in the business;
- to maintain financial strength and allocate capital efficiently to support new business growth;
- to satisfy the requirements of its policyholders and regulators; and
- to retain financial flexibility by maintaining strong liquidity.

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

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

- The Group's technical provisions, being:
  - the liabilities of the Group calculated on a best estimate basis (the 'BEL'); plus
  - the cost of transferring non-hedgeable risks (known as 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').

Capital in excess of that required to meet the technical provisions is known as Own Funds. As at 30 June 2016, Own Funds for the Group are £2,486m (1 January 2016: £1,902m) made up as follows:

	30 Jun 2016 £m	1 Jan 2016 £m
Total IFRS equity	1,303	1,042
Liability valuation differences and other adjustments	817	511
Total Tier 1	**2,120**	**1,553**
IFRS valuation of subordinated debt	349	349
Debt valuation differences	17	–
Total Tier 2	366	349
Own Funds	**2,486**	**1,902**

The Group holds both debt and equity to optimise its capital structure and improve shareholder return. During the period to 30 June 2016, £200m of equity was issued by the Group.

Note 18 – Capital Management continued

Movement in Own Funds

	30 Jun 2016 £m
Closing Solvency I balance (31 December 2015)	**1,367**
Impact of change of solvency regime	535
Opening Solvency II Balance (1 January 2016)	**1,902**
New business	388
Management of in-force book	53
Expenses	(43)
Demographic experience variance	(5)
Other	1
Operating surplus	**394**
Economic profits	58
Non-recurring expenses	(14)
Finance costs	(15)
Tax	(20)
Share issuance	200
Employee based trust	(20)
Capital contribution	1
Closing Balance as at 30 June 2016	**2,486**

As part of the transitional arrangements in relation to the introduction of Solvency II, the Group is permitted to take credit for transitional solvency relief which amortises to zero over the next 16 years. Recalculating the transitional solvency relief as at 30 June 2016 results in an increase in the amount of solvency relief to reflect the change in economic conditions since the Aegon Transaction and this is allowed for in the relevant line items in the analysis above.

The capital position is sensitive to changes in market conditions, due to changes in the value of the assets and the effect that changes in investment conditions may have on the value of the liabilities. The Group seeks to mitigate these risks through the 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.

NOTES TO THE FINANCIAL STATEMENTS CONTINUED

Note 19 – Related-Parties Disclosures

Ultimate Holding Companies

The ultimate holding companies of RHUK are:

- The Goldman Sachs Group, Inc.: 32.7%
- The Blackstone Group L.P.: 26.5%
- GIC Private Limited: 26.5%
- MassMutual Financial Group: 6.5%

The remaining percentage is owned by management, employees and The Elian Employee Benefit Trustee Ltd.

Related-Party Transactions

The Group entered into various transactions with fellow participating interests which are subject to common control from the same source, including Goldman Sachs International, Goldman Sachs and Co., the Goldman Sachs Group, Inc., Goldman Sachs Asset Management International, and Rothesay Life (Cayman) Limited. Details of transactions and balances in respect of these transactions are as follows:

	30 Jun 2016 £m	30 Jun 2015 £m	31 Dec 2015 £m
Statement of Comprehensive Income			
Realised/(unrealised) losses on financial assets and liabilities	(625)	(16)	(134)
Interest income on bank deposits	1	–	–
Income from money market securities held in collective investment schemes	–	1	3
Interest on collateralised agreements and financing	12	15	37
Service fee charges	(2)	(2)	(3)
Finance costs	(1)	(1)	(7)

	30 Jun 2016 £m	30 Jun 2015 £m	31 Dec 2015 £m
Statement of Financial Position			
Derivative financial assets and liabilities	(1,967)	(989)	(1,355)
Collateralised agreements and financing	942	1,429	914
Collective investments schemes	891	772	470
Accrued interest	–	83	10
Amounts payable to related party	(455)	(233)	(227)
Capital			
Ultimate Parent Company	468	268	268
Capital contribution	6	7	5

The nominal value of derivatives contracts outstanding with related parties as at 30 June 2016 was £32,599m (30 June 2015: £38,150m and 31 December 2015: £36,465m).

Note 19 – Related-Parties Disclosures continued

The Group continues to develop fully independent infrastructure and computer systems. As of 1 September 2015, the Group fully migrated its middle office and back office functions to an independent third-party. Any services/support which remains is provided by Goldman Sachs and are provided on an arm's-length basis under a Transitional Service Agreement ('TSA').

Transactions with Key Management Personnel

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

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

The remuneration of key management personnel of the Group as at 30 June 2016 was salaries, bonus, and other benefits of £1.4m (period to 30 June 2015: £1.2m and year to 31 December 2015: £9m), equity-based compensation payments of £0.1m (period to 30 June 2015: £nil and year to 31 December 2015: £nil) and pensions costs of £0.1m (period to 30 June 2015: £0.1m and year to 31 December 2015: £0.1m). On 19 February 2016, eight members of key management personnel and their families sold 20,907 £1.00 B Ordinary Shares to The Trust for consideration of £14.4m.

Transactions with Rothesay Pensions Management Limited

	30 Jun 2016 £m	30 Jun 2015 £m	31 Dec 2015 £m
Statement of Comprehensive Income			
Cost transfer	–	–	–
Statement of Financial Position			
Other receivables	1	–	1
Capital	–	–	–

Transactions with Rothesay Life Plc

	30 Jun 2016 £m	30 Jun 2015 £m	31 Dec 2015 £m
Statement of Comprehensive Income			
Cost transfer	1	–	–
Statement of Financial Position			
Other payables	30	11	11
Capital	814	384	384

Note 20 – Subsidiary Undertakings

Subsidiary Undertakings

The Financial Statements include the Financial Statements of RHUK and the subsidiaries listed in the following table:

Group undertakings	Country of incorporation	Primary business operation	Held at lower of cost or net realisable value £m	30 Jun 2016 % equity interest	31 Dec 2015 % equity interest
Rothesay Pensions Management Limited	UK	Service company	–	100%	100%
Rothesay Life PLC (formerly known as Rothesay Life Limited)	UK	Life insurance	814	100%	100%
Rothesay Assurance Limited (formerly known as MetLife Assurance Limited)	UK	Life insurance	3	100%	100%
LT Mortgage Financing Limited	UK	Service company	–	100%	100%

The above subsidiary undertakings are registered in the UK. 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 Limited has remained dormant during the first half of 2016. Rothesay Assurance Limited is in the process of being de-authorised and will be wound up in due course.

Note 21 – Financial Commitments and Contingencies

Operating Lease Commitments

Operating lease rental commitments arise where a Group 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:

	30 Jun 2016 £m	30 Jun 2015 £m	31 Dec 2015 £m
Not later than one year	1	1	1
Later than one year and no later than five years	7	4	3
Later than five years	8	2	3
Total minimum lease payments	**16**	**7**	**7**

The Group signed a new lease during the period for an additional floor of The Leadenhall Building. This is to accommodate the growth of the business.

Other Commitments

During prior years the Group executed transactions to purchase partly-funded bonds. The Group expects to pay a further £173m within the next five years (30 June 2015: £197m and 31 December 2015: £197m), £25m of this being due within 12 months of the financial reporting date (30 June 2015: £24m and 31 December 2015: £24m).

	30 Jun 2016 £m	30 Jun 2015 £m	31 Dec 2015 £m
Not later than one year	25	24	24
Later than one year and no later than five years	148	173	173
Later than five years	–	–	–
Total other commitments	**173**	**197**	**197**

MCEV SUPPLEMENTARY FINANCIAL STATEMENTS

Market Consistent Embedded Value

Supplementary Financial Statements

The Group has prepared Supplementary Financial Statements on a Market Consistent Embedded Value ('MCEV') basis. The results have been prepared in accordance with the European Insurance CFO Forum Market Consistent Embedded Value Principles ('MCEV Principles') (Copyright © Stichting CFO Forum Foundation 2008) which were published in 2008 and revised in October 2009 and May 2016. Consistent with the MCEV Principles revision in May 2016 an explicit allowance has been made at 30 June 2016 for the new European regulatory regime (Solvency II). No allowance for Solvency II was made in comparative periods.

The Group considers that embedded value reporting provides investors with a useful measure of the future profit streams of the Group's in-force long-term business and is a valuable supplement to statutory accounts.

Group Statement of Financial Position

As at 30 June 2016

	Period ended 30 Jun 2016 £m	Period ended 30 Jun 2015 £m	Year ended 31 Dec 2015 £m
Assets			
Value of in-force business	752	496	435
Financial investments, and property, plant and equipment	42,025	21,786	24,594
Accrued interest and prepayments	232	90	165
Reinsurance assets	525	285	274
Receivables	1,015	188	381
Cash and cash equivalents	205	119	98
Total assets	**44,754**	**22,964**	**25,947**
Total equity	**2,055**	**1,383**	**1,445**
Liabilities			
Insurance contract liabilities	22,487	13,229	14,230
Payables and financial liabilities	19,557	8,091	9,884
Borrowings	588	225	358
Deferred tax liabilities	3	3	3
Accruals and deferred income	65	33	27
Total liabilities	**42,699**	**21,581**	**24,501**
Total equity and liabilities	**44,754**	**22,964**	**25,947**

The notes on pages 43 to 55 form an integral part of these Supplementary Financial Statements.

Reconciliation of Shareholders' Equity on IFRS Basis to Shareholders' Equity on MCEV Basis

The shareholders' equity on an MCEV basis is consistent with the sum of the shareholders' equity on an IFRS basis, the value of in-force ('VIF') business as shown on page 49 and any debt valuation differences as shown on page 48.

The debt valuation difference arises as a result of the market value approach under MCEV which differs from amortised cost valuation under IFRS. During 2015, RLP issued £250m of subordinated debt through the public debt markets. This difference reduced to a value £1m lower on an MCEV basis as at 30 June 2016 (31 December 2015: £9m higher on an MCEV basis).

Prior to 1 January 2016, the MCEV was based on the Solvency I Pillar 1 balance sheet. As a result there were additional reserving differences between the IFRS balance sheet and the MCEV balance sheet which reflected an additional closure reserve held on a Pillar 1 basis which was deducted from the adjusted net worth of RLP. This reserve is not held on an IFRS basis.

Group MCEV Analysis of Earnings (Net of Tax)

For the six-month period ending 30 June 2016

In the table below, opening adjustments reflect the impact of adopting the revised MCEV Principles as at 1 January 2016.

Reviewed movement £m	Covered business (MCEV) £m	Non Covered business (IFRS) £m	Total Group MCEV £m
Opening MCEV	1,447	(2)	1,445
Opening adjustments	(36)	–	(36)
Adjusted opening MCEV	**1,411**	**(2)**	**1,409**
Operating MCEV earnings	339	–	339
Non-operating MCEV earnings	130	–	130
Total MCEV earnings	**469**	**–**	**469**
Other movements in IFRS net equity	430	(253)	177
Closing MCEV	**2,310**	**(255)**	**2,055**

MCEV SUPPLEMENTARY FINANCIAL STATEMENTS CONTINUED

For the six-month period ending 30 June 2015

Group MCEV analysis of earnings (net of tax) £m	Covered business (MCEV) £m	Non Covered business (IFRS) £m	Total Group MCEV £m
Opening MCEV	1,342	(128)	1,214
Opening adjustments	–	–	–
Adjusted opening MCEV	**1,342**	**(128)**	**1,214**
Operating MCEV earnings	151	–	151
Non-operating MCEV earnings	20	–	20
Total MCEV earnings	**171**	**–**	**171**
Other movements in IFRS net equity	–	(2)	(2)
Closing MCEV	**1,513**	**(130)**	**1,383**

For the six-month period ending 31 December 2015

Group MCEV analysis of Earnings (net of tax) £m	Covered business (MCEV) £m	Non-covered business (IFRS) £m	Total Group MCEV £m
Opening MCEV	**1,342**	**(128)**	**1,214**
Opening adjustments	–	–	–
Adjusted opening MCEV	**1,342**	**(128)**	**1,214**
Operating MCEV earnings	245	–	245
Non-operating MCEV earnings	(140)	126	(14)
Total MCEV earnings	**105**	**126**	**231**
Other movements in IFRS net equity	–	–	–
Closing MCEV	**1,447**	**(2)**	**1,445**

NOTES TO THE MCEV SUPPLEMENTARY FINANCIAL STATEMENTS

1. Basis of Presentation

The Group's primary Financial Statements have been prepared in accordance with International Financial Reporting Standards. The MCEV Supplementary Financial Statements have been prepared in accordance with the European Insurance CFO Forum Market Consistent Embedded Value Principles ('MCEV Principles') (Copyright © Stichting CFO Forum Foundation 2008) which were published in 2008 and revised in October 2009 and May 2016. Consistent with the MCEV Principles revised in May 2016 an explicit allowance has been made for the new European regulatory regime (Solvency II), which became effective on 1 January 2016, and associated consequences. No allowance for Solvency II was made in the comparative periods consistent with the guidance issued by CFO Forum in 2012 and revised in October 2015.

Comparative information has been provided as at 30 June 2015 and 31 December 2015.

(a) Covered Business

The covered business includes all business written by RLP. This business falls under the definition of long-term insurance business for UK regulatory purposes.

The adjustments applied to arrive at the Group MCEV are the market value of other entities within the Group.

At 30 June 2016, the Group adjustment included the deduction of £240m of debt from Rothesay HoldCo UK Limited, which was issued during 2016.

(b) New Business

New business is defined as:

- premiums from the sale of new policies written throughout the year; and
- non-contractual increments on existing policies, transacted during the year.

Acquisitions are presented separately within the new business section. For the dates shown there were no acquisitions.

2. Methodology

The MCEV is the sum of the net worth of the Group companies plus the value of in-force business. For 30 June 2016 reporting, the methodology reflects the introduction of Solvency II as described below. The methodology for the comparative periods is unchanged.

(a) Net Worth

The net worth is the market value of the shareholders' funds and the shareholders' interest in the surplus held in the long-term business funds, determined on a statutory IFRS basis at 30 June 2016 (or statutory solvency basis, with inadmissible assets included, for comparative periods).

2. Methodology continued

The net worth consists of the required capital plus the free surplus of the Group. Free surplus is defined as the assets over and above the level of required capital, described below.

(b) Value of In-Force

The value of in-force covered business ('VIF') consists of the following components:

- present value of future profits;
- time value of financial options and guarantees;
- frictional costs of required capital; and
- cost of residual non-hedgeable risks.

(c) Present Value of Future Profits

The present value of future profits ('PVFP') is the present value of the distributable profits to shareholders arising from the in-force covered business projected on a best estimate basis and discounted using the risk-free rate adjusted (where applicable) for the liquidity premium.

As at 30 June 2016, the PVFP reflects the distributable profits, net of tax payable, calculated on an IFRS basis rather than on a Solvency II basis. The PVFP has not been updated to reflect Solvency II technical provisions to retain consistency with the payment of taxation. Solvency II allowances are made through the definition of required capital and the associated frictional costs of required capital elements of the MCEV. The alternative presentation of calculating the PVFP on a Solvency II basis would not have changed the total MCEV however the constituents would differ, in particular, it would result in a transfer from PVFP to free surplus.

(d) Time Value of Financial Options and Guarantees

There are no material financial options and guarantees, and therefore the time value is nil.

The basis for policyholder options is generally set by the Group to be profit-neutral. Where there are specific contractual clauses that diverge from this, these have been appropriately allowed for within the PVFP.

The Group currently has no guaranteed surrender terms exercisable at the unilateral discretion of the pension schemes. Some counterparties are able to surrender conditional upon certain solvency events. However for the purposes of the MCEV, it is assumed that the Group continues to meet these solvency requirements and hence no value is placed on these surrender rights.

(e) Frictional Costs of Required Capital

The additional costs to a shareholder of holding the assets backing required capital within an insurance company rather than directly in the market are known as frictional costs. The additional costs allowed for are the taxation costs and any additional investment expenses on the assets backing the required capital. These costs are explicitly deducted from the PVFP.

Frictional costs are calculated by projecting forwards the future levels of required capital. Tax on investment return and investment expenses are payable on the assets backing required capital, up until the point that they are assumed to be released to shareholders.

2. Methodology continued

At 30 June 2016, the level of required capital allowed for in the calculation reflects the additional capital over the IFRS reserves required to be held under the Group's Capital policy, namely 130% of solvency capital requirement as set out in section 3(g).

(f) Cost of Non-Hedgeable Risk

The cost of residual non-hedgeable risk ('CNHR') covers risks not already allowed for in the time value of options and guarantees or in the PVFP. The allowance includes the impact of both non-hedgeable financial and non-financial risks. No allowance has been made within the CNHR for symmetric risks as these are diversifiable by investors.

The risks which contribute to the CNHR component of MCEV are:

- Counterparty default risk: the risk of losses following the failure of counterparties, for example for longevity reinsurance and over the counter derivative transactions.
- Expense risk: the risk that the amount of expenses incurred differs from current projections.
- Operational risk: the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events.

These are considered to be asymmetric risks, of which operational risk is the most material element. We have allowed for diversification benefits to the extent that these are identifiable.

The Group's demographic risks exhibit no material asymmetry. Appropriate allowance has been made within the PVFP for these risks; therefore no further allowance has been made in the CNHR.

The CNHR has been presented as an equivalent average cost of capital charge across all residual non-hedgeable risks considered to be asymmetric (as defined above), after allowing for diversification between these risks. The capital charge has been calculated in line with Rothesay's Own Risk and Solvency Assessment ('ORSA'), or Individual Capital Assessment ('ICA') for comparative periods. This capital requirement has been modelled as running off in line with the cash flow profile of the best estimate liabilities excluding the longevity swap cash flows.

The resulting annual capital charge is 3.5% (3.2% at 30 June 2015, 3.3% at 31 December 2015).

(g) Tax

The projected cash flows take into account all tax which the Group expects to pay.

The 2016 Budget announced that the corporation tax rate will be reduced to 17% from April 2020. To remain consistent with the treatment used in IFRS, Solvency II and prior period MCEV reporting as this has not been substantively enacted by 30 June 2016 the revised rate has not been included in the results.

2. Methodology continued

	30 Jun 2016	30 Jun 2015	31 Dec 2015
2016	20.00%	20.00%	20.00%
2017	19.25%	20.00%	19.25%
2018	19.00%	20.00%	19.00%
2019	19.00%	20.00%	19.00%
2020	18.25%	20.00%	18.25%
2021+	18.00%	20.00%	18.00%

(h) Consolidation Adjustments

Group entities have been incorporated at the market value.

The Group MCEV is net of external debt.

3. Assumptions

Economic Assumptions

(a) Reference rates

In setting the risk-free rate a mid-price swap yield curve provided by Goldman Sachs is used. A constant forward rate is applied after the 80-year point.

Term (years)	1	5	10	20	30
30 June 2016	0.56%	0.60%	1.00%	1.26%	1.21%
30 June 2015	0.83%	1.72%	2.18%	2.41%	2.36%
31 December 2015	0.85%	1.61%	2.05%	2.25%	2.18%

For annuity business, swap rates are adjusted for a 'liquidity premium' in deriving the reference rates. The liquidity premium is applied as a term specific addition to the swap curve set out above. The derivation uses a target investment mix and therefore aims to consider the types of investments in which the Group invests, but does not correspond exactly to the current assets holdings.

The liquidity premium is calculated on a daily basis and considers the spread over the risk-free rate observable for various asset classes. An appropriate deduction is made to the spread for credit risk. The deductions make reference to market observable credit risk information, and the resulting deduction is prudent relative to historical defaults.

The in-force liquidity premium adjustment as at 30 June 2016 was 127bps, after the deduction of investment management costs. The comparable liquidity premium adjustment as at 31 December 2015 was 111bps and 86bps as at 30 June 2015.

No liquidity premium is used in the valuation of longevity swap contracts.

The liquidity premium on new business is calculated at the point of sale and is determined using an approach consistent with that assumed for the in-force business.

3. Assumptions continued

(b) Expenses

Expenses attributed to covered businesses have been included in the MCEV calculations. Future expense assumptions include an allowance for third-party administration, investment management and maintenance expenses as well as project expenses.

No future productivity gains have been anticipated. Where subsidiary companies provide administration, investment management or other services to our life businesses, the value of profits or losses arising from these services have been included in the embedded value of new business.

(c) Expense Inflation

Internal and third-party administration expenses are projected to increase at RPI, plus a margin where appropriate.

As at 30 June 2016 the assumed rate of future expense inflation is equivalent to 3.23% (30 June 2015: 3.98%, 31 December 2015: 3.44%).

For internal service companies the fees charged to the life company reflect the underlying expenses incurred.

(d) Exchange Rates

The Group has a small amount of euro denominated liabilities. These cash flows have been converted to GBP using levels implied from cross currency swap quotes.

Non-Economic Assumptions

(e) Demographic Assumptions

Assumed future mortality has been derived from an analysis of experience with a view to giving a best estimate of future experience. Where appropriate this has been adjusted for anticipated future changes in experience, that is improvements in future policyholder longevity are allowed for.

Recent mortality experience has been analysed for each pension scheme at the end of 2015. Where the data was considered statistically credible, the mortality assumptions used in the valuation are based on this actual mortality experience. Where the data is not statistically credible, the Group has taken into account reinsurance quotes and proprietary socio-demographic models, based on postcode and other factors.

A consistent approach has been used to derive the demographic assumptions used for new business written during 2016.

3. Assumptions continued

(f) Non-Hedgeable Risk

For the balance sheet a charge of 3.5% has been applied to the Group-diversified capital required on a 1-in-200 one-year basis over the remaining lifetime of in-force business. The capital levels used are projected to be sufficient to cover non-hedgeable risks at the 99.5% confidence. The level of the diversified capital requirement to which the charge is applied is £252m (£173m at 31 December 2015). The resulting cost of non-hedgeable risks is £98.4m (£64.4m at 30 June 2015, £67.5m at 31 December 2015).

(g) Required Capital

The projected level of required capital to support the business is derived from the Group's capital management policy, which is to hold sufficient assets to meet the higher of:

- Solvency II Pillar 1 technical provisions (net of transitional measures) plus 130% of RLP's solvency capital requirement ('SCR'). In comparative periods, this was prudent reserves plus 150% of RLP's long-term insurance capital requirement ('LTICR') and resilience capital requirement ('RCR').
- Best estimate liabilities plus the economic capital requirement.

The economic capital requirement calculates the one-year value-at-risk to a 99.8% confidence interval.

The Group's capital requirement is driven by 130% of RLP's SCR. Historically the Group's capital requirement was driven by 150% of RLP's LTICR and RCR.

The Solvency II Pillar 1 transitional measures have been recalculated at 30 June 2016 in response to the reduction in interest rates over 2016. In line with the figures presented in the Strategic Report the SCR has been calculated after allowing for the impact of removing interest rate and currency hedges in excess of those required to matching the BEL.

(h) Valuation of Debt

Borrowings in the MCEV Consolidated Statement of Financial Position are valued at their market value as determined by traded levels.

Movement	Period ended 30 Jun 2016 £m	Period ended 30 Jun 2015 £m	Year ended 31 Dec 2015 £m
Face value	590	225	350
Amortised costs	(3)	–	(1)
IFRS valuation	**587**	**225**	**349**
Face value	590	225	350
Effect of marking to market	(2)	–	8
Market value/fair value	**588**	**225**	**358**

4. Group Embedded Value

Rothesay Life Group MCEV	Period ended 30 Jun 2016 £m	Period ended 30 Jun 2015 £m	Year ended 31 Dec 2015 £m
Net worth	1,906	1,117	1,370
VIF business			
Present value of future profits	953	642	578
Frictional cost of required capital	(103)	(80)	(75)
Cost of non-hedgeable risks	(98)	(65)	(68)
VIF business	**752**	**497**	**435**
Subordinated debt	(348)	(100)	(358)
MCEV of RL	**2,310**	**1,514**	**1,447**
Debt	(240)	–	–
Net assets liabilities of other Group companies	(15)	(131)	(2)
Group MCEV	**2,055**	**1,383**	**1,445**

5. Covered Business Analysis of Movement in Embedded Value (Net of Tax)

For the period ending 30 June 2016

Movement	Net worth £m	VIF £m	Debt £m	MCEV impact £m	Group adjustments £m	MCEV £m
Opening MCEV	**1,370**	**435**	**(358)**	**1,447**	**(2)**	**1,445**
Impact from implementation of Solvency II	22	(58)	–	(36)	–	(36)
Adjusted opening MCEV	**1,392**	**377**	**(358)**	**1,411**	**(2)**	**1,409**
New business value	31	291	–	322	–	322
Expected existing business contribution (reference rate)	13	4	–	17	–	17
Transfers from VIF and required capital to free surplus	23	(23)	–	–	–	–
Experience variance	28	(26)	–	2	–	2
Assumption changes	–	–	–	–	–	–
Other operating variances	2	(4)	–	(2)	–	(2)
Operating MCEV earnings	**97**	**242**	**–**	**339**	**–**	**339**
Economic variances	4	133	–	137	–	137
Other non-operating variances	413	–	10	423	(253)	170
Total MCEV earnings	**514**	**375**	**10**	**899**	**(253)**	**646**
Closing MCEV	**1,906**	**752**	**(348)**	**2,310**	**(255)**	**2,055**

5. Covered Business Analysis of Movement in Embedded Value (Net of Tax) continued

Commentary

The opening adjustment shows the impact on the MCEV as at 31 December 2015 of updating the required capital to reflect the capital policy under Solvency II and of moving from a Solvency I balance sheet presentation to an IFRS balance sheet presentation. The impact is relatively small due to the existence of transitional measures which reduce the amount of additional capital required over the next 16 years.

The new business value shows the incremental MCEV, at the point of sale, from single premium bulk annuity transactions and inward reinsurance over the first half of 2016. Longevity reinsurance in place at point of sale is also allowed for in the new business value.

The expected existing business contribution is the change in the MCEV calculated by projecting the opening assets and liabilities forward using a single weighted average reference rate (risk-free interest rate plus liquidity premium) reflecting the pattern of expected future cash flows. No further returns in excess of this have been assumed.

Experience variance represents the impact on MCEV of actual experience during the period and the expected assumptions at the start of the period.

Other operating variances include the reduction in EV through transacting additional reinsurance, and modelling changes for lump sum benefits and the costs incurred through asset transactions in the period.

Economic variances arise from market movements in credit spreads, illiquidity premium, interest rates and inflation compared to expectations. Economic conditions were significantly more volatile during 2016 than in previous periods. The main contributor to the movement in MCEV due to economic variances was LIBOR where 30-year rates fell close to 100bps during the period. The impact on the MCEV balance sheet was exacerbated by the decision to hedge the Solvency II balance sheet.

Other non-operating variances include £240m of loan capital borrowed by RHUK during the period. £230m of the proceeds of this loan were paid as equity to RLP. A further £200m of equity capital was injected into RHUK by existing shareholders. In addition the movement in Net worth reflects debt financing costs and not recurring expenses net of tax.

5. Covered Business Analysis of Movement in Embedded Value (Net of Tax) continued

For the period ending 30 June 2015

Movement £m	Free surplus	Required capital	VIF and Subordinated debt	RL MCEV
Opening MCEV	**257**	**716**	**370**	**1,342**
New business value	(232)	111	212	91
Expected existing business contribution	9	(1)	2	11
Transfers from VIF and required capital to free surplus	26	(10)	(13)	4
Experience variance	(6)	(2)	1	(6)
Assumption changes	–	–	–	–
Other operating variances	259	(6)	(200)	52
Operating MCEV earnings	**57**	**92**	**3**	**152**
Economic variances	9	(11)	19	17
Other non-operating variances	(2)	–	5	3
Total MCEV earnings	**63**	**81**	**27**	**171**
Closing MCEV	**320**	**797**	**397**	**1,514**

For the year ended 31 December 2015

Movement £m	Free surplus	Required capital	VIF and Subordinated debt	RL MCEV
Opening MCEV	**257**	**716**	**370**	**1,342**
New business value	(365)	219	340	194
Expected existing business contribution	25	(1)	6	29
Transfers from VIF and required capital to free surplus	48	(21)	(27)	–
Experience variance	25	(13)	(14)	(1)
Assumption changes	(27)	4	24	1
Other operating variances	454	(40)	(391)	23
Operating MCEV earnings	**160**	**147**	**(62)**	**245**
Economic variances	17	(22)	(4)	(9)
Other non-operating variances	95	–	(227)	(131)
Total MCEV earnings	**272**	**126**	**(293)**	**105**
Closing MCEV	**529**	**841**	**77**	**1,448**

NOTES TO THE MCEV SUPPLEMENTARY FINANCIAL STATEMENTS
CONTINUED

6. Value of New Business Over the Half Year Ended 30 June 2016

The following table sets out the after-tax value of new business for the period ended 30 June 2016, calculated at the point of sale:

Group MCEV for new business £m	Period ended 30 Jun 2016	Period ended 30 Jun 2015	Period ended 31 Dec 2015
Net worth	31	(121)	(146)
Present value of future profits	327	230	365
Frictional cost of required capital	(14)	(11)	(13)
Cost of non-hedgeable risks	(22)	(7)	(12)
RL Group MCEV	**322**	**91**	**194**

£6.5bn of new business premiums were written in the period ending 30 June 2016 (Half year 2015 £1.7bn and full year 2015 £3.2bn). This excludes regular premiums generated on the in-force inwards longevity reinsurance business written in prior years.

Economic and demographic assumptions have been used at the point of sale. The MCEV modelling assumptions for new business are consistent with those used for the in-force business, as described in the basis of preparation.

The 30 June 2016 figures have been calculated on a Solvency II basis in line with the main results. At the point of sale a transitional recalculation was performed which is reflected in the results.

The net worth does not reflect the impact of managing the new and acquired business, such as profits arising from investing assets received as premiums through the rest of the financial year.

The weighted average liquidity premium at point of sale for new business written during the period ending 30 June 2016 was 129bps (88bps for 30 June and 31 December 2015). This is broadly in line with the total in-force assumption at 30 June 2016.

7. Sensitivities

The following tables show the sensitivity of the total MCEV to:

- 1% increase and decrease in the risk-free rate of interest. No floor has been applied to the risk-free rate of interest in these sensitivities.
- 1% increase and decrease in inflation. The covers both expense inflation and benefit inflation.
- 10 basis point increase and decrease in long-term credit default assumptions with no change to liquidity premium. This stress has not been applied to UK government guaranteed debt or supranational bonds.
- 10 basis point increase and decrease in the liquidity premium, only affecting the liabilities. The market value of assets, swap curves or risk-free rate used are therefore unchanged under these sensitivities.
- Required capital equal to 100% of SCR (100% of LTICR and 100% of RCR in comparative periods).
- No sensitivity to equity or property has been shown as the Group does not directly invest in these asset classes.
- No sensitivity to swaption implied volatility has been shown as the Group has no risk to swaption implied volatilities.
- Annuity base mortality 5% higher and lower than the central case (i.e. 105% and 95%, respectively, of the central mortality rates).
- Expenses 10% higher and lower than the central case (i.e. 110% and 90% of the central assumption). Maintenance, third-party administration, investment management and project expenses have all been subjected to the stress. There is no change to expense inflation assumption.
- No sensitivity to lapse rates has been shown as the Group is not exposed to the lapse of future premiums.

NOTES TO THE MCEV SUPPLEMENTARY FINANCIAL STATEMENTS CONTINUED

7. Sensitivities continued

Sensitivities at 30 June 2016

	Net worth £m	VIF £m	Debt and Group adjustments £m	MCEV £m
As reported	1,906	752	(603)	2,055
Economic assumptions				
Interest rates +1%	(59)	(150)	16	(193)
Interest rates –1%	144	234	(17)	361
Inflation +1%	(20)	144	–	124
Inflation –1%	80	(117)	–	(37)
Credit default +10bps	(73)	–	–	(73)
Credit default –10bps	73	–	–	73
Illiquidity premium +10 bps	–	227	–	227
Illiquidity premium –10 bps	–	(232)	–	(232)
Required capital equal to 100% of statutory requirement	–	31	–	31
Non-economic assumptions				
Base mortality –5%	(81)	8	–	(73)
Base mortality +5%	78	(7)	–	71
Expenses +10%	(36)	10	–	(26)
Expenses –10%	36	(10)	–	26

The impact on the MCEV, including new business, has been presented as follows:

- The net worth calculated based on the impact on IFRS profit; consistent with the Note 13 of the Financial Statements as set out on page 25 net of tax. The tax impact of the IFRS profit; taken by applying the current tax rate at 30 June 2016, of 20%, to the pre-tax profit figure. A simplified approach has been taken to the treatment of any potential deferred tax asset created under the shock, as it has been assumed that losses have offset profit created in the current accounting period.
- The VIF component of the MCEV; which is the sum of the PVFP, Frictional CoC and CNHR.
- The debt and group adjustments. The effect of marking the debt to market is shown in the interest sensitivities. £250m of fixed debt was issued in 2015 for which there are traded levels; therefore the valuation is sensitive to market movements.

In each sensitivity calculation all other assumptions remain unchanged unless otherwise stated.

The sensitivities above include the new business written over the year. The risk profile of the new business written was materially similar to that of the in-force business. The impact of the sensitivities applied to new business in isolation can therefore be simplified as the same proportional impacts as those shown in the previous table.

Comparative sensitivities at 30 June 2015

	Net worth £m	VIF £m	Debt and Group adjustments £m	MCEV £m
As reported (£m)	1,117	497	(231)	1,383
Economic assumptions				
Interest rates +1%	45	(129)	–	(84)
Interest rates –1%	(27)	175	–	148
Inflation +1%	6	81	–	87
Inflation –1%	96	(105)	–	(9)
Credit default +10bps	(39)	(1)	–	(40)
Credit default –10bps	41	1	–	42
Illiquidity premium +10 bps	–	143	–	143
Illiquidity premium –10 bps	–	(147)	–	(147)
Required capital equal to 100% LTICR +100% RCR	–	26	–	26
Non-economic assumptions				
Base mortality –5%	(99)	8	–	(91)
Base mortality +5%	94	(7)	–	87
Expenses +10%	(20)	3	–	(17)
Expenses –10%	20	(3)	–	17

Comparative sensitivities at 31 December 2015

	Net worth £m	VIF £m	Debt and Group adjustments £m	MCEV £m
As reported (£m)	1,370	435	(360)	1,445
Economic assumptions				
Interest rates +1%	23	(84)	17	(44)
Interest rates –1%	52	124	(19)	157
Inflation +1%	9	70	–	79
Inflation –1%	47	(60)	–	(13)
Credit default +10bps	(42)	–	–	(42)
Credit default –10bps	43	–	–	43
Illiquidity premium +10 bps	–	150	–	150
Illiquidity premium –10 bps	–	(154)	–	(154)
Required capital equal to 100% LTICR +100% RCR	–	24	–	24
Non-economic assumptions				
Base mortality –5%	(72)	8	–	(64)
Base mortality +5%	68	(8)	–	60
Expenses +10%	(23)	4	–	(19)
Expenses –10%	23	(4)	–	19

STATEMENT OF DIRECTORS' RESPONSIBILITIES

In Respect of the MCEV Basis Supplementary Financial Statements

When compliance with the MCEV Principles is stated, those principles require the Directors to prepare supplementary information in accordance with the methodology contained in the CFO Forum Principles and to disclose and explain any non-compliance with the guidance included in the CFO Forum Principles.

In preparing this supplementary information, the Directors have done so in accordance with these CFO Forum Principles and have also fully complied with all the guidance included therein. Specifically, the Directors have:

- determined assumptions on a realistic basis, having regard to past, current and expected future experience and to relevant external data, and then applied them consistently;
- made estimates that are reasonable and consistent; and
- provided additional disclosures when compliance with the specific requirements of the CFO Forum Principles is insufficient to enable users to understand the impact of particular transactions, other events and conditions and the Group's financial position and financial performance.

The Supplementary Financial Statements were approved by the Board of Directors on 21 September 2016 and were signed on its behalf by:

Andrew Stoker
Chief Financial Officer
21 September 2016

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