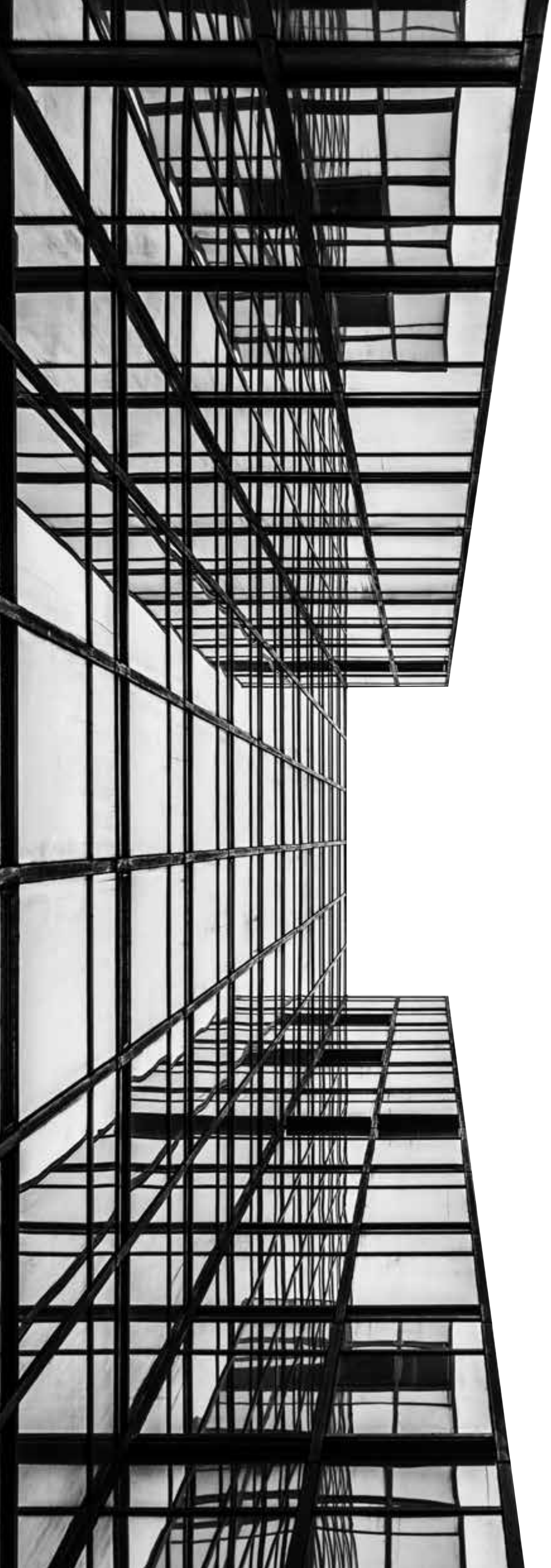


# Innovating to secure the future

Rothesay life

**Rothesay Holdco UK Limited**

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

## What we do

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

Contents



For more information
**www.rothesaylife.com**

# Strategic report

## 2018 year to date business highlights

**Purchase of £12bn of annuities:** The Group successfully completed the reinsurance of a £12bn block of in-force annuity business from Prudential plc (the 'Prudential transaction'). This was the largest transaction of its type in the UK and increased the number of lives insured by the Group by approximately 400,000.

**New business:** In addition to the Prudential transaction, the Group insured the defined benefit liabilities of the Toshiba Pension and Assurance Scheme taking new business premiums to £12.4bn (HY2017: £0.6bn and FY2017: £1.2bn).

**Market Consistent Embedded Value (MCEV):** The Group's MCEV has increased by 37% to £3,151m (HY2017: £2,288m and FY2017: £2,301m), driven largely by the Prudential transaction and associated equity injection.

**Solvency position:** A continued focus on pro-active risk management and a cautious investment strategy maintained a robust solvency position. As at 30 June 2018, the Group's SCR coverage was 157% (HY2017: 171% and FY2017: 169%) and Rothesay Life Plc's coverage was 177% (HY2017: 171% and FY2017: 163%).

**Credit rating:** Rothesay Life Plc was assigned an insurance financial strength rating of A3 by Moody's Investors Service and A+ by Fitch Ratings.

**Assets under management:** The Group's assets under management increased by 51% to £36.7bn (HY2017: £23.6bn and FY2017: £24.2bn).

**IFRS pre-tax losses:** Following completion of the Prudential transaction, we have chosen to de-risk the underlying assets and continue to be cautious about reinvesting the premium given market conditions. Given this approach, we have generated new business strain resulting in first half pre-tax losses (as anticipated when underwriting the transaction). First half pre-tax losses were £257m (HY2017: a pre-tax profit of £105m and FY2017: a pre-tax profit of £312m). As we invest the assets received from the Prudential transaction in line with our long-term investment strategy we expect to reverse this position and to generate significant IFRS profits.

**People:** We have continued to invest in the business through recruitment across the Group at all levels, including the appointment of a new Chief Technology Officer, a new Chief Auditor and a new in-house Chief Actuary.

## Key performance indicators

| New business premiums (£bn) | |
|---|---|
| HY Jun 2018 | **12.4** |
| HY Jun 2017 | 0.6 |

| IFRS (loss)/profit before tax (£m) | |
|---|---|
| HY Jun 2018 | **(257)** |
| HY Jun 2017 | 105 |

| Assets under management (£bn) | |
|---|---|
| Jun 2018 | **36.7** |
| Dec 2017 | 24.2 |
| Jun 2017 | 23.6 |

| SCR coverage at RLP (%) | |
|---|---|
| Jun 2018 | **177** |
| Dec 2017 | 163 |
| Jun 2017 | 171 |

| MCEV (£bn) | |
|---|---|
| Jun 2018 | **3.2** |
| Dec 2017 | 2.3 |
| Jun 2017 | 2.3 |

| Customer satisfaction (%) | |
|---|---|
| Jun 2018 | **98** |
| Dec 2017 | 98 |
| Jun 2017 | 98 |

We no longer consider that economic capital coverage is as a key performance metric of the Group because SCR coverage requirement is the materially binding constraint.

# Strategic report continued

## Review of the business

### Market backdrop

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

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

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

### Group performance

On 14 March 2018, the Group acquired a £12bn portfolio of annuities from Prudential plc. The transaction is structured initially as a reinsurance contract and covers approximately 400,000 policyholders who will remain customers of Prudential and continue to be serviced by Prudential until the effective date of the Part VII transfer. The premium was paid by transfer of a portfolio of gilts and other government guaranteed bonds, cash, infrastructure bonds, social housing bonds and corporate bonds. Mainly as a result of the Prudential transaction and the associated capital injection, the Group's assets under management grew to £36.7bn at 30 June 2018 (HY2017: £23.6bn and FY2017: £24.2bn) and the MCEV grew by 37% to £3,151m (HY2017: £2,288m and FY2017: £2,301m).

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

In order to ensure that the Group's operating company was appropriately capitalised post the Prudential transaction, the Group borrowed £500m from a syndicate of banks and injected the proceeds into RLP as equity along with £70m of cash held by RHUK. The Group's institutional shareholders also injected £380m of new equity with all three contributing in proportion to their existing investment. As a result, solvency coverage at RLP was 177% at 30 June 2018 (HY2017: 171% and FY2017: 163%) and 157% at Group (HY2017: 171% and FY2017: 169%). Solvency coverage is higher at RLP than Group because the bank debt held at Group does not qualify as solvency capital.

Over the first half of 2018, the Group generated IFRS losses before tax of £257m (HY2017: a pre-tax profit of £105m and FY2017: a pre-tax profit of £312m). Losses largely arose from the new business strain associated with the Prudential transaction and the actions taken by the Group to reduce investment risk. As noted above, we have sold a substantial proportion of the corporate bonds received as part of the premium for the Prudential transaction and used the proceeds to purchase gilts. We have also reduced the duration of the assets held that are not required to back liabilities on a best estimate basis. Both of these actions have adversely impacted the IFRS balance sheet because both have led to a reduction in the rate used to discount the insurance liabilities. As we invest the assets received as part of the Prudential transaction in line with our long-term investment strategy we expect to reverse these losses and to generate significant IFRS profits.

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

### Our policyholders

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

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

### Risk, capital and asset management

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

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

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

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

# Strategic report continued

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

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

## Our people

Our people are a key strength of the Group and we have continued to recruit to ensure we are well placed to meet future challenges and the continued growth of the business. During the period, headcount has increased from 179 to 196 through recruitment across the Group at all levels in the UK and also for Rothesay Asset Management US LLC. We have also brought the Chief Actuary role in-house (the role was previously outsourced to Willis Towers Watson).

We were delighted to receive the award for Best Life Insurer/Annuity Provider 2018 from the Insurance Investment Exchange, for the second year in a row.

## Looking forward

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

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

# Financial review

In the period to 30 June 2018, the Group made an operating loss before tax of £120m (HY2017: profit of £135m, FY2017: profit of £382m) and a loss before tax of £257m (profit before tax HY2017: £105m, FY2017: £312m). 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. Losses arose from the new business strain associated with the Prudential transaction, the decision to remain overweight in cash and gilts and credit spread widening.

## IFRS financial performance

| £m | HY2018 | HY2017 | FY2017 |
|---|---|---|---|
| New business profit (with assets invested) | **317** | 58 | 141 |
| Management of in-force book | **(357)** | 117 | 339 |
| Acquisition costs | **(65)** | (43) | (85) |
| Administration expenses | **(14)** | (9) | (21) |
| Experience variance | **2** | 1 | (1) |
| Other | **(3)** | 11 | 9 |
| Operating (loss)/profit before tax | **(120)** | 135 | 382 |
| Borrowing costs | **(26)** | (23)[1] | (36) |
| Non-recurring and project expenditure | **(18)** | (24) | (48) |
| Investment and economic (losses)/profits | **(93)** | 17 | 14 |
| (Loss)/profit before tax | **(257)** | 105 | 312 |

1 For HY2017, borrowing costs also include £5m of interest payable on collateral.

The Prudential transaction meant that new business premiums for the half year were £12.4bn (HY2017: £0.6bn) and the pipeline for the rest of 2018 remains strong.

With credit spreads on assets at low levels and concern about potential deterioration in credit markets, the Group has taken the decision to remain overweight in gilts and cash. As a result, the Prudential transaction led to a new business strain and over £4bn of assets remain to be invested according to the Group's long-term investment strategy. As we invest the assets received from the Prudential transaction in line with our long-term investment strategy we expect to reverse this position and generate significant IFRS profits. New business profit for the half year assuming full investment of premiums was £317m (HY2017: £58m).

New business profit is calculated assuming full deployment of premiums and the impact of any under-deployment is reported in the table as a deduction from the management of in-force book. As a result, the table shows a net loss of £357m from management of the in-force book (HY2017: profit of £117m) despite profits of over £160m being generated on the in-force book pre this adjustment. The June 2018 figure includes the impact of adopting CMI17 longevity improvements (see Note 9).

In the first half of 2018, the Group made economic losses of £93m (HY2017: a profit of £17m) as a result of credit spread widening partially offset by gains on our gilt holding.

# Financial review continued

## Balance sheet highlights

| £m | HY2018 | HY2017 | FY2017 |
|---|---|---|---|
| Financial investments | **50,755** | 37,140 | 37,302 |
| Reinsurance assets | **72** | 394 | 168 |
| Other assets | **1,315** | 704 | 904 |
| **Total assets** | **52,142** | 38,238 | 38,374 |
| Share capital and share premium | **829** | 447 | 448 |
| Capital contribution reserve | **5** | 6 | 5 |
| Retained earnings | **1,093** | 1,121 | 1,300 |
| **Total equity** | **1,927** | 1,574 | 1,753 |
| Insurance contract liabilities | **33,083** | 22,036 | 21,741 |
| Reinsurance liabilities | **500** | – | 231 |
| Payables and financial liabilities | **15,417** | 14,237 | 13,965 |
| Borrowings | **1,144** | 349 | 647 |
| Other | **71** | 42 | 37 |
| **Total liabilities** | **50,215** | 36,664 | 36,621 |
| **Total equity and liabilities** | **52,142** | 38,238 | 38,374 |

Total assets increased from £38.4bn as at 31 December 2017 to £52.1bn as at 30 June 2018 primarily as a result of new business. Assets under management increased from £24.2bn as at 31 December 2017 to £36.7bn as at 30 June 2018. These numbers can be derived from the consolidated statement of financial position by adjusting for reinsurance assets, payables, derivatives and collateralised financing as shown in the table below.

At the time of the Prudential transaction, our institutional shareholders injected £380m of equity into the Group which was then downstreamed into RLP. In addition, in order to ensure the ongoing capital strength of RLP and to provide flexibility over the next few months, the Group has borrowed £500m from a syndicate of third party banks leading to borrowings increasing from £647m as at 31 December 2017 to £1,144m as at 30 June 2018. The proceeds were then injected into RLP as equity.

Insurance contract liabilities increased from £21.7bn as at 31 December 2017 to £33.1bn as at 30 June 2018 largely as a result of the Prudential transaction. The change in longevity assumptions made at the end of 2017 resulted in some of our outward longevity reinsurance contracts becoming liabilities rather than assets on an IFRS basis (see Note 8).

| Assets under management £m | HY2018 | HY2017 | FY2017 |
|---|---|---|---|
| Total assets | **52,142** | 38,238 | 38,374 |
| *Less* reinsurance assets | **(72)** | (394) | (168) |
| *Less* payables and financial liabilities | **(15,417)** | (14,237) | (13,965) |
| **Assets under management** | **36,653** | 23,607 | 24,241 |

## Market consistent embedded value

MCEV has increased from £2,301m at 31 December 2017 to £3,151m at 30 June 2018 (HY2017: £2,288m) driven largely by the Prudential transaction and associated new equity. MCEV is summarised in the table below. Adjustments allow for Group borrowings and other Group adjustments, these adjustments increased from a deduction of £603m at 31 December 2017 to a deduction of £1,160m at 30 June 2018 due to the increase in borrowings at the time of the Prudential transaction.

| MCEV £m | HY2018 | HY2017 | FY2017 |
|---|---|---|---|
| Net assets | **3,043** | 2,184 | 2,298 |
| Value of in-force | **1,268** | 746 | 606 |
| *Less* debt and Group adjustments | **(1,160)** | (642) | (603) |
| **MCEV** | **3,151** | 2,288 | 2,301 |

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 business as shown above and debt valuation differences of £45m as at 30 June 2018. The debt valuation is £1,189m on an MCEV basis.

The value on an MCEV basis of new business written in the first half of 2018 was £384m (HY2017: £72m).

Separate disclosures in relation to MCEV will be provided as part of year end reporting. The methodology and assumptions used are consistent with those set out in the FY2017 MCEV supplementary financial statements except that demographic and expense assumptions have been updated in line with IFRS assumptions (as detailed in Note 9 but excluding prudential margins). The liquidity premium adjustment used at HY2018 was 95bps, after the deduction of investment management costs (HY2017: 101bps and FY2017: 104bps).

## Capital management

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

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

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

# Financial review continued

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

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

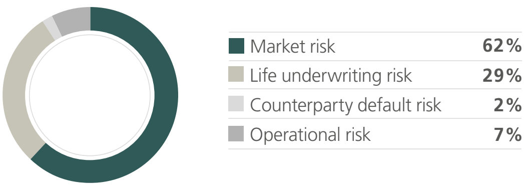
The solvency position of the Group and RLP is summarised in the table below. Group SCR coverage decreased from 169% at 31 December 2017 to 157% at 30 June 2018. SCR coverage at RLP increased from 163% on 31 December 2017 to 177% on 30 June 2018 as a result of the injection of equity into RLP. Solvency coverage is higher at RLP than Group because the bank debt held at Group does not qualify as solvency capital.

| | Group | | | RLP | | |
|---|---|---|---|---|---|---|
| £m | HY2018 | HY2017 | FY2017 | HY2018 | HY2017 | FY2017 |
| Tier 1 capital | 3,025 | 2,348 | 2,280 | 3,496 | 2,348 | 2,180 |
| Tier 2 capital | 662 | 361 | 664 | 662 | 361 | 664 |
| Own Funds available to meet SCR | 3,687 | 2,709 | 2,944 | 4,158 | 2,709 | 2,844 |
| SCR | 2,351 | 1,584 | 1,745 | 2,351 | 1,584 | 1,743 |
| **Surplus above SCR** | **1,336** | 1,125 | 1,199 | **1,807** | 1,125 | 1,101 |
| **SCR coverage** | **157%** | 171% | 169% | **177%** | 171% | 163% |

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

The Group's SCR is calculated using the standard formula. The diagram below provides a breakdown of the SCR post-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.

RLP/RHUK SCR 30 June 2018



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

An analysis of the change in SCR coverage and change in surplus over 100% SCR is shown in the table below. All numbers are shown net of tax impacts. The impact of the change in transitional on 14 March 2018 is largely included in the impact of new business.

| | HY2018 | | HY2017 | | FY2017 | |
|---|---|---|---|---|---|---|
| | Change in surplus £m | Change in SCR coverage % | Change in surplus £m | Change in SCR coverage % | Change in surplus £m | Change in SCR coverage % |
| Opening position | **1,199** | **169%** | 1,023 | 164% | 1,023 | 164% |
| Amortisation of 1/16th of transitional on 1 January | **(76)** | **(5%)** | (57) | (4%) | (57) | (4%) |
| Share issuance | **380** | **22%** | – | – | – | – |
| New business (on a fully deployed basis) | **(403)** | **(42%)** | 5 | (1%) | (29) | (5%) |
| Management of in-force book | **117** | **6%** | 95 | 6% | 91 | 5% |
| Acquisition costs and administration expenses | **(63)** | **(3%)** | (33) | (2%) | (88) | (5%) |
| Other (including experience variance) | **(2)** | **–** | (6) | 1% | (22) | (1%) |
| Finance costs | **(18)** | **(1%)** | (17) | (1%) | (30) | (2%) |
| Non-recurring and project expenditure | **(15)** | **(1%)** | (15) | (1%) | (40) | (2%) |
| Economic profits | **219** | **12%** | 127 | 9% | 46 | 2% |
| Debt issuance | **(2)** | **–** | – | – | 300 | 17% |
| Capital contribution | **–** | **–** | 3 | – | 5 | – |
| **RHUK SCR coverage** | **1,336** | **157%** | 1,125 | 171% | 1,199 | 169% |
| Capital differences between RLP and RHUK | **471** | **20%** | – | – | (98) | (6%) |
| **Closing position** | **1,807** | **177%** | 1,125 | 171% | 1,101 | 163% |

Differences between IFRS accounting standards and Solvency II mean that management actions and changes in economic conditions can have very different impacts on the two bases.

# Financial review continued

The table below provides a range of sensitivities. Where applicable, allowance has been made for the impact of recalculating transitional solvency relief. Interest rates are assumed to fall progressively and hedging adjusted accordingly. The sensitivities are not linear so these results should not be used to interpolate or extrapolate the impact of a smaller or a larger stress. The sensitivities are as at the dates shown and would be different if performed at alternative dates.

| | | HY2018 | | HY2017 | | FY2017 | |
|---|---|---|---|---|---|---|---|
| Assumption | Change in assumption | Impact on surplus £m | Impact on SCR coverage % | Impact on surplus £m | Impact on SCR coverage % | Impact on surplus £m | Impact on SCR coverage % |
| Interest rate | +100bps | **306** | **27%** | 218 | 29% | 278 | 36% |
| Interest rate | -100bps | **(35)** | **(11%)** | (67) | (15%) | (51) | (16%) |
| Inflation | +100bps | **(68)** | **(7%)** | (6) | (5%) | (57) | (9%) |
| Inflation | -100bps | **105** | **8%** | 56 | 7% | 118 | 14% |
| Annuitant mortality | +5% qx | **111** | **5%** | 85 | 7% | 82 | 6% |
| Annuitant mortality | -5% qx | **(139)** | **(7%)** | (94) | (7%) | (89) | (6%) |
| Expenses | +10% | **(65)** | **(3%)** | (41) | (3%) | (50) | (3%) |

# Report of the Directors

The Directors present their condensed financial statements for Rothesay Holdco UK Limited, registered number 08668809, (the Company or RHUK) for the period ended 30 June 2018. Comparative information has been presented for the period ended 30 June 2017 and the year ended 31 December 2017.

## 1. Results

The consolidated results for RHUK and its subsidiaries (the Group) for the period are set out in the condensed consolidated statement of comprehensive income on page 13.

## 2. Dividends

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

## 3. Registered office

The financial statements include the financial statements of RHUK and its subsidiaries; Rothesay Pensions Management Limited, Rothesay Life Plc, Rothesay Assurance Limited, LT Mortgage Financing Limited, Rothesay Asset Management UK Limited and Rothesay Asset Management US LLC. The Company and all subsidiary undertakings, with the exception of Rothesay Asset Management US LLC, are registered in the United Kingdom. The registered office and principal place of business for RHUK and its UK subsidiary undertakings is Level 25, The Leadenhall Building, 122 Leadenhall Street, London, EC3V 4AB. The registered office for Rothesay Asset Management US LLC is Corporate Trust Center, 1209 Orange Street, Wilmington, Delaware 19801, New Castle County, United States.

## 4. Post balance sheet event

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

## 5. Directors

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

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

# Report of the Directors continued

## 6. Statement of Directors’ responsibilities

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 EU and that the interim financial report includes a fair review of the information namely:

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

## 7. Date of authorisation of issue

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

On behalf of the Board

**Addy Loudiadis**
Chief Executive Officer
24 September 2018

# Condensed consolidated statement of comprehensive income
For the period ended 30 June 2018

| | Note | HY2018 £m | HY2017 £m | FY2017 £m |
|---|---|---|---|---|
| **Income** | | | | |
| Gross premiums written | 2 | 12,489 | 742 | 1,447 |
| Less: premiums ceded to reinsurers | | (519) | (327) | (781) |
| **Net premiums written** | | 11,970 | 415 | 666 |
| Investment return | 3 | (130) | 237 | 769 |
| **Total revenue** | | 11,840 | 652 | 1,435 |
| **Expenses** | | | | |
| Policyholder claims | | (757) | (751) | (1,479) |
| Less: reinsurance recoveries | | 492 | 306 | 736 |
| Change in insurance contract liabilities | | (11,341) | 40 | 330 |
| Change in the reinsurers' share of insurance contract liabilities | | (364) | (43) | (500) |
| **Net claims and change in insurance liabilities** | | (11,970) | (448) | (913) |
| Acquisition and administration expenses | 4 | (97) | (76) | (154) |
| Finance costs | 5 | (30) | (23) | (56) |
| **Total operating expenses** | | (127) | (99) | (210) |
| **(Loss)/profit before tax** | | (257) | 105 | 312 |
| Income tax credit/(expense) | 6 | 50 | (19) | (51) |
| **(Loss)/profit for the period/financial year** | | (207) | 86 | 261 |

All income and expenses relate to continuing operations.

The condensed 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 – 20 form an integral part of these financial statements.

# Condensed consolidated statement of financial position
As at 30 June 2018

| | Note | HY2018 £m | HY2017 £m | FY2017 £m |
|---|---|---|---|---|
| **Assets** | | | | |
| Property, plant and equipment | | **3** | 4 | 3 |
| Financial investments | 7 | **50,755** | 37,140 | 37,302 |
| Deferred tax asset | 13 | **3** | – | 1 |
| Reinsurance assets | 8 | **72** | 394 | 168 |
| Accrued interest and prepayments | | **443** | 241 | 312 |
| Receivables | | **454** | 281 | 337 |
| Cash and cash equivalents | | **412** | 178 | 251 |
| **Total assets** | | **52,142** | 38,238 | 38,374 |
| **Equity and liabilities** | | | | |
| **Equity** | | | | |
| Share capital | 14 | **3** | 2 | 2 |
| Employee benefit trust | 14 | **(19)** | (20) | (20) |
| Share premium | 15 | **845** | 465 | 466 |
| Capital contribution reserve | 15 | **5** | 6 | 5 |
| Other reserves | 15 | **1,093** | 1,121 | 1,300 |
| **Total equity** | | **1,927** | 1,574 | 1,753 |
| **Liabilities** | | | | |
| Reinsurance liabilities | 8 | **500** | – | 231 |
| Insurance contract liabilities | 9 | **33,083** | 22,036 | 21,741 |
| Payables and financial liabilities | 10 | **15,417** | 14,237 | 13,965 |
| Borrowings | 11 | **1,144** | 349 | 647 |
| Deferred tax liabilities | 13 | **–** | 1 | – |
| Accruals and deferred income | | **71** | 41 | 37 |
| **Total liabilities** | | **50,215** | 36,664 | 36,621 |
| **Total equity and liabilities** | | **52,142** | 38,238 | 38,374 |

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

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

**Addy Loudiadis**
Chief Executive Officer
24 September 2018
Company number 08668809

# Condensed consolidated statement of changes in equity

## For the period ended 30 June 2018

| | Share capital £m | Share premium £m | Capital contribution reserve £m | Profit and loss reserve £m | Reorganisation reserve £m | Employee benefit trust £m | Total equity £m |
|---|---|---|---|---|---|---|---|
| As at 1 January 2018 | 2 | 466 | 5 | 1,168 | 132 | (20) | 1,753 |
| Loss for the period | – | – | – | (207) | – | – | (207) |
| Share issuance | 1 | 379 | – | – | – | – | 380 |
| Vesting of stock appreciation plan | – | – | (2) | – | – | – | (2) |
| Employee share scheme | – | – | – | – | – | 1 | 1 |
| Capital contribution | – | – | 2 | – | – | – | 2 |
| **As at 30 June 2018** | 3 | 845 | 5 | 961 | 132 | (19) | 1,927 |

## For the period ended 30 June 2017

| | Share capital £m | Share premium £m | Capital contribution reserve £m | Profit and loss reserve £m | Reorganisation reserve £m | Employee benefit trust £m | Total equity £m |
|---|---|---|---|---|---|---|---|
| As at 1 January 2017 | 2 | 465 | 3 | 903 | 132 | (20) | 1,485 |
| Profit for the period | – | – | – | 86 | – | – | 86 |
| Capital contribution | – | – | 3 | – | – | – | 3 |
| **As at 30 June 2017** | 2 | 465 | 6 | 989 | 132 | (20) | 1,574 |

## For the year ended 31 December 2017

| | Share capital £m | Share premium £m | Capital contribution reserve £m | Profit and loss reserve £m | Reorganisation reserve £m | Employee benefit trust £m | Total equity £m |
|---|---|---|---|---|---|---|---|
| As at 1 January 2017 | 2 | 465 | 3 | 903 | 132 | (20) | 1,485 |
| Profit for the financial year | – | – | – | 261 | – | – | 261 |
| Share issuance | – | 1 | – | – | – | – | 1 |
| Vesting of stock appreciation plan | – | – | (4) | 4 | – | – | – |
| Capital contribution | – | – | 6 | – | – | – | 6 |
| **As at 31 December 2017** | 2 | 466 | 5 | 1,168 | 132 | (20) | 1,753 |

# Condensed consolidated cash flow statement

For the period ended 30 June 2018

| | HY2018 £m | HY2017 £m | FY2017 £m |
|---|---|---|---|
| **Cash flows from operating activities** | | | |
| (Loss)/profit for the period/financial year | **(207)** | 86 | 261 |
| **Adjustments for non cash movements in net (loss)/profit for the period/financial year** | | | |
| Depreciation | **1** | – | 1 |
| Share based payments | **2** | 4 | 5 |
| Interest income | **(420)** | (290) | (645) |
| Interest expense | **30** | 23 | 56 |
| Income tax expense | **(48)** | 20 | 54 |
| Deferred tax credit | **(2)** | (1) | (3) |
| **Net (increase)/decrease in operational assets** | | | |
| Financial investments | **(13,453)** | 1,206 | 1,043 |
| Deferred tax asset | **(2)** | – | – |
| Reinsurance assets | **96** | 43 | 269 |
| Receivables | **(67)** | (19) | 155 |
| Accrued interest and prepayments | **–** | – | 5 |
| **Net increase/(decrease) in operational liabilities** | | | |
| Insurance contract liabilities | **11,342** | (39) | (330) |
| Claims outstanding | **–** | 4 | 1 |
| Reinsurance liabilities | **269** | – | 231 |
| Financial liabilities | **1,229** | (1,196) | (1,387) |
| Other payables | **261** | 161 | (172) |
| Deferred tax liabilities | **–** | (1) | – |
| Accruals and deferred income | **20** | – | 6 |
| **Net cash flows used in operating activities** | **(949)** | 1 | (450) |
| Interest paid | **(18)** | (13) | (58) |
| Interest received | **289** | 323 | 609 |
| Tax paid | **(38)** | (46) | (62) |
| **Cash flows from operating activities** | **(716)** | 265 | 39 |
| **Cash flows from financing activities** | | | |
| Repayment of borrowings | **–** | (238) | (240) |
| Proceeds from issuance of debt | **497** | – | 300 |
| Proceeds from issue of ordinary share capital (including share premium) | **380** | – | 1 |
| **Net cash flows from financing activities** | **877** | (238) | 61 |
| **Cash outflows from investing activities** | | | |
| Net acquisition of property, plant and equipment | **–** | (1) | (1) |
| **Net cash outflows from investing activities** | **–** | (1) | (1) |
| Net increase in cash and cash equivalents | **161** | 26 | 99 |
| Cash and cash equivalents at 1 January | **251** | 152 | 152 |
| **Cash and cash equivalents at the statement of financial position date** | **412** | 178 | 251 |

# Notes to the financial statements

## Note 1 – General information and basis of preparation

### (a) General information

RHUK is the ultimate holding company of the Rothesay group of companies. RHUK is a registered limited private company incorporated and domiciled in the United Kingdom. The Company's registered office and principal place of business is Level 25, The Leadenhall Building, 122 Leadenhall Street, London, EC3V 4AB.

### (b) Basis of preparation

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

The 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.

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

### (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 any changes to existing standards, including matters of significant judgement and use of estimates. Accounting policies of the Group can be found in the 2017 Annual Report.

# Notes to the financial statements continued

## Note 2 – Segmental analysis

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

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

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

## Note 3 – Investment return

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

| | **HY2018 £m** | HY2017 £m | FY2017 £m |
|---|---|---|---|
| Interest income on financial investments at fair value through profit and loss | **420** | 290 | 645 |
| Unrealised (losses)/gains on financial investments | **(721)** | (128) | 14 |
| Realised gains on financial investments | **187** | 83 | 131 |
| Investment expenses | **(16)** | (8) | (21) |
| **Total investment return** | **(130)** | 237 | 769 |

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

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

## Note 4 – Acquisition and administration expenses

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

| | HY2018 £m | HY2017 £m | FY2017 £m |
|---|---|---|---|
| Acquisition costs | 65 | 43 | 85 |
| Administration expenses – recurring | 14 | 9 | 21 |
| Administration expenses – project and other one off expenses | 18 | 24 | 48 |
| Total operating expenses | 97 | 76 | 154 |

## Note 5 – Finance costs

| | HY2018 £m | HY2017 £m | FY2017 £m |
|---|---|---|---|
| Interest payable on collateral | 3 | 1 | 3 |
| Interest payable on collateralised agreements and financing | 1 | 4 | 17 |
| Total interest payable on collateral and collateralised agreements | 4 | 5 | 20 |
| Interest payable on borrowing from participating interest | 12 | – | 10 |
| Interest payable on third party borrowings | 14 | 15 | 26 |
| Interest payable on borrowings from affiliates | – | 3 | – |
| Total borrowing costs | 26 | 18 | 36 |
| Net finance costs | 30 | 23 | 56 |

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

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

# Notes to the financial statements continued

## Note 6 – Income tax expense

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

### (a) Tax charged in the income statement

| | HY2018 £m | HY2017 £m | FY2017 £m |
|---|---|---|---|
| *Current income tax:* | | | |
| UK corporation tax | **(48)** | 20 | 54 |
| **Total current income tax** | **(48)** | 20 | 54 |
| *Deferred tax:* | | | |
| Origination and reversal of temporary differences | **(2)** | (1) | (3) |
| **Total deferred tax** | **(2)** | (1) | (3) |
| **Total (credit)/expense in the condensed consolidated statement of comprehensive income** | **(50)** | 19 | 51 |

### (b) Reconciliation of the total tax charge

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

| | HY2018 £m | HY2017 £m | FY2017 £m |
|---|---|---|---|
| (Loss)/profit on ordinary activities before taxation | **(257)** | 105 | 312 |
| Tax calculated at UK standard rate of corporation tax of 19.00% (HY2017 and FY2017: 19.25%) | **(49)** | 20 | 60 |
| Permanent differences | **–** | – | 1 |
| Temporary differences | **(1)** | (1) | (10) |
| **Total tax (credit)/expense reported in the condensed consolidated statement of comprehensive income** | **(50)** | 19 | 51 |

## Note 7 – Fair value

The fair value of a financial instrument is the amount that would be received on the sale of an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, i.e. the exit price. Financial investments are marked to bid prices and financial liabilities are marked to offer prices. Fair value measurements do not include transaction costs. Fair value gains or losses are included in investment income.

The best evidence of fair value is a quoted price in an active market. If listed prices or quotations are not available, fair value is determined by reference to prices for similar instruments, quoted prices or recent transactions in less active markets, or internally developed models that primarily use, as inputs, market based or independently sourced parameters, including but not limited to interest rates, volatilities, equity or debt prices, foreign exchange rates, credit curves and funding rates. The fair value of certain financial investments and financial liabilities require valuation adjustments for counterparty credit quality, funding risk, transfer restrictions, illiquidity and bid/offer inputs.

## **Note 7 – Fair value** continued

Financial instruments such as corporate debt securities, covered bonds, government, sub sovereign and agency obligations, and certain money market instruments are valued by verifying to quoted prices, recent trading activity for identical or similar instruments, broker or dealer quotations or alternative pricing sources with reasonable levels of price transparency. Consideration is given to the nature of the quotations (e.g. indicative or firm) and the relationship of recent market activity to the prices provided from alternative pricing sources. Valuation adjustments are typically made: (i) if the cash instrument is subject to regulatory or contractual transfer restrictions; and/or (ii) for other premiums and discounts that a market participant would require to arrive at fair value. Valuation adjustments are generally based on market evidence.

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

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

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

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

# Notes to the financial statements continued

## Note 7 – Fair value continued

### 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; and
- Level 3: one or more inputs to valuation techniques are significant and unobservable.

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

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

| HY2018 | Level 1 £m | Level 2 £m | Level 3 £m | Total £m |
|---|---|---|---|---|
| Collective investment schemes | 1,855 | – | – | 1,855 |
| Government, sub sovereign and agency obligations | 7,092 | 12,258 | – | 19,350 |
| Corporate bonds and other corporate debt | – | 11,036 | 877 | 11,913 |
| Derivative assets | – | 11,169 | – | 11,169 |
| Collateralised agreements and financing | – | 2,368 | – | 2,368 |
| Loans secured on property | – | – | 3,942 | 3,942 |
| Certificate of deposits | – | 158 | – | 158 |
| **Total financial investments at fair value** | **8,947** | **36,989** | **4,819** | **50,755** |
| Derivative financial instruments | – | 11,649 | 5 | 11,654 |
| Collateralised financing agreements | – | 2,145 | – | 2,145 |
| **Total financial liabilities at fair value** | **–** | **13,794** | **5** | **13,799** |

| HY2017 | Level 1 £m | Level 2 £m | Level 3 £m | Total £m |
|---|---|---|---|---|
| Collective investment schemes | 1,036 | – | – | 1,036 |
| Government, sub sovereign and agency obligations | 5,793 | 6,974 | – | 12,767 |
| Corporate bonds and other corporate debt | – | 5,965 | 539 | 6,504 |
| Derivative assets | – | 10,649 | – | 10,649 |
| Collateralised agreements and financing[1] | – | 2,753 | – | 2,753 |
| Loans secured on property[1] | – | – | 3,279 | 3,279 |
| Certificate of deposits | – | 152 | – | 152 |
| Total financial investments at fair value | 6,829 | 26,493 | 3,818 | 37,140 |
| Derivative financial instruments | – | 10,860 | – | 10,860 |
| Collateralised financing agreements | – | 1,901 | – | 1,901 |
| Total financial liabilities at fair value | – | 12,761 | – | 12,761 |

## Note 7 – Fair value continued

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

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

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

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

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

# Notes to the financial statements continued

## Note 7 – Fair value continued

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

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

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

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

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

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

## Note 7 – Fair value continued

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

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

# Notes to the financial statements continued

## Note 7 – Fair value continued

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

## Note 8 – Reinsurance assets/(liabilities)

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

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

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

## Note 8 – Reinsurance assets/(liabilities) continued

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

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

## Note 9 – Insurance contract liabilities

### Key valuation assumptions

This note details the assumptions with the greatest impact on 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 | | | | | |
|---|---|---|---|---|---|---|
| | HY2018 | | HY2017 | | FY2017 | |
| | Pensions originated | Insurance originated | Pensions originated | Insurance originated | Pensions originated | Insurance originated |
| Males | 97.1% S2PMA | 103.8% PMA08 | 97.4% S2PMA | 104.4% PMA08 | 96.1% S2PMA | 104.3% PMA08 |
| Females | 97.1% S2PFA | 103.8% PFA08 | 97.4% S2PFA | 104.4% PFA08 | 96.1% S2PFA | 104.3% PFA08 |

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

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

# Notes to the financial statements continued

## Note 9 – 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. Mortality assumptions are generally set with reference to a RLP specific suite of mortality tables. These have been expressed for reporting purposes as an equivalent to the CMI S2 series of mortality tables drawn up by the Continuous Mortality Investigation (CMI) of the Institute and Faculty of Actuaries. The S2 tables are based on industry-wide experience.

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

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

### *(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 obtainable on the basket of asset matching the applicable insurance contract liabilities at 30 June 2018.

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

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

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

## **Note 9 – 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 2018, 30 June 2017 and 30 December 2017 by asset category:

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

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

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 a significant proportion of the portfolio being invested in assets with either a low probability of default due to government guarantees or expectation of higher recovery in the event of default through collateralisation, recourse to specific assets and credit default swap protection.

### *(c) Expenses*

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

# Notes to the financial statements continued

## Note 9 – Insurance contract liabilities continued

Within these expense provisions, an allowance for future expense inflation has been provided to cover the impact of both salary and price inflation. The future rate of expense inflation is assumed to be RPI (as implied by the RPI swap curve) plus an addition at each duration of 0.25% p.a. for all expenses (HY2017: 0.25% p.a. or 1.00% p.a. and FY2017: 0.25% p.a.).

### *(d) Other assumptions*

An important actuarial assumption relates to the future rate of escalation of certain benefits, but as the 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 or all of their benefit as a lump sum. The assumptions are modelled to reflect a proportion of the maximum pension commencement lump sum that a member can choose to take tax free when reaching retirement, along with the probability of the whole pension being converted to a lump sum prior to retirement. The main impact of the assumption is to change the profile of the cash flows assumed to be paid as the value of the lump sums reflect a discounted value of the same cash flows as projected using the assumptions to value the liability as an annuity.

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

### *(e) Movements in insurance contract liabilities*

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

## Note 9 – Insurance contract liabilities continued

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

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

The table above details the change in the gross and net insurance liabilities over the period. The table 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, net of reinsurance, of changes in the assumptions used:

### Net increase in net liabilities

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

# Notes to the financial statements continued

## Note 9 – Insurance contract liabilities continued

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

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

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

### *(f) Sensitivity analysis*

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

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

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

## Note 9 – Insurance contract liabilities continued

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

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

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

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

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

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

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

# Notes to the financial statements continued

## Note 9 – Insurance contract liabilities continued

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

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

## Note 10 – Payables and financial liabilities

| | HY2018 £m | HY2017 £m | FY2017 £m |
|---|---|---|---|
| Derivative financial instruments | 11,654 | 10,860 | 11,165 |
| Collateralised financing agreements | 2,145 | 1,901 | 1,405 |
| Deposits received as collateral from third parties | 1,235 | 763 | 1,264 |
| Deposits received as collateral for derivatives from participating interest | – | 626 | – |
| Current tax payable | – | 20 | 38 |
| Other taxes and social security costs | 5 | 3 | 7 |
| Other payables | 378 | 64 | 86 |
| Total payables and financial liabilities | 15,417 | 14,237 | 13,965 |

## Note 11 – Borrowings

The Group's borrowings are as follows:

| | HY2018 £m | HY2017 £m | FY2017 £m |
|---|---|---|---|
| Third party syndicated loan | 497 | – | – |
| Affiliate subordinated loan | – | 100 | – |
| Subordinated loans from participating interest | 398 | – | 398 |
| Subordinated loan notes | 249 | 249 | 249 |
| Total borrowed | 1,144 | 349 | 647 |

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

In March 2018, the Group entered into a three year term loan facility with a syndicate of third party banks. The £300m revolving credit facility entered into in March 2017 also remains effective but undrawn.

## Note 11 – Borrowings continued

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

| Notional amount | Issue date | Redemption date | Callable at par at option of the Group from | Coupon | Carrying amount HY2018 £m | Carrying amount HY2017 £m | Carrying amount FY2017 £m | Fair value HY2018 £m | Fair value HY2017 £m | Fair value FY2017 £m |
|---|---|---|---|---|---|---|---|---|---|---|
| **Subordinated loans from participating interest** | | | | | | | | | | |
| £100m | 21 December 2012 | Lender has option to convert to equity from 21 December 2022 | 21 December 2017 and every six months thereafter | 6m£L plus 4.25% | **100** | 100 | 100 | **94** | 100 | 95 |
| £300m | 19 September 2017 | 19 September 2028 | 19 September 2023 and annually thereafter | 3m£L plus 5.95% | **298** | – | 298 | **301** | – | 305 |
| **Subordinated loans** | | | | | | | | | | |
| £250m | 22 October 2015 | 22 October 2025 | 22 October 2025 | 8.00% | **249** | 249 | 249 | **294** | 279 | 303 |
| **Unsecured loans** | | | | | | | | | | |
| £500m | 14 March 2018 | 14 March 2021 | Immediate | 6m£L plus 1.00% with 0.25% step-up every six months thereafter | **497** | – | – | **500** | – | – |

For the period ended 30 June 2018, an interest expense of £26m (HY2017: £18m and FY2017: £36m) was recognised in the condensed consolidated statement of comprehensive income in respect of these borrowings.

## Note 12 – Reconciliation of borrowings

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

| | 1 January 2018 £m | Cash flows £m | Non cash flows £m | 30 June 2018 £m |
|---|---|---|---|---|
| Third party syndicated loan | – | 497 | – | 497 |
| Subordinated loans from participating interest | 398 | – | – | 398 |
| Subordinated loan notes | 249 | – | – | 249 |
| **Total borrowings** | **647** | **497** | **–** | **1,144** |

| | 1 January 2017 £m | Cash flows £m | Non cash flows £m | 31 December 2017 £m |
|---|---|---|---|---|
| Third party syndicated loan | 238 | (240) | 2 | – |
| Affiliate subordinated loan | 100 | – | (100) | – |
| Subordinated loans from participating interest | – | 300 | 98 | 398 |
| Subordinated loan notes | 249 | – | – | 249 |
| **Total borrowings** | 587 | 60 | – | 647 |

# Notes to the financial statements continued

## Note 13 – Deferred tax assets/(liabilities)

Deferred tax balances comprise:

| | HY2018 £m | HY2017 £m | FY2017 £m |
|---|---|---|---|
| Temporary differences between the financial statements and the tax deductions | 3 | (1) | 1 |
| **Total temporary differences** | 3 | (1) | 1 |

The movements in the deferred tax balances were as follows:

| | HY2018 £m | HY2017 £m | FY2017 £m |
|---|---|---|---|
| At 1 January | 1 | (2) | (2) |
| Recognition of previously unrecognised deferred tax asset | – | – | 1 |
| Timing difference | 2 | – | 1 |
| Transitional adjustments | – | 1 | – |
| Capital allowances | – | – | 1 |
| **At statement of financial position date** | 3 | (1) | 1 |

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:

| | HY2018 £m | HY2017 £m | FY2017 £m |
|---|---|---|---|
| Temporary differences in relation to equity based compensation | – | 1 | – |
| **Total temporary differences** | – | 1 | – |

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

| | HY2018 £m | HY2017 £m | FY2017 £m |
|---|---|---|---|
| At 1 January | – | 2 | 2 |
| Temporary difference in relation to equity based compensation | – | (1) | (2) |
| **At statement of financial position date** | – | 1 | – |

## Note 14 – Share capital

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

| | HY2018 | | HY2017 | | FY2017 | |
|---|---|---|---|---|---|---|
| | No. | £m | No. | £m | No. | £m |
| Ordinary share capital of £1.00 each | – | – | 30,001 | – | – | - |
| Ordinary share capital of £0.001 each | **1,214,827,671** | **1.2** | 1,034,034,369 | 1.0 | 1,034,034,369 | 1.0 |
| Preference share capital of £0.001 each | **1,214,827,671** | **1.2** | 1,034,034,369 | 1.0 | 1,034,034,369 | 1.0 |
| Restricted shares of £0.001 each | **70,000,000** | **0.1** | – | – | 70,000,000 | 0.1 |
| Authorised share capital | **2,499,655,342** | **2.5** | 2,068,098,739 | 2.0 | 2,138,068,738 | 2.1 |

In order to ensure that the Group remained appropriately capitalised following the Prudential transaction, on 14 March 2018 the Company allotted the following shares to existing institutional shareholders for total cash consideration of £380m, reflecting share premium of £379m:

- 145,713,416 A ordinary shares of £0.001 each.
- 35,079,886 C ordinary shares of £0.001 each.
- 180,793,302 preference shares of £0.001 each.

The ordinary shares issued are analysed into the following categories:

| | HY2018 | | HY2017 | | FY2017 | |
|---|---|---|---|---|---|---|
| | No. | £m | No. | £m | No. | £m |
| A £0.001 ordinary | **943,519,813** | **0.9** | 789,429,000 | 0.8 | 797,806,397 | 0.8 |
| B £0.001 ordinary | **44,159,475** | **0.1** | 81,427,369 | 0.1 | 44,159,475 | 0.1 |
| C £0.001 ordinary | **227,148,383** | **0.2** | 76,426,000 | 0.1 | 192,068,497 | 0.1 |
| D £1.00 ordinary | – | – | 30,001 | – | – | – |
| E £0.001 ordinary | – | – | 49,798,000 | – | – | – |
| F £0.001 ordinary | – | – | 36,954,000 | – | – | – |
| Total | **1,214,827,671** | **1.2** | 1,034,064,370 | 1.0 | 1,034,034,369 | 1.0 |

The A, B, and C 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.

# Notes to the financial statements continued

## Note 14 – Share capital continued

| Number of shares | HY2018 No. | HY2017 No. | FY2017 No. |
|---|---|---|---|
| At 1 January | 2,138,068,738 | 2,068,098,739 | 2,068,098,739 |
| Ordinary share issuance | 180,793,302 | – | – |
| Preference share issuance | 180,793,302 | – | – |
| Cancellation of D shares | – | – | (30,001) |
| Restricted share issuance | – | – | 70,000,000 |
| At statement of financial position date | 2,499,655,342 | 2,068,098,739 | 2,138,068,738 |

### Employee benefit trust (EBT)

On 6 January 2016, the Company established an EBT, the Rothesay Employee Share Trust (the Trust). The Trust was established to purchase and hold shares of the Company for delivery to employees of employee share schemes. Shares owned by the Trust are included at cost in the condensed consolidated statements of financial position and are shown as a deduction from shareholders equity. They are disclosed as employee scheme shares until they vest.

During the period 41,939 ordinary and 41,939 preference shares previously awarded to employees have been bought back by the Trust.

## Note 15 – Share premium account and reserve

| | Share premium £m | Capital contribution £m | Employee scheme treasury shares £m | Profit and loss reserve £m | Reorganisation reserve £m |
|---|---|---|---|---|---|
| At 1 January 2018 | 466 | 5 | (20) | 1,168 | 132 |
| Loss for the period | – | – | – | (207) | – |
| Share issuance | 379 | – | – | – | – |
| Vesting of share | – | (2) | – | – | – |
| Employee share scheme | – | – | 1 | – | – |
| Capital contribution | – | 2 | – | – | – |
| At 30 June 2018 | 845 | 5 | (19) | 961 | 132 |

| | Share premium £m | Capital contribution £m | Employee scheme treasury shares £m | Profit and loss reserve £m | Reorganisation reserve £m |
|---|---|---|---|---|---|
| At 1 January 2017 | 465 | 3 | (20) | 903 | 132 |
| Profit for the period | – | – | – | 86 | – |
| Capital contribution | – | 3 | – | – | – |
| At 30 June 2017 | 465 | 6 | (20) | 989 | 132 |

## Note 15 – Share premium account and reserve continued

| | Share premium £m | Capital contribution £m | Employee scheme treasury shares £m | Profit and loss reserve £m | Reorganisation reserve £m |
|---|---|---|---|---|---|
| At 1 January 2017 | 465 | 3 | (20) | 903 | 132 |
| Profit for the financial year | – | – | – | 261 | – |
| Share issuance | 1 | – | – | – | – |
| Vesting of stock appreciation rights | – | (4) | – | 4 | – |
| Capital contribution | – | 6 | – | – | – |
| At 31 December 2017 | 466 | 5 | (20) | 1,168 | 132 |

## Note 16 – Capital management

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

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

From 1 January 2016, the 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 period ended 30 June 2018.

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 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').

# Notes to the financial statements continued

## Note 16 – Capital management continued

Capital in excess of that required to meet the technical provisions is known as Own Funds. As at 30 June 2018, Own Funds for the Group are £3,687m (HY2017: £2,709m and FY2017: £2,944m) made up as follows:

| | HY2018 £m | HY2017 £m | FY2017 £m |
|---|---|---|---|
| Total IFRS equity | 1,927 | 1,574 | 1,753 |
| Liability valuation differences and other adjustments | 1,098 | 774 | 527 |
| Total tier 1 | 3,025 | 2,348 | 2,280 |
| Solvency II debt valuation | 662 | 361 | 664 |
| Total tier 2 | 662 | 361 | 664 |
| Own Funds | 3,687 | 2,709 | 2,944 |

The Group holds both debt and equity to optimise its capital structure and improve shareholder return. During 2018, £380m of equity was issued by the Group. During the prior year, the Group issued £300m of tier 2 debt.

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

## Note 17 – Related parties disclosures

### Ultimate holding companies

The companies with an economic interest in RHUK are:

- The Blackstone Group L.P.: 35.85%
- GIC Private Limited: 35.85%
- MassMutual Financial Group: 24.67%

The remaining percentage is owned by the Directors, management, employees and the Trust. Percentages are based on economic interest in RHUK.

### Related party transactions

Prior to the acquisition of Goldman Sachs’ shareholding by MassMutual, Blackstone and GIC on 18 December 2017 the Group entered into various transactions with former fellow participating interests all within the Goldman Sachs Group, including Goldman Sachs International, Goldman Sachs and Co, the Goldman Sachs Group Inc., Goldman Sachs Asset Management International, and Rothesay Life (Cayman) Limited. Details of such transactions are as follows. Closing balances in respect of these transactions are only shown for 30 June 2017.

## Note 17 – Related parties disclosures continued

| | HY2018 £m | HY2017 £m | FY2017 £m |
|---|---|---|---|
| **Statement of comprehensive income** | | | |
| Realised/unrealised gains/(losses) on financial assets and liabilities | – | 216 | (131) |
| Income from money market securities held in collective investment schemes | – | 1 | 1 |
| Interest on collateralised agreements and financing | – | 15 | 34 |
| Service fee charges | – | (3) | (11) |
| Investment management charges | – | – | (7) |
| **Statement of financial position** | | | |
| Derivative financial assets and liabilities | – | (1,841) | – |
| Collateralised agreements and financing | – | 924 | – |
| Collective investments schemes | – | 1,036 | – |
| Accrued interest | – | 8 | – |
| Amounts payable to related party | – | (626) | – |
| **Capital** | | | |
| Ultimate parent company | – | 467 | – |
| Capital contribution | – | 6 | – |

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

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

| | HY2018 £m | FY2017 £m |
|---|---|---|
| **Statement of comprehensive income** | | |
| Change in the reinsurers' share of insurance contract liabilities and reinsurance recoveries | (2) | (1) |
| Finance costs | (12) | 10 |
| Operating expenses | (1) | – |
| **Statement of financial position** | | |
| Reinsurance liabilities | 3 | 1 |
| Borrowings | 398 | 398 |
| **Capital** | | |
| Ultimate parent company | 513 | 282 |

# Notes to the financial statements continued

## Note 17 – Related parties disclosures continued

### Transactions with key management personnel

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

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

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

The tables below represent transactions and balances between RHUK and its subsidiaries RPML and RLP.

### Transactions with RPML

| | HY2018 £m | HY2017 £m | FY2017 £m |
|---|---|---|---|
| **Statement of financial position** | | | |
| Other receivables | 8 | 2 | 7 |
| Capital | 7 | – | 5 |

### Transactions with RLP

| | HY2018 £m | HY2017 £m | FY2017 £m |
|---|---|---|---|
| **Statement of comprehensive income** | | | |
| Finance cost | – | 1 | (4) |
| Cost transfer | (2) | – | (3) |
| **Statement of financial position** | | | |
| Other payables | 5 | 272 | 3 |
| Capital | 1,764 | 814 | 814 |
| Dividends | – | – | 370 |

## Note 18 – Investments in subsidiaries

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 | HY2018 £m | HY2017 £m | FY2017 £m | HY2018 % equity interest | HY2017 % equity interest | FY2017 % equity interest |
|---|---|---|---|---|---|---|---|---|
| Rothesay Pensions Management Limited (RPML) | UK | Service company | 7 | – | 5 | 100% | 100% | 100% |
| Rothesay Life Plc (RLP) | UK | Life insurance | 1,764 | 814 | 814 | 100% | 100% | 100% |
| Rothesay Assurance Limited | UK | Dormant | – | 2 | – | 100% | 100% | 100% |
| LT Mortgage Financing Limited (LTMF) | UK | Dormant | – | – | – | 100% | 100% | 100% |
| Rothesay Asset Management UK Limited | UK | Holding company | 5 | N/A | – | 100% | N/A | 100% |
| Rothesay Asset Management US LLC | US | Operating company | 5 | N/A | – | 100% | N/A | 100% |

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

The above subsidiary undertakings, with the exception of Rothesay Asset Management US LLC, are registered in the United Kingdom. The registered office and principal place of business for all UK subsidiary undertakings is Level 25, The Leadenhall Building, 122 Leadenhall Street, London, EC3V 4AB.

Rothesay Asset Management US LLC is registered in Delaware, United States of America. The registered office is Corporate Trust Center, 1209 Orange Street, Wilmington, Delaware 19801, New Castle County.

LT Mortgage Financing Limited has remained dormant during 2018.

On 3 October 2016, the PRA granted an application to cancel the permissions of Rothesay Assurance Limited. As it is now no longer needed, the Group has begun proceedings to voluntarily liquidate Rothesay Assurance Limited.

# Notes to the financial statements continued

## Note 19 – 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:

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

### Other commitments

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

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

## Note 20 – Post balance sheet events

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

# Glossary of terms

| | |
|---|---|
| **Acquisition costs** | Acquisition costs comprise the expenses associated with the origination of new business, including incentive payments made to employees. |
| **Administration expenses** | Administration costs represent the cost of administering the in-force book of business. |
| **Annuity** | A series of regular payments made to an individual until their death. Payments may be indexed. |
| **Assets under management** | Assets being managed by the Group. Can be derived by taking total assets and adjusting for reinsurance assets, payables, derivative liabilities and collateralised liabilities. |
| **Assumed reinsurance premiums** | Premiums received by the Group in respect of reinsurance inwards, i.e. a policy where RLP is acting as the reinsurer. |
| **Best estimate liability (BEL)** | The liabilities of the Group calculated on a best estimate basis, under Solvency II, i.e. where all the assumptions made in the calculation are best estimate. |
| **Bulk annuity** | A bulk annuity, sometimes referred to as a bulk purchase annuity, is a contract between a defined benefit pension scheme and an insurance company, whereby an insurance company insures some or all of the annuities being paid by the pension scheme. |
| **Capital contribution reserve** | The capital contribution reserve arose as a result of the stock appreciation rights granted in relation to the Rothesay Life share incentive plan. |
| **Collateralised agreements/ investments** | Loans secured on property or other collateral. |
| **Collective investment schemes** | A way of investing money alongside other investors. |
| **Corporate bonds and other corporate debt** | These are debt securities issued by corporations which are not guaranteed by governments. |
| **Credit risk** | The risk of loss or of adverse change in the financial situation resulting from fluctuations in the credit standing of issuers of securities, counterparties and any debtors. |
| **Deferred annuities** | Annuities or pensions due to be paid from a future date or when the policyholder reaches a specified age. |
| **Demographics** | Statistical data relating to the population and particular groups within it. |
| **Distributable profits** | A company's profits available for distribution are its accumulated realised profits. |

# Glossary of terms continued

| | |
|---|---|
| **Economic capital** | Represents management's internal risk-based calculation of the capital required to remain solvent for a 99.8% confidence level over a 1-year period. |
| **Economic profits** | Represent the change in IFRS profit or SII surplus as a result of changes in market conditions. |
| **Employee benefit trust (EBT)** | A trust established to purchase and hold shares of the Company for delivery to employees under employee share schemes. |
| **Equity based compensation** | Share based transactions awarded to employees under incentive plans. |
| **Equity release mortgages** | Mortgages extended to older customers (aged 55 and over) against their residential property at low loan to value percentage. Unlike a typical residential mortgage, no interest is paid monthly by the customer. Instead, the interest is simply added to the principal loan amount with the loan only repayable on death or entry into long-term care of the last remaining homeowner. |
| **Fair value** | Amount that would be received on sale of an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. |
| **Finance costs** | Represent interest payable on borrowings. |
| **Government, sub sovereign and agency obligations** | A bond issued by a country's government or corporate debt which is guaranteed by a government to repay borrowed money at a specific time. |
| **Gross premiums written** | Premiums received by RLP on new business and generated through regular premiums. |
| **In force** | An insurance policy or contract reflected on records that has not expired, matured or otherwise been surrendered or terminated. |
| **Infrastructure** | Investments in infrastructure such as water, energy and transportation. |
| **International Financial Reporting Standards (IFRS)** | Accounting standards that are applied in preparing the Group's consolidated financial statements. |
| **Investment return** | Comprises all interest income on financial investments at fair value through profit and loss, realised investment gains and losses and movements in unrealised gains and losses, as well as expenses directly related to investments executed during the period. |

| | |
|---|---|
| **Liquidity premium** | An addition to the risk-free rate used when projecting investment returns and discounting cash flows on certain types of contracts where the liabilities are illiquid and have cash flows that are predictable. |
| **Longevity risk** | The risk that a company could be exposed to a higher pay out as a result of increasing life expectancy. |
| **LTMF** | LT Mortgage Financing Limited. Currently dormant. |
| **Management of in-force book** | Profits or losses generated on the in-force book of business. |
| **Market consistent embedded value (MCEV)** | Provides an indication of the value of business written by measuring the risk-adjusted value of the in-force business, allowing for the unwind of margins. |
| **Market risk** | The risk of loss or of adverse change resulting, directly or indirectly, from fluctuations in the level and in the volatility of market prices of assets, liabilities and financial instruments. |
| **Matching adjustment** | The matching adjustment is broadly equivalent to the illiquidity premium that can be earned on the illiquid assets held to back illiquid liabilities. |
| **Mortality tables** | A table which shows for each age, what the probability is that a person of that age and gender will die before his or her next birthday. |
| **Net premiums** | Life insurance premiums, net of reinsurance premiums paid to third-party reinsurers. |
| **New business** | New insurance contracts and reinsurance inwards sold during the period. Includes business acquired through purchase of companies. |
| **New business premium** | Premium paid on new business transacted during the period and (from 2018 onwards) adjustments to new business premiums from prior periods. |
| **New business profit** | Profit generated on business transacted during the period and (from 2018 onwards) adjustments to new business premiums from prior periods. |
| **Operating profit/(loss) before tax** | Measure of profitability, capturing new business profit, in-force profit and assumption changes, but excluding market fluctuations and exceptional expenses. |
| **Own Funds** | Available capital under the Solvency II regime. |

# Glossary of terms continued

| | |
|---|---|
| **Partial internal model** | The Solvency II Directive provides for two ways of measuring risk. Insurance companies can use either the standard formula or their own internal model, which must first be approved by the PRA. RHUK has recently made a formal application to the PRA 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. |
| **Part VII transfers** | Court-approved transfer of a portfolio of contracts from one entity to another. |
| **Pillar I** | Under Solvency II, represents the solvency capital requirement calculated using a standard formula, or (partial) internal model. |
| **Prudential Regulation Authority (PRA)** | The PRA is a UK regulatory body responsible for prudential regulation and supervision of banks, building societies, credit unions, insurers and major investment firms. |
| **qx** | qx is actuarial notation used to represent the probability of a life aged x dying during the year. |
| **Regular premiums** | Payments of premium made regularly over the duration of the policy. |
| **Reinsurance** | Protection sold to or purchased from another insurance company. |
| **Reorganisation reserve** | Reflects the impact of the Group reorganisation in 2013 which led to an increase in reserves of £132m reflecting the excess of consolidated net assets to the historical cost of investment in subsidiary entities. |
| **RHUK** | Rothesay Holdco UK Limited. |
| **Risk margin** | Under Solvency II, the cost of transferring non-hedgeable risks. |
| **RLP** | Rothesay Life Plc, the Group’s regulated life company. |
| **RPML** | Rothesay Pensions Management Limited, the Group’s service company. |
| **Single premiums** | Single premium policies of insurance are those that require only a single lump sum payment from the policyholder. |
| **SCR coverage ratio** | Own Funds divided by SCR. Measure of surplus above capital requirement. |
| **Solvency capital requirement (SCR)** | Under Solvency II, capital requirement to withstand a 1-in-200 year event. |

| | |
|---|---|
| Solvency II | The solvency regime applicable from 1 January 2016. Under Solvency II, the 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. |
| Subordinated loan | A fixed interest issue or debt that ranks below other debt in order of priority for repayment if the issuer is liquidated. Holders are compensated for added risk through higher rates of interest. Under EU insurance regulation, subordinated debt is not treated as a liability and counts towards the coverage of the required minimum margin of solvency with limitations. |
| Third party administration (TPA) agreements | Contract with pensions administrator to process claims and payroll on behalf of RLP. |
| Yield | A measure of the income received from an investment compared to the price paid for the investment. Normally expressed as a percentage. |

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Rothesay life

Rothesay Holdco UK Limited,
Level 25, The Leadenhall Building,
122 Leadenhall Street, London,
EC3V 4AB

www.rothesaylife.com

T: 020 7770 5300