Rothesay Life Plc

Interim condensed financial statements for the six months ended 30 June 2019

Rothesay Life is one of the leading providers 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 £37bn of assets under management and insuring the annuities of over 780,000 individuals.

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Strategic report

The Directors present the interim condensed financial statements for Rothesay Life Plc (RLP or the Company), registered number 06127279, for the six month period ended 30 June 2019. Comparative information has been presented for the six month period ended 30 June 2018 and the year ended 31 December 2018.

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

Principal activities

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

RLP is one of the leading providers of regulated insurance solutions in the UK market for pensions de-risking. Established in 2007, RLP has grown to become one of the largest annuity providers in the UK market, with over £37bn of assets under management and insuring the annuities of over 780,000 individuals.

RLP's business strategy is focused around three key areas:
i) Protect our in-force balance sheet to ensure that our obligations to policyholders can be met.
ii) Grow through writing value-driven new business.
iii) Safeguard our brand and culture.

2019 year to date business highlights

- **Successful deployment:** Deployment of the premium received from Prudential plc during 2018 has helped contribute to first half pre-tax profits of £404m (HY2018: a pre-tax loss of £253m and FY2018: a pre-tax profit of £114m).
- **New business:** During the first six months of the year, the Company assisted four pension schemes to de-risk their liabilities, resulting in new business premiums of £0.7bn (HY2018: £12.4bn and FY2018: £13.2bn). The new business pipeline is very strong and we are well positioned for 2019 to be a record year for RLP.
- **Assets under management:** The Company's assets under management increased to £37.8bn (HY2018: £36.6bn and FY2018: £36.3bn).
- **Solvency position:** A continued focus on pro-active risk management and a cautious investment strategy meant that as at 30 June 2019, the Company's Solvency Capital Requirement (SCR) coverage was 176% (HY2018: 177% and FY2018: 180%).

The condensed statement of financial position is set out on page 7. RLP has assets under management of £37,824m (HY2018: £36,624m and FY2018: £36,316m). These numbers can be derived from the condensed statement of financial position by adjusting for reinsurance, payables, derivatives and collateralised financing as shown in the table below.

Assets under management

£m	HY2019	HY2018	FY2018
Total assets	56,990	52,114	50,214
Less reinsurance assets	(180)	(72)	(43)
Less payables and financial liabilities	(18,986)	(15,418)	(13,855)
Assets under management	37,824	36,624	36,316

Review of the business

Market backdrop

The first six months of the year saw global economic uncertainty primarily as a result of the trade tensions between the US and China. It also saw continuing political uncertainty in the UK because of the Government's failure to obtain approval of its withdrawal bill, the European election results and the resignation of Theresa May as Prime Minister.

As a result, there has been continuing volatility in markets with long-term interest rates falling and sterling weakening. Despite this, credit spreads have tightened over the half year.

These trends have continued in the second half of the year and show little signs of abating.

Despite the economic backdrop, the demand for pension scheme de-risking remains strong with employee benefit consultants suggesting that 2019 will be a record year for the bulk annuity market.

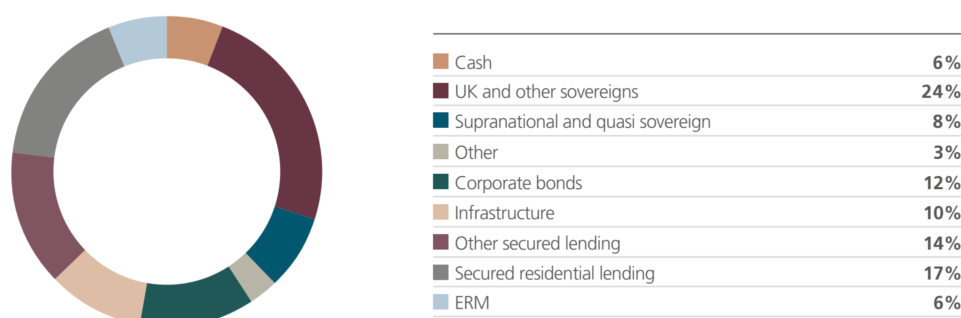
Strategic report continued

Performance

The focus of the first half of 2019 has been deployment of the assets received as part of the Prudential transaction in 2018 and capitalising on the opportunities in the bulk annuity market.

RLP has now successfully deployed all of the assets received from the Prudential transaction according to the long-term investment strategy at the yields assumed in pricing the deal and have managed to do so more quickly than assumed. This has helped contribute to the Company's first half IFRS profit of £404m (HY2018: a pre-tax loss of £253m and FY2018: a pre-tax profit of £114m). The investment mix of RLP's assets can be seen in the diagram below and includes continuing investment in equity release mortgages (ERM) and commercial real estate loans, including assets sourced through Rothesay Asset Management US LLC. During the first half of 2019, management of the Company's corporate bond portfolio was brought in-house and we have been increasing our exposure to corporate bonds on a tactical basis as opportunities arise.

Investment mix of total assets



In the first half of 2019 the Company assisted four pension schemes to de-risk their liabilities, resulting in new business premiums of £0.7bn (HY2018: £12.4bn and FY2018: £13.2bn). The new business pipeline is strong and the business is well positioned for the second half of 2019.

Largely as a result of new business and the fall in interest rates, the Company's assets under management grew by 4% to £37.8bn as at 30 June 2019 (HY2018: £36.6bn and FY2018: £36.3bn).

On 27 March 2019 the Company sold its €140m (£125m) portfolio of Irish annuities to Laguna Life DAC (Laguna Life) in order to ensure that these customers continue to receive their pensions post-Brexit. The transaction is structured initially as a reinsurance contract with Monument Re Limited (part of the Laguna Life group) and covers around 500 policyholders who will remain RLP's customers until the effective date of a Part VII transfer to Laguna Life, at which point the reinsurance agreement will also transfer to Laguna Life.

Our policyholders

RLP prides itself on the quality of the service it provides and this is borne out by its customer service statistics. In surveys, over 96% (HY2018: 98% and FY2018: 98%) of customers rate the quality of service received as good or excellent and in the first half of 2019 RLP received complaints at an annual rate of 0.72 per 1,000 policyholders (HY2018: 0.66 per 1,000 and FY2018: 0.76 per 1,000) of which 0.29 complaints per 1,000 policyholders (HY2018: 0.14 per 1,000 and FY2018: 0.23 per 1,000) were upheld.

The Laguna Life transaction should ensure that the payment of pensions to our Irish annuitants is not disrupted by the outcome of the Brexit process.

Risk, capital and asset management

The Company manages the risks associated with its annuity business in order to protect policyholder security and provide shareholders with a stable return. RLP looks to use surplus capital to fund growth opportunities which the Company assesses with a disciplined approach to risk and return.

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

The Company continues to hedge a large proportion of the longevity risk associated with the business and the Company was 76% reinsured on 30 June 2019 (HY2018: 76% and FY2018: 78%).

Following their periodic reviews, RLP's insurance financial strength ratings have been re-affirmed as A3 by Moody's Investors Service and A+ by Fitch Ratings.

Strategic report continued

In order to ensure that RLP is appropriately capitalised to take advantage of the new business pipeline, RLP issued £300m of Tier 3 debt on 12 July 2019, £400m of Tier 2 debt on 17 September 2019 and on 11 September 2019 RLP issued £500m of equity to RHUK.

The principal risks remain unchanged from the year ended 31 December 2018.

Brexit

As a UK insurer serving the domestic market, the Company's business model is largely unaffected by the UK's decision to leave the EU. The sale of our Irish portfolio to Laguna Life should ensure continuity of pensions for this group and the Company do not believe that the UK leaving the EU will affect its ability to administer the policies of ex-pat policyholders.

However, the continued uncertainty over the UK's future political and financial relationship with the EU and the potential implications for financial markets, provide investment challenges for all UK-based investors. A hard Brexit could have an adverse financial impact on the Company but regular stress testing of the balance sheet is intended to ensure that the financial and solvency impact of such an exit is within our risk tolerances.

Looking forward

As noted above, the demand for pension scheme de-risking remains strong and RLP's bulk annuity pipeline suggests that 2019 will be a record year for the market and the Company. As usual, where RLP is successful in writing new business, RLP will remain patient in asset origination which may in turn impact short-term IFRS profit performance for 2019 ahead of anticipated longer term gains.

Strategic report continued

Capital management

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

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

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

The Company is capitalised to the greater of the economic capital requirement and the regulatory Pillar 1 position. In practice, it is the Pillar 1 requirement which is more onerous and the Company aims to maintain at least 130% of the regulatory minimum requirement. As at 30 June 2019, RLP had an SCR coverage ratio of 176% (HY2018: 177% and FY2018: 180%).

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

The solvency position of RLP is summarised in the table below. SCR coverage at RLP decreased from 180% on 31 December 2018 to 176% on 30 June 2019.

Solvency position of RLP

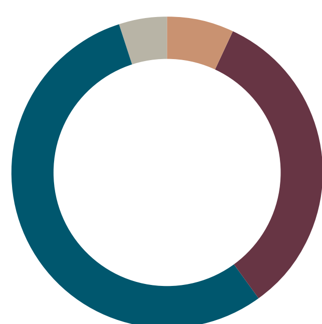
£m	HY2019	HY2018	FY2018
Tier 1 capital	3,401	3,496	3,236
Tier 2 capital	665	662	658
Own Funds available to meet SCR	4,066	4,158	3,894
SCR	2,310	2,351	2,163
Surplus above SCR	1,756	1,807	1,731
SCR coverage	176%	177%	180%

The value of transitional solvency relief was last recalculated on 31 December 2018 at the time of the adoption of the partial internal model (PIM). RLP estimate that the impact of recalculating transitional solvency relief as at 30 June 2019 would be to increase solvency coverage by 4% for RLP as a result of changes in economic conditions and the application of the financial resources requirement test.

The Company's SCR is calculated using a PIM approved for use from 31 December 2018. The PIM means that the Company's bespoke models are used for calculation of credit and counterparty risk capital and ensures that the allocation of capital to investment is consistent with the risk inherent in the types of highly secured and collateralised investments which are core to the Company's investment strategy. The standard formula is used to calculate the SCR for all other risk components and or aggregation across risk components. Work has now begun on development of a full internal model covering all risk components and aggregation across risk components.

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 SCR 30 June 2019



Operational risk	7%
Life underwriting risk	33%
Market risk	55%
Counterparty risk	5%

Report of the Directors

The Directors present their condensed financial statements for Rothesay Life Plc (the Company or RLP), registered number 06127279, for the period ended 30 June 2019. Comparative information has been presented for the period ended 30 June 2018 and year ended 31 December 2018, except for note 11 Leases (please refer to explanation in note 1).

1. Results

The results for RLP for the period are set out in the statement of comprehensive income on page 6.

2. Dividends

The Directors have recommended no payment of interim dividends during the period ended 30 June 2019 (HY2018: £nil).

3. Registered office

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

4. Post balance sheet events

On 12 July 2019 RLP issued £300m of Tier 3 bonds with maturity on 12 July 2026 and a fixed 3.375% coupon payable annually in arrears. On 17 September 2019 RLP issued £400m of Tier 2 bonds with maturity on 17 September 2029 and a fixed 5.5% coupon payable annually in arrears. The Tier 2 bonds are callable on 17 September 2024. On 11 September 2019 RLP issued £500m of equity to RHUK. The new equity and debt are intended to optimise the RHUK's Group's capital position in anticipation of the new business pipeline.

In March 2018 Rothesay Life and the Prudential Assurance Company Limited (PAC) entered into a reinsurance transaction covering a £12bn portfolio of annuities, with the expectation that this would be followed by an insurance business transfer under Part VII of the Financial Services and Markets Act 2000. The terms of the proposed transfer were reviewed by an independent expert, who was appointed to report to the High Court, who concluded that the transfer would not result in any material adverse effect on policyholders' security or benefits. Additionally, neither the Prudential Regulation Authority (PRA) nor the Financial Conduct Authority (FCA) objected to the transfer.

However on 16 August 2019 the High Court declined to sanction the transfer. Whilst this is not the preferred or optimal outcome for either party, the reinsurance transaction agreements do contain provisions to address this outcome.

Rothesay Life and PAC have been granted leave to appeal by the High Court.

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

6. Statement of Directors' responsibilities

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

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

7. Date of authorisation of issue

The financial statements were authorised for issue by the Board of Directors on 17 September 2019.

On behalf of the Board

Addy Loudiadis
Chief Executive Officer

17 September 2019

Condensed statement of comprehensive income

For the period ended 30 June 2019

	Note	HY2019 £m	HY2018 £m	FY2018 £m
Income				
Gross premiums written	2	852	12,489	13,424
Less: premiums ceded to reinsurers		(780)	(519)	(1,369)
Net premiums written		72	11,970	12,055
Investment return	3	2,127	(131)	140
Total revenue		2,199	11,839	12,195
Expenses				
Policyholder claims		(1,163)	(757)	(1,876)
Less: reinsurance recoveries		621	492	1,275
Change in insurance contract liabilities		(1,274)	(11,341)	(10,694)
Change in the reinsurers' share of insurance contract liabilities		139	(364)	(567)
Net claims and change in insurance contract liabilities		(1,677)	(11,970)	(11,862)
Acquisition and administration expenses	4	(76)	(96)	(158)
Finance costs	5	(42)	(26)	(61)
Total expenses		(1,795)	(12,092)	(12,081)
Profit/(loss) before tax		404	(253)	114
Income tax (expense)/credit	6	(76)	48	(17)
Profit/(loss) for the period/ financial year		328	(205)	97

All income and expenses relate to continuing operations.

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

Notes 1 – 21 form an integral part of these financial statements.

Condensed statement of financial position

As at 30 June 2019

	Note	HY2019 £m	HY2018 £m	FY2018 £m
Assets				
Investment in subsidiaries	19	1	–	1
Property, plant and equipment		2	3	2
Lease – right of use	11	36	–	–
Financial investments	7	55,775	50,737	49,163
Reinsurance assets	8	180	72	43
Accrued interest and prepayments		405	443	497
Receivables		453	458	357
Cash and cash equivalents		138	401	151
Total assets		56,990	52,114	50,214
Equity and liabilities				
Equity				
Share capital	14	410	410	410
Restricted Tier 1 (RT1) note	15	347	–	347
Share premium	16	1,353	1,353	1,353
Retained earnings	16	756	633	435
Total equity		2,866	2,396	2,545
Liabilities				
Reinsurance liabilities	8	671	500	673
Insurance contract liabilities	9	33,706	33,083	32,435
Payables and financial liabilities	10	18,986	15,418	13,855
Leasehold liabilities	11	36	–	–
Borrowings	12	647	647	647
Deferred tax liabilities	13	2	2	2
Accruals and deferred income		76	68	57
Total liabilities		54,124	49,718	47,669
Total equity and liabilities		56,990	52,114	50,214

Notes 1 – 21 form an integral part of these financial statements.

The financial statements were approved by the Board of Directors on 17 September 2019 and signed on its behalf by:

Addy Loudiadis
Chief Executive Officer

17 September 2019
Company number 06127279

Condensed statement of changes in equity

For the period ended 30 June 2019

	Share capital £m	Share premium £m	Tier 1 notes £m	Retained earnings £m	Total equity £m
As at 1 January 2019	410	1,353	347	435	2,545
Profit for the financial year	–	–	–	328	328
Retrospective restatement due to change in accounting treatment	–	–	–	(7)	(7)
As at 30 June 2019	410	1,353	347	756	2,866

For the period ended 30 June 2018

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

For the year ended 31 December 2018

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

Condensed cash flow statement

For the period ended 30 June 2019

	HY2019 £m	HY2018 £m	FY2018 £m
Cash flows from operating activities			
Profit/(loss) for the period/financial year	**328**	(205)	97
Adjustments for non cash movements in net profit/(loss) for the period/financial year			
Retrospective restatement due to change in accounting treatment	**(7)**	–	–
Depreciation	**2**	1	1
Interest income	**(527)**	(420)	(956)
Interest expense	**42**	26	61
Income tax expense	**76**	(48)	17
Net (increase)/decrease in operational assets			
Financial investments	**(6,612)**	(13,435)	(11,849)
Reinsurance asset	**(137)**	96	124
Receivables	**(97)**	(71)	(19)
Prepayments	**17**	–	(83)
Net increase/(decrease) in operational liabilities			
Insurance contract liabilities	**1,274**	11,342	10,688
Claims outstanding	**(3)**	–	6
Reinsurance liabilities	**(2)**	269	443
Financial liabilities	**5,068**	1,229	(1)
Other payables	**5**	267	(82)
Accruals and deferred income	**–**	22	23
Net cash flows used in operating activities	**(573)**	(927)	(1,530)
Interest paid	**(22)**	(15)	(62)
Interest received	**602**	289	843
Tax paid	**(19)**	(38)	(38)
Cash flows used in operating activities	**(12)**	(691)	(787)
Cash outflows from financing activities			
Proceeds from issuance of RT1 notes (net of issuance costs)	**–**	–	347
Proceeds from issue of ordinary share capital (including share premium)	**–**	950	950
Dividends	**–**	–	(500)
Net cash flows from financing activities	**–**	950	797
Cash flows from investing activities			
Net acquisition of property, plant and equipment	**(1)**	–	–
Investment in subsidiary	**–**	–	(1)
Net cash outflows from investing activities	**(1)**	–	(1)
Net increase in cash and cash equivalents	**(13)**	259	9
Cash and cash equivalents at 1 January	**151**	142	142
Cash and cash equivalents at the statement of financial position date	**138**	401	151

During the period there have been no cash flows in relation to leases (please see note 11 for further details).

Notes to the financial statements

Note 1 – General information and basis of preparation

(a) General information

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

(b) Basis of preparation

The condensed interim financial statements for the six month period ended 30 June 2019 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 2018, which have been prepared in accordance with IFRSs as adopted by the EU.

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

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

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

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

(c) Accounting policies

The accounting policies adopted are consistent with those of the previous financial year except that RLP has adopted IFRS 16 'Leases' as explained in the appendix of the 2018 Annual Report). IFRS 16 replaces the guidance in IAS 17. IFRS 16 now requires lessees to recognise a lease liability reflecting future lease payments and a 'right of use asset' for virtually all lease contracts. The Company has recognised a 'right of use asset' in relation to a lease executed at the end of 2018 in relation to new premises. The Company has not restated comparatives for the 2018 reporting period, as permitted under the specific transition provisions in IFRS 16. The reclassifications and the adjustments arising from the new leasing rules are therefore recognised in the opening balance sheet on 1 January 2019.

The Company has not adopted any other new standards or any changes to existing standards, including matters of significant judgement and use of estimates. Accounting policies of the Company can be found in the 2018 Annual Report.

Note 2 – Segmental analysis

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

	Regular premiums			Single premiums		
	HY2019 £m	HY2018 £m	FY2018 £m	HY2019 £m	HY2018 £m	FY2018 £m
Group pension bulk annuities	132	132	263	720	175	928
Assumed reinsurance premiums	–	–	–	–	12,182	12,233
Total gross premiums written	132	132	263	720	12,357	13,161

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

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

Note 3 – Investment return

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

	HY2019 £m	HY2018 £m	FY2018 £m
Interest income on financial investments at fair value through profit and loss	527	420	956
Unrealised gains/(losses) on financial investments	1,384	(721)	(686)
Realised gains/(losses) on financial investments	237	187	(93)
Investment expenses	(21)	(17)	(37)
Total investment return	2,127	(131)	140

The unrealised gains during the six month period were due to the impact of decreasing interest rates.

Notes to the financial statements continued

Note 4 – Acquisition and administration expenses

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

	HY2019 £m	HY2018 £m	FY2018 £m
Acquisition costs	40	64	102
Administration expenses – recurring	20	14	36
Administration expenses – project and other one-off expenses	16	18	20
Total operating expenses	**76**	96	158

Note 5 – Finance costs

	HY2019 £m	HY2018 £m	FY2018 £m
Interest payable on collateral	4	3	7
Interest payable on collateralised agreements and financing	4	1	9
Interest payable on collateral and collateralised agreements	**8**	4	16
Interest payable on third party borrowings	21	10	20
Interest payable on borrowings from participating interest	13	12	25
Total borrowing costs	**34**	22	45
Net finance costs	**42**	26	61

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

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

Note 6 – Income tax expense

The major components of the income tax expense for the six month period ended 30 June 2019 and 30 June 2018 and the financial year ended 31 December 2018 are:

(a) Tax charged in the income statement

	HY2019 £m	HY2018 £m	FY2018 £m
Current income tax:			
UK corporation tax	76	(48)	19
Adjustment in respect of prior period	–	–	(2)
Total current income tax	**76**	(48)	17
Deferred tax:			
Origination and reversal of temporary differences	–	–	–
Total deferred tax	**–**	–	–
Total expense/(credit) in the condensed statement of comprehensive income	**76**	(48)	17

(b) Reconciliation of the total tax charge

The tax expense in the condensed statement of comprehensive income for the period and the standard rate of corporation tax in the UK of 19% (HY2018 and FY2018: 19%) is reconciled below:

	HY2019 £m	HY2018 £m	FY2018 £m
Profit/(loss) on ordinary activities before taxation	404	(253)	114
Tax calculated at UK standard rate of corporation tax of 19% (HY2018 and FY2018: 19%)	77	(48)	22
Adjustment in respect of prior period		–	(2)
Difference in accounting and tax valuation basis	(19)	–	5
Utilisation of losses surrendered by Group undertakings	18	–	(8)
Total tax expense/(credit) reported in the condensed statement of comprehensive income	**76**	(48)	17

Notes to the financial statements continued

Note 7 – Financial investments

The fair value of a financial instrument is the amount that would be received on the sale of an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, i.e. the exit price. Financial investments are marked to bid prices and financial liabilities are marked to offer prices. Fair value gains or losses are included in investment income.

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

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

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

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

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

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

Determination of fair value and fair values hierarchy

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

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

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

Notes to the financial statements continued

Note 7 – Financial investments continued

The following tables show an analysis of financial instruments recorded at fair value by level of the fair value hierarchy for 30 June 2019, 30 June 2018 and 31 December 2018 (please refer to note 10 for financial liabilities):

HY2019	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Collective investment schemes	2,119	–	–	2,119
Government, sub sovereign and agency obligations	2,927	9,538	412	12,877
Corporate bonds and other corporate debt	–	13,914	1,086	15,000
Derivative assets	–	15,565	21	15,586
Collateralised agreements and financing	–	2,762	–	2,762
Loans secured on property	–	–	4,961	4,961
Equity release mortgages	–	–	2,284	2,284
Certificate of deposits	–	186	–	186
Total financial investments at fair value	5,046	41,965	8,764	55,775

HY2018	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Collective investment schemes	1,837	–	–	1,837
Government, sub sovereign and agency obligations	7,092	12,258	–	19,350
Corporate bonds and other corporate debt	–	11,036	877	11,913
Derivative assets	–	11,169	–	11,169
Collateralised agreements and financing	–	2,368	–	2,368
Loans secured on property	–	–	3,220	3,220
Equity release mortgages[1]	–	–	722	722
Certificate of deposits	–	158	–	158
Total financial investments at fair value	8,929	36,989	4,819	50,737

1 £722m of equity release mortgages which were classified as loans secured on property as at 30 June 2018 have been separately identified following the increased significance of this asset class.

FY2018	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Collective investment schemes	1,379	–	–	1,379
Government, sub sovereign and agency obligations	4,694	10,989	364	16,047
Corporate bonds and other corporate debt	–	11,732	1,091	12,823
Derivative assets	–	11,450	1	11,451
Collateralised agreements and financing	–	2,028	–	2,028
Loans secured on property	–	–	3,376	3,376
Equity release mortgages	–	–	1,897	1,897
Certificate of deposits	–	162	–	162
Total financial investments at fair value	6,073	36,361	6,729	49,163

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

Approximately 16% (HY2018: 9% and FY2018: 14%) 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 (excluding equity release mortgages which are discussed in the equity release mortgage section of note 7):

	Government, sub sovereign and agency obligations £m	Corporate debt £m	Loans secured on property £m	Derivatives £m	Total £m
At 1 January 2019	364	1,091	3,376	1	4,832
Total gains in the statement of comprehensive income:					
Unrealised gains	6	182	235	13	436
Transfer out of Level 3	–	(205)	–	–	(205)
Net purchase/additions	42	18	1,350	7	1,417
At 30 June 2019	412	1,086	4,961	21	6,480

Notes to the financial statements continued

Note 7 – Financial investments continued

	Government, sub sovereign and agency obligations £m	Corporate debt £m	Loans secured on property £m	Derivatives £m	Total £m
At 1 January 2018	–	685	3,409	–	4,094
Total gains in the statement of comprehensive income:					
Unrealised losses	–	(15)	(204)	–	(219)
Net purchases/additions	–	207	15	–	222
At 30 June 2018	–	877	3,220	–	4,097

	Government, sub sovereign and agency obligations £m	Corporate debt £m	Loans secured on property £m	Derivatives £m	Total £m
At 1 January 2018	–	685	3,409	–	4,094
Total gains in the statement of comprehensive income:					
Unrealised (losses)/gains	–	(15)	(87)	1	(101)
Net purchases/additions	364	421	54	–	839
At 31 December 2018	364	1,091	3,376	1	4,832

Please note the 30 June 2018 disclosures have been restated to remove equity release mortgages as these have been disclosed separately in note 7. Please see note 10 for details of Level 3 derivative liabilities.

The Company's policy is to determine the relevant categorisation of financial assets and liabilities at least annually and, where availability of inputs has changed, a transfer will be made between levels. During the year, the Company 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 3 to Level 2 is £205m (HY2018: £nil, FY2018: £nil) mainly as a result of improved availability of observable market transactions for the same or similar instruments. There were £nil movements from Level 2 to Level 3 (HY2018: £4m of liabilities were transferred from Level 2 to Level 3, FY2018: £nil).

Equity release mortgages

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

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

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

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

Notes to the financial statements continued

Note 7 – Financial investments continued

Given the various assumptions used in valuing the equity release mortgages, the instruments are recorded as Level 3 assets. The table below provides an analysis of the movement in the value of equity release mortgages. New business includes both the acquisition of back-books of equity release mortgages, such as the £860m portfolio of equity release mortgages from UKAR during 2018, and new origination through our strategic partners. The change in economic assumptions includes the impact of changes in interest rates and property prices. The change in demographic assumptions includes the impact of changes in pre-payment rates and assumed mortality.

	HY2019 £m	HY2018 £m	FY2018 £m
Carrying amount at 1 January	1,897	539	539
Increase in respect of new business	363	182	1,380
Redemptions/repayments	(70)	(18)	(76)
Accrued interest for the period	53	12	50
Change in economic assumptions	41	6	3
Change in demographic assumptions	–	1	1
Closing balance at statement of financial position date	2,284	722	1,897

The table below provides a summary of the discounted cash flows which are expected to arise from the equity release mortgage portfolio based on the above assumptions:

	HY2019 £m	HY2018 £m	FY2018 £m
Less than 1 year	169	50	135
1 to 5 years	551	192	471
Over 5 years	1,564	480	1,291
	2,284	722	1,897

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

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

			HY2019		
Impact on financial assets, liabilities and PBT	Main assumptions	Sensitivity	Current FV £m	(Decrease)/ Increase in FV £m	(Decrease)/ Increase in PBT £m
Financial assets					
Corporate bonds and other corporate debt	Discount rate	+50bps yield to maturity	1,086	(40)	(10)
		-50bps yield to maturity	1,086	43	10
Government sub sovereign and agency obligations	Discount rate	+50bps yield to maturity	412	(13)	(2)
		-50bps yield to maturity	412	14	3
Loans secured on property	Liquidity premium	+25bps yield to maturity	4,961	(227)	–
		-25bps yield to maturity	4,961	249	–
Loans secured on property[2]	Property prices	+10% change in property prices	4,961	14	20
		-10% change in property prices	4,961	(26)	(36)
Equity release mortgages	Liquidity premium	+50bps yield to maturity	2,284	(117)	–
		-50bps yield to maturity	2,284	128	–
Equity release mortgages	House prices	+10% change in house prices	2,284	46	52
		-10% change in house prices	2,284	(58)	(65)
Derivative assets[3]	Liquidity premium	+50bps yield to maturity	21	(23)	(9)
		-50bps yield to maturity	21	26	10

2 The comparative sensitivity for HY2018 was not disclosed because the way in which the fair value of loans secured on property was determined at HY2018 was less sensitive to the property value of the underlying collateral than the approach used from FY2018.
3 Derivative assets in relation to bond forward trades.

Notes to the financial statements continued

Note 7 – Financial investments continued

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

Impact on financial assets, liabilities and PBT	Main assumptions	Sensitivity	HY2018[4] Current FV £m	HY2018[4] (Decrease)/ Increase in FV £m	HY2018[4] (Decrease)/ Increase in PBT £m
Financial assets					
Corporate bonds and other corporate debt	Discount rate	+50bps yield to maturity	877	(41)	(14)
		-50bps yield to maturity	877	45	15
Loans secured on property	Liquidity premium	+25bps yield to maturity	3,220	(184)	–
		-25bps yield to maturity	3,220	202	–
Loans secured on property	Property price	+10% change in property prices	3,220	11	20
		-10% change in property prices	3,220	(19)	(33)
Equity release mortgages	Liquidity premium	+50bps yield to maturity	722	(39)	–
		-50bps yield to maturity	722	43	–
Equity release mortgages	House prices	+10% change in house prices	722	5	5
		-10% change in house prices	722	(6)	(6)

4 Restated to split out equity release mortgages from loans secured on property to be consistent with the disclosure shown for FY2018 and HY2019.

Impact on financial assets, liabilities and PBT	Main assumptions	Sensitivity	FY2018 Current FV £m	FY2018 (Decrease)/ Increase in FV £m	FY2018 (Decrease)/ Increase in PBT £m
Financial assets					
Corporate bonds and other corporate debt	Discount rate	+50bps yield to maturity	1,091	(58)	(18)
		-50bps yield to maturity	1,091	63	20
Government sub sovereign and agency obligations	Discount rate	+50bps yield to maturity	364	(11)	(2)
		-50bps yield to maturity	364	12	2
Loans secured on property	Liquidity premium	+25bps yield to maturity	3,376	(187)	–
		-25bps yield to maturity	3,376	206	–
Loans secured on property	Property prices	+10% change in property prices	3,376	10	14
		-10% change in property prices	3,376	(19)	(28)
Equity release mortgages	Liquidity premium	+50bps yield to maturity	1,897	(94)	–
		-50bps yield to maturity	1,897	102	–
Equity release mortgages	House prices	+10% change in house prices	1,897	39	44
		-10% change in house prices	1,897	(50)	(56)
Derivative assets	Expected defaults	+50bps credit default spread	1	–	–
		-50bps credit default spread	1	–	–

Note 8 – Reinsurance assets/(liabilities)

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

	HY2019 £m	HY2018 £m	FY2018 £m
Reinsurance assets	180	72	43
Reinsurance liabilities	(671)	(500)	(673)
Total reinsurance of insurance contract liabilities	(491)	(428)	(630)

Reinsurance assets have increased as a result of the Company selling its €140m portfolio of Irish annuities to Laguna Life DAC. This transaction is structured initially as a reinsurance contract with Monument Re Limited and covers around 500 policyholders who will remain RLP's customers until the effective date of a Part VII transfer to Laguna Life, at which point the reinsurance agreement will also transfer to Laguna Life.

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

Notes to the financial statements continued

Note 8 – Reinsurance assets/(liabilities) continued

An analysis of the movement in reinsurance of insurance contract liabilities is included 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. Excluding the impact of the reinsurance agreement with Monument Re Limited, the total amount of reinsurance held over the period has remained relatively constant. Overall, the proportion of the insurance liability reinsured has fallen slightly.

At 30 June 2019, 30 June 2018 and 31 December 2018 the Company conducted an impairment review of the reinsurance assets and found no impairment necessary.

Note 9 – Insurance contract liabilities

Insurance risk is the risk of changes in the value of the Company's net position due to changes in the insurance contract liabilities as a result of either actual demographic experience being different from assumed or revised expectations of future experience. Categories of insurance risk include the following:

- Longevity risk – This risk arises from current or projected mortality or spouse experience being lighter than assumed. This may be because actual experience is different from the results of historic experience investigations on which assumptions are based or because expectations about future improvements change. The risk is hedged by external reinsurance. As at 30 June 2019, 76% of longevity risk was reinsured (HY2018: 76%, FY2018: 78%).
- Expense risk – This risk results from future expenses required to maintain the business being higher than expected. This risk is managed through budgeting and expense management exercises.
- Other risks – Other risks include the risk that a higher proportion of insured lives have eligible dependants or that such dependants are younger than assumed. They also include the risk that policyholders exercise their options differently from assumed.

Insurance risk is managed in accordance with risk management policies and procedures established by the Company. The CRO, Chief Actuary and the risk function, which is independent of management and reports to the CEO and the Chairman of the Board Risk Committee, have responsibility for ensuring an appropriate framework is in place for assessing, monitoring and managing insurance risk. Risks are monitored and controlled through strong oversight and independent control and support functions across the business.

Key valuation assumptions

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

(a) Mortality assumptions

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

	Base mortality					
	HY2019		HY2018		FY2018	
	Pensions originated	Insurance originated	Pensions originated	Insurance originated	Pensions originated	Insurance originated
Males	94.8% S2PMA	100.2% PMA08	97.1% S2PMA	103.8% PMA08	94.8% S2PMA	100.2% PMA08
Females	94.8% S2PFA	100.2% PFA08	97.1% S2PFA	103.8% PFA08	94.8% S2PFA	100.2% PFA08

There were no changes to the base mortality assumptions at 30 June 2019 from those used at 31 December 2018. For pension scheme originated business, ultimate mortality has been used in all cases and past mortality improvements are applied assuming the base mortality rates are as at 2007. For insurance originated business, the stated base mortality basis incorporates the effect of selection adjustments for relevant policies and past mortality improvements are applied assuming the base mortality rates are as at 2008.

Recent mortality experience is analysed annually for each pension scheme and insurance originated contracts. The last review was carried out during 2018. The best estimate base mortality assumptions used in the valuation are based on this actual mortality experience. The changes to the single equivalent rates over 2018 reflect the inclusion of new business along with the results of the experience investigations.

For pension scheme originated business, mortality assumptions are generally set with reference to a Rothesay 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, a combination of bespoke mortality tables and the CMI 2008 series of annuitant mortality tables are used to value the liabilities. These have been expressed for reporting purposes as an equivalent to the CMI 2008 series tables. These incorporate the effect of selection adjustments for relevant policies.

Notes to the financial statements continued

Note 9 – Insurance contract liabilities continued

	Future mortality improvements (including margins)		
	HY2019	HY2018	FY2018
Males	CMI_2017_M[3.0%; Sκ=7.5]	CMI_2017_M[3.4%; Sκ=7.75]	CMI_2017_M[3.0%; Sκ=7.5]
Females	CMI_2017_F[3.0%; Sκ=7.5]	CMI_2017_F[3.4%; Sκ=7.75]	CMI_2017_F[3.0%; Sκ=7.5]

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 2018, mortality improvement assumptions were updated to reflect recent mortality improvements including adoption of the CMI 2017 improvement model. For both 2019 and 2018 an advanced calibration of the model has been used. The chosen long-term improvement rate assumption varies by age using a bespoke calibration that tapers non-linearly from age 70 to 0% at age 120. The best estimate long-term rates have remained unchanged.

Prudent margins are applied to the demographic basis, through the Sκ factor and the long-term rate to reflect the fact that future experience may differ from that assumed. Prudent margins were reshaped during 2018 with more prudence applied to initial improvement rates and a reduction in the long-term prudent margin. There has been no further change at 30 June 2019 from the margins applied at 31 December 2018.

(b) Economic assumptions including valuation rate of interest

The valuation rate of interest used to discount the cash flows for the purpose of valuing insurance contract liabilities is based on the yield obtainable on the basket of assets matching the applicable insurance contract liabilities at 30 June 2019. For the purposes of this calculation, any assets held by LT Mortgage Financing Limited (LTMF) or Rothesay MA No.1 Limited (RMA1) are treated as if they were held directly and intercompany arrangements ignored.

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

	HY2019	HY2018	FY2018
Equivalent rate of interest	2.10% p.a.	2.30% p.a.	2.44% p.a.

This reflects a 2.5% prudential margin applied to the risk adjusted internal rate of return obtained on the basket of matching assets and an allowance for investment management expenses of 3bps p.a. (30 June 2018: 3bps p.a. and 31 December 2018: 3bps p.a.).

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

The table below shows the average yield deduction before the application of the 2.5% prudential margin at 30 June 2019, 30 June 2018 and 31 December 2018 by asset category:

	Average yield deduction		
Asset class	HY2019	HY2018	FY2018
UK Government approved securities	0 bps	0 bps	0 bps
Secured lending	7 bps	6 bps	11 bps
Supranational/other sovereign	32 bps	26 bps	29 bps
Secured residential lending	27 bps	32 bps	28 bps
Corporate bonds (without covering credit default swaps)	55 bps	52 bps	62 bps
Infrastructure	65 bps	70 bps	75 bps
Equity release mortgages	137 bps	Not disclosed[5]	146 bps
Other[6]	10 bps	35 bps	10 bps
Overall yield deduction	32 bps	26 bps	31 bps

5 At 30 June 2018, ERMs were included in secured residential lending for disclosure purposes due to the small size of the holding. Separating ERMs out from secured residential lending has not changed the average yield deduction for secured residential lending for the HY2018.
6 Corporate bonds after allowance for covering credit default swaps have been reallocated into 'other' for HY2018 as the holding now represents less than 1% of total assets.

There have been no changes made to the methodology used to derive the credit default yield deduction over the period. Where applicable, the yield deduction reflects the 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.

Notes to the financial statements continued

Note 9 – Insurance contract liabilities continued

Allowance is made for the risks associated with equity release mortgages through the valuation of the NNEG and this is included in the overall yield deduction above. The calculation of the NNEG is described in note 7 and is calculated on a prudent basis allowing for future property price growth at a rate equivalent to 1.22% net of dilapidation costs and cost of sale (FY2018: 1.59%) and house price volatility equivalent to 13% (FY2018: 13%).

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

(c) Expense assumption

An allowance is made for future overhead maintenance expenses following an investigation into the total costs incurred by the Company during 2018 and the projected 2019 expenses. The investigation was last updated for the 31 December 2018 valuation. 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 £30 per policy per annum (p.a.) (HY2018: £24 per policy p.a. and FY2018: £30 per policy p.a.) is made with additional allowances for short-term project costs and investment management expenses.

Within these expense provisions, an allowance for future expense inflation has been provided to cover the impact of both salary and price inflation. The future rate of expense inflation is assumed to be RPI (as implied by the RPI swap curve) plus an addition at each duration of 0.25% p.a. for all expenses (HY2018: 0.25% p.a. and FY2018: 0.25% p.a.).

(d) Member option and dependants assumptions

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

For 2018 the modelling of member options was improved to separately allow for the probability that deferred annuitants choose to transfer their benefits each year. In prior years, this was allowed for by assuming an equivalent level of overall take-up occurred immediately prior to starting pension payments. The main impact of this modelling update is to change the profile of the cash flows assumed to be paid as the same cash flows are used to derive the lump sums and the annuities. The cash flow profile also impacts the composition of the basket of assets used to derive the valuation rate of interest (see note 9(b)).

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

(e) Movements in insurance contract liabilities

The table below details the change in the gross and net insurance contract liabilities over the period. The release of liabilities line reflects claims paid, release of prudent margins and unwind of discounting over the year.

	HY2019		
	Insurance liabilities £m	Reinsurance assets/ (liabilities) £m	Net liabilities £m
Carrying amount at 1 January	32,435	(630)	33,065
Increase in respect of new business	831	135	696
Release of liabilities	(963)	38	(1,001)
Effect of assumption changes	1,409	(33)	1,442
Other	(6)	(1)	(5)
Closing balance at 30 June	33,706	(491)	34,197

	HY2018		
	Insurance liabilities £m	Reinsurance assets/ (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	(401)	(7)	(394)
Effect of assumption changes	(637)	(263)	(374)
Other	2	(1)	3
Closing balance at 30 June	33,083	(428)	33,511

Notes to the financial statements continued

Note 9 – Insurance contract liabilities continued

	FY2018		
	Insurance liabilities £m	Reinsurance assets/ (liabilities) £m	Net liabilities £m
Carrying amount at 1 January	21,741	(63)	21,804
Increase in respect of new business	12,890	(43)	12,933
Release of liabilities	(1,286)	(124)	(1,162)
Effect of assumption changes	(918)	(401)	(517)
Other	8	1	7
Closing balance at 31 December	32,435	(630)	33,065

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

Net increase/(decrease) in net liabilities

Change in assumptions used	HY2019 £m	HY2018 £m	FY2018 £m
Valuation rate of interest	1,499	(103)	(401)
Inflation	(47)	(207)	(10)
Effect of economic assumption changes	1,452	(310)	(411)
Demographics	(10)	(64)	(133)
Member options	–	–	(20)
Expenses	–	–	47
Effect of non-economic assumption changes	(10)	(64)	(106)
Total change in assumptions used	1,442	(374)	(517)

As shown previously the valuation rate of interest decreased by 34bps over the period, driving the increase to the liability valuation.

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), 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.

HY2019	Change in assumptions	(Decrease)/ increase on liabilities £m	Increase/ (decrease) on PBT £m	Impact on equity £m
Annuitant mortality	+5% qx	(199)	199	161
Annuitant mortality	-5% qx	209	(209)	(170)
Interest rate	+100bps	(3,961)	(61)	(49)
Interest rate	-100bps	4,937	340	275
Inflation	+100bps	1,472	21	17
Inflation	-100bps	(1,391)	97	79
Credit default assumption	+10bps	(419)	(231)	(187)
Credit default assumption	-10bps	400	231	187
Change in property prices	+10%	(11)	73	59
Change in property prices	-10%	17	(98)	(79)
Expenses	+10%	97	(97)	(79)

Notes to the financial statements continued

Note 9 – Insurance contract liabilities continued

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

FY2018	Change in assumptions	(Decrease)/ increase on liabilities £m	Increase/ (decrease) on PBT £m	Impact on Equity £m
Annuitant mortality	+5% qx	(172)	171	139
Annuitant mortality	-5% qx	181	(179)	(145)
Interest rate	+100bps	(3,752)	26	21
Interest rate	-100bps	4,661	292	236
Inflation	+100bps	1,320	26	21
Inflation	-100bps	(1,256)	82	66
Credit default assumption	+10bps	(320)	(206)	(167)
Credit default assumption	-10bps	329	209	170
Change in property prices	+10%	(9)	59	47
Change in property prices	-10%	15	(84)	(68)
Expenses	+10%	95	(95)	(77)

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

The table below shows the impact of reinsurance on the sensitivity to mortality risk, a reduction of 76% (HY2018: 76% and FY2018: 78%).

HY2019	Change in assumptions	(Decrease)/ increase on insurance liabilities £m	(Decrease)/ increase on reinsurance asset £m	Net increase/ (decrease) on liabilities (net of reinsurance) £m
Annuitant mortality	+5% qx	(830)	631	(199)
Annuitant mortality	-5% qx	887	(678)	209

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

FY2018	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	(782)	611	(171)
Annuitant mortality	-5% qx	835	(656)	179

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.

Notes to the financial statements continued

Note 10 – Payables and financial liabilities

	HY2019 £m	HY2018 £m	FY2018 £m
Derivative financial instruments	16,054	11,654	11,790
Collateralised financing agreements	828	2,145	779
Government, sub sovereign and agency obligations	756	–	–
Total financial liabilities	17,638	13,799	12,569
Deposits received as collateral from third parties	1,166	1,235	1,128
Amounts due to Group undertakings	36	37	50
Current tax payable	74	–	17
Other payables	72	347	91
Total payables	1,348	1,619	1,286
Total payables and financial liabilities	18,986	15,418	13,855

Financial liabilities are recorded at fair value (see note 7), of which £0.5m are valued using Level 3 techniques (HY2018: £0.5m, FY2018: £0.5m), £756m are valued using Level 1 techniques and £16,881m using Level 2 techniques (HY2018: £nil, FY2018: £nil).

Note 11 – Leases

(a) Amounts included in the statement of financial position

On adoption of IFRS 16, the Company recognised lease liabilities in relation to the lease in relation to new premises, which would previously have been classified as 'operating leases' under the principles of IAS 17 'Leases'.

Assets and liabilities arising from a lease are initially measured on a present value basis. Lease liabilities include the net present value of the following lease payments:
- fixed payments, less any lease incentives receivable;
- amounts expected to be payable by the Company under residual value guarantees;
- payments of penalties for terminating the lease; and
- lease payments to be made under reasonably certain extension options.

Lease payments are discounted using the Company's incremental borrowing rate as at 1 January 2019. The weighted average lessee's incremental borrowing rate applied to the lease liabilities is 4.5%. The incremental borrowing rate represents the cost of funding to the RHUK Group at that date.

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

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

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

The Company did not have any leases previously classified as finance leases that would be impacted by measurement adjustments for adoption of IFRS 16.

Additions to the right of use asset recognised by the Company relate to the lease on the new office which was executed in May 2019 therefore there was a nil balance at 1 January 2019. The lease for The Post Building has a duration of 17 years with a break clause at 12 years which we have assumed is exercised.

The Company was not a lessor during the period.

Right of use asset

	HY2019 £m
Right of use asset	36
Right of use asset – property	
Balance at 1 January	–
Depreciation charge for the period	–
Additions	36
Balance at period end	36

Notes to the financial statements continued

Note 11 – Leases continued

(a) Amounts included in the statement of financial position continued

Lease liabilities

	HY2019 £m
Lease liability	36
Maturity analysis undiscounted liabilities	
Current liabilities	
Less than one year	1
Non-current liabilities	
One to five years	13
More than five years	36
Total undiscounted lease liabilities	50

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

(b) Amounts recognised in the statement of comprehensive income

	HY2019 £m
Depreciation charge of right of use assets – property	–
Financing charge on lease liabilities (included in note 5 Finance costs)	–

Amounts recognised in statement of cash flows

	HY2019 £m
Depreciation charge of right of use assets – property	–
Financing charge on lease liabilities	–
Total cash flows for leases	–

Note 12 – Borrowings

RLP's borrowings are as follows:

	HY2019 £m	HY2018 £m	FY2018 £m
Subordinated loans from participating interest	398	398	398
Subordinated loan notes	249	249	249
Total borrowed	647	647	647

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

					Carrying amount			Fair value		
Notional amount	Issue date	Redemption date	Callable at par at option of the Company from	Coupon	HY2019 £m	HY2018 £m	FY2018 £m	HY2019 £m	HY2018 £m	FY2018 £m
Subordinated loans from participating interest										
£100m	21 Dec 2012	Lender has option to convert to equity from 21 Dec 2022	21 Dec 2017 and every six months thereafter	6m£L plus 4.25%	100	100	100	95	94	93
£300m	19 Sept 2017	19 Sept 2028	19 Sept 2023 and annually thereafter	3m£L plus 5.95%	298	298	298	296	301	287
Subordinated loans										
£250m	22 Oct 2015	22 Oct 2025	22 Oct 2025	8.00%	249	249	249	282	294	283

For the period ended 30 June 2019, an interest expense of £23m (HY2018: £22m and FY2018: £45m) was recognised in the condensed statement of comprehensive income in respect of these borrowings.

Notes to the financial statements continued

Note 12 – Borrowings continued

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

	31 December 2018 £m	Cash flows £m	Non cash flows £m	30 June 2019 £m
Subordinated loans from participating interest	398	–	–	398
Subordinated loan notes	249	–	–	249
Total borrowings	647	–	–	647

	31 December 2017 £m	Cash flows £m	Non cash flows £m	30 June 2018 £m
Subordinated loans from participating interest	398	–	–	398
Subordinated loan notes	249	–	–	249
Total borrowings	647	–	–	647

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

Note 13 – Deferred taxation liabilities

Deferred tax balances comprise:

	HY2019 £m	HY2018 £m	FY2018 £m
Temporary differences between the financial statements and the tax deductions	(2)	(2)	(2)
Total temporary differences	(2)	(2)	(2)

The movements in the deferred tax balances were as follows:

	HY2019 £m	HY2018 £m	FY2018 £m
At 1 January	(2)	(2)	(2)
Capital allowances	–	–	–
At statement of financial position date	(2)	(2)	(2)

Note 14 – Share capital

At 30 June 2019, 30 June 2018 and 31 December 2018 share capital comprised:

	HY2019		HY2018		FY2018	
	No.	£m	No.	£m	No.	£m
Authorised share capital (ordinary shares of £1 each)	410,322,557	410	410,322,557	410	410,322,557	410

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

Note 15 – Restricted Tier 1 notes

	HY2019 £m	HY2018 £m	FY2018 £m
Loan notes issued through public debt markets	347	–	347

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

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

Notes to the financial statements continued

Note 15 – Restricted Tier 1 notes continued

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

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

Proceeds of this issuance were used to fund a dividend from RLP to RHUK in order to partially repay the bank debt held at RHUK.

Note 16 – Share premium account and reserve

	Share premium £m	Retained earnings £m
At 1 January 2019	1,353	435
Profit for the period	–	328
Retrospective restatement due to change in accounting treatment	–	(7)
At 30 June 2019	1,353	756

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

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

Note 17 – Capital management

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

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

Under the Solvency II regime, the Company is required to hold the greater of the capital required under the Solvency II Pillar 1 framework and the capital required under its own economic capital models, Solvency II Pillar 2. In practice, it is the Pillar 1 requirement which is more onerous. The Company had sufficient capital available to meet its regulatory capital requirements at all times during the period ended 30 June 2019.

Notes to the financial statements continued

Note 17 – Capital management continued

Capital in excess of that required to meet the technical provisions is known as Own Funds. As at 30 June 2019, Own Funds for RLP are £4,066m (HY2018: £4,158m and FY2018: £3,894m) made up as follows:

	HY2019 £m	HY2018 £m	FY2018 £m
Total IFRS equity	2,866	2,396	2,545
Liability valuation differences and other adjustments	535	1,100	691
Total Tier 1	3,401	3,496	3,236
Solvency II debt valuation	665	662	658
Total Tier 2	665	662	658
Own Funds	4,066	4,158	3,894

The Company holds both debt and equity to optimise its capital structure and improve shareholder return.

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

Note 18 – Related parties disclosures

Ultimate holding company

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

Related party transactions

The Company entered into various transactions with fellow participating interests which are subject to common control from the same source.

	HY2019 £m	HY2018 £m	FY2018 £m
Statement of comprehensive income			
Change in the reinsurers' share of insurance contract liabilities and reinsurance recoveries	(2)	(2)	(3)
Finance costs	(13)	(12)	(25)
Operating expenses	–	(1)	(1)
Statement of financial position			
Reinsurance liabilities	3	3	4
Borrowings	398	398	398
Capital			
Ultimate parent company	1,763	1,763	1,763

Transactions with key management personnel

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

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

	HY2019 £m	HY2018 £m	FY2018 £m
Salaries, bonus and other employee benefits	3	2	20
Equity based compensation payments	3	1	4
Total transactions	6	3	24

Notes to the financial statements continued

Note 18 – Related parties disclosures continued

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

Transactions with RPML	HY2019 £m	HY2018 £m	FY2018 £m
Statement of comprehensive income			
Cost transfer	(35)	(40)	(68)
Statement of financial position			
Other payables	33	36	47

Transactions with RHUK	HY2019 £m	HY2018 £m	FY2018 £m
Statement of comprehensive income			
Cost transfer	2	2	3
Statement of financial position			
Other receivables	9	5	6
Capital	1,764	1,763	1,764
Dividends	–	–	500

Transactions with Rothesay Asset Management US LLC	HY2019 £m	HY2018 £m	FY2018 £m
Statement of comprehensive income			
Transaction fee	(3)	(2)	(1)
Servicing fee	(1)	–	(2)
Statement of financial position			
Other payables	3	2	3

Transactions with LT Mortgage Financing Limited

During December 2018, £1.3bn of the equity release mortgage loans were transferred from RLP to its subsidiary LTMF. During June 2019, a further £0.4bn of the equity release mortgage loans were transferred from RLP to LTMF. LTMF became the beneficial owner in the equity release mortgage loans in exchange for the issue of loan notes. These transactions took place on an arm's length basis using the fair value of the equity release mortgages. Under IAS 39 the loans cannot be derecognised from the Company as RLP effectively maintains all the risk and rewards and control of the mortgages after the securitisations through the loan notes. The IFRS 4 liability discount rate, including the credit default yield deduction, is consistent with the equity release mortgages ignoring the securitisation.

Transactions with Rothesay MA No.1 Limited

During December 2018, £778m of ground rent loans were transferred from RLP to its subsidiary RMA1. RMA1 became the beneficial owner in the ground rent loans in exchange for the issue of loan notes. These transactions took place on an arm's length basis using the fair value of the ground rent loans. Under IAS 39 the loans cannot be derecognised from the Company as RLP effectively maintains all the risk and rewards and control of the loans after the securitisations through the loan notes. The IFRS 4 liability discount rate, including the credit default yield deduction, is consistent with the ground rent loans ignoring the securitisation.

Note 19 – Investment in subsidiaries

The subsidiaries of RLP are listed in the following table:

Subsidiary undertakings	Country of incorporation	Primary business operation	HY2019 £m	HY2018 £m	FY2018 £m	HY2019 % equity interest	HY2018 % equity interest	FY2018 % equity interest
Rothesay Assurance Limited	UK	Dormant company	–	–	–	100%	100%	100%
LT Mortgage Financing Limited	UK	Service company	1	–	1	100%	100%	100%
Rothesay MA No.1 Limited	UK	Service company	–	–	–	100%	N/A	100%
Rothesay MA No.2 Limited	UK	Service company	–	–	–	100%	N/A	N/A

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

The above subsidiary undertakings are registered in the United Kingdom. The registered office and principal place of business for all subsidiary undertakings is Level 25, The Leadenhall Building, 122 Leadenhall Street, London EC3V 4AB.

Notes to the financial statements continued

Note 19 – Investment in subsidiaries continued

LTMF, which was incorporated in 2015 but remained dormant since that date, began trading during 2018. RMA1 was incorporated during October 2018. Rothesay MA No.2 Limited was incorporated during March 2019.

On 3 October 2016, the PRA granted an application to cancel the permissions of Rothesay Assurance Limited. As it is no longer needed, steps have been taken to remove it from the RHUK Group, and the company was placed into members' voluntary liquidation on 4 June 2019. The company will be dissolved once the liquidation is completed.

Note 20 – Financial commitments and contingencies

Lease commitments

From 1 January 2019, IFRS 16 'Leases' became effective. IFRS 16 replaced the guidance in IAS 17. Under IAS 17, lessees were required to make a distinction between a finance lease (on balance sheet) and an operating lease (off balance sheet). IFRS 16 now requires lessees to recognise a lease liability reflecting future lease payments and a 'right of use asset' for virtually all lease contracts (see note 11). The new standard has affected the balance sheet and related ratios.

The Company plans to re-locate its UK-based operations to The Post Building during the second half of 2019 in order to accommodate the growth of the business. As a result:

- The Company has entered into a lease for space in The Post Building, which will be accounted for under IFRS 16.
- The Company has exercised its break clause under the lease for Level 25 of The Leadenhall Building. The cash flows will continue to be accounted for on a cash flow basis.
- The Company has identified a new tenant for Level 32 of The Leadenhall Building and therefore has negotiated to terminate the lease. The cash flows will therefore continue to be accounted for a on a cash flow basis.

The future aggregate minimum lease payments under the Level 25 and Level 32 Leadenhall lease are as follows:

	HY2019 £m	HY2018 £m	FY2018 £m
Not later than one year	2	2	2
Later than one year and no later than five years	–	10	18
Later than five years	–	2	37
Total minimum lease payments	**2**	14	57

Other commitments

During previous years the Company executed transactions to purchase partly funded bonds. During 2019 the Company purchased additional partly funded bonds. The Company also signed up to a number of multi-year contracts. The Company expects to pay a further £653m within the next five years (HY2018: £261m and FY2018: £258m), £285m of this being due within 12 months of the financial reporting date (HY2018: £82m and FY2018: £90m).

	HY2019 £m	HY2018 £m	FY2018 £m
Not later than one year	285	82	90
Later than one year and no later than five years	368	179	168
Later than five years	–	–	–
Total other commitments	**653**	261	258

On 20 December 2018 the Company signed an agreement under which we committed to fund a £689m loan to a third party secured on commercial real estate providing all conditions precedent to drawdown are met. The borrower drew down on the loan during January 2019.

Note 21 – Post balance sheet events

On 12 July 2019 RLP issued £300m of Tier 3 bonds with maturity on 12 July 2026 and a fixed 3.375% coupon payable annually in arrears. On 17 September 2019 RLP issued £400m of Tier 2 bonds with maturity on 17 September 2029 and a fixed 5.5% coupon payable annually in arrears. The Tier 2 bonds are callable on 17 September 2024. On 11 September 2019 RLP issued £500m of equity to RHUK. The new equity and debt are intended to optimise the RHUK's Group's capital position in anticipation of the new business pipeline.

In March 2018 Rothesay Life and the Prudential Assurance Company Limited (PAC) entered into a reinsurance transaction covering a £12bn portfolio of annuities, with the expectation that this would be followed by an insurance business transfer under Part VII of the Financial Services and Markets Act 2000. The terms of the proposed transfer were reviewed by an independent expert, who was appointed to report to the High Court, who concluded that the transfer would not result in any material adverse effect on policyholders' security or benefits. Additionally, neither the PRA nor the FCA objected to the transfer.

However on 16 August 2019 the High Court declined to sanction the transfer. Whilst this is not the preferred or optimal outcome for either party, the reinsurance transaction agreements do contain provisions to address this outcome.

Rothesay Life and PAC have been granted leave to appeal by the High Court.

Glossary of terms

Acquisition costs	Acquisition costs comprise the expenses associated with the origination of new business, including annual compensation for employees.
Administration expenses – recurring	Administration costs (shown in note 4) represent the cost of administering the in-force book of business. They include both the outsourcing costs and other costs incurred by the Company.
Annuity	A series of regular payments made to an individual until their death. Payments may be indexed.
Assets under management	Assets being managed by the Company. Can be derived by taking total assets and adjusting for reinsurance assets, derivative liabilities and collateralised liabilities. Provides a useful measure for the size of the business.
Assumed reinsurance premiums	Premiums received by the Company in respect of reinsurance inwards, i.e. a policy where RLP is acting as the reinsurer.
Best estimate liability (BEL)	The liabilities of the Company calculated on a best estimate basis under Solvency II, i.e. where all the assumptions made in the calculation are best estimate.
Bid price	A bid price is the price a buyer is willing to pay for a security.
Borrowing costs	Interest payable on borrowings. This is a subset of the finance costs shown in note 5.
Brexit	The UK's planned exit from the European Union.
Bulk annuity	A bulk annuity, sometimes referred to as a bulk purchase annuity, is a contract between a defined benefit pension scheme and an insurance company, whereby an insurance company insures some or all of the annuities being paid by the pension scheme.
Collateralised agreements/ investments	Loans secured on property or other collateral.
Collective investment schemes	A way of investing money alongside other investors.
Corporate bonds and other corporate debt	These are debt securities issued by corporations which are not guaranteed by governments.
Covered bonds	Covered bonds are debt securities issued by a bank or mortgage institution and collateralised against a pool of assets.
Credit risk	The risk of loss or of adverse change in the financial situation resulting from fluctuations in the credit standing of issuers of securities, counterparties and any debtors.
Demographics	Statistical data relating to the population and particular groups within it.
Distributable profits	A company's profits available for distribution are its accumulated realised profits.
Economic capital	Represents management's internal risk-based calculation of the capital required to remain solvent for a 99.8% confidence level over a one-year period.
Equity 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.

Glossary of terms continued

In-force	An insurance policy or contract reflected on records that has not expired, matured or otherwise been surrendered or terminated.
Infrastructure	Investments in infrastructure such as water, energy and transportation.
Insurance risk	The risk of loss or of adverse change in the value of insurance liabilities, due to inadequate pricing and provisioning assumptions.
International Financial Reporting Standards (IFRS)	Accounting standards that are applied in preparing the Company's financial statements.
Investment return	Comprises all interest income on financial investments at fair value through profit and loss, realised investment gains and losses and movements in unrealised gains and losses, as well as expenses directly related to investments executed during the year.
LTMF	LT Mortgage Financing Limited.
Longevity reinsurance (%)	The longevity reinsurance percentage provides an indication of the extent to which the Company is protected from fluctuations in longevity through reinsurance. It is derived from the IFRS sensitivity analysis.
Longevity risk	The risk that a company could be exposed to a higher payout as a result of increasing life expectancy.
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.
Mortality tables	A table which shows for each age, what the probability is that a person of that age and gender will die before their next birthday.
Net premiums	Life insurance premiums, net of reinsurance premiums paid to third party reinsurers.
Net worth	Under MCEV, the value of equity plus the value of borrowings on an IFRS basis.
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 premiums and regular premium income make up gross premiums written. New business premiums are a key indicator of the growth and realisation of the Company's strategic objectives.
Non-recurring and project expenditure	Administration – project and other one-off expenses (see note 4).
Offer price	Price at which a market maker is prepared to sell a specific security.
Own Funds	Available capital under the Solvency II regime.
Partial internal model	Under Solvency II, insurer's own model used to calculate the solvency capital requirement in relation to particular risks approved by the PRA.
Part VII transfers	Court-approved transfer of a portfolio of contracts from one entity to another.
Pillar I	Under Solvency II, represents the solvency capital requirement calculated using a standard formula or (partial) internal model.
Prudential Regulation Authority (PRA)	The PRA is a UK regulatory body responsible for prudential regulation and supervision of banks, building societies, credit unions, insurers and major investment firms.
qx	qx is actuarial notation used to represent the probability of a life aged X dying during the year.
RAL	Rothesay Assurance Limited. Now being wound up.

Glossary of terms continued

Regular premiums	Payments of premium made regularly over the duration of the policy.
Reinsurance	Protection sold to or purchased from another insurance company.
RHUK	Rothesay Holdco UK Limited.
Risk margin	Under Solvency II, the cost of transferring non-hedgeable risks.
RLP	Rothesay Life Plc, the Group's regulated life company.
RMA1	Rothesay MA No.1 Limited.
RPML	Rothesay Pensions Management Limited, the Group's service company.
Secured investments	Bespoke investments where very high levels of collateral have been negotiated and returns are generated through illiquidity premium.
Single premiums	Single premium policies of insurance are those that require only a single lump sum payment from the policyholder.
Solvency capital requirement (SCR)	Under Solvency II, capital requirement to withstand a 1-in-200 year event.
SCR coverage ratio	Own Funds divided by SCR. Measure of surplus above capital requirement.
Solvency II	The solvency regime applicable from 1 January 2016. Under Solvency II, the Company is required to hold the greater of the capital required under the new Solvency II Pillar 1 framework and the capital required under our own economic capital models Solvency II Pillar 2.
Strategy risk	The risk of loss in future earnings and capital arising from changes in the competitive, economic, legal or political environment, changing customer behaviour, or a failure to select appropriate strategic or long-term business plans.
Subordinated loan	A fixed interest issue or debt that ranks below other debt in order of priority for repayment if the issuer is liquidated. Holders are compensated for added risk through higher rates of interest. Under EU insurance regulation, subordinated debt is not treated as a liability and counts towards the coverage of the required minimum margin of solvency with limitations.
Surrender	The termination of a life insurance policy or annuity contract at the request of the policyholder after which the policyholder receives the cash surrender value, if any, of the contract.
Third party administration (TPA) agreement	Contract with pensions administrator to process claims and payroll on behalf of RLP.
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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