Rothesay Holdco UK Limited

Interim condensed consolidated 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

Key performance indicators

New business premium (£bn)

Period	Value
HY Jun 2019	0.7
HY Jun 2018	12.4

IFRS profit/(loss) before tax (£m)

Period	Value
HY Jun 2019	403
HY Jun 2018	(257)

Assets under management (£bn)

Period	Value
Jun 2019	37.8
Dec 2018	36.3
Jun 2018	36.7

SCR coverage at RLP (%)

Period	Value
Jun 2019	176
Dec 2018	180
Jun 2018	177

MCEV (£bn)

Period	Value
Jun 2019	3.7
Dec 2018	3.4
Jun 2018	3.2

Customer satisfaction (%)

Period	Value
Jun 2019	96
Dec 2018	98
Jun 2018	98

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 £403m (HY2018: a pre-tax loss of £257m and FY2018: a pre-tax profit of £102m).

New business: During the first six months of the year, the Group (RHUK and its subsidiaries) 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 the Group.

Assets under management: The Group's assets under management increased to £37.8bn (HY2018: £36.7bn and FY2018: £36.3bn).

Market Consistent Embedded Value (MCEV): The Group's MCEV has increased by 8% since year end to £3,719m (HY2018: £3,151m and FY2018: £3,441m), driven largely by new business and the change in market conditions.

Solvency position: A continued focus on pro-active risk management and a cautious investment strategy meant that as at 30 June 2019, the Group's Solvency Capital Requirement (SCR) coverage was 177% (HY2018: 157% and FY2018: 181%) and Rothesay Life Plc's (RLP) coverage was 176% (HY2018: 177% and FY2018: 180%).

People: We have continued to invest in the business through recruitment across the Group leading to an increase in headcount from 210 to 227.

Strategic report continued

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 sign of abating.

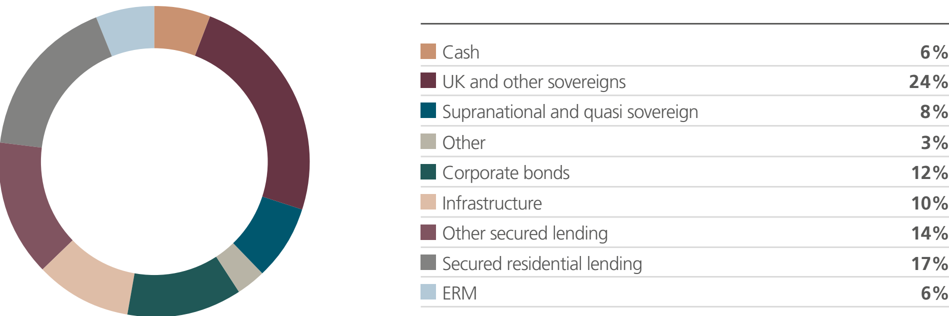
Despite the economic backdrop the demand for pension scheme de-risking remains strong with employee benefit consultants suggesting that 2019 will be a record year for the bulk annuity market.

Group 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.

We have now successfully deployed all of the assets received from the Prudential transaction according to our 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 Group's first half IFRS profit of £403m (HY2018: a pre-tax loss of £257m and FY2018: a pre-tax profit of £102m). The investment mix of the Group'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 Group'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 we 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 we are well positioned for the second half of 2019.

Largely as a result of new business and the fall in interest rates, the Group's assets under management grew by 4% to £37.8bn as at 30 June 2019 (HY2018: £36.7bn and FY2018: £36.3bn) and the MCEV grew by 8% to £3,719m (HY2018: £3,151m and FY2018: £3,441m).

On 27 March 2019 the Group 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 Rothesay Life Plc's (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.

Strategic report continued

Our policyholders

We pride ourselves on the quality of the service we provide and this is borne out by our customer service statistics. In surveys, over 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 we 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 Group manages the risks associated with our annuity business in order to protect policyholder security and provide shareholders with a stable return. We look to use surplus capital to fund growth opportunities which we assess with a disciplined approach to risk and return.

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

The Group continues to hedge a large proportion of the longevity risk associated with our business and we were 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.

On 3 April 2019, we simplified RHUK's share capital structure by consolidating the previous ordinary and preference shares into new ordinary shares (see note 14). In order to ensure that the Group 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 the Group issued £500m of equity to our institutional shareholders.

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

Brexit

As a UK insurer serving the domestic market, the Group'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 we do not believe that the UK leaving the EU will affect our 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 Group 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.

Our people

Our people are a key strength of the Group and we have continued to recruit to ensure we are well placed to meet future challenges and the continued growth of the business. During the period, headcount has increased from 210 to 227 through recruitment, particularly in asset origination, risk, technology and systems development.

Work is progressing well on the fit out of our new offices at The Post Building and we are looking forward to all our UK-based staff being together on one floor.

Looking forward

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

The equity provided to back new business also demonstrates the willingness of our institutional shareholders to provide new equity to support strategic opportunities for growing the business and our sophisticated risk management systems allow us to respond quickly as and when such opportunities arise.

Financial review

In the period to 30 June 2019, the Group made a profit before tax of £403m (loss before tax HY2018: £257m, FY2018: profit of £102m). Profits were largely driven through a combination of investing the assets received from the Prudential transaction in line with our long-term investment strategy and economic profits as a result of falling interest rates and the rise in corporate bond prices.

IFRS financial performance

£m	HY2019	HY2018	FY2018
New business profit (with assets invested)	25	317	361
Management of in-force book	369	(357)	128
Acquisition costs	(40)	(65)	(105)
Administration expenses	(20)	(14)	(36)
Experience variance	–	2	2
Other	(4)	(3)	5
Operating profit/(loss) before tax	330	(120)	355
Borrowing costs	(36)	(26)	(55)
Non-recurring, project and Group expenditure	(18)	(18)	(20)
Economic profits/(losses)	127	(93)	(178)
Profit/(loss) before tax	403	(257)	102

New business profit for the half year assuming full investment of premiums was £25m (HY2018: £317m). New business profit is calculated assuming full deployment of premiums and the impact of any under-deployment is reported in the table as a deduction from the management of in-force book.

Profits from management of the in-force book of £369m (HY2018: loss of £357m) were boosted by the impact of investing the new business premiums received during 2018.

Acquisition costs include some costs incurred in relation to business expected to be written in the second half of 2019 along with the business written during HY2019.

In the first half of 2019, the Group made economic profits of £127m (HY2018: losses of £93m) as a result of falling interest rates, rising bond prices and falls in the value of sterling.

Total assets increased from £50.2bn as at 31 December 2018 to £57.0bn as at 30 June 2019 primarily as a result of the change in market conditions. Adjusting total assets for reinsurance, payables, derivatives and collateralised financing gives assets under management of £37.8bn as shown in the table on the next page. Assets under management increased from £36.3bn as at 31 December 2018 to £37.8bn as at 30 June 2019.

Balance sheet highlights

£m	HY2019	HY2018	FY2018
Financial investments	55,776	50,755	49,174
Reinsurance assets	180	72	43
Other assets	1,042	1,315	1,016
Total assets	56,998	52,142	50,233
Share capital and share premium	818	829	829
Restricted Tier 1 (RT1) notes	347	–	347
Capital contribution reserve	12	5	10
Retained earnings	1,705	1,093	1,385
Total equity	2,882	1,927	2,571
Insurance contract liabilities	33,706	33,083	32,435
Reinsurance liabilities	671	500	673
Payables	18,979	15,417	13,849
Borrowings	647	1,144	647
Other	113	71	58
Total liabilities	54,116	50,215	47,662
Total equity and liabilities	56,998	52,142	50,233

Insurance contract liabilities increased from £32.4bn as at 31 December 2018 to £33.7bn as at 30 June 2019 largely as a result of new business and the change in market conditions partially offset by the run-off of existing business.

Financial review continued

Assets under management

£m	HY2019	HY2018	FY2018
Total assets	**56,998**	52,142	50,233
Less reinsurance assets	**(180)**	(72)	(43)
Less payables and financial liabilities	**(18,979)**	(15,417)	(13,849)
Assets under management	**37,839**	36,653	36,341

Market consistent embedded value

MCEV has increased from £3,441m at 31 December 2018 to £3,719m as at 30 June 2019 (HY2018: £3,151m) as a result of new business, falling interest rates and the rise in corporate bond prices. MCEV is summarised in the table below. Adjustments allow for Group borrowings and other Group adjustments, these adjustments increased from a deduction of £974m at 31 December 2018 to a deduction of £997m at 30 June 2019 due to a rise in the value of the Group's borrowings over the half year.

Market consistent embedded value

£m	HY2019	HY2018	FY2018
Net assets	**3,514**	3,043	3,193
Value of in-force	**1,202**	1,268	1,222
Less debt and Group adjustments	**(997)**	(1,160)	(974)
MCEV	**3,719**	3,151	3,441

The shareholders' equity on an MCEV basis is consistent with the sum of the shareholders' equity on an IFRS basis, the value of in-force business as shown above and debt valuation differences of £365m as at 30 June 2019. Most of this difference arises from the treatment of the Restricted Tier 1 notes as debt under MCEV. The debt valuation is £1,012m on an MCEV basis.

The value on an MCEV basis of new business written in the first half of 2019 was £78m (HY2018: £384m).

The methodology and assumptions used in calculating the MCEV are consistent with those set out in the FY2018 MCEV supplementary financial statements. The liquidity premium adjustment used at 30 June 2019 was 110bps, after the deduction of investment management costs (30 June 2018: 95bps and 31 December 2018: 115bps).

Financial review continued

Capital management

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

- to maintain financial strength in adverse conditions;
- to give customers long-term confidence in the Group;
- to satisfy our regulatory obligations;
- to match the profile of our assets and liabilities, taking account of the 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 Group is required to hold the greater of the capital required under the Solvency II Pillar 1 framework and the capital required under its own economic capital models, Solvency II Pillar 2.

In practice, it is the Pillar 1 requirement which is more onerous and which has a direct impact on the Group's ability to pay dividends. The Group aims to maintain at least 130% of the regulatory minimum requirement. If solvency coverage exceeds 150% of SCR, the Board will consider the requirement for excess Own Funds to meet future opportunities or consider returning capital to shareholders. The Board has considered this during the first half of 2019 and given the new business pipeline no distribution to shareholders has been made.

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

The solvency position of the Group and RLP is summarised in the table below. Group SCR coverage decreased from 181% at 31 December 2018 to 177% at 30 June 2019. SCR coverage at RLP decreased from 180% on 31 December 2018 to 176% on 30 June 2019.

Solvency position

	Group			RLP		
£m	HY2019	HY2018	FY2018	HY2019	HY2018	FY2018
Tier 1 capital	3,416	3,025	3,260	3,401	3,496	3,236
Tier 2 capital	665	662	658	665	662	658
Own Funds available to meet SCR	4,081	3,687	3,918	4,066	4,158	3,894
SCR	2,310	2,351	2,163	2,310	2,351	2,163
Surplus above SCR	1,771	1,336	1,755	1,756	1,807	1,731
SCR coverage	177%	157%	181%	176%	177%	180%
SCR coverage without transitional solvency relief	152%	108%	153%	152%	128%	152%

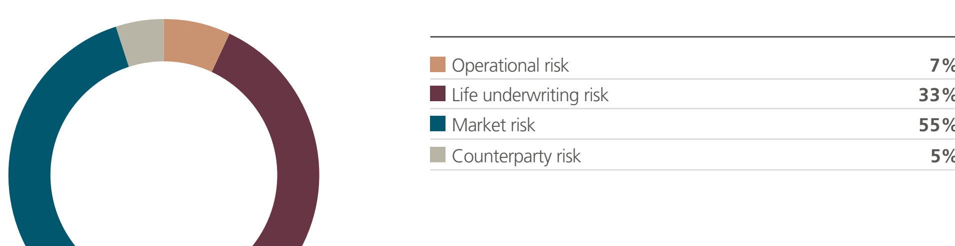
The value of transitional solvency relief was last recalculated on 31 December 2018 at the time of the adoption of the partial internal model (PIM). We estimate that the impact of recalculating transitional solvency relief as at 30 June 2019 would be to increase solvency coverage by 4% for both Group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

The Group's SCR is calculated using a PIM approved for use from 31 December 2018. The PIM means that the Group'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 Group's investment strategy. The standard formula is used to calculate the SCR for all other risk components and for 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 on the next page 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.

Financial review continued

RLP/RHUK SCR 30 June 2019



An analysis of the change in Own Funds and SCR is shown in the table below. Own Funds have increased from £3,918m to £4,081m after allowing for amortisation of 1/16th of transitional solvency relief. The biggest drivers of this change were changes in economic conditions and management of in-force book, which includes the run-off of liabilities and the impact of investing in assets which increased the matching adjustment. The SCR increased from £2,163m to £2,310m largely as a result of falling interest rates, new business and the impact of investing in more capital efficient assets. All numbers are shown net of tax impacts.

Change in Own Funds and SCR

	HY2019		HY2018		FY2018	
	Change in Own Funds £m	Change in SCR £m	Change in Own Funds £m	Change in SCR £m	Change in Own Funds £m	Change in SCR £m
Opening position	3,918	2,163	2,944	1,745	2,944	1,745
Amortisation of 1/16th of transitional on 1 January	(43)	–	(67)	–	(67)	–
New business (on a fully deployed basis)	23	63	402	805	659[1]	880
Management of in-force book	208	(142)	24	(93)	415	65
Acquisition costs and administration expenses	(49)	–	(63)	–	(120)	–
Demographic experience variance	1	–	1	(1)	2	–
Economic conditions	69	210	110	(109)	(217)	(127)
Non-recurring expenses	(15)	–	(15)	–	(17)	–
Finance costs	(30)	–	(18)	–	(48)	–
Share issuance	–	–	380	–	380	–
Debt issuance	–	–	–	–	350	–
PIM (including change in transitional)	–	–	–	–	(381)	(411)
Other	(1)	16	(11)	4	18	11
Closing position	4,081	2,310	3,687	2,351	3,918	2,163

1 The impact of new business written in HY2018 was re-assessed at FY2018 to reflect the impact of approval of the PIM, in particular the inclusion of equity release mortgages in the fully deployed investment portfolio backing new business.

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

Report of the Directors

The Directors present their condensed financial statements for Rothesay Holdco UK Limited (the Company or RHUK), registered number 08668809, for the period ended 30 June 2019. Comparative information has been presented for the period ended 30 June 2018 and the year ended 31 December 2018, except for note 11 Leases (please refer to explanation in note 1).

1. Results

The consolidated results for RHUK and its subsidiaries (the Group) for the period are set out in the consolidated statement of comprehensive income on page 10.

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 RHUK and its subsidiaries; Rothesay Pensions Management Limited, Rothesay Life Plc, Rothesay Assurance Limited, LT Mortgage Financing Limited, Rothesay Asset Management UK Limited, Rothesay MA No.1 Limited, Rothesay MA No.2 Limited and Rothesay Asset Management US LLC.

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

4. Post balance sheet 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 RHUK issued £500m of equity to our institutional shareholders. The new equity and debt are intended to optimise the 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		28 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		

Report of the Directors continued

6. Statement of Directors' responsibilities

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

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

7. Date of authorisation of issue

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

On behalf of the Board

Addy Loudiadis
Chief Executive Officer

17 September 2019

Condensed consolidated 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	2,130	(130)	141
Total revenue		2,202	11,840	12,196
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 liabilities		(1,677)	(11,970)	(11,862)
Acquisition and administration expenses	4	(78)	(97)	(161)
Finance costs	5	(44)	(30)	(71)
Total expenses		(1,799)	(12,097)	(12,094)
Profit/(loss) before tax		403	(257)	102
Income tax (expense)/credit	6	(76)	50	(17)
Profit/(loss) for the period/financial year		327	(207)	85

All income and expenses relate to continuing operations.

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

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

Condensed consolidated statement of financial position

As at 30 June 2019

	Note	HY2019 £m	HY2018 £m	FY2018 £m
Assets				
Property, plant and equipment		2	3	2
Lease – right of use asset	11	36	–	–
Financial investments	7	55,776	50,755	49,174
Deferred tax asset	13	1	3	1
Reinsurance assets	8	180	72	43
Accrued interest and prepayments		405	443	497
Receivables		445	454	353
Cash and cash equivalents		153	412	163
Total assets		56,998	52,142	50,233
Equity and liabilities				
Equity				
Share capital	14	3	3	3
Tier 1 notes	15	347	–	347
Employee benefit trust	14	(30)	(19)	(19)
Share premium	16	845	845	845
Capital contribution reserve	16	12	5	10
Other reserves	16	1,705	1,093	1,385
Total equity		2,882	1,927	2,571
Liabilities				
Reinsurance liabilities	8	671	500	673
Insurance contract liabilities	9	33,706	33,083	32,435
Payables and financial liabilities	10	18,979	15,417	13,849
Leasehold liabilities	11	36	–	–
Borrowings	12	647	1,144	647
Accruals and deferred income		77	71	58
Total liabilities		54,116	50,215	47,662
Total equity and liabilities		56,998	52,142	50,233

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 08668809

Condensed consolidated statement of changes in equity

For the period ended 30 June 2019

	Share capital £m	Share premium £m	Tier 1 notes £m	Capital contribution reserve £m	Profit and loss reserve £m	Reorganisation reserve £m	Employee benefit trust £m	Total equity £m
As at 1 January 2019	3	845	347	10	1,253	132	(19)	2,571
Profit for the period	–	–	–	–	327	–	–	327
Retrospective restatement due to change in accounting treatment	–	–	–	–	(7)	–	–	(7)
Employee share scheme	–	–	–	–	–	–	(11)	(11)
Capital contribution	–	–	–	2	–	–	–	2
As at 30 June 2019	**3**	**845**	**347**	**12**	**1,573**	**132**	**(30)**	**2,882**

For the period ended 30 June 2018

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

For the year ended 31 December 2018

	Share capital £m	Share premium £m	Tier 1 notes £m	Capital contribution reserve £m	Profit and loss reserve £m	Reorganisation reserve £m	Employee benefit trust £m	Total equity £m
As at 1 January 2018	2	466	–	5	1,168	132	(20)	1,753
Profit for the financial year	–	–	–	–	85	–	–	85
Share issuance	1	379	–	–	–	–	–	380
Vesting of stock appreciation plan	–	–	–	(2)	–	–	–	(2)
Tier 1 note issuance	–	–	347	–	–	–	–	347
Employee benefit trust	–	–	–	–	–	–	1	1
Capital contribution	–	–	–	7	–	–	–	7
As at 31 December 2018	3	845	347	10	1,253	132	(19)	2,571

Condensed consolidated 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	327	(207)	85
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
Amortisation of debt costs	–	–	3
Share based payments	5	2	8
Interest income	(527)	(420)	(956)
Interest expense	44	30	71
Income tax expense	76	(48)	17
Deferred tax credit	–	(2)	–
Net (increase)/decrease in operational assets			
Financial investments	(6,602)	(13,453)	(11,861)
Deferred tax asset	–	(2)	–
Reinsurance assets	(137)	96	124
Receivables	(90)	(67)	(16)
Prepayments	16	–	(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	(11)	261	(95)
Accruals and deferred income	(1)	20	20
Net cash flows used in operating activities	(568)	(949)	(1,546)
Interest paid	(23)	(18)	(73)
Interest received	601	289	844
Tax paid	(19)	(38)	(38)
Cash flows used in operating activities	(9)	(716)	(813)
Cash flows from financing activities			
Repayment of borrowings	–	–	(500)
Proceeds from issuance of debt	–	497	–
Proceeds from borrowings	–	–	498
Proceeds from issuance of Tier 1 (net of issuance costs)	–	–	347
Proceeds from issue of ordinary share capital (including share premium)	–	380	380
Net cash flows from financing activities	–	877	725
Cash outflows from investing activities			
Net acquisition of property, plant and equipment	(1)	–	–
Net cash outflows from investing activities	(1)	–	–
Net increase in cash and cash equivalents	(10)	161	(88)
Cash and cash equivalents at 1 January	163	251	251
Cash and cash equivalents at the statement of financial position date	153	412	163

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

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

(b) Basis of preparation

The condensed consolidated interim financial statements for the six month period ended 30 June 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 consolidated financial statements of the Group are presented in sterling (£) rounded to the nearest million (£m) except where otherwise stated.

The Group presents its consolidated statement of financial position broadly in order of liquidity.

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

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

(c) Accounting policies and change in accounting policies

The accounting policies adopted are consistent with those of the previous financial year except the Group 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 Group has recognised a 'right of use asset' in relation to a lease executed at the end of 2018 in relation to new premises. The Group 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 Group 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 Group can be found in the 2018 Annual Report.

Note 2 – Segmental analysis

All of the Group's business risks and returns are within one business segment (i.e. long-term insurance business). This includes the premium generated on inwards reinsurance contracts. The Group's operations are materially within the United Kingdom. The split between regular premiums 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 Group conducts a relatively small number of individual transactions each year. These transactions are all one-off in nature and the Group's business plans do not anticipate conducting a significant amount of repeat business.

Note 3 – Investment return

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

	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	**(18)**	(16)	(36)
Total investment return	**2,130**	(130)	141

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 consolidated 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	65	105
Administration expenses – recurring	20	14	36
Administration expenses – project and other one-off expenses	16	18	20
Group expenses	2	–	–
Total operating expenses	78	97	161

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
Total interest payable on collateral and collateralised agreements	8	4	16
Interest payable on borrowing from participating interest	13	12	25
Interest payable on third party borrowings	23	14	30
Total borrowing costs	36	26	55
Net finance costs	44	30	71

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 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	–	(2)	–
Total deferred tax	–	(2)	–
Total expense/(credit) in the condensed consolidated statement of comprehensive income	76	(50)	17

(b) Reconciliation of the total tax charge

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

	HY2019 £m	HY2018 £m	FY2018 £m
Profit/(loss) on ordinary activities before taxation	403	(257)	102
Tax calculated at UK standard rate of corporation tax of 19% (HY2018 and FY2018: 19%)	76	(49)	20
Disallowed expenditure	–	–	(1)
Adjustment in respect of prior periods	–	–	(2)
Temporary differences	–	(1)	–
Total tax expense/(credit) reported in the condensed consolidated statement of comprehensive income	76	(50)	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 Group uses other methodologies to determine fair value, which vary based on the type of instrument. Valuation inputs and assumptions are changed when corroborated by substantive observable evidence, including values realised on sales.

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

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

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

Determination of fair value and fair values hierarchy

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

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

Notes to the financial statements continued

Note 7 – Financial investments continued

Determination of fair value and fair values hierarchy *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	2,120	–	–	2,120
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	5,047	41,965	8,764	55,776

HY2018	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Collective investment schemes	1,855	–	–	1,855
Government, sub sovereign and agency obligations	7,092	12,258	–	19,350
Corporate bonds and other corporate debt	–	11,036	877	11,913
Derivative assets	–	11,169	–	11,169
Collateralised agreements and financing	–	2,368	–	2,368
Loans secured on property	–	–	3,220	3,220
Equity release mortgages[2]	–	–	722	722
Certificate of deposits	–	158	–	158
Total financial investments at fair value	8,947	36,989	4,819	50,755

2 £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	1,390	–	–	1,390
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	6,084	36,361	6,729	49,174

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.

Notes to the financial statements continued

Note 7 – Financial investments continued

Determination of fair value and fair values hierarchy *continued*

The following table shows a reconciliation of the opening and closing recorded amounts in relation to the Level 3 financial instruments recorded at fair value (excluding equity release mortgages which are discussed in the equity release 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**

	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 Group'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 Group transferred certain financial instruments between Level 2 and Level 3 of the fair value hierarchy. The recorded amount of the total assets transferred from Level 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 Group which allow the equity release mortgage holders to extinguish their loan by selling their property back to the Group at the current market value and at the point at which the mortgage must be redeemed (typically on death or transfer to long-term care), even when property values are lower than the outstanding loan balance.

Notes to the financial statements continued

Note 7 – Financial investments continued

Equity release mortgages *continued*

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.

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 we 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	–
		+10% change in property prices	4,961	14	20
Loans secured on property[3]	Property prices	-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[4]	Liquidity premium	+50bps yield to maturity	21	(23)	(9)
		-50bps yield to maturity	21	26	10

3 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.

4 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[5] 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	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)

5 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	(Decrease)/ increase in FV £m	(Decrease)/ increase in PBT £m
Financial assets					
Corporate bonds and other corporate debt	Discount rate	+50bps yield to maturity	1,091	(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 Group 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 Group 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 Group'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 Group. 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 the Group's insurance contract liability valuations. Note that insurance contract liabilities include reinsurance inwards, i.e. where the Group has reinsured a third party insurer.

(a) Mortality assumptions

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

	Base mortality					
	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.

Notes to the financial statements continued

Note 9 – Insurance contract liabilities continued

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.

	Future mortality improvements (including margins)		
	HY2019	HY2018	FY2018
Males	CMI_2017_M[3.0%; S_k=7.5]	CMI_2017_M[3.4%; S_k=7.75]	CMI_2017_M[3.0%; S_k=7.5]
Females	CMI_2017_F[3.0%; S_k=7.5]	CMI_2017_F[3.4%; S_k=7.75]	CMI_2017_F[3.0%; S_k=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 S_k 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 reduction		
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[6]	146 bps
Other[7]	10 bps	35 bps	10 bps
Overall yield deduction	32 bps	26 bps	31 bps

6 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.

7 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.

Notes to the financial statements continued

Note 9 – Insurance contract liabilities continued

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.

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 Group is holding appropriate matching assets (such as index-linked bonds and inflation-linked swaps with associated caps and floors), the impact on the overall financial position of the Group of actual or assumed changes in these rates is relatively small.

(c) Expense assumption

An allowance is made for future overhead maintenance expenses following an investigation into the total costs incurred by the Group 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.

Notes to the financial statements continued

Note 9 – Insurance contract liabilities continued

(e) Movement 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

	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 in the liability valuation.

Additional expense reserves set up to support new business have been reflected through the increase in respect of new business.

Notes to the financial statements continued

Note 9 – Insurance contract liabilities continued

(f) Sensitivity analysis

The schedule below provides an analysis of the reasonably possible movements in key assumptions that would have a material impact on liabilities (net of reinsurance), 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)

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 Group being immunised to market movements in either direction.

Notes to the financial statements continued

Note 9 – Insurance contract liabilities continued

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.

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
Current tax payable	74	–	17
Other taxes and social security costs	4	5	8
Other payables	97	378	127
Total payables	1,341	1,618	1,280
Total payables and financial liabilities	18,979	15,417	13,849

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).

Notes to the financial statements continued

Note 11 – Leases

(a) Amounts included in the statement of financial position

On adoption of IFRS 16, the Group 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 Group 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 Group'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 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 Group 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 Group 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 Group 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

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 Group has taken the modified retrospective approach.

Notes to the financial statements continued

Note 11 – Leases continued

(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

The Group's borrowings are as follows:

	HY2019 £m	HY2018 £m	FY2018 £m
Third party syndicated loan	–	497	–
Subordinated loans from participating interest	398	398	398
Subordinated loan notes	249	249	249
Total borrowed	**647**	1,144	647

In March 2018, the Group entered into a £500m three-year term loan facility with a syndicate of third party banks. On 10 October 2018, £350m of this facility was repaid using the proceeds of the RT1 note issuance in RLP. On 12 December 2018 the remaining £150m of the facility was repaid using the proceeds from a dividend from RLP. The £300m revolving credit facility entered into in March 2017 remains effective but undrawn.

The carrying amounts, fair values and features of the Group'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 Group 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
Unsecured loans										
£500m	14 Mar 2018	14 Mar 2021	Immediate	6m£L plus 1.00% with 0.25% step-up every six months thereafter	–	497	–	–	500	–

For the period ended 30 June 2019, an interest expense of £23m (HY2018: £26m and FY2018: £55m) was recognised in the condensed consolidated 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 consolidated 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
Third party syndicated loan	–	497	–	497
Subordinated loans from participating interest	398	–	–	398
Subordinated loan notes	249	–	–	249
Total borrowings	647	497	–	1,144

	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 tax assets

Deferred tax balances comprise:

	HY2019 £m	HY2018 £m	FY2018 £m
Temporary differences between the financial statements and the tax deductions	1	3	1
Total temporary differences	1	3	1

The movement in the deferred tax balances were as follows:	HY2019 £m	HY2018 £m	FY2018 £m
At 1 January	1	1	1
Timing difference	–	2	–
At statement of financial position date	1	3	1

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
Ordinary share capital of £0.001 each	–	–	1,214,827,671	1.2	1,214,827,671	1.2
Ordinary share capital of £0.002 each	1,214,827,671	2.4	–	–	–	–
Preference share capital of £0.001 each	–	–	1,214,827,671	1.2	1,214,827,671	1.2
Restricted shares of £0.001 each	90,000,000	0.1	70,000,000	0.1	70,000,000	0.1
Authorised share capital	1,304,827,671	2.5	2,499,655,342	2.5	2,499,655,342	2.5

With effect from 3 April 2019, the previous 943,519,813 A stapled shares (comprising one A ordinary share of £0.001 and the related preference share of £0.001), 44,159,475 B stapled shares (comprising one B ordinary share of £0.001 and the related preference share of £0.001) and 227,148,383 C stapled shares (comprising one C ordinary share of £0.001 and the related preference share of £0.001) have been consolidated and reclassified respectively into 943,519,813 new A ordinary shares (of £0.002 each), 44,159,475 new B ordinary shares (of £0.002 each) and 227,148,383 new C ordinary shares (of £0.002 each).

Notes to the financial statements continued

Note 14 – Share capital continued

On 20 June 2019, the Group issued 20,000,000 restricted H shares to the employee benefit trust for a total cash consideration of £0.02m.

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

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

The ordinary shares issued are analysed into the following categories:

	HY2019		HY2018		FY2018	
	No.	£m	No.	£m	No.	£m
£0.001 A ordinary	–	–	943,519,813	0.9	943,519,813	0.9
£0.001 B ordinary	–	–	44,159,475	0.1	44,159,475	0.1
£0.001 C ordinary	–	–	227,148,383	0.2	227,148,383	0.2
£0.002 new A ordinary	943,519,813	1.9	–	–	–	–
£0.002 new B ordinary	44,159,475	0.1	–	–	–	–
£0.002 new C ordinary	227,148,383	0.4	–	–	–	–
Total	1,214,827,671	2.4	1,214,827,671	1.2	1,214,827,671	1.2

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

The table below provides an analysis of the effective movement in the number of shares:

Number of shares	HY2019 No.	HY2018 No.	FY2018 No.
At 1 January	2,499,655,342	2,138,068,738	2,138,068,738
Ordinary share issuance	–	180,793,302	180,793,302
Preference share issuance	–	180,793,302	180,793,302
Preference share collapse into new ordinary shares	(1,214,827,671)	–	–
Restricted share issuance	20,000,000	–	–
At statement of financial position date	1,304,827,671	2,499,655,342	2,499,655,342

Employee benefit trust

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

The table below provides an analysis of the movement in the number of B ordinary shares held by the Trust.

Number of shares	HY2019 No.	HY2018 No.	FY2018 No.
At 1 January	11,733,106	12,783,445	12,783,445
Shares acquired from employees	3,988,119	41,939	42,849
Shares issued to employees as Restricted Stock Units vest	–	–	(1,093,188)
At statement of financial position date	15,721,225	12,825,384	11,733,106

On 4 April 2019 the Trust purchased 3,116,366 of new B ordinary shares for consideration of £8.8m. A further 871,753 B stapled shares were acquired by the Trust during the period (and prior to 3 April 2019) from employees leaving employment.

As noted above, on 20 June 2019 RHUK issued and allotted to the Trust 20,000,000 H shares and the beneficial interest was sold to eight employees of the Group immediately thereafter.

Notes to the financial statements continued

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 Group 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.

The Group has the option to cancel the coupon payment which becomes mandatory upon breach or non-compliance with RLP's SCR, a breach of the minimum capital requirement (MCR) or where the Group 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	Capital contribution reserve £m	Employee scheme treasury shares £m	Profit and loss reserve £m	Reorganisation reserve £m
At 1 January 2019	845	10	(19)	1,253	132
Profit for the period	–	–	–	327	–
Retrospective restatement due to change in accounting treatment	–	–	–	(7)	–
Employee share scheme	–	–	(11)	–	–
Capital contribution	–	2	–	–	–
At 30 June 2019	845	12	(30)	1,573	132

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

	Share premium £m	Capital contribution £m	Employee scheme treasury shares £m	Profit and loss reserve £m	Reorganisation reserve £m
At 1 January 2018	466	5	(20)	1,168	132
Profit for the financial year	–	–	–	85	–
Share issuance	379	–	–	–	–
Vesting of stock appreciation rights	–	(2)	–	–	–
Capital contribution	–	7	1	–	–
At 31 December 2018	845	10	(19)	1,253	132

Notes to the financial statements continued

Note 17 – Capital management

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

- to maintain financial strength in adverse conditions;
- to give customers long-term confidence in the Group;
- to satisfy our regulatory obligations;
- to match the profile of our assets and liabilities, taking account of the 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 Group is required to hold the greater of the capital required under the Solvency II Pillar 1 framework and the capital required under its own economic capital models, Solvency II Pillar 2. In practice, it is the Pillar 1 requirement which is more onerous. The Group had sufficient capital available to meet its regulatory capital requirements at all times during the period ended 30 June 2019.

Capital in excess of that required to meet the technical provisions is known as Own Funds. As at 30 June 2019, Own Funds for the Group are £4,081m (HY2018: £3,687m and FY2018: £3,918m) made up as follows:

	HY2019 £m	HY2018 £m	FY2018 £m
Total IFRS equity	2,882	1,927	2,571
Liability valuation differences and other adjustments	534	1,098	689
Total Tier 1	3,416	3,025	3,260
Solvency II debt valuation	665	662	658
Total Tier 2	665	662	658
Own Funds	4,081	3,687	3,918

The Group 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 Group 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 companies

The companies with an economic interest in RHUK are:

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

The remaining percentage is owned by the Directors, management, employees and the Trust (see note 14). Percentages are based on interest in ordinary shares in RHUK.

Related party transactions

The Group 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	513	513	513

Notes to the financial statements continued

Note 18 – Related parties disclosures continued

Transactions with key management personnel

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

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

	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

On 4 April 2019 members of key management personnel and their families sold new B ordinary shares to the Employee Benefit Trust for consideration of £7.8m.

The tables below represent transactions and balances between RHUK and its subsidiaries Rothesay Pensions Management Limited (RPML) and RLP.

Transactions with RPML	HY2019 £m	HY2018 £m	FY2018 £m
Statement of financial position			
Other receivables	8	8	8
Other payables	3	–	–
Capital	17	7	11

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

Transactions with Rothesay Asset Management UK	HY2019 £m	HY2018 £m	FY2018 £m
Capital	5	5	5

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.

Notes to the financial statements continued

Note 19 – Investments in subsidiaries

The financial statements include the financial statements of RHUK and the subsidiaries listed in the following table:

Group undertakings	Country of incorporation	Primary business operation	HY2019 £m	HY2018 £m	FY2018 £m	HY2019 % equity interest	HY2018 % equity interest	FY2018 % equity interest
Rothesay Pensions Management Limited	UK	Service company	17	7	11	100%	100%	100%
Rothesay Life Plc	UK	Life insurance	1,764	1,764	1,764	100%	100%	100%
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
Rothesay Asset Management UK Limited	UK	Service company	5	5	5	100%	N/A	100%
Rothesay Asset Management US LLC	US	Service company	5	5	5	100%	N/A	100%

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

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

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

LTMF, which was incorporated in 2015 but remained dormant since that date, began trading during 2018. Rothesay MA No.1 Limited was incorporated during October 2018. RMA1 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 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 Group 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 Group has entered into a lease for space in The Post Building, which will be accounted for under IFRS 16.
- The Group 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 Group 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**

Notes to the financial statements continued

Note 20 – Financial commitments and contingencies continued

Other commitments

During previous years the Group executed transactions to purchase partly funded bonds. During 2019 the Group purchased additional partly funded bonds. The Group also signed up to a number of multi-year contracts. The Group 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 Group 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 RHUK issued £500m of equity to our institutional shareholders. The new equity and debt are intended to optimise the 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

Term	Definition
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 Group.
Annuity	A series of regular payments made to an individual until their death. Payments may be indexed.
Assets under management	Assets being managed by the Group. Can be derived by taking total assets and adjusting for reinsurance assets, derivative liabilities and collateralised liabilities. Provides a useful measure for the size of the business.
Assumed reinsurance premiums	Premiums received by the Group in respect of reinsurance inwards, i.e. a policy where RLP is acting as the reinsurer.
Best estimate liability (BEL)	The liabilities of the Group calculated on a best estimate basis under Solvency II, i.e. where all the assumptions made in the calculation are best estimate.
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.
Capital contribution reserve	The capital contribution reserve arose as a result of the stock appreciation rights granted in relation to the Rothesay Life share incentive plan.
Collateralised agreements/ investments	Loans secured on property or other collateral.
Collective investment schemes	A way of investing money alongside other investors.
Corporate bonds and other corporate debt	These are debt securities issued by corporations which are not guaranteed by governments.
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.
Customer satisfaction	Policyholder feedback surveys are sent to all policyholders following any interaction with them (apart from complaints and bereavement). The Group's customer satisfaction percentage highlights the percentage of policyholders responding to feedback surveys that rate the service as good or excellent. Rothesay monitor the responses closely to identify any changes in the level of service that customers receive.
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.
Economic profits	In the analysis of financial performance, economic profits are calculated by considering the change in assets and liabilities attributable to changes in economic conditions (e.g. interest rates, credit spreads, defaults, inflation) allowing for the cost of hedging. The release of credit default allowances over time is included in the management of in-force book.
Employee benefit trust (EBT)	A trust established to purchase and hold shares of the Company for delivery under employee share schemes.
Equity-based compensation	Share based transactions awarded under incentive plans.
Equity release mortgages	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.

Glossary of terms continued

Experience variance	In the analysis of financial performance, experience variance is calculated by considering the change in liabilities as a result of actual experience being different from that assumed on a best estimate basis (e.g. policyholders living longer than assumed). The release of prudent margins is included in the management of in-force book.
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.
Group costs	Group costs represent costs incurred by RHUK.
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 Group's consolidated financial statements.
Investment return	Comprises all interest income on financial investments at fair value through profit and loss, realised investment gains and losses and movements in unrealised gains and losses, as well as expenses directly related to investments executed during the year.
Liquidity premium	An addition to the risk-free rate used when projecting investment returns and discounting cash flows on certain types of contracts where the liabilities are illiquid and have cash flows that are predictable.
Liquidity premium adjustment	In calculating the MCEV, liabilities are discounted using the risk-free rate plus a liquidity premium adjustment, designed to capture the component of yield on a portfolio of assets that is attributable to liquidity rather than credit risk.
LTMF	LT Mortgage Financing Limited.
Longevity reinsurance (%)	The longevity reinsurance percentage provides an indication of the extent to which the Group 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.
Management of in-force book	Profits or losses generated on the in-force book of business. In the analysis of financial performance, the management of in-force book is calculated by considering the impact on the assets and liabilities that can be attributed to the expected release of prudent margins, investment return on surplus assets and the impact on profit of management actions such as new investments. The management of in-force book also includes the impact of assumption changes (other than those attributable to changes in economic conditions).
Market consistent embedded value (MCEV)	Provides an indication of the value of business written by measuring the risk-adjusted value of the in-force business, allowing for the unwind of margins.
Market risk	The risk of loss or of adverse change resulting, directly or indirectly, from fluctuations in the level and in the volatility of market prices of assets, liabilities and financial instruments.
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 Group's strategic objectives.

Glossary of terms continued

New business profit	In the analysis of financial performance, new business profit is calculated on an IFRS basis by comparing the premium received with the insurance liabilities taken on. The discount rate used in calculating the insurance liabilities assumes full deployment of premiums according to the Group's investment strategy. The impact of any under-deployment (i.e. the difference between this number and new business profit calculated based on the assets received as the premium) is reported as a deduction from the management of in-force book.
Non-hedgeable risk	Under MCEV, risks not already allowed for in the time value of options and guarantees or the present value of future profits. The allowance includes the impact of both non-hedgeable financial and non-financial risks. No allowance has been made within the cost of non-hedgeable risk for symmetric risks as these are diversifiable by investors.
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.
Operating profit before tax	Measure of profitability, capturing new business profit, in-force profit and assumption changes, but which removes the distorting impact of market fluctuations and exceptional expenses. Includes recurring and non-recurring items.
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.
Regular premiums	Payments of premium made regularly over the duration of the policy.
Reinsurance	Protection sold to or purchased from another insurance company.
Reorganisation reserve	Reflects the impact of the Group reorganisation in 2013 which led to an increase in reserves of £132m, reflecting the excess of consolidated net assets to the historical cost of investment in subsidiary entities.
RHUK	Rothesay Holdco UK Limited.
Risk margin	Under Solvency II, the cost of transferring non-hedgeable risks.
RLP	Rothesay Life Plc, the Group's regulated life company.
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 Group is required to hold the greater of the capital required under the new Solvency II Pillar 1 framework and the capital required under our own economic capital models Solvency II Pillar 2.
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.

Glossary of terms continued

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.
Value of in-force business	Consists of the following components: in MCEV, present value of future profits, time value of financial options and guarantees, frictional costs of required capital and cost of residual non-hedgeable risks.
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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