

Company Number 00166055

Legal & General Assurance Society Limited
Report and Accounts 2011

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Directors' Report

The directors submit their annual report together with the audited financial statements of Legal & General Assurance Society Limited ('the Company') for the year ended 31 December 2011

Principal activities

The Company is a composite insurance company authorised in the UK whose ultimate controlling party is Legal & General Group Plc. The principal activity of the Company is life and pensions business. It has a number of operating subsidiaries, the principal activities of the Company's main subsidiaries during the year were insurance and reinsurance. A list of the principal operating subsidiaries appears in note 34. The Company's registered office is at One Coleman Street, London EC2R 5AA. It is registered in England and Wales under company registration number 00166055.

Significant events during the year

Review of business and future outlook

The Company forms a material part of the activities of Legal & General Group Plc ('Group') and on this basis the review of business that is presented within Group's financial statements is not duplicated here. This information can be found within the Directors' Report included within the Group's financial statements. The 2012 economic climate remains uncertain but the directors are confident that the Company is well positioned to exploit opportunities throughout the current economic cycle.

During the year, the directors elected to prepare financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union. The date of transition for the Company is 1 January 2010. The impact of first time adoption of IFRS is disclosed within Note 43 of the financial statements.

Principal risks and uncertainties may be categorised as follows

- Legislation and Regulation
- Financial Market and Economic Conditions
- Counterparty and Third Party Risks
- UK Financial Services Sector contagion risks
- Mortality catastrophe and other assumption uncertainties
- Industry Change

A detailed review of the Company's inherent exposures to market, credit, insurance, liquidity and operational risks, together with the framework for their management and control is set out in note 42 of the financial statements. The principal risks and uncertainties facing the Company are:

1) Legislation and Regulation

The markets in which the Company operates are highly regulated, with regulation defining the overall framework for the design, marketing and distribution of products, the acceptance and administration of business, and the prudential capital that regulated companies should hold. Government fiscal policy may also influence the design of products, the retention of existing business and the required reserves for future liabilities.

The Company bases its business strategy upon prevailing regulation and legislation, and known/anticipated change, and engages with regulatory and legislative authorities where appropriate to assist in the evaluation of change on the sector and its stakeholders.

2) Financial Market and Economic Conditions

The Company holds a broad range of investment assets to meet the obligations arising from writing insurance business. The performance and liquidity of investment markets, interest rate movements and inflation can impact the value of these assets as well as the value of the underlying obligations. A potential mismatch of assets and liabilities may impact the earnings, profitability and the capital requirements of the Company. Significant falls in investment asset values can also impact fee income from investment management activities, whilst broader economic conditions can influence the purchase of retail financial services products and the period over which the business is retained.

The Company seeks to match asset and liability cash flows to reduce the impact of changing economic conditions. Additionally, a range of risk management strategies are used to manage volatility in returns from the investment of assets and the broader effects of adverse market conditions. The effect of market and economic conditions upon fee income and the timing of the purchase and retention of retail investment products are mitigated through the utilisation of a low cost, scalable business model and by maintaining a diversified portfolio of products.

3) Counterparty and Third Party Risk

The Company is exposed to default risk in respect of the issuers of corporate debt and financial instruments, through money market and reinsurance transactions and as part of its banking arrangements. Third party risk arises with regard to reliance upon external suppliers of certain administration and IT development services.

The Company seeks to limit the potential exposure to loss from counterparty and third party failure through setting robust selection criteria and exposure limits covering factors such as counterparty financial strength, sectors and geography. Exposures against limits are actively monitored, with trigger levels being set and management action being taken to pre-empt loss from default events.

4) UK Financial Services sector contagion risks

As a significant participant in the UK retail financial services sector the earnings of the Company are influenced by the perception and confidence of the retail investor with the sector as a whole

Factors such as investment market performance actions by regulators and shock events such as significant market failures can impact the confidence of retail investors and the timing of their purchase of financial services products The Company seeks to mitigate these risks through differentiating its business model from that of its competitors This includes operating a diversified portfolio of businesses in the UK

5) Mortality catastrophe and other assumption uncertainties

The Company writes significant levels of immediate and deferred annuity business and protection business The writing of long term insurance business necessarily requires the setting of assumptions for long term trends in factors such as mortality, persistency, valuation interest rates and credit defaults

The Company uses its pricing capabilities to assess and charge an appropriate premium for known risk factors with stress testing undertaken to validate the appropriateness of key assumptions However scenarios such as a rapid advance in medical science leading to significantly enhanced annuitant longevity or an event causing widespread mortality/morbidity, coupled with a reinsurer default may impact profitability and capital Extreme shifts in financial markets and in the broader economic environment may also require other assumptions to be recalibrated

6) Industry Change

The Company may not maximise opportunities from structural and other changes within the financial services sector

The financial services sector continues to go through a period of change This presents a range of challenges as well as opportunities to providers of sufficient scale such as the Company Significant changes in the markets in which we operate may require the review and re-alignment of elements of our business strategy A failure to be sufficiently responsive to potential change and understand the implication to our businesses or the incorrect execution of change may impact the achievement of our strategic objectives We seek to ensure we have market-leading expertise in the core fields in which we operate, and actively focus on retaining the best personnel with the knowledge to design and support our products and manage their evolution as market and consumer requirements change

Key performance indicators

The directors review a range of performance indicators in monitoring the performance of the Company with the following regarded as key performance indicators

IFRS profit before tax - £120m (2010 £546m) - This measures the loss or profit in a single period before deducting tax This gives an insight into the Company's ability to generate cash flows to support dividends during a period

Shareholder funds - £3,973m (2010 £4,176m) - This represents the assets that remain once all the Company's liabilities have been accounted for

Company regulatory capital surplus - £2,736m¹ (2010 £3,146m)¹ - This is the dominant regulatory surplus capital measure for the Company

¹Figure extracted from draft unaudited regulatory returns

Further details of the Group's key performance indicators can be found in its published financial statements

Results for the year and dividend

The results for the year are set out on pages 6 to 71

A final dividend of £500m was paid in 2011 (2010 £300m) No interim dividend was paid during the year (2010 Nil)

Directorate

The directors of the Company who served during the year, together with their dates of appointment and resignation where appropriate are shown below

T J Breedon (Chairman)
J M Bury
M J Gregory
G J Hoskin
J B Pollock
N D Wilson

Financial risk management objectives

The Company's exposure to financial risk through its financial assets and liabilities is provided in detail in notes 41 & 42 of the financial statements

Creditors

Legal & General Group Plc agrees terms and conditions for its business transactions with suppliers. Payment is made in accordance with these terms provided the supplier meets its obligations. As at 31 December 2011, the average number of days of payments outstanding for the Legal & General Group of companies was 36 days (2010: 34)

Directors' Indemnities and Insurance

As permitted by Articles of Association, the directors have the benefit of an indemnity which is a qualifying third party indemnity provision as defined by Section 234 of the Companies Act 2006. The indemnity was in force throughout the last financial year and is currently in force. The ultimate parent company, Legal & General Group Plc, maintains an appropriate level of Directors' and Officers' liability insurance which is reviewed annually.

Independent Auditors

The Company has appointed PricewaterhouseCoopers LLP as independent auditor.

There is no requirement under the Companies Act or the Company's Articles of Association to hold an Annual General Meeting or lay the Company's Report and Accounts before the shareholders. The Company has also elected to dispense the need to appoint auditors annually.

Statement of Directors' Responsibilities

The directors are responsible for preparing the Directors' Report and the financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have prepared the financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union. In preparing these financial statements, the directors have also elected to comply with IFRSs issued by the International Accounting Standards Board (IASB). Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the company and of the profit or loss of the company for that period. In preparing these financial statements the directors are required to

- select suitable accounting policies and then apply them consistently
- make judgements and estimates that are reasonable and prudent
- state whether applicable International Financial Reporting Standards (IFRSs) as adopted by the European Union have been followed, subject to any material departures disclosed and explained in the financial statements. In preparing these financial statements the directors have also elected to comply with IFRSs issued by the International Accounting Standards Board (IASB).
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the company's transactions and disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Each of the directors who held office at the date of approval of this Directors' Report confirms that, so far as they are each aware, there is no relevant audit information of which the Company's auditors are unaware and each of the directors have taken all reasonable steps they ought to have taken as directors to ascertain any relevant audit information and to ensure that the Company's auditors are aware of such information. This confirmation is given in accordance with section 418(2) of the Companies Act 2006.

By Order of the Board



A D Fairhurst
On behalf of Legal & General Co Sec Limited
Company Secretary
7 March 2012

Independent Auditors' Report to the Members of Legal & General Assurance Society Limited

We have audited the financial statements of Legal & General Assurance Society Limited for the year ended 31 December 2011 which comprise the Statement of Comprehensive Income, the Balance Sheet, the Statement of Changes in Equity, the Cash Flow Statement and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

Respective responsibilities of directors and auditors

As explained more fully in the Statement of Directors' Responsibilities set out on page 4, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

This report, including the opinions, has been prepared for and only for the company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of whether the accounting policies are appropriate to the company's circumstances and have been consistently applied and adequately disclosed, the reasonableness of significant accounting estimates made by the directors and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the Report and Accounts to identify material inconsistencies with the audited financial statements. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Opinion on financial statements

In our opinion the financial statements

- give a true and fair view of the state of the company's affairs as at 31 December 2011 and of its profit and cash flows for the year then ended,
- have been properly prepared in accordance with IFRSs as adopted by the European Union, and
- have been prepared in accordance with the requirements of the Companies Act 2006.


Opinion on other matter prescribed by the Companies Act 2006

In our opinion the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept or returns adequate for our audit have not been received from branches not visited by us, or
- the financial statements are not in agreement with the accounting records and returns, or
- certain disclosures of directors' remuneration specified by law are not made, or
- we have not received all the information and explanations we require for our audit.



Thomas Robb (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
London, United Kingdom
7 March 2012

Statement of Comprehensive Income

For the year ended 31 December 2011

	Notes	2011 £m	2010 £m
Revenue			
Gross written premiums	1F G/2(i)	4 379	4 066
Outward reinsurance premiums	11	(3,329)	(2 913)
Net premiums earned		1,050	1 153
Fees from fund management and investment contracts	1G	330	342
Investment return	1X/3	371	4 899
Operational income		253	211
Total revenue		2,004	6 605
Expenses			
Claims and change in insurance liabilities		6 177	6 582
Reinsurance recoveries		(5,060)	(4 851)
Net claims and change in insurance liabilities	1F/4	1 117	1 731
Change in provisions for investment contract liabilities	1G	41	3 092
Acquisition costs	1F G	561	517
Finance costs	1P	30	17
Other expenses	1Y/5	490	540
Transfers (from)/to unallocated divisible surplus	1F	(355)	162
Total expenses		1 884	6 059
Profit before income tax		120	546
Income tax income/(expense) attributable to policyholder returns	9	243	(84)
Profit before income tax attributable to equity holders of the Company		363	462
Total income tax income/(expense)	1Q/9	177	(193)
Income tax (income)/expense attributable to policyholder returns	9	(243)	84
Income tax expense attributable to equity holders	9	(66)	(109)
Profit for the year attributable to equity holders of the Company		297	353
Other comprehensive income after tax		-	-
Total comprehensive income for the year attributable to equity holders of the Company		297	353

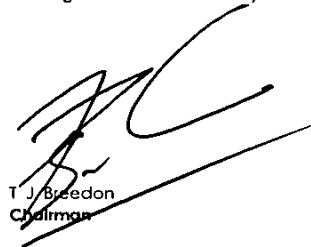
Balance Sheet

As at 31 December 2011

	Notes	2011 £m	2010 £m	1 Jan 2010 £m
Assets				
Investment in subsidiaries	1D/11	1 606	1 622	1 699
Purchased interest in long term businesses and other intangible assets	1J/12	6	3	3
Deferred acquisition costs	1F G/13	749	788	824
Plant and equipment	1L/14	36	28	27
Investment property	1K/15	1,353	1 514	1 390
Financial investments	1K/16	40,378	41 619	39 039
Reinsurers share of contract liabilities	1I/18	29 897	26 290	22 799
Deferred tax asset	1Q/19	317	252	399
Income tax recoverable	1Q/20	50	-	-
Other assets	21	926	1 227	1 480
Cash and cash equivalents	1N/22	2,051	2 223	2 087
Total assets		77 369	75 566	69 747
Equity				
Share capital	1S/23	201	201	201
Share premium	23	1,049	1 049	1 049
Retained earnings		2,723	2,926	2,873
Total shareholders' equity		3,973	4,176	4,123
Liabilities				
Participating insurance contracts	1F/24 (iii)	8,554	9 183	9 198
Participating investment contracts	1G/25 (i)	5 040	5 104	5 005
Unallocated divisible surplus	1F/26	1 091	1 446	1 284
Value of in-force non-participating contracts	1F/27	(205)	(337)	(328)
Participating contract liabilities		14,480	15 396	15 159
Non-participating insurance contracts	1F/24 (iv)	31 024	28 096	24 990
Non-participating investment contracts	1G/25 (iii)	25 183	25 891	23 480
Non-participating contract liabilities		56,207	53 987	48 470
Borrowings	1P/29	8	8	1
Income tax liabilities	1Q/20	-	140	123
Payables and other financial liabilities	1U/30	534	481	372
Other liabilities	31	2 167	1 378	1 499
Total liabilities		73 396	71 390	65 624
Total equity and liabilities		77 369	75 566	69 747

The notes on pages 10 to 71 are an integral part of these financial statements

The financial statements on pages 6 to 71 and the accompanying notes were approved by the board of directors on 7 March 2012 and were signed on their behalf by


 T. J. Breedon
 Chairman


 N. D. Wilson
 Director

Statement of Changes in Equity

	Share capital £m	Share premium £m	Retained earnings		Total equity £m
			Shareholder retained capital £m	Other £m	
For the year ended 31 December 2011					
As at 1 January	201	1 049	1 352	1,574	4,176
Total comprehensive income for the year	-	-	89	208	297
Dividends	-	-	-	(500)	(500)
As at 31 December	201	1 049	1 441	1 282	3 973
For the year ended 31 December 2010					
As at 1 January	201	1,049	1 290	1,583	4 123
Total comprehensive income for the year	-	-	62	291	353
Dividends	-	-	-	(300)	(300)
As at 31 December	201	1,049	1 352	1 574	4 176

Cash Flow Statement

For the year ended 31 December 2011

	Notes	2011 £m	2010 £m
Cash flows from operating activities			
Profit for the year		297	353
Adjustments for non-cash movements in net profit for the year			
Realised and unrealised gains on financial investments and investment properties		757	(2 689)
Reduction in carrying value of investments in subsidiaries	11	15	78
Investment income		(1,351)	(1 431)
Interest expense		16	16
Income tax (income)/expense		(177)	193
Other adjustments		8	9
Net (increase)/decrease in operational assets		603	(847)
Investments held for trading or designated as fair value through profit or loss			
Other assets		(3,324)	(3 095)
Net increase/(decrease) in operational liabilities			
Insurance contracts		2 300	3 090
Transfer to unallocated divisible surplus		(354)	162
Investment contracts		(771)	2 510
Value of in-force non-participating contracts		132	(9)
Other liabilities		940	682
Cash used in operations		(909)	(978)
Interest paid		(16)	(16)
Interest received		657	756
Income tax (paid)/received		(78)	(29)
Dividends received		689	706
Net cash flows from operating activities		343	439
Cash flows from investing activities			
Net acquisition of plant and equipment		(15)	(10)
Net cash flows from investing activities		(15)	(10)
Cash flows from financing activities			
Dividend distributions to ordinary equity holders of the Company during the year		(500)	(300)
Proceeds from borrowings		-	7
Net cash flows from financing activities		(500)	(293)
Net increase in cash and cash equivalents		(172)	136
Cash and cash equivalents at 1 January		2 223	2 087
Cash and cash equivalents at 31 December	22	2 051	2 223

The Company's cash flow statement includes all cash and cash equivalent flows including those relating to the UK long term fund policyholders

1. Accounting policies

A Basis of preparation

The Company financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB) as adopted by the European Union and with those parts of the UK Companies Act 2006 applicable to companies reporting under IFRS. The Company's financial statements also comply with IFRS and International Financial Reporting Interpretations Committee (IFRIC) interpretations as issued by the IASB. The financial statements have been prepared under the historical cost convention as modified by the revaluation of land and buildings and financial assets and financial liabilities (including derivative instruments) at fair value through profit and loss.

These separate financial statements contain information about Legal and General Assurance Society Limited as an individual company and do not contain consolidated financial information. The Company is included in the group accounts of Legal & General Group Plc and has taken advantage of the exemption under Section 400 of the Companies' Act 2006.

The Company presents its balance sheet in order of liquidity. This is considered to be more relevant than a before and after 12 months presentation given the long term nature of the Company's core business. Each asset and liability line item which combines amounts expected to be recovered or settled before and after 12 months from the balance sheet date, disclosure of the split is made by way of a note.

Financial assets and financial liabilities are disclosed gross in the balance sheet unless a legally enforceable right of offset exists and there is an intention to settle recognised amounts on a net basis. Income and expenses are not offset in the income statement unless required or permitted by any accounting standard or IFRIC interpretation as detailed in the applicable accounting policies of the Company.

First time adoption of IFRS

These financial statements represent the first annual financial statements of the Company prepared in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board. The Company adopted IFRS in accordance with IFRS 1, First-time Adoption of International Financial Reporting Standards. The first date at which IFRS was applied was January 1 2010. In accordance with IFRS, the Company has:

- a) provided comparative financial information,
- b) applied the same accounting policies throughout all periods presented
- c) retrospectively applied all effective IFRS standards as of December 31 2011, as required, and
- d) applied certain optional exemptions and certain mandatory exceptions as applicable for first time IFRS adopters.

The disclosure required by IFRS 1 concerning the transition from UK GAAP to IFRS is given in Note 43.

The Company has taken advantage of the following exceptions and exemptions as permitted by IFRS 1:

Compound financial instruments

The equity components of historic compound financial instruments which were no longer outstanding at the date of transition to IFRS have not been separated.

Investments in subsidiaries and jointly controlled entities

Deemed cost for those investments in subsidiaries at the date of transition to IFRS is taken to be the previous GAAP carrying amount at that date.

B Use of estimates

The preparation of the financial statements includes the use of estimates and assumptions which affect items reported in the consolidated balance sheet and income statement and the disclosure of contingent assets and liabilities at the date of the financial statements. Although these estimates are based on management's best knowledge of current circumstances and future events and actions, actual results may differ from those estimates, possibly significantly. This is particularly relevant to the following:

The determination of fair values of investment property (Notes 1K and 15)

Investment property in the UK is valued bi-annually by external chartered surveyors at open market values in accordance with the 'Appraisal and Valuation Manual' of The Royal Institution of Chartered Surveyors or using internal valuations and estimates during the intervening period. Outside the UK, valuations are produced in conjunction with external qualified professional valuers in the countries concerned. In the event of a material change in market conditions between the valuation date and balance sheet date, an internal valuation is performed and adjustments made to reflect any material changes in fair value.

The determination of fair values of unquoted and illiquid financial investments (Notes 1K and 16)

For unquoted financial investments, the Company obtains pricing information from a range of pricing services and brokers. Where there are indications that there is no active market, the Company seeks further evidence of the fair value from alternative pricing sources and market information. Priority is given to publicly available prices from independent sources when available, but overall, the source of pricing and/or the valuation technique is chosen with the objective of arriving at a fair value measurement which reflects the price at which an orderly transaction would take place between market participants on the measurement date. The valuation techniques include the use of recent arm's length transactions, reference to other instruments that are substantially the same, discounted cash flow analysis and, if applicable, enterprise valuation and may

Notes to the Financial Statements

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1 Accounting policies (continued)

include a number of assumptions relating to variables such as credit risk and interest rates. Changes in assumptions relating to these variables could positively or negatively impact the reported fair value of these instruments.

Estimation of deferred acquisition costs (Notes 1F, 1G and 13)

Significant costs are incurred in connection with acquiring new business, such as initial commission and the indirect costs of obtaining and processing new business. These costs are capitalised and amortised in accordance with the Company's accounting policies. The recoverability of these assets is measured and impaired if the projected future margins are less than the carrying value of the assets. To the extent that the future margins differ from those anticipated, an adjustment to the carrying value of the deferred acquisition cost assets will be necessary.

For participating contracts, acquisition costs are charged to the income statement when incurred.

Tax balances (Notes 1Q and 9)

The current tax expense is based on the taxable profits for the year after any adjustments in respect of prior years. The judgements made, and uncertainties considered, in arriving at tax balances in the financial statements are discussed in Note 9.

Deferred tax assets are recognised for temporary differences and unused tax losses. The recognition of a deferred tax asset in respect of tax losses is supported by management's best estimate of future taxable profits to absorb the losses in future years. These taxable profit projections are based on assumptions consistent with those used for EEV reporting purposes. Deferred tax assets and liabilities are offset to the extent it is permissible under IAS 1. The net movement in deferred tax assets and liabilities during the year is disclosed in Note 19.

Insurance and investment contract liabilities (Notes 1F, 1G, 24 and 25) and associated balances

Long term business liabilities can never be definitive as to their timing or the amount of claims and are therefore subject to regular reassessment. The significant estimates and assumptions used in calculating insurance liabilities are disclosed in Note 28.

C Summary of significant accounting policies

The Company has selected accounting policies which state fairly its financial position and financial performance for a reporting period. The accounting policies have been consistently applied to all years presented unless otherwise stated.

The principal accounting policies adopted in preparing these financial statements are set out below.

D Investments in subsidiary undertakings

Shares in trading subsidiary undertakings are carried at cost and are considered for impairment at each reporting date.

E Product classification

The Company's products are classified for accounting purposes as either insurance contracts (participating and non-participating) or investment contracts (participating and non-participating). Insurance contracts are contracts which transfer significant insurance risk to the insurer at the inception of the contract. Contracts which do not transfer significant insurance risk to the insurer are classified as investment contracts. Hybrid contract types containing both insurance and investment features, have been treated as investment contracts when accounting for premiums, claims and other revenue.

A number of insurance and investment contracts contain discretionary participating features (DPF) which entitle the policyholders to receive guaranteed benefits as well as additional benefits:

- the amount or timing of which is contractually at the discretion of the Company, and
- which are contractually based on
 - the performance of a specified pool of contracts or a specified type of contract,
 - realised and/or unrealised investment returns on a specified pool of assets held by the issuer, or
 - the profit or loss of the Company, fund or other entity which issues the contract.

Contracts with DPF are referred to as participating contracts. With-profits contracts are classified as participating.

F Long term insurance contracts

Premium income

Premiums are recognised as revenue when due for payment.

Claims

Death claims are accounted for on notification of death. Surrenders for non-linked policies are accounted for when payment is made. Critical illness claims are accounted for when admitted. All other claims and surrenders are accounted for when payment is due. Claims payable include the direct costs of settlement.

1. Accounting policies (continued)**Acquisition costs**

Acquisition costs comprise direct costs, such as initial commission, and the indirect costs of obtaining and processing new business. Acquisition costs relating to non-participating insurance contracts written outside the with-profits part of the UK Long Term Fund (LTF) which are incurred during a financial year are deferred by use of an asset which is amortised over the period during which the costs are expected to be recoverable, and in accordance with the expected incidence of future related margins. For participating contracts, acquisition costs are charged to the income statement when incurred.

Insurance contract liabilities

Under current IFRS requirements insurance contract liabilities are measured using UK Generally Accepted Accounting Principles (GAAP), as permitted by IFRS 4, 'Insurance contracts'. Insurance contract liabilities are determined following an annual investigation of the LTF in accordance with regulatory requirements.

For non-participating insurance contracts, the liabilities are calculated on the basis of current information using the gross premium valuation method. This brings into account the full premiums receivable under contracts written having prudent regard to expected lapses and surrenders, estimated renewal and maintenance costs and contractually guaranteed benefits. For unit linked insurance contract liabilities the provision is based on the fund value together with an allowance for any excess of future expenses over charges where appropriate.

For participating contracts, the liabilities to policyholders are determined on a realistic basis in accordance with Financial Reporting Standard (FRS) 27 'Life assurance'. This includes an assessment of the cost of any future options and guarantees granted to policyholders valued on a market consistent basis. The calculation also takes account of bonus decisions which are consistent with Legal & General Assurance Society Limited Principles and Practices of Financial Management (PPFM). The shareholders' share of the future cost of bonuses is excluded from the assessment of the realistic liability.

In determining the realistic value of liabilities for participating contracts, the value of future profits on non-participating business written in the with-profits part of the fund is accounted for as part of the calculation. The present value of future profits (PVFP) for this business is separately determined and its value is deducted from the sum of the liabilities for participating contracts and the unallocated divisible surplus.

Unsettled liabilities are recognised when premiums are received and non-unsettled liabilities are recognised when premiums are due.

Unallocated divisible surplus

The nature of benefits for participating contracts is such that the allocation of surpluses between ordinary equity holders and participating policyholders is uncertain. The amount of surplus which has not been allocated at the balance sheet date is classified within liabilities as the unallocated divisible surplus. Adjustments made to comply with FRS 27 are charged to the unallocated divisible surplus.

G Investment contracts**Premium income**

For investment contracts amounts collected as premiums are not included in the income statement but are reported as contributions to investment contract liabilities in the balance sheet.

Revenue from investment contracts

Fees charged for investment management services are recognised as revenue as the services are provided. Initial fees, which exceed the level of recurring fees and relate to the future provision of services, are deferred and amortised over the anticipated period in which the services will be provided.

Claims

Claims are not included in the income statement but are deducted from investment contract liabilities. The movement in investment contract liabilities consists of claims incurred in the period less the corresponding elimination of the policyholder liability originally recognised in the balance sheet and the investment return credited to policyholders.

Acquisition costs

For participating investment contracts acquisition costs comprise direct costs such as initial commission and the indirect costs of obtaining and processing new business. These costs are charged to the income statement when incurred.

For non-participating investment contracts only directly related acquisition costs relating to investment management services which vary with and are related to, securing new contracts and renewing existing contracts, are capitalised as an intangible asset and amortised over the period during which the costs are expected to be recoverable from future revenue. All other costs are recognised as expenses when incurred.

Notes to the Financial Statements

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1. Accounting policies (continued)

Trail commission

The Company operates distribution agreements with intermediaries where further commission costs are payable in each period in which a relevant policy remains in-force. For relevant non-participating investment contracts, a liability for the present value of this future commission cost is recognised in the balance sheet on inception of the contract. The present value of future commission costs is deferred as an asset and amortised over the period during which the related revenue will be recognised. At each subsequent reporting date the liability is re-measured to fair value because this financial liability is part of a portfolio of unit linked assets and liabilities whose performance is evaluated on a fair value basis. Any increase in the liability is recognised as an additional deferred cost. Any change in lapse assumptions or revisions to the underlying assumptions for future cash flows will be reflected in the fair value movement for a period. If the future commission liability decreases, a corresponding adjustment is made to the amortisation of the asset.

Investment contract liabilities

Under current IFRS requirements, participating investment contract liabilities are measured using UK GAAP, as permitted by IFRS 4 (see above for insurance contract liabilities). Participating investment contract liabilities are determined in accordance with IFRS 27, including a value for guarantees, in the same way as insurance contracts.

Non-participating investment contracts are unit linked contracts. Unit linked liabilities are measured at fair value by reference to the value of the underlying net asset values of the Company's unitised investment funds at the balance sheet date.

Unitised liabilities are recognised when premiums are received and non-unitised liabilities are recognised when premiums are due.

H Liability adequacy tests

The Company performs liability adequacy testing on its insurance liabilities to ensure that the carrying amount of liabilities (less related deferred acquisition costs) is sufficient to cover current estimates of future cash flows. When performing the liability adequacy test, the Company discounts all contractual cash flows and compares this amount with the carrying value of the liability. Any deficiency is immediately charged to the income statement, initially reducing deferred acquisition costs and then by establishing a provision for losses.

I Reinsurance

The Company and its insurance subsidiaries cede insurance premiums and risk in the normal course of business in order to limit the potential for losses and to provide financing. Outwards reinsurance premiums are accounted for in the same accounting period as the related premiums for the direct or inwards reinsurance business being reinsured. Reinsurance assets include balances due from reinsurers for paid and unpaid losses and loss adjustment expenses, ceded unearned premiums and ceded future life policy benefits. Amounts recoverable from reinsurers are estimated in a manner consistent with the claim liability associated with the reinsured policy. Reinsurance is recorded as an asset in the balance sheet unless a right of offset exists, in which case the associated liabilities are reduced commensurately.

J Intangible assets

Purchased interest in long term businesses

The carrying value of purchased interests in long term business represents the remaining unamortised portion of the actuarially determined fair values of purchased long term in-force business. The value of the in-force business purchased on the acquisition of Alliance & Leicester Life Assurance Company Ltd is amortised over its economic life.

Software costs

Intangible assets, comprising internally developed software and software purchased from third parties, are recognised in the balance sheet if it is probable that the relevant future economic benefits attributable to the asset will flow to the Company and their cost can be measured reliably and are either identified as separable, or they arise from contractual or other legal rights, regardless of whether those rights are transferable or separable. Where the criteria are met, software costs are capitalised at cost and amortised over their expected useful life.

K Investments

Investment property

Land and buildings which are held for long term rental yields and capital growth are carried at fair value with changes in fair value recognised in the profit and loss account within investment income. Land and buildings in the UK are valued bi-annually by external chartered surveyors at open market values in accordance with the 'Appraisal and Valuation Manual' of The Royal Institution of Chartered Surveyors. Outside the UK, valuations are produced in conjunction with external qualified professional valuers in the countries concerned. In the event of a material change in market conditions between the valuation date and balance sheet date, an internal valuation is performed and adjustments made to reflect any material changes in fair value.

Financial investments

The Company classifies its financial investments on initial recognition as held for trading (HFT), designated at fair value through profit or loss (FVTPL), or loans and receivables. Initial recognition of financial investments is on the trade date.

The Company's policy is to measure investments at FVTPL. All derivatives other than those designated as hedges are classified as HFT.

1 Accounting policies (continued)

Certain financial investments held by the Company are designated as FVTPL as their performance is evaluated on a total return basis consistent with asset performance reporting to the Group Investment and Market Risk Committee and the Company's investment strategy. Assets designated as FVTPL include debt securities and equity instruments which would otherwise have been classified as AFS under IAS 39 'Financial instruments: recognition and measurement'. Assets backing participating and non-participating policyholder liabilities are designated as FVTPL. For participating contracts the assets are managed on a fair value basis to maximise the total return to policyholders over the contract life. The Company's non-participating investment contract liabilities are measured on the basis of current information and are designated as FVTPL to avoid an accounting mismatch in the income statement.

The fair values of quoted financial investments are based on current bid prices. If the market for a financial investment is not active, the Company establishes fair value by using valuation techniques such as recent arm's length transactions, consensus market pricing, reference to similar listed investments, discounted cash flow models or option pricing models.

Private equity investments are valued in accordance with the International Private Equity and Venture Capital Valuation Guidelines, which represent current best practice, developed by the Association Française des Investisseurs en Capital, the British Venture Capital Association and the European Private Equity and Venture Capital Association. The techniques used for determining fair value include earnings multiples, the price of a recent investment or a net asset basis.

Financial investments classified as HFT and FVTPL are measured at fair value with gains and losses reflected in the income statement. Transaction costs are expensed as incurred.

Loans and receivables are initially measured at fair value plus acquisition costs, and subsequently measured at amortised cost using the effective interest method.

L Plant and equipment

The initial cost of an item of plant or equipment is capitalised where it is probable that future economic benefits associated with the item will flow to the Company and the cost of the item can be measured reliably. The cost is then depreciated on a straight line basis over the item's estimated useful working life. This ranges from 3-20 years.

M Impairment policy

The Company reviews the carrying value of its financial assets (other than those held at FVTPL) at each balance sheet date. If the carrying value of a financial asset is impaired, the carrying value is reduced through a charge to the income statement. There must be objective evidence of impairment as a result of one or more events which have occurred after the initial recognition of the asset. Impairment is only recognised if the loss event has an impact on the estimated future cash flows of assets held at amortised cost.

Assets which are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use.

N Cash and cash equivalents

Cash and cash equivalents include cash in hand, deposits held at call with banks, treasury bills and other short term highly liquid investments with original maturities of three months or less.

O Derivative financial instruments

The Company's activities expose it to the financial risks of changes in foreign exchange rates and interest rates. The Company uses derivatives such as foreign exchange forward contracts and interest rate swap contracts to hedge these exposures.

Where the risks and characteristics of derivatives embedded in other contracts are not closely related to those of the host contract and the whole contract is not carried at fair value, the derivative is separated from that host contract and measured at fair value, with fair value movements reflected within investment return, unless the embedded derivative itself meets the definition of an insurance contract.

P Borrowings

Borrowings are recognised initially at fair value, net of transaction costs. Borrowings classified as liabilities are subsequently stated at amortised cost. The difference between the net proceeds and the redemption value is recognised in the income statement over the borrowing period using the effective interest method.

Q Income taxes

Income tax

The tax shown in the income statement comprises current and deferred tax.

Current tax comprises tax payable on current period profits, adjusted for non-tax deductible or non-taxable items, and any adjustments to tax payable in respect of previous periods. Current tax is recognised in the income statement unless it relates to items which are recognised in other comprehensive income.

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1. Accounting policies (continued)

Deferred income tax

Deferred tax is calculated on differences between the accounting value of assets and liabilities and their respective tax values. Deferred tax is also recognised in respect of unused tax losses to the extent it is probable that future taxable profits will arise against which the losses can be utilised. Deferred tax is charged or credited to the income statement except when it relates to items recognised in other comprehensive income.

For presentation, the tax shown in the income statement has been apportioned between that attributable to policyholders' returns and equity holders' profits.

For this apportionment, the equity holders' tax on certain long term business is estimated using equity holders' profit after tax, which is grossed up at the statutory tax rate. For the remaining long term business, the effective tax rate for that entity is used. The balance of income tax associated with UK long term business is classified as income tax attributable to policyholders' returns.

Deferred tax assets and liabilities are not discounted.

Deferred income tax is provided on temporary differences arising on investments in subsidiaries and associates, except where the Company controls the timing of the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future (or if it will, then it will not generate any incremental tax liability for the Company).

R Leases

Where a significant proportion of the risks and rewards of ownership is retained by the lessor, leases are classified as operating leases. Payments made as lessees under operating leases (net of any incentives from the lessor) are charged to the income statement on a straight line basis over the period of the lease.

S Share capital

Equity instruments

An equity instrument is any contract which evidences a residual interest in the net assets of an entity. It follows that a financial instrument is treated as equity if:

- there is no contractual obligation to deliver cash or other financial assets or to exchange financial assets or liabilities on unfavourable terms, and
- the instrument is either a non-derivative which contains no contractual obligation to deliver a variable number of own equity instruments, or is a derivative which will be settled only by the Company exchanging a fixed amount of cash, or other financial assets, for a fixed number of its own equity instruments.

Dividend recognition

A dividend distribution to the Company's shareholders is recognised as a liability in the period in which the dividends are authorised and are no longer at the discretion of the Company. Final dividends are accrued when approved by the Company's Directors and interim dividends are accrued when paid.

T Provisions

Provisions are recognised when the Company has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate of the amount of the obligation can be made. Where the Company expects a provision to be reimbursed, for example under an insurance contract, the reimbursement is recognised as a separate asset but only when the reimbursement is virtually certain. The Company recognises a provision for onerous contracts when the expected benefits to be derived from a contract are less than the unavoidable costs of meeting the obligations under the contract.

U Payables and other financial liabilities

Payables and other financial liabilities comprise derivative liabilities, collateral received from banks and other liabilities. The derivative liabilities comprise a variety of exchange traded and over-the-counter derivative financial instruments, including futures, options, forward currency contracts and swaps such as interest rate swaps, cross-currency swaps and credit default swaps measured at fair value.

V Foreign currency transactions

Foreign currency transactions are translated into the functional currency using the exchange rate prevailing at the date of the transactions. The functional currency of the Company's foreign operations is the currency of the primary economic environment in which these entities operate. Foreign exchange gains and losses are recognised in the income statement except when recognised in equity as qualifying cash flow or net investment hedges.

X Investment return

The reporting of investment return comprises investment income, unrealised gains and losses from financial investments held at FVTPL and realised gains and losses from all financial assets.

1. Accounting policies (continued)

Investment income includes dividends, interest and rent. Dividends are accrued on an ex-dividend basis. Interest and rent are included on an accruals basis. Interest income for financial assets which are not classified as FVTPL is recognised using the effective interest method.

Y Other expenses

Other expenses comprise administrative expenses, management fees payable, corporate expenses and other charges. Other costs are accounted for as they arise.

Z Standards, interpretations and amendments to published standards that are not yet effective

Certain standards, amendments and interpretations to existing standards have been published which are mandatory for the Company's accounting periods beginning on or after 1 January 2012 or later periods but which the Company has not adopted early, as follows:

- Amendment to IFRS 9 'Financial Instruments' on classification and measurement, issued in November 2009 (effective for annual periods commencing on or after 1 January 2015). This is the first part of a new standard on classification and measurement of financial assets that will replace IAS 39. IFRS 9 has two measurement categories: amortised cost and fair value. All equity instruments are measured at fair value. A debt instrument is classified as amortised cost only if the entity is holding it to collect contractual cash flows and the cash flows represent principal and interest; otherwise it must be measured at fair value through profit or loss. Further amendments to IFRS 9 dealing with financial liabilities, were published in October 2010. These include amortised cost accounting for most financial liabilities with bifurcation of embedded derivatives. The main change is that in cases where the fair value option is taken for financial liabilities, the part of a fair value change due to an entity's own credit risk is recorded in other comprehensive income rather than the income statement unless this creates an accounting mismatch. The Company does not intend to early adopt this standard.
- IFRS 13, 'Fair value measurement' issued in May 2011 (expected to come into force for periods beginning on or after 1 January 2013). This standard aims to improve consistency and reduce complexity by providing a precise definition of fair value and a single source of fair value measurement and disclosure requirements for use across IFRSs. The requirements do not extend the use of fair value accounting but provide guidance on how it should be applied where its use is already required or permitted by other standards. We are currently assessing the impact which this will have on the Company's financial statements.

Notes to the Financial Statements

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2 Analysis of revenue

(1) Long term business

Gross premiums written

	Non Par icipating	Par- icipating	Investment linked	Total	Non Par- icipating	Par- icipating	Investment linked	Total
	2011	2011	2011	2011	2010	2010	2010	2010
	£m	£m	£m	£m	£m	£m	£m	£m
Individual								
- Periodic	950	120	27	1 097	920	141	30	1 091
- Single	1 085	335	-	1 420	1 168	428	-	1 596
	2 035	455	27	2 517	2 088	569	30	2 687
Group								
- Periodic	391	5	-	396	434	7	-	441
- Single	1 466	-	-	1 466	936	2	-	938
	1 857	5	-	1 862	1 370	9	-	1 379
	3 892	460	27	4 379	3 458	578	30	4 066

Gross premiums written by destination are not materially different from gross premiums written by origin. The above figures include inward reinsurance premium of £67m (2010: £103m) from Legal & General America (LGA). This amount is reinsured to Legal & General Pensions Limited (LGPL) under the existing reinsurance arrangement.

New Business (gross of reinsurance)

New business is presented for all long term business written by the Company including both insurance and investment contracts. Investment contracts are accounted for on a deposit accounting basis and are not included in gross premiums written in the above table.

	Non Par icipating	Par icipating	Investment linked	Total	Non - Par- icipating	Par- icipating	Investment linked	Total
	2011	2011	2011	2011	2010	2010	2010	2010
	£m	£m	£m	£m	£m	£m	£m	£m
Individual								
- Periodic	131	2	312	445	118	2	368	488
- Single	462	372	2 186	3 020	1 142	343	1 635	3 120
	593	374	2 498	3 465	1 260	345	2 003	3 608
Group								
- Periodic	116	-	-	116	57	1	-	58
- Single	1 461	-	-	1 461	897	2	-	899
	1 577	-	-	1 577	954	3	-	957
	2 170	374	2 498	5 042	2 214	348	2 003	4 565

There are three classes of business for conventional individual protection where there is a material difference between gross and net of reinsurance annualised new business premiums: term assurance which is 26.8% reinsured (2010: 36.6%), whole of life assurance which is 21.5% reinsured (2010: 18.1%) and income protection which is 62.0% reinsured (2010: 63.1%).

Non-profit pension new business is 100% reinsured (2010: 100%) and group protection new business is 67.8% reinsured (2010: 43.7%).

New periodic premiums arise where the terms and conditions anticipate more than one premium being paid over the period of the policy; new single premiums comprise all premiums which do not fall to be categorised as periodic premiums.

3 Investment return

	2011 £m	2010 £m
Financial investment return ¹	166	4,597
Property investment return ²	205	302
Investment return	371	4,899

1 Financial investment return includes fair value gains and losses dividends and interest. Net (losses)/gains (excluding interest and dividend income) of £(832)m (2010: £2,655m) arose on financial investments designated as FVTPL and £58m (2010: £(54)m) arose on derivative contracts classified as HFT. Investment income of £7m (2010: £16m) arose on loans and receivables.

2 Property investment return includes £191m (2010: £204m) of rental income.

4 Net claims and change in insurance liabilities

From continuing operations	2011 £m	2010 £m
Claims paid		
- gross	3,746	3,501
- reinsurance recoveries	(2,025)	(1,861)
	1,721	1,640
Change in insurance liabilities		
- gross	2,431	3,081
- reinsurance recoveries	(3,035)	(2,990)
Net claims and change in insurance liabilities	1,117	1,731

The roll-forward of the insurance contract liabilities is provided in Note 24.

Net claims and change in insurance liabilities relate wholly to long term insurance.

5 Other expenses

	2011 £m	2010 £m
Auditor's remuneration	6	-
Depreciation of plant and equipment	14	8
Reduction in carrying value of investment in subsidiaries	11	16
Amortisation of purchased interest in long term businesses and other intangibles	-	1
Direct operating expenses arising from investment properties which generate rental income	11	15
Lease rental costs	28	27
Insurance of risk on unit linked investment contracts	65	69
Other administrative expenses	362	341
Total other expenses	490	540

The Company does not have direct staff costs. Other group entities contract staff for the needs of the Company's activities and then recharge a proportion of those costs to the Company. The recharged costs are part of "Other administrative expenses" above. Please also refer to Note 7 Employee information.

6 Auditors' remuneration

	2011 £m	2010 £m
Remuneration receivable by the Company's auditor for the audit of the Company's financial statements	0.4	0.4
Total remuneration	0.4	0.4

The disclosure of fees payable to the auditor and its associates for other (non-audit services) has not been made because this has been disclosed in the consolidated financial statements of the Group.

7 Employee information

The Company does not have direct employees since they are employed by a fellow subsidiary of Legal & General Group Plc. The Company is recharged a proportion of the staff costs.

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8 Foreign exchange and exchange rates

Profit for the year includes foreign exchange gains and losses on financial instruments. The profit for the year also includes foreign exchange losses of £1.2m (2010: £1.8m) arising on conversion of monetary assets and liabilities to functional currencies.

Principal rates of exchange used for translation are:

	2011 Year end	2010 Year end	2010 1 Jan
United States Dollar	1.55	1.57	1.62
Euro	1.20	1.17	1.13

9 Income tax expense

	2011 £m	2010 £m
Current tax	(19)	71
Deferred tax		
- Origination and reversal of temporary differences	(135)	146
- Reduction in UK Corporate tax rate to 25% (2010: 27%)	2	1
Total deferred tax	(133)	147
Adjustment to equity holders tax in respect of prior years	(25)	(25)
Total income tax expense	(177)	193
Less tax attributable to policyholder returns	243	(84)
Income tax expense attributable to equity holders	66	109

For presentation, the tax shown in the income statement has been apportioned between that attributable to policyholders' returns and equity holders' profits.

For this apportionment, the equity holders' tax on long-term business is estimated using equity holders' profit after tax, which is grossed up at the statutory tax rate. The balance of income tax associated with UK long-term business is classified as income tax attributable to policyholders' returns.

The tax attributable to equity holders differs from the tax calculated at the standard corporation tax rate applicable to companies operating in the UK of 26.5% (2010: 28%). The differences are explained below:

	2011 £m	2010 £m
Profit from continuing operations before income tax attributable to equity holders of the Company	363	462
Equity holders' income tax expense calculated at 26.5% (2010: 28%)	96	129
Effects of:		
Disallowable expenditure for tax purposes	9	7
Non-taxable income such as dividends	(4)	(29)
Adjustments in respect of prior years' tax	(25)	(25)
Differences between taxable and accounting investment gains	6	31
Lower tax on Shareholder Retained Capital (SRC) investment return	(18)	(5)
Impact of reduction in UK corporation tax rate to 25% (2010: 27%) on deferred tax balances	2	1
Income tax expense attributable to equity holders	66	109

Following the 2010 Budget announcement, the rate of UK corporation tax is expected to reduce progressively to 23% by 1 April 2014. To calculate the current tax on UK profits, the rate of tax used is 26.5% (2010: 28%), which is the UK average rate of corporation tax applicable for the year.

The UK rate of tax used for the calculation of deferred tax is 25% (2010: 27%), which is the rate of corporation tax that is expected to apply when the differences as mentioned above reverse. This rate will apply from 1st April 2012 (2010: 1st April 2011) onwards.

To calculate current and deferred tax on overseas profits, the relevant tax rates applicable in those countries have been applied.

Tax calculated on profit before tax at 26.5% (2010: 28%) would amount to £96m (2010: £129m). The difference between this number and the total tax of £(177)m (2010: £193m) is made up of the reconciling items above, which total £(30)m (2010: £(20)m), and the effect of the apportionment methodology on tax applicable to policyholder returns of £(243)m (2010: £84m).

10 Dividends

	Per share 2011 p	Total 2011 £m	Per share 2010 p	Total 2010 £m
Ordinary share dividends paid in the year				
- Current year final dividend	248.23	500	148.94	300

11 Investment in subsidiaries

	2011 £m	2010 £m
Cost		
As at 1 January	1 622	1 699
Acquisitions	-	-
Disposals	-	-
Reduction in carrying value	(16)	(77)
As at 31 December	1 606	1 622

The reduction in the carrying value has been made to reflect capital repayments

12 Purchased interest in long term business and other intangible assets

	PILTB 2011 £m	Other intangible assets 2011 £m	Total 2011 £m	PILTB 2010 £m	Other intangible assets 2010 £m	Total 2010 £m
Cost and Net Book Value						
As at 1 January	3	-	3	3	-	3
Additions	-	3	3	-	-	-
As at 31 December	3	3	6	3	-	3

No amortisation has been charged for the year ended 31 December 2011 on other intangible assets

13 Deferred acquisition costs**(i) Analysis of deferred acquisition costs**

	Notes	Gross 2011 £m	Gross 2010 £m
Insurance contract deferred acquisition costs	(ii)	-	1
Investment contract deferred acquisition costs	(iii)	749	787
Deferred acquisition costs		749	788

(ii) Insurance contract deferred acquisition costs

	Gross 2011 £m	Gross 2010 £m
As at 1 January	1	5
Acquisition costs deferred	-	-
Amortisation charged to income	(1)	(4)
Other	-	-
As at 31 December	-	1
To be amortised within 12 months	-	1
To be amortised after 12 months	-	-

(iii) Investment contract deferred acquisition costs

	Gross 2011 £m	Gross 2010 £m
As at 1 January	788	819
Acquisition costs deferred	61	60
Amortisation charged to income	(89)	(86)
Other	(11)	(6)
As at 31 December	749	787
To be amortised within 12 months	132	128
To be amortised after 12 months	617	659

There are no deferred acquisition costs relating to reinsurance

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	2011 £m	2010 £m
Cost		
As at 1 January	88	84
Additions	16	12
Disposals	(4)	(8)
As at 31 December	100	88
Accumulated Depreciation		
As at 1 January	60	57
Provided during the year	8	10
Disposals	(4)	(7)
As at 31 December	64	60
Net book value at 31 December	36	28

15 Investment property

	Shareholder 2011 £m	Non profit non-unit linked 2011 £m	With profits 2011 £m	Unit linked 2011 £m	Total 2011 £m
Fair value at 1 January	11	-	124	1 379	1 514
Additions	-	-	3	-	3
Improvements	-	-	-	5	5
Disposals	(1)	-	(8)	(174)	(183)
Fair value gain/(loss)	1	-	3	10	14
Fair value at 31 December	11	-	122	1 220	1 353

	Shareholder 2010 £m	Non profit non-unit linked 2010 £m	With- profits 2010 £m	Unit linked 2010 £m	Total 2010 £m
Fair value at 1 January	8	-	97	1 285	1 390
Additions	-	-	-	50	50
Improvements	2	-	20	2	24
Disposals	-	-	-	(48)	(48)
Fair value gain/(loss)	1	-	7	90	98
Fair value at 31 December	11	-	124	1 379	1 514

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16 Financial investments

		Shareholder	Non profit non unit linked	With profits	Unit linked	Total
	Notes	2011 £m	2011 £m	2011 £m	2011 £m	2011 £m
Financial investments at fair value designated as						
Fair value through profit or loss		2 438	3	15 857	21 905	40 203
Held for trading		3	1	165	5	174
Financial investments at fair value	(i)	2 441	4	16 022	21 910	40 377
Loans and receivables	(ii)	-	-	1	-	1
Total financial investments		2,441	4	16 023	21 910	40 378
Expected to be received within 12 months						5 897
Expected to be received after 12 months						34 481

	Shareholder	Non profit non-unit linked	With- profits	Unit linked	Total
Notes	2010 £m	2010 £m	2010 £m	2010 £m	2010 £m
Financial investments at fair value designated as					
Fair value through profit or loss	1 555	1	16 492	23 333	41 381
Held for trading	7	-	84	5	96
<hr/>					
Financial investments at fair value	(i)	1 562	1	16 576	23 338
Loans and receivables	(ii)	11	-	89	42
<hr/>					
Total financial investments		1 573	1	16 665	23 380
<hr/>					
Expected to be received within 12 months					5 581
Expected to be received after 12 months					36 038

	Shareholder	Non profit non-unit linked	With- profits	Unit linked	Total	
Notes	1 Jan 2010 £m	1 Jan 2010 £m	1 Jan 2010 £m	1 Jan 2010 £m	1 Jan 2010 £m	
Financial investments at fair value designated as						
Fair value through profit or loss	1 084	163	15 968	20 511	37 726	
Held for trading	-	2	62	8	72	
Financial investments at fair value	(i)	1 084	165	16 030	20 519	37 798
Loans and receivables	(ii)	33	1	296	911	1 241
Total financial investments		1 117	166	16 326	21 430	39 039
Expected to be received within 12 months						5 249
Expected to be received after 12 months						33 790

Investment risks on unit linked assets are borne by the policyholders. The remaining risks are outlined in the risk management note (see Note 42).

Financial investments include £28m (2010: £36m) of debt securities pledged as collateral against derivative liabilities. The assets used as collateral are Treasury Gilts (2010: Treasury Gilts) having a residual maturity of over 44 years (2010: over 45 years). Society is entitled to receive all of the cash flows from the asset during the period when it is pledged as collateral. Further, there is no obligation to pay or transfer these cash flows to another entity. Society can decide to substitute an asset which is designated as collateral at any time, provided the relevant terms and conditions of the International Swap Dealers Association agreement are met.

16 Financial investments (continued)

(i) Financial investments at fair value

	Notes	Shareholder 2011 £m	Non profit non-unit linked 2011 £m	With- profits 2011 £m	Unit linked 2011 £m	Total 2011 £m
Equity securities		1 581	1	5 831	16 896	24 309
Debt securities		847	2	9,852	4 951	15 652
Accrued interest		10	-	174	58	242
Derivative assets	17	3	1	165	5	174
Total investments at fair value		2 441	4	16 022	21 910	40 377

	Notes	Shareholder 2010 £m	Non profit non-unit linked 2010 £m	With- profits 2010 £m	Unit linked 2010 £m	Total 2010 £m
Equity securities		1 072	-	6 575	18 654	26 301
Debt securities		476	1	9 740	4 620	14 837
Accrued interest		7	-	177	59	243
Derivative assets	17	7	-	84	5	96
Total investments at fair value		1 562	1	16 576	23 338	41 477

	Notes	Shareholder 1 Jan 2010 £m	Non profit non-unit linked 1 Jan 2010 £m	With- profits 1 Jan 2010 £m	Unit linked 1 Jan 2010 £m	Total 1 Jan 2010 £m
Equity securities		996	1	5 921	16 665	23 583
Debt securities		87	160	9 843	3 783	13 873
Accrued interest		1	2	204	62	269
Derivative assets	17	-	2	62	9	73
Total investments at fair value		1 084	165	16 030	20 519	37 798

Private equity investments are included within equity securities. A gain of £8m (2010: gain of £10m) has been recognised in the income statement in respect of the movement in fair value of these investments.

Property investments which are held via partnerships or unit trust vehicles are also included within equity securities. A gain of £106m (2010: loss of £94m) has been recognised in the income statement in respect of the movement in fair value of these investments.

16 Financial investments (continued)

(ii) Loans and receivables

	Shareholder	Non profit non-unit linked	With profits	Unit linked	Total
	2011 £m	2011 £m	2011 £m	2011 £m	2011 £m
Deposits with credit institutions	-	-	-	-	-
Other loans	-	-	1	-	1
Total loans and receivables	-	-	1	-	1

	Shareholder	Non profit non-unit linked	With- profits	Unit linked	Total
	2010 £m	2010 £m	2010 £m	2010 £m	2010 £m
Deposits with credit institutions	11	-	88	42	141
Other loans	-	-	1	-	1
Total loans and receivables	11	-	89	42	142

	Shareholder	Non profit non-unit linked	With- profits	Unit linked	Total
	1 Jan 2010 £m	1 Jan 2010 £m	1 Jan 2010 £m	1 Jan 2010 £m	1 Jan 2010 £m
Deposits with credit institutions	33	1	295	911	1 240
Other loans	-	-	1	-	1
Total loans and receivables	33	1	296	911	1 241

There are no material differences between the carrying values reflected above and the fair value of these loans

(iii) Fair value hierarchy

Fair value is the amount for which an asset could be exchanged or a liability settled between knowledgeable willing parties in an arm's length transaction

Fair value measurements are based on observable and unobservable inputs. Observable inputs reflect market data obtained from independent sources while unobservable inputs reflects the Company's view of market assumptions in the absence of observable market information. The Company utilises techniques that maximise the use of observable inputs and minimise the use of unobservable inputs.

The levels of fair value measurement bases are defined as follows:

Level 1: fair values measured using quoted prices (unadjusted) in active markets for identical assets or liabilities

Level 2: fair values measured using valuation techniques for all inputs significant to the measurement other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices)

Level 3: fair values measured using valuation techniques for any input for the asset or liability significant to the measurement that is not based on observable market data (unobservable inputs)

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Legal & General Assurance Society Limited
Report and Accounts 201116 Financial investments (continued)
(iii) Fair value hierarchy (continued)

The following table presents the Company's assets by IFRS 7 hierarchy levels

For the year ended 31 December 2011	Total £m	Level 1 £m	Level 2 £m	Level 3 £m	Amortised cost £m
Shareholder					
Equity securities	1 581	1 090	221	270	-
Debt securities	847	252	595	-	-
Accrued interest	10	3	7	-	-
Derivative assets	3	3	-	-	-
Loans and receivables	-	-	-	-	-
Non profit non-unit linked					
Equity securities	1	1	-	-	-
Debt securities	2	-	2	-	-
Accrued interest	-	-	-	-	-
Derivative assets	1	-	1	-	-
Loans and receivables	-	-	-	-	-
With-profits					
Equity securities	5 831	3 806	22	2 003	-
Debt securities	9 852	2 757	7 090	5	-
Accrued interest	174	32	142	-	-
Derivative assets	145	22	140	3	-
Loans and receivables	1	-	-	-	1
Unit linked					
Equity securities	16 896	16 020	614	262	-
Debt securities	4 951	2 328	2 623	-	-
Accrued interest	58	17	41	-	-
Derivative assets	5	5	-	-	-
Loans and receivables	-	-	-	-	-
Total financial investments	40 378	26 336	11 498	2 543	1

For the year ended 31 December 2010	Total £m	Level 1 £m	Level 2 £m	Level 3 £m	Amortised cost £m
Shareholder					
Equity securities	1 072	851	115	106	-
Debt securities	476	236	240	-	-
Accrued interest	7	3	4	-	-
Derivative assets	8	5	3	-	-
Loans and receivables	11	-	-	-	11
Non profit non-unit linked					
Equity securities	-	-	-	-	-
Debt securities	1	-	1	-	-
Accrued interest	-	-	-	-	-
Derivative assets	-	-	-	-	-
Loans and receivables	-	-	-	-	-
With-profits					
Equity securities	6 575	4 470	17	2 088	-
Debt securities	9 740	2 670	7 065	5	-
Accrued interest	177	34	143	-	-
Derivative assets	83	5	78	-	-
Loans and receivables	89	-	-	-	89
Unit linked					
Equity securities	18 654	18 173	219	262	-
Debt securities	4 620	2 164	2 456	-	-
Accrued interest	59	17	42	-	-
Derivative assets	5	5	-	-	-
Loans and receivables	42	-	-	-	42
Total financial investments	41 619	28 633	10 383	2 461	142

16 Financial investments (continued)
(iii) Fair value hierarchy (continued)

As at 1 January 2010	Total £m	Level 1 £m	Level 2 £m	Level 3 £m	Amortised cost £m
Shareholder					
Equity securities	996	809	99	88	-
Debt securities	87	70	17	-	-
Accrued interest	1	1	-	-	-
Derivative assets	1	-	1	-	-
Loans and receivables	33	-	-	-	33
Non profit non-unit linked					
Equity securities	1	1	-	-	-
Debt securities	160	152	8	-	-
Accrued interest	2	2	-	-	-
Derivative assets	2	-	2	-	-
Loans and receivables	1	-	-	-	1
With-profits					
Equity securities	5 921	4 127	2	1 792	-
Debt securities	9 843	2 704	7 134	5	-
Accrued interest	204	37	167	-	-
Derivative assets	62	5	57	-	-
Loans and receivables	296	-	-	-	296
Unit linked					
Equity securities	16 663	16 389	45	229	-
Debt securities	3 783	1 756	2 027	-	-
Accrued interest	62	16	46	-	-
Derivative assets	10	10	-	-	-
Loans and receivables	911	-	-	-	911
Total financial investments	39 039	26 079	9 605	2 114	1 241

All of the Company's level 2 assets have been valued using standard market pricing sources such as iBoxx IDC and Bloomberg. However following consultation with our pricing providers and a number of their contributing brokers we have considered that these prices are not from a suitably active market and have classified them as level 2.

Level 3 assets where internal models are used to represent a small proportion of assets to which shareholders are exposed and reflect unquoted equities including investments in private equity, property vehicle, suspended securities and manually priced derivatives.

In many situations inputs used to measure the fair value of an asset or liability may fall into different levels of the fair value hierarchy. In these situations the Company determines the level in which the fair value falls based upon the lowest level input that is significant to the determination of the fair value. As a result, both observable and unobservable inputs may be used in the determination of fair values that the Company has classified with level 3.

The Company determines the fair values of certain financial assets and liabilities based on quoted market prices where available. The Company also determines fair value based on estimated future cash flows discounted at the appropriate current market rate. As appropriate, fair values reflect adjustments for counterparty credit quality, the Company's credit standing, liquidity and risk margins on unobservable inputs.

Where quoted market prices are not available, fair value estimates are made at a point in time based on relevant market data as well as the best information about the individual financial instrument. Illiquid market conditions have resulted in inactive markets for certain of the Company's financial instruments. As a result, there is generally no or limited observable market data for these assets and liabilities. Fair value estimates for financial instruments deemed to be in an illiquid market are based on judgments regarding current economic conditions, liquidity discounts, currency, credit and interest rate risks, loss experience and other factors. These fair values are estimates and involve considerable uncertainty and variability as a result of the inputs selected and may differ significantly from the values that would have been used had a ready market existed, and the differences could be material. As a result, such calculated fair value estimates may not be realisable in an immediate sale or settlement of the instrument. In addition, changes in the underlying assumptions used in the fair value measurement technique could significantly affect these fair value estimates.

Fair values are subject to a control framework designed to ensure that input variables and outputs are assessed independent of the risk taker. These inputs and outputs are reviewed and approved by a valuation committee.

16 Financial investments (continued)**(a) Significant transfers between level 1 and level 2**

There have been no significant transfers between level 1 and level 2

(b) Assets measured at fair value based on level 3

	Equity securities 2011 £m	Debt securities 2011 £m	Total 2011 £m	Equity securities 2010 £m	Debt securities 2010 £m	Total 2010 £m
As at 1 January	2 456	-	2 456	2 109	-	2 109
Total gains or losses for the period recognised						
- in profit and loss	73	-	73	298	-	298
Purchases	209	-	209	194	-	194
Sales	(203)	-	(203)	(145)	-	(145)
Transfers into level 3	-	5	5	-	-	-
Other	3	-	3	-	-	-
As at 31 December	2 538	5	2 543	2 456	-	2 456

Equity securities analysis includes derivative assets of £3m (2010 £nil)

(iii) Fair value hierarchy (continued)**(c) Effect on changes in significant unobservable inputs (level 3) to reasonably possible alternative assumptions**

As discussed above the fair values of financial instruments are in certain circumstances measured using valuation techniques that incorporate assumptions that are not evidenced by prices from observable current market transactions in the same instrument and are not based on observable market data. The following table shows the level 3 financial instruments carried at fair value as at the balance sheet date, the valuation basis, main assumptions used in the valuation of these instruments and reasonably possible increases or decreases in fair value based on reasonably possible alternative assumptions.

		Reasonably possible alternative assumptions		
		Current fair value 2011	Increase in fair value 2011	Decrease in fair value 2011
		£m	£m	£m
For the year ended 31 December 2011				
Financial Instruments	Main assumptions			
Assets				
Shareholder				
- Private equity investment vehicles ¹	Price earnings multiple	13	1	(1)
- Unquoted investments in property vehicles ²	Property yield occupancy	257	13	(13)
With-profits				
- Private equity investment vehicles ¹	Price earnings multiple	146	7	(7)
- Unquoted investments in property vehicles ²	Property yield occupancy	1 861	93	(93)
- Other		3	-	-
Unit linked				
- Unquoted investments in property vehicles ²	Property yield occupancy	262	13	(13)
Total		2 542	127	(127)

		Reasonably possible alternative assumptions		
		Current fair value	Increase in fair value	Decrease in fair value
		2010	2010	2010
		£m	£m	£m
For the year ended 31 December 2010				
Financial Instruments	Main assumptions			
Assets				
Shareholder				
Private equity investment vehicles ¹	Price earnings multiple	14	1	(1)
- Unquoted investments in property vehicles ²	Property yield occupancy	92	1	(1)
With profits				
- Private equity investment vehicles ¹	Price earnings multiple	126	9	(9)
- Unquoted investments in property vehicles ²	Property yield occupancy	1 962	93	(93)
Unit linked				
- Unquoted investments in property vehicles ²	Property yield occupancy	262	12	(12)
Total		2 456	116	(116)

¹ Private equity investments are valued in accordance with the International Private Equity and Venture Capital Valuation Guidelines. Reasonably possible alternative valuations have been determined using alternative price earnings multiples.

² Unquoted investments in property vehicles are valued by independent valuers on the basis of open market value as defined in the appraisal and valuation manual of the Royal Institute of Chartered Surveyors. Reasonably possible alternative valuations have been determined using alternative yield and occupancy assumptions.

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17 Derivative assets and liabilities

	Contract/ notional amount 2011 £m	Fair values		Contract/ notional amount 2010 £m	Fair values	
		Assets 2011 £m	Liabilities ¹ 2011 £m		Assets 2010 £m	Liabilities ¹ 2010 £m
Shareholder derivatives						
Interest rate contracts - held for trading	(210)	-	12	212	3	8
Forward foreign exchange contracts - held for trading	-	1	10	-	4	1
Equity/index derivatives - held for trading	107	2	-	(43)	-	1
Total shareholder derivatives		3	22		7	10
Non profit non-unit linked derivatives						
Equity/index derivatives - held for trading	97	1	-	112	-	-
Total non profit non-unit linked derivatives		1	-		-	-
With-profits derivatives						
Interest rate contracts - held for trading	1,352	109	102	1,469	51	57
Forward foreign exchange contracts - held for trading	-	18	7	-	4	11
Equity/index derivatives - held for trading	622	38	4	472	28	16
Other derivatives - held for trading	1	-	-	1	1	-
Total with-profits derivatives		165	113		84	84
Unit linked derivatives						
Forward foreign exchange contracts - held for trading	-	4	1	-	4	7
Equity/index derivatives - held for trading	(211)	1	2	(267)	-	3
Other derivatives - held for trading	5	-	-	8	1	-
Total unit linked derivatives		5	3		5	10
Total derivative assets and liabilities		174	138		96	104

	Contract/ notional amount 1 Jan 2010 £m	Fair values	
		Assets 1 Jan 2010 £m	Liabilities ¹ 1 Jan 2010 £m
Shareholder derivatives			
Equity/index derivatives - held for trading	2	-	-
Total shareholder derivatives		-	-
Non profit non-unit linked derivatives			
Equity/index derivatives - held for trading	112	2	-
Total non profit non-unit linked derivatives		2	-
With-profits derivatives			
Interest rate contracts - held for trading	917	35	42
Forward foreign exchange contracts - held for trading	-	3	6
Equity/index derivatives - held for trading	398	22	7
Other derivatives - held for trading	2	2	-
Total with-profits derivatives		62	55
Unit linked derivatives			
Forward foreign exchange contracts - held for trading	-	7	1
Equity/index derivatives - held for trading	36	1	1
Other derivatives - held for trading	5	1	-
Total unit linked derivatives		9	2
Total derivative assets and liabilities		73	57

¹Derivative liabilities are reported in the balance sheet within Payables and other financial liabilities (Note 30)

The notional amounts of some derivative instruments provide a basis for comparison with instruments recognised on the balance sheet. However, these amounts do not necessarily indicate the amounts of future cash flows involved or the current fair value of the instruments and therefore, do not indicate the Company's exposure to credit or price risks.

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17 Derivative assets and liabilities (continued)

The contractual undiscounted cash flows in relation to non-unit linked derivatives have the following maturity profile
Unit linked derivatives have not been included as shareholders are not directly exposed to liquidity risks

As at 31 December 2011	Maturity profile of undiscounted cash flows						Total £m
	Fair values £m	Within 1 year £m	1-5 years £m	5-15 years £m	15-25 years £m	Over 25 years £m	
Cash inflows							
Shareholder derivatives							
Derivative assets	3	74	-	-	-	-	74
Derivative liabilities	(22)	392	5	5	-	-	402
Non profit non-unit linked derivatives							
Derivative assets	1	-	1	-	-	-	1
With-profits derivatives							
Derivative assets	165	553	134	36	115	5	843
Derivative liabilities	(113)	360	30	20	58	2	470
Total	34	1,379	170	61	173	7	1,790
Cash outflows							
Shareholder derivatives							
Derivative assets	3	(71)	-	-	-	-	(71)
Derivative liabilities	(22)	(406)	(12)	(7)	-	-	(425)
Non profit non-unit linked derivatives							
Derivative assets	1	-	-	-	-	-	-
With-profits derivatives							
Derivative assets	165	(512)	(38)	(30)	(83)	(4)	(667)
Derivative liabilities	(113)	(388)	(79)	(36)	(90)	(3)	(596)
Total	34	(1,377)	(129)	(73)	(173)	(7)	(1,759)
Net shareholder derivatives cash flows		(11)	(7)	(2)	-	-	(20)
Net non profit non-unit linked derivatives cash flows		-	1	-	-	-	1
Net with-profits derivatives cash flows		13	47	(10)	-	-	50

17 Derivative assets and liabilities (continued)

As at 31 December 2010	Maturity profile of undiscounted cash flows						Total £m
	Fair values £m	Within 1 year £m	1-5 years £m	5-15 years £m	15-25 years £m	Over 25 years £m	
Cash inflows							
Shareholder derivatives							
Derivative assets	7	280	5	22	16	4	327
Derivative liabilities	(10)	99	14	12	-	-	125
Non profit non-unit linked derivatives							
Derivative assets	-	-	-	-	-	-	-
Derivative liabilities	-	-	-	-	-	-	-
With profits derivatives							
Derivative assets	84	224	132	103	30	4	493
Derivative liabilities	(84)	797	66	131	52	8	1 054
Total	(3)	1 400	217	268	98	16	1 999
Cash outflows							
Shareholder derivatives							
Derivative assets	7	(277)	(6)	(16)	(12)	(4)	(315)
Derivative liabilities	(10)	(105)	(19)	(10)	-	-	(134)
Non profit non-unit linked derivatives							
Derivative assets	-	-	-	-	-	-	-
Derivative liabilities	-	-	-	-	-	-	-
With-profits derivatives							
Derivative assets	84	(202)	(75)	(99)	(27)	(4)	(407)
Derivative liabilities	(84)	(845)	(91)	(144)	(58)	(9)	(1,147)
Total	(3)	(1 429)	(191)	(269)	(97)	(17)	(2 003)
Net shareholder derivatives cash flows		(3)	(6)	8	4	-	3
Net non profit non-unit linked derivatives cash flows		-	-	-	-	-	-
Net with-profits derivatives cash flows		(26)	32	(9)	(3)	(1)	(7)

As at 1 January 2010	Maturity profile of undiscounted cash flows						Total £m
	Fair values £m	Within 1 year £m	1-5 years £m	5-15 years £m	15-25 years £m	Over 25 years £m	
Cash inflows							
Shareholder derivatives							
Derivative assets	-	-	-	-	-	-	-
Derivative liabilities	-	-	-	-	-	-	-
Non profit non-unit linked derivatives							
Derivative assets	2	-	2	-	-	-	2
Derivative liabilities	-	-	-	-	-	-	-
With profits derivatives							
Derivative assets	62	289	93	84	28	4	498
Derivative liabilities	(55)	256	84	108	49	11	508
Total	9	545	179	192	77	15	1 008
Cash outflows							
Shareholder derivatives							
Derivative assets	-	-	-	-	-	-	-
Derivative liabilities	-	-	-	-	-	-	-
Non profit non-unit linked derivatives							
Derivative assets	2	-	-	-	-	-	-
Derivative liabilities	-	-	-	-	-	-	-
With-profits derivatives							
Derivative assets	62	(266)	(52)	(85)	(24)	(3)	(430)
Derivative liabilities	(55)	(271)	(122)	(111)	(54)	(13)	(571)
Total	9	(537)	(174)	(196)	(78)	(16)	(1 001)
Net shareholder derivatives cash flows		-	-	-	-	-	-
Net non profit non-unit linked derivatives cash flows		-	2	-	-	-	2
Net with-profits derivatives cash flows		8	3	(4)	(1)	(1)	5

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18 Reinsurers' share of contract liabilities

	Notes	Non profit non-unit linked 2011 £m	With- profits 2011 £m	Unit linked 2011 £m	Total 2011 £m
Reinsurers' share of					
Insurance contract liabilities	24	28 212	1	8	28 221
Investment contract liabilities	25	-	11	1,665	1 676
Reinsurers' share of contract liabilities		28,212	12	1 673	29,897
<hr/>					
	Notes	Non profit non-unit linked 2010 £m	With- profits 2010 £m	Unit linked 2010 £m	Total 2010 £m
Reinsurers' share of					
Insurance contract liabilities	24	25 176	1	7	25 184
Investment contract liabilities	25	-	-	1 106	1 106
Reinsurers' share of contract liabilities		25,176	1	1,113	26,290
<hr/>					
	Notes	Non profit non-unit linked 1 Jan 2010 £m	With- profits 1 Jan 2010 £m	Unit linked 1 Jan 2010 £m	Total 1 Jan 2010 £m
Reinsurers' share of					
Insurance contract liabilities	24	22 187	1	5	22 193
Investment contract liabilities	25	-	1	604	605
Reinsurers' share of contract liabilities		22 187	2	609	22 798

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19 Deferred tax asset / (liability)

The deferred tax balances are as follows

	As at 31 December 2011 £m	As at 31 December 2010 £m	As at 1 January 2010 £m
Deferred tax asset	317	252	399
	317	252	399

Deferred tax assets and (liabilities) have been recognised/(provided) for the following types of temporary differences and unused tax losses. The movement in these balances during the year is as follows

	Net tax asset as at 1 January 2011 £m	Tax (charged)/ credited to the income statement £m	Tax (charged)/ credited to equity £m	Net tax asset as at 31 December 2011 £m
Unrealised gains on investments	(125)	205	-	80
Excess of depreciation over capital allowances	39	-	-	39
Expenses	131	(2)	-	129
Tax losses	205	(137)	-	68
Other	2	(1)	-	1
Deferred tax asset/(liabilities)	252	65	-	317

Included in the amounts credited/(charged) to income and equity in 2011 is £(2)m relating to the change in UK corporation tax rate from 28% to 26% in April 2011 and to 25% in April 2012

	Net tax asset as at 1 January 2010 £m	Tax (charged)/ credited to the income statement £m	Tax credited/ (charged) to equity £m	Net tax asset as at 31 December 2010 £m
Unrealised gains on investments	(18)	(107)	-	(125)
Excess of depreciation over capital allowances	40	(1)	-	39
Expenses	143	(12)	-	131
Tax losses	233	(28)	-	205
Other	1	1	-	2
Deferred tax assets/(liabilities)	399	(147)	-	252

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19 Deferred tax asset / (liability) (continued)

Unrecognised deferred tax assets

The Company has the following unrelieved tax losses carried forward as at 31 December 2011. No deferred tax asset has been recognised in respect of these tax losses as at 31 December 2011 or 31 December 2010 as it is probable that there will be no suitable taxable profits emerging in future periods against which to relieve them. Relief for these tax losses will only be recognised if it becomes probable that suitable taxable profits will arise in future periods. The potential deferred tax asset unrecognised as at 31 December 2011 is £15m (2010: £15m).

	Gross 2011 £m	Tax 2011 £m	Gross 2010 £m	Tax 2010 £m	Gross 1 Jan 2010 £m	Tax 1 Jan 2010 £m
Tax losses in respect of equity and property assets	77	15	77	15	77	15
Unrecognised deferred tax asset	77	15	77	15	77	15

20 Income tax

Income Tax Recoverable	2011 £m	2010 £m	1 Jan 2010 £m
Tax payable within 12 months	(32)	-	-
Tax due after 12 months ¹	82	-	-
Income tax recoverable	50	-	-
¹ £82m relates to tax recoverable in respect of EU claims			
Income Tax Liabilities	2011 £m	2010 £m	1 Jan 2010 £m
Tax due within 12 months	-	140	123
Tax due after 12 months	-	-	-
Income tax liabilities	-	140	123

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21 Other assets

	Shareholder	Non profit non-unit linked	With- profits	Unit linked	Total
	2011 £m	2011 £m	2011 £m	2011 £m	2011 £m
Reinsurance receivables	3	10	-	-	13
Accrued interest and rent	-	-	30	91	121
Prepayments and accrued income	14	16	-	-	30
Other receivables ¹	17	639	70	36	762
Other assets	34	665	100	127	926
Due within 12 months					911
Due after 12 months					15

	Shareholder	Non profit non-unit linked	With- profits	Unit linked	Total
	2010 £m	2010 £m	2010 £m	2010 £m	2010 £m
Reinsurance receivables	2	13	-	-	15
Accrued interest and rent	1	-	42	87	130
Prepayments and accrued income	16	15	-	-	31
Other receivables ¹	8	903	80	60	1 051
Other assets	27	931	122	147	1 227
Due within 12 months					1 215
Due after 12 months					12

	Shareholder	Non profit non-unit linked	With- profits	Unit linked	Total
	1 Jan 2010 £m	1 Jan 2010 £m	1 Jan 2010 £m	1 Jan 2010 £m	1 Jan 2010 £m
Reinsurance receivables	-	9	-	-	9
Accrued interest and rent	2	7	39	74	122
Prepayments and accrued income	12	13	-	1	26
Other receivables ¹	7	1 233	41	42	1 323
Other assets	21	1 262	80	117	1 480
Due within 12 months					1 472
Due after 12 months					8

Other receivables includes £522m (2010: £807m) due from Group companies

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22 Cash and cash equivalents

	Shareholder	Non profit non-unit linked	With- profits	Unit linked	Total
	2011 £m	2011 £m	2011 £m	2011 £m	2011 £m
Cash at bank and in hand ¹	124	22	52	192	390
Cash equivalents	131	2	622	906	1 661
Cash and cash equivalents	255	24	674	1 098	2 051

	Shareholder	Non profit non-unit linked	With- profits	Unit linked	Total
	2010 £m	2010 £m	2010 £m	2010 £m	2010 £m
Cash at bank and in hand ¹	284	26	58	200	568
Cash equivalents	95	2	700	858	1,655
Cash and cash equivalents	379	28	758	1 058	2 223

	Shareholder	Non profit non-unit linked	With- profits	Unit linked	Total
	1 Jan 2010 £m	1 Jan 2010 £m	1 Jan 2010 £m	1 Jan 2010 £m	1 Jan 2010 £m
Cash at bank and in hand ¹	5	(1)	34	153	191
Cash equivalents	84	10	925	877	1 896
Cash and cash equivalents	89	9	959	1 030	2 087

¹ Included in the above are cash balances held in trust of £91m (2010 £274m)

23 Share capital and share premium

	Number of shares 000	2011 £m	2010 £m	1 Jan 2010 £m
Issued share capital				
Fully paid ordinary shares of £1 each	201 430	201	201	201
Share premium		1 049	1 049	1 049

There is one class of ordinary shares. All shares issued carry equal voting rights. There has been no change in the authorised share capital during the year.

The holders of the Company's ordinary shares are entitled to receive dividends as declared and are entitled to one vote per share at shareholder meetings of the Company.

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24 Insurance contract liabilities

(i) Analysis of insurance contract liabilities

	Notes	Gross 2011 £m	Reinsurance 2011 £m	Gross 2010 £m	Reinsurance 2010 £m	Gross 1 Jan 2010 £m	Reinsurance 1 Jan 2010 £m
Participating insurance contracts	(iii)	8,554	(1)	9,183	(1)	9,198	(1)
Non-participating insurance contracts ¹	(iv)	31,021	(28,220)	28,093	(25,183)	24,987	(22,192)
General insurance contracts		3	-	3	-	3	-
Insurance contract liabilities		39,578	(28,221)	37,279	(25,184)	34,188	(22,193)

¹ Excluding General Insurance contracts

During the year the Company entered into prospective reinsurance arrangements which resulted in a profit of £173m (2010: £137m). This profit has been reflected in the statement of comprehensive income for the year.

(ii) Expected insurance contract liability cash flows

	Date of undiscounted cash flow				Total £m	Carrying value £m
	0-5 years £m	5-15 years £m	15-25 years £m	Over 25 years £m		
As at 31 December 2011						
Participating insurance contracts	5,336	2,841	761	309	9,247	8,554
Non-participating insurance contracts	8,308	16,204	13,686	16,631	54,829	23,069
General insurance contracts	-	-	-	-	-	-
Insurance contract liabilities	13,644	19,045	14,447	16,940	64,076	31,623

	Date of undiscounted cash flow				Total £m	Carrying value £m
	0-5 years £m	5-15 years £m	15-25 years £m	Over 25 years £m		
As at 31 December 2010						
Participating insurance contracts	5,755	3,515	973	320	10,563	9,123
Non-participating insurance contracts	8,013	16,900	13,551	15,755	54,218	26,858
General insurance contracts	-	-	-	-	-	-
Insurance contract liabilities	13,768	20,415	14,524	16,075	64,781	35,981

	Date of undiscounted cash flow				Total £m	Carrying value £m
	0-5 years £m	5-15 years £m	15-25 years £m	Over 25 years £m		
As at 1 January 2010						
Participating insurance contracts	5,695	3,829	1,067	369	10,960	9,142
Non-participating insurance contracts	7,077	14,577	12,442	15,300	49,995	23,764
General insurance contracts	-	-	-	-	-	-
Insurance contract liabilities	12,771	18,406	13,509	15,669	60,355	32,906

Insurance contract undiscounted cash flows are based on the expected date of settlement.

Amounts under unit linked contracts are generally repayable on demand and the Company is responsible for ensuring there is sufficient liquidity within the asset portfolio to enable liabilities to unit linked policyholders to be met as they fall due. However the terms of funds investing in less liquid assets permit the deferral of redemptions for predefined periods in circumstances where there are not sufficient liquid assets within the fund to meet the level of requested redemptions. Accordingly unit linked liabilities have been excluded from the table.

24 Insurance contract liabilities (continued)**(iii) Movement in participating insurance contract liabilities**

	Notes	Gross 2011 £m	Reinsurance 2011 £m	Gross 2010 £m	Reinsurance 2010 £m
As at 1 January		9,183	(1)	9,198	(1)
New liabilities in the year		363	-	473	-
Liabilities discharged in the year		(1,418)	-	(1,257)	-
Unwinding of discount rates		78	-	62	-
Effect of change in non-economic assumptions	28	(26)	-	45	-
Effect of change in economic assumptions	28	357	-	657	-
Other		17	-	5	-
As at 31 December		8,554	(1)	9,183	(1)
Expected to be settled within 12 months (net of reinsurance)		1,355	-	1,231	-
Expected to be settled after 12 months (net of reinsurance)		7,198	-	7,951	-

(iv) Movement in non-participating insurance contract liabilities

	Notes	Gross 2011 £m	Reinsurance 2011 £m	Gross 2010 £m	Reinsurance 2010 £m
As at 1 January		28,093	(25,183)	24,987	(22,192)
New liabilities in the year		2,459	(2,615)	2,088	(2,191)
Liabilities discharged in the year		(1,551)	1,502	(1,354)	1,375
Unwinding of discount rates		1,261	(1,211)	1,226	(1,156)
Effect of change in non-economic assumptions	28	(392)	283	(146)	132
Effect of change in economic assumptions	28	1,175	(1,150)	1,298	(1,175)
Other		(24)	154	(6)	24
As at 31 December		31,021	(28,220)	28,093	(25,183)
Expected to be settled within 12 months (net of reinsurance)		251	-	137	-
Expected to be settled after 12 months (net of reinsurance)		2,550	-	2,773	-

25 Investment contract liabilities**(i) Analysis of investment contract liabilities**

	Notes	Gross 2011 £m	Reinsurance 2011 £m	Gross 2010 £m	Reinsurance 2010 £m	Gross 1 Jan 2010 £m	Reinsurance 1 Jan 2010 £m
Participating investment contracts		5,040	-	5,104	-	5,005	(1)
Non-participating investment contracts	(iii)	25,183	(1,676)	25,891	(1,106)	23,480	(604)
Investment contract liabilities	(ii)	30,223	(1,676)	30,995	(1,106)	28,485	(605)
Expected to be settled within 12 months (net of reinsurance)		2,562	-	2,662	-	2,429	-
Expected to be settled after 12 months (net of reinsurance)		25,985	-	27,227	-	25,451	-

(ii) Movement in investment contract liabilities

	Gross 2011 £m	Reinsurance 2011 £m	Gross 2010 £m	Reinsurance 2010 £m
As at 1 January	30,995	(1,106)	28,485	(605)
Reserves in respect of new business	2,814	(653)	2,548	(416)
Amounts paid on surrenders and maturities during the year	(3,316)	31	(2,995)	40
Investment return and related benefits	(11)	52	3,217	(125)
Management charges	(259)	-	(260)	-
As at 31 December	30,223	(1,676)	30,995	(1,106)

25 Investment contract liabilities (continued)**(iii) Non-participating investment contract liability fair value hierarchy**

As at 31 December 2011	Total £m	Level 1 £m	Level 2 £m	Level 3 £m	Amortised cost £m
Non-participating investment contracts	25,183	25,183	-	-	-

As at 31 December 2010	Total £m	Level 1 £m	Level 2 £m	Level 3 £m	Amortised cost £m
Non-participating investment contracts	25,891	25,891	-	-	-

As at 1 January 2010	Total £m	Level 1 £m	Level 2 £m	Level 3 £m	Amortised cost £m
Non-participating investment contracts	23,480	23,480	-	-	-

There have been no significant transfers between any of the levels

(iv) Expected investment contract liability cash flows

As at 31 December 2011	Date of undiscounted cash flow				Total £m	Carrying value £m
	0-5 years £m	5-15 years £m	15-25 years £m	Over 25 years £m		
Participating investment contracts	2,201	2,591	886	73	5,751	5,040

As at 31 December 2010	Date of undiscounted cash flow				Total £m	Carrying value £m
	0-5 years £m	5-15 years £m	15-25 years £m	Over 25 years £m		
Participating investment contracts	2,269	2,944	1,196	102	6,511	5,104

As at 1 January 2010	Date of undiscounted cash flow				Total £m	Carrying value £m
	0-5 years £m	5-15 years £m	15-25 years £m	Over 25 years £m		
Participating investment contracts	2,243	2,982	1,365	142	6,732	5,005

Investment contract undiscounted net cash flows are based on the expected date of settlement

Amounts under unit linked contracts are generally repayable on demand and the Company is responsible for ensuring there is sufficient liquidity within the asset portfolio to enable liabilities to unit linked policyholders to be met as they fall due. However the terms of funds investing in less liquid assets permit the deferral of redemptions for predefined periods in circumstances where there are not sufficient liquid assets within the fund to meet the level of requested redemptions. Accordingly unit linked liabilities have been excluded from the reported cash flows.

A maturity analysis based on the earliest contractual repayment date would present investment contract liabilities as due on the earliest period of the table because policyholders can exercise cancellation options at their discretion. In such a scenario the liability would be reduced due to the application of surrender penalties.

26 Unallocated divisible surplus

	2011 £m	2010 £m
As at 1 January	1,446	1,284
Transferred from the Income statement	(354)	162
As at 31 December	1,092	1,446

It is intended that the with-profits part of the LTF will be managed on the basis that it will remain open to new business and therefore there is no expectation of any distribution from the Inherited estate

27 Value of in-force non-participating contracts**(i) Movement in value of in-force non-participating contracts**

	2011 £m	2010 £m
As at 1 January	337	328
Unwinding of the discount rates	19	18
Investment return	(79)	16
Other	(72)	(25)
As at 31 December	205	337
Expected to be settled within 12 months	25	45
Expected to be settled after 12 months	180	292

(ii) Expected net cash flows

	Date of undiscounted cash flow				Total £m	Carrying value £m
	0-5 years £m	5-15 years £m	15-25 years £m	Over 25 years £m		
As at 31 December 2011						
Value of in-force non-participating contracts	142	127	56	34	359	205

	Date of undiscounted cash flow				Total £m	Carrying value £m
	0-5 years £m	5-15 years £m	15-25 years £m	Over 25 years £m		
As at 31 December 2010						
Value of in-force non-participating contracts	231	242	103	53	629	337

	Date of undiscounted cash flow				Total £m	Carrying value £m
	0-5 years £m	5-15 years £m	15-25 years £m	Over 25 years £m		
As at 1 January 2010						
Value of in-force non-participating contracts	250	224	108	57	639	328

Value of in-force (VIF) non-participating undiscounted net cash flows are based on the expected date of realisation. The VIF relates entirely to insurance contracts

28 Long term insurance valuation assumptions**(i) Non-participating business**

For its non-participating business the Company seeks to make prudent assumptions about its future experience based on current market conditions and recent experience. The approach used to set non-participating assumptions is generally similar to that used to determine the assumptions used for FSA Regulatory Peak 1 although the actual assumptions may sometimes differ from those used for regulatory reporting purposes. These assumptions incorporate prudent margins in excess of best estimate assumptions to reduce the possibility of actual experience being less favourable than assumed.

Valuation rates of interest and discount rates

The valuation interest rate for each contract type is based on the yield on the assets backing the contract adjusted for the risk that asset proceeds are not received by the Company. For some business this yield is the gross redemption yield on fixed interest securities and the running yield on variable interest securities. For other business it is the Internal Rate of Return on the portfolio of backing assets.

In 2011 the Company continued to hold an additional reserve to protect against the risk of an uplift in defaults in the current economic conditions and also maintained the level of the long term default allowance of 40bps (2010: 40bps) per annum for unapproved securities backing non-profit business, 35bps (2010: 35bps) for unapproved securities backing with-profit business and for approved securities and swaps backing both with and non-profit business the allowance remains at 3bps per annum (2010: 3bps) and 27.3bps for property. For unapproved securities backing non-profit annuity business the credit default allowances equate to 61bps (2010: 64bps) per annum when expressed over the duration of the assets held leading to an overall total default provision of £1.6bn (2010: £1.5bn). A similar methodology has been used for assets backing with-profits business. The Company believes the total default allowance is prudent to cover all reasonably foreseeable circumstances.

For equity investments, the yield is based on the current dividend yield adjusted for prudence.

Mortality and morbidity

Mortality and morbidity assumptions are set with reference to standard tables drawn up by the Continuous Mortality Investigation Bureau (CMI) of the Institute and Faculty of Actuaries. These tables are based on industry wide mortality and morbidity experience for insured lives.

The majority of internal statistical investigations are carried out at least annually to determine the extent to which the Company's experience differs from that of the industry and suggest appropriate adjustments which need to be made to the valuation assumptions.

Persistence

The Company monitors its persistency experience and carries out detailed investigations annually. Persistency can be volatile and past experience may not be an appropriate future indicator. The Company tries to balance past experience and future conditions by making prudent assumptions about the future expected long term average persistency levels.

For non-participating contracts where explicit persistency assumptions are not made, prudence is also incorporated into the liabilities by ensuring that they are sufficient to cover the more onerous of the two scenarios where the policies either remain in-force until maturity or where they discontinue at the valuation date.

Expenses

The Company monitors its expense experience and carries out detailed investigations regularly to determine the expenses incurred in writing and administering the different products and classes of business. An allowance for expense inflation in the future is also made taking account of both salary and price information.

(ii) Participating business

For its participating business the Company seeks to establish its liabilities at their realistic value in line with the requirements set out in FRS 27. Non-economic assumptions are set to represent the Company's best estimates of future experience.

Economic assumptions

Realistic valuation requires a market consistent economic model. The model is calibrated using market data from a variety of market sources. This enables assumptions to be determined for the term structure of risk-free interest rates, property and equity volatility. Risk-free interest rates are determined with reference to the gilt-yield curve on the valuation date increased by 10bps.

Property volatility is set with reference to historic variations in property prices. Equity volatility is set so that the model reproduces observed market prices of traded equity derivatives. Correlations between asset classes are based on historic data. Each investment scenario contains a consistent set of assumptions for investment returns and inflation.

Future bonuses

Future reversionary and terminal bonuses are consistent with the bonus policies set out in the Company's Principles and Practices of Financial Management.

28 Long term insurance valuation assumptions (continued)**Value of in-force for non-participating business**

The Company creates an asset for the expected value of future profits arising on non-participating contracts written in the with-profits part of the Company LTF

The economic assumptions used to calculate the value of these profits are consistent with those used to calculate liabilities for with-profits business, with the addition of a liquidity premium in respect of assets backing non-participating annuity business. Non-economic assumptions represent best estimates of expected future experience on this business. An explicit allowance is made for non-market risk

Guaranteed annuity options

The guarantees are valued on a market consistent basis. The valuation methodology allows for the correlation between interest rates and the proportion of policyholders who take up the option

Premiums - non-participating business

For those contracts where the policyholder does not have the right to vary the amount of the premium paid, full credit is taken for the premiums contractually due at the valuation date. For contracts where the policyholder has the option to vary the rate of premium, the provision is taken as being the higher of the amount calculated as if the policyholder continues to make premium payments or alternatively ceases to pay premiums altogether

Persistency - non-participating business

Lapse rates are used in the valuation of certain classes of long term business. Where this is the case, the valuation persistency basis is set by applying a prudential margin over the best estimate assumptions. See note 28 - table (iii) for the major products where lapse rates have been used

For term assurance business, the margin acts to increase the best estimate lapse rate in the early part of a policy's lifetime (when it is being treated as an asset) but to reduce the best estimate lapse rate later in the policy's lifetime (when it is treated as a liability). The crossover point at which the margin changes direction is assessed for broad product groups but applied at a policy by policy level. Any liability to reinsurers on discontinuance within the first four years from inception is allowed for explicitly in the cash flows using the valuation lapse basis, together with a prudent allowance for clawback of commission from agents upon lapse

For unutilised business, the margin acts to either increase or decrease the best estimate lapse rates depending upon which approach results in the higher liability. The direction of the margin is assessed for unit life business and unit pensions business separately

A summary of the lapse basis for major classes of business, as defined by the requirements of the annual returns to the FSA, is shown in note 28 table (iii)

The following notes refer to note 28 - tables (i) and (ii)

1. For product groups where liabilities are positive, the lower interest rate of 2.25% is used. However, for product groups where liabilities are negative, the higher rate of 6.60% is used

2. The percentage of the table varies with the duration of the policy for first five years

3. For term assurance with critical illness, morbidity rates are assumed to deteriorate at a rate of 0.5% pa for males and 0.75% pa for females (2010: 0.50% pa for males and 0.75% pa for females). There is an additive loading of 1% (2010: 1%) for guaranteed term contracts post policy duration 5

4. Table created by blending PCXA00 with PNXA00 tables. The base table to be used for BPA policies in deferment is PNMA00 up to and including age 55 and PCMA00 for age 65 and above for males. The identical method is applied to females using PNFA00 and PCFA00

5. For vested annuities, mortality rates are assumed to reduce according to CMI's mortality improvement model, CMI 2009, with the following parameters

Males: Long Term Rate of 2% p.a. (2010: 2% p.a.) up to age 85 tapering to 0% at 120

Females: Long Term Rate of 1.5% p.a. (2010: 1.5% p.a.) up to age 85 tapering to 0% at 120

For certain annuities, a further allowance is made for the effect of initial selection

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28 Long term insurance valuation assumptions (continued)

The table below sets out the current valuation assumptions used to establish the long term liabilities for the Company. Full disclosure of the valuation assumptions are set out in the Abstract of the Valuation Report contained within the FSA returns.

The principal assumptions are

(i) Rate of interest/discount rate

	2011	2010
Non-Participating Business		
Life assurances	2.25%pa and 6.60%pa ¹	2.25%pa and 7.60%pa ¹
Pension assurances	2.25%pa and 6.60%pa ¹	2.50 - 3.50% pa and 7.60%pa ¹
Annuities in deferment	4.601% pa	4.975% pa
Annuities in deferment (RPI linked net rate after allowance for inflation)	0.86% pa	1.040% pa
Vested annuities	4.601% pa	4.975% pa
Vested annuities (RPI linked net rate after allowance for inflation)	-0.40 - 0.86% pa	0.40 - 1.040% pa
Participating Business		
Risk free rate (10 years)	2.23% pa	3.78% pa
Future bonuses	Determined stochastically in line with bonus policy as stated in the PPFM	Determined stochastically in line with bonus policy as stated in the PPFM
UK Equity volatility (10 year option term)	27.2%	26.2%
Property volatility	15.0%	15.0%

(ii) Mortality Tables

	2011	2010
Non-Participating Business		
Non-linked individual term assurances		
- Smokers	78% TMS00/TFS00 Sel 5	116% TMS00 / TFS00 Sel 5
- Non-smokers	90% TMN00/TFN00 Sel 5	136% TMN00 / TFN00 Sel 5
- Smoker status unknown	83% TM00/TF00 Sel 5	103% TM00 / TF00 Sel 5
Non-linked individual term assurances with terminal illness		
- Smokers	90% - 112% TMS00/TFS00 Sel 5 ²	96% TMS00 / TFS00 Sel 5
- Non-smokers	85% - 115% TMN00/TFN00 Sel 5 ²	93% TMN00 / TFN00 Sel 5
Non-linked individual term assurances with critical illness		
- Smokers	91% - 101% CIBT93M/F Ult Comb ³	99% CIBT93M / F Ult Comb ²
- Non-smokers	57% - 67% CIBT93M/F Ult Comb ³	68% CIBT93M / F Ult Comb ²
Other non-linked non profit life assurances	100% of A67/70 ultimate tables	100% of A67/70 ultimate tables
Annuities in deferment	82.5% - 89.4% PNMA00/PNFA00 ⁴	88 - 92% PNMA00/PNFA00
Vested annuities ⁵		
- Bulk purchase annuities	84.3 - 90.4% PCMA00/PCFA00	89 - 93% PCMA00/PCFA00
- Other annuities	62.2% - 115.4% PCMA00/PCFA00	55 - 86% PCMA00/PCFA00

28 Long term insurance valuation assumptions (continued)**(iii) Persistency - non participating business (continued)**

Product	2011 Average lapse rate for the policy years			
	1 - 5 %	6 - 10 %	11 - 15 %	16 - 20 %
Level term	13.9	9.2	5.6	2.9
Decreasing term	14.0	9.3	6.0	5.5
Accelerated critical illness cover	21.7	11.1	5.3	5.0
Pensions term	13.0	8.5	5.6	5.1
Whole of Life (conventional non-profit)	3.9	1.9	1.0	0.0
Savings endowment (unitised with-profit)	0.0	1.4	1.6	4.0
Target cash endowment (unitised with-profits)	0.0	3.6	3.0	2.4
Savings endowment (unit linked)	0.0	1.4	1.6	4.0
Target cash endowment (unit linked)	0.0	3.6	3.0	2.4
Bond (unitised with-profits)	1.0	2.0	2.3	1.8
Bond (unit linked)	2.6	5.9	3.6	3.3
Individual pension regular premium (unitised with-profits)	1.4	1.3	1.3	1.3
Individual pension regular premium (unit linked)	2.4	1.7	1.6	1.6
Group pension regular premium (unitised with-profits)	2.2	2.3	2.1	2.1
Group pension regular premium (unit linked)	2.6	2.3	1.4	1.4
Trustee Investment Plan regular premium (unitised with-profits)	1.3	1.3	1.3	1.3
Trustee Investment Plan regular premium (unit linked)	1.3	1.3	1.3	1.3
Individual pension single premium (unitised with-profits)	3.5	3.4	3.4	3.4
Individual pension single premium (unit linked)	4.4	3.8	2.9	2.9
Group pension single premium (unitised with-profits)	10.9	10.9	10.9	10.9
Group pension single premium (unit linked)	6.7	6.7	6.7	6.7
Trustee Investment Plan single premium (unitised with-profits)	6.8	5.6	3.8	3.8
Trustee Investment Plan single premium (unit linked)	6.8	5.6	3.7	3.7

Product	2010 Average lapse rate for the policy years			
	1 - 5 %	6 - 10 %	11 - 15 %	16 - 20 %
Level term	13.9	9.4	6.0	3.1
Decreasing term	14.1	9.5	6.4	6.0
Accelerated critical illness cover	21.2	10.7	5.5	5.2
Pensions term	12.7	8.5	6.0	5.6
Whole of Life (conventional non-profit)	4.1	1.9	0.9	0.0
Savings endowment (unitised with-profit)	0.0	1.7	2.2	4.4
Target cash endowment (unitised with-profits)	3.2	3.2	3.2	2.6
Savings endowment (unit linked)	0.0	1.7	2.2	4.4
Target cash endowment (unit linked)	3.2	3.2	3.2	2.6
Bond (unitised with-profits)	1.1	2.0	2.5	2.4
Bond (unit linked)	2.6	6.3	3.9	3.5
Individual pension regular premium (unitised with-profits)	1.2	1.1	1.1	1.1
Individual pension regular premium (unit linked)	2.2	1.6	1.4	1.4
Group pension regular premium (unitised with-profits)	2.1	2.1	2.0	2.0
Group pension regular premium (unit linked)	2.1	1.9	1.3	1.3
Trustee Investment Plan regular premium (unitised with-profits)	1.4	1.4	1.4	1.4
Trustee Investment Plan regular premium (unit linked)	1.3	1.3	1.3	1.3
Individual pension single premium (unitised with-profits)	3.4	3.3	3.2	3.2
Individual pension single premium (unit linked)	4.0	3.5	2.7	2.7
Group pension single premium (unitised with-profits)	11.2	11.2	11.2	11.2
Group pension single premium (unit linked)	7.6	7.6	7.6	7.6
Trustee Investment Plan single premium (unitised with-profits)	6.4	5.3	3.8	3.8
Trustee Investment Plan single premium (unit linked)	6.8	5.8	4.3	4.3

Endowment reserve

The endowment reserve has been set taking reasonable account of an assessment of the expected future population of complaints, the expected uphold rate for these complaints, the potential impact of any Financial Ombudsman Service decisions on referred complaints and the average compensation per complaint.

Overseas business

In calculating the long term business provisions for international long term business operations, local actuarial tables and interest rates are used.

29 Borrowings

Borrowings have no set repayment dates and are in pounds sterling. The interest rate is set 1% above the base rate (0.5%) and this is deemed to be an arm's length rate. The borrowings are carried at amortised cost in the balance sheet.

30 Payables and other financial liabilities

	Notes	2011 £m	2010 £m	1 Jan 2010 £m
Derivative liabilities	17	137	104	57
Other		397	377	315
Payables and other financial liabilities		534	481	372
Settled within 12 months		434	325	226
Settled after 12 months		100	156	146

Other includes future commission payments which have contingent settlement provisions of £170m (2010: £164m). This liability has been determined using the net present value of the future commission which will be payable on fund values. This valuation technique uses assumptions which are consistent with the Company's effective rate of interest, investment return assumptions and persistency assumptions used in other valuations, but it is not determined by reference to published price quotations.

The trail commission liability is the present value of future trail commission on new business. Trail commission is amortised over a period representing the discounted mean term of the trail commission cashflows. This is currently 13 years for life business and 21 years for pensions business. The undiscounted value which is expected to be paid at maturity in respect of such commission is £247m (2010: £234m). Payables and other financial liabilities settled after 12 months are expected to be settled within five years with the exception of derivative liabilities as disclosed in Note 16.

Fair value hierarchy

	Total £m	Level 1 £m	Level 2 £m	Level 3 £m	Amortised cost £m
As at 31 December 2011					
Derivative liabilities	137	22	112	3	-
Other	397	18	-	170	209
Payables and other financial liabilities	534	40	112	173	209
As at 31 December 2010					
Derivative liabilities	104	22	82	-	-
Other	377	-	-	162	215
Payables and other financial liabilities	481	22	82	162	215
As at 1 January 2010					
Derivative liabilities	57	9	48	-	-
Other	315	-	-	147	168
Payables and other financial liabilities	372	9	48	147	168

Trail commissions are modelled using expected cash flows incorporating expected future persistency. They have therefore been classified as level 3 liabilities. The entire movement in the balance has been reflected in the income statement during the year. A reasonably possible alternative persistency assumption would have the effect of increasing or decreasing the liability by £5m (2010: £5m).

There have been no significant transfers between levels.

31 Other liabilities

	2011 £m	2010 £m	1 Jan 2010 £m
Accruals	116	109	100
Deferred income liabilities	328	372	434
Intra Group balances ¹	1,706	880	950
Other payables	17	17	15
Other liabilities	2,167	1,378	1,499
Settled within 12 months	162	147	158
Settled after 12 months	2,005	1,231	1,341

¹See Note 39 (v) Related party transactions**32 Contingent liabilities, guarantees and indemnities**

Provision for the liabilities arising under contracts with policyholders is based on certain assumptions. The variance between actual experience from that assumed may result in those liabilities differing from the provisions made for them. Liabilities may also arise in respect of claims relating to the interpretation of policyholder contracts, or the circumstances in which policyholders have entered into them. The extent of these liabilities is influenced by a number of factors including the actions and requirements of the FSA ombudsman rulings, industry compensation schemes and court judgments.

The Company receives claims and becomes involved in actual or threatened litigation and regulatory issues from time to time. The Company ensures that it makes prudent provision as and when circumstances calling for such provision become clear and that it has adequate capital and reserves to meet reasonably foreseeable eventualities. The provisions made are regularly reviewed. It is not possible to predict with certainty the extent and the timing of the financial impact of these claims, litigation or issues.

In 1975, Legal & General Assurance Society Limited was required by the Institute of London Underwriters (ILU) to execute the ILU form of guarantee in respect of policies issued through the ILU's Policy Signing Office on behalf of NRG Victory Reinsurance Company Ltd (Victory), a company which was then a subsidiary of the Company. In 1990, Nederlandse Reassurantie Groep Holding NV (the assets and liabilities of which have since been assumed by Nederlandse Reassurantie Groep NV under a statutory merger in the Netherlands) acquired Victory and provided an indemnity to the Company against any liability the Society may have as a result of the ILU's requirement, and the ILU agreed that its requirement of the Society would not apply to policies written or renewed after the acquisition. Nederlandse Reassurantie Groep NV is now owned by Columbia Insurance Company, a subsidiary of Berkshire Hathaway Inc. Whether the Society has any liability as a result of the ILU's requirement and, if so, the amount of its potential liability is uncertain. The Society has made no payment or provision in respect of this matter.

33 Commitments**(i) Capital commitments**

Authorised and contracted commitments by the LTF not provided for in respect of investments, relating to property development and private equity, payable after 31 December 2011 are £194m (2010: £225m).

(ii) Operating lease commitments

	2011 £m	2010 £m
The future aggregate minimum lease payments under non-cancellable operating leases are as follows:		
- Not later than 1 year	11	12
- Later than 1 year and not later than 5 years	40	44
- Later than 5 years	74	83
	125	139
Future aggregate minimum sublease payments expected to be received under operating subleases	8	3
The future aggregate minimum lease receivables under non-cancellable operating leases are as follows:		
- Not later than 1 year	2	0
- Later than 1 year and not later than 5 years	6	1
- Later than 5 years	-	2
	8	3

34 Subsidiary undertakings

The subsidiary undertakings of Legal & General Assurance Society Limited are listed below. Each undertaking operates mainly in its country of incorporation and has only one class of issued ordinary shares unless stated otherwise.

Held directly by the Company	Nature of business	Incorporated in
City & Urban Developments Limited	Holding Company	England & Wales
Insurebeam Limited	Holding Company	England & Wales
Legal & General (Meteor) Limited	Dormant Company	England & Wales
Legal & General Direct (Holdings) Limited ¹	Dormant Company	England & Wales
Legal & General Estate Agencies Limited	Holding Company	England & Wales
Legal & General Insurance (FS) Limited ²	Insurance Company	England & Wales
Legal & General International (Holdings) Limited	Holding Company	England & Wales
Legal & General Investment Management Dormant (Holdings) Limited	Non-trading	England & Wales
Legal & General Pensions Limited	Insurance Company	England & Wales
Legal & General Professional Trust Services Limited	Insurance Company	England & Wales
Legal & General Retail (Holdings) Limited	Holding Company	England & Wales
Legal & General Shellco (No 1) Limited	Dormant Company	England & Wales
Nationwide Life Limited	Insurance Company	England & Wales
The Cavendish Land Company Limited	Investment Holding Company	England & Wales
Legal & General LL Feeder Company Jersey Limited	Property Company	Jersey
Legal & General Trustees Limited	Dormant Company	England & Wales
Held indirectly through subsidiary undertakings	Nature of business	Incorporated in
Banner International Holdings BV	Dormant Company	Netherlands
Banner Life Insurance Company Limited	Dormant Company	England & Wales
Bridge End Computers Limited	Dormant Company	England & Wales
Commercial International Life Company SAE ³	Life Insurance	Egypt
Glanfield Securities Limited	Non-trading	England & Wales
Infoplacement fr	Management Company	France
Key Consultants Mortgages Nationwide Limited	Non-trading	England & Wales
Key Mortgage & Property Limited	Leasehold Property	England & Wales
Key Surveyors Nationwide Limited	Non-trading	England & Wales
Legal & General Holdings (France)	Holding Company	France
Legal & General Asset Management (France)	Investment Company	France
Legal & General Bank (France)	Financial Services	France
Legal & General Deutschland Service-GmbH	Financial Services	Germany
Legal & General Direct Limited	Dormant Company	England & Wales
Legal & General Finance Europe BV	Dormant Company	Netherlands
Legal & General GI Computer Services Limited	Dormant Company	England & Wales
Legal & General Healthcare Limited	Dormant Company	England & Wales
Legal & General International Limited	Holding Company	England & Wales
Legal & General Investment Trust Limited	Non-trading	England & Wales
Legal & General Nederland Beleggingen B V	Financial Services	Netherlands
Legal & General Nederland Exploitatie Maatschappij B V	Real Estate	Netherlands
Legal & General Nederland Levensverzekering Maatschappij N V	Long term business	Netherlands
Legal & General Nederland Vastgoed Maatschappij B V	Real Estate	Netherlands
Legal & General Overseas Holdings B V	Holding Company	Netherlands
Legal & General Overseas Holdings Limited	Holding Company	England & Wales
Legal & General Retail (Holdings) Limited	Holding Company	England & Wales
Legal & General Shellco (No 1) Limited	Dormant Company	England & Wales
Legal & General Surveying Services Limited	Surveying Services	England & Wales
Legal and General (France) SA	Life Insurance	France
Legal et General Risques Divers (France)	Insurance Company	France
Southgate Associates Limited	Dormant Company	England & Wales
Tringham Housing Limited	Dormant Company	England & Wales
Legal & General Investment Trust Limited	Dormant Company	England & Wales
Winstanley 1 Limited	Holding Company	England & Wales
Winstanley 2 Limited	Property Company	England & Wales
Foxfield Estates Limited	Non-trading	England & Wales
Legal & General UK Property Income Fund Jersey Limited	Property Company	England & Wales

¹ Legal & General Direct (Holdings) Limited has both Ordinary 'A' and Ordinary 'B' shares in issue. All shares are held by Legal and General Assurance Society Limited.

² Legal & General Insurance Limited has both Ordinary and Preference shares in issue. All shares are held by Legal and General Assurance Society Limited.

³ Legal and General Assurance Society Limited has an indirect holding of 55% of the issued shares of Commercial International Life Company SAE.

Unless stated above, all subsidiaries are 100% owned and all have a 31 December financial year end.

35 Parent companies and fellow subsidiaries

The immediate parent company of Legal and General Assurance Society Limited is Legal & General Insurance Holdings Limited, a company incorporated in England and Wales. The ultimate holding company for both of those entities is Legal & General Group Plc. The results of Legal & General Assurance Society Limited are included in the Legal & General Group Plc's consolidated financial statements and therefore the Company does not prepare consolidated financial statements. These accounts therefore provide information about Legal & General Assurance Society Limited as an individual undertaking. Copies of the accounts of the ultimate holding company, Legal & General Group Plc, are available, at the Registered Office, One Coleman Street, London, EC2R 5AA, on the group website at www.legalandgeneralgroup.com or from the Company Secretary.

36 Investment vehicles

The Company has the following significant investment holdings which have been included as Investments designated as FVTPL.

Company name	Incorporated in	% equity shares held
English Cities Fund	England & Wales	37.5
Meteor Industrial Partnership	England & Wales	49.95
The Leisure Fund Unit Trust	England & Wales	24.6
The Warrington Retail Unit Trust	Jersey	50
Arlington Business Parks Unit Trust	Jersey	39.51
Bracknell Property Unit Trust	Jersey	50.38
Northampton Shopping Centre Unit Trust	Jersey	100
Central St Giles Unit Trust	Jersey	50
Ealing Shopping Centre Unit Trust	Jersey	100
Chineham Shopping Centre Unit Trust	Jersey	100
UK Logistics Unit Trust	Jersey	42.68
ARC Property Fund	Jersey	80
Gresham Street Unit Trust	Jersey	100
Bucklersbury House Unit Trust	Jersey	100
Performance Retail Unit Trust	Jersey	66.66
Legal & General Life Fund Limited Partnership	England & Wales	100
The Cavendish Land Company Limited	England and Wales	100
Saatchi&Satl Trustee Limited	Scotland	100

37 Share based payments

Legal & General Group Plc (the Group) grants share based payments to employees within the Group. The Group recognises an expense for these payments measured indirectly by reference to the fair value of the equity instruments granted. The expense is recognised over the vesting period as the services are received. The relevant company has recharged its share of this expense with reference to the benefits it receives from the employees. The full disclosures required by IFRS 2 are provided in the consolidated Group IFRS financial statements.

The total expense recharged to the Company in relation to share based payments was \$9.2m (2010: \$9.1m).

38 Directors' emoluments

	2011 \$'000	2010 \$'000
Short-term employee benefits	1,219	1,414
Social security costs	198	197
Post-employment benefits	169	168
Other long-term benefits	-	-
Termination benefits	-	-
Share-based incentive awards	1,048	1,098
Aggregate emoluments	2,634	2,877

38 Directors' emoluments (continued)

These figures represent the portion of the directors' emoluments allocated in respect of their services to the Company. No fees were paid by the Company to the directors. Directors are not employees of the Company but their services are reflected in a management charge levied by the parent. Emoluments relate to salaries and performance bonuses.

Retirement benefits are accruing to 6 directors under a defined benefit pension scheme. Two directors are members of a defined contribution pension scheme and the value of the apportioned company contribution in the year is £27,943 (2010: £22,176).

Share based incentive awards includes share options vested during the year. Comparative figures have been updated to reflect this additional disclosure.

Highest paid director

	2011 £'000	2010 £'000
Emoluments	878	797
Defined benefit pension scheme accrued at end of year*	27	25

* Accrued pension represents the amount of the annual pension that would be payable to the director when he reaches normal pension age.

Directors' emoluments for the Group during the year have been attributed to the Company on the basis of the time spent on Company business by each Director.

Directors' loans

At 31 December 2011 there were no loans to directors (2010: none).

Directors' transactions and arrangements

No director had any material interest in any contract or arrangement of significance in relation to the business of the Company during 2011.

39 Related party transactions**(i) Key management personnel**

Key management personnel represented by the members of the board of directors are listed on page 3. Director remuneration is discussed in detail in note 38.

(ii) Reinsurance

As at December 2011 the Company held a reinsurance asset of £26,430m with respect to reinsurance ceded to its subsidiary Legal & General Pensions Limited (2010: £23,386m) and of £1,512m (2010: \$938m) with respect to reinsurance ceded to an other related party Legal & General Assurance (Pensions Management) Limited.

The Company paid £2,872m (2010: £2,045m) of reinsurance premium, received £205m (2010: £165m) of reinsurance commission and received £1,676m (2010: £1,124m) in claims from Legal & General Pensions Limited on the business reinsured.

With regards to its transactions with Legal & General America Inc. a related party belonging to Legal & General Group PLC, the Company accepted £67m (2010: £103m) of reinsurance premium for reinsuring term life business, paid £18m in commission (2010: \$nil), received £11m (2010: \$nil) in investment income and paid £28m (2010: \$nil) in claims. A reinsurance liability of £148m (2010: £124m) is held to cover this business.

(iii) Investments in Group unit trusts

The Company held £4,605m (2010: £4,301m) in investments in unit trusts controlled and managed by Group companies that classify as other related parties. In 2011 the Company made a £533m loss (2010: £448m profit) from investing in those trusts.

(iv) Receivables

As at 31 December	2011 £m	2010 £m
From ultimate parent company	6	4
From subsidiaries		
- Legal & General Pensions Limited (incl. contingent loan)	224	596
- Other subsidiaries	57	54
From other related parties		
- Legal & General America Inc. - funds withheld balance on reinsurance	132	103
- Other related parties	103	50
Total	522	807

None of the receivables above are impaired. The company received £22m (2010: £11m) of interest income on the above receivables. The contingent loan is owed to the Company's Shareholder Fund (SHF) and is interest bearing at variable rate of LIBOR + 1%. The interest is accrued monthly but settled annually. The repayment of the contingent loan and related interest is subject to a surplus arising from the long term business of Legal & General Pensions Limited (LGPL). Where the surplus of LGPL is insufficient to cover the interest repayment in any year, the unpaid portion of the interest payment accrues to future years. The outstanding loan balance currently stands at £216m (2010: £581m).

39 Related party transactions (continued)**(v) Payables**

	2011	2010
As at 31 December	£m	£m
To immediate parent company (Legal & General Insurance Holdings Limited)	499	0
To ultimate parent company (Legal & General Group Plc treasury)	414	365
To subsidiaries		
- Legal & General Overseas Holdings Limited	298	298
- Legal & General Shellco (No 1) Limited	107	107
- Legal & General Pensions Limited	90	51
- Other subsidiaries	24	24
To other related parties		
- property investment vehicles	210	-
- other	64	35
Total	1,706	880

(vi) Other income and charges

	2011	2010
Income due from related parties	£m	£m
Income from other related parties		
- Legal & General Retail Investments (Holdings) Limited	43	41
Total income	43	41

	2011	2010
Charges due to related parties	£m	£m
Charges due to parent companies		
- Interest charges	0.3	0.3
Charges due to other related parties		
- Legal & General Investment Management (Holdings) Limited - investment management charges	61	61
- Legal & General Partnership Holdings Limited	57	44
- Legal & General America Inc. (mentioned under reinsurance)	18	-
- Interest charges	1.2	0.8
- other	7	7
Total charges	144.5	113.1

(vii) Dividends

The Company paid \$500m (2010: \$300m) in dividend to its parent company Legal & General Insurance Holdings Limited and received dividend from its subsidiaries - \$20m (2010: \$80m) from Nationwide Life Limited, \$42m (2010: \$13m) from Legal & General International (Holdings) Limited and \$25k (2010: \$21k) from Legal & General Insurance Limited.

(viii) Guarantees

The Company has guaranteed to meet the liabilities of the following entities as they fall due: Insurebeam Limited - up to \$19m (2010: \$19m); Key Consultants Mortgages Nationwide Limited - up to \$42k (2010: \$35k); Key Mortgage and Property Limited - up to \$4m (2010: \$4m) and Legal & General International (Holdings) Limited - up to \$166m (2010: \$166m).

40 Management of capital resources

The Company's total capital resources of £5.1 bn (2010: £5.7 bn) on an IFRS basis comprise equity holders capital £4.0 bn (2010: £4.3 bn) and unallocated divisible surplus £1.1 bn (2010: £1.4 bn).

The Company writes a range of long term insurance and investment business in the LTF. This fund is segregated from the Company's other assets. The fund includes participating (with-profits) business where policyholders and shareholders share in the risks and rewards and non-participating (non profit) business where the shareholders receive the profits. Capital in excess of an amount required to cover the liabilities is currently held both within and outside of the Company LTF. This capital provides support for new and existing non profit business within the Company.

Capital management policies and objectives

The Company aims to manage its capital resources to maintain financial strength, policyholder security and relative external financial strength ratings advantage. The Company also seeks to maximise its financial flexibility by maintaining strong liquidity and by utilising a range of alternative sources of capital including equity, senior debt and reinsurance.

Capital measures

The Company measures its capital on a number of different bases, including those which comply with the regulatory framework within which the Company operates and those which the directors consider most appropriate for managing the business. The measures used by the Company are:

- **Accounting bases**

Management use the primary financial statements prepared on an IFRS basis to manage capital and cash flow usage and to determine dividend paying capacity.

In addition, the directors believe that the supplementary accounts to the Legal & General Group Plc report and accounts, prepared using EEV principles, provide an alternative view of the Company's long-term operations and the value of the business to shareholders. Accordingly, the Company's net asset value and total capital employed are also analysed and measured on this basis and form part of the EEV Group accounts.

- **Regulatory bases**

The financial strength of the Company is measured under local regulatory requirements (see below). One of these regulatory measures, Individual Capital Assessment (ICA), measures capital using risk based techniques and provides a measure of economic capital.

Basis of regulatory capital and corresponding regulatory capital requirements

Required capital for the life business is based on the rules of the FSA. The Company must hold assets in excess of the higher of two amounts, the first being calculated using the FSA rules (Pillar 1), the second being an economic capital assessment by the Company which is reviewed by the FSA (Pillar 2, otherwise known as ICA).

The public Pillar 1 capital calculation is calculated by applying fixed percentages to liabilities and sums assured at risk. There are further stress tests for participating liabilities as measured in the Realistic Balance Sheet, which may increase the required capital. The private Pillar 2 capital calculation is an assessment of the economic capital required to ensure that the company can meet its liabilities with a high likelihood, as they fall due. This is achieved by stochastic modelling and scenario testing. The result is reviewed and may be modified by the FSA.

The Company has not breached any regulatory capital requirements at any time during the year.

Available regulatory capital resources

Capital resources available to meet the UK capital requirements are determined using FSA valuation rules. The asset valuation rules are based on IFRS, adjusted for both admissibility limits and specific valuation differences. The Company's regulatory capital position statement in the table below sets out the different sources of capital held within the Company. The Company's total available capital resources, based on the unaudited draft FSA returns, are £4.7 bn (2010: £4.9 bn) of which £1.7 bn (2010: £1.8 bn) is held by the LTF.

The total available capital resources of the Company's with-profits business of £0.7 bn (2010: £1.0 bn) are determined in accordance with the realistic balance sheet rules prescribed by the FSA. The capital resources reflect the surplus in that part of the fund which is in excess of any constructive obligation to policyholders. The liabilities within the consolidated balance sheet do not include the amount representing the shareholders' share of future bonuses. However, for capital reporting, the shareholders' share is deducted from capital resources in the capital statement.

At 31 December 2011, the realistic value of the UK participating liabilities was £13.6 bn (2010: £14.2 bn) under the FSA realistic capital regime. The excess of realistic assets over realistic liabilities was £0.7 bn (2010: £1.0 bn).

1 The FSA returns are audited and filed subsequent to the finalisation of these financial statements.

40 Management of capital resources (continued)

Table 1 - Regulatory capital position statement

As at 31 December 2011	UK with- profits £m	UK non profit and SRC ¹ £m	Total life £m	Share- holders equity £m	Total £m
Ordinary shareholders' equity outside the LTF	-	-	-	2 532	2 532
Ordinary shareholders' equity held in the LTF	-	1 441	1 441	-	1 441
Capital and reserves attributable to ordinary equity holders of the Company	-	1 441	1 441	2,532	3 973
Adjustments onto regulatory basis					
Unallocated divisible surplus	1 091	-	1 091	-	1 091
Other	(345)	(501)	(846)	467	(379)
Total available capital resources	746	940	1 686	2 999	4 685
IFRS liability analysis					
UK participating liabilities on realistic basis					
- Options and guarantees	1 153	-	1 153	-	1 153
- Other policyholder obligations	12 418	23	12 441	-	12 441
Overseas participating liabilities	-	-	-	-	-
Unallocated divisible surplus	1 091	-	1 091	-	1 091
Value of in-force non-participating contracts	(205)	-	(205)	-	(205)
Participating contract liabilities	14 457	23	14 480	-	14,480
Unit linked non-participating life assurance liabilities	506	477	983	-	983
Non-linked non-participating life assurance liabilities	2 102	27,936	30,038	-	30 038
Unit linked non-participating investment contract liabilities	8 044	17 139	25 183	-	25,183
General insurance liabilities	-	-	-	3	3
Non-participating contract liabilities	10 652	45 552	56 204	3	56 207

As at 31 December 2010	UK with- profits £m	UK non profit and SRC ¹ £m	Total life £m	Share- holders equity £m	Total £m
Ordinary shareholders' equity outside the LTF	-	-	-	2 824	2 824
Ordinary shareholders' equity held in the LTF	-	1 352	1 352	-	1 352
Capital and reserves attributable to equity holders of the Company	-	1 352	1 352	2 824	4 176
Adjustments onto regulatory basis					
Unallocated divisible surplus	1,446	-	1 446	-	1 446
Other	(493)	(507)	(1 000)	247	(753)
Total available capital resources	953	845	1 798	3 071	4 869
IFRS liability analysis					
UK participating liabilities on realistic basis					
- Options and guarantees	768	-	768	-	768
- Other policyholder obligations	13 491	28	13 519	-	13 519
Overseas participating liabilities	-	-	-	-	-
Unallocated divisible surplus	1 446	-	1 446	-	1 446
Value of in-force non-participating contracts	(337)	-	(337)	-	(337)
Participating contract liabilities	15 368	28	15 396	-	15 396
Unit linked non-participating life assurance liabilities	602	7 359	7 961	-	7 961
Non-linked non-participating life assurance liabilities	2 024	18 108	20 132	-	20 132
Unit linked non-participating investment contract liabilities	8 677	17 214	25 891	-	25 891
General insurance liabilities	-	-	-	3	3
Non-participating contract liabilities	11,303	42 681	53 984	3	53 987

40 Management of capital resources (continued)**Available regulatory capital resource risks**

The Company's available capital resources are sensitive to change in market conditions due to both changes in the value of the assets and to the effect that changes in investment conditions may have on the value of the liabilities. Capital resources are also sensitive to assumptions and experience relating to mortality and morbidity and to a lesser extent expenses and persistency.

The most significant sensitivities arise from the following four risks:

(i) market risk in relation to UK participating business which would crystallise if adverse changes in the value of the assets supporting this business could not be fully reflected in payments to policyholders because of the effect of guarantees and options. The capital position of this business would also deteriorate if increases to the market cost of derivatives resulted in an increase in the liability for guarantees and options in the realistic balance sheet.

(ii) market risk in relation to the UK annuity business which would crystallise if the return from the fixed interest investments supporting this business were lower than that assumed for reserving. The majority of the UK annuity business is reassured to Legal & General Pensions Limited.

(iii) mortality risk in relation to the UK annuity business which would crystallise if the mortality of annuitants improved more rapidly than the assumptions used for reserving.

(iv) mortality risk in relation to UK term assurance business which would crystallise if mortality of the lives insured was higher than that assumed possibly because of an epidemic.

Movements in life business regulatory capital resources

The movement in the life business regulatory capital resources is shown in Table 2.

Table 2 - Movements in life business regulatory capital resources

	UK with profits £m	UK non profit and SRC £m	Total Life £m	Share holders Equity £m	Total Life £m
As at 1 January 2011	953	845	1 798	3 071	4 869
Effect of investment variations	(88)	36	(52)	-	(52)
Effect of changes in valuation assumptions	5	43	48	-	48
Changes in management policy	(4)	-	(4)	-	(4)
New business	(17)	(76)	(93)	-	(93)
Cash distributions	-	(190)	(190)	190	-
Other factors ¹	(103)	282	179	(262)	(83)
As at 31 December 2011	746	940	1 686	2 999	4 685
	UK with- profits £m	UK non profit and SRC £m	Total Life £m	Share- holders Equity £m	Total Life £m
As at 1 January 2010	841	688	1 529	2 768	4 297
Effect of investment variations	210	76	286	-	286
Effect of changes in valuation assumptions	(41)	58	17	-	17
Changes in regulatory requirements	-	-	-	-	-
New business	(17)	(77)	(94)	-	(94)
Cash distributions	-	(150)	(150)	150	-
Other factors ¹	(40)	250	210	153	363
As at 31 December 2010	953	845	1 798	3 071	4,869

¹Other factors in Shareholders' equity include movement in subsidiaries valuation (FSA NBV basis) £206m (2010: £214m), payment of dividend (£500m) (2010: £300m), movement in inadmissible assets and valuation differences £nil (2010: £21m) and net movement in profit and loss account £34m (2010: £218m).

41 Assets analysis

The Company has categorised its assets and liabilities in the following disclosure in accordance with the level of shareholder exposure to market and credit risks. The four categorisations presented are:

- **Unit linked**

For unit linked contracts, there is a direct link between the investments and the obligations. Unit linked business is written in both the Company's LTF. The financial risk on these contracts is borne by the policyholders. The Company is therefore not directly exposed to any market risk, currency risk or credit risk for these contracts. Detailed risk disclosures have not been presented for unit linked assets and liabilities.

- **With-profits**

Policyholders and shareholders share in the risks and returns of the with-profits part of the Company's LTF. The return to shareholders on virtually all participating products is in the form of a transfer to shareholders' equity, which is analogous to a dividend from the Company's LTF and is dependent upon the bonuses credited or declared on policies in that year. The bonuses are broadly based on historic and current rates of return on equity, property and fixed income securities, as well as expectations of future investment returns. With-profits also includes participating business in the France operation which shares similar characteristics. The with-profits classification excludes unit linked contracts.

- **Non profit non-unit linked**

Shareholders are exposed to the risk and rewards of ownership of assets backing non profit non-unit linked business held within UK LTFs.

- **Shareholder**

All other assets are classified as shareholder assets. Shareholders of the Company are directly exposed to market and credit risk on these assets.

The table below presents an analysis of the balance sheet by category. All of the quantitative risk disclosures in Note 41 (Risk management and control) have been provided using this categorisation.

As at 31 December 2011	Shareholder £m	Non profit non unit linked £m	With- profits £m	Unit linked £m	Total £m
Assets					
Investment in subsidiaries	1 558	48	-	-	1 606
Purchased interest in long term businesses and other intangible assets	3	3	-	-	6
Plant and equipment	36	-	-	-	36
Investments	2 706	28	16 819	24 229	43 782
Other operational assets ¹	34	29 655	231	2,019	31 939
Total assets	4,337	29,734	17 050	26 248	77 369
Liabilities					
Participating contract liabilities	-	23	14 457	-	14 480
Non-participating contract liabilities	3	27 942	2 102	26 159	56 206
Senior borrowings	-	-	8	-	8
Other liabilities	194	1 958	463	87	2 702
Total liabilities	197	29,923	17,030	26 246	73 396

As at 31 December 2010	Shareholder £m	Non profit non unit linked £m	With- profits £m	Unit linked £m	Total £m
Assets					
Investment in subsidiaries	1 574	48	-	-	1 622
Purchased interest in long term businesses and other intangible assets	3	-	-	-	3
Plant and equipment	28	-	-	-	28
Investments	1 963	30	17 544	25 818	45 355
Other operational assets ¹	26	26 905	262	1 365	28 558
Total assets	3 594	26 983	17 806	27 183	75 566
Liabilities					
Participating contract liabilities	-	28	15 368	-	15 396
Non-participating contract liabilities	2	24 945	2 063	26 977	53 987
Senior borrowings	-	-	8	-	8
Other liabilities	207	1 171	523	98	1 999
Total liabilities	209	26 144	17 962	27 075	71 390

¹ Other operational assets is made up of mainly reinsurance assets.

42 Risk management and control

This section describes the Company's approach to risk management. It covers the overall approach that applies to all risks and includes a detailed review of risks within the Company's key businesses.

Risk management objectives

The Company's primary objective in undertaking risk management activity is to manage risk exposures in line with risk appetite, minimising its exposure to unexpected financial loss and limiting the potential for deviation from anticipated outcomes. In this respect, a framework of limits and qualitative statements, aligned with the Company's risk appetite, is in place for material exposures.

Risk management approach

A significant part of the Company's business involves the acceptance and management of risk. The Company is exposed to insurance, market, credit, liquidity and operational risks and operates a formal risk management framework to ensure that all significant risks are identified and managed. The risk factors mentioned below should not be regarded as a complete and comprehensive statement of all potential risks and uncertainties.

Insurance risk: exposure to loss arising from claims experience being different to that anticipated.

Market risk: exposure to loss as a direct or indirect result of fluctuations in the value of, or income from, specific assets.

Credit risk: exposure to loss if another party fails to perform its financial obligations to the Company.

Liquidity risk: the risk that the Company, though solvent, either does not have sufficient financial resources available to enable it to meet its obligations as they fall due, or can secure them only at excessive cost.

Operational risk: exposure to loss arising from inadequate or failed internal processes, people, systems, or from external events.

Management of risks

The Company seeks to manage its exposures to risk through control techniques which ensure that the residual risk exposures are within acceptable tolerances agreed by the Board. The key control techniques for the major categories of risk exposure are summarised in the following sections.

Insurance risk

Insurance risk is implicit in the Company's insurance business and arises as a consequence of the type and volume of business written and the concentration of risk in particular policies or groups of policies subject to the same risks. A detailed review of the Company's inherent residual risks associated with insurance products is included within the long term insurance risks section of note 42. Insurance risk is managed using the following techniques:

Policies and delegated authorities for underwriting, pricing and reinsurance

The Company's insurance risk policy sets out the overall framework for the management of insurance risk. As part of the framework, a structure of delegated pricing and underwriting authorities is in place. Pricing is based on assumptions, such as mortality and persistency, which have regard to past experience and to trends. Insurance exposures are limited through reinsurance. Overall, the Company seeks to be conservative in its acceptance of insurance risks by establishing strict underwriting criteria and limits. The underwriting policy is clearly documented, setting out risks which are unacceptable and the terms applicable for non-standard risks.

Reinsurance is used to reduce potential loss to the Company from individual large risks. It may also be used to manage capital or to provide access to specialist underwriting expertise. The Company makes extensive use of reinsurance for its individual protection business, placing a proportion of all risks meeting prescribed criteria.

Reserving Policy

The Company has a documented reserving policy setting out the basis on which the liabilities are to be determined using statistical analysis and actuarial experience. Policies are in line with locally established actuarial techniques, relevant regulation and legislation. Further details of the assumption setting process are included in note 28.

42 Risk management and control (continued)**Market risk**

The Company exposure to market risk is influenced by one or more external factors including changes in specified interest rates financial instrument prices foreign exchange rates and indices of prices or rates

Significant areas where the Company is exposed to these risks are

- assets backing insurance and investment contracts other than unit linked contracts
- assets and liabilities denominated in foreign currencies and
- other financial assets and liabilities

The Company's market risk policy sets out the overall framework for the management of market risk. The policy is reinforced by more granular investment policies for long term and other business which have due regard to the nature of liabilities and guarantees and other embedded options given to policyholders

The Company manages market risk using the following methods

Asset liability matching

The Company manages its assets and liabilities in accordance with relevant regulatory requirements reflecting the differing types of liabilities it has in each business

For business such as immediate annuities which is sensitive to interest rate risk analysis of the liabilities is undertaken to create a portfolio of securities the value of which changes in line with the value of liabilities when interest rates change. This type of analysis helps protect profits from changing interest rates. Interest rate risk cannot be completely eliminated due to the nature of the liabilities and early redemption options contained in the assets

For businesses where a range of asset types including equity and property are held to meet liabilities the Company uses stochastic models to assess the impact of a range of future return scenarios on investment values and associated liabilities. This allows the Company to devise an investment and with-profits policyholder bonus strategy which optimises returns to its policyholders over time whilst limiting the capital requirements associated with these businesses. The Company uses this method extensively in connection with its with-profits business

Derivatives

The Company uses derivatives to reduce market risk. The most widely used derivatives are exchange-traded equity futures and swaps. The Company may use futures to facilitate efficient asset allocation. In addition derivatives are used to improve asset liability matching and to manage interest rate foreign exchange and inflation risks. It is the Company's policy that amounts at risk through derivative transactions are covered by cash or corresponding assets and that swaps are collateralised to reduce counterparty exposure

Interest rate risk

Interest rate risk is the risk that the Company is exposed to lower returns or loss as a direct or indirect result of fluctuations in the value of or income from specific assets and liabilities arising from changes in underlying interest rates

The Company is exposed to interest rate risk on the investment portfolio it maintains to meet the obligations and commitments under its non-linked insurance and investment contracts. In that the proceeds from the assets may not be sufficient to meet the Company's obligations to policyholders

To mitigate the risk that guarantees and commitments are not met the Company purchases financial instruments which broadly match the expected non-participating policy benefits payable by their nature and term. The composition of the investment portfolio is governed by the nature of the insurance or savings liabilities the expected rate of return applicable on each class of asset and the capital available to meet the price fluctuations for each asset class relative to the liabilities they support

Asset liability matching significantly reduces the Company's exposure to interest rate risk. Sensitivity to interest rate changes is included in Tables 6 of Note 42

Inflation risk

Inflation risk is the potential for loss as a result of relative or absolute changes in inflation rates. The Company is exposed to inflation risk in two specific areas

- Certain non-linked contracts such as annuities may provide for future benefits to be paid taking account of changes in the level of inflation. Contracts in payment may also include an annual adjustment for movements in price indices subject to an annual cap. The Company seeks to manage the risk of movements in price indices through an appropriate investment strategy including the use of inflation swaps and
- In writing long term business the Company makes assumptions regarding the future costs of product servicing. The assumptions take account of changes in price indices and the costs of employment with stress testing evaluating the effect of significant deviations on the Company's capital position

Currency risk

The Company is potentially exposed to loss as a result of fluctuations in the value of or income from assets denominated in foreign currencies. The Company manages its currency risk exposure in respect of long term business assets and liabilities denominated in non sterling currencies by backing obligations with investments in the same currency and through hedging using derivatives

The Company is not directly exposed to risks on unit linked contracts. Detailed risk disclosures have not been presented for unit linked assets and liabilities

42 Risk management and control (continued)**Table 1 - Currency risk**

Table 1 summarises the Company's exposure to foreign currency exchange risk in sterling

As at 31 December 2011						
Shareholder	Euro £m	US Dollar £m	Japanese Yen £m	Other £m	Sterling £m	Carrying value £m
Assets						
Investment in subsidiaries	-	-	-	-	1,558	1,558
Purchased interest in long term businesses and other intangible assets	-	-	-	-	3	3
Plant and equipment	-	-	-	-	36	36
Investments	37	510	43	31	2,085	2,706
Other operational assets	2	8	-	1	23	34
Total assets	39	518	43	32	3,705	4,337
Liabilities						
Non-participating contract liabilities	-	-	-	-	4	4
Other liabilities	-	402	-	-	(208)	194
Total liabilities	-	402	-	-	(204)	198
Non profit non-unit linked						
Assets						
Investment in subsidiaries	-	-	-	-	48	48
Purchased interest in long term businesses and other intangible assets	-	-	-	-	3	3
Investments	-	-	-	-	28	28
Other operational assets	-	-	-	-	29,655	29,655
Total assets	-	-	-	-	29,734	29,734
Liabilities						
Participating contract liabilities	-	-	-	-	23	23
Non-participating contract liabilities	-	-	-	-	27,942	27,942
Other liabilities	-	-	-	-	1,958	1,958
Total liabilities	-	-	-	-	29,923	29,923
With-profits						
Assets						
Investments	318	1,029	411	823	14,238	16,819
Other operational assets	-	7	-	3	221	231
Total assets	318	1,036	411	826	14,459	17,050
Liabilities						
Participating contract liabilities	-	-	-	-	14,458	14,458
Non-participating contract liabilities	-	-	-	-	2,102	2,102
Senior borrowings	-	-	-	-	8	8
Other liabilities	(17)	300	2	3	174	462
Total liabilities	(17)	300	2	3	16,742	17,030

42 Risk management and control (continued)

Table 1 - Currency risk (continued)

As at 31 December 2010

Shareholder	Euro £m	US Dollar £m	Japanese Yen £m	Other £m	Sterling £m	Carrying value £m
Assets						
Purchased interest in long term businesses and other intangible assets	-	-	-	-	3	3
Investment in subsidiaries	-	-	-	-	1 574	1 574
Plant and equipment	-	-	-	-	28	28
Investments	30	97	-	37	1 799	1 963
Other operational assets	2	-	-	(8)	32	26
Total assets	32	97	-	29	3 436	3 594
Liabilities						
Non-participating contract liabilities	-	-	-	-	2	2
Other liabilities	15	-	-	-	192	207
Total liabilities	15	-	-	-	194	209
Non profit non-unit linked						
Assets						
Investment in subsidiaries	-	-	-	-	48	48
Investments	-	-	-	-	30	30
Other operational assets	-	-	-	-	26 905	26 905
Total assets	-	-	-	-	26 983	26 983
Liabilities						
Participating contract liabilities	-	-	-	-	28	28
Non-participating contract liabilities	-	-	-	-	24 945	24 945
Other liabilities	-	-	-	-	1 171	1 171
Total liabilities	-	-	-	-	26 144	26 144
With-profits						
Assets						
Investments	1 626	914	505	797	13 702	17 544
Other operational assets	-	3	-	-	259	262
Total assets	1 626	917	505	797	13 961	17 806
Liabilities						
Participating contract liabilities	-	-	-	-	15,368	15 368
Non-participating contract liabilities	-	-	-	-	2 063	2 063
Senior borrowings	-	-	-	-	8	8
Other liabilities	650	204	-	-	(331)	523
Total liabilities	650	204	-	-	17 108	17 962

42 Risk management and control (continued)

The Company's management of currency risk reduces shareholders' exposure to exchange rate fluctuations. The Company's exposure to a 10% exchange movement in the US Dollar and Euro on an IFRS basis, net of hedging activities, is detailed in Table 2.

Table 2 – Currency sensitivity analysis

Currency sensitivity test	Impact on equity 2011 £m	Impact on equity 2010 £m
10% Euro appreciation	3	1
10% US Dollar appreciation	8	1

Other price risk

Other price risk is the risk that the fair value of future cash flows of a financial instrument will fluctuate because of changes in market prices other than those arising from interest rate risk or currency risk. These changes may be as a result of features of the individual instrument, its issuer, or factors affecting all similar financial instruments traded in the market.

The Company controls its exposure to geographic price risks by using internal country credit ratings. These ratings are based on macroeconomic data and key qualitative indicators. The latter take into account economic, social and political environments. Table 3 indicates the Company's exposure to different equity markets around the world. Unit-linked equity investments are excluded from the table as the risk is retained by the policyholder.

Table 3 – Exposure to worldwide equity markets

	Shareholder 2011 £m	Non profit non-unit linked 2011 £m	With- profits 2011 £m	Total 2011 £m	Shareholder 2010 £m	Non profit non-unit linked 2010 £m	With- profits 2010 £m	Total 2010 £m
UK	454	-	1,387	1,841	422	-	2,199	2,621
North America	-	-	745	745	-	-	422	422
Europe	24	-	515	539	25	-	688	713
Japan	-	-	402	402	-	-	492	492
Asia Pacific	30	-	566	596	26	-	448	474
Other	-	-	39	39	11	-	144	155
Listed equities	508	-	3,654	4,162	484	-	4,393	4,877
Unlisted UK equities	91	-	1,011	1,102	89	-	1,009	1,098
Holdings in unit trusts	982	1	1,166	2,149	499	-	1,173	1,672
Total equities	1,581	1	5,831	7,413	1,072	-	6,575	7,647

The Company holds non-unit-linked property investments totalling £132m (2010: £139m) of which £132m (2010: £132m) are located in the UK.

Credit risk

The Company's credit risk policy defines the overall framework for the management of credit risk. Significant areas where the Company is exposed to credit risk are:

- The Company holds corporate bonds to back part of its insurance liabilities. Significant exposures are managed by the application and regular review of concentration limits, with allowance being made in the actuarial valuation of the insurance liabilities for possible defaults, and
- The Company limits its exposure to insurance risk by ceding part of the risks it assumes to the reinsurance market. To limit the risk of reinsurer default, the Company operates a credit rating policy when arranging cover. When selecting new reinsurance partners, the Company considers only companies which have a minimum credit rating equivalent to A- from Standard & Poor's. Exposure limits for new and existing reinsurers are determined based on credit ratings and projected exposure. Aggregate counterparty exposures are regularly monitored at Company level.

The credit profile of the Company's assets exposed to credit risk is shown in Table 4. The credit rating bands are provided by independent rating agencies. For unrated assets, the Company maintains internal ratings which are used to manage exposure to these counterparties. Unit-linked assets have not been included as shareholders are not directly exposed to risk.

The carrying amount of non-unit-linked assets included in the balance sheet represents the maximum credit exposure. No impairment provisions have been made.

42 Risk management and control (continued)

Table 4 - Exposure to credit risk

As at 31 December 2011	Notes	AAA \$m	AA \$m	A \$m	BBB \$m	BB and below \$m	Unrated other \$m	Total \$m
Shareholder								
Government securities		238	-	-	-	-	-	238
Other fixed rate securities		124	141	240	101	2	-	608
Variable rate securities		-	-	1	-	-	-	1
Total debt securities		362	141	241	101	2	-	847
Accrued interest		3	1	3	3	-	-	10
Derivative assets	17	-	-	3	-	-	-	3
Cash and cash equivalents	22	88	55	32	-	-	80	255
Financial assets		453	197	279	104	2	80	1,115
Other assets	21	-	18	-	-	-	16	34
		453	215	279	104	2	96	1,149
<hr/>								
Non profit non-unit linked								
Other fixed rate securities		1	1	-	-	-	-	2
Total debt securities		1	1	-	-	-	-	2
Derivative assets	16	-	-	-	-	1	-	1
Cash and cash equivalents	21	1	3	20	-	-	-	24
Financial assets		2	4	20	-	1	-	27
Reinsurers' share of contract liabilities	17	-	1,236	393	-	-	26,582	28,211
Other assets	21	4	-	-	-	-	661	665
		6	1,240	413	-	1	27,243	28,903
<hr/>								
With-profits								
Government securities		1,825	4	1	-	-	1	1,831
Other fixed rate securities		2,772	1,124	2,007	1,761	125	203	7,992
Variable rate securities		-	-	19	5	-	5	29
Total debt securities		4,597	1,128	2,027	1,766	125	209	9,852
Accrued interest		64	20	44	43	1	2	174
Loans and receivables	16(ii)	-	-	-	-	-	1	1
Derivative assets	17	-	10	155	-	-	-	165
Cash and cash equivalents	22	348	287	39	-	-	-	674
Financial assets		5,009	1,445	2,265	1,809	126	212	10,866
Reinsurers' share of contract liabilities	18	-	1	-	-	-	12	13
Other assets	21	-	-	-	-	-	100	100
		5,009	1,446	2,265	1,809	126	324	10,979

At the year end the Company held £62m (2010: £793m) of collateral in respect of non-unit linked derivative assets

42 Risk management and control (continued)

Table 4 - Exposure to credit risk (continued)

As at 31 December 2010	Notes	AAA £m	AA £m	A £m	BBB £m	BB and below £m	Unrated other £m	Total £m
Shareholder								
Government securities		222	-	-	-	-	-	222
Other fixed rate securities		33	23	103	60	22	2	243
Variable rate securities		7	2	2	-	-	-	11
Total debt securities		262	25	105	60	22	2	476
Accrued interest		3	-	2	2	-	-	7
Loans and receivables	16(ii)	-	6	6	-	-	-	12
Derivative assets	17	-	4	3	-	-	-	7
Cash and cash equivalents	22	-	46	333	-	-	-	379
Financial assets		265	81	449	62	22	2	881
Other assets	21	-	20	-	-	-	7	27
		265	101	449	62	22	9	908
Non profit non-unit linked								
Other fixed rate securities		-	1	-	-	-	-	1
Total debt securities		-	1	-	-	-	-	1
Cash and cash equivalents	22	2	7	19	-	-	-	28
Financial assets		2	8	19	-	-	-	29
Reinsurers share of contract liabilities	18	-	770	859	-	-	23 546	25 175
Other assets	21	3	-	-	-	-	928	931
		5	778	878	-	-	24 474	26 135
With-profits								
Government securities		1 667	5	-	-	-	1	1 673
Other fixed rate securities		2 803	1 098	2 290	1 270	140	373	7 974
Variable rate securities		47	12	25	4	-	5	93
Total debt securities		4 517	1 115	2 315	1 274	140	379	9 740
Accrued interest		68	19	56	29	1	4	177
Loans and receivables	16(ii)	-	40	48	-	-	1	89
Derivative assets	17	-	6	49	-	-	29	84
Cash and cash equivalents	22	278	299	180	-	-	1	758
Financial assets		4 863	1 479	2 648	1 303	141	414	10 848
Reinsurers share of contract liabilities	18	-	-	2	-	-	-	2
Other assets	21	-	-	-	-	-	122	122
		4 863	1 479	2 650	1 303	141	536	10 972

42 Risk management and control (continued)

Table 5 provides information regarding the carrying value of financial assets which have been impaired and the ageing analysis of financial assets which are past due but not impaired. Unit linked assets have not been included as shareholders are not exposed to the risks from unit linked policies.

Table 5 - Ageing of financial assets that are past due but not impaired

As at 31 December 2011	Notes	Neither past due nor impaired £m	Financial assets that are past due but not impaired				Financial assets that have been impaired £m	Carrying value £m
			0-3 months £m	3-6 months £m	6 months-1 year £m	Over 1 year £m		
Shareholder								
Government securities		238	-	-	-	-	-	238
Other fixed rate securities ¹		608	-	-	-	-	-	608
Variable rate securities		2	-	-	-	-	-	2
Total debt securities		848	-	-	-	-	-	848
Accrued interest		10	-	-	-	-	-	10
Loans and receivables	16(ii)	-	-	-	-	-	-	-
Derivative assets	17	3	-	-	-	-	-	3
Cash equivalents	22	131	-	-	-	-	-	131
Financial assets		992	-	-	-	-	-	992
Other assets	21	34	-	-	-	-	-	34
		1 026	-	-	-	-	-	1 026
Non profit non-unit linked								
Other fixed rate securities		2	-	-	-	-	-	2
Total debt securities		2	-	-	-	-	-	2
Derivative assets	17	1	-	-	-	-	-	1
Cash equivalents	22	2	-	-	-	-	-	2
Financial assets		5	-	-	-	-	-	5
Reinsurers share of contract liabilities	18	28 212	-	-	-	-	-	28 212
Other assets	21	542	105	8	2	8	-	665
		28 759	105	8	2	8	-	28 882
With-profits								
Government securities		1,831	-	-	-	-	-	1 831
Other fixed rate securities		7 992	-	-	-	-	-	7 992
Variable rate securities		28	-	-	-	-	-	28
Total debt securities		9,851	-	-	-	-	-	9 851
Accrued interest		174	-	-	-	-	-	174
Loans and receivables	16(ii)	1	-	-	-	-	-	1
Derivative assets	17	164	-	-	-	-	-	164
Cash equivalents	22	622	-	-	-	-	-	622
Financial assets		10 812	-	-	-	-	-	10 812
Reinsurers share of contract liabilities	18	12	-	-	-	-	-	12
Other assets	21	84	16	-	-	-	-	100
		10 908	16	-	-	-	-	10 924

42 Risk management and control (continued)

Table 5 - Ageing of financial assets that are past due but not impaired (continued)

As at 31 December 2010	Notes	Neither past due nor impaired £m	Financial assets that are past due but not impaired				Financial assets that have been impaired £m	Carrying value £m
			0-3 months £m	3-6 months £m	6 months-1 year £m	Over 1 year £m		
Shareholder								
Government securities		222	-	-	-	-	-	222
Other fixed rate securities		243	-	-	-	-	-	243
Variable rate securities		11	-	-	-	-	-	11
Total debt securities		476	-	-	-	-	-	476
Accrued interest		7	-	-	-	-	-	7
Loans and receivables	16(ii)	11	-	-	-	-	-	11
Derivative assets	17	7	-	-	-	-	-	7
Cash equivalents	22	95	-	-	-	-	-	95
Financial assets		596	-	-	-	-	-	596
Reinsurers' share of contract liabilities	18	-	-	-	-	-	-	-
Other assets	21	27	-	-	-	-	-	27
		623	-	-	-	-	-	623
Non profit non-linked								
Government securities		-	-	-	-	-	-	-
Other fixed rate securities		1	-	-	-	-	-	1
Variable rate securities ¹		-	-	-	-	-	-	-
Total debt securities		1	-	-	-	-	-	1
Accrued interest		-	-	-	-	-	-	-
Loans and receivables	16(ii)	-	-	-	-	-	-	-
Derivative assets	17	-	-	-	-	-	-	-
Cash equivalents	22	2	-	-	-	-	-	2
Financial assets		3	-	-	-	-	-	3
Reinsurers' share of contract liabilities	18	25 175	-	-	-	-	-	25 175
Other assets	21	931	-	-	-	-	-	931
		26 109	-	-	-	-	-	26 109
With-profits								
Government securities		1 673	-	-	-	-	-	1 673
Other fixed rate securities		7 974	-	-	-	-	-	7 974
Variable rate securities		93	-	-	-	-	-	93
Total debt securities		9 740	-	-	-	-	-	9 740
Accrued interest		177	-	-	-	-	-	177
Loans and receivables	16(ii)	89	-	-	-	-	-	89
Derivative assets	17	84	-	-	-	-	-	84
Cash equivalents	22	700	-	-	-	-	-	700
Financial assets		10 790	-	-	-	-	-	10 790
Reinsurers' share of contract liabilities	18	2	-	-	-	-	-	2
Other assets	21	122	-	-	-	-	-	122
		10 914	-	-	-	-	-	10 914

Liquidity risk

The Company's liquidity risk policy defines the framework for the management of liquidity risk. The Company does not seek exposure to liquidity risk in its own right, but recognises that exposure to liquidity risk can arise as a consequence of the markets in which it operates, the products that it writes and through the execution of investment management strategies.

The liquidity risks to which Legal & General Assurance Society may be exposed primarily stem from low probability events that if not adequately planned for may result in unanticipated liquidity requirements. Such events may include a flu pandemic or natural disaster leading to significantly higher levels of claims than would normally be expected and extreme market conditions impacting the timing of cash flows or the ability to realise investments at a given value within a specified timeframe. Collateral requirements for derivative/futures transactions and other types of financial instrument can also give rise to liquidity risk if sufficient cash or suitable alternative assets are not available to meet collateral calls when due.

42 Risk management and control (continued)

A limited level of contingent liquidity risk is an accepted element of writing contracts of insurance. However, the Company's insurance businesses seek to maintain sufficient liquid assets and standby facilities to meet a prudent estimate of the cash outflows that may arise from contingent events. The level of required liquidity to be maintained by insurance funds is identified using techniques including cash flow analysis for ranges of extreme scenarios and stress tests for shock events.

To ensure an appropriate pool of liquid assets are maintained in line with a prudent estimate of cash outflows, the profile of investment assets held to meet future liabilities from writing insurance business are structured to include an appropriate proportion of cash and other readily realisable assets. The required profile is formally defined as part of asset benchmarks provided to the investment managers, with regular management information provided by the investment manager on the actual holding relative to the fund benchmarks. The level of insurance funds held in cash and other readily realisable assets at 31 December 2011 was £279m (2010: £407m).

In addition to each insurance fund maintaining a pool of liquid assets, the Group's Treasury function provides formal facilities to the Group's operating subsidiaries to cover contingent liquidity requirements arising from more extreme events and where investment assets may not be readily realisable. The facility available to each subsidiary is determined through analysis of potential shock events and the potential timing differences that may arise in cash flows.

Specific liquidity risks associated with the Company's core product lines and the risk mitigation techniques are as follows:

Protection Potential for liquidity risk within the Company's protection businesses may arise should the rate of claims diverge significantly from that anticipated, typically as a consequence of an extreme event.

The risk of being unable to settle claims as they fall due is actively managed with provision being made and cash pools maintained within investment portfolios for a prudent estimate of the potential claims that may arise from in-force business, taking account of extreme events. Such provisions are validated using stress tests. The use of reinsurance also acts to mitigate liquidity, the effect of the treaties being to limit the Company's liability for the overall sums assured, with a recovery being made from the reinsurance counterparty for that element of the claim covered by the treaty. Whilst timing differences can arise between the payment of claims and reimbursement by reinsurance counterparties, the Company seeks to ensure that these are accommodated from cash pools.

With-profits Exposure to liquidity risk may arise if the profile of investment assets held to meet obligations to with-profits policyholders is not aligned with the maturity profile of policies, or the profile does not adequately take account of the rights of policyholders to exercise options or guarantees to specified early surrender terms or minimum rates of return.

Liquidity risk associated with with-profits business is managed through the analysis of the maturity profile of the fund, taking account of projected future levels of bonus, policyholders' reasonable expectations and projected early withdrawals, and ensuring that an appropriate proportion of the fund is held in cash or other readily realisable assets to meet each tranche of maturities and anticipated early withdrawals as they fall due. Where policyholders have discretion to require early payment of policy proceeds (for example by requesting a surrender value), appropriate contractual safeguards are in place to ensure that the fund and remaining policyholders are not disadvantaged should a material number of policyholders exercise this discretion.

Unit linked business Investment risks associated with unit linked business, including those associated with liquidity, are generally borne by the holders of units in these funds. Liquidity risk specifically arises for unit holders in that certain asset classes in which the funds invest, such as property, in certain market conditions may not be readily realisable or only realisable in a specified timeframe at a diminution of value. Liquidity risks associated with these asset classes are documented and communicated to customers in point of sale product literature. Product terms & conditions also highlight that for certain product types that include asset classes that may be illiquid, the Group retains the right to defer the processing of fund withdrawal requests for up to six months, should underlying assets need to be realised to meet payment requests. To minimise the need to invoke these terms, the funds seek to maintain sufficient holdings in cash assets to meet foreseeable withdrawal activity.

Annuities Potential for liquidity risk arises within two specific aspects of the annuity business – (i) changes in future pension commitments and (ii) collateral requirements for risk hedging strategies. The Company is not exposed to those risks as the annuity business is reinsured to Legal and General Pensions Limited.

Please also refer to notes 24 & 25 which disclose the expected insurance / investment contract liability cashflows.

42 Risk management and control (continued)**Operational risk**

All business managers are required to confirm regularly the adequacy of controls over operational risks to business unit Risk and Compliance Committees (RCCs). Significant control issues which business areas identify are escalated to business unit RCCs which oversee their resolution. There are a number of categories under which operational risk and its management across the Company can be considered and these are outlined in the following paragraphs.

Other risk**Internal process failure**

The Company is potentially exposed to the risk of loss from failure of the internal processes with which it transacts its business. The Company ensures the adequacy of the controls over its processes and regular reviews are undertaken of their appropriateness and effectiveness.

People

The Company is potentially exposed to the risk of loss from inappropriate actions by its staff. The risk is actively managed by business management and human resource (HR) functions. Recruitment is managed centrally by HR functions and all new recruits undergo a formal induction programme. All employees have job descriptions setting out their accountabilities and reporting lines and are appraised annually in accordance with agreed performance management frameworks. Employees are provided with appropriate training to enable them to meet the relevant regulatory requirements. Risks relating to health and safety and other legislation are managed through the provision of relevant training to all staff.

Outsourcing

The Company is potentially exposed to the actions or failure of suppliers contracted to provide services on an outsourced basis. The required minimum standards of control for outsourced arrangements are set out in the outsourcing and critical supplier policy.

Legal

Legal risk is the risk of loss from unclear or deficient product documentation, inadequate documentation in support of material contracts such as reinsurance treaties, the incorrect interpretation of changes in legislation, employment related disputes and claims and commercial disputes with suppliers. The risks are actively managed through the Legal Risk framework which defines minimum standards of control to be applied to minimise the risk of loss.

Compliance

Compliance risk within the Company relates to the risk of non-adherence to legislative requirements, regulations and internal policies and procedures. Responsibility for ensuring adherence to relevant legal and regulatory requirements is vested in individual business managers.

Event

Event risk relates to the potential for loss arising from significant external events such as terrorism, financial crisis, major changes in fiscal systems or disasters. Typically such events have a low likelihood of occurrence, a material impact and can be difficult to prevent. The Company's risk mitigation focuses on minimising the business disruption and potential financial loss which may ensue from such an event. This includes maintaining a framework for the management of major incidents, the maintenance and regular testing of detailed business, technical and location recovery plans and the provision of insurance cover for the loss of buildings, contents and information technology systems and for the increased cost of working in the event of business disruption.

Fraud

The Company is potentially exposed to the risk of internal fraud, claims-related fraud and external action by third parties. The risk of internal fraud is managed through a number of processes including the screening of staff at recruitment, segregation of duties and management oversight. The activities of Internal Audit also act to counter the risk. Claims-related fraud is managed by ensuring business processes are designed to fully validate claims and ensure that only bona fide claims are settled. Anti-fraud techniques are regularly updated to mitigate risks and emerging threats. The Company's approach to mitigating fraud and other dishonest acts is supported by promoting an open and honest culture in all dealings between employees, managers and those parties with which the Company has contact. A formal code of ethics sets out the Company's expectations in this respect. Effective and honest communication is essential if malpractice is to be effectively dealt with. The Company has defined whistle blowing procedures to enable all employees and those who work with the Company to raise matters of concern in confidence. Personnel independent of the business reporting line act as designated whistle blowing contacts and include the heads of Internal Audit and Compliance.

Technology

The Company places a high degree of reliance on IT in its business activities. The failure of IT systems could potentially expose the Company to significant business disruption and loss. To mitigate this risk, standards and methodologies for developing, testing and operating IT systems are maintained. Disaster recovery facilities enable IT operations to be conducted at remote locations in the event of the loss of computer facilities at a principal office site. All records are remotely backed up and computer suites are equipped with alternative power sources.

42 Risk management and control (continued)**Concentration of risk**

As part of the ongoing risk assessment processes the Company considers the concentration of risk. The Company seeks to manage concentrations by setting limits around the maximum exposure to loss that it can tolerate from a series of related events. Limits set include maximum exposures to single lives, geographic locations, financial instruments and reinsurance balances.

Long term insurance risks

Long term insurance products are structured as either participating or non-participating. The level of shareholders' interest in the value of policies and their share of the related profit or loss varies depending upon the contract structure.

Non-participating contracts

Non-participating business is written mainly in the non profit part of the Long Term Fund (LTF). Profits accrue solely to shareholders. In addition, there is some non-participating business in the with-profits part of the LTF where the profits are shared between participating policyholders and shareholders.

Protection business (individual and group)

The Company offers protection products which provide mortality or morbidity benefits. They may include health, disability, critical illness and accident benefits. These additional benefits are commonly provided as supplements to main life policies but can also be sold separately. The benefit amounts would usually be specified in the policy terms. Some sickness benefits cover the policyholder's mortgage repayments and are linked to the prevailing mortgage interest rates. In addition to these benefits, some contracts may guarantee premium rates, provide guaranteed insurability benefits and offer policyholders conversion options.

Life savings business

A range of contracts are offered in a variety of different forms to meet customers' long term savings objectives. Policyholders may choose to include a number of protection benefits within their savings contracts. Typically, any guarantees under the contract would only apply on maturity or earlier death. On certain older contracts, there may be provisions guaranteeing surrender benefits. Savings contracts may or may not guarantee policyholders an investment return. Where the return is guaranteed, the Company may be exposed to interest rate risk with respect to the backing assets.

Pensions (individual and corporate)

These are long term savings contracts through which policyholders accumulate pension benefits. Some older contracts contain a basic guaranteed benefit expressed as an amount of pension payable or a guaranteed annuity option, which exposes the Company to interest rate and longevity risk. These guarantees become more costly during periods when interest rates are low or when annuitant mortality improves faster than expected. The ultimate cost will also depend on the take-up rate of any option and the final form of annuity selected by the policyholder.

Other options provided by these contracts include an open market option on maturity, early retirement and late retirement. The Company would generally have discretion over the terms on which these options are offered.

Key risk factors**(a) Insurance risk****(i) Mortality**

For contracts providing death benefits, higher mortality rates would lead to an increase in claims costs. For annuity contracts, the Company is exposed to the risk that mortality experience is lower than assumed. Lower than expected mortality would require payments to be made for longer and increase the cost of benefits provided. The Company regularly reviews its mortality experience and industry projections of longevity and adjusts the valuation and pricing assumptions accordingly.

The Company is exposed to mortality risk on protection and annuity business. For protection products, the Company has entered into reinsurance arrangements to mitigate this risk and provide financing.

42 Risk management and control (continued)**(ii) Persistency**

In the early years of a policy lapses and surrenders are likely to result in a loss to the Company as the acquisition costs associated with the contract would not have been recovered from product margins. Some contracts include surrender deductions to mitigate this risk.

In later periods once the acquisition costs have been recouped, the effect of lapses and surrenders depends upon the relationship between the exit benefit if any and the liability for that contract. Exit benefits are not generally guaranteed and the Company has some discretion in determining the amount of the payment. As a result, the effect on profit in later periods is expected to be broadly neutral.

Following the adoption of PS06/14 in 2006 the persistency assumption for non-participating protection business allows for the expected pattern of persistency adjusted to incorporate a margin for adverse deviation.

There is no persistency risk exposure for annuities in payment and these contracts do not provide a lapse or surrender option.

(iii) Morbidity rates

The cost of health related claims depends on both the incidence of policyholders becoming ill and the duration over which they remain ill. Higher than expected incidence or duration would increase costs over the level currently assumed in the calculation of liabilities.

(iv) Expense variances

Higher expenses and/or expense inflation will tend to increase the amount of the reserves required. The Company is exposed to the risk that its liabilities are not sufficient to cover future expenses.

(v) Geographic concentrations of risk

Insurance risk may be concentrated in geographic regions altering the risk profile of the Company. The most significant exposure of this type arises for the group protection business where a single event could result in a large number of related claims. To reduce the overall exposure current contracts include an 'event limit' which caps the total liability. Additionally excess of loss reinsurance arrangements further mitigate the exposure.

(vi) Epidemics

The spread of an epidemic could cause large aggregate claims across the Company's portfolio. Quota share reinsurance contracts are used to manage this risk. The management of associated counterparty risks from the use of reinsurance is set out on page xx. Depending on the nature of an epidemic, mortality experience may lead to a reduction in the cost of claims for annuity business.

(vii) Accumulation of risks

There is limited potential for single incidents to give rise to a large number of claims across the different contract types written by the Company. However, there are potentially material correlations of insurance risk with other types of risk exposure. These correlations are difficult to estimate though they would tend to be more acute as the underlying risk scenarios became more extreme. An example of the accumulation of risk is the correlation between reinsurer credit risk with mortality and morbidity exposures.

(b) Market risk

Investment of the assets backing the Company liabilities reflects the nature of the liabilities being supported. For non-participating business, the strategy is to invest in fixed income securities of appropriate maturity dates. The risk of default on fixed interest securities is managed through diversified portfolios with exposure limits for individual economies, sectors and counterparties.

Interest rate risk is reduced by managing the duration and maturity structure of each investment portfolio in relation to the estimated cash flows of the liabilities it supports. A number of derivatives are held to enable the closer matching of assets and liabilities and to mitigate further exposure to interest rate movements, in particular to limit the exposure to any options and guarantees in contracts.

In addition, the exposure to these risks is allowed for in the actuarial valuation of liabilities under these contracts.

Participating contracts

Participating contracts are supported by the with-profits part of the LTF. They offer policyholders the possibility of payment of benefits in addition to those guaranteed by the contract. The amount and timing of the additional benefits (usually called bonuses) are contractually at the discretion of the Company.

Discretionary increases to benefits on participating contracts are allowed in one or both of annual and final bonus form. These bonuses are determined in accordance with the principles outlined in the Group's PPFM for the management of the with-profits part of the Company's LTF. The principles include:

- The with-profits part of the Company's LTF will be managed with the objective of ensuring that its assets are sufficient to meet its liabilities without the need for additional capital.
- With-profits policies have no expectation of any distribution from the with-profits part of the Company's LTF's inherited estate. The inherited estate is the excess of assets held within the Society LTF over and above the amount required to meet liabilities, including those which arise from the regulatory duty to treat customers fairly in settling discretionary benefits, and
- Bonus rates will be smoothed so that some of the short term fluctuations in the value of the investments of the with-profits part of the Company's LTF and the business results achieved in the with-profits part of the UK LTF are not immediately reflected in payments under with-profits policies.

42 Risk management and control (continued)

At 30 June 2005 an assessment was made of the expected cost of guarantees and options to be paid in the future and funds with the same value to meet these costs were allocated from the capital in the with-profits sub-fund. The value of the funds is regularly assessed and is reduced by the cost of guarantees and options paid since 1 July 2005. At each assessment point, if the value of the funds is lower than the expected cost of guarantees and options it is possible to make deductions from asset shares to cover the difference. It is intended to limit deductions to no more than 0.75% each year up to a maximum of 5% per policy.

Following the movement in the expected cost and the value of the associated funds up to 31 December 2011, and in accordance with the PPFM a deduction of 0.75% was made to the asset shares. This followed a deduction of 0.2% made in respect of the year to 31 December 2010. In the technical provisions allowance was also made for future charges and deductions in respect of the expected costs of meeting future guarantees and options not covered by the current year deduction. For policyholders who decide to surrender a charge will generally be made in respect of the expected cost of guarantees and options not covered by the charge already taken.

Some older participating contracts include a guaranteed minimum rate of roll up of the policyholder's fund up to the date of retirement or maturity.

The nature of the participating contracts written in the with-profits part of the Company's LTF is that more emphasis can be placed on investing to maximise future investment returns. This results in a broader range of investments being held within the fund.

With-profits bonds

These contracts provide an investment return to the policyholder which is determined by the attribution of regular and final bonuses over the duration of the contract. In addition the contracts provide a death benefit typically of 101% of the value of the units allocated to the policyholder.

Pension contracts

The Company has sold pension contracts containing guaranteed annuity options which expose the Company to both interest rate and longevity risk. The market consistent value of these guarantees carried in the balance sheet is £57m (2010: £35m).

Deferred annuity contracts

The Company has written some deferred annuity contracts which guarantee minimum pensions. These options expose the Company to interest rate and longevity risk as the cost would be expected to increase with decreasing interest rates and improved longevity. The market consistent value of these guarantees carried in the balance sheet is £185m (2010: £125m).

Endowment contracts

These contracts provide a lump sum on maturity determined by the addition of annual and final bonuses over the duration of the contract. In addition the contracts provide a minimum sum assured death benefit.

Key risk factors

The insurance and market risk exposures for participating business are largely the same as those discussed for non-participating contracts. The main differences in the operation of these contracts are discussed below.

(a) Insurance risk - Persistency

At early durations the nature of the persistency risks on with-profits business is largely the same as for non-participating business and is influenced mainly by the ability to recover acquisition costs from product margins. At later durations there is less scope for withdrawal to result in a loss for the Company as these contracts typically provide explicit allowances for market conditions. Allowance for future withdrawals is made in the assessment of participating contract liabilities. The Company is generally exposed to the risk that future withdrawals are lower than assumed, resulting in higher future guarantee costs.

(b) Market risk

The financial risk exposure for participating contracts is different from that for non-participating business. Greater emphasis is placed on investing to maximise future investment returns rather than matching assets to liabilities. This results in holding significant equity and property investments. Lower investment returns increase the costs associated with maturity and investment guarantees provided on these contracts.

These risks are managed by maintaining capital sufficient to cover the consequences of mismatch under a number of adverse scenarios. In addition different investment strategies are followed for assets backing policyholder asset shares and assets backing other participating liabilities and surplus. The former include significant equity and property holdings whilst the latter are invested largely in fixed interest securities. The assets held are managed so as to provide a partial hedge to movements in fixed interest yields and equity markets.

The methodology used to calculate the liabilities for participating contracts makes allowance for the possibility of adverse changes in investment markets on a basis consistent with the market cost of hedging the guarantees provided. The methodology also makes allowance for the cost of future discretionary benefits, guarantees and options.

The value of future discretionary benefits depends on the return achieved on assets backing these contracts. The asset mix varies with investment conditions reflecting the Company's investment policy which aims to optimise returns to policyholders over time whilst limiting capital requirements for this business.

42 Risk management and control (continued)

The distribution of surplus to shareholders depends upon the bonuses declared for the period. Typically, bonus rates are set having regard to investment returns, although the Group has some discretion setting rates and would normally smooth bonuses over time. The volatility of investment returns could impact the fund's capital position and its ability to pay bonuses. If future investment conditions were less favourable than anticipated, the lower bonus levels resulting would also reduce future distributions to shareholders.

However, business which is written in the with-profits part of the LTF is managed to be self-supporting. The unallocated divisible surplus in the fund would normally be expected to absorb the impact of these investment risks. Only in extreme scenarios, where shareholders were required to provide capital support to the with-profits part of the LTF, would these risks affect equity.

As part of the 2007 LTF restructure, the 1996 Sub-fund (£321m) was merged into the Shareholder Retained Capital (SRC). As a result, the Board undertook to initially maintain £500m of assets within Society to support the with-profits business. The amount of the commitment reduced to £350m in 2011 and will then gradually reduce to zero over a period not exceeding seven years.

The Company's approach to setting bonus rates is designed to treat customers fairly. The approach is set out in the PPFM for the with-profits part of the LTF. In addition, bonus declarations are also affected by FSA regulations relating to Treating Customers Fairly (TCF) which limit the discretion available when setting bonus rates. The Company's approach to setting bonuses and meeting the FSA's TCF regulations may increase the Company's exposure to market risk should the ability to cut bonuses during periods when investment returns are poor be reduced.

Unit linked contracts

The Company's primary exposure to financial risk from these contracts is the risk of volatility in asset management fees due to the impact of interest rate and market price movements on the fair value of the assets held in the linked funds, on which investment management fees are based. The Company is also exposed to the risk of an expense overrun should the market depress the level of charges which could be imposed, although for some contracts the Group has discretion over the level of management charges levied.

Sensitivity analysis

Table 6 shows the impact on pre-tax profit and equity, net of reinsurance, under each sensitivity scenario for the non-participating business written in the non-profit part of the LTF.

Table 6 - long term business IFRS sensitivity analysis

	Impact on pre- tax profit net of reinsurance 2011 £m	Impact on equity net of reinsur- ance 2011 £m	Impact on pre- tax profit net of reinsurance 2010 £m	Impact on equity net of reinsur- ance 2010 £m
Sensitivity test				
10% decrease in equity values	(1,294)	(994)	(1,532)	(1,119)
7.5% decrease in property values	(101)	(74)	(114)	(83)
1% increase in interest rates	28	20	23	16
1% decrease in interest rates	(59)	(43)	(33)	(24)
Credit spread widens by 100 bps with no change in expected defaults	-	-	-	-
1% increase in inflation	(6)	(4)	(35)	(25)
Default of largest reinsurer	(694)	(510)	(679)	(489)
5% decrease in annuitant mortality	(1)	(1)	(1)	(1)

- In calculating the alternative values, all other assumptions are left unchanged. In practice, items of the Company's experience may be correlated.
- The Company seeks to actively manage its asset and liability position. A change in market conditions may lead to changes in the asset allocation or charging structure which may have a more or less significant impact on the value of the liabilities. The analysis also ignores any second order effects of the assumption change, including the potential impact on the Company's asset and liability position and any second order tax effects.
- These stresses use the assets that back the liabilities. Any excess assets have not been stressed in these calculations.
- The sensitivity of the profit to changes in assumptions may not be linear. They should not be extrapolated to changes of a much larger order.
- The change in interest rate test assumes a 100 basis point change in the gross redemption yield on fixed interest securities together with a 100 basis point change in the real yields on variable securities. Valuation interest rates are assumed to move in line with market yields adjusted to allow for the impact of FSA regulations.
- In the sensitivity for credit spreads, corporate bond yields have increased by 100bps, gilt and approved security yields unchanged, and there has been no adjustment to the default assumptions.
- The inflation stress adopted is a 1% pa increase in inflation resulting in a 1% pa reduction in real yield and no change to the nominal yield. In addition, the expense inflation rate is increased by 1% pa.
- The reinsurer stress shown is equal to the technical provisions ceded to that insurer.
- The annuitant mortality stress is a 5% reduction in the mortality rates for immediate and deferred annuitants with no change to the mortality improvement rates (so for example a rate that was 80% of a standard table would become 76% of that standard table).
- Default of largest reinsurer. The largest reinsurer was deducted at an entity level by mathematical reserves ceded. The largest reinsurer to the Company external to the Group is Swiss Re. The increase in reserves is consistent with the reinsured reserves.

43 IFRS 1 First-time adoption of International Financial Reporting Standards**(i) Reconciliation of Income Statement for the year ended 31 December 2010**

	Notes	Revenue \$m	Expenses \$m	Profit after tax \$m
As reported under UK GAAP		6,605	6,175	430
Reduction in carrying value of investment in subsidiaries	(e)	-	77	(77)
Other adjustments	(f)	-	1	(1)
As reported under IFRS		6,605	6,253	352
Attributed to equity holders of the company				352

(ii) Reconciliation of the Balance Sheet as at 31 December 2010

	As reported UK GAAP \$m	Adjustments Restated \$m	IFRS Restated \$m
Assets			
Investment in subsidiaries	2,505	(883)	1,622
Value of in-force non participating contracts	337	(337)	-
Purchased interest in long term business	3	-	3
Deferred acquisition costs	788	-	788
Plant and equipment	28	-	28
Investment property	135	1,379	1,514
Financial investments	18,914	22,705	41,619
Assets held to cover linked liabilities	25,934	(25,934)	-
Reinsurers share of contract liabilities	26,290	-	26,290
Deferred tax recoverable	252	-	252
Other assets	630	597	1,227
Cash and cash equivalents	368	1,855	2,223
	76,184	(618)	75,566
Equity and liabilities			
Equity holders capital	4,466	(290)	4,176
Technical provisions	68,274	(68,274)	-
Participating insurance contracts	-	9,183	9,183
Participating investment contracts	-	5,104	5,104
Unallocated divisible surplus	1,446	-	1,446
Value of in force non participating contracts	-	(337)	(337)
Non-participating insurance contracts	-	28,096	28,096
Non-participating investment contracts	-	25,891	25,891
Senior borrowings	8	-	8
Income tax liabilities	140	-	140
Payables and other financial liabilities	472	9	481
Other liabilities	1,378	-	1,378
	76,184	(618)	75,566

(iii) Analysis of adjustments to the Balance Sheet as at 31 December 2010

	(a) \$m	(b) \$m	(c) \$m	(d) \$m	(e) \$m	(f) adjustments \$m	Total \$m
Assets							
Investment in subsidiaries	-	-	(214)	(592)	(77)	-	(883)
Value of in-force non-participating contracts	-	-	-	-	-	(337)	(337)
Purchased interest in long term business	-	-	-	-	-	-	-
Deferred acquisition costs	-	-	-	-	-	-	-
Plant and equipment	-	-	-	-	-	-	-
Investment property	-	5	-	-	-	1,374	1,379
Financial investments	-	-	-	-	-	22,705	22,705
Assets held to cover linked liabilities	-	-	-	-	-	(25,934)	(25,934)
Reinsurers share of contract liabilities	-	-	-	-	-	-	-
Deferred tax recoverable	-	-	-	-	-	-	-
Other assets	-	5	-	592	-	-	597
Cash and cash equivalents	-	-	-	-	-	1,855	1,855
	-	10	(214)	-	(77)	(337)	(618)
Equity and liabilities							
Equity holders capital	1	-	(214)	-	(77)	-	(290)
Technical provisions	-	-	-	-	-	(68,274)	(68,274)
Participating insurance contracts	-	-	-	-	-	9,183	9,183
Participating investment contracts	-	-	-	-	-	5,104	5,104
Unallocated divisible surplus	-	-	-	-	-	-	-
Value of in force non participating contracts	-	-	-	-	-	(337)	(337)
Non-participating insurance contracts	(1)	-	-	-	-	28,097	28,096
Non-participating investment contracts	-	-	-	-	-	25,891	25,891
Senior borrowings	-	-	-	-	-	-	-
Income tax liabilities	-	-	-	-	-	-	-
Payables and other financial liabilities	-	10	-	-	-	(1)	9
Other liabilities	-	-	-	-	-	-	-
	-	10	(214)	-	(77)	(337)	(618)

43 IFRS 1 First-time adoption of International Financial Reporting Standards (continued)**(iv) Reconciliation of the Balance Sheet as at 1 January 2010**

	As reported UK GAAP £m	Adjustments Restated £m	IFRS Restated £m
Assets			
Investment in subsidiaries	2 680	(981)	1 699
Value of in-force non-participating contracts	328	(328)	-
Purchased interest in long term business	3	-	3
Deferred acquisition costs	824	-	824
Plant and equipment	27	-	27
Investment property	104	1 286	1 390
Financial investments	18 518	20 521	39 039
Assets held to cover linked liabilities	23 853	(23 853)	-
Reinsurers share of contract liabilities	22 799	-	22 799
Deferred tax recoverable	399	-	399
Other assets	493	987	1 480
Cash and cash equivalents	39	2 048	2 087
	70 067	(320)	69 747
Equity and liabilities			
Equity holders capital	4 122	1	4 123
Technical provisions	62 674	(62 674)	-
Participating insurance contracts	-	9 198	9 198
Participating investment contracts	-	5 005	5 005
Unallocated divisible surplus	1 284	-	1 284
Value of in-force non-participating contracts	-	(328)	(328)
Non-participating insurance contracts	-	24 990	24 990
Non-participating investment contracts	-	23 480	23 480
Senior borrowings	1	-	1
Provisions	-	-	-
Income tax liabilities	123	-	123
Payables and other financial liabilities	364	8	372
Other liabilities	1 499	-	1 499
	70 067	(320)	69 747

(v) Analysis of adjustments to the Balance Sheet as at 1 January 2010

	(a) £m	(b) £m	(c) £m	(d) £m	(e) £m	Total adjustments £m
Assets						
Investment in subsidiaries	-	-	-	(981)	-	(981)
Value of in-force non-participating contracts	-	-	-	-	(328)	(328)
Purchased interest in long term business	-	-	-	-	-	-
Deferred acquisition costs	-	-	-	-	-	-
Plant and equipment	-	-	-	-	-	-
Investment property	-	2	-	-	1 284	1 286
Financial investments	-	-	-	-	20 521	20 521
Assets held to cover linked liabilities	-	-	-	-	(23 853)	(23 853)
Reinsurers share of contract liabilities	-	-	-	-	-	-
Deferred tax recoverable	-	-	-	-	-	-
Other assets	-	6	-	981	-	987
Cash and cash equivalents	-	-	-	-	2 048	2 048
	-	8	-	-	(328)	(320)
Equity and liabilities						
Equity holders capital	1	-	-	-	-	1
Technical provisions	-	-	-	-	(62 674)	(62 674)
Participating insurance contracts	-	-	-	-	9 198	9 198
Participating investment contracts	-	-	-	-	5 005	5 005
Unallocated divisible surplus	-	-	-	-	-	-
Value of in-force non-participating contracts	-	-	-	-	(328)	(328)
Non-participating insurance contracts	(1)	-	-	-	24 991	24 990
Non-participating investment contracts	-	-	-	-	23 480	23 480
Senior borrowings	-	-	-	-	-	-
Income tax liabilities	-	-	-	-	-	-
Payables and other financial liabilities	-	8	-	-	-	8
Other liabilities	-	-	-	-	-	-
	-	8	-	-	(328)	(320)

43 IFRS 1 First-time adoption of International Financial Reporting Standards (continued)**(vi) Notes to the reconciliation of the Balance Sheet at 31 December 2010 at 1 January 2010 and reconciliation of Income Statement for 2010**

The UK GAAP balance sheet has been presented in a format consistent with International Financial Reporting Standards (IFRS). No changes have been made to the previously reported numbers for UK GAAP and the analyses of the adjustments are based on UK GAAP as at 31 December 2010.

(a) Claims equalisation provision

Under UK GAAP an equalisation provision is recognised in the individual accounts of general insurance companies to reduce the volatility in results arising from exceptional levels of claims in certain classes of business. Under IFRS such provisions are not permitted as no liability exists at the balance sheet date. Elimination of the claims equalisation provision results in an increase in equity holders' capital of £1.3m at 31 December 2010 (1 January 2010: £0.9m) and an increase of £0.4m to profit after tax for the year ended 31 December 2010.

(b) Accounting for leases

Under UK GAAP there is a requirement to spread operating lease incentives over the shorter of the lease term and the period to the first rent review to market rates. Under IFRS these should be recognised as a reduction of the rental expense over the lease term on a straight line basis unless another systematic basis is representative of the time pattern of the lessee's benefit from the use of the leased asset.

A secondary requirement under IFRS is that the land and buildings elements of a lease of land and buildings are considered separately for the purposes of lease classification, and should be accounted for accordingly.

The cumulative impact of the above two changes results in an increase/decrease in equity holders' capital of £nil at 31 December 2010 (1 January 2010: £nil) and an increase/decrease of £nil to profit after tax for the year ended 31 December 2010.

(c) Subsidiary valuation

Under UK GAAP the carrying value of subsidiaries is stated at current value. Under IFRS these are stated at cost. For the purposes of the first time adoption of IFRS the cost is measured as the carrying value on the date of transition. An elimination of the subsequent revaluation performed under UK GAAP during 2010 is required; this results in a decrease in equity holders' capital of £214m at 31 December 2010 (1 January 2010: £Nil).

(d) Contingent loan presentation

Under UK GAAP loans to subsidiaries that are considered long term in nature and the repayment of which is contingent on the emergence of surplus within the subsidiary are included within the investment in subsidiaries. Under IFRS these loans are classified as a long term loan.

(e) Reduction in carrying value of investment in subsidiaries

With the change in methodology to calculate carrying value of subsidiaries noted in point (c) the carrying values are reviewed annually. This adjustment is the result of this review (see note 11).

(f) Other adjustments

A number of presentational or reclassification changes adjustments are required under IFRS.