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2018



THURSDAY



RM \*R826QY9M\* #24  
28/03/2019  
COMPANIES HOUSE



# Annual Report

For the year ended 31 December 2018



THURSDAY



A24 \*A8274UQA\* #283  
28/03/2019  
COMPANIES HOUSE



## 2018 Highlights

**£89m**

Operating capital  
generation



**172%**

Capital Coverage Ratio

**£687m**

Capital Surplus



**£136m**

Operating profit

**£20m**

Profit before tax



**1.2m**

Members

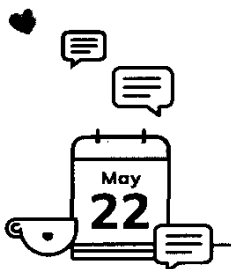


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# A mutual for today and tomorrow



When we were founded in 1843, it was in the belief that people could remove the financial burden of a decent burial. We encouraged people to come together as a collective group to protect themselves and the people that mattered to them, and this very idea of mutuality and community still lives on today. Although society has changed, the desire to protect and provide for loved ones, and whatever the future might hold, is as important today as it was when we started.

The concept of mutuality and importance of membership is at the heart of LV=. It is because of our mutual ethos that we continue to focus on the needs of our members, and it is our members who can express how they feel about any changes we might have in the way we are run.

Ultimately, we want to offer people valuable financial solutions to help them live confident lives and for everyone who is a member to benefit from being part of a mutual, regardless of what product they buy.

However, the laws and regulations that govern us, as a friendly society, have become outdated. We believe this stops us running the business to the best effect and in members' fundamental interest. That's why we're putting forward some proposals for change in 2019.

To begin with we want to alter the way we are governed. To do that we must convert to a company limited by guarantee. If that happened we'd still be mutual but we'd become governed by the Companies Act 2006 instead of the Friendly Societies Act 1992. It would give us more freedom and flexibility to compete in the modern world and preserve and protect LV= for all our members and customers.

We've also got a legacy book which stretches back a long time, so we'd like to change our constitutional rules to clarify what happens when we are unable to re-establish contact with members we've lost touch with, and when we would therefore stop considering them as members.

On 22 May 2019 we'll hold a Special General Meeting so our members can tell us what they think of our proposals. Until then more can be found at [LV.com/future](http://LV.com/future).

If all goes to plan, and members, the board and our regulators agree that the proposals – particularly the one to convert to a company

limited by guarantee – should go ahead, we'd become Liverpool Victoria Financial Services Limited and embark on some further plans to make LV= even stronger for the future.

Once governed by the Companies Act we would be able to carry out some plans that align to our vision for the future. These would involve proposals via a legal process which are called schemes of arrangement. These allow us to put forward changes to our members and policyholders which are scrutinised by the Court.

The first thing we'd look to do is to revise our fund structure. We plan to create a new fund called the Mutual Capital fund, leaving our With-profits policies in the existing With-profits fund and transferring all our other business into the new fund. This will enable us to clarify the rights and interests of our members and policyholders. In doing so it will give us better opportunities to develop existing and new lines of business.

We'd also like to amend a rule in our current constitution. If the financial landscape changed to such an extent that we thought for the benefit of our members we should alter our mutual status, we'd be hard pressed to achieve the level of member participation in any decision required under our current rules. We have no plans to change our mutual status but it is important to have this flexibility in case the need arises in the future. This proposed amendment to our constitution would therefore implement a more sensible and practical solution in terms of the volume of members who would need to vote on any changes we might choose to propose.

At the point that we embark on schemes of arrangement, we'll give members and policyholders the chance to express their views on any proposals. Through these changes we aim to create an even stronger mutual, which is prepared for whatever the future brings. Ensuring we are ready and able to adapt to consumer needs and what's right for our members and LV= as a whole, both now and for generations to come.

**“Our goal is to remain a mutual insurance company for as long as it is right for our members.”**

**The board of LV=**





## Our proposals:

**Today:**

**Mutual  
Friendly Society**

**Governed by the  
Friendly Societies  
Act 1992**

**22 May 2019:**

**Special  
General Meeting**

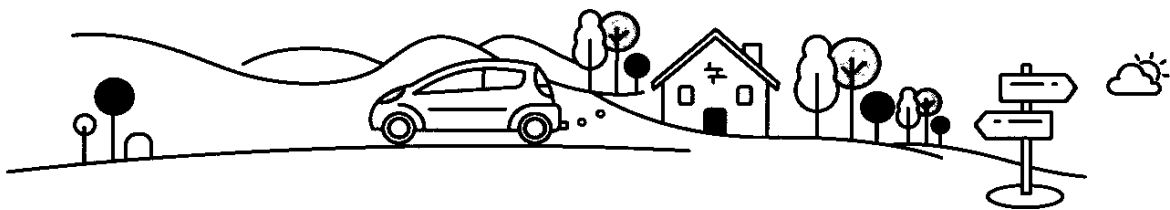
**Vote 1:** To convert to  
a company limited by  
guarantee  
**Vote 2:** To clarify who  
is a member of LV=



**To be a:**

**Mutual Company  
Limited by Guarantee**

**Governed by  
the Companies  
Act 2006**



**The future:**

This will open the  
door so we can  
carry out some  
further plans\*

**Once again,  
members will have  
a say in these plans**

\* Our future plans are described in more detail on the previous page.



# Creating Green Heart experiences



In 2018  
Green Heart  
supported over  
**1,100**  
customers, members  
and colleagues

LV= Green Heart Support is just one example why being a mutual we're able to put customers and members at the heart of everything we do.

**We believe that we're different from other insurers and supporting our customers when they're facing some truly unexpected situations in their lives is what our core purpose is all about – helping people to Live Confident.**

As much as everyone would like to protect themselves against anything life can throw at them, its unpredictable nature means people often face extraordinary circumstances when they least expect it. Whilst our products provide peace of mind at a practical level by protecting your possessions and providing for your loved ones, it's the customer experience delivered with heart – our green heart experiences – that shows that we listen to and understand you, the person behind the policy.

For us, empowering our people to recognise when we can make a difference to someone's life is what sets us apart. As our customer facing people take

time to get to know a bit more about the person on the other end of the phone, they sometimes uncover some of the more extraordinary circumstances our customers find themselves in. That's when they can step in to give some unexpected extra support, from a simple gesture to show empathy through to truly life changing assistance. We call this Green Heart Support.

We want our employees to know that working here they can make a positive impact to the lives of our customers and in 2018 through Green Heart we supported over 1,100 customers, members and colleagues by giving them an extra bit of confidence and support when they needed it most.

## Jean Thomas, Life Claims Customer Service

"What we're trying to do on our calls is to make our customers' journeys as pain-free as possible. Although you're talking about the day-to-day claims process, you're also listening to what's going on in the background, to what sometimes isn't said. That is where Green Heart comes in, because you can really make a difference. Obviously, you can't give every person you speak to a Green Heart gesture, you have to distinguish what makes something really different.

One of the nicest things that happened recently was at the end of the call a customer commented, that talking to me was like talking to a friend and I had made their life so much easier at a difficult time.

In essence, that's what Green Heart does, it humanises the situation, and also helps the customer realise they aren't just another claimant. We talk to them at some of their most difficult and painful times, so if we can, we want

to do something to make it a little bit easier, a little bit brighter for them. I feel really proud to work for a company that goes above and beyond for its customers."

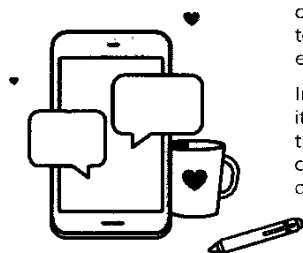


## Customer feedback

"Dear Jean,

Thank you so much for your amazing care and concern, and for going the extra mile to help the whole family, which is really above and beyond.

With very sincere and very grateful thanks to you once again for your amazing support, on behalf of all members of my family."





### Libby Brittain, General Insurance Claims Handler



"I took a call from our customer who'd been involved in an accident with a lorry, which had fled the scene. During the call the customer told me she needed her car repaired as soon as possible

as her young child had been diagnosed with a life-threatening illness. She sounded as though she was really struggling, and it was clear how important her car was to her as her child was undergoing regular hospital treatment.

Having any sort of accident is stressful, and especially made worse when the third-party flees the scene. However, what really made this stand out for me was what this particular customer was also dealing with at home. As well as managing the claim for her, I just wanted to do something to show her that we care and we're there to support her at her time of need.

I'm so pleased we have things like Green Heart Support to show our caring side. When I saw the feedback from the customer it brought a little tear to my eye."

### Customer feedback

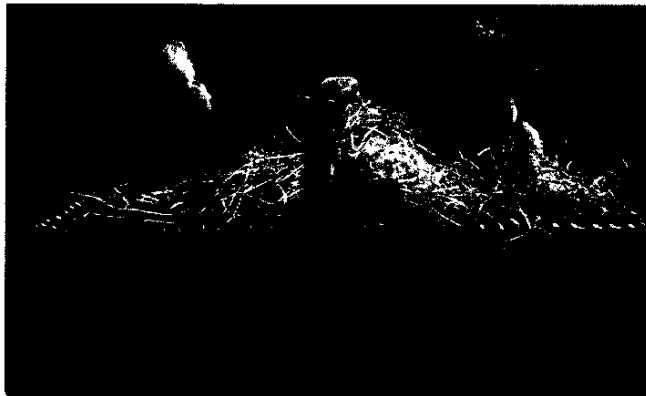


LV= 11 hrs

Dear LV...thank you for the wonderful hamper you sent over the summer after hearing about our unfortunate accident and circumstances at home. In the moment I opened the unexpected parcel, my emotions overcame me with the feeling that somebody who doesn't even know me, truly cares... It was very much needed that day... god bless you all, especially Elizabeth Brittain for thinking of us and making such a beautiful gesture ♥

LV undoubtedly live up to their name.

PS: I cannot seem to add more pictures...there was so much more underneath the straw and my children are still busy a few weeks on playing with their gifts!



"What makes us truly special is that we have shown our Green Heart 1,174 times in 2018 to our customers, members and employees when they've needed us most through Green Heart Support."

Richard Rowney, Chief Executive



# Strategic Report

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We have tried to use plain English throughout this document to make it as understandable as possible for all our stakeholders. However, some of the information in the report is quite technical and it has been necessary to use terminology or performance measures which are not commonly understood. To assist the reader a glossary is provided on page 86 and explanations as to why we use certain non-standard performance measures is provided on page 87. Definitions of these non-standard performance measures are provided throughout the document where actual performance is reported.

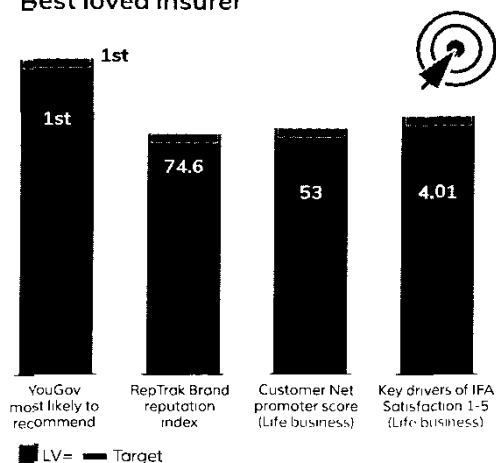


# Key Performance Indicators



Our Key Performance Indicators (KPIs) are those that the directors judge to be most effective in measuring the group's performance in the year and assessing progress against our strategic objectives.

## Best loved insurer



### Aim

We aim to deliver excellent customer service levels, while consistently treating the customer fairly. We set challenging targets across a range of relevant opinion surveys to measure our 'Best loved' performance.

### Performance

Demonstrating outstanding levels of customer service is one of the many ways that we aim to be Britain's Best Loved insurer.

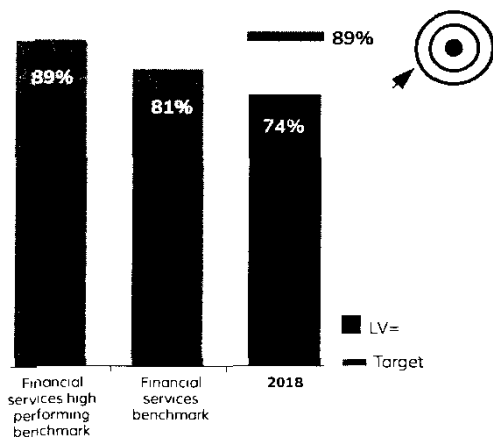
We have met our targets for brand reputation, Net promoter score and IFA satisfaction and also remain YouGov's most likely to recommend insurer.

As well as the results of opinion surveys, our performance is demonstrated through the many awards LV= has won during the year.

### Link to directors' remuneration

Brand and customer satisfaction metrics contribute to the annual bonus vesting.

## LVFS employee engagement



### Aim

We aim to have high LVFS employee engagement and target levels in line with high performing financial services organisations (HPO).

### Performance

Over the last three years, as the business has gone through a period of significant restructuring, it's understandable that our people are really feeling the change and this is reflected in our overall LVFS engagement levels. Our 2018 engagement score of 74% sits significantly below the targeted HPO norm of 89%.

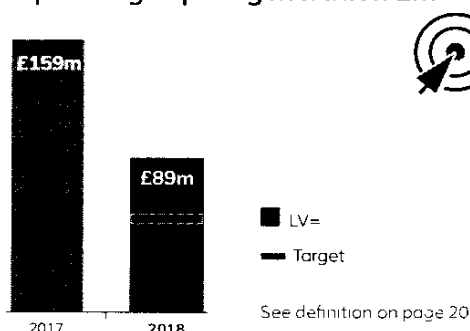
We recognise that the process of transforming to a fitter mutual for the future is challenging for our people and it is a key priority of the board to ensure that employees are fully engaged as LV= continues to develop during 2019.

### Link to directors' remuneration

LVFS employee engagement contributes to the annual bonus vesting.



## Operating capital generation £m



### Aim

We aim to generate positive operating capital, above or in-line with our financial plan. Plan operating capital generation for 2018 was £56m.

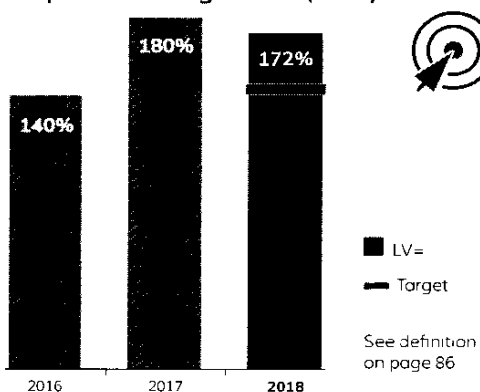
### Performance

Operating capital generation includes positive contributions from both the life and general insurance trading businesses. Capital contributions are supported by rigorous cost control whilst trading performance was impacted by reduced contribution from life new business and severe weather events in general insurance. See further analysis on pages 20 and 21.

### Link to directors' remuneration

Life operating capital generation contributes to the annual bonus vesting. It excludes the impact of general insurance and group items.

## Capital coverage ratio (CCR) %



### Aim

We aim to ensure the long-term sustainability of the group by maintaining a robust Capital Coverage Ratio (CCR). We target a CCR % above risk appetite of 140%.

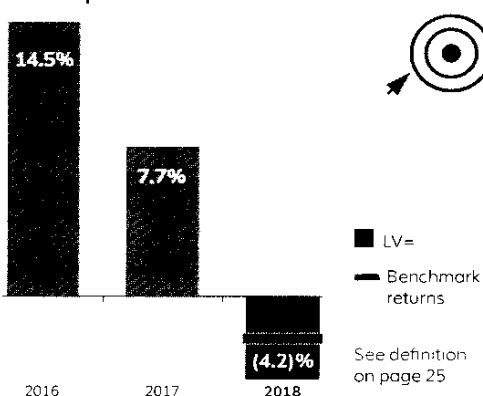
### Performance

The Capital Coverage Ratio is well above risk appetite. The strong capital position has enabled management to strengthen the quality of reported capital by removing the management action to potentially claw back awarded mutual bonus; this reduced the CCR by 29%. See further analysis on page 21.

### Link to directors' remuneration

CCR% is derived from group eligible own funds and the solvency capital requirement. Growth in own funds contributes to the 2018-2020 LTIP scheme vesting.

## With-profits return %



### Aim

To support our With-profits members we aim to deliver With-profits fund performance at or above benchmark. For 2018 the benchmark performance was negative at (2.6)%.

### Performance

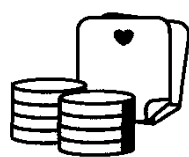
The main LVFS With-profits fund returns were negative at (4.2)% during the year against a backdrop of a volatile investment market. The fund invests in a large amount of equity holdings (£885m, 44% of the portfolio) and these were exposed to movements in the UK and overseas stock markets. Investments in gilts and bonds amounted to £677m (33% of the portfolio) and were impacted by changes in interest rates. See analysis on page 25.

### Link to directors' remuneration

The LV= With-profits return performance relative to benchmark contributes to the 2016-2018 and 2017-2019 LTIP schemes' vesting.

# Chairman's Review

**Alan Cook**  
Chairman



**£26m**

Mutual bonus allocated to members' policies as detailed below:

**1.0%**  
policy uplift

Heritage  
With-profits policies

**0.2%  
to 0.5%**  
policy uplift

Flexible Guarantee  
policies

2018 was a challenging year with a combination of severe bad weather at the start, continued competitive pressures and fluctuating investment markets reflecting uncertainty over the UK's future relationship with Europe. If I was to summarise our financial performance it would be steady progress towards our goals and we are reporting a capital surplus of £687m and an operating profit of £136m. Against this backdrop I'm pleased that we have been able to allocate a mutual bonus of £26m. A 1.0% policy uplift has been applied to our heritage With-profits policies and a 0.5% or 0.2% policy uplift for our Flexible Guarantee policies.

Brexit continues to dominate the domestic political landscape and while there is limited direct impact on LV=, as we trade exclusively in the UK, we have been keeping a keen eye on developments particularly in relation to investment markets which do not like uncertainty.

We welcome the absence of further changes to the pensions regime in the Autumn budget. People looking to save want certainty and the simpler the system, the more certain they can be around their future wealth.

As you will be aware, we started 2018 with a new partner for our general insurance business in Allianz and the success of the relationship has been a priority for the board.

While we no longer own 100% of the general insurance business we do maintain overall control of the board. I chair the board and Richard Rowney, together with two of our non-executive directors David Barral and David Neave, are also directors.

The deal with Allianz is structured in two phases and at the end of 2019 they will acquire a further 20.9% of the general insurance business giving them a 69.9% share. At this point they will take overall control. Progress is going well and at that stage I will be standing down from the general insurance board and a new independent chairman appointed.

We are now embarking on the next chapter of our story as a focused life and pensions business.

In last year's report I said that one of our priorities was to build a sustainable life business. LV= is a friendly society and governed by the Friendly Societies Act. Many of its provisions are outdated and it restricts our ability to manage our business effectively and in the best interest of members.

In order to have more flexibility and freedom to compete we want to make some changes to our structure and composition.

Firstly, it is our intention to convert from a friendly society to a company limited by guarantee. This would mean that we would be governed by the Companies Act, rather than the Friendly Societies Act.

Such a change will not alter our mutual status and our wish is to ensure we remain a mutual insurance company so that we can continue to deliver value for our members for many years to come.

Secondly, we currently hold our customers' money and investment income in one With-profits fund and are required by regulations to continue to sell a meaningful level of With-profits business. Demand for these products continues to fall and later in the year, once we are a company limited by guarantee, we are proposing to change to manage the business through two funds, one for With-profits and a second mutual capital fund for all of our other business.

Alongside these changes we continue to transform the composition of the board as we assemble a team with the right blend of skills and experience for this next stage in LV= 's development.

Wayne Snow joined LV= in June and was appointed to the board in July as our chief risk officer, a role he previously held at Phoenix Group, the UK's largest specialist closed life insurance and pension fund consolidator. Prior to this he held a number of positions within the Phoenix Group including financial risk director and corporate development actuary.

Tanya Lawler was appointed as a non-executive director in September and brings extensive experience from the retail, media and telecommunications sectors, having spent much of her career at well-known brands including eBay, J Sainsbury's and Home Retail Group.

We start 2019 with a robust capital position and some exciting plans as we seek to build on our mutual heritage and well-respected reputation by creating a better mutual for the future.

# Chief Executive's Review

**Richard Rowney**

Chief Executive



**172%**

Solvency II Capital Coverage Ratio

Following the actions taken in 2017 to strengthen our capital position, 2018 has been all about putting the building blocks in place from which to build a sustainable future as a focused, life and pensions business.

Our capital position continues to be strong and our Capital Coverage Ratio remains at a healthy 172% with positive contributions from both trading businesses. At this level it is well within our risk appetite and maintaining this relative position will continue to be an area of management focus in the future.

Our general insurance strategic partnership with Allianz which came into effect at the start of the year is working well. We will complete the process of transferring the renewal rights for Allianz personal lines business to LV= in May and remain on track to complete the operational separation of the general insurance business including the associated transfer of support services currently provided to them ahead of plan.

At a group level, cost savings offset lower levels of trading performance which resulted in the operating profit remaining flat at £136m (2017: £134m). Profit before tax was hit by a number of one-off impacts leading to a significantly reduced profit before tax of £20m (2017: £122m) (see page 110).

We continue to make good progress in our programme to significantly reduce our cost base and on-going good cost control has resulted in a further £19m decrease in operating costs across life and general insurance.

Having a professional, proactive and effective risk function is fundamental to the success of any insurance business and during 2018 we bolstered our risk management capabilities through the appointment of Wayne Snow as chief risk officer and board member.

Looking to the future, we have identified a number of structural changes that we want to make to improve our ability to manage the business in the best interest of members and compete on a more level playing field with other insurers. Alan Cook touched on our planned changes in his Chairman's review and more information is available on pages 4 and 5.

## Life

Trading conditions for our life business were tough in 2018 and while we delivered an operating profit of £60m in line with 2017, new business sales were down 13% at £1.80bn compared to £2.07bn in 2017. Further details relating to the life business financial performance can be found on page 22 and on pages 30 and 31.

During the second half of the year we took a number of actions to stimulate growth across both protection and retirement including a product refresh of Individual Income Protection and signing a deal with specialist fund manager Vanguard to offer a low-cost, high-value, passive pension investment option for our customers and advisers. Both initiatives have been well received in the market and provide good momentum going into 2019.

The concept of mutuality and the importance of membership are at the heart of LV=. We were founded in 1843 and like other long established life insurers some of our policies have been in existence for a very long time and over the years we have lost contact with many of these members because they've either moved house or passed away. As a mutual, we believe that reconnecting with lost members or their families is the right thing to do. In September we launched an advertising campaign focused on tracing old Liverpool Victoria Friendly Society Whole-Of-Life, savings and endowment policies. We will continue this work to reconnect with lost members in 2019.

## General insurance

Our general insurance business delivered an operating profit of £107m and a combined operating ratio of 92.0% with prior year reserve releases partially offsetting the adverse impact of the severe weather at the start of the year, some one-off large losses on home insurance policies and on-going claims inflation which continues to outstrip premium inflation.

Overall premiums have remained flat at £1.6bn as we start to see the impact of the transfer in of personal renewal rights from Allianz and transfer out of commercial renewal rights to Allianz.

As part of the transfer in of the personal home and motor business we launched five new broker products across 1,400 brokers, of which around 150 are potential new partners for our general insurance business. We also continue to develop





**£136m**  
Operating profit



**MOST TRUSTED**  
LIFE INSURANCE PROVIDER  
**LV=**



the range of products available to our direct personal customers with the highly successful launch of our multi-car product.

The underlying business is performing well and our award winning service continues to attract and retain customers. Satisfaction levels remain very high with our net promoter score at +70.

### Brand

We are very proud of the strength and heritage of the LV= brand and we maintain our ambition to be 'Britain's Best Loved' insurer.

Being trusted and recommended by customers, *members and intermediaries underpins our Best Loved ambition* and we are therefore particularly pleased that we remain YouGov's 'Most Recommended' insurer and in the Moneywise Customer Service Awards we were named Most Trusted Life Insurance provider for the sixth consecutive year.

Our general insurance business was named Insurance Brand of the Year at the Insurance Marketing and PR Awards.

At the Financial Adviser Service Awards in November LV= was awarded five star ratings in both the Investments and the Protection and Life and Pensions categories. In September we retained our title of 'Best Income Protection Provider' at the Investment Life & Pensions Moneyfacts Awards for the ninth year.

The strength of the LV= brand is not just about the awards that we win, at its core is the difference we make to people's lives.

### Members

As a mutual we don't have shareholders, allowing us to share our surplus profits with our members.

We have allocated a mutual bonus for 2018 of £26m, through eligible policy uplifts ranging from 0.2% to 1.0%. Our mutual bonus scheme allows us to reward eligible members for their continued investment in the Society by sharing a portion of our surplus profits with them. Since the launch of the mutual bonus in 2011, LV= has allocated a total mutual bonus of £182m to eligible member policies.

Our members can also benefit from a range of specific benefits, such as product discounts, access to a support fund and access to free telephone based legal advice along with health, wellness and counselling services.

Through our Green Heart Support initiative, we continue to offer support, beyond just our policy or product, to members and customers going through a particularly difficult time. During 2018 we supported over 1,100 individuals and families with a personal touch ranging from hampers, to counselling support, to giving experiences for families to make some memories together.

Being a mutual enables us to make an extra difference to people's lives and for our people it engenders a great sense of pride. You can read more about Green Heart Support on pages 6 and 7.

### Gender pay gap and diversity

We have again this year published our gender pay gap report and at an overall level there has been no significant change to 2017's results. This was expected as many of the actions we put in place to address our gender pay gap are long term and it will take a number of years before we start to see the changes taking affect.

At 28.5%, our mean gender pay gap is lower than the indicative average for the financial services industry (35%) but it's still higher than the UK average for all industries (17%) as reported by the Office for National Statistics in 2017. Our median pay gap stands at 24.6%.

We have identified that our gender pay gap is driven by the structure of our workforce. At present, we have a lower representation of females in senior leadership roles and higher representation of females in more junior roles. While we recognise that we need to take specific action to tackle our gender pay gap by focusing our efforts on increasing the female population at senior levels this is only one part of the equation.

Taking a broader view we believe there is a need both to continue supporting all areas of our existing Diversity and Inclusion programme (disability, multi-cultural, sexual orientation and gender) and focusing on further fostering an inclusive culture in order to bring about real change.

We remain a signatory of the HM Treasury Women in Finance Charter and are committed to increasing the proportion of women in senior positions. As part of this commitment we have introduced targeted development programmes to support the career aspirations of talented females and to develop a broader pipeline of women to 'balance the pyramid' at all levels.

In 2017 and 2018 we delivered diversity training for our senior leaders to foster a more inclusive culture. Following its success we will be delivering this Call it Out training to our wider management population throughout 2019.

### Strategy

I remain proud of the work that our people do day-in day-out to support our customers and members and am confident in the future direction of the organisation. 2019 will be another important year for LV= as we complete the second phase of the transaction with Allianz which will see them take a controlling stake in our general insurance business and we make the necessary structural changes that will provide the foundation from which to build a sustainable, focused life business and a mutual that is fitter for the future.

The LV= Strategic Report on pages 8 to 47 was approved by the board of directors on 21 March 2019 and signed on its behalf by:

**Richard Rowney,**  
Chief Executive



# Our Core Purpose, Strategy and Business Model



The world is changing at a faster rate than ever before, across technology and socially and it is important that we at LV= keep up with it. In order to do this our business needs to evolve. We know that the insurance industry is facing a big transformation with new business models, Fintech, investment in big data and start-ups shifting customer expectations. At the same time, customer lifestyles and working patterns are changing, leading to a range of emerging consumer needs relating to insurance and finances more generally. It is with this in mind that we believe everyone deserves to live confidently and we exist to ensure everyone can do that. We believe our blueprint (see below) and our vision for the future, developed in 2018 which builds on this further, is the best way to move forward at pace to maintain and grow our business.



## Our blueprint, what it means

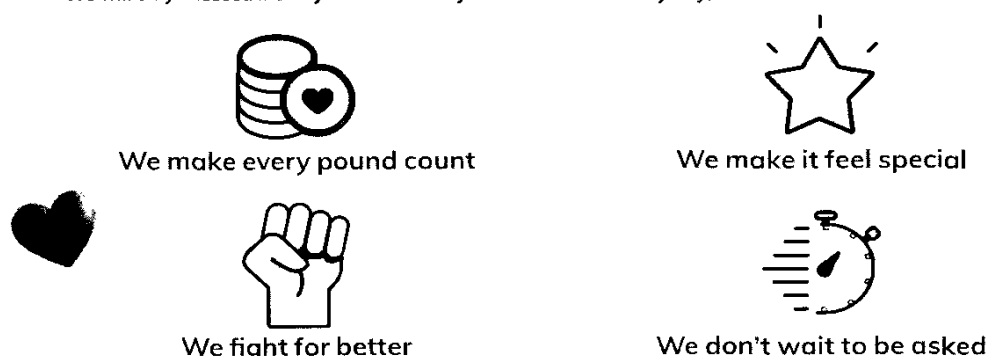
We believe that everyone deserves to Live Confident, and we exist to help people to do that. For us this means:

- Being proactive about preventing things going wrong, not just fixing them when they do.
- Fighting for and leading the way in doing things that are in our members' and customers' best interests.
- Being transparent, well-intentioned and absolutely honest in all that we do.

### To deliver on that promise there are three things we must do:

- Deliver Green Heart experiences for our customers, IFAs, colleagues and members – to help them feel confident about life and confident in us.
- Harness the latest technologies, evolve how we operate and bring in the new talent needed to ensure that we remain relevant and competitive today and well into the future. We have termed this LV=3.0.
- Build a business that is sustainably Lean and strong so we can achieve our goals over the long term whilst continuing to grow member value.

We will only succeed if everyone at LV= truly lives our values every day, so that:



If we do all of this our members and customers will be able to live bigger lives; our people will be able to fulfil their aspirations, and LV= will be able to make an important and valued difference for longer. People and LV= will be able to Live Confident.

We are building an even better mutual for the future founded on a clear purpose, values, a trusted brand and innovative solutions that meet customer, member and IFA needs. We believe this gives us a clear point of difference and we will continue to do things that combine the competitive performance of a PLC with the trusted behaviours of a mutual.

## Strategic priorities for the group

### Green Heart experiences

- Define and nurture the culture we need to thrive, delivering a highly engaged workforce and equipping us with the talent and capability to drive our strategy forward.
- Strengthen and reposition our brand to build on its current strength and position as a mutual for today and tomorrow with broader propositions aligned to our proposed growth strategy.

### LV= 3.0

- Build a strong and deep strategic partnership with Allianz both through the general insurance business and by identifying broader opportunities to leverage capabilities and work together.
- Develop, agree and execute the strategy to deliver accelerated growth, with new proposition launches to establish the proof points for this strategy. Define a transformation plan with strong change delivery focus at the heart.

### Lean and strong

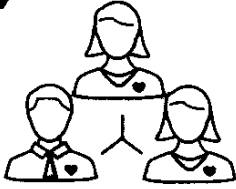
- Deliver the core strategy to ensure financial and strategic sustainability, and deliver priority projects (e.g. a new ISA product).
- Embed a strong risk management framework and culture, and comply with the regulatory changes being implemented within the General Data Protection Regulations (GDPR).

### Building a mutual for today and tomorrow

Underpinning these priorities is the work underway to create a mutual with a clearly defined social purpose, member reward strategy and an appropriate legal structure to enable the business to prosper in the long term and grow member value.

## Building on the blueprint, our vision for the future

In 2018 we took our blueprint one step further and built the vision for our future to become an even better mutual. We have set ourselves ambitions on how we will achieve this.



# 2 million

We will have over 2 million members who will benefit from our propositions and member benefits

**Members and society**

# 1 million

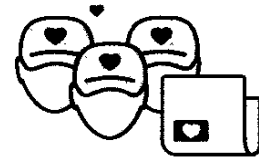
We will make financial advice and guidance available to 1 million people in the UK



# £100m

We will deliver £100m of value for our members with a cost base of £100m

**Financials**



# Top 100

We will be a Sunday Times Top 100 employer

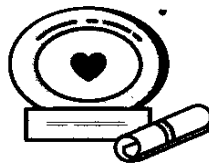
**Employees**



# Best loved

**Brand and marketplace**

We will be best loved for IFAs



# Reputation

**Brand and marketplace**

We will have a Top 50 position in brand reputation



# Top 5

**Brand and marketplace**

We will have a Top 5 position in our chosen market places of protection, retirement income and Robo-Advice

In order to make our ambitions a reality we will...



**Create meaningful membership**, where our members truly feel the value of being a member with LV=. We will help to tackle the broader issues in society, using our unique expertise to help people support all generations of their family.

**Be a challenger brand**, famous for being caring, pioneering and delivering iconic Green Heart experiences. We will be passionate about helping members and IFAs achieve their goals with systems thinking at the heart of our processes.

**Live our values** that we have explained on page 16 and our working environment will be diverse and inclusive, our people will feel proud to work here and fulfilled in their career and recommend LV= as an employer.

For our operating and distribution model we will be digitally led and easy to do business with for our IFAs and partners. We will create products that have a competitive edge and that will be IFA focused and we will build strong strategic partnerships to reach more members.

We will achieve our purpose, ambition and vision by focusing day to day on our big three drivers in the blueprint of Green Heart experiences, Lean and strong, and LV= 3.0.

## How we have performed against our strategic agenda in 2018

Our blueprint for the future will provide us with direction as we navigate the challenges and opportunities over the years ahead.

Our strategic agenda for 2018 was aligned to these drivers: Green Heart experiences, LV= 3.0 and Lean and strong.



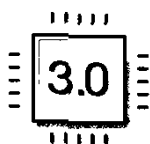
### Green Heart experiences

Green Heart experiences leave customers, colleagues and members feeling more confident about life and more confident in us.

In 2017 we launched Green Heart Support to help and comfort our customers and members, when they need it most. We aim to show that LV= is an insurer with a difference – that we act with care and compassion, and provide support to change lives for the better.

In 2018 we rolled the programme out across the organisation and have helped 1,174 customers, members and employees when they have needed us through our Green Heart Support. We feel that providing Green Heart Support is something that drives who we are.

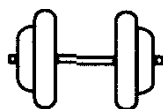
Our continued focus on our customers and members has again led to numerous awards across our business. We have won the Moneywise Customer Service Awards for the 'Most Trusted Life Insurance Provider' for the sixth year in a row, as well as the Moneyfacts award for Best Income Protection provider for the ninth year in a row. We are also YouGov's 'The UK's Most Recommended Insurer', voted by consumers, as well as being awarded Best Technology Innovation with our partner Wealth Wizards at the Pension Awards.



### LV= 3.0

LV= 3.0 harnesses the power of the latest digital technologies, evolving how we operate and bringing in new talent so our customers and members can live confident in the future.

2018 has seen the introduction of the Transformation Directorate, who are a team of people brought together from different areas of the business, all with a focus on strategic change. This team are responsible for delivering the projects within the approved Transformation Plan, through which we will start to deliver projects under LV= 3.0.



### Lean and strong

Being lean and strong ensures our customers, colleagues and members can remain confident in LV= over the long term as we eradicate waste and build on the strong financial foundations needed to be there for them in the future.

In 2018 we have achieved the following:

- Income Protection re-launch with extended product features and benefits. These changes have really strengthened our Income Protection product, and given us a more competitive edge in the market.
- A reduction in operating expenses year-on-year of £19m, which demonstrates good progress in our programme to significantly reduce our cost base.

- Moved our customer pension investments from ten funds to newer style equivalents managed by a new provider. This provides greater protection to both LV= and our members' monies and the new funds will also charge lower fees to customers.

### Business Model

The LV= group is run for the benefit of our members and is therefore different from other organisations which are owned by shareholders. We believe this difference is important in serving customers, engaging with employees and creating long-term value for our members.

Our members are customers who have certain longer-term financial products with us, such as life insurance, protection, investments or retirement policies. They have voting rights and can expect to influence the key decisions made in the Society. Eligible members may benefit from a share of any surplus profits which the group is able to allocate. They also have access to a number of additional benefits and services such as member discounts, the member care helpline and member support fund.

We aim to grow member value consistently over the longer term while managing the risk involved in doing so appropriately.

Our products comprise:

- **Retirement and protection products:** including savings and investments, and financial advice, covering peoples' lives and incomes;
- **Heritage legacy products:** focuses on savings and investment products that are no longer actively marketed, the majority of these being With-profits products.

Our product portfolio represents a careful balance of well-established, profitable lines and selective investments in growth lines, distributed to consumers, brokers, IFAs and sold directly. This mix of business lines and distribution channels provides us with diversification of risks and helps mitigate the impact of adverse market conditions and business cycles which affect specific products or distribution channels.

Our **members' funds** are managed on our behalf by our strategic partners, Columbia Threadneedle Investments, BlackRock, AgFe and Aberdeen Standard Investments. This allows us to focus on our core expertise of risk-based insurance business while benefiting from the investment management expertise of our partners. The partnership arrangements are reviewed regularly to ensure the risk and return balance is appropriate for our members.

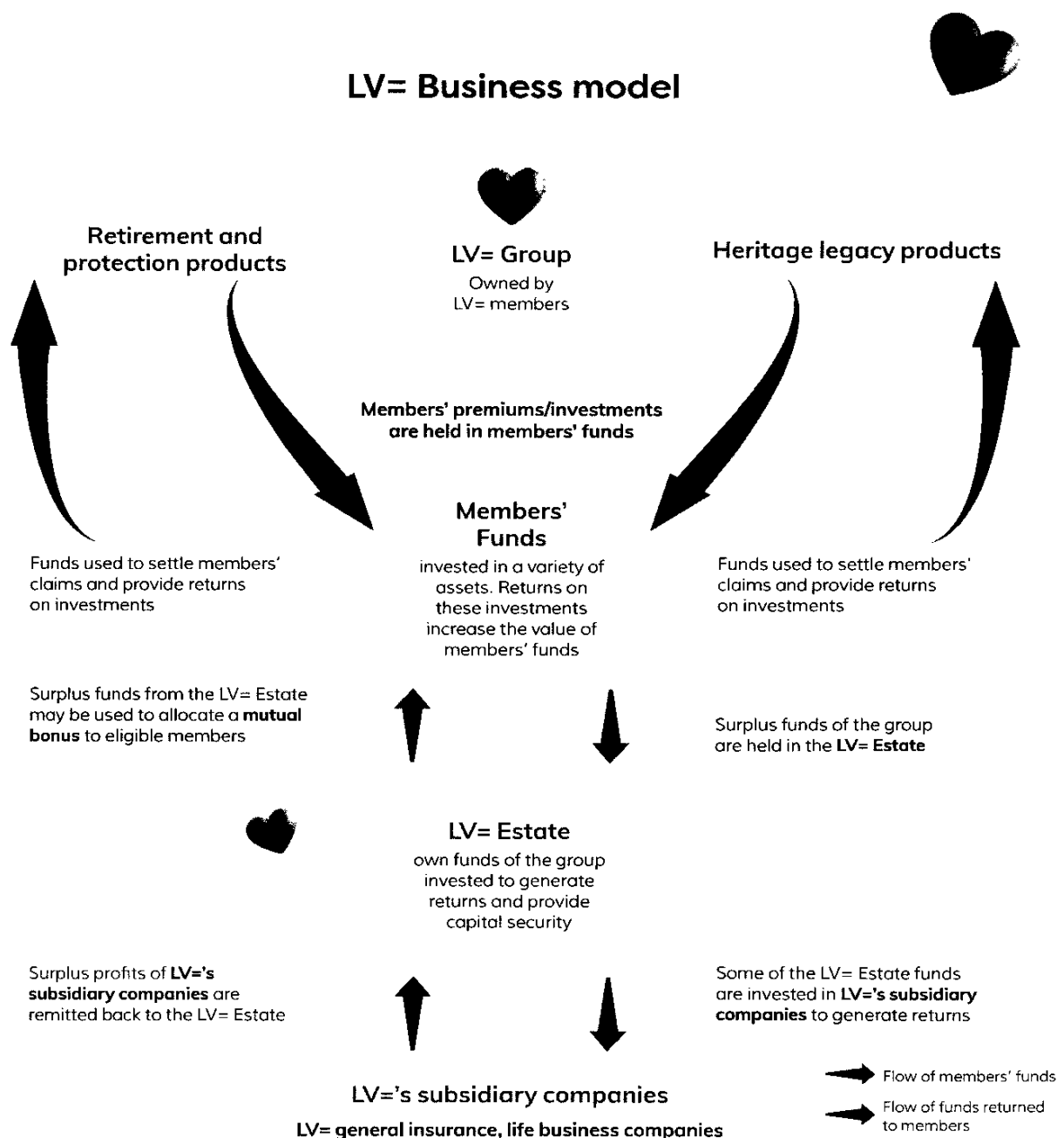
Surplus funds of the group are held in the **LV= Estate**. This is made up of unallocated divisible surplus accumulated in prior years. Estate own funds are invested to generate returns and provide the LV=group with a capital buffer.

When the financial performance and financial and capital strength of the LV= group allows, surplus funds from the LV= Estate may be used to allocate a **mutual bonus** to eligible members.

As well as investing in the debt and equity of other companies, the LV= Estate has invested a significant proportion of its funds into **LV='s subsidiary companies**. The majority of this investment is in the LV= general insurance business, which sells a variety of products, including motor and home, distributed directly or via brokers.

Surplus profits of the **LV= general insurance business** are remitted back to the LV= Estate. Following the transaction with Allianz, LV= receives 51% of any future distributed profits, until such time as there is a further sale of this investment.

The **life business** companies, such as LV= Equity Release, LV= Commercial Mortgages and Wealth Wizards, provide the life business with wider strategic and capital advantages.



# Group Finance Director's Review

**Andy Parsons**

Group Finance Director



## Overview

During 2018 we have focused on reducing our cost base to prepare for the future as a sustainable independent life and pensions business once we complete the transfer of control of the general insurance business at the end of 2019 and exit the agreement to provide central services. Our capital position has remained strong throughout the year, with positive operating capital generated by the life and general insurance businesses and stable operating profits. In the life business year-on-year cost savings have offset lower levels of new business contribution whilst the general insurance business has weathered the impact of the Beast from the East and non-injury claims inflation, to achieve a satisfactory underwriting profit and strong personal lines premium growth.

## Financial summary

### Operating capital generation

Operating capital generation of £89m (2017: £159m) includes positive contributions from both the life and general insurance trading businesses.

#### Operating capital generation 2018 £m

- Increase
- Decrease
- Total



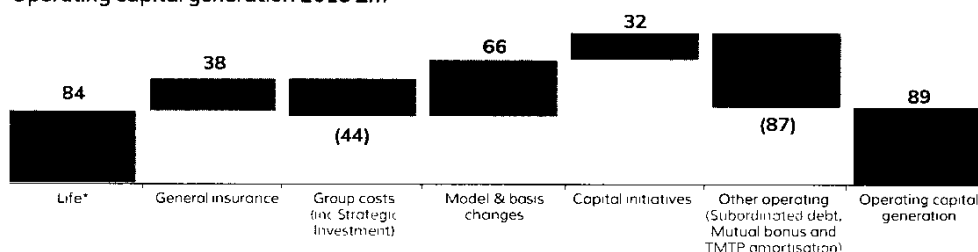
### Definitions

#### Capital surplus generation

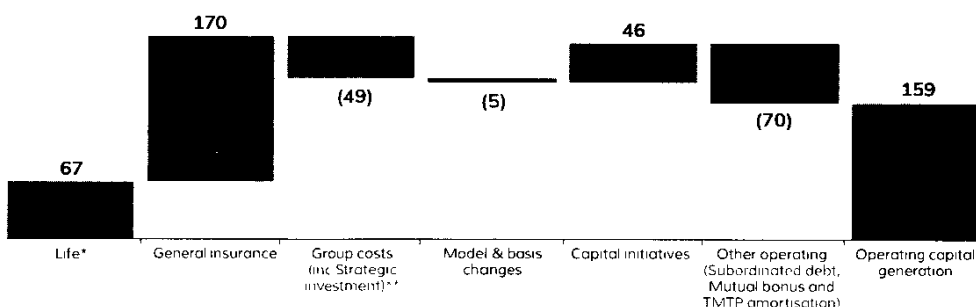
Capital surplus generation is based on the Solvency II surplus capital generated from our business operations and presented after the impact of strategic projects and financing costs.

#### Operating capital generation

Operating capital generation is capital surplus generation adjusted to remove the effects of temporary volatility, from market movements and the static nature of Transitional Measures on Technical Provisions (TMTP), changes in defined benefit pension schemes and exceptional items.



#### Operating capital generation 2017 £m



\* 2017 results are restated to include expected investment returns above the risk free rate within life capital generation; previously this was included within economic variances. This change has been made to reflect the risk premium on assets invested by the life business. 2017 operating capital generation has been increased by £24m accordingly.

\*\* 2017 results are restated by £2m to exclude the costs associated with creating a letter natural for the future. These costs are presented outside of operating capital as they are not associated with the performance of our trading businesses.

The life business generated operating capital of £84m (2017: £67m). Strong cost control offset the reduced contribution from new business written in the year. The 2017 result also included the impact of recognising a £12m provision for the costs associated with the FCA Legacy review.

Operating capital generated by the general insurance business of £38m is lower than in 2017 (£170m) reflecting our reduced equity stake of 51%, but also due to the non-recurrence of several one-off improvements in the capital position for general insurance in 2017. The result includes a £22m benefit due to our reserving assumption for the Ogden discount rate moving to 0% following the Civil Liability Bill receiving Royal assent.

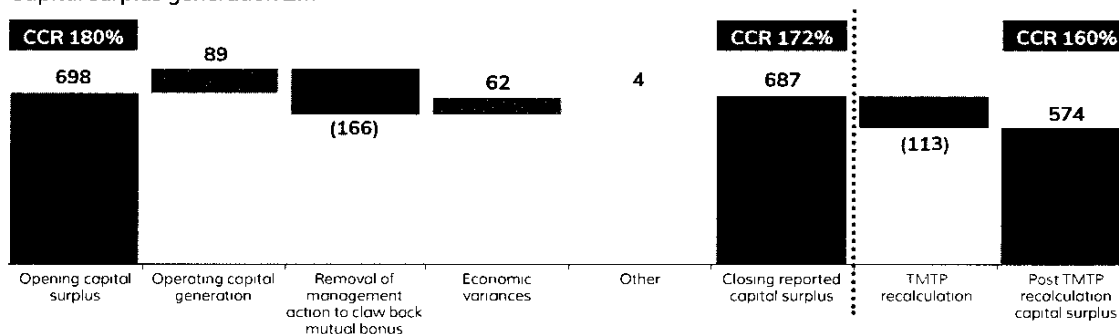
Positive model and basis changes and capital initiatives contribute £98m (2017: £41m) to capital generation. These include modelling improvements for our pensions business to better reflect policyholder behaviour post pension freedoms, favourable impacts due to updated longevity assumptions and also investment management contract renegotiations which strengthened our capital position. This offsets £131m (2017: £119m) of group costs, strategic investment, debt interest, mutual bonus and TMTP amortisation which are also included in the group operating capital position.

### Capital surplus generation

At the end of 2018 the group capital surplus was £687m (2017: £698m) with a Capital Coverage Ratio (CCR) of 172% (2017: 180%) which was well within risk appetite. The strong capital position has enabled management to improve the quality of reported capital by removing the benefit associated with management's ability to claw back previously awarded mutual bonus in times of stress; this reduced the overall capital surplus by £166m. The capital surplus has been favourably impacted by market movements.

The closing capital surplus includes the positive benefit of £490m from TMTP. If a TMTP recalculation was performed, this would reduce the surplus by £113m, resulting in a CCR of 160% at the 2018 year end.

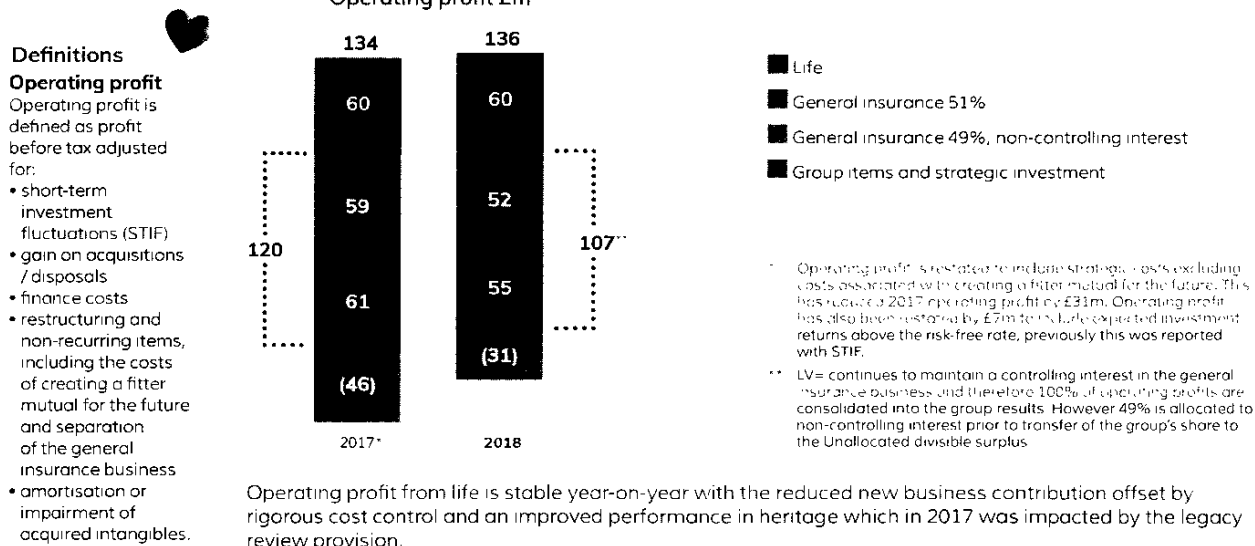
Capital surplus generation £m



### Operating profit

Operating profit at £136m (2017: £134m) includes £60m from life and £107m from general insurance, partially offset by group items and strategic investment of £31m.

Operating profit £m



Operating profit from life is stable year-on-year with the reduced new business contribution offset by rigorous cost control and an improved performance in heritage which in 2017 was impacted by the legacy review provision.

Operating profit from the general insurance business of £107m (2017: £120m) includes an underwriting result of £99m (2017: £102m) and investment returns of £8m (2017: £18m). The reduction in underwriting result is primarily due to adverse current year claims experience, offset by favourable prior-year run-off of £106m (2017: £46m).

Group items and strategic investment have reduced by £15m demonstrating improved cost control.

Operating profit as a non-GAAP measure is reconciled to the Statement of Comprehensive Income in Note 2 of the financial statements.



## Life financial summary

Results £m	2018	2017
New business contribution	19	37
Existing business	17	(3)
Model and basis changes	24	26
<b>Operating profit</b>	<b>60</b>	<b>60</b>



### Definitions

#### Present value of new business premiums (PVNBP)

The total of new single premium sales received in the year plus the discounted value at the point of sale of the regular premiums we expect to receive over the term of the new contract sold in the year. For Equity Release this represents the amount of loans provided.

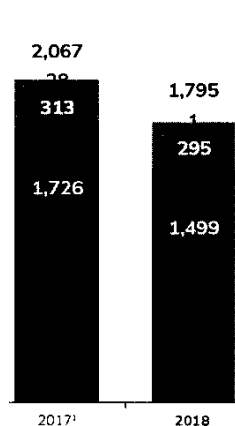
#### New business contribution

The contribution to operating profit as a result of new business written. This is reported gross of cost of capital and investment in new propositions. It includes the value-add on new business and deduction for expense overruns (i.e. the difference between the actual net costs of acquisition in the period and the costs that have been allowed for in the pricing decisions which have already been recorded in value-add on new business above).

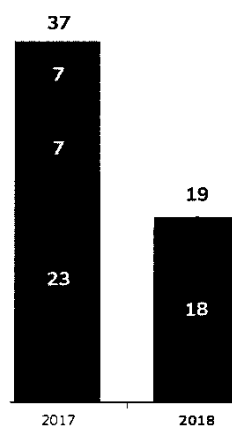
1 PVNBP has been restated to align the definition of PVNBP across all metrics used in management reporting. PVNBP is now presented on a Solvency II basis adjusted to include future regular premiums on pensions. This is based on best estimate assumptions, and re-stated to remove margins previously used in the calculation. This has increased 2017 PVNBP by £50m.

2 Whole-Of-Life and Mortgage and Lifestyle Protection products were discontinued in 2017 and the impact of these products is shown separately

PVNBP £m



New business contribution £m

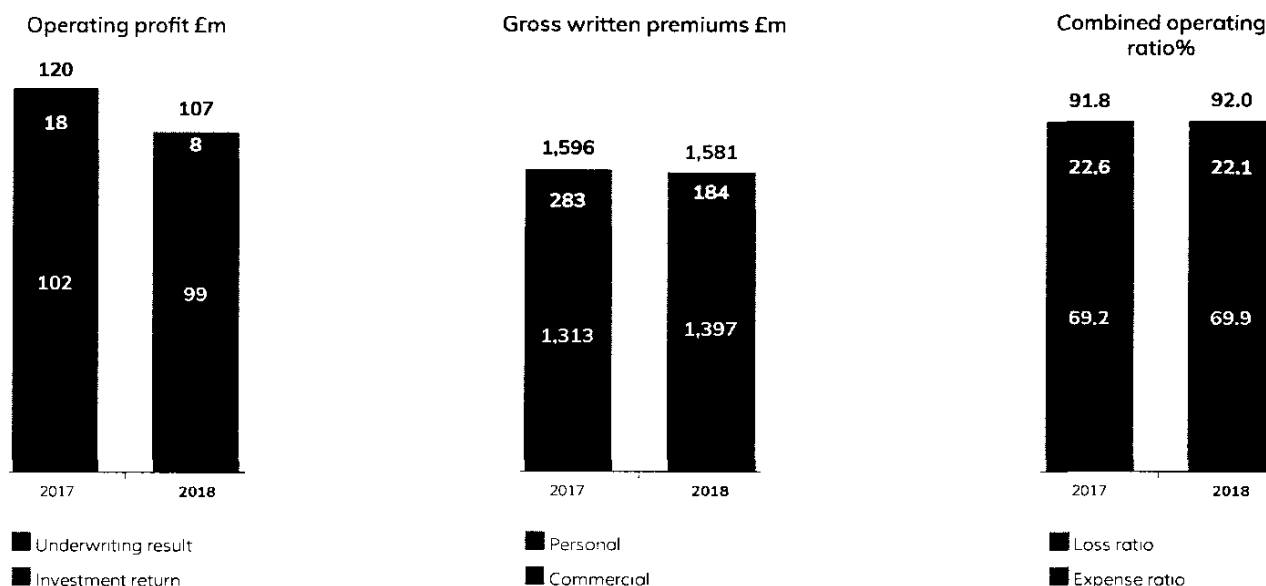


Retirement new business sales were down 13% from 2017 on a PVNBP basis to £1.5bn. Significant movements include a £306m (23%) reduction in pensions sales, with defined benefit to defined contribution transfers reducing from their peak at the end of 2017. This is partially offset by strong growth in Equity Release with sales up by £92m (77%) due to a very successful year as our presence in this market grows. During 2018 we redesigned our Flexible Guarantee product proposition and also entered an investment fund contract with Vanguard, ensuring that our propositions continue to provide good value for customers and are capital efficient for the Society. Reduced sales volumes have led to lower new business contribution.

Ongoing protection sales have decreased by £18m (6%) versus 2017. Across our continuing product lines we have experienced a change in mix during 2018, with Term Life sales continuing to grow strongly, whilst volumes of Income Protection and Critical Illness have reduced. Improvements to our market leading Income Protection proposition in the summer have been well received with sales on an increasing trend through the second half of the year. New business contribution has also been impacted by the change in business mix from Income Protection to Term Life.

Operating profit from life is flat year-on-year, with the reduction in new business contribution of £18m offset by rigorous cost control and an improved performance in heritage which was impacted by the £12m legacy review provision in 2017. The improvement in existing business of £20m is driven in part by the non-repeat of negative experience on equity release prepayment rates in 2017. Model and basis changes at £24m (2017: £26m) include the impacts of changes to reserving basis assumptions arising from the annual basis review (see page 61) and management actions. Management actions favourably contribute to the result and include benefits from the renegotiation of a new investment management contract with Columbia Threadneedle Investments.

## General insurance financial summary



Operating profit of £107m (2017: £120m) includes an underwriting result of £99m (2017: £102m) and investment returns of £8m (2017: £18m). The reduction in underwriting result is primarily due to adverse current year claims experience, including £17m from the Beast from the East, offset by favourable prior year run off of £106m (2017: £46m). The prior year run off includes a £35m benefit from an improved expectation for the Ogden Discount rate. Investment returns continue to be low and have been impacted by losses on interest rate swaps, which were previously held to hedge against fluctuations in interest rates, of £7m; these were closed out in July as part of a revised Investment strategy.

Gross written premiums of £1,581m were 1% lower than in 2017, however underlying personal lines premiums grew by 6%, excluding the impact of the commercial lines business which started to transfer to Allianz during the year. Growth in personal lines has been generated by an 8% increase in customer policies as a result of good retention rates and strong sales of new business supported by the launch of a number of new products, in particular Multi-car.

Motor premium rates reduced early in the year, following positive progress towards the Civil Liabilities Bill which will reset the Ogden Discount Rate and market-wide falls in the number of whiplash claims. Rates then rebounded in the second half reflecting the increase in claims costs due to vehicle repair cost inflation, as well as higher overall claims frequency. Other product lines also incurred high levels of claims costs as our household account was impacted by unfavourable weather experience from both the Beast from the East early in the year and an increase in subsidence frequency following the warm and dry summer weather conditions. Furthermore the commercial lines business was affected by an unprecedented number of large losses.

The combined operating ratio at 92.0% continues to show consistent strong delivery at just 0.2% adverse to 2017 with claims slightly adverse in aggregate mostly offset by favourable expenses, including lower commission spend.

### Definitions

#### Loss ratio

The ratio of net benefits and claims to net earned premiums.

#### Expense ratio

The ratio of general insurance other expenses net of other income to net earned premiums.

#### Combined ratio

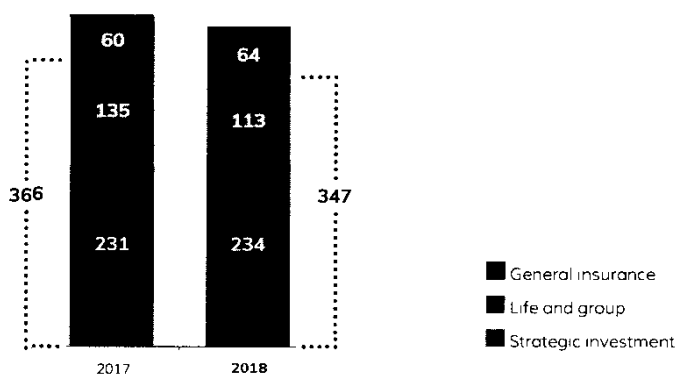
The total of the loss ratio plus the expense ratio.

## IFRS result analysis

### Expenses

Cost control remains a key priority and this is demonstrated by the continued reduction in operating expenses year-on-year of £19m.

Operating expenses £m



#### Definitions

##### Operating expenses

Operating expenses are management expenses (which excludes commission) before deduction for amounts ceded to reinsurers. These are adjusted to exclude one-off costs associated with the Allianz transaction, creating a fitter mutual for the future and GMP pension equalisation adjustment.

Prior periods are restated by £5m to exclude costs associated with creating a fitter mutual for the future and amortisation of acquired intangibles. This aligns the definition of operating expenses to represent items included with operating profit.

##### Treatment of policyholders tax

LV= pays tax on behalf of its policyholders when they make gains on their investments.

The tax paid is deducted from the policyholders' asset share. Policyholder tax is reported in Income tax expense with the deduction from policyholders' asset share credited to Short-term investment fluctuations and related items.

##### Profit/(loss) before tax (PBT)

Our measure of PBT is defined as International Financial Reporting Standards (IFRS) profit before tax, mutual bonus allocated, and transfer to unallocated divisible surplus and includes the PBT from both continuing and discontinuing businesses.

Life and group costs have reduced by over 16% reflecting a continued strong focus on cost efficiencies throughout the year driving savings in staff and bonus costs, marketing spend, contractual costs and project spend. This discipline will continue through 2019 as we drive further efficiencies in the life business ahead of the exit from the agreement to provide central services to the general insurance business.

General insurance costs have remained broadly flat year-on-year with £12m of expense savings embedded into the agreement to provide central services offset by an increase in advertising and promotional spend to support the rollout of Pioneer, with additional products (Multi-car and Home), and additional investment in pricing and digital areas.

Increased strategic investment spend has been incurred as we continue to invest for the future, and includes amortisation of the re-platforming programme in general insurance.

### Profit before tax

Profit before tax of £20m (2017: £122m) includes the positive impacts from operating profit of £136m (2017: £134m) and recognition of a £17m derivative asset regarding the option to sell the group's remaining equity stake in the general insurance business. Short-term investment fluctuations (STIF) are negative at £66m (2017: positive £30m) and include £37m (2017: £6m positive) relating to the impact of unmatched market movements in the value of investments driven by adverse impacts of widening corporate bond spreads causing losses on annuities. STIF also includes £29m (2017: £24m positive) relating to tax credits on policyholders' asset shares.

Costs impacting PBT include the costs associated with restructuring of the group of £34m (2017: £19m), financing costs including interest on subordinated debt of £24m (2017: £24m) and £9m (2017: £3m) of other items. Cost associated with restructuring the group of £34m (2017: £19m) include costs associated with the separation of the general insurance business of £25m (2017: £17m) and £9m (2017: £2m) invested in creating a fitter mutual for the future. Other items of £9m (2017: £3m) include £6m expense incurred from Guaranteed Minimum Pension (GMP) equalisation in our staff pension scheme (see page 171) and amortisation of acquired intangibles.

The 2017 result was also impacted by £52m profit on the sale of the commercial business renewal rights to Allianz and £48m increase in life reserves due to the change in economic basis for long-term insurance liabilities.

### Tax

The total tax credit of £14m (2017: £50m charge) includes £29m related to tax credits on losses on policyholder asset shares. The corresponding debit is reported within short-term investment fluctuations. Profits in the general insurance business generated a tax charge of £17m. Our tax policy is published on our website LV.com.

### IFRS Surplus (UDS)

Unallocated divisible surplus (UDS) has decreased by £62m in the year, which includes PBT adjusted for movements in other comprehensive income relating to revaluations of the staff pension schemes (£29m reduction, 2017: £19m increase) and revaluation of investments classified as available for sale (£10m reduction, 2017: £nil). Other items impacting the movement in UDS are a deduction of £31m relating to the non-controlling interest share of income (2017: £2m share of loss), mutual bonus allocated to members' policies of £26m (2017: £26m) and a £14m income tax credit (2017: £50m charge).

## Investment performance

Columbia Threadneedle Investments (CTI) manages the active investments for both the With-profits and FGB product funds. The funds invest in a range of asset classes including equities, fixed income, property and others.

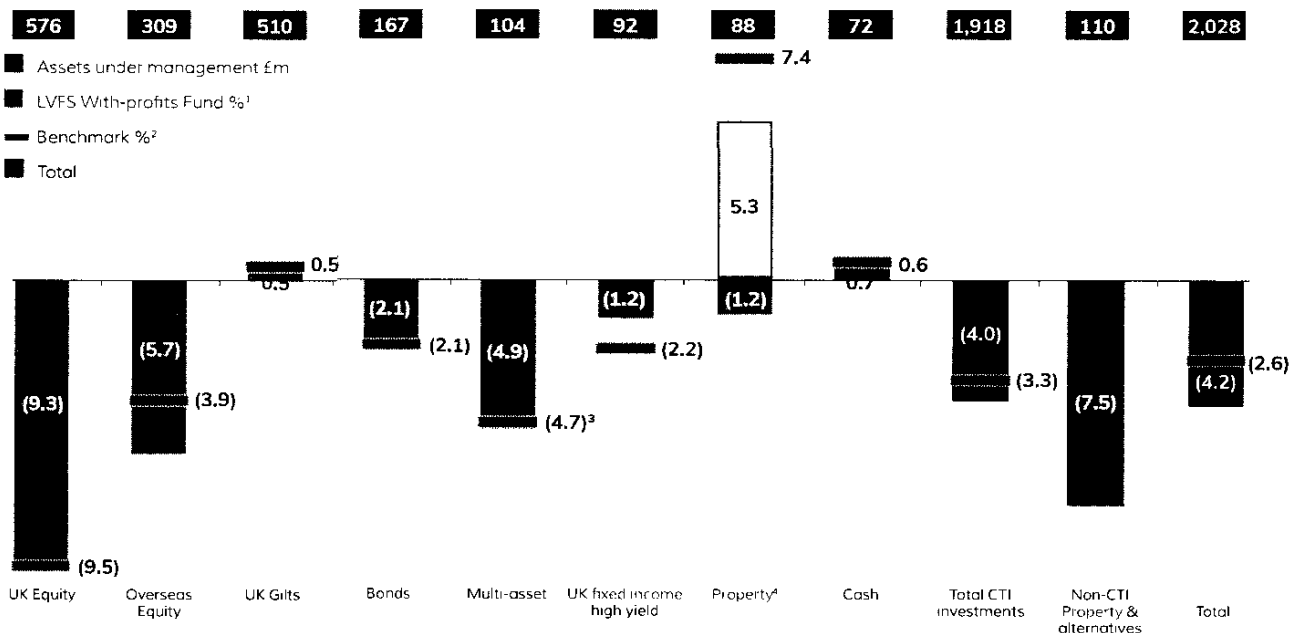
Market sentiment shifted significantly and swiftly over the year from concern that the global economy would grow too fast to concern that the economy would stagnate following trade wars and the impact of a China slowdown. As a result, global equity markets were volatile and weak during 2018 with all but the US market experiencing significant losses in GBP terms. The strategy of our asset manager CTI, to purchase shares in high quality companies that are expected to grow over a medium-term horizon suffered from market conditions more than defensive strategies during 2018.

Property was a key source of underperformance; hurt by uncertainty. In December, CTI temporarily changed the pricing basis of the dual-priced UK Property Fund in which we invest, from "offer" basis to "bid" basis. The change was made as a result of outflows from the CTI fund and ensures that investors who exit the fund pay their fair share of the additional expenses incurred should sales be required to meet those redemptions, effectively protecting the remaining investors such as LV=. The impact to the share price (and therefore performance) of the move to bid basis was a negative movement of around 6.5%. When the funds revert to an "offer" basis there should be a corresponding positive performance impact.

Non-CTI Property and alternatives are historic illiquid investments that have not performed well in 2018. We are looking at strategic options regarding these investments.

### Main LVFS With-profits fund performance

The main With-profit fund returns were negative at 4.2% in the year (2017: 7.7% positive returns) and below benchmark, impacted in particular by the property and overseas equities underperformance.



1 This represents assets held within the main LVFS With-profits fund. It excludes CB pensions and assets held in the LVFS With-profits fund. The performance of this fund represents a change in value of the fund itself, rather than a change in the value of individual members' policies during the year.

2 Benchmark performance is calculated using a blend of recognised metrics which reasonably represent the market level performance for the mix of assets included in the main LVFS With-profits fund.

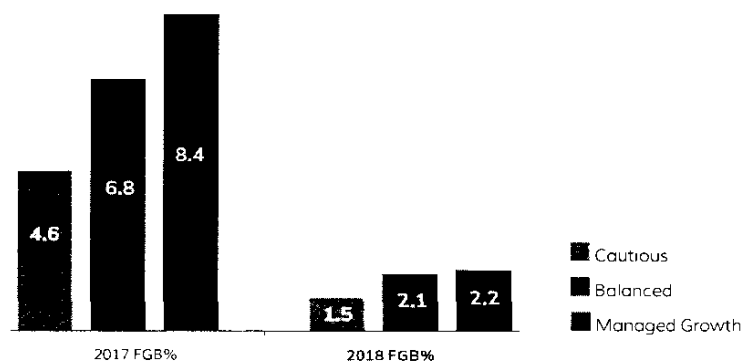
3 This represents an average of relevant peer group returns.

4 Property returns are impacted by the change in pricing from offer to bid. Excluding this, property returns are 5.3%.

### Flexible Guarantee returns %<sup>5</sup>

The Flexible Guarantee Bond (FGB) returns on our Cautious, Balanced and Managed Growth funds were 1.5%, 2.1% and 2.2% (2017: 4.6%, 6.8% and 8.4%) respectively. FGB funds have generated positive returns for most policyholders during 2018 despite the adverse market conditions.

5 FGB returns are the smoothed returns to policyholders which takes the average of the fund's daily underlying unit price over the preceding 26 weeks to produce an averaged price.



## Definitions

### Capital reporting basis

The capital coverage ratio represents the ratio of eligible own funds over the Solvency Capital Requirement in accordance with the Solvency II regime.

The 31 December 2018 figures are estimated and have not been subject to an external audit opinion. The group capital resources table shows the estimated eligible own funds, Solvency Capital Requirement and surplus funds of the group. Figures exclude RNPFN and Teachers ring-fenced funds. Calculations are based on the Standard Formula approach using the Volatility and Matching Adjustment (for eligible business) and TMTP recalculated as agreed by the PRA during the year.

### Tiers of capital

There are three tiers of capital defined by Solvency II. The quality of capital is important as the higher the quality the more likely it will be available in the event that it is needed, for example to be able to pay out claims. Tier 1 capital primarily represents high quality capital which is generally more secure and capable of absorbing losses. Tier 2 capital represents our subordinated debt and Tier 3 capital is the lowest quality of capital (deferred tax assets).

- Market risks<sup>2</sup>
- Life insurance risk
- Operational and counterparty risk
- General insurance risk

## Capital performance

At the end of 2018 the group capital surplus on a Solvency II Standard Formula basis is estimated to be £687m (2017: £698m) with a capital coverage ratio of 172% (2017: 180%). This includes the removal of the management action to potentially claw back mutual bonus.

### Solvency II

Since the implementation of Solvency II, the group has applied the Matching Adjustment to the majority of its annuity business as an integral part of the group's approach to asset and liability management. The group also applies Transitional Measure on Technical Provisions (TMTP) and the Volatility Adjustment. The TMTP provides firms with relief over a period of up to 16 years from implementation of Solvency II from the financial impact on Technical Provisions of moving to the Solvency II regime. The TMTP amortises annually over 16 years from 2016.

The group complied with all regulatory capital requirements that it was subject to throughout the reporting period.

### Group capital surplus

£m	2018	2017
<b>Eligible own funds</b>		
Tier 1	1,241	1,178
Tier 2	372	379
Tier 3	24	10
<b>Total eligible own funds</b>	<b>1,637</b>	<b>1,567</b>
<b>Solvency capital requirement</b>	<b>950</b>	<b>869</b>
<b>Surplus<sup>1</sup></b>	<b>687</b>	<b>698</b>
<b>Capital Coverage Ratio (CCR)</b>	<b>172%</b>	<b>180%</b>

1 The capital surplus reported in the Annual Report is based on the best-estimate of the results at the Annual Report signing date. It is possible that this result will be adjusted prior to final publication of the group Solvency Financial Condition Report later in 2019.

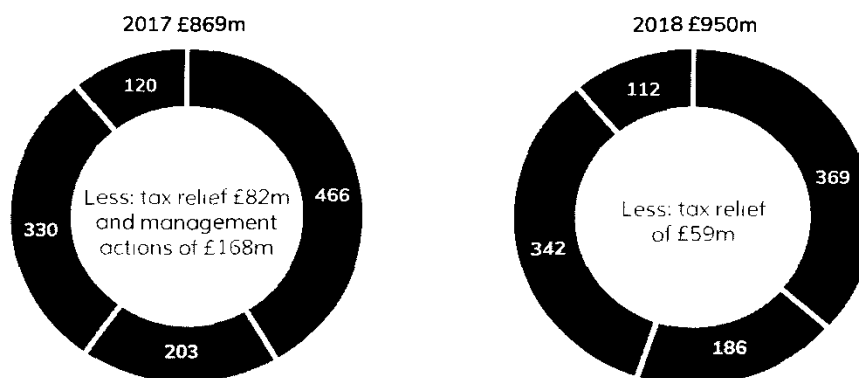
In order to report our Capital Coverage Ratio on a standard 'Investor view' basis, the eligible own funds and Solvency capital requirement exclude amounts attributable to the Royal National Pension Fund for Nurses (RNPFN) and Teachers ring-fenced funds. Including these funds, to provide a 'Regulatory view', would not change the capital surplus shown above as these funds do not require capital support. It would however increase capital required, and therefore dilute the reported Capital Coverage Ratio to 166%.

As the majority shareholder in the general insurance business the group retains control of the business, and as a result the capital calculation consolidates the risk profiles of the two entities and benefits from diversification between the different exposures. At the end of 2019, upon sale of a further equity stake in the general insurance business, the group's shareholding will reduce below 50%, at which point the capital calculation would no longer be based on this consolidation of the risk exposures.

Eligible own funds include the positive benefit of TMTP of £490m (2017: £528m) after the annual step down of £38m, (2017: £37m). TMTP is required to be recalculated for business and economic change at least every two years and the most recent recalculation was the industry-wide recalculation on 31 December 2017. The estimated impact of a potential TMTP recalculation on the 31 December 2018 surplus would be a reduction of £113m, resulting in a Capital Coverage Ratio of 160%.

The capital surpluses discussed here make assumptions about the out-turn of Brexit negotiations. It is possible the final outcome of the negotiations may impact the capital position.

### Solvency capital requirement

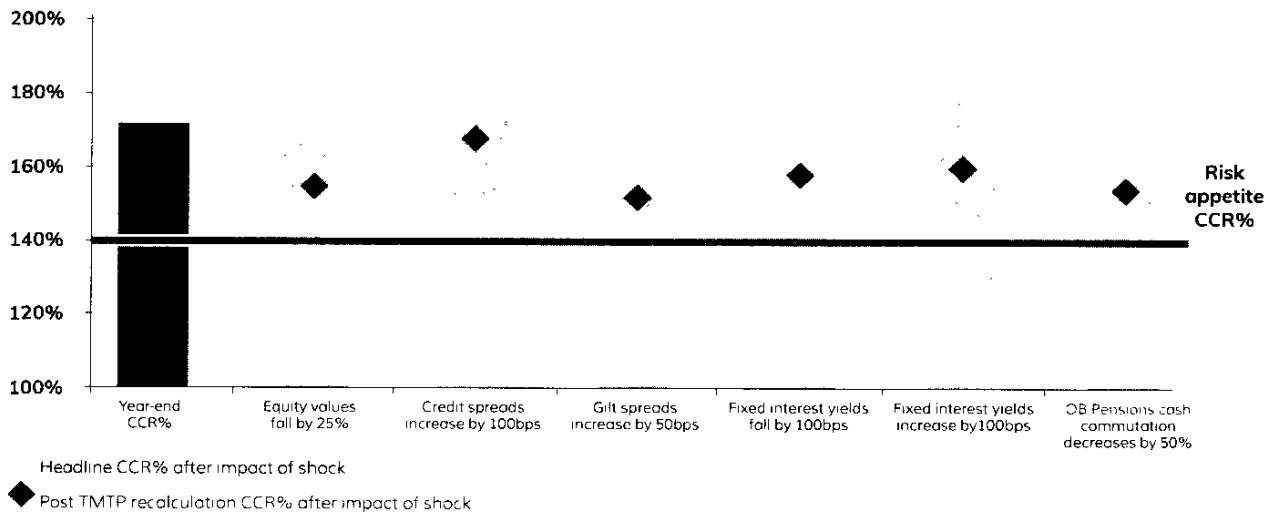


2 Market risks include credit, equity, property, interest rate, and other risks.

### Sensitivity analysis of Solvency II group capital surplus

The following table shows the sensitivity of the group's Capital Coverage Ratio to economic assumptions on a pre and post TMTP recalculation basis. All other assumptions remain unchanged for each sensitivity, except where these are directly affected by the revised economic conditions or where a management action that is allowed for in the solvency capital requirement calculation is applicable for that sensitivity. The credit and gilt spread sensitivities represent a widening of yields on relevant asset classes in basis points (bps) relative to swap rates. The sensitivities below allow for the impact of the group's hedging strategy.

#### Sensitivity of Capital Coverage Ratio (CCR) % to changes in economic assumptions



**172%**  
Solvency II Capital  
Coverage Ratio

The group's capital surplus position is sensitive to the above economic assumptions due to the following:

- A fall in equity values reduces the value of the group's defined benefit pension schemes, increases With-profits guarantee costs and reduces the benefit of future charges on unit-linked business, all of which are partially hedged to equity market movements. A TMTP recalculation would not reduce the impact of this sensitivity as TMTP is predominantly driven by interest rate related market risks.
- A widening of credit spreads, relative to swaps, increases the value of the group's defined benefit pension schemes by reducing the value of future liabilities. It also reduces the value of liabilities using the Volatility Adjustment. This is partially offset by a reduction in corporate bond values held to support the general insurance business lines. Following a TMTP recalculation, the benefit reduces further due to the loss of Volatility Adjustment and increased risk associated with annuity business, arising from an assumption under the previous solvency regime of increased credit defaults as spreads widen.
- A widening of gilt spreads, relative to swaps, reduces the value of the group's defined benefit pension schemes and the assets invested to support the Society's liabilities.
- Changes to fixed interest rate yields (both swap and gilt rates) lead to changes in the group's capital surplus position prior to a TMTP recalculation as the Solvency II yield exposure is hedged on a post-TMTP recalculation basis. Following a TMTP recalculation, the residual exposure largely arises from the defined benefit pension schemes.
- A decrease in the rate at which OB Pensions deferred annuity policyholders commute their annuities to cash increases the group's liabilities. This is because the liability to pay the annuity is higher than that to pay the cash lump-sum: this implies an annuity rate significantly more generous than that currently available in the market.

### Capital management considerations

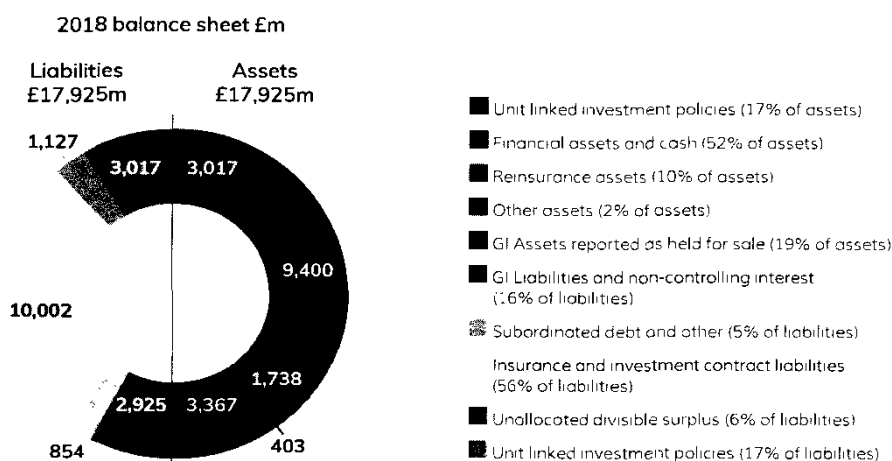
The PRA issued a policy statement (PS 13/18) in December 2018 outlining their expectations in respect of firms investing in equity release mortgage portfolios. The purpose was to ensure that where firms have invested in equity release mortgages, appropriate allowances are made for the risks to which they are (directly or indirectly) exposed. The guidance primarily impacts firms investing in equity release mortgages since the inception of Solvency II and holding them within a Matching Adjustment portfolio. The group does not have equity release mortgages in its Matching Adjustment portfolio and therefore the PRA policy statement has minimal impact on its capital position.

The Bank of England announced during 2018 that firms should treat a London Interbank Offered Rate (LIBOR) discontinuation event 'as something that will happen and which they must be prepared for'. The FCA and PRA issued a joint Dear CEO letter to major banks and insurers to seek assurance that firms' senior managers and boards understand the risks and are taking appropriate action now to enable the move to alternative rates ahead of the end of 2021. The most significant exposures to LIBOR faced by the group are:

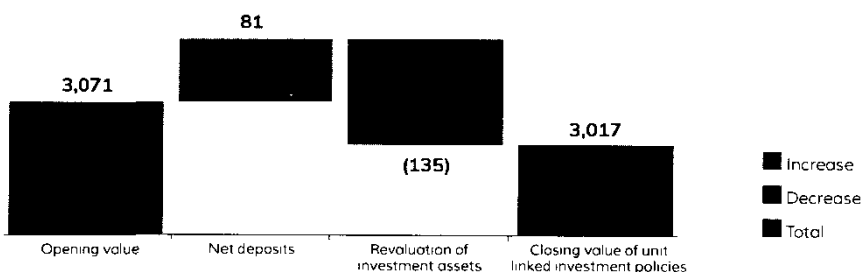
- Solvency II risk-free rate: The Solvency II liability discount rate is based on the LIBOR swap curve.
- Derivative portfolio: The group's interest rate swaps reference LIBOR providing a close match to the Solvency II liabilities.

The group has plans to gradually transition its modest derivative portfolio and is keeping abreast of developments regarding the Solvency II discount curve.

### Balance sheet



### Movement in unit linked investment policies £m



**Definitions**  
**Unit linked investment policies**  
 Policyholders purchase units in the investment fund. Any movements in the value of the investment fund will result in an identical change in the value of the policy.

Balance sheet assets have decreased by £0.6bn in the year to £17.9bn. This decrease is driven by net losses on investments of £605m, including £135m relating to unit linked policies. This has also led to a corresponding fall in the valuation of insurance contract liabilities. The assets and liabilities of the general insurance business are presented separately from other group assets and liabilities as it is now reported as a discontinued operation under IFRS 5.

## Liquidity management

Operational liquidity outflow of £36m includes liquidity generated by our life trading businesses of £35m (2017: £28m) offset by outflows of investment in strategic projects and financing costs. Whilst the general insurance business has generated capital during the year, any dividends in respect of this will be received by the Society in 2019 due to the uncertainties regarding Brexit.

Non-operational and one-off items include funding contributions to our staff pension schemes following the triennial valuation in the year and movements in working capital. Other items impacting liquidity are £29m of economic variances and £42m of model and basis changes. During the year we have also allocated a mutual bonus of £26m to eligible policyholders.

The table below summarises the operational liquidity generated for the Society.

£m	2018	2017
<b>Opening operational liquidity</b>	<b>947</b>	<b>306</b>
Life liquidity generation	35	28
General insurance dividends	–	95
Other dividends	–	23
Group costs and strategic investment	(48)	(48)
Finance costs	(23)	(23)
<b>Operational liquidity (outflow)/inflow</b>	<b>(36)</b>	<b>75</b>
Sale of equity stake in general insurance business	–	489
Pension scheme contribution	(44)	(6)
Working capital and other	(38)	(23)
Economic variances	(29)	6
Model and basis changes and capital initiatives	(42)	126
<b>Non-operational and one-off items</b>	<b>(153)</b>	<b>592</b>
Mutual bonus	(26)	(26)
<b>Closing operational liquidity</b>	<b>732</b>	<b>947</b>

### Definition Operational liquidity

Operational liquidity is generated from movements in free assets in the year (including cash and cash equivalents and surplus assets within funds in excess of matched liabilities).

This excludes amounts attributable to the RNPEN and Teachers ring-fenced funds. The movements in operational liquidity are not reconcilable to the group's IFRS Statement of Cash Flows.

## Outlook

2019 will be a transformational year for LV=. By the end of 2019 we plan to have exited the agreement to provide central services as we transfer control of the general insurance business to Allianz. Going forward we will be focusing on the group as a life and pensions business and we will be working with members and the regulator to reshape the Society to build a better mutual for the future. Alongside our continued focus on costs and the capital position we are also investing in the life business product propositions to generate future improvements in the life trading results. This will ensure the business is well placed to meet its future financial and strategic plans.



# Life Review

**John Perks**

Managing Director of Life



**£60m**

Operating profit



2018 has seen our life business face strong competition in our chosen markets while managing a high change agenda as we restructure for our future as a life and pensions focused business. In the face of these challenges I am very pleased that the life business has continued to generate good levels of operating capital and operating profit. The hard work, dedication and professionalism of our people has been a constant throughout the year and I am extremely grateful to them for this. It is the quality of our people and their focus on ensuring that the needs of our customers, members and IFAs are met that differentiates us from our competitors and ensures that we remain Best Loved.

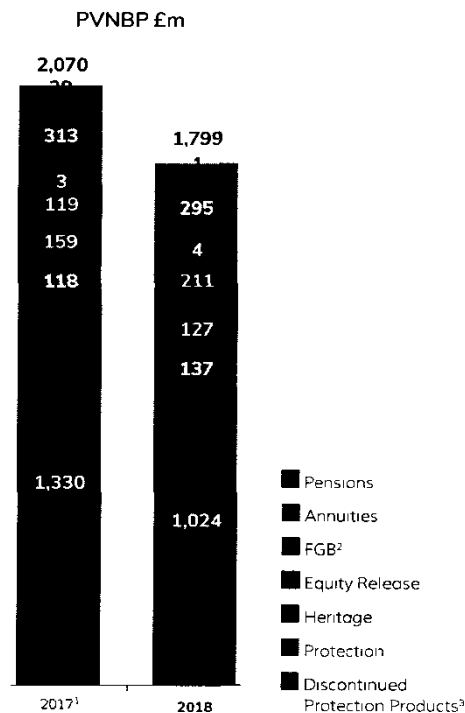
## 2018 life results

The life business generated an operating profit of £60m, in line with 2017. This includes the impact of favourable capital management actions and the exit of some product lines. The underlying trading business saw reduced levels of new business contribution in a highly competitive market. Modelling changes reflecting the latest consumer experience post Pensions Freedom and Choice also led to lower margins from pensions new business. This was offset by rigorous cost control and the non-recurrence of the legacy review costs incurred in 2017.

New business sales have reduced by 13% year-on-year on a present value of new business premium (PVNBP) basis, predominantly impacting the pensions business as the defined benefit to defined contribution transfer peak seen in the previous year dropped-off in 2018.



- 1 PVNBP has been restated to align the definition of PVNBP across all metrics used in management reporting. PVNBP is now presented on a Solvency II basis (adjusted to include future regular premiums on pensions). This is based on best estimate assumptions, and re-stated to remove margins previously used in the calculation. This has increased 2017 PVNBP by £50m.
- 2 Sales figures for Flexible Guarantee Bonds (FGB) exclude investments by Pensions customers into the Flexible guarantee fund. These flexible guarantee bond sales within our pensions wrapper are included within pensions sales.
- 3 Whole-Of-Life and Mortgage and Lifestyle Protection products were discontinued in 2017 and the impact of these products is shown separately.



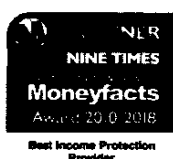
## Retirement

Retirement new business sales were down 13% from 2017 on a PVNBP basis to £1.5bn. Within pensions, sales were down by £306m (23%), with defined benefit to contribution transfers reducing from their peak at the end of 2017. The new investment fund contract entered into with Vanguard in the second half of the year has improved the competitiveness of the pension investment proposition which, alongside a number of pricing and proposition initiatives already in flight, we expect to translate into sales growth in 2019. Equity Release has had a very successful year as our presence in this market grows, with sales up by £92m (77%). Annuity sales have also improved by £19m (16%), totalling £137m. Flexible Guarantee Bond (FGB) volumes declined by £32m (20%) to £127m due to reduced marketing and promotions while we took steps to redesign our proposition. The various in-year changes have shifted the mix slightly to lower margin products, reducing new business contribution.

Income from our Retirement Advice Service grew 6% year-on-year with significant growth driven by our largest corporate partner, Reassure. This reflects our advisers helping more customers than ever to plan for an affordable retirement and to access their pensions by providing them with regulated advice solutions. Income from our direct to consumer business has reduced year-on-year as we reviewed promotional activity in 2018.



**MOST TRUSTED**  
LIFE INSURANCE PROVIDER  
LV=



## Protection

Protection sales have decreased by £45m (13%) on 2017, £27m of which reflects the decision taken last year to improve the sustainability of the protection business with the closure of Whole-Of-Life (both intermediated and direct-to-consumer products) and the niche Mortgage and Lifestyle Protection offerings. These closures reflected our focus on return on capital and appropriate customer products from a conduct risk perspective. Term Life sales continue to increase achieving double digit sales growth for another year. Income Protection volumes have reduced by 9% on 2017 reflecting the low sales in the first half of the year; performance in the second half of the year was flat year-on-year as the marketplace responded to the enhancements made to our Income Protection product. Critical Illness sales have decreased by 40% on 2017 as we have focused our efforts on developing our value driving Income Protection proposition. New business contribution has been impacted by the change in business mix from Income Protection to Term Life as well as the closure of our capital intensive propositions.

In the third quarter we launched our extended Income Protection proposition to include rehabilitation support services as soon as our customer is unable to work, improved benefits

for medical professionals, and we are now the only provider to offer parent and child cover at no extra cost. Our strong proposition continues to be recognised as market leading, including winning the 'Best Income Protection provider' Moneyfacts award for the ninth year in a row.

We continue to develop Fastway, our quote and apply system, in order to support our goal of providing simpler access to good quality propositions at a good price. 2019 will see further products being added to the suite.

## Heritage

Our heritage business includes legacy With-profits policies along with some non-profit business. The business includes With-profits and unit-linked business acquired from the Royal National Pension Fund for Nurses (RNPfN) as well as policies from Teachers Assurance, which was bought in 2016 and integrated into our accounts and fully migrated to our core systems at the end of the year.

Recent maturity and surrender values for LVFS With-profits policies show that LV= continues to perform strongly, exceeding median payouts in all selected policy categories and achieving top quartile payouts in all pension categories, when compared against industry payouts.

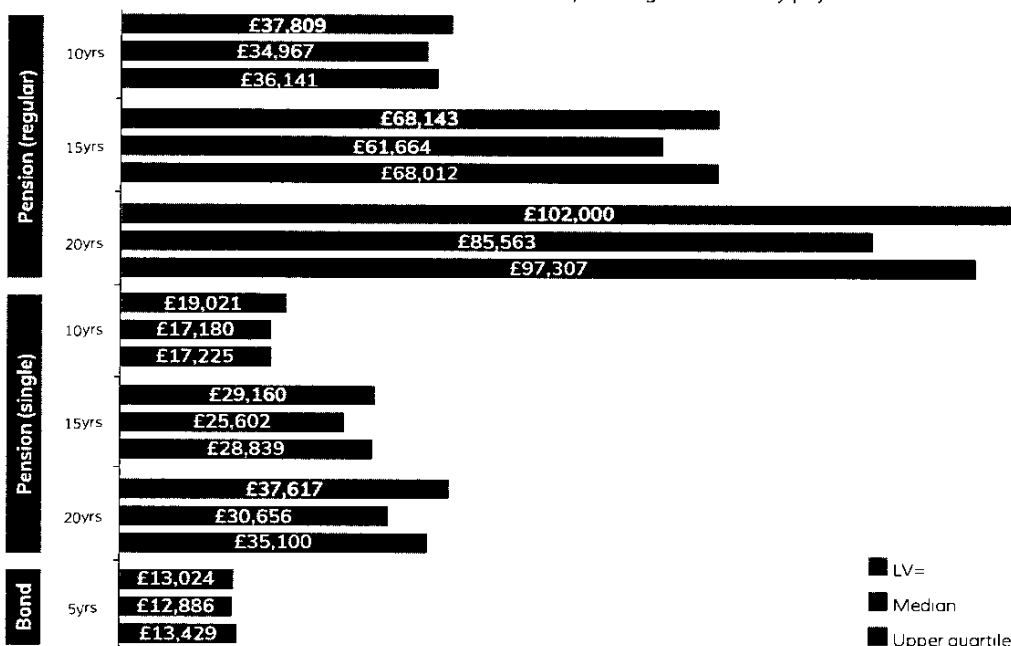
1 The LV= payouts are based on the following policies:

- Pension – Policyholder retiring at age 65, maturing 1 January 2018. Premium of £200 monthly (Pension regular) and single premium of £10,000 (Pension single)
- Bond – A five year investment of £10,000 in the FGB balanced series 2 fund (no guarantees), maturing at 1 November 2018.

2 The industry payouts (median and upper quartile) are taken from past performance surveys and relate to maturities and bond surrenders during 2018. The sources are:

- Pension (regular) and Pension (single) – Money Management survey published March 2018.
- Bond – Money Management survey published January 2019.

3 No data is provided for Endowment performance as no Money Management survey has been published since April 2016. The previous results of our payouts compared with benchmark industry performance are shown on page 47 of the 2016 Annual Report.



## Looking Ahead

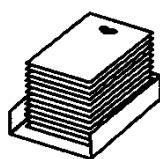
We are a top ten UK life insurer and will continue to develop our strong propositions, and our award-winning customer and sales support. We are also continuing to improve our online capability to make us 'easy to do business with'. We will be driving our best loved strategic initiative in 2019, focused on improving our adviser experience. This will include the launch of a new business-to-business (B2B) marketing strategy and optimisation of our current distribution model.

Throughout 2018 we have continued to support our customers and members in extraordinary and unusual circumstances, when they need help the most but expect it the least. This demonstrates that we are an insurer with a difference; we act with care and compassion, and provide support to change lives for the better. In 2019, we will be launching our Green Heart Revolution, strongly supporting our Best Loved initiative, by reducing processing times and improving the service we provide to both advisers and customers.

# General Insurance Review

**Steve Treloar**

Chief Executive, General Insurance



Over  
**5 million**  
customer policies

When I reflect on 2018, I am exceptionally proud of what was achieved, particularly in the face of what was a challenging year for the industry with numerous bad weather events, including the Beast from the East followed by the hot summer resulting in a high number of subsidence claims.

We started the year as a brand new organisation, following the launch of the strategic partnership with Allianz. In the space of 12 months, we have successfully transferred the majority of the personal lines home and motor business from Allianz, created five new products and broadened our distribution with these new products offered across 1,400 brokers, of which around 150 were new partners to LV= Broker. We also started transferring our commercial lines portfolio to Allianz. All of this was achieved while maintaining a high level of service to our brokers and I am extremely grateful for the patience and professionalism shown by our employees.



**+70**  
net promoter score

Throughout the year, we have continued to focus on ensuring that our underlying business is performing well. We ended the year with the number of customer policies we have increasing by 7% to just over 5 million, which is an incredible growth rate in a competitive market. Our Net Promoter Score (NPS) at +70 puts us ahead of our target and in the world class category for customer satisfaction.

As well as focusing on the underlying strength of the business, we also put a significant amount of effort into transforming it to ensure that we're fit for the future. Within direct, we successfully completed our biggest ever transformation project with the full rollout of Pioneer, our new policy and billing system. This has already started delivering some great results, helping us launch our new Multi-car proposition which is proving very popular with customers. Within Claims, we introduced a number of new digital solutions and integrated machine learning models into our Guidewire Claimcenter application. Recognising that transformation isn't always about changing processes and operations and adopting new technologies, we also invested in our people with the launch of the Digital Transformation academy, an internally focused programme which provides a series of opportunities to help our employees learn new skills or gain qualifications within the technology and digital sectors.

It is the people in our company that make our business successful and it is with thanks to them that throughout the year we continued to be recognised for providing excellent service and good value to our customers, receiving a number of awards including Which? Recommended Provider for Car Insurance and Brand Management Award at the Insurance Post British Insurance Awards.

Looking more closely at our financials, our results for the year have been strong, despite the severe bad weather affecting our household account and significant inflation affecting motor repair claims costs.

Our 2018 operating profit of £107m (2017: £120m) includes an underwriting result of £99m (2017: £102m) and investment returns of £8m (2017: £18m). However, if we look at the lines of business we will continue to operate in (which excludes the commercial lines business transferring to Allianz), operating profits are up 7% at £135m (2017: £126m). The discontinued commercial lines generated an operating loss of £28m (2017: operating loss £6m), primarily due to an unprecedented number of large losses.

Investment returns at £8m continue to be low and were impacted in the first half of the year by losses of £7m on interest rate swaps contracts which were closed out in mid-year as part of a new investment strategy.

Although Gross Written Premiums of £1.6bn are 1% lower than 2017, underlying premiums have grown by 6%, excluding the impact of the transferring commercial lines business. As already noted, customer policies have also grown by 7% to reach 5.2 million.

In 2018, we experienced high levels of prior year reserve releases from a combination of continued anti-fraud delivery and the settlement of a number of higher value claims predicated upon the Civil Liability Act. We are obviously very pleased that the Civil Liability Bill received Royal Assent towards the end of last year and as a result we have revised our assumption for the Ogden Discount Rate to 0% (previously negative 0.75%). These combining factors have subsequently produced favourable prior year claims releases of £106m (2017: £46m).

There has also been a strong focus on cost control throughout 2018 and this will continue in 2019. The expense ratio improved by 0.5% to 22.1% (2017: 22.6%).



**£998m**  
direct premiums

## Direct

We continued to grow in LV= branded motor and home portfolios as a result of high renewal retention and significant new-business sales following the launch of Multi-car and the extension of our home product range including policies tailored to buy-to-let landlords. This growth was supported by our continuous focus on providing great value products, underpinned by award-winning customer service. The full rollout of our Pioneer programme was also successfully completed and has been a key enabler in enhancing our product range and making it easier to do business with us. During the year, we also benefited from a major facelift to LV.com, with a completely new design and tone of voice designed to bring our brand personality to life.

As a result of all this work, direct customer policies passed 4 million, growing by 8% to 4.1 million and premiums grew by 4% from £960m in 2017 to £998m. Divisional operating profit of £101m (2017: £106m) was down slightly from the previous year mainly due to lower investment returns. Direct continued to deliver a great combined operating ratio of 89.9% (2017: 89.5%).

## Broker

2018 has been a year of significant changes in the Broker division, most notably for the successful business transfers between LV= General Insurance and Allianz.

The business transfers allowed us to broaden our personal lines product range with five new products launched whilst continuing with our commitment to deliver high standards of customer service. In 2017, our ongoing commitment to service excellence was recognised with the award of the Institute of Customer Service ServiceMark Accreditation and in 2018 a mid-accreditation survey demonstrated that we have not just maintained our service standards but improved them. We are extremely proud that our brokers have given us a rating of 84.4 which is 5.7 above the insurance sector average.

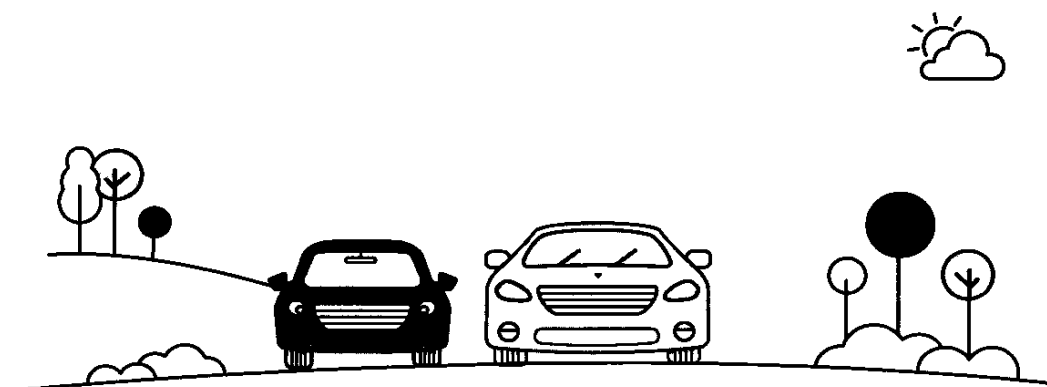
2018 operating profit was £9m (2017: £30m). The personal lines business has continued to perform well and has delivered a profit of £44m, an increase of 19% year-on-year (2017: £37m). Unfortunately though, in 2018 we saw an unprecedented level of large losses within commercial lines which impacted the overall broker result. Broker premiums of £583m (2017: £636m) were impacted by the business transfers; although premiums on personal line products increased 13% from £356m to £402m. While the overall combined ratio declined to 99.0% (96.6% in 2017) the personal lines ratio improved from 91.5% to 88.1%.

## Looking ahead

2019 will no doubt be another significant year of change for us, particularly as we move towards Allianz becoming our majority shareholder at the end of 2019. We also face the uncertainties pending the UK's stance on Brexit. With the world changing steadily around us, we must continue doing what we're good at while looking to the future and developing our business to meet customer needs. We've already been making excellent progress with this but we need to ensure that this remains a priority for us.

Trust is also going to be a key challenge for our industry in 2019 with for example the FCA market-wide study into the pricing practices of general insurance taking place this year. Our customers expect us to be there when the worst happens and on a very fundamental level our job is to bring peace of mind to the millions of customers we support. We know from our NPS scores and customer retention numbers that we have a unique position in our industry as a trusted brand but this is something we have never taken for granted and we know how important it is to ensure we do what is right for our customers.

We're proving every day that driven by our values, putting colleagues first and keeping customers at the heart of all we do we can overcome any challenges that we are faced with, and I am confident that we can continue to deliver the outstanding customer service that we are famous for.



# Risk Management

**Wayne Snow**  
Chief Risk Officer



## Introduction

I joined the board of LV= on 2 July 2018 as chief risk officer. This acknowledges the group's increased focus on risk management as a significant influence in shaping LV='s future direction and strategy. I bring extensive experience from my previous roles in the life and pensions industry (see page 54) and during 2018 I have overseen the design and implementation of material improvements within the group's risk management strategy, framework and operating model – something that will continue to evolve and embed throughout 2019 and beyond.

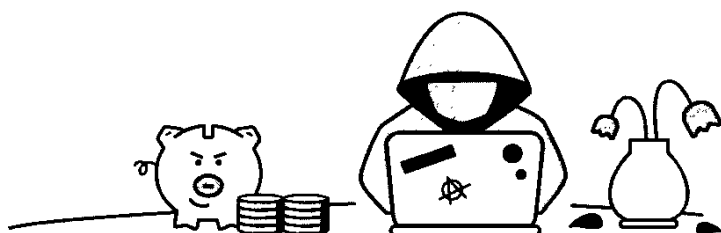
## Overall board responsibilities

The LV= board are responsible for determining the risks which the group faces and ensuring that they are appropriately controlled. These include the risks to the business model and future performance, those which threaten the solvency and/or liquidity of the group and those which could have a detrimental impact upon our members, customers or other stakeholders.

The board discharge this responsibility through the implementation of a robust risk management framework (LV=RM) which includes the setting of a proportionate risk strategy, risk appetite and clear risk mandate and organisational design. The Risk Committee, on behalf of the board, regularly monitor the operation and effectiveness of the LV=RM Framework to ensure that it continues to drive a suitably robust risk culture within LV=.

The Risk Committee met seven times during 2018 with the principal activities:

- Approval of the LV= risk strategy and changes to the LV=RM Framework, in particular improvements to risk reporting, risk policies and risk and control self-assessment processes.
- Further development of the board's risk appetite.
- Regular consideration of the group risk profile which included:
  - An assessment of performance against risk appetite.
  - An assessment of the principal risks facing LV=.
  - Monitoring of the group's risk management and internal control systems.
  - A statement of risk management effectiveness.
- Consideration of emerging risk issues, including Brexit.
- Review of the ongoing development of the group's product governance framework to ensure continued focus on customer outcomes.
- Oversight and monitoring of critical and important third party suppliers.
- Oversight of the group's strategic ambition to transition into a fitter mutual for the future, carrying out a detailed review of all proposals prior to work commencing.
- Oversight of the activities being conducted to separate the life and general insurance businesses ahead of completion of the strategic transaction with Allianz in 2019.



## Risk management framework

The LV= RM Framework comprises a systematic set of processes, tools and behaviours which collectively are used to assess risks that could impact the delivery of the group's business strategy, and ensure that these are considered and dealt with effectively, consistently and on a timely basis.

The LV=RM Framework is owned by the LV= chief risk officer on behalf of the board and has been developed through 2018 in order to support high quality risk decision making, protect member value, ensure good customer outcomes and inspire confidence in the group for all of its stakeholders. These enhancements form part of a strategy of continuous improvement of the group's risk management capability, and will continue throughout 2019 as the group strives to drive a strong risk culture that ensures the business is managed in line with the board's risk appetite.

**The risk universe, risk strategy and the eight key elements of the LV= RM framework are summarised below and on pages 36 to 37.**



## Risk strategy

As an insurance provider in a complex and highly regulated market, LV= is exposed to a wide range of risks from its past, present and future activity.

The risk strategy is aligned with the LV= business strategy and ensures that an effective approach to risk management is in place, in line with its business and financial goals. This risk strategy seeks:

- To inform the board in setting a robust risk appetite which ensures that the business model and strategy are designed and executed in a controlled manner to safeguard member value.
- To drive a strong risk culture that ensures the business is managed in line with the board's risk appetite.

The risk strategy and associated LV= RM Framework is reviewed on at least an annual basis as part of the broader LV= strategic planning process and based upon changes in both the internal and external environment.

## Risk universe

As a consequence of writing insurance business, LV= is exposed to financial, operational, conduct and strategic risk. LV= 's profitability and growth is dependent upon the proactive management of these risks. These risks need to be considered as LV= continues to restructure and run the group as a fitter mutual for the future in accordance with its stated values.

In order to ensure that all of these key risks are fully considered, LV= has put in place a detailed risk hierarchy which breaks down the high level risk categories into a series of more detailed risks.

The high-level risk categories which LV= is exposed to are:

### Financial risks

- L** Life insurance risk
- G** General insurance risk
- F** Financial markets risk
- C** Credit counterparty risk
- L** Liquidity risk

### Non-financial risks

- S** Strategic risk
- C** Conduct risk
- O** Operational risk

Clear executive accountabilities for managing each of these key risks have been articulated and agreed at the Risk Committee.

### Risk governance

LV= operates a three lines of defence model as part of its day-to-day operations, as prescribed within a board-approved risk mandate. The board delegates much of its oversight of risk matters to the Risk Committee, which together with the (executive) Management Risk Committee, the chief risk officer and the risk management teams, ensures that the group is operating in line with the requirements of the LV=RM Framework.

The roles and responsibilities across the three lines of defence model are included within the risk strategy and are summarised as follows:

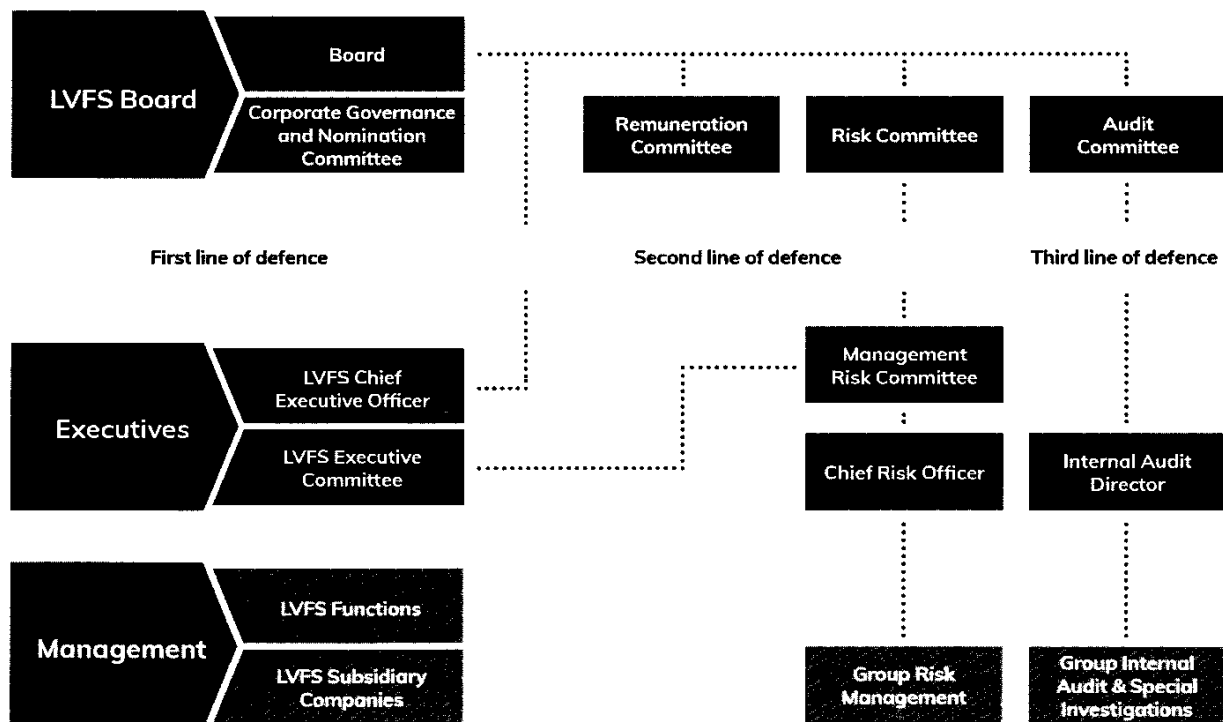
**First line of defence:** led by the chief executive who is supported by the Executive Committee and the senior leadership team. The executive teams are required to identify, assess, manage and report on the risk profile on a current and forward looking basis. Sound risk management tools, practices and knowledge facilitate informed business decision making in accordance with the LV=RM Framework, and in particular LV='s risk appetite.

**Second line of defence:** led by the chief risk officer who is supported by the group risk management team and other risk management professionals across the organisation. Group risk management develops and directs the implementation of the LV=RM Framework, monitors, reviews and challenges first line compliance with this framework and escalates material breaches to the board.

**Third line of defence:** led by the internal audit director who is supported by the group internal audit team and the Audit Committee. Group internal audit provides independent and objective assurance to the Audit Committee and to executive management on the effectiveness of the systems of risk management and internal controls across the group.

These roles and responsibilities align to the risk governance structure as shown below:

### LV= risk governance structure



LVFS subsidiary board committees are subordinate to the LVFS board and are excluded from this diagram.

## Risk appetite

The board has established a series of quantitative and qualitative risk appetite statements which cover five broad dimensions:

- Overall attitude to risk
- Financial
- Conduct
- Operational and transformation
- Regulatory and stakeholder engagement

Each of these appetite statements provides direction to senior management regarding their priorities in the execution of the risk strategy and where appropriate, are underpinned by a suite of more granular supporting measures, limits and triggers. These risk appetite statements are reviewed at least annually and are embedded within the operation of the LV=RM Framework. Clear governance exists in respect of ownership, oversight and the treatment of risks which are considered to be outside of risk appetite. Operation of the risk appetite methodology is evidenced through the provision of clear and timely management information which delivers insight to senior management and helps to drive robust and well informed risk-based decision making.

## Risk policies and standards

A suite of board-approved risk policies (plus associated supporting policies and standards) is in place which documents both the board's requirements, as well as senior management's approach to meeting those requirements. Policy owners are aligned to LV='s high level risk categories and have individual accountability for delivering ongoing effective risk management in accordance with the overall direction set by the board.

The second line risk management function maintains the integrity and consistency of the policy suite on behalf of the board and ongoing policy compliance is considered through regular risk and control self-assessment and through annual risk and controls attestation.

## Risk and control assessment

The group undertakes a quarterly assessment of its key risks and controls to determine whether the risk and control environment is appropriately defined and operating in line with expectations. There is a group-wide process for the identification, escalation and remediation of risk events and control failures. In addition, independent risk-based assurance reviews are undertaken on a regular basis by both the second and third lines in order to confirm that the overarching LV=RM Framework processes are working effectively.

## Own risk and solvency assessment (ORSA)

The ORSA is a fundamental part of the group's capital management processes under the LV=RM Framework. The ORSA consists of processes that are designed to ensure those risks mitigated by holding capital are appropriately assessed, the capital requirements are understood on a forward looking basis, and that this insight is used to inform decision making. The solvency position of the business is driven by the Standard Formula basis under the Solvency II regime.

On an annual basis, an ORSA report is presented to the board which consolidates the findings from these processes, which include business planning, stress testing and scenario analysis, including reverse stress testing, and regular monitoring of the group solvency position.

The 2018 ORSA report, produced in June, included the outcome of stress tests on the current balance sheet which included the demonstration that the current capital held would be sufficient to withstand a stress of significantly over the 1-in-100 level before the regulatory capital surplus would be exhausted.

This is before allowance for management actions to aid recovery, such as exercising the put option to sell the residual stake in the general insurance business.

On a forward looking basis, scenario analysis was completed as part of the business planning process. This demonstrated that the Capital Coverage Ratio remained comfortably in excess of the risk appetite level in a severe but plausible Brexit led economic downturn scenario. The impact on solvency from further adverse regulatory, operational and more extreme financial events (such as a large reinsurer default) was also assessed.

## Culture and performance

The establishment of the LV= RM Framework has been designed to ensure the embedding of a strong, behavioural-based risk culture across the entire group. This is driven by a distinct tone from the top and its application forms part of the group's performance management regime.

The operation of the LV=RM Framework is assessed on an annual basis and forms part of the inputs to the Executive Performance Plan. Risk performance features as part of an overall balanced scorecard and on an individual basis via a risk adjusted remuneration process, which is overseen by the Remuneration Committee.

## Training and communication

A programme of training and communication is in place to ensure that the components of the LV=RM Framework are understood and applied consistently across the group. This training and communication is targeted at all levels within the organisation to ensure that everyone has an appropriate level of understanding of the framework requirements which are applicable to them. The programme includes board and senior executive training and extends through to components which are used in the induction of new colleagues joining LV=.

## Risk management information and reporting

Regular, relevant and timely risk reporting is in place across all three lines of defence to demonstrate the operation of the LV=RM Framework. As part of the development of this management information, the Risk Committee has helped to define the report structure and content in order to ensure that the material provided to them contains information which is sufficient and appropriate for them to exercise their oversight responsibilities.

## Risk management effectiveness

The group conducts an annual risk attestation process in which all senior executives attest to the effectiveness of the control environment operating in their areas. The outputs from this process are used to inform the declarations within this Annual Report, in accordance with the UK Corporate Governance Code requirements.





Additionally, the group conducts an annual risk maturity and culture assessment to gauge the effectiveness of the embedding of the LV=RM Framework and to test how the risk culture of the group is evolving over time. The outputs from this assessment are used to determine areas for further development under LV='s programme of continuous improvement.




## Key risks and uncertainties

Within its overarching risk universe, the group has identified eight high-level categories which represent the most material areas of financial and non-financial risk exposure faced by the organisation. The board's overall attitude to each of these exposures is described within its risk strategy.

However, at any point in time the group will also likely face a series of specific risks which reflect the prevailing risk and control environment and are influenced by a variety of internal and external factors. Over the past year, the top risks faced by the group are summarised within the table below. The LV= RM Framework ensures that these risks are monitored and regularly reported as the internal and external environment evolves over time, allowing for management actions to be adapted as appropriate.

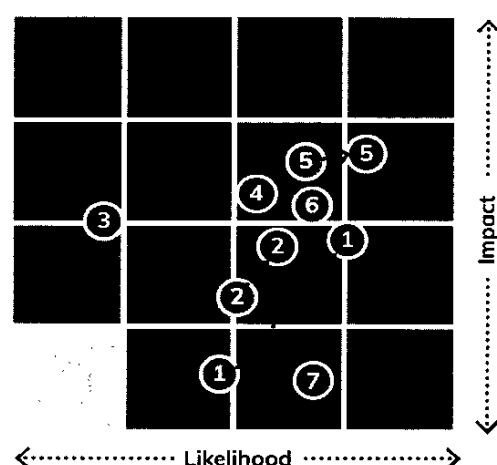
Key risks	Potential impact	Mitigation	Change from last year
<b>1 S</b> <b>Political, economic and regulatory uncertainty</b> The risk of failure to achieve the group business plan due to material and prolonged uncertainty within the political economic and regulatory landscape.	<p>The full impact of the political and economic uncertainties in the UK has been difficult to gauge during 2018 due to the continued lack of clarity around Brexit. This has been particularly relevant for the general insurance business.</p> <p>However, no immediate change is expected in the UK regulatory framework in the short term, or any significant legislative changes in the life and pensions market due to the current political situation.</p>	<p>The potential impact of Brexit on both operational capability and the financial position of the group has been a specific area of focus for the board throughout 2018, and will continue to be through 2019. Brexit planning will consider both the immediate period following the UK's exit from the EU, and the longer-term implications on LV='s business model. Stress testing of the life and general insurance businesses has concluded that the group remains robust under a wide range of severe scenarios.</p>	<p>The heightened level of risk is attributable to the close proximity and likelihood of the UK leaving the EU with no deal in place.</p> <p>Uncertainty over the nature of the UK exit from the EU has led to economic volatility in investment markets.</p> 
<b>2 C</b> <b>Conduct risk</b> The risk that conduct risk controls are ineffective resulting in negative customer outcomes.	<p>The complexity and long-term nature of life and pensions products means that as customer needs change over time, there is the potential that products do not perform as customers would expect and that the products no longer deliver appropriate customer outcomes.</p>	<p>LV= has in place a product governance framework which ensures each new product or changes to products are subject to review. In addition, regular product reviews are undertaken which ensure existing products perform as customers would expect and continue to deliver appropriate customer outcomes.</p>	<p>Increases in regulatory expectations and the increased levels of activity by claims management companies, has caused this risk exposure to increase.</p> 
<b>3 F</b> <b>Corporate bond spread</b> The risk that there is a change in the market value of LV='s corporate bond holdings.	<p>Corporate bonds are held to back the LVFS Pension Scheme (plus general insurance and annuity liabilities). As bond values fluctuate in the open market, any unmatched movement in the associated liabilities would expose the group to an unforeseen profit or loss.</p>	<p>Regular monitoring of the group's exposure takes place at the Asset and Liability Committee and through specific, active monitoring undertaken by the group's asset manager. Management actions are regularly reviewed and executed in order to address any specific exposures. LV= makes use of a matching adjustment allowance in its regulatory reporting to mitigate against the impact of economic volatility on assets held to match long-term liabilities.</p>	<p>This risk exposure remains unchanged from last year.</p> 
<b>4 D</b> <b>Cyber security</b> The risk that LV= does not have a sufficiently robust strategy and control infrastructure in place to protect itself against, or to recover from, a cyber event.	<p>The high-level of threat from the external environment continued during 2018. High profile data loss incidents such as those affecting Facebook and British Airways demonstrate the serious impact such events can have.</p>	<p>LV= operates a comprehensive cyber risk strategy which is designed to ensure that the group continues to identify, assess and respond to the ever changing threat of a cyber attack.</p>	<p>Further development of the group's cyber risk strategy, embedding of controls targeted at data privacy and enhanced mechanisms for monitoring and reporting mean that although the external environment generates a heightened risk, the residual impact of this risk remains stable.</p> 

Key risks	Potential impact	Mitigation	Change from last year
<b>5 0 S</b> <b>Delivery risk</b> The risk that the quality, timing and / or cost of delivering business as usual objectives or key strategic initiatives is impacted adversely due to the loss of key staff, or poorly executed change activity.	The series of strategic initiatives, including the delivery of the second phase of the transaction with Allianz and the move to a fitter mutual for the future, have created pressure upon people, processes and IT systems which could have a detrimental impact on business delivery to customers and other external stakeholders.	The board has established a structure of executive sponsorship and strong programme governance, challenge and escalation for all of the key initiatives undertaken across the group. This is delivered through the centralised Transformation Directorate and is subject to board oversight at both LVFS board and LVGIG board level.	Despite having a strong control environment in place, the high levels of complexity and the interrelated nature of projects in the strategic portfolio mean that the residual risk has increased slightly from last year. 

### LV= top risk assessment

The residual risk assessment for the LV= top risks, including movements during the year, is illustrated as shown:

- 1 Political, economic and regulatory uncertainty
  - 2 Conduct risk
  - 3 Corporate bond spread
  - 4 Cyber security
  - 5 Delivery risk
  - 6 General Data Protection Regulation (merged into risk 2)
  - 7 UK health and social provision (closed)
- .....> Movement since YE 2017



### Emerging risks

As well as monitoring near-term risks, the Risk Committee also considers potential risks, threats and opportunities which may impact the group at some point in the future. This process takes place formally twice per year (with more frequent assessments taking place as and when required) and captures emerging risks such as those key risks described below:

Key emerging risks	Description
<b>S</b> <b>Change in UK Government</b>	A new Government introduces a radical new agenda in public policy (e.g. changes in employment law, growing unionisation, increases in the minimum wage, employee representation on boards etc).
<b>S</b> <b>New market entrants/disruption from digital</b>	New players enter the market, most likely in the general insurance or protection sectors.
<b>D</b> <b>New regulation</b>	Regulators introduce new regulation (e.g. in the pension transfer market or more onerous capital standards), or raise the bar in terms of the standards expected for compliance.
<b>G</b> <b>Renewal pricing review</b>	Depending upon the outcome of its market study (following a super-complaint to the Competition and Markets Authority), there is a risk that the FCA will impose an industry-wide cap on general insurance renewal premiums for home and motor insurance products.

In addition, the Risk Committee is cognisant of certain global risks such as climate change which have the potential to pose specific risks to both life and general insurance companies. In general insurance, climate change is likely to manifest itself in increased claims volatility and catastrophe claims from weather related events, and can lead to incorrect pricing and reserving of general insurance risks. In the life insurance business, whilst prolonged climate change will, in the long term, impact both longevity and mortality experience, a move to a lower carbon use economy may have an impact on the value of the assets held by LV= and the associated future investment decisions that the group chooses to make.

LV= will need to respond effectively to the impacts of both physical and investment risks arising from climate change in order to avoid an adverse impact on business strategy. This risk will therefore continue to be an area of focus for LV= and is managed through the LV= RM Framework both as an emerging risk and through the careful management of the volatility in the risks which LV= manages.

# Corporate Responsibility Report

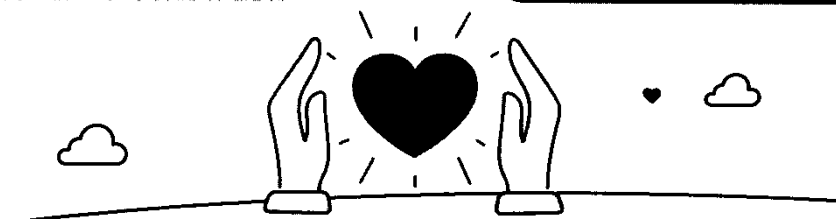
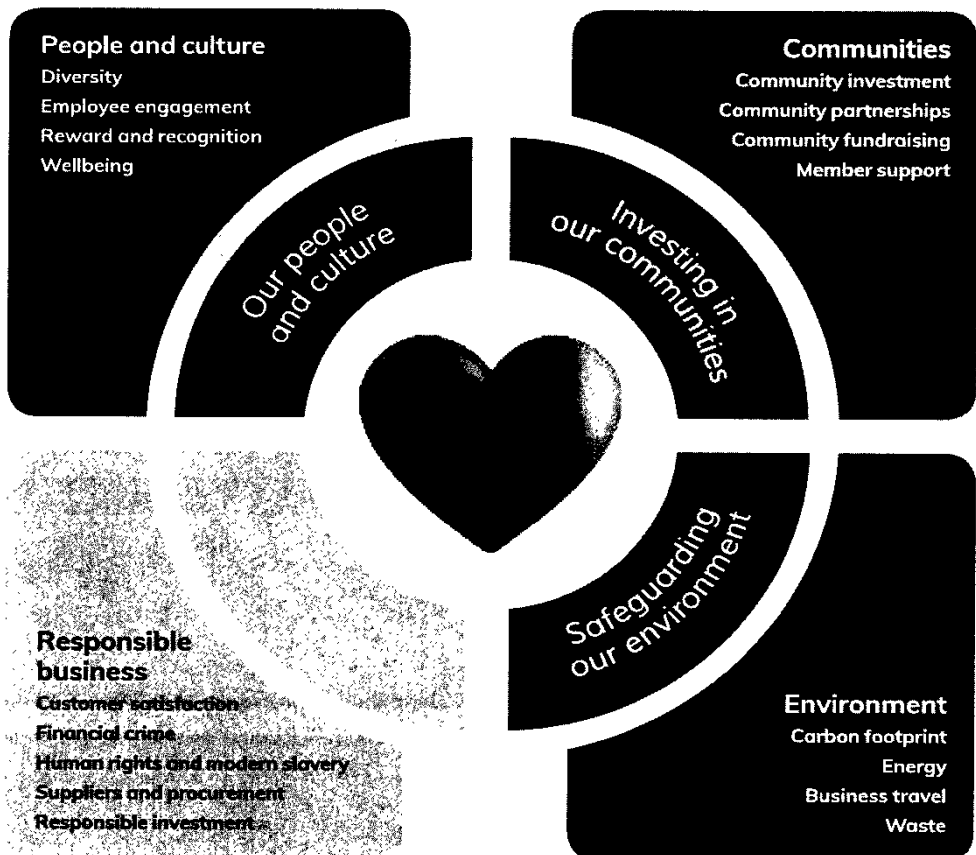
**Mary Stewart**  
Brand and Marketing Director



Our corporate responsibility approach is focused on supporting our customers and members to Live Confident. Being a mutual, we think confidence unites everyone and it's this ethos that helped us to shape our approach. The four key areas we believe will help show the LV= difference are putting our customers at the heart of our business, looking after our people, investing in our communities and caring about our impact on the environment.



Our people  
donated over  
**5,700**  
volunteering hours



## Investing in our communities

As part of our external review with London Benchmarking Group, we have been able to review the impact of our community initiatives. Our support has been focused in three key areas again this year – health, social welfare and education. In 2018 we gave £608,074 in time and donations to good causes. This included £116,805 worth of volunteering, £307,443 in corporate donations and matched funding and £183,826 in employee fundraising.



LV= KidZone reunited

# 192

lost children  
with their families  
(down from 219 in 2017)

### Community investment

Community investment for 2018 includes not only the donations given to local good causes and groups, but also the financial benefit through volunteering. Using the benchmarking results we can report that we gave over 5,700 hours worth of time and expertise, which amounts to an investment of over £116,000 across all activity.

Our regional community committees have continued to support our local communities with various fundraising activities and donations. The committees are made up of volunteer employees, and have a small budget to help support the areas where our people work and live and to increase engagement between teams. The budget that regional community committees received and distributed to local causes was £75,000. The majority of this was used to support health and social welfare. The committees have developed long-standing relationships with a variety of community projects, one example of this is the support our Ipswich team have given to the local theatre company. You can read more below.

### Community partnerships

We continue to support various partnerships across the UK.

LV= KidZone, now in its 12th year, has grown in size with this beach safety scheme now covering both Bournemouth and Poole beaches.

Working with Bournemouth Council and the RNLI, the team keep children safe on the beach. With the long, hot summer enjoyed across the UK in 2018, the beaches had a record number of visitors coming to the area. The beach team handed out over 72,000 wristbands, a 68% increase on 2017. With the increase in area covered and the number of people on the beach the scheme not only had to recruit additional team members but we also had to open earlier, during the May bank holiday. 192 children were reported missing and reunited with their families, a reduction from previous years reflecting the benefits of higher scheme participation and awareness by families.

Age UK's Call in Time is now our longest volunteering partnership. We have 40 volunteers making weekly calls as part of the charity's telephone befriending scheme. We have regular contact with Age UK to make sure that our volunteers are still making a positive difference to isolated older people. We are also reviewing other opportunities to partner with Age UK to help support their programmes.



We have

# 40

volunteers talking to  
lonely older people

### Based on a True Story

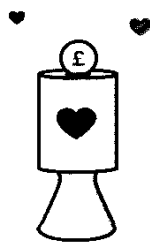


This year is the fourth year our regional community committee in Ipswich chose to support the Wolsey Theatre's Creative Learning team, engaging with young people across Suffolk. The creative team use the arts to develop creativity, unlock potential, explore diversity and celebrate identity. The creative team delivers a five week tour to around 50 primary schools and a three week tour to at least 15 secondary schools each year.

In 2018, we funded over 1,000 children from across the county to see Based on a True Story. It was an interactive show that introduced them to the ideas of difference, and the positive impact we can have on the lives of others when we realise that we all have more in common than we might think at first. Our support allowed for these sessions to be free to children in years 3 and 4, and the show supports the teaching of the Key Stage 2 PSHE curriculum.

In total, over 4,000 young people have benefited from the shows, introducing them to key themes around difference and diversity. The aim is to encourage them to explore how preconceptions about others can potentially shape behaviour towards them.





In 2018 our  
Pennies for Charity  
scheme raised over

**£16k**



Our Member Support  
Fund has helped

**56**

members through  
difficult times

## Community fundraising

Our charity matching scheme boosts our people's fundraising activity by matching £ for £ the amount raised up to £500 per employee or £1,000 per team. Matching applications were made for the fundraising by over 120 of our people which raised £115,062 for charities and we matched £50,477, boosting the donations to good causes that are close to our people's hearts. Payroll Giving contributed an additional £30,500, this scheme is an easy way for employees to donate on a monthly basis to their favourite charities.

2018 was our ninth year supporting Pennies for Charity; over this time our people have given an incredible £102,430 to over 50 local charities just from the odd pence from their net monthly pay. We vote every year on the charity to benefit from the regular donation, each office selects their favourite beneficiary for the following 12 months. In 2018, we selected eight new charities that between them received £16,716. The charities ranged from a homeless shelter in Bristol to a local group in Exeter who support children through bereavement.

Fundraising activity in our offices raised an additional £21,549 for local and national charities. This included £11,261 raised for national campaigns such as Sport Relief, Macmillan Coffee Morning and Children in Need through activities including cake sales, raffles and tuck shops. For the 12th year, over 100 volunteers took calls as part of our Children in Need call centre on the appeal night in November. We had a busy night taking calls and donations totalling over £50,000, the evening was opened by Tim Bunting, the charity's Head of New Partnerships.

## Member support

Our Member Support Fund has helped 56 members through difficult or unusual times. The support can be practical or financial. We received applications for a variety of reasons, many from members facing financial difficulty as a result of health issues or family problems. We have provided financial support to people going through extremely difficult times. The total cost of the Member Support Fund was £50,815. Visit [LV.com/members](http://LV.com/members) for more stories about how the fund has helped our members.

There are several benefits to being a member with LV=, we offer discounts between 5-10% off various insurance policies. Members can request the reduction off car, home, pet, travel, caravan, motorcycle or classic car insurances.

Members also have access to telephone based legal advice along with health, wellness and counselling services. During 2018 there was an increase in the number of members calling our free care line service, with over 1,300 calls made.

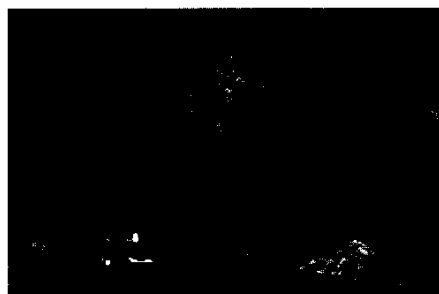
## Helping our member through a difficult time

Our Member Support Fund has supported hundreds of members since it launched. It's part of Green Heart Support and provides support for customers and members going through a difficult time. We received an application from Mark who had recently undergone back surgery and needed practical support to help a career change take off. The practical support available to members was exactly what Mark needed.

After his injury, Mark was unable to return to work due to the manual nature of his job and was at a loss as to what to do next. Mark spent a year hoping he would be able to return to his old job, but the reality that this would no longer be an option eventually set in. Mark held income protection insurance with us which supported him through this time.

In addition to a financial pay out each month, his policy included treatment from a certified occupational therapist to help him regain his strength and movement. Mark had been considering a career change so he decided to train to become a woodworker and he enrolled

on a self-funded course to gain the skill he needed to start up his own business.



Mark's new business was keeping him busy and he was enjoying his new career, but he needed two vital pieces of equipment that would mean he could do more in less time. Our Member Support Fund provided essential investment in his future, and allowed him the budget to grow his business.

## Environment

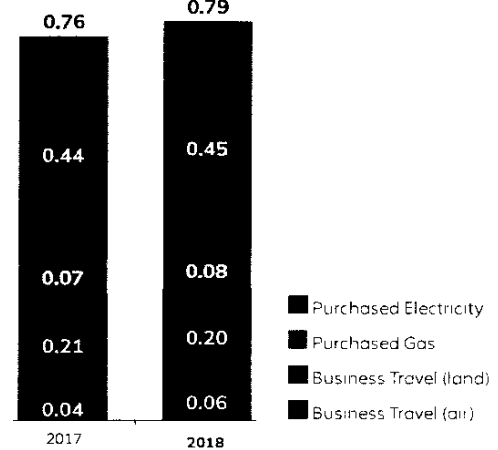
Our commitment to helping to protect the environment is still a priority. There are several schemes already in place and with the implementation of an environmental strategy in 2019, we are looking into opportunities to become an even greener business. Target setting will allow us to benchmark our activity; goals and incentives will provide opportunities for our people to proactively assist in reaching these.

Our existing waste management policy is focused on reducing the rubbish that ends up in landfill sites. Contractors collect general waste from our offices, this is then processed at recycling centres to ensure all recyclable items are removed and ultimately diverted from landfill.

Reducing our carbon footprint is still an area we are committed to and we continue to work on implementing ways to reduce this, including the power management tool Nightwatchman. We are also signed up to two government incentive energy saving schemes – the energy efficiency scheme for measuring carbon footprint and the energy saving opportunity scheme (ESOS) to manage improvements to energy within our buildings.

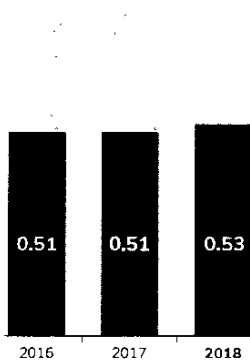
### Greenhouse gas emissions

Carbon emissions  
(tonnes CO2 equivalent  
p/employee)



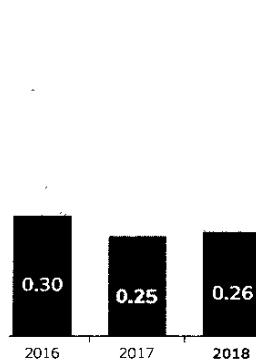
### Energy usage

(tonnes CO2 equivalent  
p/employee)



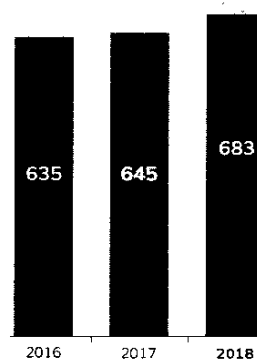
### Business Travel

(tonnes CO2 equivalent  
p/employee)



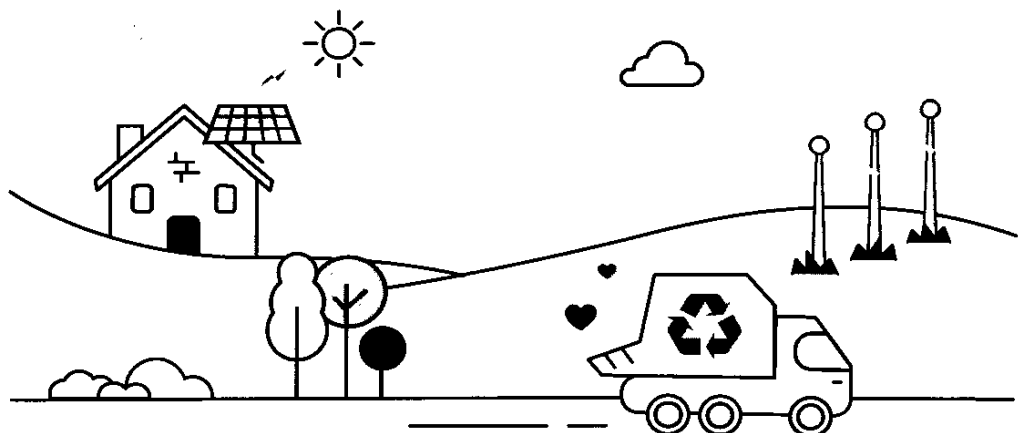
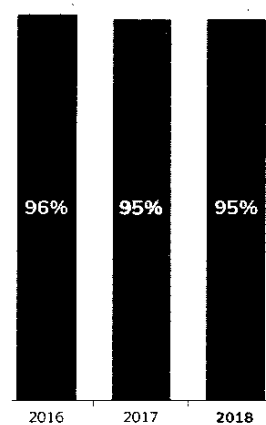
### Waste

(tonnes)



### Recycling

(as a % of  
overall waste)



## Responsible business practice

### Customer satisfaction

At LV=, we pride ourselves on our customer service; our awards and accolades show that we continue to deliver excellent customer service. In 2018 we were awarded the Moneywise most trusted life insurer for the sixth year in a row.

Our teams work hard to give our customers and members the best service, however from time to time things can go wrong. When this happens we do our best to make sure that we put it right and ensure our customers receive a fair outcome. This is reflected by the number of appeals that were upheld by the Financial Ombudsman Service (FOS) in our favour.

	Complaints received 2018	Referred to FOS 2018	Outcome in LV='s favour
Life	2,560	4%	92%
Heritage	687	3%	83%
Legacy business*	1,876	1%	100%
General insurance	18,602	3%	78%

\* Mainly PPI claims against our legacy banking business.

### Financial crime

In 2018, we prevented over £70m being lost through fraudulent activity. Fighting financial crime will remain central to our activities and is why we continue to examine our processes and look to find any possible weaknesses that may lead to LV= being subject to fraud.

We have reviewed our group approach around sanctions, money laundering and terrorist financing risks. As a result, our processes have been enhanced and our systems reviewed and developed, significantly strengthening our position.

Data Vishing, the illegal access of data and data theft, increased in 2018. This has negatively impacted the level of fraud losses and the associated operational costs. We are hopeful that the Civil Liabilities Act 2018, also known as Whiplash Reform, and the FCA's pension cold calling ban, will reduce this activity in 2019. Our internal Vishing App provides employees with an easy way to report nuisance or impersonation calls. The App also provides data that is regularly analysed to allow us to proactively identify emerging data threats. The ability to alert appropriate regulators or agencies aids the disruption of criminal activity and can lead to enforcement action.

Launching in January 2020, the fifth Money Laundering Directive will require us to ensure any new compliance expectations are met and embedded across LV=.

### Bribery and fraud

Detecting and preventing fraud and bribery continues to be a priority for us in 2018. Our 'Speak Up' service is a confidential hotline and mailbox, where our people can report any suspicions of wrong-doing in confidence that their concerns will be taken seriously, and without any fear of recrimination. The service is operated by our internal audit team, providing a genuinely independent way to report concerns, and is

overseen by our Speak Up Champion. The Speak Up service is operated in accordance with the requirements set out by the FCA and PRA. We regularly promote the service internally to ensure teams are reminded of how to report concerns.

### Human rights and modern slavery

We continue to adhere to fair employment practices and acknowledge our responsibilities to human rights. We publish our approach and confirm the actions taken to assess and mitigate against any risk of modern slavery and human trafficking occurring in our business and supply chain. More information can be found on LV.com.

### Suppliers and procurement

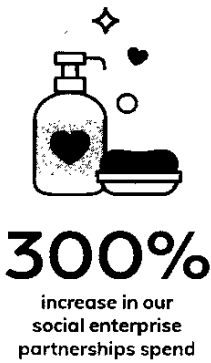
LV= partnered with Heliios Information Limited, an external company, to manage Financial service Supplier Qualification Systems (FSQS). Heliios is a UK based company with extensive experience in collecting and maintaining supplier data. FSQS is a due diligence system which supports collation of compliance and assurance information. As part of our standard assurance activities suppliers are requested to complete the FSQS qualification and compliance process. It's vital we have robust systems in place in order to respond to regulatory change and to demonstrate that we are proactively striving to minimise risk across our supply chain. After our first year of membership we are delighted that we now have over 500 suppliers added to the system.

### Green Heart procurement

In 2017 we reported that we had signed up to the Buy Social Corporate Challenge, which aims to have £1 billion of spend with social enterprises by the end of 2020. One aim of the challenge is to encourage corporates to support social enterprises to grow their revenues and impact by tapping into existing corporate purchasing. Our social



**£70m**  
prevented in  
fraudulent losses

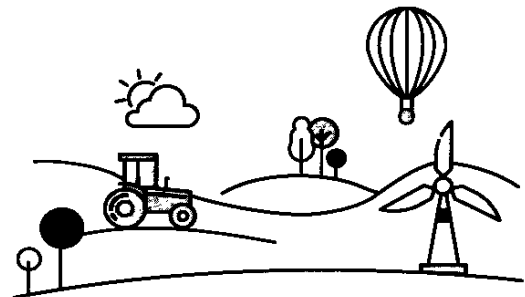


enterprise partnerships increased during 2018 and we're delighted to have increased our total spend by 300%. Our social enterprise suppliers now include WildHearts, BECO soap and Mediorite and we are reviewing several future potential partnerships.

We know that LV= can make more of a positive impact on society by encouraging our existing suppliers to consider transforming lives through the power of the supply chain. To do this, we held our first Green Heart Procurement conference where we brought together some of our suppliers and social enterprises. We want our commitment to buy social to be a priority for our existing and new supply chain. By setting benchmarks for future spend and partnerships we hope that more of our annual spend can help transform lives.

## Responsible Investment

Working with Columbia Threadneedle Investments and Blackrock as our key investment partners we can make sure that we are responsibly investing our customers' money. Our investment partners are both signatories to the UN's Principles for Responsible Investment and the UK Stewardship Code on Corporate Governance. This means investment decisions are made not only based on financial performance but also on environmental, social and ethical factors.



## WildHearts Social Enterprise

Our partnership with WildHearts was the start of our social enterprise journey in 2018, the process was simple but the impacts made have been incredible. We are proud that just by switching our stationery supplier we have made a positive change to over 900 lives in under 12 months.

WildHearts Group is a portfolio of companies that, through their activities and profits, create global social change. Their 'Business for Good' offers a variety of ways that business can help address the country's and the world's most pressing problems through their purchases of goods and services.

The social initiatives are diverse, from addressing social mobility in the UK by equipping young people with key development and employability skills, to addressing gender inequality in the developing world.

**Just through changing who we buy our paper, pens and envelopes from we have helped people across the world.**



## Here's what we've been able to achieve through our partnership with WildHearts



### Microfinance

We have transformed 657 lives globally through 'microfinance', a scheme that provides banking and related financial services to those who have traditionally been excluded. WildHearts funds loans that enable our predominantly female clients to set up small businesses. Alongside this, they are provided with relevant training that equips them with the necessary skills and resources to run their businesses sustainably. This support helps women to become self-sufficient for their daily needs and over time, to work their way out of poverty. The money women earn helps to provide food security for their families, better housing, access to healthcare and an education for their children. Microfinance estimate that each loan will impact five lives directly.

### Love to Learn


Our support provided 328 Love to Learn packs that contain essential materials for learning such as paper, pencils and rulers, enabling girls across the world to go to school and gain a good education.

One of the main barriers to educating girls is gender discrimination. In many countries across the world, young women do not complete secondary school education, meaning they not only leave school without the basic reading and writing skills but they are also removed from the safe and secure environment that school offers. By providing this essential education equipment to girls it can help parents to fund the costs of sending them to school.



## Our People and Culture

Creating a diverse and inclusive culture remains at the heart of our strategy for the future. In 2017, we launched several initiatives to help achieve gender balance at all levels and we're pleased to have made some further positive changes throughout this year. We want employees to feel proud to work for LV=, with policies and strategies that show how we respect and value individuality.



**£33k**  
average full-time  
employee salary  
in 2018

### Diversity

The board have been continuing to work on embedding our diversity policy into every area of LV=. The acknowledgement that a diverse board provides a balanced approach to the successful delivery of our strategy is reflected through many of our new schemes.

This is only part of our commitment within our board diversity policy. The board diversity policy ensures that the board has a varied skill base, experience, education and professional background. The race and gender of an applicant will not impact the recruitment process. These are key considerations for the Corporate Governance and Nomination Committee when considering new applications in order to maintain an appropriate range and balance of skills, experience and backgrounds on the board.

We will continue to support all areas of our existing Diversity and Inclusion programme (disability, multi-cultural, sexual orientation and gender) and will focus on further fostering an inclusive culture in order to bring about real change. We're looking to establish a new disability network and Pride network in 2019.

### Diversity training

Senior leaders and managers attended our new 'call it out' sessions. These are to equip our leaders with practical tools and techniques to call out non-inclusive behaviour and language. The course focused on providing an understanding of the importance of speaking-up to foster an inclusive culture that benefits and supports employees at LV=.

### Women in Finance

Signing up to the Women in Finance charter in 2016 is another way we're showing our commitment to increasing the proportion of female senior leaders. The voluntary HM Treasury scheme enabled us to set targets and shape supporting activity, all with the aim of gender balance. We're on track to achieve our pledge to reach 40% or above in senior roles by 2020.

### Gender pay gap

Since 2017 UK employers with over 250 employees must report on their gender pay gap. This is a measure of the difference between males' and females' average earnings across an organisation and something that we welcome because we want talented people to have equal opportunities to grow their careers and we believe that gender balance is vital to our success.

This year, at a group level, there has been no significant change to the previous year's results with the mean gender pay gap at 28.5% (27.6% the previous year). This was expected as many of the actions we put in place to address our gender pay gap are long term and it will take a number of years before we start to see material positive changes

taking effect. In addition to our group gender pay gap results, we have also published results for LVFS and LVGI separately for the first time and the details of these can be seen by viewing our full Gender Pay Gap Report on LV.com.

We're confident that pay at LV= is fair and equitable and we understand that our gender pay gap is driven by the structure of our workforce. At present we have a higher representation of males in senior roles and a higher representation of females in more junior roles. We understand why the gap exists, recognise there is work to be done and are focused on the steps needed to close the gap.

### Flexible working

We understand the importance of having flexible working options available to all of our employees. To make sure that we are evolving our approach and to keep encouraging talent to join the business, we have set up a working group to foster a flexible working culture. Our aim is to encourage more uptake in flexible working options, especially amongst men who currently only make up a small proportion of those benefiting from flexible working patterns.

### Targeted development programme

Alongside the board diversity policy, our commitment to ensure equal opportunities and our existing career development courses, we have introduced two targeted development programmes specifically for women. These are our Accelerate and Catalyst programmes. Both programmes not only support our ambitions to increase the number of women at senior manager, director and board level but also work with other companies on initiatives with the aim to move the gender balance across all roles in financial services.

The 30% Club is a cross-company and sector mentoring scheme providing external mentoring and networking opportunities. We signed up in 2017 to broaden the pipeline of female talent coming through the organisation and make a change to the number of women promoted to senior and board roles. With seven women currently being mentored by external senior leaders who have substantial business experience, we hope that this will have further impact on progress towards our targets.



We have  
**32**  
Mental Health First  
Aiders available across  
all of our sites

## Employee engagement

Engaged people are key to our success, not only do they create Green Heart experiences for our customers, members and colleagues but they help our business thrive. Each year we invite our people to complete a confidential survey to provide feedback via our Engage employee survey.

Our 2018 LVFS engage score of 74% sits significantly below the targeted HPO norm of 89%. We recognise that the process of transforming to a fitter mutual for the future is challenging for our people and it is a key priority of the board to ensure that employees are fully engaged as LV= continues to develop during 2019.

## Reward and recognition

We are committed to making sure our people are rewarded fairly through regular review of our pay levels to ensure they are competitive with market rates. We pay all our employees at least the Living Wage Foundation rates of pay. In 2018, the average full-time employee salary was £33,000. In addition to basic pay, all our employees participate in an incentive scheme which is structured around both individual and business performance.

All employees automatically become members of the LV= Pension Plan or My LVGIG Savings Plan when they start working for us. They also have

access to the LV= Pensions Village which allows them to track their contributions and the impact contribution levels will have on their retirement plans.

We understand that the needs of our employees are different, so through our flexible benefits platform we give all employees the opportunity to select the benefits most suited to their individual needs and lifestyles.

## Wellbeing

We understand the importance of our people's wellbeing and have many initiatives already in place through our wellbeing support programme. We have recently recruited more champions from across the business to support activities and to make sure that wellbeing days are held at each office for people to discuss and share experiences.

We are aware of the importance of supporting our people's mental health. Our Mental Health First Aid is available to help someone who is developing a mental health issue, experiencing a worsening of a current mental health issue or in a mental health crisis. We have continued to train and increase the numbers of Mental Health First Aiders and now have 32 available across all of our sites.

## Helping Holly to reach her full potential

When the Accelerate course was first launched in March 2017, we wanted to offer a specific development course that provided career specific advice and support for women. We found that significantly fewer women were moving into senior roles than men. In fact, the number is almost half. We wanted to understand what the barriers are and how we can proactively change this.

Thirteen women were selected from across the business; all had been identified as being talent within their teams and departments. Each was potentially in line for a more senior role and we wanted to work with them to support them to take the next step in their career. The group attended regular training and development sessions in addition to having monthly mentoring with senior managers.

**We're delighted with the outcome and the feedback – over 50% are now in more senior roles and all would recommend the course. Their experience has been compiled and reviewed and we're in the processes of creating the Accelerate 2019 course.**

## Holly's story

**“I was delighted to be selected to join Accelerate. I felt proud to be recognised and really pleased to have the opportunity to focus on my development.**

*I felt the course provided a blend of challenge, inspiration and endless opportunities for personal development in a supportive and very human environment. The programme was amazing, in six months we covered so much and I really liked the variety of approaches; from in depth personal assessments and 360 degree feedback to online support materials, sessions with a qualified coach, and really engaging classroom learning with experts in resilience and personal impact, amongst others.*

*It was clear Accelerate was going to be valuable from the very first session. I've gained new skills and tools along with a new network of incredibly talented colleagues who were alongside me on this journey. I genuinely feel I've grown and developed a huge amount over the last year. I understand myself and recognise my potential in a far clearer way than before.*

*Achieving a promotion during the programme was a real highlight for me and I feel so ready for the next steps in my career. I'd love to support any future groups on the Accelerate programme and would highly recommend it to anyone who is considering applying.*”



# Corporate Governance Report

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# Corporate Governance Statement

We comply with the Financial Reporting Council's UK Corporate Governance Code, (the 'Code')



## Compliance with the Code for the year ended 31 December 2018

The board believes in adopting and promoting high standards of corporate governance and has adopted a governance structure based on the principles and provisions of the UK Corporate Governance Code. The Society has complied with the Code with the exception that during the reporting year a decision was taken by the board that only the chairman will offer himself for annual re-election by members at the Annual General Meeting.

The board has determined that the annual election of the chairman provides an adequate means for members to register concern with the performance of the board directors who continue to stand for re-election at least every three years. From 2019 the board has determined that this exception will be removed and all directors will stand for reappointment annually.

In order to comply with the Code, the Society interprets all references to "shareholders" to mean its members and reference to "major shareholders" as those members invited to attend the Member Panel.

## 2018 Corporate Governance Code

The Corporate Governance and Nomination Committee reviewed the board's governance options in light of the publication of the FRC's revised UK Corporate Governance Code and the Wates Corporate Governance Principles for Large Private Companies. The board agreed to continue to adopt the UK Corporate Governance Code and adhere to the highest standard of corporate governance and best practice.

## Alignment of the board to the group's culture, values and governance arrangements

The role of the board is to set the tone from the top on the group's governance, culture and values and to be collectively responsible for the long-term success of the group. For the board this means not only ensuring that we comply with all relevant laws and regulations and ensuring that we have high standards of internal control and risk management, but that we run our business with integrity.

The board ensures that we truly live our values every day, delivering 'Green Heart experiences' for our customers, colleagues and members, harnessing the latest technologies and building a business that is sustainably lean and strong. By doing this the board helps ensure that LV= will enable people to 'Live Confident'.

## Working as a collective board

At the year-end, the board comprised of an independent non-executive chairman, six independent non-executive directors and three executive directors who collectively possess an appropriate balance of expertise in the financial services industry, in particular life insurance, investments, risk and governance. The composition and tenure of the board is summarised below.

As members of a unitary board, non-executive directors should meet without the executive members present to scrutinise and hold to account the performance of management and individual executive directors against agreed performance objectives.

The particular skills and experience that each director brings to the board are included on pages 54 to 56.

<sup>1</sup> As per the Code 'smaller companies' are defined as those that are below FTSE 350 throughout the year immediately prior to the reporting year. The Society is deemed as 'FTSE 350 equivalent' as it does not fall below the threshold for compliance with Solvency II.

### Board member composition

Executive

3

Independent Chairman

1

Independent Non-executive

6

We therefore satisfy the Code's recommendation that at least half of the board should consist of independent non-executive directors

### Board member balance

Male

8

Female

2

20% female representation on the board

### Board members' tenure

up to 3 years

8

3-6 years

1

over 6 years

1

In accordance with the Society's rules, all directors offer themselves for re-election every 3 years. The chairman offers himself for re-election annually

(As at 31 December 2018)

## Changes to board composition

There have been a number of changes to the board membership and committee composition during the year:

The board welcomed Alison Hutchinson, Luke Savage and Tanya Lawler as non-executive directors during the year. The new members bring a broad breadth of knowledge and diverse experience and expertise to the board.

James Dean resigned on 31 March after six years on the board. Caroline Burton stepped down at the Society's AGM on 7 June after a seven year tenure.

Alison Hutchinson took over as Remuneration Committee chair and Colin Ledlie replaced Caroline Burton as the chair of the Investment Committee from 7 June. Luke Savage became Audit Committee chair from 1 April upon James Dean's resignation and brings highly relevant financial experience to the role.

David Barral took on the responsibilities as senior independent director from 1 April and provides a sounding board for the chair and serves as an intermediary for the other directors and members. The senior independent director with the non-executive directors should meet without the chair present at least annually to appraise the chair's performance, and on other occasions as necessary.

Wayne Snow joined the board as an executive director on 2 July and as the Society's chief risk officer.

## Board effectiveness

The Code recommends that an externally facilitated review of board effectiveness takes place at least every three years.

In 2017 the board undertook an external review, which was facilitated by Steve Southall of Ernst & Young (EY). The review included a combination of director interviews and board and committee observations. The recommendations from the evaluation were compiled in an action plan which was addressed and delivered in 2018.

The Corporate Governance and Nomination Committee discussed the approach for the 2018 review and agreed that although an in-depth external review was undertaken in 2017, and external support was not required by the Code, a follow up review for 2018 would nevertheless be led by EY to ensure a consistency of approach. The independence of EY was

considered and it was agreed that the additional projects that EY had been engaged with throughout the business, did not impact or invalidate the independence of the review.

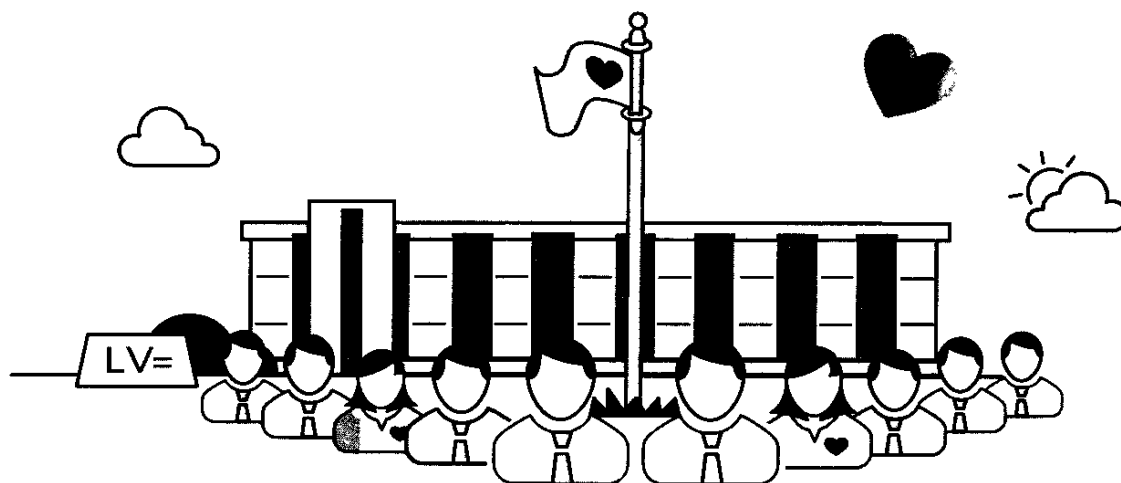
The review would focus on the board with the scope concentrated on an assessment of the implementation of key recommendations raised from the last review and that the board continued to provide effective challenge to management.

EY undertook a detailed review of a broad range of documentation before observing a board meeting. EY also carried out interviews with all board members as well as the company secretary.

EY presented their findings from the evaluation and their recommendations to the board at its meeting in February 2019 with actions to be delivered in 2019. The review has concluded that the board were operating effectively noting that eleven of the twelve key recommendations from the 2017 review had been implemented, with the remaining one due to be completed in March 2019. The recommendations, as reported in the 2017 annual report, covered areas of governance, board operations, culture, management information and risk and oversight. The review also covered the effective challenge of management by the board noting that the board had established a culture where challenge was encouraged and expected, with EY observing significant board debate with participation from all board members. The effectiveness of the board's committees was addressed individually by a comprehensive questionnaire and focused fundamentally on an assessment of the committee's composition, agendas, quality of information, meeting attendance and interaction with the board and other committees.

The chairman evaluated the performance of the non-executives during the year and individually and collectively identified any areas of development. The senior independent director and the non-executive directors met without the chairman present to assess his performance. The report was discussed with the chairman and the feedback from the appraisal considered.

The directors are satisfied that the board and each of the committees that were evaluated are operating effectively. The review identified some actions and recommendations that will help maintain and improve the board's effectiveness.





## The Board

*The board are responsible for our strategic success and represent the interests of members and customers.*

We have a strong, experienced and diverse board with a good balance of skills.



Alan Cook  
Richard Rowney  
Andy Parsons  
Wayne Snow  
David Barral

David Neave  
Luke Savage  
Colin Ledlie  
Alison Hutchinson  
Tanya Lawler



**Alan Cook CBE (65)**  
**Chairman**

**Date of appointment:** 1 January 2017  
(LVFS board), 20 June 2017  
(chairman)

**Experience:** Alan has extensive financial services experience across insurance, banking and investments. Prior to his appointment at LV=, Alan was chair of Permanent TSB group, one of the four leading banks in Ireland, and was senior independent director of Sainsbury's Bank and on the board of MetLife Europe. Alan has also previously served as the chair of the University of Bedfordshire, the Irish Life Group in Ireland and the Highways Agency as well as being a non-executive director at the Department of Transport, Financial Ombudsman Service and the Office of Fair Trading. As an executive, he has also been managing director of Post Office Ltd, chief executive officer of National Savings & Investments and chief operating officer for UK and Europe of Prudential Assurance. Alan is also a past chair and current patron of 'Action for ME', the UK's leading charity supporting sufferers of ME/CFS.

**External appointments:** Chair of Chetwood Financial Ltd.

**Committee membership:** Chair of the Corporate Governance and Nomination Committee and a member of the Risk, Investment and Remuneration Committees.

Chair of the Board of Liverpool Victoria General Insurance Group Limited and its two regulated subsidiaries. Member of the Risk and Nomination and Remuneration Committees for these entities.



**Andy Parsons (54)**  
**Group Finance Director**

**Date of appointment:** 30 June 2017

**Experience:** Having held executive positions at several leading financial institutions, Andy's career in finance has spanned over 25 years. His particular areas of expertise include life and general insurance. Prior to joining LV=, Andy held the roles of finance director, divisional risk officer and more recently longstanding life, pensions and investment director for the insurance business of Lloyds Banking Group from 2012 to 2017. He previously also worked at Friends Life Group, AXA and Zurich Financial Services where he held a number of executive financial roles.

**External appointments:** Member of the Trustee and Finance Group, Oxfam GB.

**Committee membership:** Member of the Investment Committee and director of various LV= group subsidiaries.



**Richard Rowney (48)**  
**Chief Executive**

**Date of appointment:** 1 March 2010  
(LVFS board), 28 July 2016  
(chief executive)

**Experience:** Richard spent 14 years at Barclays Bank holding a number of senior positions across corporate and retail banking including overseeing integration of the Woolwich and Barclays retail banks. Since joining LV= in 2007, Richard oversaw the creation of the operational support areas including the rebrand to LV= and the in-sourcing of our IT and HR functions. In 2010 Richard was promoted to managing director of life and pensions. Richard has led the transformation of this business to create one of the UK's leading protection and retirement specialists, including the acquisition of Wealth Wizards. Richard was appointed group chief executive officer in 2016 and oversaw the creation of the strategic partnership with Allianz to create one of the major players in the UK general insurance marketplace.

**External appointments:** Board member of the Association of British Insurers.

**Committee membership:** Member of the Investment and Corporate Governance and Nomination Committees.

Director of various LV= group subsidiaries and non-executive director of Liverpool Victoria General Insurance Group Limited and its two regulated subsidiaries and a member of the Audit Committee for these entities.



**Wayne Snow (46)**  
**Chief Risk Officer**

**Date of appointment:** 2 July 2018

**Experience:** Wayne joined LV= from the Phoenix Group where he was group chief risk officer and Phoenix life board director. During his 13 years at Phoenix, Wayne held a variety of roles across risk management, finance and corporate development before becoming chief risk officer in 2013.

**External appointments:** None.

**Committee membership:** None, director of various LV= group subsidiaries.





**David Barral (57)**  
**Senior Independent**  
**Non-Executive Director**

**Date of appointment:** 7 March 2016

**Experience:** David has had a 39 year career in financial services. He joined LV= from Aviva PLC where he was the chief executive of UK and Ireland life insurance, the largest business unit within the Aviva group. Previous positions include sales director, marketing director and chief operating officer. David brings a mix of strategic, transformation and operational experience with a strong focus on customers, risk and governance. He is a former chair of the ABI Retirement and Savings Committee.

David was appointed senior independent director from 1 April 2018. As the senior independent director, David provides a sounding board to the chair and is available to members if they have concerns which contact through the normal channels of chair, chief executive and other executive directors has failed to resolve or for which contact is inappropriate.

**External appointments:** Independent customer champion at Old Mutual Wealth.

**Committee membership:** Chair of the Risk Committee and member of the Audit, Investment and Corporate Governance and Nomination Committees.

Non-executive director of Liverpool Victoria General Insurance Group Limited and its two regulated subsidiaries. Chair of the Audit Committee for these entities.



**David Neave (59)**  
**Non-Executive Director**

**Date of appointment:** 1 June 2013

**Experience:** David has 35 years of experience in the general insurance industry, with a particular specialism in personal lines and technical expertise in a range of functions including underwriting, claims and partnerships. David held various roles at RSA including managing director of corporate partnerships and claims services director for the overall UK business. Subsequently he was managing director of general insurance for the Co-operative Banking Group Ltd, and has been chair of the Insurance Fraud Bureau and the ABI Financial Crime Committee and a director of the Motor Insurers' Bureau and the International Co-operative and Mutual Insurance Federation.

**External appointments:** Non-executive director of Slater & Gordon UK, the Solicitors Indemnity Fund and a director of Bayleaf Consulting Ltd. An advisor at Accenture's UK Insurance Practice.

**Committee membership:** Member of the Risk, Remuneration and Corporate Governance and Nomination Committees.

Non-executive director of Liverpool Victoria General Insurance Group Limited and its two regulated subsidiaries. Chair of the Nomination and Remuneration Committee and the Risk Committee for these entities.



**Colin Ledlie (52)**  
**Non-Executive Director**

**Date of appointment:** 1 August 2017

**Experience:** Colin is an experienced non-executive director, actuary and risk professional with over 30 years' experience working in the insurance industry. Colin previously held a number of senior executive roles at Standard Life PLC, including chief actuary and chief risk officer.

**External appointments:** Non-executive director of ReAssure Limited, BUPA and the National Records of Scotland.

**Committee membership:** Chair of the Investment Committee and member of the Audit, Risk and With-profits Committees.



**Alison Hutchinson CBE (51)**  
**Non-Executive Director**

**Date of appointment:** 1 January 2018

**Experience:** Alison has a strong background in both IT and financial services, having started her career at IBM where she became global director of online financial services. In 2000, she joined Barclays Bank where she held senior management positions including marketing director of Barclaycard. In 2004 she moved to specialist mortgage provider Kensington Group, where she was managing director and then group chief executive officer, leading the successful sale of the business to Investec in 2008. In 2009, Alison founded a digital charity, The Pennies Foundation, and developed a non-executive portfolio. In 2016, Alison was awarded a CBE for services to the economy and charities.

**External appointments:** Chief executive of The Pennies Foundation and a non-executive director of the Yorkshire Building Society and DFS Furnishings PLC.

**Committee membership:** Chair of the Remuneration Committee and a member of the Corporate Governance and Nomination Committee.



**Luke Savage (57)**  
**Non-Executive Director**

**Date of appointment:** 1 February 2018

**Experience:** Luke has over 30 years' experience in a range of finance and operational roles across banking and insurance.

He is the former group chief financial officer of Standard Life PLC, a FTSE 100 life insurance and long-term savings and investment business. Luke is a qualified accountant. Previous positions include director of finance, risk management and operations at Lloyd's of London, and prior to that, senior financial roles at Deutsche Bank AG and Morgan Stanley.

**External appointments:** Non-executive director of DWF Group Limited and Numis Corporation Ltd. Member of the Council, treasurer, and chair of the Finance and Investment Committee of Queen Mary University of London.

**Committee membership:** Chair of the Audit Committee and member of the Corporate Governance and Nomination Committee.



**Tanya Lawler (47)**  
**Non-Executive Director**

**Date of appointment:** 1 September 2018

**Experience:** Tanya is a business leader with over 25 years' experience in the digital, retail, media, telecommunications and consulting industries, having worked in the internet and digital space since 1992. Recent experience includes VP at eBay UK and digital and commercial director positions at J Sainsbury's and Home Retail Group. Tanya has experience across the UK, Australasian, Western and Eastern European, and Scandinavian markets.

**External appointments:** None.

**Committee membership:** Member of the Risk and Remuneration Committees.

#### Out-going directors

##### **James Dean (61) Former Non-Executive Director and Senior Independent Director**

**Date of appointment:** 26 July 2012

**Date of resignation:** 31 March 2018

**External appointments:** Chairman of the Stafford Railway Building Society, R.J. Young Properties (Stafford) Ltd and Reigate Grammar School. Non-executive director at Rathbone Brothers plc.

##### **Caroline Burton (69) Former Non-Executive Director**

**Date of appointment:** 9 September 2011

**Date of resignation:** 7 June 2018

**External appointments:** Non-executive director of BlackRock Small Companies Investment Trust PLC, member of the appointments committee at Hermes Property Unit trust and advisory work for pension schemes.

#### Terms of appointment

The terms of appointment for the non-executive directors are available for review, upon request, from the Society's registered office and before the Society's AGM.

#### External commitments

Executive directors may be invited to become non-executive directors of other companies, subject to the agreement of the Society. These appointments provide an opportunity to gain broader experience outside LV= and therefore benefit the Society. Providing that appointments are not likely to lead to a conflict of interest, executive directors may accept non-executive director appointments and retain the fees received.

Each executive director's external commitments are listed above. All non-executive directorships have been approved by the board and are deemed not to conflict with the Society's business. No fees have been received in respect of these external appointments.

#### Time commitment

The time commitment of each non-executive director is regularly reviewed and any new external appointments are considered by the chairman and approved by the board. The board consider whether there is a conflict of interest and ensure that the director continues to be able to provide sufficient time to their role on the board of the Society.

## Board committees

A full description of the responsibilities and a summary of duties and the activities undertaken during the year can be found on pages 59 to 69.

The terms of reference for the board committees are reviewed each year and published on our website. They can be viewed at [LV.com/boarddocs](http://LV.com/boarddocs)

### Board – chair Alan Cook

Establish values, culture and ethics, appointment and removal of directors. Financial and strategic matters, mergers, acquisitions and disposals. Monitor board committees.



Each director formally appointed to the board is eligible to attend formal board, ad-hoc and strategy meetings. The table shows attendance of formal board meetings only.

The composition of the board varied as follows:

- 1 James Dean resigned from the board on 31 March 2018. David Barral took over responsibilities as Senior Independent Director and Luke Savage replaced James as chair of the Audit Committee.
- 2 Caroline Burton resigned from the board on 7 June 2018. Alison Hutchinson and Colin Ledlie took over the responsibilities as chair of the Remuneration and Investment Committees respectively.
- 3 Luke Savage joined the board on 1 February 2018 and became Audit Committee chair on 1 April 2018.
- 4 Alison Hutchinson joined the board on 1 January 2018 and replaced Caroline Burton as Remuneration Committee chair from 7 June 2018.
- 5 Wayne Snow joined the board as an executive director and the Society's chief risk officer on 2 July 2018.
- 6 Tanya Lawler joined the board on 1 September 2018.

### Audit Committee – chair Luke Savage

Review internal control, financial reporting process and output. Review internal and external auditor effectiveness.

### Investment Committee – chair Colin Ledlie

Oversee investment strategy, align business and risk strategy. Monitor performance of external fund managers.

### Risk Committee – chair David Barral

Monitor risk governance and framework, group's economic capital model and systems of governance. Focus on risk exposure. Embed risk culture.

### With-profits Committee – chair Graham Berville

Compliance with the Principles and Practices of Financial Management. Protect the interests of the With-profits policyholders.

### Remuneration Committee – chair Alison Hutchinson

Determine executive pay policy, monitor LTIP schemes, recommend annual bonus rates.

### Corporate Governance and Nomination Committee – chair Alan Cook

Monitor balance of board's skills and experience. Shortlist and recommend candidates for appointments. Reviews the selection process.

### RNPFN supervisory board – chair Peter Nowell

Protect the interests of the RNPFN policyholders, monitor compliance with policies.

## Board membership and attendance in 2018

In addition to the 13 formal board meetings held during 2018, the board also met twice for strategy and planning sessions. In 2019 the board expects to meet at least ten times and to have two strategy and planning sessions.

Against each name in the table below is shown the number of meetings at which the director was present and the number of meetings that the director was eligible to attend.

Formal meetings held: 13	Eligible to attend	Meetings attended	% of attendance
Alan Cook	13	13	100%
David Barral	13	13	100%
James Dean <sup>1</sup>	4	3	75%
Caroline Burton <sup>2</sup>	6	6	100%
Luke Savage <sup>3</sup>	12	12	100%
Colin Ledlie	13	11	85%
David Neave	13	12	92%
Andy Parsons	13	13	100%
Richard Rowney	13	13	100%
Alison Hutchinson <sup>4</sup>	13	10	77%
Wayne Snow <sup>5</sup>	5	5	100%
Tanya Lawler <sup>6</sup>	4	4	100%

## Re-election and retirement

Under the Society's rules all directors are required to stand for re-election at least once every three years. Alan Cook, Alison Hutchinson, Andy Parsons and Colin Ledlie were all put forward for re-election and reappointed by the members at the 2018 AGM. As part of the new requirements of the Corporate Governance Code which the board has agreed to adopt, going forward all directors will stand for re-election, effective from 2019.

Further details of the directors' suitability and expertise can be found within their biographies on pages 54 to 56.

Under the Corporate Governance Code, in order to maintain the independence of the board, directors must retire after a nine-year term. However the board adopts a best practice approach where directors typically resign after a shorter term of six years, although flexibility is retained to ensure robust succession and the preservation of required skills on the board.

## Matters reserved for the board

There is a clear list of matters which only the board can decide on; other matters are delegated to the chief executive. Matters reserved for the Society's board are outlined in the table below.

The board ensures that directors, especially the non-executive directors, have access to independent professional advice where they judge it necessary to discharge their responsibilities as directors and have access to the advice and services of the company secretary.

Strategy and planning	<ul style="list-style-type: none"> <li>Establishing the tone from the top for values, culture and ethics.</li> <li>Determining and overseeing delivery of the group's strategy.</li> <li>Approval and monitoring of long-term strategic plans and objectives.</li> <li>Approval and monitoring of the group annual business plan for the coming five years.</li> </ul>
Appointment and removal of officers	<ul style="list-style-type: none"> <li>Appointment and removal of the Society's chairman, deputy chairman (if appointed), senior independent director, company secretary, group chief executive, chief investment officer, chief risk officer, With-profits actuary and actuarial function holder and directors of the Society and its subsidiaries.</li> </ul>
Financial matters	<p>Approval of:</p> <ul style="list-style-type: none"> <li>Capital or revenue expenditure exceeding £5m or greater than £2.5m where this expenditure is over the agreed budget, or any expenditure deemed to be outside the normal course of business.</li> <li>The annual bonus declaration.</li> <li>Recommendations, if any, to the Financial Condition Report.</li> <li>The Valuation Report and the Annual Report.</li> <li>Solvency II financial reporting, including approval of the ORSA, the group's economic capital model and its embedding, risk appetite statements and systems of governance as recommended by the Risk and Audit Committees.</li> </ul>
Mergers, acquisitions and disposals	<ul style="list-style-type: none"> <li>Mergers, acquisitions and disposals either by the Society or any of its subsidiaries with a value greater than £5m.</li> <li>Approval of mergers, acquisitions and disposals and overseeing effective integration.</li> </ul>
Governance and compliance	<p>Approval of:</p> <ul style="list-style-type: none"> <li>The Notice of AGM (including reappointment of auditors), any proposed amendments to the memorandum and rules and related documentation in connection with the AGM.</li> <li>The Notice of the results of the AGM and any resolutions to be raised at the Member Panel where there was a significant vote against.</li> <li>Approval and periodic review to discuss specific policy statements as the board may determine from time to time including principal risk policies (except those delegated to the Risk Committee).</li> <li>Any political donations (none made).</li> <li>The membership of board committees.</li> <li>The terms of reference of board committees, subsidiary company boards and the Executive Asset and Liability Matching Committee.</li> <li>Policy changes in pension entitlement and staff pension scheme funding.</li> </ul>

## Audit Committee

The Audit Committee is required to meet at least three times a year, in accordance with its terms of reference, and has an agenda linked to events in the group's financial calendar including approving any press releases to the market on financial reporting. During the year, the committee met six times which included approval of all financial and trading disclosures. The committee is expected to meet at least six times in 2019. Details of each member's attendance is provided below:

Formal meetings held: 6	Eligible to attend	Meetings attended	% of attendance
Luke Savage <sup>1</sup>	6	6	100%
Colin Ledlie	6	5	83%
David Barral	6	5	83%
James Dean <sup>2</sup>	2	2	100%
Caroline Burton <sup>3</sup>	2	2	100%

The company secretary acts as secretary to the Audit Committee. Other individuals may be invited to attend all or part of any meeting as and when appropriate including, but not limited to, the chief executive, the group finance director, the internal audit director, the chief risk officer and the general insurance finance director.

The external auditors (PricewaterhouseCoopers LLP (PwC)) attended all of the committee's main meetings in 2018.

All members of the committee are independent and bring significant and relevant skills and experience to the function of the committee. All members undertake induction training and continuing professional development. In particular, the chairman Luke Savage as the former group chief financial officer at Standard Life plc, and Colin Ledlie as the former group chief actuary at Standard Life plc, have the requisite 'recent and relevant financial experience', as recommended by the Corporate Governance Code.

The terms of reference of the Audit Committee include all matters required under the Corporate Governance Code and follow the Financial Reporting Council (FRC) guidance. Compliance with the committee's terms of reference is reviewed annually to ensure the committee has discharged all of its responsibilities in the year.

### The primary purposes of the Audit Committee are to:

- Review the financial reporting process and outputs so as to ensure the balance, transparency and integrity of published financial information and the group's process for monitoring compliance with laws and regulations affecting financial reporting.
- Review the effectiveness of the group's internal controls and risk management systems.
- Review the effectiveness of the internal audit function, whose remit covers all risk classes.
- Review the effectiveness of the external audit process, the remit for which is external reporting matters including the appointment of and ensuring the independence of the external auditor and the use of the external auditor for non-audit services.

<sup>1</sup> Chair of the committee from 1 April 2018 (member of the committee from appointment as director on 1 February 2018).

<sup>2</sup> James Dean chaired the committee until he resigned as a director on 31 March 2018.

<sup>3</sup> Caroline Burton was a member of the committee until she resigned as a director at the 2018 AGM.



## Significant issues addressed by the Audit Committee during the year

The Audit Committee pays particular attention to matters it considers to be important by virtue of their impact on the group's solvency, results or remuneration of senior management, or the level of complexity, judgement or estimation involved in their application on the consolidated financial statements. The main areas of focus during the year are set out in the following significant issues table.

Area of focus	Audit Committee action in year	Conclusion / outcome
<b>Financial reporting</b>		
<b>Goodwill</b> The appropriateness of the £34m carrying value of goodwill associated with the continuing business that is held on the consolidated Statement of Financial Position.	<p>The committee reviewed the assumptions used by management in performing the annual impairment assessment which compares the recoverable amount against the carrying value of the life business.</p> <p>Consideration has been given to the appropriateness of value in use calculations, including discount rates applied.</p>	<p>The committee concluded that the assumptions used to assess goodwill for impairment are appropriate.</p> <p>Results of the calculations confirmed that the carrying value of goodwill is supportable and therefore no impairment was required.</p>
<b>Pension scheme accounting</b> The methodology and assumptions used for accounting for the group pension schemes; the net pension benefit asset comprises: <ul style="list-style-type: none"> <li>• LVFS scheme £186m asset.</li> <li>• Ockham scheme £13m asset.</li> <li>• Teachers scheme £2m liability.</li> </ul>	<p>The committee considered the assumptions used for calculating IAS 19 'remeasurement of defined benefit schemes'.</p> <p>The committee noted that £6m past service costs had been recognised regarding Guaranteed Minimum Payments (GMP) equalisation.</p> <p>The committee noted the continued recognition of a surplus in the LVFS and Ockham schemes in compliance with the current IFRIC 14 'The limit on a defined benefit asset' based on the gradual settlement of scheme liabilities.</p>	<p>The committee is satisfied that appropriate assumptions have been used in calculating the remeasurement of defined benefit pension schemes.</p> <p>The committee agreed that the pension benefit asset associated with the LVFS and Ockham schemes is recoverable and that it is appropriate to recognise the asset.</p>
<b>Matters related to the general insurance business transaction</b> <ul style="list-style-type: none"> <li>• Continued consolidation of the general insurance business by LVFS and recognition of a non-controlling interest for the 49% held by Allianz.</li> <li>• Valuation of the put option and forward contract associated with sale of a further equity stake in LVGIG.</li> <li>• Accounting for the general insurance business as a disposal group held for sale.</li> </ul>	<p>The committee reviewed management's papers regarding the accounting treatment of the general insurance business including assessment of continued control over the LVGIG group and valuation of the derivatives associated with the sale of a further equity stake in LVGIG.</p> <p>The committee reviewed the disclosures in the Annual Report regarding presentation of the general insurance business as a discontinued operation.</p> <p>The committee noted that the external auditor has been engaged throughout the process and has agreed with management's accounting treatment.</p>	<p>The committee is satisfied that management have performed a thorough assessment of control over the general insurance business and that the financial reporting of these matters is appropriate.</p>
<b>Changes to accounting standards</b> <ul style="list-style-type: none"> <li>• The group and Society has deferred IFRS 9 'Financial Instruments' in accordance with the amendment to IFRS 4 'Insurance Contracts'. Relevant disclosures are included within Note 1 of the financial statements.</li> <li>• IFRS 15 'Revenue from contracts with customers' has been adopted and relates to £47m of fee and commission income.</li> </ul>	<ul style="list-style-type: none"> <li>• The committee noted the additional disclosures regarding the temporary exemption from IFRS 9.</li> <li>• The committee noted that there was minimal impact from adoption of IFRS 15 and that the existing accounting treatment remains appropriate.</li> <li>• The committee noted that the impact of IFRS 16 will be immaterial and will be adopted on a modified retrospective approach.</li> </ul>	<p>The committee is satisfied that the financial reporting and disclosures within the Annual Report appropriately reflect the changes in accounting standards adopted in 2018 and the group's exposure to the impact of future changes in accounting standards.</p>
<b>Future changes to accounting standards:</b> <ul style="list-style-type: none"> <li>• IFRS 16 'Leases' will change the accounting of £7m of operating lease commitments associated with continuing activities. There will be minimal impact on the finance lease held by the group.</li> <li>• IFRS 17 'Insurance contracts' will significantly change the accounting for the group's insurance contracts.</li> </ul>	<ul style="list-style-type: none"> <li>• The committee reviewed management's plans and timelines regarding compliance with financial reporting regulations over accounting for insurance contracts in accordance with IFRS 17.</li> </ul>	<p>The committee is satisfied that appropriate progress has been made in planning for IFRS 17.</p>

Area of focus	Audit Committee action in year	Conclusion / outcome
<b>Insurance liabilities</b>		
<p><b>Changes to reserving basis assumptions arising from the annual basis review</b></p> <p>Updates to the demographic basis including:</p> <ul style="list-style-type: none"> <li>• Changes to the structure of unit-linked persistency assumptions, reflecting emerging policyholder behaviour.</li> <li>• Changes to OB Pensions cash commutation levels.</li> <li>• Refinement of Equity Release prepayment modelling through inclusion of policyholder age as a driver of prepayments.</li> <li>• Changes to protection mortality including changing the mortality basis on Whole Of Life products.</li> <li>• Mortality improvements associated with adoption of the latest CMI 2017 tables calibrated to the group's demographic outlook.</li> <li>• Changes to FGB mass lapse and guarantee cancellation rates to anticipate policyholder reactions to changes in market conditions.</li> </ul> <p>Updates to methodology, mainly relating to unit costs and expense inflation assumptions, and also other business changes.</p>	<p>The committee reviewed and challenged management's report regarding the proposed changes to non-economic assumptions in the valuation of insurance contract liabilities. The committee considered industry data and the impact of the changes on the insurance contract liabilities.</p> <p>The committee agreed a number of changes to the calculation of the long-term insurance contract liabilities including changes to demographic assumptions and updates to methodology.</p>	<p>The committee concurred with management as to the reasonableness of the revised assumptions.</p>
<p><b>Other life reserving changes:</b></p> <ul style="list-style-type: none"> <li>• Impact of a revised investment management contract with Columbia Threadneedle Investments on investment management fee assumptions.</li> <li>• Results of review of Term mortality experience.</li> <li>• Improvements to modelling of unit-linked pensions and a number of products in the RNPFN ring-fenced fund.</li> </ul>	<p>The committee reviewed and challenged management's report regarding the proposed changes to modelling and assumptions in the valuation of insurance contract liabilities and their impacts.</p> <p>The committee agreed a number of changes to the calculation of the long-term insurance contract liabilities including changes to demographic assumptions and updates to methodology.</p>	<p>The committee concurred with management as to the reasonableness of the revised assumptions and methodology.</p>
<p><b>Additional specific technical provisions</b></p> <ul style="list-style-type: none"> <li>• A reserve of £34m is included to reflect the costs retained by the continuing business upon separation of the general insurance business from the group.</li> <li>• Reserves have been increased by £5m due to discontinuing a management action applied to some unitised With-profits policies designed to remove smoothing from their payouts in certain market conditions. The reserve held for addressing the outcomes of the legacy review is retained at £12m. The reserve covers board approved rectification exercises, changes to payout methodology for some groups of policies regarding improving the targeting of policyholder asset shares. The reserve also covers items subject to ongoing investigation.</li> </ul>	<ul style="list-style-type: none"> <li>• The committee reviewed management's assessment of the impact on life reserves of separation of the general insurance business and were comfortable that a reserve of £34m is appropriate.</li> <li>• The committee noted that discontinuing the management action regarding smoothing and the changes in payout methodology were supported by the With-profits Committee and With-profits actuary, following their review of the changes and the impact on reserves.</li> </ul>	<p>The committee concurred with management's valuation of the quantitative impact on reserves arising from these matters.</p>

Area of focus	Audit Committee action in year	Conclusion / outcome
<b>Insurance liabilities (continued)</b>		
<p><b>General insurance reserve margin</b></p> <p>The reserving claims margin held over and above management's best estimate liabilities for IFRS has been maintained in line with the claims margin policy implemented in 2017.</p> <p>The closing claims margin position has continued to be aligned to the 75th percentile of the reserve risk distribution and this reflects the continued uncertainty in the market.</p> <p>This equates to 5.0% of the best estimate reserve, reducing from 5.6% held at the 2017 year-end following the re-calibration of the reserve risk distribution during this period.</p>	<p>Management have submitted a detailed reserve report for the LVGIG Audit Committee's consideration.</p> <p>The LVGIG Audit Committee reviewed management's analysis of the reserving margin, which demonstrated that the position has been maintained in line with the claims margin policy.</p> <p>The decisions reached at the LVGIG Audit Committee were reported to the LVFS Audit Committee. The LVFS Audit Committee exercised oversight of the reserving process through review of the decisions reached at the LVGIG Audit Committee.</p>	<p>The LVGIG Audit Committee recommended the proposal to maintain the general insurance reserving margin in line with the 75th percentile of the reserve risk distribution to the LVGIG board and this is reflected in the year-end reserves.</p> <p>The LVFS Audit Committee concurred with the conclusions reached by the LVGIG Audit Committee.</p>
<p><b>Ogden discount rate</b></p> <p>During 2018 the Civil Liability Bill received Royal Assent and is therefore now the Civil Liabilities Act.</p> <p>The Act includes the methodology and frequency with which the Ogden discount rate is to be set, with a revised rate being released by August 2019. Claimants will be assessed as "low risk" investors rather than "very low risk", which is assumed currently. As such an increase in the Ogden discount rate is anticipated.</p> <p>The best estimate reserves have been set in light of this; with a revision to the best estimate Ogden discount rate from -0.75% utilised at the 2017 year-end to 0.0% at the 2018 year-end.</p>	<p>Management have submitted a detailed reserve report for the LVGIG Audit Committee's consideration.</p> <p>The LVGIG Audit Committee reviewed the details outlined in the general insurance reserving report, including the rationale for revising the <i>best estimate Ogden discount rate for lump sum personal injury claim settlement</i>.</p> <p>The decisions reached at the LVGIG Audit Committee were reported to the LVFS Audit Committee. The LVFS Audit Committee exercised oversight of the change to the Ogden discount rate assumption through review of the decisions reached at the LVGIG Audit Committee.</p>	<p>The LVGIG Audit Committee recommended the proposal from management that the best estimate for lump sum personal injury settlements should assume an Ogden discount rate of 0.0% to the LVGIG board. This is reflected in the year-end reserves.</p> <p>The LVFS Audit Committee concurred with the conclusions reached by the LVGIG Audit Committee.</p>
<b>Solvency II reporting</b>		
<p><b>Future management actions</b></p> <p>Future actions are available to management to protect the capital position in adverse scenarios. The future management actions plan has been revised; changes include removal of the management action to reduce the capital requirement through clawback of mutual bonus.</p>	<p>The committee reviewed and challenged the future management actions plan including the proposal to remove the mutual bonus clawback action following improvement in the capital position in 2017.</p> <p>The committee noted that although the action has been removed, mutual bonus clawback remains an option available to management.</p>	<p>The committee approved the future management actions plan, noting that it was appropriate to remove the management action to clawback mutual bonus.</p>
<p><b>Approval of an update to the recalculation methodology for Transitional Measures on Technical Provisions (TMTP)</b></p> <p>TMTP is usually recalculated on a bi-annual basis. The TMTP recalculation policy has been amended to increase the threshold at which a request would be sought from the PRA for approval of a further TMTP recalculation.</p>	<p>The committee reviewed and challenged the proposal to amend the TMTP policy taking into consideration the strengthening of the capital position and de-risking of the balance sheet in 2017.</p>	<p>The committee approved the proposal to amend the TMTP recalculation policy.</p>
<p><b>Group Solvency Financial Condition Report (SFCR)</b></p> <p>The group filed the 2017 SFCR during the year, a part of its annual narrative Solvency II Pillar 3 reporting.</p>	<p>The committee carefully considered the 2017 single group SFCR produced by management for external reporting.</p>	<p>The committee recommended the SFCR to the board and Disclosure Committee for public disclosure.</p>



## Summary of key activities during 2018 by which the Audit Committee discharged its responsibilities:

### Financial reporting

- Analysed and scrutinised the key accounting policies, judgements, estimates and actuarial assumptions with management, the external auditors and the chief actuary.
- Maintained group oversight of general insurance financial reporting. This includes valuation of insurance contract liabilities for which review is delegated to the LVGIG Audit Committee, for recommendation to the LVGIG board.
- Reviewed procedures for dealing with any complaints regarding accounting, reporting, internal control or auditing matters.
- Considered management's review of the viability and going concern status of the group, ensuring that appropriate capital and liquid assets are in place to allow the group results to be reported on a going concern basis.
- Monitored the financial results communicated to members, including the Annual Report.
- Reviewed and recommended all external financial reporting for the Society (including press releases and any interim announcements put onto the regulatory news service of the London Stock Exchange) to the board (or the Disclosure Committee) together with supporting narrative, ensuring estimates, judgements and reporting issues are considered so that there is appropriate balance, transparency and integrity of information contained in the Annual Report.
- At the request of the board, the committee considered whether the 2018 Annual Report was fair, balanced and understandable and whether it provided the necessary information for stakeholders to assess LV=’s position, performance, business model and strategy. In reviewing the Annual Report the Audit Committee has concluded that this was the case.

### Internal audit

- Periodically reviewed and approved internal audit plans for 2018 to ensure they reflected the group's priorities, plans and risk profiles.
- Considered and approved the initial internal audit plan for the first quarter of 2019 (third line of defence) ensuring it was complementary to the group risk management function (second line of defence). The internal audit plan is derived from a risk-based assessment of the business and a review against the group's risk profiles.
- Received update reports from the internal audit director as to the effectiveness of the governance, risk management and internal control framework within the group.
- Received a summary of assurance over significant change initiatives including separation of the general insurance business from the group, changes to the business model, the Risk Development Programme (RDP), GDPR and Pioneer.
- Received updates on ongoing issues, significant findings and the adequacy of remediation activity together with supporting internal audit reports.
- Concluded that internal audit's budget, together with changes to the budget agreed during the year, was sufficient to allow internal audit to deliver its objectives.
- Held responsibility for approving any updates to the audit charter which is available on the company's external website.
- Confirmed that the internal audit director's independence has been maintained.

- Assessed internal audit effectiveness taking into account how resource challenges have been managed, the independent feedback from external audit and the regulators, and the views of executive management.
- Confirmed the appointment of Vanessa Swanton to the role of internal audit director, succeeding Alison Ward after a suitable transition period.

### Internal controls

- Received an annual attestation and associated exception report regarding the effectiveness of the risk management system and controls being operated.
- Reviewed the arrangements through which employees can raise concerns about possible irregularities relating to financial reporting or other matters and reviewed the summary of whistleblowing reports.

### Solvency II

- Reviewed and recommended all Solvency II external financial reporting for the group including the release of the 2017 Solvency Financial Condition Report.
- Reviewed and challenged the annual regulatory capital calculations, including the methodology associated with a recalculation of TMTP and the interaction with the Financial Resource Requirement (FRR) test.
- Delegated to the chief executive and group finance director the approval of the quarterly regulatory capital submissions to the PRA.

### External audit

#### Effectiveness of the external auditor

- The committee reviewed an evaluation of the effectiveness of the external auditor, which was prepared by internal audit using input from across the group. Key stakeholders involved in the 2017 year-end audit process were interviewed and/or completed a questionnaire to evaluate the effectiveness of the external auditor's processes and key individuals, and also to identify opportunities to enhance the effectiveness and added value from the external auditor. Areas assessed were expertise, communication, team, and delivery. The committee concluded that the external audit was effective.

#### Re-appointment of external auditor

- PwC have been the group's external auditor since 2008. Legislation regarding audit firm rotation requires that the external audit contract be put out to tender at least every ten years, however the maximum duration cannot exceed 20 years. As reported in last year's Annual Report, following a tender process the Audit Committee proposed to the board that PwC be re-appointed as statutory auditor and that this appointment would be subject to member approval at the AGM in June 2018. This resolution was approved by the members at the June 2018 AGM.

#### Auditor independence

- Reviewed the policy for the use of the external auditor for any non-audit related work and following the committee's recommendation, the threshold for engagements requiring the prior approval of the Audit Committee was reduced.
- Monitored the use of the external auditor for any non-audit related work, to ensure its continued independence was not prejudiced and to ensure that the provision of such services did not impair the external auditor's objectivity.

- Ensured that the external auditor has reviewed its own independence in line with these criteria and its own ethical guidance standards and has confirmed to the committee that following its review it is satisfied that it has acted in accordance with relevant regulatory and professional requirements and that its objectivity is not impaired.
- Approved the total fees paid to or invoiced by the external auditor of £2,066,000 which includes £1,628,000 for the statutory audit of the Society and its subsidiaries, £407,000 for audit related assurance services including the audit of Solvency II regulatory returns, and £31,000 for non-audit work which is 3% of the maximum fee for non-audit work permissible. Having considered compliance with our policy and the fees paid to the external auditor, the committee is satisfied as to the continued independence and objectivity of the external auditor.
- Reviewed and approved the external auditor's proposed audit scope and approach for the current year as set out in its 2018 audit plan, in the light of the group's present circumstances and changes in regulatory and other requirements.
- Discussed with the external auditor any audit problems encountered in the normal course of audit work, including any restrictions on audit scope or access to information as part of ensuring that significant findings and recommendations made by the external auditor and management's proposed response were received, discussed and appropriately acted upon.
- Met privately with the external auditors, PwC.

### Committee's effectiveness

The committee reviews its own effectiveness annually and, during the year, this review was led by the committee's chairman. The committee also reviews the effectiveness of each meeting prior to conclusion to ensure continuous improvement.

### Committee's achievements and future priorities

#### Achievements in 2018

- **Financial reporting:** Reviewed and challenged the changes in modelling and assumptions used to value insurance contract liabilities.
- **Solvency II:** Approved the future management actions plan which saw an improvement in the quality of the reported capital.
- **Internal controls:** Provided oversight of internal control reporting and matters arising from whistleblowing reports.
- **Internal audit:** Provided stewardship over resolution of improvement areas identified by internal audit in the year.
- **External audit:** Improved oversight of external auditor independence through reduction in the threshold for Audit Committee approval of additional non-audit services.
- **Effectiveness:** Strengthened the committee through the appointment of Luke Savage as chair of the committee who has significant and relevant insurance and financial reporting experience from his former role as group chief financial officer at Standard Life plc.

#### Priorities for 2019

- Stewardship of the financial impact of the reduction in the group's investment in the general insurance business to a minority holding by the end of 2019.
- Oversight of the financial reporting implications of Brexit developments.
- Review of significant changes in financial reporting on the group, including valuation of insurance contract liabilities and changes in accounting standards.
- Review and challenge of the annual regulatory capital calculations, including the methodology associated with a recalculation of TMTP and the interaction with the Financial Resource Requirement (FRR) test.
- Governance of matters related to internal and external audit.

## Investment Committee

The Investment Committee met four times in 2018 and is expected to meet four times in 2019. The committee comprises three non-executive directors and two executive directors. Representatives from the group's asset manager, Columbia Threadneedle Investments, the chief capital and investment officer, the chief risk officer, and the With-profits actuary are regular attendees who attend by invitation. Details of each member's attendance is provided below:

Formal meetings held: 4	Eligible to attend	Meetings attended	% of attendance
Colin Ledlie <sup>1</sup>	2	2	100%
Caroline Burton <sup>2</sup>	2	2	100%
Richard Rowney	4	4	100%
Andy Parsons	4	4	100%
David Barral	4	4	100%
Alan Cook	4	4	100%

### The role of the committee

It is responsible for:

- Developing, recommending and overseeing the investment strategy for the group, aligned to the business and risk strategy.
- Monitoring and reviewing the operational performance of Columbia Threadneedle Investments covering its relative investment performance against mandates set, service levels, contract terms and conditions including its charges compared to alternative providers.
- Investment activity undertaken by management including the oversight of the group's Asset and Liability Committee (ALCO) delegated activities and effectiveness of decisions and actions.

### Principal activities undertaken in 2018

During the year, the committee undertook the following activities:

- Monitored the investment portfolio performance.
- Discussed Columbia Threadneedle Investments' performance including compliance with delegated authorities.
- Reviewed and revised the group's With-profits and estate strategies.
- Oversight of the renewal negotiations and approval of the asset manager's contract.
- Assessed the scenarios and impacts of Brexit on the market and the Society's portfolios.

## Risk Committee

The Risk Committee met formally seven times in 2018 and once to hold a risk workshop. The committee is expected to meet six times in 2019. The committee is made up of five non-executive directors and each member's attendance is provided below:

Formal meetings held: 7	Eligible to attend	Meetings attended	% of attendance
David Barral <sup>3</sup>	7	7	100%
David Neave	7	6	86%
James Dean <sup>4</sup>	2	1	50%
Alan Cook	7	5	71%
Colin Ledlie	7	7	100%
Tanya Lawler <sup>5</sup>	2	2	100%

1 Colin Ledlie was appointed chair of the Investment Committee from June 2018 following the resignation of Caroline Burton on 7 June 2018.

2 Caroline Burton resigned from the board at the Society's AGM on 7 June 2018.

3 Chair of the Risk Committee

4 James Dean resigned from the board on 31 March 2018.

5 Tanya Lawler was appointed to the board and became a committee member on 1 September 2018.

Other attendees include, but are not limited to: the chief executive, the group finance director, the chief risk officer, the internal audit director, the director of compliance, and the group chief actuary.

### The role and principal activities of the committee


The principal role of the committee is to consider the risks faced by LV= and advise the board.

More details of the group's policy on risk management, and the activities of the committee during the year are set out in the Risk Management section on pages 34 to 39.

## With-profits Committee

In accordance with its terms of reference, the With-profits Committee was scheduled to meet five times in 2018. In light of the progress and importance of our work to build a sustainable mutual, the committee met twelve times during the year and is expected to meet at least five times in 2019. The committee is made up of an independent chairman, one independent member, one Teachers nominee independent member and one LVFS non-executive director. Details of each member's attendance is provided below:

Formal meetings held: 12	Eligible to attend	Meetings attended	% of attendance
Graham Berville <sup>1</sup>	12	12	100%
Steve Sarjant <sup>2</sup>	12	11	92%
Ian Blanchard <sup>3</sup>	12	11	92%
Colin Ledlie	12	10	83%

- 
- 1 Chair of the committee.
  - 2 Independent member.
  - 3 Teachers nominee independent member.

### Changes to the composition of the committee

The committee decided that a member nominated from management was no longer required as a member of the committee, but management would attend upon request. Succession planning and the appointment of an additional independent member will be considered in 2019.

### The role of the committee

The committee's role in respect of the LVFS Fund and the Teachers Assurance Fund is to:

- Consider and exercise independent judgement towards the rights, interests and fair treatment of With-profits policyholders and advise the board accordingly.
- Bring independent judgement of the assessment of compliance with the statement of Principles and Practices of Financial Management (PPFM).
- Monitor how any competing or conflicting interests between different groups of policyholders are resolved.
- Review and recommend to the board the level and eligibility of bonus rates (including mutual bonus).
- Monitor investment performance and review investment strategy.
- To fulfil the requirements of the Instrument of Transfer of Engagements entered into by the Teacher's Provident Society Limited and LV= that relate to the committee.

The committee can engage external professional advisers to assist in delivering its objectives effectively. It also draws on the expertise of the With-profits actuary. Contribution is also provided by the life chief actuary, head of heritage products and the chief capital and investment officer, who regularly attend meetings.

### Principal activities undertaken in 2018

During the year, and in addition to its core responsibilities, the committee undertook the following activities:

- Discussed and considered the implications of the proposals for a sustainable mutual on the With-profits policyholders. In addition to the five scheduled meetings, the committee held seven additional meetings during the year to review the papers ahead of the board meetings and provided comments to the board to facilitate the discussions.
- Considered the appointment of, and welcomed, a new With-profits actuary.
- Conducted an annual effectiveness review. The process was managed internally and comprised a questionnaire completed by all members and two regular attendees. Recommendations on training, membership and the interaction with other board committees were highlighted and will be considered during 2019.
- Undertook performance reviews of the chairman and the independent members.
- Reviewed and recommended the approval of the renewed investment management contract with Columbia Threadneedle Investments.
- Continued to monitor the outcomes from the legacy programme and considered proposed remediation and improvements.
- Reviewed customer communications.
- Oversaw the options for the future of the Teachers Assurance Group Pension Scheme.
- Considered 'no adverse effect' and 'best interests' tests for LV='s ongoing investment in Wealth Wizards and LVGIG.

## Remuneration Committee

The Remuneration Committee met seven times during 2018 and is expected to meet five times in 2019. The committee is made up of at least three non-executive directors and each member's attendance is provided below:

Formal meetings held: 7	Eligible to attend	Meetings attended	% of attendance
Alison Hutchinson <sup>1</sup>	7	7	100%
Caroline Burton <sup>2</sup>	3	3	100%
David Neave	7	7	100%
Alan Cook	7	7	100%
Tanya Lawler <sup>3</sup>	2	2	100%

### The role and principal activities of the committee

On behalf of the board, the committee determines:

- The group's policy on executive remuneration.
- The group's policy and governance on variable remuneration.
- The specific remuneration packages for each of the executive directors and certain senior managers, including the group-wide incentive and bonus schemes.

A summary of the group's policy on executive and senior management remuneration, and the activities of the Remuneration Committee during the year are set out in the Report on Directors' Remuneration on pages 73 to 85.

## Corporate Governance and Nomination Committee

The Corporate Governance and Nomination Committee met four times in 2018 and is expected to meet at least twice in 2019. For the majority of the year, the committee comprised of at least three non-executive directors, the chairman and the chief executive. Details of each member's attendance is provided below:

Formal meetings held: 4	Eligible to attend	Meetings attended	% of attendance
Alan Cook <sup>4</sup>	4	4	100%
Richard Rowney	4	4	100%
James Dean <sup>5</sup>	1	1	100%
Caroline Burton <sup>2</sup>	1	0	0%
David Neave	4	4	100%
David Barral	4	4	100%
Alison Hutchinson <sup>6</sup>	2	2	100%
Luke Savage <sup>7</sup>	1	1	100%

1 Alison Hutchinson was appointed chair of the Remuneration Committee from June 2018 following the resignation of Caroline Burton on 7 June 2018.

2 Caroline Burton resigned from the board at the Society's AGM on 7 June 2018.

3 Tanya Lawler was appointed to the board and became a committee member on 1 September 2018.

4 Chair of the Corporate Governance and Nomination Committee.

5 James Dean resigned on 31 March 2018.

6 Alison Hutchinson joined the committee on 1 September 2018.

7 Luke Savage joined the committee on 22 November 2018.

### Changes to the composition of the committee

James Dean and Caroline Burton stepped down from the committee following their resignations from the board. Resulting from discussions with the chairman during the year, it was agreed that Alison Hutchinson and Luke Savage would join the committee in their capacity as chair of the Remuneration and Audit Committees respectively.

### The role of the committee

The committee:

- Evaluates the balance of skills, knowledge and experience on, and required by, the board for board appointments and certain senior management roles.
- Reviews and recommends the approach for the board's annual effectiveness review.
- Oversees the board's governance arrangements and makes appropriate recommendations to the board.
- Ensures compliance with the UK Corporate Governance Code, and other applicable legislations, and ensures best practice is carried out.

### Involvement of external consultants

Following a review of the current skills, strengths and experience of the board, recruitment consultants, Russell Reynolds Associates (previously The Zygos Partnership), were instructed to help compile a short-list of candidates to interview for a non-executive director who had specific customer and member experience. At the conclusion of the recruitment process, the committee reviewed the candidates and made recommendations to the board for approval. Russell Reynolds had no other connection with the Society.

Odgers Berndtson were instructed to assist with the recruitment of the chief risk officer position.

### Principal activities undertaken in 2018

During the year, the committee undertook the following activities:

- Evaluated the balance of skills on the board and identified a greater requirement for customer and member experience amongst the directors which initiated the recruitment search for a non-executive director with appropriate expertise.
- Instructed external search consultants to undertake the recruitment process for the appointment of Tanya Lawler and recommended the appointment to the board.
- Considered and recommended the appointment of the chief risk officer and the company secretary to the board for approval.
- Assessed the composition of the committees and made changes where necessary to address or improve any identified gaps in skills or experience.
- Discussed succession planning of the board and the wider LV= group.
- Undertook a review of the non-executive directors' independence and time commitment, both external and internal, to ensure that each director had sufficient time to discharge their responsibilities.
- Discussed the professional development plans and non-executive director training for the year.
- Discussed and agreed the approach for the board effectiveness review and the scope of the review.
- Reviewed the board diversity policy and performance against its set objectives.
- Reviewed and discussed the implications of the revised UK Corporate Governance Code.

### RNPFN Supervisory Board

The RNPFN Fund is a ring-fenced sub-fund within the Society which holds the remaining business transferred from the Royal National Pension Fund for Nurses on 31 December 2001.

The RNPFN Supervisory Board met four times during 2018 and is expected to meet four times in 2019. The Supervisory Board comprises three independent members one of which is the chairman, and two LV= management nominated members.

Formal meetings held: 4	Eligible to attend	Meetings attended	% of attendance
Peter Nowell <sup>1</sup>	4	4	100%
Rodney Baker-Bates	4	3	75%
Mike Kipling <sup>2</sup>	3	3	100%
David Davies <sup>3</sup>	1	1	100%
Andy Young <sup>4</sup>	4	4	100%
Paul Downey <sup>4</sup>	4	4	100%


Other regular attendees include the With-profits actuary, the head of heritage products and the chief capital and investment officer.

### Changes to the composition of the committee

David Davies stepped down from his role as an independent member in February 2018 and was replaced by Mike Kipling in February 2018. Mike has extensive experience in the life insurance industry, in particular the With-profits sector. He was chief actuary of Royal and Sun Alliance Life, investment director of Phoenix Life and With-profits actuary of Friends Life. He was a Vice-President of the Institute of Actuaries.

### The role of the committee

The RNPFN Supervisory Board is a subcommittee of the LVFS Board and was established in accordance with the RNPFN Schemes of Transfer, the legal documents that govern the operation of the RNPFN fund. At the request of the LVFS Board, the RNPFN Supervisory Board also fulfils the function of the RNPFN With-profits Committee.

 1 Chair of the committee.

2 Mike Kipling joined the committee on 22 February 2018.

3 David Davies resigned on 21 February 2018.

4 Management nominated committee members.

The role of the RNPFN Supervisory Board (when acting as a Supervisory Board) is to:

- Monitor the management of the RNPFN Funds including investment and bonus policy.
- Monitor compliance with the RNPFN Schemes of Transfer.
- Review any proposal from the board to cease to maintain the RNPFN Fund as a separate sub-fund.
- Consider the appropriate level of capital support, and to consider whether a deficit has occurred and how any contingent loan advanced is repaid.

The role of the RNPFN Supervisory Board (when acting as a With-profits Committee) is to:

- Consider interests and expectations of its members.
- Advise on its views on the interests of the RNPFN With-profits policy holders.
- Bring independent judgement of the assessment of compliance with the statement of Principles and Practices of Financial Management (PPFM).
- Monitor how any competing or conflicting interests between different groups of policyholders are resolved.
- Provide advice to the board on any other matters within its terms of reference.

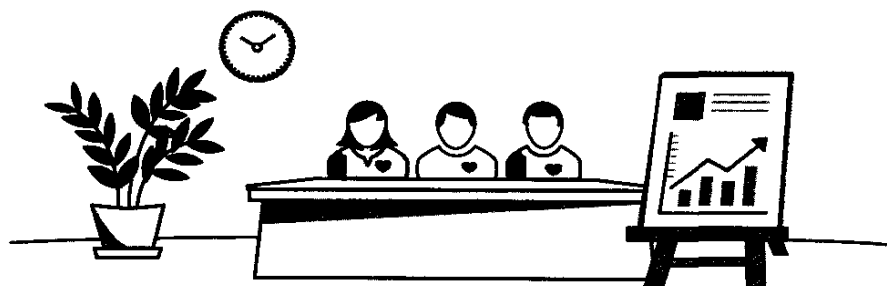
#### Principal activities undertaken in 2018

During the year and in addition to its core responsibilities, the committee undertook the following activities:

- Welcomed a new committee member and ensured a thorough induction plan was undertaken.
- Considered the impact of negotiations on the renewal of the investment management contract with Columbia Threadneedle Investments.
- Continued to monitor the outcomes from the legacy product review programme and considered proposed remediation and improvements.
- Continued an ongoing programme of improvements to policyholder communications.
- Reviewed the investment strategy for the RNPFN Fund.
- Reviewed the run off of policies over time to gauge when the RNPFN Fund is likely to reach the threshold to be merged with the LVFS fund.
- Discussed the implications of the proposed separation of the LVFS fund structure for the RNPFN Fund and its members.
- Reviewed the proposal to convert the Society to a company limited by guarantee.

#### Executive Committee

The chief executive chairs this committee meeting to monitor the group's business performance. It also meets in order to help him meet the responsibilities which the board has delegated to him and as a precursor to its monthly reporting to the board.



# Directors' Report

**Michael Jones**  
Company Secretary



## Business activities and future prospects

LV= is an incorporated friendly society that, together with various subsidiaries, carries out insurance and financial services business in the United Kingdom (UK). These activities include With-profits insurance, life protection, pensions, annuities, online retirement advice, equity release, motor, home, pet and travel insurance. The directors consider that all the activities undertaken by the group during the year were within the Society's rules and relevant regulatory permissions.

The board sets objectives and priorities supported by key performance indicators and targets, which it monitors on an ongoing basis throughout the year. During 2018, the key objectives and priorities were aligned to our strategic agenda as outlined on pages 15 to 19.

## Business strategy

The board has chosen to set out the group's strategic report information required under applicable law and regulations in full, which can be found on pages 8 to 47 of this report.

## Basis of accounting

These financial statements are presented using International Financial Reporting Standards (IFRS), as adopted by the European Union, drawn up on a going concern basis. Further details about the directors' responsibilities for the financial statements are described on page 72.

## Going concern and viability statement

In accordance with the provisions of the UK Corporate Governance Code, the directors are required to assess the prospect of the group as a going concern generally over the next 12 months and also its longer-term viability.

### Going concern

Under the UK Corporate Governance Code the directors are required to state whether the business is a going concern. In considering this requirement, the directors have taken into account the following:

- The group financial plan, which was approved by the board and in particular the forecast regulatory solvency position. Sensitivity analysis is included within this forecast.

- For the group, regulatory solvency is given more attention than liquidity. This is because, by the nature of its business, the group holds very substantial liquid assets on its balance sheet which would enable it to pay claims and expenses as they fall due for at least a 12 month period.
- The principal risks and uncertainties that could impact the group's solvency and liquidity over the next 12 months.

Having due regard to these matters and after making appropriate enquiries, the directors confirm that they consider it appropriate to prepare the financial statements on a going concern basis.

### Viability statement

Our members rely on the sustainability of the group over the longer term and this is reflected in our business model and management of risk. An assessment of viability is integral to our strategic planning and decision making process in order that we can continue in operation and meet our obligations to policyholders. Our strategy is developed considering members' best interests, value accretion, solvency and liquidity. The principal risks and uncertainties that the group is exposed to underpin the strategic planning process and are outlined in further detail on pages 38 and 39.

### Period of assessment

A three-year time period of assessment has been used in the board's assessment of viability. Each year a financial plan is developed and is subject to robust review and challenge by the board. This plan is over a five-year horizon, with greater certainty associated with the first three years, and a further two years included to provide the board with an extended plan for strategic decision making. The board recognises that uncertainty increases over time and this is reflected in the period for the assessment of viability. Specifically, it takes into account the current uncertainty in relation to the economic, political and regulatory environment and the typical timescale over which changes to major regulations and the external landscape affecting our business tend to take place.



### Summary of capital position

Significant management actions were taken during 2017 to strengthen and de-risk the balance sheet, including the general insurance business transaction with Allianz and reinsurance of the Ordinary Branch (OB) Pensions portfolio. Capital generation has continued to be a key management objective during 2018 (see page 11), ensuring the group retains an above risk appetite capital surplus and solidifying the sustainability of the group for the future.

### Strategic planning process

The strategic planning process includes an assessment of the sustainability and resilience of our business model and an in-depth analysis of the group's forecast risk profile, capital, solvency and liquidity. The validity of the planning process is assessed by reconciling the projections to actual business outcomes over the past planning cycle, and understanding differences that are identified in order to continually improve the process going forward. The plan provides a road map for implementing the group's strategic objectives and is underpinned by a series of economic and other assumptions which are subject to stress and scenario testing outlined below.

A key element of the group's strategy is the planned conversion from a friendly society to a mutual limited by guarantee and the subsequent creation of a mutual capital fund. This will provide the group with further flexibility to enable the business to prosper in the long term and grow member value.

### Stress and scenario testing

Assessment of the risks to achieving the projected performance is an integral part of the planning process. As part of the Own Risk and Solvency Assessment (ORSA) process we perform stress tests to assess the capital resilience of the group to a range of severe but plausible scenarios (see page 37). These tests allow the board to review and challenge the strategic plan and risk management strategy. In considering these scenarios the impacts of mitigating management actions designed to maintain or restore capital, liquidity and solvency to within risk appetite are considered.

The de-risking of the balance sheet, outlined above, has helped to reduce the sensitivity to non-market stresses and associated scenarios. In the scenarios tested, sufficient mitigating actions have been identified to enable the directors to have a reasonable expectation that the group would remain viable over the three year period of assessment.

In addition, the group conducts a reverse stress test which gives the board an understanding of the maximum resilience of the group to extremely severe adverse scenarios. Results of stress tests form part of the process to set the group's risk appetite capital coverage ratio of 140%, equivalent to a buffer of £380m at 31 December 2018 above the regulatory capital requirement, to protect against shocks and stresses (see page 27).

### Formal viability statement

The directors make this viability statement based on a robust assessment of those risks that could threaten the business model, future profitability, solvency, liquidity or capital adequacy of the group. Based on this assessment, the directors have a reasonable expectation that the group will be able to continue in operation and meet its liabilities as they fall due over the three-year period to December 2021.

### Margin of solvency

Throughout the year and at 31 December 2018 we held the required capital resources for each business class as prescribed by the PRA.

### Assessment of risk

We look to create value for members by maintaining an appropriate balance between the returns that we seek and the level and type of risk we take on in order to achieve these returns.

In accordance with the UK Corporate Governance Code, the directors have carried out a robust assessment of the principal risks facing the group and Society, including those which would threaten its business model, future performance, solvency or liquidity.

A full overview of our risk management can be found on pages 34 to 39 and further details of the ongoing monitoring and the annual review of the effectiveness of risk management systems can be found in the Audit Committee report on page 63. Note 4 of these accounts also provides further detail about our risk management and control.

### Internal control

The board has overall responsibility for the group's internal control systems and for monitoring effectiveness of these. Implementation and maintenance of the internal control systems are the responsibility of the executive directors and senior management. The performance of the internal control systems is reviewed by the relevant board committees, principally the Audit Committee which receives reports from the internal audit, compliance and risk functions.

The Audit Committee report on pages 59 to 64 describes the main features of the internal control and risk management systems in relation to the financial reporting process and the process for preparing consolidated accounts, which are a subset of the internal control systems under the supervision of the board's committees.

The group's internal control systems are designed to manage, rather than eliminate, the risk of failure to meet business objectives and can only provide reasonable, and not absolute, assurance against material misstatement or loss. In assessing what constitutes reasonable assurance, the board has regard to materiality and to the relationship between the cost of, and benefit from, internal control systems.

The regular review of the effectiveness of the system of risk management and internal control concluded that these systems remain effective and there were no significant failings or weaknesses to report.

### Independent auditor

A resolution for the re-appointment of PricewaterhouseCoopers LLP (PwC) as auditor will be proposed at the 2019 AGM. Legislation regarding audit firm rotation requires the external audit contract to be tendered at least every ten years. In 2017, a competitive tender was carried out with PwC being reappointed. PwC has been the group's auditor since 2008.

### Board directors and interests

The current members of the board and details of its various committees are shown on pages 50 to 69.

We continued to maintain liability insurance cover for our directors and officers during the year and as at the date of approval of these financial statements.

### Our employees

Details about our people, our people policies including the employment of disabled persons, engagement with our staff generally and board diversity policy can be found on pages 40 to 47 of this report, headed 'Corporate Responsibility Report'.

## Charitable donations

A full view of our charitable donations and corporate social responsibility activities can be found on pages 41 and 42. No political donations were made in 2018.

## Fixed assets

Changes in our fixed assets are shown in note 27 to the financial statements

## Statement of disclosure of information to the auditor

As at the date of this report each director confirms that:

- So far as he or she is aware, there is no information relevant to the audit of the Society's and the group's financial statements for the year ended 31 December 2018 of which the auditor is unaware.
- He or she has taken all steps that he or she ought to have taken in his/her duty as a director to make him/her aware of any relevant audit information and to establish that the Society's auditor is aware of that information.

## Directors' statement of responsibility

The Friendly Societies Act 1992 (1992 Act) requires a Friendly Society's Committee of Management to prepare accounts for each accounting period. As we are incorporated under the 1992 Act our board of directors has assumed the responsibilities and duties of the Committee of Management in relation to these accounts.

These accounts must comply with the relevant provisions of the 1992 Act, and present fairly the financial position, financial performance and cash flows of the Society and the group at the end of the accounting period. In carrying out this duty, the directors have chosen to use IFRS as adopted by the European Union.

A fair presentation of our accounts in accordance with IFRS requires our directors to:

- Select suitable accounting policies and ensure they are applied consistently.
- Prepare the accounts on a going concern basis, unless it is inappropriate to presume that the Society and the group will continue in business.
- Make judgements and accounting estimates that are reasonable and prudent.
- Present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information.
- Provide additional disclosures when compliance with the specific requirements in IFRS is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the Society's and the group's financial position and financial performance.

- State that the Society and the group have complied with applicable IFRSs, subject to any material departures disclosed and explained in the accounts.

The directors are also responsible for maintaining:

- Proper accounting records which are intended to disclose with reasonable accuracy, at any time, the financial position of the Society and the group.
- Appropriate internal control systems to safeguard our assets and to prevent and detect fraud and other irregularities.
- The integrity of the corporate and financial information included on our website LV.com.

Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Each of the directors, whose names and functions are shown on pages 54 to 56 confirm that to the best of their knowledge and belief:

- The Society and the group financial statements, which have been prepared in accordance with IFRS as adopted by the EU, give a true and fair view of the assets, liabilities, financial position and profit of the Society and the group.
- The Business Reviews on pages 20 to 33 of the Strategic Report include a fair review of the development and performance of the business during the financial year and the financial position of the group at the end of 2018.
- A description of the group's principal risks and details of the group's risk governance structure are provided on pages 34 to 39.

Having taken all the matters considered by the board and brought to the attention of the board during the year into account, the directors are satisfied that the Annual Report, taken as a whole, is fair, balanced and understandable, and provides the information necessary for our members and investors to assess the Society's and the group's position and performance, business model and strategy.

By order of the Board of Directors



**Michael Jones**  
Company Secretary

21 March 2019

# Report on Directors' Remuneration

**Alison Hutchinson**

Chairman of the Remuneration Committee



## Annual Statement

Dear member,

I am pleased to share the Directors' Remuneration Report, including details of directors' pay for the year ending 31 December 2018. Our role as a committee is to ensure that our remuneration policy aligns with the board approved strategy and performance, as well as value created for members.

This report is split into three sections;

- This Annual Statement.
- The Directors' Remuneration Policy, which was put forward and approved by members at the 2018 AGM with a 94% vote "for", is summarised on page 77.
- The Annual Report on Remuneration on pages 78 to 85. This includes information on the pay decisions made in respect of 2018 and details of how the policy will be implemented in 2019, and will be subject to a member vote at the 2019 AGM.

### Remuneration policy and the link to long-term business performance

Our remuneration policy is designed to support the strategy of the Society, promote the long-term sustainable success of the Society, and seeks to align remuneration with performance. Variable remuneration, with the amount paid linked to performance forms an important part of the remuneration package for all employees.

All employees are eligible to participate in the group annual bonus, with the total pool to be shared amongst all employees calculated based on group performance. Group performance for the purposes of determining the annual bonus pool is assessed based on the group balanced scorecard with a mix of financial and non-financial performance conditions.

Each individual's bonus amount is then determined based on their individual performance. For more senior employees, a proportion of any bonus award may be deferred and paid out in a later year, ensuring that our executives remain focused on both the short-term and long-term health of the Society.

Senior employees also participate in the group Long-Term Incentive Plan (LTIP). The final value of an LTIP award is determined based on long-term performance conditions measured over a three year period. The LTIP therefore incentivises senior employees and rewards them for delivering the strategic priorities and strong business performance over the long term.

As chair of the Remuneration Committee, since June 2018, I and the committee are keen to ensure even stronger alignment between member value and executive and employee remuneration going forward. Further information on the changes made to remuneration for 2019 is set out later in this Annual Statement.

### Overview of performance

2018 threw up a number of challenges but there were positive outcomes as our capital position remains strong at 172%, and the group generated £89m of surplus operating capital.

Following the sale of a 49% equity stake in the general insurance business to Allianz at the end of 2017 the group has established a strong strategic partnership with Allianz, and in the first full year of working together, the general insurance business has performed as expected.

As outlined earlier in this report the business experienced challenging trading in the life business, especially in the generation of profitable new business measured by Economic Value of New Business ('EVNB'), but overall the group achieved an operating profit of £136m.

## 2018 performance and remuneration outcomes

The 2018 group balanced scorecard, used to measure performance and determine the size of the bonus pool, was structured as follows:

- 50% on financial measures (each with equal weightings):
  - Life operating capital surplus
  - General insurance dividend flow
  - Economic value of new business (EVNB)
- 50% on non-financial measures:
  - Strategy and change (20%)
  - Customer, member and brand (10%)
  - Risk and compliance (10%)
  - Leadership and diversity (10%)

As set out above, during 2018 the group made good progress on capital generation and maintaining a strong capital position, and in the first year of the strategic partnership with Allianz the general insurance business has performed as expected. Generating profitable new business, measured by EVNB, has been more challenging. Performance against the Customer, member and brand measure has been strong, whilst we recognise that further work could have been done against the Strategy and change, Leadership and diversity, and Risk and compliance targets during 2018. The targets across all measures were set at very stretching levels which is reflected in the final outcome.

Further analysis of the group's performance against the 2018 group balanced scorecard is shown on page 80.

This has resulted in the Remuneration Committee determining that a bonus pool of £6.5 million for distribution amongst LVFS employees would be appropriate in respect of 2018. This is lower than in 2017 (£23m for the combined LV group and £12m for the equivalent LVFS), reflecting a reduced headcount in 2018 following the strategic partnership with Allianz, the very stretching targets set for 2018, and actual performance in 2018. The distribution of the bonus resulted in the average percentage bonus received by our employees being 8.6% of bonus-able earnings.

In addition to performance against the group balanced scorecard, individual performance targets for each of the executive directors are used to determine their individual bonus amounts. The 2018 outcomes for each of the executive directors range from 38% of maximum to 51% of maximum. Further commentary on the personal performance of each individual executive director against their objectives and their 2018 bonus awards is shown on pages 80 and 81.

Our 2016-18 LTIP awards were subject to stretching performance conditions related to growth in Average Adjusted Group Profit Before Tax (AAGPBT), and awards held by current and former executive directors, had a further performance condition based on Relative Investment Performance (RIP), which had a 25% weighting. The threshold target has not been met under either performance condition and therefore the 2016-18 LTIP will lapse in full. Further detail is provided on page 81.

## Remuneration from 2019 onwards

To improve our remuneration policy and practices, a number of refinements have been made for 2019 to further align our remuneration policies and practices with our business strategy and member interests. Whilst the general structures remain appropriate and aligned to market practice, we have made changes to the detail of how the policy is structured and will operate. These changes are summarised below.

### Base salary

We review executive directors' salaries at the same time as all other employees. Richard Rowney and Andy Parsons will not receive any salary increases for 2019. Wayne Snow will receive a salary increase from £325,000 to £350,000 effective from 1 April 2019. This increase reflects a commitment made on appointment to increase his salary to £350,000 effective from 1 April 2019, based on his performance and development into the role during 2018.

In 2019, the average LVFS employee salary increase will be 2.1% (effective from 1 April 2019).

### Group annual bonus

There are no proposed changes to the bonus opportunity for executive directors for 2019, with the chief executive officer having a bonus opportunity of 150% of bonus-able earnings and other executive directors an opportunity of 120% of bonus-able earnings. The committee reviewed the performance measures used and is proposing to increase the weighting of the Member and advisory advocacy measure (from 10% to 20%) to emphasise the critical importance of acting in our members' best interests, and correspondingly decrease the weighting of the Strategy and change measure (from 20% to 10%). The committee will consider the size of the member bonus, as well as performance in the round, when determining the size of any bonus pool and individual bonus pay-outs. Further information on the 2019 group balanced scorecard is shown on page 84.

### LTIP

For the 2019-21 LTIP awards, the committee is proposing to make lower target awards of 120% of salary for the chief executive officer and 101% (rounded) of salary for the group finance director and 100% of salary for the chief risk officer, taking into account the reduced complexity of the business following the strategic partnership with Allianz.

The LTIP will continue to be based on a mixture of financial measures (75% weighting) and strategic goals (25% weighting) as set out below:

- 75% weighting: Financial measures, based around Growth in own funds, Return on capital supporting new business and total life operational expenses.
- 25% weighting: Strategic goals, based around developing a sustainable, vibrant business with a diverse and talented workforce, with measures based on customer satisfaction, employee engagement, and gender.
- An underpin related to risk whereby no vesting will occur if appropriate levels of risk management have not been achieved.

For 2019 Return on Capital Supporting New Business has replaced Economic Value of New Business (EVNB) as a measure as we believe it is clearer to express this measure as a target return on the capital rather than a £ amount.

For 2019 LTIP awards onwards there will be a two-year holding period following the end of the performance period for executive directors, taking into account the provisions of the new UK Corporate Governance Code.

Further information on the LTIP is shown on pages 84 and 85.

## Board changes

I was appointed to the board on 1 January 2018 and then appointed to chair the Remuneration Committee from 7 June 2018 to replace Caroline Burton.

Wayne Snow performed the role of chief risk officer from the date he was employed by LV= on 26 June 2018. Formal appointment to the board took place on 2 July 2018. Wayne Snow's remuneration package upon appointment is in line with our existing remuneration policy, which included no buy-outs from his previous employer.

Further changes to board composition are shown on page 51.

## Listening to members

We have discussed remuneration with members during 2018 and value their views and opinions. It has also been useful to continue open dialogue with each other and we intend that this will continue during 2019.

We aim to comply with the highest standards of corporate governance and our Report on Directors' Remuneration has again been prepared in line with the reporting requirements which apply to listed companies.

We are aware of the changes to the UK Corporate Governance Code for listed companies and the implications on remuneration and with our advisors, Deloitte, we are monitoring how we introduce these changes. As a matter of principle, we look to follow the Code where possible.

We already comply with a number of the provisions within the new Code, for example, the committee already sets the remuneration for the senior management team as well as for the executive directors and has historically reviewed wider workforce pay policies and trends when setting executive director pay. We have also taken a proactive decision to implement a two-year holding period for the executive directors for the 2019-21 LTIP award onwards.

At a wider board level, we are considering how best to further employee engagement on matters such as remuneration. Whilst we do not have shares (due to our mutual status) which executive directors can hold post-employment, deferred bonus and LTIP awards (for good leavers) continue on their original timescales (including any holding period), ensuring that executive directors continue to have an interest in the Society's performance post-leaving. The committee will continue to review

the remuneration arrangements and policies in light of the new Code and how best practice evolves.

We have published our gender pay gap report and at an overall level there has been no significant change to 2017's results. This was expected as many of the actions we put in place to address our gender pay gap are long term and it will take a number of years before we start to see the changes taking effect. We have identified that our gender pay gap is driven by the structure of our workforce. At present, we have a lower representation of females in senior leadership roles and higher representation of females in more junior roles. As part of the actions put in place to address this, we are using remuneration as another lever and have included a gender measure in both the annual bonus and LTIP for 2019-21.

In conclusion, I trust that members will agree that given the challenging backdrop the group has delivered a solid performance which has been reflected in the remuneration of the executive directors in 2018 and that it warrants your approval of the Annual report on remuneration.

I hope that as members you will support the resolution at this year's AGM. As always, the committee and I are keen to receive feedback so we can take on board your views in the future.

On behalf of the Remuneration Committee I recommend you endorse the report.

Yours sincerely



**Alison Hutchinson,**  
Chairman of the Remuneration Committee

# 2018 Remuneration Summary

LV= financial performance  
in 2018



**£89m**  
Operating capital  
generation



**172%**  
Capital cover ratio



**(4.2)%**  
LVFS main  
With-profits fund  
performance



LV= non-financial  
performance in 2018



**Best  
loved**



**74%**  
LVFS employee  
engagement

■ Achieved target

■ Missed target

## Measures used for the 2018 annual bonus scheme and long-term incentive plan

### 2018 Annual bonus

Financial	Payout = 39%
Non-financial	Payout = 39%
<b>Total</b>	<b>Payout = 78%</b>

### 2016-2018 LTIP

Average Adjusted Group Profit Before Tax (AAGPBT)	Payout = 0%
Relative Investment Performance (RIP)	Payout = 0%
<b>Total</b>	<b>Payout = 0%</b>

## How much our executive directors earned in respect of 2018 from our ongoing remuneration policy (£'000)

Richard Rowney	1,003
Andy Parsons	650
Wayne Snow	394

■ Salary, pension and other benefits

■ Annual bonus

	Total remuneration (£'000)	Annual bonus (% of maximum)	Long-term incentives (% of maximum)
Richard Rowney	1,003	44%	–
Andy Parsons	650	38%	n/a
Wayne Snow	394	51%	n/a

## Remuneration policy

Our remuneration policy was approved by members at the AGM held on 7 June 2018. The full remuneration policy can be viewed in the 2017 LV= Annual Report.

The key elements of our remuneration framework are set out below.

### Remuneration policy for executive directors

	Operation	Maximum opportunity
<b>Salary</b>	Salaries are reviewed annually (but not necessarily increased) taking into account several factors including individual experience, responsibilities, function and sector, along with individual and group performance.	No prescribed maximum.
<b>Benefits</b>	Includes temporary living costs, car allowance, medical insurance, income protection and life assurance, which are available to all staff and directors on equal terms.	No prescribed maximum <sup>1</sup>
<b>Pensions</b>	Directors can elect to join a defined contribution pension scheme or receive a cash sum in lieu of pension contributions.	Chief executive: maximum 22% of base salary. Other directors: maximum 14% of base salary. <sup>2</sup>
<b>Annual Bonus</b>	The annual bonus pool is measured against annual group financial objectives, accounting for 50% of the assessment, and a balanced scorecard of objectives covering Strategy and change, Customer, member and brand, Risk and compliance and Leadership and diversity, accounting for the remaining 50%.	Chief executive: maximum payment of 150% of bonus-able earnings. <sup>3</sup> Other directors: maximum payment of 120% of bonus-able earnings. <sup>3</sup>
<b>Group long-term incentive plan (LTIP)</b>	Performance is measured over a three year period, which is then followed by a two year holding period. For 2019-21 awards 75% weighting will be based on three financial measures covering Growth in own funds, Return on capital supporting new business and Total life operational expenses. The remaining 25% weighting will be based on non-financial measures. There is an underpin related to risk whereby no vesting will occur if appropriate levels of risk management have not been achieved.	Maximum payout is capped at two times the initial award, the value of which is up to: Chief executive: 150% of salary; Other board executive directors: 125% of salary.
<b>Deferral</b>	Between 40%-60% of the variable remuneration paid to executive directors is deferred, initially through the Long Term Incentive Plan (LTIP). If this ratio is not met, then a portion of the annual bonus payment for that year will be deferred.	
<b>Malus/Clawback</b>	The committee may apply malus and/or clawback in respect of deferred awards and/or LTIP in any circumstances in which the committee, in its absolute discretion, considers that the Society is required to do so by any Remuneration Code.	

<sup>1</sup> There is no prescribed maximum for benefits overall however car allowance has a maximum of £10,200.

<sup>2</sup> For all new appointments maximum pension contribution is 14% of salary (including Andy Parsons and Wayne Shaw). The chief executive has a higher pension contribution at 22% due to historic reasons and he is the only employee who has this arrangement.

<sup>3</sup> Bonus-able earnings is all basic salary paid in 2018 (includes statutory payments). It excludes additional payments such as overtime, salary supplements and holiday pay.

As outlined on page 84, remuneration decisions taken in respect of the coming year differ from the policy outlined above as follows:

- For the 2019-21 LTIP awards, the committee is proposing to make lower target awards of 120% of salary for the chief executive officer, 101% (rounded) of salary for the group finance director and 100% of salary for the chief risk officer, taking into account the reduced complexity of the business following the strategic partnership with Allianz.
- For 2019-21 LTIP awards onwards there will be a two-year holding period following the end of the performance period for executive directors.

Details of our policy on recruitment and promotions, service contracts, payments for loss of office and non-executive directors can be found in our remuneration policy as set out in the 2017 LV= Annual Report.

## Annual Report on Remuneration

### The Remuneration Committee

The Remuneration Committee determines the remuneration policy for the executive directors and agrees the remuneration of each executive director and other senior managers. The committee reviews the effectiveness of the remuneration policy and strategy at least once a year and all incentive and bonus schemes are established and monitored by the committee.

Members of the committee are provided with training and topical briefing sessions on developments and trends in executive remuneration, particularly as this relates to the financial sector.

### Committee membership, attendance and advisors to the committee

During 2018 the committee members were:

- Alison Hutchinson, who was appointed to the board on 1 January 2018 and then appointed to chair the Remuneration Committee from 7 June 2018.
- Caroline Burton who resigned on 7 June 2018 from the role as chair of the Remuneration Committee and as board member.
- David Neave, who was a member of the committee for all of 2018.
- Alan Cook who is board chairman and was a member of the committee for all of 2018.
- Tanya Lawler who joined as a member of the committee from 1 September 2018.

The chief executive is invited to meetings except when his own remuneration is being discussed. Other senior employees, such as the group finance director, the chief risk officer, the human resources director and the head of reward and benefits, regularly provide advice to the committee and normally attend meetings by invitation.

Following their appointment in 2015 as external advisor, Deloitte LLP provided advice to the committee on remuneration levels and structures, and attended committee meetings by invitation. The committee undertakes due diligence periodically to ensure that our committee advisor remains independent of the Society and that the advice provided is impartial and objective. Deloitte LLP are members of the Remuneration Consultants' Group and, as such, voluntarily operate under the code of conduct in relation to executive remuneration consulting in the UK.

The total fees paid to Deloitte in respect of services that materially assisted the committee during the year were £68,800 for LVFS. During the year Deloitte also provided the group with advice in relation to internal audit services and payroll tax services and advised the LVGIG Remuneration Committee. Fees for these additional services are not included in the figure above.

### Committee activities in 2018

In 2018 the committee met seven times.

The matters which were addressed included:

- Review of the overall policy relating to directors' remuneration.
- Review of salary and bonus levels.
- Ongoing requirements in relation to compliance with the remuneration regulations of the Solvency II regulations and the UK Corporate Governance Code.
- Determination of recruitment and termination arrangements for joiners, promotions and leavers.
- Review of the 2018 balanced scorecard and 2018-20 LTIP.
- Consideration of various remuneration issues related to the strategic partnership with Allianz.
- Preparation of the report on directors' remuneration.
- Other routine matters throughout the year.

### All-employee remuneration

The committee also takes an active role in overseeing remuneration arrangements for the wider employee population. LV= has committed to paying at least the Living Wage Foundation's minimum hourly rates of pay to all employees, with employees paid a minimum of £9.00 per hour outside London and £10.55 in London (including our Croydon office).

LV= conducts regular salary benchmarking, both internally and externally against the wider market, to ensure our employee pay rates remain competitive. We also offer all employees the opportunity to participate in an incentive arrangement (bonus or sales incentive) as well as the opportunity to individually select the benefits they receive as part of their total reward package.



## Remuneration for the past year (year ended 31 December 2018)

### Summary table of executive directors' remuneration – Audited

The remuneration of individual directors, including that of the highest paid director, was as follows:

£'000	Year	Salary and fees	Other benefits <sup>1</sup>	Pension <sup>2</sup>	Annual bonus <sup>3</sup>	Long-term incentives <sup>4</sup>	Total from ongoing remuneration policy	Other remuneration <sup>5</sup>	Total
Richard Rowney	2018	525	17	116	345	–	1,003	–	1,003
	2017	505	17	111	606	480	1,719	–	1,719
Andy Parsons	2018	396	29	45	180	n/a	650	–	650
	2017	217	8	22	250	–	497	450	947
Wayne Snow <sup>6</sup>	2018	168	7	19	200	n/a	394	–	394
	2017	–	–	–	–	–	–	–	–
<b>Total</b>	<b>2018</b>	<b>1,089</b>	<b>53</b>	<b>180</b>	<b>725</b>	<b>–</b>	<b>2,047</b>	<b>–</b>	<b>2,047</b>
	<b>2017</b>	<b>722</b>	<b>25</b>	<b>133</b>	<b>856</b>	<b>480</b>	<b>2,216</b>	<b>450</b>	<b>2,666</b>

1. Benefits include car allowance, medical insurance, health screening, income protection cover and life cover. Benefits also include £14k temporary living costs provided to Andy Parsons for six months of 2018 per his service agreement.

2. These amounts have been taken as cash in lieu of forgone pension contributions by all executive directors.

3. This relates to the annual bonus awarded for the year ended 31 December 2018. Further details of this payment are set out on pages 80 and 81. An element of these full year amounts may be subject to deferral.

4. This relates to the vesting of the 2016/2018 LTIP awards based on the performance to 31 December 2018 which resulted in nil payout.

5. Other remuneration in 2017 relates to incentive arrangements that Andy Parsons had with his previous employer which the committee agreed to buy-out as part of his offer to join the Society.

6. Wayne Snow performed the role of chief risk officer from the date he was employed by LV= on 26 June 2018. Formal appointment to the board took place on 2 July 2018, however his full remuneration since commencing employment has been included in the table above.

### Summary table of non-executive directors' remuneration – Audited

£'000	Year	Base fee	Other fees <sup>1</sup>	Total fees <sup>2</sup>
Alan Cook (chairman) <sup>3</sup> Member of Investment, Risk and Remuneration Committees. Chair of the Corporate Governance and Nomination Committee. Chairman of LVGIG board.	2018	200	50	250
	2017	153	–	153
Alison Hutchinson <sup>4</sup> Chair of Remuneration Committee, member of Corporate Governance and Nomination Committee.	2018	53	10	63
	2017	–	–	–
Caroline Burton <sup>5</sup> Chair of Remuneration and Investment Committees and member of Audit and Corporate Governance and Nomination Committees.	2018	23	12	35
	2017	53	29	82
David Barral Senior independent director, chair of Risk Committee, member of Audit, Investment and Corporate Governance and Nomination Committees. Non-executive director and Audit Committee chair of LV= general insurance subsidiaries.	2018	53	46	99
	2017	53	22	75
Colin Ledlie Chair of Investment Committee, member of With-profits, Risk and Audit Committees.	2018	53	20	73
	2017	22	6	28
Luke Savage <sup>6</sup> Chair of Audit Committee and member of Corporate Governance and Nomination Committee.	2018	48	12	60
	2017	–	–	–
David Neave Member of Risk, Remuneration and Corporate Governance and Nomination Committees. Non-executive director and Risk and Remuneration Committee chair of LV= general insurance subsidiaries.	2018	53	37	90
	2017	53	24	77
Tanya Lawler <sup>7</sup> Member of Remuneration and Risk Committees.	2018	18	3	21
	2017	–	–	–
James Dean <sup>8</sup> Senior independent director, chair of Audit Committee and member of Risk and Corporate Governance and Nomination Committees.	2018	13	7	20
	2017	53	25	78
<b>Total</b>	<b>2018</b>	<b>514</b>	<b>197</b>	<b>711</b>
	<b>2017</b>	<b>387</b>	<b>106</b>	<b>493</b>

No additional fees are paid for membership of the Corporate Governance and Nomination Committee.

1. Other fees relate to committee chair and membership fees and subsidiary board fees.

2. For all those who started or left in the year or were appointed to a different role, the full fees figures reflect fee for those changes. Changes in committee membership during the year are shown on pages 57 to 69.

3. Alan Cook's other fees relate to his position as chairman of LVGIG.

4. Alison Hutchinson was appointed to the board on 1 January 2018.

5. Caroline Burton resigned on 7 June 2018.

6. Luke Savage was appointed on 1 February 2018.

7. Tanya Lawler was appointed on 1 September 2018.

8. James Dean resigned on 31 March 2018.

### Annual bonus for the year ended 31 December 2018 – Audited

The annual bonus for the year under review was based on performance against annual group financial objectives, risk metrics and a balanced scorecard of personal objectives. Details of actual performance against targets are as follows:

Measure	Payout % for target performance	Threshold	Plan	Maximum	Actual	Vesting
Life operating capital surplus <sup>1</sup>	16.7%	£30m	£45m	£60m	£91m	22%
General insurance dividend flow <sup>2</sup>	16.7%	£29m	£37m	£44m	£37m	17%
Economic value of New business	16.7%	£10m	£15m	£20m	£(3)m	0%
Strategy and change	20%				Threshold	17%
Customer, member and brand	10%	See target objectives in table below			Plan	10%
Risk and compliance	10%				Threshold	7%
Leadership and diversity	10%				Threshold	5%
	<b>100%</b>					<b>78%</b>

<sup>1</sup> Life operating capital surplus is operating capital generation excluding the impact of general insurance and group items

<sup>2</sup> Although no formal dividend has been declared due to the uncertainties regarding Brexit, the expected dividends to be remitted in respect of the 2018 general insurance performance have been included in determining the annual bonus out-turn.

The financial performance of the group accounts for 50% of the annual bonus target, which is made up of three measures, each with equal weighting. The group operates a performance range for the three financial elements that are included within the scheme (see table above) which is considered to be stretching at all levels. Threshold is the level of performance that must be achieved to release 70% of the bonus pool. Plan is the level of performance that must be achieved to release 100% of the bonus pool. Maximum is the level of performance that must be achieved to release 130% of the bonus pool.

As detailed in the table above, the total weighted outcome, including non-financial measures, results in executive directors and other senior managers receiving a bonus pool vesting at 78%. Discretion has been applied in increasing the bonus pool for all other employees to 80% as recognition of employee's contribution in a challenging year when the business is being split.

### Individual and strategic

The table below gives a broad indicator of how each executive director performed against their individual and strategic objectives along with a description of those objectives. The total bonus awarded to each director and the percentage deferred is set out in the next table.

	Individual and strategic objectives (50% weighting)	Indication of performance
	Objectives as chief executive:	
Richard Rowney	<ul style="list-style-type: none"> <li>Progress against key strategic priorities including maintaining the group's capital position, securing our future as a sustainable mutual and clarifying the ownership of the group.</li> <li>Manage a well-controlled separation of the general insurance business by the end of 2019.</li> <li>Deliver the financial plan and targets, including strong expense control.</li> <li>Operate within the group's risk appetite.</li> <li>Deliver excellent customer satisfaction scores to remain Britain's best loved insurer.</li> <li>Continue to deliver good employee engagement scores and champion diversity and inclusion.</li> </ul>	Perform
	Objectives as group finance director:	
Andy Parsons	<ul style="list-style-type: none"> <li>Maintain the Society's capital position, secure our future as a sustainable mutual and clarifying the ownership of the Society.</li> <li>Deliver financial operational performance.</li> <li>Operate within the group's risk appetite.</li> <li>Develop the investment strategy.</li> <li>Deliver the financial plan and targets, including strong expense control.</li> </ul>	Perform
	Objectives as chief risk officer:	
Wayne Snow	<ul style="list-style-type: none"> <li>Progress against key strategic priorities including development and implementation of the risk management framework.</li> <li>Operate within the group's risk appetite.</li> <li>Ensure the Society is compliant with relevant regulations including General Data Protection Regulation and Senior Managers and Certification Regime.</li> </ul>	Perform

Risk is taken into account when appraising all performance measures and the committee may reduce (including to nil) any bonus payment if it considers that risk exceeded acceptable levels.

The Remuneration Committee looks at the performance of the business in the round to understand any internal and external factors that have impacted performance and the broad trajectory of the business and market conditions, before determining the appropriate level of bonus to be released.

	Payout (% of maximum)	Total 2018 bonus (£'000s)	Total 2018 bonus (% of bonus- able earnings)	2018 bonus deferred %	2018 bonus deferred <sup>1</sup> (£'000s)
Richard Rowney	44%	345	66%	0%	–
Andy Parsons	38%	180	45%	0%	–
Wayne Snow <sup>2</sup>	51%	200	62%	0%	–

1. Amounts deferred achieve the deferral criteria by hereby 40% of variable remuneration (or 90% if variable remuneration is above £500,000) is deferred. Amounts are calculated using the 2018 bonus and the 2016-2018 LTIP award. Any variable pay amount deferred will be paid in equal parts over the following three years. During the deferral period, the value of deferred amounts will be tied to the value of members' invested funds, thereby creating a link to ongoing performance.

2. As part of his joining contract, the Remuneration Committee agreed that Wayne Snow would have the opportunity of being entitled to a full year's bonus.

### Group LTIP payments made in the year (2016 – 2018 scheme) – Audited

The 2016-18 LTIP scheme is based on a performance period from 1 January 2016 to 31 December 2018.

For the 2016-2018 scheme, the payout is based on:

- AAGPBT\*: 75% of award for Richard Rowney and former directors Mike Rogers and Philip Moore.
- Relative Investment Performance: 25% of award for Richard Rowney and former directors Mike Rogers and Philip Moore.

Performance against the specific performance targets is as follows:

- AAGPBT\* of £94m was below threshold of £103m and resulted in nil payout.
- Relative investment performance of 105 basis points below benchmark was below threshold of equal to the benchmark and resulted in nil payout.

\* AAGPBT – Average Adjusted Group Profit Before Tax over the three year period of the scheme

The unvested awards are subject to malus and the vested awards paid are subject to claw-back provisions, which can apply in scenarios where events later come to light that would have meant the payout amount was inappropriate (such as a material re-statement of the Society's financial results, an error was made in determining the payout amount, the recipient committed an act of gross misconduct or a material failure in risk management).

#### Group LTIP summary of awards and amounts vested during 2018 – Audited

£'000	Award	Unvested awards at 1 January 2018 <sup>1</sup>	Awards made in the year	To be paid in respect of 2016-2018 scheme	Of which deferred	Unvested awards at 1 January 2019 <sup>2</sup>
Richard Rowney	2016-2018	246		–	–	–
	2017-2019	490				490
	2018-2020		788			788
Andy Parsons	2017-2019	293				293
	2018-2020		497			497
Wayne Snow	2018-2020		406			406

1 Unvested awards are shown at the value of the base award level. Unvested awards at 1 January 2018 are in respect of awards granted in March 2016 and 2017.

2 Unvested awards at 1 January 2019 are in respect of awards granted in March 2017 and 2018.

#### Group LTIP awards made in the year (2018 – 2020 scheme) – Audited

	Type of award	Initial award (£'000)	Financial	Non Financial	% of initial award that would vest at maximum performance	Vesting determined by performance over
			% of initial award that would vest at threshold performance			
			75% weighting	25% weighting		
Richard Rowney	Cash	788	50%	50%	200%	3 years to 31 December 2020
Andy Parsons	Cash	497	50%	50%	200%	
Wayne Snow	Cash	406	50%	50%	200%	

#### Pensions – Audited

Since the closure of the defined benefit (DB) section of our pension scheme to future accrual in 2013, executive directors have had the choice of receiving contributions into the defined contribution (DC) section of our pension scheme or being paid an equivalent cash allowance. All executive directors received cash payments in lieu of pension contributions.

#### Additional information on 2018 remuneration

##### Percentage change in remuneration levels

The table below shows the movement in the salary, benefits and annual bonus for the group chief executive between the current and previous financial year compared to the total amounts for the same elements for all employees.

	Salary	Taxable benefits	Bonus
Chief executive	0%	3.3%	(43%)
% change based on a static population excluding the chief executive	2.4% <sup>1</sup>	3.9%	(24%)

1 The increase in employee salary reflects the annual pay rise from April 2018 of 2.4% (As reported in the 2017 Remuneration Report) and excludes the impact of promotions.

Ratio of chief executive salary to average employee FTE salary 16:1, (2017: 16:1). We aim to adopt the new UK Corporate Governance Code CEO ratio from 1 January 2020.

### Relative importance of the spend on pay

The table below shows the group's actual spend on pay (for all employees) relative to the mutual bonus, which represents a significant, discretionary disbursement of profit to members.

	Total remuneration		
	2018 £m	2017 £m	% change
Staff costs	256	255	0%
Mutual bonus	26	26	0%

### Chief executive's remuneration over ten financial years

The total remuneration figures for the chief executive during each of the last ten financial years are shown in the table below. The total remuneration figure includes the annual bonus based on that year's performance and LTIP awards based on three year performance periods ending in the relevant year.

For 2016, total remuneration reflects the amounts received by Richard Rowney and Mike Rogers for the periods each director performed the role of chief executive.

The annual bonus payout and LTIP vesting level as a percentage of the maximum opportunity are also shown for each of these years.

	2009	2010	2011	2012	2013	2014	2015	2016		2017	2018
	Mike Rogers	Mike Rogers	Mike Rogers	Mike Rogers	Mike Rogers	Mike Rogers	Mike Rogers	Mike Rogers	Richard Rowney	Richard Rowney	Richard Rowney
Total remuneration (£'000)	997	1,247	2,177	2,622	2,364	1,666	1,970	891	610	1,719	1,003
Bonus % of maximum awarded %	77%	86%	95%	100%	74%	80%	86%	13%	79%	80%	44%
LTIP % of maximum vesting %	0%	0%	100%	100%	90%	25%	59%	49%	50%	100%	0%

### Payments upon recruitment and promotion of directors

Wayne Snow was appointed as the chief risk officer in June 2018.

Upon appointment Wayne's salary was set at £325,000 with a commitment made on appointment to increase this to £350,000 effective 1 April 2019 based on his performance and development into the role. Wayne's bonus maximum opportunity and LTIP award level were set in line with our remuneration policy, i.e. a bonus maximum of 120% of salary and LTIP maximum award of 125% of salary (with payout capped at two times the LTIP initial award). There are no buy-outs associated with this appointment.

### Payments to past directors – Audited

Previous Directors, Mike Rogers and Philip Moore, retained eligibility to participate in the long-term incentive schemes to which they had already been invited to participate. All awards were pro-rated to their final dates in employment, 31 December 2016 for Mike and 30 June 2017 for Philip, with the amount payable based on the applicable performance conditions.

The 2016-18 LTIP was below threshold and resulted in a nil payout.

- 1 There were 3,054 abstentions to this resolution.
- 2 There were 3,541 abstentions to this resolution.
- 3 An increase in weighting has been applied to member and advisor advocacy to emphasise the critical importance to employees of acting in our members interests.



## Directors' Loans

As at 31 December 2018 there were no loans outstanding to directors.

## Results of members' votes on remuneration resolutions at 2018 AGM

At the Society's AGM in June 2018 the members approved the 2017 Remuneration Report, with 95% of the 49,996 total votes cast in favour<sup>1</sup> and the Remuneration Policy with 94% of the 49,521 total votes cast in favour<sup>2</sup>.

## Remuneration decisions taken in respect of the coming year (year ending 31 December 2019)

### Executive director salary

Current salary levels and those which will apply from 1 April 2019 are as follows:

	Effective from April 2019 £'000	As at 31 December 2018 £'000	Percentage change
Richard Rowney	525	525	0%
Andy Parsons	398	398	0%
Wayne Snow <sup>1</sup>	350	325	8%

<sup>1</sup> At the time of appointment a commitment was made to increase Wayne's salary to £350,000 effective from 1 April 2019, based on his performance and development in the role during 2018.

### Performance targets to be applied for the 2019 annual bonus and group LTIP (2019-2021 scheme)

For 2019, the annual bonus will continue to be based on a balanced scorecard of group financial and non-financial objectives. For 2019, the financial objective weighting is 50%, with the non-financial measures accounting for the remaining 50%. There are no proposed changes to the bonus opportunity for executive directors for 2019, with the chief executive officer having a bonus opportunity of 150% of salary and other executive directors an opportunity of 120% of salary.

The details of our 2019 group balanced scorecard are shown below:

Target	Measure	Weighting
Financial	Life operating capital surplus, operating expenses and the economic value of new business.	50%
Member and advisor advocacy	Putting in place the foundations for a fitter mutual for the future, brand and customer satisfaction metrics, subject to discretion if member bonus not in line with policy <sup>3</sup> .	20%
Strategy and change	Progress made towards the delivery of the five year strategic objectives.	10%
Risk	Embedding of the risk management framework and operating within the groups risk appetite.	10%
Leadership and diversity	Strong employee engagement and diversity and inclusion metrics.	10%

The committee reviewed the performance measures used and is proposing to increase the weighting of the Member and advisory advocacy measure (from 10% to 20%) to emphasise the critical importance of acting in our members' best interests, and correspondingly decrease the weighting of the Strategy and change measure (from 20% to 10%).

For the 2019-21 LTIP awards, the committee is proposing to make lower target awards of 120% of salary for the chief executive officer, 101% (rounded) of salary for the group finance director and 100% of salary for the chief risk officer, taking into account the reduced complexity of the business following the strategic partnership with Allianz.

The LTIP will continue to be based on a mixture of financial measures (75% weighting) and strategic goals (25% weighting).

For 2019 Return on Capital Supporting New Business has replaced Economic Value of New Business (EVNB) as a measure as we believe it is clearer to express this measure as a target return on the capital rather than a £ amount.

For 2019-21 LTIP awards onwards there will be a two-year holding period following the end of the performance period for executive directors.

The 2019-21 LTIP awards (to be granted in 2019) will be subject to the following performance conditions:

Performance condition	Weighting	Underpin
Financial measures based around growth in own funds, expenses and return on capital supporting new business.	75%	An underpin related to risk whereby no vesting will occur if appropriate levels of risk management have not been achieved.
Non-financial measures, based around (i) Being ranked number one for customer experience and business growth for IFAs by 2022 (ii) Financial Services norm for staff engagement (iii) Senior female band C and above percentage by 2020.	25%	

The actual targets associated with the bonus and LTIP are considered commercially sensitive at this time. They will be disclosed retrospectively in the relevant Directors' Remuneration Report.

#### Non-executive directors' fees

Fees for the non-executive directors are determined by the board, based on the responsibility and time committed to the group's affairs and appropriate market comparisons. Individual non-executive directors do not take part in discussions regarding their own fees. Fees are reviewed annually and any changes are implemented from 1 June each year. No fee increase was made during 2018 and so the fees that have been effective from 1 June 2016 still apply from 1 June 2018, as set out below:

	Current fees
Chairman	£200,000
Non-executive director base fee	£53,000
Additional fees:	
Senior independent director	£6,500
LVGIG board chair	£50,000
Committee chair (various including of general insurance subsidiary boards)	£7,500-£13,000
Committee membership (various including of general insurance subsidiary boards)	£3,650-£5,500

Fees effective from 1 June 2019 will be approved in May 2019. Additional fees are payable for being a member of LV= general insurance subsidiary boards.

The directors approved the Report on Directors' Remuneration on 21 March 2019.



**Alison Hutchinson**  
Chairman of the Remuneration Committee

## A to Z Glossary

**ABI:** Association of British Insurers.

**Asset shares:** Asset shares reflect the amount of money paid into policies by way of premiums and investment returns, less the costs of administering those policies.

**Best Estimate Liability (BEL):** The best estimate of the expected cost of future policyholder claims and expenses net of expected future income including premiums and charges. Calculations are discounted using a regulatory risk free discount rate (adjusted as permitted).

**Capital Coverage Ratio (CCR):** Eligible own funds divided by Solvency Capital Requirement (SCR).

**Claims margin:** Within general insurance a margin is held above the BEL to allow for risk and uncertainty in the estimates of claims reserves.

**Economic Value of New Business (EVNB):** The total profit expected from new business after allowing for all expected expenses and the cost of the solvency capital required to support it.

**Eligible own funds:** Capital resources held; this includes the excess of assets over liabilities (excluding the subordinated debt) in the Solvency II balance sheet and is subject to tier restrictions.

**Equity release:** A lifetime mortgage where interest is added to the loan and is settled by the property sale proceeds when the borrower dies or enters permanent residential care.

**Financial Conduct Authority (FCA):** A body that regulates the conduct of retail and wholesale financial services firms.

**Gross Written Premiums (GWP):** Premiums written during the year reported before deduction for unearned premiums and premiums ceded to reinsurers.

**Industrial Branch (IB):** Small premium Whole-Of-Life and endowment policies.

**International Financial Reporting Standards (IFRS):** Accounting standards issued by the International Accounting Standards Board (IASB). Our financial statements are prepared in accordance with IFRS as endorsed by the EU.

**Longevity risk:** The risk associated with increased life expectancy of policyholders.

**Loss Portfolio Transfer (LPT):** In a loss portfolio transfer a reinsurer assumes and accepts an insurer's existing open and future claims liabilities through the transfer of the insurer's loss reserves.

**LVFS:** Liverpool Victoria Friendly Society.

**LVGIG:** Liverpool Victoria General Insurance Group Limited.

**Minimum Capital Requirement (MCR):** A lower threshold than the SCR; the MCR represents the minimum amount of capital that an insurer is required to hold to cover its risks. If the MCR is breached authorisation of insurance activities should be withdrawn.

**Morbidity risk:** The risk associated with the likelihood that a policyholder will fall ill.

**Mortality risk:** The risk associated with the likelihood that a policyholder will die during the period of insurance cover.

**Mutual:** A business that is owned by its members rather than by shareholders.

**Mutual bonus:** A discretionary enhancement to asset shares.

**Ogden discount rate:** The legislated rate used to calculate awards for bodily injury claims that are taken as a lump sum.

**Open-Ended Investment Companies (OEICs):** Investment funds that constantly change in size as investors add or withdraw funds. OEICs give the investor access to a number of sub-funds with different objectives.

**Ordinary Branch (OB):** With-profits endowments, Whole-Of-Life, annuities and pensions policies.

**Periodic Payment Orders (PPOs):** An annuity style award paid to claimants instead of a lump sum, where indexed payments can be varied to meet likely future changes in circumstance.

**Persistency:** The expectation of the level of policies that will be retained by policyholders over their contract terms.

**Present value of acquired in-force business (PVIF):** The group's interest in the expected cash flows of insurance and investment contracts acquired through a business combination.

**Protection:** A policy providing a cash sum on the death or critical illness of the life assured.

**Prudential Regulation Authority (PRA):** A regulatory body that is responsible for the prudential regulation and supervision of financial services firms.

**Quota Share (QS):** A type of pro rata reinsurance contract in which the insurer and reinsurer share premiums and losses according to a fixed percentage.

**Regular premium:** Premiums received in respect of long-term contracts where the policyholder agrees to make regular payments throughout the term of the contract.

**Risk Margin (RM):** The opportunity cost of holding regulatory capital for existing business. This is an amount of capital that is held above the BEL against non-hedgeable risks associated with supporting the business.

**RNPFN:** Royal National Pension Fund for Nurses.

**Self-Invested Personal Pension (SIPP):** A personal pension plan that allows investors to make their own investment decisions.

**Single premium:** Premiums received in respect of long-term contracts where one premium is paid at inception and there is no obligation for the policyholder to make subsequent payments.

**Solvency II (SII):** The capital adequacy regime for the European insurance industry that establishes a comprehensive framework for insurance supervision and regulation.

**Solvency Capital Requirement (SCR):** The amount of regulatory capital that we are required to hold. LV= applies the Standard Formula in calculating the SCR. The capital required is based on our ability to survive a 1 in 200 year stress event, considering our investment strategy, risk profile and allowing for diversification.

**Transitional Measures on Technical Provisions (TMTP):** Transitional relief for the higher capital requirements of SII compared with the previous capital regulatory regime. This is amortised over a 16 year period from 1 January 2016.

**UK Corporate Governance Code:** The Code sets out standards of good governance practice. It covers, amongst other things, the board composition and its accountability and relations with business owners.

**Unallocated Divisible Surplus (UDS):** The amounts that have yet been formally declared as bonuses for participating policyholders, together with the free assets of the group.

**With-profits fund:** An investment fund where we combine all of our With-profits investors' money and manage it on their behalf.



## LV= Use of non-GAAP\* measures

Non-GAAP measure	Why we use the non-GAAP measure
<b>Operating capital generation</b>	Strengthening our capital position has been a key priority for the group over recent years. Operating capital generation is included as the primary KPI and reflects how management are monitoring the performance of the business. Capital generation is based on the Solvency II surplus capital generated from our business operations. See definition on page 20.
<b>Profit before tax</b>	Because LV= is a mutual, any remaining profit is transferred to the unallocated divisible surplus, leaving a final balance for profit each year of £nil. This would mean that if we applied the strict GAAP definition our profit before tax would simply be equal and opposite to our tax charge. This is not a useful presentation for users and we therefore provide an alternative measure for profit before tax which allows meaningful comparisons with the profit before tax disclosed by other proprietary companies. See definition on page 24.
<b>Operating profit</b>	Operating profit is the key performance measure for IFRS profitability. This measure provides useful information regarding the financial performance of the group as it represents management's view of the performance of the business. For the life business this measure represents the longer-term return from all its businesses. For the general insurance business this measure represents the return from insurance activities, i.e. underwriting profit and investment returns. Operating profit also includes the impact of group items and strategic investment. Previously centrally managed costs were excluded from operating profit. This is replaced with strategic investment which is reported as part of operating profit in order to support management's focus on cost control. See definition on page 21.
<b>Short-term investment fluctuations (STIF)</b>	Short-term investment fluctuations represent the difference between the long-term average return expected from assets and the actual investment return achieved on these assets in the current period. These are presented outside of operating profit for the life business in order to exclude the impact of temporary volatility. This includes the impact of tax charge deducted from policy asset shares and the RNPFN fund.
<b>Restructuring and non-recurring items</b>	Costs associated with restructuring and other non-recurring items that are not associated with running the trading business of the group are reported below operating profit.
<b>Operating expenses</b>	Operating expenses are presented on a basis consistent with operating profit; i.e. excluding the impact of restructuring and non-recurring costs and amortisation/impairment of intangibles acquired in business combinations. Commission is excluded from this metric in order to avoid distortion from the impact of changes in sales volumes. See definition and details of changes made to this non-GAAP measure on page 24.
<b>Investment performance %</b>	Provides a measure of the performance of the investment strategy. The performance of the With-profits fund and flexible guarantee funds drives the returns to policyholders. See definition on page 25.
<b>Operational liquidity</b>	Certain liquid assets reported in the Statement of Financial Position are required to match reserves and therefore do not provide a true measure of the available liquidity of the group i.e. the 'free' funds available to meet its obligations as they fall due. See definition on page 29.
<b>Life</b>	
<b>Present value of new business premiums (PVNBP)</b>	PVNBP provides a measure of the value of new business written in the year that is more useful than IFRS new business premiums as it includes the present value of the regular premiums we expect to receive over the term of contracts sold in the year. See definition and details of changes made to this non-GAAP measure on page 22.
<b>New business contribution</b>	The contribution to operating profit as a result of new business written on a PVNBP basis provides a measure of profit generated by management actions during the year, rather than from in-force business. See definition on page 22.

### General insurance

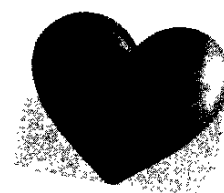
<b>Loss ratio</b>	The loss ratio enables management to monitor general insurance product performance by comparing the level of earned premiums with incurred claims. See definition on page 23.
<b>Expense ratio</b>	The expense ratio provides a measure of cost efficiency of the general insurance business. See definition on page 23.
<b>Combined ratio</b>	The combined ratio provides a barometer for underwriting profit. See definition on page 23.

\* GAAP means Generally Accepted Accounting Principles, which are the financial accounting standards followed by the accounting companies.



# Our Accounts

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## Independent auditors' report to the members of Liverpool Victoria Friendly Society Limited

Year ended 31 December 2018

### Report on the audit of the financial statements

#### Opinion

In our opinion, Liverpool Victoria Friendly Society Limited's group financial statements and Society financial statements (the "financial statements"):

- give a true and fair view of the state of the group's and of the Society's affairs as at 31 December 2018 and of the group's and the Society's income and expenditure and cash flows for the year then ended;
- have been properly prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Friendly Societies Act 1992 and, as regards the group financial statements, Article 4 of the IAS Regulation.

We have audited the financial statements, included within the Annual Report, which comprise: the group and Society statement of financial position as at 31 December 2018; the group and Society statement of comprehensive income, and the group and Society statement of cash flows for the year then ended, and the notes to the financial statements, which include a description of the significant accounting policies.

Our opinion is consistent with our reporting to the Audit Committee.

#### Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)") and applicable law. Our responsibilities under ISAs (UK) are further described in the Auditors' responsibilities for the audit of the financial statements section of our report. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

#### Independence

We remained independent of the group in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, which includes the FRC's Ethical Standard, as applicable to listed public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

To the best of our knowledge and belief, we declare that non-audit services prohibited by the FRC's Ethical Standard were not provided to the group or the Society.

Other than those disclosed in note 13 to the financial statements, we have provided no non-audit services to the group or the Society in the period from 1 January 2018 to 31 December 2018.

#### Our audit approach

##### Context

Liverpool Victoria Friendly Society Limited (the "Society") is an incorporated friendly society that, together with various subsidiaries, carries out insurance and financial services business in the UK. At the end of 2017 the group completed a strategic partnership with Allianz which resulted in 49% of the group's General Insurance business being sold to Allianz. Control has been retained at 31 December 2018 and consequently the General Insurance business has continued to be consolidated with Allianz's 49% stake being recognised as a non-controlling interest in the group's financial statements. The ongoing accounting treatment of the transactions entered into with Allianz together with external and internal changes impacting the valuation of the life and general insurance contract liabilities, have been key focus areas for our audit.

## Overview

- |                          |  |
|--------------------------|--|
| <b>Materiality</b>       | <ul style="list-style-type: none"> <li>Overall group materiality: £33.8 million (2017: £36.5 million), based on 3% of Unallocated Divisible Surplus ('UDS').</li> <li>Overall Society materiality: £30 million (2017: £32.9 million), based on 3% of Unallocated Divisible Surplus ('UDS').</li> </ul>   |
| <b>Audit scope</b>       | <ul style="list-style-type: none"> <li>The group consists of 26 active statutory entities, but primarily operates through three main trading entities (Liverpool Victoria Friendly Society Limited, Liverpool Victoria Insurance Company Limited and Highway Insurance Company Limited) at 15 locations across the UK. In our view, all three main trading entities required full scope audits of their complete financial information, due to their size and risk characteristics.</li> <li>In addition to the group's head offices in Bournemouth, we visited 4 other locations. Our procedures performed at those other locations primarily focused on understanding the systems and controls in place over the recording and processing of new and renewal business and claims.</li> <li>Taken together, the procedures we performed over the 3 main trading entities, balances included in a further 3 reporting units and the group consolidation entries accounted for over 88% of the group's Unallocated Divisible Surplus ('UDS'), and over 99% of the group's net earned premiums.</li> </ul> |
| <b>Key audit matters</b> | <ul style="list-style-type: none"> <li>The valuation of long-term insurance contract liabilities (Group and Society: £9.6bn (2017: £9.9bn)).</li> <li>The valuation of gross general insurance claims liabilities (Group: £1.5bn (2017: £1.6bn)).</li> <li>The accounting of the General Insurance business and associated transactions following the 49% sale to Allianz in 2017 (Group).</li> </ul>  |

## The scope of our audit

As part of designing our audit, we determined materiality and assessed the risks of material misstatement in the financial statements. In particular, we looked at where the directors made subjective judgements, for example in respect of significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain.

### Capability of the audit in detecting irregularities, including fraud

Based on our understanding of the group and industry, we identified that the principal risks of non-compliance with laws and regulations related to breaches of UK and European regulatory principles, such as those governed by the Prudential Regulation Authority and the Financial Conduct Authority (see page 38 of the Annual Report), and we considered the extent to which non-compliance might have a material effect on the financial statements of the group and Society. We also considered those laws and regulations that have a direct impact on the financial statements of the group and Society such as the Friendly Societies Act 1992 legislation, the Companies Act 2006, the UK Corporate Governance Code (voluntarily applied), the Prudential Regulation Authority's regulations, the UK tax legislation and equivalent local laws and regulations applicable to significant component teams, and we considered the extent to which non-compliance might have a material effect on the financial statements. We evaluated management's incentives and opportunities for fraudulent manipulation of the financial statements (including the risk of override of controls), and determined that the principal risks were related to posting inappropriate journal entries to increase revenue or reduce expenditure of the group and Society and management bias in accounting estimates and judgemental areas of the financial statements such as the valuation of long-term insurance contract liabilities and general insurance claims liabilities. The group engagement team shared this risk assessment with the component auditors so that they could include appropriate audit procedures in response to such risks in their work. Audit procedures performed by the group engagement team and/or component auditors included:

- Discussions with the Board, management, internal audit, senior management involved in the Risk and Compliance function and the group's and Society's legal function, including consideration of known or suspected instances of non-compliance with laws and regulation and fraud;
- Assessment of matters reported on the group's and Society's whistleblowing register including the quality and results of management's investigation of such matters;
- Reviewing correspondence between the Society and the Prudential Regulation Authority ('PRA') and Financial Conduct Authority in relation to compliance with laws and regulations. We also meet with the PRA to discuss compliance matters during the course of our audit;
- Reviewing Board minutes as well as relevant meeting minutes, including those of the With-Profits Committee, Risk Committee and the Reserving Committee;
- Reviewing data regarding policyholder complaints, the group's and Society's register of litigation and claims, internal audit reports, compliance reports in so far as they related to non-compliance with laws and regulations and fraud;
- Procedures relating to the valuation of long-term insurance contract liabilities and general insurance claims liabilities described in the related key audit matters below;
- Identifying and testing journal entries, in particular any journal entries posted with unusual account combinations, such as a credit to revenue and a debit to the balance sheet (other than to expected accounts being debtors and cash), which may be indicative of the overstatement or manipulation of revenue;
- Designing audit procedures to incorporate unpredictability around the nature, timing or extent of our testing; and
- Procedures over the valuation of one-off transactions specifically in respect of the forward contract and linked put option entered into with Allianz in 2017 described in the related key audit matter overleaf.

There are inherent limitations in the audit procedures described above and the further removed non-compliance with laws and regulations is from the events and transactions reflected in the financial statements, the less likely we would become aware of it. Also, the risk of not detecting a material misstatement due to fraud is higher than the risk of not detecting one resulting from error, as fraud may involve deliberate concealment by, for example, forgery or intentional misrepresentations, or through collusion.

### Key audit matters

Key audit matters are those matters that, in the auditors' professional judgement, were of most significance in the audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) identified by the auditors, including those which had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team. These matters, and any comments we make on the results of our procedures thereon, were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. This is not a complete list of all risks identified by our audit.

Key audit matter	How our audit addressed the key audit matter
<p><b>The valuation of long-term insurance contract liabilities (Group and Society: £9.6bn (2017: £9.9bn))</b></p> <p><b>Refer to page 61 (Audit Committee Report) and note 20 to the financial statements</b></p> <p>The group and Society financial statements include liabilities for the estimated cost of settling benefits and claims associated with life products. We focused on this area because of the significance of these amounts in deriving the group and Society's result, and because of the use of a suite of economic and demographic data and assumptions, which are often highly subjective. In particular, we focused on the most judgemental assumptions having an impact on the liabilities, namely longevity assumptions (i.e. life expectancy of policyholders for annuity products) including management's use of the CMI 2017 projection model for the first time this year.</p> <p>Included within these liabilities is a reserve of £34m in relation to the projected future impact of costs which will be retained by the continuing business upon separation of the general insurance business from the group. We paid particular focus to this reserve due to the fact that it has been derived outside of the standard actuarial models, and the assumptions regarding these future costs is highly judgemental.</p>	<p>Our work to address the valuation of the long-term insurance contract liabilities was supported by our in-house life actuarial specialists and included the following procedures:</p> <ul style="list-style-type: none"> <li>• We tested the underlying data, including key reconciliations, and this testing was performed with no material exceptions.</li> <li>• We compared the methodology, models and assumptions used against recognised actuarial practises and underlying internal experience, and by applying our industry knowledge and experience, and found them to be reasonable.</li> <li>• We performed an independent annual benchmarking survey, which allowed us to further challenge the assumptions setting process by comparing certain assumptions used relative to the Society's industry peers.</li> </ul> <p><b>Specific areas of testing:</b></p> <p><b>Longevity assumptions</b></p> <p>In respect of longevity assumptions we:</p> <ul style="list-style-type: none"> <li>• Base longevity: Verified the appropriateness and accuracy of data used by management to model base longevity for the Society's annuity portfolios. We reviewed management's assessments in calculating the assumptions based on that data and considered the extent to which the assumptions used were consistent with other sources of information, such as industry-wide mortality investigations.</li> <li>• Future improvements: Considered the appropriateness of management's use of the CMI 2017 projection model. This included considering management's use of industry data to model longevity improvements for the Society's annuity contracts against the Society's own experience and verifying the data used. Our market benchmarking survey indicated the use of the CMI 2017 model is in line with the majority of other benchmark respondents.</li> <li>• Used the above information to critically assess and challenge the judgements made by management and to determine whether there was any evidence of management bias.</li> </ul> <p>Based on the work performed we found that the longevity assumptions used were supported by the evidence we obtained.</p> <p><b>Additional expense reserve (£34m)</b></p> <ul style="list-style-type: none"> <li>• We obtained supporting information to validate management's assumptions regarding the level of costs which will be retained post separation.</li> <li>• Using this supporting information, we independently reperformed the calculation of the projected total impact of these costs, over the relevant future years, in order to determine an expected total reserve. This was then compared to management's booked reserve.</li> </ul> <p>Based on the work performed we found that the additional expense reserve was within a range that we consider to be acceptable.</p>

## Key audit matter

**Valuation of gross general insurance contract liabilities (£1.5bn (2017: £1.6bn))**

**Refer to page 62 (Audit Committee Report) and note 20 to the financial statements**

The group financial statements include liabilities for the estimated cost of settling general insurance claims. These are included within insurance contract liabilities.

We focused on this area due to the significance of these liabilities to the group's balance sheet and because of the inherent subjectivity of their valuation.

In particular, we focused on:

- The accuracy of claims data used to estimate the claims liabilities, in particular, the completeness of recorded claims and the consistency in setting case estimates;
- Whether any changes to the underlying risk profile of the policies written (for example, the concentration of younger drivers or changes to postcode mix) are appropriately reflected in the estimation of claims liabilities;
- The methodologies and assumptions used in estimating the costs of claims for general insurance products (mainly motor policies), in particular for those claims such as personal injury, which can take a long time to settle and where the amounts concerned can be large; and
- Whether any trends in the underlying claims experience, whether driven by internal or market level factors, have been appropriately reflected in the estimates of future claim costs.

## How our audit addressed the key audit matter

Our work to address the valuation of the general insurance claims liabilities was supported by our in-house non-life actuarial specialists, and included the following procedures:

- We tested the completeness and accuracy of claims data used in the determination of the liabilities; and
- We performed independent re-projection testing over 58% of claims liabilities and methodology and assumptions reviews over a further 20% and key indicator checks over 20%. We assessed whether the relevant data source selected by management was appropriate for use in the actuarial estimate of the contracted liabilities.

**Specific areas of testing****Completeness of recorded claims and consistency of case estimates**

We tested the reconciliation of source claims data to that used in the actuarial modelling process. In order to assess the completeness of recorded claims, we observed claims being recorded directly onto the claims systems, and tested the operation of the controls over the handling of complaints.

We tested the effectiveness of the quality assurance processes over the work of the claims handlers in order to determine whether claims were being assessed on a consistent basis and examined a sample of claims to obtain evidence that they were based on appropriate supporting information.

**Consistency of risk exposure**

We assessed management's assertion that there had been no significant changes in the risk profile for material lines of business by inspecting their analyses, discussing claims trends, examining the characteristics behind claims development, and utilising our own independent trend analyses.

**Methodologies and assumptions**

We carried out a substantial amount of our work on the claims liabilities at 30 September 2018, rolling forward our work to the year-end.

We performed independent re-projection testing by independently selecting our own methodology and assumptions to estimate the reserves for some of the most significant components of the claims liabilities.

We evaluated the methodology and assumptions used by management to estimate the most judgemental components of the claims liabilities. We took into account any changes to the types of risks underwritten by the business, which could increase the level of uncertainty and judgement in the estimates.

Particular focus was given to the future potential Ogden rate change that will impact certain types of personal injury claims where we evaluated management's rationale for changing the assumed discount rate to 0% against government announcements and market practice and performed testing over source data on a sample basis to be able to conclude on the quantification of the adjustment to reserves resulting from the change in assumption.

For lower risk categories of reserves we considered trends in various indicators such as paid to incurred ratios, incurred to ultimate ratios and other Key Performance Indicators ("KPIs").

Where we felt it was appropriate, we performed independent calculations to quantify the impact of differences between management's actuarial analysis or assumptions and those which we would have conducted or selected ourselves based on our understanding of market trends and the particular circumstances of the group.

**Trends in the underlying claims experience**

We considered the run-off of prior year liabilities, the sensitivity of the liabilities to alternative methods and assumptions and, where relevant, industry benchmarking.

We also examined trends in ratios driven by internal or market level factors, including those between the initial case estimates and the final costs of settlement.

Based on the work performed, no evidence was identified to suggest issues with respect to the completeness and accuracy of claims data. Furthermore, we found the methodology and assumptions used in estimating the costs of claims were appropriate and supported by the evidence we obtained.

Key audit matter	How our audit addressed the key audit matter
<p><b>The accounting of the General Insurance business and associated transactions following the 49% sale to Allianz in 2017 (Group)</b></p> <p><b>Refer to page 60 (Audit Committee Report) and note 12 to the financial statements</b></p> <p>At the end of 2017 the group disposed of 49% of its holding in its General Insurance business to Allianz. The second phase of the transaction will result in a further stake being sold in two years' time and is based on an agreed valuation of £1.020bn for the entire General Insurance business. Should the Society choose to settle earlier, it has the flexibility to do so by exercising its put option.</p> <p>At 31 December 2018 control continues to be retained by the Society and therefore the General Insurance business has continued to be consolidated in the group's financial statements with Allianz's 49% stake being recognised as a non-controlling interest.</p> <p><b>Key matters we focused on as part of our audit included the following:</b></p> <p>Retention of control of the General Insurance business. Due to changes in facts and circumstances during the year, including new contracts entered into and a change in the composition of the General Insurance business Board, our work over the assessment of control by the group has required an increased level of scepticism due to the significant judgements management have made in their assessment; and</p> <p>Valuation of the forward contract and linked put option due to the application of valuation estimates and a significant level of management judgement.</p>	<p><b>Accounting treatment of the General Insurance business in the group's financial statements</b></p> <p>We reviewed accounting papers produced by management which evaluated whether control is retained by the Society at the year-end. This considered changes in facts and circumstances arising since the prior year including new contracts entered into and a change in the composition of the General Insurance business Board.</p> <p>We made our own assessment as to the most appropriate accounting treatment and used this as a basis to challenge the key judgements made by management, including the assessment of any management bias.</p> <p>We verified management's conclusion that the General Insurance business should continue to be consolidated at the year-end against requirements of the International Financial Reporting Standards. We assessed various factors in forming this conclusion including:</p> <ul style="list-style-type: none"> <li>• Evaluating whether contracts entered into with Allianz had been completed on an arm's length basis; and</li> <li>• Evaluating whether the change in composition of the General Insurance Board had an impact on the Society's power to influence.</li> </ul> <p>Based on the work performed, we found that the evidence supporting management's accounting treatment for the General Insurance business to be consolidated in the group financial statements was appropriate and that the significant judgement applied had been appropriately assessed, presented and disclosed.</p> <p><b>Valuation of the forward contract and linked put option</b></p> <p>Our work to address the valuation of the forward contract and linked put option was supported by our in-house valuation experts. Using a methodology used widely in the insurance industry, we independently developed a range of values within which we would expect the value of the financial instrument to lie. Our valuations were derived using market available information combined with the historic profit levels achieved by the general insurance business.</p> <p>Based on the work performed we determined that the resultant valuation recognised in the group financial statements was acceptable.</p>

#### How we tailored the audit scope

We tailored the scope of our audit to ensure that we performed enough work to be able to give an opinion on the financial statements as a whole, taking into account the structure of the group and the Society, the accounting processes and controls, and the industry in which they operate.

The group is structured along two business units, being 'Life' (including Protection, Heritage and Retirement Solutions) and 'General Insurance'. The group's financial statements consist of a consolidation of 26 active statutory entities; but the group primarily operates through the three main trading entities; the Society, encompassing the 'Life' business unit and two general insurance companies, at 15 locations across the UK.

All three main trading entities are material to the group and were audited by the group engagement team. In establishing the overall approach to the group audit, we determine the type of work that we needed to perform at each entity to be able to conclude whether sufficient appropriate audit evidence had been obtained as a basis for our opinion on the group financial statements as whole.

In addition to the group's head offices in Bournemouth, we visited four other locations, two of which were visited for the purposes of the Society audit. Our procedures performed at those other locations primarily focused on understanding the systems and controls in place over the recording and processing of new and renewal business and claims.



In our view, all three main trading entities required a full scope audit of their complete financial information, due to their size and risk characteristics. Taken together, the procedures we performed over the three main trading entities, balances included in a further 2 reporting units and the group consolidation entries accounted for over 88% of the group's Unallocated Divisible Surplus ('UDS'), and over 99% of the group's net earned premiums.

### Materiality

The scope of our audit was influenced by our application of materiality. We set certain quantitative thresholds for materiality. These, together with qualitative considerations, helped us to determine the scope of our audit and the nature, timing and extent of our audit procedures on the individual financial statement line items and disclosures and in evaluating the effect of misstatements, both individually and in aggregate on the financial statements as a whole.

Based on our professional judgement, we determined materiality for the financial statements as a whole as follows:

	Group financial statements	Society financial statements
<b>Overall materiality</b>	£33.8 million (2017: £36.5 million).	£30 million (2017: £32.9 million).
<b>How we determined it</b>	3% of the group's Unallocated Divisible Surplus ('UDS').	3% of the Society's Unallocated Divisible Surplus ('UDS').
<b>Rationale for benchmark applied</b>	In arriving at this judgement we considered the financial measures which we believe to be most relevant to the members of the group as a body. Members' interests in the group are represented primarily by the UDS and, consequently, the UDS was considered to be the primary metric to use to determine materiality. We have also had regard to other measures such as the group's regulatory capital surplus and other performance metrics such as operating profit and have compared the level of audit work required to be performed over the group Statement of Comprehensive Income using these alternative benchmarks.	Consistent with the group we considered the financial measures, which we believe to be most relevant to the members of the Society as a body. Members' interests in the Society are represented primarily by the UDS and, consequently, the UDS was considered to be the primary metric to use to determine materiality. We have also had regard to other measures such as the Society's regulatory capital surplus and other performance metrics such as operating profit and have compared the level of audit work required to be performed over the Statement of Comprehensive Income using these alternative benchmarks.

For each component in the scope of our group audit, we allocated a materiality that is less than our overall group materiality. The range of materiality allocated across components was between £4.3 million and £33.5 million. Certain components were audited to a local statutory audit materiality that was also less than our overall group materiality.

We agreed with the Audit Committee that we would report to them misstatements identified during our audit above £1.7 million (Group audit) (2017: £1.8 million) and £1.5 million (Society audit) (2017: £1.6 million) as well as misstatements below those amounts that, in our view, warranted reporting for qualitative reasons.

### Going concern

In accordance with ISAs (UK) we report as follows:

#### Reporting obligation

We are required to report if we have anything material to add or draw attention to in respect of the directors' statement in the financial statements about whether the directors considered it appropriate to adopt the going concern basis of accounting in preparing the financial statements and the directors' identification of any material uncertainties to the group's and the Society's ability to continue as a going concern over a period of at least twelve months from the date of approval of the financial statements.

#### Outcome

We have nothing material to add or to draw attention to.

However, because not all future events or conditions can be predicted, this statement is not a guarantee as to the group's and Society's ability to continue as a going concern. For example, the terms on which the United Kingdom may withdraw from the European Union, are not clear, and it is difficult to evaluate all of the potential implications on the group's trade, customers, suppliers and the wider economy.

## Reporting on other information

The other information comprises all of the information in the Annual Report other than the financial statements and our auditors' report thereon. The directors are responsible for the other information. Our opinion on the financial statements does not cover the other information and, accordingly, we do not express an audit opinion on, except to the extent otherwise explicitly stated in this report, any form of assurance thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If we identify an apparent material inconsistency or material misstatement, we are required to perform procedures to conclude whether there is a material misstatement of the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report based on these responsibilities.

With respect to the Directors' Report, we also considered whether it had been prepared in accordance with the Friendly Societies Act 1992 and the regulations made under it.

Based on the responsibilities described above and our work undertaken in the course of the audit, the Friendly Societies Act 1992 (FSA92) and ISAs (UK) require us also to report certain opinions and matters as described below (required by ISAs (UK) unless otherwise stated).

### Directors' Report

In our opinion, based on the work undertaken in the course of the audit, the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements and has been prepared in accordance with the Friendly Societies Act 1992 and the regulations made under it. (FSA92)

In light of the knowledge and understanding of the group and the Society and their environment obtained in the course of the audit, we did not identify any material misstatements in the Directors' Report. (FSA92)

### The directors' assessment of the prospects of the group and of the principal risks that would threaten the solvency or liquidity of the group

As a result of the directors' voluntary reporting on how they have applied the UK Corporate Governance Code (the "Code"), we are required to report to you if we have anything material to add or draw attention to regarding:

- The directors' confirmation on page 71 of the Annual Report that they have carried out a robust assessment of the principal risks facing the group, including those that would threaten its business model, future performance, solvency or liquidity.
- The disclosures in the Annual Report that describe those risks and explain how they are being managed or mitigated.
- The directors' explanation on pages 70 to 71 of the Annual Report as to how they have assessed the prospects of the group, over what period they have done so and why they consider that period to be appropriate, and their statement as to whether they have a reasonable expectation that the group will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions.

We have nothing to report in respect of this responsibility.

### Other Code Provisions

As a result of the directors' voluntary reporting on how they have applied the Code, we are required to report to you if, in our opinion:

- The statement given by the directors, on page 72, that they consider the Annual Report taken as a whole to be fair, balanced and understandable, and provides the information necessary for the members to assess the group's and Society's position and performance, business model and strategy is materially inconsistent with our knowledge of the group and Society obtained in the course of performing our audit.
- The section of the Annual Report on pages 60 to 62 describing the work of the Audit Committee does not appropriately address matters communicated by us to the Audit Committee.

We have nothing to report in respect of this responsibility.

## Responsibilities for the financial statements and the audit

### Responsibilities of the directors for the financial statements

As explained more fully in the Directors' statement of responsibility set out on page 72, the directors are responsible for the preparation of the financial statements in accordance with the applicable framework and for being satisfied that they give a true and fair view. The directors are also responsible for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are responsible for assessing the group's and the Society's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the group or the Society or to cease operations, or have no realistic alternative but to do so.

### Auditors' responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

A further description of our responsibilities for the audit of the financial statements is located on the FRC's website at: [www.frc.org.uk/auditorsresponsibilities](http://www.frc.org.uk/auditorsresponsibilities). This description forms part of our auditors' report.

### Use of this report

This report, including the opinions, has been prepared for and only for the Society's members as a body in accordance with Section 73 of the Friendly Societies Act 1992 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.

## Other required reporting

### Friendly Societies Act 1992 exception reporting

Under the Friendly Societies Act 1992 we are required to report to you if, in our opinion:

- we have not received all the information and explanations and access to documents we require for our audit; or
- adequate accounting records have not been kept by the group or Society; or
- the financial statements are not in agreement with the accounting records.

We have no exceptions to report arising from this responsibility.

## Appointment

Following the recommendation of the audit committee, we were appointed by the members on 29 May 2008 to audit the financial statements for the year ended 31 December 2008 and subsequent financial periods. The period of total uninterrupted engagement is 11 years, covering the years ended 31 December 2008 to 31 December 2018.

## Other voluntary reporting

### Going concern

The directors have requested that we review the statement on page 70 in relation to going concern as if the Society were a premium listed company. We have nothing to report having performed our review.

### The directors' assessment of the prospects of the group and of the principal risks that would threaten the solvency or liquidity of the group

The directors have requested that we perform a review of the directors' statements on pages 71 and 70 that they have carried out a robust assessment of the principal risks facing the group and in relation to the longer-term viability of the group, as if the Society were a premium listed company. Our review was substantially less in scope than an audit and only consisted of making inquiries and considering the directors' process supporting their statements; checking that the statements are in alignment with the relevant provisions of the Code; and considering whether the statements are consistent with the knowledge and understanding of the group and Society and their environment obtained in the course of the audit. We have nothing to report having performed this review.

### Directors' remuneration

The Society voluntarily prepares a Directors' Remuneration Report in accordance with the provisions that apply to companies subject to the Companies Act 2006. The directors requested that we audit the part of the Directors' Remuneration Report specified by the Companies Act 2006 to be audited as if the Society were a quoted company.

In our opinion, the part of the Directors' Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006.

### Andrew G Hill (Senior Statutory Auditor)

for and on behalf of PricewaterhouseCoopers LLP  
Chartered Accountants and Statutory Auditors  
London

21 March 2019

## Statement of Comprehensive Income

Year ended 31 December 2018

	Notes	Group		Society	
		2018	2017 Restated – see Note 1	2018	2017 Restated – see Note 1
		£m	£m	£m	£m
Gross earned premiums	5	788	835	787	835
Premiums ceded to reinsurers	5	(246)	(1,092)	(246)	(1,092)
<b>Net earned premiums</b>	5	<b>542</b>	(257)	<b>541</b>	(257)
Investment income	6	300	319	363	430
Net (losses)/gains on investments	7	(605)	394	(612)	379
Other income	8	47	37	24	22
<b>Total income</b>		<b>284</b>	493	<b>316</b>	574
Gross benefits and claims	9	(904)	(872)	(903)	(871)
Claims ceded to reinsurers	9	238	237	238	237
<b>Net benefits and claims</b>	9	<b>(666)</b>	(635)	<b>(665)</b>	(634)
Gross change in long-term contract liabilities, excluding mutual bonus	22	539	(590)	538	(590)
Change in long-term contract liabilities ceded to reinsurers	22	(9)	1,035	(9)	1,035
Change in non-participating value of in-force business	22	10	(30)	10	(30)
<b>Net change in contract liabilities, excluding mutual bonus before change in economic basis</b>	22	<b>540</b>	415	<b>539</b>	415
Change in economic basis	22	–	(48)	–	(48)
<b>Net change in contract liabilities, excluding mutual bonus</b>	22	<b>540</b>	367	<b>539</b>	367
Finance costs	10	(24)	(24)	(23)	(23)
Other operating and administrative expenses	11	(224)	(243)	(196)	(222)
<b>Total other expenses</b>		<b>(248)</b>	(267)	<b>(219)</b>	(245)
<b>Total benefits, claims and expenses, excluding mutual bonus</b>		<b>(374)</b>	(535)	<b>(345)</b>	(512)
<b>(Loss)/profit before tax and mutual bonus from continuing operations</b>		<b>(90)</b>	(42)	<b>(29)</b>	62
Mutual bonus		(26)	(26)	(26)	(26)
Income tax credit/(expense)	34	31	(20)	31	(24)
<b>(Loss)/profit after tax and mutual bonus from continuing operations</b>		<b>(85)</b>	(88)	<b>(24)</b>	12
<b>Profit after tax from discontinued operations</b>	12	<b>93</b>	134	–	–
Non-controlling interest		(36)	2	–	–
Transfer from/(to) the Unallocated divisible surplus	46	28	(48)	24	(12)
<b>Profit for the year</b>		<b>–</b>	–	<b>–</b>	–
Other comprehensive income					
<b>Items that will be reclassified to profit or loss – discontinued operations</b>					
Net loss on available for sale financial assets, net of tax	12	(10)	–	–	–
<b>Items that will not be reclassified to profit or loss – continuing operations</b>					
Re-measurements of defined benefit pension schemes, net of tax	39	(29)	19	(27)	19
Other comprehensive income, net of tax		(39)	19	(27)	19
Non-controlling interest		5	–	–	–
Transfer from/(to) the Unallocated divisible surplus	46	34	(19)	27	(19)
<b>Total comprehensive income for the year</b>		<b>–</b>	–	<b>–</b>	–

As a Friendly Society, all net earnings are for the benefit of participating policyholders and are carried forward within the Unallocated divisible surplus. Accordingly, there is no profit for the year shown in the Statement of Comprehensive Income.

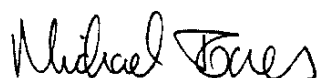
The Group and the Society have not presented a Statement of Changes in Equity as there are no equity holders in either the Group or Society.

## Statement of Financial Position

As at 31 December 2018

	Notes	Group		Society	
		2018 £m	2017 £m	2018 £m	2017 £m
<b>Assets</b>					
Pension benefit asset	39	199	178	199	178
Intangible assets	28	47	315	8	10
Investments in group undertakings	29	–	–	896	897
Property and equipment	27	29	37	9	7
Investment properties		–	3	–	3
Deferred acquisition costs	23	–	95	–	–
Reinsurance assets	24	1,738	2,305	1,738	1,747
Prepayments and accrued interest	31	77	124	70	71
Loans and other receivables	17	407	258	84	65
Insurance receivables	30	41	308	40	29
Corporation tax asset	35	5	–	5	–
Financial assets at fair value through income	14	11,538	13,853	11,334	11,875
Derivative financial instruments	15	65	81	65	80
Cash and cash equivalents (excluding bank overdrafts)		412	974	392	424
Assets held for sale	12	3,367	–	–	–
<b>Total assets</b>		<b>17,925</b>	<b>18,531</b>	<b>14,840</b>	<b>15,386</b>
<b>Liabilities</b>					
Unallocated divisible surplus	46	1,127	1,189	999	1,050
Participating insurance contract liabilities	20	5,092	5,279	5,092	5,279
Participating investment contract liabilities	16	691	746	691	746
Non-participating value of in-force business	21	(303)	(293)	(303)	(293)
		<b>6,607</b>	6,921	<b>6,479</b>	6,782
Non-participating insurance contract liabilities	20	4,522	7,078	4,508	4,635
Non-participating investment contract liabilities	16	3,017	3,071	3,017	3,071
		<b>7,539</b>	10,149	<b>7,525</b>	7,706
Non-controlling interest	47	404	373	–	–
Pension benefit obligation	39	2	–	–	–
Deferred tax liability	36	78	97	78	98
Provisions	40	8	20	7	13
Subordinated liabilities	18	348	358	348	348
Derivative financial instruments	15	190	193	190	187
Other financial liabilities	19	59	62	59	62
Corporation tax liability	37	–	20	–	9
Insurance payables	32	28	50	28	22
Trade and other payables	33	146	288	126	159
Liabilities directly associated with assets held for sale	12	2,516	–	–	–
<b>Total liabilities</b>		<b>17,925</b>	<b>18,531</b>	<b>14,840</b>	<b>15,386</b>

The financial statements on pages 98 to 189 were approved by the Board of Directors on 21 March 2019 and signed on its behalf by:



**Michael Jones**  
Company Secretary

21 March 2019

## Statement of Cash Flows

Year ended 31 December 2018

	Notes	Group		Society	
		2018 £m	2017 £m	2018 £m	2017 £m
<b>Cash and cash equivalents at 1 January</b>		<b>963</b>	<b>783</b>	<b>416</b>	<b>460</b>
<b>Cash flows arising from:</b>					
<b>Operating activities</b>					
Cash used in operating activities before movements in investments held at fair value through income or OCI	51	(491)	(735)	(298)	(732)
Net decrease/(increase) in investments held at fair value through income		937	19	(60)	395
Net increase in AFS financial assets at fair value through OCI		(1,007)	–	–	–
Cash used in operating activities		(561)	(716)	(358)	(337)
Proceeds from sale of investment properties		4	5	4	5
Dividend income received		118	117	113	109
Interest income received		260	303	189	213
Utilisation of provisions		(9)	(5)	(6)	(5)
Finance cost paid		(1)	(1)	–	–
Income tax paid		(27)	(13)	(10)	(12)
Net cash flows used in operating activities		(216)	(310)	(68)	(27)
<b>Investing activities</b>					
Net proceeds from purchase/sale of general insurance renewal rights		–	51	–	–
Increase in investment in group undertakings		–	–	(6)	(85)
Proceeds from sale of property and equipment		6	–	–	–
Dividend income received from group undertakings		–	–	67	94
Purchase of property, equipment and intangibles	27, 28	(28)	(38)	(5)	(3)
Net cash flows (used in)/generated from investing activities		(22)	13	56	6
<b>Financing activities</b>					
Proceeds from sale of stake in general insurance subsidiary		–	500	–	–
Interest paid on subordinated debt	10	(23)	(23)	(23)	(23)
Net cash flows (used in)/generated from financing activities		(23)	477	(23)	(23)
<b>Net (decrease)/increase in cash and cash equivalents</b>		<b>(261)</b>	<b>180</b>	<b>(35)</b>	<b>(44)</b>
<b>Cash and cash equivalents at 31 December</b>		<b>702</b>	<b>963</b>	<b>381</b>	<b>416</b>

### Cash and cash equivalents comprise:

Bank balances		110	108	93	76
Short-term bank deposits		302	866	299	348
<b>Cash and cash equivalents per the Statement of Financial Position</b>		<b>412</b>	<b>974</b>	<b>392</b>	<b>424</b>
Bank balances and short-term deposits attributable to discontinued operations	12	319	–	–	–
		731	974	392	424
Non-offsettable bank overdrafts (see note 33)		(11)	(11)	(11)	(8)
Bank overdrafts attributable to discontinued operations		(18)	–	–	–
<b>Cash and cash equivalents per the Statement of Cash Flows</b>		<b>702</b>	<b>963</b>	<b>381</b>	<b>416</b>

The Group and Society classifies the cash flows for the acquisition and disposal of financial assets and the net purchases/sales of investment properties as operating cash flows, as the purchases are funded from the cash flows associated with the origination of insurance and investment contracts.

Cash flows from discontinued operations are disclosed separately within Note 12.

## Notes to the Financial Statements

Year ended 31 December 2018

### Significant accounting policies

This section describes the LV= Group's significant accounting policies and accounting estimates that relate to the financial statements and notes as a whole. If an accounting policy or an accounting estimate relates to a specific note, the applicable accounting policy and/or accounting estimate is contained within the relevant note. These policies have been consistently applied to all years presented, unless otherwise stated.

#### 1. Significant accounting policies

##### Basis of presentation

The Group financial statements consolidate the results of the Society and its subsidiary companies. The Group's and Society's financial statements conform to International Financial Reporting Standards (IFRS) and interpretations issued by the IFRS Interpretations Committee as published by the International Accounting Standards Board and adopted by the European Union. In addition the Society's financial statements comply with the Friendly Societies (Accounts & Related Provisions) Regulations 1994 (the Regulations).

In accordance with IFRS 4 on Insurance Contracts, the Group has applied existing accounting practices for insurance contracts and participating investment contracts modified as appropriate to comply with the IFRS framework and applicable standards. Further details are given in accounting policy c) below.

The financial statements have been prepared under the historical cost convention as modified by the revaluation of investment properties and financial assets and liabilities (including derivatives and non-participating investment contract liabilities) at fair value. Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates ('the functional currency'). Unless otherwise noted, the consolidated financial statements are presented in millions of pounds sterling, which is the Group's presentation and functional currency.

Within the financial statements the Group uses the term Profit before tax to refer to Profit before tax, mutual bonus and UDS transfer as disclosed on the Statement of Comprehensive Income. This is to provide a more representative Profit before tax figure as described in the LV= use of Non-GAAP measures disclosed on page 87.

As described in the Directors' Report on page 70, after making enquiries, the directors have a reasonable expectation that the Group has adequate resources to continue in operational existence for the foreseeable future. The Group therefore continues to adopt the going concern basis in preparing its consolidated financial statements.

##### Restatements

##### General insurance discontinued operations

On 28 December 2017 the Group entered into a transaction with Allianz whereby a majority stake in the LVGIG group (the general insurance business within the Group) is being sold to Allianz based on an agreed valuation of LVGIG of £1.020bn. The first stage was completed on 28 December 2017 with a minority interest of 49% in LVGIG being sold. The second stage will complete by 31 December 2019 following settlement of a forward contract to sell an additional 20.9% stake to Allianz unless the Group exercises its put option to Allianz over its remaining shareholding earlier.

At 31 December 2018 the Group retains control and consolidates LVGIG and its subsidiaries, however as the second stage will be completed within a year from the reporting date and will result in a loss of control, the LVGIG group is a disposal group that is classified as held for sale in accordance with IFRS 5, and presented as a discontinued operation. As a result the comparative Statement of Comprehensive Income is re-presented as if the LVGIG group had been discontinued from 1 January 2017.

##### Significant accounting estimates and judgements

The preparation of financial statements in accordance with IFRS requires the use of estimates. Where such estimates are complex they often involve a significant level of management judgement in applying those estimates. These significant accounting estimates are disclosed within the financial statements separately from those judgements that management have made in applying accounting policies.

The following areas involve significant judgement by management on policy application:

Area	Significant accounting judgements	Note
Consolidation	Continued consolidation of LVGIG Group	1
Insurance and participating investment contract liabilities	Changes in methodology	20
Reinsurance assets	Transfer of insurance risk for new reinsurance arrangements entered into	24
Pension benefit asset	Right to a refund from the pension scheme's assets	39

The following areas include significant estimates and assumptions, including the exercise of management judgement:

Area	Significant accounting estimates	Note
Fair value financial assets	Estimate of fair value where there is no or limited market data	14
Insurance and participating investment contract liabilities	Assumptions and adjustments used in determining insurance contract liabilities; Assessment of future options and guarantees; Estimate of ultimate cost of claims	20
Intangibles	Estimation of recoverable amount of each Cash Generating Unit	28
Pension benefit asset	Assumptions used to measure the pension benefit obligation	39

## Notes to the Financial Statements (continued)

Year ended 31 December 2018

### 1. Significant accounting policies (continued)

#### Accounting policies

##### a) Consolidation

##### (i) Subsidiaries

Subsidiaries are all entities, over which the Group (directly or indirectly) has control.

The Group controls an entity when the Group has all of the following:

- power over the relevant activities of the entity, for example through voting or other rights;
- exposure to, or rights to, variable returns from its involvement with the entity; and
- the ability to affect those returns through the power over the entity.

The assessment of control is based on the consideration of all the facts and circumstances. The Group reassesses whether it controls an entity if facts and circumstances indicate that there are changes to one or more of the three elements of control.

Subsidiaries are fully consolidated from the date on which control is transferred to the Group using uniform accounting policies consistently applied across the Group. They are excluded from consolidation from the date on which control ceases.

The Group uses the purchase method of accounting to account for the acquisition of subsidiaries. Accordingly, the cost of an acquisition is measured as the fair value of the cash or other assets given, equity instruments issued and liabilities incurred or assumed at the date control passes. Identifiable assets acquired, liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date, irrespective of the extent of any minority interest.

The excess of the cost of acquisition over the fair value of the Group's share of the identifiable net assets acquired is recorded as goodwill. If the cost of acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference is recognised directly in the Statement of Comprehensive Income for the period.

Intra-group transactions, balances and unrealised gains on intra-group transactions are eliminated on consolidation. Unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred.

Non-controlling interests are initially measured as the proportionate share of the subsidiary's identifiable net assets. The balance is subsequently increased by the amount of profit after tax attributable to the non-controlling interest during the period net of any dividends paid. As the Society is a mutual it has no equity, therefore non-controlling interests are presented within liabilities.

Details of the Society's subsidiaries are given in Note 43.

#### Significant accounting judgements

The Group has concluded that it continues to control LVGIG following the sale of 49% of the voting rights to Allianz, through consideration of power to influence the variable returns that the Group is exposed to. The Group has appointed five of the nine members of the LVGIG Board and holds 51% of the voting

rights. Variable returns will be received in the form of dividends in proportion to shareholdings. Whilst Allianz does hold veto rights these are considered to be only protective in nature.

##### (ii) Associates and jointly controlled entities in property holding companies

Joint ventures are arrangements where the Group has joint control and rights to the net assets of the entity. The Group does not currently have any associates, which are all entities over which the Group has significant influence but not control, generally accompanying a shareholding of more than 20% and less than 50% of the voting rights.

For each investment in an associate or jointly controlled entity the Group determines whether to apply the equity method or to designate the investment at fair value through profit or loss in accordance with the exemption permitted under IAS 28 applicable to investment-linked insurance funds. The Group currently has a joint venture in an investment property holding company. Due to the nature of this joint venture the Group has taken the exemption to designate this investment at fair value through profit or loss within UK unlisted investments.

##### b) Disposal groups held for sale and discontinued operations

Disposal groups are classified as held for sale in accordance with IFRS 5 if their carrying amount will be recovered principally through a sale transaction rather than through continuing use and a sale is considered highly probable. A discontinued operation is a component of the business that has been disposed of or is classified as held for sale and that represents a separate major line of business, or is part of a single co-ordinated plan to dispose of such a line of business.

Assets within a disposal group that is classified as held for sale are measured at the lower of their carrying amount and fair value less costs to sell, except for assets such as deferred tax assets, assets arising from employee benefits, financial assets and investment property that are carried at fair value and contractual rights under insurance contracts, which are specifically exempt from this requirement. The overall disposal group is measured at the lower of carrying value and fair value less costs to sell.

The assets and liabilities of a disposal group classified as held for sale are presented separately from the other assets and liabilities in the Statement of Financial Position. Non-current assets within a disposal group are not depreciated or amortised from the point of classification as held for sale.

The results of discontinued operations are presented separately in the Statement of Comprehensive Income. It comprises the profit or loss after tax from discontinued operations together with the gain or loss after tax recognised on disposal. Other comprehensive income attributable to discontinued operations is also presented separately.

In the period in which an operation is first classified as discontinued, the Statement of Comprehensive Income and Statement of Cash Flows for the comparative prior period are re-presented to present those operations as discontinued.



## Notes to the Financial Statements (continued)

Year ended 31 December 2018

### 1. Significant accounting policies (continued)

#### Accounting policies (continued)

##### c) Contract classification

The Group issues contracts that transfer insurance risk, financial risk or both.

Insurance contracts are those contracts that transfer significant insurance risk. Such contracts may also transfer financial risk. As a general guideline, the Group defines as significant insurance risk the possibility of having to pay benefits on the occurrence of an insured event that are at least 10% more than the benefits payable if the insured event did not occur. Investment contracts are those contracts that transfer financial risk with no significant insurance risk.

All With-profits contracts have been classified as participating contracts as these contracts entitle the holder to receive, as a supplement to guaranteed benefits, additional benefits or bonuses:

- that are likely to be a significant portion of the total contractual benefits;
- whose amount or timing is contractually at the discretion of the Group; and
- that are contractually based on:
  - (i) the performance of a specified pool of contracts or a specified type of contract;
  - (ii) realised and/or unrealised investment returns on a specified pool of assets held by the fund; or
  - (iii) the unallocated surplus of the fund that issues the contract.

#### Product classification

Business unit	Product classification			
	Insurance (Participating)	Insurance (Non-participating)	Investment (Participating)	Investment (Non-participating)
Life	n/a	<b>All Protection products</b> Significant insurance risk (primarily morbidity and mortality) is transferred from the policyholder to LV= whereby the policyholder is financially compensated on occurrence of the insured event (such as injury, illness or death). Policyholders are not entitled to a share of the surplus of the funds.	n/a	n/a
	<b>Flexible Guarantee Bond (FGB)</b> FGB funds include a significant death benefit. Policyholders are entitled to a share of the surplus of the With-profits fund.	<b>Retirement non-profit funds (fixed term / enhanced annuities)</b> Significant insurance risk is transferred (mortality / longevity) from the policyholder to LV=. Policyholders are not entitled to a share of the surplus of the funds.	n/a	<b>Unit-linked pensions, including SIPP</b> No significant insurance risk is transferred to LV=; the customer chooses their investment(s) and is exposed to the associated financial risk with no additional participation benefits.
	<b>LVFS Heritage (including RNPFN and Teachers Assurance Funds) With-profits life and pensions policies</b> These policies transfer significant insurance risk (mortality / longevity) from the policyholder to LV=. Policyholders are entitled to a share of the surplus of their respective With-profits fund.	<b>LVFS Heritage (including RNPFN and Teachers Assurance Funds) conventional non-profit life, pensions and annuities in payment</b> These policies transfer significant insurance risk (mortality / longevity) from the policyholder to LV=. Policyholders are not entitled to a share of the surplus of the funds.	<b>LVFS Heritage (including Teachers Assurance Fund) With-profits investments</b> These investment products provide the policyholder with market returns. The value paid to the policyholder is not significantly impacted by whether pay-out is on surrender, maturity or death, therefore this is not an insurance contract. The investments entitle the policyholder to a share of the surplus of the With-profits fund.	<b>LVFS Heritage (including RNPFN Fund) linked life and pensions</b> These products do not transfer significant insurance risk from policyholder to LV=. Policyholders are not entitled to a share of the surplus of the funds.

## Notes to the Financial Statements (continued)

Year ended 31 December 2018

### 1. Significant accounting policies (continued)

#### Accounting policies (continued)

Business unit	Product classification			
	Insurance (Participating)	Insurance (Non-participating)	Investment (Participating)	Investment (Non-participating)
	n/a	<b>All general insurance products</b> Significant insurance risk is transferred from the policyholder to LV= whereby LV= will compensate the policyholder for any loss arising from an insured event (such as motor collisions, property damage).  The customer does not participate in any options or guarantees and there is no fund to share in a surplus.	n/a	n/a
<b>General Insurance</b>				

#### d) Foreign currencies

Investment assets and liabilities denominated in foreign currencies are translated to sterling at rates of exchange ruling at the end of the year. Purchases and sales of investments denominated in foreign currencies are translated at the rates prevailing at the dates of the transactions. Exchange gains and losses are dealt with in that part of the Statement of Comprehensive Income in which the underlying transaction is reported.

#### e) Financial assets and liabilities

##### Recognition

The Group classifies its financial assets and liabilities upon initial recognition as shown below. The classification is impacted by the nature of the instrument and the purpose for which the investments were acquired:

Category	Financial Instrument	Basis of classification	Subsequent Measurement	Recognition of change in fair value
<b>Designated fair value through profit or loss (FVTPL) on initial recognition</b>	Debt securities, Equity securities	Where the investment return is managed on the basis of the total return on investment.	Fair value using prices at the end of the period.	Income Statement – Net investment gains/ (losses).
	Loans secured on residential and commercial property		Fair value on a discounted cash flow basis, taking into account no negative equity guarantees where relevant.	
	Non-participating investment contract liabilities		Amount equal to the fair value of the associated unit-linked financial assets.	
<b>Fair value through profit or loss Held for trading</b>	Derivative assets/(liabilities)	Derivatives are classified as held for trading as required by IAS 39.	Carried at fair value. Asset/ (liability) classification dependant on whether fair value is positive or negative.	Income Statement – Net investment gains/ (losses).
<b>Designated Available for sale (AFS) on initial recognition</b>	Debt Securities	Newly invested assets within a separate investment portfolio (which are not held for trading) that are designated as AFS on initial recognition.	The asset is carried at fair value.  Interest on debt securities is recorded using the effective interest method.	Other Comprehensive Income – items that may be reclassified to profit or loss.
<b>Loans and receivables</b>	Loans, reinsurance deposits, other deposits and financial assets arising from non-investment activities	Financial assets with fixed or determinable payments not quoted in an active market.	Amortised cost using the effective interest method.	Income Statement – Net investment gains/ (losses) when realised or impaired.

## Notes to the Financial Statements (continued)

Year ended 31 December 2018

### 1. Significant accounting policies (continued)

#### Accounting policies (continued)

Category	Financial Instrument	Basis of classification	Subsequent Measurement	Recognition of change in fair value
<b>Cash and cash equivalents</b>	Cash and cash equivalents	Consist of cash and highly liquid investments that are readily convertible into a known amount of cash.	Carrying amounts at amortised cost.	n/a
<b>Other financial liabilities</b>	Subordinated debt	Financial liabilities with fixed or determinable payments and maturity date.	Amortised cost using the effective interest method.	n/a

The accounting policy for each type of financial asset or liability is included within the relevant note for the category.

All financial assets classified as Available for sale are held within the LVGIG group. As such these are included in Assets held for sale disclosed within the Discontinued operations in Note 12.

#### Derecognition

A financial asset is derecognised when:

- the rights to receive cash flows from the asset have expired; or
- the Group has transferred its rights to receive cash flows from the asset and has:
  - transferred the risks and rewards of the asset; or
  - transferred control of the asset.

A financial liability is derecognised when the obligation under the liability is discharged or cancelled or expires.

#### f) Liability adequacy testing

##### Long-term insurance and participating investment contract liabilities

At each reporting date, an assessment is made of whether the recognised long-term contract liabilities are adequate, using current estimates of future cash flows. If that assessment shows that the carrying amount of the liabilities (less related assets) is insufficient in light of the estimated future cash flows, the deficiency is recognised in the Statement of Comprehensive Income by setting up an additional liability.

##### General insurance

At each reporting date liability adequacy tests are performed to ensure the adequacy of insurance contract liabilities, net of related deferred acquisition costs. In performing these tests, current best estimates of future contractual cash flows and claims handling and administration expenses, as well as investment income from the assets backing such liabilities, are used. Any deficiency is immediately charged to the Statement of Comprehensive Income and an unexpired risk reserve is established.

#### g) Impairment of non-financial assets

Assets that have an indefinite useful life, for example goodwill, are not subject to amortisation and are tested annually for impairment. Assets that are subject to amortisation or depreciation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the

lowest levels for which there are separately identifiable cash flows (cash-generating units).

Non-financial assets, other than goodwill, that suffered impairment are reviewed for possible reversal of the impairment at each reporting date.

#### h) Cash and cash equivalents

Cash and cash equivalents comprise cash at bank and in hand, and short-term deposits with an original maturity of three months or less.

For the purpose of the Statement of Cash Flows, Cash and cash equivalents are as defined above but are shown net of outstanding bank overdrafts.

#### i) Collateral

Collateral is received or pledged in the form of cash collateral and non-cash collateral.

##### Cash collateral

Cash collateral received, which is not legally segregated from the Group, is recognised as an asset with a corresponding liability for its repayment in the Statement of Financial Position.

Cash collateral pledged, which is legally segregated from the Group, is derecognised from Cash and cash equivalents and a corresponding asset for its return is recognised in the Statement of Financial Position.

##### Non-cash collateral

Non-cash collateral received where the counterparty is not in default, that is neither sold nor repledged, is not recognised in the Statement of Financial Position. Non-cash collateral pledged where the Group is not in default is not derecognised from the Statement of Financial Position and remains within the appropriate asset classification.

#### j) Mutual bonus

The Mutual bonus declared by the Society is presented on the Statement of Comprehensive Income below Profit before tax and not within the Gross change in long-term contract liabilities. This is to provide a more representative Profit before tax figure as described in the LV= use of Non-GAAP measures disclosed on page 87. The impact on Gross changes in long-term contract liabilities is disclosed separately within Note 22.

## Notes to the Financial Statements (continued)

Year ended 31 December 2018

### 1. Significant accounting policies (continued)

#### Changes and future developments in accounting policies

##### a) New and amended standards adopted by the Group

The following new and amended standards that have been adopted by the EU for accounting periods beginning on or after 1 January 2018 have been adopted by the Group.

##### (i) New standards and interpretations

###### IFRS 15 'Revenue from contracts with customers'

IFRS 15 replaces IAS 18 'Revenue' and applies to non-insurance revenue, providing a principles based approach for revenue recognition that is underpinned by the achievement of performance obligations. At 31 December 2018 £47m (2017: £37m) of fee and commission income from the Group's continuing business is in the scope of the standard, of which £20m (2017: £22m) relates to asset management fees. The Group's previous accounting policy under IAS 18 for fee and commission income to recognise revenue over time as the services are provided is consistent with the requirements of IFRS 15, and accordingly no adjustments or restatement of prior periods have been necessary. Unbilled receivables and Contract assets replace accrued income whilst Contract liabilities replace deferred income; these are recognised when payments are received in phasing consistent with the pattern of revenue recognition. Disclosure of revenue from contracts with customers is included in Note 8.

###### IFRIC 22 'Foreign currency transactions and advance consideration'

IFRIC 22 clarifies that advanced payments for goods or services should be recognised using the spot rate on the date of the advanced payment / receipt and not retranslated at the date that the associated IFRS balance is recognised. This is consistent with how such transactions are accounted for by the Group, therefore this amendment does not impact the Group's financial statements.

##### (ii) Amendments to standards

###### IAS 28 'Investments in associates and joint ventures'

IAS 28 has been amended to clarify that the option to account for investments in associates at fair value through profit or loss where these investments are held by mutual funds, such as the Society, can be made separately for each investment, upon acquisition of each investment. Currently the Group has one such investment, and this is accounted for at fair value through profit or loss. As part of the general insurance transaction with Allianz, the group has a forward contract to sell a further 20.9% equity stake in LVGIG to Allianz by 31 December 2019, resulting in a remaining minority interest held by the Group. This amendment to IAS 28 clarifies that the Group will have the choice of whether to account for any retained investment in an associate using the equity method, or at fair value through profit or loss.

###### IAS 40 'Investment property'

IAS 40 has been amended to clarify the circumstances under which a property is deemed to have transferred between classification as Investment property in accordance with IAS 40, as owner occupied in accordance with IAS 16 'Property, plant and equipment' or inventory in accordance with IAS 2 'Inventories'. The only investment property held by the Group has been disposed of during 2018; therefore this amendment has no impact.

###### IFRS 12 'Disclosure of interests in other entities'

The IASB effective date for the amendment to IFRS 12 'Disclosure of Interests in Other Entities' was 1 January 2017 however it was adopted by the EU on 7 February 2018 and has therefore been adopted by the Group in 2018. IFRS 12 has been amended to clarify that even though entities are not required to present summarised financial information for investments that are classified as held for sale in accordance with IFRS 5, entities are still required to present all other information required by IFRS 12 for such investments. This amendment is relevant for the disclosures of the Group's investment in the general insurance subsidiaries which are presented as held for sale; therefore the Group will continue to disclose all other information required by IFRS 12 for the LVGIG group of businesses.

###### Amendment to IFRS 4 'Insurance contracts': Applying IFRS 9 'Financial instruments' with IFRS 4 'Insurance contracts'

The amendment provides two approaches that can be applied by eligible insurers to address concerns arising from the different effective dates of IFRS 9 and IFRS 17 'Insurance Contracts'; the overlay approach and the temporary exemption from IFRS 9 until adoption of IFRS 17. The Group and the Society are eligible insurers and have taken the temporary exemption from IFRS 9.

As an insurer that has elected to apply the temporary exemption from IFRS 9, information is disclosed below regarding compliance with the criteria to apply the temporary exemption; and categories of financial asset to facilitate comparability with entities applying IFRS 9.

###### Compliance with the criteria for the temporary exemption from IFRS 9

The IFRS 4 amendment adopted in the reporting period permits insurance entities which meet the predominance ratio test to have a temporary exemption from IFRS 9 where this standard has not yet been adopted. The predominance ratio test is required to be performed at the reporting entity level, using the annual reporting date that immediately precedes 1 April 2016 (i.e. 31 December 2015).

The predominance ratio test of an entity's insurance liabilities against its total liabilities includes two tests:

- 1) The carrying amount of its liabilities arising from contracts within IFRS 4's scope must be significant compared to the total carrying amount of all of its liabilities; and
- 2) The carrying amount of the insurer's liabilities connected with insurance compared with the total carrying amount of all of its liabilities must be above a threshold. Liabilities connected with insurance include IFRS 4 liabilities, Investment contract liabilities measured at fair value through profit or loss (FVTPL) applying IAS 39 and other liabilities that are connected to these insurance and investment contracts.

The threshold for liabilities connected with insurance compared with total liabilities is:

- Greater than 90%, or
- Greater than 80% but less than or equal to 90% and the entity provides evidence that it does not have a significant activity that is unrelated to insurance.

The Group and the Society meet the criteria to apply the temporary exemption from IFRS 9 as the predominance ratio test is passed based on the 31 December 2015 financial statements.

## Notes to the Financial Statements (continued)

Year ended 31 December 2018

### 1. Significant accounting policies (continued)

#### Changes and future developments in accounting policies (continued)

The carrying value of liabilities within IFRS 4's scope at 31 December 2015 was significant at 80% (Society 77%) of total liabilities<sup>1</sup>. The 90% threshold for liabilities connected with insurance is passed by both the Group (93%) and the Society (93%) once non-participating investment contract liabilities are included as liabilities connected with insurance. As at 31 December 2018 the Group and the Society continue to meet the predominance ratio threshold. No subsequent reassessment of the predominance ratio test is required; however the liabilities within IFRS 4's scope and those connected with insurance at 31 December 2018 continue to exceed 90% of total liabilities.

The fair value at 31 December 2018 and the amount of change in the fair value during the reporting period of the Group and Society's financial assets are as follows:

	Group		Society	
	Fair value at 31 December 2018	Movement in fair value recognised in the Statement of Comprehensive Income	Fair value at 31 December 2018	Movement in fair value recognised in the Statement of Comprehensive Income
	£m	£m	£m	£m
<b>Financial assets (associated with continuing operations)</b>				
<b>1) Financial assets that meet the SPPI criteria and not classified as FVTPL</b>				
Loans and other receivables	407	—	84	—
Short-term insurance receivables <sup>2</sup>	35	—	34	—
	<b>442</b>	<b>—</b>	<b>118</b>	<b>—</b>
<b>2) All other financial assets</b>				
Insurance receivables relating to OB pensions annuities held at FVTPL <sup>2</sup>	6	—	6	—
Financial assets at fair value through profit or loss	11,538	(600)	11,334	(600)
Derivative financial instruments – assets	65	(5)	65	(5)
Derivative financial instruments – liabilities	(190)	(5)	(190)	(5)
	<b>11,419</b>	<b>(605)</b>	<b>11,215</b>	<b>(605)</b>

The following table represents the Group and Society's exposure to credit risk on financial assets that meet the SPPI criteria:

	AA	A	Not rated	Past due but not impaired
	£m	£m	£m	£m
<b>Financial assets (associated with continuing operations)</b>				
<b>Group</b>				
Loans and other receivables	—	350	57	—
Short-term insurance receivables <sup>2</sup>	22	—	10	3
	<b>22</b>	<b>350</b>	<b>67</b>	<b>3</b>
<b>Society</b>				
Loans and other receivables	—	—	84	—
Short-term insurance receivables <sup>2</sup>	21	—	10	3
	<b>21</b>	<b>—</b>	<b>94</b>	<b>3</b>

<sup>2</sup> The carrying amount of the financial asset measured applying IAS 39 is deemed to be a reasonable approximation of its fair value.

Note: In the case of financial assets held at amortised cost, the amounts disclosed are the carrying amounts applying IAS 39, before adjusting for any impairment allowances. The table above includes £70m (Society £97m) of short-term receivables that are not rated. The fair value of these financial assets at 31 December 2018 is equal to their carrying value.

In addition, within the discontinued operations that are classified in the Statement of Financial Position as Held for sale there are investment financial assets with a fair value of £1,095m (movement in fair value of £895m including fair value revaluations of £(12)m during the reporting period) that meet the definition for separate disclosure in category 1. Discontinued operations also hold short-term receivables of £294m. The investment assets are all deemed low credit risk with credit ratings above investment grade as follows: AAA: £296m, AA: £202m, A: £347m, BBB: £250m. In addition short-term receivables of £294m comprise £39m at AA credit rating and £255m that are not rated. The fair value of these financial assets at 31 December 2018 is equal to their carrying value.

The financial assets associated with discontinued operations that are held at FVTPL have a fair value of £754m (movement in fair value of £(701)m including fair value revaluations of £(24)m during the reporting period). The non-insurance subsidiaries within the Group have adopted IFRS 9 within their individual financial statements from 1 January 2018. Relevant consolidation adjustments have been made in the Group financial statements to ensure uniform accounting policies are applied within financial statements of the Group. IFRS 9 information can be obtained from the individual financial statements available on Companies House for the non-insurance subsidiaries listed in Note 43.

## Notes to the Financial Statements (continued)

Year ended 31 December 2018

### 1. Significant accounting policies (continued)

#### Changes and future developments in accounting policies (continued)

##### b) New standards and interpretations not yet adopted

A number of new standards and amendments to standards and interpretations are effective for annual periods beginning after 1 January 2019, and have not been applied in preparing these consolidated financial statements.

##### IFRS 16 'Leases'

Issued in January 2016, IFRS 16 replaces existing leases guidance, including IAS 17 'Leases', IFRIC 4 'Determining whether an Arrangement contains a Lease', SIC-15 'Operating Leases – Incentives' and SIC-27 'Evaluating the Substance of Transactions Involving the Legal Form of a Lease'.

##### Nature of change

IFRS 16 will result in almost all leases being recognised on the Statement of Financial Position by lessees, as the distinction between operating and finance leases is removed. Under the new standard, an asset (the right to use the leased item) and a financial liability to pay rentals are recognised. The only exceptions are short-term and low-value leases.

Lessees will also be required to remeasure the lease liability upon the occurrence of certain events (e.g. a change in the lease term, a change in future lease payments resulting from a change in an index or rate used to determine those payments). The lessee will generally recognise the amount of the remeasurement of the lease liability as an adjustment to the right-of-use asset.

Previously, the Group recognised operating lease expense on a straight-line basis over the term of the lease, and recognised assets and liabilities only to the extent that there was a timing difference between actual lease payments and the expense recognised. The nature of expenses related to those leases will now change because the Group will recognise a depreciation charge for right-of-use assets and interest expense on lease liabilities.

There will not be a significant impact for leases previously recognised as finance leases.

##### Transition

The Group plans to apply IFRS 16 initially on 1 January 2019, using the modified retrospective approach. Therefore, the cumulative effect of adopting IFRS 16 will be recognised as an adjustment to the opening balance of retained earnings at 1 January 2019, with no restatement of comparative information. Furthermore for the lease that the Group classified as a finance lease under IAS 17, the carrying amount of the right-of-use asset and the lease liability at the date of initial application shall be the carrying amount of the lease asset and lease liability immediately before that date measured applying IAS 17.

The Group will elect to use the exemptions for lessees proposed by the standard on lease contracts for which the lease terms ends within 12 months as of the date of initial application, and lease contracts for which the underlying asset is of low value.

The Group intends to apply the practical expedient for lessees to rely on its assessment of whether leases are onerous applying IAS 37 'Provisions, Contingent Liabilities and Contingent Assets' as at 31 December 2018 as an alternative to performing an impairment review. As a result the right-of-use asset recognised

on 1 January 2019 is adjusted by the amount of any provision for onerous leases recognised in the Statement of Financial Position at 31 December 2018.

The Group plans to apply the practical expedient to grandfather the definition of a lease on transition. This means that it will apply IFRS 16 to all contracts entered into before 1 January 2019 and identified as leases in accordance with IAS 17 and IFRIC 4.

##### Impact on the Group's continuing business

As at the reporting date, the Group has non-cancellable operating lease commitments of £7m, see Note 42. Of these commitments, approximately £1m relate to leases which are short-term or of low value assets which will be recognised on a straight-line basis as an expense in profit or loss. For the remaining lease commitments the Group expects to recognise right-of-use assets of approximately £7m on 1 January 2019, and lease liabilities of £6m. The Group holds a lease classified as a finance lease under IAS 17 with an asset of £17m and a finance lease liability of £19m at 31 December 2018; these balances will become the value of the right-of-use asset and lease liability on transition to IFRS 16.

The actual impacts of adopting the standard on 1 January 2019 may change because the new accounting policies are subject to change until the Group presents its first financial statements following the date of initial application.

##### IFRS 17 'Insurance contracts'

Issued in May 2017, IFRS 17 replaces IFRS 4 'Insurance contracts'. The original effective date of IFRS 17 was 1 January 2021; however the IASB has proposed a one-year deferral subject to public consultation ahead of formal approval. This standard provides an accounting model for insurance contracts that is more useful and consistent for insurers. In contrast to the requirements in IFRS 4, which are largely based on grandfathering previous local accounting policies, IFRS 17 provides a comprehensive model for insurance contracts, covering all relevant accounting aspects. The core of IFRS 17 is the general model, supplemented by:

- A specific adaptation for contracts with direct participation features (the variable fee approach); and
- A simplified approach (the premium allocation approach) mainly for short-duration contracts.

The standard will have a material impact on the Group and Society and transitioning the Group and Society's accounting to the new standard will require significant effort.

##### IFRS 9 'Financial instruments'

IFRS 9 addresses the classification, measurement and recognition of financial assets and financial liabilities and replaces IAS 39. The effective date was 1 January 2018, however as noted on page 106, IFRS 9 has been deferred by the Group and Society in order to align adoption with that of IFRS 17. In line with the proposed deferral of the IFRS 17 effective date noted above, the IASB has also proposed that the temporary exemption from IFRS 9 for qualifying insurers be extended until 1 January 2022.

There are no other new or amended standards yet to be adopted by the Group that are expected to have a significant effect on the consolidated financial statements of the Group.

## Notes to the Financial Statements (continued)

Year ended 31 December 2018

### Segmental information

This section details the disclosures required under IFRS 8 Operating segments.

These segmental disclosures are based on operating segments that reflect the level within the Group at which key strategic and resource allocation decisions are made and the way in which operating performance is reported internally to the Group board of directors.

During the year regular reporting to the Group board of directors has changed to focus primarily on Solvency II capital metrics and this is reflected in the change in Key Performance Indicators on page 11. IFRS information reported to the board is now limited to IFRS based Operating profit, with reconciliation to the Statement of Comprehensive Income. The board now manages all Continuing operations as one business 'Life and Group'. Therefore segment reporting is disclosed for the two segments of 'Life and Group' and the discontinued general insurance business 'General insurance'.

Comparative segmental information has been restated to reflect this change.

## 2. Segmental information

### Accounting for operating profit

Operating profit is a non-GAAP measure and is calculated as IFRS profit before tax, mutual bonus and UDS transfer adjusted for the following items:

- Central items including the impact of strategic transactions.
- Short-term investment fluctuations.
- Finance costs.

The activities of each operating segment are described below:

### Life and Group

The principal activity of the Life and Group operating segment is the provision of Protection and Retirement Solutions products and managing the Heritage products and the Estate fund. The core products offered in Protection are Life, Critical Illness and Income Protection Insurance. The core products offered in Retirement Solutions are Fixed-Term Annuities, Self-Invested Personal Pensions (SIPPs), Equity Release Mortgages and Flexible Guarantee Bonds. Heritage products include legacy With-profits business (both Ordinary Branch and Industrial Branch), the ring-fenced RNPEN Fund, containing the business acquired from the Royal National Pension Fund for Nurses in 2001, and the ring-fenced TA Fund, containing the With-profits business acquired from Teachers Provident Society Limited in 2016. The Heritage products are no longer actively marketed, although the Society continues to sell newer With-profits products via the Life business channels.

### General insurance – Discontinued operation

The principal activity is to underwrite general insurance business through both direct and broker distribution channels. The primary sources of premium income are from the sale of Motor and Home products. For 2018 reporting the general insurance segment results are disclosed as a discontinued operation within the analysis of segment Operating profit.

Transactions between reportable segments are on normal commercial terms, and are included within the reported segments.

The profit measure used by the Group board of directors to monitor performance is Operating profit. Operating profit by segment is shown in the table below, together with a reconciliation of operating profit to the IFRS profit/(loss) before tax.

## Notes to the Financial Statements (continued)

Year ended 31 December 2018

### 2. Segmental information (continued)

#### a) Segment profit

	2018 £m	2017 £m
Life	60	60
General insurance	107	120
Group items and strategic investment	(31)	(46)
<b>Operating profit</b>	<b>136</b>	<b>134</b>
Short-term investment fluctuations and related items	(66)	30
Finance costs	(24)	(24)
Central items	(26)	(18)
<b>Profit before tax from continuing and discontinued operations</b>	<b>20</b>	<b>122</b>
Less: Discontinued operations	(110)	(164)
<b>Loss before tax from continuing operations</b>	<b>(90)</b>	<b>(42)</b>

#### b) Major customers

The directors consider the Group's external customers to be individual policyholders. As such, the Group is not reliant on any individual customer.



## Notes to the Financial Statements (continued)

Year ended 31 December 2018

### Capital and risk management

This section details the capital and risk management approach of the Society and Group. The Group seeks to create value for its members by investing in the development of the business while maintaining an appropriate level of capital available. The risk appetite for each type of principal risk is set based on the amount necessary to meet the PRA's capital requirements.

#### 3. Capital management

##### Policies and objectives

Capital is managed on both economic and regulatory bases to ensure the Group has sufficient funds to meet its business objectives, the promises made to members and policyholders and regulatory requirements.

The Group's key capital management objectives are:

- (i) To ensure the Group's financial strength and to support the risks it takes on as part of its business;
- (ii) To give confidence to policyholders and other stakeholders who have relationships with the Group;
- (iii) To comply with capital requirements imposed by its UK regulator, the PRA, in association with the European Insurance and Occupational Pensions Authority (EIOPA) and Solvency II legislation; and
- (iv) To ensure the Group's strategy can be implemented and is sustainable.

These objectives are reviewed at least annually and benchmarks are set by which to judge the adequacy of the Group's capital. The capital position is monitored against those benchmarks to ensure that sufficient capital is available to the Group.

The Group complied with all regulatory capital requirements that it was subject to throughout the reporting period.

##### Capital Management

Capital is monitored and managed at a Group and entity level. The Group manages capital resources under Solvency II at the level of Eligible own funds. Excluding RNPfN and Teachers ring-fenced funds, Eligible own funds were £1,637m for the Group (2017: £1,567m) and £1,457m for the Society (2017: £1,418m). Including RNPfN and Teachers ring-fenced funds, Eligible own funds were £1,732m for the Group (2017: £1,677m) and £1,552m for the Society (2017: £1,528m). The inclusion of the ring-fenced funds does not change the Group capital surplus. The large divergence between Group and Society Eligible own funds over the year is caused by the reporting treatment of the majority holding of the general insurance subsidiaries and corresponds to the Group solvency capital requirement reflecting the entire general insurance subsidiaries and not just the 51% holding.

The Group seeks to deploy capital where it believes the risk is properly rewarded. Asset and liability matching is extensively used and risks are hedged where the Group believes it would otherwise receive insufficient return for the risk taken or to reduce volatility.

The Group Solvency II results are not due to be submitted to the PRA until after the release of the Annual Report. As a result, the Eligible own funds figures disclosed above are based on the best estimate of the results at the Annual Report signing date and may differ to the results published as part of the annual Solvency Financial Condition Report.

##### Risk appetite

The Group has embedded its approach to risk management through its risk appetite. The risk appetite for capital management is that sufficient solvency capital is held to ensure that the Group can continue to trade following a severe adverse movement in markets or other risks. As at 31 December 2018,

the capital risk appetite was set to target a Capital Coverage Ratio of 140%. See further details on risk management on pages 34 to 39.

##### Measurement and monitoring of capital

The capital position of the Group is monitored on a regular basis and reviewed formally on a monthly basis by the Group Asset and Liability Committee (ALCO). These objectives are reviewed and benchmarks are set by which to judge the adequacy of the Group's capital and ensure that sufficient capital is available.

The Group's capital requirements are forecast on a regular basis and compared against the available capital and the Group's minimum internal rate of return. The internal rate of return forecast to be achieved on potential investments is also measured against minimum required benchmarks taking into account the risks associated with the investment.

##### Methodology

Eligible own funds comprise the excess of the value of assets over the liabilities, as valued on a Solvency II basis. Subordinated debt issued by the Group is considered to be part of Eligible own funds, rather than a liability, as it is subordinate to policyholder claims.

Assets are valued at IFRS fair value with adjustments to remove intangibles and deferred acquisition costs, and to value reinsurers' share of technical provisions consistent with the Solvency II regulations.

Liabilities are valued on a best estimate market consistent basis, with the application of a Matching Adjustment, for valuing qualifying annuity liabilities, and a Volatility Adjustment for other qualifying business. Transitional measure on technical provisions (TMTP) is recognised on the balance sheet and has been calculated on a basis approved by the Audit Committee which seeks to capture the differences between the total Financial Resources Requirement under the previous Solvency I regime and the new Solvency II regime.

The liabilities include the Risk Margin which represents an allowance for the cost of capital for a purchasing insurer taking on the portfolio of liabilities and residual risks that are deemed to be not hedgeable under Solvency II. This is calculated using a cost of capital of 6% as prescribed by EIOPA, and represents the cost to the purchaser of raising capital to meet the regulatory capital requirements.

The Solvency Capital Requirement (SCR) is the amount of capital required to cover the 1-in-200 worst projected future outcome in the year following the valuation, allowing for realistic management and policyholder actions and the impact of the stress on the tax position of the Group. This allows for diversification between the different businesses within the Group and between the risks to which they are exposed.

## Notes to the Financial Statements (continued)

Year ended 31 December 2018

### 3. Capital management (continued)

All non-insurance regulated businesses are included using their current regulatory surplus.

Allowance is made within the Solvency II Balance Sheet for the Group's defined benefit pension scheme using results on an IFRS basis.

#### Assumptions

The calculation of the Solvency II balance sheet and associated capital requirements requires a number of assumptions, including:

- (i) assumptions required to derive the present value of best estimate liability cash flows. Non-market assumptions are broadly the same as those used to derive the Group's IFRS disclosures. Future investment returns and discount rates are those defined by EIOPA, which means that the risk free rates used to discount liabilities are market swap rates, with a 10 basis point deduction to allow for credit risk. For eligible annuity business, the liability discount rate includes a Matching Adjustment. For other eligible business, the liability discount rate includes a Volatility Adjustment;
- (ii) assumptions regarding management actions. The only management actions allowed for are those that have been approved by the Board and are in place at the balance sheet date.

#### Use of and limitations of sensitivity analysis

Sensitivity analysis is used to determine the effect of a change in a key assumption while other assumptions remain unchanged. In reality, there is a correlation between the assumptions and other factors. It should also be noted that these sensitivities are non-linear, and larger or smaller impacts should not be interpolated or extrapolated from these results.

The sensitivity analysis does not take into consideration that the Group's assets and liabilities are actively managed. Additionally, the Solvency II position of the Group may vary at the time that any actual market movement occurs. For example, the Group's financial risk management strategy aims to manage the exposure to market fluctuations.

As investment markets move past various trigger levels, management actions could include selling investments, changing investment portfolio allocation, adjusting bonuses credited to policyholders, and taking other protective action.

Other limitations of sensitivity analysis include the use of hypothetical market movements to demonstrate potential risk that only represent the Group's view of possible near-term market changes that cannot be predicted with any certainty, and the assumption that all interest rates move in an identical fashion.

#### Stress and scenario testing

Due to the limitations of sensitivity analysis in isolation, the Group undertakes a series of stress and scenario tests to ensure the robustness of its solvency position in regard to different levels of new business growth, movements in investment markets and changes in other assumptions such as the expected lifetime of our enhanced annuity customers.

In looking at movements in investment markets the Group considers a number of single stresses (e.g. a significant fall in equities) but more importantly because investment markets are highly correlated consideration is given to how they will move together in stressed conditions. The Group uses the outcomes of the stress and scenario testing to develop the management actions that would be undertaken if capital or other performance measures move outside of the defined risk appetite.

In order to plan for the future operations of the Group, forecast plans are produced including stress and scenario testing to provide the board with assurance that the Group will be able to withstand adverse events if they arise.

#### Reconciliation of Group IFRS UDS to Solvency II Eligible own funds

The table below gives a reconciliation of Group IFRS Unallocated divisible surplus to the Group's Eligible own funds on a Solvency II basis.

The Group Solvency II results are not due to be submitted to the PRA until after the release of the Annual Report. As a result, the Group Solvency II results disclosed below are based on the best estimate of the results at the Annual Report signing date and may differ to the results published as part of the annual Solvency Financial Condition Report.

	2018 £m	2017 £m
<b>IFRS Unallocated divisible surplus</b>	<b>1,127</b>	<b>1,189</b>
Remove DAC, goodwill and other intangible assets and liabilities	(405)	(410)
Add subordinated debt treated as available capital	372	379
Insurance contract valuation differences	356	305
Difference in non-controlling interest calculation methods	308	279
Deferred tax adjustments	25	11
Other	13	6
Less net eligible own funds relating to ring-fenced funds	(159)	(192)
<b>Eligible own funds (excluding ring-fenced funds)</b>	<b>1,637</b>	<b>1,567</b>
RNPEN – eligible own funds	112	125
Restriction of own funds in respect of RNPEN	(37)	(34)
Teachers – eligible own funds	47	67
Restriction of own funds in respect of Teachers	(27)	(48)
<b>Group Eligible own funds as submitted to the PRA</b>	<b>1,732</b>	<b>1,677</b>

## Notes to the Financial Statements (continued)

Year ended 31 December 2018

### 4. Risk management and control

The Group's primary business activities include the provision of insurance, investment and retirement products to UK-based customers. In providing these products the Group accepts and needs to manage risk. A description of these risks and how they relate to the Group's products is outlined below and the Group's approach to managing and controlling these risks through its governance and risk management framework is set out on pages 34 to 39.

As part of its risk management programme, the Group records its current and projected risk position across a defined set of risk categories. In addition a measure of the sensitivity on Profit before tax and Unallocated divisible surplus under both deterministic and stochastic scenarios is performed.

Management uses the insight gained through these sensitivities to help manage the Group's risk exposure and sustainability. The models, scenarios and assumptions used are reviewed regularly and updated as necessary including any interdependencies between risk types. This section includes the impact on the three measures of a sensitivity test that calibrates to a reasonably possible change in a single risk type.

#### Principal risks and categories

The Risk Management section of the Strategic Report on pages 34 to 39 sets out the principal risks and uncertainties that the Group faces. In addition, the Group uses a standard categorisation to group together similar risks. All such risks are subject to the same risk management and control framework. However, they impact the business and its financial performance in different ways. The following sections provide more detail on these main categories of risks and how they impact the Group.

#### a) Insurance risk

Insurance risk arises both from the claims commitment that the Group has made to its policyholders and the pricing assumptions made in respect of the policy of insurance. As such, this covers the following risks:

- The timing and the amount of the claim is uncertain and hence there is a risk that the exposure to loss arising from this claims experience is different to that anticipated.
- The product is priced assuming certain assumptions covering how long the policy will be maintained by the customer (persistence risk) and the cost of administering the product over its life cycle (expense risk). There is a risk that across the Group's insurance portfolio the actual experience is different to that assumed when the product is priced. This is more likely the longer the term of the product and therefore is usually only a significant factor in life insurance products.

#### Insurance concentration risk

The Group is not exposed to significant concentrations of insurance risk. Experience shows that the larger the portfolio of similar independent insurance contracts, the smaller the relative variability about the expected outcome will be. In addition, a more diversified portfolio is less likely to be affected by a change in any subset of the portfolio. The Group has developed its insurance underwriting strategies to diversify the type of insurance risks accepted and within each of these categories to achieve a sufficiently large population of risks to reduce the variability of the expected outcome. The Group writes a diverse

mix of insurance business across a wide group of people and businesses. However, as the Group has substantially written all of its business in the UK, results are sensitive to demographic and economic changes arising in the UK.

The Group minimises the level of insurance concentration through the use of portfolio analysis and reinsurance.

The Group assesses its insurance risk in two broad categories: life insurance risk and general insurance risk and the specific components of each of these are further outlined below:

#### (i) Life insurance

The Group's life insurance activities primarily involve the provision of protection, retirement and savings products. These products are long term in nature and provide key benefits to the policyholder and their dependants.

A number of key assumptions are made when determining the future claims liability that will arise from these policyholder commitments. These are based on prior experience and latest forecasts in trends and patterns and include the future life expectancy and health of policyholders, the extent to which contracts will be terminated early, how much insurance contract administration costs will increase, growth in the value of investments, interest rates and tax rates.

Details of life insurance contract liabilities and associated valuation assumptions are disclosed in Notes 20 and 25 respectively.

Differences in actual experience versus the original key assumptions will give rise to liabilities that differ from those originally anticipated. In addition the assumptions made regarding the length of time the policy stays in force and the cost of administering the policy may vary from original assumptions. Wherever these outcomes vary from the original or most recent estimates they may give rise to a change in life insurance risk exposure, the primary life insurance risks prevalent within the Group's products are described below:

#### Mortality, longevity and morbidity

Life protection and annuity business is exposed to changes in life expectancy (mortality – reduced life expectancy, longevity – increased life expectancy) and health expectancy (morbidity) experience.

Protection product liabilities are exposed to mortality and morbidity risks whereby higher mortality rates and adverse morbidity will lead to increases in contract liabilities. Annuity product liabilities are exposed to longevity risk whereby contract liabilities will increase with life expectancy.

Mortality, longevity and morbidity risk is managed in the Group through the assessment of the risk associated with individual policyholders against a set of acceptance (underwriting) criteria, which may include an individual's medical history, occupation, smoking and drinking habits (i.e. indicators of life expectancy). The actual experience of policyholders is then regularly monitored to assess that the underwriting criteria remain appropriate and that the level of risk being assumed by the Group remains within its risk appetite.

## Notes to the Financial Statements (continued)

Year ended 31 December 2018

### 4. Risk management and control (continued)

#### Persistence

In pricing life insurance business, the Group makes assumptions as to how long the policyholder is likely to retain the product. Persistence risk arises from the actual experience being different to the assumptions. The level of persistence influences the ability to recover initial costs of sale from the premiums and charges that relate to the product. The Group is exposed to persistence risk whereby the profitability is adversely impacted by changes in the length of time that policies remain in force.

For certain Heritage products the level of persistence influences the estimated cost of guarantees and options. The risk for these products is that a larger proportion of the portfolio remains in-force to take advantage of these guarantees and options.

Persistence risk is managed in the Group through the assessment of the risk associated with different products against the assumptions used when pricing and subsequently valuing the insurance obligations. The actual lapse experience segmented into appropriate product groups is regularly monitored to assess whether the pricing and valuation assumptions remain appropriate and that the level of risk being assumed by the Group remains within its risk appetite.

#### Cash take-up

In pricing life insurance business, the Group makes assumptions as to how many policyholders are likely to take the lump sum cash option at retirement. Cash take-up risk arises from the actual experience being different to the assumptions. The level of cash take-up influences the future cost of the product, as the cost of paying a guaranteed annuity income for life is more onerous than the lump sum cash at retirement option.

Cash take-up risk is managed in the Group through the assessment of the risk associated with different products against the assumptions used when pricing and subsequently valuing the insurance obligations. The actual cash take-up experience, segmented into appropriate product groups, is regularly monitored to assess whether the pricing and valuation assumptions remain appropriate and that the level of risk being assumed by the Group remains within its risk appetite.

#### Expense

In pricing life insurance business, assumptions are made as to how long the Group will need to continue to service and maintain the product and communicate with the policyholder. The Group is exposed to the risk that the charges it deducts from policyholder benefits are not sufficient to cover the full extent of these expenses. In addition, the Group makes an assumption as to how much this service and maintenance will cost each year. Expense risk is the exposure from these assumptions on cost and duration varying from the assumed levels, with higher than expected expenses reducing profits.

The Group manages this risk through an ongoing assessment of the factors that will generate additional expenses in the product servicing costs and the average duration of life insurance products.

#### Reinsurance

In order to mitigate the mortality, longevity and morbidity risk within the Group's life insurance book described earlier, a proportion of mortality, longevity and morbidity risk is transferred via reinsuring policy commitments through agreements with reinsurance companies.

In December 2017, the Group reinsured a large portfolio of heritage deferred and immediate With-profits annuity policies (OB Pensions), with RGA, a leading global life reinsurer. The agreement covers specified levels of benefits, thereby significantly reducing the level of market and longevity risk associated with the portfolio, and was executed at a price that was lower than the best estimate value of the liabilities. The Group retains certain risks associated with the portfolio, primarily those related to expenses, discretionary benefits and policyholder optionality.

#### Life insurance concentration

The Group's exposure to life insurance risk is captured in the long-term insurance and investment contract liabilities set out below. The products listed below cover the Group's protection, annuity and pensions products and also the investment exposure arising from the Group's savings and investment products. The Society's exposure to life insurance risk is consistent with that of the Group.

Group	2018			2017		
	Gross £m	Reinsurance £m	Net £m	Gross £m	Reinsurance £m	Net £m
Whole life	3,262	(44)	3,218	3,242	(41)	3,201
Endowment	345	–	345	418	–	418
Term Assurance	394	(438)	(44)	316	(339)	(23)
Immediate and deferred annuity contracts	4,305	(940)	3,365	4,586	(1,004)	3,582
UWP pensions and protected retirement plans	1,370	–	1,370	1,388	–	1,388
Critical illness	107	(92)	15	98	(86)	12
Income protection	197	(224)	(27)	265	(277)	(12)
ISA	95	–	95	100	–	100
Other	172	–	172	212	–	212
	10,247	(1,738)	8,509	10,625	(1,747)	8,878
Long-term claims liabilities	58	–	58	50	–	50
Unit linked	3,017	–	3,017	3,071	–	3,071
	13,322	(1,738)	11,584	13,746	(1,747)	11,999

## Notes to the Financial Statements (continued)

Year ended 31 December 2018

### 4. Risk management and control (continued)

#### Life insurance risk sensitivities

The table below sets out the impact on the Unallocated divisible surplus and Profit before tax for movements in key assumptions. The Society's exposure to life insurance risk is materially consistent with that of the Group.

Sensitivity analysis for the change in assumptions used in long-term insurance and investment contract liabilities	Impact on Profit before tax, mutual bonus and UDS transfer	Impact on the Unallocated divisible surplus
	£m	£m
Increase in mortality rates by 10% – Non annuity products	(8)	(8)
Decrease in mortality rates by 10% – Annuity products	(25)	(25)
Increase in morbidity rates by 10%	(25)	(25)
Increase in persistency by 25%	8	8
Decrease in OB pensions cash take-up rates by 50%	(70)	(70)
Increase in expenses by 10%	(46)	(46)

The impact of an adverse or favourable movement in the assumptions is largely symmetric. The persistency sensitivity is performed as stresses to the persistency assumptions proportionally for all products and therefore implicitly allows for offsets between products exposed to different directional sensitivities.

#### (ii) General insurance

For 2018 reporting the General insurance business has been classified as a discontinued operation and the related assets and liabilities have been separately categorised on the Statement of Financial Position as "Assets held for sale" and "Liabilities directly associated with assets held for sale". For further details see Note 12.

The Group's insurance activities are primarily concerned with the pricing, acceptance and management of risks from its policyholders. In accepting risks the Group commits to paying claims and therefore these risks must be understood. The Group manages these risks through its underwriting strategy, reinsurance arrangements and proactive claims handling.

For a portfolio of insurance contracts where the theory of probability is applied to pricing and provisioning, the main risk that the Group faces under its insurance contracts is the risk that actual claims exceed the carrying value of the Group's claims reserves. The risk arises from the inherent uncertainties as to the occurrence, amount and timing of insurance claims. For general insurance contracts this is primarily represented by exposure to risks which may lead to significant claims in terms of frequency or value. These would include major weather events, subsidence and large single claims arising from either the motor business (injury claims) or Small and Medium Size Enterprise ('SME') business (liability and/or property claims). There is also a risk that the prices charged for unexpired risks to which the Group is contractually committed may prove to be insufficient to absorb the cost of the claims which they will generate and any related deferred acquisition cost. Procedures are in place to measure, monitor and control exposure to all these risks.

#### General insurance concentration

The table below sets out the Group's concentration of general insurance contract liabilities by type of contract:

	2018			2017		
	Gross £m	Reinsurance £m	Net £m	Gross £m	Reinsurance £m	Net £m
Motor	1,204	(388)	816	1,349	(439)	910
Commercial	245	(66)	179	230	(70)	160
Household	74	(20)	54	54	(24)	30
Other	5	(1)	4	10	(10)	—
	1,528	(475)	1,053	1,643	(543)	1,100

#### Reinsurance

Motor business is exposed to the risk of large bodily injury claims, where the claim amounts can be significant due to the cost of care required for the claimant. The Group has excess of loss reinsurance contracts which reduce its exposure to large claims. The Group's retention is £5m per claim (2017: £5m per claim).

Property business (domestic and commercial) is exposed to catastrophic risks such as those resulting from storms or floods as well as risks such as subsidence. The Group has reinsurance contracts which provide protection against catastrophic weather events.

SME business, which has now ceased to be sold, is exposed to large individual property losses and also to liabilities arising from employment and commercial activities. The Group has reinsurance contracts which provide protection against these liabilities.

In addition to the reinsurance contracts described above, the Group also has entered into a Loss Portfolio Transfer Agreement resulting in reinsurance of 20% of its booked general insurance reserves as at 31 December 2015. The Group has also historically entered into a 20% Quota Share reinsurance arrangement for 2016 to 2018 (each year treated separately). Similarly, an additional 20% Quota Share arrangement has been entered into for 2019. Whilst the primary driver of these transactions was efficient capital management, the contracts also have the effect of reducing the Group's exposure to general insurance concentration risk.

## Notes to the Financial Statements (continued)

Year ended 31 December 2018

### 4. Risk management and control (continued)

#### Claims development

The claims provision is the estimated cost of outstanding claims from expired risks. The provision is calculated largely from using the Group's historic claims development data.

How much the past claim development will reflect future claims development will be impacted by the following factors:

- Changes in actuarial processes and methodology.
- Changes in risk profile.
- Changes in underwriting, rating and policy conditions.
- Changes in legislation and regulation e.g. PPOs, Ministry of Justice reforms, changes to the Ogden discount rate, etc.
- Changes to internal operational processes.
- Changes in other external factors e.g. 'claims farming' / accident management firms.

It is therefore important that the impact of these items on claims development is understood. Whilst every effort has been made to ensure the claims provision appropriately allows for such changes, there remains uncertainty in the eventual outcome as a result. This uncertainty can change from year to year depending on the timing and magnitude of these items.

The Group has identified the major uncertainties surrounding the future development of claims and where appropriate these have been allowed for explicitly. An additional provision is held within the claims provision in order to cover the uncertainty around further fluctuations in claim development with a given degree of confidence.

The Group's reserves are particularly susceptible to potential retrospective changes in legislation and new court decisions, both positively and adversely. An example of such would be a change in the Ogden discount rate. This is the discount rate set by the relevant government bodies and used by courts to calculate lump sum awards in personal injury cases.

Uncertainty in claims estimation is more significant for large personal injury claims on both a lump sum and a PPO basis, which for the latter include annually indexed payments that are typically made over the lifetime of the injured party. Claims reserves for PPOs are held on a discounted basis and are sensitive to changes in this discount benefit. Large lump sum personal injury claims are heavily exposed to the Ogden Discount rate.

On 20 December 2018 the Civil Liability Bill received Royal Assent and is thus the Civil Liability Act, with a revised Ogden Discount Rate expected to be announced in the summer of 2019. The Act should ensure a more proportional rate is applied to lump sum settlements for personal injury claims as well as providing a framework for future reviews to the rate. Whilst the revised rate is not yet known the Group anticipates an increase from the current legislative rate of -0.75%, with the best estimate reserves being held at the equivalent of a 0% Ogden Discount Rate.

The table below provides a sensitivity analysis of the potential impact of a change on a discounting basis for PPO claims and changes to the Ogden discount rate for lump sum settlements on large personal injury claims. The sensitivities allow for a change in the single factor with all other assumptions left unchanged. Other potential risks beyond the ones described in the table could have an additional financial impact on the Group.

	Increase/(decrease) in Profit before tax, mutual bonus and UDS transfer		Increase/(decrease) in Unallocated divisible surplus	
	2018 £m	2017 £m	2018 £m	2017 £m
<b>Periodic Payment Orders (PPOs)</b>				
Impact of a 1% increase in the discount rate used to value PPOs	10	*	8	*
Impact of a 1% reduction in the discount rate used to value PPOs	(14)	*	(11)	*
<b>Lump sum personal injury settlements</b>				
Impact of the Ogden discount rate moving to +0.5% p.a.	21	*	17	*
Impact of the Ogden discount rate moving to -0.5% p.a.	(25)	*	(20)	*

1 The PPO sensitivity relating to an increase or decrease in the discounting basis used for valuing such claims, illustrating a movement in the time value of money on a net of reinsurance basis.

2 The Ogden discount rate sensitivities provides clarity of the impact on the claims provision if the discount rate were to increase beyond the best estimate assumption of 0% up to 0.5% or down to -0.5%.

3 The selection of these sensitivities should not be interpreted as a prediction.

\* 2017 comparative not available.

## Notes to the Financial Statements (continued)

Year ended 31 December 2018

### 4. Risk management and control (continued)

#### Analysis of general insurance claims development

The tables below reflect the cumulative incurred claims including both claims notified and incurred but not reported ('IBNR') for each successive accident year at each Statement of Financial Position date, together with the cumulative payments to date. The Group aims to maintain appropriate reserves in order to protect against adverse future claims experience and developments.

Analysis of claims development – gross of reinsurance	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Total
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
Initial estimate of gross provision	607	773	909	1,089	1,077	1,051	1,049	1,148	1,124	1,221	
One year later	589	825	915	1,042	1,015	1,000	1,100	1,089	1,082		
Two years later	589	841	902	1,018	999	982	1,070	1,042			
Three years later	588	835	895	992	986	968	1,008				
Four years later	603	825	892	981	998	937					
Five years later	599	829	876	999	952						
Six years later	598	830	892	984							
Seven years later	577	843	888								
Eight years later	578	842									
Nine years later	581										
<b>Current estimate of cumulative claims</b>	<b>581</b>	<b>842</b>	<b>888</b>	<b>984</b>	<b>952</b>	<b>937</b>	<b>1,008</b>	<b>1,042</b>	<b>1,082</b>	<b>1,221</b>	<b>9,537</b>
Cumulative payments to date	(576)	(799)	(871)	(956)	(886)	(879)	(883)	(852)	(758)	(629)	(8,089)
Liability recognised in the Statement of Financial Position for 2009 to 2018 accident years	5	43	17	28	66	58	125	190	324	592	1,448
Liability recognised in the Statement of Financial Position in respect of prior accident years											63
Claims handling provision											17
<b>Gross general insurance claims liabilities as at 31 December 2018</b>											<b>1,528</b>

Analysis of claims development – net of reinsurance	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Total
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
Initial estimate of net provision	584	764	899	1,063	1,057	1,039	916	1,002	838	936	
One year later	578	805	899	1,024	995	934	1,008	836	831		
Two years later	565	821	893	1,003	943	923	939	817			
Three years later	562	808	888	964	937	918	890				
Four years later	577	798	874	955	947	885					
Five years later	570	797	863	964	903						
Six years later	566	791	869	952							
Seven years later	560	798	868								
Eight years later	559	807									
Nine years later	562										
<b>Current estimate of cumulative claims</b>	<b>562</b>	<b>807</b>	<b>868</b>	<b>952</b>	<b>903</b>	<b>885</b>	<b>890</b>	<b>817</b>	<b>831</b>	<b>936</b>	<b>8,451</b>
Cumulative payments to date	(559)	(792)	(860)	(937)	(859)	(840)	(798)	(676)	(608)	(499)	(7,428)
Liability recognised in the Statement of Financial Position for 2009 to 2018 accident years	3	15	8	15	44	45	92	141	223	437	1,023
Liability recognised in the Statement of Financial Position in respect of prior accident years											13
Claims handling provision											17
<b>Net general insurance claims liabilities as at 31 December 2018</b>											<b>1,053</b>

## Notes to the Financial Statements (continued)

Year ended 31 December 2018

### 4. Risk management and control (continued)

#### b) Financial markets risk

As a result of the insurance, investment and retirement products offered to policyholders the Group is exposed to financial markets through the investment of premiums and investment lump sums in various investment assets such as equities, gilts, corporate bonds and property.

Financial markets risk is defined as the risk that arises from adverse fluctuations or increased volatility in asset values, asset income or interest rates. This includes credit spread widening. The Group manages these risks through aligning the investment strategy, asset allocation and performance benchmarks with the Group's risk appetite and utilising asset liability matching and stochastic modelling techniques. These actions aim to match the risks arising from the liabilities under the Group's insurance and investment contracts with the risks inherent in its assets and the capital available to ensure the Group is able to meet policyholder commitments when they fall due and to achieve a sufficient return for members.

In addition to the actions summarised above the Group may also look to use derivative instruments particularly to assist in hedging policyholder guaranteed options and, where cost effective, to transfer risks it believes are either unrewarded or which it believes can be better managed by a third party. For example, derivatives are used to reduce exposure to fluctuations in interest rates, exchange rates and for efficient portfolio management purposes. The main derivatives used for this function are interest rate contracts (including interest rate swaps and options), forward foreign exchange contracts and equity derivatives (index futures and options) respectively. The Group does not hold derivatives for investment purposes, they are held purely as a risk management technique to manage financial market risk exposures within its investment holdings (see Note 15 on how these are used).

The investment management agreement between the Group and Columbia Threadneedle Investments specifies the limits for holdings in certain asset categories and currencies. Asset allocation and performance benchmarks are set, which ensure that each fund has an appropriate mix of assets and is not over or under exposed to a particular asset category, currency or specific investment. The Funds Management Group monitors the actual asset allocation and performance against benchmarks with oversight provided by Group ALCO and the Investment Committee.

The Group is not exposed to financial markets risk in respect of assets held to cover unit linked liabilities as these risks are borne by the holders of the contracts concerned, except to the extent that income from the fund based management charges levied on these contracts varies directly with the value of the underlying assets. Such assets are, however, prudently managed in order to meet policyholders' risk and reward expectations. In addition, regulatory requirements prescribe the type and quality of assets that can be held to support these liabilities.

The key types of financial markets risk to which the Group is exposed are set out in more detail in the following paragraphs. Sensitivities to key market risks are shown on page 120.

#### (i) Asset performance risk

Asset performance risk is the risk that the fair value or future cash flows of an asset or liability will fluctuate because of changes in market prices, other than those arising from interest rate or currency risks.

The Group is primarily exposed to asset performance risk arising from its investment in equities, property, gilts and corporate bonds.

#### Equity price risk

The Group is exposed to equity price risk from daily fluctuations in the market values of the equity portfolio. These assets are used to support contractual liabilities arising from investment and long-term insurance contracts. For investment and long-term linked insurance contracts the price movements are matched with corresponding movements in contractual obligations. For participating insurance contracts the aim is to achieve growth in excess of the obligations. For general insurance contracts, equities are held to achieve an investment return. Decreases in the market price of equities will negatively impact the profits and capital of the Group. The risks from investing in equities are managed by investing in a diverse portfolio of high quality securities ensuring that holdings are diversified across industries and concentrations in any one company or industry are limited by parameters established by the Investment Committee. In addition, the Group may use derivatives to reduce the level of equity price risk.

#### Property price risk

The Group is subject to property price risk due to its exposure to the residential and commercial property market through its equity release and commercial mortgage products, where sustained underperformance in property prices could result in proceeds on sale being exceeded by the mortgage debt at the date of redemption (see Note 14 for disclosures relating to loans secured on residential and commercial property). This risk is managed through limits on the maximum loan to value ratio and seeking to limit concentrations in particular geographic areas. In addition, monitoring of actual experience in house prices versus expected is undertaken.

#### Corporate bond price risk (Credit spread risk)

The credit spread risk represents the risk of adverse fluctuation in the values of assets and liabilities due to changes in the level of corporate bond credit spreads.

A widening in credit spreads, over and above risk-free yields, causes bond values to decrease. There is a partial offset where the value of certain insurance liabilities fall in value but the overall impact on IFRS profits is negative. Conversely a narrowing of credit spreads results in a positive impact on IFRS profits. The Group monitors credit spread risk by regularly reviewing its exposure to corporate bonds by sector (e.g. financial or non-financial), credit rating and duration and through its asset and liability matching tools.



## Notes to the Financial Statements (continued)

Year ended 31 December 2018

### 4. Risk management and control (continued)

#### (ii) Interest rate risk

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

Interest rate risk arises primarily from the Group's investments in long-term debt and fixed income securities and their movement relative to the value placed on the insurance liabilities. A number of products sold by the Group have features that influence the Group's exposure to interest rate risk. These features include guaranteed surrender values, guaranteed annuity options and minimum surrender and maturity values, which can lead to the present value of claims being higher than the value of the backing assets, when interest rates change.

The Group manages interest rate risk by investing in fixed income securities which closely match the interest rate sensitivity of the liabilities, where such investments are available. The Group also makes use of derivatives in addition to physically held assets to manage the interest rate exposure resulting from the liabilities. The Group manages its exposure on both an IFRS basis and a regulatory capital basis under Solvency II, and currently focuses on regulatory capital. These derivatives are principally interest rate swaps and swaptions.

Exposure to interest rate risk is monitored using several techniques, including scenario testing, stress testing and asset liability duration control.

#### (iii) Investment concentration

Investment concentration risk arises through exposure to particular asset types, geographical markets, industry sectors, groups of business undertakings or similar activities. The Group may suffer losses in the investment portfolio as a result of over exposure to particular sectors engaged in similar activities or similar economic features that would cause their ability to meet contractual obligations to be similarly affected by changes in economic, political and other conditions. The Group's trading activities are UK-based and associated insurance and investment contract liabilities are impacted by the UK marketplace and hence there is a high concentration in corresponding matching UK investment assets.

The Group invests in a portfolio of assets and seeks to maximise portfolio expected return for a given amount of portfolio risk, or equivalently minimise risk for a given level of expected return, by carefully choosing the proportions of various assets. The Investment Committee sets the Group's investment strategy and recommends to the Board the policy and limits required. Responsibility for implementation is delegated to the Chief Investment Officer, with day to day investment activities being undertaken by the Group's investment manager, Columbia Threadneedle Investments.

The Funds Management Group monitors the actual asset allocation and performance against benchmarks with oversight provided by Group ALCO and the Investment Committee.

#### Eurozone exposure

The table below shows the Group's exposure by country of incorporation of the counterparty at 31 December 2018. The Society's exposure to Eurozone risk is materially consistent with that of the Group.

	2018			2017		
	Sovereign £m	Non Sovereign £m	Total £m	Sovereign £m	Non Sovereign £m	Total £m
Italy	—	30	30	—	35	35
Spain	—	64	64	—	49	49
Other Eurozone	124	1,378	1,502	327	1,068	1,395
Total	124	1,472	1,596	327	1,152	1,479

The Group's combined exposure to Greece, Cyprus and Portugal is £1m (2017: £1m). Non-sovereign exposure includes £88m (2017: £102m) of subordinated debt.

## Notes to the Financial Statements (continued)

Year ended 31 December 2018

### 4. Risk management and control (continued)

#### (iv) Foreign currency risk

The Group predominantly operates within the UK and is therefore not significantly exposed to currency exposures within its normal trading activities. However, the Group's investment strategy and policies allow for a limited level of investment in overseas markets, via both equities and fixed interest securities. The main currency exposures here are to the Euro and US dollar.

The risk to the Group is that the fair value or future cash flows of an overseas investment asset will change as a result of changes in foreign exchange rates. Currency risk is managed by the use of exposure limits and authorisation controls operated within the Group's risk management framework.

The table below summarises the Group's exposure, after hedging, to foreign currency exchange risk in sterling.

	2018			2017		
	Euro £m	US Dollar £m	Total £m	Euro £m	US Dollar £m	Total £m
Derivatives	—	(2)	(2)	—	(1)	(1)
Equity securities	5	123	128	13	122	135
Cash and cash equivalents	12	4	16	13	5	18
	<b>17</b>	<b>125</b>	<b>142</b>	<b>26</b>	<b>126</b>	<b>152</b>

The Society's exposure to foreign currency risk in 2018 amounted to £5m Euros and £125m US dollars (2017: £14m Euros and £126m US dollars).

A strengthening of the value of sterling against the foreign currency (increase in exchange rates), in which the investment asset is denominated, will lead to a devaluation of the asset value and any associated income flows. A weakening of the value of sterling against the foreign currency will have the reverse impact.

The sensitivity of investment assets to a 10% increase/decrease in Euro and US Dollar exchange rates, net of derivatives, is £2m (2017: £3m) and £13m (2017: £13m) respectively. In determining the percentage rates to use in this sensitivity the movements in the actual market rates of Euro and US Dollars during 2018 were taken into account. The above table incorporates all material currency risk to Profit before tax. Therefore, a 10% increase/decrease across all currencies could impact Profit before tax by up to £14m (2017: £15m).

Some foreign debt securities are denominated in sterling so bear no direct currency risk and have not been included within the above table.

#### (v) Summary of market risk sensitivities

The table below sets out the impact on Profit before tax and the Unallocated divisible surplus for movements in sectors of the market that the Group is invested in, net of derivatives, excluding the Group's defined benefit pension schemes. Explanation of the movements, and where the sensitivity for the Society is materially different to the Group, are provided below.

In determining the percentage rates to use in the sensitivity analysis reference has been made to those used for internal reporting within the Group. Where sensitivities have not been produced in both directions, the impact of the sensitivity in the other direction is materially consistent with the sensitivity provided.

	2018		2017	
	Impact on Profit before tax, mutual bonus and UDS transfer £m	Impact on the Unallocated divisible surplus £m	Impact on Profit before tax, mutual bonus and UDS transfer £m	Impact on the Unallocated divisible surplus £m
<b>Sensitivity analysis to movements in key market sectors</b>				
Equity values fall by 20%	(60)	(26)	(69)	(34)
Property values fall by 12.5%	(12)	(7)	(17)	(12)
Credit spreads increase by 100bps relative to swap yields	(82)	(74)	(89)	(83)
Government Bond spreads increase by 50bps relative to swap yields	(22)	(14)	(16)	(7)
Fixed interest yields fall by 50bps	30	13	38	20
Fixed interest yields increase by 100bps	(56)	(28)	(64)	(35)

Market sensitivities remain in line with last year with moderate reductions in exposures across most risks. Consistent with last year, the aim of the LVFS interest rate hedging strategy is to stabilise Solvency II post-TMTP surplus, including capital requirements. In particular, the assets used to hedge the regulatory capital requirement exposure to interest rates materially affect the interest sensitivity on an IFRS basis, with no offsetting capital movement to counteract the movements in the assets.

## Notes to the Financial Statements (continued)

Year ended 31 December 2018

### 4. Risk management and control (continued)

#### (v) Summary of market risk sensitivities (continued)

In addition, the general insurance business hedging strategy was updated over the year, where its holding of interest rate swaps were closed and replaced with longer duration corporate bond and gilts to better match its PPO exposure, increasing the Group's exposure to credit and government bond spreads relative to swap yields. However, the credit spread relative to swaps sensitivity reduced in aggregate over the year due to changes in the exposure of the non-profit annuity portfolio.

Asset values and, where appropriate, asset share changes are reflected in each sensitivity. With-profits future policy related liabilities are recalculated using these revised values and, where appropriate, economic scenarios generated by an asset model calibrated to the revised risk-free rate.

#### (vi) Fair value estimation

The following fair value estimation tables present the Group's and Society's assets and liabilities measured at fair value by level of the fair value measurement hierarchy at 31 December 2018.

##### Level 1 – quoted prices

The fair value of financial instruments included in the Level 1 category is based on the value within the bid-ask spread that is most representative of fair value quoted in an active market at the year-end date. An instrument is regarded as quoted in an active market if quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service or regulatory agency and those prices represent actual and regularly occurring market transactions on an arm's length basis.

##### Level 2 – observable inputs

Level 2 financial instruments are not traded in an active market and their fair value is determined using valuation techniques. These valuation techniques maximise the use of data from observable current market transactions (where it is available) using pricing obtained via pricing services, even where the market is not active. It also includes financial assets with prices based on broker quotes.

Specific valuation techniques used to value financial instruments classified as Level 2 include:

- Derivatives are valued by discounted cash flow techniques, using observable yield curves and models such as Black Scholes using implied market forward rates and volatilities.
- Units in listed investment funds are valued using quoted prices from external pricing services.
- Debt securities are valued using quoted prices from external pricing services.
- Loans secured on commercial property are valued using discounted cash flows to reflect changes in underlying gilt yields and debt margins.
- Non-participating investment contract liabilities are valued on a basis consistent with the underlying assets in the investment fund.

##### Level 3 – significant unobservable inputs

If one or more of the significant inputs is not based on observable market data, the instrument is included in Level 3.

Specific valuation techniques used to value financial instruments and other financial investments held at fair value classified as Level 3 include:

- Private equity holdings are valued on a net asset value basis using unobservable external unit prices factoring in distributions or calls since the latest valuations. The private equity valuations are reviewed on a monthly basis by group treasury to ensure ongoing validity and accuracy.
- The fair value of the loans secured on residential property is determined using discounted cash flow projections. The expected value of redemptions are estimated based on the assumed prepayments over future time periods (months), mortality and long-term care entry rates including any early redemption charges. The expected redemptions are discounted at swap rates plus spread plus allowances for risk factors, liquidity and profit deferral. The full swap curve is used so each discount rate is matched to the appropriate cash flow. The risk factors in the discount rate are an allowance for the 'No Negative Equity Guarantee' provided to the policyholder with the loan, the value of which depends on the projection of the underlying property value and how this compares to the projected loan value. The assumptions used for prepayment, mortality and long-term care are based on the experience of the in-force book supported by industry data. The valuation is performed by the asset reporting team and reviewed by the Actuarial Asset Reporting Manager. The assumptions are set by the Board upon recommendation by the Audit Committee.

There were no changes to the valuation techniques during the year. There were no transfers between Levels 1 and 2 during the year.

The Group's policy is to recognise transfers into and out of fair value hierarchy levels as at the date of the event or change in circumstances that caused the transfer.

The valuation of all of the Group's investment holdings is performed by independent and qualified valuers.

Any changes to fair value are recognised within net gains/losses on investments within the Statement of Comprehensive Income with the exception of investment contract liabilities where the movement is recognised within the Gross change in contract liabilities. Details of these gains/losses are disclosed within Notes 7 and 22 respectively.

## Notes to the Financial Statements (continued)

Year ended 31 December 2018

## 4. Risk management and control (continued)

Group	2018				2017			
	Level 1 £m	Level 2 £m	Level 3 £m	Total fair value £m	Level 1 £m	Level 2 £m	Level 3 £m	Total fair value £m
<b>Financial assets</b>								
<b>Derivative financial instruments</b>								
Interest rate swaps	-	52	-	52	-	69	-	69
Gilt forwards	-	3	-	3	-	4	-	4
Swaptions	-	-	-	-	-	-	1	1
Equity/index derivatives	-	10	-	10	-	7	-	7
	-	65	-	65	-	80	1	81
<b>Financial assets held at fair value through income</b>								
Shares, other variable yield securities and units in unit trusts								
- UK listed	1,244	5,511	-	6,755	1,973	5,656	-	7,629
- UK unlisted	-	-	78	78	-	-	91	91
- Overseas listed	108	-	-	108	117	-	-	117
- Overseas unlisted	-	-	33	33	-	-	42	42
Debt and other fixed income securities								
- UK listed	923	1,590	-	2,513	1,179	1,853	-	3,032
- Overseas listed	70	1,112	-	1,182	77	1,995	-	2,072
Loans secured on residential property	-	-	648	648	-	-	667	667
Loans secured on commercial property	-	221	-	221	-	200	-	200
Other	-	-	-	-	-	3	-	3
	2,345	8,434	759	11,538	3,346	9,707	800	13,853
<b>Assets held for sale</b>	235	1,514	-	1,749	-	-	-	-
	2,580	10,013	759	13,352	3,346	9,787	801	13,934
<b>Financial liabilities</b>								
<b>Non-participating investment contract liabilities</b>	-	3,017	-	3,017	-	3,071	-	3,071
<b>Derivative financial instruments</b>								
Cash flow swaps	-	184	-	184	-	186	-	186
Interest rate swaps	-	2	-	2	-	4	-	4
Gilt forwards	-	4	-	4	-	-	-	-
Equity/index derivatives	-	-	-	-	3	-	-	3
	-	190	-	190	3	190	-	193
	-	3,207	-	3,207	3	3,261	-	3,264

## Notes to the Financial Statements (continued)

Year ended 31 December 2018

### 4. Risk management and control (continued)

Society	2018				2017			
	Level 1 £m	Level 2 £m	Level 3 £m	Total fair value £m	Level 1 £m	Level 2 £m	Level 3 £m	Total fair value £m
<b>Financial assets</b>								
<b>Derivative financial instruments</b>								
Interest rate swaps	–	52	–	52	–	68	–	68
Gilt forwards	–	3	–	3	–	4	–	4
Swaptions	–	–	–	–	–	–	1	1
Equity/index derivatives	–	10	–	10	–	7	–	7
	–	65	–	65	–	79	1	80
<b>Financial assets held at fair value through income</b>								
Shares, other variable yield securities and units in unit trusts								
– UK listed	1,055	5,510	–	6,565	1,309	5,535	–	6,844
– UK unlisted	–	–	78	78	–	–	91	91
– Overseas listed	108	–	–	108	112	–	–	112
– Overseas unlisted	–	–	33	33	–	–	42	42
Debt and other fixed income securities								
– UK listed	911	1,588	–	2,499	1,166	1,495	–	2,661
– Overseas listed	70	1,112	–	1,182	77	1,178	–	1,255
Loans secured on residential property	–	–	648	648	–	–	667	667
Loans secured on commercial property	–	221	–	221	–	200	–	200
Other	–	–	–	–	–	3	–	3
	2,144	8,431	759	11,334	2,664	8,411	800	11,875
	2,144	8,496	759	11,399	2,664	8,490	801	11,955
<b>Financial liabilities</b>								
<b>Non-participating investment contract liabilities</b>	–	3,017	–	3,017	–	3,071	–	3,071
<b>Derivative financial instruments</b>								
Cash flow swaps	–	184	–	184	–	186	–	186
Interest rate swaps	–	2	–	2	–	–	–	–
Gilt forwards	–	4	–	4	–	–	–	–
Equity/index derivatives	–	–	–	–	1	–	–	1
	–	190	–	190	1	186	–	187
	–	3,207	–	3,207	1	3,257	–	3,258

## Notes to the Financial Statements (continued)

Year ended 31 December 2018

## 4. Risk management and control (continued)

The table below presents the movements in Level 3 financial instruments for the year ended 31 December 2018.

Group	At 1 January 2018 £m	Total gains/ (losses) recognised through income £m	Purchases £m	Sales £m	At 31 December 2018 £m	Unrealised gains/(losses) recognised through income in 2018 £m
<b>Financial assets</b>						
<b>Derivative financial instruments</b>						
Swaptions	1	–	–	(1)	–	–
	1	–	–	(1)	–	–
<b>Financial assets held at fair value through income</b>						
Shares, other variable yield securities and units in unit trusts						
– UK unlisted	91	(13)	–	–	78	(13)
– Overseas unlisted	42	(1)	–	(8)	33	3
Loans secured on residential property*	667	(6)	32	(45)	648	–
	800	(20)	32	(53)	759	(10)
	801	(20)	32	(54)	759	(10)

Group	At 1 January 2017 £m	Total gains/ (losses) recognised through income £m	Purchases £m	Sales £m	At 31 December 2017 £m	Unrealised gains/(losses) recognised through income in 2017 £m
<b>Financial assets</b>						
<b>Derivative financial instruments</b>						
Swaptions	1	–	–	–	1	–
	1	–	–	–	1	–
<b>Financial assets held at fair value through income</b>						
Shares, other variable yield securities and units in unit trusts						
– UK unlisted	120	(7)	–	(22)	91	(3)
– Overseas unlisted	55	(8)	1	(6)	42	(10)
Loans secured on residential property*	685	5	35	(58)	667	–
	860	(10)	36	(86)	800	(13)
	861	(10)	36	(86)	801	(13)

\* In relation to Loans secured on residential property, purchases represent loans advanced plus accrued interest and sales represent loans repaid.

## Notes to the Financial Statements (continued)

Year ended 31 December 2018

## 4. Risk management and control (continued)

Society	At 1 January 2018 £m	Total gains/ (losses) recognised through income £m	Purchases £m	Sales £m	At 31 December 2018 £m	Unrealised gains/(losses) recognised through income in 2018 £m
<b>Financial assets</b>						
<b>Derivative financial instruments</b>						
Swaptions	1	–	–	(1)	–	–
	1	–	–	(1)	–	–
<b>Financial assets held at fair value through income</b>						
Shares, other variable yield securities and units in unit trusts						
– UK unlisted	91	(13)	–	–	78	(13)
– Overseas unlisted	42	(1)	–	(8)	33	3
Loans secured on residential property*	667	(6)	32	(45)	648	–
	800	(20)	32	(53)	759	(10)
	801	(20)	32	(54)	759	(10)

Society	At 1 January 2017 £m	Total gains/ (losses) recognised through income £m	Purchases £m	Sales £m	At 31 December 2017 £m	Unrealised gains/(losses) recognised through income in 2017 £m
<b>Financial assets</b>						
<b>Derivative financial instruments</b>						
Swaptions	1	–	–	–	1	–
	1	–	–	–	1	–
<b>Financial assets held at fair value through income</b>						
Shares, other variable yield securities and units in unit trusts						
– UK unlisted	120	(7)	–	(22)	91	(3)
– Overseas unlisted	54	(7)	1	(6)	42	(10)
Loans secured on residential property*	684	6	35	(58)	667	–
	858	(8)	36	(86)	800	(13)
	859	(8)	36	(86)	801	(13)

\* In relation to Loans secured on residential property, purchases represent loans advanced plus accrued interest and sales represent loans repaid.

## Notes to the Financial Statements (continued)

Year ended 31 December 2018

## 4. Risk management and control (continued)

## Information about fair value measurements using significant unobservable inputs (Level 3)

Included below are the significant unobservable inputs that impact the valuation of the material level 3 assets and liabilities for the Group, these apply equally to the Society.

Group	Fair value at 31 December 2018 £m	Fair value at 31 December 2017 £m	Valuation technique(s)	Unobservable inputs	Range of unobservable inputs (probability – weighted average)	Relationship of unobservable inputs to fair value
<b>Financial assets</b>						
<b>Derivative financial instruments</b>						
Swaptions	–	1	Mark-to-model	Interest rate volatility	Could be several percentage points	Higher interest rate volatility results in higher contract value.
	–	1				
<b>Financial assets held at fair value through income</b>						
Shares, other variable yield securities and units in unit trusts						
– UK unlisted	78	91	Adjusted net asset method	Price per unit	Could vary significantly due to the range of holdings	The higher the price per unit, the higher the fair value.
				Distributions or calls since last valuation	Could vary significantly due to the range of holdings	The fair value varies on distributions/calls and period since last valuation.
– Overseas unlisted	33	42	Adjusted net asset method	Price per unit	Could vary significantly due to the range of holdings	The higher the price per unit, the higher the fair value.
				Distributions or calls since last valuation	Could vary significantly due to the range of holdings	The fair value varies on distributions/calls and period since last valuation.
Loans secured on residential property	648	667	Discounted cash flow	Spread	Varies based on cohorts of loans	The spread (together with the underlying risk free yield curve) forms the discount rate used to value the cashflows.
				Prepayments	Varies by policy year: min 3.2% – max 11.8%	Prepayment rate will determine the profile of expected cashflows.
				Mortality and long-term care assumptions	Annuitant mortality tables are applied	Mortality and long- term care rate will determine the profile of expected cashflows.
	759	800				
	759	801				



## Notes to the Financial Statements (continued)

Year ended 31 December 2018

### 4. Risk management and control (continued)

#### Sensitivity to changes in unobservable inputs (Level 3)

The only financial instrument which is significantly impacted by reasonably possible changes in unobservable inputs is the loans secured on residential property. The loans secured on residential property are sensitive to changes in discount rate spread, which includes the profit and liquidity premium as well as the No Negative Equity Guarantee risk allowance.

The impact of reasonably possible alternative assumptions is shown in the table below:

Description	Unobservable input	2018			2017		
		Reasonably possible alternative assumptions			Reasonably possible alternative assumptions		
		Current fair value	Increase in fair value	Decrease in fair value	Current fair value	Increase in fair value	Decrease in fair value
		£m	£m	£m	£m	£m	£m
Loans secured on residential property	Discount rate +/- 50bps	648	28	(26)	667	33	(30)

#### c) Credit counterparty risk

Credit counterparty risk (credit risk) is defined as the risk of loss if another party fails to perform its obligations or fails to perform them in a timely fashion. Exposure to credit risk may arise in connection with a single transaction or an aggregation of transactions (not necessarily the same type) with a single counterparty.

The Group encounters credit counterparty risk from different sources, firstly within the business activities associated with its insurance, investment and retirement products and secondly in the financial assets held in the Group's investment portfolio.

Credit counterparty risk is managed via a Group policy and risk limits covering aspects such as total exposure, and concentration. Group counterparty exposures are monitored by Group ALCO, with ultimate oversight of risk being undertaken by the Risk Committee.

The main credit counterparty risks within the Group are as follows:

##### Investment counterparties

The key other source of credit risk arises from the assets held in the investment portfolio. The risk is that the investment counterparty enters financial difficulties and the fair value of the asset diminishes or the income stream is not paid; alternatively the counterparty becomes insolvent and the value of the asset is written off.

The investment portfolio contains a range of assets, including equities, corporate bonds and other fixed income securities and cash deposits. The credit counterparty risk policy stipulates approved counterparties, permitted investments and geographical territories, as well as detailing specific asset class exposure limits. These are implemented within the investment management agreement with Columbia Threadneedle Investments. The policy and agreements also require that asset holdings are within regulatory limits that restrict excessive concentrations with individual counterparties or with particular asset classes. In order to minimise its exposure to credit risk the Group invests primarily in higher graded assets, rated BBB and above.

In addition, the Group uses derivatives to transfer elements of financial markets risk exposures. Where possible, significant counterparty exposures from over-the-counter derivatives are mitigated by the use of collateral. The fair value of the derivative is matched by collateral received from the counterparty, which increases or reduces in line with the contract's fair value. The collateral can be sold or re-pledged by the Group and is repayable if the contract terminates or the contract's fair value decreases. Details of collateral received and pledged is included within the offsetting disclosure on page 129.

##### Loans secured on residential and commercial property

The retirement business provides residential and commercial mortgage lending and is exposed to credit risk arising from mortgage loans provided. This risk is managed by using the property as security against the loan, assessment of the risk and maintaining a low loan to value ratio. Aberdeen Standard Investments have replaced AgFe as the Group's mandated originator and asset manager for new commercial mortgages, and use their considerable expertise to source and underwrite loan prospects. AgFe continue to work with LV= in the ongoing management of the existing commercial mortgages which they previously sourced.

Note 14 provides further disclosure and provisions for 'No Negative Equity Guarantees' on equity release mortgages.

##### Reinsurance counterparties

Reinsurance agreements are entered into to transfer an element of potential insurance risk exposure from contract liabilities. This does not, however, discharge the Group's liability as primary insurer. If a reinsurer fails to pay a reinsurance claim, the Group remains liable for the payment to the policyholder. To manage this exposure the creditworthiness of reinsurers is considered by reviewing their financial strength prior to finalisation of any contract, which is then regularly reviewed. In addition, collateral is held to manage the counterparty exposure to the reinsurer.

##### Reinsurance concentration risk

Reinsurance concentration risk is minimised through contracting with a diverse range of reinsurance counterparties with credit ratings within our risk appetite. Reinsurance concentration risk is managed through reviewing the credit rating of reinsurance counterparties and exposure limits.

## Notes to the Financial Statements (continued)

Year ended 31 December 2018

### 4. Risk management and control (continued)

#### Insurance receivables

Insurance sales expose the Group to credit risk from policyholders and intermediaries for outstanding premiums. The creditworthiness of the intermediaries is assessed and credit limits are used to manage any potential concentration risk associated with individual counterparties.

*The creditworthiness of policyholders who take out premium finance on general insurance products is assessed at the time of sale and outstanding premiums are monitored and collected via a dedicated budget accounts function.*

No further credit risk provision is required in excess of the normal provision for doubtful receivables.

Credit exposures also arise within general insurance, where claims expense recoveries are due from other insurers' policyholders who are at fault for any repairs expense suffered by the Group's policyholders. These exposures are managed via a dedicated recoveries team and an industry wide compensation scheme is in place to provide cover for default by an individual insurer.

The tables below show the credit profile of the Group's assets. The credit risk profile of the Society is materially consistent with that of the Group.

	Neither past due nor impaired						Past due but not impaired £m	Past due and impaired £m	Total £m	
Credit risk exposure 2018	AAA £m	AA £m	A £m	BBB £m	Below BBB £m	Not rated £m				Total £m
Debt and other fixed income securities	343	1,641	984	726	1	–	3,695	n/a	n/a	3,695
Loans secured on residential and commercial property	–	–	–	–	–	869	869	n/a	n/a	869
Derivative assets	–	–	–	–	–	65	65	n/a	n/a	65
Loans and other receivables	–	–	350	–	–	57	407	–	–	407
Reinsurance assets	–	1,728	1	–	–	9	1,738	–	–	1,738
Insurance receivables	–	28	–	–	–	10	38	3	–	41
Cash and cash equivalents	–	131	268	13	–	–	412	n/a	n/a	412
	343	3,528	1,603	739	1	1,010	7,224	3	–	7,227

	Neither past due nor impaired							Past due but not impaired	Past due and impaired	
	AAA	AA	A	BBB	Below BBB	Not rated	Total			Total
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
Credit risk exposure 2017										
Debt and other fixed income securities	578	1,839	1,421	1,150	115	1	5,104	n/a	n/a	5,104
Loans secured on residential and commercial property	–	–	–	–	–	867	867	n/a	n/a	867
Derivative assets	–	–	–	–	–	81	81	n/a	n/a	81
Loans and other receivables	–	–	200	–	–	58	258	–	–	258
Reinsurance assets	–	2,227	73	–	–	5	2,305	–	–	2,305
Insurance receivables	–	18	17	–	–	265	300	7	1	308
Cash and cash equivalents	–	312	517	145	–	–	974	n/a	n/a	974
	578	4,396	2,228	1,295	115	1,277	9,889	7	1	9,897

In addition to amounts disclosed above for 2018, included within Assets held for sale on the Statement of Financial Position are £2,507m of assets exposed to credit risk relating to the general insurance business. Of these £2,251m are investment grade, with the remainder predominantly being Not rated balances due from policyholders.

#### Impairment

The Group reviews the carrying value of its financial assets held at amortised cost at each Statement of Financial Position date. If the carrying value of a financial asset is impaired, the carrying value is reduced through a charge to the Statement of Comprehensive Income.

## Notes to the Financial Statements (continued)

Year ended 31 December 2018

### 4. Risk management and control (continued)

#### Offsetting financial assets and financial liabilities

Financial assets and liabilities are offset in the Statement of Financial Position when the Group intends to apply a current legally enforceable right to offset. Master netting arrangements and collateral are utilised by the Group to minimise credit risk exposure.

The following financial assets and liabilities of the Group are subject to offsetting, enforceable master netting arrangements and similar agreements. The Society's exposure to credit risk associated with offsetting is materially consistent with that of the Group.

An analysis is included of netting arrangements which meet the offsetting criteria within IAS 32 and are set off in the Statement of Financial Position and related amounts which do not meet the criteria.

	Amounts recognised in the Statement of Financial Position			Related amounts not set off in the Statement of Financial Position		
	Gross amount £m	Amounts offset £m	Net amount £m	Financial Instruments* £m	Collateral pledged/ (received) £m	Net amount £m
<b>As at 31 December 2018</b>						
<b>Financial assets</b>						
Derivative financial assets	65	–	65	(2)	(59)	4
	<b>65</b>	<b>–</b>	<b>65</b>	<b>(2)</b>	<b>(59)</b>	<b>4</b>
<b>Financial liabilities</b>						
Derivative financial liabilities	(190)	–	(190)	2	185	(3)
Bank overdrafts	(31)	21	(10)	–	–	(10)
	<b>(221)</b>	<b>21</b>	<b>(200)</b>	<b>2</b>	<b>185</b>	<b>(13)</b>
<b>As at 31 December 2017</b>						
<b>Financial assets</b>						
Derivative financial assets	81	–	81	–	(79)	2
Cash and cash equivalents	24	(21)	3	–	–	3
	<b>105</b>	<b>(21)</b>	<b>84</b>	<b>–</b>	<b>(79)</b>	<b>5</b>
<b>Financial liabilities</b>						
Derivative financial liabilities	(193)	–	(193)	–	192	(1)
Bank overdrafts	(34)	24	(10)	–	–	(10)
	<b>(227)</b>	<b>24</b>	<b>(203)</b>	<b>–</b>	<b>192</b>	<b>(11)</b>

\* Collateral requirements arising from derivatives between the Society and Goldman Sachs are managed on a net basis.

In accordance with IFRS 7 the collateral reported in the table above is limited to the amount reported in the Statement of Financial Position for the associated financial instrument.

Total collateral held by the Group in relation to derivative financial assets is £59m (2017: £79m) and is all cash collateral received (2017: split between cash collateral received of £62m and gilts received of £17m). No collateral received from the counterparty has been sold or repledged (2017: £nil).

Total collateral pledged by the Group is £185m (2017: £196m) and is split between corporate bonds pledged in relation to cash flow swaps of £184m (2017: £186m), and future margin of cash of £1m (2017: future margin of cash of £8m and cash collateral paid of £2m).

Collateral posted to LV= by the counterparty to a derivative contract which is valued as being 'in-the-money' can be drawn upon following certain events of default as defined in the relevant International Swaps and Derivatives Association (ISDA) agreement. This includes failure by the counterparty to comply with or perform any agreement or obligation defined in the ISDA or Credit Support Annex if such failure is not remedied within 30 days after notice of such failure is given. Bankruptcy of the counterparty to a trade could also result in collateral posted being drawn upon to mitigate any financial exposure to the Group.

## Notes to the Financial Statements (continued)

Year ended 31 December 2018

### 4. Risk management and control (continued)

#### d) Liquidity risk

Liquidity risk is the risk that the Group cannot make payments as they become due because there are insufficient assets in cash form, or in a form that can be converted to cash in a timely fashion at close to fair market value.

The Group encounters potential liquidity risk exposures from its different business activities. It principally arises from its insurance and investment contracts and the timing of the associated policyholder commitments. In the general insurance business there is the potential for increased demand for cash, above normal claims expense patterns, for example to meet adverse UK weather events. In the life business increased demands for cash can also arise from events such as higher instances of death/sickness claims or mass surrenders/lapses of policies. In addition, the Group uses derivatives to transfer potential exposures on financial markets risks and certain derivative contracts, for example, interest rate swaps can result in additional collateral calls which must be met from liquid assets at short notice.

Liquidity is maintained at a prudent level, with a buffer to cover contingencies including the provision of temporary liquidity to subsidiary companies. A Group Liquidity Risk Policy and associated standards have been set to maintain sufficient liquid assets. At Group level there is a liquidity risk appetite statement which requires that sufficient liquid resources are maintained to cover net cash outflows under stressed conditions. This is captured in a liquidity cover ratio and is monitored by the Group ALCO.

The risk exposure is managed using several methods and techniques, which include:

- Maintaining forecasts of cash requirements and adjusting investment management strategies as appropriate to meet these requirements, both in the short and long term;
- Holding sufficient assets in investments which are readily marketable in a sufficiently short timeframe to be able to settle liabilities as these fall due;
- Forecasting additional cash demands under stressed conditions, including demands for collateral, and management actions to be taken to liquidate sufficient assets to meet the increased demands; and
- Appropriate matching of the maturities of assets and liabilities. The Group undertakes asset and liability management to ensure that the duration of liabilities is matched by assets.

## Notes to the Financial Statements (continued)

Year ended 31 December 2018

### 4. Risk management and control (continued)

The table below summarises the maturity profile of the assets of the Group and Society on the expected recovery timing.

	Group			Society		
	Within 1 year £m	Over 1 year £m	Total £m	Within 1 year £m	Over 1 year £m	Total £m
<b>Maturity profile of assets 2018</b>						
Pension benefit asset	–	199	199	–	199	199
Intangible assets	–	47	47	–	8	8
Investments in group undertakings	–	–	–	–	896	896
Property and equipment	–	29	29	–	9	9
Reinsurance assets	1	1,737	1,738	1	1,737	1,738
Prepayments and accrued interest	77	–	77	70	–	70
Loans and other receivables	407	–	407	84	–	84
Insurance receivables	41	–	41	40	–	40
Corporation tax asset	5	–	5	5	–	5
Financial assets at fair value through income	6,757	4,781	11,538	6,567	4,767	11,334
Derivative financial instruments	4	61	65	4	61	65
Cash and cash equivalents	412	–	412	392	–	392
Assets held for sale	3,367	–	3,367	–	–	–
	<b>11,071</b>	<b>6,854</b>	<b>17,925</b>	<b>7,163</b>	<b>7,677</b>	<b>14,840</b>

	Group			Society		
	Within 1 year £m	Over 1 year £m	Total £m	Within 1 year £m	Over 1 year £m	Total £m
<b>Maturity profile of assets 2017</b>						
Pension benefit asset	–	178	178	–	178	178
Intangible assets	–	315	315	–	10	10
Investments in group undertakings	–	–	–	–	897	897
Property and equipment	–	37	37	–	7	7
Investment properties	3	–	3	3	–	3
Deferred acquisition costs	95	–	95	–	–	–
Reinsurance assets	53	2,252	2,305	–	1,747	1,747
Prepayments and accrued interest	124	–	124	71	–	71
Loans and other receivables	258	–	258	65	–	65
Insurance receivables	308	–	308	29	–	29
Financial assets at fair value through income	7,736	6,117	13,853	6,776	5,099	11,875
Derivative financial instruments	4	77	81	4	76	80
Cash and cash equivalents	974	–	974	424	–	424
	<b>9,555</b>	<b>8,976</b>	<b>18,531</b>	<b>7,372</b>	<b>8,014</b>	<b>15,386</b>

## Notes to the Financial Statements (continued)

Year ended 31 December 2018

### 4. Risk management and control (continued)

The tables below summarise the maturity profile of insurance contracts and financial liabilities of the Group and Society.

As permitted by IFRS 4, the maturity profiles for insurance and participating investment contracts are presented based on the estimated timing of the amounts recognised in the Statement of Financial Position.

The remaining financial liabilities are presented based on the undiscounted contractual obligations and as such will not tie into the balances disclosed within the Statement of Financial Position. Non-participating investment contract liabilities, accounted for in accordance with IAS 39, can be called upon immediately by the policyholder and are therefore presented as 'on demand'.

Group	Unit-linked (on demand)	Within 1 year	1-3 years	3-5 years	Over 5 years	Total
<b>Maturity profile of financial, insurance and investment contract liabilities 2018</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>
Participating insurance contract liabilities	–	466	770	687	3,169	5,092
Participating investment contract liabilities	–	47	59	55	530	691
Non-participating value of in-force business	(51)	(16)	(29)	(24)	(183)	(303)
Non-participating insurance contract liabilities	–	275	505	462	3,280	4,522
Non-participating investment contract liabilities	3,017	–	–	–	–	3,017
Total insurance and investment contract liabilities	2,966	772	1,305	1,180	6,796	13,019
Financial liabilities						
– Derivative financial instruments	–	4	–	1	185	190
– Subordinated liabilities	–	–	–	350	–	350
– Other financial liabilities	–	–	1	7	51	59
Insurance payables	–	28	–	–	–	28
Trade and other payables	–	120	2	2	21	145
	2,966	924	1,308	1,540	7,053	13,791

Group	Unit-linked (on demand)	Within 1 year	1-3 years	3-5 years	Over 5 years	Total
<b>Maturity profile of financial, insurance and investment contract liabilities 2017</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>
Participating insurance contract liabilities	–	462	801	752	3,264	5,279
Participating investment contract liabilities	–	35	63	64	584	746
Non-participating value of in-force business	(23)	(17)	(31)	(26)	(196)	(293)
Non-participating insurance contract liabilities	–	258	498	485	3,409	4,650
General insurance claims liabilities	–	547	517	274	305	1,643
Non-participating investment contract liabilities	3,071	–	–	–	–	3,071
Total insurance and investment contract liabilities	3,048	1,285	1,848	1,549	7,366	15,096
Financial liabilities						
– Derivative financial instruments	–	6	(6)	27	166	193
– Subordinated liabilities	–	–	–	–	360	360
– Other financial liabilities	–	–	–	–	62	62
Insurance payables	–	50	–	–	–	50
Trade and other payables	–	213	4	2	22	241
	3,048	1,554	1,846	1,578	7,976	16,002

For investment and long-term linked insurance contracts (Unit linked) the Group matches all the assets on which the unit prices are based with assets in the portfolio. The Group 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.

## Notes to the Financial Statements (continued)

Year ended 31 December 2018

### 4. Risk management and control (continued)

Society	Unit-linked (on demand)	Within 1 year	1-3 years	3-5 years	Over 5 years	Total
<b>Maturity profile of financial, insurance and investment contract liabilities 2018</b>	£m	£m	£m	£m	£m	£m
Participating insurance contract liabilities	–	466	770	687	3,169	5,092
Participating investment contract liabilities	–	47	59	55	530	691
Non-participating value of in-force business	(51)	(16)	(29)	(24)	(183)	(303)
Non-participating insurance contract liabilities	–	274	504	461	3,269	4,508
Non-participating investment contract liabilities	3,017	–	–	–	–	3,017
Total insurance and investment contract liabilities	2,966	771	1,304	1,179	6,785	13,005
Financial liabilities						
– Derivative financial instruments	–	4	–	1	185	190
– Subordinated liabilities	–	–	–	350	–	350
– Other financial liabilities	–	–	1	7	51	59
Insurance payables	–	28	–	–	–	28
Trade and other payables	–	119	–	–	–	119
	2,966	922	1,305	1,537	7,021	13,751

Society	Unit-linked (on demand)	Within 1 year	1-3 years	3-5 years	Over 5 years	Total
<b>Maturity profile of financial, insurance and investment contract liabilities 2017</b>	£m	£m	£m	£m	£m	£m
Participating insurance contract liabilities	–	462	801	752	3,264	5,279
Participating investment contract liabilities	–	35	63	64	584	746
Non-participating value of in-force business	(23)	(17)	(31)	(26)	(196)	(293)
Non-participating insurance contract liabilities	–	257	496	484	3,398	4,635
Non-participating investment contract liabilities	3,071	–	–	–	–	3,071
Total insurance and investment contract liabilities	3,048	737	1,329	1,274	7,050	13,438
Financial liabilities						
– Derivative financial instruments	–	4	(6)	27	162	187
– Subordinated liabilities	–	–	–	–	350	350
– Other financial liabilities	–	–	–	–	62	62
Insurance payables	–	22	–	–	–	22
Trade and other payables	–	149	–	–	–	149
	3,048	912	1,323	1,301	7,624	14,208

#### e) Operational risk

Operational risk is defined as the potential for loss resulting from inadequate or failed internal processes, people and systems or from external events. It is inherent in every part of the business and covers a wide spectrum of issues. Senior management are responsible for ensuring that the material operational risks as relevant to their area of responsibilities are identified, assessed and managed using the approach as outlined in the Group LV= Risk Management Framework. A formal attestation process provides assurance about the effectiveness of the overall control environment and reports on any material exceptions.

Operational risk is unrewarded and is therefore inherently unattractive. LV= is highly exposed to operational failures because of the high level of customer service inherent in its business model. It therefore looks to limit and 'maintain' its exposure to operational risk and do so by establishing a robust control environment using a combination of assessment, testing and audit. The Group will always seek to uphold its brand image with customers, employees and other external parties and the Group has no appetite whatsoever for regulatory weaknesses or failings that lead to censure actions.

## Notes to the Financial Statements (continued)

Year ended 31 December 2018

### Performance

The notes included within this section focus on the performance and results of the Group and Society. Information on the income generated, benefits and claims paid, expenditure incurred and mutual bonus declared are presented here.

#### 5. Net earned premiums

##### Accounting for net earned premiums

Written premiums include new business premiums plus ongoing regular premiums received for in-force policies. Furthermore an estimate is included for premiums due from intermediaries. Net earned premiums are arrived at following deductions for premiums payable to reinsurers and in general insurance, unearned premium is deferred.

##### Long-term insurance and participating investment contracts

Regular premiums on long-term insurance and participating investment contracts are recognised as income when due for payment. For single premium business, recognition occurs on the date from which the policy is effective.

##### General insurance contracts

General insurance premiums written reflect business coming into force during the year. Earned premium is written premium adjusted for unearned premium. Unearned premium is that proportion of a premium written in a year that relates to periods of risk after the Statement of Financial Position date. Unearned premiums are calculated on a time apportionment basis. The proportion attributable to subsequent periods is deferred as a provision for unearned premiums.

The general insurance business has been disclosed as a discontinued operation in 2018 and 2017 has been restated accordingly – see Note 12.

##### Non-participating investment contracts

Premiums and claims relating to non-participating investment contracts are not recognised in the Statement of Comprehensive Income but are recorded as contributions to and deductions from the non-participating investment contract liabilities recorded in the Statement of Financial Position.

	Group		Society	
	2018	2017 Restated - see Note 1	2018	2017
	£m	£m	£m	£m
<b>Gross earned premiums</b>				
<b>Long-term insurance and participating investment contracts</b>				
<b>Single premium</b>				
<b>New business</b>				
Investments and savings	354	420	354	420
Pensions and annuities	170	151	170	151
<b>Regular premium</b>				
<b>New business</b>				
Life and health protection	33	37	33	37
<b>Existing in-force business</b>				
Investments and savings	28	33	28	33
Pensions and annuities	8	9	8	9
Life and health protection	195	185	194	185
<b>Gross earned premiums</b>	<b>788</b>	<b>835</b>	<b>787</b>	<b>835</b>
<b>Premiums ceded to reinsurers</b>				
Long-term insurance premiums	(246)	(1,092)	(246)	(1,092)
	(246)	(1,092)	(246)	(1,092)
<b>Net earned premiums</b>	<b>542</b>	<b>(257)</b>	<b>541</b>	<b>(257)</b>

Gross written premiums for non-participating investment contracts which are deposit accounted for and not included above (refer to Note 16)

456	656	456	656
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All contracts are written in the UK.

Recurrent single premium rebates from the Department for Work and Pensions are included as new business single premiums. Pensions vested into annuity contracts during the year are included as new annuity single premium business at the annuity purchase price. Where periodic premiums are received other than annually, the periodic new business premiums are stated on an annualised basis.

In December 2017 the Society and Group entered into a reinsurance arrangement in respect of the OB Pension portfolio. This increased Premiums ceded to reinsurers by £829m.



## Notes to the Financial Statements (continued)

Year ended 31 December 2018

### 6. Investment income

#### Accounting for investment income

Investment income includes dividends, interest from debt and other fixed income securities, interest on loans secured on residential and commercial property and interest on loans and receivables. Dividends are recorded on the date on which the shares are declared ex-dividend. Interest receivable from investments at fair value is accounted for on an accruals basis. Interest receivable on loans and receivables is calculated on an effective interest rate basis.

	Group		Society	
	2018	2017 Restated - see Note 1	2018	2017
	£m	£m	£m	£m
Income from investments at fair value through income:				
– Dividend income	113	109	113	109
– Interest income from debt and fixed interest securities	141	165	141	164
– Interest on loans secured on residential property	34	36	34	36
– Interest on loans secured on commercial property	8	9	8	9
Interest on loans and receivables	4	–	–	–
Interest income from group undertakings	–	–	–	18
Dividend income from group undertakings	–	–	67	94
	300	319	363	430

### 7. Net (losses)/gains on investments

#### Accounting for net (losses)/gains on investments

##### Realised gains and losses

Realised gains and losses on investments are calculated as the difference between net sales proceeds and purchase price.

##### Unrealised gains and losses

Unrealised gains and losses on investments represent the difference between the valuation of fair value assets at the Statement of Financial Position date and their valuation at the last Statement of Financial Position date or, where purchased during the year, the purchase price. A reversal is made of previously recognised gains or losses in respect of disposals made during the year.

	Group		Society	
	2018	2017 Restated - see Note 1	2018	2017
	£m	£m	£m	£m
Investment properties	1	3	1	3
Investments at fair value through income:				
– Debt securities	(160)	1	(160)	2
– Equity securities	(432)	419	(432)	419
– Derivatives at fair value through income	(5)	(36)	(5)	(36)
– Loans and mortgages	(6)	4	(6)	4
– Other	(3)	3	(3)	3
Investments in group undertakings	–	–	(7)	(16)
	(605)	394	(612)	379

Included within net (losses)/gains on investments are realised gains of £253m (2017: £568m) for the Group and realised gains of £253m (2017: £568m) for the Society.

## Notes to the Financial Statements (continued)

Year ended 31 December 2018

## 8. Other income

	Group		Society	
	2018	2017 Restated - see Note 1	2018	2017
	£m	£m	£m	£m
<b>Revenue from contracts with customers</b>				
Fee and commission income	47	37	24	22
	47	37	24	22
<b>Other income from insurance contracts</b>	–	–	–	–
	47	37	24	22

## 9. Net benefits and claims

## Accounting for net benefits and claims

Net benefits and claims include amounts paid and also the change in provision for claims. Included within these are the related internal and external claims handling costs and also deductions for the expected value of recoveries. Reinsurance recoveries are accounted for in the same period as the related claim.

## Long-term insurance and participating investment contracts

Maturity claims and regular annuity payments are accounted for when due for payment. Surrenders are accounted for on the earlier of the date when paid or when the policy ceases to be included within the long-term insurance contract liability. Death claims and other claims are accounted for when the Group is notified. The value of claims on participating contracts includes bonuses paid or payable.

## General insurance contracts

Claims incurred comprise claims paid in the year and changes in the provisions for outstanding claims, including provisions for claims incurred but not reported together with any other adjustments to claims from previous years. The general insurance business has been disclosed as a discontinued operation in 2018 and 2017 has been restated accordingly – see Note 12.

It is likely that the final outcome will prove to be different from the original liability established. Provisions are adjusted at the Statement of Financial Position date to represent an estimate of the expected outcome.

	2018			2017		
	Gross	Reinsurance	Net	Gross Restated - see Note 1	Reinsurance Restated - see Note 1	Net Restated - see Note 1
Group	£m	£m	£m	£m	£m	£m
<b>Long-term insurance and participating investment contracts</b>						
Benefits and claims paid	896	(232)	664	868	(237)	631
Change in the provision for claims	8	–	8	4	–	4
Fair value adjustment to reinsurance receivable	–	(6)	(6)	–	–	–
	904	(238)	666	872	(237)	635
Net benefits and claims for non-participating investment contracts which are deposit accounted for and not included above (refer to Note 16)	375	–	375	366	–	366
	2018			2017		
	Gross	Reinsurance	Net	Gross	Reinsurance	Net
Society	£m	£m	£m	£m	£m	£m
<b>Long-term insurance and participating investment contracts</b>						
Benefits and claims paid	895	(232)	663	866	(237)	629
Change in the provision for claims	8	–	8	5	–	5
Fair value adjustment to reinsurance receivable	–	(6)	(6)	–	–	–
	903	(238)	665	871	(237)	634
Net benefits and claims for non-participating investment contracts which are deposit accounted for and not included above (refer to Note 16)	375	–	375	366	–	366

## Notes to the Financial Statements (continued)

Year ended 31 December 2018

### 10. Finance costs

	Group		Society	
	2018	2017 Restated - see Note 1	2018	2017
	£m	£m	£m	£m
Interest expense on subordinated liabilities (see Note 18)	23	23	23	23
Other interest expense	1	1	–	–
	24	24	23	23

### 11. Other operating and administrative expenses

#### Accounting for other operating and administrative expenses

Other operating and administrative expenses are accounted for as incurred. Acquisition costs relate to the costs of acquiring new business during the financial year. These include all commission and incentive payments to sales staff and third parties incurred in writing new contracts.

	Group		Society	
	2018	2017 Restated - see Note 1	2018	2017
	£m	£m	£m	£m
Commission paid on acquisition of business	57	59	50	54
Amortisation and impairment of intangible assets	4	4	3	2
Depreciation on property and equipment	4	5	2	3
(Profit)/loss on disposal of property and equipment	(3)	1	–	1
Investment management expenses and charges	9	15	10	15
Auditors' remuneration (see Note 13)	1	1	1	1
Employee benefits expense (see Note 38)	109	255	101	249
Management charge allocated to group undertakings	(45)	(208)	(58)	(215)
Rent, rates and other facilities expense	8	11	9	12
Marketing and advertising	7	10	7	9
Other staff costs	21	16	20	15
IT costs	25	36	25	36
Fees	28	32	27	31
Other expenses	3	12	3	15
Claims handling cost recognised in Gross benefits and claims	(4)	(6)	(4)	(6)
	224	243	196	222

The £(45)m (2017: £(208m)) management charge allocated to group undertakings reported by the Group represents the amounts recharged to the discontinued operations during the year.

Included within rent, rates and other facilities expense are operating lease rentals of £1m (2017: £4m).

## Notes to the Financial Statements (continued)

Year ended 31 December 2018

### 12. Discontinued operations

#### a) Description

On 28 December 2017 the Group entered into a transaction with Allianz whereby a majority stake in LVGIG group (the general insurance business within the Group) is being sold to Allianz based on an agreed valuation of LVGIG of £1.020bn. The first stage was completed on 28 December 2017 with a minority interest of 49% in LVGIG being sold and the £124m gain on disposal being recognised directly within the Unallocated divisible surplus as a transaction with owners that did not result in a loss of control – see Notes 46 and 47.

The second stage will complete by 31 December 2019 following settlement of a forward contract for sale of an additional 20.9% stake to Allianz unless the Group exercises its put option over its remaining shareholding earlier. The put option has been valued at a positive fair value of £17m at 31 December 2018 impacting Net losses on investments and Derivative financial instruments within the Discontinued operations and Assets held for sale disclosures in sections b) and c) respectively. Assumptions and judgement were used in the estimation of the fair value of the put option leading to significant levels of uncertainty associated with the reported fair value of £17m. The second stage of the transaction will result in a loss of control and therefore the associated gain or loss on disposal will be recognised in the Statement of Comprehensive Income.

At 31 December 2018 the Group retains control and continues to consolidate LVGIG and its subsidiaries, however as the second stage will be completed within a year from the reporting date and will result in a loss of control, the LVGIG group is a disposal group that is classified as held for sale in accordance with IFRS 5 'Non-current Assets Held for Sale and Discontinued Operations', and presented as a discontinued operation.

The disposal group is measured at its carrying value as this is lower than the fair value of the agreed sale price less transaction costs.

#### b) Financial performance and cash flow information

Financial information relating to the discontinued operations for the years to 31 December 2018 and 2017 are presented below:

	2018 £m	2017 £m
Gross earned premiums	1,610	1,604
Premiums ceded to reinsurers	(383)	(363)
<b>Net earned premiums</b>	<b>1,227</b>	<b>1,241</b>
Investment income	53	55
Net losses on investments	(24)	(34)
Gain on sale of commercial business renewal rights	–	52
Other income	56	48
<b>Total income</b>	<b>1,312</b>	<b>1,362</b>
Insurance claims and loss adjustment expenses	(1,033)	(1,155)
Insurance claims and loss adjustment expenses recoverable from reinsurers	175	298
<b>Net insurance claims</b>	<b>(858)</b>	<b>(857)</b>
Gross operating and administrative expenses	(417)	(413)
Expenses recoverable from reinsurers	73	72
<b>Net operating and administrative expenses</b>	<b>(344)</b>	<b>(341)</b>
Finance costs	–	–
<b>Total claims and expenses</b>	<b>(1,202)</b>	<b>(1,198)</b>
<b>Profit before tax from discontinued operations</b>	<b>110</b>	<b>164</b>
Income tax expense	(17)	(30)
<b>Profit for the year from discontinued operations</b>	<b>93</b>	<b>134</b>
<b>Other comprehensive loss for the year from discontinued operations, net of tax</b>	<b>(10)</b>	<b>–</b>
<b>Total comprehensive income for the year from discontinued operations</b>	<b>83</b>	<b>134</b>

The net cash flows incurred by the LVGIG group are as follows:

	2018 £m	2017 £m
Net cash (outflow)/inflow from operating activities	(149)	215
Net cash (outflow)/inflow from investing activities	(22)	16
Net cash (outflow)/inflow from financing activities	(64)	9
<b>Net cash (outflow)/inflow generated from discontinued operations</b>	<b>(235)</b>	<b>240</b>

## Notes to the Financial Statements (continued)

Year ended 31 December 2018

### 12. Discontinued operations (continued)

#### c) Assets held for sale

	2018 £m
<b>Assets</b>	
Intangible assets (see Note 28)	271
Property and equipment (see Note 27)	5
Deferred tax asset (see Note 36)	2
Deferred acquisition costs (see Note 23)	86
Reinsurance assets (see Note 20 f&g)	490
Prepayments and accrued interest	51
Loans and other receivables	129
Insurance receivables	265
Financial assets at fair value through income	736
AFS financial assets at fair value through OCI	995
Derivative financial investments	18
Cash and cash equivalents (excluding bank overdrafts)	319
<b>Assets held for sale</b>	<b>3,367</b>
<b>Liabilities</b>	
Insurance contract liabilities (see Note 20 f&g)	2,283
Provisions (see Note 40)	8
Subordinated liabilities	11
Corporation tax liability	10
Insurance payables	28
Trade and other payables	176
<b>Liabilities directly associated with assets held for sale</b>	<b>2,516</b>

### 13. Auditors' remuneration

	2018 £000	2017 £000
Audit of Society	825	896
Fees payable to the Society's auditors and its associates for other services:		
– Audit of subsidiaries	803	720
– Audit-related assurance services	407	457
– Other tax services	8	57
– Other non-audit services not covered above	23	205
	<b>2,066</b>	<b>2,335</b>

Included in the table above are costs of £843,000 (2017: £750,000) relating to the discontinued operations.

In addition to the amounts disclosed above, expenses relating to audit work of £75,000 (2017: £150,000) were paid to the auditors in respect of the year ended 31 December 2018.

## Notes to the Financial Statements (continued)

Year ended 31 December 2018

### Financial assets and liabilities

This section presents information relating to the financial assets and liabilities (excluding insurance contract-related assets and liabilities which are disclosed in Note 20) held by the Society and Group. These financial assets and liabilities are held at either fair value or amortised cost as defined by the Group's accounting policies.

#### 14. Financial assets – Fair value through income

##### Accounting for financial assets and liabilities at fair value through income

Financial assets at fair value through income has two sub categories:

- Financial assets held for trading; and
- Those designated at fair value through income at inception.

Derivatives are classified at fair value through income as they are held for trading (see note 15). Financial assets designated at fair value through income at inception are part of a group of financial assets that are managed and their performance evaluated and reported to the board on a fair value basis in accordance with the Group's documented investment strategy. These assets are measured at market prices, or prices consistent with market ratings should no price be available. Day one gains are recognised only where valuations use data from observable markets. Any unrealised or realised gains or losses are taken to the Statement of Comprehensive Income, as fair value gains or losses, or realised gains or losses respectively, as they occur.

Financial assets at fair value through income include listed and unlisted investments, units in authorised unit trusts, open ended investment companies (OEICs), loans secured on residential and commercial property, and other investments.

Financial liabilities at fair value through income include derivative financial instruments and non-participating investment contract liabilities; see Notes 15 and 16 respectively.

The IFRS "fair value hierarchy" levels for financial assets and liabilities required under IFRS 13 are disclosed within Note 4.

##### Loans secured on residential property

The fair value of the loans secured on residential property (arising from the equity release mortgage business) is determined by discounting the expected cash flows which take into account the contractual interest rolled up on the loans, and expected repayment profiles based on assumed mortality and early loan repayment rates. The discount rate is based on the swap yield curve increased by a spread and an allowance for risks associated with the 'No Negative Equity Guarantee'.

The loans incorporate a 'No Negative Equity Guarantee' to customers. The contractual terms of these guarantees require the company to accept the lower of the market value of the customer's property and the value of the loan plus accrued interest at the date of redemption as full settlement of the mortgage. For almost all loans it is expected that the No Negative Equity Guarantee will not be invoked and the value of the loan plus accrued interest will be received.

The fair value of the guarantee is determined using a stochastic model.

The fair value of the loans is determined using assumptions for interest rates, future house price inflation and its volatility, mortality rates, long-term care rates and early loan repayment rates, to give management's best estimate view of the discounted value of cash flows required to settle any future financial obligation arising at the Statement of Financial Position date.

The loans secured on residential property within the Society are purchased from a subsidiary company that is authorised to initiate these loans. The purchase by the Society is at origination value plus 7% (which is expensed in the Society when paid).

##### Loans secured on commercial property

The fair value of the loans secured on commercial property is determined using discounted cash flows to reflect changes in underlying gilt yields and debt margins. Where the value is not expected to be recovered through ongoing loan payments, the fair value represents the recoverable value of the property in the market post transaction costs.

#### Significant accounting estimates

##### Fair value of financial assets

Market observable inputs are used wherever possible. Judgement is applied to determine whether a market is active; this is based upon the facts and circumstances of the relevant market. In the absence of an active market, estimation of fair value is achieved by using valuation techniques such as recent arm's length transactions, discounted cash flow analysis and option pricing models. For discounted cash flow analysis, estimated future cash flows and discount rates are based on current market information and rates applicable to financial instruments with similar yields, credit quality and maturity characteristics. This valuation will also take into account the marketability of the assets being valued.

Details of the key assumptions used in the absence of an active market are contained in the fair value estimation tables, as required by IFRS 13, disclosed in Note 4.

## Notes to the Financial Statements (continued)

Year ended 31 December 2018

### 14. Financial assets – Fair value through income (continued)

	Group		Society	
	2018 £m	2017 £m	2018 £m	2017 £m
<b>Financial assets – Fair value through income</b>				
Shares, other variable yield securities and units in unit trusts				
– UK listed	6,755	7,629	6,565	6,844
– UK unlisted	78	91	78	91
– Overseas listed	108	117	108	112
– Overseas unlisted	33	42	33	42
Debt and other fixed income securities				
– UK listed	2,513	3,032	2,499	2,661
– Overseas listed	1,182	2,072	1,182	1,255
Loans secured on residential property	648	667	648	667
Loans secured on commercial property	221	200	221	200
Other	–	3	–	3
	<b>11,538</b>	<b>13,853</b>	<b>11,334</b>	<b>11,875</b>
Assets held to cover linked liabilities included above	<b>3,066</b>	<b>3,130</b>	<b>3,066</b>	<b>3,130</b>

Included within the 2017 comparatives are amounts of £1,437m relating to the general insurance business. In 2018 these balances have been disclosed as Assets held for sale within Note 12. For details on exposure to foreign exchange currency risk see page 120.

### 15. Derivative financial instruments

#### Accounting for derivative financial instruments

Derivatives are initially recognised at fair value on the date on which a derivative contract is entered into and are subsequently re-measured at their fair value. There are no designated hedging relationships within the Group that qualify for hedge accounting, all are classified as held for trading. Derivatives are settled on a gross basis.

Changes in the fair value of derivative instruments are recognised immediately in gains or losses on investments in the Statement of Comprehensive Income for the period. Realised gains or losses are taken to the Statement of Comprehensive Income on occurrence.

The Group uses derivatives primarily to reduce its exposure to interest rate risk and to protect against fluctuations in equity values. The cash flow swaps improve asset-liability matching within the annuity fund.

Group	2018			2017		
	Contract/ notional amount £m	Fair value – asset £m	Fair value – liability £m	Contract/ notional amount £m	Fair value – asset £m	Fair value – liability £m
Interest rate swaps	424	52	(2)	811	69	(4)
Gilt forwards	464	3	(4)	624	4	–
Cash flow swaps	1,005	–	(184)	1,070	–	(186)
Swaptions	–	–	–	87	1	–
Forward exchange contracts	–	–	–	2	–	–
Equity/index derivatives	110	10	–	211	7	(3)
	<b>2,003</b>	<b>65</b>	<b>(190)</b>	<b>2,805</b>	<b>81</b>	<b>(193)</b>

Included within the 2017 comparatives is a net liability of £5m relating to the general insurance business. In 2018 these balances have been disclosed within Assets held for sale in Note 12.

Society	2018			2017		
	Contract/ notional amount £m	Fair value – asset £m	Fair value – liability £m	Contract/ notional amount £m	Fair value – asset £m	Fair value – liability £m
Interest rate swaps	424	52	(2)	444	68	–
Gilt forwards	464	3	(4)	624	4	–
Cash flow swaps	1,005	–	(184)	1,070	–	(186)
Swaptions	–	–	–	87	1	–
Equity/index derivatives	110	10	–	132	7	(1)
	<b>2,003</b>	<b>65</b>	<b>(190)</b>	<b>2,357</b>	<b>80</b>	<b>(187)</b>

## Notes to the Financial Statements (continued)

Year ended 31 December 2018

### 16. Investment contract liabilities

#### Accounting for investment contract liabilities

##### Non-participating contracts

Investment contract liabilities are recognised when contracts are entered into and premiums are charged. These liabilities are initially recognised at transaction price excluding any transaction costs directly attributable to the issue of the contract. Designation at inception is at fair value in order to avoid a measurement inconsistency with the associated financial assets.

Deposits and withdrawals are recorded directly as an adjustment to the contract liability in the Statement of Financial Position, a method known as deposit accounting. Fees charged and investment income received are recognised in the Statement of Comprehensive Income when earned.

Fair value adjustments are measured at each reporting date and are recorded in the Statement of Comprehensive Income. Fair value is calculated as the number of units allocated to the policyholder in each unit linked fund multiplied by the unit price of those funds at the Statement of Financial Position date. The unit prices are determined with reference to the fund assets and liabilities, which are valued on a basis consistent with that used to measure the equivalent assets and liabilities in the Statement of Financial Position, adjusted for the effect of future tax arising from any unrealised gains or losses. For a contract that can be cancelled by the policyholder, the fair value cannot be less than the surrender value.

##### Participating contracts

Insurance and participating investment contract liabilities are valued using accounting policies consistent with those adopted prior to the transition to IFRS as permitted under IFRS 4 'Insurance contracts'. The accounting treatment of these contracts is described within Note 20.

#### a) Analysis of investment contract liabilities

	Notes	Group		Society	
		2018 £m	2017 £m	2018 £m	2017 £m
Non-participating investment contract liabilities	16b	3,017	3,071	3,017	3,071
Participating investment contract liabilities	16c	691	746	691	746
		3,708	3,817	3,708	3,817

#### b) Movement in non-participating investment contract liabilities

	Group		Society	
	2018 £m	2017 £m	2018 £m	2017 £m
Balance at 1 January	3,071	2,547	3,071	2,547
Deposits received from policyholders	456	656	456	656
Payments made to policyholders	(375)	(366)	(375)	(366)
Change in contract liabilities included in the Statement of Comprehensive Income	(135)	234	(135)	234
Balance at 31 December	3,017	3,071	3,017	3,071

The change in contract liabilities as shown in the Statement of Comprehensive Income comprises principally the allocation of the net investment return to policyholders of investment contracts less allowances for taxes.



## Notes to the Financial Statements (continued)

Year ended 31 December 2018

### 16. Investment contract liabilities (continued)

#### c) Movement in participating investment contract liabilities

	Group		Society	
	2018 £m	2017 £m	2018 £m	2017 £m
Balance at 1 January	746	690	746	690
Premiums received	8	9	8	9
Liabilities paid for deaths, maturities, surrenders, benefits and claims	(36)	(37)	(36)	(37)
Benefits and claims variation	1	1	1	1
Fees deducted	(3)	(4)	(3)	(4)
Accretion of investment income or change in unit prices	(27)	54	(27)	54
Adjustment due to changes in assumptions:				
– Investment return	(1)	1	(1)	1
– Expense	–	(3)	–	(3)
– Other basis changes	6	–	6	–
Other	(9)	23	(9)	23
Mutual bonus	6	7	6	7
Change to economic basis	–	5	–	5
Balance at 31 December	691	746	691	746

### 17. Loans and other receivables

#### Accounting for loans and other receivables

Loans and other receivables are initially measured at fair value and then subsequently measured at amortised cost using the effective interest rate method. Loans include secured notes and reverse repurchase agreements which represent the consideration paid to the borrower. Other receivables comprise amounts due to the Society from group undertakings and other receivables including outstanding investment sales and are recognised when due.

The Group assesses at each Statement of Financial Position date whether there is any indication that a loan or receivable, or a group of loans or receivables, is impaired. For loans, the amount of any impairment loss is measured as the difference between the carrying amount and the present value of future cash flows (discounted at the original effective interest rate). For receivables, where there is objective evidence that the carrying value is impaired then the impairment loss will be recognised in the Statement of Comprehensive Income.

	Group		Society	
	2018 £m	2017 £m	2018 £m	2017 £m
Secured loan notes	200	–	–	–
Reverse repurchase agreements	150	200	–	–
Cash collateral pledged	1	10	1	3
Amounts due from group undertakings	5	–	33	25
Investments receivable	35	26	35	20
Other receivables	16	22	15	17
	407	258	84	65

Included within the 2017 comparatives are amounts of £217m relating to the general insurance business. In 2018 these balances have been disclosed as Assets held for sale within Note 12.

In December 2018 a subsidiary of the Society invested in £200m of secured loan notes and £150m of reverse repurchase agreements, both of these investments mature in 2019.

The £5m amount due from group undertakings reported at Group level represents the balance due to the Group from the general insurance business that is classified as held for sale (see Note 12).

Details of impairments on financial assets held at amortised cost are included within the credit counterparty risk section (c) of Note 4. The carrying amounts disclosed above reasonably approximate fair value at the Statement of Financial Position date.

## Notes to the Financial Statements (continued)

Year ended 31 December 2018

### 18. Subordinated liabilities

#### Accounting for subordinated liabilities

Subordinated liabilities are initially measured at the fair value of the proceeds less attributable transaction costs. Subsequent to initial recognition they are measured at amortised cost. The transaction costs are amortised over the period to the expected redemption date on an effective interest rate basis. The amortisation charge is included in the Statement of Comprehensive Income within finance costs. An equivalent amount is added to the carrying value of the liability such that at the redemption date the value of the liability equals the redemption value.

	Group		Society	
	2018	2017	2018	2017
	£m	£m	£m	£m
Subordinated notes (GBP 350m)	348	348	348	348
Subordinated notes (EUR 12m)	—	10	—	—
	348	358	348	348

All the subordinated liabilities are expected to be settled more than 12 months after the balance sheet date.

In 2013 the Society issued £350m of Fixed Rate Reset Subordinated Notes at par. The directly related costs of £4m incurred to issue the Notes have been capitalised as part of the carrying value and are being amortised using the effective interest rate basis over the period to the first call date in 2023. The effective interest rate on the £350m liability is 6.654% resulting in a £23m finance charge for the year (see Note 10).

The Notes have a maturity date of 22 May 2043 but the issuer has the option to redeem the Notes at the first call date of 22 May 2023 and at five yearly intervals thereafter up to the maturity date.

Interest is payable on the Notes at a fixed rate of 6.5% (£23m) per annum for the period until the first call date on 22 May 2023, payable annually in arrears on 22 May each year. If the Notes are not redeemed on 22 May 2023, the interest rate is reset on that date and at five yearly intervals thereafter at a rate equal to the five year gilt rate quoted on the day before the reset date plus an initial margin of 463 basis points and a step up margin of 100 basis points.

There is an option of cumulative deferral of interest at the issuer's discretion and mandatory interest deferral in the event that a regulatory deficiency interest deferral event has occurred or is continuing (breach of the applicable regulatory solvency capital requirement of the issuer or group) or would occur if payment of interest on the subordinated notes were to be made. Following any deferral of a principal or interest payment, the Society would be prevented from declaring any distribution to members which falls within the Mutual Bonus arrangements. The Society has the option to elect to defer payment of interest in whole or in part and this will not constitute a default or give the right to the noteholders or the trustee to accelerate repayment of the Notes or to take any enforcement action.

The €12m subordinated notes are issued by a subsidiary undertaking and are repayable in 2034. Interest on these Notes is payable at the 3 month euro deposit rate plus a margin of 365 basis points. The euro denominated notes are held by a general insurance subsidiary and for 2018 reporting are included within the Liabilities directly associated with assets held for sale in Note 12.

Subordinated liabilities are held in the Statement of Financial Position at amortised cost. The fair value at 31 December 2018 was £367m (2017: £405m). The valuation of the subordinated notes was determined by reference to the bid price obtained from the markets as at 31 December 2018. Management consider this to be representative of fair value.

### 19. Other financial liabilities

	Group		Society	
	2018	2017	2018	2017
	£m	£m	£m	£m
Cash collateral received	59	62	59	62
	59	62	59	62

The carrying amounts disclosed above reasonably approximate fair value at the Statement of Financial Position date.

## Notes to the Financial Statements (continued)

Year ended 31 December 2018

### Insurance contract related assets and liabilities

This section presents information relating to insurance contract related assets and liabilities held by the Society and Group. The assumptions used in the valuation of the insurance contract liabilities are disclosed within Note 25 with sensitivities to these assumptions disclosed separately within Note 4.

#### 20. Insurance contract liabilities

##### Accounting for insurance contract liabilities

Insurance contract liabilities are recognised for insurance contracts in existence at the end of the reporting period. Such liabilities are only derecognised when the obligation specified in the contract is discharged, cancelled or expires.

IFRS 4 Insurance Contracts permits the continued application, for income statement presentation and liability measurement purposes, of accounting policies that were being used at the date of transition to IFRS, except where a change is deemed to make the financial statements more relevant to the economic decision-making needs of users and no less reliable, or more reliable and no less relevant to those needs. As such, the Group accounting for insurance contracts and participating investment contracts is in accordance with the Statement of Recommended Practice issued by the Association of British Insurers in December 2005, amended in December 2006 and withdrawn in December 2015. The Group continues to apply this Statement of Recommended Practice.

##### a) Long-term insurance contract liabilities and participating investment contract liabilities

###### (i) Participating business

Participating business includes both participating insurance and participating investment contract liabilities. The liabilities are calculated in accordance with the PRA's previous 'realistic' liability regime, which was the regime in place at the date of transition to IFRS. In particular, provision is made for all bonus payments (declared and future, reversionary and terminal) estimated, where necessary, in a manner consistent with the relevant fund's Principles and Practices of Financial Management (PPFM). The liabilities include an allowance for the time and intrinsic value of options and guarantees granted to policyholders and for future management actions.

The realistic participating liabilities are based on the aggregate value of policy asset shares reflecting past premiums, investment return, expenses and charges applied to each policy. Allowance is also made for policy-related liabilities such as guarantees, options and future bonuses calculated using a stochastic model simulating investment returns, asset mix, expense charges and bonuses.

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 on the non-participating business ('Non-participating value of the in-force business') is separately determined and its value is deducted from the sum of the liabilities for participating contracts and the Unallocated divisible surplus.

The non-participating value of the in-force business is separately disclosed within Note 21. Such an amount is not recognised for business written outside participating contract funds.

###### (ii) Non-participating business

The liability is calculated to comply with the reporting requirements under the PRA's handbook using a gross premium valuation method or a method at least as prudent as the gross premium method. This was the regime in place on adoption of

IFRS. The Society and relevant subsidiaries have adopted the modified statutory solvency basis in the valuation of provisions for non-participating business.

Liabilities for non-participating business are either included within the long-term insurance contract liabilities or the investment contract liabilities, depending upon the product classification.

##### b) General insurance claims and insurance contract liabilities

For 2018 reporting these balances are included within 'Liabilities associated with assets held for sale' – see Note 12.

Claims incurred comprise claims and related internal and external claims handling costs paid in the year and changes in the provisions for outstanding claims, including provisions for claims incurred but not reported and related claims handling costs, together with any other adjustments to claims from previous years. Where applicable, deductions are made for recoveries from other parties.

Provision is made for the estimated cost of claims incurred but not settled, including the cost of claims incurred but not reported. The estimated cost of claims includes expenses to be incurred in settling claims and a deduction for the expected value of recoveries. However, given the inevitable uncertainty in establishing claims provisions, it is likely that the final outcome will prove to be different from the original liability established. Provisions are adjusted at the Statement of Financial Position date to represent a best estimate of the expected outcome.

Provisions are calculated allowing for reinsurance recoveries and a separate asset is recorded for the reinsurers' share of the provision.

Standard actuarial claims projection techniques are used to estimate outstanding claims. Such methods extrapolate the development of paid and incurred claims, recoveries from third parties, average cost per claim and ultimate claim numbers for each accident year, based upon the observed development of earlier years and expected loss ratios. The main assumption underlying these techniques is that past claims development experience can be used to project ultimate claims costs. In the case of PPOs, the annuity type structure of the claim payments mean that these have to be projected over a longer-term period and reserved for on a discounted basis accordingly. Allowance for one off occurrences or changes in legislation, policy conditions or portfolio mix, is also made in arriving at the estimated ultimate cost of claims, in order that it represents the most likely outcome, taking account of all the uncertainties involved. To the extent that the ultimate cost is different from the estimate, where experience is better or worse than that assumed, the surplus or deficit will be credited or charged to the Statement of Comprehensive Income in future years.

For general insurance contracts, provision is made, if required, for any anticipated claims and claims handling costs that are anticipated to exceed the unearned premiums, net of deferred acquisition costs. An estimate is made for future investment income arising from the unearned premiums, and used to reduce the unexpired risk provision. Unexpired risk surpluses and deficits are offset where business classes are managed together and a provision is made if an aggregate deficit arises.

## Notes to the Financial Statements (continued)

Year ended 31 December 2018

### 20. Insurance contract liabilities (continued)

#### Significant accounting estimates and judgements

The valuation of insurance contract liabilities requires management judgement in applying the appropriate accounting treatment and the use of estimates. Where the use of estimates involves management judgement, these are explained separately to judgements involving the application of accounting policies.

#### a) Long-term insurance contract liabilities and participating investment contract liabilities

##### (i) Significant accounting estimates

Estimate	Judgement applied to estimate
<p><b>Assumptions and adjustments applied in the valuation of insurance liabilities</b></p> <p>The valuation of participating contract liabilities is based on assumptions reflecting the best estimate at the time. The valuation of non-participating insurance contracts is based on prudent assumptions; a separate calculation is also performed to assess the non-participating value of in-force business which is based on best estimate assumptions. All contracts are subject to liability adequacy tests, which reflects management's best current estimate of future cash flows.</p> <p>The assumptions used for mortality, morbidity and longevity are based on standard industry or reinsurers' tables. The assumptions used for investment returns and discount rates are based on current market yields. The assumptions used for expenses and persistency reflect product characteristics and are primarily based on relevant internal experience.</p> <p>The assumptions for mortality improvements are based on the latest version of the Institute and Faculty of Actuaries Continuous Mortality Investigation (CMI) Mortality Projections Model, referred to as CMI_2017.</p> <p>Due to the long-term nature of the liabilities, the estimates are subject to significant uncertainty.</p> <p><b>Assessment of future options and guarantees</b></p> <p>The value of options and guarantees on With-profits business is valued within the market-consistent discounted cash flow valuation, the most material of which are minimum benefit guarantees on LVFS With-profits business and guaranteed annuity options on RNPFN.</p> <p>Due to the asymmetric nature of these liabilities, stochastic valuation techniques are required. A market consistent economic scenario generator is used with a wide range of future economic conditions to capture the asymmetry, and a discounted cash flow model is used to derive a value of the liability at the valuation date. These techniques are widely used in the life insurance industry to value liabilities with embedded options and guarantees.</p> <p>The valuation models make appropriate allowance for both management and policyholder actions, where appropriate, including appropriate demographic assumptions on option or guarantee dates.</p>	<p>The assumptions used for mortality, morbidity and longevity are adjusted where appropriate to reflect the Group's own experience. In particular, for impaired annuities the mortality assumptions are adjusted so as to allow for convergence to standard mortality at advanced ages. These adjustments vary according to lifestyle or medical condition, gender, age and duration in-force.</p> <p>The assumptions used for discount rates are adjusted for the Group's own risk exposure. Non-participating value of in-force business valuation makes allowance for a margin of risk and adverse deviation.</p>

##### (ii) Significant accounting judgements

#### Changes to methodology for long-term insurance contract liabilities and participating investment contract liabilities

A number of significant changes have been made during 2018:

- Further reviews of the Society's cost base, including an assessment of those costs retained by the existing business at the end of the Transitional Services Agreement with the general insurance business, have led to a provision of £34m being made against retained costs.
- Significant improvements have been made to the modelling of the Society's unit-linked business, to more accurately reflect assumed policyholder behaviour post Pensions Freedoms.
- Changes to FGB mass lapse and guarantee cancellation rates to anticipate policyholder reactions to changes in market conditions.

Details of all the long-term insurance and investment contract liabilities valuation assumptions and the non-participating value of in-force business valuation assumptions are disclosed separately within Notes 25 and 26 respectively.

## Notes to the Financial Statements (continued)

Year ended 31 December 2018

### 20. Insurance contract liabilities (continued)

#### Significant accounting estimates and judgements (continued)

##### b) General insurance claims and insurance contract liabilities

For 2018 reporting these balances are included within 'Liabilities associated with assets held for sale' – see Note 12.

##### (i) Significant accounting estimates

Estimate	Judgement applied to estimate
<p><b>Estimate of ultimate cost of claims</b></p> <p>The estimation of the ultimate liability arising from claims made under insurance contracts is the most critical accounting estimate for the general insurance business. For general insurance contracts estimates are made for the expected ultimate cost of claims as at the Statement of Financial Position date and the cost of claims incurred but not yet reported. It can take a significant period of time before the ultimate cost of claims can be established with certainty, and the final outcome may be better or worse than that provided.</p> <p>There are several sources of uncertainty that need to be considered in the estimate of the liability that will ultimately be paid for such claims. In particular, motor insurance policies are exposed to claims for personal injury.</p> <p>Estimation of the ultimate cost of large personal injury claims is a complex process and cannot be done using conventional actuarial techniques given they typically exhibit low frequency and high severity. Significant factors that affect the personal injuries estimation process are legislation (e.g. the Ogden discount rate used to value lump sum settlements), judicial decisions and the long delay to settlement. Due to this uncertainty it is not possible to determine the future development of personal injury claims with the same degree of reliability as with other types of claims.</p> <p>Claims that have or are likely to settle on a Periodic Payment Order ('PPO') basis require a high degree of judgement due to the nature of the settlement, which has an annuity-type structure, i.e. they are typically paid annually over the claimant's life with mortality, inflation and investment returns being the key risks. Due to the settlement structure, payments have to be projected over a longer-term period and reserved for on a discounted basis accordingly. Therefore, the estimation of ultimate claims cost involves projecting mortality rates, discount rates and benefit indexation rates, which is unlike all other general insurance liabilities.</p> <p>On 20 December 2018 the Civil Liability Bill received Royal Assent and is thus the Civil Liability Act, with a revised Ogden Discount Rate expected to be announced in the summer of 2019. The Act should ensure a more proportional rate is applied to lump sum settlements for personal injury claims as well as providing a framework for future reviews to the rate. Whilst the revised rate is not yet known the Group anticipates an increase from the current legislative rate of -0.75%, with the best estimate reserves being held at the equivalent of a 0% Ogden Discount Rate. The rationale utilised in setting the best estimate rate has included: a review of the opinions and papers provided to date by the Government Actuarial Department (GAD) and the expected real returns from appropriate portfolios of assets.</p> <p>Large claims impacting each relevant business class are generally assessed separately, being measured either at the face value of the loss adjusters' estimates or projected separately in order to allow for the future development of large claims.</p>	<p>While management believes that the insurance contract liabilities carried at year end are adequate, the application of statistical techniques requires significant judgement.</p> <p>The estimation of these claims is based on historical experience projected forward. Where possible, the Group adopts multiple techniques to provide a best estimate of the required level of provisions. This assists in developing greater understanding of the trends inherent in the data being projected. The Group's estimates of losses and loss expenses are reached after a review of several commonly accepted actuarial projection methodologies, as well as more bespoke methods and a number of different bases to determine these provisions. These include methods based upon the following:</p> <ul style="list-style-type: none"> <li>• the development of previously paid claims, where payments to date are extrapolated for each prior year;</li> <li>• estimates based upon a projection of claims numbers and average cost;</li> <li>• incurred claims development, where incurred claims to date for each year are extrapolated based upon observed development of earlier years; and</li> <li>• expected loss ratios.</li> </ul>

Provisions are initially calculated gross of any reinsurance recoveries. A separate estimate is made of the amounts that will be recoverable from reinsurers based upon the gross provisions and having due regard to collectability.

## Notes to the Financial Statements (continued)

Year ended 31 December 2018

## 20. Insurance contract liabilities (continued)

## a) Analysis of insurance contract liabilities and reinsurance assets

Group	Note	2018			2017		
		Gross £m	Reinsurance £m	Net £m	Gross £m	Reinsurance £m	Net £m
<b>Participating insurance contract liabilities</b>							
Long-term insurance contract liabilities	20 b	5,092	–	5,092	5,279	–	5,279
<b>Non-participating insurance contract liabilities</b>							
Reinsurance relating to participating contracts*	20 b	–	(897)	(897)	–	(933)	(933)
Long-term insurance contract liabilities	20 c	4,269	(695)	3,574	4,371	(644)	3,727
Long-term linked insurance contract liabilities	20 d	195	(146)	49	229	(170)	59
Long-term claims liabilities	20 e	58	–	58	50	–	50
		4,522	(1,738)	2,784	4,650	(1,747)	2,903
General insurance unearned premiums	20 f	–	–	–	785	(15)	770
General insurance claims liabilities	20 g	–	–	–	1,643	(543)	1,100
		–	–	–	2,428	(558)	1,870
		4,522	(1,738)	2,784	7,078	(2,305)	4,773

Society	Note	2018			2017		
		Gross £m	Reinsurance £m	Net £m	Gross £m	Reinsurance £m	Net £m
<b>Participating insurance contract liabilities</b>							
Long-term insurance contract liabilities	20 b	5,092	–	5,092	5,279	–	5,279
<b>Non-participating insurance contract liabilities</b>							
Reinsurance relating to participating contracts*	20 b	–	(897)	(897)	–	(933)	(933)
Long-term insurance contract liabilities	20 c	4,255	(695)	3,560	4,356	(644)	3,712
Long-term linked insurance contract liabilities	20 d	195	(146)	49	229	(170)	59
Long-term claims liabilities	20 e	58	–	58	50	–	50
		4,508	(1,738)	2,770	4,635	(1,747)	2,888

\* From December 2017 the Group entered into a reinsurance arrangement in respect of the OB Pension portfolio. The OB Pensions portfolio is a participating insurance contract liability, whereas the associated reinsurance is classified as non-participating as disclosed in the tables above.

## Notes to the Financial Statements (continued)

Year ended 31 December 2018

### 20. Insurance contract liabilities (continued)

#### b) Movement in long-term insurance contract liabilities – participating

Group and Society	2018			2017		
	Gross £m	Reinsurance £m	Net £m	Gross £m	Reinsurance £m	Net £m
Balance at 1 January	5,279	–	5,279	4,999	–	4,999
Premiums received	27	–	27	31	–	31
Liabilities paid for deaths, maturities, surrenders, benefits and claims	(427)	–	(427)	(444)	–	(444)
New business	340	–	340	403	–	403
Benefits and claims variation	33	–	33	57	–	57
Fees deducted	(20)	–	(20)	(23)	–	(23)
Accretion of investment income or change in unit prices	(103)	–	(103)	224	–	224
Adjustment due to changes in assumptions:						
– Mortality/morbidity/longevity	(22)	–	(22)	(44)	–	(44)
– Investment return	(27)	–	(27)	38	–	38
– Expense	(1)	–	(1)	(15)	–	(15)
– Lapse and surrender rates	7	–	7	1	–	1
– Other basis changes	1	–	1	–	–	–
Model changes	9	–	9	12	–	12
Other	(14)	–	(14)	(59)	–	(59)
Teachers Assurance (TA) fund special bonus	(10)	–	(10)	(9)	–	(9)
Mutual bonus	20	–	20	19	–	19
Change in economic basis	–	–	–	89	–	89
Balance at 31 December	5,092	–	5,092	5,279	–	5,279

#### b) Movement in non-participating reinsurance assets relating to long-term participating insurance contract liabilities

Group and Society	2018			2017		
	Gross £m	Reinsurance £m	Net £m	Gross £m	Reinsurance £m	Net £m
Balance at 1 January	–	(933)	(933)	–	–	–
Inception of OB pensions reinsurance contract	–	–	–	–	(847)	(847)
Liabilities paid for deaths, maturities, surrenders, benefits and claims	–	10	10	–	–	–
Benefits and claims variation	–	3	3	–	–	–
Accretion of investment income or change in unit prices	–	(5)	(5)	–	–	–
Adjustment due to changes in assumptions:						
– Mortality/morbidity/longevity	–	9	9	–	–	–
– Investment return	–	19	19	–	(9)	(9)
– Lapse and surrender rates	–	1	1	–	–	–
Model changes	–	(2)	(2)	–	–	–
Other	–	1	1	–	(1)	(1)
Change in economic basis	–	–	–	–	(76)	(76)
Balance at 31 December	–	(897)	(897)	–	(933)	(933)

## Notes to the Financial Statements (continued)

Year ended 31 December 2018

## 20. Insurance contract liabilities (continued)

## c) Movement in long-term insurance contract liabilities – non-participating

Group	2018			2017		
	Gross £m	Reinsurance £m	Net £m	Gross £m	Reinsurance £m	Net £m
Balance at 1 January	4,371	(644)	3,727	4,204	(474)	3,730
Premiums received	170	(68)	102	156	(61)	95
Liabilities paid for deaths, maturities, surrenders, benefits and claims	(423)	92	(331)	(393)	76	(317)
New business	246	(163)	83	156	(113)	43
Benefits and claims variation	11	(3)	8	30	(16)	14
Fees deducted	(17)	(1)	(18)	(16)	–	(16)
Accretion of investment income or change in unit prices	59	(1)	58	43	–	43
Adjustment due to changes in assumptions:						
– Mortality/morbidity/longevity	(68)	67	(1)	(6)	(9)	(15)
– Investment return	(64)	13	(51)	80	(6)	74
– Expense	13	2	15	24	–	24
– Lapse and surrender rates	(2)	5	3	13	(9)	4
– Other basis changes	(27)	10	(17)	14	–	14
Model changes	4	(5)	(1)	(2)	(4)	(6)
Other	(4)	1	(3)	18	(1)	17
Change in economic basis	–	–	–	50	(27)	23
Balance at 31 December	4,269	(695)	3,574	4,371	(644)	3,727

Society	2018			2017		
	Gross £m	Reinsurance £m	Net £m	Gross £m	Reinsurance £m	Net £m
Balance at 1 January	4,356	(644)	3,712	4,189	(474)	3,715
Premiums received	170	(68)	102	155	(61)	94
Liabilities paid for deaths, maturities, surrenders, benefits and claims	(422)	92	(330)	(391)	76	(315)
New business	246	(163)	83	156	(113)	43
Benefits and claims variation	11	(3)	8	30	(16)	14
Fees deducted	(17)	(1)	(18)	(16)	–	(16)
Accretion of investment income or change in unit prices	59	(1)	58	43	–	43
Adjustment due to changes in assumptions:						
– Mortality/morbidity/longevity	(68)	67	(1)	(6)	(9)	(15)
– Investment return	(64)	13	(51)	80	(6)	74
– Expense	13	2	15	24	–	24
– Lapse and surrender rates	(2)	5	3	13	(9)	4
– Other basis changes	(27)	10	(17)	14	–	14
Model changes	4	(5)	(1)	(2)	(4)	(6)
Other	(4)	1	(3)	17	(1)	16
Change in economic basis	–	–	–	50	(27)	23
Balance at 31 December	4,255	(695)	3,560	4,356	(644)	3,712



## Notes to the Financial Statements (continued)

Year ended 31 December 2018

### 20. Insurance contract liabilities (continued)

#### d) Movement in long-term linked insurance contract liabilities

	2018			2017		
	Gross £m	Reinsurance £m	Net £m	Gross £m	Reinsurance £m	Net £m
<b>Group and Society</b>						
Balance at 1 January	229	(170)	59	192	(127)	65
Premiums received	42	(17)	25	45	(18)	27
Liabilities paid for deaths, maturities, surrenders, benefits and claims	(38)	25	(13)	(41)	25	(16)
New business	(18)	3	(15)	15	(33)	(18)
Benefits and claims variation	2	(1)	1	6	(5)	1
Fees deducted	(2)	–	(2)	(2)	–	(2)
Accretion of investment income or change in unit prices	1	–	1	1	–	1
Adjustment due to changes in assumptions:						
– Mortality/morbidity/longevity	(9)	9	–	(14)	–	(14)
– Investment return	(5)	2	(3)	4	(1)	3
– Expense	(1)	–	(1)	5	–	5
– Lapse and surrender rates	(1)	1	–	4	(3)	1
– Other basis changes	(5)	2	(3)	–	–	–
Model changes	–	–	–	(3)	–	(3)
Other	–	–	–	3	–	3
Change in economic basis	–	–	–	14	(8)	6
Balance at 31 December	195	(146)	49	229	(170)	59

#### e) Movement in long-term claims liabilities

	2018			2017		
	Gross £m	Reinsurance £m	Net £m	Gross £m	Reinsurance £m	Net £m
<b>Group</b>						
Balance at 1 January	50	–	50	46	–	46
Claims notified	904	(232)	672	872	(237)	635
Claims paid during the year	(896)	232	(664)	(868)	237	(631)
Balance at 31 December	58	–	58	50	–	50

	2018			2017		
	Gross £m	Reinsurance £m	Net £m	Gross £m	Reinsurance £m	Net £m
<b>Society</b>						
Balance at 1 January	50	–	50	45	–	45
Claims notified	903	(232)	671	871	(237)	634
Claims paid during the year	(895)	232	(663)	(866)	237	(629)
Balance at 31 December	58	–	58	50	–	50

#### f) Movement in general insurance unearned premiums

	2018			2017		
	Gross £m	Reinsurance £m	Net £m	Gross £m	Reinsurance £m	Net £m
<b>Group</b>						
Balance at 1 January	785	(15)	770	793	(17)	776
Premiums written in the year	1,580	(383)	1,197	1,596	(361)	1,235
Premiums earned during the year	(1,610)	383	(1,227)	(1,604)	363	(1,241)
Liabilities directly associated with assets held for sale	(755)	15	(740)	–	–	–
Balance at 31 December	–	–	–	785	(15)	770

#### g) Movement in general insurance claims liabilities

	2018			2017		
	Gross £m	Reinsurance £m	Net £m	Gross £m	Reinsurance £m	Net £m
<b>Group</b>						
Balance at 1 January	1,643	(543)	1,100	1,563	(472)	1,091
Movement in claims incurred in prior accident years	(253)	110	(143)	(34)	(12)	(46)
Claims incurred in the current accident year	1,221	(285)	936	1,124	(286)	838
Claims paid during the year	(1,083)	243	(840)	(1,010)	227	(783)
Liabilities directly associated with assets held for sale	(1,528)	475	(1,053)	–	–	–
Balance at 31 December	–	–	–	1,643	(543)	1,100

## Notes to the Financial Statements (continued)

Year ended 31 December 2018

## 21. Non-participating value of in-force business

## Accounting for the non-participating value of in-force business

In determining the realistic value of liabilities for participating contracts as disclosed in Note 20, 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 of the non-participating business ('non-participating value of in-force business') is separately determined and its value is deducted from the sum of the liabilities for participating contracts and the Unallocated divisible surplus. Such an amount is not recognised for business written outside participating contract funds.

The principal assumptions are disclosed separately within Note 26.

## Analysis of non-participating value of in-force business

	Group		Society	
	2018 £m	2017 £m	2018 £m	2017 £m
Balance at 1 January	293	324	293	324
Premiums received	(1)	(1)	(1)	(1)
Liabilities paid for deaths, maturities, surrenders, benefits and claims	(12)	(14)	(12)	(14)
New business	31	41	31	41
Benefits and claim variation	(6)	(1)	(6)	(1)
Fees deducted	(9)	(6)	(9)	(6)
Accretion of investment income or change in unit prices	(3)	8	(3)	8
Adjustment due to changes in assumptions:				
– Mortality/morbidity/longevity	(3)	(17)	(3)	(17)
– Investment return	(4)	(4)	(4)	(4)
– Expense	10	(10)	10	(10)
– Lapse and surrender rates	7	(9)	7	(9)
– Other basis changes	(6)	(3)	(6)	(3)
Model changes	9	(5)	9	(5)
Other	(3)	(9)	(3)	(9)
Change in economic basis	–	(1)	–	(1)
Balance at 31 December	303	293	303	293

## 22. Net change in long-term contract liabilities and non-participating value of in-force business

	Group		Society	
	2018 £m	2017 £m	2018 £m	2017 £m
<b>Gross decrease/(increase) in long-term contract liabilities</b>				
Decrease/(increase) in long-term insurance contract liabilities – participating	187	(191)	187	(191)
Decrease/(increase) in investment contract liabilities – participating	55	(51)	55	(51)
Decrease/(increase) in long-term insurance contract liabilities – non-participating	102	(117)	101	(117)
Decrease/(increase) in investment contract liabilities – non-participating	135	(234)	135	(234)
Decrease/(increase) in long-term linked insurance contract liabilities	34	(23)	34	(23)
	513	(616)	512	(616)
Mutual bonus (disclosed separately on the Statement of Comprehensive Income)	26	26	26	26
	539	(590)	538	(590)
<b>(Decrease)/increase in long-term contract liabilities ceded to reinsurers</b>				
Increase in long-term insurance contract liabilities relating to non-participating contracts	51	143	51	143
(Decrease)/increase in long-term insurance contract liabilities relating to participating contracts	(36)	857	(36)	857
(Decrease)/increase in long-term linked insurance contract liabilities	(24)	35	(24)	35
	(9)	1,035	(9)	1,035
<b>Increase/(decrease) in non-participating value of in-force business</b>	10	(30)	10	(30)
<b>Net change in contract liabilities before change in economic basis</b>	540	415	539	415
Change in economic basis	–	(48)	–	(48)
<b>Net change in contract liabilities</b>	540	367	539	367

In December 2017 the Group entered into a reinsurance arrangement in respect of the OB Pension portfolio, this had an initial impact of £847m on Long-term contract liabilities ceded to reinsurers. For further details see Note 24.

## Notes to the Financial Statements (continued)

Year ended 31 December 2018

### 23. Deferred acquisition costs

#### Accounting for deferred acquisition costs

The proportion of the costs of acquiring new general insurance business which relate to unearned premiums are deferred and recognised as an asset to the extent that they are recoverable out of margins in future matching revenues.

Acquisition costs comprise all allowable costs incurred in writing new contracts. Deferred acquisition costs are amortised over a period which is consistent with the assessment of the expected pattern of receipt of future revenue margins for each product type.

All deferred acquisition costs are tested for recoverability at each reporting date. The carrying values are adjusted to recoverable amounts and any resulting impairment losses are charged to the Statement of Comprehensive Income.

Group	£m
At 1 January 2018	95
Acquisition costs deferred	183
Amortisation	(192)
Transfer to assets held for sale	(86)
<b>At 31 December 2018</b>	<b>–</b>
At 1 January 2017	102
Acquisition costs deferred	195
Amortisation	(202)
<b>At 31 December 2017</b>	<b>95</b>

Acquisition costs are costs of acquiring new business and include commissions, underwriting expenses and policy issue expenses. There were no deferred acquisition costs held by the Society in 2018 (2017: £nil).

### 24. Reinsurance assets

#### Accounting for reinsurance assets

Contracts entered into by the Group with reinsurers under which the Group is compensated for losses on the insurance contracts issued by the Group are classified as reinsurance contracts. A contract is only accounted for as a reinsurance contract where there is significant insurance risk transfer between the insured and the insurer. Reinsurance assets are the net contractual rights arising from cashflows due from and to reinsurance companies for ceded insurance liabilities. Amounts are estimated in a consistent manner with the gross reserves of the underlying policies and in accordance with the relevant reinsurance contract.

An impairment review is performed at the Statement of Financial Position date. Impairment occurs when there is evidence that the Group will not recover outstanding amounts under the contract, such losses being recorded immediately in the Statement of Comprehensive Income.

All reinsurance contracts are classified as non-participating as the Group and the reinsurer do not share in the returns on underlying items. This is consistent with the treatment of reinsurance contracts separate from the underlying contracts issued.

#### Significant accounting judgements

##### Classification of the Group's contracts with reinsurers as reinsurance contracts

Management have applied judgement in determining whether contracts entered into with reinsurers transfer significant insurance risk and can therefore be accounted for as reinsurance contracts. In making this judgement management review all terms and conditions of each contract and obtain the opinion of an independent expert where necessary.

In order for significant insurance risk to be transferred the following conditions must both be met:

- It is reasonably possible that the reinsurer may realise a significant loss from the contract; and
- There is a reasonable possibility of a significant range of outcomes from the contract.

In December 2017 the Society entered into a reinsurance arrangement in relation to the OB Pensions portfolio included within Participating insurance contract liabilities in Note 20. This was part of the strategy to de-risk the Solvency II balance sheet by reducing the longevity risk exposure and capital requirement. Management judged that significant insurance risk had been transferred to the reinsurer following a review of the terms and conditions of the contract.

The resulting reinsurance asset is disclosed below as the 'Reinsurers' share of long-term contract liabilities – participating'.

## Notes to the Financial Statements (continued)

Year ended 31 December 2018

### 24. Reinsurance assets (continued)

	Note	Group		Society	
		2018 £m	2017 £m	2018 £m	2017 £m
Reinsurers' share of provision for unearned premiums	20 a	–	15	–	–
Reinsurers' share of long-term insurance contract liabilities - non participating	20 a	695	644	695	644
Reinsurers' share of long-term insurance contract liabilities - participating	20 a	897	933	897	933
Reinsurers' share of long-term linked insurance contract liabilities	20 a	146	170	146	170
Reinsurers' share of claims liabilities	20 a	–	543	–	–
		<b>1,738</b>	<b>2,305</b>	<b>1,738</b>	<b>1,747</b>

For 2018 reporting the Reinsurers' share of provision for unearned premiums and Reinsurers' share of claims liabilities are included within Assets held for sale – see Note 12.

The carrying amounts disclosed above reasonably approximate fair value at the Statement of Financial Position date.

### 25. Long-term insurance and investment contract liabilities valuation assumptions

The basis of the calculation of the long-term insurance contract liabilities is described in the accounting policies. The liability is calculated separately for each life operation. Material judgement is required in calculating the liability. In particular there is discretion over the assumptions used. For participating business, the liability is calculated in accordance with the PRA's realistic capital regime. Non-participating liabilities are valued using a gross premium method.

In calculating the realistic liabilities, account has also been taken of future management actions consistent with those set out in the Principles and Practices of Financial Management.

The assumptions used to calculate the liability depend on the circumstances prevailing in each of the life operations. The assumptions used in determining the liability are estimated to give a result within the normal range of outcomes. To the extent that the ultimate cost differs to the amounts provided, for example where experience is worse than that assumed, the surplus or deficit will be credited or charged to the Statement of Comprehensive Income in future years.

When valuing options and guarantees the asset model used was the Moody's Market-Consistent Asset Model. This is a deflator model based on published financial economic theory that is capable of market-consistent valuations for multiple asset classes in multiple currencies. For this valuation it was calibrated to market data as at 31 December 2018 representative of the nature and term of the guarantees inherent in participating insurance contracts within the participating insurance contract funds.

The accounting policies for long-term insurance and investment contract liabilities are included within Notes 20 and 16 respectively. Sensitivities to changes in assumptions are included within Note 4.

#### a) Society

##### (i) Participating insurance contracts

For participating insurance contracts, a market consistent valuation is used to calculate the liability. This involves placing a value on liabilities similar to the market value of assets with similar cash flow patterns. The key assumptions used in this valuation are set out below.

#### Interest rates

The risk-free interest rates assumed are:

Year	2018	2017
5	<b>1.20%</b>	0.94%
15	<b>1.43%</b>	1.33%
25	<b>1.46%</b>	1.37%
35	<b>1.44%</b>	1.30%

These interest rates are gross of tax and investment expenses.

## Notes to the Financial Statements (continued)

Year ended 31 December 2018

### 25. Long-term insurance and investment contract liabilities valuation assumptions (continued)

#### Other assumptions

Best estimate assumptions are set for inflation, mortality, expenses and persistency. The future expense inflation assumption is modelled as RPI plus 0.1% (2017: RPI plus 0.5%) and RPI plus 1% (2017: RPI plus 1%) for business in the Teachers ring-fenced fund, where RPI in both 2018 and 2017 is modelled stochastically.

Benchmark asset mix for assets backing asset shares	2018				2017			
	Cash	Fixed interest	Equities	Property	Cash	Fixed interest	Equities	Property
Flexible Guarantee Funds Cautious	2%	68%	20%	10%	2%	68%	20%	10%
Flexible Guarantee Funds Balanced	2%	48%	35%	15%	2%	48%	35%	15%
Flexible Guarantee Funds Managed	2%	33%	50%	15%	2%	33%	50%	15%
All in One Bond Cautious Fund	0%	80%	10%	10%	0%	80%	10%	10%
All in One Bond Balanced Fund	0%	30%	35%	35%	0%	30%	35%	35%
All in One Bond Managed Fund	0%	5%	85%	10%	0%	5%	85%	10%
Other With-Profit	3%	39%	49%	9%	3%	39%	49%	9%

#### Mortality rate tables

	2018	2017
Conventional Life Business	85% AMC00/90% AFC00	75% AM80 Females -3yrs
Conventional Pensions Business	130% AMC00/AFC00 CMI_2017_1.5%/1.25% LT	130% AMC00/AFC00 CMI_2016_ 1.5%/1.25% LT
Conventional Industrial Branch Business	80% up to age 80, rising linearly to 100% at age 100, of ELT16	80% up to age 80, rising linearly to 100% at age 100, of ELT16
Non-Unitised Accumulating Pensions Business	85% AMC00/AFC00	65% AM80
Unitised Accumulating Life Business	85% AMC00/AFC00	80% AM80/AF80
Unitised Accumulating Pensions Business	85% AMC00/AFC00	80% AM80
Unitised Accumulating Bond Business	85% AMC00/AFC00	80% AM80
Unitised Accumulating Life ISA Business	85% AMC00/AFC00	80% AM80 select/AF80 select
Heritage Annuities in Payment	115% RMV00/121% RFV00 CMI_2017 1.5%/1.25% LT	116% RMV00/116% RFV00 CMI_2016 1.5% /1.25% LT

#### Per policy expenses – regular premiums

	2018	2017
Conventional Life Business	£29.26	£25.74
Conventional Pensions Business	£45.12	£29.95
Conventional Industrial Branch Business*	£11.15	£14.54
Non-Unitised Accumulating Pensions Business	£45.12	£29.95
Unitised Accumulating Life Business	£29.26	£25.74
Unitised Accumulating Pensions Business	£45.12	£29.95
Unitised Accumulating Bond Business	£29.26	£25.74
Unitised Accumulating Life ISA Business	£29.26	£25.74
Heritage Annuities in Payment	£54.44	£40.71

\* The unit cost for IB business has been grossed-up to allow for a reduction made to the in-force data to reflect policies that are believed no longer likely to give rise to a claim.

#### Persistency – lapses, surrenders and paid up rates

A review of persistency is carried out annually. Assumptions for each product class are adjusted where necessary to reflect more recent experience.

#### Options and guarantees

Allowance is made in respect of cash commutation options on OB Pensions.

## Notes to the Financial Statements (continued)

Year ended 31 December 2018

## 25. Long-term insurance and investment contract liabilities valuation assumptions (continued)

## (ii) Non-participating insurance contracts

Interest rate	2018	2017
Non-profit temporary assurances*	1.35%	1.25%
Whole of life assurances*	1.35%	1.25%
Permanent health insurance:		
a) active lives	1.35%	1.25%
b) claims reserves	1.20%	1.00%
Critical illness	1.35%	1.25%
Retirement Solutions annuities in payment MAP	2.39%	2.11%
Retirement Solutions annuities in payment non-MAP	3.29%	3.37%

\* These interest rates are netted down at 20% tax for life contracts written before 1 January 2013.

Investment expenses	2018	2017
Non-profit temporary assurances*	0.06%	0.12%
Whole of life assurances*	0.06%	0.12%
Permanent health insurance:		
a) active lives	0.06%	0.12%
b) claims reserves	0.06%	0.12%
Critical illness	0.06%	0.12%
Retirement Solutions annuities in payment MAP	0.11%	0.19%
Retirement Solutions annuities in payment non-MAP	0.03%	0.03%

\* These expenses are netted down at 20% tax for life contracts written before 1 January 2013.

Mortality rate tables	2018	2017
Non-profit temporary assurances*	TMN00,TMS00/TFN00,TFS00 CMI_2017 1.5%/1.25% LT	TMN00,TMS00/TFN00,TFS00 CMI_2016 1.5%/1.25% LT
Whole of life assurances (50+)*	AMC00/AFC00 CMI_2017 1.5%/1.25% LT	AMC00/AFC00 CMI_2016 1.5%/1.25% LT
Whole of life assurances (Lifetime+)*	TMN00,TMS00/TFN00,TFS00 CMI_2017 1.5%/1.25% LT	TMN00,TFN00/TMS00,TFS00 CMI_2016 1.5%/1.25% LT
Retirement Solutions annuities in payment**	80.75% RMV00/RFV00 CMI_2017 1.5%/1.25% LT	80.75% RMV00/RFV00 CMI_2016 1.5%/1.25% LT

\* A series of duration and age-related adjustment factors are applied to the base mortality rates. These adjustments vary by product line and smoking status.

\*\*The mortality rates for enhanced annuity contracts are adjusted so as to allow for convergence to standard mortality at advanced ages. These adjustments vary according to lifestyle or medical condition, gender, age and duration in-force.

Morbidity rate tables	2018	2017
Permanent health insurance		
a) active lives	CMIR12	CMIR12
b) claims reserves	CMIR12	CMIR12
Critical illness	Reinsurer rates	Reinsurer rates

A series of adjustments are made to the standard mortality and morbidity tables to take account of actual experience and publicly available market data. The adjustments for permanent health insurance vary by product line, age, smoking status, sickness duration, deferred periods and occupations.

## Notes to the Financial Statements (continued)

Year ended 31 December 2018

### 25. Long-term insurance and investment contract liabilities valuation assumptions (continued)

#### (ii) Non-participating insurance contracts (continued)

Per policy expenses – regular premiums	2018	2017
Non-profit temporary assurances	£18.79	£18.80
Whole of life assurances	£18.79	£18.80
Permanent health insurance:		
a) active lives	£18.79	£25.01
b) claims reserves (per policy in claim)	£893.39	£810.35
Critical illness	£18.79	£18.80
Retirement Solutions annuities in payment (life annuity)	£59.88	£44.67
Retirement Solutions annuities in payment (fixed term)	£59.88	£44.67

#### Options and guarantees

There are no significant options and guarantees in the non-participating business.

#### (iii) Investment and long-term linked insurance contracts

The provision for unit linked business is equal to the value of the assets to which the contracts are linked. This is classified as an investment product and the liability is included within the long-term investment contract liabilities.

Within insurance contract liabilities the provisions for index-linked permanent health insurance claims, index-linked temporary assurances and index-linked annuities in payment have been calculated using the same mortality and morbidity assumptions as used for the corresponding non-linked liabilities for both 2018 and 2017.

#### b) Society (originally Teachers)

##### (i) Participating insurance contracts

As part of the Teachers acquisition in 2016, the Society purchased the non-participating business from Teachers Assurance. The Teachers Assurance participating business remains within the ring-fenced TA Fund (see section e).

##### (ii) Non-participating insurance contracts

#### Interest rate

The interest rates for Teachers are set using an approach consistent with that described for the Society in section a (ii).

Mortality rate tables	2018	2017
Teachers annuities in payment	55.25% RMV00/80.75% RFV00 CMI_2017 1.5%/1.25% LT	55.25% RMV00/80.75% RFV00 CMI_2016 1.5%/1.25% LT

Per policy expenses	2018	2017
Teachers annuities in payment	£59.88	£31.33

#### Options and guarantees

There are no options and guarantees in the non-participating business.

#### (iii) Investment linked contracts

The provision for unit linked business is equal to the value of the assets to which the contracts are linked. This is classified as an investment product and the liability is included within the long-term investment contract liabilities. The provision for unit linked contracts is equal to the value of the units plus a non-unit liability consisting of a sterling reserve calculated by carrying out cash flow projections on appropriate bases.

## Notes to the Financial Statements (continued)

Year ended 31 December 2018

### 25. Long-term insurance and investment contract liabilities valuation assumptions (continued)

#### c) Liverpool Victoria Life Company Limited – Ordinary Long-Term Fund

##### (i) Participating insurance contracts

Liverpool Victoria Life Company Limited has no participating business.

##### (ii) Non-participating insurance contracts

Interest rate	2018	2017
Non-profit temporary assurances*	1.35%	1.25%
Other assurances*	1.38%	1.33%

\* These interest rates are netted down at 20% tax.

Investment expenses	2018	2017
Non-profit temporary assurances*	0.06%	0.12%
Other assurances*	0.08%	0.11%

\* These expenses are netted down at 20% tax.

Mortality rate tables	2018	2017
Non-profit temporary assurances*	TMN00,TMS00/TFN00,TF500 CMI_2017 1.5%/1.25% LT	TMN00,TMS00/TFN00,TF500 CMI_2016 1.5%/1.25% LT
Other assurances	AM92/AF92	AM92/AF92

\* A series of duration and age-related adjustment factors are applied to the base mortality rates. These adjustments vary by product line and smoking status.

Per policy expenses – regular premiums	2018	2017
Non-profit temporary assurances	£18.79	£18.80
Other assurances	£24.00	£29.99

#### d) RNPFN fund

RNPFN denotes Royal National Pension Fund for Nurses, which is a ring-fenced fund. The free assets attributable to this fund are reported as insurance contract liabilities of the Society.

##### (i) Participating business

For participating insurance contracts, a market-consistent valuation is used to calculate the liability. This involves placing a value on liabilities similar to the market value of assets with similar cash flow patterns. The key assumptions used in this valuation are set out in the tables below.

##### Interest rates

The interest rates for RNPFN are set using an approach consistent with that described for the Society in section a(i).

##### Other assumptions

Best estimate assumptions are set for inflation, mortality, expenses and persistency. The future expense inflation assumption is modelled as RPI plus 0.1% (2017: RPI plus 0.5%), where RPI in both 2018 and 2017 is modelled stochastically.

Benchmark asset mix for assets backing asset shares	2018	2017
Cash	4%	4%
Fixed interest	64%	65%
UK Equities	32%	31%

Mortality rate tables	2018	2017
Conventional Life Business	60% AM/F00 ult	60% AM/F00 ult
Life Deferred Annuities	50% AM/F00 ult	50% AM/F00 ult
Pension Deferred Annuities	50% AM/F00 ult	50% AM/F00 ult
Unitised With-profits business	60% AM/F00 ult	60% AM/F00 ult



## Notes to the Financial Statements (continued)

Year ended 31 December 2018

### 25. Long-term insurance and investment contract liabilities valuation assumptions (continued)

#### (i) Participating business (continued)

Per policy expenses – regular premiums	2018	2017
Conventional Life Business	£29.26	£25.74
Pensions Deferred Annuities	£45.12	£29.95
Life Deferred Annuities	£29.26	£25.74
Unitised With-profits ISA	£29.26	£25.74
Unitised With-profits Bond	£29.26	£25.74

#### Persistency – lapses, surrenders and paid up rates

A review of persistency is carried out annually. Assumptions are adjusted where appropriate to reflect more recent experience.

#### Options and guarantees

The provisions held in respect of guaranteed annuity options are determined on a market consistent basis. The total amount provided in respect of the future costs of the guaranteed annuity options was £82m (2017: £89m).

#### (ii) Non-participating business

Interest rate	2018	2017
Non-profits assurances*	1.60%	1.54%
Non-profits general deferred annuities*	1.60%	1.54%
Annuities in Payment (Life)*	1.60%	1.54%
Annuities in Payment (Pension)	1.60%	1.54%
Pension Deferred Annuities	1.60%	1.54%

\* These interest rates are netted down at 20% tax for life contracts written before 1 January 2013.

Investment expenses	2018	2017
Non-profits assurances*	0.06%	0.17%
Non-profits general deferred annuities*	0.06%	0.17%
Annuities in Payment (Life)*	0.06%	0.17%
Annuities in Payment (Pension)	0.06%	0.17%
Pension Deferred Annuities	0.06%	0.17%

\* These expenses are netted down at 20% tax for life contracts written before 1 January 2013.

Mortality rate tables	2018	2017
Non-profits assurances	72.0% AM/F00 ult	72.0% AM/F00 ult
Non-profits general deferred annuities	42.5% AM/F00 ult	42.5% AM/F00 ult
Annuities in Payment (Male)	68.0% IML00 with CMI_2009 improvement model with a long-term improvement rate of 1.75%	61.2% IML00 with CMI_2009 improvement model with a long-term improvement rate of 1.75%
Annuities in Payment (Female)	75.7% IFL00 with CMI_2009 improvement model with a long-term improvement rate of 1.5%	72.3% IFL00 with CMI_2009 improvement model with a long-term improvement rate of 1.5%
Pension Deferred Annuities	42.5% AM/F00 ult	42.5% AM/F00 ult

Appropriate adjustments were made to the standard mortality tables to take account of actual experience and publicly available market data.

## Notes to the Financial Statements (continued)

Year ended 31 December 2018

### 25. Long-term insurance and investment contract liabilities valuation assumptions (continued)

#### (iii) Linked fund

There are two main classes of contract included within the linked fund, one is classified as an insurance contract and the liability is included within the long-term unit linked insurance contract liabilities, the other is classified as an investment product and the liability is included within the investment contract liabilities. The provision for unit linked contracts is equal to the value of the units. A non-unit liability consisting mainly of a sterling reserve calculated by carrying out cash flow projections on appropriate bases is included within the liability for insurance contracts only.

Interest rate	2018	2017
Unit linked assurances*	1.60%	1.54%

\* This interest rate is netted down at 20% tax for life contracts written before 1 January 2013.

Investment expenses	2018	2017
Unit linked assurances*	0.06%	0.17%

\* This expense is netted down at 20% tax for life contracts written before 1 January 2013.

Mortality rate tables	2018	2017
Unit linked assurances	72.0% AM/F00 ult	72.0% AM/F00 ult

#### e) TA fund

The TA fund denotes the Teachers Assurance Fund, which is a ring-fenced fund. The free assets attributable to this fund are reported as insurance and investment contract liabilities of the Society.

#### (i) Participating contracts

For participating contracts, a market consistent valuation is used to calculate the liability. This involves placing a value on liabilities similar to the market value of assets with similar cash flow patterns. The key assumptions used in this valuation are set out below.

#### Interest rates

The risk-free interest rates assumed are:

Year	2018	2017
5	1.20%	0.94%
15	1.43%	1.33%
25	1.46%	1.37%
35	1.44%	1.30%

These interest rates are gross of tax and investment expenses.

#### Other assumptions

Best estimate assumptions are set for inflation, mortality, expenses and persistency. The future expense inflation assumption is modelled as RPI, where RPI in both 2018 and 2017 is modelled stochastically.

#### Benchmark asset mix for assets backing

asset shares	2018	2017
Cash	5%	5%
Fixed interest	35%	35%
Equities	53%	53%
Property	7%	7%

Mortality rate tables	2018	2017
Conventional Life Business	50% AM92 / 65% AF92	50% AM92 / 65% AF92
Unitised Accumulating Life Business	50% AM92 / 65% AF92	50% AM92 / 65% AF92
Unitised Accumulating Bond Business	50% AM92 / 65% AF92	50% AM92 / 65% AF92
Unitised Accumulating Life ISA Business	50% AM92 / 65% AF92	50% AM92 / 65% AF92

## Notes to the Financial Statements (continued)

Year ended 31 December 2018

### 25. Long-term insurance and investment contract liabilities valuation assumptions (continued)

#### (i) Participating contracts (continued)

Per policy expenses	2018	2017
Conventional Life Business	£40.21	£38.84
Unitised Accumulating Life Business	£40.21	£38.84
Unitised Accumulating Bond Business	£40.21	£38.84
Unitised Accumulating Life ISA Business	£40.21	£38.84

#### Persistency – lapses, surrenders and paid up rates

A review of persistency is carried out annually. Assumptions for each product class are adjusted where necessary to reflect more recent experience.

#### Options and guarantees

There are no guaranteed annuity or financial options within the contracts participating in the TA Fund.

### 26. Non-participating value of in-force business valuation assumptions

#### a) Society

##### Non-participating contracts

##### Interest rates

The earned rate and discount rate are set by reference to the risk free yield curve applicable at the valuation date with appropriate adjustments for an illiquidity premium and margins for risk and uncertainty, with the exception of Retirement Solutions annuities in payment where the earned rate is based on the IRR of the risk adjusted backing assets cashflows.

Mortality rate tables	2018	2017
Non-profit temporary assurances*	TMN00,TMS00/TFN00,TFS00 CMI_2017 1.5%/1.25% LT	TMN00,TMS00/TFN00,TFS00 CMI_2016 1.5%/1.25% LT
Whole of Life Assurances (50+)*	AMC00/AFC00 CMI_2017 1.5%/1.25% LT	AMC00/AFC00 CMI_2016 1.5%/1.25% LT
Whole of Life Assurances (Lifetime+)*	TMN00,TMS00/TFN00,TFS00 CMI_2017 1.5%/1.25% LT	TMN00,TMS00/TFN00,TFS00 CMI_2016 1.5%/1.25% LT
Retirement Solutions annuities in payment**	95% RMV00/RFV00 CMI_2017 1.5%/1.25% LT	95% RMV00/RFV00 CMI_2016 1.5%/1.25% LT
Unit linked pensions (original LVFS)	80% AX92C20	80% AX92C20
Teachers annuities in payment	65% RMV00/95% RFV00 CMI_2017 1.5%/1.25% LT	65% RMV00/95% RFV00 CMI_2016 1.5%/1.25% LT

\* A series of duration and age-related adjustment factors are applied to the base mortality rates. These adjustments vary by product line and smoking status.

\*\*The mortality rates for enhanced annuity contracts are adjusted so as to allow for convergence to standard mortality at advanced ages. These adjustments vary according to lifestyle or medical condition, gender, age and duration in-force.

Morbidity rate tables	2018	2017
Permanent health insurance:		
a) active lives	CMIR12	CMIR12
b) claims reserves	CMIR12	CMIR12
Critical illness	Reinsurer rates	Reinsurer rates

A series of adjustments are made to the standard mortality and morbidity tables to take account of actual experience and publicly available market data. The adjustments for permanent health insurance vary by product line, age, smoking status, sickness duration, deferred periods and occupations.

#### Persistency and unit costs

Persistency and unit costs assumptions are based on our best estimate of future experience. A review of persistency is carried out annually. Assumptions for each product class are adjusted where appropriate to reflect more recent experience.

## Notes to the Financial Statements (continued)

Year ended 31 December 2018

## Fixed assets and investments

This section gives detail on the tangible, intangible and investment assets of the Society and Group that are used to generate profit for the business.

## 27. Property and equipment

## Accounting for property and equipment

Operational property and equipment are held at cost less accumulated depreciation. Cost includes the original purchase price of the asset and the costs attributable to bringing the asset to its working condition for its intended use. Both property and equipment are depreciated to their estimated residual values on a straight line basis over their estimated useful lives. The periods used are as follows:

Freehold buildings and finance lease property	10 to 50 years
Leasehold property enhancements	10 years or lease term if shorter
Fixtures and fittings	3 to 10 years
IT equipment	3 to 8 years
Land is not depreciated.	

Assets are written down to their recoverable amount where this is less than the carrying value.

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each Statement of Financial Position date.

Group	Freehold and leasehold property £m	Leasehold property enhancements £m	Fixtures, fittings and IT equipment £m	Total £m
<b>Cost:</b>				
At 1 January 2018	43	14	27	84
Additions	–	1	4	5
Disposals	(14)	(3)	(4)	(21)
Transfer to assets held for sale	–	(8)	(10)	(18)
<b>At 31 December 2018</b>	<b>29</b>	<b>4</b>	<b>17</b>	<b>50</b>
<b>Accumulated depreciation:</b>				
At 1 January 2018	19	10	18	47
Provided in the year	1	1	3	5
Disposals	(11)	(3)	(4)	(18)
Transfer to assets held for sale	–	(6)	(7)	(13)
<b>At 31 December 2018</b>	<b>9</b>	<b>2</b>	<b>10</b>	<b>21</b>
<b>Net book value at 31 December 2018</b>	<b>20</b>	<b>2</b>	<b>7</b>	<b>29</b>
<b>Cost:</b>				
At 1 January 2017	43	15	28	86
Additions	–	1	1	2
Disposals	–	(2)	(2)	(4)
<b>At 31 December 2017</b>	<b>43</b>	<b>14</b>	<b>27</b>	<b>84</b>
<b>Accumulated depreciation:</b>				
At 1 January 2017	17	11	15	43
Provided in the year	2	1	4	7
Disposals	–	(2)	(1)	(3)
<b>At 31 December 2017</b>	<b>19</b>	<b>10</b>	<b>18</b>	<b>47</b>
<b>Net book value at 31 December 2017</b>	<b>24</b>	<b>4</b>	<b>9</b>	<b>37</b>

Included within the Freehold and leasehold property category above are assets held under finance leases with a net book value of £17m (2017: £18m).

## Notes to the Financial Statements (continued)

Year ended 31 December 2018

### 28. Intangible assets

#### Accounting for goodwill and intangible assets

##### Goodwill

Goodwill represents the excess of the cost of an acquisition over the fair value of the Group's share of the identifiable net assets of the acquired subsidiary at the acquisition date and is included in intangible assets. Goodwill is reviewed for impairment at the end of the first full year of acquisition. Thereafter, it is tested at each Statement of Financial Position date for impairment against the recoverable amount (being the higher of value in use or fair value less costs of disposal) of the relevant cash generating unit and carried at cost less accumulated impairment losses.

Goodwill arising on acquisitions prior to 1998 has been eliminated against the Unallocated divisible surplus. Goodwill on acquisitions prior to 1 January 2006 (the date of transition to IFRS) is carried at its original cost less cumulative amortisation on that date, less any impairment subsequently incurred.

Gains and losses on the disposal of an entity include the carrying amount of goodwill relating to the entity sold.

##### Present value of acquired in-force business (PVIF)

On acquisition of a portfolio of long-term insurance and investment contracts, the net present value of the Group's interest in the expected post-tax cash flows of the in-force business is capitalised as an intangible asset.

The carrying value of the asset is amortised, in line with the original expected run-off over a period of 10 years, based on the anticipated lives of the majority of the related contracts. Amortisation is stated net of any unwind of the discount rate. The carrying value of the asset is assessed annually using current assumptions in order to determine whether any impairment has arisen, compared to the amortised acquired value.

##### Other intangibles

Where an acquisition takes place that gives access to existing customers, distribution channels or the right to charge for investment or policy administration services, the fair value of these is recognised as an intangible asset.

The carrying value of the asset is amortised, on a straight line basis over its expected economic life. The expected economic life of other intangibles carried by the Group is determined by reference to acquired business, considering factors such as the remaining terms of agreements, the normal lives of related products and the competitive position, and lies within the range of 10 to 20 years. The carrying value of the asset is assessed annually for indications of impairment.

##### IT Software

Costs directly attributable to the development of software for internal use are capitalised as intangible assets if it is probable that the asset created will generate future economic benefits. Costs incurred to establish technological feasibility or to maintain existing levels of performance are recognised as an expense.

Software costs, including computer application software licences, are amortised using the straight line method over their useful lives (three to eight years). The amortisation periods used are reviewed annually. Software values are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. Where the carrying amount is not recoverable the asset is written down immediately to the estimated recoverable amount, based on value in use calculations.

Any amortisation or impairment charges for all intangibles are recorded in the Statement of Comprehensive Income within Other operating and administrative expenses.

##### Significant accounting estimate

##### Impairment assessment of goodwill

The Group determines whether goodwill is impaired at least on an annual basis. This requires an estimation of the recoverable amount of the cash generating unit to which the goodwill is allocated. The Group has allocated the goodwill to two single cash generating units based on the key operating segments of the Group being the Long-term insurance business and the General insurance business, which is held for sale.

Details of the key assumptions used in the estimation of the recoverable amounts and the carrying value at the reporting date are contained at the end of this note.

## Notes to the Financial Statements (continued)

Year ended 31 December 2018

## 28. Intangible assets (continued)

Group	Goodwill £m	Other intangible assets £m	PVIF £m	Software and licence costs £m	Total £m
<b>Cost:</b>					
At 1 January 2018	241	52	3	95	391
Additions	–	–	–	23	23
Transfer to assets held for sale	(186)	(25)	–	(108)	(319)
<b>At 31 December 2018</b>	<b>55</b>	<b>27</b>	<b>3</b>	<b>10</b>	<b>95</b>
<b>Accumulated amortisation:</b>					
At 1 January 2018	21	40	–	15	76
Charge for the year	–	3	1	16	20
Transfer to assets held for sale	–	(23)	–	(25)	(48)
<b>At 31 December 2018</b>	<b>21</b>	<b>20</b>	<b>1</b>	<b>6</b>	<b>48</b>
<b>Net book value at 31 December 2018</b>	<b>34</b>	<b>7</b>	<b>2</b>	<b>4</b>	<b>47</b>
<b>Cost:</b>					
At 1 January 2017	241	51	3	59	354
Acquired through business combinations	–	1	–	–	1
Additions	–	–	–	36	36
<b>At 31 December 2017</b>	<b>241</b>	<b>52</b>	<b>3</b>	<b>95</b>	<b>391</b>
<b>Accumulated amortisation:</b>					
At 1 January 2017	21	37	–	5	63
Charge for the year	–	3	–	8	11
Impairment in year	–	–	–	2	2
<b>At 31 December 2017</b>	<b>21</b>	<b>40</b>	<b>–</b>	<b>15</b>	<b>76</b>
<b>Net book value at 31 December 2017</b>	<b>220</b>	<b>12</b>	<b>3</b>	<b>80</b>	<b>315</b>

Other intangible assets comprise the value of the future benefit derived from the acquired customer base of the Teachers business and the value of the Tomorrow/Retirement Solutions distribution channel, which are being amortised over periods varying between 10 and 20 years from the original acquisition date. These intangible assets will be fully amortised by 2027.

Of the £20m (2017: £11m) amortisation charge for the year, £4m (2017: £4m) is presented within Other operating and administrative expenses in the Statement of Comprehensive Income and £16m (2017: £7m) relates to the discontinued general insurance business (see note 12). There was no impairment charge in 2018 (2017: £2m).

## Notes to the Financial Statements (continued)

Year ended 31 December 2018

### 28. Intangible assets (continued)

#### Impairment testing of goodwill

Goodwill is reviewed annually for impairment, or more frequently when there are indicators that impairment may have occurred, by comparing the carrying value to its recoverable amount. The recoverable amount of the cash generating unit is based on value in use calculations. The calculations are based upon discounting expected pre-tax cash flows at a risk-adjusted interest rate appropriate to the cash generating unit, the determination of both of which requires the exercise of judgement. The estimation of pre-tax cash flows is sensitive to the periods for which forecasts are available and to assumptions regarding the long-term sustainable cash flows. While forecasts are compared with actual performance and external economic data, expected cash flows reflect management's view of future performance.

#### Key assumptions used in the annual impairment testing of intangible assets

The key assumptions used for impairment testing are set out below.

The recoverable amount of the long-term insurance business has been determined using discounted cash flow predictions based on financial plans approved by management covering a five year period, with a terminal growth rate applied thereafter. Both the growth rates and the discount rates used are consistent with the ranges observed in the market place.

	2018	2017
	Long-term insurance	Long-term insurance
<b>Assumptions</b>		
Terminal growth rate	<b>1.5%</b>	1.5%
Pre-tax discount rate	<b>9%</b>	9%
Recoverable amount in excess of carrying value	<b>£116m</b>	£169m
<b>Sensitivities</b>		
Impact on recoverable amount of a 2% increase in pre-tax discount rate	<b>£57m</b>	£69m
Pre-tax discount rate required to eliminate headroom	<b>15%</b>	17%
Impact on recoverable amount of a 10% annual reduction in forecast cashflows	<b>£32m</b>	£38m
Reduction required in annual forecast cashflows to eliminate headroom	<b>36%</b>	44%

**Notes to the Financial Statements (continued)**

Year ended 31 December 2018

**29. Investments in group undertakings****Accounting for investments in group undertakings****Shares in subsidiaries**

The subsidiaries are held in the Society's Statement of Financial Position at cost less any provision for impairment. An assessment of the realisable value is made at the year end and, if the Directors assess that there has been a permanent fall in that value below the carrying value, a provision is made to bring the carrying value down to the assessed realisable value.

**Loan stock in subsidiaries**

Loan stock in subsidiaries is initially measured at fair value. Subsequent to initial recognition it is measured at amortised cost.

<b>Society</b>	<b>2018 £m</b>	<b>2017 £m</b>
<b>Shares in subsidiaries</b>		
Cost less provisions at 1 January	<b>887</b>	496
Additions	<b>1</b>	81
Conversion of loan stock to equity	<b>–</b>	326
Reduction in carrying value including impairment	<b>(7)</b>	(16)
	<b>881</b>	887
<b>Loan stock in subsidiaries</b>		
Cost at 1 January	<b>10</b>	306
Additions	<b>5</b>	4
Redemptions	<b>–</b>	(300)
	<b>15</b>	10
<b>Shares and loan stock in subsidiaries at 31 December</b>	<b>896</b>	897

The Society has examined the carrying value of its subsidiaries and concluded that an impairment of £7m (2017: £16m) was required in regard to these investments.

During 2017 £326m of loans and related interest owed to the Society by its subsidiary LV Capital PLC were converted to equity and a further £81m of capital was invested in subsidiaries of the Society.

Further details of the Group's loan stock are given in Note 48 and the Group's investments in Notes 43 and 44.



## Notes to the Financial Statements (continued)

Year ended 31 December 2018

### Other assets and liabilities

This section describes the other assets and liabilities arising from the life insurance business within the Society and the life insurance and general insurance businesses within the Group.

#### 30. Insurance receivables

	Group		Society	
	2018	2017	2018	2017
	£m	£m	£m	£m
Due from policyholders	10	190	9	10
Due from agents, brokers and intermediaries	—	82	—	—
Due from reinsurers	31	36	31	19
	41	308	40	29

Included within the 2017 comparatives are amounts of £279m relating to the general insurance business. In 2018 these balances have been disclosed as Assets held for sale within Note 12.

The carrying amounts disclosed above reasonably approximate fair value at the Statement of Financial Position date.

#### 31. Prepayments and accrued interest

	Group		Society	
	2018	2017	2018	2017
	£m	£m	£m	£m
Accrued interest	63	85	56	62
Prepayments	14	39	14	9
	77	124	70	71

Included within the 2017 comparatives are amounts of £47m relating to the general insurance business. In 2018 these balances have been disclosed as Assets held for sale within Note 12.

#### 32. Insurance payables

	Group		Society	
	2018	2017	2018	2017
	£m	£m	£m	£m
Due to policyholders	18	18	18	15
Due to brokers and intermediaries	1	1	1	—
Due to reinsurers	9	31	9	7
	28	50	28	22

Included within the 2017 comparatives are amounts of £28m relating to the general insurance business. In 2018 these balances have been disclosed as Liabilities directly associated with assets held for sale within Note 12.

The carrying amounts disclosed above reasonably approximate fair value at the Statement of Financial Position date.

#### 33. Trade and other payables

##### Accounting for trade and other payables

Trade and other payables are recognised as they fall due. They are measured initially at fair value and subsequently at amortised cost. Premiums received for contracts with an inception date after the end of the period are held as deferred revenue.

	Group		Society	
	2018	2017	2018	2017
	£m	£m	£m	£m
Bank overdrafts	11	11	11	8
Trade payables	6	17	5	16
Amounts owed to group undertakings	—	—	6	21
Other taxes and social security costs	8	56	7	10
Other creditors	38	42	36	31
Finance lease liabilities	19	19	—	—
Accruals	64	143	61	73
	146	288	126	159

Included within the 2017 comparatives are amounts of £126m relating to the general insurance business. In 2018 these balances have been disclosed as Liabilities directly associated with assets held for sale within Note 12.

The carrying amounts disclosed above reasonably approximate fair value at the Statement of Financial Position date.

## Notes to the Financial Statements (continued)

Year ended 31 December 2018

## Taxation

This section presents information relating to the tax charge and movements in the corporation and deferred tax assets and liabilities held by the Society and Group.

## 34. Income tax (credit)/expense

## Income tax (credit)/expense

Income tax (credit)/expense recorded in the Statement of Comprehensive Income represents the current year corporation tax (credit)/charge. As a mutual, the corporation tax (credit)/charge for the Society relates to policyholder tax (receivable)/payable on the net investment return levied on certain types of business. Whereas for Group subsidiaries corporation tax is charged on trading profits arising in the year. The current year tax (credit)/charge excludes the deferred tax movement included within the re-measurement of the defined benefit pension scheme and available for sale financial assets in Other Comprehensive Income.

## Current income tax

Current income tax liabilities and assets are measured at the amount expected to be paid to or recovered from the taxation authorities. The tax rates and tax laws used to compute the amount are those that are enacted or substantively enacted at the Statement of Financial Position date.

## Deferred income tax

Deferred income tax is recognised, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. Deferred income tax is determined using tax rates (and laws) that have been enacted or substantively enacted by the Statement of Financial Position date and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled. Deferred income tax assets are recognised to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised.

Deferred income tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets against current tax liabilities and when the deferred income taxes assets and liabilities relate to income taxes levied by the same taxation authority on either the taxable entity or different taxable entities where there is an intention to settle the balances on a net basis.

## a) Current year tax (credit)/charge

	Group		Society	
	2018 £m	2017 £m	2018 £m	2017 £m
<b>Current tax</b>				
Current year	14	39	(3)	16
Adjustment in respect of prior years	(1)	–	(1)	(1)
<b>Total current tax</b>	<b>13</b>	<b>39</b>	<b>(4)</b>	<b>15</b>
<b>Deferred tax</b>				
Temporary differences	(27)	7	(27)	9
Tax losses	–	4	–	–
<b>Total deferred tax</b>	<b>(27)</b>	<b>11</b>	<b>(27)</b>	<b>9</b>
<b>Total income tax (credit)/expense</b>	<b>(14)</b>	<b>50</b>	<b>(31)</b>	<b>24</b>
<b>Income tax (credit)/expense attributable to:</b>				
(Loss)/profit from continuing operations	(31)	20	(31)	24
Profit from discontinued operations	17	30	–	–
	<b>(14)</b>	<b>50</b>	<b>(31)</b>	<b>24</b>

## b) Reconciliation of tax (credit)/charge

	Group		Society	
	2018 £m	2017 £m	2018 £m	2017 £m
(Loss)/profit before tax, mutual bonus and UDS transfer from continuing operations	(90)	(42)	(29)	62
Profit before tax, mutual bonus and UDS transfer from discontinued operations	110	164	–	–
Profit/(loss) before tax, mutual bonus and UDS transfer*	20	122	(29)	62
Tax calculated at the average standard rate of corporation tax in the UK at 19% (2017: 19.25%)	4	23	(5)	12
<b>Permanent differences</b>				
Income and expenses not subject to tax	8	13	–	–
Mutual profit not subject to tax	5	(12)	5	(12)
Unprovided deferred tax movement	–	1	–	–
Policyholder I-E tax	(30)	25	(30)	25
Adjustment to current tax charge in respect of prior years	(1)	–	(1)	(1)
<b>Total (credit)/charge</b>	<b>(14)</b>	<b>50</b>	<b>(31)</b>	<b>24</b>

## Notes to the Financial Statements (continued)

Year ended 31 December 2018

### 34. Income tax (credit)/expense (continued)

\* As a Friendly Society, all net earnings are for the benefit of participating policyholders and are carried forward within the Unallocated divisible surplus (UDS), resulting in the profit for each financial year being zero. Therefore, the resulting (loss)/profit before tax required to be disclosed under IAS 12 will always be equal to the tax (credit)/charge being £14m loss (2017: £50m profit) and £31m loss (2017: £24m profit) for the Group and Society respectively. In order to present a more meaningful disclosure the (Loss)/profit before tax, mutual bonus and UDS transfer is disclosed in the tables above.

### 35. Corporation tax asset

	Group		Society	
	2018	2017	2018	2017
	£m	£m	£m	£m
Corporation tax receivable	5	—	5	—
	5	—	5	—

### 36. Deferred tax liability

	Group	Society
	£m	£m
Balance at 1 January 2018	(97)	(98)
Amounts recorded in the Statement of Comprehensive Income within profit for the year	27	27
Amounts recorded within Other Comprehensive Income	(6)	(7)
Transfer to assets held for sale	(2)	—
<b>Balance at 31 December 2018</b>	<b>(78)</b>	<b>(78)</b>

	Group		Society	
	2018	2017	2018	2017
	£m	£m	£m	£m
<b>a) Analysis of deferred taxation temporary differences</b>				
Excess of depreciation	—	2	—	—
Temporary differences on expenses	2	3	2	4
Temporary differences on unrealised gains	(11)	(40)	(11)	(40)
Temporary difference on re-measurement of defined benefit pension scheme	(69)	(62)	(69)	(62)
<b>Deferred tax liability</b>	<b>(78)</b>	<b>(97)</b>	<b>(78)</b>	<b>(98)</b>

#### b) Deferred taxation asset not recognised

Tax losses unrecognised	8	8	—	—
	8	8	—	—

The value of deferred tax liabilities expected to be settled after more than 12 months is £74m in the Group (2017: £87m) and £74m in the Society (2017: £88m).

The calculation of deferred tax balances at the year-end takes into account the reduction in the UK main corporation tax rate to 17%, substantively enacted on 6 September 2016 and effective from 1 April 2020.

The valuation and recoverability of deferred tax assets relating to capital allowances in excess of depreciation, temporary differences on expenses and taxable losses carried forward is dependent on the availability of future taxable profits within the Society and Group. Management forecasts currently support the future recoverability of deferred tax assets recognised in the Statement of Financial Position as at 31 December 2018.

### 37. Corporation tax liability

	Group		Society	
	2018	2017	2018	2017
	£m	£m	£m	£m
Corporation tax payable	—	20	—	9
	—	20	—	9

## Notes to the Financial Statements (continued)

Year ended 31 December 2018

### Employee benefits

This section details the costs and commitments associated with employing our staff.

#### 38. Employee benefits expense

##### Accounting for staff costs under IAS 19

The Society and Group apply IAS 19 Employee benefits in accounting for staff costs.

##### Short-term employee benefits

Salaries, accrued bonuses and social security costs are recognised over the period in which the employees provide the services to which the payments relate.

	Group		Society	
	2018	2017	2018	2017
	£m	£m	£m	£m
Wages and salaries	89	218	82	213
Social security costs	9	21	8	21
Pension costs	11	16	11	15
	<b>109</b>	<b>255</b>	<b>101</b>	<b>249</b>

Of the £101m (2017: £249m) employee benefit expense in the Society, £34m (2017: £133m) is recharged to other Group companies, leaving £67m (2017: £116m) of staff costs directly relating to the Society.

Wages and salaries include charges for ongoing in flight long-term incentive plans (LTIPs) for Life and Group employees of £3.4m in 2018 (2017: £6.0m). The Group LTIP plan terms are described in the Report on Directors' Remuneration on page 77.

For the 2016-18 scheme the Group performance is below threshold for both growth in adjusted average pre-tax profits and Relative Investment Performance resulting in £nil payout for LVFS eligible employees in 2019.

On 29 December 2017, 3,717 employees (excluding contractors and temporary staff) from the Society transferred to Liverpool Victoria General Insurance Group Limited (LVGI/G) under a TUPE arrangement. In 2018 the average number of employees employed by LVGI/G was 3,680. These figures have been excluded from the table below.

The number of employees during the year, including executive directors, calculated on a monthly average basis, was as follows:

	Group		Society	
	2018	2017	2018	2017
	Number	Number	Number	Number
Member and customer contact	902	3,784	860	3,730
Administration	1,092	2,080	1,041	2,045
	<b>1,994</b>	<b>5,864</b>	<b>1,901</b>	<b>5,775</b>

## Notes to the Financial Statements (continued)

Year ended 31 December 2018

### 39. Pension benefit asset/(obligation)

#### Accounting for pension benefits under IAS 19

For defined benefit schemes, the net surplus or deficit is calculated annually with the assets measured at fair value at the Statement of Financial Position date and the liabilities discounted at the rate of return available on high quality corporate bonds. The net surplus, to the extent recoverable, or deficit is recognised as a pension benefit asset or liability in the Statement of Financial Position. A separate liability for future funding requirements is recognised for a scheme where the Society does not have an unconditional right to any of the assets of the pension schemes which would remain following the schemes' termination.

The pension cost for the schemes is analysed between current service cost, past service cost, net interest on the net defined benefit liability and any gain or loss on settlement. Current service cost is the actuarially calculated present value of the benefits earned by the active employees in each period. Past service costs, relating to employee service in prior periods arising in the current period as a result of the introduction of, or improvement to, retirement benefits, are recognised in Other operating and administrative expenses on a straight-line basis over the period in which the increases in benefits vest or are earned.

All movements other than re-measurements in respect of the pension benefit obligation are recognised in Other operating and administrative expenses in the Statement of Comprehensive Income. Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are recognised as re-measurements in Other Comprehensive Income in the period in which they arise.

For defined contribution plans, the Group pays contributions to two independently administered pension funds. The Group has no further payment obligations once the contributions have been paid. The contributions are recognised as an employee benefit expense when they are due.

#### Significant accounting estimates and judgements

##### a) Significant accounting estimate

##### Valuation of the defined benefit obligation

The valuations of the pension benefit obligations for the Group's three defined benefit schemes require actuarial assumptions about discount rates, inflation, longevity and future pension

increases. Due to the long-term nature of these obligations, the estimates are subject to significant uncertainty.

Details of the principal assumptions used for each of the material defined benefit schemes are disclosed within the valuations of the individual schemes disclosed in sections (iv).

##### b) Significant accounting judgements

##### Recognition of defined benefit asset

Management have applied judgement in evaluating whether the net pension asset can be recognised for each of the pension schemes in accordance with the existing IFRIC 14, 'The limit on a defined benefit asset, minimum funding requirement and their interaction'.

Recognising a net pension asset under the current criteria of IFRIC 14 is allowable for both the LV and Ockham Pension Schemes because the terms of the pension scheme trust deeds state that the Society has an unconditional right to any assets of the schemes which ultimately remain following the schemes' termination, assuming the gradual settlement of the scheme liabilities over time until all members have left the schemes. No liability is recognised for future funding contributions as these will increase the recognised net pension asset when paid.

However this is not the case for the trust deed of the Teachers Assurance Group Pension Scheme, therefore the net pension asset for this scheme is not recognised and a liability is recognised for future funding contributions.

The IASB are continuing their research program during 2019 on an amendment to IFRIC 14. This amendment, once effective in future accounting periods, may impact the recognition of the pension fund surplus. Management will consider the implications of the amendment once it has been published.

##### Guaranteed Minimum Pension (GMP) equalisation

Management have applied judgement in evaluating a provision for the estimated costs arising following the high court ruling on the Lloyds Bank GMP equalisation case in October 2018. Guaranteed Minimum Pension (GMP) relates to service built up on or before 5 April 1997 and was intended to replicate features of state benefits which at the time were different for men and women. Past service cost represents our estimated liability to address inequalities in respect of GMP.

#### Defined benefit pension schemes

The Group operates three pension schemes with defined benefit sections, the LV= Employee Pension Scheme ("LV Scheme"), the Ockham Pension Scheme and the Teachers Assurance Group Pension Scheme. The Society is the principal employer for the LV Scheme and the Ockham Pension Scheme. Teachers Management Services Limited, a subsidiary of the Society, is the principal employer for the Teachers Assurance Group Pension Scheme. The LV Scheme and the Ockham Pension Scheme are both hybrid schemes with a defined benefit section and a defined contribution section.

#### Defined contribution pension schemes

All Society employees are eligible to join the defined contribution section of the LV Scheme. Employees contribute a minimum of 3% of salary. The employee contribution is double matched by the Society up to a maximum employer contribution of 14%. The assets of this scheme are held separately from those of the Group in an independently administered fund. The Group's contribution under this scheme during the year amounted to £9m (2017: £18m).

From 29 December 2017, employees who moved to LVGIG under a TUPE arrangement ceased to be members of the LV Scheme and joined the new My LVGIG Savings Plan, a Group Personal Pension plan. From this date all LVGIG employees were eligible to join the scheme. The Group's contribution under this scheme during the year amounted to £10m (2017: £nil).

## Notes to the Financial Statements (continued)

Year ended 31 December 2018

## 39. Pension benefit asset/(obligation) (continued)

## a) Summary of defined benefit schemes

	2018				2017			
	LV Scheme £m	Ockham £m	Teachers £m	Total £m	LV Scheme £m	Ockham £m	Teachers £m	Total £m
<b>Pension benefit asset/obligation</b>								
Asset	186	13	–	199	163	15	–	178
Obligation	–	–	(2)	(2)	–	–	–	–
	186	13	(2)	197	163	15	–	178
	2018				2017			
	LV Scheme £m	Ockham £m	Teachers £m	Total £m	LV Scheme £m	Ockham £m	Teachers £m	Total £m
<b>Re-measurements</b>								
Re-measurements	(17)	(3)	(2)	(22)	40	(5)	–	35
Income tax expense	(8)	1	–	(7)	(17)	1	–	(16)
<b>Amount charged to Comprehensive Income</b>	(25)	(2)	(2)	(29)	23	(4)	–	19
<b>Cumulative re-measurements recognised in the Statement of Comprehensive Income</b>	176	(13)	(2)	161	193	(10)	–	183

Further details of the Group's defined benefit pension schemes are disclosed below.

## b) LV Scheme

## (i) Information about the scheme

The final salary section of the LV scheme provides benefits to members in the form of a guaranteed level of pension payable for life. The level of benefits depends upon the member's length of service and their final salary.

The scheme assets are held in a separate trustee-administered fund to meet long-term pension liabilities to past and present employees.

The liabilities of the scheme are measured by discounting the best estimate of future cash flows to be paid out by the scheme using the projected unit method, which is an accrued benefits valuation method.

The scheme has a Corporate Trustee required to act in the best interests of the scheme's beneficiaries. The Trustee may be removed at the discretion of the Society, in its capacity as principal employer, provided that the board of any new trustee company comprises three directors representing the members, including one director who must be a pensioner and a further four directors selected by the Society. With the agreement of the Society, the directors of the Corporate Trustee may co-opt one other director.

The final salary section is closed to new entrants and was closed to future accrual for existing members on 30 June 2013, at which time they were eligible to join the defined contribution section of the scheme.

	2018 £m	2017 £m
<b>(ii) Net Statement of Financial Position</b>		
Present value of defined benefit obligation	(1,254)	(1,331)
Fair value of plan assets	1,440	1,494
<b>Pension benefit asset at the end of the year</b>	186	163

## Notes to the Financial Statements (continued)

Year ended 31 December 2018

### 39. Pension benefit asset/(obligation) (continued)

#### b) LV Scheme (continued)

	Present value of obligation £m	Fair value of plan assets £m	Total £m
<b>(iii) The movement in the net defined benefit asset over the year is as follows:</b>			
<b>At 1 January 2018</b>	<b>(1,331)</b>	<b>1,494</b>	<b>163</b>
<b>Pension costs:</b>			
Current service cost	(2)	–	(2)
Interest (expense)/income	(32)	37	5
Past service cost	(6)	–	(6)
	<b>(40)</b>	<b>37</b>	<b>(3)</b>
<b>Re-measurements:</b>			
– Return on plan assets, excluding amounts included in interest (expense)/income	–	(73)	(73)
– Loss from changes in demographic assumptions	(12)	–	(12)
– Gain from changes in financial assumptions	86	–	86
– Experience loss	(18)	–	(18)
	<b>56</b>	<b>(73)</b>	<b>(17)</b>
<b>Other movements:</b>			
– Contributions by employer	–	43	43
– Benefits paid	61	(61)	–
	<b>61</b>	<b>(18)</b>	<b>43</b>
<b>At 31 December 2018</b>	<b>(1,254)</b>	<b>1,440</b>	<b>186</b>
<b>At 1 January 2017</b>	<b>(1,308)</b>	<b>1,422</b>	<b>114</b>
<b>Pension costs:</b>			
Current service cost	(1)	–	(1)
Interest (expense)/income	(37)	40	3
	<b>(38)</b>	<b>40</b>	<b>2</b>
<b>Re-measurements:</b>			
– Return on plan assets, excluding amounts included in interest (expense)/income	–	94	94
– Gain from changes in demographic assumptions	4	–	4
– Loss from changes in financial assumptions	(58)	–	(58)
	<b>(54)</b>	<b>94</b>	<b>40</b>
<b>Other movements:</b>			
– Contributions by employer	–	7	7
– Benefits paid	69	(69)	–
	<b>69</b>	<b>(62)</b>	<b>7</b>
<b>At 31 December 2017</b>	<b>(1,331)</b>	<b>1,494</b>	<b>163</b>

## Notes to the Financial Statements (continued)

Year ended 31 December 2018

### 39. Pension benefit asset/(obligation) (continued)

#### b) LV Scheme (continued)

(iv) Principal assumptions used	2018	2017
Discount rate	2.95%	2.50%
RPI inflation	3.25%	3.20%
CPI inflation	2.25%	2.20%
Pension increases for in-payment benefits		
– RPI price inflation capped at 5% pa, floor of 3% pa	3.45%	3.45%
– RPI price inflation capped at 5% pa	3.40%	3.40%
– RPI price inflation capped at 2.5% pa	2.50%	2.50%
– CPI price inflation capped at 3.0% pa	2.35%	2.35%
Rate of (non-guaranteed minimum pension) increases in deferment	2.25%	2.20%
Cash commutation		
Active at the time of scheme closure	20%	20%
Deferred at the time of scheme closure	20%	20%
Scheme member valuation date	31 March 2018	31 March 2015

The discount rate and inflation rate assumptions for 2018 and 2017 have been set with reference to yield curves. The single rates disclosed above represent the weighted average equivalent rate based on the yield curve used. The pension increase assumptions disclosed represent spot rates on the yield curve at the approximate duration of the scheme's liabilities.

For 2018, mortality for members is assumed to follow LV specific Club Vita individual base tables, based on pooled experience during the period 2014 to 2016 (2017: LV specific Club Vita tables 2011 – 2013).

The table below shows the life expectancy assumptions used in the accounting assessments based on the average future life expectancy of a scheme member who is a pensioner aged 65 (non-pensioner is assumed to be 45 now).

Future life expectancy assumptions (in years) as at 31 December	2018	2017
Pensioner (currently aged 65)		
– Male	22.6	22.7
– Female	24.4	24.3
Non-pensioner (at age 65, currently aged 45)		
– Male	23.6	23.9
– Female	25.8	25.8

In all cases, as at 31 December 2018 CMI Core 2017 projections with a long-term rate of improvement of 1.50% a year have been applied (31 December 2017: CMI Core 2016 projections with a long-term rate of improvement of 1.50%).

#### (v) Sensitivity analysis: Impact on defined benefit obligation of making changes to key assumptions

	Change in assumption	Impact on defined benefit obligation
Discount rate	Decrease by 0.5%	Increase by £115m (9%)
RPI rate	Increase by 0.5%	Increase by £86m (7%)
Life expectancy	Increase by 1 year	Increase by £44m (3%)

The sensitivity analysis has been calculated by valuing the defined benefit obligation using the amended assumptions shown in the table above and keeping the remaining assumptions the same as disclosed in the principal assumptions table for the scheme, except in the case of the inflation sensitivity where other assumptions that depend on assumed inflation have also been amended correspondingly.



## Notes to the Financial Statements (continued)

Year ended 31 December 2018

### 39. Pension benefit asset/(obligation) (continued)

#### b) LV Scheme (continued)

##### (vi) Plan asset information

The following table shows a breakdown of the plan assets:

	2018				2017			
	Quoted £m	Unquoted £m	Total £m	%	Quoted £m	Unquoted £m	Total £m	%
Equities and unit trusts	93	5	98	7	99	7	106	7
Debt securities	1,651	–	1,651	115	1,687	–	1,687	113
Cash and cash equivalents	125	–	125	9	113	4	117	8
Real estate/property	–	4	4	–	–	5	5	–
Derivatives	(16)	(454)	(470)	(33)	21	(469)	(448)	(30)
Other	–	32	32	2	–	27	27	2
	1,853	(413)	1,440	100	1,920	(426)	1,494	100

The use of derivatives is predominantly gilt repos and swaps to hedge the interest and inflation exposure. A longevity swap also exists to mitigate the risk of higher than expected life expectancy arising on the bulk of members within the pensions in payment cohort. The longevity risk associated with pre-retirement members still remains largely with the scheme. In addition a proportion of the derivative exposure relates to a synthetic equity strategy used to gain exposure to global equity markets.

In determining and reviewing the Scheme's investment strategy, the Trustee adopts a Pensions Risk Management Framework (PRMF). This framework translates the principal goal of paying member benefits into measurable funding objectives and risk constraints, agreed by the Trustee. The PRMF is reviewed and monitored by the Trustee on at least a quarterly basis.

The Trustee's primary funding objective is to reach full funding on the Technical Provisions basis, with a long-term target of moving towards being fully funded on a Gilts +0.25% liability valuation basis by 2028 if possible. In setting the investment strategy, the Trustee aims to:

- Target an expected return on assets close to that required to meet the funding objectives within the PRMF;
- Manage the investment risk including that arising due to mismatch between assets and liabilities and limit the total risk on the Scheme below the risk budget set in the PRMF;
- Maintain suitable liquidity of assets such that the Scheme is not forced to buy and sell investments at particular times to pay member benefits or meet potential collateral calls.

Following the triennial scheme valuation which took place as at 31 March 2018, the Society as principal employer agreed, on behalf of participating employees, to make a one-off payment of £35,400,000 and to continue to pay monthly deficit reduction contributions of £416,667 until 31 March 2028 to meet the statutory funding objective\*. In addition to these funding contributions, the Society continues to make payments of £179,019 per month towards the regular expenses of administering the defined benefit section of the Scheme plus payments equal to the pension protection fund (PPF) levies. The next formal valuation of the Scheme is due no later than 31 March 2021.

\* The statutory funding objective is that the Scheme must have 'sufficient and appropriate' assets to meet the expected costs of providing members past service benefits.

##### (vii) Pension scheme risks

Through its defined benefit pension schemes the Group is exposed to a number of risks, the most significant of which are detailed below:

<b>Asset volatility:</b>	The plan liabilities are calculated using a discount rate set with reference to corporate bond yields; if plan assets underperform this yield, this will create a deficit. The plan assets are predominantly held in debt securities which match the liabilities with a small holding of equities that are expected to outperform corporate bonds in the long-term.
<b>Changes in bond yields:</b>	A decrease in corporate bond yields will increase plan liabilities, although this will be offset by an increase in the value of the scheme's bond holdings.
<b>Inflation risk:</b>	The majority of the scheme's benefit obligations are linked to inflation, therefore an increase in inflation will lead to an increase in liabilities. In most cases, caps on the level of inflationary increases and derivatives are in place to protect the scheme against significant rises in inflation.
<b>Life expectancy:</b>	The scheme's obligations are to provide benefits for the life of the member, so any increases in life expectancy will result in an increase in the scheme's liabilities. In 2012 the trustees of the LV Scheme entered into a longevity swap which mitigated the majority of this risk for the LV scheme.

## Notes to the Financial Statements (continued)

Year ended 31 December 2018

## 39. Pension benefit asset/(obligation) (continued)

## b) LV Scheme (continued)

## (viii) Expected maturity analysis of undiscounted pension benefits:

	Less than a year £m	Between 1-2 years £m	Between 2-5 years £m	Over 5 years £m	Total £m
<b>At 31 December 2018</b>	<b>50</b>	<b>42</b>	<b>154</b>	<b>2,018</b>	<b>2,244</b>

The weighted average duration of the gross defined benefit obligation is 17 years. The expected contributions to the scheme for the year ending 31 December 2019 are £7m.

## c) Ockham Scheme

## (i) Information about the scheme

The final salary section of the Ockham scheme provides benefits to members in the form of a guaranteed level of pension payable for life. The level of benefits depends upon the members' length of service and their final salary. The scheme is closed to new entrants and future accrual. The scheme assets are held in separate trustee-administered funds to meet long-term pension liabilities to past employees. The liabilities of the scheme are measured by discounting the best estimate of future cash flows to be paid out by the scheme using the projected unit method, which is an accrued benefits valuation method.

The scheme has a Corporate Trustee required to act in the best interests of the scheme's beneficiaries. The Trustee may be removed at the discretion of the Society, in its capacity as principal employer, provided that any new trustee board comprises two directors representing the members and up to four directors selected by the Society.

## (ii) Net Statement of Financial Position

	2018 £m	2017 £m
Present value of defined benefit obligation	(141)	(149)
Fair value of plan assets	154	164
<b>Pension benefit asset at the end of the year</b>	<b>13</b>	<b>15</b>

## (iii) The movement in the net defined benefit asset over the year is as follows:

	Present value of obligation £m	Fair value of plan assets £m	Total £m
<b>At 1 January 2018</b>	<b>(149)</b>	<b>164</b>	<b>15</b>
<b>Pension costs:</b>			
Interest (expense)/income	(3)	4	1
	(3)	4	1
<b>Re-measurements:</b>			
– Return on plan assets, excluding amounts included in interest (expense)/income	–	(8)	(8)
– Loss from changes in demographic assumptions	(3)	–	(3)
– Gain from changes in financial assumptions	6	–	6
– Experience gains	2	–	2
	5	(8)	(3)
<b>Other movements:</b>			
– Benefits paid	6	(6)	–
	6	(6)	–
<b>At 31 December 2018</b>	<b>(141)</b>	<b>154</b>	<b>13</b>
<b>At 1 January 2017</b>	<b>(143)</b>	<b>163</b>	<b>20</b>
<b>Pension costs:</b>			
Interest (expense)/income	(4)	4	–
	(4)	4	–
<b>Re-measurements:</b>			
– Return on plan assets, excluding amounts included in interest (expense)/income	–	3	3
– Loss from changes in financial assumptions	(8)	–	(8)
	(8)	3	(5)
<b>Other movements:</b>			
– Benefits paid	6	(6)	–
	6	(6)	–
<b>At 31 December 2017</b>	<b>(149)</b>	<b>164</b>	<b>15</b>

## Notes to the Financial Statements (continued)

Year ended 31 December 2018

### 39. Pension benefit asset/(obligation) (continued)

#### c) Ockham Scheme (continued)

(iv) Principal assumptions used	2018	2017
Discount rate	2.85%	2.50%
RPI inflation	3.25%	3.20%
CPI inflation	2.25%	2.20%
Pension increases for in-payment benefits		
– RPI price inflation capped at 5% pa	3.35%	3.35%
– linked to RPI inflation	3.35%	3.35%
– fixed rate	in line with scheme rules	in line with scheme rules
Rate of (non-guaranteed minimum pension) increases in deferment	2.25%	2.20%
Cash commutation – Deferreds	20%	20%
Scheme member valuation date	31 March 2018	31 March 2015

The discount rate and inflation rate assumptions for 2018 and 2017 have been set with reference to yield curves. The single rates disclosed above represent the weighted average equivalent rate based on the yield curve used. The pension increase assumptions disclosed represent spot rates on the yield curve at the approximate duration of the scheme's liabilities.

Mortality rate assumptions are based on the same mortality tables as disclosed within the LV Scheme, but using Ockham specific individual base tables.

Future life expectancy assumptions (in years) as at 31 December	2018	2017
Pensioner (currently aged 65)		
– Male	23.4	23.5
– Female	24.5	24.5
Non-pensioner (at age 65, currently aged 45)		
– Male	24.2	24.6
– Female	26.3	26.2

#### (v) Sensitivity analysis: Impact on defined benefit obligation of making changes to key assumptions

	Change in assumption	Impact on defined benefit obligation
Discount rate	Decrease by 0.5%	Increase by £11m (8%)
RPI rate	Increase by 0.5%	Increase by £7m (5%)
Life expectancy	Increase by 1 year	Increase by £5m (4%)

The sensitivity analysis has been calculated by valuing the defined benefit obligation using the amended assumptions shown in the table above and keeping the remaining assumptions the same as disclosed in the principal assumptions table for the scheme, except in the case of the inflation sensitivity where other assumptions that depend on assumed inflation have also been amended correspondingly.

#### (vi) Plan asset information

Plan assets are comprised as follows:

	2018				2017			
	Quoted £m	Unquoted £m	Total £m	%	Quoted £m	Unquoted £m	Total £m	%
Equities and unit trusts	68	–	68	44	71	–	71	43
Debt securities	79	–	79	51	91	–	91	56
Derivative swaps	–	1	1	1	–	2	2	1
Cash and cash equivalents	6	–	6	4	–	–	–	–
	153	1	154	100	162	2	164	100

In determining and reviewing the Scheme's investment strategy, the Trustee adopts an objectives based approach. This translates the principal goal of paying member benefits into measurable funding objectives and risk constraints, agreed by the Trustee. These objectives are reviewed and monitored by the Trustee on a regular basis.

## Notes to the Financial Statements (continued)

Year ended 31 December 2018

### 39. Pension benefit asset/(obligation) (continued)

#### c) Ockham Scheme (continued)

The Trustee's primary funding objective is to reach full funding on the Technical Provisions basis, with a long-term target of moving towards being fully funded on a Gilts +0.25% liability valuation basis by 2028 if possible. In setting the investment strategy, the Trustee aims to:

- Target an expected return on assets close to that required to meet the funding objective;
- Manage the investment risk including that arising due to mismatch between assets and liabilities and limit the total risk on the Scheme below the risk budget;
- Maintain suitable liquidity of assets such that the Scheme is not forced to buy and sell investments at particular times to pay member benefits or meet potential collateral calls.

Following the triennial scheme valuation which took place as at 31 March 2018, the Society as principal employer agreed, on behalf of participating employees, to make annual deficit reduction contributions of £2,000,000, commencing 31 March 2019 until 31 March 2028 to meet the statutory funding objective. In addition to these funding contributions, the Society will make payments of £29,167 per month towards the regular expenses of administering the defined benefit section of the Scheme plus payments equal to the pension protection fund (PPF) levies.

The next formal valuation of the Scheme is due no later than 31 March 2021.

#### (vii) Pension scheme risks

Details of the pension scheme risks that the Group is exposed to are disclosed within the LV Scheme.

#### (viii) Expected maturity analysis of undiscounted pension benefits:

	Less than a year £m	Between 1-2 years £m	Between 2-5 years £m	Over 5 years £m	Total £m
<b>At 31 December 2018</b>	<b>6</b>	<b>6</b>	<b>18</b>	<b>197</b>	<b>227</b>

The weighted average duration of the defined benefit obligation is 15 years.

The expected contributions to the Ockham pension scheme for the year ending 31 December 2019 are £2m.

#### d) Teachers Assurance Group Pension Scheme

The Teachers Assurance Group Pension Scheme is a final salary pension scheme, which provides benefits to members in the form of a guaranteed level of pension payable for life. The level of benefits depends upon the member's length of service and their final salary.

The fair value of the plan assets was £33m (2017: £34m) and the present value of the obligations was £28m (2017: £30m) as at 31 December 2018. The surplus of £5m (2017: £4m) has not been recognised because under IFRIC 14, the wording of the scheme trust deed does not allow the Society the right to the scheme's assets following the scheme's termination. Future funding obligations have created a liability of £2m. The scheme is closed to new entrants and was closed to future accrual for existing members on 31 December 2015. Funding contributions of £375,000 were paid during the year (2017: £20,000) from the Teachers Assurance fund, a closed fund within the Society.

Following the triennial scheme valuation which took place as at 30 September 2017, Teachers Management Services Limited as principal employer agreed to make a one off payment during 2018 of £375,000 followed by monthly deficit reduction contributions of £25,000 running from January 2019 until September 2027. These contributions, which will also be made from the Teachers Assurance fund, have been recognised as a liability in accordance with IFRIC 14.

On 7 February 2019 the Trustee purchased a bulk annuity policy as an investment of the Scheme from an insurance company, Rothesay Life. The bulk annuity policy is designed to fully match the Scheme's liabilities, providing funding to the Scheme for all members' benefit payments as they fall due. The Teachers Assurance fund made a special contribution of £4.5m towards the cost of the policy.

Due to the immaterial nature of the Teachers scheme no detailed disclosures have been made.

## Notes to the Financial Statements (continued)

Year ended 31 December 2018

### Provisions, contingent liabilities and commitments

This section describes the provisions, contingent liabilities and commitments of the Society and Group arising from the ongoing life business and the exit from the banking and asset management businesses in prior years.

#### 40. Provisions

##### Accounting for provisions

Provisions are recognised when the Group has a present legal or constructive obligation as a result of past events, it is more likely than not that an outflow of resources will be required to settle the obligation and the amount has been reliably estimated. Where the Group expects some or all of a provision to be reimbursed it is recognised as a separate asset when the reimbursement is certain.

Provisions are measured at the present value of the expenditure required to settle the obligation using a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the obligation.

The expense relating to provisions is presented in the Statement of Comprehensive Income.

	Group £m	Society £m
<b>Movement during the year on provisions</b>		
Balance at 1 January 2018	20	13
Provided during the year	7	1
Released during the year	(2)	(1)
Utilised during the year	(9)	(6)
Transfer to liabilities directly associated with assets held for sale	(8)	–
<b>Balance at 31 December 2018</b>	<b>8</b>	<b>7</b>

	Group		Society	
	2018	2017	2018	2017
	£m	£m	£m	£m
<b>Provisions relate to:</b>				
Payment protection insurance	4	8	4	8
Restructuring	–	5	–	–
Onerous contracts on property leases	–	2	–	2
Compensation payable on customer complaints	1	1	–	–
Other	3	4	3	3
	<b>8</b>	<b>20</b>	<b>7</b>	<b>13</b>

Included within the 2017 comparatives are amounts of £5m relating to the general insurance business. In 2018 these balances have been disclosed as Liabilities directly associated with assets held for sale within Note 12.

The payment protection insurance (PPI) provision is held to cover future payments in respect of claims relating to PPI policies potentially mis-sold to customers. Given the assumptions made it is expected that up to £4m of payments will be set against this provision before the Financial Conduct Authority's claim deadline in August 2019.

## Notes to the Financial Statements (continued)

Year ended 31 December 2018

### 41. Contingent liabilities

#### Accounting for contingent liabilities

Contingent liabilities are disclosed if there is a possible future obligation as a result of a past event, or if there is a present obligation as a result of a past event but either a payment is not probable or the amount cannot be reasonably estimated.

The Society has granted a contingent loan facility to the RNPFN fund, a closed fund within the Society, up to a maximum of £100m (the value applying for 2018 was £60m), to be used in the event of a shortfall in the capital resources of that fund. The RNPFN fund is required to manage its capital in a manner so as not to require use of this facility and, if it is used, to repay it to the Society as soon as possible. While undrawn a charge for the facility is made at 1% per annum.

As part of the general insurance transaction with Allianz Holdings Plc, Liverpool Victoria Friendly Society Limited acts as guarantor to the obligations entered into by its wholly owned subsidiary, LV Capital PLC.

The Society has granted a guarantee to the trustees of the Teachers Assurance Group Pension Scheme, to guarantee the payment of certain contributions and payments to the scheme by Teachers Management Services Limited (TMS). TMS, a subsidiary of the Society, is the principal employer for the Scheme. Under the Instrument of Transfer executed by the Society and Teachers Provident Society Limited on 6 May 2016 (and effective from 1 June 2016) the Society has the ability to charge all liabilities relating to the scheme to the Teachers Assurance fund, a closed fund within the Society.

The Society has granted guarantees to the landlords of its leased properties, to guarantee that the tenants, subsidiaries of the Society, shall pay the rents reserved by the leases and observe and perform the tenant covenants of the leases and that if the tenants fail to do so, the Society shall pay or observe and perform them.

The Society has provided a guarantee in relation to a mortgage purchase agreement between its subsidiary LV Equity Release Limited and Phoenix Life Limited. In the event that the subsidiary fails to pay any amount in connection with the agreement, the Society would cover the payment and any loss incurred by the counterparty as a result.

### 42. Commitments

#### Accounting for assets held under leases

Where assets are financed by leasing arrangements and the risks and rewards are substantially transferred to the Group, such finance leases are treated as if the assets had been purchased outright and the corresponding liability to the lessor is included as an obligation in trade and other payables. The liability is based on the present value of the minimum lease payments at the inception of the lease. Depreciation on leased assets is charged to the Statement of Comprehensive Income on a straight line basis over the lower of the term of the lease or its estimated useful life. The capital element on finance leases is shown in the property and equipment note.

Lease payments are treated as consisting of capital and interest elements and the interest is charged to the Statement of Comprehensive Income.

All other leases are operating leases and the costs in respect of operating leases are charged on a straight line basis over the lease term. The value of any lease incentive received to take on an operating lease (for example, rent free periods) is recognised as a prepayment and is released over the life of the lease.

	Group		Society	
	2018	2017	2018	2017
	£m	£m	£m	£m
Capital commitments	9	14	9	13
Operating lease commitments	7	14	7	8
Finance lease commitments	19	19	–	–
Other financial commitments	91	32	91	26
	126	79	107	47

Included within the 2017 Group comparatives are amounts of £12m relating to the general insurance business.

## Notes to the Financial Statements (continued)

Year ended 31 December 2018

### 42. Commitments (continued)

#### Capital commitments

Capital commitments relate to authorised and contracted commitments payable but not provided for regarding financial investment and property and equipment.

#### Operating lease commitments

The Group leases various properties under non-cancellable operating lease agreements. The leases have varying terms, escalation clauses and renewal rights.

#### Finance lease commitments

Finance lease commitments relate to a property with a remaining lease term of 22 years. The lease is on a fixed repayment basis and no arrangements have been entered into for contingent payments. The Group's obligations under finance leases are secured by the lessors' charges over the leased assets.

Group	2018			2017		
	Gross liability £m	Finance charge £m	Present value £m	Gross liability £m	Finance charge £m	Present value £m
<b>Minimum lease payments</b>						
Within one year	1	–	1	1	–	1
Between one and five years	5	(3)	2	5	(3)	2
Over five years	21	(5)	16	22	(6)	16
	<b>27</b>	<b>(8)</b>	<b>19</b>	<b>28</b>	<b>(9)</b>	<b>19</b>

#### Other financial commitments

The Group has entered into several long-term contracts following service outsourcing which will end no later than 2023. These contracted commitments have not been provided for in the financial statements.

## Notes to the Financial Statements (continued)

Year ended 31 December 2018

## Scope of consolidation

This section presents information on the Group's investments in subsidiaries, joint ventures, associates and structured entities. Detail is also given of the Unallocated divisible surplus of the Society and Group.

## 43. Subsidiary undertakings

All subsidiary undertakings are included in the consolidation. The proportion of the voting rights in the subsidiary undertakings held directly by the parent company do not differ from the proportion of ordinary shares held. The Group and all principal undertakings are incorporated and domiciled in England and Wales. All holdings are in relation to ordinary shares. The registered office is County Gates, Bournemouth BH1 2NF.

Name	Principal activity	Percentage held by Group	Percentage held by non-controlling interests
<b>Subsidiaries directly owned by the Society</b>			
Frizzell Financial Services Limited (Note 1)	Property management	100%	0%
LV Life Services Limited (Note 1)	Management services	100%	0%
LV Commercial Mortgages Limited (Note 1)	Commercial mortgages	100%	0%
NM Pensions Trustees Limited (Note 1)	Self-invested personal pension (SIPP) administrator	100%	0%
Liverpool Victoria Financial Advice Services Limited (Note 1)	Financial advice services	100%	0%
Liverpool Victoria Life Company Limited	Life insurance	100%	0%
LV Protection Limited	Insurance	100%	0%
LV Capital PLC (Note 1)	Holding company	100%	0%
LV Equity Release Limited (Note 1)	Origination of equity release lifetime mortgages	100%	0%
Teachers Property Limited (Note 1)	Property services	100%	0%
Teachers Financial Services Limited (Note 1)	Insurance and financial intermediary	100%	0%
Teachers Assurance Company Limited	General insurance	100%	0%
Teachers Management Services Limited (Note 1)	Management services	100%	0%
Sovereign Unit Trust Managers Limited (Note 1)	Portfolio manager	100%	0%
Liverpool Victoria Banking Services Limited (Note 2)	Dormant	100%	0%
Ayresbrook Limited (Note 2)	Dormant	100%	0%
Liverpool Victoria Asset Management Limited (Note 2)	Dormant	100%	0%
Highway Corporate Capital Limited (Note 2)	Dormant	100%	0%
Ockham Corporate Limited (Note 2)	Dormant	100%	0%
NLC Name No. 1 Limited (Note 2)	Dormant	100%	0%
NLC Name No. 2 Limited (Note 2)	Dormant	100%	0%
NLC Name No. 3 Limited (Note 2)	Dormant	100%	0%
NLC Name No. 4 Limited (Note 2)	Dormant	100%	0%
NLC Name No. 5 Limited (Note 2)	Dormant	100%	0%
NLC Name No. 7 Limited (Note 2)	Dormant	100%	0%
The LV= Pension Trustee Limited (Note 2)	Dormant trustee company	Note 3	
The LV= General Trustee Limited (Note 2)	Dormant trustee company	Note 3	
The Ockham Pension Trustee Limited (Note 2)	Dormant trustee company	Note 3	
Liverpool Victoria Trustees Limited (Note 2)	Dormant trustee company	Note 3	
Liverpool Victoria Financial Services Limited (Note 1)	Active (non-trading)	Note 3	
<b>Wealth Wizards Limited Group of Companies</b>		70%	30%
Wealth Wizards Limited	IT software		
Wealth Wizards Benefits Limited * (Note 1)	Financial intermediary		
Wealth Wizards Advisers Limited * (Note 1)	Financial intermediary		
<b>Liverpool Victoria General Insurance Group of Companies</b>		51%	49%
Liverpool Victoria General Insurance Group Limited *	General insurance holding company		
Liverpool Victoria Insurance Company Limited *	General insurance		
Highway Insurance Company Limited *	General insurance		
LV Repair Services Limited * (Note 1)	Repair services		
LV Assistance Services Limited * (Note 1)	Road Rescue – Pay on use		
LV Insurance Management Limited * (Note 1)	Management services		
Highway Insurance Group Limited * (Note 1)	General insurance holding company		
Highway Group Services Limited * (Note 2)	Dormant		

\* Owned by a subsidiary undertaking of the Society

**Note 1** – The financial statements of these subsidiary undertakings have not been audited for the year ended 31 December 2018. These subsidiary undertakings are exempt from the requirements of the Companies Act 2006 relating to the audit of individual financial statements by virtue of Section 479A of the Companies Act 2006.

**Note 2** – The financial statements of these dormant companies have not been audited for the year ended 31 December 2018. These companies were entitled to exemption from audit under section 480 of the Companies Act 2006 relating to dormant companies.

**Note 3** – These companies are limited by Guarantee and have no issued share capital.



## Notes to the Financial Statements (continued)

Year ended 31 December 2018

### 43. Subsidiary undertakings (continued)

All the principal subsidiaries have the same year end as the Society and all have been included in the consolidation.

#### Non-controlling interest

Further details on the non-controlling interests in Liverpool Victoria General Insurance Group Limited and Wealth Wizards Limited are disclosed in Note 47.

#### Significant restrictions

Following the completion of the sale of a 49% stake in Liverpool Victoria General Insurance Group Limited to Allianz Holdings plc there are restrictions associated with this subsidiary and the subsidiaries it directly owns. The general insurance assets and liabilities identified in Note 47 are ring-fenced and distributions from these subsidiaries can only be made in accordance with the dividend policy contractually agreed with Allianz as part of the sale. Allianz has a protective veto right over any dividends paid outside of policy.

Whilst the Society retains control over the LVGIG group, the shareholders agreement includes protective veto rights for the minority investor that restricts the Society's ability to make changes to the capital structure, initiate insolvency proceedings, make a further sale of the business or enter into a merger or acquisition.

## Notes to the Financial Statements (continued)

Year ended 31 December 2018

### 44. Associates and joint ventures

The associates and joint ventures of the Society at 31 December 2018 are shown below. They are incorporated and domiciled in England and Wales.

Name	Class of shares	Year end	Principal activity	Percentage held
<b>Joint ventures</b>				
Great Victoria Partnership	*	31/03/2018	Investment property	50.0%

\* The percentage held represents the share of the partnership capital and partner loans held by the Society as at 31 December 2018.

The Group holds 50% of the voting rights of its joint arrangement. The Group has joint control over this arrangement as, under the contractual agreement, unanimous consent is required from all parties to the agreement for all relevant activities.

The Group's joint arrangement is structured as a partnership and provides the Group and the other parties to the agreement with rights to the net assets of the partnership. Therefore, this arrangement is classified as a joint venture.

#### Commitments and contingent liabilities in respect of joint ventures

There are no commitments or contingent liabilities relating to the Group's interest in the joint venture.

#### Summarised financial information for joint ventures

In accordance with the provisions of IFRS 12 which states that an entity may present the summarised financial information on the basis of the joint venture's or associate's financial statements if:

- the entity measures its interest in the joint venture or associate at fair value in accordance with IAS 28; and
- the joint venture or associate does not prepare IFRS financial statements and preparation on that basis would be impracticable or cause undue cost.

The summarised financial information set out below is presented on the basis of the Great Victoria Partnership's financial statements for the year ended 31 March 2018.

Within the Group financial statements this holding is accounted for as an investment at fair value in accordance with the exemptions permitted under IAS28 applicable to investment-linked insurance funds.

	31 March 2018 £m	31 March 2017 £m
<b>Summarised Statement of Financial Position</b>		
<b>Assets</b>		
Non-current		
– Investment properties	231	229
Current		
– Other assets	16	15
	<b>247</b>	<b>244</b>
<b>Liabilities</b>		
Non-current		
– Financial liabilities	(80)	(79)
Current		
– Other liabilities	(4)	(5)
	<b>(84)</b>	<b>(84)</b>
<b>Net assets</b>	<b>163</b>	<b>160</b>
Partners' capital	5	6
Retained earnings	158	154
<b>Total partners' funds</b>	<b>163</b>	<b>160</b>

## Notes to the Financial Statements (continued)

Year ended 31 December 2018

### 44. Associates and joint ventures (continued)

Summarised Statement of Comprehensive Income	31 March 2018 £m	31 March 2017 £m
Net rental income	11	12
Revaluation surplus/(deficit) on investment properties	3	(13)
Loss on sale of investment properties	—	(9)
<b>Operating profit/(loss)</b>	<b>14</b>	<b>(10)</b>
Finance costs	(3)	(3)
<b>Profit/(loss) for the year</b>	<b>11</b>	<b>(13)</b>

### 45. Investments in unconsolidated structured entities

The Group has interests in structured entities which are not consolidated as the definition of control has not been met based on the proportion of the investment of the structured entity held by the Group. As at 31 December 2018 the Group's interest in unconsolidated structured entities, which are classified as investments held at fair value through profit or loss are shown below:

Investment	2018 £m	2017 £m
Open Ended Investment Companies	5,464	5,430
Unit trusts	329	343
Liquidity funds	655	1,017
	<b>6,448</b>	<b>6,790</b>

Included within the above are £2,951m (2017: £2,995m) of investments held to cover linked liabilities. Other than these, the Group's exposure to financial loss from the interest in the unconsolidated structured entities is limited to the investment amount shown above. The Group is not required to provide financial support to the entities, nor does it sponsor the entities.

### 46. Unallocated divisible surplus

#### Accounting for the Unallocated divisible surplus

The Unallocated divisible surplus represents the excess of assets over and above the long-term insurance contract liabilities and other liabilities. It represents amounts that have yet to be formally declared as bonuses for the participating contract policyholders together with the free assets of the Society and Group. Any profit or loss for the year arising through the Statement of Comprehensive Income (for the Society and for the Group) is transferred to or from the Unallocated divisible surplus.

UK regulations, the Group's Principles and Practices of Financial Management, and the terms and conditions of participating contracts set out the bases for the determination of the amounts on which the participating additional discretionary contract benefits are based and within which the Group may exercise its discretion as to the quantum and timing of their payment to contract holders.

	Group		Society	
	2018 £m	2017 £m	2018 £m	2017 £m
Balance at 1 January	1,189	998	1,050	1,019
Transfer included within profit for the year	(28)	48	(24)	12
Transfer included within other comprehensive income	(34)	19	(27)	19
Gain on sale of non-controlling interest in LVGIG	—	124	—	—
<b>Balance at 31 December</b>	<b>1,127</b>	<b>1,189</b>	<b>999</b>	<b>1,050</b>

## Notes to the Financial Statements (continued)

Year ended 31 December 2018

### 47. Non-controlling interest

The table below details the non-controlling interests held in subsidiaries of the Group as at 31 December:

	LVGIG Group £m	Wealth Wizards Group £m	Total £m
Balance at 1 January 2018	376	(3)	373
Share of profit/(loss) after tax	38	(2)	36
Share of movement in other comprehensive income	(5)	–	(5)
<b>Balance at 31 December 2018</b>	<b>409</b>	<b>(5)</b>	<b>404</b>
Balance at 1 January 2017	–	(1)	(1)
Initial recognition of non-controlling interest on sale of LVGIG stake	376	–	376
Share of loss after tax	–	(2)	(2)
<b>Balance at 31 December 2017</b>	<b>376</b>	<b>(3)</b>	<b>373</b>

#### Summarised financial information on subsidiaries with material non-controlling interests

Summarised financial information is presented in order to enable users to understand the interest that non-controlling interests have in the Group's activities and cash flows.

At 31 December 2018 the LVGIG Group of companies is a disposal group that is classified as held for sale in accordance with IFRS 5 'Non-current Assets Held for Sale and Discontinued Operations', and has been presented as a discontinued operation – refer Note 12.

The Statement of Financial Position of the LVGIG Group is disclosed below for comparative purposes.

	2018 £m	2017 £m
<b>Assets</b>		
Intangible assets	271	264
Financial assets at fair value through income	736	1,437
AFS financial assets at fair value through OCI	995	–
Deferred acquisition costs	86	95
Reinsurance assets	490	558
Insurance receivables	265	279
Other assets	188	275
Cash and cash equivalents	319	540
<b>Total assets</b>	<b>3,350</b>	<b>3,448</b>
<b>Liabilities</b>		
Insurance contract liabilities	2,283	2,427
Subordinated liabilities	11	11
Other liabilities	222	242
<b>Total liabilities</b>	<b>2,516</b>	<b>2,680</b>
<b>Equity</b>	<b>834</b>	<b>768</b>
<b>Total equity and liabilities</b>	<b>3,350</b>	<b>3,448</b>

The Wealth Wizards Group of companies are not material to the Group.

## Notes to the Financial Statements (continued)

Year ended 31 December 2018

### Other disclosures

This section details other disclosure matters, comprising: related party transactions, directors' emoluments, With-profits actuary details and other relevant Society information.

#### 48. Related party transactions

##### a) Key management compensation

Key management personnel of the Group comprise all executive and non-executive directors and senior management. The summary of the compensation of key management personnel for the year is as follows:

	Group	
	2018	2017
	£000	£000
Short-term employment benefits	4,339	5,815
Other long-term benefits	380	2,606
Post-employment benefits	27	44
Termination benefits	–	1,202
<b>Total compensation of key management personnel</b>	<b>4,746</b>	<b>9,667</b>

The aggregate premiums payable for the year by the Group Executive and Non-Executive Directors in respect of the Group's products was £17,473 (2017: £20,502).

##### b) Transactions between the Society and other Group companies

	2018	2017
	£m	Restated* £m
Management charge by the Society (see note 11)	58	215
Beneficial interest of subsidiary in loans sold to the Society	39	33
Investment expenses charge to the Society	(3)	(3)
Interest income from group undertakings	–	18
Dividend income from group undertakings	67	94

\* In 2017, the Beneficial interest of subsidiary in loans sold to the Society was reported as the full loan stock. This has been restated to show the loans sold in the year.

Balances outstanding between the Society and other Group companies:

	2018	2017
	£m	£m
Payable by the Society	(6)	(21)
Receivable by the Society	33	25
Loans owed to the Society	15	10

##### c) Loans to related parties

Loans owed to the Society represent a loan agreement with Wealth Wizards Limited with a facility limit of £22.5m. Repayment is due by 2021 and £15m of this loan had been drawn down at 31 December 2018 (2017: £10m).

On 30 September 2017 the Society purchased 326,053,921 ordinary £1 shares in LV Capital PLC, in exchange for the cancellation of the £300m loan notes and the repayment of outstanding interest.

##### d) Other related party disclosure

The Society has granted a contingent loan facility to the RNPFN fund, a closed fund within the Group and a guarantee to the Trustees of the Teachers Assurance Group Pension Scheme. Further details of these, and other guarantees issued on behalf of subsidiaries, are disclosed in Note 41.

#### 49. With-profits Actuary

The following information has been provided in accordance with section 77 of the Friendly Societies Act 1992.

- The With-profits Actuary of the Society until 12 September 2018 was Mr A Walton, who was employed by Liverpool Victoria Friendly Society Limited. The total emoluments of Mr Walton during this period were £192,181 (2017: £297,159) including pension contributions, car allowance, LTIPs and other benefits. Mr Walton was a participant in the Society's long-term incentive plan and held one insurance policy issued by a subsidiary of the Society.
- The With-profits Actuary of the Society from 12 September 2018 is Mrs T Abbey, a partner in Deloitte LLP. Mrs Abbey was not a member of the Society at any time in 2018. Mrs Abbey had no pecuniary interest in any transactions with the Society at any time during the year except her interest as partner in the firm of Deloitte LLP to whom fees for professional services were paid amounting to £501,608. Mrs Abbey did not receive, nor will receive any other pecuniary benefit.

## Notes to the Financial Statements (continued)

Year ended 31 December 2018

### 50. Directors' emoluments

a) Emoluments of individual directors, including emoluments of the Chairman and highest paid director were as follows for the Society:

	Annual remuneration £000					Total remuneration £000		
	2018					2017		
	Salary and fees	Bonus	Pension related benefits	Other benefits	Total	Total	LTIP 2016-18	Total
R. Rowney	525	345	116	17	1,003	1,239	–	1,003
A. Parsons	396	180	45	29	650	497	–	650
W. Snow (appointed 02 July 2018) (1)	168	200	19	7	394	–	–	394
A. Cook	250	–	–	–	250	153	–	250
D. Barral	99	–	–	–	99	75	–	99
D. Neave	90	–	–	–	90	77	–	90
C. Ledlie	73	–	–	–	73	28	–	73
A. Hutchinson (appointed 1 January 2018)	63	–	–	–	63	–	–	63
L. Savage (appointed 1 February 2018)	60	–	–	–	60	–	–	60
T. Lawler (appointed 1 September 2018)	21	–	–	–	21	–	–	21
C. Burton (resigned 7 June 2018)	35	–	–	–	35	82	–	35
J. Dean (resigned 31 March 2018)	20	–	–	–	20	78	–	20
S. Treloar (resigned 28 December 2017)	–	–	–	–	–	815	–	–
P. Moore (resigned 29 June 2017)	–	–	–	–	–	260	–	–
M. Austen (resigned 20 June 2017)	–	–	–	–	–	87	–	–
C. Keers (resigned 20 June 2017)	–	–	–	–	–	33	–	–
	1,800	725	180	53	2,758	3,424	–	2,758

(1) Wayne Snow performed the role of chief risk officer from the date he was employed by LV= on 26 June 2018. Formal appointment to the board took place on 2 July 2018, however his full remuneration since commencing employment has been included in the table above. As part of his joining contract, the Remuneration Committee agreed that Wayne Snow would have the opportunity of being entitled to a full year's bonus.

Further details of the annual bonus awarded for the year ended 31 December 2018 are set out on pages 80 and 81.

Pension related benefits are amounts taken as cash in lieu of forgone pension contributions.

Other benefits include temporary living costs, car allowance, medical insurance, health screening, income protection cover and life cover.

The 2016-18 LTIP was below threshold and resulted in a £nil payout.

#### b) Pension arrangements

The LV= Employee Pension Scheme is administered at Group level and incorporates both defined benefit and defined contribution sections.

The defined benefit section was closed to future accrual in 2013 at which point existing members were eligible to join the defined contribution section.

The Society has made no contributions to personal pension arrangements during 2018 (2017: £nil).

There were no contributions to the defined contribution section in 2018 (2017: £15k).

Richard Rowney is a deferred member of the defined benefit section.

	2018	2017
Deferred pension at end of year	£000	£000
Richard Rowney	32	31

## Notes to the Financial Statements (continued)

Year ended 31 December 2018

### 51. Cash used in operating activities

	Group		Society	
	2018 £m	2017 £m	2018 £m	2017 £m
(Loss)/profit before tax, mutual bonus and UDS transfer from continuing operations	(90)	(42)	(29)	62
Profit before tax, mutual bonus and UDS transfer from discontinued operations	110	164	–	–
<b>Profit/(loss) before tax, mutual bonus and UDS transfer</b>	<b>20</b>	<b>122</b>	<b>(29)</b>	<b>62</b>
Investment income	(353)	(374)	(363)	(430)
Other interest income	(27)	(32)	–	–
Net losses/(gains) on investments	629	(360)	605	(395)
Finance costs	24	24	23	23
Gain on sale of commercial business renewal rights	–	(52)	–	–
Net decrease/(increase) in derivatives	7	(20)	13	14
<b>Non-cash items</b>				
Movement in deferred acquisition costs	9	7	–	–
Amortisation of intangible assets	20	11	3	2
Depreciation of property and equipment	5	7	2	3
(Profit)/loss on disposal of property and equipment	(3)	1	–	1
Impairment of intangible assets	–	2	–	–
Increase in provisions	5	13	–	7
Increase in pension benefit asset	(41)	(9)	(41)	(9)
Impairment write-offs in subsidiaries	–	–	7	16
Mutual bonus	(26)	(26)	(26)	(26)
<b>Changes in working capital</b>				
(Increase)/decrease in loans and receivables	(273)	33	(19)	90
Decrease/(increase) in reinsurance assets	77	(1,215)	9	(1,146)
Decrease/(increase) in insurance receivables	2	(15)	(11)	(13)
(Increase)/decrease in prepayments	(2)	2	(5)	16
(Decrease)/increase in participating insurance contract liabilities	(187)	280	(187)	280
(Decrease)/increase in non-participating insurance contract liabilities	(273)	280	(127)	209
(Increase)/decrease in non-participating value of in-force business	(10)	31	(10)	31
(Decrease)/increase in participating investment contract liabilities	(55)	56	(55)	56
(Decrease)/increase in non-participating investment contract liabilities	(54)	524	(54)	524
Increase in subordinated liabilities	1	1	–	1
Decrease in other financial liabilities	(3)	(54)	(3)	(54)
Increase/(decrease) in insurance payables	6	(1)	6	1
Increase/(decrease) in trade and other payables	11	29	(36)	5
<b>Cash used in operating activities</b>	<b>(491)</b>	<b>(735)</b>	<b>(298)</b>	<b>(732)</b>

### 52. Solvency and Financial Condition Report

The Solvency and Financial Condition Report of the Group as at 31 December 2018 will be available on LV.com after it has been submitted to the Prudential Regulation Authority or on request from the Group Company Secretary, County Gates, Bournemouth, BH1 2NF.

### 53. Society information

Liverpool Victoria Friendly Society Limited is a UK-incorporated and domiciled Friendly Society registered under the Friendly Societies Act 1992.

LV= and Liverpool Victoria are trademarks of Liverpool Victoria Friendly Society Limited. LV= and LV= Liverpool Victoria are trading styles of the Liverpool Victoria group of companies. Liverpool Victoria is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and Prudential Regulation Authority, and is a member of the Association of British Insurers and the Investment and Life Assurance Group.

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