

SCOTTISH WIDOWS LIMITED

(Formerly Clerical Medical Investment Group Limited)

ANNUAL REPORT
AND
FINANCIAL STATEMENTS

31 DECEMBER 2015



Member of Lloyds Banking Group plc

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COMPANY INFORMATION

Board of Directors

N E T Prettejohn (Chairman)

M Christophers
M G Culmer
A M Parsons*
V Maru
A M Blance
C J Thornton*
R L M Wohanka
J E M Curtis
J F Hylands
K A Cook
A Lorenzo*

* denotes Executive Director

Company Secretary

J M Jolly

Actuarial Function Holder

R J McIntyre

Independent Auditors

PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
2 Glass Wharf
Bristol
BS2 0FR

Registered Office

25 Gresham Street
London
EC2V 7HN

Company Registration Number

3196171

GROUP STRATEGIC REPORT

The directors present their strategic report on Scottish Widows Limited ("the Company") and its subsidiary undertakings (together referred to as "the Group") for the year ended 31 December 2015. The Company is limited by share capital and changed its name from Clerical Medical Investment Group Limited to Scottish Widows Limited on 31 December 2015.

The Group contributes to the results of the Insurance division of Lloyds Banking Group ("LBG"). Since Scottish Widows was founded 200 years ago, we have been focused on helping customers protect themselves today whilst preparing for a secure financial future. Our objective is to be the best insurance and retirement savings business for customers; providing simple, trusted, value for money products accessible through our customers preferred channels.

The external business environment is changing rapidly driven by regulations, technology and customer preferences, and legislative changes. Increased regulatory intervention is changing the way customers are saving for and accessing their savings for retirement. Rapid adoption of digital across Insurance is changing market dynamics with customers increasingly turning to these channels. Customer engagement is evolving from a fairly static relationship to more dynamic, service-oriented engagement.

We have evolved our strategy in response to changing customer needs and prioritised investment on four core markets, where we see the opportunity to deliver sustainable growth by taking advantage of strong macro-trends.

For Life and Pensions, the Group will become the "Go To Group" for Retirement for both personal and commercial customers, capturing the structural growth opportunity created by an ageing UK population as well as political and regulatory interventions (for example in relation to pensions freedom).

- In **Protection**, we will rebuild direct relationships through a multi-channel, multi-brand engagement model and build scale through entry into the intermediary channel
- In **Corporate Pensions**, we will increase capacity to build a scale and efficient business that serves our growing customer base, providing a better employer experience and improved member engagement. Additionally, we can build on banking relationships to selectively win new schemes in target segments
- In **Retirement**, we can capitalise on our unique opportunity of being part of the wider LBG and are looking to invest in the Retirement account proposition to further build on an already strong presence and help franchise customers navigate their retirement journey, offering simple, value-for-money products
- In **Bulk Annuities**, we have successfully entered a fast growing and profitable market whilst building on wider LBG experience in asset origination and building on our Commercial Bank relationships to help employers de-risk their defined benefit pensions schemes

We will respond to margin pressures by **building scale**, further **reducing our cost base** and **simplifying our IT landscape** to reduce complexity and to improve agility.

Our Insurance Strategy will create a scalable and efficient business and deliver value for money propositions for our customers that are aligned to clear and growing customer needs.

Principal activities

The principal activity of the Group is the undertaking of ordinary long-term insurance and savings business and associated investment activities in the United Kingdom. The Group also has branches operating within the EU, which write a relatively small amount of business, principally in Germany. The Group offers a wide range of life insurance products such as annuities, pensions, whole life, term life and investment type products through independent financial advisors, the LBG network and direct sales. The Group also reinsures business with insurance entities external to the Group.

Result for the Year

The result for the year ended 31 December 2015 is a Group profit after tax of £143m (2014: £105m). The result reflects improved valuation rates on the annuity business due to further investment in low risk higher yielding assets, positive market conditions in the year, as well as the continuing impact of German Insurance Business litigation as discussed below. The Directors consider the result to be satisfactory in light of these factors.

GROUP STRATEGIC REPORT (CONTINUED)**Corporate reorganisation**

During the year, a corporate restructuring exercise transferred ownership of the Company from SW Funding plc (previously Scottish Widows plc) to Scottish Widows Group Ltd (which is the holding company which directly and indirectly owns entities within the Insurance division of LBG). This restructure was undertaken as a step in advance of the insurance business transfer scheme which is described further below.

Insurance Business Transfer Scheme

On 26 November 2015, the High Court of Justice approved the transfer of the long-term insurance business of each of the below entities (the "transferors"), each a fellow group undertaking, to the Company, pursuant to an insurance business transfer scheme, under Part VII of the Financial Services and Markets Act 2000:

- SW Funding plc (previously Scottish Widows plc)
- Scottish Widows Annuities Limited (SWA), Scottish Widows Unit Funds Limited (SWUF) and Pensions Management (S.W.F.) Limited (PM) (subsidiaries of SW Funding plc)
- Clerical Medical Managed Funds Limited (CMMF), Halifax Life Limited (HLL) and St Andrew's Life Assurance plc (SAL) (subsidiaries of the Company)

As a result of the Part VII, going forwards, the Company will be the sole life insurance underwriter within the Insurance division.

The long-term business of transferors is represented by the assets and liabilities of those entities, which were transferred under the insurance business transfer scheme at book value. For the Group, any entity gains or losses arising in the transferors had an equal gain in the reserves of SW Limited Company, the net impact to the Group (SW Limited) is a gain of £4,307m in reserves.

Assets transferred from SW Funding plc included that entity's immediate subsidiaries, with the exception of those noted below, and Special Purpose Vehicles, and hence ownership of these subsidiaries is transferred to the Company. Ownership of certain insurance businesses covered by the insurance business transfer scheme, namely SWA, SWUF, and PM, remains with SW Funding plc.

The transfer provides the Group with a more efficient solvency capital position, simplifies Solvency II reporting, and will result in the emergence of cost synergies due to a reduction in the number of legal operating entities. The transfer was effective 31 December 2015 and therefore income / expenses relating to the business transferred remains within the transferor companies for the year then ended. Further details can be found in note 40.

As a result of listed debt transferred into the Company, 2015 is the first year for which the Company is required to produce consolidated accounts. Listed debt transferred comprises £1,500m fixed rate subordinated notes. If the Group had consolidated its IFRS accounts for 2014, its capital and reserves would have been £2,249m, compared to Company capital and reserves of £1,728m as at that date.

In 2015 Company capital and reserves of £4,641m were impacted by:

- £5,117m from the transfer of long-term insurance business from SW Funding plc and its insurance subsidiaries
- £476m impairment from the transfer of long-term insurance business from subsidiaries of the Company

The 2015 consolidated capital and reserves of Scottish Widows Limited Group after the transfer were £6,485m, increased by £4,307m as a result of the Insurance Business Transfer Scheme (see note 40).

FCA treating customers fairly thematic review

The Financial Conduct Authority (FCA) has referred a number of firms, including Scottish Widows Limited and SWA, to its enforcement division after publishing its thematic review on fair treatment of long-standing customers in the life insurance sector on 3 March 2015. Regulatory responsibility for the historic business of SWA transferred to SWL as result of the Insurance Business Transfer Scheme. The FCA will investigate the behaviour around disclosing exit and paid-up charges to customers after December 2008, when regulatory rules around treating customers fairly took effect. The FCA have stated that the commencement of investigations should not be taken to indicate they will necessarily result in a penalty being imposed or that redress will be payable. No provision is held in respect of this review at this time. This will continue to be assessed as the investigation progresses.

GROUP STRATEGIC REPORT (CONTINUED)**Key performance indicators***Funds under management*

Funds under management relating to policyholder liabilities were £106.8bn (2014: £41.5bn), including £73.8bn transferred as a result of the Insurance Business Transfer Scheme. The remaining movement reflects net flows from policyholders and investment return for the period.

Capital Resources

The Directors believe that the Company currently have adequate capital resources and will continue to do so in the foreseeable future. On a Pillar 1 basis the estimated regulatory surplus of the Company in excess of capital requirements is £3.5bn (2014: £1.5bn). On a Pillar 1 basis the estimated regulatory surplus attributable to the shareholder, excluding the regulatory surplus attributable to the with profits funds, is £3.3bn (2014: £1.5bn).

Solvency II

Our business model maximises the capital benefits from risk diversification available under Solvency II, having received PRA approvals for the use of our Internal Model to calculate our Solvency Capital Requirement and for the use of the Matching Adjustment, which has a beneficial impact on the level of regulatory capital we hold in relation to annuities business.

The Insurance Business Transfer Scheme is integral to achieving this strategy and under Solvency II, the Insurance Division of LBG is now able to recognise additional capital diversification benefits which will flow from the management of capital and risk within this overall structure.

The Group's preparations for Solvency II have progressed through 2015. The Group has already embedded Solvency II into its way of working and takes this into account when considering capital requirements. The Group has embedded a Risk Management Framework, with the Own Risk and Solvency Assessment (ORSA) a central feature to this framework. Further information on the capital position of the Group is given in note 36.

Following the successful implementation of Solvency II on 1 January 2016 the Insurance Group's capital position remains robust with estimated Solvency II excess capital at end December 2015 of £3.2 billion which represents a solvency ratio of 148%. This position is supported by approximately £1 billion of transitional arrangement benefits which will be phased out over the next sixteen years.

Liquidity

The Group regularly monitors its liquidity position to ensure that, even under stressed conditions, the Group has sufficient liquidity to meet its obligations and remain within the approved risk appetite. Liquidity methodology and reporting has been updated to ensure readiness for Solvency II.

Other Sources where KPIs are presented

The Group also forms part of LBG's Insurance Division. The development, performance and position of the Insurance Division are presented within LBG's annual report, which does not form part of this report.

The Directors consider that the above are the key performance indicators which are appropriate to the principal activity of the Group. These, together with other metrics which cover customer, operational measures and capital, are included in the balanced scorecard which is used to measure all aspects of the performance of the business. In addition, the Directors are of the opinion that the information contained in the Group's Prudential Regulation Authority (PRA) returns on capital resources and requirements and regular actuarial reports, in conjunction with the information presented in the financial statements as a whole, provide the management information necessary for the Directors to understand the development, performance and position of the business of the Group.

GROUP STRATEGIC REPORT (CONTINUED)**Review of the business**

In addition to the progress made against the strategic initiatives summarised earlier there are other areas that are worthy of note and these are described below. Decisions taken in the areas described below and in pursuit of our strategy are brought to life for the Board through the ORSA completed annually.

Investment strategy

As part of its efficient balance sheet management, the Group is focused on investments that improve risk adjusted returns and provide more diversification of assets to match its liabilities. In particular, the Group continues to identify investment opportunities in long term, low risk higher yielding illiquid assets available within LBG and developing the Group's capability to originate new loan assets, leveraging the capabilities of LBG as appropriate. This is expected to continue to deliver significant increased investment return to the Group without increasing credit risk beyond the Group's risk appetite.

During 2015, the Group continued to acquire illiquid credit assets from, or issued by, parties within LBG totalling £78m (2014: £625m) secured on equity release mortgages and direct loans (including infrastructure projects). Equity release mortgage assets were acquired initially by SW Funding plc prior to the insurance business transfer scheme. All assets were acquired at their fair value from LBG parties. Further details on the credit risk and fair value measurement of these assets can be found in note 36.

Recapture of a Portfolio of Unit-linked policies - Equitable Life

In 2001, Equitable Life and former HBOS group companies, which are subsidiaries of the Company (Halifax Life, Clerical Medical Investment Group and Clerical Medical Managed Funds) entered into an administration and reinsurance agreement covering unit-linked, non-profit, group pensions and annuity business. In 2012, Equitable Life decided to transfer unit-linked business back from Halifax Life to mitigate impending Solvency II issues. The relevant recapture agreement was signed in 2014 and the assets transfer was completed in March this year with an estimated NAV of £1.9bn. Further details can be found in note 3 and note 23.

The key implications of this transfer for the Group are two-fold. First, diminishing value creation opportunity as the Group now acts only as a reinsurer and box manager for the transferred business and second, higher per unit costs for remaining business as assets under management reduce. Assets will continue to be managed by Aberdeen Asset Management (AAM).

Bulk Annuities

Included in the Group balance sheet are the assets and liabilities in relation to bulk deals which originated in SW Funding plc, prior to the insurance business transfer scheme.

In July 2015, SW Funding plc undertook a reorganisation from its With Profit Fund to its Non-Profit Fund, in respect of £2.4bn of liabilities and in November 2015, entered into its first external bulk deal, bringing in £422m of liabilities from a third party pension scheme.

Transfer out of underlying investments - Lloyds Defined Contribution Scheme Trustees

Scottish Widows 'Investment only' platform currently hosts four LBG defined contribution pension arrangements. Recently, each of the relevant scheme Trustees have decided to transfer the scheme investments away from a Scottish Widows investment platform to AXA. This decision is partly driven by the Trustees' desire to fully comply with the Pension Regulators Code of Practice and also to make their Schemes 'future-proof' which can support their medium / long term plans for investment design and communications. Total assets in question equate to £2.5bn as at May 2015.

Litigation in relation to insurance branch business in Germany

The Group has received a number of claims from customers relating to policies issued by Clerical Medical Investment Group Limited (recently renamed Scottish Widows Limited) but sold by independent intermediaries in Germany, principally during the late 1990s and early 2000s. Following decisions in July 2012 from the Federal Court of Justice (FCJ) in Germany the Group recognised provisions totalling £517m during the period to 31 December 2014.

GROUP STRATEGIC REPORT (CONTINUED)

Recent experience has been slightly adverse to expectations and the Group has noted decisions of the FCJ in 2014 and 2015 involving German insurers in relation to a German industry-wide issue regarding notification of contractual 'cooling off' periods. Accordingly, a provision increase of £25 million has been recognised giving a total provision of £545m. The remaining unutilised provision as at 31 December 2015 is £124m (31 December 2014: £197m).

The validity of the claims facing the Group depends upon the facts and circumstances in respect of each claim. As a result the ultimate financial effect, which could be significantly different from the current provision, will only be known once all relevant claims have been resolved.

Outlook

The Directors consider that the Group's and Company's principal activities will continue to be unchanged in the foreseeable future.

Principal risks and uncertainties

The management of the business and the execution of the Company's and Group's strategy are subject to a number of risks. The financial risk management objectives and policies of the Company and Group and the exposure to market, insurance, credit, capital, liquidity, regulatory & legal, conduct, people, governance, operational and financial reporting risks are set out in note 36. As a result of the Insurance Business Transfer Scheme, the risks affecting the Insurance division predominantly reside with the Company going forwards.

The Group, like other insurers, is subject to legal proceedings in the normal course of business and the industry-wide environment of increased regulatory, legislative and oversight requirements. Whilst it is not practicable to forecast or determine the final results of all pending or threatened legal proceedings, management does not believe that such proceedings, including litigation, will have a material effect on the results and financial position of the Group except for the German insurance business litigation, for which a provision has been established, as discussed earlier in this report and set out in note 26.

On behalf of the Board of Directors

A M Parsons
Director
24 March 2016



DIRECTORS' REPORT

The Directors present the audited consolidated financial statements of the Company and the Group. The Company is a limited liability company, domiciled and incorporated in the United Kingdom. Details of all the subsidiary undertakings are given in note 14.

Results and dividend

The result for the year ended 31 December 2015 is a Group profit after tax of £143m (2014: £105m). The result reflects improved valuation rates on the annuity portfolio due to further investment in low risk higher yielding assets, positive market conditions in the year, as well as the continuing impact of German Insurance Business litigation discussed in notes 2 and 26. The Directors consider the result for the year to be satisfactory in light of these factors. Further information on the results of the Group, and future prospects of the business, are provided in the Group Strategic Report.

During the year, £245m interim dividends (2014: £nil) were paid. The Directors recommend no payment of a final dividend in respect of the year ended 31 December 2015 (2014: £nil).

The results above represent the consolidated results of the Group, which are presented for the first time. The consolidated results do not include any income statement impacts in relation to insurance business transferred from SW Funding, Scottish Widows Annuities Limited, Scottish Widows Unit Funds Limited, and Pensions Management (S.W.F.) Limited, under of the Insurance Business Transfer Scheme since this occurred on 31 December 2015, the year end date. However, since Clerical Medical Managed Funds Limited, Halifax Life Limited and St Andrew's Life Assurance plc are subsidiaries of SW Ltd their results are included in the consolidated statement of comprehensive income.

Post balance sheet events

On 18 February 2016 Scottish Widows Limited provided the Scottish Widows Group Ltd (SWG) with a £330m liquidity loan, repayable on 6 February 2017. Further details can be found in note 42.

Directors

The names of the current Directors are listed on page 3. Changes in directorships during the year and since the end of the year are as follows:

J F Hylands	(appointed 19 March 2015)
D J S Oldfield	(resigned 30 June 2015)
N M Bryson	(resigned 31 July 2015)
J Goford	(resigned 13 February 2015)
A M Blance	(appointed 17 July 2015)
K A Cook	(appointed 19 October 2015)
A Lorenzo	(appointed 02 March 2016)
T E Strauss	(resigned 21 October 2015)

Particulars of the Directors' emoluments are set out in note 37.

Directors' indemnities

Lloyds Banking Group plc has granted to the Directors of the Company a deed of indemnity through deed poll which constituted 'qualifying third party indemnity provisions' for the purposes of the Companies Act 2006. The deed was in force during the whole of the financial year and at the date of approval of the financial statements. Directors no longer in office but who served on the Board of the Company at any time in the financial year had the benefit of this contract of indemnity during that period of service. The indemnity remains in force for the duration of a Director's period of office. The deed indemnifies the Directors to the maximum extent permitted by law.

The Deed for existing Directors is available for inspection at the registered office of Lloyds Banking Group plc. In addition, the Group has in place appropriate Directors and Officers Liability Insurance cover which was in place throughout the financial year.

Disclosure of information to auditors

Each person who is a Director at the date of approval of this report confirms that, so far as the Director is aware, there is no relevant audit information of which the Company's auditors are unaware and each Director has taken all the steps that he ought to have taken as a Director in order to make himself aware of any relevant audit information and to establish that the Company's auditors are aware of that information. This confirmation is given, and should be interpreted in accordance with, the provisions of the Companies Act 2006.

Future developments

Details of future developments are provided in the Group Strategic Report.

DIRECTORS' REPORT (continued)**Employees**

LBG is committed to providing employment practices and policies which recognise the diversity of the workforce and ensure equality for employees regardless of sex, race, disability, age, sexual orientation or religious belief. In the UK, LBG belongs to the major employer groups campaigning for equality for all staff, including Employers' Forum on Disability, Employers' Forum on Age and Stonewall. LBG is also represented on the Board of Race for Opportunity and the Equal Opportunities Commission. Involvement with these organisations enables LBG to identify and implement best practice for staff.

Employees are kept closely involved in major changes affecting them through such measures as team meetings, briefings, internal communications and opinion surveys. These meetings, briefings and internal communications also serve to achieve a common awareness of the financial and economic factors that affect the performance of the company. There are well established procedures, including regular meetings with recognised unions, to ensure that the views of employees are taken into account in reaching decisions. Schemes offering share options or the acquisition of shares are available for most staff, to encourage their financial involvement in LBG.

Political contributions

During the year, the Group made no political contributions (2014: £nil).

Corporate governance

In accordance with the Financial Conduct Authority's Disclosure and Transparency Rule ("DTR") 7.2.1, the disclosures required by DTR 7.2.5R are within note 36 to the accounts and are therefore incorporated into this report by reference.

Going concern

The going concern of the Company and the Group is dependent on successfully maintaining adequate levels of capital and liquidity. In order to satisfy themselves that the Company and the Group have adequate resources to continue to operate for the foreseeable future, the Directors have considered a number of key dependencies which are set out in the risk management section under principal risks and uncertainties: funding and liquidity pages 84 to 87 and capital position on pages 87 to 88 and additionally have considered projections (including stress testing) for the Group's capital and funding position. Having consulted on these, the Directors conclude that it is appropriate to continue to adopt the going concern basis in preparing the accounts.

Hedging and financial risk management

Disclosures relating to hedge accounting are included within note 1 to the accounts, disclosures relating to financial risk management are included in note 36 to the accounts and are therefore incorporated into this report by reference.

Modern Slavery Act

We welcome the Modern Slavery Act and will issue our first statement in 2017, setting out the steps we take to ensure that slavery and human trafficking has not taken part in any place of our business or its supply chain.

Statement of Directors' responsibilities

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

Company law requires the Directors to prepare financial statements for each financial year. Under that law, the Directors have prepared the Group and Parent Company financial statements in accordance with International Financial Reporting Standards ("IFRSs") as adopted by the European Union. Under company law, the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Group and Company and of the profit or loss of the Group for that period.

In preparing these financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgments and accounting estimates that are reasonable and prudent;
- state whether applicable IFRSs as adopted by the European Union have been followed, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis, unless it is inappropriate to presume that the Company will continue in business.

DIRECTORS' REPORT (continued)

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and the Group and enable them to ensure that the financial statements comply with the Companies Act 2006 and, as regards the Group financial statements, Article 4 of the IAS Regulation. They are also responsible for safeguarding the assets of the Company and the Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The Directors are responsible for the maintenance and integrity of these financial statements as presented on the Company's website www.scottishwidows.co.uk. Legislation in England and Wales governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Each of the Directors whose names are listed on page 3 confirms that, to the best of their knowledge:

- the Group and Company financial statements, which have been prepared in accordance with IFRSs as adopted by the EU, give a true and fair view of the assets, liabilities, financial position and profit of the Group and Company; and
- the Strategic Report on pages 4 to 8, and the Directors' Report on pages 9 to 11 include a fair review of the development and performance of the business and the position of the Group and Company, together with a description of the principal risks and uncertainties that it faces.

On behalf of the Board of Directors



A M Parsons
Director
24 March 2016

INDEPENDENT AUDITORS' REPORT TO THE MEMBER OF SCOTTISH WIDOWS LTD (FORMERLY CLERICAL MEDICAL INVESTMENT GROUP LIMITED)**Report on the financial statements****Our opinion**

In our opinion:

- Scottish Widows Limited's (formerly Clerical Medical Investment Group Limited's) Group financial statements and Company financial statements (the "financial statements") give a true and fair view of the state of the Group's and of the Company's affairs as at 31 December 2015 and of the Group's profit and the Group's and the Company's cash flows for the year then ended;
- The Group financial statements have been properly prepared in accordance with International Financial Reporting Standards ("IFRSs") as adopted by the European Union;
- the Company financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union and as applied in accordance with the provisions of the Companies Act 2006; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the Group financial statements, Article 4 of the IAS Regulation.

What we have audited

In applying the financial reporting framework, the directors have made a number of subjective judgements, for example in respect of significant accounting estimates. In making such estimates, they have made assumptions and considered future events.

The financial statements, included within the Annual Report and Financial Statements (the "Annual Report"), comprise:

- the Balance Sheets as at 31 December 2015;
- the Consolidated Statement of Comprehensive Income for the year then ended;
- the Statements of Cash Flows for the year then ended;
- the Statements of Changes In Equity for the year then ended; and
- the notes to the financial statements, which include a summary of significant accounting policies and other explanatory information.

The financial reporting framework that has been applied in the preparation of the financial statements is applicable law and IFRSs as adopted by the European Union and, as regards the Company financial statements, as applied in accordance with the provisions of the Companies Act 2006.

In applying the financial reporting framework, the directors have made a number of subjective judgements, for example in respect of significant accounting estimates. In making such estimates, they have made assumptions and considered future events.

Opinion on other matter prescribed by the Companies Act 2006

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

Other matters on which we are required to report by exception**Adequacy of accounting records and information and explanations received**

Under the Companies Act 2006 we are required to report to you if, in our opinion:

- we have not received all the information and explanations we require for our audit; or
- adequate accounting records have not been kept by the Company, or returns adequate for our audit have not been received from branches not visited by us; or
- the Company financial statements are not in agreement with the accounting records and returns.

INDEPENDENT AUDITORS' REPORT TO THE MEMBER OF SCOTTISH WIDOWS LTD (continued)

We have no exceptions to report arising from this responsibility.

Directors' remuneration

Under the Companies Act 2006 we are required to report to you if, in our opinion, certain disclosures of directors' remuneration specified by law are not made. We have no exceptions to report arising from this responsibility.

Our responsibilities and those of the directors

As explained more fully in the Statement of Directors' responsibilities set out on page 10, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view.

Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland) ("ISAs (UK & Ireland)"). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

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

What an audit of financial statements involves

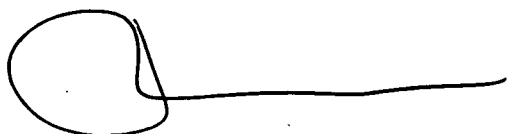
We conducted our audit in accordance with ISAs (UK & Ireland). An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of:

- whether the accounting policies are appropriate to the group's and the company's circumstances and have been consistently applied and adequately disclosed;
- the reasonableness of significant accounting estimates made by the directors; and
- the overall presentation of the financial statements.

We primarily focus our work in these areas by assessing the directors' judgements against available evidence, forming our own judgements, and evaluating the disclosures in the financial statements.

We test and examine information, using sampling and other auditing techniques, to the extent we consider necessary to provide a reasonable basis for us to draw conclusions. We obtain audit evidence through testing the effectiveness of controls, substantive procedures or a combination of both.

In addition, we read all the financial and non-financial information in the Annual Report to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.



Joanne Leeson (Senior Statutory Auditor)

For and on behalf of PricewaterhouseCoopers LLP

Chartered Accountants and Statutory Auditors

Bristol

24 March 2016

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 2015

	Notes	2015 £m	2014 £m
		<u>Group</u>	<u>Group</u>
Revenue			
Gross earned premiums	3	(1,254)	890
Premiums ceded to reinsurers		(77)	(78)
Premiums net of reinsurance		(1,331)	812
Fee and commission income	4	117	103
Investment income	5	1,410	1,868
Net (losses) / gains on assets and liabilities at fair value through profit or loss	6	(321)	1,045
Total revenue		(125)	3,828
Expenses			
Gross claims and benefits paid		(2,926)	(3,102)
Claims recoveries from reinsurers		75	76
		(2,851)	(3,026)
Change in liabilities arising from insurance contracts and participating investment contracts	23	3,954	972
Change in liabilities arising from non-participating investment contracts		(196)	(513)
Change in assets arising from reinsurance contracts held	17	16	41
Change in unallocated surplus	24	3	5
		3,777	505
Net loss attributable to external interests in collective investment vehicles		(190)	(477)
Operating expenses	7	(353)	(476)
Expenses for asset management services received		(146)	(152)
Finance costs	9	(32)	(42)
		(721)	(1,147)
Total expenses		205	(3,668)
Profit before tax		80	160
Taxation credit / (charge)	10	63	(55)
Profit for the year		143	105
Other comprehensive income			
Items that may subsequently be reclassified to profit or loss			
Movement in net investment hedges, net of tax		-	6
Currency translation differences		3	2
		3	8
Other comprehensive income, net of tax		3	8
Total comprehensive income for the year		146	113

The notes set out on pages 18 to 96 are an integral part of these financial statements.

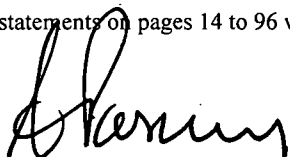
BALANCE SHEETS AS AT 31 DECEMBER 2015

	Notes	31 December 2015		31 December 2014	
		£m	£m	£m	£m
		<i>Group</i>	<i>Company</i>	<i>Group</i>	<i>Company</i>
ASSETS					
Intangible assets including insurance intangible assets	11	245	95	109	109
Deferred costs	12	1,766	1,741	491	331
Deferred tax assets	13	258	224	24	8
Investment in subsidiaries	14	-	428	-	486
Tangible fixed assets	15	17	-	-	-
Investment properties	16	4,228	315	1,125	536
Assets arising from reinsurance contracts held	17	8,396	8,396	340	1,004
Current tax recoverable	13	19	19	4	4
Prepayments		35	30	3	2
Derivative financial instruments	18	2,064	1,986	851	727
Loans and receivables	19	12,799	4,885	1,377	776
Investments at fair value through profit or loss	20	103,143	96,984	44,350	20,508
Cash and cash equivalents	21	2,106	880	705	381
Total assets		135,076	115,983	49,379	24,872
EQUITY AND LIABILITIES					
Capital and reserves attributable to the Group's equity shareholder					
Share capital	22	70	70	70	70
Share premium		1	1	1	1
Retained profits		6,414	6,573	2,178	1,657
Total equity		6,485	6,644	2,249	1,728
Liabilities					
Insurance contracts and participating investment contract liabilities	23	79,716	79,716	25,906	14,039
Unallocated surplus	24	288	288	51	51
		80,004	80,004	25,957	14,090
Future profits on non-participating business in the With Profits Funds	25	(79)	(79)	-	-
Deferred tax liabilities	13	551	548	120	87
Current tax payables	13	88	46	79	44
Provisions for other liabilities and charges	26	200	186	227	227
Accruals and deferred income	28	111	31	25	19
Subordinated debt	29	1,671	1,688	628	628
Non-participating investment contract liabilities	30	22,759	22,759	10,099	7,230
Derivative financial instruments	18	1,857	1,791	564	485
Other financial liabilities	31	4,484	2,361	526	334
External interests in collective investment vehicles		16,889	-	8,868	-
Borrowings	32	6	4	37	-
Retirement benefit liability	27(a)	50	-	-	-
Total liabilities		128,591	109,339	47,130	23,144
Total equity and liabilities		135,076	115,983	49,379	24,872

The notes set out on pages 18 to 96 are an integral part of these financial statements. During the year the company changed its name from Clerical Medical Investment Group Limited to Scottish Widows Limited.

The financial statements on pages 14 to 96 were approved by the Board on 24 March 2016.

A M Parsons
Director



STATEMENTS OF CASH FLOWS FOR THE YEAR ENDED 31 DECEMBER 2015

	Notes	2015		2014	
		£m	£m	£m	£m
		<i>Group</i>	<i>Company</i>	<i>Group</i>	<i>Company</i>
Cash flows from operating activities					
Profit/(loss) before tax		80	428	160	(8)
Adjusted for:					
Amortisation of intangible assets	11	14	14	20	20
Finance costs	9	32	32	42	42
Dividends received		-	(445)	-	(10)
Net decrease/(increase) in operating assets and liabilities	33	2,921	(4,646)	(21)	218
Net assets acquired from fellow group undertakings		(3,048)	4,332	-	-
Repayment of subordinated debt	29	286	286	19	19
Taxation paid		(97)	(43)	(39)	(3)
Net cash flows from/(used in) operating activities		188	(42)	181	278
Cash flows from investing activities					
Cash and cash equivalents acquired from fellow group undertakings	40	7,508	655	-	-
Dividends received		-	445	-	10
Net cash flows from investing activities		7,508	1,100	-	10
Cash flows from financing activities					
Redemption of subordinated debt	29	(286)	(286)	(19)	(19)
Dividends paid	34	(245)	(245)	-	-
Finance costs paid	9	(32)	(32)	(42)	(42)
Net cash flows used in financing activities		(563)	(563)	(61)	(61)
Net increase in cash and cash equivalents		7,133	495	120	227
Cash and cash equivalents at the beginning of the year		893	381	773	154
Net cash and cash equivalents at the end of the year	21	8,026	876	893	381

The notes set out on pages 18 to 96 are an integral part of these financial statements.

Net assets acquired from fellow group undertakings reflects operating assets and liabilities acquired as part of the Insurance Business Transfer Scheme (see note 40).

STATEMENTS OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 2015

Group

	Notes	Share capital £m	Share premium £m	Retained profits £m	Total attributable to owner of the parent £m
Balance as at 1 January 2014		70	1	2,065	2,136
Profit for the year		-	-	105	105
Other comprehensive income					
Currency translation		-	-	2	2
Movement in net investment hedges, net of tax				6	6
Other comprehensive income for the year		-	-	8	8
Balance as at 31 December 2014		70	1	2,178	2,249
Profit for the year		-	-	143	143
Other comprehensive income					
Currency translation		-	-	3	3
Other comprehensive income for the year		-	-	146	146
Fair value movement		-	-	28	28
Dividend		-	-	(245)	(245)
Impact of the Insurance Business Transfer Scheme	40	-	-	4,307	4,307
Balance as at 31 December 2015		70	1	6,414	6,485

Company

	Notes	Share capital £m	Share premium £m	Retained profits £m	Total attributable to owner of the parent £m
Balance as at 1 January 2014		70	1	1,667	1,738
Loss for the year		-	-	(6)	(6)
Other comprehensive loss for the year		-	-	(4)	(4)
Dividend		-	-	-	-
Balance as at 31 December 2014		70	1	1,657	1,728
Profit for the year		-	-	520	520
Other comprehensive income for the year		-	-	-	-
Dividend		-	-	(245)	(245)
Impact of the Insurance Business Transfer Scheme	40	-	-	4,641	4,641
Balance as at 31 December 2015		70	1	6,573	6,644

Not all of the above amounts can be distributed to the equity holder since the Company is required to meet regulatory capital requirements. Further details are given in note 36.

The notes set out on pages 18 to 96 are an integral part of these financial statements.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

1. Accounting policies

The accounting policies adopted in the preparation of the financial statements, which have been consistently applied to all periods presented in these financial statements unless stated otherwise, are set out below.

(a) Basis of preparation

As a result of listed debt transferring into the Company under the Insurance Business Transfer Scheme, 2015 is the first year for which the Company has produced consolidated accounts. The financial statements of the Group and Company have been prepared:

- (1) in accordance with the International Accounting Standards ("IASs") and IFRSs issued by the International Accounting Standards Board and the Standards and Interpretations ("SICs") and International Financial Reporting Interpretations issued by its IFRS Interpretations Committee ("IFRS IC"), as endorsed by the European Union;
- (2) in accordance with those parts of the Companies Act 2006 applicable to companies reporting under IFRSs;
- (3) in respect of the Group's and Company's With Profits Fund liabilities, in accordance with Financial Reporting Standard ("FRS") 103 "Insurance Contracts" issued by the United Kingdom Accounting Standards Board; and
- (4) under the historical cost convention, as modified by the revaluation of investment properties and certain financial assets and financial liabilities at fair value through profit or loss, as set out in the relevant accounting policies.

The Directors are satisfied that the Group and Company have adequate resources to continue in business for the foreseeable future. Accordingly, the financial statements of the Group and Company have been prepared on a going concern basis.

In accordance with IAS 1 "Presentation of Financial Statements", assets and liabilities in the balance sheet are presented in accordance with management's estimated order of liquidity. Analysis of the assets and liabilities of the Group and Company into amounts expected to be received or settled within 12 months after the reporting date (current) and more than 12 months after the reporting date (non-current) is presented in the notes.

This is the first period for which consolidated accounts have been presented, comparative consolidated figures are presented for 2014, as required by IAS 1.

The Group has taken advantage of the provisions of section 408 of the Companies Act 2006 and has not disclosed a statement of comprehensive income and related notes in respect of the Company.

Standards and interpretations effective in 2015

The Group has adopted the following new standards, amendments to standards and interpretations of published standards which became effective for financial years beginning on or after 1 January 2015: IAS 24 "Related Party Disclosures (Key Management Personnel)". Details are included within note 37.

Details of standards and interpretations in issue but which have not been adopted early are set out at note 41.

(b) Basis of consolidation

The assets, liabilities and results of Group undertakings (including structured entities) are included on the basis of financial statements made up to the reporting date. Group undertakings include all entities controlled by the Group. The Group controls an entity when it has power over the entity, is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through the exercise of power. This generally accompanies a shareholding of more than one half of the voting rights. The existence and effect of substantive rights that are currently exercisable or convertible are considered when assessing whether the Group controls another entity and the Group reassesses whether or not it controls an entity if facts and circumstances indicate that there are changes to any of these elements.

Collective investment vehicles and limited partnerships ("investment vehicles") where the Group has control, in part through its long term funds, are consolidated. Control arises where the Group has substantive rights to remove the external decision maker of the investment vehicle, and has a significant exposure to variable returns from the beneficial interest it holds in the investment vehicle. Where a subsidiary or related party of the Group acts as the decision maker of an investment vehicle the Group considers a number of factors in determining whether it acts as principal and therefore controls the investment vehicle including: an assessment of the scope of the Group's decision making authority over the investment vehicle; the rights held by other parties including substantive removal rights without cause over the Group acting as decision maker; the remuneration to which the Group is entitled in its capacity as decision maker; and the Group's exposure to variable returns from the beneficial interest it holds in the investment vehicle.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

1. Accounting policies (continued)**(b) Basis of consolidation (continued)**

Consolidation can be appropriate in circumstances where the Group has less than a majority beneficial interest. Where a collective investment vehicle is consolidated the interest of parties other than the Group are reported within liabilities as external interests in collective investment vehicles. Where a limited partnership is consolidated the non-controlling interest is reported in equity. Group undertakings are fully consolidated from the date on which the ability to exercise control is transferred to the Group and cease to be consolidated from the date on which the ability to exercise control ceases.

The treatment of transactions with non-controlling interests depends on whether, as a result of the transaction, the Group loses control of the subsidiary. Changes in the parent's ownership interest in a subsidiary that do not result in a loss of control are accounted for as equity transactions; any difference between the amount by which the non-controlling interests are adjusted and the fair value of the consideration paid or received is recognised directly in equity and attributed to the owners of the parent entity. Where the group loses control of the subsidiary, at the date when control is lost the amount of any non-controlling interest in that former subsidiary is derecognised and any investment retained in the former subsidiary is remeasured to its fair value; the gain or loss that is recognised in profit or loss on the partial disposal of the subsidiary includes the gain or loss on the remeasurement of the retained interest.

Intragroup transactions, balances and gains and losses on transactions between Group companies have been eliminated.

All the financial statements included are uniformly prepared in conformity with IFRSs and the Group's accounting policies and have adopted consistent accounting policies as at 31 December 2015.

(c) Product classification

The Group issues contracts that transfer insurance risk or financial risk or both.

Insurance contracts

Insurance contracts are those contracts which 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 which are significantly more than the benefits payable if the insured event were not to occur. Once a contract has been classified as an insurance contract, it remains an insurance contract for the remainder of its lifetime, even if the insurance risk reduces significantly over time.

Investment contracts

Any long term contracts not considered to be insurance contracts under IFRSs because they do not transfer significant insurance risk are classified as investment contracts. Such contracts are further analysed between those with and without a discretionary participation feature ("DPF"). Contracts containing a DPF are referred to as participating investment contracts and those without a DPF as non-participating investment contracts.

A DPF is a contractual right that gives investors the right to receive, as a supplement to guaranteed benefits, additional discretionary benefits or bonuses that are likely to be a significant portion of the total contractual benefits, through participation in the surplus arising from the assets held in the fund. The Group has the discretion within the constraints of the terms and conditions of the contract to allocate part of this surplus to the policyholders and part to the Group's shareholder. Participating investment contracts are accounted for in the same manner as insurance contracts in accordance with the requirements of IFRS 4 "Insurance Contracts".

Non-participating investment contracts are contracts that neither transfer significant insurance risk nor contain a DPF.

Hybrid contracts

For certain investment contracts within Scottish Widows heritage, the contract can be partly invested in units which contain a DPF and partly in units without. Where switching levels for similar contracts are deemed to be significant, new investment contracts which contain an option to switch into investment contracts with DPF have been classified as participating investment contracts. Where the switching levels are not deemed to be significant, a new contract is split, with units containing a DPF being allocated as a participating investment contract and the units without a DPF as a non-participating investment contract. Investment contracts which were in force when IFRS was implemented in 2005 were classified according to the switching levels observed at the time and retain their original classification. For certain investment contracts, the contract can be partly invested in units which contain a DPF and partly without. Where the contract is split, part is allocated as a non-participating investment contract and part as a participating investment contract.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

1. Accounting policies (continued)**(d) Financial assets and financial liabilities**

Management determines the classification of its financial assets and financial liabilities at initial recognition. Management's policies for the recognition of specific financial assets and financial liabilities, as identified on the balance sheet, are set out under the relevant accounting policies.

Financial assets are derecognised when the rights to receive cash flows from the financial assets have expired or where the Group has transferred substantially all of the risks and rewards of ownership. Financial liabilities are derecognised only when the obligation specified in the contract is discharged, cancelled or expires.

All financial assets and financial liabilities are designated at fair value through profit or loss, with the exception of certain loans and receivables, subordinated debt, other financial liabilities and borrowings, which are stated at amortised cost (as described in policies (p), (y), (ab) and (ad) respectively). The classification depends on the purpose for which the financial assets and financial liabilities were acquired.

Certain financial assets and financial liabilities, whose default accounting treatment would be to record these balances at amortised cost, are instead designated at fair value through profit or loss as they are held to match insurance and investment contract liabilities linked to the changes in fair value of these assets and liabilities, thereby reducing measurement inconsistencies, and reflecting the fact that these are managed and their performance evaluated on a fair value basis. Information on these balances is provided internally on a fair value basis to the Group's key management. The Group's investment strategy is to invest in equity and debt securities, loans, investment property, derivatives and cash and to evaluate the Group's investments with reference to their fair values. For further details on the Group's fair value methodology see policy (n).

(e) Fair value methodology

All assets and liabilities carried at fair value, or for which a fair value measurement is disclosed, are categorised into a "fair value hierarchy" as follows:

(i) Level 1

Valued using quoted prices (unadjusted) in active markets for identical assets and liabilities to those being valued. An active market is one in which similar arm's length transactions in the instrument occur with both sufficient frequency and volume to provide pricing information on an ongoing basis. Examples include listed equities, listed debt securities, Open Ended Investment Companies ("OEICs") and unit trusts traded in active markets and exchange traded derivatives such as futures.

(ii) Level 2

Valued using inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (as prices) or indirectly (derived from prices). If the asset or liability has a specified (contractual) term, a Level 2 input must be observable for substantially the full term of the asset or liability. Level 2 inputs include the following:

- Quoted prices for similar (but not identical) instruments in active markets;
- Quoted prices for identical or similar instruments in markets that are not active, where prices are not current, or price quotations vary substantially either over time or among market makers;
- Inputs other than quoted prices that are observable for the instrument (for example, interest rates and yield curves observable at commonly quoted intervals and default rates);
- Inputs that are derived principally from, or corroborated by, observable market data by correlation or other means.

Examples of these are securities measured using discounted cash flow models based on market observable swap yields, and listed debt or equity securities in a market that is inactive.

(iii) Level 3

Valued using inputs for the asset or liability that include significant unobservable inputs (inputs not based on observable market data). Unobservable inputs may have been used to measure fair value where observable inputs are not available. This approach allows for situations in which there is little, if any, market activity for the asset or liability at the measurement date (or market information for the inputs to any valuation models). Unobservable inputs reflect the assumptions the Group considers that market participants would use in pricing the asset or liability, for example private equity investments held by the Group and Company.

Where estimates are used, these are based on a combination of independent third-party evidence and internally developed models, calibrated to market observable data where possible. Further analysis of the Group's and Company's instruments held at fair value is set out at note 36. The Group's management, through a fair value pricing committee, review information on the fair value of the Group's financial assets and financial liabilities and the sensitivities to these values on a regular basis.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

1. Accounting policies (continued)**(e) Fair value methodology (continued)****(iii) Level 3 (continued)**

No assets are classified as held-to-maturity or available-for-sale. Derivative assets (other than a derivative which is a designated and effective hedging instrument) are classified as held for trading. With the exception of derivative liabilities, no liabilities are classified as held for trading.

Transaction costs incidental to the acquisition of a financial asset are expensed through the statement of comprehensive income, within net gains and losses on assets and liabilities at fair value through profit or loss.

Financial assets and financial liabilities are offset and the net amount reported in the balance sheet only when there is a legally enforceable right to offset the recognised amounts, both in the normal course of business and in the event of default, and there is an intention to settle on a net basis, or to realise the asset and settle the liability simultaneously.

Transfers between different levels of the fair value hierarchy are deemed to have occurred at the next reporting date after the change in circumstances that caused the transfer.

(f) Revenue recognition**Premium income**

Premiums received in respect of life insurance contracts and participating investment contracts are recognised as revenue when they become payable by the policyholder and are shown before deduction of commission. Premiums ceded to reinsurers are recognised when the related gross premiums are recognised. Gross and ceded premiums are recorded through the relevant lines in the statement of comprehensive income.

Fee and commission income

The Group receives ongoing investment management fees which are recognised as revenue as the services are provided.

The Group also receives initial investment management fees in the form of an adjustment, or charge, to the amount invested. These fees are in respect of services rendered in conjunction with the issue and management of investment contracts where the Group actively manages the consideration received from its customers to fund a return that is based on the investment profile that the customer selected on origination of the contract. These services comprise an indeterminate number of acts over the lives of the individual contracts and, therefore, the Group defers these fees and recognises them on a straight-line basis over the estimated lives of the contracts unless there is evidence to support an alternative recognition basis. Where an alternative recognition basis is applied, this is calculated by reference to experience information in respect of the period over which income from contracts is earned. The income is recognised through the statement of comprehensive income, within fee and commission income. The liability is recognised in the balance sheet within accruals and deferred income until recognition criteria are met.

Investment income

Interest income for all interest-bearing financial instruments is recognised in the statement of comprehensive income as it accrues, within investment income.

Dividends receivable in respect of listed shares and collective investment vehicles are recognised on the date that these are quoted ex-dividend; other dividend income is recognised when the right to receive the dividend is established. All dividends received are recognised through the statement of comprehensive income, within investment income.

Rental income in respect of investment properties is recognised on a straight line basis over the term of the lease. The costs of incentives are recognised as a reduction of total income over the term of the lease on a straight line basis.

Net gains and losses on assets and liabilities at fair value through profit or loss

Net gains and losses on assets and liabilities at fair value through profit or loss includes both realised and unrealised gains and losses. Movements are recognised in the statement of comprehensive income in the period in which they arise.

Other income

Other income recognised in the statement of comprehensive income comprises recharges of costs incurred in respect of several LBG subsidiaries which are not consolidated in these financial statements. Income is recognised as the related expenses are incurred.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

1. Accounting policies (continued)**(g) Expense recognition****Claims**

Claims are recorded as an expense on the earlier of the maturity date or the date on which the claim is notified. Claims recoveries from reinsurers are recognised when the related claims are recognised. Claims and claims recoveries are recognised through the relevant lines in the statement of comprehensive income. Claims handling costs and interest on late claims are also included in claims.

Operating expenses

Commission paid in respect of the business written by the Group is recognised through the statement of comprehensive income, within operating expenses. Where certain criteria are met, commission and other acquisition costs may be deferred. The circumstances under which such costs are deferred are set out at policy (j).

Other operating expenses are recognised in the statement of comprehensive income as incurred, within operating expenses.

Expenses for asset management services received

Expenses for asset management services received are recognised in the statement of comprehensive income as they accrue, within expenses for asset management services received.

Finance costs

Interest expense for all interest-bearing financial instruments is recognised in the statement of comprehensive income as it accrues, within finance costs.

(h) Leases

Assets leased to or from third parties, including properties leased to tenants, are classified as finance leases if the lease agreements transfer substantially all the risks and rewards of ownership to the lessee; all other leases are classified as operating leases. Operating lease rental income and expenditure are recognised on a straight-line basis over the life of the leases through the statement of comprehensive income, within investment income and operating expenses respectively.

Properties leased out to tenants under operating leases are included in investment properties in the balance sheet.

(i) Intangible assets including insurance intangible assets**(i) Acquired value of in-force business**

Insurance and investment contracts acquired in business combinations (other than business combinations falling within policy (ag)) are initially measured at fair value at the time of acquisition and subsequently held at amortised cost. The initial fair value includes the recognition of an acquired value of in-force ("acquired VIF") asset which reflects the present value of future cash flows expected from the business acquired. The asset is shown gross of attributable tax and a corresponding deferred tax liability has been established.

Amortisation of the acquired VIF balance and related tax is carried out on a best estimate basis over the estimated life of the contracts. The amortisation charge for the year is recognised through the statement of comprehensive income, within operating expenses. The carrying value of the acquired VIF balance is tested for impairment at each reporting date or when there is an earlier indication of impairment (further information on the Group's impairment policy is set out at policy (s)). Such an asset is not recognised in respect of future profits on contracts written in the normal course of business.

(ii) Software development costs

Costs that are directly associated with the acquisition of software licences and the production of identifiable and unique software products controlled by the Group, and that is expected to generate economic benefits exceeding costs beyond one year, are recognised as intangible assets, subject to de minimis limits. Direct costs include the software development team's employee costs and an appropriate portion of relevant overheads. All other costs associated with developing or maintaining computer software programmes are recognised through the statement of comprehensive income as an expense as incurred, within operating expenses.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

1. Accounting policies (continued)**(i) Intangible assets including insurance intangible assets (continued)****(ii) Software development costs (continued)**

Computer software development costs recognised as assets are valued at cost and amortised using the straight-line method over their expected useful lives, not exceeding a period of seven years. Subsequent expenditure is only capitalised when it increases the expected future economic benefits of the specific asset to which it relates. The amortisation charge for the year in respect of software licences and software development costs is recognised through the statement of comprehensive income, within operating expenses. The carrying value of the assets is tested for impairment at each reporting date. Further information on the Group's impairment policy is set out at policy (s).

(j) Deferred costs**(i) Deferred acquisition costs**

The costs of acquiring new insurance contracts and participating investment contracts (excluding those assessed on a realistic basis in accordance with FRS 103), which are incurred during a financial period but which relate to subsequent financial periods, are deferred to the extent that they are recoverable out of future revenue margins. The deferred acquisition cost asset is amortised over the lifetime of the related contracts based on the pattern of margins arising from these contracts unless there is evidence to support an alternative recognition basis. Where an alternative recognition basis is applied, this is calculated by reference to experience information in respect of the period over which income from contracts is earned. The amortisation charge for the year is recognised through the statement of comprehensive income, within operating expenses. The carrying value of the asset is tested for impairment at each reporting date. Further information on the Group's impairment policy is set out at policy (s).

(ii) Deferred origination costs

Costs which are directly attributable and incremental to securing new non-participating investment contracts are capitalised. This asset is subsequently amortised over the estimated contractual lifetime of each policy on a straight-line basis unless there is evidence to support an alternative recognition basis. Where an alternative recognition basis is applied, this is calculated by reference to experience information in respect of the period over which income from contracts is earned. The amortisation charge for the year is recognised through the statement of comprehensive income, within operating expenses. The carrying value of the asset is tested for impairment at each reporting date. Further information on the Group's impairment policy is set out at policy (s).

(k) Investment in subsidiaries

The Company owns a number of subsidiaries as set out in note 14. Certain subsidiaries do not form part of actively managed investment portfolios and the risks and rewards of owning those subsidiaries primarily rest with the shareholder of the Company, including such investments where ownership of the subsidiary is split between the Company's long-term fund and its shareholder fund. These subsidiaries are held initially at cost, being the fair value of the consideration given to acquire the holding, then subsequently at cost subject to impairment. Further information on the Group's impairment policy is set out at policy (s).

Certain subsidiaries, including holdings in collective investment vehicles, are held primarily as vehicles through which specific investments are held as part of the actively managed investment portfolios. These subsidiaries hold assets which are designated at fair value through profit or loss in accordance with IAS 39 "Financial Instruments: Recognition and Measurement" and primarily match policyholder liabilities. Accordingly, subsidiaries which are managed as part of policyholder investment funds are carried at fair value and presented within investments at fair value through profit or loss in the Company (see policy q). Changes in their fair value are reflected in the statement of comprehensive income, within net gains and losses on assets and liabilities at fair value through profit or loss.

(l) Tangible fixed assets

All property (other than investment property) and equipment is stated at cost less accumulated depreciation and any impairment in value. 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. Subsequent costs are included in an asset's carrying value only when it is probable that future economic benefits related to the asset will flow to the Group and such costs can be measured reliably.

Depreciation of tangible fixed assets is calculated on a straight-line basis to allocate the difference between the cost and the estimated residual value over the estimated useful lives of these assets. The depreciation charge is recognised through the statement of comprehensive income, within operating expenses.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

1. Accounting policies (continued)**(l) Tangible fixed assets (continued)**

The periods generally applicable are:

- Buildings 40 years
- Fixtures and fittings 15 years
- Computer equipment 3 years
- Other equipment 5 years
- Furnishings 10 years

Land is considered to have an indefinite useful life and is therefore not depreciated.

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each reporting date.

Assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. In the event that an asset's carrying amount is determined to be greater than the recoverable amount, it is written down immediately. The recoverable amount is the higher of the asset's fair value less costs to sell and its value in use.

(m) Investment properties

Investment properties comprise freehold and long leasehold land and buildings, which are held either to earn rental income or for capital appreciation, or both, are initially measured at cost, being the fair value of the consideration given, including directly attributable transaction costs. Subsequently, on a periodic basis and at each reporting date, such properties are carried at fair value, being the open market value, as assessed by qualified external appraisers who have recent experience in the relevant location and the category of properties being valued. If this information is not available, alternative valuation methods such as discounted cash flow analysis or recent prices are used. Investment property being redeveloped for continuing use as investment property, or for which the market has become less active, continues to be measured at fair value.

Gains or losses arising from changes in the fair values of investment properties are recognised in the statement of comprehensive income in the period in which they arise, within net gains and losses on assets and liabilities at fair value through profit or loss.

Service charge income and expense are disclosed separately within the relevant note.

(n) Assets arising from reinsurance contracts held

The Group cedes reinsurance in the normal course of business. Where the reinsurance contract transfers significant insurance risk to the reinsurer, the assets arising from reinsurance contracts held are classified as insurance contracts. Where the reinsurance contract does not transfer significant insurance risk to the reinsurer, the assets arising from reinsurance contracts held are classified as a financial asset designated as fair value through profit or loss.

Assets arising from reinsurance contracts held – classified as insurance contracts

These assets are recognised within assets arising from reinsurance contracts held. Amounts recoverable from or due to reinsurers are measured consistently with the amounts associated with the underlying contracts and in accordance with the terms of each reinsurance contract. These balances are subject to an annual impairment review. Further information on the Group's impairment policy is set out at policy (s).

Changes in these assets are recognised on the face of the statement of comprehensive income, through change in assets arising from reinsurance contracts held.

Premiums ceded and claims reimbursed are recognised when corresponding insurance premium assumed and claims incurred. These items are disclosed separately on the face of the statement of comprehensive income.

Assets arising from reinsurance contracts held – at fair value through profit or loss

Amounts due from reinsurers in respect of contracts that do not transfer significant insurance risk to the reinsurer are designated as fair value through profit or loss as this ensures consistency of valuation with the underlying liabilities. These contracts, whilst legally reinsurance contracts, do not meet the definition of a reinsurance contract under IFRSs. Where this is the case, the amounts recoverable have been recognised as a financial asset within assets arising from reinsurance contracts held. Changes in these assets are recognised on the face of the statement of comprehensive income, through change in assets arising from reinsurance contracts held. These balances are subject to an annual impairment review. Further information on the Group's impairment policy is set out at policy (s).

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

1. Accounting policies (continued)

(o) Derivative financial instruments

Classification

Derivative financial instruments, including embedded derivatives, are held for trading, with the exception of derivatives which are designated as effective hedging instruments, which are held at fair value through profit or loss. Derivatives held for trading are used for the purposes of efficient portfolio management or to match contractual liabilities.

Recognition

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.

Measurement

The best evidence of the fair value of a derivative at initial recognition is the transaction price unless the fair value of that instrument is evidenced by comparison with other observable current market transactions in the same instrument.

Fair values are obtained from quoted market prices in active markets, including recent market transactions. For over-the-counter ("OTC") derivatives, the value is derived from a hierarchy of valuation sources, as follows:

- primary source – an independent valuation source
- secondary source – generally, this would be the counterparty valuation
- tertiary source – generally, this would be the fund manager valuation

Data from a primary source will initially be used in valuing derivatives. However, tolerance checks are also performed between valuations derived from different sources in order to validate the calculated valuations, detect any potential discrepancies and, if appropriate, select a secondary or tertiary price for use in the valuation instead. If, as a result of this process, the primary, secondary and tertiary values for an instrument are not within tolerance, then the valuation is referred to the relevant authority within Insurance Finance to agree a final pricing decision.

For exchange traded contracts, the value is based on the quoted bid price at close of business where the contract is an asset held. Where the contract is a liability held, the value is based on the quoted ask price at close of business.

Changes in the fair value of derivatives are recognised in the statement of comprehensive income, through net gains and losses on assets and liabilities at fair value through profit or loss.

Hedge accounting

In limited circumstances, derivatives are designated as fair value hedges. Hedge accounting allows one instrument, generally a derivative such as a swap, to be designated as a hedge of another instrument such as a loan.

Derivatives may only be designated as hedging instruments provided certain strict criteria are met. At the inception of a hedge, its terms must be clearly documented and there must be an expectation that the derivative will be highly effective in offsetting changes in the fair value of the hedged risk. The hedge documentation must also specify the methodology that will be used to measure effectiveness. Changes in the fair value of derivatives that are designated as fair value hedges are recorded in the statement of comprehensive income, through net gains and losses on assets and liabilities at fair value through profit or loss, together with the changes in the fair value of the hedged asset or liability that are attributable to the hedged risk.

The effectiveness of the hedging relationship must be tested throughout its life. A hedge is regarded as highly effective if the change in fair value of the hedge instrument and the hedge item are negatively correlated within a range of 80% to 125%, either for the period since effectiveness was last tested or for the period since inception. Where the hedge is highly effective, the net impact on the statement of comprehensive income is minimised. If, at a reporting date, it is concluded that the hedge is no longer highly effective in achieving its objective, the hedge relationship is terminated. Should this happen, changes in the fair value of the hedged item are no longer recognised in the statement of comprehensive income and the adjustment that has been made to the carrying amount of the hedged item is amortised to the statement of comprehensive income over the period to maturity of the hedged item.

Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recorded in the statement of comprehensive income, together with the changes in the fair value of the hedged asset or liability that are attributable to the hedged risk. If the hedge no longer meets the criteria for hedge accounting, changes in the fair value of the hedged item attributable to the hedged risk are no longer recognised in the statement of comprehensive income.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

1. Accounting policies (continued)**(o) Derivative financial instruments (continued)****Hedge accounting (continued)**

The cumulative adjustment that has been made to the carrying amount of the hedged item is amortised to the statement of comprehensive income using the effective interest method over the period to maturity.

Changes in the fair value of derivatives that qualify as a net investment hedge on foreign operations are taken to other comprehensive income when the hedge is deemed to be effective. The ineffective portion of any net investment hedge is recognised in the statement of comprehensive income immediately. The fair values of derivative instruments used for hedging purposes are disclosed in note 18.

All derivatives are presented as assets when their fair value is positive and as liabilities when their fair value is negative.

(p) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and that are not designated as fair value through profit or loss at initial recognition.

Loans and receivables are initially recognised at fair value less directly attributable transaction costs and subsequently measured at amortised cost, subject to impairment. With the exception of certain long-term loans made to related parties, in practice the carrying value of these balances equates to the fair value due to the short-term nature of the amounts included within loans and receivables.

A charge for impairment in respect of loans and receivables would be made in the statement of comprehensive income when there is objective evidence that the Group will not be able to collect all amounts due according to their original terms. The impairment charge would be recognised through operating expenses in that part of the statement of comprehensive income. Receivables arising from insurance contracts are also classified in this category and are reviewed for impairment as part of the impairment review of loans and receivables. Such amounts are reflected through the statement of comprehensive income, within gross premiums written and claims recoveries from reinsurers. Further information on the Group's impairment policy is set out at policy (s).

(q) Investments at fair value through profit or loss

Investments at fair value through profit or loss comprise debt and equity securities.

Classification

A financial asset is classified in this category at inception if acquired principally for the purpose of selling in the short-term, if it forms part of a portfolio of financial assets in which there is evidence of short-term profit-taking, or if designated as such.

Recognition

Purchases and sales of financial assets are recognised on the trade date, i.e. the date the Group commits to purchase the asset from, or deliver the asset to, the counterparty. Investments are initially recognised at cost, being the fair value of the consideration given, and are subsequently remeasured at fair value.

Measurement

The fair values of investments are based on current bid prices. If the market for a financial asset is not active, and also for unlisted securities, the Group establishes fair value by using valuation techniques. These include the use of similar arm's length transactions and reference to other instruments that are substantially the same, making maximum use of market inputs and relying as little as possible on entity-specific inputs.

For equity investments that are quoted and actively traded in organised financial markets, fair value is determined by reference to Stock Exchange quoted market bid prices at the final pricing point on the reporting date. Prices are provided by vendors such as Reuters or Bloomberg or by direct reference to the Stock Exchange.

For quoted debt security investments, bid prices at the final pricing point on the reporting date are obtained from index providers who obtain prices from a number of leading brokers, investment banks and market makers. Where no independent price is available, a valuation technique is used to determine fair value. The technique uses a spread over a comparable term gilt as the best estimate of fair value. Spreads are calculated by reference to the wider market movement in credit spreads, the way in which the security is structured, other assets issued by the issuer or other assets with similar characteristics.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

1. Accounting policies (continued)**(q) Investments at fair value through profit or loss (continued)****Measurement (continued)**

For corporate bonds, the Group's management perform a comparison of information received from the index provider used against other available price sources on a monthly basis to ensure that prices can be supported by market data.

The fair value of holdings in collective investment vehicles (including OEICs and Unit Trusts) is determined as the last published price applicable to the vehicle at the reporting date.

In addition to the measurement policies, investment asset prices are reviewed weekly to identify those assets where the price has not moved for at least six days. This review provides an initial indication that the market for each identified asset may be inactive. These assets are then reviewed by management who may identify an alternative price source for assets which in their view are still actively traded. On conclusion that a particular asset is illiquid, management will identify an alternative valuation technique by deciding whether an appropriate price can be obtained from a recognised independent broker. Where this is the case, the broker will be approved as a price source for the asset. A price will then be obtained from the broker on a monthly basis. A review of all illiquid assets and prices obtained or calculated is conducted by the Fair Value Pricing Committee on a monthly basis.

For equity investments such as private equity, fair value is determined by reference to the most recent valuation, adjusted for any cash movements or other relevant information since the last valuation point, which is likely to be up to one quarter prior to the reporting date.

In order to ensure that a fair value is recognised for unquoted or illiquid debt securities, the primary price source is an external broker valuation. If available, a further external broker valuation is sought as a secondary valuation source in order to validate the primary source. A formal review is then carried out which challenges the external valuation and includes consideration of the impact of any relevant movements in underlying variables such as:

- underlying movements in the relevant markets, for example credit spreads;
- how current transactions are being priced in the market;
- how the security is structured; and
- any supporting quantitative analysis as appropriate, for example with reference to Bloomberg or internal models.

Structured entities

The Group invests in structured entities arising from investments in investment properties held through limited partnerships. Some of these limited partnerships are consolidated, as set out at policy (b). The unconsolidated limited partnerships are initially recognised at cost, being the fair value of the consideration given. After initial recognition, such assets are accounted for and measured at fair value, which equates to the relevant proportion of the published net asset value of the company. This valuation is based on open market valuations of the properties held by the limited partnership, as provided at the reporting date by independent valuers.

The Group holds investments in structured entities arising from investments in collective investment vehicles, carried at fair value. Some of these structured entities are consolidated, as set out at policy (b). Unconsolidated collective investment vehicles are carried at fair value as set out at policy (k).

(r) Cash and cash equivalents

Cash and cash equivalents includes cash at bank, short-term highly liquid investments with original maturities of three months or less (excluding such investments as otherwise meet this definition but which are held for investment purposes rather than for the purposes of meeting short-term cash commitments) and bank overdrafts where a legal right of set off exists.

(s) Impairment**Financial assets**

The carrying value of all financial assets held at amortised cost is reviewed for impairment whenever events or circumstances indicate that the carrying amount may not be recoverable. The identification of impairment and the determination of recoverable amounts is an inherently uncertain process involving various assumptions and factors, including the financial condition of the counterparty, expected future cash flows, observable fair prices and expected net selling prices. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its estimated recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and the present value of estimated future cash flows discounted at the asset's original effective interest rate.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

1. Accounting policies (continued)**(s) Impairment (continued)****Non-financial assets**

Assets that have an indefinite useful life, for example land, are not subject to depreciation or amortisation and are tested annually for impairment. Assets that are subject to amortisation 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 estimated recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and its value in use. For the purpose of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows.

If there is objective evidence that an impairment loss has occurred, the amount of the loss is charged to the relevant line in the statement of comprehensive income in the period in which it occurs. Non-financial assets that suffered an impairment are reviewed for possible reversal of the impairment at each reporting date.

Impairment process

Objective evidence that an asset or group of assets is impaired includes observable data that comes to the attention of the Group and Company about the following events:

- (i) significant financial difficulty of the issuer or debtor;
- (ii) a breach of contract;
- (iii) the disappearance of an active market for that asset because of financial difficulties; or
- (iv) observable data indicating that there is a measurable decrease in the estimated future cash flow from a group of assets since the initial recognition of those assets, even where the decrease cannot yet be identified with the individual assets of the Group or Company, including:
 - adverse changes in the payment status of issuers or receivables; or
 - national or local economic conditions that correlate with defaults on the assets in the Group or Company.

The Group first assesses whether objective evidence of impairment exists individually for assets that are individually significant. If the Group determines that no objective evidence of impairment exists for an individually assessed asset, whether significant or not, it includes the asset in a group of assets with similar credit risk characteristics and collectively assesses them for impairment. Those characteristics are relevant to the estimation of future cash flows for groups of such assets by being indicative of the issuer's ability to pay all amounts due under the contractual terms of the debt instrument being evaluated. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognised are not included in a collective assessment of impairment.

(t) Taxes

Tax on the profit or loss for the year is recognised in the statement of comprehensive income within taxation and comprises current and deferred tax.

Current tax

Current tax is the expected tax payable on the taxable income for the period, using tax rates and legislation enacted or substantively enacted at the reporting date, together with adjustments to estimates made in prior years.

Deferred tax

Deferred tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes at the reporting date. However, if the deferred tax arises from initial recognition of an asset or liability in a transaction other than a business combination that, at the time of the transaction affects neither accounting nor taxable profit nor loss, it is not accounted for. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities; using tax rates and legislation enacted or substantively enacted at the reporting date.

Deferred tax assets are only recognised to the extent that it is probable that future taxable profits will be available against which the temporary differences, carry-forward of unused tax assets and unused tax losses can be utilised.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

1. Accounting policies (continued)**(t) Taxes (continued)**

The carrying amount of deferred tax assets is reviewed at each reporting date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the deferred tax asset to be utilised. Deferred tax assets and liabilities held out with the policyholder liabilities are undiscounted.

Allocation of tax charge between shareholder and policyholders

The tax expense in the statement of comprehensive income is analysed between policyholder and shareholder tax. This allocation is based on the definition of policyholders' share and shareholders' share of taxable profit under current UK tax rules.

(u) Share capital

Shares are classified as equity when there is no obligation to transfer cash or other assets. Incremental costs directly attributable to the issue of equity instruments are shown in equity as a deduction from the proceeds, net of tax.

Dividends payable

Dividends payable on ordinary shares are recognised in equity in the period in which they are approved.

(v) Insurance contracts and participating investment contracts

The Group issues life insurance contracts to protect customers from the consequences of events (such as death, critical illness or disability) that would affect the ability of the customer or their dependants to maintain their current level of income and also issues pension and annuity contracts. Guaranteed claims paid on occurrence of the specified insured event are either fixed or linked to the extent of the economic loss suffered by the policyholder.

Insurance contracts or participating investment contracts in the Group's With Profits Funds

Liabilities of the Group's With Profits Funds, including guarantees and options embedded within products written by the funds, are accounted for under the realistic method in accordance with the requirements of FRS 103. However, in contrast to the approach used for the PRA's realistic capital regime, projected transfers out of the funds into other funds of the Group are not treated as insurance liabilities, but are recorded in unallocated surplus. Changes in the value of these liabilities are recognised in the statement of comprehensive income, through change in liabilities in insurance contracts and participating investment contract liabilities.

Liabilities for non-participating insurance contracts in the Group's With Profits Funds are measured using the traditional regulatory assessment. In addition, the realistic value of future profits on those contracts is recognised as an offset to the corresponding liabilities in the balance sheet, as future profits on non-participating business in the With Profits Funds. The movement in this balance is recognised in the statement of comprehensive income, through change in liabilities arising from insurance contracts and participating investment contracts.

Insurance contracts which are neither unit-linked nor in the Group's With Profits Funds

The liability is calculated by estimating the future cash flows over the duration of in-force policies and discounting them back to the valuation date, allowing for probabilities of occurrence. The liability will vary with movements in interest rates and with the cost of life assurance and annuity benefits where future mortality is uncertain. Assumptions are made in respect of all material factors affecting future cash flows, including future interest rates, mortality and costs. Changes in the value of these liabilities are recognised in the statement of comprehensive income, through change arising from insurance contracts and participating investment contract liabilities.

Insurance contracts which are unit-linked

Allocated premiums in respect of unit-linked contracts that are either insurance contracts or participating investment contracts are recognised as liabilities. These liabilities are increased or reduced by the change in the unit prices and are reduced by policy administration fees, mortality and surrender charges and any withdrawals. Non-unit reserves are also established for expected future expenses not covered by future margins, inadequacy of benefit charges to cover benefit claims, and inadequacy of guarantee charges to cover guarantees. Income consists of fees deducted for mortality, policy administration and surrender charges. Interest or changes in the unit prices credited to the account balances incurred in the period are charged as expenses in the statement of comprehensive income, through changes in liabilities arising from insurance contracts and participating investment contracts. Benefit claims in excess of the account balances incurred in the period are charged as expenses in the statement of comprehensive income, through gross claims and benefits paid.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

1. Accounting policies (continued)

(v) Insurance contracts and participating investment contracts (continued)

Unallocated surplus

Any amounts in the With Profits Funds not yet determined as being due to policyholders or the equity holder and projected transfers out of the funds to other funds of the Group are recognised as an unallocated surplus which is shown separately from the other insurance liabilities.

Bonuses

Bonuses in a given year comprise:

- Unit price increases and new reversionary bonuses declared in respect of that year which are provided within the calculation of liabilities arising from insurance and participating investment contracts;
- Terminal and interim bonuses paid out to policyholders on maturity and included within gross claims and benefits paid.

(w) Retirement benefit obligations

As part of the Insurance Transfer of Business effective 31st December 2015 (see note 40), the Group acquired Scottish Widows Services Limited as a subsidiary, and the Company assumed the role of principal employer for the Scottish Widows Retirement Benefit Scheme ("SWRBS") pension scheme within the Group. Individuals employed by the Group may be members of the Scottish Widows Retirement Benefit Scheme or of other pension schemes administered by LBG. All schemes are funded through payments to trustee-administered funds, determined, in the case of the defined benefit arrangements, by periodic actuarial calculations.

The Group contributes to both defined benefit and defined contribution elements of the pension schemes in question. A defined benefit plan is a pension plan that defines an amount of pension benefit that an employee will receive on retirement, dependent on one or more factors such as age, years of service and pensionable salary. A defined contribution plan is a pension plan under which the Group pays fixed contributions; there is no legal or constructive obligation to provide a specific benefit outcome.

Scottish Widows Retirement Benefit Scheme

A full actuarial valuation of this defined benefit scheme is carried out at least every three years with interim reviews in the intervening years; the valuation is updated to 31 December each year by a qualified actuary. For the purposes of these annual updates scheme assets are included at their fair value and scheme liabilities are measured on an actuarial basis using the projected unit credit method by an independent, qualified actuary appointed by LBG.

The amount recognised in the balance sheet in respect of the defined benefit element of the pension scheme is the present value of the defined benefit obligation at the reporting date less the fair value of plan assets. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows using interest rates equivalent to the market yields at the reporting date on high-quality corporate bonds that are denominated in the currency in which the benefits will be paid and that have terms to maturity that are approximate to the terms of the related pension asset/liability.

A surplus is only recognised to the extent that it is recoverable through a right to make reduced contributions in the future or to receive a refund from the scheme. The Group recognises any change in the effect of the surplus that can be recognised in other comprehensive income within remeasurements of the retirement benefit asset.

The Group recognises in profit or loss the current service cost of providing pension benefits and the net interest on the net defined benefit obligation. The current service cost is recognised within operating expenses. The net interest on the net defined benefit obligation is recognised within finance costs, and is determined by applying the discount rate used to measure the net defined benefit obligation at the beginning of the period to the net defined benefit obligation at that date, taking account of changes in the net defined benefit obligation during the period as a result of contributions and benefit payments.

Past service costs are changes in the defined benefit obligation arising from plan amendments or curtailments and are recognised immediately in profit or loss, within operating expenses, when the plan amendment or curtailment occurs. The Group recognises the gain or loss on a settlement of the defined benefit obligation immediately in profit or loss when the settlement occurs.

The Group recognises in other comprehensive income, within remeasurements of the retirement benefit obligations, actuarial gains and losses arising from experience adjustments and changes in the actuarial assumptions, and the return on plan assets excluding the net interest on the net defined benefit obligation that is recognised in profit or loss.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

1. Accounting policies (continued)**(w) Retirement benefit obligations (continued)****Scottish Widows Ltd share of LBG defined benefit pension scheme deficit**

Some employees are members of certain LBG defined benefit pension schemes. Accordingly, defined benefit pension scheme accounting, as set out above, has been applied to reflect the Group's share of those schemes' deficits.

Full actuarial valuations of these group-wide schemes are carried out at least every three years, with interim reviews in the intervening years which are updated by qualified independent actuaries. Scheme assets are included at their fair value. Scheme liabilities are measured on an actuarial basis using the projected unit credit method and are discounted using rates equivalent to the market yields at the reporting date on high-quality corporate bonds that have terms to maturity approximating to the terms of the related pension liability.

The Group's share of the resulting net surplus or deficit, determined on the basis of the Group's cash contributions into the schemes for employee members (calculated in accordance with the rules of each scheme) is included in the consolidated balance sheet. The Group's profit or loss includes the Group's share of the current and past service costs of providing pension benefits, the gain or loss on a settlement of the defined benefit obligation, and the net interest on the net defined benefit obligation. The Group's other comprehensive income includes the Group's share of actuarial gains and losses arising from experience adjustments and changes in the actuarial assumptions, the return on plan assets excluding the net interest on the net defined benefit obligation that is recognised in profit or loss, and changes in the effect of a retirement benefit asset that can be recognised to the extent that it is recoverable. These amounts are recognised in the same way as the respective amounts in relation to the SWRBS.

Defined contribution schemes

Contributions made by the Group to defined contribution arrangements, including Your Tomorrow, are recognised in the statement of comprehensive income as an employee benefit expense when they are due, within operating expenses.

(x) Provisions for liabilities and other charges

Provisions are recognised when the Group has a present legal or constructive obligation as a result of past events, when it is probable that the obligation will result in an outflow of resources to settle the obligation and when a reliable estimate of the amount of the obligation can be made. If the effect is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessment of the time value of money and, where appropriate, the risks specific to the liability.

The Group recognises a provision for onerous contracts when the expected benefits to be derived from contracts are less than the unavoidable costs of meeting the obligations under the contracts.

Contingent liabilities are possible obligations whose existence depends on the outcome of uncertain future events or those present obligations where the outflows of resources are uncertain or cannot be measured reliably. Contingent liabilities are not recognised in the financial statements but are disclosed unless the likelihood of possible obligations arising is remote.

(y) Subordinated debt

Subordinated debt comprises dated and undated loan capital. They are recognised initially at fair value, being the issue proceeds net of transaction costs incurred. Subordinated debt is subsequently stated at amortised cost: any difference between the proceeds (net of transaction costs) and the redemption value is recognised in the statement of comprehensive income through finance costs over the period of the liabilities using the effective interest rate applicable to the instrument. Both dated and undated subordinated debt is adjusted for hedged interest rate risk. Changes in the resulting value of these subordinated debt is accounted for as set out at policy (o). Interest payable is recognised in the statement of comprehensive income, through finance costs.

The subordinated guaranteed bonds are classified as a liability on the basis of the existence of a capital disqualification event considered to be a genuine settlement provision in the context of current uncertainty surrounding the direction of future regulatory rule developments.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

1. Accounting policies (continued)**(z) Non-participating investment contracts**

The Group's non-participating investment contracts are primarily unit-linked. These contracts are accounted for as financial liabilities whose value is contractually linked to the fair values of financial assets within the Group's unitised investment funds. The value of the unit-linked financial liabilities is determined using current unit prices multiplied by the number of units attributed to the contract holders at the reporting date. Their value is never less than the amount payable on surrender, discounted for the required notice period where applicable. Investment income allocated to non-participating investment contracts is included in change in non-participating investment contract liabilities.

Deposits and withdrawals are not accounted for through the statement of comprehensive income but are accounted for directly in the balance sheet as adjustments to the liability arising from non-participating investment contracts.

Fee and commission income in relation to non participating unit linked investment business is presented within the statement of comprehensive income within fee and commission income.

(aa) Liability adequacy test

At each reporting date, liability adequacy tests are performed to ensure the adequacy of the insurance contracts and participating investment contract liabilities net of related deferred costs and acquired VIF. In performing these tests, current best estimates of future contractual cash flows, claims handling and policy administration expenses, as well as investment income from assets backing such liabilities, are used. Any deficiency is immediately charged to the statement of comprehensive income, initially by writing off the relevant assets and subsequently by establishing a provision for losses arising from the liability adequacy tests.

(ab) Other financial liabilities

Other financial liabilities are initially recognised at fair value less directly attributable transaction costs and subsequently measured at amortised cost. In practice, the carrying value of these balances equates to the fair value due to the short-term nature of the amounts included within other financial liabilities.

(ac) External interests in collective investment vehicles

External interests in collective investment vehicles which are accounted for by the Group as investments in subsidiaries as set out at policy (k) above are initially recognised, and subsequently stated, at fair value. The fair value of holdings in these funds is determined at the valuation point applicable to the collective investment vehicles at the reporting date as set out under policy (q) above. Changes in the fair value of this balance are recognised in the statement of comprehensive income, through net profit attributable to external interests in collective investment vehicles.

(ad) Borrowings

Borrowings are recognised initially at fair value, being the issue proceeds net of transaction costs incurred. In practice, due to the nature of these balances, being bank overdrafts, the carrying value equates to the fair value of these liabilities as the borrowings are repayable on demand.

(ae) Foreign currency translation

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"). The consolidated financial statements are presented in pounds sterling, (rounded to the nearest million ("£m")), which is the company's presentation and functional currency.

Monetary items denominated in foreign currencies are translated into sterling at the exchange rates ruling at the reporting date. Non-monetary items denominated in foreign currencies that are measured at fair value are translated at the exchange rates ruling at the date when the current fair value is determined. Non-monetary items denominated in foreign currencies that are measured at historical cost are translated at the exchange rates ruling at the date of the transaction. Revenue transactions and those relating to the acquisition and realisation of investments have been translated at rates of exchange ruling at the time of the respective transactions. Any exchange differences are dealt with in that part of the statement of comprehensive income in which the underlying transaction is reported.

The results and financial position of the Group's foreign operations that have a functional currency different from the presentational currency are translated into the presentation currency as follows. The assets and liabilities of foreign operations are translated into sterling at foreign exchange rates ruling at the balance sheet date.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

1. Accounting policies (continued)**(ae) Foreign currency translation (continued)**

The income and expenses of foreign operations are translated into sterling at average exchange rates, unless these do not approximate to the foreign exchange rates ruling at the dates of the transactions in which case income and expenses are translated at the dates of the transactions. Foreign exchange differences arising on the translation of foreign operations are recognised in other comprehensive income.

(af) Collateral

The Group receives or pledges collateral in the form of cash or securities in respect of derivative transactions it undertakes. The Group also receives collateral in the form of securities in respect of stock lending agreements, repurchase agreements and certain loans made to related parties. Collateral received is recognised as an asset on the balance sheet when the risks and rewards of ownership are substantially transferred to the Group. A corresponding liability for repayment of collateral is recognised in financial liabilities. Collateral received that is not recognised on the balance sheet is legally segregated from the assets of the Group. Collateral pledged continues to be recognised as an asset on the balance sheet unless the risks and rewards have been substantially transferred to the counterparty.

(ag) Business combinations of entities under common control

Business combinations of entities under common control are outside the scope of IFRS 3 "Business Combinations" in accordance with paragraph 2(c). As a result there is currently no specific guidance in IFRS for the accounting treatment or disclosure of such transactions so management has applied IAS 8 "Accounting Policies, Changes in Accounting Estimates and Errors" in developing an appropriate policy. The result of this is that the principles of predecessor accounting are applied to business combinations of entities under common control, meaning that the acquirer does not restate acquired assets or liabilities to fair value but instead incorporates predecessor carrying values.

Predecessor accounting was applied for the Insurance Business Transfer Scheme, as explained fully at note 40. Predecessor carrying values, being the book values in each company, were used as transfer values. No payment was made for assets transferred, with any difference between the consideration paid and the net assets acquired taken to reserves, as shown in the Statement of Changes in Equity.

Predecessor values have been assessed with reference to the Scottish Widows Group, using the previously consolidated position of SW Funding plc as proxy (since SWG does not prepare consolidated accounts). This is to ensure that the IAS 8 requirements of comparability, relevance and reliability, reflecting the economic substance of little change from the Insurance Business Transfer Scheme, are achieved.

2. Critical accounting estimates and judgments in applying accounting policies

The Group's management makes estimates and judgments that affect the reported amount of assets and liabilities. Estimates and judgments are continually evaluated and based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Revisions to accounting estimates are recognised in the period in which the estimate is revised and in any future periods affected.

(a) Insurance contracts and participating investment contract liabilities

The estimation of the ultimate liability arising from insurance contracts and participating investment contracts which are not unit-linked is the Group's most critical accounting estimate.

In accordance with FRS 27, the liabilities of the Group's With Profits Funds are calculated using stochastic simulation models which value liabilities on a basis consistent with tradable market option contracts (a "market-consistent" basis). The liabilities are sensitive to both investment market conditions and changes to a number of non-economic assumptions, such as the level of take-up of options inherent in the contracts, mortality rates and lapses prior to dates at which a guarantee would apply.

For insurance contracts outside the With Profits Funds, the liabilities are calculated using a projection of future cash flows after making prudent assumptions about matters such as investment return, expenses, credit default and mortality. Discount rates used to value the liabilities are set with reference to the risk adjusted yields on the underlying assets. The most critical non-economic assumptions are mortality rates in respect of annuity business written and levels of future expenses.

Such assumptions are based on recent actual experience, supplemented by industry information where appropriate. No critical accounting estimates apply for participating investment contracts as the contract liabilities arising outside of the With Profits Funds are almost entirely current unit values.

At each reporting date, the estimates and assumptions referred to above are reassessed for adequacy and changes will be reflected in adjustments to the liability, through the statement of comprehensive income. Further information on these assumptions is given in note 35.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

2. Critical accounting estimates and judgments in applying accounting policies (continued)**(a) Insurance contracts and participating investment contract liabilities (continued)**

Sensitivities regarding changes to key assumptions in calculating liabilities arising from insurance contracts and participating investment contracts are given in note 35.

(b) Intangible assets including intangible insurance assets**Acquired value of in-force business**

Following the acquisition of General Life Assurance Society by Clerical Medical in 1996, the Group holds an asset representing the acquired VIF.

The asset arising on the acquisition was calculated by projecting the future surpluses and other cash flows attributable arising from business written, excluding the value of future investment risk margins, discounted at an appropriate rate. The key assumptions used in estimating future surpluses related to lapse rates and expenses. The assumptions were determined on a best-estimate basis and, as above, were based on recent actual experience and industry information where appropriate. Amortisation of this balance and the related deferred tax is carried out on a best estimate basis over the estimated life of the contracts. The amortisation charge for the year is recognised through the statement of comprehensive income, within operating expenses. The carrying value of this asset is tested for impairment at each reporting date. Further information on this asset is given in note 11.

(c) Deferred costs

For insurance contracts and participating investment contracts (excluding those assessed on a realistic basis in accordance with FRS 103) acquisition costs which are incurred during a financial period but which relate to subsequent financial periods are deferred to the extent that they are recoverable out of future revenue margins. All other costs are recognised as expenses when incurred. The calculation of the deferred acquisition cost asset and its pattern of amortisation requires estimation of both the expected pattern of receipt of future revenue margins and the period that the business is expected to remain in force. Further information on this asset is given in note 12.

The recognition of costs and income in respect of non-participating investment contracts is governed by IAS 18 "Revenue". Under this standard, directly attributable and incremental costs to securing new business are capitalised and are then subsequently amortised over the period of the provision of the investment management services. Estimation is required of the period that the business is expected to remain in force and prudent assumptions are required for contracts which do not have a fixed maturity date.

(d) Retirement benefit obligations

The majority of the Group's employees are members of the SWRBS, although some employees are members of certain LBG Schemes. All schemes provide defined benefits and/or defined contribution benefits to the members of those schemes.

(e) Taxation

The Group recognises current and deferred tax assets in line with IAS 12 "Income Taxes". In recognising these assets, management takes into account the likely impact of any tax issues that are subject to ongoing discussion with HM Revenue and Customs and other tax authorities. With regard to the Group's and Company's deferred tax assets, a significant feature is the management judgment applied in determining the timing, sensitivities and probability of them crystallising. This judgment is based on tax forecasts reflecting new business assumptions, sensitivities and proposed management actions. Further information in relation to the Group's and Company's current and deferred tax assets is set out in notes 10 and 13.

(f) Fair value of financial instruments

In accordance with IFRS 7, the Group categorises financial instruments carried on the balance sheet at fair value using a three level hierarchy. Financial instruments categorised as level 1 are valued using quoted market prices and therefore there is minimal judgement applied in determining fair value. However, the fair value of financial instruments categorised as level 2 and, in particular, level 3 is determined using valuation techniques. These valuation techniques involve management judgement and estimates, the extent of which depends on the complexity of the instrument and the availability of market observable information. Further details of these valuations are described in note 36.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

2. Critical accounting estimates and judgments in applying accounting policies (continued)

(g) Provisions for other liabilities and charges

The Group has received a number of claims from customers relating to policies issued by Clerical Medical Investment Group Limited (recently renamed Scottish Widows Limited) but sold by independent intermediaries in Germany, principally during the late 1990s and early 2000s. Following decisions in July 2012 from the Federal Court of Justice (FCJ) in Germany the Group recognised provisions totalling £517m during the period to 31 December 2014. Recent experience has been slightly adverse to expectations and the Group has noted decisions of the FCJ in 2014 and 2015 involving German insurers in relation to a German industry-wide issue regarding notification of contractual 'cooling off' periods. Accordingly, a provision increase of £25m has been recognised giving a total provision of £545m. The remaining unutilised provision as at 31 December 2015 is £124m (31 December 2014: £197m).

The validity of the claims facing the Group depends upon the facts and circumstances in respect of each claim. As a result the ultimate financial effect, which could be significantly different from the current provision, will only be known once all relevant claims have been resolved.

The Directors believe this provision represents an appropriate estimate of the financial impact based upon a series of assumptions, including the number of claims received from the respective populations of different classes of policies, the proportion upheld, and resulting legal and administration costs. Further information in relation to the provision is set out in note 26.

(h) Use of predecessor accounting in the Insurance Business Transfer Scheme

As noted in the Accounting Policies, it is judged appropriate to use predecessor accounting in relation to assets and liabilities transferred to the Company from other group related undertakings. The Directors consider it appropriate to adopt predecessor accounting values from SW Funding plc (formerly Scottish Widows plc), as carrying values best reflecting the economic substance of the transaction. This is consistent with the approach for similar transfers of business within the Insurance division of LBG in the past.

Predecessor values have been assessed with reference to the Scottish Widows Group, using the previously consolidated position of SW Funding plc as proxy (since SWG does not prepare consolidated accounts). This is to ensure that the IAS 8 requirements of comparability, relevance and reliability, reflecting the economic substance of little change from the Insurance Business Transfer Scheme, are achieved.

3. Segmental analysis

In the opinion of the Directors, the Group operates in a single business segment, being the provision of long-term insurance and investment contracts, and therefore the following specific disclosure requirements under IFRS 8 "Operating Segments" are required. The table below provides a summary of the gross premiums written within the single business segment:

<i>Group</i>	2015 £m	2014 £m
Regular premiums	447	564
Single premiums	(1,701)	326
Total	(1,254)	890

Further, a summary of the gross premiums written by the segment's main product types is shown below

<i>Group</i>	2015 £m	2014 £m
Corporate pensions	57	63
Individual pensions	35	62
Retirement income	97	117
Protection	274	319
Investments	244	329
Reduction in premiums from reinsurance recapture	(1,961)	-
Total	(1,254)	890

Of the above gross written premiums, £130m relates to the European business with the remaining written in the UK.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

3. Segmental analysis (continued)

On the 8 March 2015, the Equitable Life Assurance Society recaptured a portfolio of unit-linked and protection business that was reinsured to the HLL a subsidiary of the Company. Group gross premiums written were impacted by the transfer of the HLL book to ELAS, reducing premiums by £1.9bn on the statement of comprehensive income, and reducing the gross balance sheet position, as set out in note 23.

4. Fee and commission income

<i>Group</i>	2015 £m	2014 £m
Fund management and policy administration fees	89	98
Change in deferred income	1	1
Other	27	4
Total	117	103

Other income includes £27m as a result of the recapture during the year by the Equitable Life Assurance Society of its reassured business. Further information on the impact of this recapture on the Company's 2015 results is set out in note 3 and note 23.

5. Investment income

<i>Group</i>	2015 £m	2014 £m
Net income on investments designated at fair value through profit or loss	1,264	1,720
Interest income on swap	20	14
Financial instruments at amortised cost		
Interest income on LBG group loans	22	14
Rental income on investment properties	68	88
Service charge income	3	8
Foreign currency translation differences	7	18
Other	26	6
Total	1,410	1,868

6. Net (losses) / gains on assets and liabilities at fair value through profit or loss

<i>Group</i>	2015 £m	2014 £m
Derivative financial instruments at fair value through profit or loss	4	127
Investments designated at fair value through profit or loss	(448)	779
Investment properties at fair value through profit or loss	96	141
Foreign exchange	27	(2)
Total	(321)	1,045

7. Operating expenses

<i>Group</i>	2015 £m	2014 £m
Acquisition and origination costs in respect of insurance and investment contracts	10	26
Expenses for administration	222	207
	232	233
Provision in relation to German insurance business litigation	25	121
Provision in relation to European restructure	-	11
Change in deferred costs	72	76
Service charge expense	3	8
Amortisation of acquired VIF	14	20
Other	7	7
Total	353	476

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

8. Auditors' remuneration

<i>Group</i>	2015	2014
Audit fees	£000	£000
Fees payable to the Group's auditor for the audit of the Company's annual financial statements and the consolidation	1,784	393
Fees payable to the Group's auditor and its associates for other services:		
Audit of subsidiaries	154	200
Audit-related assurance services	1,162	628
Total	3,100	1,221

During the year, the audit fees of £34,000 in respect of pension schemes were borne by a related undertaking, SW Funding plc (2014: £30,000).

9. Finance costs

<i>Group</i>	2015	2014
	£m	£m
Interest on swaps	1	4
Interest on subordinated debt	31	38
Total	32	42

10. Taxation

(a) Current year tax (credit)/charge

<i>Group</i>	2015	2014
	£m	£m
Current tax:		
UK corporation tax	55	44
Adjustment in respect of prior years	7	(2)
Total current tax	62	42
Deferred tax:		
Origination/(reversal) of temporary differences	(120)	12
Change in tax rate	(5)	-
Adjustment in respect of prior years	-	1
Total deferred tax	(125)	13
Total income tax (credit)/charge	(63)	55

The policyholder tax benefit or expense is included in the income tax (credit)/charge. Policyholder tax is a credit of £(75)m (2014: charge of £52m), including a prior year tax charge of £1m (2014: charge of £1m).

(b) Reconciliation of tax (credit)/charge

<i>Group</i>	2015	2014
	£m	£m
Profit before tax	80	160
Tax at 20.25% (2014: 21.5%)	16	34
Effects of:		
Tax exempt income	(22)	(20)
Non-deductible policyholder tax	(60)	41
Adjustment in respect of prior years	7	(1)
Change in tax rate	(5)	-
Other	1	1
Total	(63)	55

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

10. Taxation (continued)

The Finance Act 2013 reduced the standard rate of corporation tax from 23% to 21% with effect from 1 April 2014 and from 21% to 20% with effect from 1 April 2015. Accordingly, the Company's profits for this accounting period are taxed at an effective rate of 20.25%.

The Finance (No. 2) Act 2015 reduced the rate of Corporation Tax from 20% to 19% with effect from 1 April 2017 and from 19% to 18% with effect from 1 April 2020. The impact of these reductions in tax rate, which are applicable to the calculation of deferred tax assets and liabilities at the reporting date, is reflected in the above table.

11. Intangible assets including intangible insurance assets

	2015		2014	
	£m	£m	£m	£m
	<i>Group</i>	<i>Company</i>	<i>Group</i>	<i>Company</i>
Acquired VIF	95	95	109	109
Software development costs	150	-	-	-
Total	245	95	109	109

<i>Group</i>	Acquired VIF	2015 Software development costs	Total	Acquired VIF	2014 Software development costs	Total
	£m	£m	£m	£m	£m	£m
Cost						
At 1 January	651	-	651	651	-	651
Transferred from fellow group undertakings (see note 40)	-	307	307	-	-	-
At 31 December	651	307	958	651	-	651
Accumulated amortisation and impairment						
At 1 January	(542)	-	(542)	(522)	-	(522)
Amortisation during the year	(14)	-	(14)	(20)	-	(20)
Transferred from fellow group undertakings (see note 40)	-	(157)	(157)	-	-	-
At 31 December	(556)	(157)	(713)	(542)	-	(542)
Carrying amount						
At 31 December	95	150	245	109	-	109

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

11. Intangible assets including intangible insurance assets (continued)

<i>Company</i>	Acquired VIF £m	2015 Software development costs £m	Total £m	Acquired VIF £m	2014 Software development costs £m	Total £m
Cost						
At 1 January	651	-	651	651	-	651
Transferred from fellow group undertakings (see note 40)	-	-	-	-	-	-
At 31 December	651	-	651	651	-	651
Accumulated amortisation and impairment						
At 1 January	(542)	-	(542)	(522)	-	(522)
Amortisation during the year	(14)	-	(14)	(20)	-	(20)
Transferred from fellow group undertakings (see note 40)	-	-	-	-	-	-
At 31 December	(556)	-	(556)	(542)	-	(542)
Carrying amount						
At 31 December	95	-	95	109	-	109

Of the above total for acquired VIF, £81m (2014: £95m) is expected to be recovered more than one year after the reporting date. The remaining amortisation period is 12 years. Of the above total for software development costs, £121m (2014: £nil) is expected to be amortised more than one year after the reporting date.

12. Deferred costs

		2015		2014	
		£m	£m	£m	£m
		<i>Group</i>	<i>Company</i>	<i>Group</i>	<i>Company</i>
Deferred acquisition costs	(a)	1,513	1,513	363	243
Deferred origination costs	(b)	253	228	128	88
Total		1,766	1,741	491	331

(a) Deferred acquisition costs

	2015		2014	
	£m	£m	£m	£m
	<i>Group</i>	<i>Company</i>	<i>Group</i>	<i>Company</i>
At 1 January	363	243	401	266
Amounts incurred during the year	1	1	7	7
Amortisation during the year	(47)	(32)	(45)	(30)
Transferred from fellow group undertakings (see note 40)	1,196	1,301	-	-
At 31 December	1,513	1,513	363	243

Of the above total, £1,385m for Group and £1,385m for Company (2014: £317m for Group and £213m for Company) is expected to be recovered more than one year after the reporting date.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

12. Deferred costs (continued)

(b) Deferred origination costs

	2015		2014	
	£m	£m	£m	£m
	<i>Group</i>	<i>Company</i>	<i>Group</i>	<i>Company</i>
At 1 January	128	88	157	110
Amounts incurred during the year	1	1	2	2
Amortisation during the year	(25)	(19)	(31)	(24)
Transferred from fellow group undertakings (see note 40)	149	158	-	-
At 31 December	253	228	128	88

Of the above total, £213m for Group and £189m for Company (2014: £104m for Group and £71m for Company) is expected to be recovered more than one year after the reporting date.

13. Tax assets and liabilities

	2015		2014	
	£m	£m	£m	£m
	<i>Group</i>	<i>Company</i>	<i>Group</i>	<i>Company</i>
Current tax recoverable	19	19	4	4
Deferred tax assets	258	224	24	8
Total tax assets	277	243	28	12
Current tax liabilities	88	46	79	44
Deferred tax liabilities	551	548	120	87
Total tax liabilities	639	594	199	131

Deferred tax assets for trading losses, expenses deductible in future periods and accelerated capital losses are recognised on the basis of future profit projections, which show sufficient future taxable profits to utilise these assets. Of the deferred tax assets included in the above table, £19m for Group and £14m for Company (2014: £9m for Group and £1m for Company) is expected to be realised within one year of the reporting date.

Included in the above table are deferred tax assets transferred from fellow group undertakings valued at £107m for Group and £116m for Company, and deferred tax liabilities transferred from fellow group undertakings valued at £428m for Group and £482m for Company.

Of the deferred tax liabilities included in the above table, £74m for Group and £74m for Company (2014: £18m for Group and £13m for Company) is expected to be settled within one year of the reporting date.

Also included in the above table, are current tax assets transferred from fellow group undertakings, valued at £15m for Group and Company and current tax liabilities transfer from fellow group undertakings, valued at £46m for Group and £20m Company.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

13. Tax assets and liabilities (continued)

(a) Recognised deferred tax

Deferred 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 taxes relate to the same fiscal authority.

The amounts are as follows:

	2015		2014	
	£m	£m	£m	£m
	<u>Group</u>	<u>Company</u>	<u>Group</u>	<u>Company</u>
Deferred tax assets comprise:				
Trading losses	70	70	-	-
Pension and other post retirement obligations	18	-	-	-
Expenses deductible in future periods	151	151	16	-
Accelerated capital allowances	19	2	-	-
Transitional adjustments for new life tax regime	-	-	8	8
Other	-	1	-	-
Total deferred tax assets	258	224	24	8
Deferred tax liabilities comprise:				
Unrealised gains on investment assets	29	29	-	-
Deferred acquisition costs	225	225	97	65
Transitional adjustments on introduction of new life tax regime	276	276	1	-
Deferred tax on acquired VIF	18	18	22	22
Other	3	-	-	-
Total deferred tax liabilities	551	548	120	87
Net deferred tax liabilities	293	324	96	79

Deferred tax assets for trading losses, expenses deductible in future periods and accelerated capital losses are recognised on the basis of future profit projections, which show sufficient future taxable profits to utilise these assets.

Of the deferred tax assets and liabilities balances shown in the above table, £(233)m for Group and £(233)m Company (2014: £7m for Group and £7m Company), relating to 2013 tax regime transitional adjustments, are expected to be settled more than one year after the reporting date.

Policyholder provisions of £nil (2014: £nil), consistent with the new life tax regime introduced in 2013, are included within unallocated surplus in respect of with profit business.

The Finance (No. 2) Act 2015 reduced the rate of Corporation Tax from 20% to 19% with effect from 1 April 2017 and from 19% to 18% with effect from 1 April 2020. The impact of these reductions in tax rate, which are applicable to the calculation of deferred tax assets and liabilities at the reporting date, is reflected in the above table.

The tax (credit)/charge in the statement of comprehensive income relating to each item is as follows:

	2015	2014
	£m	£m
	<u>Group</u>	<u>Group</u>
Expenses deductible in future periods	(101)	29
Deferred acquisition costs	(16)	(13)
Deferred tax on acquired VIF	(3)	(4)
Transitional adjustments on introduction of new life tax regime	1	1
Change in tax rate	(6)	-
Total deferred tax (credit)/charge	(125)	13

(b) Unrecognised deferred tax

Deferred tax assets are recognised for tax loss carry forwards only to the extent that realisation of the related tax benefit is probable. The deferred tax assets not recognised are not subject to any expiry date.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

13. Tax assets and liabilities (continued)

(b) Unrecognised deferred tax (continued)

Deferred tax assets have not been recognised in respect of unrelieved capital losses of £nil (2014: £14m Group and £nil Company), as there is insufficient certainty as to the availability of future profits. Deferred tax assets have not been recognised in respect of excess expenses carried forward of £539m (2014: £65m Group and £65m Company) as there is insufficient certainty as to the availability of future profits.

14. Investment in subsidiaries

<i>Company</i>	2015 £m	2014 £m
At 1 January	486	486
Transferred from fellow group undertakings (see note 40)	418	-
Impairment of investment in subsidiaries (see note 40)	(476)	-
At 31 December	428	486

Companies, Partnerships and Groups (Accounts and Reports) Regulations 2015 (SI 2015/980)

UK company law no longer provides the option to include reduced disclosures in relation to a company's related undertakings in the notes to their annual accounts. Therefore information on all related undertakings is required by section 409 Companies act 2006, including subsidiaries, joint ventures, associated undertakings and undertakings in which they have a significant influence.

All entities below are wholly-owned, directly or indirectly, and transact insurance or reinsurance business, investment management activities or services in connection therewith, unless otherwise stated. Following are particulars of the Company's subsidiaries and associates immediately prior to the Insurance Business Transfer Scheme:

Incorporated in England & Wales:

Halifax Life Limited ²	St Andrew's Life Assurance plc
Clerical Medical Managed Funds Limited	Oystercatcher LP
Clerical Medical (Dartford Number 2) Limited	Clerical Medical (Dartford Number 2) Limited
Clerical Medical General Reversionary and Investment Company (80%)	Oystercatcher Residential Limited
Clerical Medical Forestry Limited	Oystercatcher Nominees Limited
Clerical Medical Properties Limited	York & Becket Nominees Limited (50%)
York & Becket Nominees No 4 Limited (50%)	York & Becket Nominees No 3 Limited (50%)

Incorporated in Luxembourg:

Clerical Medical Non Sterling Property SARL	Celsius European Lux 2 SARL
SARL Fonciere de Rives	SCI Toulouse Capitouls (dissolved 31/12/2015)
SCI Norli	SCI Archos (dissolved 23/12/2015)
SCI Laval Invest (dissolved 23/12/2015)	SCI Gandre (dissolved 31/12/2015)
SARL HIRAM	SCI Astoria Invest
SCI Mercury Invest	SCI Millenium AP1
SCI A-AP1 (dissolved 23/12/2015)	SCI Rambeateau CFF
SCI Massy AP1 (dissolved 31/12/2015)	SCI de l'Horloge
SAS Compagnie Fonciere de France	SCI Synergie (dissolved 31/12/2015)
SARL Coliseum	SCI Argenteuil PPI (dissolved 12/11/2015)
SCI Equinoxe	

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

14. Investment in subsidiaries (continued)

Incorporated in Netherlands:

Clerical Medical Non Sterling Guadalix Holdco BV	Clerical Medical Non Sterling Guadalix Propco SL
Clerical Medical Non Sterling Megpark Holdco BV	Clerical Medical Non Sterling Megpark Propco SL
Clerical Medical Non Sterling Arts LSA	Clerical Medical Non Sterling Arts FSA

Incorporated in Isle of Man:

CM Venture Investments Limited

Incorporated in Jersey:

Clerical Medical (Waterlooville One) Limited	Clerical Medical (Waterlooville Two) Limited
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As part of Insurance Business Transfer Scheme, see note 40, the company acquired issued share capital in the following entities:

Incorporated in England & Wales:

Scottish Widows Administration Services Limited	Vision Park Management Limited
Scottish Widows Unit Trust Managers Limited	Barbirolli Square LP
SWAMF (GP) Limited	Scottish Widows Active Management Fund
SWAMF Nominee (1) Limited	Waverley SOCA LLC
SWAMF Nominee (2) Limited	Waverley Wilshire Rodeo LLC
Fontview Limited	Waverley Fund II Investor
Newfont Limited	Waverley Fund III Investor
Starfont Ltd	Lothian LLC
Dalkeith Corporation LLC	Delancey Rolls UK Limited
Murrayfield LLC	Delancey Arnold UK Limited
Morrison Street LLC	Industrial Real Estate Nominee Limited
Rolls Development UK Limited ¹	The Great Wigmore Partnership (G.P.) Limited
Industrial Real Estate (GP) Limited	The Great Wigmore Partnership
Industrial Real Estate Limited (Partnership)	Great Wigmore Property Limited

Incorporated in Scotland:

Scottish Widows Property Management Limited	Scottish Widows Pension Trustees Limited
Scottish Widows (Port Hamilton) Limited	SW No 1 Limited
Scottish Widows Trustees Limited	Scottish Widows Fund and Life Assurance Society
Scottish Widows Services Limited	

Incorporated in Jersey:

SWUF Nominee 1 Limited	SWUF Nominee 3 Limited
SWUF Nominee 2 Limited	SWUF Nominee 4 Limited

Incorporated in Netherlands:

Scottish Widows Industrial Properties Europe BV	St Michel Holding Company No 1
St Witz Holding Company No 1	St Michel Holding Investment Property
St Witz Investment Property	France Industrial Premises Holding

¹ Associated undertaking² Impaired during year, see note 40

The investments in subsidiaries included above are generally recoverable more than one year after the reporting date. The holding in Industrial Real Estate Ltd Partnership, Rolls Development UK Limited, Delancey Arnold UK Limited and Delancey Rolls UK Limited increased to 100% as a result of the Insurance Business Transfer Scheme, see note 40.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

14. Investment in subsidiaries (continued)

The ability of regulated entities to pay cash dividends to the Company or repay loans or advances is restricted by regulatory solvency requirements as well as Companies Act distributable reserves requirements. The ability of non-regulated entities to pay cash dividends to the Company or repay loans or advances is restricted by Companies Act distributable reserves requirements.

Collective investment vehicles and limited partnerships ("investment vehicles") where the Group has control, in part through its long term funds, are consolidated as set out in at policy 1(b). In line with the provisions of IFRS 10 "Consolidated financial statement" the table below lists those collective investment vehicles and limited partnerships where the Group had control as at 31 December 2015.

Name Of Umbrella And Undertaking	% Held	Name Of Umbrella And Undertaking	% Held
Aberdeen Global Liquidity Funds plc (i)		JP Morgan Fund II ICVC (viii)	
Aberdeen Sterling Liquidity Fund	43%	JPM Balanced Managed Fund	69%
Aberdeen Global Liquidity Funds plc (i)		Multi Manager UK Equity Growth Fund (iv)	67%
Euro Liquidity Fund	51%	Multi Manager UK Equity Income Fund (iv)	20%
Aberdeen Investment Cash OEIC plc (ii)		Aberdeen European Property Fund (iii)	59%
Aberdeen Sterling Investment Cash Fund	53%	Aberdeen Global High Yield Bond Fund (iii)	35%
Aberdeen Investment Fund ICVC (iii)		Aberdeen Private Equity Fund Of Funds (2007) plc (ii)	97%
Aberdeen World Emerging Markets Equity Fund	75%	Aberdeen Sterling Bond Fund (iii)	100%
Aberdeen World Government Bond Fund	49%	AGFE UK Real Estate Senior Deb Mutual Fund (ix)	83%
ACS Pooled Property (iv)		Baillie Gifford Japanese Equity Pension Fund (x)	82%
Scottish Widows Pooled Property ACS Fund	100%	Baillie Gifford North American Equity Pension Fund (x)	58%
Scottish Widows Pooled Property ACS Fund 2	100%	Blackrock Balanced Growth Portfolio Fund (xi)	35%
BNY Mellon Investments Funds ICVC(v)		Blackrock Emerging Markets Fund (xi)	20%
Insight Global Absolute Return Fund	83%	Blackrock UK Smaller Companies Fund (xi)	24%
Insight Global Multi-Strategy Fund	44%	ETFS Livestock ETFS Livestock (xii)	55%
Newton Managed Income Fund	29%	ETFS Precious Metals ETFS Precious Metals (xii)	21%
Newton Multi-Asset Growth Fund (Formerly Newton Managed Fund)	31%	Schroder Gilt And Fixed Interest Fund (xiii)	23%
Newton Oriental Fund	39%	SSGA Asia Pacific Tracker Fund (xiv)	82%
Newton UK Equity Fund (Formerly Newton Income Fund)	22%	SSGA Europe (Ex UK) (xiv)	95%
Newton UK Opportunities Fund	44%	SSGA MPF Global Equity 50:50 Fund (xiv)	73%
The Boston Company UK Opportunities Fund	21%	SSGA UK Equity Tracker Fund (xiv)	91%
HBOS Actively Managed Portfolio Funds ICVC(vi)		SWIP European Balanced Property Fund (xvi)	84%
Absolute Return Fund	93%	Thesis - Tm Levitas A Fund (xvi)	
Diversified Income Fund	82%	Thesis - Tm Levitas A Fund	35%
Diversified Return Fund	97%	Thesis - Tm Levitas B Fund	26%
Dynamic Return Fund	97%	Nordea 1 Diversified Return Fund	91%
HBOS Global Investment Funds ICVC (vi)		Scottish Widows Income And Growth Funds ICVC(iv)	
Emerging Markets Focus Fund	81%	Adventurous Growth Fund	67%
European Focus Fund	87%	Balanced Growth Fund	27%
European Strategic Fund	97%	Corporate Bond 1 Fund	100%
Far Eastern Focus Fund	93%	Corporate Bond PPF Fund	100%
Japanese Focus Fund	97%	Scottish Widows GTAA 1	82%
US Focus Fund	79%	SW Corporate Bond Tracker	100%
US Strategic Fund	98%	UK Index Linked Gilt Fund	100%
HBOS International Investment Funds ICVC(vi)		Scottish Widows Investment Solutions Funds ICVC (iv)	
European Fund	73%	Adventurous Solution	78%
Far Eastern Fund	45%	Asia Pacific (Ex Japan) Equity Fund	98%
International Growth Fund	52%	Balanced Solution	51%
Japanese Fund	92%	Cautious Solution	45%
HBOS International Investment Funds ICVC (vi)		Defensive Solution	75%
North American Fund	85%	Discovery Solution	51%
HBOS Property Investment Funds ICVC (vi)		Dynamic Solution	60%
UK Property Fund	45%	European (Ex UK) Equity Fund	98%
HBOS Specialised Investment Funds ICVC (vi)		Fundamental Index Emerging Markets Equity Fund	96%
Cautious Managed Fund	54%	Fundamental Index Global Equity Fund	96%
Ethical Fund	70%	Fundamental Index UK Equity Fund	86%
Fund Of Investment Trusts	42%	Japan Equities Fund	95%
Smaller Companies Fund	49%	SSTL ADF SW FDMTL Index GLO EQ	100%
Special Situations Fund	47%	Strategic Solution US Equities Fund Scottish Widows	59%
HBOS UK & Fixed Interest Investment Funds ICVC (vi)		Managed Investment Funds ICVC	100%
International Fixed Income Fund	93%	Balanced Portfolio Fund	82%
UK Focus Fund	90%	Cash Fund	99%
UK Gilt Fund	79%	Cautious Portfolio Fund	60%
UK High Income Fund	83%	International Equity Tracker Fund	99%
UK Index-Linked Gilt Fund	24%	Opportunities Portfolio Fund	93%
UK Smaller Companies Alpha Fund	81%	Progressive Portfolio Fund	74%
UK Strategic Fund	94%	Scottish Widows Overseas Growth Investment Funds ICVC(iv)	
HBOS UK Investment Funds ICVC (vi)		American Growth Fund	88%
U.K. FTSE All-Share Index Tracking Fund	56%	European Growth Fund	89%
UK Equity Income Fund	60%	Global Growth Fund	52%
UK Growth Fund	62%	Japan Growth Fund Pacific Growth Fund Scottish	99%
Insight Investment Funds-Of-Funds II ICVC (v)		Widows Tracker And Specialist Investment Funds	37%
Absolute Insight Fund	39%	ICVC	
Invesco Perpetual Far Eastern Investment Series (vii)		Emerging Markets Fund	90%
Invesco Perpetual Asian Equity Income Fund	25%	International Bond Fund	68%
		Overseas Fixed Interest Tracker Fund	99%
		UK All Share Tracker Fund	93%

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

14. Investment in subsidiaries (continued)

Name Of Umbrella And Undertaking	% Held	Name Of Umbrella And Undertaking	% Held
UK Fixed Interest Tracker Fund	98%	Universe, The CMI Global Network (xix)	
UK Index-Linked Tracker Fund	88%	CMIG Access 80%	100%
UK Smaller Companies Fund	28%	CMIG Focus Euro Bond	100%
UK Tracker Fund	48%	CMIG GA 70 Flexible	100%
Scottish Widows UK And Income Investment Funds ICVC(iv)		CMIG GA 80 Flexible	100%
Corporate Bond Fund	52%	CMIG GA 90 Flexible	100%
Environmental Investor Fund	68%	Continental Euro Equity	97%
Ethical Fund	70%	Euro Bond	63%
Gilt Fund	97%	Euro Currency Reserve	96%
High Income Bond Fund	24%	Japan Enhancedequity	96%
Safetyplus ® Fund	72%	Pacific Enhanced Basin	74%
Strategic Income Fund	61%	UK Equity	76%
UK Growth Fund	62%	US Bond	94%
UBS Investment Funds ICVC (xviii)		US Currency Reserve	80%
UBS UK Opportunities Fund (Formerly UBS UK Select Fund)	50%	US Enhanced Equity	88%
		European Enhanced Equity	100%

Principal place of business

- (i) 25/28 North Wall Quay, Dublin, Ireland
- (ii) 39/40 Upper Mount Street, Dublin, Ireland
- (iii) 1 Bread Street London EC4M 9HH
- (iv) 15 Dalkeith Road Edinburgh EH16 5WL
- (v) 160 Queen Victoria St London EC4V 4LA
- (vi) Trinity Road, Halifax West Yorkshire HX1 2RG
- (vii) 30 Finsbury Square, London EC2A 1AG
- (viii) 60 Victoria Embankment EC4Y 0JP
- (ix) 55 Baker Street, London W1U 8EW
- (x) 1 Rutland Court, Edinburgh EH3 8EY
- (xi) 12 Throgmorton Avenue, London EC2N 2DL
- (xii) 48 Wall Street, 11th Floor, New York 10005
- (xiii) 31 Gresham Street London EC2V 7QA
- (xiv) 20 Churchill Place, Canary Wharf London E14 5HJ
- (xv) 80 route d'Esch, L-1470 Luxembourg
- (xvi) St Johns Street, Chichester, West Sussex PO19 1UP
- (xvii) 562 Rue De Neudorf, L-2220 Luxembourg
- (xviii) 21 Lombard Street London EC3V 9AH
- (xix) 106 route d'Arlon, L-8210 Mamer Grand Duchy of Luxembourg

15. Tangible fixed assets

	Land and buildings £m	Land and buildings £m
	<u>Group</u>	<u>Company</u>
Cost		
At 31 December 2014	-	-
Transferred from fellow group undertakings (see note 40)	27	-
At 31 December 2015	27	-
Accumulated depreciation		
At 31 December 2014	-	-
Transferred from fellow group undertakings (see note 40)	(10)	-
At 31 December 2015	(10)	-
Carrying amount		
At 31 December 2014	-	-
At 31 December 2015	17	-

The valuation of the land and buildings for the purposes of impairment testing was undertaken by Jones Lang LaSalle. The above assets are generally recoverable more than one year after the reporting date.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

16. Investment properties

	2015		2014	
	£m	£m	£m	£m
	<u>Group</u>	<u>Company</u>	<u>Group</u>	<u>Company</u>
At 1 January	1,125	536	1,426	593
Additions – new properties	510	1	125	-
Additions – subsequent expenditure on existing properties	21	12	36	23
Disposals	(957)	(538)	(620)	(157)
Net gain from change in fair values	96	11	158	77
Transferred from fellow group undertakings (see note 40)	3,433	293	-	-
At 31 December	4,228	315	1,125	536

In 2015, £707m of property assets held within Group funds were transferred to an Authorised Contractual Scheme (“ACS”) in exchange for an equivalent unlisted equities in the ACS (see note 20). This was in order to better support ongoing liquidity and portfolio management objectives.

Rental income arising from investment properties during the year, included in investment income, amounted to: Group £68m (2014: £88m) and Company £15m (2014: £45m). Direct operating expenses (included within operating expenses) arising in respect of such investment properties during the year amounted to: Group £11m (2014: £10m) and Company £1m (2014: £6m).

Expenditure on investment properties which did not generate rental income was: Group £nil (2014: £nil) and Company £nil (2014: £nil). The carrying value of land held for development in Group is £156m (2014: £19m) and Company is £nil (2014: £19m). The carrying value of investment property under development in Group is £20m (2014: £2m) and Company is £nil (2014: £2m).

Due to the nature of the above assets, there is no fixed term associated with these investments. The investment properties are independently valued by, DTZ, Knight Frank, and Savills on at least a quarterly basis for the purpose of determining the open market value of the properties.

Investment properties are generally recoverable more than one year after the reporting period.

17. Assets arising from reinsurance contracts held

Assets arising from reinsurance contracts held can be analysed between those classified as insurance contracts and those classified as financial assets designated at fair value through profit or loss as follows:

<u>Group</u>	2015			2014		
	Re-insurance contracts	Classified as Fair value through profit or loss	Total	Re-insurance contracts	Classified as Fair value through profit or loss	Total
	£m	£m	£m	£m	£m	£m
At 1 January	302	38	340	343	54	397
Movement recognised through the statement of comprehensive income	(16)	-	(16)	(41)	-	(41)
Movement recognised directly through the balance sheet	-	(3)	(3)	-	(16)	(16)
Transferred from fellow group undertakings (see note 40)	350	7,725	8,075	-	-	-
At 31 December	636	7,760	8,396	302	38	340
Amounts in respect of liabilities arising from insurance and participating investment contracts	636	7,478	8,114	302	-	302
Amounts in respect of liabilities arising from non-participating investment contracts	-	282	282	-	38	38
Total	636	7,760	8,396	302	38	340

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

17. Assets arising from reinsurance contracts held (continued)

<i>Company</i>	Re- insurance contracts £m	2015 Classified as Fair value through profit or loss £m	Total £m	Re- insurance Contracts £m	2014 Classified as Fair value through profit or loss £m	Total £m
At 1 January	220	784	1,004	264	756	1,020
Movement recognised through the statement of comprehensive income	(9)	120	111	(44)	190	146
Movement recognised directly through the balance sheet	-	(179)	(179)	-	(162)	(162)
Transferred from fellow group undertakings (see note 40)	425	7,035	7,460	-	-	-
At 31 December	636	7,760	8,396	220	784	1,004
Amounts in respect of liabilities arising from insurance and participating investment contracts	636	7,478	8,114	220	-	220
Amounts in respect of liabilities arising from non-participating investment contracts	-	282	282	-	784	784
Total	636	7,760	8,396	220	784	1,004

Assets arising from reinsurance contracts held include £7,694m for Group and Company (2014: £307m for Group and £891m for Company) that is expected to be settled more than one year after the reporting date.

18. Derivative financial instruments

In the normal course of business, the Group and Company enters into swap contracts, option contracts, index futures contracts and forward foreign exchange contracts. All such contracts are undertaken either for efficient portfolio management purposes or for the purpose of matching contractual liabilities. In addition, the Company has entered into a swap for the specific purpose of hedging movements in the fair value of certain subordinated debt, as described in note 29.

Swap contracts include currency, interest and inflation rate swaps. Currency swaps generally involve the exchange of interest payment obligations denominated in different currencies; the exchange of principal can be notional or actual. An interest or inflation rate swap is an agreement between two parties to exchange fixed and variable rate interest payments, based upon interest or inflation rates defined in the contract, without the exchange of the underlying principal amount.

Option contracts include index and single equity options. Such options represent a contract sold by one party to another party offering the right, but not the obligation, to buy or sell a financial asset at an agreed price on a specified future date or within a specified period of time.

Index futures contracts are used to hedge the investment portfolio against adverse movements in underlying markets or effecting policy switches between markets without the need to trade the underlying securities. Futures may also be used for the purposes of efficient portfolio management provided that their substance would otherwise be permitted as a series of direct transactions. Forward foreign exchange contracts are an agreement to buy or sell a specified amount of foreign currency on a specified future date at an agreed rate.

Details regarding derivative financial instruments are given in the following tables:

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

18. Derivative financial instruments (continued)

<u>Group</u>	Contract Amount £m	2015 Fair value assets £m	Fair value liabilities £m	Contract Amount £m	2014 Fair value assets £m	Fair value liabilities £m
Derivative financial instruments held for trading:						
Swap contracts	27,180	1,326	(1,479)	4,035	297	(275)
Option contracts	6,412	504	(253)	5,883	516	(260)
Index futures contracts	5,048	36	(36)	860	22	(16)
Forward foreign exchange contracts	6,568	59	(89)	1,627	5	(10)
Derivative financial instruments designated as fair value hedges	1,500	139	-	302	11	(3)
Total	46,708	2,064	(1,857)	12,707	851	(564)
<u>Company</u>	Contract Amount £m	2015 Fair value assets £m	Fair value liabilities £m	Contract Amount £m	2014 Fair value assets £m	Fair value liabilities £m
Derivative financial instruments held for trading:						
Swap contracts	26,978	1,319	(1,479)	3,527	250	(225)
Option contracts	5,486	496	(248)	4,493	461	(239)
Index futures contracts	1,911	5	(20)	344	1	(12)
Forward foreign exchange contracts	2,688	27	(44)	926	4	(9)
Derivative financial instruments designated as fair value hedges	1,500	139	-	303	11	-
Total	38,563	1,986	(1,791)	9,593	727	(485)

Of the above total, derivative financial instruments assets transferred from fellow group undertakings were valued at £1,249m for Group and £1,278m for Company. Of the above total, derivative financial instruments liabilities transferred from fellow group undertakings were valued at £1,286m for Group and £1,299m for Company.

Derivative financial instrument fair value assets include £1,930m for Group and £1,921m for Company (2014: £794m for Group and £694m for Company) that is expected to be recovered more than one year after the reporting date.

Derivative financial instrument fair value liabilities include £1,708m for Group and £1,708m for Company (2014: £517m for Group and £447m for Company) that is expected to be settled more than one year after the reporting date.

The fair value hedges included in the above tables represent interest rate swaps in respect of the interest payments relating to subordinated debt issued by the Group. These instruments form part of hedge relationships with the subordinated debt issued.

Details of collateral accepted and pledged in respect of derivative financial instruments are given in note 36.

19. Loans and receivables

	2015		2014	
	£m	£m	£m	£m
	<u>Group</u>	<u>Company</u>	<u>Group</u>	<u>Company</u>
Investments held through liquidity funds	5,926	-	225	-
Accrued income, dividend and rent	508	159	307	11
Loans to related parties	3,752	3,752	150	-
Other amounts due from related parties	212	112	451	665
Amounts receivable from direct insurance business	17	17	17	9
Reverse repurchase asset	962	135	14	4
Other	1,422	710	213	87
Total	12,799	4,885	1,377	776

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

19. Loans and receivables (continued)

Of the above total loans and receivables transferred from fellow group undertakings were valued at £11,478m for Group and £4,136m for Company. Of the above total, £2,381 for Group and £nil for Company (2014: £790m for Group and £640m for Company) is expected to be recovered more than one year after the reporting date. The carrying amount of loans to related parties is a reasonable approximation of fair value.

Reverse repurchase assets relate to cash collateral received and reinvested under derivatives and stock lending programmes and were previously held off-balance sheet and have been recognised on Balance Sheet as at 31 December 2015 with prior year comparative updated for consistency, further details are shown in note 36.

There is no significant concentration of credit risk with respect to loans and receivables. Further information in respect of credit risk, including collateral held against loans to related parties, is given in note 36.

20. Investments at fair value through profit or loss

	2015		2014	
	£m	£m	£m	£m
	<i>Group</i>	<i>Company</i>	<i>Group</i>	<i>Company</i>
Shares and other variable yield securities	66,954	80,208	33,511	17,587
Debt and other fixed/variable income securities	36,189	16,776	10,839	2,921
Total investments at fair value	103,143	96,984	44,350	20,508

Of the above total investments at fair value through profit or loss transferred from fellow group undertakings were valued at £63,587m for Group and £77,243m for Company.

Of the debt securities £32,546m for Group and £16,523m for Company (2014: £3,483m for Group and £2,904m for Company) is expected to be recovered more than one year after the reporting date. Due to the nature of shares and other variable yield securities there is no fixed term associated with these securities. Included within the Company's shares and other variable yield securities are shares in subsidiary undertakings of £57,358m (2014: £7,541m), which are held at fair value through profit or loss.

During 2015, the Group acquired illiquid credit assets from, or issued by, parties within LBG totalling £78m (2014: £810m), excluding £1,362m assets transferred within the Insurance Business Transfer Scheme. These credit assets are secured on Infrastructure, Social Housing and Education Loans. The structured entities are consolidated when the Group has control in accordance with the consolidation policy set out in note 1(b). In 2015, £707m (2014: £nil) of property assets held within the Group funds were transferred to an Authorised Contractual Scheme ("ACS") in exchange for an unlisted equities in the ACS, in order to better support ongoing liquidity and portfolio management objectives.

Of the total debt securities included above £3,620m for Group (2014: £798m) and £3,336m for Company (2014: £694m) is secured on real estate. Of the debt securities above, £5,564m (2014: £1,125m) for Group and £5,210m (2014: £1,125m) for Company was acquired from a related party. All transactions were completed at arm's length.

Interests in unconsolidated structured entities

Included within investments at fair value through profit or loss are investments in unconsolidated structured entities for Group and Company of £19.2bn (2014: Group £14.9bn and Company £17.3bn) arising from investments in collective investment vehicles and limited partnerships.

The collective investment vehicles and limited partnerships are primarily financed by investments from investors in the vehicles. The investments are carried at fair value and the Group's maximum exposure to loss is equal to the carrying value of the investment.

However, investments in collective investment vehicles and limited partnerships are primarily held to match policyholder liabilities and the majority of the risk from a change in the value of the Group's investment is matched by a change in policyholder liabilities. At 31 December 2015, the total net assets of unconsolidated collective investment vehicles and limited partnerships in which the Group and Company held a beneficial interest was £616.8bn (2014: Group £436.4bn and Company £200.9bn). During the year the Group has not provided any non-contractual financial or other support to these unconsolidated collective investment vehicles and limited partnerships.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

20. Investments at fair value through profit or loss (continued)

Interests in unconsolidated structured entities (continued)

The Group sponsors a range of collective investment vehicles and limited partnerships where it acts as the decision maker over the investment activities and markets the funds under one of LBG's brands. The Group earns fees from managing the investments of these funds. The investment management fees that the Group earned from these sponsored unconsolidated collective investment vehicles and limited partnerships, including those in which the Group held no interest at 31 December 2015, was £187m (2014: £nil).

Interests in consolidated structured entities

The Group consolidates a number of structured entities, in accordance with the consolidation policy set out in note 1(b).

As part of the Insurance Transfer of Business effective 31st December 2015 (see note 40), the Company has fully assumed a guarantee granted by SW Funding plc. The guarantee concerns a contractual arrangement with State Street Trustees Limited (SSTL), which acts as the Depository of a consolidated structured entity, the Scottish Widows Property Authorised Contractual Scheme (SWACS). Under the terms of the contractual arrangement, the Company has indemnified SSTL against all losses suffered or incurred by SSTL arising out of or in relation to the scheme property of the SWACS, which consists of real property and for which SSTL is the legal owner. During the year, no losses have arisen and the Company has made no payment under this contractual arrangement.

All assets acquired from LBG were acquired at their fair value and further details on the credit risk and fair value measurement of these assets can be found in note 36. During the year, the Group has not provided any non-contractual financial support to consolidated structured entities and has no current intention of providing such support.

Within shares and other variable yield securities are cash funds of £425m for Group and £416m for Company (2014: £163m for Group and £124m for Company) representing collateral received and reinvested under in relation to derivatives contracts and stocklending programmes, further details is given in note 36.

21. Cash and cash equivalents

Cash and cash equivalents for the purposes of the statement of cash flows include the following:

	2015		2014	
	£m	£m	£m	£m
	<u>Group</u>	<u>Company</u>	<u>Group</u>	<u>Company</u>
Cash at bank	1,344	623	418	195
Short term deposits	762	257	287	186
Cash at bank	2,106	880	705	381
Investments held through liquidity funds (note 19)	5,926	-	225	-
	8,032	880	930	381
Less: bank overdrafts (note 32)	(6)	(4)	(37)	-
Total	8,026	876	893	381

Cash and cash equivalents in the above table contains amounts of £167m (2014: £501m) which are held entirely within the long-term insurance funds of the Company.

22. Share capital

	2015		2014	
	£m	£m	£m	£m
	<u>Group</u>	<u>Company</u>	<u>Group</u>	<u>Company</u>
Issued and fully paid share capital:				
70,000,000 ordinary shares of £1 each	70	70	70	70
Total	70	70	70	70

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

23. Liabilities arising from insurance contracts and participating investment contracts

An analysis of the change in liabilities arising from insurance contracts and participating investment contracts and reinsurers' share of insurance and participating investment contract liabilities is as follows:

<i>Group</i>	£m	2015 £m	£m	£m	2014 £m	£m
	<i>Gross</i>	<i>Reinsurance</i>	<i>Net</i>	<i>Gross</i>	<i>Reinsurance</i>	<i>Net</i>
At 1 January	25,906	(302)	25,604	26,878	(343)	26,535
New business	176	-	176	170	-	170
Changes in existing business	(2,058)	8	(2,050)	(1,422)	5	(1,417)
Assumption changes	(176)	8	(168)	280	36	316
Transferred business to ELAS	(1,896)	-	(1,896)	-	-	-
Transfers from fellow group undertakings (see note 40)	57,764	(7,828)	49,936	-	-	-
At 31 December	79,716	(8,114)	71,602	25,906	(302)	25,604

<i>Company</i>	£m	2015 £m	£m	£m	2014 £m	£m
	<i>Gross</i>	<i>Reinsurance</i>	<i>Net</i>	<i>Gross</i>	<i>Reinsurance</i>	<i>Net</i>
At 1 January	14,039	(220)	13,819	14,286	(264)	14,022
New business	156	-	156	137	-	137
Changes in existing business	(990)	4	(986)	(616)	5	(611)
Assumption changes	(150)	6	(144)	232	39	271
Transfers from fellow group undertakings (see note 40)	66,661	(7,904)	58,757	-	-	-
At 31 December	79,716	(8,114)	71,602	14,039	(220)	13,819

An analysis of the expected maturities of liabilities arising from insurance contracts and participating investment contracts is given in note 36.

On the 8 March 2015, the Equitable Life Assurance Society recaptured a portfolio of unit-linked and protection business that was reinsured to the Group. The portfolio is subject to a number of risks as set out in note 36.

On recapture, the Group derecognised £1,961m of insurance contract liabilities, this being reflected as a change in liabilities arising from insurance contracts. The Group transferred £1,961m of assets equal to the value of the unit-linked reserves transferred. On recapture the Group also derecognised £22m of additional protection and sterling reserves, this being reflected as a change in liabilities arising from insurance contracts.

The transfer value of £1,896m in the table above reflects the position at the beginning of the year.

24. Unallocated surplus

An analysis of the change in unallocated surplus is as follows:

	2015 £m	£m	2014 £m	£m
	<i>Group</i>	<i>Company</i>	<i>Group</i>	<i>Company</i>
At 1 January	51	51	56	56
Change recognised through the statement of comprehensive income	(3)	(3)	(5)	(5)
Transfers from fellow group undertakings (see note 40)	240	240	-	-
At 31 December	288	288	51	51

Of the above total, £236m for Group and £236m for Company (2014: £45m for Group and £45m for Company) is expected to be settled more than one year after the reporting date.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

25. Future profits on non-participating business in the With Profits Funds

An analysis of the change in future profits on non-participating business in the Scottish Widows With Profits Fund is as follows:

	2015		2014	
	£m	£m	£m	£m
	<i>Group</i>	<i>Company</i>	<i>Group</i>	<i>Company</i>
At 1 January	-	-	-	-
Change recognised through the statement of comprehensive income	-	-	-	-
Transfers from fellow group undertakings (see note 40)	79	79	-	-
At 31 December	79	79	-	-

£79m for Group and Company (2014: £nil for Group and Company) is expected to be recovered more than one year after the reporting date.

26. Other provisions

	2015			2014		
<i>Group</i>	German insurance business litigation	Other	Total	German insurance business litigation	Other	Total
	£m	£m	£m	£m	£m	£m
At 1 January	197	30	227	246	28	274
Increase in the year	25	20	45	120	12	132
Amount utilised in the period	(98)	(16)	(114)	(169)	(10)	(179)
Transfers from fellow group undertakings (see note 40)	-	42	42	-	-	-
At 31 December	124	76	200	197	30	227

	2015			2014		
<i>Company</i>	German insurance business litigation	Other	Total	German insurance business litigation	Other	Total
	£m	£m	£m	£m	£m	£m
At 1 January	197	30	227	246	28	274
Increase in the year	25	20	45	120	12	132
Amount utilised in the period	(98)	(16)	(114)	(169)	(10)	(179)
Transfers from fellow group undertakings (see note 40)	-	28	28	-	-	-
At 31 December	124	62	186	197	30	227

Of the above total, £60m for Group and Company (2014: £122m for Group and Company) is expected to be settled more than one year after the reporting date.

Customer claims in relation to insurance branch business in Germany

The Group has received a number of claims from customers relating to policies issued by Clerical Medical Investment Group Limited (recently renamed Scottish Widows Limited) but sold by independent intermediaries in Germany, principally during the late 1990s and early 2000s. Following decisions in July 2012 from the Federal Court of Justice (FCJ) in Germany the Group recognised provisions totalling £517m during the period to 31 December 2014. Recent experience has been slightly adverse to expectations and the Group has noted decisions of the FCJ in 2014 and 2015 involving German insurers in relation to a German industry-wide issue regarding notification of contractual 'cooling off' periods. Accordingly, a provision increase of £25m has been recognised giving a total provision of £545m. The remaining unutilised provision as at 31 December 2015 is £124m (31 December 2014: £197m).

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

26. Other provisions (continued)**Customer claims in relation to insurance branch business in Germany (continued)**

The validity of the claims facing the Group depends upon the facts and circumstances in respect of each claim. As a result the ultimate financial effect, which could be significantly different from the current provision, will only be known once all relevant claims have been resolved.

Contingent liabilities*Tax authorities*

The Group provides for potential tax liabilities that may arise on the basis of the amounts expected to be paid to tax authorities. This includes open matters where HMRC adopt a different interpretation and application of tax law which might lead to additional tax. A number of Group companies have an open matter in relation to a claim for group relief of losses incurred in a former Irish banking subsidiary of LBG, which ceased trading on 31 December 2010. In the second half of 2013 HMRC informed LBG that their interpretation of the UK rules, permitting the offset of such losses, denies these claims; if HMRC's position is found to be correct, management estimate that this would result in an increase in the Group's current tax liability of approximately £16m. LBG does not agree with HMRC's position and, having taken appropriate advice, does not consider that this is a case where additional tax will ultimately fall due on the Group.

FCA treating customers fairly thematic review

The Financial Conduct Authority (FCA) has referred a number of firms, including Scottish Widows Limited and SWA, to its enforcement division after publishing its thematic review on fair treatment of long-standing customers in the life insurance sector on 3 March 2015. Regulatory responsibility for the historic business of SWA transferred to SWL as result of the Insurance Business Transfer Scheme. The FCA will investigate the behaviour around disclosing exit and paid-up charges to customers after December 2008, when regulatory rules around treating customers fairly took effect. The FCA have stated that the commencement of investigations should not be taken to indicate they will necessarily result in a penalty being imposed or that redress will be payable. No provision is held in respect of this review at this time. This will continue to be assessed as the investigation progresses.

27. Retirement benefit obligations

As part of the Insurance Transfer of Business (see note 40), the Company gained Scottish Widows Services Limited as a subsidiary, and the Company assumed the role of principal employer of the Scottish Widows Retirement Benefit Scheme ("SWRBS") pension scheme. As the transfer was effective 31st December 2015, the profit / loss impact of the scheme remains within SW Funding plc. The Group's employees may be members of the SWRBS, which provides mainly defined benefits, or members of LBG Schemes, which provide defined benefits and/or defined contribution benefits to the members of those schemes.

(a) Scottish Widows Retirement Benefits Scheme**(a) (i) Characteristics of the SWRBS**

The SWRBS is a funded scheme in the UK. The SWRBS is established under trust and administered by its trustees. The SWRBS is funded in compliance with the Pensions Act 2004. A valuation exercise is carried out for the scheme at least every three years, whereby scheme assets are measured at market value and liabilities ("Technical Provisions") are measured using prudent assumptions, if a deficit is identified a recovery plan is agreed and sent to the Pensions Regulator for review. The outcome of this valuation process, including agreement of any recovery plans, is agreed between the Principal Employer for the purposes of the scheme (which is the Company from 1 January 2016), Lloyds Bank plc and the scheme Trustee.

The latest full valuation of the SWRBS was carried out as at 1 July 2013; this has been updated to 31 December 2015 by an independent, qualified actuary appointed by LBG. Employee contributions made during the year were £nil (2014: £nil).

The Group currently expects to pay contributions of approximately £14m to the SWRBS in 2016. The responsibility for the governance of the SWRBS lies with the Pension Trustees. The SWRBS is managed by a Trustee Board (the Trustee) whose role is to ensure that the SWRBS is administered in accordance with the SWRBS rules and relevant legislation, and to safeguard the assets in the best interests of all members and beneficiaries. The Trustee is solely responsible for setting investment policy and for agreeing funding requirements with the Principal Employer for the purposes of the scheme (which is the Company from 1 January 2016) through the triennial valuation process. The Board of Trustees is composed of directors appointed by the Company and directors nominated in accordance with the Trustee's member-nominated director arrangements under the Pensions Act 2004.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

27. Retirement benefit obligations (continued)

(a) (ii) Amounts in the Financial Statements of the SWRBS

The amounts recognised in the Group's balance sheet are as follows:

	2015 £m	2014 £m
Fair value of scheme assets	1,111	-
Present value of defined benefit obligations	(1,161)	-
Asset recognised in the balance sheet	(50)	-

The amount transferred onto the Group's balance sheet from fellow group undertakings was £50m (see note 40).

The following tables provide an analysis of the SWRBS assets:

	Fair value of assets with quoted prices £m	2015 Fair value of assets with unquoted prices £m	Total £m	Fair value of assets with quoted prices £m	2014 Fair value of assets with unquoted prices £m	Total £m
Debt instruments	290	-	290	-	-	-
Pooled investment vehicles	-	806	806	-	-	-
Money market instruments, derivatives cash and other assets and liabilities	-	15	15	-	-	-
Total fair value of scheme assets	290	821	1,111	-	-	-

The SWRBS' collective investment vehicles comprise:

	2015 £m	2014 £m
UK equity investment funds	75	-
Non-UK equity investment funds	140	-
Corporate bond funds	214	-
Private equity funds	9	-
Property partnerships and unit trusts	63	-
Emerging market equity funds	47	-
Multi strategy alternative credit funds	89	-
Liquidity funds	169	-
At 31 December	806	-

The principal actuarial and financial assumptions used in valuations of the SWRBS were as follows:

	2015 %	2014 %
Discount rate	3.83%	-
Rate of inflation		
Retail Prices Index	3.04%	-
Consumer Price Index	2.04%	-
Rate of salary increases	0.00%	-

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

27. Retirement benefit obligations (continued)

(a) (ii) Amounts in the Financial Statements of the SWRBS (continued)

The principal actuarial and financial assumptions used in valuations of the SWRBS were as follows:

	2015 %	2014 %
Discount rate	3.83%	-
Rate of inflation		
Retail Prices Index	3.04%	-
Consumer Price Index	2.04%	-
Rate of salary increases	0.00%	-
	2015 Years	2014 Years
Life expectancy for member aged 60, on the valuation date:		
Men	28.0	-
Women	30.5	-
Life expectancy for member aged 60, 15 years after the valuation date:		
Men	29.4	-
Women	32.0	-

(a) (iii) Amount, timing and uncertainty of future cash flows

Risk exposure of SWRBS

Whilst the Group is not exposed to any unusual, entity specific or scheme specific risks in SWRBS, it is exposed to a number of significant risks, detailed below:

Inflation rate risk: the SWRBS's benefit obligations are linked to inflation both in deferment and once in payment. Higher inflation will lead to higher liabilities although this will be partially offset by holdings of inflation-linked assets, such as gilts.

Interest rate risk: The defined benefit obligation is determined using a discount rate derived from yields on AA-rated corporate bonds. A decrease in corporate bond yields will increase plan liabilities although this will be partially offset by an increase in the value of bond holdings.

Longevity risk: The SWRBS obligations are to provide benefits for the life of the members so increases in life expectancy will result in an increase in the plans' liabilities.

Investment risk: SWRBS assets are invested in a diversified portfolio of debt securities, equities and other return-seeking assets. If the assets underperform the discount rate used to calculate the defined benefit obligation, it will reduce the surplus or increase the deficit. Volatility in asset values and the discount rate will lead to volatility in the net pension liability on the Group's balance sheet and in other comprehensive income. To a lesser extent this will also lead to volatility in the IAS 19 pension expense in the Group's statement of comprehensive income.

The ultimate cost of the defined benefit obligations to the Group will depend upon actual future events rather than the assumptions made. The assumptions made are unlikely to be borne out in practice and as such the cost may be higher or lower than expected.

Sensitivity analysis

The effect of reasonably possible changes in key assumptions on the value of SWRBS liabilities and the resulting pension charge in the Group's statement of comprehensive income and on the net defined benefit pension scheme asset is set out below. The sensitivities provided assume that all other assumptions and the value of the SWRBS' assets remaining unchanged, and are not intended to represent changes that are at the extremes of possibility. The calculations are approximate in nature and full detailed calculations could lead to a different result. It is unlikely that isolated changes to individual assumptions will be experienced in practice. Due to the correlation of assumptions, aggregating the effects of these isolated changes may not be a reasonable estimate of the actual effect of simultaneous changes in multiple assumptions.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

27. Retirement benefit obligations (continued)

(a) (iii) Amount, timing and uncertainty of future cash flows (continued)

Effect of reasonably possible alternative assumptions	Increase (decrease) in the net defined benefit pension scheme liability	
	2015	2014
	£m	£m
Inflation:		
Increase of 0.1 per cent	(20)	-
Decrease of 0.1 per cent	20	-
Discount rate:		
Increase of 0.1 per cent	26	-
Decrease of 0.1 per cent	(26)	-
Expected life expectancy of members:		
Increase of one year	(38)	-
Decrease of one year	37	-

Sensitivity analysis method and assumptions

The inflation assumption sensitivity applies to both the assumed rate of increase in the Consumer Prices Index (CPI) and the Retail Prices Index (RPI). The assumed pension increases before and after retirement is linked to inflation (either CPI or RPI) subject to certain minimum and maximum limits. The inflation assumption sensitivity allows for a corresponding impact of changing the inflation assumption as the assumed pension increases both before and after retirement. The sensitivity analysis does not include the impact of any possible change in the rate of salary as pensionable salaries have been frozen since 2 April 2014.

The life expectancy assumption has been applied by allowing for an increase/decrease in life expectation from age 60 of one year, based upon the approximate weighted average age for each scheme. Whilst this is an approximate approach and will not give the same result as a one year increase in life expectancy at every age, it provides an appropriate indication of the potential impact on the schemes from changes in life expectancy. There was no change in the methods and assumptions used in preparing the sensitivity analysis from the prior year.

Asset-liability matching strategies

The SWRBS investment strategy is determined by the Trustee of the SWRBS in consultation with the Principal Employer for the purposes of the scheme (the Company from 1 January 2016). It is regularly reviewed and developed. A principal element of the strategy is to hold matching assets, primarily index-linked gilts, in respect of the liabilities of the SWRBS represented by pensions in payment and a proportion of deferred pension liabilities. The objective is to reduce the volatility of the SWRBS funding position caused by changes in market expectations of interest rates and inflation and the assets are structured to take into account the profile of the SWRBS liabilities. Credit default swaps and corporate bonds provide a credit overlay to these matching assets, which in total comprise approximately 61.5% of the SWRBS assets. The remaining assets are invested in diversified return-seeking assets.

Maturity profile of defined benefit obligation

The weighted average duration of the defined benefit pension obligation is 26 years (2014: 26 years).

Guarantee to the trustees of SWRBS

As part of the Insurance Transfer of Business effective 31st December 2015 (see note 40), the Company has assumed the pension guarantee previously granted by SW Funding plc. The Company provides a guarantee to the trustees of SWRBS to explicitly cover the minimum legal funding obligations imposed on the employer s (Scottish Widows Services Limited ("SWS") and Lloyds Bank plc) by Sections 75 and 75A of the Pensions Act 1995 and under the rules of the scheme. As a result, the Company will be liable to its proportionate share of the deficit in the SWRBS at the relevant time (calculated as the cost of securing benefits with an insurer) in the event that: SWRBS is wound up; the employer becomes insolvent; or an employer ceases to employ active members of SWRBS at a time when another employer continues to do so, but the associated debt is not apportioned to another employer.

The guarantee is considered to have an immaterial value on the basis that the likelihood of the Company making a payment under the guarantee is considered to be remote. Consequently, there are currently no indications that any amounts payable under this guarantee will materially affect the financial position of the Company.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

27. Retirement benefit obligations (continued)

(b) Defined contribution schemes

The SWRBS also includes a defined contribution section; most of the members have now transferred to the Your Tomorrow defined contribution section of the Lloyds Bank Pension Scheme No. 1. During the year ended 31 December 2015, there was no charge to the statement of comprehensive income, since the charge was borne by a related party SW Funding plc, prior to the Insurance Business Transfer Scheme. There were no outstanding or prepaid contributions at 31 December 2015.

(c) Other LBG schemes

The Group's share of any LBG schemes has become immaterial, resulting in no amounts being recognised on the Group's balance sheet in respect of LBG schemes. The change in the net defined benefit liability was recognised through Other Comprehensive Income. Details of the LBG schemes can be found in the financial statements of the Company's ultimate parent company.

28. Accruals and deferred income

	2015		2014	
	£m	£m	£m	£m
	<i>Group</i>	<i>Company</i>	<i>Group</i>	<i>Company</i>
Accrued expenses	55	1	10	5
Deferred income	56	30	15	14
Total	111	31	25	19

Of the above, total accruals and deferred income transferred from fellow group undertakings were valued at £107m for Group and £28m for Company. Of the above total, £46m for Group and £21m for Company (2014: £11m for Group and £10m for Company) is expected to be settled more than one year after the reporting date.

29. Subordinated debt

The carrying value shown in the balance sheet is as follows:

	2015		2014	
	£m	£m	£m	£m
	<i>Group</i>	<i>Company</i>	<i>Group</i>	<i>Company</i>
Subordinated debt	1,534	1,551	604	604
Issue costs	(17)	(17)	9	9
	1,517	1,534	613	613
Accrued interest on subordinated debt	49	49	10	10
Fair value hedge adjustment	105	105	5	5
Total	1,671	1,688	628	628

Of the above total subordinated debt transferred from fellow group undertakings were valued at £1,355 for Group and £1,375m for Company.

Details of the subordinated debt of the Company comprise £51m of 7.375% undated Subordinated Guaranteed Bonds held by Clerical Medical Finance plc, the redemption of which is at the option of Clerical Medical Finance plc and is generally not allowable prior to 5 November 2019. The interest rate charged to the Company by Clerical Medical Finance plc is 7.61%.

£250m of floating rate subordinated notes issued by Scottish Widows Limited (formerly CMIG) in June 2012 were redeemed as part of the Insurance Business Transfer Scheme (note 40). The Company incurred a £64m charge to reserves from reversing a prior year gain recognised previously by the note holder (SW Funding plc).

On 24 June 2015 Clerical Medical Finance plc, a subsidiary of LBG, exercised its option to redeem €388m of 4.25% undated Subordinated Guaranteed Bonds, the proceeds of which had been loaned to the Company on a similar interest (4.27%) and repayment terms. An interest rate swap had been put in place in respect of the €388m tranche of the subordinated debt, which was accounted for using hedge accounting, as set out in note 1(o).

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

29. Subordinated debt (continued)

The following external subordinated notes were originally issued by SW Funding plc and transferred to the Company, within the Insurance Business Transfer Scheme (as permitted within the terms of issuance):

£1,500m of fixed rate subordinated notes were issued in April 2013, at a discount of £13m. Redemption is due in 2023 for £850m of the notes, and in 2043 for the remaining £650m. Interest is payable on a quarterly basis at a rate of 5.5% on the former and 7% on the latter. Repayment of the notes is subordinate to the claims of the Company's senior creditors, including all policyholders. The interest rate risk of the notes is managed using a derivative which is accounted for using hedge accounting, as set out in note 1(o).

The fair values of the subordinated debt of the Group and Company are as follows:

<u>Group</u>	2015		2014	
	£m	£m	£m	£m
	<u>Carrying value</u>	<u>Fair value</u>	<u>Carrying value</u>	<u>Fair value</u>
Undated subordinated debt	51	54	252	248
Dated subordinated debt	1,620	1,620	376	361
Total	1,671	1,674	628	609

<u>Company</u>	2015		2014	
	£m	£m	£m	£m
	<u>Carrying value</u>	<u>Fair value</u>	<u>Carrying value</u>	<u>Fair value</u>
Undated subordinated debt	51	54	252	248
Dated subordinated debt	1,637	1,637	376	361
Total	1,688	1,691	628	609

The fair value of undated subordinated debt has been calculated using published bid prices at the reporting date. The fair value of dated subordinated debt has been assessed by management with reference to published prices.

30. Non-participating investment contract liabilities

An analysis of the change in net liabilities arising from non-participating investment contracts is as follows:

<u>Group</u>	2015			2014		
	£m	£m	£m	£m	£m	£m
	<u>Gross</u>	<u>Reinsurance</u>	<u>Net</u>	<u>Gross</u>	<u>Reinsurance</u>	<u>Net</u>
At 1 January	10,099	(38)	10,061	10,699	(55)	10,644
New business	38	-	38	48	-	48
Changes in existing business	(776)	3	(773)	(648)	17	(631)
Transfers from fellow group undertakings (see note 40)	13,398	(247)	13,151	-	-	-
At 31 December	22,759	(282)	22,477	10,099	(38)	10,061

<u>Company</u>	2015			2014		
	Gross £m	Reinsurance £m	Net £m	Gross £m	Reinsurance £m	Net £m
At 1 January	7,230	(784)	6,446	7,718	(756)	6,962
New business	25	-	25	31	-	31
Changes in existing business	(526)	58	(468)	(519)	(28)	(547)
Transfers from fellow group undertakings (see note 40)	16,030	444	16,474	-	-	-
At 31 December	22,759	(282)	22,477	7,230	(784)	6,446

An analysis of the contractual and expected maturities of liabilities arising from non-participating investment contracts is given in note 36.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

31. Other financial liabilities

	2015		2014	
	£m	£m	£m	£m
	<i>Group</i>	<i>Company</i>	<i>Group</i>	<i>Company</i>
Amounts payable in respect of direct insurance business	400	400	91	85
Due to related parties	1,301	913	35	28
Repurchase creditor	91	91	88	88
Due to brokers	317	88	41	-
Collateral liability	1,387	551	177	128
Other	988	318	94	5
Total	4,484	2,361	526	334

Of the above total other financial liabilities transferred from fellow group undertakings were valued at £3,714m for Group and £1,902m for Company. Of the above total, £1,083m for Group and £576m for Company (2014: £nil for Group and Company) is expected to be settled more than one year after the reporting date. Included within other liabilities, as required by IAS 32 "Financial Instruments: Presentation", is £100m of 6% cumulative preference shares issued by the Company during 2005.

The Group and Company has recognised assets and liabilities in relation to cash collateral received and reinvested in relation to derivatives contracts and stock lending programme. The liability is recognised as Collateral Liability within Other financial liabilities and the reinvestment assets as Reverse Repurchase Assets, within Loans and Receivables and cash funds within Investments at fair value through profit or loss. These investments were previously held off-balance sheet and have been recognised on Balance Sheet as at 31 December 2015 with prior year comparative updated for consistency.

32. Borrowings

	2015		2014	
	£m	£m	£m	£m
	<i>Group</i>	<i>Company</i>	<i>Group</i>	<i>Company</i>
Bank overdrafts	6	4	37	-
Total	6	4	37	-

Of the above total bank overdrafts transferred from fellow group undertakings were valued at £4m for Group and £4m for Company. The fair value of the balances set out above is not materially different to the carrying value due to the short-term nature of these balances.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

33. (Increase)/decrease in operating assets and liabilities

	2015		2014	
	£m	£m	£m	£m
	<i>Group</i>	<i>Company</i>	<i>Group</i>	<i>Company</i>
(Increase)/decrease in operating assets:				
Deferred costs	(1,275)	(1,410)	(9)	(9)
Investment properties	(3,103)	221	765	57
Assets arising from reinsurance contracts held	(8,056)	(7,392)	48	16
Fixed Assets	(17)	-	-	-
Prepayments	(32)	(28)	13	-
Financial assets:				
Derivative financial instruments	(1,213)	(1,259)	(450)	(422)
Loans and receivables	(5,721)	(4,109)	148	80
Investments at fair value through profit or loss	(58,793)	(76,476)	1,362	980
Net increase in operating assets	(78,210)	(90,453)	1,877	702
Increase/ (decrease) in operating liabilities:				
Liabilities arising from insurance contracts and participating investment contracts	53,810	65,677	(973)	(247)
Unallocated surplus	237	237	(5)	(5)
Retirement benefit obligations	50	-	-	-
Other provisions	(27)	(41)	(47)	(47)
Accruals and deferred income	86	12	5	1
Financial liabilities:				
Subordinated debt liabilities	1,043	1,060	(30)	(30)
Liabilities arising from non-participating investment contracts	12,660	15,529	(591)	(488)
Derivative financial instruments	1,293	1,306	307	267
Other financial liabilities	3,958	2,027	181	65
External interest in collective investment vehicles	8,021	-	(745)	-
Net increase/(decrease) in operating liabilities	81,131	85,807	(1,898)	(484)
Net decrease/(increase) in operating assets and liabilities	2,921	(4,646)	(21)	218

34. Dividends paid

	2015 £m	2014 £m
Total dividends paid on equity shares	245	-

The dividend paid in the year amounted to £3.50 (2014: £nil per share).

35. Liabilities arising from insurance contracts and investment contracts – assumptions, change in assumptions and sensitivities

Policyholder liabilities can be analysed into With Profits Fund liabilities and non-participating fund liabilities. In accordance with FRS 2103, the liabilities of the With Profits Funds are accounted for using the realistic capital regime of the PRA (realistic liabilities). All non-participating liabilities are accounted for using a traditional prospective actuarial discounted cash flow methodology.

(1) Processes used to determine key assumptions in respect of insurance and investment contracts**(a) Liabilities of the With Profits Funds calculated on a realistic basis**

The Group and Company has With Profits Funds containing both insurance and participating investment contracts. The main components of the realistic liabilities are: with profits benefit reserves (i.e. the total asset shares for with profits policies); the costs of options and guarantees; deductions levied against asset shares and the impact of smoothing policy.

The realistic assessment is carried out using a stochastic simulation model which values liabilities on a market consistent basis. The calculation of realistic liabilities uses best estimate assumptions of e.g. mortality, persistency and expenses.

The processes for determining the key assumptions are set out below, and unless otherwise stated, remain unchanged from the prior year:

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

35. Liabilities arising from insurance contracts and investment contracts – assumptions, change in assumptions and sensitivities (continued)**(a) Liabilities of the With Profits Funds calculated on a realistic basis (continued)***Investment returns and discount rates*

A stochastic economic scenario generator, which uses recognised asset models, provides future asset value and yield scenarios; these determine investment returns for each scenario. The economic scenario generator is calibrated to observable yield curves and option prices where possible. Nominal interest rates are modelled using a standard interest rate model, calibrated to risk-free yields. The risk-free yield is defined as the spot yield derived from the UK swap yield curve less a deduction for credit risk. The liabilities are valued by discounting projected future cash flows using the risk free yield.

Investment volatility

The volatility of future equity returns in excess of nominal interest rates has been calibrated to at-the-money-forward options of up to 10 years term on appropriate indices. The indices used are the FTSE-100, the EuroStoxx-50, and the S&P 500. For property, no observable prices exist and so volatility has been derived from analysis of historic data.

Mortality

The mortality and morbidity assumptions, including allowances for improvements in longevity for annuitants, are based on recent actual experience, industry tables and projection models, and mortality rates implied by indicative reinsurance terms.

Persistency

Persistency is a function of both the rate of policy termination and the rate at which policyholders stop paying regular premiums. The assumed levels of these rates are based on a combination of historical experience and management's views on future experience taking into consideration potential changes that may result from guarantees and options becoming more valuable under adverse market conditions.

Maintenance expenses

Allowance is made for the charges applied to the With Profits Funds and these are, for conventional with profits business, governed by the relevant Schemes of Transfer.

Guaranteed annuity option take-up rates

The guaranteed annuity option take-up rates are set with regard to the Company's recent actual experience, increased to reflect future uncertainties where the exercise of options by policyholders might increase liabilities.

(b) Liabilities of the non-participating funds**(i) Insurance contracts and participating investment contracts**

The liabilities of the Group and Company are determined on the basis of recognised actuarial methods and consistently with the approach to be used for the PRA returns. The methods used involve estimating future policy cash flows over the duration of the in-force book of policies, and discounting these cash flows back to the valuation date allowing for probabilities of occurrence.

The liabilities will vary with movements in interest rates (this applies in particular to the cost of guaranteed benefits payable in the future) and with movements in the cost of life assurance and annuity benefits for which future mortality is uncertain. Assumptions are made in respect of all material factors affecting future cash flows, including future interest rates, mortality and costs. Generally, assumptions used to value the liabilities contain a margin for adverse deviation and are determined as required by PRA rules. This margin for adverse deviation is based on management's judgment and reflects management's views on the inherent level of uncertainty. The assumptions to which the liabilities are most sensitive are the interest rates used to discount the cash flows and the mortality assumptions, particularly those for annuitants.

The key assumptions used in the measurement of the non-participating fund liabilities are:

Interest rates

The rates used are derived consistently with the approach to be used for the PRA returns. These limit the rates of interest that can be used by reference to a number of factors including the dividend and earnings yields on equities, rental income, and redemption yields on fixed interest assets at the valuation date. Margins for risk are allowed for in the assumed interest rates. These are derived from the limits used for PRA reporting, including reductions made to the available yields to allow for default risk based upon the credit rating of each stock, and an over-riding restriction which limits the yield from investments in property by reference to the yield from appropriate long-term gilts.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

35. Liabilities arising from insurance contracts and investment contracts – assumptions, change in assumptions and sensitivities (continued)**(i) Insurance contracts and participating investment contracts (continued)***Mortality and morbidity*

The mortality and morbidity assumptions, including allowances for improvements in longevity for annuitants, are set with regard to the Group's actual experience where this provides a reliable basis, and relevant industry data otherwise, and includes a margin for adverse deviation. Improvements in female annuitant mortality are assumed to follow the CMI 2014 projection for females from the Actuarial profession's mortality committee with a long term rate of improvement of 1.75% per annum. Similarly improvements in male annuitant mortality are assumed to follow the CMI 2014 projection for males from the Actuarial Profession's mortality committee with a long term rate of improvement of 2% per annum.

Maintenance expenses

Allowance is explicitly made for future policy costs. Expense loadings are determined by reference to an internal analysis of current and expected future expense levels, plus a margin for adverse deviations. Explicit allowance is made for future expense inflation from the valuation date. No allowance is made for any expected reductions in expense levels that have not occurred at the valuation date.

Persistency rates

Prudent lapse rate assumptions have been used for term assurance business and other business categories. Whether a lapse rate is prudent broadly depends on whether the policy liability is negative or positive at any point in its life, thus for each policy a high lapse rate is assumed at points where the projected liability is negative and a low lapse rate is assumed at points where the projected liability is positive.

(ii) Non-participating investment contracts

These contracts are unit-linked, and the liability is determined as the value of the units allocated to the contracts plus an allowance for other amounts not reflected in the unit value.

(2) Key assumptions**(a) With Profits Funds**

Assumptions are set for the realistic valuation of the Company's With Profits Funds. In addition, liabilities in respect of non-participating policies in the SW With Profits Fund are also accounted for on the regulatory assessment.

(i) Investment returns and discount rates

In the realistic valuation of liabilities in calibrating the economic scenario generator, the risk-free yield curve is defined as the UK swap yield curve less a deduction for credit risk.

The following interest rates are assumed in the regulatory valuation of non-participating policies in the SW With Profits Fund:

Class of business	Interest rate (net)	
	2015 %	2014 %
Annuities in Payment	2.20	2.30
Deferred Annuities	2.10	2.00

(ii) Investment volatility (realistic liabilities only)

The calibration of the stochastic simulation model uses implied volatilities of derivatives where possible, or historical observed volatility where it is not possible to observe meaningful prices. For example, as at 31 December 2015, the 10 year-equity-implied-at-the-money assumption was 22.6% (22.3% as at 31 December 2014). The assumption for property volatility was 12.8% (31 December 2014: 13.1%). The volatility of interest rates has been calibrated to the implied volatility of swaptions which was broadly 32% as at 31 December 2015 (31 December 2014: 29%).

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

35. Liabilities arising from insurance contracts and investment contracts – assumptions, change in assumptions and sensitivities (continued)

(iii) Mortality assumptions

The mortality assumptions for the main classes of business are set with regard to recent Group experience and general industry trends, all of which are adjusted for smoker status and age / sex specific factors. The mortality tables used in the valuation are summarised below:

SW With Profits Fund

		2015	2014
Assurances (excluding term assurances)			
Conventional With Profits	Males		
	Smoker	68% AMS00 ult	81% AMS00 ult
	Non-smoker	68% AMN00 ult	73% AMN00 ult
	Unknown	60% AMC00 ult	68% AMC00 ult
	Females		
	Smoker	68% AFS00 ult	61% AFS00 ult
	Non-smoker	80% AFN00 ult	80% AFN00 ult
	Unknown	65% AFC00 ult	65% AFC00 ult
Unitised Assurances	Males	42% AMC00 ult	42% AMC00 ult
	Females	59% AFC00 ult	59% AFC00 ult
Annuities			
Purchased (whole life)	Males	95% IML00 Ult	95% IML00 Ult
		CMI_2014_M_1.75%_CAI0.08_T85	CMI_2012_M_1.75%_C85
	Females	80% IFL00 Ult	80% IFL00 Ult
		CMI_2014_F_1.5%_CAI0.08_T85	CMI_2012_F_1.5%_C85
Self-employed / Personal Pensions	Males	81% RMV00 Ult	90% RMV00 Ult
		CMI_2014_M_1.75%_CAI0.08_T85	CMI_2012_M_1.75%_C85
	Females	88.3% RFV00 Ult	112% RFV00 Ult
		CMI_2014_F_1.5%_CAI0.08_T85	CMI_2012_F_1.5%_C85
Other Annuities in payment	Males	90%-101% PCMA0 Ult	100-113% PCMA00 Ult
		CMI_2014_M_1.75%_CAI0.08_T85	CMI_2012_M_1.75%_C85
	Females	73-77% PCFA0 Ult	93%-98% PCFA00 Ult
		CMI_2014_F_1.5%_CAI0.08_T85	CMI_2012_F_1.5%_C85
Deferred Annuities	Males	66% AMC00 Ult	72 % AMC00 ult
	Females	77% AFC00 Ult	77 % AFC00 ult

With regard to the above and subsequent tables:

CMI_2014_M_1.75%_CAI0.08_T85' denotes that future improvement factors, which are applied from 31 December 2002, are taken from CMI 2014 tables for males, with a long term improvement rate of 1.75% per annum and constant addition of 0.08%, tapering starting at age 85. Similarly 'CMI_2014_F_1.5%_CAI0.08_T85' tables are used for females.

CMI_2012_M_1.75%_C85' denotes that future improvement factors, which are applied from 31 December 2002, are taken from CMI 2012 tables for males, with a long term improvement rate of 1.75% per annum, tapering starting at age 85. Similarly 'CMI_2012_F_1.5%_C85' tables are used for females.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

35. Liabilities arising from insurance contracts and investment contracts – assumptions, change in assumptions and sensitivities (continued)

(iii) Mortality assumptions (continued)

CMIG With Profits Fund

		2015	2014
Assurances (excluding term assurances)			
Conventional With Profits	Males	35% AMC00 Ultimate	40% AMC00 Ultimate
	Females	57% AFC00 Ultimate	55% AFC00 Ultimate
Unitised Assurances	Males	77% AMC00 Ultimate	80% AMC00 Ultimate
	Females	82% AFC00 Ultimate	85% AFC00 Ultimate
Annuities			
Self-employed / Personal Pensions	Males	99% PCMA00 CMI_2014 1.75% CAI0.08%_T85	96% PCMA00 CMI 2012 - 1.75% _C85
	Females	103% PCFA00 CMI_2014 1.5% CAI0.08%_T85	98% PCFA00 CMI 2012 - 1.5% _C85
Deferred Annuities	Males	99% PCMA00 CMI_2014 1.75% CAI0.08%_T85	96% PCMA00 CMI 2012 - 1.75% _C85
	Females	103% PCFA00 CMI_2014 1.5% CAI0.08%_T85	98% PCFA00 CMI 2012 - 1.5% _C85

(iv) Other assumptions

Deferred annuity contracts with a guaranteed-rate annuity option have been valued based upon an assumed rate of take-up of the guaranteed annuity option of 85% for the realistic assessment (85% assumed at 31 December 2014).

(b) Non-participating funds

The principal assumptions underlying the calculation of each of the business transferred in from Group companies in respect of non-participating fund liabilities are given below.

(i) Investment returns and discount rates

Formerly Scottish Widows plc Class of business	Interest rate (net)	
	2015 %	2014 %
Conventional Life business and non-unit reserves on linked life business (pre-2013)	1.04	0.96
Conventional Life business and non-unit reserves on linked life business (post-2013)	1.30	1.20
Non-unit reserves on linked pension business (Retirement account, solutions and stakeholder)	1.30	1.20
Conventional pensions business and non-unit reserves on other linked pensions business	1.30	1.20
Annuities in payment	3.10	2.89

Formerly Clerical Medical Investment Group Ltd Class of business	Interest rate (net)	
	2015 %	2014 %
Conventional Life business and non-unit reserves on linked life business	0.93	0.81
Formerly SW Protection business	1.04	0.81
Conventional pensions business and non-unit reserves on other linked pensions business	1.16	1.01
Annuities in payment	3.09	2.95

Formerly Halifax Life Limited Class of business	Interest rate (net)	
	2015 %	2014 %
Non-unit reserves on linked pension business	1.16	1.01
ELAS reassured annuities in payment	2.95	2.93
Annuities in payment	2.90	2.03

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

35. Liabilities arising from insurance contracts and investment contracts – assumptions, change in assumptions and sensitivities (continued)

Formerly St Andrew's Life Assurance plc Class of business	Interest rate (net)	
	2015 %	2014 %
Conventional Life business	0.95	0.81
Non-unit reserves on linked life business	0.93	0.81

(ii) Mortality assumptions

The mortality assumptions for the main classes of business are as follows:

Formerly Scottish Widows plc

		2015	2014
Protection for Life	Males		
	Smoker	104% TMS00 (5) Select	104% TMS00 (5) Select
	Non smoker	104% TMN00 (5) Select	104% TMN00 (5) Select
	Females		
	Smoker	97% TFS00 (5) Select	97% TFS00 (5) Select
	Non smoker	95% TFN00 (5) Select	95% TFN00 (5) Select
Term Assurances			
	Males		
	Smoker	76 – 116% TMS00 (5) Select	76 – 116% TMS00 (5) Select
	Non smoker	70 – 145% TMN00 (5) Select	79 – 145% TMN00 (5) Select
	Unknown	70% TMN00 (5) Select to 144% TMC00 (5) Select	79% TMN00 (5) Select to 144% TMC00 (5) Select
	Females		
	Smoker	74 – 132% TFS00 (5) Select	73 – 132% TFS00 (5) Select
	Non smoker	74 – 137% TFN00 (5) Select	69 – 137% TFN00 (5) Select
	Unknown	74% TFN00 (5) Select to 137% TFC00 (5) Select	69% TFN00 (5) Select to 137% TFC00 (5) Select
Unitised Pensions (Solutions, Stakeholder)	Males	55% AMC00 Ult	59% AMC00 Ult
	Females	57% AFC00 Ult	58% AFC00 Ult
Retirement Account	Males	66% AM92 Ult	66% AM92 Ult
	Females	55% AF92 Ult	55% AF92 Ult
Transferred from Lloyds Bank	Males		
	Smoker	77% AMS00 Ult	83% AMS00 Ult
	Non smoker	96% AMN00 Ult	102% AMN00 Ult
	Unknown	96% AMN00 Ult	102% AMN00 Ult
	Females		
	Smoker	84% AFS00 Ult	80% AFS00 Ult
	Non smoker	94% AFN00 Ult	90% AFN00 Ult
	Unknown	94% AFN00 Ult	90% AFN00 Ult

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

35. Liabilities arising from insurance contracts and investment contracts – assumptions, change in assumptions and sensitivities (continued)

		2015	2014
Annuities			
Purchased (whole life)	Males	86% IML00 Ult CMI_M_2014 2.0%_CAI0.08%_T90	86% IML00 Ult CMI_2012_M_2%
	Females	72% IFL00 Ult CMI_F_2014 1.75%_CAI0.08%_T90	72% IFL00 Ult CMI_2012_F_1.75%
Self-employed / personal Pensions	Males	85% RMV00 Ult CMI_M_2014 2.0%_CAI0.08%_T90	81% RMV00 Ult CMI_2012_M_2%
	Females	99% RFV00 Ult CMI_F_2014 1.75%_CAI0.08%_T90	101% RFV00 Ult CMI_2012_F_1.75%
Other Annuities in payment	Males	94 - 112% PCMA00 Ult CMI_M_2014 2.0%_CAI0.08%_T90	90 - 112% PCMA00 Ult CMI_2012_M_2%
	Females	82 - 95% PCFA00 Ult CMI_F_2014 1.75%_CAI0.08%_T90	83 - 95% PCFA00 Ult CMI_2012_F_1.75%
Executive Pensions	Males	94 PCMA00 Ult CMI_M_2014 2.0%_CAI0.08%_T90	90% PCMA00 Ult CMI_2012_M_2%
	Females	82% PCFA00 Ult CMI_F_2014 1.75%_CAI0.08%_T90	84% PCFA00 Ult CMI_2012_F_1.75%
Group scheme annuities	Males	106% PCMA00 Ult CMI_M_2014 2.0%_CAI0.08%_T90	102% PCMA00 Ult CMI_2012_M_2%
	Females	87% PCFA00 Ult CMI_F_2014 1.75%_CAI0.08%_T90	88% PCFA00 Ult CMI_2012_F_1.75%
Transferred from Lloyds TSB	Males	112% PCMA00 Ult CMI_M_2014 2.0%_CAI0.08%_T90	112% PCMA00 Ult CMI_2012_M_2%
	Females	95% PCFA00 Ult CMI_F_2014 1.75%_CAI0.08%_T90	95% PCFA00 Ult CMI_2012_F_1.75%

CMI_2014_M_2.0%_CAI0.08_T90 denotes that future improvement factors, which are applied from 31 December 2002, are taken from CMI 2014 tables for males, with a long term improvement rate of 2.00% and constant addition of 0.08%, tapering starting at age 90. Similarly 'CMI_2014_F_1.75%_CAI0.08_T90' tables are used for females.

CMI_2012_M_2.0%' denotes that future improvement factors, which are applied from 31 December 2002, are taken from CMI 2012 tables for males, with a long term improvement rate of 2.0% per annum and tapering starting at age 90. Similarly 'CMI_2012_F_1.75%' tables are used for females.

Under the mortality assumptions adopted for personal/ self employed business a male aged 65 will live on average for over 25 years.

		2015	2014
Deferred Annuities			
	Males	59% AMC00 Ult	65% AMC00 Ult
	Females	69% AFC00 Ult	69% AFC00 Ult

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

35. Liabilities arising from insurance contracts and investment contracts – assumptions, change in assumptions and sensitivities (continued)

Formerly Clerical Medical Investment Group Ltd

The mortality assumptions for the main classes of business are as follows:

		2015	2014
Term Assurances			
	Males	31% TMC00 Select	40% TMC00 Select
	Females	50% TFC00 Select	52% TFC00 Select
Annuities			
Purchased (whole life)	Males	89% PCMA00 CMI_M_2014 2.0%_CAI0.08%_T90	86% PCMA00 CMI 2012- 2.0%
	Females	93% PCFA00 CMI_F_2014 1.75%_CAI0.08%_T90	88% PCFA00 CMI 2012 – 1.75%
Self-employed / personal Pensions	Males	89% PCMA00 CMI_M_2014 2.0%_CAI0.08%_T90	86% PCMA00 CMI 2012- 2.0%
	Females	93% PCFA00 CMI_F_2014 1.75%_CAI0.08%_T90	88% PCFA00 CMI 2012 – 1.75%
Other Annuities in payment	Males	89% PCMA00 CMI_M_2014 2.0%_CAI0.08%_T90	86% PCMA00 CMI 2012- 2.0%
	Females	93% PCFA00 CMI_F_2014 1.75%_CAI0.08%_T90	88% PCFA00 CMI 2012 – 1.75%
Deferred annuities	Males	89% PCMA00 CMI_M_2014 2.0%_CAI0.08%_T90	86% PCMA00 CMI 2012- 2.0%
	Females	93% PCFA00 CMI_F_2014 1.75%_CAI0.08%_T90	88% PCFA00 CMI 2012 – 1.75%

'CMI_2014_M_2.00%_CAI0.08_T90' denotes that future improvement factors, which are applied from 31 December 2002, are taken from CMI 2014 tables for males, with a long term improvement rate of 2.00% and constant addition of 0.08%, tapering starting at age 90. Similarly CMI_2014_F_1.75%_CAI0.08_T90 tables are used for females.

'CMI_2012_M_2.00%' denotes that future improvement factors, which are applied from 31 December 2002, are taken from CMI 2012 tables for males, with a long term improvement rate of 2.00% per annum tapering starting at age 90. Similarly 'CMI_2012_F_1.75%' tables are used for females.

Under the mortality assumptions adopted for personal/ self employed business a male aged 65 will live on average for over 25 years.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

35. Liabilities arising from insurance contracts and investment contracts – assumptions, change in assumptions and sensitivities (continued)

Formerly Halifax Life Limited

The mortality assumptions for the main classes of business are as follows:

		2015	2014
UL Individual Pensions Regular Premium	Males	68% AMC00 Ult	77% AMC00 Ult
	Females	68% AFC00 Ult	72% AFC00 Ult
UL Individual Pensions Single Premium	Males	68% AMC00 Ult	77% AMC00 Ult
	Females	68% AFC00 Ult	72% AFC00 Ult
UL Group Pension	Males	94% AMC00 Ult	94% AMC00 Ult
	Females	88% AFC00 Ult	99% AFC00 Ult
Pension Annuities	Males	89% PCMA00 CMI_M_2014 2.0%_CAI0.08%_T90	86% PCMA00(100% CMI_2012 2%) 88% PCFA00(100% CMI_2012 1.75%)
	Females	93% PCFA00 CMI_F_2014 1.75%_CAI0.08%_T90	
Deferred Annuities	Males	89% PCMA00 CMI_M_2014 2.0%_CAI0.08%_T90	86% PCMA00(100% CMI_2012 2%) 88% PCFA00(100% CMI_2012 1.75%)
	Females	93% PCFA00 CMI_F_2014 1.75%_CAI0.08%_T90	

CMI_2014_M_2.00%_CAI0.08_T90 denotes that future improvement factors, which are applied from 31 December 2002, are taken from CMI 2014 tables for males, with a long term improvement rate of 2.00% and constant addition of 0.08%, tapering starting at age 90. Similarly CMI_2014_F_1.75%_CAI0.08_T90 tables are used for females.

CMI_2012_M_2.00%' denotes that future improvement factors, which are applied from 31 December 2002, are taken from CMI 2012 tables for males, with a long term improvement rate of 2.00% per annum tapering starting at age 90. Similarly 'CMI_2012_F_1.75%' tables are used for females.

Formerly St Andrew's Life Assurance plc

The mortality assumptions for the main classes of business are as follows:

		2015	2014
Term Assurances	Males		
	Smoker	86% TMS00Select	86% TMS00Select
	Non-Smoker	90% TMN00Select	104% TMN00Select
	Females		
	Smoker	109% TFS00Select	109% TFS00Select
	Non-Smoker	104% TFN00Select	104% TFN00Select
Investment Bonds	Males	66% AMC00Ult	72% AMC00Ult
	Females	94% AFC00Ult	94% AFC00Ult

(3) The effect of changes in key assumptions**(a) With Profits Funds**

There is no net impact on profit before tax of the changes in key assumptions within the With Profits Funds as any change in policyholder liabilities is offset by an equal and opposite movement in the unallocated surplus of the long-term business.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

35. Liabilities arising from insurance contracts and investment contracts – assumptions, change in assumptions and sensitivities (continued)

(b) Non-participating funds

Changes in certain key assumptions were made during the year with the following impacts on profit after tax:

Variable	Impact on profit after tax			
	2015		2014	
	£m	£m	£m	£m
	<i>Group</i>	<i>Company</i>	<i>Group</i>	<i>Company</i>
Mortality	81	71	(3)	(5)
Expenses	-	-	25	19
Lapses	(31)	(28)	(3)	4
Valuation interest rate	(14)	(12)	(14)	(19)
Inflation	(18)	(17)	59	53

The table does not include assets transferred within the Insurance Business Transfer Scheme.

(4) Sensitivity analysis (in respect of insurance and participating investment contracts only)

(a) With Profits Funds

There is no net impact on profit before tax of the changes in key assumptions within the With Profits Funds as any change in policyholder liabilities is offset by an equal and opposite movement in the unallocated surplus of the long-term business.

(b) Non-participating funds

The following table demonstrates the effect of changes in key assumptions on profit after tax assuming that the other assumptions remain unchanged. In practice this is unlikely to occur, and changes in some assumptions may be correlated. The table does not include assets transferred within the Insurance Business Transfer Scheme.

Variable	Change in variable	Impact on profit after tax			
		2015		2014	
		£m	£m	£m	£m
		<i>Group</i>	<i>Company</i>	<i>Group</i>	<i>Company</i>
Annuitant Mortality	5% reduction	(52)	(45)	(51)	(44)
Non-annuitant Mortality	5% reduction	8	1	8	1
Lapses	10% reduction	(22)	(17)	(21)	(17)
Future maintenance expenses and investment expenses	10% reduction	60	50	57	46
Interest rate – change in redemption yield ⁽¹⁾	0.25% reduction	(43)	(36)	(44)	(41)
Interest rate – change in valuation margin ⁽²⁾	0.25% reduction	(83)	(68)	(85)	(69)

(1) This interest rate sensitivity shows the impact of a 0.25% movement in gilt yields and all of the consequential impacts on key economic assumptions including the investment returns, the valuation rates of interest and values of assets backing the business in question. This excludes any impact on assets not backing the liabilities.

(2) This interest rate sensitivity shows, for pensions annuity business, the impact of a change to the valuation rate of interest without a corresponding change to asset yields; this would increase the margin available to cover default and other risks.

36. Risk management

The principal activity of the Group is the undertaking of ordinary long-term insurance and savings business and associated investment activities in the United Kingdom. The Group offers a wide range of life insurance products such as annuities, pensions, whole life, term life and investment type products through independent financial advisors, the LBG network and direct sales. The Company also reinsures business with insurance entities external to the Group.

The Group assesses the relative costs and concentrations of each type of risk through the Individual Capital Assessment (“ICA”) and material issues are escalated to the Insurance Risk Committee and the Insurance Executive Committee.

This note summarises these risks and the way in which the Group manages them.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

36. Risk management (continued)**(a) Governance framework**

The Group is part of LBG, which has established a risk management function with responsibility for implementing the LBG risk management framework within the Group.

Responsibility for the setting and management of risk appetite and risk policy resides with the Board of each Group company. The Board manages risks in line with LBG and Insurance risk policies. The Board has delegated certain risk matters to the Insurance Risk Oversight Committee with the operational implementation of these being assigned to the Insurance Risk Committee.

The approach to risk management aims to ensure that there is effective independent checking or “oversight” of key decisions through the operation of a “three lines of defence” model. The first line of defence is line management, who have direct accountability for risk decisions. The Risk function provides oversight and challenge and forms the second line of defence.

Internal Audit constitutes the third line of defence, whose objective is to provide the required independent assurance to the Audit Committee and the Board that risks within the Group are recognised, monitored and managed within acceptable parameters.

An enterprise-wide risk management framework for the identification, assessment, measurement and management of risk is in place. The framework is in line with LBG’s risk management principles and covers the full spectrum of risks that the Group and Company are exposed to. Under this framework, risks are categorised according to an approved LBG risk language which has been adopted across the Group. This covers the principal risks faced by the Group, including the exposures to market, insurance, credit, capital, liquidity, regulatory & legal, conduct, people, governance, operational and financial reporting risks. The performance of the Group, its continuing ability to write business and the strategic management of the business depend on its ability to manage these risks.

Policy owners, identified from appropriate areas across the business, are responsible for drafting the LBG and Insurance risk policies, for ensuring that they remain up-to-date and for facilitating any changes. These policies are subject to at least an annual review, or earlier if deemed necessary. Limits are prescribed within which those responsible for the day to day management of each Group company can take decisions. Line management are required to follow prescribed reporting procedures to the bodies responsible for monitoring compliance with policy and controlling the risks.

(b) Risk appetite

Risk appetite is the amount and type of risk that the Board is prepared to seek, accept or tolerate and is fully aligned to Group and LBG strategy. The Board has defined a framework for the management of risk and approved a set of risk appetite statements that cover financial risks (earnings, capital, insurance, credit, market and liquidity), operational risks, people, conduct risks, regulatory & legal risks, financial reporting and governance risks. The risk appetite statements set limits for exposures to the key risks faced by the business. Risk appetite is reviewed at least annually by the Board.

Experience against Risk Appetite is reported monthly (by exception) and quarterly (in full) to the IRC, quarterly (by exception) to the ROC and bi-annually (by exception) to the Insurance Board. Copies are also supplied regularly to the Group’s regulators as part of the close and continuous relationship. Reporting focuses on ensuring, and demonstrating to the Board, and their delegate the IROC, that the Group is run in line with approved risk appetite. Any breaches of risk appetite require clear plans and timescales for resolution.

(c) Financial risks

The Group writes a variety of insurance and investment contracts which are subject to a variety of financial risks, as set out below. Contracts can be either single or regular premium and conventional (non-profit), with profits or unit-linked in nature.

The Group is exposed to a range of financial risks through its financial assets, financial liabilities, assets arising from reinsurance contracts and liabilities arising from insurance and investment contracts. In particular, the key financial risk is that long-term investment proceeds are not sufficient to fund the obligations arising from its insurance and investment contracts. The most important components of financial risk are market, insurance, credit, capital and liquidity risk.

The Group manages these risks in a number of ways, including risk appetite assessment and monitoring of capital resource requirements. In addition, the Principles and Practices of Financial Management (“PPFM”) set out the way in which the with profits business is managed. The Group also uses financial instruments (including derivatives) as part of its business activities and to reduce its own exposure to market risk and credit risk.

For with profits business, subject to minimum guarantees, policyholders’ benefits are influenced by the smoothed investment returns on assets held in the With Profits Funds. The smoothing cushions policyholders from daily fluctuations in investment markets. This process is managed in accordance with the published PPFM’s.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

36. Risk management (continued)

(c) Financial risks (continued)

The financial risks arising from providing minimum guaranteed benefits are borne in the With Profits Funds, but the Group bears financial risk in relation to the possibility that in extreme market conditions the With Profits Funds might be unable to bear the full costs of the guarantees. The amount of the guaranteed benefits increases as additional benefits are declared and allocated to policies.

For unit-linked business, policyholders' benefits are closely linked to the investment returns on the underlying funds. In the short term, profit and equity are therefore largely unaffected by investment returns on assets in internal unit-linked funds as any gains or losses will be largely offset by changes in the corresponding insurance and investment contract liabilities, provided that there is appropriate matching of assets and liabilities within these funds. However, any change in the market value of these funds will have an indirect impact on the Group and Company through the collection of annual management and other fund related charges. As markets rise or fall, the value of these charges rises or falls correspondingly.

For non-participating business, the principal market risk is interest rate risk, which arises because assets and liabilities may exhibit differing changes in market value as a result of changes in interest rates. Asset and liability matching is used to mitigate the impact of changes in interest rates where the difference is material.

Financial assets and financial liabilities are measured on an ongoing basis either at fair value or at amortised cost. The summary of significant accounting policies (note 1) describes how the classes of financial instruments are measured and how income and expenses, including fair value gains and losses, are recognised.

The timing of the unwind of the deferred tax assets and liabilities is dependent on the timing of the unwind of the temporary timing differences, arising between the tax bases of the assets and liabilities and their carrying amounts for financial reporting purposes, to which these balances relate.

The sensitivity analyses given throughout this note are based on a change in an assumption while holding all other assumptions constant. In practice, this is unlikely to occur as changes in some of the assumptions may be correlated, for example changes in interest rates and changes in market values. The sensitivity analysis presented also represents management's assessment of a reasonably possible alternative in respect of each sensitivity, rather than worst case scenario positions.

(1) Market risk

Market risk is defined as the risk that unfavourable market moves (including changes in and increased volatility of interest rates, market-implied inflation rates, credit spreads and prices for bonds, foreign exchange rates, equity, property and commodity prices and other instruments) lead to reductions in earnings and/or value.

Investment holdings within the Group are diversified across markets and, within markets, across sectors. Holdings of individual assets are diversified to minimise specific risk and large individual exposures are monitored closely. For assets held with unit-linked funds, investments are only permitted in countries and markets which are sufficiently regulated and liquid.

Market risk policy is dependent on the nature of the funds in question, and can be broadly summarised as follows:

- Assets held in shareholder funds are invested in money market funds, gilts, loans and investment grade bonds to match regulatory capital requirements. The balance of the shareholder fund assets is managed in line with the policies of LBG to optimise shareholder risk and return. This includes suitable use of derivatives to minimise shareholder risk.
- Unit-linked assets are invested in accordance with the nature of the fund mandates.
- Conventional non-profit liabilities are "close matched" as far as possible in relation to currency, nature and duration.
- With Profits Funds are managed in line with the published PPFMs. Benchmarks and minimum and maximum holdings in asset classes are specified to allow limited investment management discretion whilst ensuring adequate diversification. Swaps, swaptions, variable rate bonds and associated additional swap transactions provide significant protection to the With Profits Funds from the effects of interest rate falls in respect of the cost of guaranteed annuity rates.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

36. Risk management (continued)

(1) Market risk (continued)

Below is an analysis of assets and liabilities at fair value through profit or loss and assets and liabilities for which a fair value is required to be disclosed, according to their fair value hierarchy (as defined in note 1 (e)).

Group As at 31 December 2015

	Level 1 £m	Fair value hierarchy		Total £m
		Level 2 £m	Level 3 £m	
Investment properties	-	-	4,228	4,228
Equity securities	65,622	171	1,161	66,954
Debt securities	8,557	20,776	6,856	36,189
Derivative financial assets	43	1,990	31	2,064
Total assets	74,222	22,937	12,276	109,435
Derivative financial liabilities	40	1,817	-	1,857
Liabilities arising from non-participating investment contracts	-	22,759	-	22,759
Subordinated debt	-	1,671	-	1,671
Total liabilities	40	26,247	-	26,287

Company As at 31 December 2015

	Level 1 £m	Fair value hierarchy		Total £m
		Level 2 £m	Level 3 £m	
Investment properties	-	-	315	315
Equity securities	78,939	292	977	80,208
Debt securities	2,119	7,870	6,787	16,776
Derivative financial assets	5	1,950	31	1,986
Total assets	81,063	10,112	8,110	99,285
Derivative financial liabilities	20	1,771	-	1,791
Liabilities arising from non-participating investment contracts	-	22,759	-	22,759
Subordinated debt	-	1,688	-	1,688
Total liabilities	20	26,218	-	26,238

Group As at 31 December 2014

	Level 1 £m	Fair value hierarchy		Total £m
		Level 2 £m	Level 3 £m	
Investment properties	-	-	1,125	1,125
Equity securities	33,239	-	272	33,511
Debt securities	5,597	3,992	1,250	10,839
Derivative financial assets	18	833	-	851
Total assets	38,854	4,825	2,647	46,326
Derivative financial liabilities	25	539	-	564
Liabilities arising from non-participating investment contracts	-	10,099	-	10,099
Subordinated debt	628	-	-	628
Total liabilities	653	10,638	-	11,291

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

36. Risk management (continued)

(1) Market risk (continued)

Company As at 31 December 2014

	Fair value hierarchy			
	Level 1	Level 2	Level 3	Total
	£m	£m	£m	£m
Investment properties	-	-	536	536
Equity securities	17,203	-	384	17,587
Debt securities	396	1,363	1,162	2,921
Derivative financial assets	4	723	-	727
Total assets	17,603	2,086	2,082	21,771
Derivative financial liabilities	22	463	-	485
Liabilities arising from non-participating investment contracts	-	7,230	-	7,230
Subordinated debt	628	-	-	628
Total liabilities	650	7,693	-	8,343

Transfers between level one and level two

The fair value level of FX Forwards instruments has moved from level one to level two. A total of £30m of FX Forwards were transferred from level one to level two during 2015. FX Forwards are short dated instruments that are modelled using current exchange rates and interest rates and are therefore classified as level two in the fair value hierarchy in line with IFRS 13.

A total of £287m of investments in equities were transferred from level one to level two during 2015 (2014: £nil). These investments relate to private equity fund of funds which are valued using published prices for the funds, however, as the underlying investments within the funds are less liquid, these were moved to level two.

Participating investment contracts are not included above, on the basis that fair value and carrying value would not be materially different.

The derivative securities classified as Level 2 above have been valued using a tri-party pricing model as determined by the Pricing Source Agreement between Aberdeen Asset Management (formally Scottish Widows Investment Partnership - SWIP) and State Street. Prices are sourced from external sources, counterparties, and the Investment Manager (Aberdeen Asset Management). Where the primary value is within tolerance of the secondary value, the primary value will be utilised.

If the primary and secondary values are out of tolerance, then the primary value will be validated against the tertiary value. If it is within tolerance the primary value will be applied. If primary and tertiary values are out with tolerance, then the secondary value is validated against the tertiary value. If secondary and tertiary values are within tolerance, then the secondary value is applied. If they are out of tolerance then the investment manager is notified to allow them to make the final pricing decision.

Assets classified as level 3 comprise private equity investments and property investment vehicles, within equity securities, investment properties, certain loans assets, structured bonds and equity release mortgages within debt securities and prepayment swaps within derivative financial assets.

Private equity investments are valued using the financial statements of the underlying companies prepared by the general partners, adjusted for known cash flows since valuation and subject to a fair value review to take account of other relevant information. Property investment vehicles are valued based on the net asset value of the relevant company which incorporates surveyors' valuations of property. Investment property is independently valued as described in note 16. Valuations are based on observable market prices for similar properties. Adjustments are applied, if necessary, for specific characteristics of the property, such as the nature, location, or condition of the specific asset. If such information is not available alternative valuation methods such as discounted cash flow analysis or recent prices in less active markets are used. Where any significant adjustments to observable market prices are required, the property would be classified as level 3. Whilst such valuations are sensitive to estimates, it is believed that changing one or more of the assumptions to reasonably possible alternative assumptions would not change the fair value significantly.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

36. Risk management (continued)

(1) Market risk (continued)

Loan assets

Loans classified as level 3 are valued using a discounted cash flow model. The discount rate comprises market observable interest rates, a risk margin that reflects credit scores that are calibrated to observed ratings and credit spreads on bonds issued within the same sector, and an incremental liquidity premium that is estimated by reference to historical spreads at origination on similar loans where available and established measures of market liquidity. An expected value approach, based on historical data, is applied to options embedded in the loans. The effect of applying reasonably possible alternative assumptions to the value of these loans would be to decrease the fair value by £262m (2014: £180m) or increase it by £324m (2014: £193m).

Structured bond

The structured bond is a bespoke transaction between LBG and the European Investment bank. It is structured as a long chain of swaptions linked to annuity schedules detailed in the product specification. It is valued using the hull white swaption valuation model. The expected cashflows from the asset are impacted by both intrinsic movements in rates and volatility (potential for rates to move into the money in the future). The asset is discounted using the EIB credit curve and an additional illiquidity premium. The effect of applying reasonably possible alternative assumptions to the value of these asset backed securities and covered bonds would be to decrease the fair value by £10m (2014: £2m) or increase it by £10m (2014: £3m).

Equity release mortgages

A portfolio of Equity Released Mortgages is securitised through a Special Purpose Vehicle into a Senior Note (A Note) and a Junior Note (B Note). These notes are classified as level 3.

The equity release mortgages are valued using a discounted cashflow approach. Decrements (mortality, voluntary early repayment, entry into long-term care) are used to determine the incidence of cash flows. The discount rate is based on a risk free rate plus a spread to compensate for the risks associated with the loans which is determined on portfolio level. There is a No Negative Equity Guarantee on the mortgages which is valued with a time-dependent Black-Scholes model. The effect of applying reasonably possible alternative assumptions to the value of these loans would be to decrease the fair value by £14m or increase it by £13m.

Prepayment swap

The Level 3 derivative is a bespoke prepayment swap mitigating prepayment risk within Loan Assets. An expected value approach based on historical data using a stochastic process is applied to value the derivative. The effect of applying a reasonably possible alternative assumption to the value of this asset would be to decrease the fair value by £nil or increase it by £nil.

The table below shows movements in the assets and liabilities measured at fair value based on valuation techniques for which any significant input is not based on observable market data (level 3 only).

Group

	2015		2014	
	£m	£m	£m	£m
	<u>Assets</u>	<u>Liabilities</u>	<u>Assets</u>	<u>Liabilities</u>
Balance at 1 January	2,647	-	2,701	-
Transfers in	27	-	16	-
Transfers out	(12)	-	-	-
Purchases	662	-	704	-
Disposals	(1,097)	-	(898)	-
Net gains recognised within net gains on assets and liabilities at fair value through profit or loss in the statement of comprehensive income	94	-	124	-
Transfers in from fellow group undertakings (see note 40)	9,955	-	-	-
Balance at 31 December	12,276	-	2,647	-
Total unrealised gains for the period included in the statement of comprehensive income for assets and liabilities held at 31 December	59	-	183	-

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

36. Risk management (continued)

(1) Market risk (continued)

Company

	2015		2014	
	£m	£m	£m	£m
	<i>Assets</i>	<i>Liabilities</i>	<i>Assets</i>	<i>Liabilities</i>
Balance at 1 January	2,082	-	1,601	-
Transfers in	11	-	9	-
Transfers out	(9)	-	-	-
Purchases	168	-	678	-
Disposals	(675)	-	(265)	-
Net gains (losses) recognised within net gains (losses) on assets and liabilities at fair value through profit or loss in the statement of comprehensive income	9	-	59	-
Transfers in from fellow group undertakings (see note 40)	6,524	-	-	-
Balance at 31 December	8,110	-	2,082	-
Total unrealised gains/(losses) for the period included in the statement of comprehensive income for assets and liabilities held at 31 December	29	-	29	-

Total gains or losses for the period included in the statement of comprehensive income, as well as total gains or losses relating to assets and liabilities held at the reporting date, are presented in the statement of comprehensive income, through net gains/losses on assets and liabilities at fair value through profit or loss.

(i) Equity and property risk

The exposure of the Group's insurance and investment contract business to equity risk relates to financial assets and financial liabilities whose values will fluctuate as a result of changes in market prices other than from interest and foreign exchange fluctuations. This is due to factors specific to individual instruments, their issuers or factors affecting all instruments traded in the market. Accordingly, the Group monitors exposure limits both to any one counterparty, and any one market.

The sensitivity analysis below illustrates how the fair value of future cash flows in respect of equities and properties, net of offsetting movements in insurance and investment contract liabilities, will fluctuate because of changes in market prices at the reporting date.

	Impact on profit after tax and equity for the year	
	2015	2014
	£m	£m
10% (2014: 10%) increase in equity prices	(9)	(4)
10% (2014: 10%) decrease in property prices	-	-

(ii) Interest rate risk

Interest rate risk is the risk that the value of future cash flows of a financial instrument will fluctuate because of changes in interest rates and the shape of the yield curve. Interest rate risk in respect of the Group's insurance and investment contracts arises when there is a mismatch in duration or yield between liabilities and the assets backing those liabilities.

The Group's interest rate risk policy requires that the maturity profile of interest-bearing financial assets is appropriately matched to the guaranteed elements of the financial liabilities.

A fall in market interest rates will result in a lower yield on the assets supporting guaranteed investment returns payable to policyholders. This investment return guarantee risk is managed by matching assets to liabilities as closely as possible. An increase in market interest rates will result in a reduction in the value of assets subject to fixed rates of interest which result in losses may if, as a result of an increase in the level of surrenders, the corresponding fixed income securities have to be sold.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

36. Risk management (continued)

(ii) Interest rate risk (continued)

The effect of changes in interest rates in respect of financial assets which back insurance contract liabilities is given in note 35. The effect on the Group of changes in the value of investments held in respect of investment contract liabilities due to fluctuations in market interest rates is negligible as any changes will be offset by movements in the corresponding liability.

The sensitivity analysis below illustrates how the fair value of future cash flows in respect of interest-bearing financial assets, net of offsetting movements in insurance and investment contract liabilities, will fluctuate because of changes in market interest rates at the reporting date.

	Impact on profit after tax and equity for the year	
	2015 £m	2014 £m
25 basis points (2014: 25 basis points) increase in yield curves	43	44
25 basis points (2014: 25 basis points) decrease in yield curves	(43)	(44)

For the 2015 analysis above, the impacts on profit after tax and equity are different since equity impacts take account of the assets and liabilities transferred to the Group under the Insurance Business Transfer Scheme.

(iii) Foreign exchange risk

Foreign exchange risk relates to the effects of movements in exchange markets including changes in exchange rates.

US corporate bonds are held within the annuity portfolio, the cash flows of which are hedged to ensure close matching of the annuity liabilities is maintained. Foreign exchange risk arises on these investments as there may be a mismatch in fair values of the bonds and derivatives resulting from movements in US dollar - sterling exchange rates.

With the exception of these holdings, the overall risk to the Group is minimal due to the following:

- The Group's principal transactions are carried out in pounds sterling;
- The Group's financial assets are primarily denominated in the same currencies as its insurance and investment contract liabilities; and
- Other than shareholder funds, all non-linked investments of the non-profit funds are in sterling or are currency matched. The effect on the Group of changes in the value of investments held in respect of investment contract liabilities due to fluctuations in foreign exchange rates is negligible as any changes will be offset by movements in the corresponding liability.

The fair value of US dollar assets and liabilities, net of offsetting movements in insurance and investment contract liabilities, will fluctuate because of changes in exchange rates at the reporting date, however sensitivity analysis has identified a £nil impact in 2015 on profit after tax and equity (2014: £nil)

(2) Insurance risk

Insurance risk is defined as the risk of adverse developments in the timing, frequency and severity of claims for insured/underwritten events and in customer behaviour, leading to reductions or volatility in earnings and/or value.

The principal risk the Group faces under insurance contracts is that the actual claims and benefit payments exceed the amounts expected at the time of determining the insurance liabilities.

The nature of the Group's business involves the accepting of insurance risks which primarily relate to mortality, longevity, morbidity, persistency and expenses. Each company within the Group which transacts new business underwrites policies to ensure an appropriate premium is charged for the risk or that the risk is declined.

The Group principally writes the following types of life insurance contracts:

- Life assurance – where the life of the policyholder is insured against death or permanent disability, usually for pre-determined amounts;

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

36. Risk management (continued)**(2) Insurance risk (continued)**

- Annuity products – where typically the policyholder is entitled to payments which cease upon death; and
- Morbidity products – where the policyholder is insured against the risk of contracting a defined illness.

For contracts where death is the insured risk, the most significant factors that could increase the overall level of claims are epidemics or widespread changes in lifestyle, such as eating, smoking and exercise habits, resulting in earlier or more claims than expected. The possibility of a pandemic, for example one arising from Ebola, is regarded as a potentially significant mortality risk. For contracts where survival is the insured risk, the most significant factor is continued improvement in medical science and social conditions that would increase longevity.

For contracts with fixed and guaranteed benefits and fixed future premiums, there are no mitigating terms and conditions that significantly reduce the insurance risk accepted. For participating investment contracts, the participating nature of these contracts results in a significant portion of the insurance risk being shared with the policyholder.

Insurance risk is also affected by the policyholders' right to pay reduced or no future premiums, to terminate the contract completely or to exercise a guaranteed annuity option. As a result, the amount of insurance risk is also subject to policyholder behaviour. On the assumption that policyholders will make decisions that are in their best interests, overall insurance risk will generally be aggravated by policyholder behaviour. For example, it is likely that policyholders whose health has deteriorated significantly will be less inclined to terminate contracts insuring death benefits than those policyholders who remain in good health.

The Group has taken account of the expected impact of policyholder behaviour in setting the assumptions used to measure insurance and investment contract liabilities.

The principal methods available to the Group to control or mitigate longevity, mortality and morbidity risk are through the following processes:

- Underwriting (the process to ensure that new insurance proposals are properly assessed);
- Pricing-to-risk (new insurance proposals would usually be priced in accordance with the underwriting assessment);
- Claims management;
- Product design;
- Policy wording; and
- The use of reinsurance and other risk mitigation techniques.

Rates of mortality and morbidity are investigated annually based on the Group's recent experience and future mortality assumptions are set using the latest population data available. Where they exist, the reinsurance arrangements of each company in the Group are reviewed at least annually.

Persistency risk is the risk associated with the ability to retain long-term business and the ability to renew short-term business. The Group aims to reduce its exposure to persistency risk by undertaking various initiatives to promote customer loyalty. These initiatives are aimed both at the point of sale and through direct contact with existing policyholders, for example through annual statement information packs.

Further information on assumptions, changes in assumptions and sensitivities in respect of insurance and participating investment contracts is given in note 35.

(3) Credit risk

The risk that counterparties with whom we have contracted, fail to meet their financial obligations, resulting in loss to the Group.

Investment counterparty default risk arises primarily from holding investment assets, and reinsurer default credit risk primarily arises from exposure to reinsurers.

Credit risk in respect of unit-linked funds is borne by the policyholders and credit risk in respect of With Profits Funds is largely borne by the policyholders. Consequently, the Group has no significant exposure to credit risk for those funds.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

36. Risk management (continued)

(3) Credit risk (continued)

For non-linked funds investments, limits on the exposure to a single entity are specified and monitored. Bond exposures are managed through credit rating bands and maximum exposures to individual assets and sectors are set. Assets are restricted to securities in a specified list of countries, and limits applicable to property portfolios are set to prevent concentration of exposure to single tenants and single buildings. Loan assets held in the annuity portfolio, that have been purchased from LBG as part of the Group's investment strategy to invest in low-risk higher yielding illiquid assets, are monitored using established robust processes and controls.

Shareholder funds are managed in line with the Insurance Credit Risk Policy and the wider LBG Credit Risk Policy and the principles are the same as those outlined above in respect of non-linked funds.

Reinsurance is primarily used to reduce insurance risk. However, it is also sought for other reasons such as improving profitability, reducing capital requirements and obtaining technical support. In addition, reinsurance is also used to offer Investment Fund Links which we are unable to provide through other means. The Group's reinsurance strategy is to reduce the volatility of profits through the use of reinsurance whilst managing the insurance and credit risk within the constraints of the risk appetite limits.

The Group has reinsurance on all significant lines of business where mortality, morbidity or property risks exceed set retention limits. This does not, however, discharge the Group's liability as primary insurer. If a reinsurer fails to pay a claim for any reason, the Group remains liable for the payment to the policyholder. All new material reinsurance treaties are subject to Board approval and reinsurance arrangements are reviewed annually to ensure that the reinsurance strategy is being achieved.

Policies are treated as lapsed when payments from the policyholder have not been received for three consecutive months and the policyholder has not provided further information in respect of the non-payment of premiums.

Exposure to other trade receivables is assessed on a case by case basis, using a credit rating agency where appropriate.

The tables below analyse financial assets subject to credit risk using Standard & Poor's rating or equivalent.

Group As at 31 December 2015

	Total £m	AAA £m	AA £m	A £m	BBB or lower £m	Not rated £m
Assets arising from reinsurance contracts held	8,396	-	121	2,094	33	6,148
Debt securities	36,189	10,905	6,939	9,706	8,562	77
Derivative financial instruments	2,064	-	2	969	1,019	74
Loans and receivables	12,799	303	3,909	6,120	684	1,783
Cash at bank	2,106	114	518	780	304	390
Total	61,554	11,322	11,489	19,669	10,602	8,472

Group As at 31 December 2014

	Total £m	AAA £m	AA £m	A £m	BBB or lower £m	Not rated £m
Assets arising from reinsurance contracts held	340	-	59	281	-	-
Debt securities	10,839	5,864	1,803	2,134	1,027	11
Derivative financial instruments	851	-	-	780	70	1
Loans and receivables	1,377	168	15	847	6	341
Cash at bank	705	-	351	298	10	46
Total	14,112	6,032	2,228	4,340	1,113	399

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

36. Risk management (continued)

(3) Credit risk (continued)

Company As at 31 December 2015

	Total £m	AAA £m	AA £m	A £m	BBB or lower £m	Not rated £m
Assets arising from reinsurance contracts held	8,396	-	121	2,094	33	6,148
Debt securities	16,776	4,499	3,110	5,693	3,377	97
Derivative financial instruments	1,986	-	2	968	1,011	5
Loans and receivables	4,885	7	9	3,407	683	779
Cash at bank	880	-	461	112	285	22
Total	32,923	4,506	3,703	12,274	5,389	7,051

Company As at 31 December 2014

	Total £m	AAA £m	AA £m	A £m	BBB or lower £m	Not rated £m
Assets arising from reinsurance contracts held	1,004	-	-	222	31	751*
Debt securities	2,921	574	765	1,385	195	2
Derivative financial instruments	727	-	-	703	24	-
Loans and receivables	776	5	13	727	6	25
Cash at bank	381	-	258	113	10	-
Total	5,809	579	1,036	3,150	266	778

* Relates to the company's subsidiary, CMMF

Amounts classified as "not rated" within assets arising from reinsurance contracts held principally relate to amounts due from other Group companies which are not rated by Standard & Poor's or an equivalent rating agency.

Maximum credit exposure

The maximum credit risk exposure of the Group in the event of other parties failing to perform their obligations is detailed below. No account is taken of any collateral held and the maximum exposure to loss, which includes amounts held to cover unit-linked and With Profits funds liabilities, is considered to be the balance sheet carrying amount.

<i>Group</i>	Maximum exposure £m	2015 Offset £m	Net exposure £m	Maximum exposure £m	2014 Offset £m	Net exposure £m
Loans and receivables	12,799	-	12,799	1,377	-	1,377
Investments at fair value through profit or loss:						
Debt Securities	36,189	-	36,189	10,839	-	10,839
Assets arising from reinsurance contracts held	8,396	-	8,396	340	-	340
Derivative financial instruments	2,064	-	2,064	851	-	851
Cash and cash equivalents	2,106	-	2,106	705	-	705
At 31 December	61,554	-	61,554	14,112	-	14,112

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

36. Risk management (continued)

(3) Credit risk (continued)

Maximum credit exposure (continued)

<i>Company</i>	Maximum exposure £m	2015 Offset £m	Net exposure £m	Maximum exposure £m	2014 Offset £m	Net exposure £m
Loans and receivables	4,885	-	4,885	776	-	776
Investments at fair value through profit or loss:						
Debt Securities	16,776	-	16,776	2,921	-	2,921
Assets arising from reinsurance contracts held	8,396	-	8,396	1,004	-	1,004
Derivative financial instruments	1,986	-	1,986	727	-	727
Cash and cash equivalents	880	-	880	381	-	381
At 31 December	32,923	-	32,923	5,809	-	5,809

(i) Concentration risk

Credit concentration risk

Credit concentration risk relates to the inadequate diversification of credit risk. The Group requires strict control on the use of derivatives by each fund as set out in the Insurance Derivatives Risk Policy ("DRP").

Credit risk is managed through the setting and regular review of counterparty credit and concentration limits on asset types which are considered more likely to lead to a concentration of credit risk. For other asset types, such as UK government securities or investments in funds falling under the Undertakings for Collective Investment in Transferable Securities "UCITS" Directive, no limits are prescribed as the risk of credit concentration is deemed to be immaterial. This policy supports the approach mandated by the PRA for regulatory reporting.

At 31 December 2015 and 31 December 2014, the Group did not have any significant concentration of credit risk with a single counterparty or group of counterparties where limits applied. With the exception of Government bonds and UCITS funds, the largest aggregated counterparty exposure is 1.9% (2014: 1.6% of the Group's total assets).

Liquidity concentration risk

Liquidity concentration risk arises where the Group is unable to meet its obligations as they fall due or do so only at an excessive cost, due to over-concentration of investments in particular financial assets or classes of financial asset.

As most of the Group's invested assets are diversified across a range of marketable equity and debt securities in line with the investment options offered to policyholders it is unlikely that a material concentration of liquidity concentration could arise.

This is supplemented by active liquidity management in the Group, to ensure that even under stress conditions the Group has sufficient liquidity as required to meet its obligations. This is delegated by the Board to and monitored through the Insurance Finance Committee ("IFC"), the Insurance Risk Committee ("IRC"), Insurance Shareholder Investment Management Committee ("ISIM") and Banking and Liquidity Operating Committee ("BLOC").

(ii) Collateral management

Collateral in respect of derivatives

The requirement for collateralisation of OTC derivatives, including the levels at which collateral is required and the types of asset that are deemed to be acceptable collateral, are set out in a Credit Support Annex ("CSA"), which forms part of the International Swaps and Derivatives Association ("ISDA") agreement between the Company and the counterparty.

The CSA will require collateralisation where any net exposure to a counterparty exceeds the OTC counterparty limit, which must be established in accordance with the DRP. The aggregate uncollateralised exposure to any one counterparty must not exceed limits specified in the DRP. Where derivative counterparties are related, the aggregate net exposure is considered for the purposes of applying these limits.

Acceptable collateral is defined in each instance and must take into account the quality and appropriateness of the proposed collateral as well as being acceptable to the entity receiving the collateral. Collateral may include cash, corporate bonds, supranational debt and government debt.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

36. Risk management (continued)

(ii) Collateral management (continued)

Assets with the following carrying amounts have been pledged in accordance with the terms of the relevant CSAs entered into in respect of various OTC derivative contracts:

	2015		2014	
	£m	£m	£m	£m
	<u>Group</u>	<u>Company</u>	<u>Group</u>	<u>Company</u>
Financial assets:				
Investments at fair value through profit or loss	322	322	44	33
Cash and cash equivalents	273	273	77	75
Total	595	595	121	108

Collateral pledged in form of financial assets, is continued to be recognised in the balance sheet as the Group and Company retains all risks and rewards of the transferred assets. The Group and the Company has the right to recall any collateral pledged provided that this is replaced with alternative acceptable assets. The counterparty has right to repledge or sell the collateral in the absence of default by the Group and Company.

Cash collateral pledged where the counterparty retains the risks and rewards is derecognised from the balance sheet and a corresponding receivable is recognised for its return.

Where the Group and Company receives collateral in form of financial instruments for which counterparty retains all risks and rewards, it is not recognised in the balance sheet. The fair value of financial assets accepted as collateral for OTC derivatives but not recognised in the balance sheet amounts to £471m (2014: £263m) by the Group and £471m (2014: £259m) by the Company, all of which is permitted to be sold or repledged in the absence of default. However the policy of the Group and Company is not to repledge assets, and hence no collateral was sold or repledged by the Group or Company during the year or in the prior year.

Where the Group and Company receives collateral in form of cash, it is recognised in the balance sheet along with a corresponding liability to repay the amount of collateral received within other financial liabilities. The amount of cash collateral received by the Group and Company amounts to £425m (2014: £163m) and £416m (2014: £124m) respectively.

Collateral in respect of Stock Lending

The Group and Company lend financial assets held in its portfolio to other institutions. The Insurance Investment Strategy Committee (IISC) and its sub-committee Investment Management Operational Review Committee (IMOR) are responsible for setting the parameters of stock lending. Stock lending is permitted in accordance with the Insurance Stock Lending Policy. All stock lending takes place on an open/call basis, enabling the loan to be recalled at any time within the standard settlement terms of the market concerned.

The financial assets lent do not qualify for derecognition as the Group and Company retains all risks and rewards of the transferred assets except for the voting rights. The aggregate carrying value of securities on loan by the Group is £4,658m (2014: £3,503m) and by the Company is £550m (2014: £111m).

It is Group's and Company's practice to obtain collateral in stock lending transactions. The accepted collateral can include cash, equities, certain bonds and money market instruments. On a daily basis, the fair value of collateral is compared to the fair value of stock on loan. The value of collateral must always exceed the value of stock on loan.

Where the Group and Company receives collateral in form of financial instruments for which counterparty retains all risks and rewards, it is not recognised in the balance sheet. The fair value of financial assets accepted as collateral but not recognised in the balance sheet amounts to £3,998m (2014: £3,739m) by the Group and £440m (2014: £115m) by the Company. The Group and the Company is not permitted to sell or repledge the collateral in the absence of default.

Where the Group and Company receives collateral in form of cash, it is recognised in the balance sheet along with a corresponding liability to repay the amount of collateral received within other financial liabilities. The amount of cash collateral received by the Group and Company amounts to £963m (2014: £14m) and £135m (2014: £4m) respectively.

There were no defaults in respect of stock lending during the year ended 31 December 2015 (2014: none) which required a call to be made on collateral.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

36. Risk management (continued)**(ii) Collateral management (continued)****Collateral in respect of Reverse Repurchase Agreement**

The Group and Company entered into Reverse Repurchase Agreements whereby it purchased financial instruments with an agreement to resell them back to the counterparty at an agreed price. These transactions are in effect collateralised loans and are reported accordingly. The cash on loan is recognised as Loans and Receivables. The amount of cash on loan in this regard is £963m (2014: £14m) for the Group and £135m (2014: £4m) for Company.

The financial assets received as collateral are not recognised on the balance sheet as the counterparty retains all risks and rewards. The fair value of financial assets accepted as collateral amounted to is £1,009m (2014: £15m) for the Group and £142m (2014: £4m) for Company.

Collateral in respect of Repurchase Agreement

Collateral pledged in respect of a repurchase agreement with HBOS treasury continues to be recognised on the Company's balance sheet, the amount pledged was £516m (2014: £88m) for Group and Company.

Collateral in respect of loans to related parties

The Company has made loans to related parties against which collateral is held. The collateral includes asset backed securities and covered bonds with a fair value of at least 130% of the cash lent.

Collateral amounts held are not recognised as assets. At 31 December 2015, collateral with a fair value of £1,846m (2014: £768m) was held by the group and £1,577m (2014: £768m) available to the Group to sell or repledge in the absence of default by the counterparty. Of this, £1,846m (2014: £569m) was held by the Company and £1,577m (2014: £569m) available to the Company to sell or repledge in the absence of default by the counterparty, as the remainder had been repledged to other Group companies in return for loans received. No other collateral (2014: £nil) was repledged during the year by the Group or Company. The Group and Company have an obligation to return these assets to the pledgor.

(iii) Offsetting

The following tables show financial assets and liabilities which have been set off in the balance sheet and those which have not been set off but for which the Group and the Company has enforceable master netting agreements in place with counterparties. They include Derivatives, Repurchase and Reverse Repurchase arrangements.

a) Derivatives

The derivative assets and liabilities in the tables below consist of over-the-counter (OTC) and exchange traded derivatives (ETD). The value of gross/net amounts for derivatives in the table below comprises those that are subject to master netting arrangements. The right to set off balances under these master netting agreements or to set off cash and securities collateral only arises in the event of non payment or default and, as a result, these arrangements do not qualify for offsetting under IAS 32. As a result no amount has been set off in the balance sheet. Total derivatives presented in the balance sheet are shown in note 18.

The "financial instruments" amounts in the tables below show the values that can be set off against the relevant derivatives asset and liabilities in the event of default under master netting agreements. In addition, the Group and the Company holds and provides cash and securities collateral in respect of derivative transactions to mitigate credit risks.

In the tables below, the amounts of Derivatives assets or liabilities presented are offset first by financial instruments that have the right of offset under master netting with any remaining amount reduced by the amount collateral.

b) Repurchase and Reverse Repurchase Arrangements

The Group and the Company participates in repurchase (repo) and reverse repurchase arrangements (reverse repo). The gross/net amount in the table shows the relevant assets that the Group and the Company has been transferred to counterparties under these arrangements. Cash and non cash collateral is received by the Group and the Company for securities transferred. Cash collateral may be reinvested by the Group and Company through reverse repurchase arrangements (reverse repo) against non cash collateral.

In the tables below, the amounts that are subject to Repo and Reverse Repo are set off against the amount of collateral received according to the relevant legal agreements, showing the potential net amounts.

The actual fair value of collateral may be greater than amounts presented in the tables below in the case of over collateralisation.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

36. Risk management (continued)

(iii) Offsetting (continued)

b) Repurchase and Reverse Repurchase Arrangements (continued)

Detailed disclosure on collateral management can be found in the notes below:

Group as at 31 December 2015

	Gross amounts of assets / liabilities £m	Amounts set off in the balance sheet £m	Net amounts presented in the balance sheet ¹ £m	Related amounts where set off not permitted in the balance sheet ²		Potential net amounts if offset of related amounts permitted £m
				Financial instruments £m	Collateral £m	
Financial assets						
OTC Derivatives	1,962	-	1,962	(1,089)	(854)	19
ET Derivatives	43	-	43	(17)	(21)	5
Repo	516	-	516	-	(516)	-
Reverse Repo	963	-	963	-	(963)	-
Financial liabilities						
OTC Derivatives	(1,727)	-	(1,727)	1,089	577	(61)
ET Derivatives	(40)	-	(40)	17	23	-

Group as at 31 December 2014

	Gross amounts of assets / liabilities £m	Amounts set off in the balance sheet £m	Net amounts presented in the balance sheet ¹ £m	Related amounts where set off not permitted in the balance sheet ²		Potential net amounts if offset of related amounts permitted £m
				Financial instruments £m	Collateral £m	
Financial assets						
OTC Derivatives	814	-	814	(395)	(391)	28
ET Derivatives	16	-	16	(2)	(14)	-
Repo	91	-	91	-	(91)	-
Reverse Repo	14	-	14	-	(14)	-
Financial liabilities						
OTC Derivatives	(535)	-	(535)	395	118	(22)
ET Derivatives	(15)	-	(15)	2	15	2

Company as at 31 December 2015

	Gross amounts of assets / liabilities £m	Amounts set off in the balance sheet £m	Net amounts presented in the balance sheet ¹ £m	Related amounts where set off not permitted in the balance sheet ²		Potential net amounts if offset of related amounts permitted £m
				Financial instruments £m	Collateral £m	
Financial assets						
OTC Derivatives	1,954	-	1,954	(1,089)	(845)	20
ET Derivatives	5	-	5	(4)	(1)	-
Repo	516	-	516	-	(516)	-
Reverse Repo	135	-	135	-	(135)	-
Financial liabilities						
OTC Derivatives	(1,727)	-	(1,727)	1,089	577	(61)
ET Derivatives	(20)	-	(20)	4	16	-

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

36. Risk management (continued)

b) Repurchase and Reverse Repurchase Arrangements (continued)

Company as at 31 December 2014

	Gross amounts of assets / liabilities	Amounts set off in the balance sheet	Net amounts presented in the balance sheet ¹	Related amounts where set off not permitted in the balance sheet ²		Potential net amounts if offset of related amounts permitted
				Financial instruments	Collateral	
	£m	£m	£m	£m	£m	£m
Financial assets						
OTC Derivatives	712	-	712	(338)	(349)	25
ET Derivatives	1	-	1	-	(1)	-
Repo	91	-	91	-	(91)	-
Reverse Repo	4	-	4	-	(4)	-
Financial liabilities						
OTC Derivatives	(464)	-	(464)	338	106	(20)
ET Derivatives	(12)	-	(12)	-	12	-

The following notes are relevant to the tables on preceding page:

1) The value of net amounts presented in the balance sheet for derivatives comprises those derivatives held by the Group and the Company that are subject to master netting arrangements. Total derivatives presented in the balance sheet are shown in note 18.

2) The Group and the Company enters into derivative transactions with various counterparties which are governed by industry standard master netting agreements. The Group and the Company holds and provides cash and securities collateral in respective of derivative transactions covered by these agreements. The right to set off balances under these master netting agreements or to set off cash and securities collateral only arises in the event of non-payment or default and, as a result, these arrangements do not qualify for offsetting under IAS 32.

(ii) Liquidity risk

Liquidity risk is defined as the risk that the Group has insufficient financial resources to meet its commitments as they fall due, or can only secure them at excessive cost.

Liquidity risk may result from either the inability to sell financial assets quickly at their fair values; or from an insurance liability falling due for payment earlier than expected; or from the inability to generate cash inflows as anticipated.

Liquidity risk has been analysed as arising from payments to policyholders (including those where payment is at the discretion of the policyholder) and non policyholder related activity (such as investment purchases and the payment of shareholder expenses).

In order to measure liquidity risk exposure the Group's liquidity is assessed in a stress scenario. Liquidity risk is actively managed and monitored to ensure that, even under stress conditions, the Company Group has sufficient liquidity to meet its obligations and remains within approved risk appetite. Liquidity risk appetite considers two time periods; three month stressed outflows are required to be covered by primary liquid assets; and one year stressed outflows are required to be covered by primary and secondary liquid assets, after taking account of management actions. Primary liquid assets are gilts or cash, and secondary liquid assets are tradable non-primary assets. The stressed outflows also make allowance for the increased collateral that needs to be posted under derivative contracts in stressed conditions. Liquidity risk is actively managed and monitored to ensure that, even under stress conditions, the Group has sufficient liquidity to meet its obligations and remains within approved risk appetite.

Liquidity methodology and reporting has been updated to ensure readiness for Solvency II.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

36. Risk management (continued)

(ii) Liquidity risk (continued)

Liquidity risk is managed in line with the Insurance Liquidity Risk Policy and the wider LBG Funding and Liquidity Policy. Liquidity risk in respect of each of the major product areas is primarily mitigated as follows:

Annuity contracts

Assets are held which are specifically chosen to correspond to the expectation of timing of annuity payments. Gilts, corporate bonds, loans and, where required, derivatives are selected to reflect the expected annuity payments as closely as possible and are regularly rebalanced to ensure that this remains the case in future.

With profits contracts

For with profits business, a portfolio of assets is held in line with investment mandates which will reflect policyholders' reasonable expectations.

Liquidity is maintained within the portfolio via the holding of cash balances and a substantial number of highly liquid assets, principally gilts, bonds and listed equities. Management also have the ability to sell less liquid assets at a reduced price if necessary, with any loss being borne within the With Profits Fund. Losses are managed and mitigated by anticipating policyholder claim payments to plan sales of underlying assets within funds.

Non-participating contracts

For unit-linked products, portfolios are invested in accordance with unit fund mandates. Deferral clauses are included in policyholder contracts to give time, when necessary, to realise linked assets without being a forced seller. As at 31 December 2015, there are no funds under management subject to deferral.

For non-linked products other than annuity contracts, backing investments are mostly held in gilts with minimal liquidity risk. Investments are arranged to minimise the possibility of being a distressed seller whilst at the same time investing to meet policyholder obligations. This is achieved by anticipating policyholder behaviour and sales of underlying assets within funds.

Shareholder funds

For shareholder funds, liquidity is maintained within the portfolio via the holding of cash balances and a substantial number of highly liquid assets, principally gilts and bonds.

The following tables indicate the timing of the contractual cash flows arising from the Group and Company's financial liabilities, as required by IFRS 7. The table is based on the undiscounted cash flows of financial liabilities based on the earliest date on which the Company is obliged to pay. The table includes both interest and principal cash flows.

Liquidity risk in respect of liabilities arising from insurance contracts and participating investment contracts has been analysed based on the expected pattern of maturities as permitted by IFRS 4 rather than by contractual maturity. A maturity analysis of liabilities arising from non-participating investment contracts based on expected contract maturities is also given as it is considered that this analysis provides additional useful information in respect of the liquidity risk relating to contracts written by the Group and Company.

Group As at 31 December 2015

Liabilities	Carrying amount	No stated maturity	Contractual cash flows				
			Less than 1 month	1-3 months	3-12 months	1-5 years	More than 5 years
	£m	£m	£m	£m	£m	£m	£m
Liabilities arising from non-participating investment contracts	22,759	-	22,759	-	-	-	-
External interests in collective investment vehicles	16,889	16,889	-	-	-	-	-
Derivatives held for trading	1,857	-	41	121	111	500	1,579
Subordinated debt	1,671	51	-	-	92	461	2,528
Borrowings	6	-	4	-	-	2	-
Other financial liabilities	4,484	518	2,455	310	118	1,083	-
Total	47,666	17,458	25,259	431	321	2,046	4,107

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

36. Risk management (continued)

(ii) Liquidity risk (continued)

Group As at 31 December 2014

Liabilities	Carrying amount	No stated maturity	Contractual cash flows				
			Less than 1 month	1-3 months	3-12 months	1-5 years	More than 5 years
	£m	£m	£m	£m	£m	£m	£m
Liabilities arising from non-participating investment contracts	10,099	-	10,099	-	-	-	-
External interests in collective investment vehicles	8,868	8,868	-	-	-	-	-
Derivatives held for trading	564	-	-	23	16	1	524
Subordinated debt	628	356	-	-	21	95	678
Borrowings	37	37	-	-	-	-	-
Other financial liabilities	526	186	260	-	88	-	-
Total	20,722	9,447	10,359	23	125	96	1,202

The contractual cash flow analysis set out above has been based on the earliest possible contractual date, regardless of the surrender penalties that might apply and has not been adjusted to take account of such penalties.

An analysis of the contractual cash flows in respect of insurance and investment contract liabilities by expected contract maturity, on a discounted basis, is shown below:

Group As at 31 December 2015

Maturity Analysis for insurance and investment contracts	Total £m	Less than 1 month	1-3 months	3-12 months	1-5 years	More than 5 years
		£m	£m	£m	£m	£m
Insurance and participating investment contracts	79,716	993	1,006	4,634	20,794	52,289
Non-participating investment contracts	22,759	397	310	1,414	6,434	14,204

Group As at 31 December 2014

Maturity Analysis for liabilities arising from insurance and investment contracts	Total £m	Less than 1 month	1-3 Months	3-12 months	1-5 years	More than 5 years
		£m	£m	£m	£m	£m
Insurance and participating investment contracts	25,906	253	444	1,865	7,186	16,158
Non-participating investment contracts	10,099	110	203	917	3,583	5,286

Company As at 31 December 2015

Liabilities	Carrying amount	No stated maturity	Contractual cash flows				
			Less than 1 month	1-3 months	3-12 months	1-5 years	More than 5 years
	£m	£m	£m	£m	£m	£m	£m
Borrowings	4	-	4	-	-	-	-
Liabilities arising from non-participating investment contracts	22,759	-	22,759	-	-	-	-
Derivative financial instruments	1,791	-	9	90	108	500	1,579
Subordinated debt	1,688	52	-	-	92	461	2,545
Other financial liabilities	2,361	538	1,155	-	92	576	-
Total	28,603	590	23,927	90	292	1,537	4,124

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

36. Risk management (continued)

(ii) Liquidity risk (continued)

Company As at 31 December 2014

Liabilities	Carrying amount	Contractual cash flows					
		No stated maturity	Less than 1 month	1-3 months	3-12 months	1-5 years	More than 5 years
	£m	£m	£m	£m	£m	£m	£m
Borrowings	-	-	-	-	-	-	-
Liabilities arising from non-participating investment contracts	7,230	-	7,230	-	-	-	-
Derivative financial instruments	485	-	-	22	16	139	539
Subordinated debt	628	356	-	-	21	95	678
Other financial liabilities	334	128	118	-	88	-	-
Total	8,677	484	7,348	22	125	234	1,217

The contractual cash flow analysis set out above has been based on the earliest possible contractual date, regardless of the surrender penalties that might apply and has not been adjusted to take account of such penalties.

An analysis of liabilities arising from insurance and investment contracts by expected contract maturity, on a discounted basis, is shown below:

Company As at 31 December 2015

Maturity Analysis for liabilities arising from insurance contracts and investment contracts	Total £m	Less than 1 month £m	1-3 months £m	3-12 months £m	1-5 years £m	More than 5 years £m
		£m	£m	£m	£m	£m
Insurance and participating investment contracts	79,716	993	1,006	4,634	20,794	52,289
Non-participating investment contracts	22,759	397	310	1,414	6,434	14,204

Company As at 31 December 2014

Maturity Analysis for insurance and investment contract liabilities	Total £m	Less than 1 month £m	1-3 months £m	3-12 months £m	1-5 years £m	More than 5 years £m
		£m	£m	£m	£m	£m
Insurance and participating investment contracts	14,039	122	239	1,083	4,142	8,453
Non-participating investment contracts	7,230	71	136	630	2,512	3,881

(iii) Capital risk

Capital risk is defined as the risk that the Group has a sub-optimal amount or quality of capital or that capital is inefficiently deployed across the Group. The risk that:

- the Group, or one of its separately regulated subsidiaries, has insufficient capital to meet its regulatory capital requirements;
- the Group has insufficient capital to provide a stable resource to absorb all losses up to a confidence level defined in the risk appetite;
- the Group loses reputational status by having capital that is regarded as inappropriate, either in quantity, type or distribution; and/or
- the capital structure is inefficient.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

36. Risk management (continued)

(iii) Capital risk (continued)

The business of several of the companies within the Group is regulated by the PRA and the Financial Conduct Authority ("FCA"). The PRA specifies the minimum amount of capital that must be held by each of the regulated companies within the Group in addition to their insurance liabilities. Under the PRA rules, each insurance company within the Group must hold assets in excess of the higher of:

- (i) the Pillar 1 amount, which is calculated by applying fixed percentages of mathematical reserves and capital at risk; and
- (ii) the Pillar 2 amount, which is derived from an economic capital assessment undertaken by each regulated company, which is reviewed by the PRA.

The minimum required capital must be maintained at all times throughout the year. These capital requirements and the capital available to meet them are regularly estimated in order to ensure that capital maintenance requirements are being met.

In addition capital requirements and capital available under Solvency II are estimated in order to ensure that Solvency II capital requirements will be met when Solvency II is introduced.

The Group's objectives when managing capital are:

- to have sufficient capital to safeguard the Group's ability to continue as a going concern so that it can continue to provide returns for the shareholder and benefits for other stakeholders;
- to comply with the insurance capital requirements set out by the PRA in the UK;
- when capital is needed, to require an adequate return to the shareholder by pricing insurance and investment contracts according to the level of risk associated with the business written; and
- to meet the requirements of the Schemes of Transfer.

The capital management strategy is such that the single integrated insurance business (comprising SWG and its subsidiaries, including the Group) will hold capital in line with the stated risk appetite for the business, which is to be able to withstand a one in ten year stress event without breaching the capital requirements. At SWG level it is intended that all surplus capital above that required to absorb a one in ten year stress event will be distributed to LBG.

The Company's capital comprises all components of equity, movements in which are set out in the statement of changes in equity and includes subordinated debt (note 29).

The table below sets out the regulatory capital and the required capital held at 31 December in each year on a Pillar 1 basis. The current year information is taken from the final PRA return.

<u>Company</u>	2015			2014		
	With Profit	Shareholder / Non-Profit	Total	With Profit	Shareholder / Non-Profit	Total
	£m	£m	£m	£m	£m	£m
Regulatory Capital held	5,123	4,305	9,428	1,414	1,798	3,212
Regulatory Capital Required	(4,896)	(1,030)	(5,926)	(1,360)	(335)	(1,695)
Regulatory Surplus	227	3,275	3,502	54	1,463	1,517

All minimum regulatory requirements were met during the year.

(d) Operational risk

Operational risk is defined as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. There are a number of secondary categories of operational risk including the undernoted:

Financial crime and fraud risk

Financial crime concerns activity related to money laundering, sanctions, terrorist financing and bribery. Fraud covers acts intended to defraud, misappropriate property or circumvent the law. These activities could give rise to risk of reduction in earnings and/or value, through financial or reputational loss. Losses may include censure, fines or the cost of litigation.

Information security and physical security risk

Information security risk relates to the risk of reductions in earnings and/or value, through financial or reputational loss, resulting from theft of or damage to the security of the Group's information and data. Physical security risk relates to the risk to the security of people and property.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

36. Risk management (continued)**(d) Operational risk (continued)****Operational resilience risk**

Operational resilience risk covers the risk of instances of interruptions to business operations (including critical buildings, critical and core infrastructure and IT systems, suppliers and colleagues), as a consequence of external or internal events due to insufficient resilience, inadequate recovery strategies and/or continuity systems and controls.

Change risk

Change risk is related to the management of change - designing and implementing key projects or programme. Potential loss could arise from failure requirements, budget or timescale; failure to implement change effectively; or failure to realise desired benefits.

Sourcing and service provision risk

Sourcing risk covers the risk of reductions in earnings and/or value through financial or reputational loss from risks associated with activity related to the agreement and management of services provided by third parties including outsourcing.

Service provision risk covers the risks associated with provision of services to a third party and with the management of internal intra-group service arrangements.

IT systems and cyber risk

The risk of reductions in earnings and/or value through financial or reputational loss resulting from the failure to develop, deliver, maintain, or protect against cyber attack, the company's IT solutions. The Directors have embedded a risk framework and monitor the effective operation of this across the Group.

(e) People risk

People risk is defined as the risk that the Group fails to lead, manage and enable colleagues to deliver to customers, shareholders and regulators leading to an inability to deliver the Group's strategy.

(f) Regulatory and Legal risk

Regulatory and legal risk is defined as the risk that the Group is exposed to fines, censure, legal or enforcement action, civil or criminal proceedings in the courts (or equivalent) and risk that the Group is unable to enforce its rights as anticipated.

Regulators aim to protect the rights of customers, ensuring firms satisfactorily manage their affairs for the benefit of customers and that they retain sufficient capital and liquidity. The Group has embedded a risk framework to closely monitor and manage its legal and regulatory risks, and maintains regular interaction with its regulators.

(g) Conduct risk

Conduct risk is defined as the risk of customer detriment or regulatory censure and/or a reduction in earnings/value, through financial or reputational loss, from inappropriate or poor customer treatment or business conduct.

The Group is focused on delivering fair customer outcomes, and has embedded a risk framework to effectively monitor and manage its conduct risks.

(h) Financial reporting risk

Financial reporting risk is defined as the risk that the Group suffers reputational damage, loss of investor confidence and/or financial loss arising from the adoption of inappropriate accounting policies, ineffective controls over financial and regulatory reporting, failure to manage the associated risks of changes in taxation rates, law, ownership or corporate structure and the failure to disclose accurate and timely information.

(i) Governance risk

Governance risk is defined as the risk that the Group's organisational infrastructure fails to provide robust oversight of decision making and the control mechanisms to ensure strategies and management instructions are implemented effectively.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

37. Related party transactions

(a) Ultimate parent and shareholding

The Group's immediate parent undertaking is Scottish Widows Group Limited, a company registered in the United Kingdom. Scottish Widows Group Limited has taken advantage of the provisions of the Companies Act 2006 and has not produced consolidated financial statements.

The Company's ultimate parent company and ultimate controlling party is Lloyds Banking Group plc, which is also the parent undertaking of the largest group of undertakings for which group accounts are drawn up and of which the Company is a member. Lloyds Bank plc is the parent undertaking of the smallest such group of undertakings for which group accounts are drawn up and of which the Company is a member. Copies of the Lloyds Banking Group plc financial statements in which the Company is consolidated can be obtained from the Group Secretary's Department, Lloyds Banking Group plc, 25 Gresham Street, London EC2V 7HN or downloaded via www.lloydsbankinggroup.com.

(b) Transactions and balances with related parties

Transactions with other LBG companies

In accordance with IAS 24 "Related Party Disclosures", transactions and balances between Group companies have been eliminated on consolidation and have not been reported as part of the consolidated financial statements.

The Group has entered into transactions with related parties in the normal course of business during the year. Loans to related parties are made on normal arm's length commercial terms.

Relationship	2015			
	Income	Expenses	Payable at	Receivable at
	during period £m	during period £m	period end £m	period end £m
Parent	-	-	-	2,261
Subsidiary	4	(69)	-	-
Other related parties	186	(431)	(2,218)	2,436

Relationship	2014			
	Income	Expenses	Payable at	Receivable at
	during period £m	during period £m	period end £m	period end £m
Parent	71	(21)	(262)	633
Subsidiary	-	-	-	-
Other related parties	58	(118)	(508)	11,110

The Company has entered into transactions with related parties in the normal course of business during the year. Loans to related parties are made on normal arm's length commercial terms.

Relationship	2015			
	Income	Expenses	Payable at	Receivable at
	during period £m	during period £m	period end £m	period end £m
Parent	-	-	-	2,261
Subsidiary	474	(69)	(266)	302
Other related parties	183	(155)	(1,771)	2,342

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

37. Related party transactions (continued)

(b) Transactions and balances with related parties (continued)

Relationship	2014		Payable at period end £m	Receivable at period end £m
	Income during period £m	Expenses during period £m		
Parent	71	(21)	(262)	633
Subsidiary	10	(1)	(19)	7,255
Other related parties	90	(110)	(504)	7,819

Further, amounts relating to other related parties of £8,053m due from OEICs investments were outstanding at 31 December 2015 (2014: £11,452m). The above balances are unsecured in nature and are expected to be settled in cash.

Included within the consolidated statement of comprehensive income were net expense amounts relating to related other parties of £56m (2014: £219m) from OEIC investments.

Parent undertaking transactions relate to all reported transactions and balances with Scottish Widows Group Limited, the group's immediate parent. Such transactions with the parent company are primarily financing (through capital and sub-ordinated debt), provision of loans and payment of dividends.

Transactions with other related parties (which including Subsidiary, Associates, Joint Ventures and Other categories above) are primarily in relation to intra-group reinsurance and operating and employee expenses.

For both 2015 and 2014, staff costs were borne by a related party company outside the Group.

Details of the Insurance Business Transfer Scheme, which was undertaken with related parties in the LBG group Insurance Division, are provided separately in Note 40.

Change to IAS 24 Related Party Disclosures (Key Management Personnel)

The amendment to IAS 24 clarifies that a management entity providing key management personnel services to a reporting entity is a related party of the reporting entity. Consequently, the reporting entity must disclose as related party transaction the amounts incurred for the service paid or payable to the management entity that provides the key management personnel services.

Transactions between the Group and entity employing key management

Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the Company which, for the Company, are the Executive Directors. Key management personnel, as defined by IAS 24, are employed by a management entity, transactions with this entity are as follows:

Key management compensation:

	2015 £m	2015 £m	2014 £m	2014 £m
	<u>Group</u>	<u>Company</u>	<u>Group</u>	<u>Company</u>
Short-term employee benefits	0.7	0.4	0.7	0.3
Long term incentive plan	0	0	0.1	0
Share-based payments	0.4	0.2	0.2	0.1
Total	1.1	0.6	1.0	0.4

Retirement benefits accrued to two Directors and key management personnel (2014: nil) under defined benefit pension schemes. Seventeen Directors and key management personnel (2014: nil) are paying into a defined contribution scheme. The aggregate value of contributions paid to a pension scheme for qualifying services was £nil for the Group (2014: £nil) and £nil for the Company (2014: £nil).

Certain members of key management in the Group, including the highest paid director, provide services to other companies within LBG. In such cases, for the purposes of this note, figures have been included based on an apportionment to the Group of the total compensation earned.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

37. Related party transactions (continued)

The aggregate amount of money receivable by directors and key management, and the net value of assets received/receivable by directors and key management, under long term incentive schemes in respect of qualifying services was £0.4m (2014: £nil). During the year, two directors exercised share options (2014: nil) and eighteen directors' received qualifying services shares under long term incentive schemes (2014: 7).

In addition, during the year amounts of £99k (2014: £nil) became payable to the highest paid director in relation to their retirement from office.

Detail regarding the highest paid Director is as follows:

	2015 £m	2015 £m	2014 £m	2014 £m
	<u>Group</u>	<u>Company</u>	<u>Group</u>	<u>Company</u>
Apportioned aggregate emoluments	0.5	0.1	0.2	0.1
Defined benefits pension scheme accrued benefit at 31 December	-	-	-	-

The highest paid Director did not exercise share options during the year, but was granted shares in respect of qualifying service. (2014: The highest paid director exercised share options and was granted shares in respect of qualifying service during the year).

Other transactions - HM Treasury

In January 2009, the UK government through HM Treasury became a related party of the Company following its subscription for ordinary shares issued under a placing and open offer. As at 31 December 2015, HM Treasury held an interest of 9.1 per cent in the Company's ordinary share capital, with its interest having fallen below 20 per cent on 11 May 2015. As a consequence of HM Treasury no longer being considered to have a significant influence, it ceased to be a related party of the Company for IAS 24 purposes at that date.

There were no material transactions between the Group or Company and HM Treasury during the year (2014: none) that were not made in the ordinary course of business or that are unusual in their nature or conditions. In addition, the Group and Company have entered into transactions with HM Treasury on an arm's length basis including, but not exclusively in relation to, the payment of corporation tax and value added tax.

38. Operating leases

The total future minimum rental payments receivable under non-cancellable leases, including subleases, are as follows:

	2015 £m	2015 £m	2014 £m	2014 £m
	<u>Group</u>	<u>Company</u>	<u>Group</u>	<u>Company</u>
Within one year	210	17	55	37
Between two and five years	708	56	162	101
Beyond five years	1,285	143	342	214
Total	2,203	216	559	352

The total future minimum rental payments payable under non-cancellable leases are as follows:

	2015 £m	2015 £m	2014 £m	2014 £m
	<u>Group</u>	<u>Company</u>	<u>Group</u>	<u>Company</u>
Within one year	5	2	1	1
Between two and five years	9	-	3	3
Beyond five years	416	4	168	168
Total	430	6	172	172

The total of contingent rents recognised as income during the year was £nil (2014: £nil). The total of contingent rents recognised as operating expenses during the year was £1m (2014: £0.5m). Operating lease receipts and payments represent rental receivable and payable by the Group for certain of its properties. Generally the Group's operating leases are for terms of 15 years or more.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

39. Capital commitments

The Group has given an undertaking to provide up to £1,416m (2014: £554m) of capital to private equity investments and at 31 December 2015, £1,193m had been drawn down (2014: £450m). The remainder of the funds committed can no longer be drawn down as the draw down period has closed. The Group has contracted for, but not paid for, £37m (2014: £6m) of development expenses for investment property. Of this amount, the Company has contracted for, but not paid for, £nil (2014: £6m). The Company invests in a number of private equity entities to which capital of £1,416m was committed at 31 December 2015 (2014: £554m). The total amount drawn down at 31 December 2015 was £1,193m (2014: £450m). The remainder of the funds committed can be drawn down as required by the private equity entities.

40. Insurance Business Transfer Scheme

On 26 November 2015, the High Court of Justice approved the transfer of the long-term insurance business of each of the below entities (the "transferors"), each a fellow group undertaking, to the Company, pursuant to an insurance business transfer scheme, under Part VII of the Financial Services and Markets Act 2000:

- SW Funding plc (previously Scottish Widows plc)
- SWA, SWUF and PM (subsidiaries of SW Funding plc)
- CMMF, HLL and SAL (subsidiaries of the Company)

As a result of the Part VII, going forwards, the Company will be the sole life insurance underwriter within the Insurance division.

The long-term business of transferors is represented by the assets and liabilities of those entities, which are transferred under the insurance business transfer scheme at book value. Any losses arising in the transferors had an equal gain in the reserves of SW Limited Company. The overall impact on the consolidated Group reserves is a gain of £4,307m in reserves.

Assets transferred from SW Funding plc included that entity's immediate subsidiaries, with the exception of those noted below, and Special Purpose Vehicles, and hence ownership of these subsidiaries is transferred to the Company. Ownership of certain insurance businesses covered by the insurance business transfer scheme, namely SWA, SWUF, and PM remains with SW Funding plc.

The overall impact on IFRS retained profits of Group and Company was as follows:

	Note	£m	£m
		<u>Group</u>	<u>Company</u>
Transfer in from fellow group undertakings:			
From within the Group		-	625
From outside the Group		4,624	4,543
Eliminate consolidation impact	A	(266)	-
Reserves impact net of eliminations		4,358	5,168
Write down of subordinated debt	B	(51)	(51)
Total equity transferred		4,307	5,117
Impairment of subsidiaries	C	-	(476)
Total		4,307	4,641

Note A Elimination of internal impact

Internal reinsurance agreements between the scheme participants have collapsed, as the business is all held within the Company. This gives a reduction in the reinsurance asset and corresponding liability, with no impact on net assets.

Note B Write down of subordinated debt

Following transfer into the Company, subordinated debt with a nominal value of £262m, previously marked up in value to £326m within Scottish Widows Funding plc, is eliminated upon transfer in the Company, giving a reduction in reserves of £64m (£51m net of tax).

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

40. Insurance Business Transfer Scheme (continued)

Note C Impairment of subsidiaries

The transfer has reduced the net assets of the subsidiaries, resulting in the following impairments in their carrying value in the Company:

Subsidiary	Impaired In	Parent Company £m
Clerical Medical Managed Funds Limited	Scottish Widows Ltd	425
Halifax Life Limited	Scottish Widows Ltd	51

The effect of this Transfer In on the Group's balance sheet, eliminating internal balances, is as follows:

	Part VII Transfer In £m	Consol Impact £m	Group Impact £m
Intangible assets including insurance intangible assets	150	-	150
Deferred costs	1,345	-	1,345
Deferred tax assets	107	-	107
Current tax recoverable	15	-	15
Investment in subsidiaries	418	(418)	-
Tangible fixed assets	17	-	17
Investment properties	3,433	-	3,433
Assets arising from reinsurance contracts held	37,094	(29,019)	8,075
Prepayments	33	-	33
Derivative financial instruments	1,249	-	1,249
Loans and receivables	12,841	(1,363)	11,478
Investments at fair value through profit or loss	63,820	(233)	63,587
Cash and cash equivalents	1,586	-	1,586
Total Assets	122,108	(31,033)	91,075
Share capital	152	(152)	-
Share premium	-	-	-
Retained profits	4,624	(317)	4,307
Total Equity	4,776	(469)	4,307
Insurance contract and participating investment contract liabilities	59,938	(2,174)	57,764
Unallocated surplus	240	-	240
Future profits on non-participating business within the With Profits Funds	(79)	-	(79)
Deferred tax liabilities	441	(13)	428
Current tax payables	46	-	46
Provisions for other liabilities and charges	42	-	42
Accruals and deferred income	107	-	107
Retirement benefit liability	50	-	50
Subordinated debt	1,618	(263)	1,355
External interest in collective investment vehicles	8,413	-	8,413
Non-participating investment contract liabilities	40,243	(26,845)	13,398
Derivative financial liabilities	1,286	-	1,286
Other financial liabilities	4,983	(1,269)	3,714
Borrowings	4	-	4
Total Liabilities	117,332	(30,564)	86,768
Total Equity and Liabilities	122,108	(31,033)	91,075

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

40. Insurance Business Transfer Scheme (continued)

The effect of this Transfer In on the Company's balance sheet, eliminating internal balances, is as follows:

	Part VII Transfer In	Eliminate Internal Impact	Company Impact
	£m	£m	£m
Deferred costs	1,459	-	1,459
Deferred tax assets	88	28	116
Current tax recoverable	15	-	15
Investment in subsidiaries	418	-	418
Investment properties	293	-	293
Assets arising from reinsurance contracts held	37,279	(29,819)	7,460
Prepayments	30	-	30
Derivative financial instruments	1,278	-	1,278
Loans and receivables	5,473	(1,337)	4,136
Investments at fair value through profit or loss	77,243	-	77,243
Cash and cash equivalents	659	-	659
Total Assets	124,235	(31,128)	93,107
Share capital	-	-	-
Share premium	-	-	-
Retained profits	5,168	(51)	5,117
Total Equity	5,168	(51)	5,117
Insurance contract and participating investment contract liabilities	68,846	(2,185)	66,661
Unallocated surplus	240	-	240
Future profits on non-participating business within the With Profits Funds	(79)	-	(79)
Deferred tax liabilities	467	15	482
Current tax payables	20	-	20
Provisions for other liabilities and charges	28	-	28
Accruals and deferred income	28	-	28
Subordinated debt	1,637	(262)	1,375
External interest in collective investment vehicles	-	-	-
Non-participating investment contract liabilities	43,665	(27,635)	16,030
Derivative financial liabilities	1,299	-	1,299
Other financial liabilities	2,912	(1,010)	1,902
Borrowings	4	-	4
Total Liabilities	119,067	(31,077)	87,990
Total Equity and Liabilities	124,235	(31,128)	93,107

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

41. Future accounting developments

The following pronouncements may have a significant effect on the Group's financial statements but are not applicable for the year ending 31 December 2015 and have not been applied in preparing these financial statements. Except as disclosed below, the full impact of these accounting changes is being assessed by the Group.

Pronouncement	Nature of change	IASB effective date
IFRS 9 "Financial Instruments" ¹	<p>Replaces IAS 39 "Financial Instruments: Recognition and Measurement."</p> <p>IFRS 9 requires financial assets to be classified into three measurement categories, fair value through profit and loss, fair value through other comprehensive income and amortised cost, on the basis of the objectives of the entity's business model for managing its financial assets and the contractual cash flow characteristics of the instruments. The requirements for derecognition are broadly unchanged from IAS 39. The standard also retains most of the IAS 39 requirements for financial liabilities except for those designated at fair value through profit or loss whereby that part of the fair value change attributable to the entity's own credit risk is recorded in other comprehensive income.</p> <p>IFRS 9 also replaces the existing IAS 39 'incurred loss' impairment approach with an expected credit loss approach. Loan commitments and financial guarantees not measured at fair value through profit or loss are also in scope.</p> <p>The hedge accounting requirements of IFRS 9 are more closely aligned with risk management practices and follow a more principle-based approach than IAS 39.</p> <p>IFRS 9 is not expected to have a significant financial impact on the financial results or position of the Group or Company.</p>	Annual periods beginning on or after 1 January 2018
IFRS 15 "Revenue from Contracts with Customers" ¹	Replaces IAS 18 "Revenue" and IAS 11 "Construction Contracts". IFRS 15 establishes principles for reporting useful information about the nature, amount, timing and uncertainty of revenue and cash flows arising from an entity's contracts with customers. Revenue is recognised at an amount that reflects the consideration to which the entity expects to be entitled in exchange for goods and services. Financial instruments, leases and insurance contracts are out of scope and so this standard is not expected to have a significant impact on the financial results or position of the Group or Company.	Annual periods beginning on or after 1 January 2018

¹ At the date of this report, these pronouncements are awaiting EU endorsement.

There are no other standards or interpretations that are not yet effective and that would be expected to have a material impact on the group.

42. Post balance sheet events

(a) On 18 February 2016 Scottish Widows Limited provided the Scottish Widows Group Ltd (SWG) with a £330m liquidity loan, repayable on 6 February 2017. The loan carries interest at the rate of 12 month LIBOR minus 0.15%, payable at maturity. SWG provided collateral in respect of the loan in the form of ordinary shares held in its subsidiary Scottish Widows Financial Services Holdings, and asset backed securities ("ABS") stock-borrowed from St Andrew's Insurance plc ("STAI") and Lloyds Bank General Insurance Limited ("LBGI") for a period of 12 months.

(b) The proposed reduction in the rate of corporation tax to 17% on 1 April 2020 is expected to be enacted during 2016. The effect of this change upon the Group's deferred tax balances is estimated to be an £11m reduction in the net deferred tax liability for the Group and a £12m reduction in the net deferred tax liability for the Company.