



Annual Report

For the year ended 31 December 2017





**Est
1843**

5,800
employees



6.3m
policies in-force

1.1
million members



Helping people look after the things they love for 175 years

On 3 March 1843 a business venture was launched that had the strongest of social implications. The first official meeting of the Liverpool Independent Legal Victoria Burial Society took place at 37 Blake Street, Liverpool at the home of William Fenton, a 36 year old customs officer who, together with his associates sought a way to persuade people in Liverpool to protect themselves, and their loved ones, from some of life's catastrophes.

They were visionaries – they could see a way to ease the hardship for those who couldn't afford the most basic of burials for their loved ones. The whole premise was about mutual self-help and instilling an element of confidence into the lives of poverty-stricken families and communities.

Throughout our 175 years we've stayed true to our mutual roots and believe it is just as important today as it was in 1843. Not only that, our purpose reflects our early beginnings as it seeks to make more people more confident, more of the time.

During our first half-century the Society grew swiftly. By 1884 the headquarters had moved from Liverpool to London. Despite the alliance with our northern cities, London was the centre of commerce and the number of staff had grown from six on 3 March 1843 to 150 clerks at the 'Chief Office' and over 2,000 agents and collectors.

Liverpool Victoria went on to survive the terrible adversity of two world wars and achieved a landmark moment in 1950 when assets passed the £100 million mark. While other, smaller and less successful mutuals fell by the wayside or merged with their counterparts we continued to go from strength to strength.

In 1996 Liverpool Victoria entered a new and exciting era. The Society took over the Frizzell Group, an already established general insurance provider. In doing so, we entered a completely new market-place with greater opportunities for expansion. The emergence of technology, new regulation and a shift in customer needs also spearheaded a change of philosophy and working practices – teams of agents no longer went door-to-door collecting premiums, business was done by phone or post.

Fast forward to 2006 and a re-brand to the more modern and vibrant LV=, and the appearance of our green heart, witnessed another growth spurt and the rise of new partnerships and acquisitions – not to mention a general insurance business that has quadrupled in size since then.

We've weathered many a storm over our 175 year history. We're immensely proud that thanks to our people and our members we're still here and living proof of our roots and our heritage.

We believe that confidence unites everyone: individuals, families, communities and society. Today we want to help people live bigger more confident lives, just like our founders set out to do so many years ago.

2017
highlights

180%
Solvency II
Capital Coverage Ratio

7.7%
With-profits
investment performance

£158m
Operating profit

£122m
Profit before tax*

*see definition on p21

£26m
Mutual bonus



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Green Heart Support



Helping make more people more confident, more of the time

With our purpose to help people live more confident lives we launched Green Heart support in 2017. It was created with the idea of bettering the lives of our own members and customers – the people that trust us to look out for them.

Our products are designed to provide confidence at a functional level – whether it’s knowing that your personal possessions are protected, peace of mind that you’re looking after your loved ones’ future if something happened to you, or the assurance that you have financial security in your retirement years.

By the very nature of our business we often hear from people when they’re in the midst of some of the most difficult situations they’ll ever face. That’s why we decided to create a way to support customers when they are going through extraordinary or unusual times – giving them a boost that makes a difference to their lives, above and beyond what their policy is there to deliver.

Green Heart support enhances people’s lives when they need it most but least expect it. By empowering our customer facing people to make it feel special for our customers, they can step in with a simple gift or gesture through to truly life changing assistance. For us, recognising when we can make a difference to someone’s life is the essence of Green Heart support. We want our employees to know that by working for us they are helping to make a real difference to thousands of lives. Just as importantly, we want our customers to know we are always looking out for them and we try to do the right thing when someone is going through extraordinary circumstances, stepping in with something extra special whenever we can.



“ In 2017 Green Heart support made a difference to 193 customers and members with help valued at £70,000. In 2018 we expect to reach over 2,500 customers and members with help valued at over £400,000. ”

Richard Rowney
Chief executive

We paid for a month’s worth of hospital parking for Jane to visit her fiancé after Keith was struck down by an unknown illness while they were on holiday. Back home, doctors were baffled as Keith was still unable to talk or function normally. We were able to help take some stress and expense away from Jane by paying the parking fees and sending her a luxury hamper so she could relax after exhausting days at the hospital.



“ In a time when you feel you are just a number in the industry of insurance it gave me a boost, a personal boost. ”

Green Heart support paid for Bill and Eileen to stay in a lovely hotel together with their close family. We wanted to help make one more precious memory for them after their daughter was diagnosed with a terminal illness and given only a few weeks to live.



We sent a luxury throw and some financial support to our member Carol to provide a sentiment of comfort after the loss of her daughter who had a life-limiting condition. Once her daughter’s full-time carer, Carol was lonely and struggling to cope.

“ LV= didn’t just go the extra mile they went an extra 3,000 miles. ”





Strategic Report

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Overview

The following pages outline our performance during 2017 and give a review of our business areas and our strategy.

We have chosen to observe the requirement of the Department for Business Innovation and Skills (BIS) narrative reporting regulations, which requires the preparation of a strategic report, even though we are not formally required to do this.

£37m
Life operating profit

76%
Employee engagement

£121m
General insurance operating profit

£133m
Operating capital generation

1st
UK best loved

Key Performance Indicators



Our key performance indicators for 2017 measure performance against our goal of growing member value and our vision of being Britain's best loved insurer. Our board assesses progress against our strategic agenda and also the way we manage risks and a range of other financial and qualitative measures covering the significant aspects of our business.

In 2018 our Operating profit KPI will change to Capital generation to reflect the increasing focus of the board on this measure. Additional performance indicators are reported in the financial review section of this report.

- Achieved target
- Progressing towards target
- Missed target

Britain's best loved insurer

To be Britain's best loved insurer

Explanation of measure

We use a combination of surveys to assess our performance of delivering consistent green heart experiences to our customers and members.

2017 Target

To rank in the top five for relevant opinion surveys and deliver excellent customer service levels whilst consistently treating the customer fairly.

Performance

1st UK best loved



Commentary

In an independent survey by Opinium of 4,021 customers in the insurance industry, LV= was voted best loved by more of our customers than other brands by their customers surveyed.

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

2018 Target

Our aim is to differentiate ourselves in the market against competitors based on customer and member satisfaction measured against relevant awards and opinion surveys.

Staff engagement

Explanation of measure

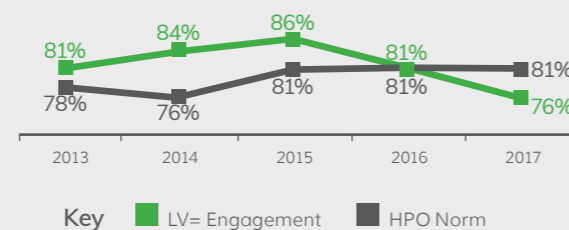
Our people are a major differentiator for LV= and are crucial to delivering our best loved vision so it is important they are engaged with the work we do. The engagement metric has been updated to 'Sustainable engagement' which adds 'enabled' and 'energised' to traditional engagement. This measure drives greater insight enabling linkage analysis of engagement to business performance.

2017 Target

Focus on retaining engagement scores at or above the UK high performing organisations norm of 81%.

Performance

76% engagement



Commentary

2017 has been a year of significant change across the group and we recognise that the uncertainty that our people have experienced during this time is reflected in the sustainable engagement score of 76%.

2018 Target

To focus on delivering strong employee engagement.

At the end of 2017 the group is in a much stronger position and we will work with our people to advance the group forward under our new structure whilst improving engagement and the confidence of our staff.

Grow member value

Operating profit

Explanation of measure

Operating profit is the key performance measure for the profitability of the group. This measure represents management's view of the performance of the ongoing business without distortion from temporary volatility. See page 20 for definition.

Our Operating profit metric has been changed from a trading operations measure which excluded heritage to a total Operating profit measure. This change reflects the incorporation of heritage into the life business segment under John Perks as managing director of the combined life business, in order to align with the future strategic direction of the overall life business.

2017 Target

To deliver superior returns commensurate with the markets in which we operate. Planned operating profit was £86 million.

Commentary

General insurance operating profit at £121 million represents a 7% growth over the 2016 pre-Ogden result. This reflects the strong underwriting discipline employed in writing new business and favourable claims performance experienced. Life operating profit at £37 million includes contribution from new business and has increased from £13 million in 2016, primarily due to favourable current year model and basis changes.

Performance

£158m



* 2016 Operating profit is before the £139 million adverse impact of the change in the Ogden discount rate.

LVFS main with-profits fund performance

Explanation of measure

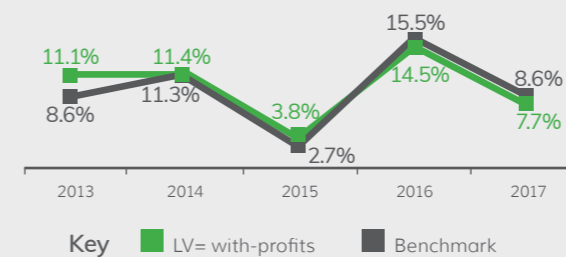
This is the pre-tax return made on the main LV= with-profits fund, which is an actively managed investment fund consisting of our with-profits policyholders' funds that we manage on behalf of policyholders.

2017 Target

To deliver with-profits fund performance at or above benchmark. For 2017 the benchmark level was 8.6%. See page 26 for definition.

Performance

7.7%



Commentary

The return on the with-profits fund is supported by strong equity returns (12.3% UK and 16.6% overseas), offsetting the low gilt yields (2.6%) experienced in the year. The fund underperformed against the benchmark by 0.9% largely because of adverse performance on long-standing investments in property and alternatives.

2018 KPIs and targets

In 2018 our KPIs will change to reflect our plans for the future of the group. Our operating profit KPI will be replaced with a measure of operating capital generation to reflect the increased focus on capital in the Solvency II regulatory environment. We will continue to measure the performance of our members' funds against relevant benchmarks.

Capital Coverage Ratio (CCR)

Explanation of measure

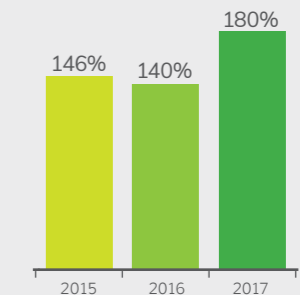
To ensure the sustainability of the group we monitor our Capital Coverage Ratio (CCR). See page 92 for definition.

2017 Target

To ensure the Solvency II capital coverage ratio is above the group's risk appetite framework of £350 million (or about 140% as at 31 December 2017).

Performance

180%



Commentary

Our group surplus capital has increased by £331 million and capital coverage ratio improved by 40 percentage points to 180%. This includes the positive impact of the general insurance transaction with Allianz (£444 million, 51%), capital generated from the general insurance business over the year (£170 million, 20%) and the adverse impact of a TMTP recalculation at the year-end (£246 million, 28%). We have also implemented various capital initiatives over the year to de-risk the Solvency II balance sheet, including the longevity reinsurance of the OB pensions portfolio, and closure of certain capital intensive product lines in protection.

Chairman's Review

Alan Cook
Chairman



The group has had a very good financial year in 2017 and has delivered an operating profit of £158 million, up from an operating loss of £12 million the previous year. This performance has enabled the board to allocate a mutual bonus of £26 million to eligible members' policies this year.

When I joined LV= in January 2017, I joined a business which had many of the fundamentals for success already in place; a well-known and well respected brand, coupled with a strong reputation for excellent customer service.

But the two trading businesses of life and general insurance were constrained due to the relative capital weakness of the group. Improving the capital position and reducing risk has been the number one priority of the board for some time.

As a result of a range of management actions, most notably the creation of the strategic partnership with Allianz, the capital challenges have largely been resolved. Further detail on the rationale and implications of the deal with Allianz can be found in the Group Finance Director's Review on page 22 and the General Insurance Review on page 31.

That's not to say we won't keep looking for ways to continue to de-risk the business and improve the capital position. That is just a prudent way to operate. Addressing the capital weakness is only part of the equation and the board has also been looking to the future.

Since the beginning of the year we've seen changes at both the board and executive level as we assemble the right team to take the business forward.

I joined the board in January, taking over as chairman after the AGM in June and would like to acknowledge the work of my predecessor Mark Austen both as chairman for the last four years and as a member of the board for ten.

Andy Parsons joined the executive team as group finance director in June. This was at a critical point in the discussions with Allianz and he played a key role alongside Richard Rowney in negotiating an innovative and financially beneficial deal.

In August, Colin Ledlie joined as a non-executive director. As well as being an experienced non-executive director, Colin also brings a wealth of actuarial and risk experience having previously been chief actuary and chief risk officer at Standard Life.

Following the formation of the strategic partnership with Allianz I also became chairman of the jointly owned general insurance business (LVGIG) from 28 December. At this time, Steve Treloar, chief executive of LVGIG, stood down from the board of LVFS.

There have been further board changes at the beginning of 2018 with Alison Hutchinson and Luke Savage joining as non-executive directors on 1 January and 1 February respectively. Alison is currently chief executive of Fintech charity The Pennies Foundation, a non-executive director of the Yorkshire Building Society and until the end of 2017 was a non-executive director of Aviva Life UK. Luke was most recently group chief financial officer at Standard Life and prior to that, finance director at Lloyd's of London for ten years.

As we look to the future, we do so with renewed confidence and a focus on three priorities; building a sustainable life business, making the partnership with Allianz work and developing future growth areas.

Throughout the next phase of the evolution of LV= we will always remember that our members not only own LV= products or investments they are also the owners of the business. The values of a mutual; of shared ownership, community and a sense of social purpose over and above pure profit are just as relevant now as they have ever been.

I'd like to conclude by thanking my fellow board members for the support they have given me in my first six months as chairman and the contribution they have made around the board table. I'd also like to thank all our people who work tremendously hard, day in, day out to look after the needs of all of our customers and finally our members for their continued support of the Society.

2017 has been a transformational year in the history of LV= with the creation of the strategic partnership with Allianz. We end the year with a much improved capital position supported by strong trading performance. The life business is well placed to build on its track record of profitable growth and looking to the future we continue to pursue new digital opportunities and explore partnerships to create the next trading business or businesses.

£158m
Operating profit

Chief Executive's Review

Richard Rowney
Chief Executive



Alan Cook ended his Chairman's review by stating that 2017 has been a transformative year for the LV= group and I am very proud of what we have achieved.

We have secured a landmark strategic partnership with Allianz which creates the UK's third largest personal lines insurer, delivered the first stages of our £100 million investment to transform our general insurance product and distribution capability, brought together our protection, retirement and heritage business areas under a single leadership and launched LV= Tomorrow signalling our investment in innovation as we build new revenue streams for the future.

All this is coupled with a very strong trading performance. At a headline level the group's operating profit was £158 million, up from a £12 million operating loss in 2016 and the profit before tax was £122 million compared to a loss before tax of £49 million in 2016. This greatly improved financial performance was driven by positive contributions from both our general insurance and life businesses.

Throughout 2017 we continued to take a number of actions to improve our capital position and also the performance of our business including the implementation of a strategic cost reduction programme to significantly reduce our cost base. So far this has delivered £33 million of annualised expense savings against planned costs through a combination of a reduction in headcount and stronger discipline on discretionary spend. Our capital coverage ratio has increased to 180% from 140% at the end of 2016, measured on a standard formula basis. I said in last year's annual report that we were working to get the group back within its capital risk appetite and we have done this.

General insurance

Our general insurance business delivered an operating profit of £121 million for the year and a combined operating ratio of 91.8% reflecting strong underwriting discipline, the impact of cost savings and reduced claims frequency as well as the benefit from market wide post-Ogden rate increases.

Following the disproportionately large decrease in the Ogden discount rate announced by the then Justice Secretary in February 2017 we were pleased that the Government have recently committed to reforming the rate with the publication of its Civil Liability Bill. We have consistently argued for a system that ensures fair payments for those injured while also reducing the cost of car insurance at a time when premiums are at a record high.

At the end of December we completed the planned sale of a 49% stake in our general insurance businesses to Allianz Holdings PLC for a total consideration of £500 million. This deal was originally announced in August 2017 and will see the creation of a strategic partnership between both businesses. Combining LV='s strong brand, longstanding reputation in personal insurance and excellent customer service with the financial strength, digital expertise and data analytics of Allianz is something for the competition to fear.

Life

2017 saw further growth in our life business as we continue to build both top and bottom line momentum. Operating profit of £37 million increased by £24 million over 2016 and new business sales of £2.0 billion, measured as the Present Value of New Business Premiums, were up 9% compared to the previous year, excluding the impact of enhanced annuities which were exited in 2016.

During the year we brought together our protection, retirement and heritage businesses promoting John Perks to the role of managing director for the combined life business.

We have also taken a number of management actions to improve the capital position of our life business including closing capital consumptive products such as lifetime annuities and protection 50+. In December we signed a reinsurance deal with RGA to reinsure around £1 billion of OB pensions deferred annuity liabilities (see page 25), de-risking the balance sheet for the future.

180%
Capital Coverage
Ratio



LV= moved up 68 places to



in the KPMG Nunwood Customer Experience Excellence Index

Brand

Our brand is regarded by many external commentators as one of our strongest assets. It was one of the attractions for Allianz when considering partnering with LV=.

Underpinning our brand is our continued ambition to be 'Britain's Best Loved' insurer. In May, LV= was named Which? Insurance Provider of the Year and in June won the Moneywise Customer Service Awards for Most Trusted Insurer for the second year running and Most Trusted Life Insurer for the fifth year running. In November it was announced that we had moved up 68 places to 32nd place in the KPMG Nunwood Customer Experience Excellence Index, a cross-sector ranking of 295 brands in the UK. In addition we remain YouGov's 'Most Recommended' insurer.

In 2017 we also launched Green Heart support. This exists to support LV= customers when extraordinary things happen and they need help most, but least expect it. We can offer LV= customers and members small or medium sized gestures, right through to life changing support. To date 193 awards of support have been made totalling £70,000 with over £400,000 put aside to support customers and members in 2018.

Gender and diversity

For the first time this year UK companies with more than 250 employees must report on their gender pay gap which is the measurement of the difference between all men and women's average earnings.

We have reported a 24% median gender pay gap and a mean of 28%. While this is higher than we would like, it is the right side of average compared to peers and competitors. The bonus pay gap is calculated on all bonuses, including LTIP payments and sales incentives paid in the year up to April 2017 and we have reported a median bonus pay gap of 37% and mean of 53%.

We have analysed the data and are confident that the gender pay and bonus gap is not an equal pay issue, but instead driven by the structure of the workforce with fewer women than men in senior leadership roles. Further information can be found on our website LV.com/genderpaygap.

Creating a diverse and inclusive culture is a key priority for LV=. We joined the HM Treasury's Women in Finance Charter last year and have committed to increasing the female population at senior levels.

Strategy

In February 2017 we launched a clear and simple blueprint for the future of LV=. This established a common purpose of helping our customers, colleagues and communities to 'Live Confident'.

Our strategic priorities focus on building stronger financial foundations, harnessing digital technologies to improve our core business and explore new profit areas and creating Green Heart Experiences for our customers and colleagues that leave them feeling more confident about life and more confident in LV=.

Underpinning these priorities is the work underway to create a sustainable mutual with a clearly defined social purpose, member reward strategy and an appropriate legal structure to enable the business to prosper in the long term and grow member value. We will update members on this work at this year's AGM.

The strategic partnership with Allianz allows us to continue to benefit from a growing personal insurance business while also leaving us better placed to maintain the growth of our life business and pursue new digital opportunities.

It also provides a number of opportunities to leverage our joint capabilities through working together and we are keen to explore the possibilities of broadening the relationship beyond general insurance and into the life and health areas.

The Strategic Report on pages 8 to 51 was approved by the board of directors on 28 March 2018 and signed on its behalf by:

Richard Rowney, Chief Executive



Our Core Purpose, Strategy and Business Model

The world is constantly changing and it is important that we at LV= keep up with it. In order to do this our business needs to evolve. We know that the insurance industry is facing a big transformation with new business models, Fintech, investment in big data and start-ups shifting customer expectations. At the same time, customer lifestyles and working patterns are changing, leading to a range of emerging consumer needs relating to insurance and finances more generally. It is with this in mind that last year we introduced our new strategy. We call it our blueprint and we believe it is the best way to move forward at pace to maintain and grow our business.





What it means

We believe that everyone deserves to Live Confident, and we exist to help people to do that.

For us this means:

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



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

- 1 Deliver Green Heart Experiences for our customers, colleagues and members by designing and delivering solutions that prevent as well as fix – and inspire total trust.
- 2 Build a business that is sustainably Lean & Strong so we can achieve our goals over the long term whilst continuing to grow member value.
- 3 Harness the latest technologies, evolve how we operate and bring in the new talent needed to ensure that we lead the industry today and into the future. We have termed this LV=3.0.



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

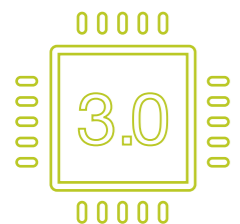
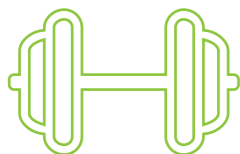
- We make it feel special
- We make every pound count
- We don't wait to be asked
- We fight for better



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



We still believe that our **Sharp with a Heart** philosophy gives us a clear point of difference and we will continue to do things that combine the competitive performance of a PLC with the trusted behaviours of a mutual.



Future strategic priorities for the group

Green Heart Experiences

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

Lean & Strong

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

LV= 3.0

- 5 Build a strong and deep strategic partnership with Allianz both through the general insurance business and by identifying broader opportunities to leverage capabilities and work together.
- 6 Develop, agree and execute the strategy to deliver accelerated growth, with new proposition launches to establish the proof points for this strategy, a three year transformation plan defined, and successful development of Wealth Wizards.

Building a sustainable mutual

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

How we have performed against our strategic agenda in 2017

Last year we introduced our blueprint for our future and alongside it our three strategic thrusts, that will provide us with direction as we navigate the challenges and opportunities over the years ahead.

Our strategic agenda for 2017 was aligned to these strategic thrusts: Green Heart Experiences, Lean and Strong and LV= 3.0.

Green Heart Experiences

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

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

So far we've helped 193 customers and members and are rolling the programme out across the organisation so we can help more members over the course of 2018.

We also recognise that our employee experience is critical if we are to enable our people to help our members. We are in the process of reviewing our employee value proposition to ensure we recognise our people appropriately for helping our customers and members.

Our continued focus on our customers has again led to numerous awards across our business. We've been named Insurance Provider of the Year at the Which? awards 2017, we won the Moneywise Customer Service Awards for 'Most Trusted Insurer' for the second year running and the 'Most Trusted Life Insurance Provider' for the fifth year in a row. We also remain YouGov's 'Most Recommended' insurer, and in the KPMG Nunwood Customer Experience Excellence Index we have been placed 32nd across all brands and industries, up from 100th place the year before.

Lean and Strong

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

The main achievement this year has been the successful negotiation and delivery of the strategic general insurance partnership with Allianz. This has contributed to a significant improvement in our capital strength and hence customer and member security. The deal delivers great value for our members and policyholders, and supports the LV= brand.

We have also achieved the following:

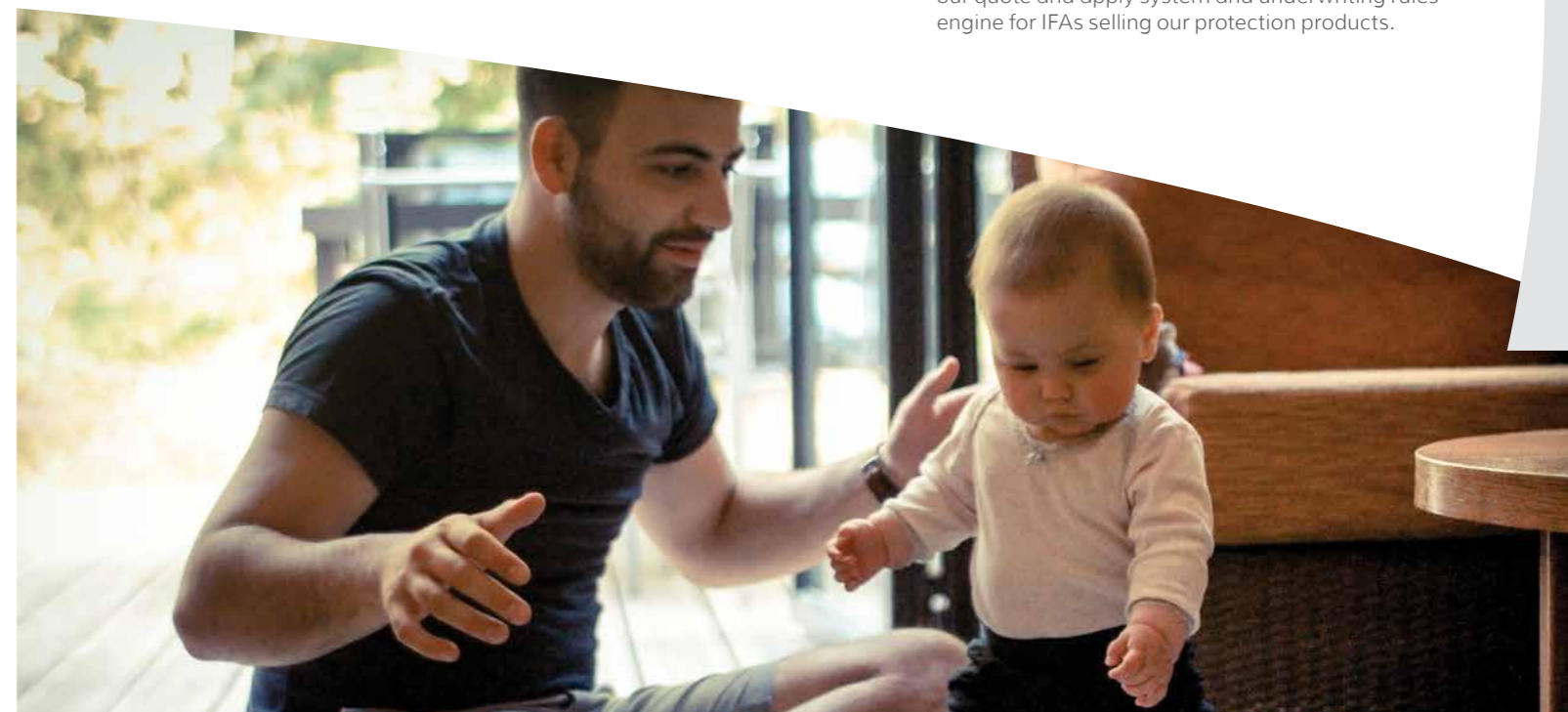
- Concluded a deal to reinsure our OB pensions business with RGA, significantly reducing our risk exposure and capital requirements;
- Delivered £33 million of savings against planned costs through our strategic cost programme, which has left us with an expense base that will hopefully allow us to compete with the best in the market; and
- Implemented systems thinking across the organisation, and investigated the opportunity presented by robotic process automation to streamline our processes and deliver a step change in our risk culture.

LV= 3.0

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

2017 has seen delivery of significant milestones on Pioneer, which is transforming our product and distribution capability in the general insurance direct business and it allows us to deliver more competitive and tailored insurance offerings. We have rolled out functionality to our motor, classic car and motorbike books of business, and are working to deliver the improved functionality to our home book in 2018.

We have also continued the rollout of Fastway – our quote and apply system and underwriting rules engine for IFAs selling our protection products.



Business Model

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

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

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

Our products comprise:

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

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

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

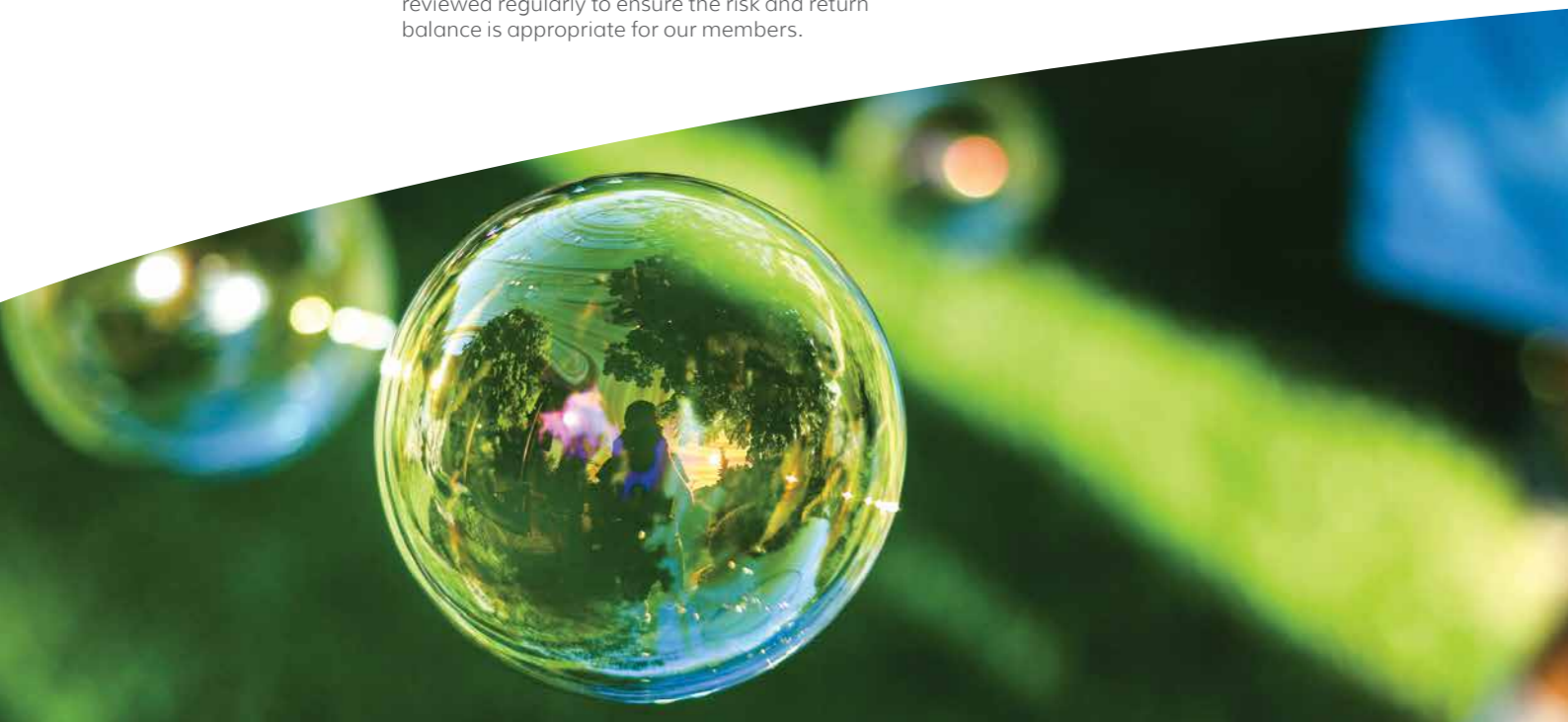
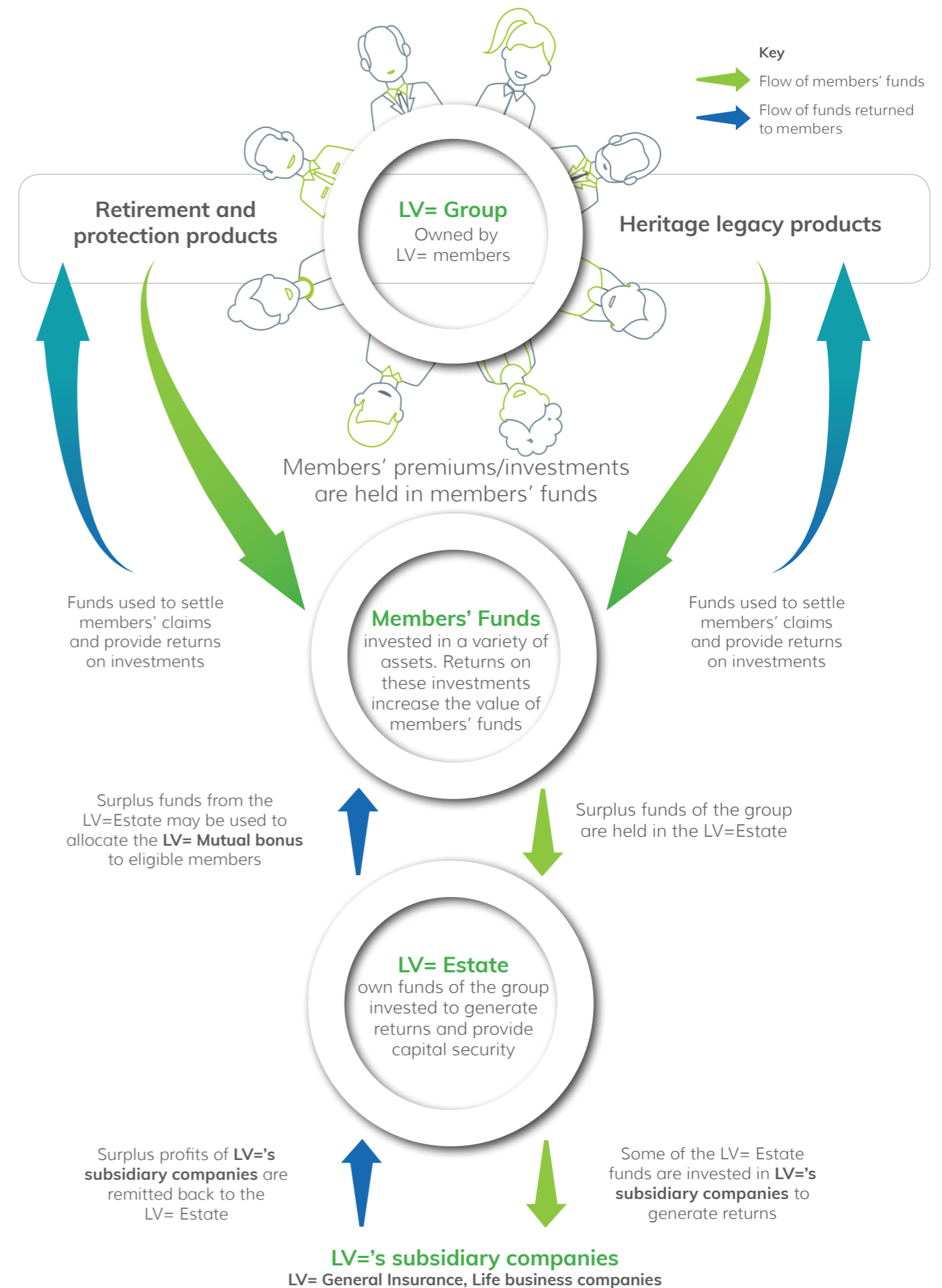
Surplus funds of the group are held in the **LV= Estate**. This is made up of unallocated divisible surplus accumulated in prior years. Estate own funds are invested to generate returns and provide the LV=group with a capital buffer.

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

As well as investing in the debt and equity of other companies, the LV= Estate has invested a significant proportion of its funds into **LV='s subsidiary companies**. The majority of this investment is in the LV= general insurance business, which sells a variety of products, including motor and home, to both personal and commercial customers, distributed directly or via brokers. Surplus profits of the **LV= general insurance business** are remitted back to the LV= Estate. Following the transaction with Allianz, LV= will receive 51% of any future distributed profits, until such time as there is a further sale of this investment. It has sold the renewal rights of its commercial broker lines business to Allianz as part of this transaction.

The LV= general insurance business provides the group with more than just remitted profits. In addition to diversification of risk, strategic advantages include the larger foot-fall of our successful general insurance business increasing brand awareness and the customer centric approach taken across the LV= businesses enhancing the opportunities for cross-selling and customer retention. Similarly the **Life business companies**, such as LV= Equity Release, LV= Commercial Mortgages and Wealth Wizards, provide the life business with wider strategic and capital advantages.

LV= Business model - A modern mutual



Group Finance Director's Review

Andy Parsons
Group Finance Director

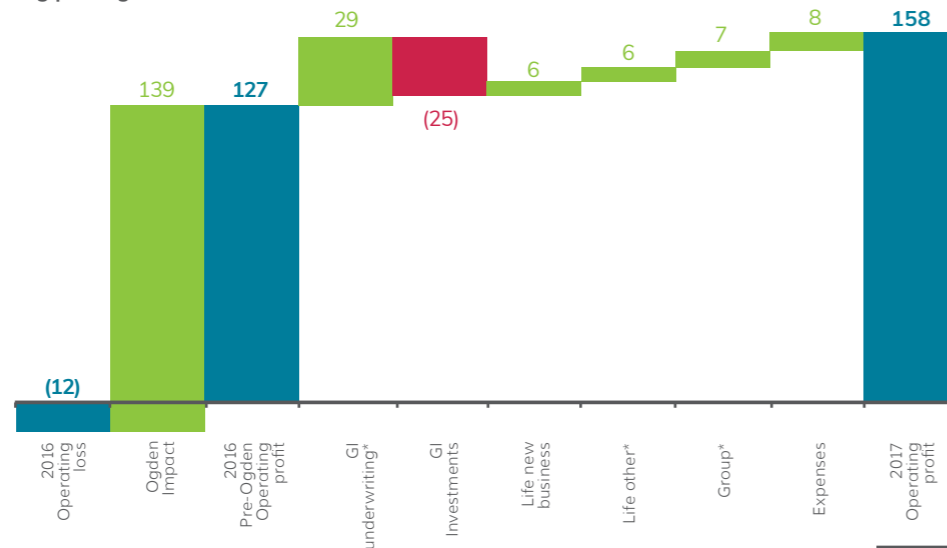


Overview

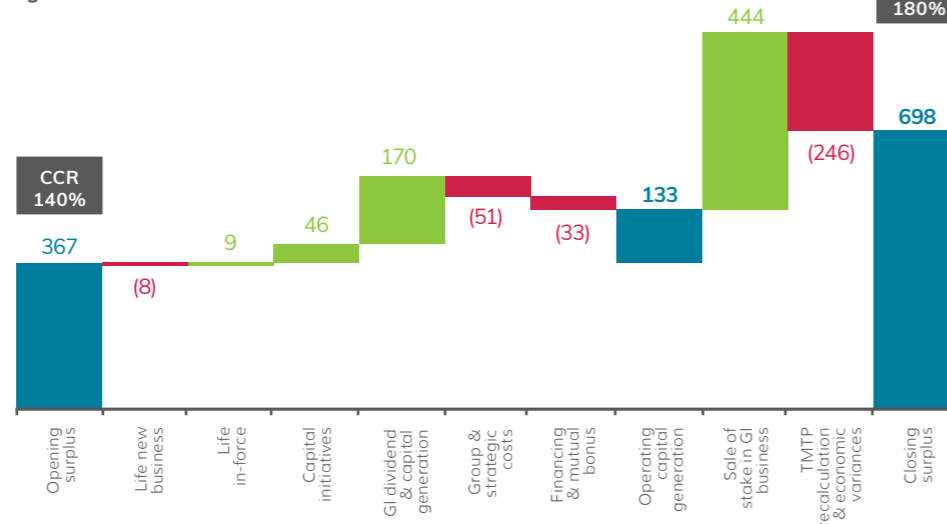
In my first year as group finance director I am pleased to report strong growth in operating profit and a significant strengthening in our capital position following the completion of the general insurance transaction with Allianz at the end of the year.

Group operating profit of £158 million includes £121 million from general insurance and £37 million from our life business. General insurance (GI) profits have benefited from improved rates and favourable claims experience and the business has been able to strengthen its reserves against future shocks. Life business operating profit has benefited from strong growth in its pensions business and from the favourable impact of model and basis changes. Expenses are also down £8 million year on year, following completion of a strategic cost review, which has reduced headcount by 400 people, whilst minimising redundancies.

Operating profit growth £m



Capital generation £m



Definitions

Operating profit

Operating profit is defined as the profit from our business operations adjusted for the effects of temporary volatility and presented before the impact of strategic projects and financing costs.

* Gross of expenses

Capital generation

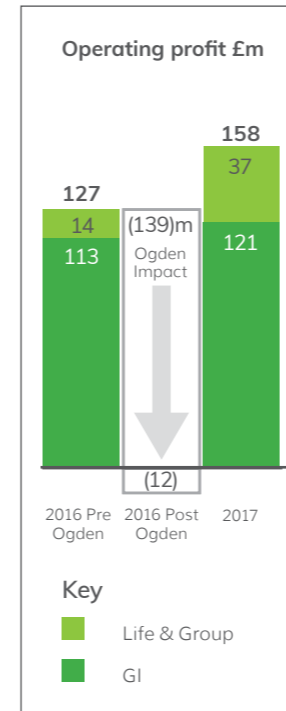
Capital generation is based on the Solvency II surplus capital generated from our business operations and presented after the impact of strategic projects and financing costs.

Operating capital generation

Operating capital generation is Capital generation adjusted to remove the effects of temporary volatility, from market movements and the static nature of TMTP, changes in defined benefit pension schemes and exceptional items.

Key

- Increase
- Decrease
- Total



Operating profit £m

2016 Pre Ogden 2016 Post Ogden 2017

Key

- Life & Group
- GI

Life reserving reporting basis change

During the year we have changed our life IFRS reserving reporting basis to better align with Solvency II. This involved applying the swap curve used in Solvency II as the definition of the risk-free rate, rather than the gilt rate curve used previously. This one-off change is recognised in 2017 with no prior year restatement and has adversely affected PBT by £48 million.

Our group surplus capital has increased by £331 million and capital coverage ratio improved by 40 percentage points to 180%. This includes the positive impact of the general insurance transaction with Allianz (£444 million, 51%), capital generated from the general insurance business over the year (£170 million, 20%) and the adverse impact of TMTP recalculation and economic variances (£246 million, 28%). We have also implemented various capital initiatives over the year to de-risk the Solvency II balance sheet, including the reinsurance of the OB pensions portfolio and closure of certain capital intensive product lines.

Financial summary

Operating profit

The group has delivered an operating profit of £158 million (2016: £12 million loss), with strong results from its general insurance business and an improved life business result.

The general insurance business operating profit of £121 million is made up of underwriting profits of £103 million (2016: £70 million) and investment returns of £18 million (2016: £43 million). The improved underwriting result is even more pleasing given that we have strengthened reserve margins by an additional £31 million during the year.

The improved life business operating profit of £37 million reflects an increase in new business contribution to £37 million (2016: £31 million), with continued positive contributions generated by flexible guarantee bond and protection products and an improvement in volumes and margins in pensions. A £26 million positive impact from model and basis changes has been largely offset by £19 million of adverse experience variances.

Profit before tax

Profit Before Tax (PBT) of £122 million is a significant improvement over the prior year loss before tax of £49 million, which included a £139 million adverse impact from the Ogden rate change. Current year PBT is favourably impacted by growth in operating profit, the £35 million benefit of the general insurance transaction on PBT and £37 million favourable short-term investment fluctuations (2016: £14 million). Items adversely impacting PBT include a £48 million increase in reserves following a life reserving reporting basis change, £24 million interest on the subordinated debt (2016: £24 million) and £36 million of central costs (2016: £30 million) which include costs related to the strategic review, Solvency II costs and strategic spend on capital optimisation initiatives.

IFRS Surplus (UDS) generation

Unallocated divisible surplus (UDS) rose by £191 million and includes the profit from the Allianz transaction. A mutual bonus of £26 million was allocated to eligible members' policies during the year.

£m



Notes

- Life business results are reported including heritage as these are now managed as one business.
- Short-term investment fluctuations and related items include the favourable impact of tax deducted from policy asset shares and the RNPFN fund totalling £24m (2016: £42m) and £13m relating to market movements.
- Change in accounting estimate to align IFRS reporting economic basis with Solvency II.
- The total positive impact of the general insurance transaction on the transfer to Unallocated Divisible Surplus (UDS) is £159m. Of this £52m relating to the sale of the commercial business renewal rights, and £17m costs are recognised in PBT; £124m relating to the sale of a 49% equity stake is taken directly to UDS.
- Profit/(loss) before tax (PBT): Our measure of PBT is defined as profit before tax, mutual bonus allocated, and transfer to Unallocated divisible surplus. This definition allows meaningful comparisons with the PBT disclosed by other companies.
- Income tax expense includes tax deducted from policy asset shares and the RNPFN fund totalling £24m and tax on trading businesses of £26m.

General insurance business transaction

A long-term transaction has been entered into with Allianz Holdings PLC that will ultimately result in Allianz owning a majority stake in the general insurance business. On 28 December 2017 LV= sold a 49% equity stake to Allianz. As part of the transaction the general insurance business exchanged for consideration the renewal rights on its commercial lines business for those on Allianz Insurance PLC's personal lines business. As part of the overall transaction there is a fixed price forward contract for £213 million regarding a further 20.9% equity stake that results in transfer of control to Allianz on or before 31 December 2019.

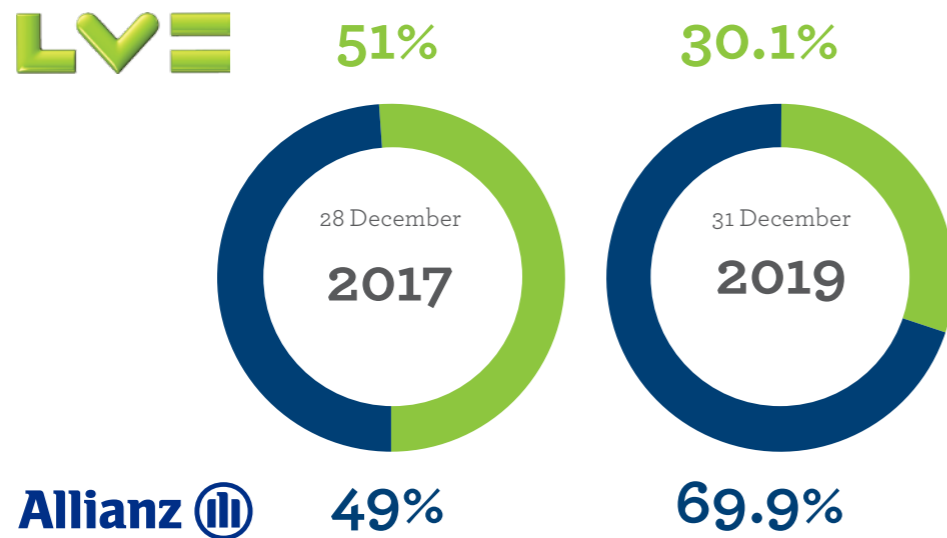
A gain of £35 million related to the general insurance transaction is recognised within PBT. This relates to the sale of the commercial lines renewal rights from Liverpool Victoria General Insurance Group (LVGIG) to Allianz and the costs associated with the overall transaction. The £124 million gain on sale of the 49% equity stake in LVGIG Ltd is recognised directly in the IFRS surplus (UDS) as a transaction with owners that does not result in a loss of control.

Overall the IFRS surplus (UDS) increased by £159 million as a result of the transaction in 2017 comprising:

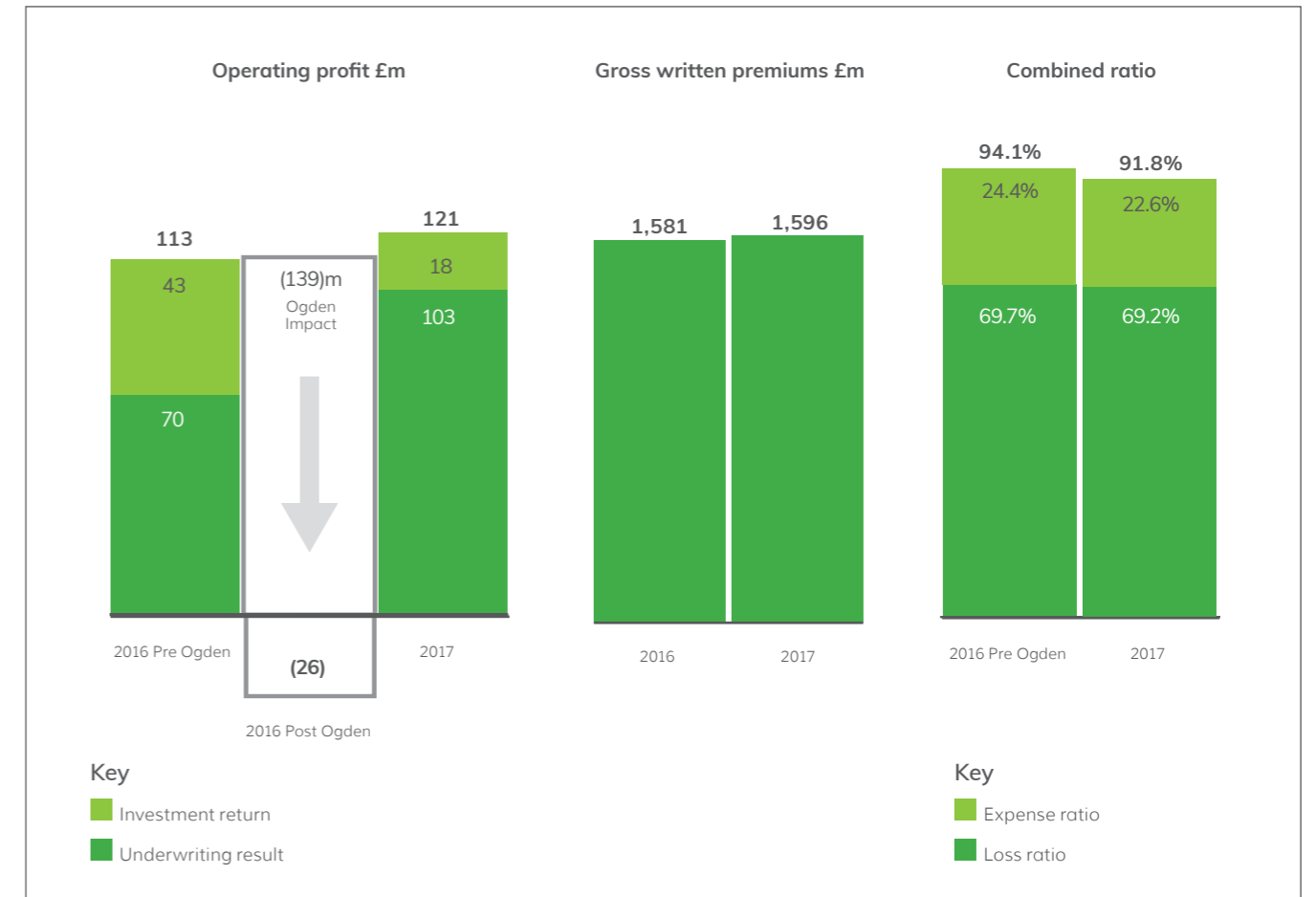
- £124 million gain on sale of 49% equity stake in LVGIG Ltd, recognised directly in IFRS surplus (UDS)
- £52 million profit relating to the sale of commercial lines renewal rights
- £17 million transaction and related restructuring costs

The transaction with Allianz will allow LV= to continue to benefit from a growing personal lines general insurance business, while also enabling us to strengthen our capital position, leaving us well placed to continue to expand our life and pensions business and pursue new digital opportunities. The general insurance business will benefit from LV='s excellent brand and reputation in personal insurance and Allianz's financial strength and digital expertise, and a shared passion for customer service.

Ownership of the general insurance business



General insurance financial summary



Gross written premiums for 2017 are broadly in line with 2016 at £1,596 million. General insurance operating profit of £121 million is up £8 million compared to the 2016 result of £113 million (prior to the impact of the Ogden rate change), driven by a strong underwriting result of £103 million.

We have implemented motor rate increases in the wake of the reduction in the Ogden discount rate. In addition favourable claims experience has led to releases of prior year claims reserves of £46 million (2016: £54 million), including £17 million resulting from a case-by-case review of claims impacted by the Ogden change. We have also strengthened our reserves against unexpected shocks, such as the change to the Ogden rate in March 2017, increasing our overall margin on claims reserves by £31 million.

The reduced expense ratio of 22.6% (2016 pre-Ogden: 24.4%) is driven by a reduction in expenses and an increase in profit commission on reinsurance. Savings in expenses reflects management's strong focus on cost control and operational efficiency.

Investment returns at £18 million are £25 million lower than the prior year due to lower returns on assets held in bonds and gilts. During 2017 we changed our investment strategy to reduce our exposure to equity volatility including increased hedging. Overall investment performance was 0.9% (2016: 2.1%).

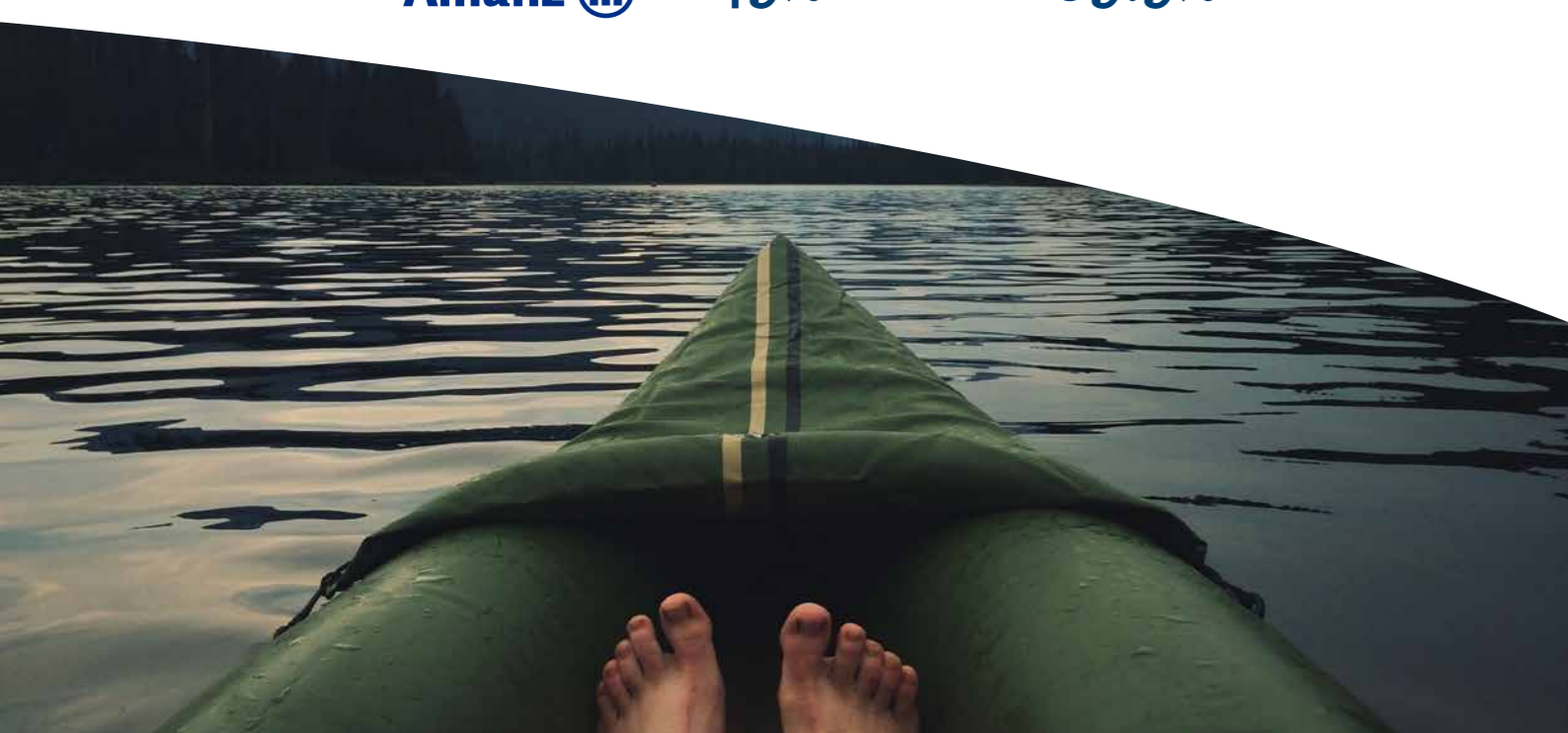
During the year we have exited the unprofitable broker home market and have sold the renewal rights on our commercial lines business to Allianz at the end of the year.

Definitions

Loss ratio
The ratio of Net benefits and claims to Net earned premiums.

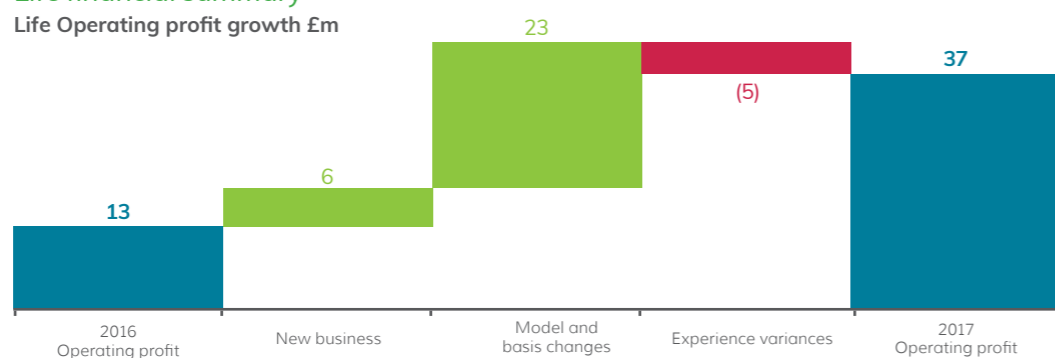
Expense ratio
The ratio of general insurance Other expenses net of Other income to Net earned premiums.

Combined ratio
The total of the Loss ratio plus the Expense ratio.



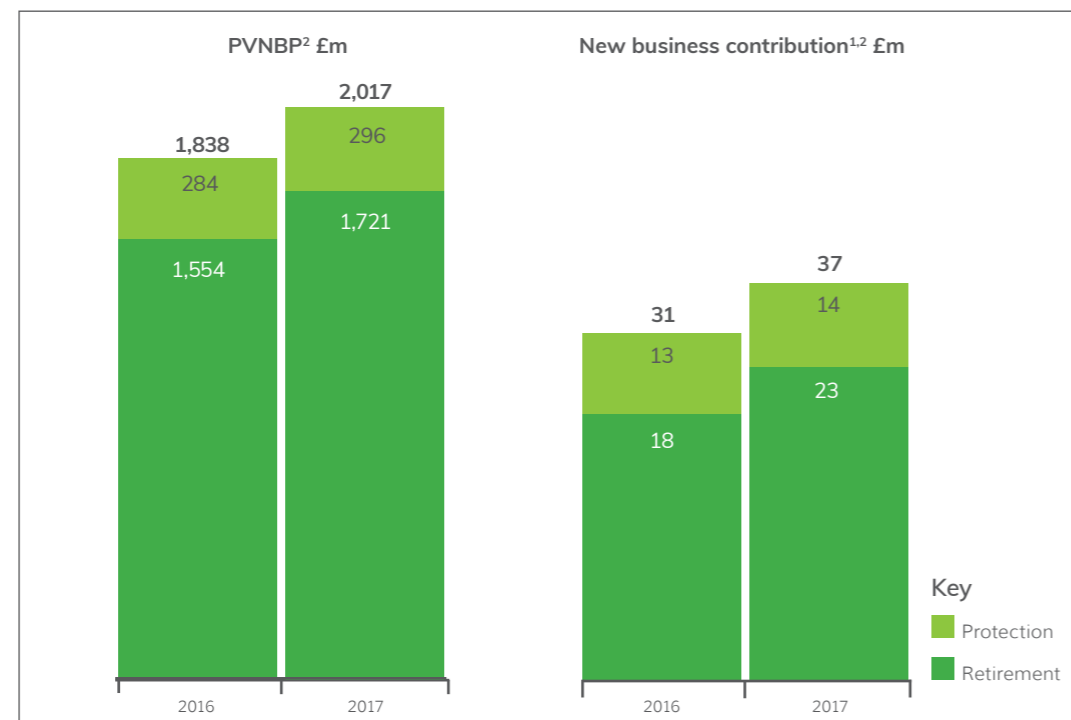
Life financial summary

Life Operating profit growth £m



Results £m

	2017	2016
New business contribution ^{1,2}	37	31
Existing business	11	9
Strategic investment	(11)	(11)
Model and basis changes	26	3
Experience variances	(19)	(14)
Wealth Wizards/Financial Advice Services	(7)	(5)
Operating profit	37	13



Life sales on a PVNBP basis in 2017 are £2,020 million (including heritage premiums of £3 million, 2016: £8 million) a 9% increase over 2016 (excluding the impact of enhanced annuities which were exited at the end of 2016).

There has been significant growth in pensions sales to £1,325 million (up 33% on 2016) boosted by ongoing transfers from final salary schemes. In the first half of this year a number of actions were taken to improve the long-term performance of our protection business, such as closing to new business the mortgage and lifestyle protection product and our underwritten whole-of-life offering. Despite these changes a 4% growth in protection present value of new business premiums has been achieved to £296 million.

Life operating profit includes new business contribution of £37 million (up £6 million compared to 2016) driven by strong volumes and margins in pensions. Strategic investment costs of £11 million were incurred in the development of new business.

Favourable model and basis changes of £26 million (2016: £3 million) relate to changes in longevity assumptions and the beneficial impact of the OB pensions reinsurance arrangement together with the adverse impact of higher equity release prepayment rates, changes to charges associated with the legacy review and expenses including a provision for potential stranded costs arising from the Allianz transaction.

The result was also impacted by £19 million adverse experience variances (2016: £14 million) relating to increases in equity release prepayment rates and adverse mortality experience.

Definitions

PVNBP: Present value of new business premiums

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

New business contribution

The contribution to underlying operating profit as a result of new business written. This is reported gross of cost of capital and investment in new propositions. It includes the value-add on new business and deduction for expense overruns.

1 New business contribution has been re-aligned with the IFRS valuation excluding cost of capital. Prior periods have been restated accordingly resulting in a reduction in the new business contribution before investment in new propositions for 2016 of £7m.

2 Enhanced annuities were discontinued in 2016. PVNBP sales of enhanced annuities in 2016 were £99 million. After restatement of £2m to align with the IFRS valuation, new business contribution excluding cost of capital from enhanced annuities was £nil million. 2016 results have been restated accordingly.

Expenses

Expenses have benefited from the strategic cost reduction programme launched in 2017, which secured £33 million of cost savings in the year against the planned cost base and helped deliver a year on year reduction of £16 million in operating expenses across both our trading businesses. The Group saw an overall year on year reduction of £8 million, including an £8 million increase in strategic investment spend.

Our general insurance business continued to deliver excellent customer experience, while maintaining a clear focus on cost control to generate a £4 million reduction in expenses. Our life business achieved a £12 million reduction in expenses through the strategic cost review and continued investment in systems and digital initiatives.

Headcount savings of over 400 people have been achieved with minimal redundancies, with additional savings delivered through strong day-to-day cost management discipline and an ongoing review of discretionary spend. Management continues to focus strongly on underlying cost control.

Tax

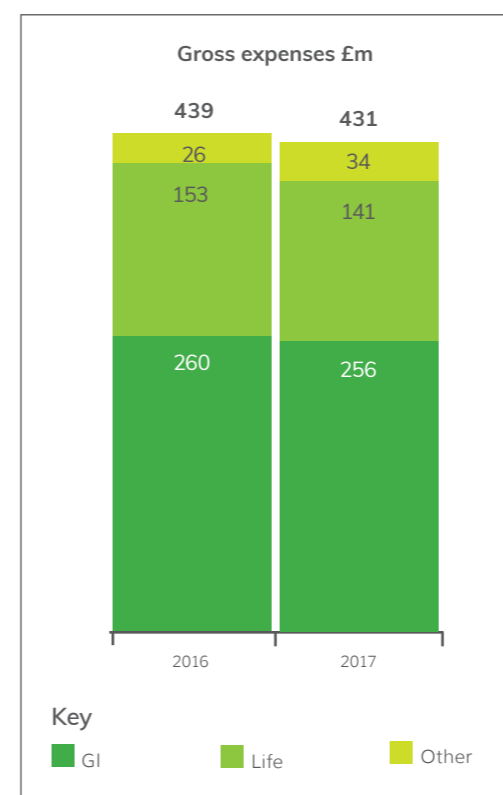
The tax charge of £50 million (2016: £35 million) includes £24 million (2016: £42 million) related to tax on income on policyholder asset shares, the corresponding credit is reported within Short-term investment fluctuations. The remaining tax charge largely relates to our general insurance business which delivered strong profits in the year, compared with a loss in 2016 following the change in the Ogden rate. Our tax policy is included on our website lv.com.

Balance sheet

Balance sheet assets have grown by £1.7 billion in the year to £18.5 billion. This includes the receipt of £0.5 billion from the sale of a 49% equity stake in the general insurance business and an increase of £0.5 billion in the value of unit linked investment contracts. Reinsurance assets have increased by £1.2 billion largely driven by the reinsurance arrangement entered into with RGA over the OB pensions portfolio.

Unit linked and other financial assets include £7.9 billion in shares, other variable yield securities and units in unit trusts, £5.1 billion in debt and other fixed income securities, £0.9 billion in loans secured on residential and commercial mortgages and £1 billion of cash.

Insurance and investment contract liabilities have been increased by new business, changes to economic basis and assumptions and investment returns increasing policyholder assets, offset by claims paid. Other liabilities have increased due to the recognition of a £0.4 billion non-controlling interest balance following the sale of an equity stake in the general insurance business.



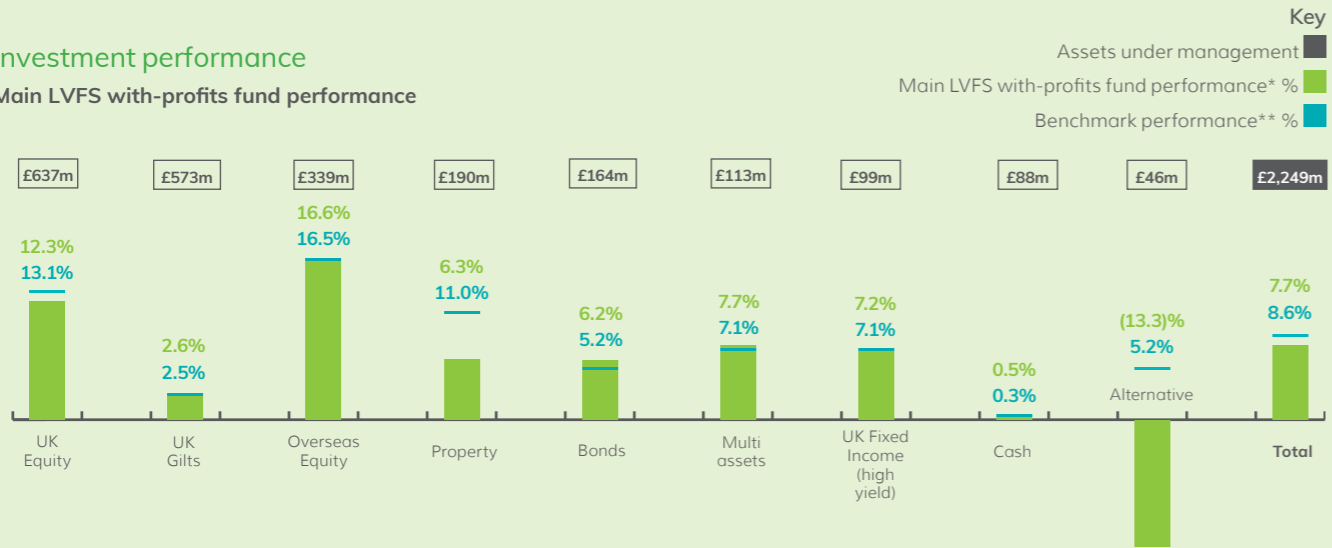
OB pensions reinsurance arrangement

In December 2017, the group reinsured a large portfolio of heritage deferred and immediate with-profits annuity policies (OB pensions), with RGA, a leading global life reinsurer. The agreement covers specified levels of benefits, thereby significantly reducing the level of market and longevity risk associated with the portfolio, and was executed at a price that was lower than the best estimate value of the liabilities. The group retains certain risks associated with the portfolio, primarily those related to expenses, discretionary benefits, changes to the policyholder take-up rate of the cash commutation option and some retained longevity risk.



Investment performance

Main LVFS with-profits fund performance



With-profits

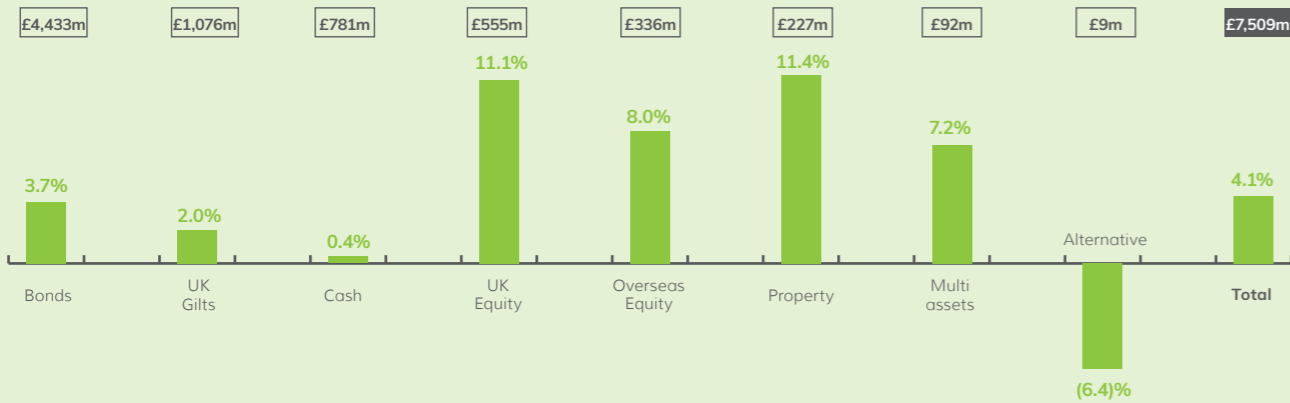
The main LVFS with-profits fund provided a return of 7.7% (2016: 14.5%) for our with-profits members. The return on the with-profits fund is supported by strong equity returns of 12.3% on UK and 16.6% on overseas equities, offsetting the low gilt yields of 2.6% experienced in the year. The fund underperformed against the benchmark by 0.9% largely because of adverse performance on long-standing investments in property and alternatives.

Key

- UK Equity 28%
- UK Gilts 26%
- Overseas Equity 15%
- Property 9%
- Bonds 7%
- Multi-asset 5%
- UK Fixed Income (high yield) 4%
- Cash 4%
- Alternative 2%



Other Group Assets fund performance*** %

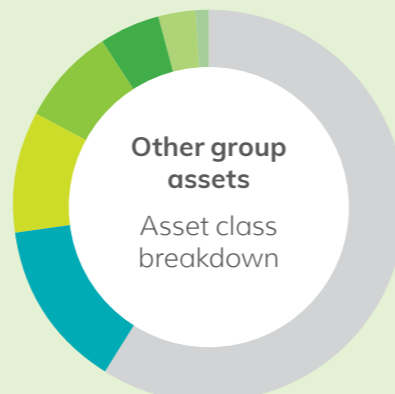


Other group assets

Outside of the main LVFS with-profits fund and the RNPFN and Teachers ring-fenced funds, the majority of assets are invested in gilts and bonds which achieved returns of 2.0% and 3.7% respectively. Overall these funds achieved a return of 4.1% (2016: 10.0%).

Key

- Bonds 59%
- UK Gilts 14%
- Cash 10%
- UK Equity 8%
- Overseas Equity 5%
- Property 3%
- Multi-asset 1%
- Alternative 0%



Definitions

Capital reporting basis

The capital coverage ratio represents the ratio of eligible own funds over the Solvency Capital Requirement in accordance with the Solvency II regime. The 31 December 2017 figures are estimated and have not been subject to an external audit opinion.

The group capital resources table shows the estimated eligible own funds, Solvency Capital Requirement (SCR) and surplus funds of the group. Figures exclude RNPFN and Teachers ring-fenced funds. Calculations are based on the Standard Formula approach using the Volatility and Matching Adjustment (for eligible business) and TMTP recalculated as agreed by the PRA during the year.

Tiers of Capital

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

Capital performance

At the end of 2017 the group capital surplus on a Solvency II Standard Formula basis is estimated to be £698 million (2016: £367 million) with a coverage ratio of 180% (2016: 140%).

Solvency II

Since 1 January 2016, the group has operated on a Standard Formula basis for calculating its regulatory capital position. An internal model application was submitted in early 2017, however in light of the changes to the risk profile that would be introduced by the transactions with Allianz and RGA at the end of the year, a recommendation was approved by the board not to proceed with the application and to continue using the Standard Formula method.

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

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

Group capital surplus

£m	2017	2016
Eligible own funds		
Tier 1	1,178	885
Tier 2	379	385
Tier 3	10	26
Total Eligible own funds	1,567	1,296
Solvency capital requirement (SCR)	869	929
Surplus	698	367
Capital coverage ratio (CCR)	180%	140%

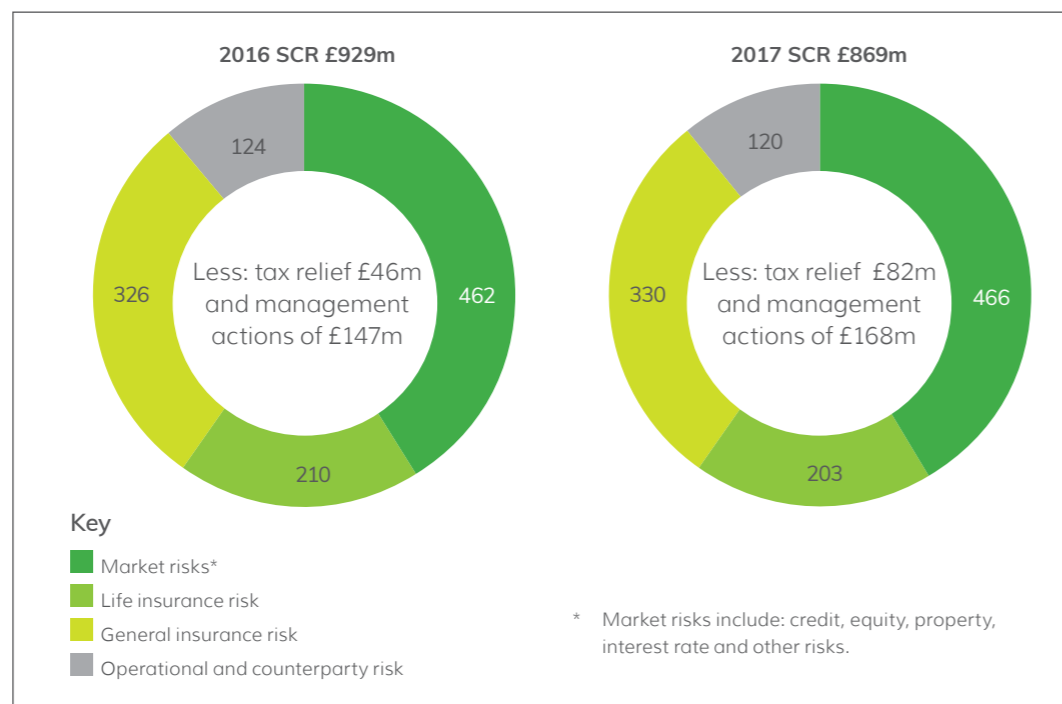
Eligible own funds and SCR exclude amounts attributable to the RNPFN and Teachers ring-fenced funds. Including these funds would not change the capital surplus shown above as these funds do not require capital support. It would however dilute the CCR.

Eligible own funds include the positive benefit of TMTP of £528 million (2016: £837 million). TMTP is required to be recalculated at least every two years and there has been an industry-wide recalculation on 31 December 2017.

There was a £246 million reduction in surplus capital due to TMTP recalculation and economic variances. This adverse impact largely relates to the favourable change in economic conditions since the last TMTP recalculation on 31 August 2016, and the step-down of TMTP as at 1 January 2017. The step-down of TMTP at the end of 2017 of £37 million has been allowed for within the capital surplus and the capital generation analysis. The next step-down of TMTP will be on 31 December 2018.

* This represents assets held within the conventional with-profits fund. It excludes OB pensions and assets held within the unitised with-profits fund. The performance of this fund represents a change in value of the fund itself, rather than a change in the value of individual members' policies during the year.
 ** Benchmark performance is calculated using a blend of recognised metrics which reasonably represent the market level performance for the mix of assets included in the main LVFS with profits-fund.
 *** Other group assets are assets invested by the general insurance and life businesses.

Solvency Capital Requirement



Sensitivity analysis of Solvency II group capital surplus

The following table shows the sensitivity of the group's Solvency II capital surplus and capital coverage ratio to economic assumptions. All other assumptions remain unchanged for each sensitivity, except where these are directly affected by the revised economic conditions or where a management action that is allowed for in the SCR calculation is applicable for that sensitivity. The analysis also provides the benefit from a further recalculation of TMTP, following the stress event. The credit and gilt spread sensitivities represent a widening of yields on these asset classes relative to swap rates. The sensitivities below allow for the impact of the group's hedging strategy.

Changes in economic assumptions	No Further TMTP Recalculation		With Further TMTP Recalculation	
	Impact on surplus capital (£m)	Impact on CCR (%)	Impact on surplus capital (£m)	Impact on CCR (%)
Equity values fall by 25%	(89)	(10)	(89)	(10)
Credit spreads increase by 100bps	146	18	63	9
Gilt spreads increase by 50bps	(128)	(15)	(62)	(7)
Fixed interest yields fall by 100bps	(112)	(18)	82	3
Fixed interest yields increase by 100bps	91	15	(57)	(3)

The group's capital surplus position is affected by the sensitivities due to the following:

- A fall in equity values reduces the value of the group's defined benefit pension schemes, increases with-profits guarantee costs and reduces the benefit of future charges on unit-linked business; all of which are partially hedged to equity market movements. There is no benefit from TMTP recalculation to equity market movements as TMTP is predominantly driven by interest rate related market risks.
- A widening of credit spreads, relative to swaps, increases the value of the group's defined benefit pension schemes, reduces the value of liabilities using the Volatility Adjustment, offset by a reduction in corporate bond values held to support the general insurance business lines. Following TMTP recalculation, the benefit reduces due to the loss of Volatility Adjustment and increased risk from future credit defaults associated with annuity business assumed under the previous solvency regime.
- A widening of gilt spreads, relative to swaps, reduces the value of the group's defined benefit pension schemes and the assets invested to support the Society's liabilities. The OB pensions reinsurance transaction has reduced the reliance on TMTP recalculations, hence improving surplus capital stability.
- Changes to fixed interest rate yields (both swap and gilt rates) lead to changes in the group's capital surplus position, as the Solvency II yield exposure is hedged on a post-TMTP recalculation basis. Following a TMTP recalculation, the residual exposure largely arises from defined benefit pension schemes.

180%
Solvency II
Capital Coverage
Ratio

Capital management actions

During 2017 we have taken a number of actions to improve our capital position and to reduce the sensitivity of our capital position to market movements including:

- sale of a 49% stake in our general insurance business and a fixed-price forward contract over sale of a further 20.9%, with an option to sell the remaining stake at a fixed price for two years;
- entered into a reinsurance treaty which substantially reduced the volatility and capital held for a block of with-profits deferred annuities within our OB pensions portfolio;
- reduced the equity exposure within the general insurance companies;
- closure of certain capital-intensive product lines in our protection portfolio; and
- increased the scope of hedging to our flexible guarantee and unit-linked product lines.

Liquidity management

The group's operational liquidity inflow of £62 million was a £115 million improvement on the prior year outflow of £53 million. This is highly encouraging, reflecting a significant improvement in the life position following the decision to exit markets with high new business cash and capital strain, such as enhanced annuities and recognising the growing scale of the life trading businesses. The strong general insurance trading performance also resulted in improved surplus cash remitted in the year, despite action to strengthen reserves following the Ogden rate change in March 2017.

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

LVFS operational liquidity

£m	2017	2016
General insurance surplus cash remitted	95	7
Other subsidiaries surplus cash remitted	23	18
Life	5	(26)
Group items *	(29)	(25)
Debt interest paid	(23)	(23)
Tax paid	(9)	(4)
Operational liquidity inflow/(outflow)	62	(53)
General insurance business transaction	489	-
Economic and other non-operational	116	(131)
Net inflow/(outflow) before mutual bonus	667	(184)
Mutual bonus	(26)	(17)
Net inflow/(outflow)	641	(201)

Operational liquidity held at 31 December

	947	306
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* Group items comprise centrally managed costs and the return on the free estate.

On 28 December 2017 the group entered into a transaction with Allianz to sell a stake in its general insurance business, the consideration from this transaction, net of associated costs borne by the Society, generated £489 million of liquidity inflow.

In addition to the inflow from the general insurance business transaction, the net inflow includes £62 million of operational liquidity and £116 million of economic and non-operational items, mainly as a result of positive impacts coming through from cash and capital optimisation initiatives. The inflows across the group have resulted in an overall net inflow of £641 million, increasing our stock position to £947 million.

Outlook

2017 has been a pivotal year for LV= in which significant steps have been taken to strengthen the financial foundation of the group. The significant management actions taken to de-risk the balance sheet including the creation of the strategic partnership with Allianz and reinsurance of the OB pensions portfolio has provided the group with an above risk appetite capital surplus, whilst the positive earnings from both the general insurance and life businesses provide a positive platform from which the group can move forwards, supporting the future sustainability of the group.

Definition

Operational liquidity

Operational liquidity is generated from movements in free assets in the year (including cash and cash equivalents and surplus assets within funds in excess of matched liabilities). This excludes amounts attributable to the RNPFN and Teachers ring-fenced funds and is not directly reconcilable to the group's IFRS Statement of Cash Flows.

£62m
Operational liquidity
inflow

General Insurance Review

Steve Treloar
Chief Executive, General Insurance



At the end of my first full year with LV= I look back with enormous pride at how we have continued to give our customers the great service they deserve. This was achieved against a backdrop of one of the most challenging regulatory years that motor insurers have ever faced, historically low investment returns, and a devastating year-end car park fire. And all this happened at the same time as we were successfully negotiating and completing our new strategic partnership with Allianz!

Throughout, we have striven continually to give excellent service and good value to our customers, and we were delighted to close the year holding the Which? Insurer of the Year award and the 2017 Moneywise Most Trusted Insurer award. These awards are a testament to how our colleagues have, once again, put our customers at the very heart of our business. Their instincts were powerfully demonstrated to me recently by the way that everyone responded to the fire at the Echo Arena Liverpool, working together to address an unprecedented event by straightforwardly answering a simple question: "what is the right thing to do for our customers?"

I am especially grateful for, and humbled by, their dedication in what has, at times, been an uncertain period, and particularly so for our people working for great customer outcomes in our commercial area.

The reduction in the Ogden rate increased our 2016 claims incurred by £139 million and forced us to increase prices to customers. I was therefore very pleased when the Government recently published legislation to address this issue. The new system would not only ensure fair payments for those making claims but would also help reduce the cost of motor insurance for drivers at a time when premiums have been at record highs for hard-pressed motorists. I remain fully committed to passing on 100% of any discount rate savings produced by this legislation.



Our 2017 operating profit of £121 million is up £8 million compared to 2016's result of £113 million (prior to the impact of the Ogden rate change), and £147 million up compared to the post-Ogden operating loss of £26 million. We reacted rapidly to the Ogden rate change, putting through immediate price increases and maintaining disciplined underwriting and pricing controls in a very uncertain year. We purposefully chose to exit unprofitable general home business through our broker channel in April 2017, and while overall policy numbers were down 2%, when the impact of our withdrawal from broker home is taken into account, policy numbers in our chosen markets actually grew by 1%. Overall gross written premiums were up 1%, and without the impact of broker home actually grew by 2%.

As expected, at £46 million the releases from prior year claims reserves were not as large as those in previous years (2016: £54 million). Of this, £17 million resulted from a case-by-case review of claims impacted by the Ogden change.

The Ogden discount rate change highlighted the risk our business faces from unexpected shocks of this magnitude. Accordingly, we decided to increase our overall margin on claims reserves to give improved protection in this area. Our operating profit would have been £31 million higher at £152 million without the increased prudence in claims reserves.

Falling returns on investment income were compensated for by good expense control, disciplined pricing and underwriting and an increasing use of systems thinking to design our business straightforwardly around our customer needs.

Our claims area successfully delivered a number of initiatives, including the formation of our own building contractor network, dedicated LV= branded bodyshops, market leading anti-fraud activity, and efficiency gains through automation. All these combined produce record motor claims customer satisfaction with a net promoter score of +69, while simultaneously helping to contain claims inflation and deliver expense savings.

Direct

Our direct business continued to grow in LV= branded motor and home portfolios due to strong sales and market-leading renewal retention. This growth was driven by our continuous focus on providing great-value products, underpinned by great customer service. The market did see an increase in customers shopping around following repricing for Ogden, and average premium increases were subdued as a result of our disciplined approach in the market. We maintained growth in our heartland with overall policies increasing by 3% to 3.7 million. Overall premiums therefore grew strongly by 5% from £913 million in 2016 to £960 million. The loss ratio, before the impact of the claims margin strengthening, improved to 69.6% from 71.8% in 2016 (prior to Ogden strengthening), and we posted record divisional profits of £106 million.

We have invested heavily in our new policy administration system, Pioneer, and have delivered transformational change in our business and capabilities, achieving our "go live" goals of switch-on for motor insurance in 2017. We have launched our new multicar proposition, and by year end we had also rolled out our car, motorbike, and classic car products to all our new customers and have also begun renewing policies onto our new system. We are already getting great feedback from customers and colleagues, and are looking forward to launching our new home insurance proposition in 2018. We will then move on to decommissioning our legacy policy systems.

Broker

2017 saw continued strong progression in the profits of the broker division from a pre-Ogden operating profit of £26 million last year to an improved operating profit of £30 million in 2017. Without claims margin strengthening, profits would have been £18 million higher at £48 million.

Our withdrawal from the home general market has been carried out in an orderly fashion, and we have maintained a strong and disciplined approach to underwriting and pricing in an extremely competitive market. We continue to see strong support from our brokers as a result of our overall service and proposition. Our ongoing commitment to service excellence was recognised with the award of the Institute of Customer Service ServiceMark Accreditation, and LV= achieved an overall UK Customer Satisfaction Survey score significantly higher than the insurance industry average at 82.5.

In the broker personal lines market we have reduced our exposure to purely aggregator business, widening our distribution reach through key partnerships with motor manufacturers, retail brands and digital channels. We continue to grow our range of specialist lines solutions. While commercial gross written premiums grew by 6%, our disciplined approach and withdrawal from unprofitable lines meant that overall broker premiums fell by £32 million from £668 million to £636 million. However, our combined ratio, before the impact of the claims margin strengthening, improved to a record 93.7% compared to 99.3% in 2016 (prior to Ogden strengthening).

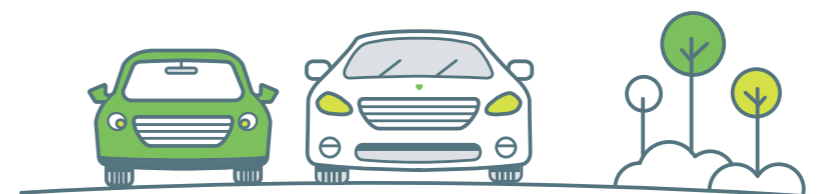
Looking ahead

Our general insurance business is already reaping the benefits of strong positioning in all our chosen markets from the combination of excellent customer service, exciting digital offerings being rolled out and an exceptionally strong brand franchise. We have navigated our way through a challenging year to deliver record underwriting profits in 2017. 2018 will bring fresh challenges to a motor insurance market with the remaining uncertainties around the passage of the Ogden discount rate and whiplash reform contained within the recently published Civil Liability Bill.

We are progressing rapidly with our new strategic partner, Allianz UK, to finalise robust joint plans to begin welcoming their renewing motor and specialist home customers later this year, while Allianz will similarly welcome our commercial customers. I am extremely confident that both enterprises will continue to offer the excellent customer service throughout this period that each has become famous for. We will maintain our prices to give value to our customers while they are with us, and we are already seeing technology investments delivering productivity improvements. There is more to come in this area. We remain cautious in an uncertain investment market, and will concentrate on delivering underwriting profits rather than relying on volatile and unpredictable returns.

Our franchise increasingly shines through in a market crowded by "me too" players, and I am confident that our strong foundations, clear plan, and the backing of our new strategic partner mean that we will continue to deliver excellent service to our customers, and growth and profits to our joint shareholders.

£121m
Operating profit





A movie night hamper together with a restaurant voucher were the right gestures for taxi driver Mike after he was held at gunpoint in his cab. After running off with his day's takings we wanted to help Mike enjoy some family time and take his mind off the events.



We sent David a purifying food processor and a recipe book to help him while he recovered from a broken jaw. He had been checking the parking fees at a meter when two men mugged him and stole his car.



“ To say your beautiful gift was a complete surprise would be an understatement. ”

Nadia needed to get away after witnessing a traumatic accident so we organised for her and her husband to stay in a nice hotel. She'd comforted an injured person who had been hit by a drunk driver, while waiting for the ambulance.

“ Blown away with this amazing thoughtful act by @lv. They'd noticed we'd lost some sentimental items in the fire...It's a lovely act that has lifted our spirits. ”

Names have been changed to protect identities.

Life Review

John Perks
Managing Director of Life



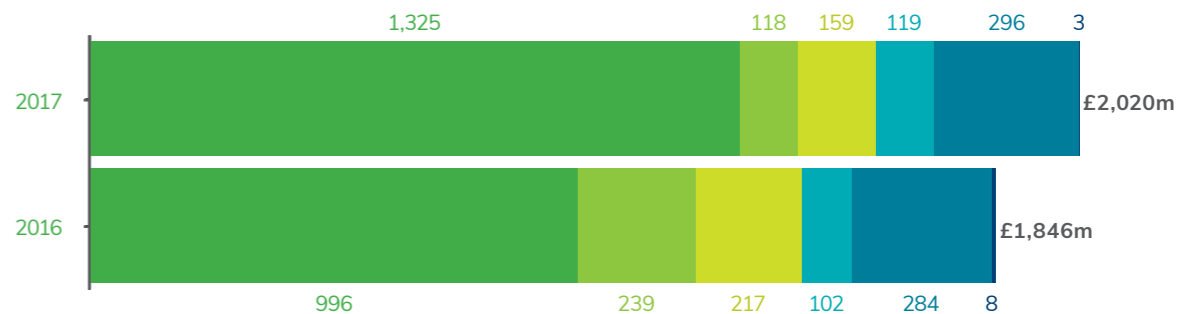
2017 life results

2017 saw the integration of retirement, heritage and protection into a single business, enabling alignment of our strategic objective to help customers to live confident lives by providing market leading products with modern value added services. This will help evolve our mutual business from a traditional life and pensions offering to broader services in Health, Wealth and Knowledge.

The life business generated an operating profit of £37 million, £24 million above 2016, with the continued strength of the trading businesses supported by favourable capital management actions and expense savings following the completion of our strategic cost review.

New business volumes have exceeded £2 billion on a present value of new business premiums (PVNBP) basis for the first time, demonstrating 9% growth year on year, driven by strong growth in pensions, equity release and protection.

PVNBP £m



Key

- Pensions¹
- Annuities²
- FGB
- Equity release
- Protection
- Heritage

Notes

- 1 Flexible guarantee fund, our flexible guarantee bond sold within our pensions wrapper, is included within the pensions PVNBP (2017: £260 million, 2016: £344 million).
- 2 Annuities excludes enhanced annuities which were exited in 2016 (2016: £99 million).

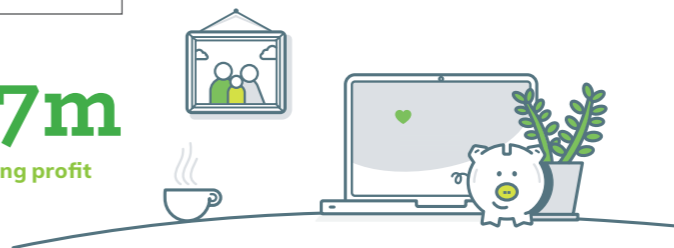
Retirement

The retirement business continued its year on year growth with volumes 11% up on 2016. Pensions new business sales have increased by a third from 2016 levels supported by the increase in defined benefit to defined contribution transfers following pension freedoms. In addition, equity release sales have grown by 17% driven by increased levels of external funding and new product enhancements, including the introduction of LV= Doctor Services, which has been introduced across all new protection and retirement business. The launch of a new version of the flexible guarantee product range in the second half of 2017 resulted in reduced marketing activity earlier in the year and therefore lower volumes compared to 2016.

Income from our Retirement Advice Service grew 25% year on year reflecting growth in our corporate solutions distribution, with success in securing deals with a number of partners who recognise the importance of offering their customers direct access to regulated advice. Our services focus on helping customers plan for an affordable retirement and accessing their pensions, including strong demand from customers for our advice when considering the suitability of transferring some or all of their defined benefits into more flexible retirement income arrangements.

With the support of Wealth Wizards, the company in which we have had a majority stake since August 2015, we have also seen significant efficiency benefits from the development of ground breaking advice automation technology.

£37m
Operating profit





Protection

Protection volumes grew 4% versus 2016 reflecting strong performance in term life, which achieved double digit sales growth, and continued strong performance in income protection. This growth was achieved in spite of decisions taken around risk and distribution management, in particular where we closed our 50+ product as well as our protection advice service.

To support our goal of providing good quality propositions at a fair price, we have continued to develop Fastway, our quote and apply system. Fastway combines the benefits of technology with the expertise of our people, providing a faster and more intuitive application journey and enables more clients to be covered quicker. This has been very well received by financial advisers and continues to be a key driver of our increased sales volumes and cost control.

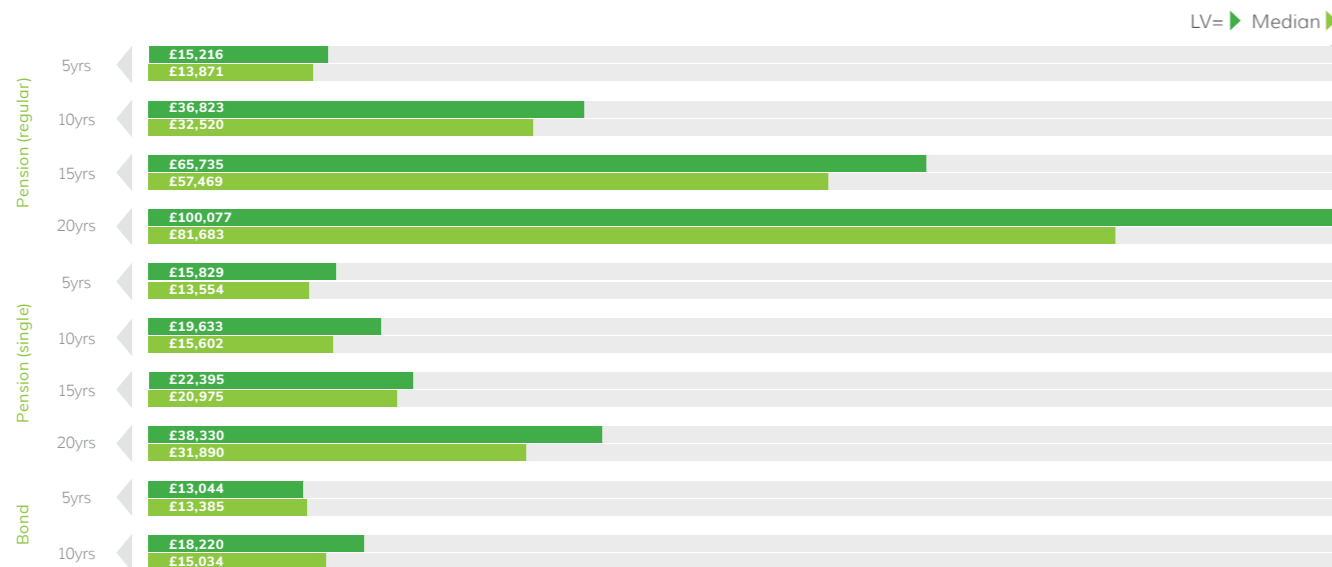
We continue to significantly invest in technology and processes and 2017 saw the launch of LV= Doctor Services which gives simple, fast and convenient access to a UK general practitioner or medical specialist. This is a key illustration of where LV= goes beyond the financial support expected from an insurer. Our LV= adviser centre is continually being developed and provides a range of tools, calculators and support to achieve our goal of being easy to do business with.

Heritage

Our heritage business includes ordinary branch and industrial branch with-profits policies along with some non-profit business. The business includes with-profits and unit-linked business acquired from the Royal National Pension Fund for Nurses ('RNPFN') as well as policies from Teachers Assurance, which was bought in 2016 and integrated into our business this year.

We achieved a good return on the main LV= with profits fund of 7.7% although this falls below the benchmark of 8.6%. The fund underperformed against the benchmark by 0.9% largely because of adverse performance on long-standing investments in property and alternatives.

Recent maturity and surrender values for LVFS with-profits policies show that LV= continues to perform strongly, exceeding median payouts for all but one of the policy selected categories and achieving top quartile payouts in eight of the ten categories, when compared against industry payouts.



Notes

- The payouts are based on the following policies:
 - Pension (regular) – Policyholder retiring at age 65: monthly premium of £200, maturing 1 January 2017.
 - Pension (single) – Policyholder retiring at age 65, an investment of £10,000, maturing 1 January 2017.
 - Bond – An investment of £10,000 as at 1 November 2017. Figures have been calculated using the FGB balanced fund (no guarantees) for the 5 year term. The 10 year LV= figures are based on the with-profits growth bond.

2 The industry payouts are taken from past performance surveys and relate to maturities and bond surrenders during 2017.

- The sources are:
- Pension (regular) – Money Management survey published March 2017.
 - Pension (single) – Money Management survey published March 2017.
 - Bond – Money Management survey published January 2018.

3 The Money Management survey used to benchmark our Endowment payouts against is not available at the date of the 2017 Annual Report release. The previous results of our payouts compared with benchmark industry performance are shown on page 47 of the 2016 Annual Report.

Looking ahead

We are a top ten life insurer with a strong history of growth in both the retirement and protection businesses.

2017 saw the unification of our trading businesses which created a strong, stable foundation from which to deliver our future strategy. The consolidation of the life business enables us to look beyond life and pensions to become a "Life partner" across the customer journey. We can better engage with customers and provide a more comprehensive offering, responding to their key life events.

Over time we will evolve our proposition from a traditional life and pensions offering to providing broader services in Health, Wealth and Knowledge; the key influencers of confidence. The world is changing at a faster rate than ever before; across technology, the environment and politics. In this context we believe that everyone deserves to live confident, and we exist to ensure that people can do that.

We sent our customers some Wiltshire farm food vouchers so they could have some food delivered while part of their home was being adapted. Two years ago, 60 year old Hannah was diagnosed with Alzheimer's, and she now needs constant care. Her husband had organised for some workmen to create a bedroom and wet room for her and we wanted to do something to minimise the disruption.



We organised an adjustable bed to make life that little bit easier for Wendy. After treatment for breast cancer Wendy encountered complications due to the surgery and had to undergo several further procedures. She also suffers from a number of other medical conditions and is in constant discomfort.

“ LV= has completely delivered on its promise to members. ”

“ The gift, which was entirely out of the blue, and completely unexpected, has led me to realise that in the tough old world of big business there are still many kind people out there whose actions help to mitigate difficult experiences. ”



To help Paul get back on his feet and make a living again we paid for two large pieces of equipment for his new venture. After a severe back injury Paul had been forced to give up his physically demanding job and was bedbound for months.

Risk Management

David Dullaway
Chief Risk Officer



Overall objectives

The LV= board is responsible for determining and controlling the nature and extent of the principal risks which the group faces, including those that would threaten its business model, future performance, solvency and/or liquidity positions. Board members discharge their duties in this respect through the monitoring of robust enterprise wide risk management and internal controls frameworks which cover the full range of risks to which LV= is exposed. These are supported by a suite of clear risk principles, policies and standards which are maintained and managed by experienced risk specialists under a three lines of defence model.

On behalf of the board, the Risk Committee regularly monitors the operation and effectiveness of such risk management and internal control systems which then enables the board and all LV= employees to make better informed business decisions that generate value for our members, whilst ensuring good customer outcomes and confidence for our stakeholders.

The purpose of this Risk Management section is to provide a brief overview of the types of material risks to which we are exposed, plus information on how these are being managed and monitored during a period of structural change and against a backdrop of economic and political uncertainty and increased regulatory oversight.

External environment

The wider external environment proved to be challenging during 2017. We continued to operate under a heightened level of uncertainty with political, financial and regulatory risks being the predominant themes over the year, exacerbated by the level of uncertainty around the outcome of the Brexit negotiations.

In March 2017 the UK government reduced the Ogden discount rate from 2.5% to -0.75%, which required the whole motor insurance industry to materially increase reserves held against future lump-sum personal injury claims. In September 2017 a government review into how the discount rate is set concluded that a revised methodology should be legislated for. We have welcomed the Government's recent publication of their Civil Liability Bill which seeks to address this, with an expectation that the planned outcome is a partial reversal of the previous reduction. However, there are a number of factors influencing this potential change meaning that its impact and timing remain uncertain.

There is also considerable uncertainty over the extent to which improvements in life expectancy experienced over the last 40 years will continue into the future. Indeed, despite continued medical advances, emerging lifestyle changes may begin to slow or even reverse this trend. We continue to monitor our own experience carefully and analyse external population data to identify emerging trends.

We expect the overall heightened level of uncertainty to continue throughout 2018 and will continue to operate a prudent investment philosophy with a clear focus on strong risk management. The sale of a 49% stake in our general insurance business for £500 million to Allianz at the end of 2017 has also established a strong solvency and liquidity base for the group which is able to withstand a wide range of potential stress conditions.



£698m
Capital surplus
£348m above risk appetite

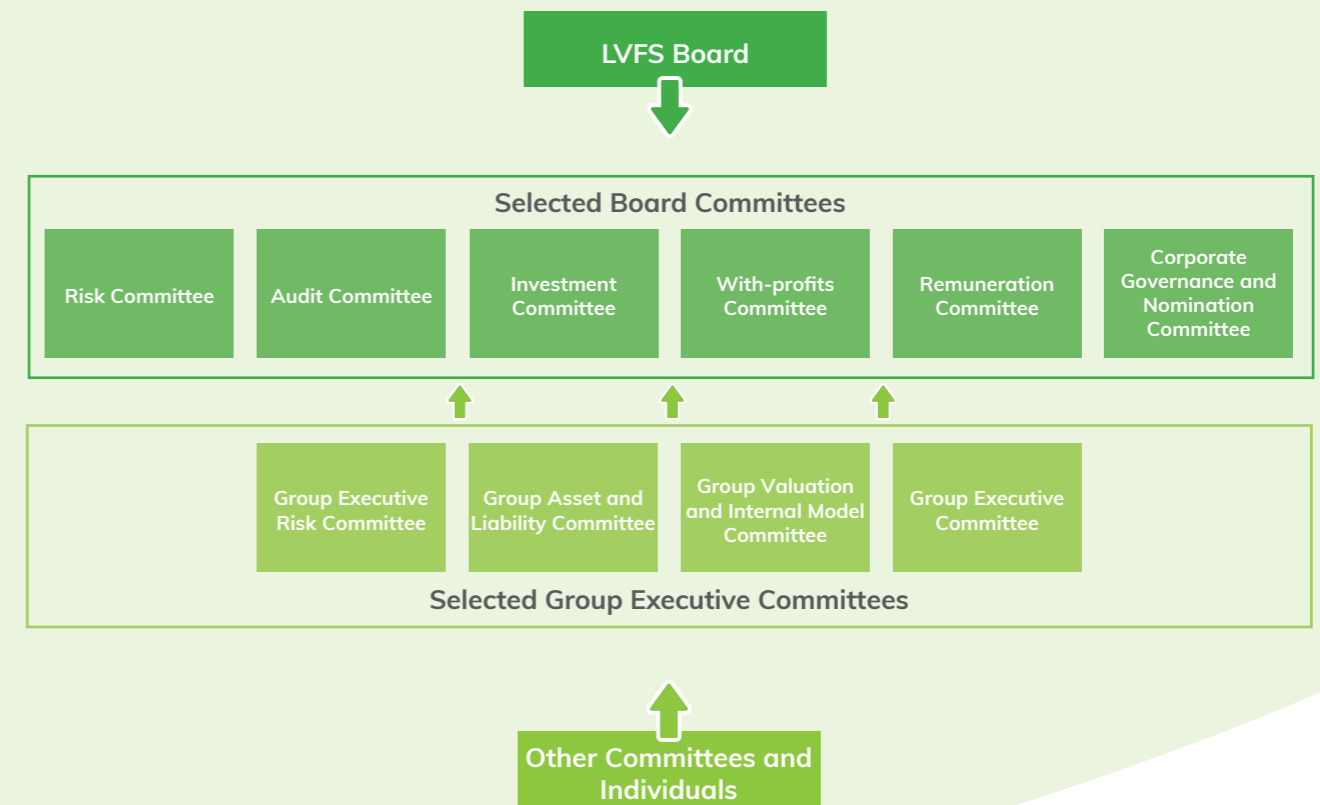
Our approach to risk management

The effective management of our risks is a fundamental building block which supports the delivery of our strategy, protects the value that we create for our members and helps us to identify opportunities where we can make the best use of our capital.

Our risk management practices are continually evolving in order to embrace industry practice; however our approach continues to revolve around the following key components:

- **A risk culture and governance structure** which facilitates and enables robust challenge and oversight and encourages all LV= employees to actively engage in risk management.
- **A risk appetite framework** which sets out the type and amount of risk the group is able and willing to accept.
- **An Enterprise Risk Management Framework (ERMF)** that sets out the principles, policies, minimum standards and operations for risk management across the group.
- **The Own Risk and Solvency Assessment (ORSA)** which is an ongoing process by which the board assesses the current and projected risk and solvency position of the group and its regulated entities.
- **A risk and control assessment process** which is used to identify, assess, control and report our risks in accordance with the risk appetite and ERMF.
- **Stress and scenario testing** which considers a range of severe yet plausible and reverse stress scenarios which are designed to challenge the continued financial and operational resilience of the group on a forward looking basis.

In accordance with the committee governance structure shown below, the board is ultimately responsible for monitoring the effectiveness of the group's risk management and internal control systems (including financial, operational and compliance controls).



In 2016 the board commissioned an external review of risk management effectiveness with a follow-up external review taking place at the start of 2018. In the interim, both the board and the Risk Committee received periodic reports from the chief risk officer during 2017 which focused upon specific areas of risk management performance.

Our risk culture and governance structure

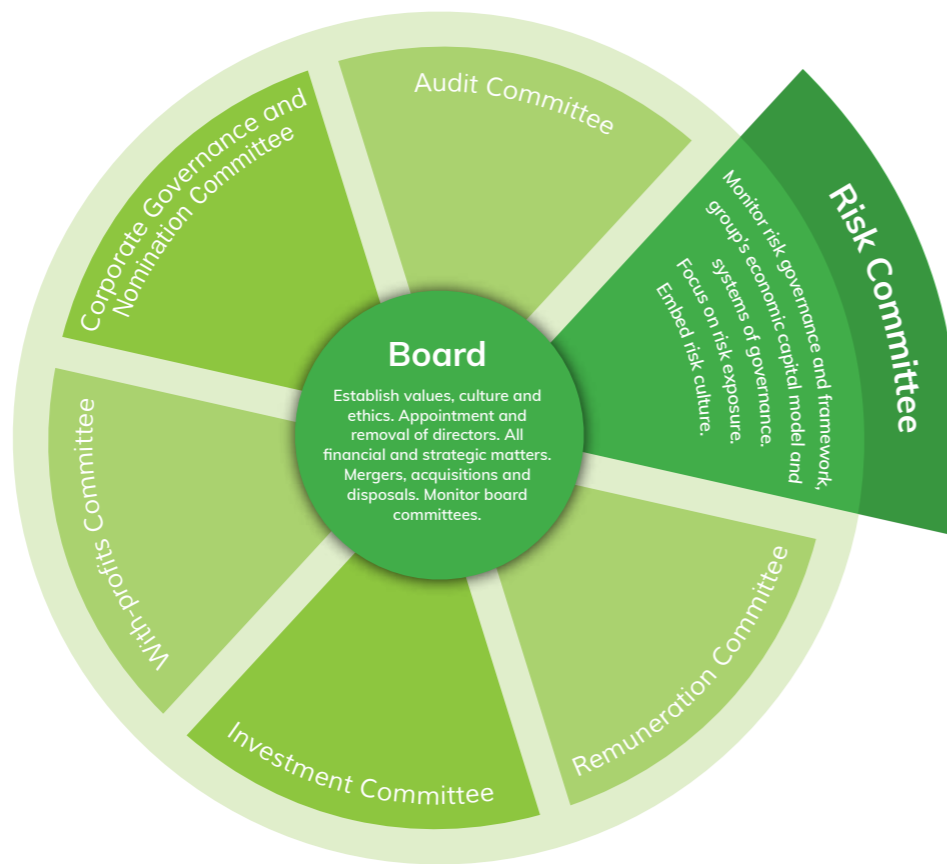
Over a number of years, our risk management approach and engagement with the business has sought to embed a culture of risk ownership and accountability throughout the group, supported by a robust risk framework and governance infrastructure which delivers the necessary risk management capability. The fundamental building blocks which enable our risk management approach are described below:

Risk culture: The way we think and act as individuals and as a business. It encompasses our attitudes, capabilities and behaviours such as “tone from the top”, risk transparency and risk competency, and is achieved through rewarding appropriate risk behaviours. Our culture drives how we identify, understand and openly discuss, and act upon, both current and future risks.

Risk mandate: To support our risk management approach we operate a three lines of defence model of risk management, with clearly defined roles, responsibilities and mandates for individuals and committees, as follows:

- **First line:** Day to day risk management is delegated from the board to the chief executive and, through a system of delegated authorities and limits, to business managers.
- **Second line:** Risk oversight is provided by the chief risk officer and supported by the group risk management function and through established risk committees such as the Group Executive Risk Committee (GERC) and with reporting to the Risk Committee. The majority of members of the GERC are the executive managers of the first-line functions whereas independent oversight is provided by non-executive directors at the Risk Committee.
- **Third line:** Independent verification of the adequacy and effectiveness of the internal risk and control management systems is provided by our internal audit function. This is independent from all other operational functions and operates subject to supervision and challenge by the Audit Committee.

Risk governance: Our risk governance framework operates through group-wide risk policies and business standards which are aligned to a formal committee governance structure incorporating clearly defined roles, responsibilities and delegated authorities. The diagram below outlines the current Risk Committee governance arrangements:



The board is able to discharge its responsibilities with respect to risk governance, mandate and culture through the operation of the Risk Committee. This body makes recommendations to the board in respect of leadership, direction and oversight of the group’s risk appetite, risk tolerance and risk management frameworks. In doing so, it plays a key role in delivering effective risk oversight as well as being responsible for review and challenge of the group’s regulatory and internal control policies and procedures and its compliance monitoring plan.

Our risk appetite framework

The value of the business comprises the net value of the assets and liabilities (balance sheet value) plus its brand and reputation (franchise value). Our risk appetite framework has therefore been developed to focus on safeguarding these value drivers and the board regularly reviews its appetite for risk within this context. During 2017 we operated within five board-approved risk appetite dimensions each supported by a qualitative risk appetite statement, as outlined in the table below:

Risk appetite dimension	Risk appetite statement
Financial Strength	LV= will hold a level of capital surplus that is equivalent to being assessed as an S&P ‘A’ rated firm.
Solvency Strength	LV= has no appetite to breach the regulatory Minimum Capital Requirement (MCR) and is only prepared to breach the Solvency Capital Requirement (SCR) in the event of a severe financial market led stress scenario.
Liquidity	LV= will hold sufficient liquid capital resources to ensure it can meet its liquidity requirements in both normal and stressed circumstances.
Reputation and Capability	LV= will seek to avoid risks that materially impair its reputation, while ensuring that its treatment of customers and its operational capabilities are designed to deliver fair customer outcomes.
Stakeholder Commitment	LV= will, in stressed market conditions and over a cumulative three year period, aim to generate sufficient profit after tax to meet its planned mutual bonus and debt interest payments without recourse to retained earnings.

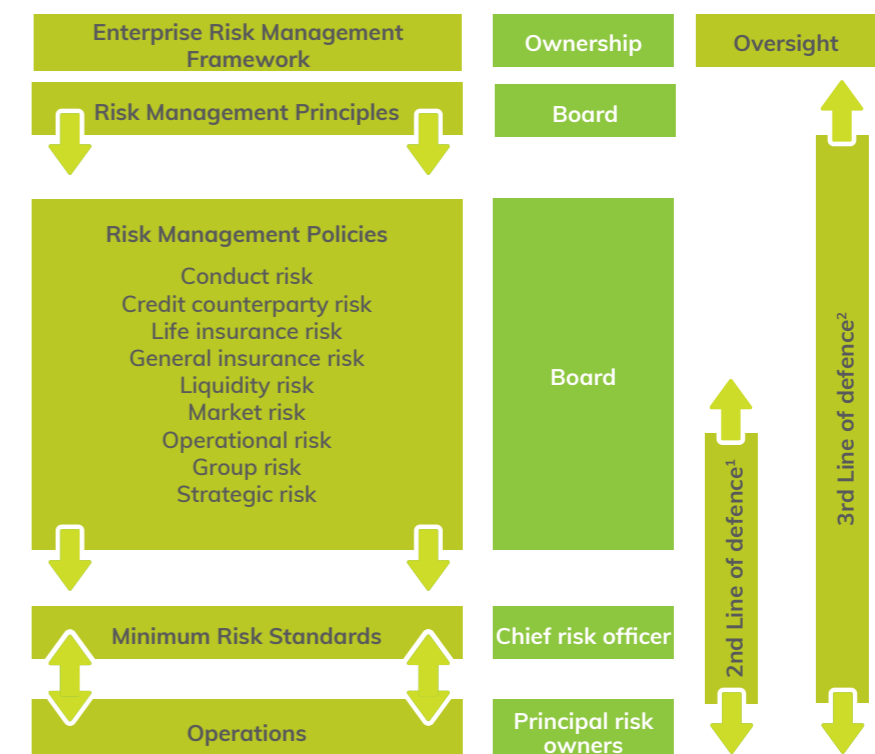
These risk appetite statements are designed to set out the risks we believe we are capable of managing in order to generate a return; the risks we can support but which we share with third parties; and the risks we seek to avoid or minimise.

Each risk appetite statement is supported by risk limits (or tolerances) and triggers which provide us with a suite of early warning indicators for when risks start to deteriorate, allowing timely actions to be initiated.

The management of risk against risk appetite is brought to life and embedded across the organisation through the application of risk principles, policies and standards which are laid out within our ERMF.

Our Enterprise Risk Management Framework (ERMF)

The group’s ERMF is designed to enable and support the safe delivery of the group’s strategy and business objectives within risk appetite. It comprises a suite of documented governance, internal control and risk management frameworks with clear lines of accountability around principal risk ownership, attestation and control. The ERMF is made up of the following elements:



1 2nd line of defence: Group risk management on behalf of the Risk Committee.
 2 3rd line of defence: Group internal audit on behalf of the Audit Committee.

Risk management principles

Fundamental values and statements representing the group’s approach to consideration of risk. The principles ultimately support the safe delivery of the strategy and plan (e.g. board statements on risk preferences and aversions).

Risk management policies

Clear requirements and rules which have been designed to ensure that the risk management principles are appropriately delivered. They establish a framework within which the board’s requirements for risk management are delivered and executed (e.g. risk appetite limits and risk capital constraints).

Minimum risk standards

The minimum requirements within which the business must operate in order to demonstrate the development and management of the group’s risk-taking activity in line with the risk principles and policies (e.g. calculation methodologies and reporting requirements).

Operations

The core functions of the group which ensure that the business is managed and monitored within agreed boundaries. These comprise activities and processes which are owned by the business in order to monitor and manage the group’s underlying risks.

The board and senior management seek and obtain confirmation over the appropriateness and effectiveness of the ERMF design, execution and monitoring through a process of attestation. This process takes place on an ongoing basis with regular oversight and review as part of the operation of the three lines of defence.

The overall system of governance and ERMF is owned and maintained by the chief risk officer on behalf of the board, with accountability for the definition, design, monitoring and maintenance of any associated risk sub-frameworks clearly described within the group risk management organisational design. It also provides both the context and architecture for our risk and control assessment process.

Our Own Risk and Solvency Assessment process (ORSA)

The group’s ORSA embeds effective risk management into all areas of the business. It captures a number of activities such as the regular identification and review of LV=’s risks and the current and future assessment of the solvency and liquidity position of the group.

The ORSA is not a one-off process. Individual activities take place throughout the year, with outputs providing a current and forward looking assessment of the risk and capital position of the group, included within regular management information.

Formal ORSA reporting takes place on an annual basis with quarterly updates presented to the Risk Committee to keep the board apprised of the group’s evolving risk profile and risk management initiatives.

The annual ORSA report is produced for the board and represents a key part of our strategic planning cycle informing the board’s assessment of group strategy, sustainability and ongoing viability.



Our risk and control assessment process

The risk and control assessment process is made up of four key stages which are set out within the figure below. Each step comprises a number of established sub-processes within LV=, as determined by our ERMF, and generates a suite of risk registers plus associated action plans (where necessary).



Identify – To identify and categorise risks in accordance with the group’s risk taxonomy;

Assess – To quantify the materiality of each risk against a suite of financial and non-financial measures and in accordance with risk appetite;

Control – To identify and/or design and implement controls to mitigate each material risk; and

Report – To regularly monitor and report upon the effectiveness of controls in mitigating material risk exposures and where necessary escalate control failures and put in place remedial measures.

This process happens throughout the year across all areas of the business, with support provided by group risk management. Outputs are captured on a centralised risk management system and are presented quarterly to the relevant executive risk committees, with overall monitoring and oversight exercised by the Risk Committee.

In accordance with the ERMF, the risk and control assessment process has been designed to bring to life the linkages between the group’s overarching internal control framework and the associated risk categorisation, principal risk ownership and risk appetite frameworks. It is also designed to identify risks before they materialise. This gives us time to identify and capture risks as they emerge, understand them and respond accordingly. We are then able to use this process to inform our stress testing and capital adequacy assessments across the group as part of our ORSA.

Stress and scenario testing

As part of our regular ORSA activities, financial risk modelling is used to assess the amount of each risk type against its risk appetite. This modelling is aligned to our capital metrics to allow the board to understand the capital requirements and key drivers associated with our principal risks.

We also performed stress tests throughout 2017 to assess the capital resilience of the group under a range of severe but plausible scenarios covering areas such as: general macro-economic downturn, stresses to the business model, emerging regulatory impacts, sector-specific and company-specific risks (including operational risks), risk concentrations and emerging competitor and customer challenges.

These stress tests allow the board to review and challenge the strategic plan and risk management strategy on a forward looking basis. This includes an assessment of the impact and effectiveness of mitigating management actions designed to maintain or restore capital, liquidity and solvency to within risk appetite.

The de-risking of the balance sheet has helped to reduce our sensitivity to certain stress scenarios. In the scenarios tested during 2017, sufficient actions were available to management to maintain the viability of the group over the three year period of assessment.

In addition, reverse stress tests which determine particular points of failure not only confirm our ongoing resilience to extreme events, but are also used to inform the setting of our capital risk appetite buffers (over and above the regulatory capital requirement) in order to protect the group against future shocks and stresses. For 2017, reverse stress scenarios included a major disruption to the general insurance business, a material increase in longevity and further significant volatility in financial markets.

Our principal risks and uncertainties

LV= has defined three (increasingly granular) levels of principal risk categories (levels 1, 2 and 3) which represent a documented and agreed common risk taxonomy that is understood by the board and promotes consistency and comparability of reporting across the group. This risk categorisation framework is reviewed and approved annually by the Audit Committee and is supported by the principal risk ownership framework which provides clarity over risk accountabilities and improves the understanding between those who identify, model and make risk-based decisions. Together these frameworks also encourage easier and clearer aggregation of risks and capital by risk type.

Level 1 principal risks are all owned by the chief executive and represent the highest category of risks which are faced by the group, covering the following areas:

(Level 1) principal risk category	Principal risk description
Financial markets risk	Adverse movement in asset values, asset income, interest rates or inflation.
Life insurance risk	Life insurance experience is different to current best-estimate assumptions.
General insurance risk	General insurance experience is different to current best-estimate assumptions.
Credit counterparty risk	A counterparty defaults on its obligations or fails to meet them in a timely fashion.
Operational risk	Loss resulting from inadequate or failed internal processes, people and systems or from external events.
Liquidity risk	The risk that the group and/or its subsidiaries, though solvent, either do not have sufficient financial resources available to meet their obligations when they fall due, or can secure them only at excessive cost.
Group risk	The risk arising from the membership of the group, including potential conflicts of strategy, competition for financial resources from other businesses and the reputational impact from the activities of other parts of the group.
Strategic risk	Risks which can be quantified and understood, and which would have a major impact on the group's business model.

The group's principal risk categories are expected to remain relatively stable over time. Within the boundaries of this risk framework, and by using our risk and control assessment methodology, senior management will continually assess the more dynamic day-to-day risks faced by the business, from both a first and second line perspective. Aggregated, the most material of these are known as our top risks and are tracked monthly by senior management and by the board.

A selection of these top risks is provided in the following table. These tend to change month on month and therefore this should not be considered to be an exhaustive list of all the risks that the group faces, but rather those which at the year end we believed had the greatest potential to affect our business model, future performance, solvency or liquidity. Throughout 2017 all of our top risks, along with proposed mitigating actions, were subject to robust review and challenge by senior management, the Risk Committee and by the board.

Top risk	Risk management actions
Political and regulatory uncertainty The risk of failure to achieve the group business plan due to material and prolonged uncertainty within the political and regulatory landscape.	We continue to remain alert to the risks associated with the UK political and regulatory uncertainty. For example, the outcome of the Brexit negotiations remains unclear and the UK's political landscape changed during 2017 with the establishment of a minority government. The full impact of this period of political uncertainty is as yet unknown, although there may be increased market volatility over the coming months. We continue to give careful consideration to these risks through our ongoing emerging risk process which is prominent in our risk oversight.
Regulatory challenges Failure to comply with current (known) or future (unknown) regulation / legislation resulting in regulatory censure (e.g. fines or enforcement).	We continue to work hard with the regulators to ensure that the group meets all of its regulatory commitments, especially against a backdrop of the challenging regulatory change agenda (e.g. GDPR, Universal Credit). We remain alert to the changing agenda and continue to monitor the impact of potential changes across all risk categories.
General Data Protection Regulation (GDPR) The risk of a material loss resulting from compliance with new GDPR legislation which will become enshrined in UK law from May 2018 (or the receipt of regulatory fines due to non-compliance).	We proactively seek to manage and mitigate the risks associated with GDPR. During 2017 we appointed a General Data Protection Officer (GDPO) who has actively monitored and assessed the impact of proposed changes in UK GDPR legislation as it has moved through parliament. The GDPO is supported by a dedicated change programme to ensure that we are compliant when the new legislation comes into final effect.
UK health and social provision The inherent risk that treatment of private (insurance) provision benefits under Universal Credit may have an adverse impact on the life and health insurance industry, particularly around the individual income protection market where LV= is recognised as a market leader.	We continue to liaise with the relevant Government departments and the industry to quantify the potential impact and implications of Universal Credit on existing and prospective (income) protection policyholders. As we lobby for fairer treatment from Government, we continue to hold awareness and training sessions internally and externally and are reviewing our claims proposition and communications to existing policyholders. Furthermore, as Universal Credit is rolled out across the country, we're addressing any individual LV= policyholder claimant issues as they arise on a case-by-case basis.
Corporate bond spread The risk that there is a change in the market value of LV='s corporate bond holdings over and above risk free yields.	We continue to accept corporate bond spread risk as part of our business strategy and risk taking activity. With the exception of Brexit, risks from the domestic market remain relatively stable overall across the major markets, spreads between corporate and sovereign bond yields remain compressed, particularly for high-yield corporate bonds. In managing this risk we stipulate minimum levels of credit quality (both at an individual and portfolio level) and place limits on credit concentrations by issuer, sector and type of instrument.
Conduct risk The risk that conduct risk controls are ineffective for new business and/or our legacy books contain a material number of cases where there is evidence of customer detriment due to mis-selling.	We continue to consider all aspects of conduct risk and the potential impact of customer detriment in everything we do. During 2017, we updated our conduct risk framework and suite of associated management information. Control enhancements and structural changes have also been made to enable senior management and the Risk Committee to provide greater challenge and support around the conduct risk agenda. These activities will continue into 2018.
Information security / cyber security The risk that LV= does not have a sufficiently robust strategy and control infrastructure in place to protect itself against, or recover from, an event which results in the loss, misuse or reduction in the confidentiality, integrity or availability of its customer data.	We continue to remain alert to and seek to minimise the threat from cyber risk. Recent high profile ransomware attacks around the world show this threat to be both real and increasing. Cyber security therefore continues to feature within our top risks in order to reflect the heightened risk environment and level of additional vigilance undertaken in order to maintain our security architecture framework.
IT change delivery The risk of reduced availability, lack of stability and/or total failure of critical IT systems as a result of a failure to execute IT change effectively.	We continue to be alert to the increasing demands placed upon our IT infrastructure, especially with the approaching IT systems separation under the strategic partnership with Allianz. To address the issue of stretch across the change portfolio a monthly summary of project activity is presented to the group executive committee, who apply a start/stop/continue lens to prioritise project activity. This has been further supported by a regular review of critical change milestones and a central review of the strategic investment budget allocations.
Delivery risk The risk that key strategic initiatives, business objectives and/or regulatory obligations are not met due to loss of key staff or the demands of the change portfolio exceed the available capacity.	We continue to experience and initiate a high degree of internal change whilst also managing our business-as-usual commitments. In order to achieve this successfully, we regularly review our capacity and resourcing requirements, responding to any pressure points through a combination of careful capacity planning, reprioritisation and/or resource management. We also have a number of key initiatives in place to ensure that the wellbeing of our staff is monitored and our teams are supported.

Current and future developments

The group completed two transactions during 2017 that had a significant (positive) impact on its overall risk profile. These were:

- 1 The sale of a majority interest in its general insurance business to Allianz over two tranches, with completion of the first tranche (49%) at the end of 2017 and the remaining second tranche scheduled for completion by 31st December 2019; and
- 2 The reinsurance of longevity and market risk associated with our with-profits deferred annuities within the OB pensions portfolio to Reinsurance Group of America.

The Risk Committee received regular reports from the business and from the chief risk officer on the impact of these transactions and reported on its findings and recommendations to the board.

Following an external review of risk management, performed at the committee's request in 2016, the committee has also closely monitored the development and implementation of improvements to the risk management target operating model (people, processes and systems). In particular, during 2017 the Risk Committee reviewed and approved: the risk mandate, the risk appetite framework, the implementation of new liquidity risk tolerances, improvements to conduct risk and the performance of a broad range of operational risk scenario workshops.

This programme of continuous review and improvement will continue into 2018 with the introduction of a revised target operating model and organisational design for group risk management. This will enable the delivery of updated risk appetite and framework documentation, a planned upgrade to our risk management system (driving improvements in our risk and control assessment processes) and a focus on embedding an effective and proportionate risk management culture through better engagement and collaboration across all three lines of defence.

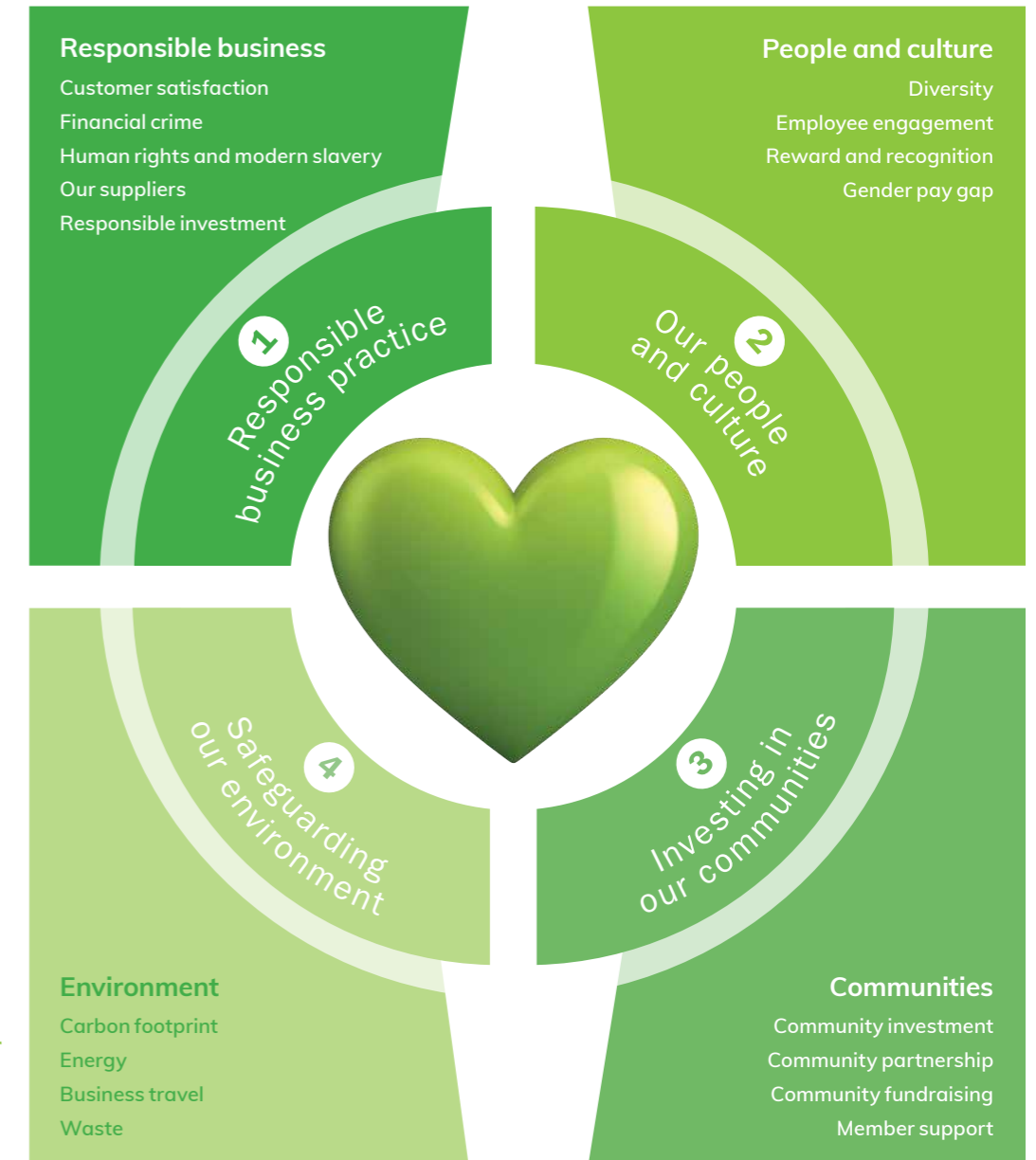
Corporate Responsibility Report

Katie Wadey
Chief Customer Officer



We believe that everyone deserves to Live Confident and our approach to corporate responsibility is all about putting our customers at the heart of our business, looking after our people, investing in our communities and caring about our impact on our surroundings.

To help us focus on those areas where we believe we can make the most difference, we have structured our approach around four key areas:



Our people donated over
2,500
volunteering hours





Responsible business practice

Customer satisfaction

Creating great experiences for our customers by going above and beyond what is expected of an insurance company is one of the things that makes us different and in 2017 helped us move up 68 places to 32nd in the Nunwood rankings – KPMG’s independent survey of 295 well-known brands across all consumer facing sectors.

From time to time, things can go wrong and when that does happen we aim to put right any complaints as quickly as possible and make sure our customers receive a fair outcome, which is reflected by the number of appeals that were upheld by the Financial Ombudsman Service (FOS) in our favour.

	Complaints received 2017	Referred to FOS 2017	Outcome in LV=’s favour 2017
General Insurance	16,564	4%	79%
Life*	1,751	5%	90%
Heritage	499	5%	83%
Legacy business**	1,815	1%	100%

* Includes protection, retirement solutions, tied advisors, whole-of-market.
 ** Includes bank.

Financial crime

Fighting for better is central to our values and culture and in 2017 our commitment to fighting financial crime helped protect LV= from potential fraudulent losses of £56 million.

In June 2017, the new UK Money Laundering regulations were introduced. LV= has been working to ensure new compliance expectations are met and it also gave us an opportunity to review our group approach to sanctions, money laundering and terrorist financing risks. As a result the business is now not only compliant with new regulations, we’ve also built more efficient ways of working and strengthened our staff knowledge.

In September 2017, the Criminal Finances Act 2017 introduced the new corporate offence of failure to prevent facilitation of tax evasion. This means LV= needs to ensure appropriate systems and controls are in place to prevent our staff, or independent parties acting on behalf of LV=, knowingly facilitating tax evasion. As a result of this we are implementing new processes across our business areas and also investing more time in our people through training and awareness sessions to ensure our people are educated and aware.

Bribery and fraud

Bribery and fraud is something we take seriously as these types of crimes undermine the confidence and trust that our customers place in us and it is the responsibility of every employee to ensure they do not engage in these practices. We have robust controls to detect and prevent bribery, fraud and any other financial crime including a fully confidential ‘Speak up’ line where our people can report crime and other misconduct behaviour.

Human rights and modern slavery

At LV= we are committed to fair employment practices and to upholding human rights. Our Modern Slavery Statement, which is published annually on LV.com, confirms our approach and the steps that we have taken to assess and mitigate against the risk of modern slavery and human trafficking occurring in our business and supply chains.



Our suppliers

As a UK-based company our supply chain is straightforward, with the majority of our suppliers also in the UK. In 2017, our total spend was £1.75 billion and the largest proportion of our spend is related to UK-based suppliers who help resolve home and motor claims for our customers.

In 2017, to help strengthen LV=’s oversight and control of its supply chain we became members of Financial services Supplier Qualification System (FSQS). FSQS is a community based due diligence system which supports ongoing supplier policy compliance and demonstrates to our customers, members and our regulators that we are in control of our third-party relationships.

We’re delighted with the development of LV= Green Heart Procurement, which is our commitment to partnering with social enterprises to help them compete effectively for our business. Social enterprises reinvest their profits to address some of the most pressing issues in society. As they start to win our business, LV= will be providing help and support for people going through some of life’s toughest challenges, giving them confidence when they need it the most. To underpin our commitment, LV= are proud to be one of the first ten businesses to sign-up to the Buy Social Corporate Challenge, which aims to push £1 billion of spend towards social enterprises by the end of 2020.

Responsible investment

Our customers put their trust in us to ensure that their money is well managed, so it is important that we work with investment partners that share our values and belief that well-run businesses who understand the need for long-term sustainability, largely return better value to investors.

Our two key investment partners are Columbia Threadneedle Investments and BlackRock. Both are signatories to the UN’s Principles for Responsible Investment and the UK Stewardship Code on Corporate Governance. Investment decisions are not made solely on financial performance, with environmental, social and ethical considerations recognised as important factors in determining returns.



Our people and culture

Creating a diverse workforce

A diverse and inclusive culture is key to the successful delivery of LV=’s future strategy. We are committed to creating a culture which respects and values individual differences, a place where everybody feels comfortable being themselves and where their views are recognised and respected in a truly inclusive business. For 2017 gender balance was a key focus.

Board diversity policy

The board has adopted the following diversity policy: “LV= recognises and embraces the benefits of having a diverse board, and sees diversity at board level as an essential element in maintaining a competitive advantage. A truly diverse board will include and make good use of differences in the skills, regional and industry experience, education and professional background, race, gender, and other qualities of directors. These differences will be considered in determining the optimum composition of the board and, when possible should be balanced appropriately. With regards to gender, the board supports the target for 30% female representation on the board by 2020. All board appointments will be made on merit and in the context of the skills and experience the board, as a whole, requires to be effective. The Corporate Governance and Nomination Committee reviews and assesses board composition on behalf of the board and recommends the appointment of all new directors to the board.”

Application of the board diversity policy

In reviewing board composition, the Corporate Governance and Nomination Committee will consider the benefits of all aspects of diversity including, but not limited to, those described above, in order to maintain an appropriate range and balance of skills, experience and backgrounds on the board.

In identifying suitable candidates for appointment to the board, the Corporate Governance and Nomination Committee will consider candidates on merit against objective criteria and with due regard to the benefits of diversity on the board. For further details of the board appointment process, see page 71.

Performance against policy

As at year end, women made up 13% of the LVFS board including 17% of non-executive directors. During the year the board appointed one executive director and one non-executive director (both male) and recommended two further directors who have been appointed in 2018 (one male, one female). These appointments are based on the recommendations of the Corporate Governance and Nomination Committee, using the assistance of an external recruitment consultant. Each director had a different area of expertise and professional background which will balance the skills and experience of the board. For more details of the composition of the board and the new appointments, see pages 54 to 60.

Women in Finance Charter

We want talented people to have equal opportunities to grow their careers at LV= and we’re committed to increasing the female population at senior levels in line with the voluntary HM Treasury Women in Finance Charter we signed up to in 2016. We’re on track to achieve our pledge to have 40%, or above, female representation at senior levels by 2020 and we’re delighted that one of our female leaders, Katie Wadey, our chief customer officer, was recognised in the ‘Top 100 Women to Watch’ list for 2017 as part of the Female FTSE Index published by Cranfield University.

30% Club

In 2017 as part of our focus on gender diversity we signed up as a partner to the 30% Club, a cross-company, cross-sector mentoring scheme, with the ultimate goal of broadening the pipeline of female talent coming through organisations and making a step-change to the number of women attaining senior and board roles.

Women in Finance Awards

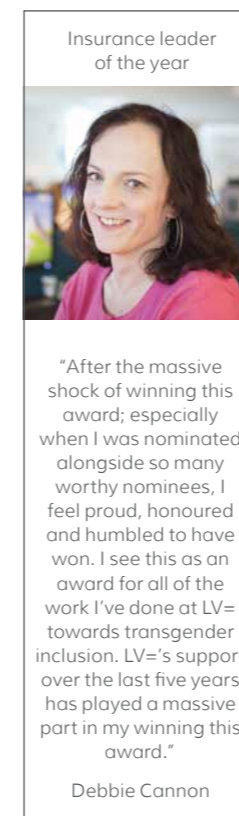
The Women in Finance Awards are the finance industry’s largest diversity event and in 2017 we sponsored the headline award ‘Woman of the Year’, as presented by our chairman, Alan Cook.

We were also very proud to see one of our colleagues and Pride network champion, Debbie Cannon, awarded ‘Insurance Leader of the Year’ at the awards for her truly inspiring journey, her compelling honest story, and for standing up as a role model to other women in the sector.

Disability

Disability continues to be an area of importance to LV=. Our employees have been increasingly open regarding both seen and unseen disabilities over the last two years, through the sharing of personal stories.

As we move into 2018, in addition to gender balance our LV= Equals network is driving our multicultural diversity and inclusion agenda and we’re committed to re-energising our Disability Network as part of our wider diversity and inclusion agenda.



90%
 say we support diversity in the workplace*



90%

believe strongly in the goals and objectives of LV=*



89%

believe our values are clear*



90%

feel they are able to use their own judgement to do the right thing*



87%

feel they have the opportunity to ask questions*

* Employee engagement results

Employee engagement

We know that having engaged employees has a positive impact on customer experience and therefore business performance, which is why each year we invite our people to give us feedback via our Engage employee survey. The survey is anonymous and the results identify key focus areas we all need to work on for the rest of the year.

2017 has been a year of significant change across the group and we recognise that the uncertainty that our people have experienced during this time is reflected in the sustainable engagement score of 76%, 5% lower than 2016.

Reward and recognition

We are committed to making sure our people are rewarded fairly through the regular review of our pay levels to ensure they are competitive both internally and externally with market rates. We pay all our employees at least the Living Wage rates of pay. In 2017, the average full time employee salary was £32,200 (2016: £31,500). In addition to basic pay, all our employees participate in an incentive scheme which is structured around both individual and business performance. In 2017 the average bonus was 11.7% of bonus-able earnings.

All employees automatically become members of the LV= Pension Plan when they start working for us. They also have access to the LV= Pensions Village which allows them to track their contributions and the impact contribution levels will have on their retirement plans.

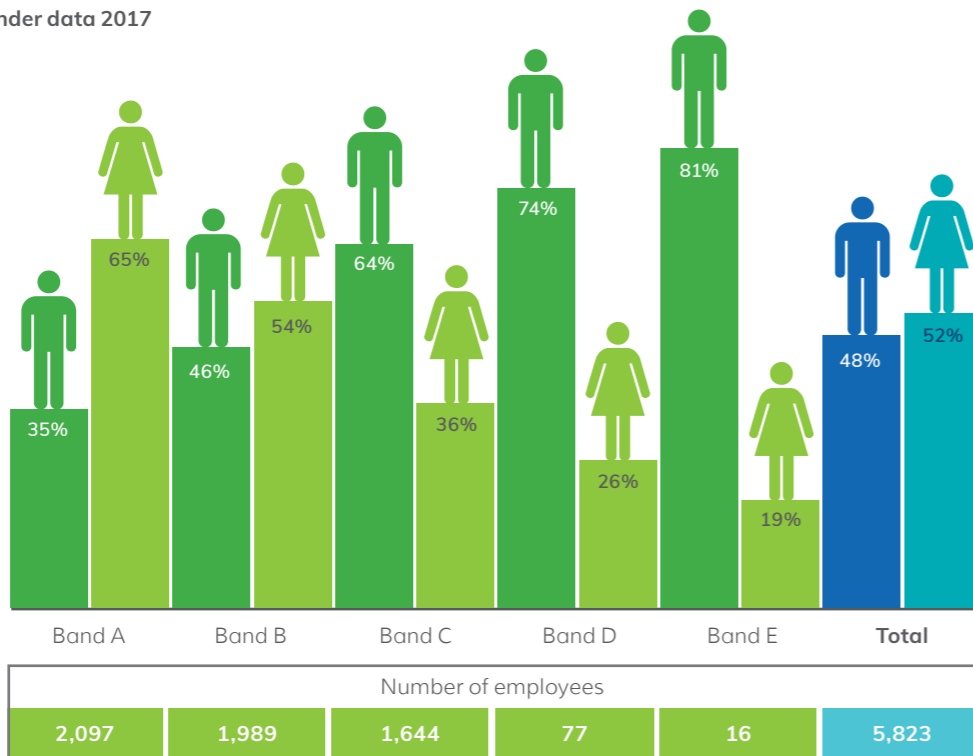
We understand that the needs of our employees are different, so through our flexible benefits platform we give all employees the opportunity to select the benefits most suited to their individual needs and lifestyles.

Gender pay gap

UK employers with over 250 employees must now report on their gender pay gap. This is a measure of the difference between males' and females' average earnings across an organisation and something that we welcome because we want talented people to have equal opportunities to grow their careers and we believe that gender balance is vital to our success. We have published our gender pay gap, using data from April 2017, and at 28%, our mean gender pay gap is lower than the indicative average for the financial services industry (34%). We understand why it exists, recognise there is work to be done and are focused on the steps needed to close the gap. To view our full Gender Pay Gap Report visit LV.com.

Proportionately the split between the overall number of males and females working for LV=, as at the end of 2017, stood at 52% female and 48% male. From a job role perspective where a band A is most junior and band E most senior, the infographic below shows the ratio of female employees in each band:

Gender data 2017

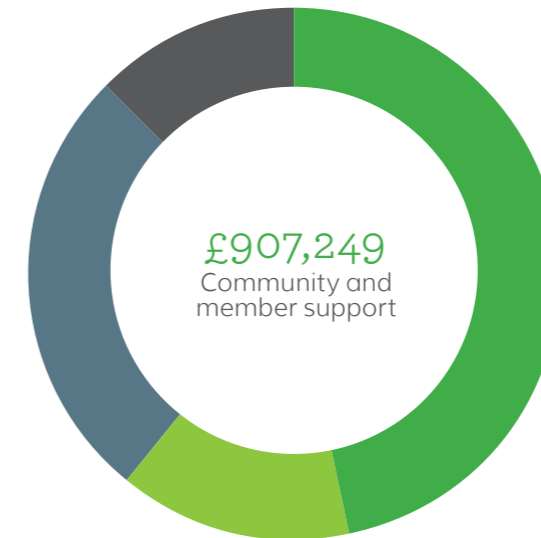


Key

Band	Typical roles
A	Sales, service and claims representatives
B	Team leaders, personal assistants and administration
C	Technical and managerial
D	Senior leaders and heads of department
E	Executives



Investing in our communities



- Community investment **£373,808**
- Community partnerships **£75,546**
- Community fundraising **£330,075**
- Member support **£127,820**

Our focus for 2017 has been to better understand the impact we make in communities. In June we became a member of the London Benchmarking Group so that we could better measure the impacts made through our commitment to the community. Last year we reached just over 42,000 people through our investment, partnership and fundraising in three key areas of health, education and social welfare.

Community investment

We want to create a lasting positive impact through a programme of activity, not only by way of donations, but by harnessing the power of our own people volunteering their time and fundraising. During 2017 our community contributions were worth over £373,000 to a variety of good causes and community projects.

To help decide how best to lend our support we have Regional Community Committees made up of employee volunteers in each of our offices. They continued to work with the London Benchmarking Group to better understand the impact of the £175,000 donated and support given to 228 charities during the year.

Our people truly live our values of 'we don't wait to be asked' and 'we make it feel special' and make a huge difference by getting out in the community sharing their skills, knowledge and time, with LV= matching up to two and a half days per year. This not only benefits the community, and in 2017 over 2,500 hours were spent supporting directly in our local communities, but is great personal development for our people.

Community partnerships

Over the years we have created a number of community partnerships and built strong relationships with charities and community groups on programmes around shared interests.

Our longest standing partnership is LV= KidZone now in its eleventh year. Working with Bournemouth council and the RNLI, the scheme helps keep children safe along Bournemouth's beaches. In 2017, around 40,000 wristbands were handed out to local and visiting families and they reunited 219 children, an all-time record number of lost children, on average within just six minutes, with their loved ones.

A more recent partnership is with AutoRaise, the vehicle repair industry's charity tackling the industry-wide skills shortage. As a car insurer, we know that our customers need their vehicles to be repaired to a safe and high standard by highly skilled people and as a platinum partner with AutoRaise, we're working with the charity to help attract the next generation of apprentices and raise the profile of the benefits that a career in the repair industry can bring.

Loneliness continues to be a big society concern and we've strengthened our commitment in 2017 (by increasing the number of employees by 50% to sixty volunteers) to take part in Age UK's telephone befriending service. During the year, our people have made over 950 calls to those in society who may not otherwise get to speak to another human being.



LV= KidZone reunited

219

lost children with their families (up from 184 in 2016)

Call in Time spent

500 hours

talking to lonely older people





55%
of our people registered in our Pennies for Charity scheme

Community fundraising

It isn't just the close to home charities and community projects that bring out the best in our people, for over a decade we've been supporting national fundraising events like Children in Need, Comic Relief and Macmillan Coffee Morning. In 2017 our peoples' fundraising meant these charities received over £33,000. It is not only their fundraising that helped these charities, as we continue to be one of Children in Need's official call centres for their telethon event in November, with over 100 of our people volunteering and taking over 1,500 calls and £60,000 in donations on the night.

Our payroll giving and £ for £ charity matching schemes continue to support our people as they raise funds for causes close to their own hearts. In 2017 our people raised over £244,000 and benefited from a further £67,500 in corporate matching.

We also now have over half of all of our people donating the odd pence from their net pay each month through Pennies for Charity, raising over £18,600 in 2017, which was distributed to a local charity voted for by each office.

Extra support for members

The Member Care Line is an additional benefit available to all members offering a 24 hour telephone advice line where members can access legal, medical and counselling support. In 2017 advisers dealt with 1,064 calls from members seeking assistance, at a cost of £42,000.

First established in 2012, the Member Community Fund ran for the first six months of 2017 with £20,000 distributed to The Pod charity, ACT for SMA and The Encephalitis Society.

The Member Support Fund was set up in 2001 to help members in financial hardship. During the last decade this Fund awarded over £450,000 to more than 500 members and their families. During the year, the Member Support Fund has supported 40 members with over £50,000 and became part of Green Heart support at the end of June.

Members who choose to take out car, home, pet, travel, caravan, motorcycle or classic car insurance with us can receive between 5-10% off the price of their premium. This financial benefit amounted to £2,154,540 of direct value to members in 2017.

We reached over **42,000** people through our social programme

Regional community committees donated **£175,000** and helped 228 charities

£330,075 fundraised by our people for good causes



Safeguarding our environment

Environment

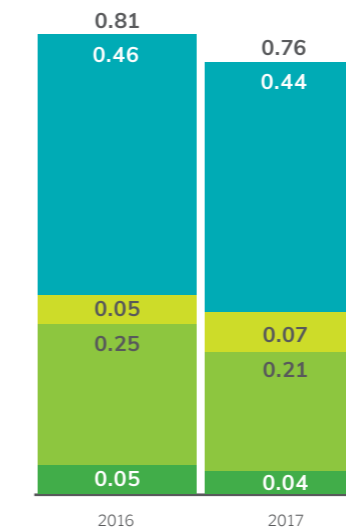
As a UK insurer, our environmental impacts are small in comparison to many other businesses. However, we are committed to managing the impacts of our day to day business on the three areas where we have most influence – carbon emissions as a result of our energy consumption, employee travel, and our overall waste management.

Carbon footprint

In 2017 we rolled out a power management tool called Nightwatchman which automatically shuts down our idle desktop workstations after business hours, and then wakes them back up at the start of the next working day. This measure should reduce our carbon footprint by as much as 566 metric tonnes of CO2 a year from next year.

Greenhouse gas emissions

Carbon emissions (tonnes CO2 equivalent p/employee)



Key

- Purchased Electricity
- Purchased Gas
- Business Travel (Land)
- Business Travel (Air)

* From April 2017 the assumptions on waste and recycling collection weights per volume changed as a result of a change of provider. These different assumptions were applied retrospectively to enable like for like comparison.



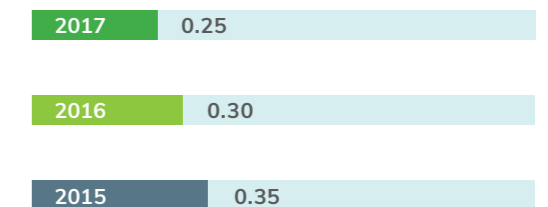
Energy

Energy usage (tonnes CO2 equivalent p/employee)



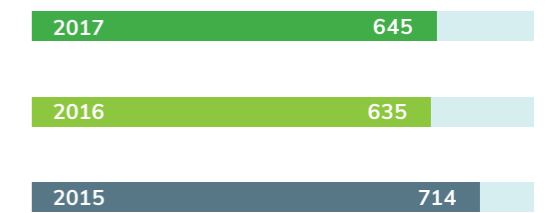
Business travel

Travel (tonnes CO2 equivalent p/employee)



Waste and recycling*

Waste (tonnes)



Recycling (as a % of overall waste)





Corporate Governance Report

Corporate Governance Statement	54
Directors' Report	72
Report on Directors' Remuneration	75

Overview

The following pages outline our corporate governance framework and our approach to remuneration.

Alan Cook
appointed as Chairman

Exceeded maximum profit targets for Bonus and LTIP

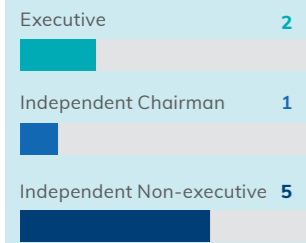
75%
Independent members on the board

We adhere to the UK Corporate Governance Code

Corporate Governance Statement

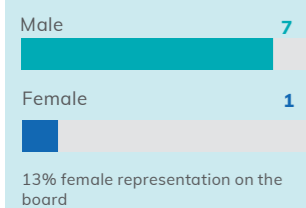
We comply with the Financial Reporting Council's UK Corporate Governance Code, (the 'Code')

Board member composition

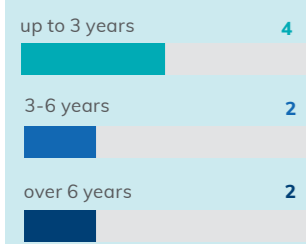


We therefore satisfy the Code's recommendation that at least half of the board should consist of independent non-executive directors.

Board member balance



Board members' tenure



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

(As at 31 December 2017)

Compliance with the Code for the year ended 31 December 2017

Due to the Society's debt listing on the London Stock Exchange, the board has adopted a governance structure based on the principles and provisions of the Code with the following exceptions during the reporting year:

- i. **a decision taken by the board to allow Mark Austen (chairman until June 2017) to be a member of the Audit Committee.** The Audit Committee membership includes three independent non-executive directors as required by the Code and Mark's membership to the committee was in addition to this. The Code recommends that the chairman may only be a member of the Audit Committee in 'smaller companies'¹. However, Mark was a member of the Audit Committee prior to his appointment as chairman of the board in 2013 and it was deemed that Mark had recent and relevant financial experience and continued to make a valuable contribution to the Audit Committee. Alan Cook was appointed as chairman following Mark's resignation in June 2017 and the board decided that Alan would not replace Mark as a member of the Audit Committee.
- ii. **a decision taken by the board that only the chairman will offer himself for annual re-election by members at the Annual General Meeting.** The board has determined that the annual election of the chairman provides an adequate means for members to register concern with the performance of the board directors who continue to stand for re-election at least every three years.

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

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

The role of the board is to set the tone from the top on the group's governance, culture and values and to be collectively responsible for the long-term success of the group. For the board this means not only ensuring that we comply with all relevant laws and regulations and

ensuring that we have high standards of internal control and risk management, but that we run our business with integrity.

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

Working as a collective board

At the year-end, the board comprised an independent non-executive chairman, five independent non-executive directors and two executive directors (following the resignation of Steve Treloar on 28 December 2017) who collectively possess an appropriate balance of expertise in the financial services industry, including general insurance and life insurance, investments, risk and governance. This ensures a balance of skills, understanding and perspectives relevant to the group's business. As members of a unitary board, the non-executive directors meet, without the executive directors present, to constructively challenge and help develop proposals on strategy. The particular skills and experience that each director brings to the board are included on pages 58 to 60. The composition and tenure is summarised to the left.

Changes to board composition

There have been a number changes at board level during the year under review:

Alan Cook joined the Society's board on 1 January 2017 as a non-executive director and chairman designate. Following a member vote at the AGM, Alan became chairman of the board in June 2017, replacing Mark Austen who had served four years as chairman and ten years on the board. Alan has extensive financial services experience across insurance, banking and investment and his full biography has been included on page 58.

Andy Parsons joined the Society in June 2017 as a board member and group finance director following the departure of Philip Moore. Andy has over 25 years' industry experience (see biography on page 58).

After six years, Cath Keers resigned from the board in July 2017. The board welcomed Colin Ledlie as a new non-executive director in August 2017.

Colin has also joined the Audit, Risk and With-profits Committees and his biography, detailing his relevant skills and experience, is included on page 59.

Steve Treloar, who joined the Society in May 2016 as an LVFS board member, resigned from the board in December 2017 following the sale of a 49% stake in the general insurance business to Allianz. He remained on the board of Liverpool Victoria General Insurance Group Limited as chief executive. Further details of the transaction with Allianz have been included on page 22.

In 2018 the board was pleased to welcome two new non-executive directors; Alison Hutchinson and Luke Savage. Alison joined the board on 1 January 2018 and has a strong background in financial services as well as IT, digital marketing and cyber security. Luke joined the board on 1 February 2018 and was most recently group chief financial officer at Standard Life and prior to that finance director at Lloyds of London for ten years.

Board effectiveness

The Code recommends an externally facilitated review of board effectiveness at least every three years. Although a review was undertaken in 2015, as a prerequisite of the chairman's appointment, it was decided that the board undertake an external review in 2017. The chairman, supported by the company secretary, interviewed a number of consultants and appointed Steve Southall of EY to carry out the review and work alongside the board. Steve has significant experience of conducting board evaluations for companies within the financial services industry and offered a different perspective to the more traditional governance-focused reviews.

The process included a full review of the Audit, Remuneration and Risk Committees focusing fundamentally on the committees' interaction with the board and also considered the quality, transfer and escalation of information.

In light of the number of changes to the board composition throughout the year, and the strategic challenges faced by the Society, the main objectives of the evaluation were to provide an assessment of the past effectiveness of the board in order to make recommendations and provide guidance for the new chairman in leading the board going forward.

EY met initially with the company secretary to gain a broader understanding of the board's history and approach to governance before undertaking a detailed review of a broad range of documentation. EY also carried out interviews with all board members as well as the chief risk officer, director of compliance, internal audit director and the company secretary. The interviews focused on the effectiveness of the current board, but also discussed the issues which had historically impacted the board's effectiveness.

EY observed a board, Audit Committee and Risk Committee meeting to gain a broader understanding of the operation of the board and the interaction and challenge made by the directors.

EY presented the results of the evaluation and recommendations to the board at its meeting in November 2017 and a number of actions were agreed to be addressed throughout 2018.

The directors are satisfied that the board and each of the committees that were evaluated are operating effectively. The review has identified some actions and recommendations that will help maintain and improve its effectiveness. The following 'key areas' were highlighted and the actions taken to improve on these areas are outlined in the table below.

Key focus area	Action taken
Governance framework Continue to improve the form and focus of board meetings and the structure of board agendas as the board moves into a more "business as usual" environment following a period of transition.	The format of the meeting agendas will be updated to ensure sufficient time is dedicated to each agenda item. An effective governance framework will be implemented to accurately capture delegated authorities and the process for issuing and monitoring actions arising from the meeting, through to closure, will be improved.
Board operations Maintain and continuously develop the appropriate skills and experiences of the collective board. Continue to make improvements to the flow of management information before submission to the board.	A training programme (both collective and individual) will be prepared to strengthen the skills and knowledge of the board. The expectations of the senior independent director will be discussed and the role strengthened and used more effectively to assist the chairman. Further training will be provided to those preparing board papers and the board and committee schedules will be reviewed to facilitate the flow of management information and to ensure that the discussion and challenge, through appropriate forums, has been held and approvals sought before any paper is submitted to the board.
Culture and behaviour To continue to develop a culture which enables effective challenge by the board, led by the chair.	Meetings of the non-executives will be held outside the formal board meetings to discuss, amongst other matters, the effectiveness of the chairman.
Management information Guidance and additional support to the board will be provided to ensure that they have all the information required (including historic and current) to discharge their duties.	Guidance and refresher training on how to use the on-line board paper portal will be provided to the board to ensure that information can be easily accessed when needed. The use of the on-line 'reading rooms' to ensure the most effective use of board papers and reference materials will continue to be used.
Risk and oversight The board will have a greater involvement in monitoring and reviewing the risks affecting the Society and its business and the board.	Improved reporting on the existing and emerging risks will be produced in order to facilitate discussion and challenge from the board. Conduct risk will continue to be a priority for the Risk Committee and the board.

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



The Board

The board ensures that we truly live our values every day, delivering 'Green Heart Experiences' for our customers, colleagues and members, harnessing the latest technologies and building a business that is sustainably lean and strong. By doing this the board help ensure that LV= will be able to make people 'Live Confident'. We have a strong, experienced and diverse board with a good balance of skills.



Back row L to R

David Barral
David Neave
James Dean
Andy Parsons

Front row L to R

Colin Ledlie
Caroline Burton
Alan Cook
Richard Rowney



Alan Cook CBE (64) Chairman

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

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

External appointments: Chairman of the University of Bedfordshire and chairman of Chetwood Financial Ltd.

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

Chairman of Liverpool Victoria General Insurance Group Limited and its two regulated subsidiaries with effect from 28 December 2017.



Andy Parsons (53) Group Finance Director

Date of appointment: 30 June 2017

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

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

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



Richard Rowney (47) Chief Executive

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

Experience: Richard spent 14 years at Barclays Bank holding a number of senior positions across corporate and retail banking including overseeing integration of the Woolwich and Barclays retail banks. Since joining LV= in 2007, Richard has overseen the creation of the operational support areas, including the rebrand to LV= and the in-sourcing of our IT and HR functions. Richard was appointed group chief executive in 2016 and prior to this he had been managing director of life and pensions, appointed in 2010. Richard led the transformation of this business to create one of the UK's leading protection and retirement specialists, including the acquisition of Wealth Wizards in 2015.

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

Committee membership: Member of the Investment and Corporate Governance and Nomination Committees and a director of various LV= group subsidiaries.

Non-executive director of Liverpool Victoria General Insurance Group Limited and its two regulated subsidiaries.



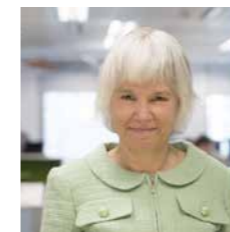
James Dean (60) Senior Independent Non-Executive Director

Date of appointment: 26 July 2012

Experience: James is a chartered accountant and is recognised as an expert in insurance accounting having spent much of his 30 years' experience in audit and advisory roles. As a senior partner at EY he dealt with clients such as AXA UK PLC, Prudential PLC, Legal & General Group PLC, RSA Insurance Group PLC and Aviva PLC, also serving on boards outside the firm including as chairman of the ICAEW Insurance Committee. He is also a former global IFRS leader for the insurance sector of EY.

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

Committee membership: Chairman of the Audit Committee and member of the Risk and Corporate Governance and Nomination Committees. As the senior independent director, James provides a sounding board to the chairman and is available to members if they have concerns which contact through the normal channels of chairman, chief executive and other executive directors has failed to resolve or for which contact is inappropriate.



Caroline Burton (68) Non-Executive Director

Date of appointment: 9 September 2011

Experience: Caroline has a life insurance background and is a highly experienced figure in the asset management industry having spent 26 years with Guardian Royal Exchange PLC, where she was in charge of investments from 1990 until 1999. She acts as a pensions and business adviser for a number of pension funds and charities and her expertise puts her in good stead to monitor the management of LV='s assets.

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

Committee membership: Chairman of the Investment Committee and (with effect 20 June 2017) chairman of the Remuneration Committee. Caroline is a member of the Audit and Corporate Governance and Nomination Committees. Caroline was also a non-executive director of LV= general insurance subsidiaries until 28 December 2017.



David Neave (58) Non-Executive Director

Date of appointment: 1 June 2013

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

External appointments: Non-executive director of Slater & Gordon UK, FirstPort Insurance Services Ltd, the Solicitors Indemnity Fund and a director of Bayleaf Consulting Ltd.

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

Non-executive director of Liverpool Victoria General Insurance Group Limited, with effect from 28 December 2017, and its two regulated subsidiaries, since 16 December 2016. Chairman of the Nomination and Remuneration Committee and the Risk Committee for these entities.



David Barral (56) Non-Executive Director

Date of appointment: 7 March 2016

Experience: David has had a 38 year career in financial services. He joined us from Aviva PLC where he was the chief executive of UK and Ireland life insurance, the largest business unit within the Aviva group. Previous positions include sales director, marketing director and chief operating officer. David brings a mix of strategic, transformation and operational experience with a strong focus on customers, risk and governance. He is a former chairman of the ABI Retirement and Savings Committee.

External appointments: Chairman of Virgin Wines, independent customer champion at Old Mutual Wealth.

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

Non-executive director of Liverpool Victoria General Insurance Group Limited and its two regulated subsidiaries with effect from 28 December 2017. Chairman of the Audit Committee for these entities.



Colin Ledlie (51) Non-Executive Director

Date of appointment: 1 August 2017

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

External appointments: Non-executive director of ReAssure, BUPA and the National Records of Scotland. Chair of the Institute and Faculty of Actuaries' Finance and Investment Board.

Committee membership: Member of the Audit, Risk and With-profits Committees.

Appointed in 2018



Alison Hutchinson CBE (50) Non-Executive Director

Date of appointment: 1 January 2018

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

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

Committee membership: Member of the Remuneration Committee.



Luke Savage (56) Non-Executive Director

Date of appointment: 1 February 2018

Experience: Luke has over 30 years' experience in a range of finance and operational roles across banking and insurance. He is the former group chief financial officer of Standard Life PLC, a FTSE 100 life insurance and long-term savings and investment business. Luke is a qualified accountant. Previous positions include director of finance, risk management and operations at Lloyd's of London, global head equity product control at Deutsche Bank AG and various positions at Morgan Stanley.

External appointments: Director of Lutine Yachts Ltd. Member of the Council, Treasurer, and chair of the Finance and Investment Committee of Queen Mary University of London.

Committee membership: Member of the Audit Committee (chair of the Audit Committee with effect from 1 April 2018).

Out-going directors

Steve Treloar (49) Former Managing Director of General Insurance

Date of appointment: 5 May 2016

Date of resignation from the LVFS board: 28 December 2017

External appointments: Chair of the Association of British Insurers Property Committee.

Philip Moore (58) Former Group Finance Director

Date of appointment: 10 November 2010

Date of resignation from the LVFS board: 29 June 2017

External appointments: Trustee and chairman of the finance committee of the Royal British Legion, chair of governors at Aylward Academy. Audit Committee chair of Towergate Insurance until 31 March 2017.

Mark Austen (68) Former Chairman

Date of appointment: 20 September 2006 (LVFS board), 23 May 2013 (chairman)

Date of resignation from LVFS board: 20 June 2017

External appointments: Non-executive director of Alpha Bank London Ltd.

Cath Keers (52) Former Non-Executive Director

Date of appointment: 14 December 2010

Date of resignation from LVFS board: 20 June 2017

External appointments: Non-executive positions at Royal Mail Group and Talk Talk Group.

Terms of appointment

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

External commitments

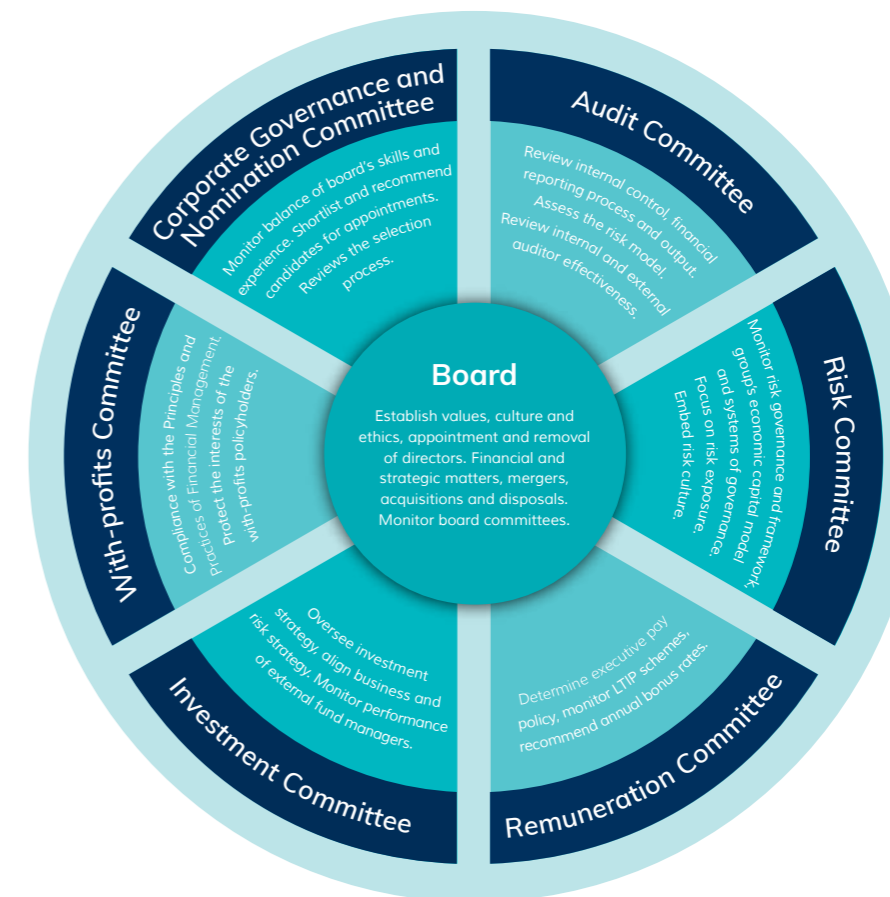
Executive directors may be invited to become non-executive directors of other companies, subject to the agreement of the Society. These appointments provide an opportunity to gain broader experience outside LV= and therefore benefit the Society. Providing that appointments are not likely to lead to a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

Each executive director's external commitments are listed above. All non-executive directorships have been approved by the board and are deemed not to conflict with the Society's business. Each executive director retains the fees received from the external appointment. Details of such fees are made available on page 85.

Board committees

Each committee is provided with sufficient resources to undertake its duties. A full list of duties and the activities undertaken during the year can be found on pages 63 to 71.

The terms of reference for the board committees are reviewed each year and published on our website. They can be viewed at lv.com/boarddocs



Board membership and attendance in 2017

In addition to the 11 formal board meetings held during 2017, the board also met four times on an additional ad-hoc basis to discuss primarily the Allianz transaction and twice for strategy and planning sessions. In 2018 the board expects to meet at least ten times and to have two strategy and planning sessions.

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

Formal meetings held: 11	Eligible to attend	Meetings attended	% of attendance
Alan Cook ¹	11	11	100%
Richard Rowney	11	11	100%
Andy Parsons ²	5	5	100%
James Dean	11	11	100%
Caroline Burton	11	11	100%
David Neave	11	11	100%
David Barral	11	10	91%
Colin Ledlie ³	4	3	75%
Steve Treloar ⁴	11	11	100%
Philip Moore ²	6	6	100%
Mark Austen ¹	6	6	100%
Cath Keers ⁵	6	5	83%

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

The composition of the board varied as follows:

- 1 Alan Cook joined the board on 1 January 2017 and took over as chairman on 20 June 2017 following the departure of Mark Austen at the AGM.
- 2 Andy Parsons joined the board on 30 June 2017 following the departure of Philip Moore on 29 June 2017.
- 3 Colin Ledlie joined the board on 1 August 2017.
- 4 Steve Treloar resigned from the board on 28 December 2017.
- 5 Cath Keers resigned from the board on 20 June 2017.

Re-election and retirement

Under the Society's rules all directors are required to stand for re-election at least once every three years. Alison Hutchinson, Colin Ledlie, Andy Parsons and Luke Savage will stand for their first re-election at the Society's 2018 AGM. Further details of the directors' suitability and expertise can be found within their biographies on pages 58 to 60.

Under the Corporate Governance Code, in order to maintain the independence of the board, directors must retire after a six year term. Caroline Burton and James Dean have each completed their six year term and will retire in 2018. It is proposed that Luke Savage will take on the chairmanship of the Audit Committee and David Barral will fulfil the role of senior independent director following James Dean's retirement.

Under the Corporate Governance Code, the chairman must stand for re-election annually; therefore Alan Cook will also put himself forward for re-election at the 2018 AGM.

Matters reserved for the board

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

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

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

Audit Committee

The Audit Committee is required to meet at least three times a year, in accordance with its terms of reference, and has an agenda linked to events in the group's financial calendar including approving any press releases to the market on financial reporting. During the year, the committee met eight times which included approval of all financial and trading disclosures. The committee is expected to meet at least six times in 2018. Details of each member's attendance is provided below:

Formal meetings held: 8	Eligible to attend	Meetings attended	% of attendance
James Dean ¹	8	8	100%
Caroline Burton	8	8	100%
David Barral	8	6	75%
Colin Ledlie ²	3	3	100%
Mark Austen ²	4	3	75%

¹ Chair of the Committee.

² Colin Ledlie was appointed on 1 August 2017 and replaced Mark Austen who stepped down at the 2017 AGM.

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

The external auditors (PricewaterhouseCoopers LLP (PwC)) attended all of the committee's main meetings in 2017, except when the audit retender or their own performance was being reviewed.

Following the replacement of Mark Austen with Colin Ledlie, all members of the committee are independent. All members bring significant and relevant skills and experience to the function of the committee. All members undertake induction training and continuing professional development. James Dean, in particular, as the chairman and a former senior partner at EY, and Colin Ledlie as Group Chief Actuary at Standard Life PLC, have the requisite 'recent and relevant financial experience', as recommended by the Corporate Governance Code.

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

The primary purposes of the Audit Committee are to:

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



Significant issues addressed by the Audit Committee during the year

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

Area of focus	Audit Committee action in year	Conclusion / outcome
Financial reporting		
Goodwill The appropriateness of the £220 million carrying value of goodwill that we hold on our group Statement of Financial Position.	The committee has reviewed the assumptions used by management in performing the annual impairment assessment which compares the recoverable amount against the carrying value for both the general insurance and life businesses as separate cash generating units. Consideration has been given to the appropriateness of value in use calculations, including discount rates applied.	The committee has concluded that the assumptions used to assess the goodwill for impairment are appropriate. Results of the calculations confirmed that carrying values of goodwill were supportable and therefore no impairment was required.
Pension scheme accounting The methodology and assumptions used for accounting for the material group pension schemes; the net pension benefit asset comprises: <ul style="list-style-type: none"> • LVFS scheme £163 million asset • Ockham scheme £15 million asset 	The committee has considered the assumptions used for calculating IAS 19 'remeasurement of defined benefit schemes' and approved changes made where appropriate. The committee also noted the continued recognition of a surplus in the LVFS and Ockham schemes in compliance with the current IFRIC 14 'The limit on a defined benefit asset' based on the gradual settlement of scheme liabilities.	The committee is satisfied that appropriate assumptions have been used in calculating the remeasurement of the pension schemes. The committee agrees that the pension benefit asset associated with the LVFS and Ockham scheme is recoverable and that it is appropriate to recognise the asset.
General insurance business transaction accounting treatment <ul style="list-style-type: none"> • LVFS will continue to consolidate the general insurance business and recognise a non-controlling interest for the 49% sold to Allianz in 2017. • The impact of the sale of the stake in the general insurance business is recognised directly within Unallocated divisible surplus as a transaction with owners. • The sale of the commercial lines future renewal rights is accounted for in accordance with IFRS 3 'Business Combinations' and recognised in 2017. • A provision has been included for the restructuring of the general insurance business. 	The committee reviewed management's papers regarding the accounting implications of the sale of a stake in the general insurance business and the related sale of future commercial renewal rights. The committee noted that the external auditor has been engaged throughout the process and has agreed with management's accounting treatment on these matters.	The committee is satisfied that management have performed a thorough assessment of the accounting implications of the transaction and that the financial reporting is appropriate.
Capitalisation of IT software Capitalised costs of £54 million relate to a new general insurance policy system 'Pioneer' which has been launched in the year. Amortisation commenced from the main go-live date for motor, and will continue for eight years which reflects the strategic nature of the asset.	The committee reviewed management's report regarding the accounting treatment of Pioneer, including the date the asset was brought into use and the amortisation period. The committee noted that the amortisation period is longer than other IT software assets previously capitalised and that this reflects the strategic nature of the asset.	The committee concurs with management's conclusion regarding the commencement and term of the amortisation period.
Deferral of IFRS 9 The group and Society will defer IFRS 9 'Financial Instruments' until the adoption of IFRS 17 'Insurance Contracts' in 2021. The sale of the stake in the general insurance business does not impact the group and Society's compliance with the IFRS 9 deferral criteria. The general insurance business and the remainder of the consolidated group separately and in aggregate meet the deferral criteria.	The committee reviewed management's assessment of the advantages and disadvantages of deferring IFRS 9 until IFRS 17 is adopted. Management recommended deferral, which would enable the group to progress towards a new accounting basis for financial instruments and insurance contracts, in line with peers.	The committee, noting management's arguments, approved the deferral of IFRS 9 until 2021 in February 2017 ahead of the publication of the 2016 annual report. The committee is satisfied that this decision remains appropriate.

Area of focus	Audit Committee action in year	Conclusion / outcome
Life Insurance liabilities £ 9,929 million		
OB pensions reinsurance A reinsurance arrangement has been entered into regarding the OB pensions portfolio. This is accounted for as a reinsurance contract as significant insurance risk has been transferred to the reinsurer. The assets backing the OB pensions policies have been disposed of as part of the transaction.	The OB pensions portfolio has significant exposure to longevity risk. To mitigate this risk a reinsurance arrangement was entered into to significantly reduce this exposure. The committee reviewed management's assessment of the transfer of significant insurance risk in the reinsurance contract and the transfer of financial assets.	The committee concurred with management that significant insurance risk has transferred to the reinsurer, resulting in the arrangement being accounted for as a reinsurance asset.
Change in IFRS reserving basis The base risk-free discount rate for IFRS reserving has been aligned with that in Solvency II, changing from gilts to the EIOPA swap curve. The impact of this change is a £48 million increase in insurance contract liabilities net of reinsurance and has been recognised in current year profit.	The committee reviewed management's recommendation to change the IFRS reserving basis to better align with SII reporting. The committee noted that the impact of the change in basis will be recognised in 2017 without a restatement of prior year comparatives as this is a change in accounting estimate.	The committee is satisfied that the change in reserving basis is appropriate and meets the definition of a change in accounting estimate.
CMI 2016 The CMI 2016 mortality projections model has been adopted for the IFRS reserves. This has resulted in a £49 million reduction in reserves net of reinsurance.	The committee reviewed and challenged management's report covering the impact of adopting the CMI 2016 model including the changes in mortality rates and use of a smoothing parameter which impact the insurance contract liabilities.	The committee was satisfied that the mortality assumptions used for the year-end IFRS reserves are appropriate.
Changes in unit cost allocations The calculation of the insurance contract liabilities is impacted by changes in unit costs and stranded costs associated with the general insurance transaction. A review of the allocations of unit costs has been performed in 2017.	The committee reviewed the change in unit cost allocations, which reflected an update to methodology and the development of the business, and discussed with management the validity of this approach.	The committee is satisfied that the changes in unit cost allocations implemented by management are appropriate.
Other key life assumptions and methodology matters In addition to the changes considered above, other changes in non-economic assumptions have been made to reflect updates and experience.	The committee reviewed and challenged management's report regarding the proposed changes to non-economic assumptions in the valuation of insurance contract liabilities. The committee considered industry data and the impact of the changes on the insurance contract liabilities. The committee agreed a number of changes to the calculation of the long-term insurance contract liabilities including the equity release prepayment rate and persistency associated with unit-linked pensions.	The committee concurred with management as to the reasonableness of the revised assumptions.
Legacy review A reserve of £12 million has been recognised during the year associated with the FCA legacy review. This relates to proposals to better target maturity values to asset shares for certain legacy product policyholders.	The committee reviewed management's assessment regarding the recognition of a reserve relating to the proposed changes, including the approval of the approach to be taken by the With-profits Committee and the FCA.	The committee was satisfied that sufficient progress has been made regarding reaching a solution to better target policyholder asset shares and that a reserve is required to be recognised based on management's best estimate of the impact.

Area of focus	Audit Committee action in year	Conclusion / outcome
General Insurance liabilities £1,643 million		
General insurance reserve margin The reserving margin on top of management's best estimate liabilities for IFRS has been increased from a flat 2.5% to being aligned to the 75th percentile of the reserve risk distribution in the year to reflect the additional uncertainty in the market.	The committee reviewed management's analysis of the reserving margin which demonstrated that the margin should be increased. The committee noted that the previous margin was lower than others in the industry.	The committee approved the increase in the general insurance reserving margin to be aligned to the 75th percentile of the reserve risk distribution and this is reflected in the year-end reserves.
Ogden discount rate In March 2017 the Ogden discount rate used in valuing lump sum personal injury settlements was reduced from 2.5% to minus 0.75%. Subsequently on 20 March 2018 the Government put forward the Civil Liability Bill which seeks to have the discount rate established on the basis of a "low risk diversified portfolio" rather than using index linked gilts as a proxy for a "very low risk investment strategy". If enacted this would be expected to result in an increase in the rate. While the draft legislation has been published, it and the new framework, have not yet been enacted; therefore the Ogden discount rate used in the calculation of our reserves remains at minus 0.75%.	The committee reviewed and agreed with the details outlined in the general insurance reserving report, including the rationale for maintaining the current Ogden discount rate within the best estimate.	The committee concurs with management that lump sum personal injury settlements should continue to use the Ogden discount rate of minus 0.75% and this is reflected in our year-end reserves.
Solvency II		
Withdrawal of Internal Model application The group withdrew its Internal Model application due to the significant change in the group's risk profile associated with the transaction with Allianz and other capital initiatives, such as reinsurance of the OB pensions portfolio. The transaction with Allianz involved selling a 49% stake in our general insurance business in 2017 and includes a forward contract for Allianz to purchase a further 20.9% in 2019.	The committee discussed the impact of the significant ongoing changes to the risk profile of the group on the Internal Model application.	The committee agreed with management that the group should withdraw its Internal Model application.
Capital impact of general insurance business transaction The sale of the stake in the general insurance business has contributed a 51 percentage point increase in the Capital Coverage Ratio (CCR) of the group.	The committee reviewed external reports commissioned to assess the cash and capital impact of the proposed sale of a stake in the general insurance business as part of the review of strategic options available to the group. The committee has reviewed management's calculations of the CCR, including the beneficial impact of the sale of the stake in the general insurance business.	The committee approved the Annual Report including the regulatory capital results.
Impact of Transitional Measures on Technical Provisions (TMTP) A recalculation of TMTP has been performed at 31 December 2017 and is included in the calculation of the regulatory capital. This has reduced the group's CCR by 28 percentage points.	The committee has reviewed and challenged management's proposed TMTP recalculation methodology. The committee has reviewed the calculations of the CCR, including the adverse impact of the recalculation of TMTP.	The committee was satisfied with the methodology used by management in recalculating TMTP.
Group Solvency Financial Condition Report (SFCR) The group filed the 2016 SFCR during the year, which is the annual narrative Solvency II Pillar 3 reporting.	The committee reviewed the 2016 group SFCR produced by management for external reporting, noting that it was a single group SFCR including all relevant entities.	The committee recommended the SFCR to the board and Disclosure Committee for public disclosure.

Summary of key activities during 2017 by which the Audit Committee discharged its responsibilities:

Financial reporting

- Analysed and scrutinised the key accounting policies, judgements, estimates and actuarial assumptions with management, the external auditors and the chief actuary;
- Reviewed procedures for dealing with any complaints regarding accounting, reporting, internal control or auditing matters;
- Considered management's review of the viability and going concern status of the group, ensuring that appropriate capital and liquid assets are in place to allow the group results to be reported on a going concern basis;
- Monitored the financial results communicated to members, including the Annual Report;
- Reviewed and recommended all external financial reporting for the Society (including press releases and any interim announcements put onto the regulatory news service of the London Stock Exchange) to the board (or the Disclosure Committee) together with supporting narrative, ensuring estimates, judgements and reporting issues are considered so that there is appropriate balance, transparency and integrity of information contained in the Annual Report; and
- At the request of the board, the committee considered whether the 2017 Annual Report was fair, balanced and understandable and whether it provided the necessary information for stakeholders to assess LV='s position, performance, business model and strategy. In reviewing the Annual Report the Audit Committee has concluded that this was the case.

Internal audit

- Periodically reviewing the internal audit plans for 2017 to ensure they reflected the group's priorities, plans and risk profiles, approving internal audit's plans on a quarterly basis;
- Considering and approving the internal audit plan for 2018, this being derived from a risk-based assessment of the business and a review against the group's risk profiles;
- Receiving update reports from the internal audit director as to the effectiveness of the governance, risk management and internal control framework within the group;
- Receiving a summary of assurance over significant change initiatives including Pioneer, the RDP (Risk Development Programme) and the setup of the general insurance transaction with Allianz;
- Receiving updates on ongoing issues, significant findings and the adequacy of remediation activity, and having access to all internal audit reports;
- Considering whether internal audit's budget, together with changes to the budget agreed during the year, was sufficient to allow internal audit to deliver the plan;
- Approving updates to the audit charter, (the charter being available on our external website);
- Confirming that the internal audit director's independence has been maintained;

Taking into account how resource challenges have been managed, the positive independent feedback from external audit and the regulators, and the views of executive management when assessing that the internal audit function was performing effectively.

Internal controls

- Received the annual attestation and associated exception report regarding the effectiveness of the risk management system and controls being operated (for more details on this process see page 40); and
- Reviewed the arrangements through which employees can raise concerns about possible irregularities relating to financial reporting or other matters including reviewing all whistleblowing reports.

Solvency II

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

External audit

Effectiveness of the external auditor

The committee reviewed an evaluation of the effectiveness of the external auditor, which was prepared by internal audit using input from across the group. Key stakeholders involved in the 2016 year-end audit process were interviewed and/or completed a questionnaire to evaluate the effectiveness of the external auditor's processes and key individuals, and also to identify opportunities to enhance the effectiveness and added value from the external auditor. Areas assessed were: expertise, communication, team, and delivery. The committee concluded that the external audit was effective.

Audit tender

In last year's Annual Report, the group announced its intention to launch a competitive audit tender process during 2017, in response to changes in UK and EU legislation requiring that the external audit contract be put out to tender at least once every ten years and allowing re-appointment of the incumbent auditor for a further ten years. PwC have been the group's auditor since 2008.

During the year, the committee had oversight and responsibility for carrying out the tender for external audit services.

The process

- A selection panel was created, led by the chair of the Audit Committee and made up of one other member of the Audit Committee and the internal audit director. Three senior finance management representatives were also in attendance;
- Three audit firms reached the final stage of the tender process, one of which was a "mid-tier" audit firm;
- There was an opportunity for the tendering firms to meet with key LV= executives relevant to the audit and the chair of the Audit Committee, who were available to answer questions relating to the audit itself and matters arising from the data room. Selection panel members received detailed responses from each firm to a formal request for proposal;
- Each firm delivered a presentation to the selection panel during which questions were raised by the panel and each presentation was debated and evaluated immediately afterwards and scored against pre-defined selection criteria which included: understanding of our business and risks; experience and fit of the lead partner; senior audit team capability; approach to ensuring audit quality; transition approach; and value provided from the audit.

The outcome

Having taken into account each of the selection criteria and the quality of the presentations, the selection panel unanimously agreed to propose to the Audit Committee and in turn the committee agreed to propose to the board that PwC be re-appointed as statutory auditor following completion of the 2017 year-end process and that this appointment would be subject to member approval at the AGM in June 2018. The committee would like to thank each firm for their participation in the tender process.

Auditor independence

- The group has introduced a revised policy for the use of the auditor for non-audit work which is aimed at safeguarding and supporting the independence and objectivity of the external auditor. The policy is in full compliance with UK corporate governance requirements and takes into account the Financial Reporting Council's Revised Ethical Standard 2016 for Auditors which was issued on 17 June 2016. The policy regulates the appointment of former audit employees to senior finance positions in the group and sets out the approach to be taken by the group when using the non-audit services of the external auditor. The policy distinguishes between (i) those services where it is considered appropriate to use the external auditor (such as statutory and non-statutory audit and assurance work) and (ii) prohibited services where the independence of the external auditor could be threatened and the external auditor must not be used. The policy restricts the non-audit fee the group can pay to the audit firm in any one year to 70% of the average audit fees paid over the previous three years. Any engagement above £100,000 requires prior approval by the chairman of the Audit Committee and must be reported to the committee at its next meeting;
- The committee reviewed the policy for and monitored the use of the external auditors for any non-audit related work to ensure their continued independence was not prejudiced and to ensure that the provision of such services did not impair the external auditors' objectivity;
- The external auditor has reviewed its own independence in line with these criteria and its own ethical guidance standards and has confirmed to the committee that following its review it is satisfied that it has acted in accordance with relevant regulatory and professional requirements and that its objectivity is not impaired;
- Total fees paid to or invoiced from the external auditors were £2,335,000 which includes £1,616,000 for the statutory audit of the Society and its subsidiaries. £457,000 relates to audit related assurance services including the audit of Solvency II regulatory returns, and £262,000 for non-audit work which accounts for 30% of the average audit fee paid over the previous 3 years. Having considered compliance with our policy and the fees paid to the external auditor, the committee is satisfied as to the continued independence and objectivity of the external auditor;
- Significant non-audit services provided by the auditor during the year related to Solvency II regulatory support and cost £203,000. The committee concluded that it was in the interests of the group to purchase them from the external auditor, rather than another supplier because they are familiar with our solvency II models through their audit related assurance work. Auditor objectivity and independence was safeguarded by the measures described above;
- The committee reviewed and approved the external auditors' proposed audit scope and approach for the current year as set out in its 2017 audit plan, in the light of the group's present circumstances and changes in regulatory and other requirements;
- Discussed with the external auditor any audit problems encountered in the normal course of audit work, including any restrictions on audit scope or access to information as part of ensuring that significant findings and recommendations made by the external auditors and management's proposed response were received, discussed and appropriately acted upon; and
- Met privately with the external auditors, PwC.

Committee's effectiveness

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

Committee's achievements and future priorities

Achievements in 2017
Oversaw the sale of a stake in the general insurance business to Allianz and considered the accounting and capital implications of this transaction.
Oversaw significant transactions and changes in assumptions in the year, including adoption of the CMI 2016 mortality projections model, the OB pension reinsurance transaction, and changes in assumptions for unit costs.
Reviewed and challenged the appropriateness of the change in general insurance margin from a flat 2.5% to being aligned to the 75th percentile of the reserve risk distribution in the year to reflect the additional uncertainty in the market.
Recommending the re-appointment of PwC as external auditor following a retender process.
Strengthened the committee through the recruitment of Colin Ledlie who has significant and relevant insurance and financial reporting experience from his roles as chief actuary and group chief risk officer at Standard Life PLC.

Priorities for 2018

Continued focus on the areas outlined in the significant issues table on pages 64 to 66.
Assessment of the impact of the forthcoming change to IFRIC 14 regarding the limit on a defined pension benefit asset.
Review of the progress against plans for implementation of IFRS 17 'Insurance Contracts' in 2021.
Oversight of the restructuring of the group following the completion of the sale of a stake in the general insurance business.

Investment Committee

The Investment Committee meets at least twice a year. It met four times in 2017 and is expected to meet four times in 2018. The committee comprises three non-executive directors and two executive directors. Representatives from the group's asset manager, Columbia Threadneedle Investments, the group chief investment officer, the group chief risk officer, and the group chief actuary are regular attendees who attend by invitation. Details of each member's attendance is provided opposite:

- Chair of the committee.
- Andy Parsons replaced Philip Moore as a Committee member from 30 June 2017.
- Alan Cook replaced Mark Austen as a member of the committee upon his retirement from the board on 20 June 2017.
- Chair of the committee.
- Independent member.
- Teachers nominee independent member.
- Colin Ledlie, joined the committee on 1 August 2017.
- John Perks attended 5/5 meetings until July 2017 and was replaced by Katie Wadey who attended 2/6 meetings.
- Cath Keers resigned from the committee on 20 June 2017.

Formal meetings held: 4	Eligible to attend	Attended meetings	% of attendance
Caroline Burton ¹	4	4	100%
Richard Rowney	4	4	100%
Andy Parsons ²	1	0	0%
David Barral	4	4	100%
Alan Cook ³	1	1	100%
Philip Moore ²	3	3	100%
Mark Austen ³	3	3	100%

The role of the committee

It is responsible for:

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

Principal activities undertaken in 2017

During the year, the committee undertook the following activities:

- Reviewed counterparty risk and compliance with the counterparty policy;
- Monitored the effectiveness of the derivative portfolio and investment performance portfolio;
- Discussed credit exposure and proposed actions including credit triggers;
- Reviewed the group's with-profits and general insurance investment strategies;
- Discussed Columbia Threadneedle Investments' performance including compliance with delegated authorities;
- Oversight of the renewal negotiations of the asset manager's contract; and
- Considered and recommended the adoption of the environmental, social and governance policy.

With-profits Committee

The With-profits Committee was scheduled to meet four times in 2017 in accordance with its terms of reference. However, due to the strategic challenges and volume of change, the committee met eleven times during the year. It is expected to meet six times in 2018. The committee comprises one LVFS non-executive director, an independent chairman, one independent member, one Teachers nominee independent member and one management nominated member. The chairman has extensive and relevant industry experience and was formerly chief executive of Police Mutual and holds a number of other non-executive positions. Details of each member's attendance is provided below:

Formal meetings held: 11	Eligible to attend	Attended meetings	% of attendance
Graham Berville ⁴	11	11	100%
Steve Sarjant ⁵	11	11	100%
Ian Blanchard ⁶	11	10	91%
Colin Ledlie ⁷	4	4	100%
Management nominated member ⁸	11	7	64%
Cath Keers ⁹	5	0	0%

Changes to the composition of the committee

Cath Keers stepped down as the LVFS board appointed representative on the committee in June 2017 and was replaced by Colin Ledlie, from August 2017. Colin has extensive experience of the with-profits business and his full biography is included on page 59. Katie Wadey (the group's chief customer officer) joined the committee as the management nominated member in July 2017, replacing John Perks (Life managing director) who continued to attend the meeting as a regular attendee. It was decided that, in 2018, a management nominated member would no longer be appointed as a member of the committee but would attend upon request.

The role of the committee

The committee's role in respect of the LV= and Teachers with-profits funds is to:

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

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

Principal activities undertaken in 2017

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

- Welcomed two new committee members and ensured a thorough induction plan was undertaken;
- Considered the impact on policyholders of the strategic partnership with Allianz and several other strategic initiatives aimed at creating a sustainable mutual with a clearly defined social purpose, member reward strategy and an appropriate legal structure to enable the business to prosper in the long term and grow member value;
- Considered the impact of the negotiations on the renewal of the investment management contract with Columbia Threadneedle Investments;
- Considered the impact on the policyholders of various capital optimisation initiatives such as the reinsurance of the OB Pensions business.
- Strengthened the committee's relationship with the regulator;
- Continued to monitor the outcomes from the legacy product review programme and considered any proposed remediation and improvements;
- Continued with an ongoing programme of improvements to policyholder communication;
- Completed a review of the investment strategy for the main with-profits fund and oversaw its implementation; and
- Following the committee's positive effectiveness review, conducted by Advanced Boardroom Excellence in November 2016, agreed an action plan to implement further improvements to the committee's effectiveness.

Risk Committee

The Risk Committee met nine times in 2017 and is expected to meet seven times in 2018. The committee is made up of five non-executive directors and each member's attendance is provided below:

Formal meetings held: 9	Eligible to attend	Attended meetings	% of attendance
David Barral ¹	9	9	100%
David Neave	9	8	89%
James Dean	9	7	78%
Alan Cook ²	4	4	100%
Colin Ledlie ³	3	3	100%
Mark Austen ²	5	4	80%

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

The role and principal activities of the committee

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

More details of the group's policy on risk management, and the activities of the committee during the year are set out in the Risk Management section on pages 36 to 44.

Remuneration Committee

The Remuneration Committee met eight times during 2017 and is expected to meet five times in 2018. The committee is made up of at least three non-executive directors and each member's attendance is provided below:

Formal meetings held: 8	Eligible to attend	Attended meetings	% of attendance
Caroline Burton ⁴	8	8	100%
David Neave	8	7	88%
Alan Cook ⁵	4	4	100%
Cath Keers ⁴	4	4	100%
Mark Austen ⁶	4	4	100%

Other attendees include the HR director, head of reward, the chief executive and the chief risk officer, who attend by invitation.

The role and principal activities of the committee

On behalf of the board, the committee determines:

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

More details of the group's policy on executive and senior management remuneration, and the activities of the Remuneration Committee during the year are set out in the Report on Directors' Remuneration on pages 75 to 91.

- 1 Chair of the committee.
- 2 Mark Austen resigned from the committee on 20 June 2017 at which date Alan Cook became a member of the committee.
- 3 Colin Ledlie was appointed to the board and became a committee member on 1 August 2017.
- 4 Caroline Burton was appointed chair of the committee from July 2017 following the departure of Cath Keers in June 2017.
- 5 Alan Cook joined the committee on 1 January 2017.
- 6 Mark Austen resigned from the committee in June 2017.

- 1 Alan Cook took over as chairman on 20 June 2017 following the departure of Mark Austen at the AGM.
- 2 Cath Keers resigned on 20 June 2017.

Corporate Governance and Nomination Committee

The Corporate Governance and Nomination Committee met six times in 2017 and is expected to meet at least twice in 2018. During the year, the committee comprised all the pre-existing independent non-executive directors, the chairman and the chief executive. Details of each member's attendance is provided below:

Formal meetings held: 6	Eligible to attend	Attended meetings	% of attendance
Alan Cook ¹	6	6	100%
Richard Rowney	6	6	100%
James Dean	6	4	67%
Caroline Burton	6	3	50%
David Neave	6	6	100%
David Barral	6	4	67%
Mark Austen ¹	3	3	100%
Cath Keers ²	3	2	67%

Changes to the composition of the committee

Historically, all non-executive directors were members of the committee. Following discussions with the chairman, it was agreed that as it was not a requirement for all non-executive directors to be members of the committee, the membership would be revised. The committee's terms of reference were reviewed and updated to require up to four non-executive directors to be appointed as members of the committee. It was further agreed that the senior independent director would be a mandatory member of the committee.

The role of the committee

The committee:

- Evaluates the balance of skills, knowledge and experience on, and required by, the board for board appointments and certain senior management roles;
- Prepares a description of the role and capabilities required for any particular appointment;
- Oversees the board's governance arrangements and makes appropriate recommendations to the board; and
- Ensures compliance with the UK Corporate Governance Code, and other applicant legislations, and ensures best practice is carried out.

Involvement of external consultants

Recruitment consultants, The Zygos Partnership (TZP), were instructed to help compile a short-list of candidates to interview for the non-executive director vacancies throughout the year. At the conclusion of the recruitment process, the committee reviewed the candidates and made recommendations to the board for approval. TZP had no other connection with the Society. EgonZehnder were instructed to assist with the recruitment of the group finance director position. Five candidates were shortlisted including four external and one internal applicant. Further details of the board appointments made throughout the year are included on pages 54 to 55.

Principal activities undertaken in 2017

During the year, the committee undertook the following activities:

- Evaluated the balance of skills on the board and identified a greater requirement for actuarial knowledge amongst the directors which initiated the recruitment search for a non-executive director with appropriate expertise to fulfil the skills gap;
- Reviewed the Board Diversity Policy and performance against its set objectives. See page 47 for further details of the Board Diversity Policy, its implementation and objectives.
- Discussed succession planning of the board and the wider LV= group;
- Instructed external search consultants to undertake the recruitment process for the group finance director position and the vacant non-executive position initiated by the resignation of Cath Keers at the AGM;
- Considered the shortlist of candidates for the role, including their time commitment and any potential conflicts of interest before making a recommendation to the board;
- Undertook a thorough review of the directors' time commitment, both external and internal, to ensure that each director had sufficient time to discharge their responsibilities;
- Discussed the professional development plans and non-executive director training for the year; and
- Considered the scope and shortlist of consultants for the externally facilitated board evaluation which encompassed an effectiveness review of the Audit, Remuneration and Risk Committees.

Executive Committee

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

Directors' Report

Rachel Small
Company Secretary



Business activities and future prospects

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

The board sets objectives and priorities supported by key performance indicators (KPIs) and targets, which it monitors on an ongoing basis throughout the year. During 2017, the key objectives and priorities were aligned to our strategic agenda as outlined on pages 15 and 16.

Business strategy

The board has chosen to set out the group's strategic report information required under applicable law and regulations in full, which can be found on pages 8 to 51 of this report.

Board directors and interests

The current members of the board and details of its various committees are shown on pages 56 to 71.

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

Basis of accounting

These financial statements are presented using International Financial Reporting Standards (IFRS), as adopted by the European Union, drawn up on a going concern basis. Further details about the directors' responsibilities for the financial statements are described on page 74.

Going concern and viability statement

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

Going concern

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

- The group plan, which was approved by the board and in particular the forecast regulatory solvency position. Sensitivity analysis is included within this forecast (for further detail on this analysis see page 28);
- For the group, regulatory solvency is given more attention than liquidity. This is because, by the nature of its business, the group holds very substantial liquid assets on its balance sheet which would enable it to pay claims and expenses as they fall due for at least a 12 month period; and
- The principal risks and uncertainties that could impact the group's solvency and liquidity over the next 12 months (for further detail on the principal risks and uncertainties assessed in 2017 see pages 36 to 44).

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

Viability statement

Our members rely on the sustainability of the group over the longer term and this is reflected in our business model and management of risk. An assessment of viability is integral to our strategic planning and decision making process in order that we can continue in operation and meet our obligations to policyholders.

Period of assessment

A three-year time period of assessment has been used in the board's assessment of viability. Each year a strategic plan is developed and is subject to robust review and challenge by the board. This plan is over a five-year horizon, with greater certainty associated with the first three years, and a further two years to provide the board with an extended plan for strategic decision making. The board recognises that uncertainty increases over time and this is reflected in the period for the assessment of viability.

Strategic planning process

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

Stress and scenario testing

Assessment of the risks to achieving the projected performance is an integral part of the planning process. As part of the ORSA process we perform stress tests to assess the capital resilience of the group to a range of severe but plausible scenarios (see page 28 and 41). These tests allow the board to review and challenge the strategic plan and risk management strategy. In considering these scenarios the impacts of mitigating management actions designed to maintain or restore capital, liquidity and solvency to within risk appetite are considered.

The significant management actions taken to strengthen and de-risk the balance sheet including the strategic partnership with Allianz and reinsurance of the OB pensions portfolio has provided the group with an above risk appetite capital surplus, solidifying the sustainability of the group for the future. The de-risking of the balance sheet has helped to reduce the sensitivity to non-market stresses and associated scenarios. In the scenarios tested, sufficient mitigating actions have been identified to enable the directors to have a reasonable expectation that the group would remain viable over the three year period of assessment.

In addition, the group conducts a reverse stress test which gives the board an understanding of the maximum resilience of the group to extremely severe adverse scenarios. Results of stress tests form part of the process to set the group's capital risk appetite for a buffer of £350 million to be held above the regulatory capital requirement to protect against shocks and stresses (see page 28).

Formal viability statement

The directors make this viability statement based on a robust assessment of those risks that could threaten the business model, future profitability, solvency, liquidity or capital adequacy of the group. Based on this assessment, the directors have a reasonable expectation that the group will be able to continue in operation and meet its liabilities as they fall due over the three-year period to December 2020.

Fixed assets

Changes in our fixed assets are shown in note 26 to the financial statements.

Margin of solvency

Throughout the year and at 31 December 2017 we held the required capital resources for each business class as prescribed by the PRA.

Independent auditor

A resolution for the re-appointment of PricewaterhouseCoopers LLP (PwC) as auditor will be proposed at the 2018 AGM, following a competitive tender which was carried out during the year. Further details are shown on page 67 of the Corporate Governance Report.

Assessment of risk

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

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

A full overview of our risk management can be found on pages 36 to 44 and further details of the ongoing monitoring and the annual review of the effectiveness of risk management systems can be found in the Audit Committee report on page 67. Note 4 of these accounts also provides further detail about our risk management and control.

Internal control

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

The Audit Committee report on pages 63 to 68 describes the main features of the internal control and risk management systems in relation to the financial reporting process and the process for preparing consolidated accounts, which are a subset of the internal control systems under the supervision of the board's committees.

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

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

Our employees

Details about our people, our people policies including the employment of disabled persons, and engagement with our staff generally can be found on pages 47 and 48 of this report, headed 'Corporate Responsibility Report'. Our board diversity policy is included on page 47.

Charitable donations

A full view of our charitable donations and corporate social responsibility activities can be found on pages 49 and 50. No political donations were made in 2017.

Statement of disclosure of information to the auditor

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

- 1 So far as he or she is aware, there is no information relevant to the audit of the Society's and the group's financial statements for the year ended 31 December 2017 of which the auditor is unaware;
- 2 He or she has taken all steps that he or she ought to have taken in his/her duty as a director to make him/her aware of any relevant audit information and to establish that the Society's auditor is aware of that information.

Directors' statement of responsibility

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

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

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

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

The directors are also responsible for maintaining:

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

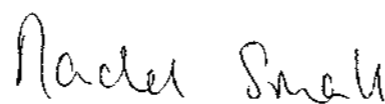
Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Each of the directors, whose names and functions are shown on pages 58 to 60, confirm that to the best of their knowledge and belief:

- The Society and the group financial statements, which have been prepared in accordance with IFRS as adopted by the EU, give a true and fair view of the assets, liabilities, financial position and profit of the Society and the group;
- The Business Reviews on pages 20 to 35 of the Strategic Report include a fair review of the development and performance of the business during the financial year and the financial position of the group at the end of 2017; and
- A description of the group's principal risks and details of the group's risk governance structure are provided on pages 36 to 44.

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

By order of the Board of Directors



Rachel Small
Group Company Secretary
28 March 2018

Report on Directors' Remuneration

Caroline Burton
Chairman of the Remuneration Committee



Annual Statement

Dear member,

The performance of LV= in 2017 has significantly improved from 2016, with the group delivering an operating profit of £158 million. As well as the strong financial performance, a number of important strategic goals were achieved too, in particular the agreement of the strategic partnership with Allianz.

Under the terms of the agreement, we acquired the renewal rights for the personal home and motor activities of Allianz Insurance PLC, while Allianz acquired our commercial broker insurance renewal rights. A strategic partnership has been created to run the enlarged personal lines general insurance business, which will trade under the LV= brand. As well as creating a personal lines business of significant scale and presence within the market under an award winning brand, the transaction proceeds will help to secure the cash and capital strength of the Society.

As chair of the Remuneration Committee, I appreciate the need to ensure that individuals throughout the organisation who have worked hard to achieve the successes in 2017 are appropriately rewarded. It is also important that we ensure our ongoing remuneration policy supports and incentivises the ongoing success of the Society. The remuneration policy approved at the 2015 AGM has come to the end of its three year lifecycle. Therefore, a new remuneration policy will be put forward at the 2018 AGM. We have considered our approach to remuneration during 2017 and having looked for other alternatives, we do not feel it is appropriate or in the best interests of the Society to make any significant changes to how we structure remuneration. Therefore, the new remuneration policy we set out in this Report on Directors' Remuneration does not include any significant changes to our structure.

Remuneration policy and the link to long-term business performance

Our remuneration policy seeks to align remuneration with performance. Salaries are targeted at median levels against the external market, for executive directors and for all employees. Variable remuneration, with the amount paid linked to performance, therefore forms an important part of their remuneration package.

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

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

Senior employees also participate in the group long-term incentive plan. The final value of an LTIP award is determined based on long-term performance conditions measured over a three year period. The final value can range from zero to two times the initial value, depending on performance. The LTIP therefore incentivises senior employees and rewards them for delivering high performance business results over the long-term.

2017 performance and remuneration outcomes

The 2017 group balanced scorecard, used to measure performance and determine the size of the bonus pot, was structured as follows:

- 55% on financial measures: normalised group operating profit; and
- 45% non-financial measures:
 - 15%: Strategy and change;
 - 10%: Customer and member;
 - 10%: Risk and compliance; and
 - 10%: People.

Normalised group operating profit for 2017 was £158 million, which compared to £108 million in 2016, against a target of £86 million. This strong financial performance was driven by both the general insurance and life businesses, but also further added to by the strategic cost transformation programme we commenced in 2016.

We have seen significant expense reductions, reflective of significant management action to reduce our cost base, predominantly achieved through a reduction in our salary bill, and stronger discipline on discretionary spend items.

Performance against the non-financial measures was also strong, resulting in the Remuneration Committee determining that a bonus pot of £23 million for distribution amongst employees (based on individual performance against their objectives) would be appropriate in respect of 2017. The distribution of the bonus pot under the group annual bonus scheme, resulted in the average percentage bonus received by our employees being 11.7% of bonus-able earnings (8.6% for 2016).

Further analysis of the group's performance against the 2017 group balanced scorecard is shown on page 78.

As well as performance against the measures in the group balanced scorecard being used to determine the size of the bonus pot on a group level, it is also used as part of the assessment of the performance of each executive director.

In addition to performance against the group balanced scorecard, with weighting on particular areas for some individuals, individual performance targets for each of the executive directors are used to determine their individual bonus amounts. The 2017 outcomes for each of the executive directors range from 11% of maximum to 83% of maximum. Further commentary on the personal performance of each individual executive director against their objectives and their 2017 bonus awards is shown on pages 86 and 87. A portion of each bonus received by Richard Rowney and Steve Treloar, will be deferred for payment over the next three years, with the value linked to the value of investments in the with-profits fund, ensuring a continued link to the performance of the Society.

Our 2015-17 LTIP awards were subject to stretching performance conditions related to growth in Average Adjusted Group Profit Before Tax (AAGPBT). In addition, awards held by Mike Rogers and Philip Moore had a further performance condition based on Relative Investment Performance (RIP), which had a 25% weighting. Under the performance conditions, for any LTIP payment to be due, AAGPBT over the three year performance period needed to exceed AAGPBT over the previous three years by 5% and the RIP of our main with-profits fund needed to perform in line with benchmark over the past three years. At this level of growth, LTIP awards would payout at 0.5 times their initial value or 0.56 times their initial value for Mike Rogers and Philip Moore. For the maximum payout to be due (i.e. two times the initial value), AAGPBT over the three year performance period needed to exceed AAGPBT over the previous three years by 13% and the RIP of our main with-profits fund needed to outperform the benchmark by 60 basis points.

The actual figure achieved for AAGPBT was £151 million, an increase of 110% compared to the previous three year period, resulting in the maximum payout of two times the initial value being due for this measure. The RIP was below benchmark over the past three years resulting in nil payout for this measure. Therefore, 2015-17 LTIP awards subject only to the AAGPBT performance condition will payout at maximum (two times their initial value). For 2015-17 LTIP awards also subject to the RIP condition (with a 25% weighting), the payout level is 1.5 times their initial value. The payments to executive directors holding 2015-17 LTIP awards will be made in three equal tranches on an annual basis from May 2018.

Board changes

Philip Moore stepped down from the board in June 2017 and Andy Parsons was appointed in his place as group finance director. Andy Parsons' remuneration package upon appointment is in line with our existing remuneration policy that was approved by members in May 2015. Details of all remuneration arrangements are set out on pages 89 and 90 of the Report on Directors' Remuneration.

As explained in our 2016 Report on Directors' Remuneration, Alan Cook was appointed to the board on 1 January 2017 as an independent non-executive director of the Society and chairman designate. Mark Austen stepped down from the board and his position as chairman from June 2017, from which point Alan Cook took on the role of chairman.

Cath Keers also stepped down from the board in June 2017 and I took on the role of chairman of the Remuneration Committee. Colin Ledlie joined the board in August 2017.

Steve Treloar stepped down from the LVFS board on 28 December 2017, on completion of the strategic partnership with Allianz.

Changes to remuneration during 2017

In our 2016 Report on Directors' Remuneration, we explained that Richard Rowney had been appointed to the role of chief executive on a salary of £490,000, being set below market levels, with the intention that this would be increased as Richard grew into the role of chief executive and based on his performance. In July 2017, once he had completed one year in the role, the Remuneration Committee considered Richard's salary level. Based on his progression into the chief executive role over that time and his strong performance, it was determined that it would be appropriate to award him an increase. Richard's salary was therefore increased to £525,000 (an increase of 7%) with effect from 1 August 2017.

Remuneration from 2018 onwards

We review executive directors' salaries at the same time as all other employees. In 2018, the average employee salary increase will be 2.4% (effective from 1 April 2018). The average salary increase for executive committee members is 1%. As chief executive, Richard Rowney's salary will not increase at this time (in light of his increase awarded during 2017). His next salary review will be aligned with the following all employee salary review in 2019.

To improve our remuneration policy and practices, a number of refinements have been made for 2018. Whilst the general structures remain appropriate and aligned to market practice, we have made changes to the detail of how the policy is structured and will operate. These changes are summarised below.

Group annual bonus:

- The group balanced scorecard will have an increased weighting on strategy and change (from 15% to 20%)
- The financial measure will have a reduced weighting (from 55% to 50%)
- The financial measure will change from normalised operating profit to measures on:
 - Operating capital surplus
 - Dividend flow from the general insurance business
 - Economic value of new business

Further information on the 2018 group balanced scorecard is shown on pages 80 and 91.

LTIP awards, from 2018-20 and beyond:

Long-term growth in group profit has previously been the main performance measure used as profit contributes to growing member value and provides the resources for us to invest in the Society's future. However, we propose to make changes to the performance measures for our 2018-20 LTIP awards.

The AAGPBT performance measure will no longer apply and will be replaced with the following performance measures:

- 75% weighting: Financial measures, based around growth in own funds and economic value of new business: and
- 25% weighting: strategic goals, based around (i) developing a sustainable, growing, vibrant business; (ii) excellent franchise health; and (iii) ensuring a strong risk and capital position.
- An underpin related to risk whereby no vesting will occur if appropriate levels of risk management have not been achieved.

This reflects the need for a capital adjusted performance measure, given the increased importance of capital over recent years. Furthermore, the financial measures will be a good proxy for the value of the business and therefore management's success in delivering value for members. The introduction of strategic goals will help incentivise and reward the delivery of important goals that contribute to the long-term health of the Society.

The LTIP maximum award value that can be made to the chief executive will increase from 100% of salary to 150% of salary, and from 75% of salary to 125% of salary for other executive directors. This change is intended to increase the long-term remuneration element to more market aligned levels and to provide additional incentivisation to the executive directors to grow the LV= business and increase member value over the longer term, from 2018 and beyond. For 2018-20 LTIP awards, it is intended that awards will be granted at these new, increased maximum levels. However, in future years, the awards may be made at lower levels, which will be determined by the committee at the appropriate time.

The Remuneration Committee is confident that these refinements to the policy will support the achievement of the new strategy by incentivising executive directors and other senior employees to drive the growth of the LV business.

Further information on the new LTIP performance measures is shown on page 81 and 91.

Listening to members

We have discussed remuneration structures and policy with members a number of times at member panels during 2017. Each discussion was useful in hearing well considered opinions from members and allows us to take these views into account when making remuneration decisions. It has also been useful to continue open dialogue with each other and we intend that this will continue during 2018.

We aim to comply with the highest standards of corporate governance and our Report on Directors' Remuneration has again been prepared in line with the reporting requirements which apply to listed companies. On that basis, and as it is three years since our directors' remuneration policy was approved by members (at our 2015 AGM), we are proposing a member vote on our remuneration policy at our 2018 AGM. Therefore, there will be two resolutions relating to our 2017 Report on Directors' Remuneration that will be subject to a member vote at our 2018 AGM. These will be on:

- Our revised remuneration policy for 2018 onwards; and
- The implementation of our remuneration policy in 2017 (the usual annual vote).

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

Yours sincerely



Caroline Burton
Chairman of the Remuneration Committee

2017 Remuneration Summary



LV= financial performance in 2017

£158m
operating profit

180%
capital cover ratio

7.7%
LVFS
main with-profits fund performance

LV= non-financial performance in 2017

1st
UK best loved

76%
engagement

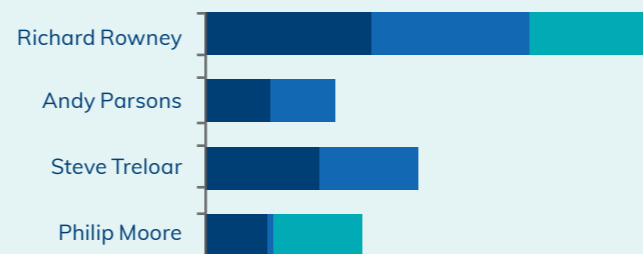
Key

- ♥ Achieved target
- ♥ Progressing towards target
- ♥ Missed target

Financial measures used for the 2017 annual bonus scheme and long-term incentive plan

2017 Annual bonus	
Normalised group operating profit	Payout = 100% of maximum profit
2015-2017 LTIP	
Average Adjusted Group Profit Before Tax (AAGPBT)	Payout = 100% of maximum
Relative Investment Performance (RIP)	Payout = 0% of maximum

How much our executive directors earned in 2017 from our ongoing remuneration policy



	Total remuneration (£'000)	Annual bonus (% of maximum)	Long-term incentives (% of maximum)
Richard Rowney	1,719	80%	100%
Andy Parsons ¹	497	53%	N/A
Steve Treloar	815	83%	N/A
Philip Moore ²	599	11%	75%

Key

- ▶ Salary, pension and other benefits
- ▶ Annual bonus
- ▶ Long-term incentives

¹ In addition to this remuneration from our ongoing policy, Andy Parsons received £450,000 on appointment as group finance director in respect of a buy-out for incentive arrangements with his previous employer which lapsed upon his departure to join LV=.

² Amounts above relate to remuneration received for services as directors. For Philip Moore this excludes any amounts received as payments for contractual commitments on leaving office. See page 90.

Remuneration policy

When developing our remuneration policy we compare ourselves to other businesses, in particular financial services organisations of a similar size to our own, to ensure our policy is designed to support recruitment and retention of talented people who are able to achieve stretching targets and deliver greater benefits for our members. Our aim is to provide remuneration packages that are targeted at median against the external market, and which have a significant proportion dependent upon the delivery of strong performance. Our remuneration policy is governed by good risk management practice to ensure that management are incentivised appropriately to support the short, medium and long-term interests of our members. The policy for executive directors is described in more detail below.

We are subject to the Solvency II regulations and fully adhere to the remuneration aspects of those. While we currently remain outside the scope of the Financial Conduct Authority's (FCA) remuneration rules that apply to other financial services sectors, we keep them under regular review and aspire to follow their spirit.

Seeking the views of members

The committee is keen to hear members' views on the Society's remuneration policy and the remuneration decisions which the committee takes on our members' behalf. During 2017, we held feedback and discussion sessions at our member panel gatherings and we will continue to do so. We value dialogue with members and always consider the variety of views from members carefully, alongside other relevant factors when making remuneration decisions.

At our 2017 AGM, the annual advisory vote on our Report on Directors' Remuneration received support from 94% of our members who voted. In addition to the annual advisory vote, we will also hold a vote on our directors' remuneration policy at our 2018 AGM. This was last approved at our 2015 AGM so holding the vote after three years is in accordance with our practice of meeting the full governance requirements on executive directors' remuneration that apply to listed companies.

Consideration of employment conditions elsewhere in the group

When setting levels of remuneration for directors, the committee takes into account the pay arrangements across the Society as a whole to ensure that consistent underlying principles are applied for all employees when making decisions about rewards. The remuneration arrangements for the executive directors are similar to those for the general employee population, aside from quantum and participation rates in incentive schemes.

The committee takes into account employees' views with regard to remuneration generally when determining the design of the Society's remuneration policy. It does not however consult employees generally regarding the pay arrangements for senior executives, although this position is kept under review.

Remuneration policy for executive directors (to apply from 1 January 2018)

Purpose and link to strategy	Operation	Maximum opportunity	Performance measures
Salary			
To attract high performing individuals to lead the Society and continue to reward them fairly in the context of alternative opportunities open to them.	Salaries are reviewed annually (but not necessarily increased) taking account of several factors including individual experience, responsibilities, function and sector, along with individual and group performance. The committee also reviews benchmarking information on pay levels in organisations of comparable size and complexity to LV=. If salaries are increased they are normally effective from 1 April each year.	There is no prescribed maximum annual increase. The committee is guided by the general increase for the LV= employee population and wage increases generally, but on occasions may need to take into account factors such as retention risk, development in the role and/or changes in responsibility.	Individual performance is taken into account when salary levels are reviewed.

Purpose and link to strategy	Operation	Maximum opportunity	Performance measures
Benefits			
To operate a competitive benefits structure that provides adequate protection to our employees and aids recruitment and retention.	The Society currently provides: <ul style="list-style-type: none"> car allowance medical insurance income protection cover group product discounts or any other benefits, which are available to all staff and directors on equal terms. Other benefits may be introduced if considered appropriate by the committee. 	Car allowance of up to £10,200. The values of other benefits are based on the cost to the group and are not subject to a pre-determined maximum.	N/A
Pension			
To provide the facility for a competitive and viable retirement income.	Directors can elect to join a defined contribution pension scheme or receive a cash sum in lieu of pension contributions.	Up to 22% of salary may be paid as a cash sum and/or contribution to a defined contribution pension scheme. Pension contributions are currently set at: Chief executive: 22% of salary. Group finance director: 14% of salary.	N/A
Annual bonus			
To drive and reward delivery of near-term business objectives.	A performance plan is agreed with each executive for the performance year using a balanced scorecard approach. The annual bonus is not pensionable. Part of the annual bonus may be deferred. Any amount deferred will usually be paid over a period of three years.	Chief executive: maximum payment of 150% of salary (with 75% paid for on target performance). Other directors: maximum payment of 120% of salary (with 60% paid for on target performance).	The annual bonus pot is measured against annual financial objectives, accounting for at least 50% of the assessment and a balanced scorecard of non-financial objectives accounting for the balance of the assessment. For 2018, these will include strategy and change, customer and member, risk and compliance and people. Risk is taken into account when assessing performance against all the measures in the balanced scorecard and the committee may reduce or cancel any bonus payment if it considers that risk exceeded acceptable levels. No annual bonus payments will be made for below threshold performance. The committee has the discretion to adjust the formulaic outcomes both upwards and downwards (including to zero) to ensure alignment of pay with performance.

Purpose and link to strategy	Operation	Maximum opportunity	Performance measures
Long-term incentive plan (LTIP)			
To drive and reward the achievement of longer-term business objectives, so creating a powerful retention incentive. The scheme provides further alignment between the interests of executive directors and members.	LTIP payouts will be made in cash. One-third of any payment will normally be made after three years when the award vests, one-third will be deferred for a further year and one-third will be deferred for two years after vesting. Performance will be measured over a period of at least three years.	Maximum payout is capped at two times the initial award, the value of which is up to: Chief executive: 150% of salary; Other board executive directors: 125% of salary.	The LTIP performance measures will be based on financial and non-financial measures, with financial measures making up at least 50%. For 2018-2020 LTIP awards, the financial measures will be based around growth in own funds and new business and will have a 75% weighting. The remaining 25% focus on strategic goals, based around (i) developing a sustainable, growing, vibrant business; (ii) excellent franchise health; and (iii) ensuring a strong risk and capital position. An underpin related to risk whereby no vesting will occur if appropriate levels of risk management have not been achieved. No LTIP payments will be made for below threshold performance. The committee has the discretion to adjust the formulaic outcomes both upwards and downwards (including to zero) to ensure alignment of pay with performance.
Deferred variable pay and malus and 'clawback'			
In line with the requirements of the Solvency II regulations and PRA and FCA guidance, we operate a policy of deferral that covers our annual bonus scheme and the group LTIP; this includes the option for the Remuneration Committee to clawback any deferred payments.	At least 40% of the variable remuneration paid to executive directors is delivered in long-term pay. If this ratio is not met, then a portion of the annual bonus payment for that year will be deferred. For employees whose variable remuneration is £500,000 or more, the requirement will be that 60% be in long-term pay. Long-term remuneration is normally paid over a three year period. One-third of any bonus or LTIP payment will be made when the award vests, one-third will be deferred for a further year and one-third will be deferred for two years after vesting. The committee may operate malus and/or clawback in respect of annual bonus deferred awards and/or LTIP in circumstances such as a misstatement of financial results, an error in assessing vesting levels, gross misconduct or a failure of risk management or any other circumstances in which the committee, in its absolute discretion, considers that the Society is required by any Remuneration Code to operate clawback.	N/A	N/A

The committee keeps under review all elements of remuneration and retains the discretion to make changes in response to market conditions and, in exceptional circumstances, where it is in the interest of members to do so. The committee also retains the discretion to make reasonable and proportionate changes to the remuneration policy if the committee considers this appropriate in order to respond to changing legal or regulatory requirements or guidelines.

Payments outside the policy

The Committee reserves the right to make any remuneration payments and/or payments for loss of office (including exercising any discretions available to it in connection with such payments) where the terms of the payment were agreed (i) before 1 January 2014 (the date the Society's first directors' remuneration policy came into effect); (ii) before the policy set out above came into effect, provided that the terms of the payment were consistent with the directors' remuneration policy in force at the time they were agreed; or (iii) at a time when the relevant individual was not a director of the Society. For these purposes "payments" includes the committee satisfying awards of variable remuneration.

Changes to previous policy

A number of minor changes have been made to the policy put forward to a member vote at the 2015 AGM to align it with updated best market practice. As set out in the chairman's letter, the maximum LTIP award levels have also been increased to increase the long-term remuneration element to more market aligned levels and to provide additional incentivisation to the executive directors to grow the LV= business and increase member value over the longer term, from 2018 and beyond.

Selection and disclosure of performance measures

The committee selected the performance conditions because these are central to the Society's overall strategy and are the key metrics used by the executive directors to oversee the operation of the business. The performance targets are determined annually by the committee following consultation with the Audit and Risk Committees and are typically set at a level that is above the level of the group's forecasts.

The committee is of the opinion that the performance targets for the annual bonus are commercially sensitive in respect of the Society and that it would be detrimental to the interests of the Society to disclose them before the start of the financial year. The targets will be disclosed in the annual Report on Directors' Remuneration that follows the end of the relevant financial year.

Illustrations of application of remuneration policy

The group's policy results in a significant portion of remuneration received by executive directors being dependent on group performance. The charts below illustrate how the total pay opportunities for the executive directors vary under three different performance scenarios: minimum, on target and maximum.

Key

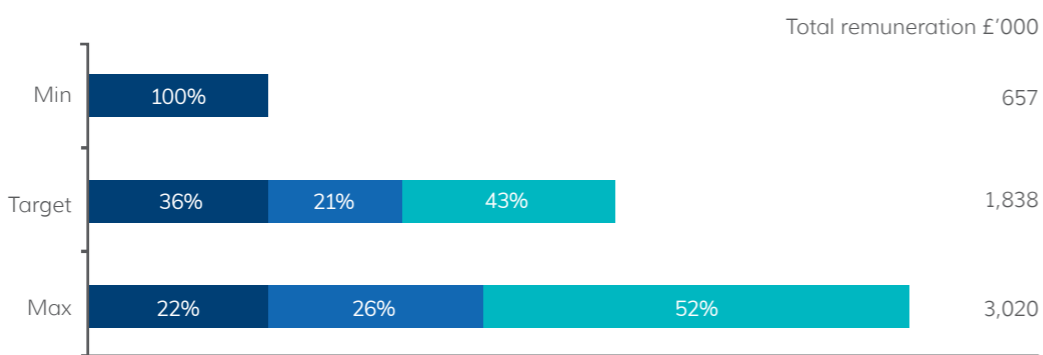
- ▶ Salary, pension and other benefits¹
- ▶ Annual bonus²
- ▶ Long-term incentives³

1 Basic salary is based on salary coming into effect on 1 April 2018. Benefits and pension levels are based on 2017 amounts on the basis that these will not be significantly different from amounts expected to be paid in 2018.

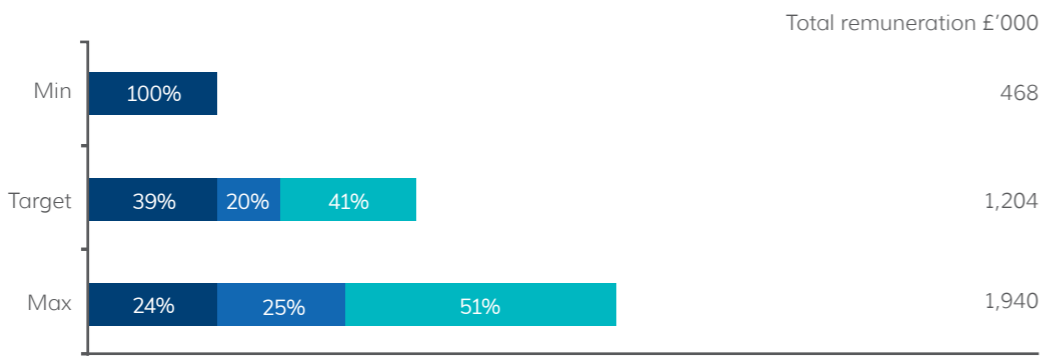
2 The on target level of bonus is 50% of the maximum bonus opportunity.

3 The on target level of the group LTIP is 50% of the maximum payout.

Richard Rowney – Chief Executive



Andy Parsons – Group Finance Director



Approach to recruitment and promotions

The remuneration package for any new executive director would be set in line with the remuneration policy in force at the time of appointment. In exceptional circumstances, to ensure we are able to recruit the most talented people to our business, it may be necessary to make an offer to a new director on terms outside the current policy. In such an event, the committee would notify members of the arrangements in the next Report on Directors' Remuneration.

When it considers it to be in the best interests of the Society and its members, the committee may offer additional cash payments to new appointees as compensation for the loss of bonus, LTIP or other such arrangements from their former employer. Any cash payments would normally take into account the time horizons and performance requirements attached to the lost remuneration. Members will be informed of any such payments in the next Report on Directors' Remuneration to be published.

In the case of an internal appointment, any variable pay element awarded in respect of the prior role would normally be allowed to payout according to its terms. For external and internal appointments, the committee may agree that the group will meet certain relocation expenses as appropriate.

Service contracts and payments for loss of office

Our executive directors are subject to a notice period of twelve months. Service contracts normally continue until the director's agreed retirement date or such other date as the parties agree. The service contracts contain a provision for early termination and notice periods given by the group are limited to twelve months or less. In certain circumstances, such as gross misconduct, a director's service contract may be terminated without notice and without any further payment or compensation, except for sums accrued up to the date of termination. If the Society terminates the employment of a director in other circumstances, compensation is generally limited to salary due for any unexpired notice period and any amount assessed by the Remuneration Committee as representing the value of other contractual benefits (including pension) which would have been received during the unexpired notice period. However, the committee may determine that a level of compensation above this is appropriate in individual cases. Payments in lieu of notice are not pensionable.

- **Termination payment** – salary plus benefits (including pension), may be subject to phasing and mitigation where this is in the interests of the Society. In addition, any statutory entitlements would be paid as necessary. In certain circumstances, a pro rata bonus may be payable, along with the entitlement to LTIP awards at the usual time, the treatment of which is set out below.

- **LTIP** – the default treatment under the LTIP is that any unvested awards lapse when employment ends. However, if an individual is a 'good leaver' (e.g. death, disability, retirement or any other situation where the Remuneration Committee determines in its discretion that the individual shall be treated as a good leaver) awards may not lapse immediately and the individual may retain their entitlement to a pro rata payment, to reflect their reduced period of employment during the term of the LTIP. Payments received under these circumstances will be subject to the same performance conditions and timescales as other participants. If it considers it appropriate to do so the committee may choose to remove the normal performance conditions and time pro rating, and/or make payments under the scheme at the point employment ends, although it is envisaged that this would only be applied in exceptional circumstances. In determining whether an executive should be treated as a good leaver or not, the committee will take into account the performance of the individual and the reasons for their departure. If employment ends after an LTIP award has vested but during its deferral period, the LTIP award will continue unless the individual resigned (unless the committee determines otherwise) or was dismissed for gross misconduct, in which case it will lapse.

Copies of the directors' service contracts and letters of appointment are available for inspection at the Society's registered office.

Summary of the policy for non-executive directors

The policy is intended to apply for three years beginning on 1 January 2018.

The committee keeps under review all elements of the policy and retains the discretion to make changes in response to market conditions and in exceptional circumstances, where it is in the interest of members to do so.

Fees – In order to attract and retain high calibre non-executive directors to the Society we pay individuals fees for the positions they undertake for the organisation. Fees are generally reviewed on an annual basis and whilst there is no prescribed maximum increase that is applied, consideration is taken of the fees paid for similar roles in other organisations, the responsibility and necessary time commitment to the group's affairs, the general increase for the broader UK employee population and on occasion the need for specific skills, changes in responsibility, or other relevant factors. No other remuneration is paid apart from these non-pensionable fees and non-executive directors are not eligible to participate in any performance-related arrangements. Fees for the non-executive directors are determined by the executive members of the board. For the chairman, fees are determined by the whole board (excluding the chairman). Non-executive directors may also be reimbursed for their travel and accommodation costs incurred in the pursuance of their duties (including any tax which may be payable in respect of such costs).

Notice – either party may give three months' notice of termination.

Annual Report on Remuneration

The Remuneration Committee

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

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

Committee membership, attendance and advisors to the committee

During 2017 the committee members were:

- Cath Keers, who chaired the committee until June 2017 when she stepped down from the board and committee;
- Caroline Burton, who was a member of the committee for all of 2017 and was appointed committee chair in June 2017;
- Mark Austen (former board chairman) was a member of the committee until June 2017;
- Alan Cook (board chairman from June 2017) joined the committee on 1 January 2017; and
- David Neave, who was a member of the committee for all of 2017.

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

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

The total fees paid to Deloitte in respect of services that materially assisted the committee during the year were £72,900. During the year, Deloitte also provided the group with advice in relation to internal audit services and payroll tax services.

Committee activities in 2017

In 2017 the committee met eight times.

The matters which were addressed included:

- Review of the overall policy relating to directors' remuneration;
- Review of all-employee remuneration policy, structures and levels;
- Review of salary and bonus levels;
- Ongoing requirements in relation to compliance with the Solvency II regulations which came into effect on 1 January 2016;
- Determination of recruitment and termination arrangements for joiners, promotions and leavers;
- Consideration of various remuneration issues related to the strategic partnership with Allianz;
- Preparation of the report on directors' remuneration; and
- Other routine matters throughout the year.

All-employee remuneration

The committee also takes an active role in overseeing remuneration arrangements for the wider employee population. LV= has committed to paying at least the Living Wage Foundation's minimum hourly rates of pay to all employees, with employees paid a minimum of £8.75 per hour outside London and £10.20 in London (including our Croydon office).

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

Remuneration for the past year (year ended 31 December 2017)

Summary table of executive directors' remuneration – Audited

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

£'000	Year	Salary and fees	Other benefits ¹	Pension ²	Annual bonus ³	Long-term incentives ⁴	Total from ongoing remuneration policy	Other remuneration	Total
Richard Rowney ⁵	2017	505	17	111	606	480	1,719	–	1,719
	2016	398	15	87	430	236	1,166	–	1,166
Andy Parsons ⁶	2017	217	8	22	250	–	497	450	947
	2016	–	–	–	–	–	–	–	–
Steve Treloar ⁷	2017	380	15	40	380	–	815	–	815
	2016	246	8	34	200	–	488	1,245	1,733
Philip Moore ⁸	2017	194	15	26	25	339	599	–	599
	2016	375	16	52	45	259	747	–	747
Total	2017	1,296	55	199	1,261	819	3,630	450	4,080
	2016	1,019	39	173	675	495	2,401	1,245	3,646

¹ Benefits include car allowance, medical insurance, health screening, income protection cover and life cover.

² These amounts have been taken as cash in lieu of forgone pension contributions by all executive directors, other than Steve Treloar. Steve Treloar received contributions to the defined contribution section of our pension scheme up to 31 March 2017 and cash in lieu of forgone pension contributions from 1 April 2017.

³ This relates to the annual bonus awarded for the year ended 31 December 2017. Further details of this payment are set out on pages 86 and 87. An element of these full year amounts will be subject to deferral.

⁴ This relates to the vesting of the 2015-2017 LTIP awards based on the performance to 31 December 2017. Two-thirds of the figures shown are deferred to be paid in equal tranches in May 2019 and May 2020.

⁵ Richard Rowney's salary was £490,000 up to 31 July 2017 and increased to £525,000 from 1 August 2017.

⁶ Andy Parsons performed the role of group finance director from the date he was employed by LV= on 12 June. Formal appointment to the board took place on 30 June 2017, however his full remuneration since commencing employment has been included in the table above. He received buyouts and these are included under Other Remuneration, details of which are included on page 89.

⁷ Steve Treloar stepped down from the board on 28 December 2017.

⁸ Philip Moore resigned from the board on 29 June 2017. The remuneration for the period he worked is reflected in the single figure table above. Philip received his normal salary and benefits up to his leave date and a payment in lieu of notice for 12 months received within 6 months of his termination date. These payments are included in the table on page 90, in the payments for contractual commitments on leaving office section. In 2017 Philip also received £21,250 in fees relating to external non-executive directorships.

Summary table of non-executive directors' remuneration – Audited

£'000	Year	Base fee	Other fees ²	Total fees ¹
Alan Cook ³ Chairman from 20 June 2017	2017	153	–	153
	2016	–	–	–
Mark Austen ⁴ Chairman until 20 June 2017	2017	87	–	87
	2016	184	–	184
Caroline Burton ⁵ Chair of Remuneration and Investment Committees, member of Audit Committee, Non executive director of LV= general insurance subsidiaries until 28 December 2017	2017	53	29	82
	2016	53	20	73
Cath Keers ⁶ Chair of Remuneration Committee, member of With-profits Committee until 20 June 2017	2017	25	8	33
	2016	53	17	70
Colin Ledlie ⁷ Member of With Profits, Risk and Audit Committees	2017	22	6	28
	2016	–	–	–
James Dean Senior independent director, chair of Audit committee, member of Risk Committee	2017	53	25	78
	2016	53	24	77
David Neave Member of Remuneration and Risk Committees and Non-executive chairman of LV= general insurance subsidiaries	2017	53	24	77
	2016	53	26	79
David Barral ⁸ Chair of Risk Committee, Member of Audit and Investment Committees, Non-executive director of LV= general insurance subsidiaries	2017	53	22	75
	2016	43	8	51
Total	2017	499	114	613
	2016	439	95	534

No additional fees are paid for membership of the Corporate Governance and Nomination Committee, therefore membership is not listed above.

¹ For all those who started or left in the year or were appointed to a different role, the total fees figure is reflective of these changes.

² Other fees relate to committee chair and membership fees.

³ Alan Cook joined the board in January 2017 as chairman designate, on an annual fee of £100,000. He was appointed chairman of the board from June 2017, at which point his annual fee increased to £200,000.

⁴ Mark Austen resigned from the board in June 2017.

⁵ Caroline Burton was appointed chair of the Remuneration Committee in June 2017.

⁶ Cath Keers resigned from the board in June 2017.

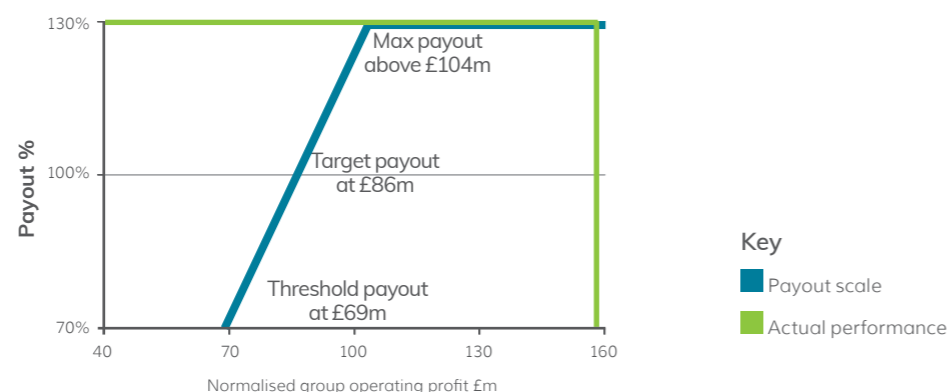
⁷ Colin Ledlie was appointed to the board in August 2017.

⁸ David Barral replaced Caroline Burton as Non-executive director of LV= general insurance subsidiaries from 28 December 2017.

Annual bonus for the year ended 31 December 2017 – Audited

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

Financial



The Society operates a performance range for the profit target of normalised group operating profit (see chart above) which is considered to be stretching at all levels. Threshold, at £69 million is the level of performance that must be achieved to release 70% of the bonus pot. Target, at £86 million is the level of performance that must be achieved to release 100% of the bonus pot. Maximum, above £104 million is the level of performance that must be achieved to release 130% of the bonus pot. The normalised group operating profit achieved in 2017 was £158 million, resulting in maximum payout.

Individual and strategic

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

	Individual and strategic objectives (45% weighting)	Indication of performance
Richard Rowney	Objectives as chief executive: <ul style="list-style-type: none"> Progress against key strategic priorities including strengthening the Society's capital position and securing our future as a modern mutual Deliver the financial plan and targets, including good cost control Solvency II implementation Operate within the Society's risk appetite Deliver excellent customer satisfaction scores to remain Britain's best loved insurer Continue to deliver good employee engagement scores and champion diversity & inclusion 	Out perform
Andy Parsons	Objectives as group finance director: <ul style="list-style-type: none"> Strengthen the Society's capital position and secure our future as a modern mutual Deliver financial operational performance Solvency II implementation Operate within the Society's risk appetite Develop the investment strategy Deliver the financial plan and targets, including good cost control 	Perform
Steve Treloar	Objectives as managing director of general insurance: <ul style="list-style-type: none"> Progress against key strategic priorities including strengthening the Society's capital position Growth of the general insurance business Build a distinct and relevant brand Deliver market leading digital solutions Operate within the Society's risk appetite 	Out perform
Philip Moore	Objectives as group finance director: <ul style="list-style-type: none"> Deliver financial operational performance Solvency II implementation Operate within the Society's risk appetite Develop the investment strategy Deliver the financial plan and targets, including good cost control 	Perform

In addition to the objectives determined at the start of the year, a key additional objective that arose during the year became the successful completion of the strategic partnership with Allianz which was achieved on 28 December 2017. Risk is taken into account when appraising all performance measures and the committee may reduce or cancel any bonus payment if it considers that risk exceeded acceptable levels. In addition, no bonus payments will be made unless the group achieves a pre-determined minimum level of profits.

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

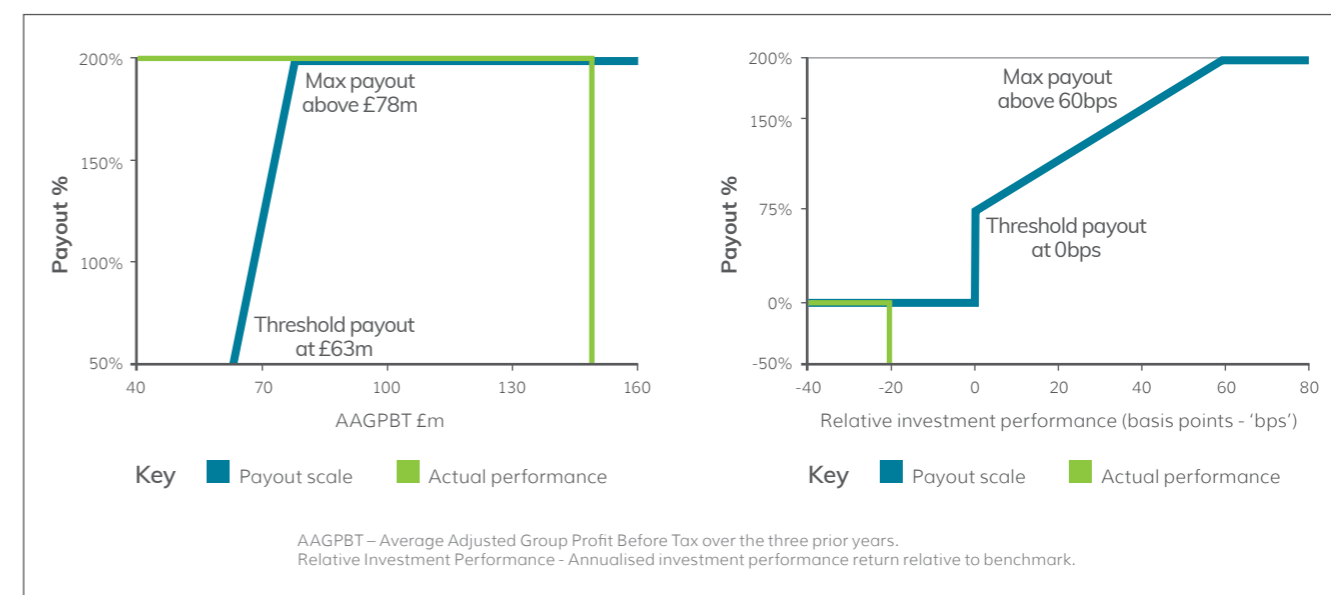
	Payout (% of maximum)	Total 2017 bonus (£'000s)	Total 2017 bonus (% of salary)	2017 bonus deferred %	2017 bonus deferred ¹ (£'000s)
Richard Rowney	80%	606	120%	8%	49
Andy Parsons ²	53%	250	64%	0%	0
Steve Treloar	83%	380	100%	28%	108
Philip Moore ³	11%	25	13%	0%	0

¹ Amounts deferred achieve the deferral criteria whereby 40% of variable remuneration (60% if variable remuneration is above £500,000) is deferred. Amounts are calculated using the 2017 bonus and the 2018-2020 LTIP award. Any variable pay amount deferred will be paid in equal parts over the following three years. During the deferral period, the value of deferred amounts will be tied to the value of members' invested funds, thereby creating a link to ongoing performance.
² As part of his joining contract, the Remuneration Committee agreed that Andy Parsons would have the opportunity of being entitled to bonus measured against his full annual salary of £390,000 and that this would not be pro-rated for his period of service.
³ Philip Moore was treated as a good leaver and as such was eligible for a pro-rata bonus until his termination date of 29 June 2017.

Group LTIP payments made in the year (2015 – 2017 scheme) – Audited

The 2015-17 LTIP scheme is based on a performance period from 1 January 2015 to 31 December 2017. For the 2015-2017 scheme, the payout is based on:

- AAGPBT: 75% of award for Mike Rogers and Philip Moore (former directors), and 100% for Richard Rowney as he was managing director of life and pensions when this award was made; and
- Relative Investment Performance: 25% of award for Mike Rogers and Philip Moore (former directors).



AAGPBT – Average Adjusted Group Profit Before Tax over the three prior years.
 Relative Investment Performance - Annualised investment performance return relative to benchmark.

Performance against the specific performance targets is as follows:

- AAGPBT of £151 million resulted in a maximum payout
- Relative investment performance of 20 basis points below benchmark was below threshold and resulted in no payout

Richard Rowney

- AAGPBT vesting (100% weighting): **200%** (maximum 200%)
- Overall vesting: **200%** (maximum 200%)

Philip Moore

- AAGPBT vesting (75% weighting): **200%** (maximum 200%)
- RIP vesting (25% weighting): **0%** (maximum 200%)
- Overall vesting: **150%** (maximum 200%)

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

Group LTIP summary of awards and amounts vested during 2017 – Audited

£'000	Award	Unvested awards at 1 January 2017 ¹	Awards made in the year	To be paid in respect of 2015-2017 scheme	Of which deferred	Unvested awards at 31 December 2017 ²
Richard Rowney	2015-2017	240	–	480	320	–
	2016-2018	246	–	–	–	246
	2017-2019	–	490	–	–	490
Andy Parsons	2017-2019	–	293	–	–	293
Steve Treloar	2016-2018	285	–	–	–	285
	2017-2019	–	285	–	–	285
Philip Moore ³	2015-2017	271	–	339	226	–
	2016-2018	277	–	–	–	277

¹ Unvested awards are shown at the base award level. Unvested awards at 1 January 2017 are in respect of awards granted in 2015 and 2016.

² Unvested awards at 31 December 2017 are in respect of awards granted in 2016 and 2017.

³ Phillip Moore was treated as a good leaver and as such was eligible for a pro-rata LTIP until his termination date of 29 June 2017.

Group LTIP awards made in the year (2017 – 2019 scheme) – Audited

	Type of award	Initial award (£'000)	Growth in Average Adjusted Group Profit Before Tax	Relative Investment Performance	% of initial award that would vest at maximum performance	Vesting determined by performance over
			% of initial award that would vest at threshold performance			
			75% weighting	25% weighting		
Richard Rowney	Cash	490	50%	75%	200%	3 years to 31 December 2019
Andy Parsons	Cash	293	50%	75%	200%	
			100% weighting	0% weighting		
Steve Treloar	Cash	285	50%	N/A	200%	

Pensions – Audited

Since the closure of the defined benefit (DB) section of our pension scheme to future accrual in 2013, executive directors have had the choice of receiving contributions into the defined contribution (DC) section of our pension scheme or being paid an equivalent cash allowance. Steve Treloar was a member of the DC section of the pension scheme, ceasing to be an active member on 1 April 2017. Following that date he received cash payments in lieu of pension contributions. All other executive directors received cash payments in lieu of pension contributions.

Additional information on 2017 remuneration

Percentage change in remuneration levels

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

	Salary	Taxable benefits	Bonus
Chief executive	7%	4%	41%
% change based on a static population excluding the chief executive	2%	4%	42%

Ratio of chief executive salary to average employee FTE salary 16:1, (2016: 17:1).

Relative importance of the spend on pay

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

	Total remuneration		
	2017 £m	2016 £m	% change
Staff costs	255	263	(3)%
Mutual bonus	26	17	53%

Chief executive's remuneration over nine financial years

The total remuneration figures for the chief executive during each of the last nine financial years are shown in the table below. The total remuneration figure includes the annual bonus based on that year's performance and LTIP awards based on three year performance periods ending in the relevant year. For 2016, total remuneration reflects the amounts received by Richard Rowney and Mike Rogers for the periods each director performed the role of chief executive.

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

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

Payments upon recruitment and promotion of directors

Andy Parsons was appointed as the group finance director to replace Philip Moore in June 2017. Upon appointment Andy's salary was set at £390,000. Andy's bonus maximum opportunity and LTIP award level were set in line with our remuneration policy, i.e. a bonus maximum of 120% of salary and LTIP award of 75% of salary (with payout capped at two times the LTIP initial award). Andy also participated in a number of incentive arrangements at his previous employer which the committee agreed to buy-out as part of his offer to join the Society. This buy out was comprised of amounts in respect of annual bonus, deferred bonuses and performance shares which were forfeited as a result of his resignation to join the Society. For the amounts in respect of annual bonus and performance shares, the applicable performance conditions were taken into account when determining their value at the time of the buy-out. The awards are not subject to further performance conditions and will payout at the same time as the original awards would have done. Buy out awards are subject to clawback provisions.

The total buyout value is £450,000, of which £193,000 is in respect of bonus and deferred bonus shares forfeited and £257,000 is in respect of LTIP shares forfeited.

Payments to past directors – Audited

As set out in our 2016 Report on Directors' Remuneration, on leaving Mike Rogers retained eligibility to participate in the long-term incentive schemes to which he had already been invited to participate. All awards were pro-rated to his final date in employment, 31 December 2016, with the amount payable based on the applicable performance conditions.

The 2015-17 LTIP award, which Mike retained 2/3 eligibility for, will payout at two times the initial award value, which will result in a 2015-17 LTIP award payout amount of £530,000 for Mike. This will be paid to him annually in one third instalments, beginning from May 2018.

Payments for contractual commitments on leaving office¹ – Audited

Philip Moore stepped down from the board on 29 June 2017. Thereafter, Philip received payments in line with his contractual entitlements in lieu of remuneration that included a payment in lieu of notice (PILON) which was made up of salary, car allowance, and cash in lieu of pension for 12 months, as follows:

Element	Amount
Salary	£376,800
Other Benefits ²	£11,482
Cash in lieu of pensions (14% of base)	£52,752
Total	£441,034

These sums were subject to the usual deductions for tax and national insurance.

As Philip Moore was employed by the Society until 29 June 2017 he was eligible to be considered for a pro-rata bonus relating to the time he was employed by the Society in the 2017 performance year. His performance was assessed by the chief executive in the usual way with payment agreed by the Remuneration Committee in early 2018. The 2017 bonus details are set out on pages 86 and 87. Payment due will be made at the same time as the general employee population, in March 2018.

Philip Moore retained eligibility to participate in the long-term incentive schemes to which he had already been invited to participate. All awards were pro-rated until his final date in employment, 29 June 2017. Any payments shall be subject to the applicable scheme multiplier, i.e. final performance of the scheme, and will be made according to the original schedule. The scheme, eligibility and payment schedules are as follows:

Scheme	Award pro-rating	1st payment due (1/3 of final outturn)	Subsequent payments (2 x 1/3 instalments)
2015-17	Pro-rated until termination date	May 2018	May 2019, May 2020
2016-18	Pro-rated until termination date	May 2019	May 2020, May 2021

The 2015-17 LTIP had a performance period ending on 31 December 2017, with details of the performance and vesting level under this scheme set out on pages 87 and 88. All amounts are subject to deferral in line with the remuneration policy.

All termination payments have been made within the existing remuneration policy and have been pro-rated for time, remain subject to performance and will be subject to the same time horizons.

Directors' Loans

As at 31 December 2017 there were no loans outstanding to directors.

Results of members' votes on remuneration resolutions at 2017 AGM

At the Society's AGM in June 2017 the members approved the 2016 Remuneration Report, with 94% of the 40,947 total votes cast in favour³.

At the previous vote on the directors' remuneration policy, which took place at the Society's AGM in May 2015, the directors' remuneration policy was approved, with 94% of the 49,327 total votes cast in favour⁴.

Remuneration decisions taken in respect of the coming year (year ending 31 December 2018)

Executive director salary

Current salary levels and those which will apply from 1 April 2018 are as follows:

	Effective from April 2018 £'000	As at 31 December 2017 £'000	Percentage change
Richard Rowney ⁵	525	525	0%
Andy Parsons ⁶	398	390	2%

1 These amounts are categorised within the regulations governing disclosures on directors' remuneration as payments for loss of office.
2 Other Benefits includes Car allowance, Medical Insurance.
3 There were 1,884 abstentions to this resolution.
4 There were 2,732 abstentions to this resolution.
5 Richard Rowney's salary increased from 1 August 2017 from £490,000 to £525,000.
6 Andy Parsons was appointed to the board in June 2017.

Performance targets to be applied for the 2018 annual bonus and group LTIP (2018-2020 scheme) in 2018

For 2018, the annual bonus will continue to be based on a balanced scorecard of group financial and non-financial objectives. For 2018, the financial objective weighting is 50%, with the non-financial measures accounting for the remaining 50%.

The details of our 2018 group balanced scorecard are shown below:

Target	Measure	Weighting
Financial	Operating capital surplus, dividend flow from the general insurance business and the economic value of new business	50%
Strategy and change	Progress made towards delivery of five-year strategic objectives	20%
Customer and member	Brand and customer satisfaction metrics, subject to discretion if member bonus not in line with policy	10%
Risk and compliance	Customer outcomes in respect of conduct and operational risk controls and operating within the group's risk appetite metrics	10%
People	High employee engagement versus high performing organisations and diversity and inclusion metrics.	10%

The 2018-20 LTIP awards (to be granted in 2018) will be subject to the following performance conditions:

Performance condition	Weighting	Underpin
Financial measures based around growth in own funds and economic value of new business	75%	An underpin related to risk whereby no vesting will occur if appropriate levels of risk management have not been achieved.
Strategic goals, based around (i) developing a sustainable, growing, vibrant business; (ii) excellent franchise health; and (iii) ensuring a strong risk and capital position.	25%	

Non-executive directors' fees

Fees for the non-executive directors are determined by the board, based on the responsibility and time committed to the group's affairs and appropriate market comparisons. Individual non-executive directors do not take part in discussions regarding their own fees. Fees are reviewed annually and any changes are implemented from 1 June each year. No fee increase was made during 2017 and so the fees that have been effective from 1 June 2016 still apply from 1 June 2017, as set out below:

	Current fees
Chairman	£200,000
Non-executive director base fee	£53,000
Additional fees:	
Senior independent director	£6,500
Investment Committee chair	£8,700
Other committees chair	£13,000
Committee membership (various)	£3,650-£5,500

Fees effective from 1 June 2018 will be approved in May 2018. Additional fees are payable for being a member of LV= subsidiary boards, including for membership of the board of the strategic partnership with Allianz (where applicable).

The directors approved the Report on Directors' Remuneration on 28 March 2018.



Caroline Burton
Chairman of the Remuneration Committee

A to Z Glossary

ABI: Association of British Insurers.

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

Best Estimate Liability (BEL): The expected cost of future policyholder claims and expenses. This is net of expected future income from these policies such as premiums and charges. Calculations are on a best estimate basis, and are discounted using a regulatory risk free discount rate (adjusted as permitted).

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

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

Eligible own funds: The amount of capital resources that we have to cover the SCR. This includes the excess of assets over liabilities (excluding the subordinated debt) in the Solvency II balance sheet and is subject to tier restrictions.

Enhanced annuity: An annuity which provides a higher level of income to purchasers with a lower life expectancy. This product was discontinued in 2016.

Equity release: A lifetime mortgage where interest is added to the loan which is repaid using the proceeds of the sale of the property when the borrower dies or enters permanent residential care.

Financial Conduct Authority (FCA): A body that regulates the conduct of retail and wholesale financial services firms.

Gross Written Premiums (GWP): Reflects business coming into force during the year and is reported before deduction for unearned premiums and premiums ceded to reinsurers.

Industrial Branch (IB): Includes small premium whole of life and endowment policies.

International Financial Reporting Standards (IFRS): Accounting standards issued by the International Accounting Standards Board (IASB). Our financial statements are prepared in accordance with IFRS as endorsed by the EU.

Longevity risk: The risk associated with increased life expectancy of policyholders.

Loss Portfolio Transfer (LPT): In a loss portfolio transfer a reinsurer assumes and accepts an insurer's existing open and future claims liabilities through the transfer of the insurer's loss reserves.

LVFS: Liverpool Victoria Friendly Society.

Minimum Capital Requirement (MCR): A lower threshold than the SCR; the MCR represents the minimum amount of capital that an insurer is required to hold to cover its risks. If the MCR is breached authorisation of insurance activities should be withdrawn.

Morbidity risk: The risk associated with the likelihood that a policyholder will fall ill.

Mortality risk: The risk associated with the likelihood that a policyholder will die during the period of insurance cover.

Mutual: A business that is owned by its members rather than by shareholders.

Mutual bonus: A discretionary enhancement to asset shares to share the results of the group's performance.

Ogden discount rate: The legislated rate used to calculate awards for bodily injury claims that are taken as a lump sum.

Open-Ended Investment Companies (OEICs): Investment funds that constantly change in size as investors add or withdraw funds. OEICs give the investor access to a number of sub-funds with different objectives.

Ordinary Branch (OB): Includes with-profits endowments, whole of life policies, annuities and pensions.

Pension annuity: An annuity uses the proceeds of a pension fund to provide an income for a fixed term or the rest of a policyholder's life.

Periodic Payment Orders (PPOs): An annuity style award paid to claimants instead of a lump sum, where indexed payments can be varied to meet likely future changes in circumstance. This transfers mortality and investment risk from the claimant to the insurer.

Permanent Health Insurance (PHI): An insurance policy paying benefits to policyholders who are incapacitated and hence unable to work due to illness or accident.

Persistency: The expectation of the level of policies that will be retained by policyholders over their contract terms.

Protection: A policy providing a cash sum on the death or critical illness of the life assured.

Prudential Regulation Authority (PRA): A regulatory body that is responsible for the prudential regulation and supervision of financial services firms.

PVIF: The present value of acquired in-force business represents the group's interest in the expected cash flows of insurance and investment contracts acquired through a business combination.

Quota Share (QS): A type of pro rata reinsurance contract in which the insurer and reinsurer share premiums and losses according to a fixed percentage.

Regular premium: Premiums received in respect of long-term contracts where the policyholder agrees to make regular payments throughout the term of the contract.

Risk appetite: The amount of risk that a business is prepared to accept or keep when carrying out its everyday activities.

Risk Margin (RM): The opportunity cost of holding regulatory capital for existing business. This is an amount of capital that is held above the BEL against non-hedgeable risks associated with supporting the business.

RNPFN: Royal National Pension Fund For Nurses.

Self-Invested Personal Pension (SIPP): A personal pension plan that allows investors to make their own investment decisions.

Single premium: Premiums received in respect of long-term contracts where one premium is paid at inception and there is no obligation for the policyholder to make subsequent payments.

Solvency II (SII): The capital adequacy regime for the European insurance industry that establishes a comprehensive framework for insurance supervision and regulation. This strengthens protection for policyholders by ensuring that companies allocate enough capital to cover all the risks in their business.

Solvency Capital Requirement (SCR): The amount of regulatory capital that we are required to hold. LV= applies the Standard Formula in calculating the SCR. The capital required is based on our ability to survive a 1 in 200 year stress event, considering our investment strategy, risk profile and allowing for diversification.

Transition (TMTP): Transitional Measures on Technical Provisions provides transitional relief over a 16 year period from the inception of SII to smooth the impact of the higher capital requirements associated with SII.

UK Corporate Governance Code: The Code sets out standards of good governance practice. It covers, amongst other things, the board composition and its accountability and relations with business owners.

Unallocated Divisible Surplus (UDS): The amounts that have yet to be formally declared as bonuses for participating policyholders together with the free assets of the group.

Unitised With-Profits (UWP): A policyholder's investment buys units in the with-profits fund.

With-profits fund: An investment fund where we combine all of our with-profits investors' money and manage it on their behalf.

LV= Use of non-GAAP* measures

Profit before tax	Because LV= is a mutual, any remaining profit is transferred to the Unallocated divisible surplus, leaving a final balance for profit each year of £nil. This would mean that if we applied the strict GAAP definition our profit before tax would simply be equal and opposite to our tax charge. We believe that this is not a meaningful presentation for users and we therefore provide an alternative measure for profit before tax which allows meaningful comparisons with the profit before tax disclosed by other proprietary companies.
Operating profit	Our operating profit measure is the key performance measure for profitability for the LV= group, life and general insurance businesses and executive remuneration in these areas is linked to this metric. This measure provides useful information regarding the financial performance of the group as it represents management's view of the performance of the business. For the group this measure represents the longer-term return from all its businesses and the cost of ongoing central overheads such as support functions. For the general insurance business this measure represents the return from insurance activities, i.e. underwriting profit and investment returns.
Short term investment fluctuations (STIF)	Short-term investment fluctuations are presented outside of operating profit for the life business in order to exclude the impact of temporary volatility. This includes the impact of tax charge deducted from policy asset shares and the RNPFN fund.
Centrally managed costs	LV= reports some of its costs below operating profit because they are not associated with running the trading business of the group.
Investment performance %	Provides a measure of the performance of the investment strategy. The performance of the with-profits fund drives the returns to our members. Within general insurance, this measure allows management to monitor the investment performance and make changes to the strategy as necessary.
Operational liquidity	Certain liquid assets reported in the Statement of Financial Position are required to match reserves and therefore do not provide a true measure of the available liquidity of the group i.e. the 'free' funds available to meet its obligations as they fall due.

General insurance

Loss ratio	The loss ratio is the ratio of incurred losses to Net earned premiums. The loss ratio enables management to monitor general insurance product performance by comparing the level of earned premiums with incurred claims.
Expense ratio	The expense ratio is the ratio of the expenses associated with acquiring, underwriting and servicing insurance contracts to Net earned premiums. The expense ratio provides a measure of cost efficiency of the general insurance business.
Combined ratio	The combined ratio is the ratio of incurred losses and expenses to Net earned premiums. The combined ratio provides a barometer for underwriting profit.

Life

Present value of new business premiums (PVNBP)	PVNBP provides a measure of the value of new business written in the year that is more useful than IFRS new business premiums as it includes the present value of the regular premiums we expect to receive over the term of contracts sold in the year.
New business contribution	The contribution to operating profit as a result of new business written on a PVNBP basis provides a measure of profit generated by management actions during the year, rather than from in-force business.
Strategic investment	Strategic investment in new propositions is the project costs invested in developing new products. These costs are excluded from New business contribution as they do not relate to the overall profitability of policies written during the year.

*GAAP means Generally Accepted Accounting Practice i.e. the strictly technical measure if you follow the accounting standards.



£122m

Profit before tax*

*see definition on p21

£1,189m

Unallocated divisible surplus

£26m

Mutual bonus

Our Accounts

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Independent auditors' report to the Members of Liverpool Victoria Friendly Society Limited

Year ended 31 December 2017

Report on the audit of the financial statements

Opinion

In our opinion, Liverpool Victoria Friendly Society Limited's group financial statements and Society financial statements (the "financial statements"):

- give a true and fair view of the state of the group's and of the Society's affairs as at 31 December 2017 and of the group's and the Society's income and expenditure and cash flows for the year then ended;
- have been properly prepared in accordance with IFRSs as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Friendly Societies Act 1992 and, as regards the group financial statements, Article 4 of the IAS Regulation.

We have audited the financial statements, included within the Annual Report, which comprise: the group and Society Statements of Financial Position as at 31 December 2017; the group and Society Statements of Comprehensive Income, and the group and Society Statements of Cash Flows for the year then ended; and the notes to the financial statements, which include a description of the significant accounting policies.

Our opinion is consistent with our reporting to the Audit Committee.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)") and applicable law. Our responsibilities under ISAs (UK) are further described in the Auditors' responsibilities for the audit of the financial statements section of our report. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Independence

We remained independent of the group in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, which includes the FRC's Ethical Standard, as applicable to listed public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

To the best of our knowledge and belief, we declare that non-audit services prohibited by the FRC's Ethical Standard were not provided to the group or the Society.

Other than those disclosed in note 12 to the financial statements, we have provided no non-audit services to the group or the Society in the period from 1 January 2017 to 31 December 2017.

Our audit approach

Context

Liverpool Victoria Friendly Society Limited (the 'Society') is an incorporated friendly society that, together with various subsidiaries, carries out insurance and financial services business in the UK. On 28 December 2017, the group completed a strategic partnership with Allianz. The transaction has resulted in 49% of the group's General Insurance business being sold to Allianz for £500m, resulting in a gain of £124m. As control has been retained, the General Insurance business has continued to be consolidated with Allianz's 49% stake being recognised as a non-controlling interest in the group's financial statements. As part of the transaction, the group entered into an agreement with Allianz to sell its commercial business renewal rights. This has resulted in a gain of £52m being recognised this year.

These significant transactions together with external and internal changes impacting the valuation of the life and general insurance contract liabilities, have been key focus areas for our audit.

Overview

Materiality	<ul style="list-style-type: none"> • Overall group materiality: £36.5 million (2016: £30 million), based on 3.1% of the group's Unallocated Divisible Surplus ('UDS'). • Overall Society materiality: £32.9 million (2016: £30 million), based on 3.1% of the Society's Unallocated Divisible Surplus ('UDS').
Audit scope	<ul style="list-style-type: none"> • The group consists of 26 active statutory entities, but primarily operates through three main trading entities (Liverpool Victoria Friendly Society Limited, Liverpool Victoria Insurance Company Limited and Highway Insurance Company Limited) at 15 locations across the UK. In our view, all three main trading entities required full scope audits of their complete financial information, due to their size and risk characteristics. • In addition to the group's head offices in Bournemouth, we visited five other locations. Our procedures performed at those other locations primarily focused on understanding the systems and controls in place over the recording and processing of new and renewal business and claims. • Taken together, the procedures we performed over the three main trading entities, balances included in a further 2 reporting units and the group consolidation entries accounted for over 99% of the group's Unallocated Divisible Surplus ('UDS'), the group's net earned premiums, and the group's profit before tax, mutual bonus and UDS transfer.
Key audit matters	<ul style="list-style-type: none"> • The valuation of long-term insurance contract liabilities (Group and Society). • The recognition and valuation of the reinsurance assets associated with the long-term insurance contract liabilities for OB Pensions (Group and Society). • The valuation of general insurance claims liabilities (Group). • The accounting and related disclosures of the sale of 49% of the General Insurance business and sale of the commercial business renewal rights to Allianz (Group).

The scope of our audit

As part of designing our audit, we determined materiality and assessed the risks of material misstatement in the financial statements. In particular, we looked at where the directors made subjective judgements, for example in respect of significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain.

We gained an understanding of the legal and regulatory framework applicable to the group and the industry in which it operates, and considered the risk of acts by the group which were contrary to applicable laws and regulations, including fraud. We designed audit procedures at group and significant component level to respond to the risk, recognising that the risk of not detecting a material misstatement due to fraud is higher than the risk of not detecting one resulting from error, as fraud may involve deliberate concealment by, for example, forgery or intentional misrepresentations, or through collusion. We focused on laws and regulations that could give rise to a material misstatement in the group and Society financial statements, including but not limited to, the Friendly Societies Act 1992 legislation, the Companies Act 2006, the UK Corporate Governance Code, the Prudential Regulation Authority's regulations, the UK tax legislation and equivalent local laws and regulations applicable to significant components.

Our tests included, but were not limited to, review of the financial statement disclosures to underlying supporting documentation; review of correspondence with, reports to and making enquiries of the regulator; review of the group's register of litigation and claims; review of policyholder complaints; review of the With-Profits Committee meeting minutes; enquiries of the Board, management, the risk and compliance function and internal audit; and review of internal audit reports, compliance reports and whistleblowing reports in so far as they related to the financial statements.

There are inherent limitations in the audit procedures described above and the further removed non-compliance with laws and regulations is from the events and transactions reflected in the financial statements, the less likely we would become aware of it.

We did not identify any key audit matters relating to irregularities, including fraud. As in all of our audits we also addressed the risk of management override of internal controls, including testing journals and evaluating whether there was evidence of bias by the directors that represented a risk of material misstatement due to fraud.

Key audit matters

Key audit matters are those matters that, in the auditors' professional judgement, were of most significance in the audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) identified by the auditors, including those which had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team. These matters, and any comments we make on the results of our procedures thereon, were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. This is not a complete list of all risks identified by our audit.

Key audit matter	How our audit addressed the key audit matter
<p>The valuation of long-term insurance contract liabilities (Group and Society: £9.9bn (2016: £9.4bn)) Refer to page 65 (Audit Committee Report) and note 19 to the financial statements</p> <p>The group and Society financial statements include liabilities for the estimated cost of settling benefits and claims associated with life products. We focused on this area because of the significance of these amounts in deriving the group and Society's result, and because of the use of a suite of economic and demographic data and assumptions, which are often highly subjective. In particular, we focused on the most judgemental assumptions having an impact on the liabilities, namely longevity assumptions (i.e. life expectancy of policyholders for annuity products) and management's use of the CMI 2016 projection model for the first time this year.</p>	<p>Our work to address the valuation of the long-term insurance contract liabilities was supported by our in-house life actuarial specialists and included the following procedures:</p> <ul style="list-style-type: none"> We tested the underlying data, including key reconciliations, and this testing was performed with no material exceptions. We compared the methodology, models and assumptions used against recognised actuarial practises and underlying internal experience, and by applying our industry knowledge and experience, and found them to be reasonable. We performed an independent annual benchmarking survey, which allowed us to further challenge the assumptions setting process by comparing certain assumptions used relative to the Society's industry peers. <p>In respect of longevity assumptions we:</p> <ul style="list-style-type: none"> Base longevity: Verified the appropriateness and accuracy of data used by management to model base longevity for the Society's annuity portfolios. We reviewed management's assessments in calculating the assumptions based on that data and considered the extent to which the assumptions used were consistent with other sources of information, such as industry-wide mortality investigations. Future improvements: Considered management's use of the CMI 2016 projection model for the first time this year by assessing management's analysis to justify their decision. This included considering management's use of industry data to model longevity improvements for the Society's annuity contracts against the Society's own experience and verifying the data used. Our market benchmarking survey indicated the use of the CMI 2016 model is consistent with other benchmark respondents, however a wide range of parameterisations have been used. We therefore challenged management's expert judgement for the parameterisation by performing sensitivity analysis to consider the impact of different parameterisations. Used the above information to critically assess and challenge the judgements made by management and to determine whether there was any evidence of management bias. <p><i>Based on the work performed we found that the longevity assumptions used were supported by the evidence we obtained.</i></p>
<p>The recognition and valuation of the reinsurance assets associated with the long-term insurance contract liabilities for OB Pensions (Group and Society: £0.9bn (2016: N/A)) Refer to page 65 (Audit Committee Report) and note 23 to the financial statements</p> <p>In December 2017 the group and Society entered into a reinsurance agreement to reinsure a substantial proportion of the OB pension portfolio to reduce its exposure to longevity risk. This has resulted in the assets backing the OB pension liabilities being transferred, an increase of £0.8bn to premiums ceded to reinsurance and the recognition of a reinsurance asset for this product of £0.9bn.</p> <p>Management have applied expert judgement in determining whether the contract entered into transferred significant insurance risk. Further modelling the future cash flows is complex due to policyholder behaviour which impacts the reinsured benefits to be received.</p>	<p>Our work to address the valuation of the reinsurance asset was supported by our in-house life actuarial specialists and included the following procedures:</p> <ul style="list-style-type: none"> We verified management's judgement that significant insurance risk had been transferred by reviewing the terms and conditions of the contract and considering various criteria in forming our own conclusion. This included assessing the Society's remaining exposure to risk and whether or not compensation would be paid to the Society for an uncertain future event adversely impacting its performance and position. We assessed the effect we expected the reinsurance agreement to have on management's modelling of future cash flows and consequently the recognition of the reinsurance asset this year. This included validating the model changes implemented by management, checking the changes made to the model were consistent with the structure and terms of the reinsurance treaty, and assessing whether the resulting financial impacts were as expected on the net of reinsurance reserves. <p><i>Based on the work performed we found that management's conclusion that significant insurance risk had been transferred and the assumptions and modelling used was supported by the evidence we obtained.</i></p>

Key audit matter	How our audit addressed the key audit matter
<p>The valuation of general insurance claims liabilities (Group: £1.6bn (2016: £1.6bn)) Refer to page 66 (Audit Committee Report) and note 19 to the financial statements</p> <p>The group financial statements include liabilities for the estimated cost of settling general insurance claims. These are included within insurance contract liabilities.</p> <p>We focused on this area due to the significance of these liabilities to the group's balance sheet and because of the inherent subjectivity of their valuation.</p> <p>In particular, we focused on:</p> <ul style="list-style-type: none"> The accuracy of claims data used to estimate the claims liabilities, in particular, the completeness of recorded claims and the consistency in setting case estimates; Whether any changes to the underlying risk profile of the policies written (for example, the concentration of younger drivers or changes to postcode mix) are appropriately reflected in the estimation of claims liabilities; The methodologies and assumptions used in estimating the costs of claims for general insurance products (mainly motor policies), in particular for those claims such as personal injury, which can take a long time to settle and where the amounts concerned can be large; and Whether any trends in the underlying claims experience, whether driven by internal or market level factors, have been appropriately reflected in the estimates of future claim costs. 	<p>Our work to address the valuation of the general insurance claims liabilities was supported by our in-house non-life actuarial specialists, and included the following procedures:</p> <ul style="list-style-type: none"> We tested the completeness, consistency and accuracy of claims data; and We performed independent re-projection testing over 55% of claims liabilities and methodology and assumptions reviews over a further 22%. Furthermore, we performed key indicator checks over 19% of the liabilities and confirmed the validity and appropriateness of claims data to identify any anomalies over the remaining balance. <p>Specific areas of testing</p> <p>Completeness of recorded claims and consistency of case estimates We tested the reconciliation of source claims data to that used in the actuarial modelling process. In order to assess the completeness of recorded claims, we observed whether there was any evidence of claims being recorded on any medium other than directly onto the claims systems, and tested the operation of the controls over the handling of complaints.</p> <p>We tested the effectiveness of the quality assurance processes over the work of the claims handlers in order to determine whether claims were being assessed on a consistent basis and examined a sample of claims to obtain evidence that they were based on the most recent claims information.</p> <p>Consistency of risk exposure We assessed management's assertion that there had been no significant changes in the risk profile for material lines of business by inspecting their analyses, discussing profiles of policies written with claims and pricing teams, examining the characteristics behind claims development, and utilising our own independent trend analyses.</p> <p>Methodologies and assumptions We carried out a substantial amount of our work on the claims liabilities at 30 September 2017, rolling forward our work to the year-end.</p> <p>We performed independent re-projection testing by independently selecting our own methodology and assumptions to estimate the reserves for some of the most significant components of the claims liabilities.</p> <p>We evaluated the methodology and assumptions used by management to estimate the most judgemental components of the claims liabilities. We took into account any changes to the types of risks underwritten by the business, which could increase the level of uncertainty and judgement in the estimates. Particular focus was given to future potential Ogden rate changes that would impact certain types of personal injury claims where we evaluated management's rationale for assumptions used against government announcements and market practice and examined sensitivity testing.</p> <p>For lower risk categories of reserves we considered trends in various indicators such as paid to incurred ratios, incurred to ultimate ratios and other Key Performance Indicators ("KPIs").</p> <p>Where we felt it was appropriate, we performed independent calculations to quantify the impact of differences between management's actuarial analysis or assumptions and those which we would have conducted or selected ourselves based on our understanding of market trends and the particular circumstances of the group.</p> <p>Trends in the underlying claims experience We considered the run-off of prior year liabilities, the sensitivity of the liabilities to alternative methods and assumptions and, where relevant, industry benchmarking.</p> <p>We also examined trends in ratios driven by internal or market level factors, including those between the initial case estimates and the final costs of settlement.</p> <p><i>Based on the work performed, no evidence was identified to suggest issues with respect to the completeness of claims data. Furthermore, we found the methodology and assumptions used in estimating the costs of claims were appropriate and supported by the evidence we obtained.</i></p>

Key audit matter	How our audit addressed the key audit matter
<p>The accounting and related disclosures of the sale of 49% of the General Insurance business and sale of the commercial business renewal rights to Allianz resulting in a gain of £124m and £52m respectively Refer to page 64 (Audit Committee Report) and note 46 to the financial statements</p> <p>Sale of General Insurance business On 28 December 2017 the group disposed of 49% of its holding in its General Insurance business to Allianz for £500m as part of a two-phase transaction. The second phase of the transaction will result in a further 20.9% stake being sold in two years' time and is based on an agreed valuation of £1.020bn for the entire General Insurance business. Should the Society choose to settle earlier, it has the flexibility to do so by exercising its put option.</p> <p>At 31 December 2017 control is retained by the Society and therefore the General Insurance business has continued to be consolidated in the group's financial statements with Allianz's 49% stake being recognised as a non-controlling interest.</p> <p>We focused on this disposal as it is a material one-off transaction. The accounting for the sale and presentation of the gain in the group financial statements is complex and involves a number of judgements and the initial accounting treatment this year forms the basis for subsequent periods. Key matters we have considered include the following:</p> <ul style="list-style-type: none"> Retention of control of the General Insurance business by the group; Completeness of the transaction including the forward contract and linked put option and whether all aspects had been appropriately reflected and accounted for in the financial statements; The measurement of the gain; and The presentation and disclosures of the transaction. <p>Sale of commercial business renewal rights The sale of the commercial business renewal rights to Allianz has resulted in a gain of £52m. Due to the fact that the group will continue to renew and administer these policies on behalf of Allianz for a short period post year-end there is judgement in determining whether or not the risks and rewards of ownership and managerial involvement had been substantially transferred to Allianz by the year-end.</p>	<p>We reviewed accounting papers produced for the main sale and purchase transaction and the sale of the commercial business renewal rights, including contracts entered into, to evaluate and assess the impact of the transactions on the group and ensure the analysis performed by management considered all accounting and disclosure impacts. We made our own assessment as to the most appropriate accounting treatment and used this as a basis to challenge the key judgements made by management, including the assessment of any management bias.</p> <p>Sale of General Insurance business For the main sale and purchase transaction we:</p> <ul style="list-style-type: none"> Verified management's conclusion that the General Insurance business should continue to be consolidated at the year-end against requirements of the International Financial Reporting Standards. We assessed various factors in forming this conclusion including assessing the proportion of and the power to influence variable returns accruing to each of the transacting parties, the level of Allianz's managerial involvement and the composition of the new General Insurance Board. Assessed the completeness of the transaction by reading the contracts to verify all aspects had been identified and appropriately reflected in the financial statements. Specifically we considered the forward contract and linked put option and assessed the appropriateness of management's assertion that the put option and forward contract had a nil-value giving consideration to the valuation date and proximity to the year-end. Recalculated the accuracy of the gain recognised by agreeing the receipt of cash consideration to bank and verifying the accounting treatment of the deferred consideration. Reviewed the presentation of the gain and disclosure of the transaction against International Financial Reporting Standards. <p><i>Based on the work performed, we found that the evidence supporting management's accounting for the sale of the General Insurance business was appropriate and that the transaction including the financial impact had been appropriately assessed, presented and disclosed.</i></p> <p>Sale of commercial business renewal rights We verified management's conclusion that the risks and rewards of ownership and managerial involvement had been substantively transferred to Allianz. In forming our view we read the contract, held discussions with the Society's external lawyers and assessed whether Allianz had taken over managerial involvement subsequent to the sale. We also tested the calculation of the gain recognised, agreed the receipt of cash to bank and assessed the presentation and disclosure of the gain, ensuring the judgements management had formed in reaching their conclusion had been clearly described.</p> <p><i>Based on the work performed, we found that the evidence supporting management's accounting for the sale of the commercial business renewal rights was appropriate. We noted no exceptions from our testing of the gain calculation.</i></p>

How we tailored the audit scope

We tailored the scope of our audit to ensure that we performed enough work to be able to give an opinion on the financial statements as a whole, taking into account the structure of the group and the Society, the accounting processes and controls, and the industry in which they operate.

The group is structured along three business units, being 'Life' (including Protection and Retirement Solutions), 'Heritage' and 'General Insurance'. The group's financial statements consist of a consolidation of 26 active statutory entities; but the group primarily operates through the three main trading entities; the Society, encompassing the 'Life' and 'Heritage' business units and two general insurance companies, at 15 locations across the UK.

All three main trading entities are material to the group and were audited by the group engagement team. In establishing the overall approach to the group audit, we determine the type of work that we needed to perform at each entity to be able to conclude whether sufficient appropriate audit evidence had been obtained as a basis for our opinion on the group financial statements as whole.

In addition to the group's head offices in Bournemouth, we visited five other locations, two of which were visited for the

purposes of the Society audit. Our procedures performed at those other locations primarily focused on understanding the systems and controls in place over the recording and processing of new and renewal business and claims.

In our view, all three main trading entities required a full scope audit of their complete financial information, due to their size and risk characteristics. Taken together, the procedures we performed over the three main trading entities, balances included in a further 2 reporting units and the group consolidation entries accounted for over 99% of the group's Unallocated Divisible Surplus ('UDS'), the group's net earned premiums, and the group's profit before tax, mutual bonus and UDS transfer.

Materiality

The scope of our audit was influenced by our application of materiality. We set certain quantitative thresholds for materiality. These, together with qualitative considerations, helped us to determine the scope of our audit and the nature, timing and extent of our audit procedures on the individual financial statement line items and disclosures and in evaluating the effect of misstatements, both individually and in aggregate on the financial statements as a whole.

Based on our professional judgement, we determined materiality for the financial statements as a whole as follows:

	Group financial statements	Society financial statements
Overall materiality	£36.5 million (2016: £30 million).	£32.9 million (2016: £30 million).
How we determined it	3.1% of the group's Unallocated Divisible Surplus ('UDS').	3.1% of the Society's Unallocated Divisible Surplus ('UDS').
Rationale for benchmark applied	In arriving at this judgement, we considered the financial measures, which we believed to be most relevant to the members of the group as a body. Members' interests in the group are represented primarily by the UDS and, consequently, the UDS was considered to be the primary metric to use to determine materiality. We have also had regard to other measures such as the group's regulatory capital surplus and other performance metrics such as operating profit and have compared the level of audit work required to be performed over the group Statement of Comprehensive Income using these alternative benchmarks.	Consistent with the group we considered the financial measures, which we believed to be most relevant to the members of the Society as a body. Members' interests in the Society are represented primarily by the UDS and, consequently, the UDS was considered to be the primary metric to use to determine materiality. We have also had regard to other measures such as the Society's regulatory capital surplus and other performance metrics such as operating profit and have compared the level of audit work required to be performed over the Statement of Comprehensive Income using these alternative benchmarks.

For each component in the scope of our group audit, we allocated a materiality that is less than our overall group materiality. The range of materiality allocated across components was between £3.8 million and £32.9 million. Certain components were audited to a local statutory audit materiality that was also less than our overall group materiality.

We agreed with the Audit Committee that we would report to them misstatements identified during our audit above £1.8 million (Group audit) (2016: £1.5 million) and £1.6 million (Society audit) (2016: £1.5 million) as well as misstatements below those amounts that, in our view, warranted reporting for qualitative reasons.

Going concern

In accordance with ISAs (UK) we report as follows:

Reporting obligation

We are required to report if we have anything material to add or draw attention to in respect of the directors' statement in the financial statements about whether the directors considered it appropriate to adopt the going concern basis of accounting in preparing the financial statements and the directors' identification of any material uncertainties to the group's and the Society's ability to continue as a going concern over a period of at least twelve months from the date of approval of the financial statements.

Outcome

We have nothing material to add or to draw attention to. However, because not all future events or conditions can be predicted, this statement is not a guarantee as to the group's and Society's ability to continue as a going concern.

Reporting on other information

The other information comprises all of the information in the Annual Report other than the financial statements and our auditors' report thereon. The directors are responsible for the other information. Our opinion on the financial statements does not cover the other information and, accordingly, we do not express an audit opinion or, except to the extent otherwise explicitly stated in this report, any form of assurance thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If we identify an apparent material inconsistency or material misstatement, we are required to perform procedures

to conclude whether there is a material misstatement of the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report based on these responsibilities.

With respect to the Directors' Report, we also considered whether it had been prepared in accordance with the Friendly Societies Act 1992 and the regulations made under it.

Based on the responsibilities described above and our work undertaken in the course of the audit, the Friendly Societies Act 1992, (FSA92) and ISAs (UK) require us also to report certain opinions and matters as described below (required by ISAs (UK) unless otherwise stated).

Directors' Report

In our opinion, based on the work undertaken in the course of the audit, the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements and has been prepared in accordance with the Friendly Societies Act 1992 and the regulations made under it. (FSA92)

In light of the knowledge and understanding of the group and the Society and their environment obtained in the course of the audit, we did not identify any material misstatements in the Directors' Report. (FSA92)

The directors' assessment of the prospects of the group and of the principal risks that would threaten the solvency or liquidity of the group

As a result of the directors' voluntary reporting on how they have applied the UK Corporate Governance Code (the "Code"), we are required to report to you if we have anything material to add or draw attention to regarding:

- The directors' confirmation on page 73 of the Annual Report that they have carried out a robust assessment of the principal risks facing the group, including those that would threaten its business model, future performance, solvency or liquidity.
- The disclosures in the Annual Report that describe those risks and explain how they are being managed or mitigated.
- The directors' explanation on page 72 of the Annual Report as to how they have assessed the prospects of the group, over what period they have done so and why they consider that period to be appropriate, and their statement as to whether they have a reasonable expectation that the group will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions.

We have nothing to report in respect of this responsibility.

Other Code Provisions

As a result of the directors' voluntary reporting on how they have applied the Code, we are required to report to you if, in our opinion:

- The statement given by the directors, on page 74, that they consider the Annual Report taken as a whole to be fair, balanced and understandable, and provides the information necessary for the members to assess the group's and Society's position and performance, business model and strategy is materially inconsistent with our knowledge of the group and Society obtained in the course of performing our audit.
- The section of the Annual Report on page 64 describing the work of the Audit Committee does not appropriately address matters communicated by us to the Audit Committee.

We have nothing to report in respect of this responsibility.

Responsibilities for the financial statements and the audit

Responsibilities of the directors for the financial statements

As explained more fully in the Directors' statement of responsibility set out on page 74, the directors are responsible for the preparation of the financial statements in accordance with the applicable framework and for being satisfied that they give a true and fair view. The directors are also responsible for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are responsible for assessing the group's and the Society's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the group or the Society or to cease operations, or have no realistic alternative but to do so.

Auditors' responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

A further description of our responsibilities for the audit of the financial statements is located on the FRC's website at: www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditors' report.

Use of this report

This report, including the opinions, has been prepared for and only for the Society's members as a body in accordance with Section 73 of the Friendly Societies Act 1992 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Other required reporting

Friendly Societies Act 1992 exception reporting

Under the Friendly Societies Act 1992 we are required to report to you if, in our opinion:

- we have not received all the information and explanations and access to documents we require for our audit; or
- adequate accounting records have not been kept by the group or Society; or
- the financial statements are not in agreement with the accounting records.

We have no exceptions to report arising from this responsibility.

Appointment

Following the recommendation of the audit committee, we were appointed by the members on 29 May 2008 to audit the financial statements for the year ended 31 December 2008 and subsequent financial periods. The period of total uninterrupted engagement is 10 years, covering the years ended 31 December 2008 to 31 December 2017.

Other voluntary reporting

Going concern

The directors have requested that we review the statement on page 72 in relation to going concern as if the Society were a premium listed company. We have nothing to report having performed our review.

The directors' assessment of the prospects of the group and of the principal risks that would threaten the solvency or liquidity of the group

The directors have requested that we perform a review of the directors' statements on pages 72 and 73 that they have carried out a robust assessment of the principal risks facing the group and in relation to the longer-term viability of the group, as if the Society were a premium listed company. Our review was substantially less in scope than an audit and only consisted of making inquiries and considering the directors' process supporting their statements; checking that the statements are in alignment with the relevant provisions of the Code; and considering whether the statements are consistent with the knowledge and understanding of the group and Society and their environment obtained in the course of the audit. We have nothing to report having performed this review.

Directors' remuneration

The Society voluntarily prepares a Directors' Remuneration Report in accordance with the provisions that apply to companies subject to the Companies Act 2006. The directors requested that we audit the part of the Directors' Remuneration Report specified by the Companies Act 2006 to be audited as if the Society were a quoted company.

In our opinion, the part of the Directors' Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006.

Andrew G Hill (Senior Statutory Auditor)

for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
London
28 March 2018

Statement of Comprehensive Income

Year ended 31 December 2017

	Notes	Group		Society	
		2017 £m	2016 £m	2017 £m	2016 £m
Gross earned premiums	5	2,439	2,760	835	1,228
Premiums ceded to reinsurers	5	(1,455)	(601)	(1,092)	(261)
Net earned premiums	5	984	2,159	(257)	967
Investment income	6	374	401	430	406
Net gains on investments	7	360	1,006	379	1,013
Gain on sale of commercial business renewal rights	46	52	–	–	–
Gain arising on Teachers acquisition		–	3	–	3
Other income	8	85	68	22	12
Total income		1,855	3,637	574	2,401
Gross benefits and claims	9	(2,027)	(2,136)	(871)	(859)
Claims ceded to reinsurers	9	535	540	237	237
Net benefits and claims	9	(1,492)	(1,596)	(634)	(622)
Gross change in long-term contract liabilities, excluding mutual bonus	21	(590)	(1,591)	(590)	(1,591)
Change in long-term contract liabilities ceded to reinsurers	21	1,035	94	1,035	94
Change in non-participating value of in-force business	21	(30)	3	(30)	3
Net change in contract liabilities, excluding mutual bonus before change in economic basis	21	415	(1,494)	415	(1,494)
Change in economic basis	21	(48)	–	(48)	–
Net change in contract liabilities, excluding mutual bonus	21	367	(1,494)	367	(1,494)
Gross operating and administrative expenses	11	(656)	(643)	(222)	(215)
Expenses recoverable from reinsurers	11	72	72	–	–
Net operating and administrative expenses	11	(584)	(571)	(222)	(215)
Finance costs	10	(24)	(24)	(23)	(23)
Investment return allocated to external unit holders		–	(1)	–	–
Total other expenses		(608)	(596)	(245)	(238)
Total benefits, claims and expenses, excluding mutual bonus		(1,733)	(3,686)	(512)	(2,354)
Profit/(loss) before tax, mutual bonus and UDS transfer		122	(49)	62	47
Mutual bonus		(26)	(17)	(26)	(17)
Income tax expense	33	(50)	(35)	(24)	(45)
Non-controlling interest		2	–	–	–
Transfer (to)/ from the Unallocated divisible surplus	47	(48)	101	(12)	15
Profit for the year		–	–	–	–
Other comprehensive income/(expense)					
Items that will not be reclassified to profit or loss					
Re-measurements of defined benefit pension schemes, net of tax	38	19	(2)	19	(2)
Transfer (to)/ from the Unallocated divisible surplus	47	(19)	2	(19)	2
Total comprehensive income for the year		–	–	–	–

As a Friendly Society, all net earnings are for the benefit of participating policyholders and are carried forward within the Unallocated divisible surplus. Accordingly, there is no profit for the year shown in the Statement of Comprehensive Income.

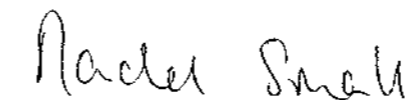
The Group and the Society have not presented a Statement of Changes in Equity as there are no equity holders in either the Group or Society.

Statement of Financial Position

As at 31 December 2017

	Notes	Group		Society	
		2017 £m	2016 £m	2017 £m	2016 £m
Assets					
Pension benefit asset	38	178	134	178	134
Intangible assets	27	315	291	10	11
Investments in group undertakings	28	–	–	897	802
Property and equipment	26	37	43	7	9
Investment properties		3	5	3	5
Deferred acquisition costs	22	95	102	–	–
Reinsurance assets	23	2,305	1,090	1,747	601
Prepayments and accrued income	30	124	140	71	99
Loans and other receivables	16	258	291	65	155
Insurance receivables	29	308	293	29	16
Corporation tax asset	34	–	6	–	–
Financial assets at fair value through income	13	13,853	13,491	11,875	11,842
Derivative financial instruments	14	81	179	80	179
Cash and cash equivalents (excluding bank overdrafts)		974	805	424	469
Total assets		18,531	16,870	15,386	14,322
Liabilities					
Unallocated divisible surplus	47	1,189	998	1,050	1,019
Participating insurance contract liabilities	19	5,279	4,999	5,279	4,999
Participating investment contract liabilities	15	746	690	746	690
Non-participating value of in-force business	20	(293)	(324)	(293)	(324)
		6,921	6,363	6,782	6,384
Non-participating insurance contract liabilities	19	7,078	6,798	4,635	4,426
Non-participating investment contract liabilities	15	3,071	2,547	3,071	2,547
		10,149	9,345	7,706	6,973
Net asset value attributable to external unit holders		–	28	–	–
Non-controlling interest	48	373	(1)	–	–
Deferred tax liability	35	97	70	98	73
Provisions	39	20	12	13	11
Subordinated liabilities	17	358	357	348	347
Derivative financial instruments	14	193	259	187	236
Other financial liabilities	18	62	116	62	116
Corporation tax liability	36	20	–	9	6
Insurance payables	31	50	51	22	21
Trade and other payables	32	288	270	159	155
Total liabilities		18,531	16,870	15,386	14,322

The financial statements on pages 104 to 197 were approved by the Board of Directors on 28 March 2018 and signed on its behalf by:



Rachel Small
Company Secretary

Statement of Cash Flows

Year ended 31 December 2017

	Notes	Group		Society	
		2017 £m	2016 £m	2017 £m	2016 £m
Cash and cash equivalents at 1 January		783	1,159	460	433
Cash flows arising from:					
Operating activities					
Cash (used in)/generated from operating activities before movements in investments held at fair value through income	52	(735)	(194)	(732)	153
Net decrease/(increase) in investments held at fair value through income		19	(521)	395	(471)
Cash used in operating activities		(716)	(715)	(337)	(318)
Proceeds from sale of investment properties		5	–	5	–
Dividend income received		117	107	109	95
Interest income received		303	313	213	235
Utilisation of provisions		(5)	(2)	(5)	(2)
Finance cost paid		(1)	(1)	–	–
Income tax paid		(13)	(23)	(12)	(17)
Net cash flows used in operating activities		(310)	(321)	(27)	(7)
Investing activities					
Net proceeds from purchase/sale of general insurance renewal rights	46	51	–	–	–
Increase in investment in group undertakings		–	–	(85)	(35)
Net cash acquired on acquisitions		–	12	–	–
Cash held on transfer of Teachers Assurance Fund to the Society		–	–	–	34
Dividend income received from group undertakings		–	–	94	44
Interest income received from group undertakings		–	–	–	24
Purchase of property, equipment and intangibles	26, 27	(38)	(44)	(3)	(10)
Net cash flows generated from/(used in) investing activities		13	(32)	6	57
Financing activities					
Proceeds from sale of stake in general insurance subsidiary	46	500	–	–	–
Interest paid on subordinated debt	10	(23)	(23)	(23)	(23)
Net cash flows generated from/(used in) financing activities		477	(23)	(23)	(23)
Net increase/(decrease) in cash and cash equivalents		180	(376)	(44)	27
Cash and cash equivalents at 31 December		963	783	416	460
Cash and cash equivalents comprise:					
Bank balances		108	189	76	144
Short-term bank deposits		866	616	348	325
Cash and cash equivalents per the Statement of Financial Position		974	805	424	469
Non-offsettable bank overdrafts (see note 32)		(11)	(22)	(8)	(9)
Cash and cash equivalents per the Statement of Cash Flows		963	783	416	460

The Group classifies the cash flows for the acquisition and disposal of financial assets and the net purchases/sales of investment properties as operating cash flows, as the purchases are funded from the cash flows associated with the origination of insurance and investment contracts.

Notes to the Financial Statements

Year ended 31 December 2017

Significant accounting policies

This section describes the LV= Group's significant accounting policies and accounting estimates that relate to the financial statements and notes as a whole. If an accounting policy or an accounting estimate relates to a specific note, the applicable accounting policy and/or accounting estimate is contained within the relevant note. These policies have been consistently applied to all years presented, unless otherwise stated.

1. Significant accounting policies

1.1 Basis of presentation

The Group financial statements consolidate the results of the Society and its subsidiary companies. The Group's and Society's financial statements conform to International Financial Reporting Standards (IFRS) and interpretations issued by the IFRS Interpretations Committee as published by the International Accounting Standards Board and adopted by the European Union. In addition the Society's financial statements comply with the Friendly Societies (Accounts & Related Provisions) Regulations 1994 (the Regulations).

In accordance with IFRS 4 on Insurance Contracts, the Group has applied existing accounting practices for insurance contracts and participating investment contracts modified as appropriate to comply with the IFRS framework and applicable standards. Further details are given in accounting policy 1.3b below.

The financial statements have been prepared under the historical cost convention as modified by the revaluation of investment properties and financial assets and liabilities (including derivatives and non-participating investment

contract liabilities) at fair value through income. Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates ('the functional currency'). Unless otherwise noted, the consolidated financial statements are presented in millions of pounds sterling, which is the Group's presentation and functional currency.

Within the financial statements the Group uses the term Profit before tax to refer to Profit before tax, mutual bonus and UDS transfer as disclosed on the Statement of Comprehensive Income. This is to provide a more representative Profit before tax figure as described in the LV= use of Non-GAAP measures disclosed on page 93.

After making enquiries, the directors have a reasonable expectation that the Group has adequate resources to continue in operational existence for the foreseeable future. The Group therefore continues to adopt the going concern basis in preparing its consolidated financial statements.

1.2 Significant accounting estimates and judgements

The preparation of financial statements in accordance with IFRS requires the use of estimates. Where such estimates are complex they often involve a significant level of management judgement in applying those estimates. These significant accounting estimates are disclosed within the financial statements separately from those judgements that management have made in applying accounting policies.

The following areas involve significant judgement by management on policy application:

Area	Significant accounting judgements	Note
Insurance and participating investment contract liabilities	Changes in methodology - Key change for 2017: Switch to EIOPA swap curve from a gilt based curve	19
Reinsurance assets	Transfer of insurance risk - Key change for 2017: Introduction of a reinsurance agreement in relation to the OB Pensions portfolio	23
Pension benefit asset	Right to a refund from the pension scheme's assets	38
Consolidation	Assessment of whether LV= controls underlying entities	44
General insurance business transaction	Financial reporting implications of the general insurance business transaction: (i) Continued consolidation of LVGIG Group (ii) Valuation of forward contract and put option (iii) Treatment of Commercial lines broker business renewal rights	46

The following areas include significant estimates and assumptions, including the exercise of management judgement:

Area	Significant accounting estimates	Note
Fair value financial assets	Estimate of fair value where there is no or limited market data	13
Insurance and participating investment contract liabilities	Assumptions and adjustments used in determining insurance contract liabilities; Assessment of future options and guarantees; Estimate of ultimate cost of claims	19
Intangibles	Estimation of recoverable amount of each Cash Generating Unit	27
Pension benefit asset	Assumptions used to measure the pension benefit obligation	38

Notes to the Financial Statements continued

Year ended 31 December 2017

1. Significant accounting policies (continued)

1.3 Accounting policies

a) Consolidation

Subsidiaries

Subsidiaries are all entities, including Open Ended Investment Companies (OEICs), over which the Group (directly or indirectly) has control.

The Group controls an entity when the Group has all of the following:

- power over the relevant activities of the entity, for example through voting or other rights;
- exposure to, or rights to, variable returns from its involvement with the entity; and
- the ability to affect those returns through the power over the entity.

The assessment of control is based on the consideration of all the facts and circumstances. The Group reassesses whether it controls an entity if facts and circumstances indicate that there are changes to one or more of the three elements of control.

Subsidiaries are fully consolidated from the date on which control is transferred to the Group using uniform accounting policies consistently applied across the Group. They are excluded from consolidation from the date on which control ceases.

The Group uses the purchase method of accounting to account for the acquisition of subsidiaries. Accordingly, the cost of an acquisition is measured as the fair value of the cash or other assets given, equity instruments issued and liabilities incurred or assumed at the date control passes. Identifiable assets acquired, liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date, irrespective of the extent of any minority interest.

The excess of the cost of acquisition over the fair value of the Group's share of the identifiable net assets acquired is recorded as goodwill. If the cost of acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference is recognised directly in the Statement of Comprehensive Income for the period.

Intra-group transactions, balances and unrealised gains on intra-group transactions are eliminated on consolidation. Unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred.

Non-controlling interests are initially measured as the proportionate share of the subsidiary's identifiable net assets.

The balance is subsequently increased by the amount of profit after tax attributable to the non-controlling interest during the period net of any dividends paid. As the Society is a mutual it has no equity, therefore non-controlling interests are presented within liabilities.

Where investments in specialised investment vehicles (such as OEICs) are consolidated the interests of other parties in these vehicles will be classified as liabilities and appear as 'Net asset value attributable to external unit holders' because they are puttable instruments. The external unit holders' share of the net investment return on the OEICs is charged or credited to the Statement of Comprehensive Income as Investment return allocated to external unit holders. Where the Group does not

control such vehicles they are carried at fair value through profit or loss within financial assets in the consolidated Statement of Financial Position.

Details of the Society's subsidiaries are given in Note 42.

Associates and jointly controlled entities in property holding companies

Joint ventures are arrangements where the Group has joint control and rights to the net assets of the entity. The Group does not currently have any associates, which are all entities over which the Group has significant influence but not control, generally accompanying a shareholding of more than 20% and less than 50% of the voting rights.

For each investment in an associate or jointly controlled entity the Group determines whether to apply the equity method or to designate the investment at fair value through income in accordance with the exemption permitted under IAS 28 applicable to investment-linked insurance funds. The Group currently has a joint venture in an investment property holding company. Due to the nature of this joint venture the Group has taken the exemption to designate this investment at fair value through income within UK unlisted investments.

b) Contract classification

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

Insurance contracts are those contracts that transfer significant insurance risk. Such contracts may also transfer financial risk. As a general guideline, the Group defines as significant insurance risk the possibility of having to pay benefits on the occurrence of an insured event that are at least 10% more than the benefits payable if the insured event did not occur.

Investment contracts are those contracts that transfer financial risk with no significant insurance risk.

All with-profits contracts have been classified as participating contracts as these contracts entitle the holder to receive, as a supplement to guaranteed benefits, additional benefits or bonuses:

- that are likely to be a significant portion of the total contractual benefits;
- whose amount or timing is contractually at the discretion of the Group; and
- that are contractually based on:
 - (i) the performance of a specified pool of contracts or a specified type of contract;
 - (ii) realised and/or unrealised investment returns on a specified pool of assets held by the fund; or
 - (iii) the unallocated surplus of the fund that issues the contract.

Notes to the Financial Statements continued

Year ended 31 December 2017

1. Significant accounting policies (continued)

1.3 Accounting policies (continued)

b) Contract classification (continued)

Product classification

Business unit	Product classification			
	Insurance (Participating)	Insurance (Non-participating)	Investment (Participating)	Investment (Non-participating)
GI	n/a	All GI products Significant insurance risk is transferred from the policyholder to LV= whereby LV= will compensate the policyholder for any loss arising from an insured event (such as motor collisions, property damage). The customer does not participate in any options or guarantees and there is no fund to share in a surplus.	n/a	n/a
Life	FGB/F FGB funds include a significant death benefit. Policyholders are entitled to a share of the surplus of the with-profits fund.	All Protection Significant insurance risk (primarily morbidity and mortality) is transferred from the policyholder to LV= whereby the policyholder is financially compensated on occurrence of the insured event (such as injury, illness or death). Policyholders are not entitled to a share of the surplus of the funds. Retirement non-profit funds (fixed term / enhanced annuities) Significant insurance risk is transferred (mortality / longevity) from the policyholder to LV=. Policyholders are not entitled to a share of the surplus of the funds.	n/a	Unit-linked pensions, including SIPP No significant insurance risk is transferred to LV=; the customer chooses their investment(s) and is exposed to the associated financial risk with no additional participation benefits.
Heritage	LVFS Heritage (including RNPFN and Teachers Assurance Funds) with-profits life and pensions policies These policies transfer significant insurance risk (mortality / longevity) from the policyholder to LV=. Policyholders are entitled to a share of the surplus of their respective with-profits fund.	LVFS Heritage (including RNPFN and Teachers Assurance Funds) conventional non-profit life, pensions and annuities in payment These policies transfer significant insurance risk (mortality / longevity) from the policyholder to LV=. Policyholders are not entitled to a share of the surplus of the funds.	LVFS Heritage (including Teachers Assurance Fund) with-profits investments These investment products provide the policyholder with market returns. The value paid to the policyholder is not significantly impacted by whether pay-out is on surrender, maturity or death, therefore this is not an insurance contract. The investments entitle the policyholder to a share of the surplus of the with-profits fund.	LVFS Heritage (including RNPFN Fund) linked life and pensions These products do not transfer significant insurance risk from policyholder to LV=. Policyholders are not entitled to a share of the surplus of the funds.

Notes to the Financial Statements continued

Year ended 31 December 2017

1. Significant accounting policies (continued)

1.3 Accounting policies (continued)

c) Foreign currencies

Investment assets and liabilities denominated in foreign currencies are translated to sterling at rates of exchange ruling at the end of the year. Purchases and sales of investments denominated in foreign currencies are translated at the rates prevailing at the dates of the transactions. Exchange gains and losses are dealt with in that part of the Statement of Comprehensive Income in which the underlying transaction is reported.

d) Financial assets and liabilities

Recognition

The Group classifies its financial assets and liabilities upon initial recognition as shown below. The classification is impacted by the nature of the instrument and the purpose for which the investments were acquired:

Category	Financial Instrument	Basis of classification	Subsequent Measurement	Recognition of change in fair value
Designated fair value through profit and loss (FVTPL) on initial recognition	Debt securities, Equity securities	Where the investment return is managed on the basis of the total return on investment.	Fair value using prices at the end of the period.	Income Statement – Net investment gains/ (losses).
	Loans secured on residential and commercial property		Fair value on a discounted cash flow basis, taking into account no negative equity guarantees where relevant.	
	Non-participating investment contract liabilities		Amount equal to the fair value of the associated unit-linked financial assets.	
Fair value through profit and loss Held for trading	Derivative assets/ (liabilities)	Derivatives are classified as held for trading as required by IAS 39.	Carried at fair value. Asset/(liability) classification dependant on whether fair value is positive or negative.	Income Statement – Net investment gains/ (losses).
Loans and receivables	Loans, reinsurance deposits, other deposits and financial assets arising from non-investment activities	Financial assets with fixed or determinable payments not quoted in an active market.	Amortised cost using the effective interest method.	Income Statement – Net investment gains/ (losses) when realised or impaired.
Cash and cash equivalents	Cash and cash equivalents	Consist of cash and highly liquid investments that are readily convertible into a known amount of cash.	Carrying amounts at amortised cost.	n/a
Other financial liabilities	Subordinated debt	Financial liabilities with fixed or determinable payments and maturity date.	Amortised cost using the effective interest method.	n/a

The accounting policy for each type of financial asset or liability is included within the relevant note for the category.

Derecognition

A financial asset is derecognised when:

- the rights to receive cash flows from the asset have expired; or
- the Group has transferred its rights to receive cash flows from the asset and has:
 - transferred the risks and rewards of the asset; or
 - transferred control of the asset.

A financial liability is derecognised when the obligation under the liability is discharged or cancelled or expires.

Notes to the Financial Statements continued

Year ended 31 December 2017

1. Significant accounting policies (continued)

1.3 Accounting policies (continued)

e) Liability adequacy testing

Long-term insurance and participating investment contract liabilities

At each reporting date, an assessment is made of whether the recognised long-term contract liabilities are adequate, using current estimates of future cash flows. If that assessment shows that the carrying amount of the liabilities (less related assets) is insufficient in light of the estimated future cash flows, the deficiency is recognised in the Statement of Comprehensive Income by setting up an additional liability.

General insurance

At each reporting date liability adequacy tests are performed to ensure the adequacy of insurance contract liabilities, net of related deferred acquisition costs. In performing these tests, current best estimates of future contractual cash flows and claims handling and administration expenses, as well as investment income from the assets backing such liabilities, are used. Any deficiency is immediately charged to the Statement of Comprehensive Income and an unexpired risk reserve is established.

f) Impairment of non-financial assets

Assets that have an indefinite useful life, for example goodwill, are not subject to amortisation and are tested annually for impairment. Assets that are subject to amortisation or depreciation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units).

Non-financial assets, other than goodwill, that suffered impairment are reviewed for possible reversal of the impairment at each reporting date.

g) Cash and cash equivalents

Cash and cash equivalents comprise cash at bank and in hand, and short-term deposits with an original maturity of three months or less.

For the purpose of the Statement of Cash Flows, Cash and cash equivalents are as defined above but are shown net of outstanding bank overdrafts.

h) Collateral

Collateral is received or pledged in the form of cash collateral and non-cash collateral.

Cash collateral

Cash collateral received, which is not legally segregated from the Group, is recognised as an asset with a corresponding liability for its repayment in the Statement of Financial Position.

Cash collateral pledged, which is legally segregated from the Group, is derecognised from Cash and cash equivalents and a corresponding asset for its return is recognised in the Statement of Financial Position.

Non-cash collateral

Non-cash collateral received where the counterparty is not in default, that is neither sold nor repledged, is not recognised in the Statement of Financial Position. Non-cash collateral pledged where the Group is not in default is not derecognised from the Statement of Financial Position and remains within the appropriate asset classification.

i) Mutual bonus

The Mutual bonus declared by the Society is presented on the Statement of Comprehensive Income below Profit before tax and not within the Gross change in long-term contract liabilities. This is to provide a more representative Profit before tax figure as described in the LV= use of Non-GAAP measures disclosed on page 93. The impact on Gross changes in long-term contract liabilities is disclosed separately within Note 21.

Notes to the Financial Statements continued

Year ended 31 December 2017

1. Significant accounting policies (continued)

1.4 Changes and future developments in accounting policies (i) New and amended standards adopted by the Group

Although no new standards have come into effect, amendments to IFRSs have been adopted by the EU for accounting periods beginning on or after 1 January 2017. These amendments have been adopted by the Group but do not have a material impact on the 2017 financial statements.

IAS 7 'Statement of cash flows' has been amended as part of the Disclosure Initiative. The amendment requires entities to provide additional information to enable users to evaluate changes in liabilities arising from financing activities. For the Group and Society this relates primarily to the Subordinated debt, and the relevant disclosure is included in Note 17.

IAS 12 'Income taxes' has been amended to clarify the treatment of deferred tax associated with unrealised gains and losses on financial instruments and also addresses the recoverability of deferred tax where this relates to an asset with a fair value below its tax base. Recognition of deferred tax by the Group and Society has been assessed and there is no impact of this clarification.

(ii) New standards and interpretations not yet adopted

A number of new standards and amendments to standards and interpretations are effective for annual periods beginning after 1 January 2018, and have not been applied in preparing these consolidated financial statements. None of these are expected to have a significant effect on the consolidated financial statements of the Group, except for the following:

Amendment to IFRS 4 'Insurance contracts': Applying IFRS 9 'Financial Instruments' with IFRS 4 'Insurance Contracts', effective from 1 January 2018. The amendment provides two approaches that can be applied by eligible insurers to address concerns arising from the different effective dates of IFRS 9 and IFRS 17 'Insurance Contracts'; the overlay approach and the temporary exemption from IFRS 9 until adoption of IFRS 17. The Group and the Society are eligible insurers and will take the temporary exemption from IFRS 9 due to the uncertainty regarding accounting for insurance contracts and the impact of this upon the classification of financial assets.

IFRS 9, 'Financial instruments', addresses the classification, measurement and recognition of financial assets and financial liabilities and replaces IAS 39. The effective date is 1 January 2018, however as noted above, IFRS 9 will be deferred for the Group and Society until adoption of IFRS 17 which is effective from 1 January 2021.

IFRS 15 'Revenue from contracts with customers' applies to non-insurance revenue and provides a principles-based approach for revenue recognition that is underpinned by the achievement of performance obligations. It replaces IAS 18 'Revenue' and is effective from 1 January 2018. At 31 December 2017 the Group had £48m (Society £24m) of revenue that is relevant for this standard, of which £22m related to asset management fees. Revenue recognition has been assessed for these revenue streams and the impact of the application of IFRS 15 will not be material for the Group and Society because the Group's existing accounting treatment, revenue being recognised on fulfilment of obligation, is broadly compliant with the new standard.

IFRS 16 'Leases' sets out the principles for the recognition, measurement, presentation and disclosure of leases. It replaces IAS 17 'Leases' and is effective from 1 January 2019. Information disclosed by lessees and lessors will enable users of financial statements to assess the effect that leases have on the financial position, financial performance and cash flows of the entity. The standard has been reviewed and it is expected that leases currently classified as operating leases will require recognition on the Statement of Financial Position at the present value of minimum lease payments. Assets and liabilities will be increased by a material amount; however the net impact on the Statement of Financial Position and Statement of Comprehensive Income is expected to be immaterial.

IFRS 17 'Insurance contracts' was issued in May 2017 and replaces IFRS 4 'Insurance contracts' from 1 January 2021. This provides an accounting model for insurance contracts that is more useful and consistent for insurers. In contrast to the requirements in IFRS 4, which are largely based on grandfathering previous local accounting policies, IFRS 17 provides a comprehensive model for insurance contracts, covering all relevant accounting aspects. The core of IFRS 17 is the general model, supplemented by:

- A specific adaptation for contracts with direct participation features (the variable fee approach)
- A simplified approach (the premium allocation approach) mainly for short-duration contracts

The standard will have a material impact on the Group and Society and the Group expects to invest significant efforts in transitioning its accounting to the new standard.

Notes to the Financial Statements continued

Year ended 31 December 2017

Segmental information

This section details the disclosures arising under IFRS 8 Operating segments. These segmental disclosures are based on operating segments that reflect the level within the Group at which key strategic and resource allocation decisions are made and the way in which operating performance is reported internally to the Group board of directors.

During the year the heritage business has been incorporated into the life business in order to align with the future strategic direction of the overall life business. Comparative segmental information has been restated to reflect this change.

2. Segmental information

Accounting for operating profit

Operating profit is a non-GAAP measure and calculated as IFRS profit before tax, mutual bonus and UDS transfer adjusted for the following items:

- Centrally managed strategic costs;
- Short-term investment fluctuations; this represents the unmatched movements in the value of investments;
- Impact of change in long-term contract liabilities economic basis; this has been performed to better align IFRS economic basis with Solvency II;
- Finance costs;
- Gains arising on strategic transactions, including acquisitions and the general insurance transaction; and
- Amortisation and impairment of acquired intangibles.

The activities of each operating segment are described below:

General insurance

The principal activity is to underwrite general insurance business through both direct and broker distribution channels. The primary sources of premium income are from the sale of Motor and Home products and Commercial Insurance for Small and Medium Size Enterprises. The General Insurance business also underwrites Road Rescue, Pet Insurance and Travel Insurance.

Life

The principal activity is the provision of Protection and Retirement Solutions products and managing our legacy Heritage products. The core products offered in Protection are Life, Critical Illness and Income Protection Insurance. The core products offered in Retirement Solutions are Fixed-Term Annuities, Self-Invested Personal Pensions (SIPPs), Equity Release Mortgages and Flexible Guarantee Bonds. Heritage products include our LVFS with-profits business (both ordinary branch and industrial branch), the Teachers Assurance ring-fenced fund and some non-profit business and unit-linked business, which was acquired from the Royal National Pension Fund for Nurses ('RNPFN'). Most of the Heritage products are no longer actively marketed, although the Society continues to sell newer with-profits products via the Life business channels.

For the purposes of this segmental disclosure, insurance and investment contract liabilities, operating profits, IFRS profit before tax and net change in contract liabilities shown for the Life business, are calculated after allocating the non-participating value of in-force business to this segment.

Central items and other

This segment comprises centrally held items such as group functions.

Transactions between reportable segments are on normal commercial terms, and are included within the reported segments.

The profit measure used by the Group board of directors to monitor performance is Operating profit. Operating profit by segment is shown in the table below, together with a reconciliation of the Total operating profit to the IFRS profit before tax.

Notes to the Financial Statements continued

Year ended 31 December 2017

2. Segmental information (continued)

The following tables give details of the Group's profit, revenue and expenses and assets and liabilities with reference to the operating segments defined on the previous page:

a) Segment profit

	General insurance £m	Life £m	Central items and other £m	Total £m
2017				
Operating profit	121	37	-	158
Centrally managed costs	(1)	(4)	(28)	(33)
Short-term investment fluctuations and related items	-	75	(38)	37
Change in long-term contract liabilities economic basis	-	(48)	-	(48)
Finance costs	-	-	(24)	(24)
Impact of general insurance transaction on profit	46	-	(11)	35
Amortisation of acquired intangibles	(2)	(1)	-	(3)
Profit/(loss) before tax, mutual bonus and UDS transfer	164	59	(101)	122

	General insurance £m	Life £m	Central items and other £m	Total £m
2016				
Operating (loss)/profit	(26)	13	1	(12)
Centrally managed costs	(2)	(4)	(21)	(27)
Short-term investment fluctuations and related items	-	53	(39)	14
Finance costs	-	-	(24)	(24)
Gain arising on Teachers acquisition	-	3	-	3
Amortisation of acquired intangibles	(2)	(1)	-	(3)
(Loss)/profit before tax, mutual bonus and UDS transfer	(30)	64	(83)	(49)

Notes to the Financial Statements continued

Year ended 31 December 2017

2. Segmental information (continued)

b) Segment revenue and expenses

All revenues disclosed in the tables below are external.

	General insurance £m	Life £m	Central items and other £m	Total £m
Year ended 31 December 2017				
Gross earned premiums	1,604	835	-	2,439
Premiums ceded to reinsurers	(363)	(1,092)	-	(1,455)
Net earned premiums	1,241	(257)	-	984
Investment and other income	121	786	(36)	871
Total segmental income	1,362	529	(36)	1,855
Gross benefits and claims	(1,155)	(872)	-	(2,027)
Claims ceded to reinsurers	298	237	-	535
Net benefits and claims	(857)	(635)	-	(1,492)
Net change in contract liabilities	-	367	-	367
Other expenses	(341)	(202)	(65)	(608)
Total segmental expenses	(1,198)	(470)	(65)	(1,733)
Profit/(loss) before tax, mutual bonus and UDS transfer*	164	59	(101)	122

	General insurance £m	Life £m	Central items and other £m	Total £m
Year ended 31 December 2016				
Gross earned premiums	1,530	1,230	-	2,760
Premiums ceded to reinsurers	(340)	(261)	-	(601)
Net earned premiums	1,190	969	-	2,159
Investment and other income	84	1,427	(33)	1,478
Total segmental income	1,274	2,396	(33)	3,637
Gross benefits and claims	(1,275)	(861)	-	(2,136)
Claims ceded to reinsurers	303	237	-	540
Net benefits and claims	(972)	(624)	-	(1,596)
Net change in contract liabilities	-	(1,488)	(6)	(1,494)
Other expenses	(332)	(220)	(44)	(596)
Total segmental expenses	(1,304)	(2,332)	(50)	(3,686)
(Loss)/profit before tax, mutual bonus and UDS transfer*	(30)	64	(83)	(49)

Gross written premiums for investment contracts which are deposit accounted for and not included above are £656m (2016: £425m).

* As a Friendly Society, all net earnings are for the benefit of participating policyholders and are carried forward within the Unallocated divisible surplus, resulting in the profit for each financial year being zero. Therefore the resulting Profit before tax required to be disclosed under IFRS 8 will always be equal to the tax charge being £50m (2016: £35m) and £24m (2016: £45m) for the Group and Society respectively. In order to present a more meaningful disclosure the Profit before tax, mutual bonus and UDS transfer is disclosed in the tables above.

Notes to the Financial Statements continued

Year ended 31 December 2017

2. Segmental information (continued)

c) Segment assets and liabilities

	General insurance £m	Life £m	Central items and other £m	Total £m
As at 31 December 2017				
Assets				
Intangible assets	244	71	–	315
Property and equipment	6	3	28	37
Financial assets	1,935	11,779	786	14,500
Reinsurance assets	558	1,747	–	2,305
Other assets	165	68	167	400
Cash and cash equivalents	540	332	102	974
Total assets	3,448	14,000	1,083	18,531
Liabilities				
Insurance and investment contract liabilities	(2,427)	(13,454)	–	(15,881)
Subordinated liabilities	(10)	–	(348)	(358)
Non-controlling interest	–	3	(376)	(373)
Other liabilities	(243)	(349)	(138)	(730)
Total liabilities excluding UDS	(2,680)	(13,800)	(862)	(17,342)
Net Assets	768	200	221	1,189
Consolidation adjustments	(654)	1	653	–
Unallocated divisible surplus (UDS)	114	201	874	1,189

	General insurance £m	Life £m	Central items and other £m	Total £m
As at 31 December 2016				
Assets				
Intangible assets	217	74	–	291
Property and equipment	8	4	31	43
Financial assets	2,078	11,848	328	14,254
Reinsurance assets	489	601	–	1,090
Other assets	170	100	117	387
Cash and cash equivalents	310	357	138	805
Total assets	3,272	12,984	614	16,870
Liabilities				
Insurance and investment contract liabilities	(2,353)	(12,357)	–	(14,710)
Subordinated liabilities	(10)	–	(347)	(357)
Other liabilities	(219)	(390)	(196)	(805)
Total liabilities excluding UDS	(2,582)	(12,747)	(543)	(15,872)
Net Assets	690	237	71	998
Consolidation adjustments	(575)	(156)	731	–
Unallocated divisible surplus (UDS)	115	81	802	998

Within the Central items and other segment, there is a balance of £1,014m (2016: £618m) which relates to Estate net assets. The Life with-profits policyholders have access to the Estate assets, if required to settle guarantees and bonuses.

d) Major customers

The directors consider the Group's external customers to be individual policyholders. As such, the Group is not reliant on any individual customer.

Notes to the Financial Statements continued

Year ended 31 December 2017

Capital and risk management

This section details the capital and risk management approach of the Society and Group. The Group seeks to create value for its members by investing in the development of the business while maintaining an appropriate level of capital available. The risk appetite for each type of principal risk is set based on the amount necessary to meet the PRA's capital requirements.

3. Capital management

Policies and objectives

Capital is managed on both economic and regulatory bases to ensure the Group has sufficient funds to meet its business objectives, the promises made to members and policyholders and regulatory requirements.

The Group's key capital management objectives are:

- To ensure the Group's financial strength and to support the risks it takes on as part of its business;
- To give confidence to policyholders and other stakeholders who have relationships with the Group;
- To comply with capital requirements imposed by its UK regulator, the PRA, in association with the European Insurance and Occupational Pensions Authority (EIOPA) and Solvency II legislation; and
- To ensure the Group's strategy can be implemented and is sustainable.

These objectives are reviewed at least annually and benchmarks are set by which to judge the adequacy of the Group's capital. The capital position is monitored against those benchmarks to ensure that sufficient capital is available to the Group.

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

Capital Management

Capital is monitored and managed at a Group and entity level. The Group manages capital resources under Solvency II at the level of Eligible own funds. Excluding RNPfN and Teachers ring-fenced funds, Eligible own funds were £1,567m for the Group (2016: £1,296m) and £1,418m for the Society (2016: £1,284m). Including RNPfN and Teachers ring-fenced funds, Eligible own funds were £1,677m for the Group (2016: £1,411m) and £1,528m for the Society (2016: £1,400m). The inclusion of the ring-fenced funds does not change the Group capital surplus. The large divergence between Group and Society Eligible own funds over the year is caused by the reporting treatment of the majority holding of the general insurance subsidiaries and corresponds to the Group solvency capital requirement reflecting the entire general insurance subsidiaries and not just the 51% holding.

The Group seeks to deploy capital where it believes the risk is properly rewarded. Asset and liability matching is extensively used and risks are hedged where the Group believes it would otherwise receive insufficient return for the risk taken or to reduce volatility.

The Group Solvency II results are not due to be submitted to the PRA until after the release of the Annual Report. As a result, the Eligible own funds figures disclosed above are based on the best estimate of the results at the Annual Report signing date and may differ to the results published as part of the annual Solvency Financial Condition Report.

Risk appetite

The Group has embedded its approach to risk management through its risk appetite. The risk appetite for capital management is that sufficient solvency capital is held to ensure that the Group can continue to trade following a severe adverse movement in markets or other risks. As at 31 December 2017, following the completion of capital management actions to de-risk the balance sheet including the sale of a 49% equity stake in the general insurance business and reinsurance of the OB

pensions portfolio, the target capital risk appetite was set to £350m above the Solvency Capital Requirement (equivalent to a Capital Coverage Ratio of 140% at 31 December 2017). See further details on risk management on pages 36 to 44.

Measurement and monitoring of capital

The capital position of the Group is monitored on a regular basis and reviewed formally on a monthly basis by the Group Asset and Liability Committee (ALCO). These objectives are reviewed and benchmarks are set by which to judge the adequacy of the Group's capital and ensure that sufficient capital is available.

The Group's capital requirements are forecast on a regular basis and compared against the available capital and the Group's minimum internal rate of return. The internal rate of return forecast to be achieved on potential investments is also measured against minimum required benchmarks taking into account the risks associated with the investment.

Methodology

Eligible own funds comprise the excess of the value of assets over the liabilities, as valued on a Solvency II basis. Subordinated debt issued by the Group is considered to be part of Eligible own funds, rather than a liability, as it is subordinate to policyholder claims.

Assets are valued at IFRS fair value with adjustments to remove intangibles and deferred acquisition costs, and to value reinsurers' share of technical provisions consistent with the Solvency II regulations.

Liabilities are valued on a best estimate market consistent basis, with the application of a Matching Adjustment, for valuing qualifying annuity liabilities, and a Volatility Adjustment for other qualifying business. Transitional measure on technical provisions (TMTP) is recognised on the balance sheet and has been calculated on a basis approved by the Audit Committee which seeks to capture the differences between the total Financial Resources Requirement under the previous Solvency I regime and the new Solvency II regime.

The liabilities include the Risk Margin which represents an allowance for the cost of capital for a purchasing insurer taking on the portfolio of liabilities and residual risks that are deemed to be not hedgeable under Solvency II, following the 1-in-200 stress event. This is calculated using a cost of capital of 6% as prescribed by EIOPA.

The Solvency Capital Requirement (SCR) is the amount of capital required to cover the 1-in-200 worst projected future outcome in the year following the valuation, allowing for realistic management and policyholder actions and the impact of the stress on the tax position of the Group. This allows for diversification between the different businesses within the Group and between the risks to which they are exposed.

All non-insurance regulated businesses are included using their current regulatory surplus.

Allowance is made within the Solvency II Balance Sheet for the Group's defined benefit pension scheme using results on an IFRS basis.

Notes to the Financial Statements continued

Year ended 31 December 2017

3. Capital management (continued)

Assumptions

The calculation of the Solvency II balance sheet and associated capital requirements requires a number of assumptions, including:

- (i) assumptions required to derive the present value of best estimate liability cash flows. Non-market assumptions are broadly the same as those used to derive the Group's IFRS disclosures. Future investment returns and discount rates are those defined by EIOPA, which means that the risk free rates used to discount liabilities are market swap rates, with a 10 basis point deduction to allow for credit risk. For eligible annuity business, the liability discount rate includes a Matching Adjustment. For other eligible business, the liability discount rate includes a Volatility Adjustment;
- (ii) assumptions regarding management actions. The only management actions allowed for are those that have been approved by the Board and are in place at the balance sheet date.

Use of and limitations of sensitivity analysis

Sensitivity analysis is used to determine the effect of a change in a key assumption while other assumptions remain unchanged. In reality, there is a correlation between the assumptions and other factors. It should also be noted that these sensitivities are non-linear, and larger or smaller impacts should not be interpolated or extrapolated from these results.

The sensitivity analysis does not take into consideration that the Group's assets and liabilities are actively managed. Additionally, the Solvency II position of the Group may vary at the time that any actual market movement occurs. For example, the Group's financial risk management strategy aims to manage the exposure to market fluctuations.

As investment markets move past various trigger levels, management actions could include selling investments, changing investment portfolio allocation, adjusting bonuses credited to policyholders, and taking other protective action.

Other limitations of sensitivity analysis include the use of hypothetical market movements to demonstrate potential

risk that only represent the Group's view of possible near-term market changes that cannot be predicted with any certainty, and the assumption that all interest rates move in an identical fashion.

Stress and scenario testing

Due to the limitations of sensitivity analysis in isolation, the Group undertakes a series of stress and scenario tests to ensure the robustness of its solvency position in regard to different levels of new business growth, movements in investment markets and changes in other assumptions such as the expected lifetime of our enhanced annuity customers.

In looking at movements in investment markets the Group considers a number of single stresses (e.g. a significant fall in equities) but more importantly because investment markets are highly correlated consideration is given to how they will move together in stressed conditions. The Group uses the outcomes of the stress and scenario testing to develop the management actions that would be undertaken if capital or other performance measures move outside of the defined risk appetite.

In order to plan for the future operations of the Group, forecast plans are produced including stress and scenario testing to provide the board with assurance that the Group will be able to withstand adverse events if they arise.

Reconciliation of Group IFRS UDS to Solvency II Eligible own funds

The table below gives a reconciliation of Group IFRS Unallocated divisible surplus to the Group's Eligible own funds on a Solvency II basis.

The Group Solvency II results are not due to be submitted to the PRA until after the release of the Annual Report. As a result, the Group Solvency II results disclosed below are based on the best estimate of the results at the Annual Report signing date and may differ to the results published as part of the annual Solvency Financial Condition Report.

	2017 £m	2016 £m
IFRS Unallocated divisible surplus	1,189	998
Remove DAC, goodwill and other intangible assets and liabilities	(410)	(393)
Add subordinated debt treated as available capital	379	385
Insurance contract valuation differences	305	505
Difference in non-controlling interest calculation methods	279	–
Deferred tax adjustments	11	24
Other	6	(19)
Less net eligible own funds relating to ring-fenced funds	(192)	(204)
Eligible own funds (excluding ring-fenced funds)	1,567	1,296
RNPFN – eligible own funds	125	139
Restriction of own funds in respect of RNPFN	(34)	(42)
Teachers – eligible own funds	67	65
Restriction of own funds in respect of Teachers	(48)	(47)
Group Eligible own funds as submitted to the PRA	1,677	1,411

Notes to the Financial Statements continued

Year ended 31 December 2017

4. Risk management and control

The Group's primary business activities include the provision of insurance, investment and retirement products to UK-based customers. In providing these products the Group accepts and needs to manage risk. A description of these risks and how they relate to the Group's products is outlined below and the Group's approach to managing and controlling these risks through its governance and risk management framework is set out on pages 36 to 44.

As part of its risk management programme, the Group records its current and projected risk position across a defined set of risk categories. In addition a measure of the sensitivity on Profit before tax and unallocated divisible surplus, under both deterministic and stochastic scenarios is performed.

Management uses the insight gained through these sensitivities to help manage the Group's risk exposure and sustainability. The models, scenarios and assumptions used are reviewed regularly and updated as necessary including any interdependencies between risk types. This section includes the impact on the three measures of a sensitivity test that calibrates to a reasonably possible change in a single risk type.

Principal risks and categories

The Risk Management section of the Strategic Report on pages 36 to 44 sets out the principal risks and uncertainties that the Group faces. In addition, the Group uses a standard categorisation to group types of similar risks. All such risks are subject to the same risk management and control framework. However, they impact the business and its financial performance in different ways. The following sections provide more detail on these main categories of risks and how they impact the Group.

a) Insurance risk

Insurance risk arises both from the claims commitment that the Group has made to its policyholders and the pricing assumptions made in respect of the policy of insurance. As such, this covers the following risks:

- The timing and the amount of the claim is uncertain and hence there is a risk that the exposure to loss arising from this claims experience is different to that anticipated.
- The product is priced assuming certain assumptions covering how long the policy will be maintained by the customer (persistence risk) and the cost of administering the product over its life cycle (expense risk). There is a risk that across the Group's insurance portfolio the actual experience is different to that assumed when the product is priced. This is more likely the longer the term of the product and therefore is usually only a significant factor in life insurance products.

Insurance concentration risk

The Group is not exposed to significant concentrations of insurance risk. Experience shows that the larger the portfolio of similar independent insurance contracts, the smaller the relative variability about the expected outcome will be. In addition, a more diversified portfolio is less likely to be affected by a change in any subset of the portfolio. The Group has developed its insurance underwriting strategies to diversify the type of insurance risks accepted and within each of these categories to achieve a sufficiently large population of risks to reduce the variability of the expected outcome.

The Group writes a diverse mix of insurance business across a wide group of people and businesses. However, as the Group has substantially written all of its business in the UK, results are sensitive to demographic and economic changes arising in the UK.

The Group minimises the level of insurance concentration through the use of portfolio analysis and reinsurance.

The Group assesses its insurance risk in two broad categories: life insurance risk and general insurance risk and the specific components of each of these are further outlined below:

(i) Life insurance

The Group's life insurance activities primarily involve the provision of protection, retirement and savings products. These products are long term in nature and provide key benefits to the policyholder and their dependants.

A number of key assumptions are made when determining the future claims liability that will arise from these policyholder commitments. These are based on prior experience and latest forecasts in trends and patterns and include the future life expectancy and health of policyholders, the extent to which contracts will be terminated early, how much insurance contract administration costs will increase, growth in the value of investments, interest rates and tax rates.

Details of life insurance contract liabilities and associated valuation assumptions are disclosed in Notes 19 and 24 respectively.

Differences in actual experience versus the original key assumptions will give rise to liabilities that differ from those originally anticipated. In addition the assumptions made regarding the length of time the policy stays in force and the cost of administering the policy may vary from original assumptions. Wherever these outcomes vary from the original or most recent estimates they may give rise to a change in life insurance risk exposure, the primary life insurance risks prevalent within the Group's products are described below:

Mortality, longevity and morbidity

Life protection and annuity business is exposed to changes in life expectancy (mortality - reduced life expectancy, longevity – increased life expectancy) and health expectancy (morbidity) experience.

Protection product liabilities are exposed to mortality and morbidity risks whereby higher mortality rates and adverse morbidity will lead to increases in contract liabilities. Annuity product liabilities are exposed to longevity risk whereby contract liabilities will increase with life expectancy.

Notes to the Financial Statements continued

Year ended 31 December 2017

4. Risk management and control (continued)

Mortality, longevity and morbidity risk is managed in the Group through the assessment of the risk associated with individual policyholders against a set of acceptance (underwriting) criteria, which may include an individual's medical history, occupation, smoking and drinking habits (i.e. indicators of life expectancy). The actual experience of policyholders is then regularly monitored to assess that the underwriting criteria remain appropriate and that the level of risk being assumed by the Group remains within its risk appetite.

Persistency

In pricing life insurance business, the Group makes assumptions as to how long the policyholder is likely to retain the product. Persistency risk arises from the actual experience being different to the assumptions. The level of persistency influences the ability to recover initial costs of sale from the premiums and charges that relate to the product. The Group is exposed to persistency risk whereby the profitability is adversely impacted by changes in the length of time that policies remain in force.

For certain Heritage products the level of persistency influences the estimated cost of guarantees and options. The risk for these products is that a larger proportion of the portfolio remains in-force to take advantage of these guarantees and options.

Persistency risk is managed in the Group through the assessment of the risk associated with different products against the assumptions used when pricing and subsequently valuing the insurance obligations. The actual lapse experience segmented into appropriate product groups is regularly monitored to assess whether the pricing and valuation assumptions remain appropriate and that the level of risk being assumed by the Group remains within its risk appetite.

Expense

In pricing life insurance business, assumptions are made as to how long the Group will need to continue to service and maintain the product and communicate with the policyholder. The Group is exposed to the risk that the charges it deducts from policyholder benefits are not sufficient to cover the full extent of these expenses. In addition, the Group makes an assumption as

to how much this service and maintenance will cost each year. Expense risk is the exposure from these assumptions on cost and duration varying from the assumed levels, with higher than expected expenses reducing profits.

The Group manages this risk through an ongoing assessment of the factors that will generate additional expenses in the product servicing costs and the average duration of life insurance products.

Reinsurance

In order to mitigate the mortality, longevity and morbidity risk within the Group's life insurance book described earlier, a proportion of mortality, longevity and morbidity risk is transferred via reinsuring policy commitments through agreements with reinsurance companies.

In December 2017, the Group reinsured a large portfolio of heritage deferred and immediate with-profits annuity policies (OB Pensions), with RGA, a leading global life reinsurer. The agreement covers specified levels of benefits, thereby significantly reducing the level of market and longevity risk associated with the portfolio, and was executed at a price that was lower than the best estimate value of the liabilities. The Group retains certain risks associated with the portfolio, primarily those related to expenses, discretionary benefits and policyholder optionality. The assets backing these OB Pensions policies were disposed of as part of this transaction. For further details on the OB pensions reinsurance arrangement see Note 23.

Life insurance concentration

The Group's exposure to life insurance risk is captured in the long-term insurance and investment contract liabilities set out below. The products listed below cover the Group's protection, annuity and pensions products and also the investment exposure arising from the Group's savings and investment products. The Society's exposure to life insurance risk is consistent with that of the Group.

Group	2017			2016		
	Gross £m	Reinsurance £m	Net £m	Gross £m	Reinsurance £m	Net £m
Whole life	3,242	(41)	3,201	2,794	16	2,810
Endowment	418	–	418	526	–	526
Term Assurance	316	(339)	(23)	243	(250)	(7)
Immediate and deferred annuity contracts	4,586	(1,004)	3,582	4,682	(111)	4,571
UWP pensions and protected retirement plans	1,388	–	1,388	1,339	–	1,339
Critical illness	98	(86)	12	73	(65)	8
Income protection	265	(277)	(12)	161	(189)	(28)
ISA	100	–	100	101	–	101
Other	212	–	212	160	(2)	158
	10,625	(1,747)	8,878	10,079	(601)	9,478
Long-term claims liabilities	50	–	50	46	–	46
Unit linked	3,071	–	3,071	2,553	–	2,553
	13,746	(1,747)	11,999	12,678	(601)	12,077

Notes to the Financial Statements continued

Year ended 31 December 2017

4. Risk management and control (continued)

Life insurance risk sensitivities

The table below sets out the impact on the Unallocated divisible surplus and Profit before tax for movements in key assumptions. The Society's exposure to life insurance risk is materially consistent with that of the Group.

Sensitivity analysis for the change in assumptions used in long-term insurance and investment contract liabilities	Impact on Profit before tax, mutual bonus and UDS transfer	Impact on the Unallocated divisible surplus
	£m	£m
Increase in mortality rates by 10% – Non annuity products	(7)	(7)
Decrease in mortality rates by 10% – Annuity products	(26)	(26)
Increase in morbidity rates by 10%	(28)	(28)
Increase in persistency by 25%	(6)	(6)
Increase in expenses by 10%	(50)	(50)

The impact of an adverse or favourable movement in the assumptions is largely symmetric. The persistency sensitivity is performed as stresses to the persistency assumptions proportionally for all products and therefore implicitly allows for offsets between products exposed to different directional sensitivities.

(ii) General insurance

The Group's insurance activities are primarily concerned with the pricing, acceptance and management of risks from its policyholders. In accepting risks the Group commits to paying claims and therefore these risks must be understood. The Group manages these risks through its underwriting strategy, reinsurance arrangements and proactive claims handling.

For a portfolio of insurance contracts where the theory of probability is applied to pricing and provisioning, the main risk that the Group faces under its insurance contracts is the risk that actual claims exceed the carrying value of the Group's claims reserves. The risk arises from the inherent uncertainties as to the occurrence, amount and timing of insurance claims. For general insurance contracts this is primarily represented by exposure to risks which may lead to significant claims in terms of frequency or value. These would include major weather events, subsidence and large single claims arising from either the motor business (injury claims) or SME business (liability and/or property claims). There is also a risk that the prices charged for unexpired risks to which the Group is contractually committed may prove to be insufficient to absorb the cost of the claims which they will generate and any related deferred acquisition cost. Procedures are in place to measure, monitor and control exposure to all these risks.

General insurance concentration

The table below sets out the Group's concentration of general insurance contract liabilities by type of contract:

	2017			2016		
	Gross £m	Reinsurance £m	Net £m	Gross £m	Reinsurance £m	Net £m
Motor	1,349	(439)	910	1,284	(408)	876
Commercial	230	(70)	160	209	(54)	155
Household	54	(24)	30	61	(10)	51
Other	10	(10)	–	9	–	9
	1,643	(543)	1,100	1,563	(472)	1,091

Reinsurance

Motor business is exposed to the risk of large bodily injury claims, where the claim amounts can be significant due to the cost of care required for the claimant. The Group has excess of loss reinsurance contracts which reduce its exposure to large claims. The Group's retention is £5m per claim (2016: £5m per claim).

Property business (domestic and commercial) is exposed to catastrophic risks such as those resulting from storms or floods as well as risks such as subsidence. The Group has reinsurance contracts which provide protection against catastrophic weather events.

SME business is exposed to large individual property losses and also to liabilities arising from employment and commercial activities. The Group has reinsurance contracts which provide protection against these liabilities.

In addition to the reinsurance contracts described above, the Group also has a 20% Quota Share reinsurance arrangement for 2016 to 2018 (each year treated separately) and a Loss Portfolio Transfer Agreement reinsuring 20% of its booked general insurance reserves as at 31 December 2015. Whilst the primary driver of these transactions was efficient capital management, the contracts also have the effect of reducing the Group's exposure to general insurance concentration risk.

Notes to the Financial Statements continued

Year ended 31 December 2017

4. Risk management and control (continued)

Claims development

The claims provision is the estimated cost of outstanding claims from expired risks. The provision is calculated largely from using the Group's historic claims development data.

How much the past claim development will reflect future claims development will be impacted by the following factors:

- Changes in actuarial processes and methodology.
- Changes in risk profile.
- Changes in underwriting, rating and policy conditions.
- Changes in legislation and regulation e.g. PPOs, Ministry of Justice reforms, changes to the Ogden discount rate, etc.
- Changes in other external factors e.g. 'claims farming'/ accident management firms.

It is therefore important that the impact of these items on claims development is understood. Whilst every effort has been made to ensure the claims provision appropriately allows for such changes, there remains uncertainty in the eventual reserve outcome as a result. This uncertainty can change from year to year depending on the timing and magnitude of these items.

The estimation of the ultimate cost of large bodily injury claims follows a more complex stochastic process given that these claims typically exhibit low frequency and high severity and hence the outcome is highly uncertain. Significant factors that affect the large injury claims estimation process are legislation (e.g. the Ogden discount rate used to value lump sum settlements), judicial decisions and the long delay to settlement. Over the last decade, there has been an increasing prevalence of Periodic Payment Order ('PPO') settlements when the Ogden discount rate was set at 2.5% p.a. and at a time when real yields were very low. These settlements have an annuity-type structure, i.e. they are typically paid annually over the claimant's life with mortality, inflation and investment returns being the key risks. Courts may decide that a claim should be settled on a PPO basis, but in some cases the claimant will request a PPO settlement. Due to all these factors, the future development of bodily injury claims have a high degree of uncertainty compared to non-injury claims.

On 27 February 2017, the Lord Chancellor announced a change in the Ogden discount rate from 2.5% p.a. to minus 0.75% p.a. This change impacted the valuation of the cost of care element of large injury claims, and required insurance companies to hold more money in reserves in order to match the inflation risk in the long term. The change in the Ogden rate resulted in a £139m increase in the Group's 31 December 2016 reserves.

The change in the Ogden discount rate during 2017 makes a lump sum settlement more attractive to claimants than it was previously, whilst the valuation of a PPO equivalent remains unchanged. Overall PPO claim settlement frequencies are expected to reduce as claimants are increasingly likely to desire a lump sum settlement.

On 7 September 2017 the Government confirmed that it plans to introduce a new framework based on how claimants actually invest, as well as making sure the rate is reviewed fairly and regularly. If passed, the Ministry of Justice indicated that if the rate were calculated using September 2017 economic conditions, the rate would fall in the range 0% p.a. to +1% p.a.

On 20 March 2018 the Government published a draft of its Civil Liability Bill. This contains proposals for changes to the discount rate and the governance around its setting. If enacted in its current form, and assuming no changes to current market conditions, this should result in lower settlements for certain types of liability claims. While the Group welcomes the proposals, there are a number of factors influencing this potential change meaning that its impact and timing remain uncertain. Therefore the Group continues to maintain a discount rate of -0.75% for reserving such claims, reflecting the current legislated rate.

The table below provides a sensitivity analysis of the potential impact of a change in the discount rate used to value PPOs and a change in the Ogden discount rate, with all other assumptions left unchanged.

	Increase/(decrease) in Profit before tax, mutual bonus and UDS transfer		Increase/(decrease) in Unallocated divisible surplus	
	2017 £m	2016 £m	2017 £m	2016 £m
Periodic Payment Orders (PPO's)				
Impact of a 1% increase in the discount rate used to value PPOs	9	8	7	6
Impact of a 1% reduction in the discount rate used to value PPOs	(13)	(11)	(11)	(9)
Lump sum personal injury settlements				
Impact of an increase in the Ogden discount rate from -0.75% p.a. to 0% p.a.	44	n/a	36	n/a

1) The sensitivities are shown on a pre-LPT and Quota Share basis.

2) The selection of these sensitivities should not be interpreted as a prediction.

Notes to the Financial Statements continued

Year ended 31 December 2017

4. Risk management and control (continued)

b) Financial markets risk

As a result of the insurance, investment and retirement products offered to policyholders the Group is exposed to financial markets through the investment of premiums and investment lump sums in various investment assets such as equities, gilts, corporate bonds and property.

Financial markets risk is defined as the risk that arises from adverse fluctuations or increased volatility in asset values, asset income or interest rates. This includes credit spread widening. The Group manages these risks through aligning the investment strategy, asset allocation and performance benchmarks with the Group's risk appetite and utilising asset liability matching and stochastic modelling techniques. These actions aim to match the risks arising from the liabilities under the Group's insurance and investment contracts with the risks inherent in its assets and the capital available to ensure the Group is able to meet policyholder commitments when they fall due and to achieve a sufficient return for members.

In addition to the actions summarised above the Group may also look to use derivative instruments particularly to assist in hedging policyholder guaranteed options and, where cost effective, to transfer risks it believes are either unrewarded or which it believes can be better managed by a third party. For example, derivatives are used to reduce exposure to fluctuations in interest rates, exchange rates and for efficient portfolio management purposes. The main derivatives used for this function are interest rate contracts (including interest rate swaps and options), forward foreign exchange contracts and equity derivatives (index futures and options) respectively. The Group does not hold derivatives for investment purposes, they are held purely as a risk management technique to manage financial market risk exposures within its investment holdings (see Note 14 on how these are used).

The investment management agreement between the Group and Columbia Threadneedle Investments specifies the limits for holdings in certain asset categories and currencies. Asset allocation and performance benchmarks are set, which ensure that each fund has an appropriate mix of assets and is not over or under exposed to a particular asset category, currency or specific investment. The Funds Management Group monitors the actual asset allocation and performance against benchmarks with oversight provided by Group ALCO and the Investment Committee.

The Group is not exposed to financial markets risk in respect of assets held to cover unit linked liabilities as these risks are borne by the holders of the contracts concerned, except to the extent that income from the fund based management charges levied on these contracts varies directly with the value of the underlying assets. Such assets are, however, prudently managed in order to meet policyholders' risk and reward expectations. In addition, regulatory requirements prescribe the type and quality of assets that can be held to support these liabilities.

The key types of financial markets risk to which the Group is exposed are set out in more detail in the following paragraphs. Sensitivities to key market risks are shown on page 125.

(i) Asset performance risk

Asset performance risk is the risk that the fair value or future cash flows of an asset or liability will fluctuate because of changes in market prices, other than those arising from interest rate or currency risks.

The Group is primarily exposed to asset performance risk arising from its investment in equities, property, gilts and corporate bonds.

Equity price risk

The Group is exposed to equity price risk from daily fluctuations in the market values of the equity portfolio. These assets are used to support contractual liabilities arising from investment and long-term insurance contracts. For investment and long-term linked insurance contracts the price movements are matched with corresponding movements in contractual obligations. For participating insurance contracts the aim is to achieve growth in excess of the obligations. For general insurance contracts, equities are held to achieve an investment return. Decreases in the market price of equities will negatively impact the profits and capital of the Group. The risks from investing in equities are managed by investing in a diverse portfolio of high quality securities ensuring that holdings are diversified across industries and concentrations in any one company or industry are limited by parameters established by the Investment Committee. In addition, the Group may use derivatives to reduce the level of equity price risk.

Property price risk

The Group is subject to property price risk due to its exposure to the residential and commercial property market through its equity release and commercial mortgage products, where sustained underperformance in property prices could result in proceeds on sale being exceeded by the mortgage debt at the date of redemption (see Note 13 for disclosures relating to loans secured on residential and commercial property). This risk is managed through limits on the maximum loan to value ratio and seeking to limit concentrations in particular geographic areas. In addition, monitoring of actual experience in house prices versus expected is undertaken.

Corporate bond price risk (Credit spread risk)

The credit spread risk represents the risk of adverse fluctuation in the values of assets and liabilities due to changes in the level of corporate bond credit spreads.

A widening in credit spreads, over and above risk-free yields, causes bond values to decrease. There is a partial offset where the value of certain insurance liabilities fall in value but the overall impact on IFRS profits is negative. Conversely a narrowing of credit spreads results in a positive impact on IFRS profits. The Group monitors credit spread risk by regularly reviewing its exposure to corporate bonds by sector (e.g. financial or non-financial), credit rating and duration and through its asset and liability matching tools.

Notes to the Financial Statements continued

Year ended 31 December 2017

4. Risk management and control (continued)

(ii) Interest rate risk

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

Interest rate risk arises primarily from the Group's investments in long-term debt and fixed income securities and their movement relative to the value placed on the insurance liabilities. A number of products sold by the Group have features that influence the Group's exposure to interest rate risk. These features include guaranteed surrender values, guaranteed annuity options and minimum surrender and maturity values, which can lead to the present value of claims being higher than the value of the backing assets, when interest rates change.

The Group manages interest rate risk by investing in fixed income securities which closely match the interest rate sensitivity of the liabilities, where such investments are available. The Group also makes use of derivatives in addition to physically held assets to manage the interest rate exposure resulting from the liabilities. The Group manages its exposure on both an IFRS basis and a regulatory capital basis under Solvency II, and currently focuses on regulatory capital. These derivatives are principally interest rate swaps and swaptions.

	2017					2016				
	Euro £m	US Dollar £m	Yen £m	Other £m	Total £m	Euro £m	US Dollar £m	Yen £m	Other £m	Total £m
Derivatives	–	(1)	–	–	(1)	(77)	(1)	–	(27)	(105)
Equity securities	13	122	–	–	135	200	123	48	108	479
Cash and cash equivalents	13	5	–	–	18	13	8	–	–	21
	26	126	–	–	152	136	130	48	81	395

The Society's exposure to foreign currency risk in 2017 amounted to £14m Euros and £126m US dollars (2016: £18m Euros and £124m US dollars).

A strengthening of the value of sterling against the foreign currency (increase in exchange rates), in which the investment asset is denominated, will lead to a devaluation of the asset value and any associated income flows. A weakening of the value of sterling against the foreign currency will have the reverse impact.

The sensitivity of investment assets to a 10% increase/decrease in Euro and US Dollar exchange rates, net of derivatives, is £3m (2016: £14m) and £13m (2016: £13m) respectively. In determining the percentage rates to use in this sensitivity the movements in the actual market rates of Euro and US Dollars during 2017 were taken into account. The above table incorporates all material currency risk to Profit before tax. Therefore, a 10% increase/decrease across all currencies could impact Profit before tax by up to £15m (2016: £27m).

Exposure to interest rate risk is monitored using several techniques, including scenario testing, stress testing and asset liability duration control.

(iii) Foreign currency risk

The Group predominantly operates within the UK and is therefore not significantly exposed to currency exposures within its normal trading activities. However, the Group's investment strategy and policies allow for a limited level of investment in overseas markets, via both equities and fixed interest securities. The main currency exposures here are to the Euro and US dollar.

The risk to the Group is that the fair value or future cash flows of an overseas investment asset will change as a result of changes in foreign exchange rates. Currency risk is managed by the use of exposure limits and authorisation controls operated within the Group's risk management framework.

The table below summarises the Group's exposure, after hedging, to foreign currency exchange risk in sterling.

Some foreign debt securities are denominated in sterling so bear no direct currency risk and have not been included within the above table.

(iv) Investment concentration

Investment concentration risk arises through exposure to particular asset types, geographical markets, industry sectors, groups of business undertakings or similar activities. The Group may suffer losses in the investment portfolio as a result of over exposure to particular sectors engaged in similar activities or similar economic features that would cause their ability to meet contractual obligations to be similarly affected by changes in economic, political and other conditions. The Group's trading activities are UK-based and associated insurance and investment contract liabilities are impacted by the UK marketplace and hence there is a high concentration in corresponding matching UK investment assets.

Notes to the Financial Statements continued

Year ended 31 December 2017

4. Risk management and control (continued)

The Group invests in a portfolio of assets and seeks to maximise portfolio expected return for a given amount of portfolio risk, or equivalently minimise risk for a given level of expected return, by carefully choosing the proportions of various assets. The Investment Committee sets the Group's investment strategy and recommends to the Board the policy and limits required. Responsibility for implementation is delegated to

the Chief Investment Officer, with day to day investment activities being undertaken by the Group's investment manager, Columbia Threadneedle Investments.

The Funds Management Group monitors the actual asset allocation and performance against benchmarks with oversight provided by Group ALCO and the Investment Committee.

Eurozone exposure

The table below shows the Group's exposure by country of incorporation of the counterparty at 31 December 2017. The Society's exposure to Eurozone risk is materially consistent with that of the Group.

	2017			2016		
	Sovereign £m	Non Sovereign £m	Total £m	Sovereign £m	Non Sovereign £m	Total £m
Italy	–	35	35	–	32	32
Spain	–	49	49	1	114	115
Other Eurozone	327	1,068	1,395	46	1,785	1,831
Total	327	1,152	1,479	47	1,931	1,978

The Group's combined exposure to Greece, Cyprus and Portugal is £1m (2016: £7m). Non-sovereign exposure includes £102m (2016: £109m) of subordinated debt.

Summary of market risk sensitivities

The table below sets out the impact on Profit before tax and the Unallocated divisible surplus for movements in sectors of the market that the Group is invested in, net of derivatives, excluding the Group's defined benefit pension schemes. The 2016 profit before tax sensitivities have been restated such that the tax charge to with-profits asset shares is applied as part of Profit before tax, with no change to Unallocated divisible surplus. Explanation of the movements, and where the sensitivity for the Society is materially different to the Group, are provided below.

In determining the percentage rates to use in the sensitivity analysis reference has been made to those used for internal reporting within the Group. Where sensitivities have not been produced in both directions, the impact of the sensitivity in the other direction is materially consistent with the sensitivity provided.

Sensitivity analysis to movements in key market sectors	2017		2016	
	Impact on Profit before tax, mutual bonus and UDS transfer £m	Impact on the Unallocated divisible surplus £m	Impact on Profit before tax, mutual bonus and UDS transfer £m	Impact on the Unallocated divisible surplus £m
Equity values fall by 20%	(69)	(34)	(87)	(39)
Property values fall by 12.5%	(17)	(12)	(19)	(15)
Credit spreads increase by 100bps relative to swap yields	(89)	(83)	(152)	(143)
Government Bond spreads increase by 50bps relative to swap yields	(16)	(7)	–	–
Fixed interest yields fall by 50bps	38	20	104	90
Fixed interest yields increase by 100bps	(64)	(35)	(182)	(159)

In 2017, there have been significant changes to the hedging strategy as part of the Group's capital optimisation activity. As a result, there is now significantly less interest rate and equity exposure in the IFRS results. In addition, the general insurance transaction with Allianz has approximately halved the exposure in market movements originating from the general insurance subsidiaries. The Society's exposure to fixed interest yields is lower than the Group as the general insurance subsidiaries engage in Solvency II related hedging, which contribute to the Group's exposure above.

The fall in credit exposure is materially driven by the OB pensions reinsurance transaction, due to the transfer of invested assets to the reinsurer, with the remaining reduction due to the general insurance transaction with Allianz and the reduction in corporate bonds backing the annuity business.

As part of aligning Solvency II and IFRS reporting, the reference risk-free rate used to set the discount rates which are used to value IFRS liabilities has been changed to be based on swap yields with a credit risk adjustment, in place of gilt yields. As the Group uses a mixture of gilt based assets alongside interest rate derivatives, there is a new exposure to IFRS profits of gilt yields rising relative to swap yields. As a result, the government bond spread sensitivity has been added.

Asset values and, where appropriate, asset share changes are reflected in each sensitivity. With-profits future policy related liabilities are recalculated using these revised values and, where appropriate, economic scenarios generated by an asset model calibrated to the revised risk-free rate.

Notes to the Financial Statements continued

Year ended 31 December 2017

4. Risk management and control (continued)

Fair value estimation

The following fair value estimation tables present the Group's and Society's assets and liabilities measured at fair value by level of the fair value measurement hierarchy at 31 December 2017.

Level 1 – quoted prices

The fair value of financial instruments included in the Level 1 category is based on the value within the bid-ask spread that is most representative of fair value quoted in an active market at the year-end date. An instrument is regarded as quoted in an active market if quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service or regulatory agency and those prices represent actual and regularly occurring market transactions on an arm's length basis.

Level 2 – observable inputs

Level 2 financial instruments are not traded in an active market and their fair value is determined using valuation techniques. These valuation techniques maximise the use of data from observable current market transactions (where it is available) using pricing obtained via pricing services, even where the market is not active. It also includes financial assets with prices based on broker quotes.

Specific valuation techniques used to value financial instruments classified as Level 2 include:

- Derivatives are valued by discounted cash flow techniques, using observable yield curves and models such as Black Scholes using implied market forward rates and volatilities.
- Units in listed investment funds are valued using quoted prices from external pricing services.
- Debt securities are valued using quoted prices from external pricing services.
- Loans secured on commercial property are valued using discounted cash flows to reflect changes in underlying gilt yields and debt margins.
- Non-participating investment contract liabilities are valued on a basis consistent with the underlying assets in the investment fund.

Level 3 – significant unobservable inputs

If one or more of the significant inputs is not based on observable market data, the instrument is included in Level 3.

Specific valuation techniques used to value financial instruments and other financial investments held at fair value classified as Level 3 include:

- Private equity holdings are valued on a net asset value basis using unobservable external unit prices factoring in distributions or calls since the latest valuations. The private equity valuations are reviewed on a monthly basis by group treasury to ensure ongoing validity and accuracy.

- The fair value of the loans secured on residential property is determined using discounted cash flow projections. The expected value of redemptions are estimated based on the assumed prepayments over future time periods (months), mortality and long-term care entry rates including any early redemption charges. The expected redemptions are discounted at swap rates plus spread plus allowances for risk factors. The full swap curve is used so each discount rate is matched to the appropriate cash flow. The assumptions used for prepayment, mortality and long-term care are based on the experience of the in-force book supported by industry data. The valuation is performed by a qualified actuary and reviewed by the Actuarial Asset Reporting Manager. The assumptions are set by the Board upon recommendation by the Audit Committee.

There were no changes to the valuation techniques during the year. There were no transfers between Levels 1 and 2 during the year.

The Group's policy is to recognise transfers into and out of fair value hierarchy levels as at the date of the event or change in circumstances that caused the transfer.

The valuation of all of the Group's investment holdings is performed by independent and qualified valuers.

Any changes to fair value are recognised within net gains/losses on investments within the Statement of Comprehensive Income with the exception of Investment contract liabilities where the movement is recognised within the Gross change in contract liabilities. Details of these gains/losses are disclosed within Notes 7 and 21 respectively.

Notes to the Financial Statements continued

Year ended 31 December 2017

4. Risk management and control (continued)

Group	2017				2016			
	Level 1 £m	Level 2 £m	Level 3 £m	Total fair value £m	Level 1 £m	Level 2 £m	Level 3 £m	Total fair value £m
Financial assets								
Derivative financial instruments								
Interest rate swaps	–	69	–	69	–	160	–	160
Gilt forwards	–	4	–	4	–	–	–	–
Swaptions	–	–	1	1	–	6	1	7
Equity/index derivatives	–	7	–	7	–	12	–	12
	–	80	1	81	–	178	1	179
Financial assets held at fair value through income								
Shares, other variable yield securities and units in unit trusts								
– UK listed	1,973	5,656	–	7,629	1,746	4,390	–	6,136
– UK unlisted	–	–	91	91	–	–	120	120
– Overseas listed	117	–	–	117	464	3	–	467
– Overseas unlisted	–	–	42	42	–	–	55	55
Debt and other fixed income securities								
– UK listed	1,179	1,853	–	3,032	1,657	1,927	–	3,584
– Overseas listed	77	1,995	–	2,072	98	2,148	–	2,246
Loans secured on residential property	–	–	667	667	–	–	685	685
Loans secured on commercial property	–	200	–	200	–	198	–	198
Other	–	3	–	3	–	–	–	–
	3,346	9,707	800	13,853	3,965	8,666	860	13,491
	3,346	9,787	801	13,934	3,965	8,844	861	13,670
Financial liabilities								
Non-participating investment contract liabilities	–	3,071	–	3,071	–	2,547	–	2,547
Derivative financial instruments								
Cash flow swaps	–	186	–	186	–	173	–	173
Interest rate swaps	–	4	–	4	–	29	–	29
Gilt spread lock	–	–	–	–	–	37	–	37
Equity/index derivatives	3	–	–	3	1	19	–	20
	3	190	–	193	1	258	–	259
	3	3,261	–	3,264	1	2,805	–	2,806

Notes to the Financial Statements continued

Year ended 31 December 2017

4. Risk management and control (continued)

	2017				2016			
	Level 1 £m	Level 2 £m	Level 3 £m	Total fair value £m	Level 1 £m	Level 2 £m	Level 3 £m	Total fair value £m
Society								
Financial assets								
Derivative financial instruments								
Interest rate swaps	–	68	–	68	–	160	–	160
Gilt forwards	–	4	–	4	–	–	–	–
Swaptions	–	–	1	1	–	6	1	7
Equity/index derivatives	–	7	–	7	–	12	–	12
	–	79	1	80	–	178	1	179
Financial assets held at fair value through income								
Shares, other variable yield securities and units in unit trusts								
– UK listed	1,309	5,535	–	6,844	1,187	4,810	–	5,997
– UK unlisted	–	–	91	91	–	–	120	120
– Overseas listed	112	–	–	112	101	1	–	102
– Overseas unlisted	–	–	42	42	–	–	54	54
Debt and other fixed income securities								
– UK listed	1,166	1,495	–	2,661	1,643	1,520	–	3,163
– Overseas listed	77	1,178	–	1,255	98	1,426	–	1,524
Loans secured on residential property	–	–	667	667	–	–	684	684
Loans secured on commercial property	–	200	–	200	–	198	–	198
Other	–	3	–	3	–	–	–	–
	2,664	8,411	800	11,875	3,029	7,955	858	11,842
	2,664	8,490	801	11,955	3,029	8,133	859	12,021
Financial liabilities								
Non-participating investment contract liabilities	–	3,071	–	3,071	–	2,547	–	2,547
Derivative financial instruments								
Cash flow swaps	–	186	–	186	–	173	–	173
Interest rate swaps	–	–	–	–	–	25	–	25
Gilt spread lock	–	–	–	–	–	37	–	37
Equity/index derivatives	1	–	–	1	1	–	–	1
	1	186	–	187	1	235	–	236
	1	3,257	–	3,258	1	2,782	–	2,783

Notes to the Financial Statements continued

Year ended 31 December 2017

4. Risk management and control (continued)

The table below presents the movements in Level 3 financial instruments for the year ended 31 December 2017.

	At 1 January 2017 £m	Total gains/ (losses) recognised through income £m	Purchases £m	Sales £m	At 31 December 2017 £m	Unrealised gains/ (losses) recognised through income in 2017 £m
Group						
Financial assets						
Derivative financial instruments						
Swaptions	1	–	–	–	1	–
	1	–	–	–	1	–
Financial assets held at fair value through income						
Shares, other variable yield securities and units in unit trusts						
– UK unlisted	120	(7)	–	(22)	91	(3)
– Overseas unlisted	55	(8)	1	(6)	42	(10)
Loans secured on residential property*	685	5	35	(58)	667	–
	860	(10)	36	(86)	800	(13)
	861	(10)	36	(86)	801	(13)

* In relation to Loans secured on residential property, purchases represent loans advanced plus accrued interest and sales represent loans repaid.

	At 1 January 2016 £m	Total gains/ (losses) recognised through income £m	Purchases £m	Sales £m	At 31 December 2016 £m	Unrealised gains/(losses) recognised through income in 2016 £m
Group						
Financial assets						
Derivative financial instruments						
Swaptions	1	–	–	–	1	–
	1	–	–	–	1	–
Financial assets held at fair value through income						
Shares, other variable yield securities and units in unit trusts						
– UK unlisted	125	(5)	4	(4)	120	(4)
– Overseas unlisted	64	5	–	(14)	55	3
Loans secured on residential property	593	75	61	(44)	685	75
	782	75	65	(62)	860	74
	783	75	65	(62)	861	74

Notes to the Financial Statements continued

Year ended 31 December 2017

4. Risk management and control (continued)

	At 1 January 2017 £m	Total gains/ (losses) recognised through income £m	Purchases £m	Sales £m	At 31 December 2017 £m	Unrealised gains/ (losses) recognised through income in 2017 £m
Society						
Financial assets						
Derivative financial instruments						
Swaptions	1	-	-	-	1	-
	1	-	-	-	1	-
Financial assets held at fair value through income						
Shares, other variable yield securities and units in unit trusts						
- UK unlisted	120	(7)	-	(22)	91	(3)
- Overseas unlisted	54	(7)	1	(6)	42	(10)
Loans secured on residential property*	684	6	35	(58)	667	-
	858	(8)	36	(86)	800	(13)
	859	(8)	36	(86)	801	(13)

* In relation to Loans secured on residential property, purchases represent loans advanced plus accrued interest and sales represent loans repaid.

	At 1 January 2016 £m	Total gains/ (losses) recognised through income £m	Purchases £m	Sales £m	At 31 December 2016 £m	Unrealised gains/(losses) recognised through income in 2016 £m
Society						
Financial assets						
Derivative financial instruments						
Swaptions	1	-	-	-	1	-
	1	-	-	-	1	-
Financial assets held at fair value through income						
Shares, other variable yield securities and units in unit trusts						
- UK unlisted	124	(4)	4	(4)	120	(4)
- Overseas unlisted	63	5	-	(14)	54	3
Loans secured on residential property	592	75	61	(44)	684	75
	779	76	65	(62)	858	74
	780	76	65	(62)	859	74

Notes to the Financial Statements continued

Year ended 31 December 2017

4. Risk management and control (continued)

Information about fair value measurements using significant unobservable inputs (Level 3)

Included below are the significant unobservable inputs that impact the valuation of the material level 3 assets and liabilities for the Group, these apply equally to the Society.

Group Description	Fair value at 31 December 2017 £m	Fair value at 31 December 2016 £m	Valuation technique(s)	Unobservable inputs	Range of unobservable inputs (probability – weighted average)	Relationship of unobservable inputs to fair value
Financial assets						
Derivative financial instruments						
Swaptions	1	1	Mark-to-model	Interest rate volatility	Could be several percentage points	Higher interest rate volatility results in higher contract value.
	1	1				
Financial assets held at fair value through income						
Shares, other variable yield securities and units in unit trusts						
- UK unlisted	91	120	Adjusted net asset method	Price per unit	Could vary significantly due to the range of holdings	The higher the price per unit, the higher the fair value.
				Distributions or calls since last valuation	Could vary significantly due to the range of holdings	The fair value varies on distributions/calls and period since last valuation.
- Overseas unlisted	42	55	Adjusted net asset method	Price per unit	Could vary significantly due to the range of holdings	The higher the price per unit, the higher the fair value.
				Distributions or calls since last valuation	Could vary significantly due to the range of holdings	The fair value varies on distributions/calls and period since last valuation.
Loans secured on residential property	667	685	Discounted cash flow	Spread	Varies based on cohorts of loans	The spread (together with the underlying risk free yield curve) forms the discount rate used to value the cashflows.
				Prepayments	Varies by policy year: min 3.5% - max 8%. Long-term assumption: 4%	Prepayment rate will determine the profile of expected cashflows.
				Mortality and long-term care assumptions	Annuitant mortality tables are applied	Mortality and long-term care rate will determine the profile of expected cashflows.
	800	860				
	801	861				

Notes to the Financial Statements continued

Year ended 31 December 2017

4. Risk management and control (continued)

Sensitivity to changes in unobservable inputs (Level 3)

The only financial instrument which is significantly impacted by reasonably possible changes in unobservable inputs is the loans secured on residential property. The loans secured on residential property are sensitive to changes in discount rate spread, which includes the profit and liquidity premium as well as the No Negative Equity Guarantee risk allowance.

The impact of reasonably possible alternative assumptions is shown in the table below:

Description	Unobservable input	2017			2016		
		Reasonably possible alternative assumptions			Reasonably possible alternative assumptions		
		Current fair value	Increase in fair value	Decrease in fair value	Current fair value	Increase in fair value	Decrease in fair value
		£m	£m	£m	£m	£m	
Loans secured on residential property	Discount rate +/- 50bps	667	33	(30)	685	38	(35)

c) Credit counterparty risk

Credit counterparty risk (credit risk) is defined as the risk of loss if another party fails to perform its obligations or fails to perform them in a timely fashion. Exposure to credit risk may arise in connection with a single transaction or an aggregation of transactions (not necessarily the same type) with a single counterparty.

The Group encounters credit counterparty risk from different sources, firstly within the business activities associated with its insurance, investment and retirement products and secondly in the financial assets held in the Group's investment portfolio.

Credit counterparty risk is managed via a Group policy and risk limits covering aspects such as total exposure, and concentration. Group counterparty exposures are monitored by Group ALCO, with ultimate oversight of risk being undertaken by the Risk Committee.

The main credit counterparty risks within the Group are as follows:

Investment counterparties

The key other source of credit risk arises from the assets held in the investment portfolio. The risk is that the investment counterparty enters financial difficulties and the fair value of the asset diminishes or the income stream is not paid; alternatively the counterparty becomes insolvent and the value of the asset is written off.

The investment portfolio contains a range of assets, including equities, corporate bonds and other fixed income securities and cash deposits. The credit counterparty risk policy stipulates approved counterparties, permitted investments and geographical territories, as well as detailing specific asset class exposure limits. These are implemented within the investment management agreement with Columbia Threadneedle Investments. The policy and agreements also require that asset holdings are within regulatory limits that restrict excessive concentrations with individual counterparties or with particular asset classes. In order to minimise its exposure to credit risk the Group invests primarily in higher graded assets, rated BBB and above.

In addition, the Group uses derivatives to transfer elements of financial markets risk exposures. Where possible, significant counterparty exposures from over-the-counter derivatives are mitigated by the use of collateral. The fair value of the derivative is matched by collateral received from the counterparty, which increases or reduces in line with the contract's fair value.

The collateral can be sold or re-pledged by the Group and is repayable if the contract terminates or the contract's fair value decreases. Details of collateral received and pledged is included within the offsetting disclosure on page 134.

Loans secured on residential and commercial property

The retirement business provides residential and commercial mortgage lending and is exposed to credit risk arising from mortgage loans provided. This risk is managed by using the property as security against the loan, assessment of the risk and maintaining a low loan to value ratio. AgFe is the Group's mandated originator and asset manager for commercial mortgages, using their considerable expertise to source and underwrite loan prospects.

Note 13 provides further disclosure and provisions for 'No Negative Equity Guarantees' on residential mortgages.

Reinsurance counterparties

Reinsurance agreements are entered into to transfer an element of potential insurance risk exposure from contract liabilities. This does not, however, discharge the Group's liability as primary insurer. If a reinsurer fails to pay a reinsurance claim, the Group remains liable for the payment to the policyholder. To manage this exposure the creditworthiness of reinsurers is considered by reviewing their financial strength prior to finalisation of any contract, which is then regularly reviewed. In addition, collateral is held to manage the counterparty exposure to the reinsurer.

Reinsurance concentration risk

Reinsurance concentration risk is minimised through contracting with a diverse range of reinsurance counterparties with credit ratings within our risk appetite. Reinsurance concentration risk is managed through reviewing the credit rating of reinsurance counterparties and exposure limits.

Notes to the Financial Statements continued

Year ended 31 December 2017

4. Risk management and control (continued)

Insurance receivables

Insurance sales expose the Group to credit risk from policyholders and intermediaries for outstanding premiums. The creditworthiness of the intermediaries is assessed and credit limits are used to manage any potential concentration risk associated with individual counterparties.

The creditworthiness of policyholders who take out premium finance on general insurance products is assessed at the time of sale and outstanding premiums are monitored and collected via a dedicated budget accounts function.

No further credit risk provision is required in excess of the normal provision for doubtful receivables.

Credit exposures also arise within general insurance, where claims expense recoveries are due from other insurers' policyholders who are at fault for any repairs expense suffered by the Group's policyholders. These exposures are managed via a dedicated recoveries team and an industry wide compensation scheme is in place to provide cover for default by an individual insurer.

The tables below show the credit profile of the Group's assets. The credit risk profile of the Society is materially consistent with that of the Group.

	Neither past due nor impaired						Total £m	Past due but not impaired £m	Past due and impaired £m	Total £m
	AAA £m	AA £m	A £m	BBB £m	Below BBB £m	Not rated £m				
Credit risk exposure 2017										
Debt and other fixed income securities	578	1,839	1,421	1,150	115	1	5,104	n/a	n/a	5,104
Loans secured on residential and commercial property	-	-	-	-	-	867	867	n/a	n/a	867
Derivative assets	-	-	-	-	-	81	81	n/a	n/a	81
Loans and other receivables	-	-	200	-	-	58	258	-	-	258
Reinsurance assets	-	2,227	73	-	-	5	2,305	-	-	2,305
Insurance receivables	-	18	17	-	-	265	300	7	1	308
Cash and cash equivalents	-	312	517	145	-	-	974	n/a	n/a	974
	578	4,396	2,228	1,295	115	1,277	9,889	7	1	9,897

	Neither past due nor impaired						Total £m	Past due but not impaired £m	Past due and impaired £m	Total £m
	AAA £m	AA £m	A £m	BBB £m	Below BBB £m	Not rated £m				
Credit risk exposure 2016										
Debt and other fixed income securities	800	2,455	1,330	1,075	170	-	5,830	n/a	n/a	5,830
Loans secured on residential and commercial property	-	-	-	-	-	883	883	n/a	n/a	883
Derivative assets	-	-	-	-	-	179	179	n/a	n/a	179
Loans and other receivables	-	-	203	-	-	87	290	1	-	291
Reinsurance assets	-	1,003	86	-	-	1	1,090	-	-	1,090
Insurance receivables	10	1	17	-	-	260	288	5	-	293
Cash and cash equivalents	-	273	410	117	-	5	805	n/a	n/a	805
	810	3,732	2,046	1,192	170	1,415	9,365	6	-	9,371

Impairment

The Group reviews the carrying value of its financial assets held at amortised cost at each Statement of Financial Position date. If the carrying value of a financial asset is impaired, the carrying value is reduced through a charge to the Statement of Comprehensive Income.

Notes to the Financial Statements continued

Year ended 31 December 2017

4. Risk management and control (continued)

Offsetting financial assets and financial liabilities

Financial assets and liabilities are offset in the Statement of Financial Position when the Group intends to apply a current legally enforceable right to offset. Master netting arrangements and collateral are utilised by the Group to minimise credit risk exposure.

The following financial assets and liabilities of the Group are subject to offsetting, enforceable master netting arrangements and similar agreements. The Society's exposure to credit risk associated with offsetting is materially consistent with that of the Group.

An analysis is included of netting arrangements which meet the offsetting criteria within IAS 32 and are set off in the Statement of Financial Position and related amounts which do not meet the criteria.

	Amounts recognised in the Statement of Financial Position			Related amounts not set off in the Statement of Financial Position		
	Gross amount £m	Amounts offset £m	Net amount £m	Financial Instruments* £m	Collateral pledged/ (received) £m	Net amount £m
As at 31 December 2017						
Financial assets						
Derivative financial assets	81	–	81	–	(79)	2
Cash and cash equivalents	24	(21)	3	–	–	3
	105	(21)	84	–	(79)	5
Financial liabilities						
Derivative financial liabilities	(193)	–	(193)	–	192	(1)
Bank overdrafts	(34)	24	(10)	–	–	(10)
	(227)	24	(203)	–	192	(11)

	Amounts recognised in the Statement of Financial Position			Related amounts not set off in the Statement of Financial Position		
	Gross amount £m	Amounts offset £m	Net amount £m	Financial Instruments* £m	Collateral pledged/ (received) £m	Net amount £m
As at 31 December 2016						
Financial assets						
Derivative financial assets	179	–	179	(46)	(116)	17
	179	–	179	(46)	(116)	17
Financial liabilities						
Derivative financial liabilities	(259)	–	(259)	46	201	(12)
Bank overdrafts	(61)	39	(22)	–	–	(22)
	(320)	39	(281)	46	201	(34)

* Collateral requirements arising from derivatives between the Society and Goldman Sachs are managed on a net basis.

In accordance with IFRS 7 the collateral reported in the table above is limited to the amount reported in the Statement of Financial Position for the associated financial instrument.

Total collateral held by the Group in relation to derivative financial assets is £79m (2016: £116m) and is split between gilts received of £17m (2016: £nil) and cash collateral received of £62m (2016: £116m). No collateral received from the counterparty has been sold or repledged (2016: £nil).

Total collateral pledged by the Group is £196m (2016: £215m) and is split between corporate bonds pledged in relation to cash flow swaps £186m (2016: £173m), cash collateral paid of £2m (2016: £40m) and future margin of cash of £8m (2016: £2m).

Collateral posted to LV= by the counterparty to a derivative contract which is valued as being 'in-the-money' can be drawn upon following certain events of default as defined in the relevant International Swaps and Derivatives Association (ISDA) agreement. This includes failure by the counterparty to comply with or perform any agreement or obligation defined in the ISDA or Credit Support Annex if such failure is not remedied within 30 days after notice of such failure is given. Bankruptcy of the counterparty to a trade could also result in collateral posted being drawn upon to mitigate any financial exposure to the Group.

Notes to the Financial Statements continued

Year ended 31 December 2017

4. Risk management and control (continued)

d) Liquidity risk

Liquidity risk is the risk that the Group cannot make payments as they become due because there are insufficient assets in cash form, or in a form that can be converted to cash in a timely fashion at close to fair market value.

The Group encounters potential liquidity risk exposures from its different business activities. It principally arises from its insurance and investment contracts and the timing of the associated policyholder commitments. In the general insurance business there is the potential for increased demand for cash, above normal claims expense patterns, for example to meet adverse UK weather events. In the life business increased demands for cash can also arise from events such as higher instances of death/sickness claims or mass surrenders/lapses of policies. In addition, the Group uses derivatives to transfer potential exposures on financial markets risks and certain derivative contracts, for example, interest rate swaps can result in additional collateral calls which must be met from liquid assets at short notice.

Liquidity is maintained at a prudent level, with a buffer to cover contingencies including the provision of temporary liquidity to subsidiary companies. A Group Liquidity Risk Policy and associated standards have been set to maintain sufficient liquid assets.

At Group level there is a liquidity risk appetite statement which requires that sufficient liquid resources are maintained to cover net cash outflows under stressed conditions. This is captured in a liquidity cover ratio and is monitored by the Group ALCO.

The risk exposure is managed using several methods and techniques, which include:

- Maintaining forecasts of cash requirements and adjusting investment management strategies as appropriate to meet these requirements, both in the short and long term;
- Holding sufficient assets in investments which are readily marketable in a sufficiently short timeframe to be able to settle liabilities as these fall due;
- Forecasting additional cash demands under stressed conditions, including demands for collateral, and management actions to be taken to liquidate sufficient assets to meet the increased demands; and
- Appropriate matching of the maturities of assets and liabilities. The Group undertakes asset and liability management to ensure that the duration of liabilities is matched by assets.

Notes to the Financial Statements continued

Year ended 31 December 2017

4. Risk management and control (continued)

The table below summarises the maturity profile of the assets of the Group and Society on the expected recovery timing.

	Group			Society		
	Within 1 year £m	Over 1 year £m	Total £m	Within 1 year £m	Over 1 year £m	Total £m
Maturity profile of assets 2017						
Pension benefit asset	–	178	178	–	178	178
Intangible assets	–	315	315	–	10	10
Investments in group undertakings	–	–	–	–	897	897
Property and equipment	–	37	37	–	7	7
Investment properties	3	–	3	3	–	3
Deferred acquisition costs	95	–	95	–	–	–
Reinsurance assets	53	2,252	2,305	–	1,747	1,747
Prepayments and accrued income	124	–	124	71	–	71
Loans and other receivables	258	–	258	65	–	65
Insurance receivables	308	–	308	29	–	29
Financial assets at fair value through income	7,736	6,117	13,853	6,776	5,099	11,875
Derivative financial instruments	4	77	81	4	76	80
Cash and cash equivalents	974	–	974	424	–	424
	9,555	8,976	18,531	7,372	8,014	15,386

	Group			Society		
	Within 1 year £m	Over 1 year £m	Total £m	Within 1 year £m	Over 1 year £m	Total £m
Maturity profile of assets 2016						
Pension benefit asset	–	134	134	–	134	134
Intangible assets	–	291	291	–	11	11
Investments in group undertakings	–	–	–	–	802	802
Property and equipment	–	43	43	–	9	9
Investment properties	–	5	5	–	5	5
Deferred acquisition costs	102	–	102	–	–	–
Reinsurance assets	100	990	1,090	(16)	617	601
Prepayments and accrued income	140	–	140	99	–	99
Loans and other receivables	290	1	291	154	1	155
Insurance receivables	293	–	293	16	–	16
Corporation tax asset	6	–	6	–	–	–
Financial assets at fair value through income	6,602	6,889	13,491	6,001	5,841	11,842
Derivative financial instruments	6	173	179	6	173	179
Cash and cash equivalents	805	–	805	469	–	469
	8,344	8,526	16,870	6,729	7,593	14,322

Notes to the Financial Statements continued

Year ended 31 December 2017

4. Risk management and control (continued)

The tables below summarise the maturity profile of insurance contracts and financial liabilities of the Group and Society.

As permitted by IFRS 4, the maturity profiles for insurance and participating investment contracts are presented based on the estimated timing of the amounts recognised in the Statement of Financial Position.

The remaining financial liabilities are presented based on the undiscounted contractual obligations and as such will not tie into the balances disclosed within the Statement of Financial Position. Non-participating investment contract liabilities, accounted for in accordance with IAS 39, can be called upon immediately by the policyholder and are therefore presented as 'on demand'.

	Unit-linked (on demand) £m	Within 1 year	1-3 years	3-5 years	Over 5 years	Total
		£m	£m	£m	£m	£m
Group						
Maturity profile of financial, insurance and investment contract liabilities 2017						
Participating insurance contract liabilities	–	462	801	752	3,264	5,279
Participating investment contract liabilities	–	35	63	64	584	746
Non-participating value of in-force business	(23)	(17)	(31)	(26)	(196)	(293)
Non-participating insurance contract liabilities	–	258	498	485	3,409	4,650
General insurance claims liabilities	–	547	517	274	305	1,643
Non-participating investment contract liabilities	3,071	–	–	–	–	3,071
Total insurance and investment contract liabilities	3,048	1,285	1,848	1,549	7,366	15,096
Financial liabilities						
– Derivative financial instruments	–	6	(6)	27	166	193
– Subordinated liabilities	–	–	–	–	360	360
– Other financial liabilities	–	–	–	–	62	62
Insurance payables	–	50	–	–	–	50
Trade and other payables	–	213	4	2	22	241
	3,048	1,554	1,846	1,578	7,976	16,002

	Unit-linked (on demand) £m	Within 1 year	1-3 years	3-5 years	Over 5 years	Total
		£m	£m	£m	£m	£m
Group						
Maturity profile of financial, insurance and investment contract liabilities 2016						
Participating insurance contract liabilities	–	481	817	723	2,978	4,999
Participating investment contract liabilities	–	42	59	75	514	690
Non-participating value of in-force business	(26)	(19)	(33)	(27)	(219)	(324)
Non-participating insurance contract liabilities	6	237	431	470	3,298	4,442
General insurance claims liabilities	–	650	550	227	136	1,563
Non-participating investment contract liabilities	2,547	–	–	–	–	2,547
Total insurance and investment contract liabilities	2,527	1,391	1,824	1,468	6,707	13,917
Financial liabilities						
– Derivative financial instruments	–	8	3	17	231	259
– Subordinated liabilities	–	–	–	–	360	360
– Other financial liabilities	–	–	–	–	116	116
Insurance payables	–	51	–	–	–	51
Trade and other payables	–	200	2	2	23	227
	2,527	1,650	1,829	1,487	7,437	14,930

For investment and long-term linked insurance contracts (unit linked) the Group matches all the assets on which the unit prices are based with assets in the portfolio. The Group is responsible for ensuring there is sufficient liquidity within the asset portfolio to enable liabilities to unit linked policyholders to be met as they fall due.

Notes to the Financial Statements continued

Year ended 31 December 2017

4. Risk management and control (continued)

Society	Unit-linked	Within 1 year	1-3 years	3-5 years	Over 5 years	Total
	(on demand)					
Maturity profile of financial, insurance and investment contract liabilities 2017	£m	£m	£m	£m	£m	£m
Participating insurance contract liabilities	–	462	801	752	3,264	5,279
Participating investment contract liabilities	–	35	63	64	584	746
Non-participating value of in-force business	(23)	(17)	(31)	(26)	(196)	(293)
Non-participating insurance contract liabilities	–	257	496	484	3,398	4,635
Non-participating investment contract liabilities	3,071	–	–	–	–	3,071
Total insurance and investment contract liabilities	3,048	737	1,329	1,274	7,050	13,438
Financial liabilities						
– Derivative financial instruments	–	4	(6)	27	162	187
– Subordinated liabilities	–	–	–	–	350	350
– Other financial liabilities	–	–	–	–	62	62
Insurance payables	–	22	–	–	–	22
Trade and other payables	–	149	–	–	–	149
	3,048	912	1,323	1,301	7,624	14,208

Society	Unit-linked	Within 1 year	1-3 years	3-5 years	Over 5 years	Total
	(on demand)					
Maturity profile of financial, insurance and investment contract liabilities 2016	£m	£m	£m	£m	£m	£m
Participating insurance contract liabilities	–	481	817	723	2,978	4,999
Participating investment contract liabilities	–	42	59	75	514	690
Non-participating value of in-force business	(26)	(19)	(33)	(27)	(219)	(324)
Non-participating insurance contract liabilities	6	235	429	469	3,287	4,426
Non-participating investment contract liabilities	2,547	–	–	–	–	2,547
Total insurance and investment contract liabilities	2,527	739	1,272	1,240	6,560	12,338
Financial liabilities						
– Derivative financial instruments	–	(11)	3	17	227	236
– Subordinated liabilities	–	–	–	–	350	350
– Other financial liabilities	–	–	–	–	116	116
Insurance payables	–	21	–	–	–	21
Trade and other payables	–	143	–	–	–	143
	2,527	892	1,275	1,257	7,253	13,204

e) Operational risk

Operational risk is defined as the potential for loss resulting from inadequate or failed internal processes, people and systems or from external events. It is inherent in every part of the business and covers a wide spectrum of issues. Senior management are responsible for ensuring that the material operational risks as relevant to their area of responsibilities are identified, assessed and managed using the approach as outlined in the Group's Enterprise Risk Management Framework. A formal attestation process provides assurance about the effectiveness of the overall control environment and reports on any material exceptions.

Operational risk is unrewarded and is therefore inherently unattractive. Consequently, the Group seeks to minimise exposure to operational risk as far as it is cost-effective to do so. The Group will always seek to uphold its brand image as "Britain's best loved insurer" with customers, employees and other external parties and the Group has no appetite whatsoever for regulatory weaknesses or failings that lead to censure actions.

Notes to the Financial Statements continued

Year ended 31 December 2017

Performance

The notes included within this section focus on the performance and results of the Group and Society. Information on the income generated, benefits and claims paid, expenditure incurred and mutual bonus declared are presented here.

5. Net earned premiums

Accounting for net earned premiums

Written premiums include new business premiums plus ongoing regular premiums received for in-force policies. Furthermore an estimate is included for premiums due from intermediaries. Net earned premiums are arrived at following deductions for premiums payable to reinsurers and in general insurance, unearned premium is deferred.

Long-term insurance and participating investment contracts

Regular premiums on long-term insurance and participating investment contracts are recognised as income when due for payment. For single premium business, recognition occurs on the date from which the policy is effective.

General insurance contracts

General insurance premiums written reflect business coming into force during the year. Earned premium is written premium adjusted for unearned premium. Unearned premium is that proportion of a premium written in a year that relates to periods of risk after the Statement of Financial Position date. Unearned premiums are calculated on a time apportionment basis. The proportion attributable to subsequent periods is deferred as a provision for unearned premiums.

Non-participating investment contracts

Premiums and claims relating to non-participating investment contracts are not recognised in the Statement of Comprehensive Income but are recorded as contributions to and deductions from the non-participating investment contract liabilities recorded in the Statement of Financial Position.

	Group		Society	
	2017	2016	2017	2016
	£m	£m	£m	£m
Gross earned premiums				
Long-term insurance and participating investment contracts				
Single premium				
New business				
Investments and savings	420	561	420	561
Pensions and annuities	151	423	151	423
Regular premium				
New business				
Life and health protection	37	37	37	37
Existing in-force business				
Investments and savings	33	31	33	31
Pensions and annuities	9	10	9	10
Life and health protection	185	166	185	166
General insurance contracts				
Motor	1,081	1,067	–	–
Commercial	283	268	–	–
Household	143	161	–	–
Other	89	83	–	–
Change in unearned premiums provision	8	(47)	–	–
Gross earned premiums	2,439	2,760	835	1,228
Premiums ceded to reinsurers				
Long-term insurance premiums	(1,092)	(261)	(1,092)	(261)
General insurance business	(361)	(345)	–	–
Change in unearned premiums provision	(2)	5	–	–
	(1,455)	(601)	(1,092)	(261)
Net earned premiums	984	2,159	(257)	967
Gross written premiums for non-participating investment contracts which are deposit accounted for and not included above (refer to Note 15)	656	425	656	425

Notes to the Financial Statements continued

Year ended 31 December 2017

5. Net earned premiums (continued)

All contracts are written in the UK.

Recurrent single premium rebates from the Department for Work and Pensions are included as new business single premiums. Pensions vested into annuity contracts during the year are included as new annuity single premium business at the annuity purchase price. Where periodic premiums are received other than annually, the periodic new business premiums are stated on an annualised basis.

In December 2017 the Society and Group entered into a reinsurance arrangement in respect of the OB Pension portfolio. This has increased Premiums ceded to reinsurers by £829m. For further details see Note 23.

6. Investment income

Accounting for investment income

Investment income includes dividends, interest from debt and other fixed income securities, interest on loans secured on residential and commercial property and interest on loans and receivables. Dividends are included on an ex-dividend basis. Interest receivable from investments at fair value is accounted for on an accruals basis. Interest receivable on loans and receivables is calculated on an effective interest rate basis.

	Group		Society	
	2017 £m	2016 £m	2017 £m	2016 £m
Income from investments at fair value through income:				
– Dividend income	117	107	109	95
– Interest income from debt and fixed interest securities	210	251	164	200
– Interest on loans secured on residential property	36	36	36	36
– Interest on loans secured on commercial property	9	7	9	7
Interest on loans and receivables	2	–	–	–
Interest income from group undertakings	–	–	18	24
Dividend income from group undertakings	–	–	94	44
	374	401	430	406

7. Net gains/(losses) on investments

Accounting for net gains/(losses) on investments**Realised gains and losses**

Realised gains and losses on investments are calculated as the difference between net sales proceeds and purchase price.

Unrealised gains and losses

Unrealised gains and losses on investments represent the difference between the valuation of fair value assets at the Statement of Financial Position date and their valuation at the last Statement of Financial Position date or, where purchased during the year, the purchase price. A reversal is made of previously recognised gains or losses in respect of disposals made during the year.

	Group		Society	
	2017 £m	2016 £m	2017 £m	2016 £m
Investment properties	3	–	3	–
Investments at fair value through income:				
– Debt securities	(28)	385	2	396
– Equity securities	430	584	419	558
– Derivatives at fair value through income	(52)	(40)	(36)	(15)
– Loans and mortgages	4	77	4	77
– Other	3	–	3	–
Investments in group undertakings	–	–	(16)	(3)
	360	1,006	379	1,013

Included within net gains/(losses) on investments are realised gains of £567m (2016: £239m) for the Group and realised gains of £568m (2016: £270m) for the Society.

Notes to the Financial Statements continued

Year ended 31 December 2017

8. Other income

	Group		Society	
	2017 £m	2016 £m	2017 £m	2016 £m
Interest income	32	30	–	–
Unit linked income	–	1	–	1
Fee and commission income	26	21	19	9
Other income	27	16	3	2
	85	68	22	12

9. Net benefits and claims

Accounting for net benefits and claims

Net benefits and claims include amounts paid and also the change in provision for claims. Included within these are the related internal and external claims handling costs and also deductions for the expected value of recoveries. Reinsurance recoveries are accounted for in the same period as the related claim.

Long-term insurance and participating investment contracts

Maturity claims and regular annuity payments are accounted for when due for payment. Surrenders are accounted for on the earlier of the date when paid or when the policy ceases to be included within the long-term insurance contract liability. Death claims and other claims are accounted for when the Group is notified. The value of claims on participating contracts includes bonuses paid or payable.

General insurance contracts

Claims incurred comprise claims paid in the year and changes in the provisions for outstanding claims, including provisions for claims incurred but not reported together with any other adjustments to claims from previous years.

It is likely that the final outcome will prove to be different from the original liability established. Provisions are adjusted at the Statement of Financial Position date to represent an estimate of the expected outcome.

Group	2017			2016		
	Gross £m	Reinsurance £m	Net £m	Gross £m	Reinsurance £m	Net £m
Long-term insurance and participating investment contracts						
Benefits and claims paid	868	(237)	631	858	(237)	621
Change in the provision for claims	4	–	4	3	–	3
General insurance contracts						
Claims paid	1,010	(227)	783	1,000	(217)	783
Claims handling costs	65	–	65	67	–	67
Change in the provision for claims	80	(71)	9	208	(86)	122
	2,027	(535)	1,492	2,136	(540)	1,596
Net benefits and claims for non-participating investment contracts which are deposit accounted for and not included above (refer to Note 15)	366	–	366	282	–	282

Society	2017			2016		
	Gross £m	Reinsurance £m	Net £m	Gross £m	Reinsurance £m	Net £m
Long-term insurance and participating investment contracts						
Benefits and claims paid	866	(237)	629	857	(237)	620
Change in the provision for claims	5	–	5	2	–	2
	871	(237)	634	859	(237)	622
Net benefits and claims for non-participating investment contracts which are deposit accounted for and not included above (refer to Note 15)	366	–	366	282	–	282

Notes to the Financial Statements continued

Year ended 31 December 2017

10. Finance costs

	Group		Society	
	2017 £m	2016 £m	2017 £m	2016 £m
Interest expense on subordinated liabilities (see Note 17)	23	23	23	23
Other interest expense	1	1	–	–
	24	24	23	23

11. Other operating and administrative expenses

Accounting for other operating and administrative expenses

Other operating and administrative expenses are accounted for as incurred. Acquisition costs relate to the costs of acquiring new business during the financial year. These include all commission and incentive payments to sales staff and third parties incurred in writing new contracts. In the general insurance business, where the benefit of these costs will be recognised in future accounting periods the costs are deferred. Reinsurance recoveries are accounted for in the same period as the related expense.

	Group		Society	
	2017 £m	2016 £m	2017 £m	2016 £m
Commission paid on acquisition of business	201	207	54	57
Movement in deferred acquisition costs	7	(3)	–	–
Amortisation and impairment of intangible assets	13	6	2	–
Depreciation on property and equipment	7	6	3	3
Loss on disposal of property and equipment	1	–	1	–
Investment management expenses and charges	17	21	15	22
Auditors' remuneration (see Note 12)	2	3	1	2
Employee benefits expense (see Note 37)	255	263	249	259
Internal staff costs capitalised as attributable costs of IT assets	(16)	(15)	–	–
Management charge allocated to group undertakings	–	–	(215)	(227)
Rent, rates and other facilities expense	20	19	12	12
Marketing and advertising	27	33	9	9
Other staff costs	48	35	15	4
IT costs	40	43	36	36
Fees	85	79	31	33
Other expenses	18	18	15	10
Claims handling cost recognised in Gross benefits and claims	(69)	(72)	(6)	(5)
Gross operating and administrative expenses	656	643	222	215
Expenses recoverable from reinsurers*	(72)	(72)	–	–
Net operating and administrative expenses	584	571	222	215

* Expenses recoverable from reinsurers represent 20% of the costs of the general insurance business which are borne by reinsurers as part of the Quota Share agreement for 2016 to 2018.

Included within Other operating and administrative expenses at Group level are £17m of costs associated with the general insurance transaction. These include transaction costs relating to the agreements (see Note 46) and additional restructuring costs provided for as a result of the transactions (see Note 39). Included within rent, rates and other facilities expense are operating lease rentals of £5m (2016: £5m).

12. Auditors' remuneration

	2017 £000	2016 £000
Audit of Society	896	848
Fees payable to the Society's auditors and its associates for other services:		
– Audit of subsidiaries	720	652
– Audit-related assurance services	457	1,223
– Other tax services	57	52
– Other non-audit services not covered above	205	326
	2,335	3,101

In addition to the amounts disclosed above, expenses relating to audit work of £150,000 (2016: £150,000) were paid to the auditors in respect of the year ended 31 December 2017.

Notes to the Financial Statements continued

Year ended 31 December 2017

Financial assets and liabilities

This section presents information relating to the financial assets and liabilities (excluding insurance contract-related assets and liabilities which are disclosed in Note 19) held by the Society and Group. These financial assets and liabilities are held at either fair value or amortised cost as defined by the Group's accounting policies.

13. Financial assets – Fair value through income

Accounting for financial assets and financial liabilities at fair value through income

Financial assets at fair value through income has two sub categories:

- Financial assets held for trading; and
- Those designated at fair value through income at inception.

Derivatives are classified at fair value through income as they are held for trading (see note 14). Financial assets designated at fair value through income at inception are part of a group of financial assets that are managed and their performance evaluated and reported to the board on a fair value basis in accordance with the Group's documented investment strategy. These assets are measured at market prices, or prices consistent with market ratings should no price be available. Day one gains are recognised only where valuations use data from observable markets. Any unrealised or realised gains or losses are taken to the Statement of Comprehensive Income, as fair value gains or losses, or realised gains or losses respectively, as they occur.

Financial assets at fair value through income include listed and unlisted investments, units in authorised unit trusts, open ended investment companies (OEICs), loans secured on residential and commercial property, and other investments.

Financial liabilities at fair value through income include derivative financial instruments and non-participating investment contract liabilities; see Notes 14 and 15 respectively.

The IFRS "fair value hierarchy" levels for financial assets and liabilities required under IFRS 13 are disclosed within Note 4.

Loans secured on residential property

The fair value of the loans secured on residential property (arising from the equity release mortgage business) is determined by discounting the expected cash flows which take into account the contractual interest rolled up on the loans, and expected repayment profiles based on assumed mortality and early loan repayment rates. The discount rate is based on the swap yield curve increased by a spread and an allowance for risks associated with the 'No Negative Equity Guarantee'.

The loans incorporate a 'No Negative Equity Guarantee' to customers. The contractual terms of these guarantees require the company to accept the lower of the market value of the customer's property and the value of the loan plus accrued interest at the date of redemption as full settlement of the mortgage. For almost all loans it is expected that the No Negative Equity Guarantee will not be invoked and the value of the loan plus accrued interest will be received.

The fair value of the guarantee is determined using a stochastic model.

The fair value of the loans is determined using assumptions for interest rates, future house price inflation and its volatility, mortality rates, long term care rates and early loan repayment rates, to give management's best estimate view of the discounted value of cash flows required to settle any future financial obligation arising at the Statement of Financial Position date.

The loans secured on residential property within the Society are purchased from a subsidiary company that is authorised to initiate these loans. The purchase by the Society is at origination value plus 7% (which is expensed in the Society when paid).

Loans secured on commercial property

The fair value of the loans secured on commercial property is determined using discounted cash flows to reflect changes in underlying gilt yields and debt margins. Where the value is not expected to be recovered through ongoing loan payments, the fair value represents the recoverable value of the property in the market post transaction costs.

Significant accounting estimates**Fair value of financial assets**

Market observable inputs are used wherever possible. Judgement is applied to determine whether a market is active; this is based upon the facts and circumstances of the relevant market. In the absence of an active market, estimation of fair value is achieved by using valuation techniques such as recent arm's length transactions, discounted cash flow analysis and option pricing models. For discounted cash flow analysis, estimated future cash flows and discount rates are based on current market information and rates applicable to financial instruments with similar yields, credit quality and maturity characteristics. This valuation will also take into account the marketability of the assets being valued.

Details of the key assumptions used in the absence of an active market are contained in the fair value estimation tables, as required by IFRS 13, disclosed in Note 4.

Notes to the Financial Statements continued

Year ended 31 December 2017

13. Financial assets – Fair value through income (continued)

	Group		Society	
	2017 £m	2016 £m	2017 £m	2016 £m
Financial assets – Fair value through income				
Shares, other variable yield securities and units in unit trusts				
– UK listed	7,629	6,136	6,844	5,997
– UK unlisted	91	120	91	120
– Overseas listed	117	467	112	102
– Overseas unlisted	42	55	42	54
Debt and other fixed income securities				
– UK listed	3,032	3,584	2,661	3,163
– Overseas listed	2,072	2,246	1,255	1,524
Loans secured on residential property	667	685	667	684
Loans secured on commercial property	200	198	200	198
Other	3	–	3	–
	13,853	13,491	11,875	11,842
Assets held to cover linked liabilities included above	3,130	2,612	3,130	2,612

For details on exposure to foreign exchange currency risk see page 124.

14. Derivative financial instruments

Accounting for derivative financial instruments

Derivatives are initially recognised at fair value on the date on which a derivative contract is entered into and are subsequently re-measured at their fair value. There are no designated hedging relationships within the Group that qualify for hedge accounting, all are classified as held for trading. Derivatives are settled on a gross basis.

Changes in the fair value of derivative instruments are recognised immediately in gains or losses on investments in the Statement of Comprehensive Income for the period. Realised gains or losses are taken to the Statement of Comprehensive Income on occurrence.

The Group uses derivatives primarily to reduce its exposure to interest rate risk and to protect against falls in equity values.

Group	2017			2016		
	Contract/ notional amount £m	Fair value – asset £m	Fair value – liability £m	Contract/ notional amount £m	Fair value – asset £m	Fair value – liability £m
Interest rate swaps	811	69	(4)	1,507	160	(29)
Gilt spread lock	–	–	–	1,120	–	(37)
Gilt forwards	624	4	–	–	–	–
Cash flow swaps	1,070	–	(186)	1,117	–	(173)
Swaptions	87	1	–	1,402	7	–
Forward exchange contracts	2	–	–	1	–	–
Equity/index derivatives	211	7	(3)	515	12	(20)
	2,805	81	(193)	5,662	179	(259)

Society	2017			2016		
	Contract/ notional amount £m	Fair value – asset £m	Fair value – liability £m	Contract/ notional amount £m	Fair value – asset £m	Fair value – liability £m
Interest rate swaps	444	68	–	1,369	160	(25)
Gilt spread lock	–	–	–	1,120	–	(37)
Gilt forwards	624	4	–	–	–	–
Cash flow swaps	1,070	–	(186)	1,117	–	(173)
Swaptions	87	1	–	1,402	7	–
Forward exchange contracts	–	–	–	1	–	–
Equity/index derivatives	132	7	(1)	118	12	(1)
	2,357	80	(187)	5,127	179	(236)

Notes to the Financial Statements continued

Year ended 31 December 2017

15. Investment contract liabilities

Accounting for investment contract liabilities**Non-participating contracts**

Investment contract liabilities are recognised when contracts are entered into and premiums are charged. These liabilities are initially recognised at transaction price excluding any transaction costs directly attributable to the issue of the contract. Designation at inception is at fair value in order to avoid a measurement inconsistency with the associated financial assets.

Deposits and withdrawals are recorded directly as an adjustment to the contract liability in the Statement of Financial Position, a method known as deposit accounting. Fees charged and investment income received are recognised in the Statement of Comprehensive Income when earned.

Fair value adjustments are measured at each reporting date and are recorded in the Statement of Comprehensive Income. Fair value is calculated as the number of units allocated to the policyholder in each unit linked fund multiplied by the unit price of those funds at the Statement of Financial Position date. The unit prices are determined with reference to the fund assets and liabilities, which are valued on a basis consistent with that used to measure the equivalent assets and liabilities in the Statement of Financial Position, adjusted for the effect of future tax arising from any unrealised gains or losses. For a contract that can be cancelled by the policyholder, the fair value cannot be less than the surrender value.

Participating contracts

Insurance and participating investment contract liabilities are valued using accounting policies consistent with those adopted prior to the transition to IFRS as permitted under IFRS 4 'Insurance contracts'. The accounting treatment of these contracts is described within Note 19.

a) Analysis of investment contract liabilities

	Notes	Group		Society	
		2017 £m	2016 £m	2017 £m	2016 £m
Non-participating investment contract liabilities	15b	3,071	2,547	3,071	2,547
Participating investment contract liabilities	15c	746	690	746	690
		3,817	3,237	3,817	3,237

b) Movement in non-participating investment contract liabilities

	Group		Society	
	2017 £m	2016 £m	2017 £m	2016 £m
Balance at 1 January	2,547	1,862	2,547	1,862
Acquired through business combinations	–	239	–	239
Deposits received from policyholders	656	425	656	425
Payments made to policyholders	(366)	(282)	(366)	(282)
Change in contract liabilities included in the Statement of Comprehensive Income	234	303	234	303
Balance at 31 December	3,071	2,547	3,071	2,547

The change in contract liabilities as shown in the Statement of Comprehensive Income comprises principally the allocation of the net investment return to policyholders of investment contracts less allowances for taxes.

Notes to the Financial Statements continued

Year ended 31 December 2017

15. Investment contract liabilities (continued)

c) Movement in participating investment contract liabilities

	Group		Society	
	2017 £m	2016 £m	2017 £m	2016 £m
Balance at 1 January	690	554	690	554
Acquired through business combinations	–	120	–	120
Premiums received	9	6	9	6
Liabilities paid for deaths, maturities, surrenders, benefits and claims	(37)	(27)	(37)	(27)
New business	–	1	–	1
Benefits and claims variation	1	4	1	4
Fees deducted	(4)	(3)	(4)	(3)
Accretion of investment income or change in unit prices	54	76	54	76
Adjustment due to changes in assumptions:				
– Investment return	1	8	1	8
– Expense	(3)	(3)	(3)	(3)
Model changes	–	1	–	1
Other	23	(50)	23	(50)
Mutual bonus	7	3	7	3
Change to economic basis	5	–	5	–
Balance at 31 December	746	690	746	690

16. Loans and other receivables

Accounting for loans and other receivables

Loans and other receivables are initially measured at fair value and then subsequently measured at amortised cost using the effective interest rate method. Loans include reverse repurchase agreements and represent the consideration paid to the borrower. Other receivables comprise amounts due to the Society from group undertakings and other receivables including outstanding investment sales and are recognised when due.

The Group assesses at each Statement of Financial Position date whether there is any indication that a loan or receivable, or a group of loans or receivables, is impaired. For loans, the amount of any impairment loss is measured as the difference between the carrying amount and the present value of future cash flows. For receivables, where there is objective evidence that the carrying value is impaired then the impairment loss will be recognised in the Statement of Comprehensive Income.

	Group		Society	
	2017 £m	2016 £m	2017 £m	2016 £m
Reverse repurchase agreements	200	200	–	–
Deposits with credit institutions	–	3	–	–
Cash collateral pledged	10	42	3	18
Amounts due from group undertakings	–	–	25	103
Investments receivable	26	18	20	16
Other receivables	22	28	17	18
	258	291	65	155

Details of impairments on financial assets held at amortised cost are included within the credit counterparty risk section (c) of Note 4. The carrying amounts disclosed above reasonably approximate fair value at the Statement of Financial Position date.

Notes to the Financial Statements continued

Year ended 31 December 2017

17. Subordinated liabilities

Accounting for subordinated liabilities

Subordinated liabilities are initially measured at the fair value of the proceeds less attributable transaction costs. Subsequent to initial recognition they are measured at amortised cost. The transaction costs are amortised over the period to the expected redemption date on an effective interest rate basis. The amortisation charge is included in the Statement of Comprehensive Income within finance costs. An equivalent amount is added to the carrying value of the liability such that at the redemption date the value of the liability equals the redemption value.

	Group		Society	
	2017 £m	2016 £m	2017 £m	2016 £m
Subordinated notes (GBP 350m)	348	347	348	347
Subordinated notes (EUR 12m)	10	10	–	–
	358	357	348	347

All the subordinated liabilities are expected to be settled more than 12 months after the balance sheet date.

In 2013 the Society issued £350m of Fixed Rate Reset Subordinated Notes at par. The directly related costs of £4m incurred to issue the Notes have been capitalised as part of the carrying value and are being amortised using the effective interest rate basis over the period to the first call date in 2023. The effective interest rate on the £350m liability is 6.654% resulting in a £23m finance charge for the year (see Note 10).

The Notes have a maturity date of 22 May 2043 but the issuer has the option to redeem the Notes at the first call date of 22 May 2023 and at five yearly intervals thereafter up to the maturity date.

Interest is payable on the Notes at a fixed rate of 6.5% (£23m) per annum for the period until the first call date on 22 May 2023, payable annually in arrears on 22 May each year. If the Notes are not redeemed on 22 May 2023, the interest rate is reset on that date and at five yearly intervals thereafter at a rate equal to the five year gilt rate quoted on the day before the reset date plus an initial margin of 463 basis points and a step up margin of 100 basis points.

There is an option of cumulative deferral of interest at the issuer's discretion and mandatory interest deferral in the event that a regulatory deficiency interest deferral event has occurred or is continuing (breach of the applicable regulatory solvency capital requirement of the issuer or group) or would occur if payment of interest on the subordinated notes were to be made. Following any deferral of a principal or interest payment, the Society would be prevented from declaring any distribution to members which falls within the Mutual Bonus arrangements. The Society has the option to elect to defer payment of interest in whole or in part and this will not constitute a default or give the right to the noteholders or the trustee to accelerate repayment of the Notes or to take any enforcement action.

The €12m subordinated notes are issued by a subsidiary undertaking and are repayable in 2034. Interest on these Notes is payable at the 3 month euro deposit rate plus a margin of 365 basis points.

Subordinated liabilities are held in the Statement of Financial Position at amortised cost. The fair value at 31 December 2017 was £405m (2016: £351m). The valuation of the subordinated notes was determined by reference to the bid price obtained from the markets as at 31 December 2017. Management consider this to be representative of fair value.

18. Other financial liabilities

	Group		Society	
	2017 £m	2016 £m	2017 £m	2016 £m
Cash collateral received	62	116	62	116
	62	116	62	116

The carrying amounts disclosed above reasonably approximate fair value at the Statement of Financial Position date.

Notes to the Financial Statements continued

Year ended 31 December 2017

Insurance contract related assets and liabilities

This section presents information relating to insurance contract related assets and liabilities held by the Society and Group. The assumptions used in the valuation of the insurance contract liabilities are disclosed within Note 24 with sensitivities to these assumptions disclosed separately within Note 4.

19. Insurance contract liabilities

19.1 Accounting for insurance contract liabilities

Insurance contract liabilities are recognised for insurance contracts in existence at the end of the reporting period. Such liabilities are only derecognised when the obligation specified in the contract is discharged, cancelled or expires.

IFRS 4 Insurance Contracts permits the continued application, for income statement presentation and liability measurement purposes, of accounting policies that were being used at the date of transition to IFRS, except where a change is deemed to make the financial statements more relevant to the economic decision-making needs of users and no less reliable, or more reliable, and no less relevant to those needs. As such, the Group accounting for insurance contracts and participating investment contracts is in accordance with the Statement of Recommended Practice issued by the Association of British Insurers in December 2005, amended in December 2006 and withdrawn in December 2015. The Group continues to apply this Statement of Recommended Practice.

a) Long-term insurance contract liabilities and participating investment contract liabilities**(i) Participating business**

Participating business includes both participating insurance and participating investment contract liabilities. The liabilities are calculated in accordance with the PRA's previous 'realistic' liability regime, which was the regime in place at the date of transition to IFRS. In particular, provision is made for all bonus payments (declared and future, reversionary and terminal) estimated, where necessary, in a manner consistent with the relevant fund's Principles and Practices of Financial Management (PPFM). The liabilities include an allowance for the time and intrinsic value of options and guarantees granted to policyholders and for future management actions.

The realistic participating liabilities are based on the aggregate value of policy asset shares reflecting past premiums, investment return, expenses and charges applied to each policy. Allowance is also made for policy-related liabilities such as guarantees, options and future bonuses calculated using a stochastic model simulating investment returns, asset mix, expense charges and bonuses.

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

The non-participating value of the in-force business is separately disclosed within Note 20. Such an amount is not recognised for business written outside participating contract funds.

(ii) Non-participating business

The liability is calculated to comply with the reporting requirements under the PRA's handbook using a gross premium valuation method or a method at least as prudent as the gross premium method. This was the regime in place on

adoption of IFRS. The Society and relevant subsidiaries have adopted the modified statutory solvency basis in the valuation of provisions for non-participating business.

Liabilities for non-participating business are either included within the long-term insurance contract liabilities or the investment contract liabilities, depending upon the product classification.

b) General insurance claims and insurance contract liabilities

Claims incurred comprise claims and related internal and external claims handling costs paid in the year and changes in the provisions for outstanding claims, including provisions for claims incurred but not reported and related claims handling costs, together with any other adjustments to claims from previous years. Where applicable, deductions are made for recoveries from other parties.

Provision is made for the estimated cost of claims incurred but not settled, including the cost of claims incurred but not reported. The estimated cost of claims includes expenses to be incurred in settling claims and a deduction for the expected value of recoveries. However, given the inevitable uncertainty in establishing claims provisions, it is likely that the final outcome will prove to be different from the original liability established. Provisions are adjusted at the Statement of Financial Position date to represent a best estimate of the expected outcome.

Provisions are calculated allowing for reinsurance recoveries and a separate asset is recorded for the reinsurers' share of the provision.

Standard actuarial claims projection techniques are used to estimate outstanding claims. Such methods extrapolate the development of paid and incurred claims, recoveries from third parties, average cost per claim and ultimate claim numbers for each accident year, based upon the observed development of earlier years and expected loss ratios. The main assumption underlying these techniques is that past claims development experience can be used to project ultimate claims costs. In the case of PPOs, the annuity type structure of the claim payments mean that these have to be projected over a longer-term period and reserved for on a discounted basis accordingly. Allowance for one off occurrences or changes in legislation, policy conditions or portfolio mix, is also made in arriving at the estimated ultimate cost of claims, in order that it represents the most likely outcome, taking account of all the uncertainties involved. To the extent that the ultimate cost is different from the estimate, where experience is better or worse than that assumed, the surplus or deficit will be credited or charged to the Statement of Comprehensive Income in future years.

For general insurance contracts, provision is made, if required, for any anticipated claims and claims handling costs that are anticipated to exceed the unearned premiums, net of deferred acquisition costs. An estimate is made for future investment income arising from the unearned premiums, and used to reduce the unexpired risk provision. Unexpired risk surpluses and deficits are offset where business classes are managed together and a provision is made if an aggregate deficit arises.

Notes to the Financial Statements continued

Year ended 31 December 2017

19. Insurance contract liabilities (continued)

19.2 Significant accounting estimates and judgements

The valuation of insurance contract liabilities requires management judgement in applying the appropriate accounting treatment and the use of estimates. Where the use of estimates involves management judgement, these are explained separately to judgements involving the application of accounting policies.

a) Long-term insurance contract liabilities and participating investment contract liabilities**(i) Significant accounting estimates**

Estimate	Judgement applied to estimate
<p>Assumptions and adjustments applied in the valuation of insurance liabilities</p> <p>The valuation of participating contract liabilities is based on assumptions reflecting the best estimate at the time. The valuation of non-participating insurance contracts is based on prudent assumptions; a separate calculation is also performed to assess the non-participating value of in-force business which is based on best estimate assumptions. All contracts are subject to liability adequacy tests, which reflects management's best current estimate of future cash flows.</p> <p>The assumptions used for mortality, morbidity and longevity are based on standard industry or reinsurers' tables. The assumptions used for investment returns and discount rates are based on current market yields. The assumptions used for expenses and persistency reflect product characteristics and are primarily based on relevant internal experience.</p> <p>The assumptions for mortality improvements are based on the latest version of the Institute and Faculty of Actuaries Continuous Mortality Investigation (CMI) Mortality Projections Model, referred to as CMI_2016.</p> <p>Due to the long-term nature of the liabilities, the estimates are subject to significant uncertainty.</p>	<p>The assumptions used for mortality, morbidity and longevity are adjusted where appropriate to reflect the Group's own experience. In particular, for impaired annuities the mortality assumptions are adjusted so as to allow for convergence to standard mortality at advanced ages. These adjustments vary according to lifestyle or medical condition, gender, age and duration in-force.</p> <p>The assumptions used for discount rates are adjusted for the Group's own risk exposure. Non-participating value of in-force business valuation makes allowance for a margin of risk and adverse deviation.</p>
<p>Assessment of future options and guarantees</p> <p>The value of options and guarantees on with-profits business is valued within the market-consistent discounted cash flow valuation, the most material of which are minimum benefit guarantees on LVFS WP business and guaranteed annuity options on RNPFN.</p> <p>Due to the asymmetric nature of these liabilities, stochastic valuation techniques are required. A market consistent economic scenario generator is used with a wide range of future economic conditions to capture the asymmetry, and a discounted cash flow model is used to derive a value of the liability at the valuation date. These techniques are widely used in the life insurance industry to value liabilities with embedded options and guarantees.</p> <p>The valuation models make appropriate allowance for both management and policyholder actions, where appropriate, including appropriate demographic assumptions on option or guarantee dates.</p>	

(ii) Significant accounting judgements**Changes to methodology for long-term insurance contract liabilities and participating investment contract liabilities**

During 2017, the Group has reviewed the accounting policy for long-term insurance contract liabilities and participating investment contract liabilities in light of the Solvency II regulatory reporting regime that came into effect from 1 January 2016. Following this review, the Group concluded that it would continue to apply the SORP as described above. However, where possible, the Group would align IFRS reporting with Solvency II with changes considered to make the information more relevant and reliable.

This has been achieved by making changes to the methodology and estimates used to calculate the value of the insurance and participating investment contract liabilities to more closely align the economic basis to that used for Solvency II as set out below.

In accordance with IAS 8 'Accounting Policies, Changes in Accounting Estimates and Errors' these changes have been treated as a 'change in accounting estimate', which is required to be recognised in the current year with no restatement of prior year comparatives.

Notes to the Financial Statements continued

Year ended 31 December 2017

19. Insurance contract liabilities (continued)

19.2 Significant accounting estimates and judgements (continued)

The total impact of the change is a charge of £48m, which has been shown in the 2017 Consolidated Statement of Comprehensive Income as a separate line item. The charge is the result of using the EIOPA swap reference risk-free rate curve, rather than a gilt based curve, to discount cash flows. This change is reported separately in the movement tables in Notes 15, 19 and 20 as 'Change in economic basis'.

Other changes in methodology

The calculation of the insurance contract liabilities is impacted by changes in unit costs. A full review of the expense allocation methodology has been carried out in 2017 and revised expense allocation assumptions have been adopted.

Details of all the long-term insurance and investment contract liabilities valuation assumptions and the non-participating value of in-force business valuation assumptions are disclosed separately within Notes 24 and 25 respectively.

b) General insurance claims and insurance contract liabilities

(i) Significant accounting estimates

Estimate	Judgement applied to estimate
<p>Estimate of ultimate cost of claims</p> <p>The estimation of the ultimate liability arising from claims made under insurance contracts is the most critical accounting estimate for the general insurance business. For general insurance contracts estimates are made for the expected ultimate cost of claims as at the Statement of Financial Position date and the cost of claims incurred but not yet reported to the Group. It can take a significant period of time before the ultimate cost of claims can be established with certainty, and the final outcome may be better or worse than that provided.</p> <p>There are several sources of uncertainty that need to be considered in the estimate of the liability that the Group will ultimately pay for such claims. In particular, motor insurance policies are exposed to claims for bodily injury and household insurance policies are exposed to claims for subsidence.</p> <p>Estimation of the ultimate cost of large bodily injury claims is a complex process and cannot be done using conventional actuarial techniques given they typically exhibit low frequency and high severity. Significant factors that affect the bodily injuries estimation process are legislation (e.g. the Ogden discount rate used to value lump sum settlements), judicial decisions and the long delay to settlement. Due to this uncertainty it is not possible to determine the future development of bodily injury claims with the same degree of reliability as with other types of claims.</p> <p>Over the last decade, there has been an increasing prevalence of Periodic Payment Order ('PPO') settlements when the Ogden discount rate was set at 2.5% and at a time when real yields were very low. These settlements have an annuity-type structure, i.e. they are typically paid annually over the claimant's life with mortality, inflation and investment returns being the key risks. Courts may decide that a claim should be settled on a PPO basis, but in the majority of cases the claimant will request a PPO settlement. A further complexity of PPO claims is that due to the annuity-type structure of the claim payments these have to be projected over a longer-term period and reserved for on a discounted basis accordingly. Therefore, the estimation of ultimate claims cost now involves projecting mortality rates, discount rates and benefit indexation rates, which is unlike all other general insurance liabilities.</p> <p>On 27 February 2017, the Lord Chancellor announced a change in the Ogden discount rate from 2.5% p.a. to minus 0.75% p.a. This change impacted the valuation of the cost of care element of large injury claims, and required insurance companies to hold more money in reserves in order to match the inflation risk in the long term. The impact of the Ogden rate change was recognised in the Group's 31 December 2016 reserves.</p>	<p>While management believes that the insurance contract liabilities carried at year end are adequate, the application of statistical techniques requires significant judgement.</p> <p>The estimation of these claims is based on historical experience projected forward. Where possible, the Group adopts multiple techniques to provide a best estimate of the required level of provisions. This assists in developing greater understanding of the trends inherent in the data being projected. The Group's estimates of losses and loss expenses are reached after a review of several commonly accepted actuarial projection methodologies, as well as more bespoke methods and a number of different bases to determine these provisions. These include methods based upon the following:</p> <ul style="list-style-type: none"> the development of previously paid claims, where payments to date are extrapolated for each prior year; estimates based upon a projection of claims numbers and average cost; incurred claims development, where incurred claims to date for each year are extrapolated based upon observed development of earlier years; and expected loss ratios.

Notes to the Financial Statements continued

Year ended 31 December 2017

19. Insurance contract liabilities (continued)

b) General insurance claims and insurance contract liabilities (continued)

(i) Significant accounting estimates (continued)

Estimate	Judgement applied to estimate
<p>The change in the Ogden discount rate during 2017 makes a lump sum settlement more attractive to claimants than it was previously, whilst the valuation of a PPO equivalent remains unchanged. Overall PPO claim settlement frequencies are expected to reduce as claimants are increasingly likely to desire a lump sum settlement.</p> <p>On 7 September 2017 the Government confirmed that it plans to introduce a new framework based on how claimants actually invest, as well as making sure the rate is reviewed fairly and regularly. If passed, the Ministry of Justice indicated that if the rate were calculated using September 2017 economic conditions, the rate would fall in the range 0% p.a. to +1% p.a.</p> <p>On 20 March 2018 the Government published a draft of its Civil Liability Bill. This contains proposals for changes to the discount rate and the governance around its setting. If enacted in its current form, and assuming no changes to current market conditions, this should result in lower settlements for certain types of liability claims. While the Group welcomes the proposals, there are a number of factors influencing this potential change meaning that its impact and timing remain uncertain. Therefore the Group continues to maintain a discount rate of -0.75% for reserving such claims, reflecting the current legislated rate.</p> <p>Large claims impacting each relevant business class are generally assessed separately, being measured either at the face value of the loss adjusters' estimates or projected separately in order to allow for the future development of large claims.</p>	<p>Over 2017 the Group has increased the Claims Margin position from the previous 2.5% of the Actuarial Best Estimate to 5.6%, in line with the 75th percentile of the Reserve Risk distribution.</p>
<p>Provisions are initially calculated gross of any reinsurance recoveries. A separate estimate is made of the amounts that will be recoverable from reinsurers based upon the gross provisions and having due regard to collectability.</p>	

Notes to the Financial Statements continued

Year ended 31 December 2017

19. Insurance contract liabilities (continued)

a) Analysis of insurance contract liabilities and reinsurance assets

Group	Note	2017			2016		
		Gross £m	Reinsurance £m	Net £m	Gross £m	Reinsurance £m	Net £m
Participating insurance contract liabilities							
Long-term insurance contract liabilities	19 b	5,279	–	5,279	4,999	–	4,999
Non-participating insurance contract liabilities							
Reinsurance relating to participating contracts	19 b	–	(933)	(933)	–	–	–
Long-term insurance contract liabilities	19 c	4,371	(644)	3,727	4,204	(474)	3,730
Long-term linked insurance contract liabilities	19 d	229	(170)	59	192	(127)	65
Long-term claims liabilities	19 e	50	–	50	46	–	46
		4,650	(1,747)	2,903	4,442	(601)	3,841
General insurance unearned premiums	19 f	785	(15)	770	793	(17)	776
General insurance claims liabilities	19 g	1,643	(543)	1,100	1,563	(472)	1,091
		2,428	(558)	1,870	2,356	(489)	1,867
		7,078	(2,305)	4,773	6,798	(1,090)	5,708

Society	Note	2017			2016		
		Gross £m	Reinsurance £m	Net £m	Gross £m	Reinsurance £m	Net £m
Participating insurance contract liabilities							
Long-term insurance contract liabilities	19 b	5,279	–	5,279	4,999	–	4,999
Non-participating insurance contract liabilities							
Reinsurance relating to participating contracts	19 b	–	(933)	(933)	–	–	–
Long-term insurance contract liabilities	19 c	4,356	(644)	3,712	4,189	(474)	3,715
Long-term linked insurance contract liabilities	19 d	229	(170)	59	192	(127)	65
Long-term claims liabilities	19 e	50	–	50	45	–	45
		4,635	(1,747)	2,888	4,426	(601)	3,825

From 4 December 2017 the Group entered into a reinsurance arrangement in respect of the OB Pension portfolio. The OB Pensions portfolio is a participating insurance contract liability, whereas the associated reinsurance is classified as non-participating as disclosed in the tables above.

Notes to the Financial Statements continued

Year ended 31 December 2017

19. Insurance contract liabilities (continued)

b) Movement in long-term insurance contract liabilities - participating

Group and Society	2017			2016		
	Gross £m	Reinsurance £m	Net £m	Gross £m	Reinsurance £m	Net £m
Balance at 1 January	4,999	–	4,999	3,972	–	3,972
Acquired through business combinations	–	–	–	222	–	222
Premiums received	31	–	31	33	–	33
Liabilities paid for deaths, maturities, surrenders, benefits and claims	(444)	–	(444)	(368)	–	(368)
New business	403	–	403	554	–	554
Benefits and claims variation	57	–	57	32	–	32
Fees deducted	(23)	–	(23)	(22)	–	(22)
Accretion of investment income or change in unit prices	224	–	224	317	–	317
Adjustment due to changes in assumptions:						
– Mortality/morbidity/longevity	(44)	–	(44)	(2)	–	(2)
– Investment return	38	–	38	217	–	217
– Expense	(15)	–	(15)	(11)	–	(11)
– Lapse and surrender rates	1	–	1	(6)	–	(6)
– Other basis changes	–	–	–	44	–	44
Model changes	12	–	12	–	–	–
Other	(59)	–	(59)	26	–	26
TA Fund special bonus	(9)	–	(9)	(23)	–	(23)
Mutual bonus	19	–	19	14	–	14
Change in economic basis	89	–	89	–	–	–
Balance at 31 December	5,279	–	5,279	4,999	–	4,999

Included within 'Other' above is a gain of £24m relating to reinsurance of the OB Pensions portfolio.

b) Movement in non-participating reinsurance assets relating to long-term participating insurance contract liabilities

Group and Society	2017			2016		
	Gross £m	Reinsurance £m	Net £m	Gross £m	Reinsurance £m	Net £m
Balance at 1 January	–	–	–	–	–	–
Inception of OB pensions reinsurance contract	–	(847)	(847)	–	–	–
Adjustment due to changes in assumptions:						
– Investment return	–	(9)	(9)	–	–	–
Other	–	(1)	(1)	–	–	–
Change in economic basis	–	(76)	(76)	–	–	–
Balance at 31 December	–	(933)	(933)	–	–	–

Notes to the Financial Statements continued

Year ended 31 December 2017

19. Insurance contract liabilities (continued)

c) Movement in long-term insurance contract liabilities – non-participating

Group	2017			2016		
	Gross £m	Reinsurance £m	Net £m	Gross £m	Reinsurance £m	Net £m
Balance at 1 January	4,204	(474)	3,730	3,621	(412)	3,209
Acquired through business combinations	–	–	–	166	(15)	151
Premiums received	156	(61)	95	150	(57)	93
Liabilities paid for deaths, maturities, surrenders, benefits and claims	(393)	76	(317)	(356)	45	(311)
New business	156	(113)	43	356	(87)	269
Benefits and claims variation	30	(16)	14	13	(3)	10
Fees deducted	(16)	–	(16)	(16)	–	(16)
Accretion of investment income or change in unit prices	43	–	43	49	–	49
Adjustment due to changes in assumptions:						
– Mortality/morbidity/longevity	(6)	(9)	(15)	(114)	136	22
– Investment return	80	(6)	74	383	(67)	316
– Expense	24	–	24	(24)	–	(24)
– Lapse and surrender rates	13	(9)	4	9	(6)	3
– Other basis changes	14	–	14	2	(1)	1
Model changes	(2)	(4)	(6)	(58)	(7)	(65)
Other	18	(1)	17	23	–	23
Change in economic basis	50	(27)	23	–	–	–
Balance at 31 December	4,371	(644)	3,727	4,204	(474)	3,730

Society	2017			2016		
	Gross £m	Reinsurance £m	Net £m	Gross £m	Reinsurance £m	Net £m
Balance at 1 January	4,189	(474)	3,715	3,606	(412)	3,194
Acquired through business combinations	–	–	–	166	(15)	151
Premiums received	155	(61)	94	150	(57)	93
Liabilities paid for deaths, maturities, surrenders, benefits and claims	(391)	76	(315)	(355)	45	(310)
New business	156	(113)	43	356	(87)	269
Benefits and claims variation	30	(16)	14	13	(3)	10
Fees deducted	(16)	–	(16)	(16)	–	(16)
Accretion of investment income or change in unit prices	43	–	43	49	–	49
Adjustment due to changes in assumptions:						
– Mortality/morbidity/longevity	(6)	(9)	(15)	(114)	136	22
– Investment return	80	(6)	74	382	(67)	315
– Expense	24	–	24	(24)	–	(24)
– Lapse and surrender rates	13	(9)	4	9	(6)	3
– Other basis changes	14	–	14	2	(1)	1
Model changes	(2)	(4)	(6)	(58)	(7)	(65)
Other	17	(1)	16	23	–	23
Change in economic basis	50	(27)	23	–	–	–
Balance at 31 December	4,356	(644)	3,712	4,189	(474)	3,715

Notes to the Financial Statements continued

Year ended 31 December 2017

19. Insurance contract liabilities (continued)

d) Movement in long-term linked insurance contract liabilities

Group and Society	2017			2016		
	Gross £m	Reinsurance £m	Net £m	Gross £m	Reinsurance £m	Net £m
Balance at 1 January	192	(127)	65	138	(80)	58
Premiums received	45	(18)	27	36	(14)	22
Liabilities paid for deaths, maturities, surrenders, benefits and claims	(41)	25	(16)	(31)	12	(19)
New business	15	(33)	(18)	13	(20)	(7)
Benefits and claims variation	6	(5)	1	2	(2)	–
Fees deducted	(2)	–	(2)	(2)	–	(2)
Accretion of investment income or change in unit prices	1	–	1	2	–	2
Adjustment due to changes in assumptions:						
– Mortality/morbidity/longevity	(14)	–	(14)	–	(4)	(4)
– Investment return	4	(1)	3	34	(14)	20
– Expense	5	–	5	(6)	–	(6)
– Lapse and surrender rates	4	(3)	1	2	(2)	–
Model changes	(3)	–	(3)	3	(3)	–
Other	3	–	3	1	–	1
Change in economic basis	14	(8)	6	–	–	–
Balance at 31 December	229	(170)	59	192	(127)	65

e) Movement in long-term claims liabilities

Group	2017			2016		
	Gross £m	Reinsurance £m	Net £m	Gross £m	Reinsurance £m	Net £m
Balance at 1 January	46	–	46	40	–	40
Claims notified	872	(237)	635	861	(237)	624
Claims paid during the year	(868)	237	(631)	(858)	237	(621)
Acquired through business combinations	–	–	–	3	–	3
Balance at 31 December	50	–	50	46	–	46

Society	2017			2016		
	Gross £m	Reinsurance £m	Net £m	Gross £m	Reinsurance £m	Net £m
Balance at 1 January	45	–	45	40	–	40
Claims notified	871	(237)	634	859	(237)	622
Claims paid during the year	(866)	237	(629)	(857)	237	(620)
Acquired through business combinations	–	–	–	3	–	3
Balance at 31 December	50	–	50	45	–	45

f) Movement in general insurance unearned premiums

Group	2017			2016		
	Gross £m	Reinsurance £m	Net £m	Gross £m	Reinsurance £m	Net £m
Balance at 1 January	793	(17)	776	744	(12)	732
Premiums written in the year	1,596	(361)	1,235	1,579	(345)	1,234
Premiums earned during the year	(1,604)	363	(1,241)	(1,532)	340	(1,192)
Acquired through business combinations	–	–	–	2	–	2
Balance at 31 December	785	(15)	770	793	(17)	776

g) Movement in general insurance claims liabilities

Group	2017			2016		
	Gross £m	Reinsurance £m	Net £m	Gross £m	Reinsurance £m	Net £m
Balance at 1 January	1,563	(472)	1,091	1,353	(386)	967
Acquired through business combinations	–	–	–	2	–	2
Movement in claims incurred in prior accident years	(34)	(12)	(46)	31	(134)	(103)
Claims incurred in the current accident year	1,124	(286)	838	1,172	(169)	1,003
Claims paid during the year	(1,010)	227	(783)	(1,000)	217	(783)
Unexpired risk provision	–	–	–	5	–	5
Balance at 31 December	1,643	(543)	1,100	1,563	(472)	1,091

Notes to the Financial Statements continued

Year ended 31 December 2017

19. Insurance contract liabilities (continued)

h) Analysis of general insurance claims development

The tables below reflect the cumulative incurred claims including both claims notified and incurred but not reported ('IBNR') for each successive accident year at each Statement of Financial Position date, together with the cumulative payments to date. The Group aims to maintain appropriate reserves in order to protect against adverse future claims experience and developments.

Analysis of claims development – gross of reinsurance	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Total
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
Initial estimate of gross provision	540	607	773	909	1,089	1,077	1,051	1,049	1,148	1,124	
One year later	540	589	825	915	1,042	1,015	1,000	1,100	1,089		
Two years later	500	589	841	902	1,018	999	982	1,070			
Three years later	490	588	835	895	992	986	968				
Four years later	491	603	825	892	981	998					
Five years later	487	599	829	876	999						
Six years later	481	598	830	892							
Seven years later	480	577	843								
Eight years later	455	578									
Nine years later	456										
Current estimate of cumulative claims	456	578	843	892	999	998	968	1,070	1,089	1,124	9,017
Cumulative payments to date	(453)	(574)	(801)	(862)	(951)	(878)	(831)	(808)	(752)	(542)	(7,452)
Liability recognised in the Statement of Financial Position for 2008 to 2017 accident years	3	4	42	30	48	120	137	262	337	582	1,565
Liability recognised in the Statement of Financial Position in respect of prior accident years											60
Claims handling provision											18
Gross general insurance claims liabilities as at 31 December 2017											1,643

Analysis of claims development – net of reinsurance	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Total
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
Initial estimate of net provision	507	584	764	899	1,063	1,057	1,039	916	1,002	838	
One year later	483	578	805	899	1,024	995	934	1,008	836		
Two years later	464	565	821	893	1,003	943	923	939			
Three years later	457	562	808	888	964	937	918				
Four years later	458	577	798	874	955	947					
Five years later	454	570	797	863	964						
Six years later	452	566	791	869							
Seven years later	450	560	798								
Eight years later	451	559									
Nine years later	451										
Current estimate of cumulative claims	451	559	798	869	964	947	918	939	836	838	8,119
Cumulative payments to date	(451)	(558)	(792)	(851)	(938)	(864)	(814)	(753)	(591)	(434)	(7,046)
Liability recognised in the Statement of Financial Position for 2008 to 2017 accident years	–	1	6	18	26	83	104	186	245	404	1,073
Liability recognised in the Statement of Financial Position in respect of prior accident years											9
Claims handling provision											18
Net general insurance claims liabilities as at 31 December 2017											1,100

Notes to the Financial Statements continued

Year ended 31 December 2017

20. Non-participating value of in-force business

Accounting for the non-participating value of in-force business

In determining the realistic value of liabilities for participating contracts as disclosed in Note 19, the value of future profits on non-participating business written in the with-profits part of the fund is accounted for as part of the calculation. The present value of future profits of the non-participating business ('non-participating value of in-force business') is separately determined and its value is deducted from the sum of the liabilities for participating contracts and the Unallocated divisible surplus. Such an amount is not recognised for business written outside participating contract funds.

The principal assumptions are disclosed separately within Note 25.

Analysis of non-participating value of in-force business

	Group		Society	
	2017 £m	2016 £m	2017 £m	2016 £m
Balance at 1 January	324	321	324	321
Premiums received	(1)	(1)	(1)	(1)
Liabilities paid for deaths, maturities, surrenders, benefits and claims	(14)	(12)	(14)	(12)
New business	41	39	41	39
Benefits and claim variation	(1)	–	(1)	–
Fees deducted	(6)	(3)	(6)	(3)
Accretion of investment income or change in unit prices	8	1	8	1
Adjustment due to changes in assumptions:				
– Mortality/morbidity/longevity	(17)	8	(17)	8
– Investment return	(4)	18	(4)	18
– Expense	(10)	(2)	(10)	(2)
– Lapse and surrender rates	(9)	–	(9)	–
– Other basis changes	(3)	–	(3)	–
Model changes	(5)	(43)	(5)	(43)
Other	(9)	(2)	(9)	(2)
Change in economic basis	(1)	–	(1)	–
Balance at 31 December	293	324	293	324

21. Net change in long-term contract liabilities and non-participating value of in-force business

	Group		Society	
	2017 £m	2016 £m	2017 £m	2016 £m
Gross increase in long-term contract liabilities				
Increase in long-term insurance contract liabilities – participating	(191)	(813)	(191)	(813)
Increase in investment contract liabilities – participating	(51)	(21)	(51)	(21)
Increase in long-term insurance contract liabilities – non-participating	(117)	(417)	(117)	(417)
Increase in investment contract liabilities – non-participating	(234)	(303)	(234)	(303)
Increase in long-term linked insurance contract liabilities	(23)	(54)	(23)	(54)
Mutual bonus (disclosed separately on the Statement of Comprehensive Income)	26	17	26	17
	(590)	(1,591)	(590)	(1,591)
Increase in long-term contract liabilities ceded to reinsurers				
Increase in long-term insurance contract liabilities relating to non-participating contracts	143	47	143	47
Increase in long-term insurance contract liabilities relating to participating contracts	857	–	857	–
Increase in long-term linked insurance contract liabilities	35	47	35	47
	1,035	94	1,035	94
(Decrease)/increase in non-participating value of in-force business	(30)	3	(30)	3
Net change in contract liabilities before change in economic basis	415	(1,494)	415	(1,494)
Change in economic basis	(48)	–	(48)	–
Net change in contract liabilities	367	(1,494)	367	(1,494)

In December 2017 the Group entered into a reinsurance arrangement in respect of the OB Pension portfolio, this has had an initial impact of £847m on Long-term contract liabilities ceded to reinsurers. For further details see Note 23.

Notes to the Financial Statements continued

Year ended 31 December 2017

22. Deferred acquisition costs

Accounting for deferred acquisition costs

The proportion of the costs of acquiring new general insurance business which relate to unearned premiums are deferred and recognised as an asset to the extent that they are recoverable out of margins in future matching revenues.

Acquisition costs comprise all allowable costs incurred in writing new contracts. Deferred acquisition costs are amortised over a period which is consistent with the assessment of the expected pattern of receipt of future revenue margins for each product type.

All deferred acquisition costs are tested for recoverability at each reporting date. The carrying values are adjusted to recoverable amounts and any resulting impairment losses are charged to the Statement of Comprehensive Income.

Group	£m
At 1 January 2017	102
Acquisition costs deferred	195
Amortisation	(202)
At 31 December 2017	95
At 1 January 2016	99
Acquisition costs deferred	202
Amortisation	(199)
At 31 December 2016	102

Acquisition costs are costs of acquiring new business and include commissions, underwriting expenses and policy issue expenses. There were no deferred acquisition costs held by the Society in 2017 (2016: £nil).

23. Reinsurance assets

Accounting for reinsurance assets

Contracts entered into by the Group with reinsurers under which the Group is compensated for losses on the insurance contracts issued by the Group are classified as reinsurance contracts. A contract is only accounted for as a reinsurance contract where there is significant insurance risk transfer between the insured and the insurer. Reinsurance assets are the net contractual rights arising from cashflows due from and to reinsurance companies for ceded insurance liabilities. Amounts are estimated in a consistent manner with the gross reserves of the underlying policies and in accordance with the relevant reinsurance contract.

An impairment review is performed at the Statement of Financial Position date. Impairment occurs when there is evidence that the Group will not recover outstanding amounts under the contract, such losses being recorded immediately in the Statement of Comprehensive Income.

All reinsurance contracts are classified as non-participating as the Group and the reinsurer do not share in the returns on underlying items. This is consistent with the treatment of reinsurance contracts separate from the underlying contracts issued.

Significant accounting judgements**Classification of the Group's contracts with reinsurers as reinsurance contracts**

Management have applied judgement in determining whether contracts entered into with reinsurers transfer significant insurance risk and can therefore be accounted for as reinsurance contracts. In making this judgement management review all terms and conditions of each contract and obtain the opinion of an independent expert where necessary.

In order for significant insurance risk to be transferred the following conditions must both be met:

- It is reasonably possible that the reinsurer may realise a significant loss from the contract; and
- There is a reasonable possibility of a significant range of outcomes from the contract.

In December 2017 the Society entered into a reinsurance arrangement in relation to the OB Pensions portfolio included within Participating insurance contract liabilities in Note 19. This was part of the strategy to de-risk the Solvency II balance sheet by reducing the longevity risk exposure and capital requirement. Management judged that significant insurance risk had been transferred to the reinsurer following a review of the terms and conditions of the contract.

The resulting reinsurance asset of £933m is disclosed below as the 'Reinsurers' share of long-term contract liabilities – participating'. The corresponding £933m being credited to the Statement of Comprehensive Income within 'Net changes in contract liabilities' in Note 21 made up of an £857m increase in long-term insurance contract liabilities relating to participating contracts and a further £76m credit due to the change in economic basis. In addition, as part of the reinsurance arrangement, the assets backing these OB Pensions policies were disposed of resulting in a charge of £829m to the Statement of Comprehensive Income included within 'Premiums ceded to reinsurers' in Note 5.

Notes to the Financial Statements continued

Year ended 31 December 2017

23. Reinsurance assets (continued)

Note	Group		Society	
	2017 £m	2016 £m	2017 £m	2016 £m
Reinsurers' share of provision for unearned premiums	19	15	17	–
Reinsurers' share of long-term insurance contract liabilities - non participating	19	644	474	644
Reinsurers' share of long-term insurance contract liabilities - participating	19	933	–	933
Reinsurers' share of long-term linked insurance contract liabilities	19	170	127	170
Reinsurers' share of claims liabilities	19	543	472	–
		2,305	1,090	1,747
				601

The carrying amounts disclosed above reasonably approximate fair value at the Statement of Financial Position date.

24. Long-term insurance and investment contract liabilities valuation assumptions

The basis of the calculation of the long-term insurance contract liabilities is described in the accounting policies. The liability is calculated separately for each life operation. Material judgement is required in calculating the liability. In particular there is discretion over the assumptions used. For participating business, the liability is calculated in accordance with the PRA's realistic capital regime. Non-participating liabilities are valued using a gross premium method.

In calculating the realistic liabilities, account has also been taken of future management actions consistent with those set out in the Principles and Practices of Financial Management.

The assumptions used to calculate the liability depend on the circumstances prevailing in each of the life operations. The assumptions used in determining the liability are estimated to give a result within the normal range of outcomes. To the extent that the ultimate cost differs to the amounts provided, for example where experience is worse than that assumed, the surplus or deficit will be credited or charged to the Statement of Comprehensive Income in future years.

a) Society**(i) Participating insurance contracts**

For participating insurance contracts, a market consistent valuation is used to calculate the liability. This involves placing a value on liabilities similar to the market value of assets with similar cash flow patterns. The key assumptions used in this valuation are set out below.

Interest rates

The risk-free interest rates assumed are:

Year	2017	2016
5	0.94%	0.55%
15	1.33%	1.75%
25	1.37%	1.98%
35	1.30%	1.80%

The basis used for risk free interest rates was changed from gilts to swaps as at 31 December 2017.

When valuing options and guarantees the asset model used was the Moody's Market-Consistent Asset Model. This is a deflator model based on published financial economic theory that is capable of market-consistent valuations for multiple asset classes in multiple currencies. For this valuation it was calibrated to market data as at 31 December 2017 representative of the nature and term of the guarantees inherent in participating insurance contracts within the participating insurance contract funds.

The accounting policies for long-term insurance and investment contract liabilities are included within Notes 19 and 15 respectively. Sensitivities to changes in assumptions are included within Note 4.

Notes to the Financial Statements continued

Year ended 31 December 2017

24. Long-term insurance and investment contract liabilities valuation assumptions (continued)

Other assumptions

Best estimate assumptions are set for inflation, mortality, expenses and persistency. The future expense inflation assumption is modelled as RPI plus 0.5% (2016: RPI plus 0.5%) and RPI plus 1% (2016: RPI plus 1%) for business in the Teachers ring-fenced fund, where RPI in both 2017 and 2016 is modelled stochastically.

Benchmark asset mix for assets backing asset shares	2017				2016			
	Cash	Fixed interest	Equities	Property	Cash	Fixed interest	Equities	Property
Flexible Guarantee Funds Cautious	2%	68%	20%	10%	2%	68%	20%	10%
Flexible Guarantee Funds Balanced	2%	48%	35%	15%	2%	48%	35%	15%
Flexible Guarantee Funds Managed	2%	33%	50%	15%	2%	33%	50%	15%
All in One Bond Cautious Fund	0%	80%	10%	10%	0%	80%	10%	10%
All in One Bond Balanced Fund	0%	30%	35%	35%	0%	30%	35%	35%
All in One Bond Managed Fund	0%	5%	85%	10%	0%	5%	85%	10%
Other With-Profit	3%	39%	49%	9%	3%	39%	49%	9%

Mortality rate tables

	2017	2016
Conventional Life Business	75% AM80 Females -3yrs	75% AM80 Females -3yrs
Conventional Pensions Business	130% AMC00/AF00 CMI_2016_1.5% LT	130% AMC00/AF00 CMI_2013_1.5% LT
Conventional Industrial Branch Business	80% up to age 80, rising linearly to 100% at age 100, of ELT16	80% up to age 80, rising linearly to 100% at age 100, of ELT16
Non-Unitised Accumulating Pensions Business	65% AM80	65% AM80
Unitised Accumulating Life Business	80% AM80/AF80	80% AM80/AF80
Unitised Accumulating Pensions Business	80% AM80	80% AM80
Unitised Accumulating Bond Business	80% AM80	80% AM80
Unitised Accumulating Life ISA Business	80% AM80 select/AF80 select	80% AM80 select/AF80 select
Heritage Annuities in Payment	Males: 116% RMV00 CMI_2016 1.5% LT Females: 116% RFV00 CMI_2016 1.25% LT	Males: 110% RMV00 CMI_2013 1.5% LT Females: 110% RFV00 CMI_2013 1.5% LT

Per policy expenses – regular premiums

	2017	2016
Conventional Life Business	£25.74	£43.30
Conventional Pensions Business	£29.95	£33.85
Conventional Industrial Branch Business*	£14.54	£15.12
Non-Unitised Accumulating Pensions Business	£29.95	£33.85
Unitised Accumulating Life Business	£25.74	£43.30
Unitised Accumulating Pensions Business	£29.95	£33.85
Unitised Accumulating Bond Business	£25.74	£43.30
Unitised Accumulating Life ISA Business	£25.74	£43.30
Heritage Annuities in Payment	£40.71	£43.30

* The unit cost for IB business has been grossed-up to allow for a reduction made to the in-force data to reflect policies that are believed no longer likely to give rise to a claim.

Persistency – lapses, surrenders and paid up rates

A review of persistency is carried out annually. Assumptions for each product class are adjusted where necessary to reflect more recent experience.

Options and guarantees

Allowance is made in respect of cash commutation options on OB Pensions.

Notes to the Financial Statements continued

Year ended 31 December 2017

24. Long-term insurance and investment contract liabilities valuation assumptions (continued)

(ii) Non-participating insurance contracts

Interest rate	2017	2016
Non-profit temporary assurances*	1.25%	1.65%
Whole of life assurances*	1.25%	1.65%
Permanent health insurance:		
a) active lives	1.25%	1.65%
b) claims reserves	1.00%	0.95%
Critical illness	1.25%	1.65%
Other assurances*	1.25%	1.65%
Retirement Solutions annuities in payment MAP	2.11%	2.68%
Retirement Solutions annuities in payment non-MAP	3.37%	2.68%
Heritage annuities in payment	Swap curve	1.79%

* These interest rates are netted down at 20% tax for life contracts written before 1 January 2013.

Investment expenses

	2017	2016
Non-profit temporary assurances*	0.12%	0.12%
Whole of life assurances*	0.12%	0.12%
Permanent health insurance:		
a) active lives	0.12%	0.12%
b) claims reserves	0.12%	0.12%
Critical illness	0.12%	0.12%
Other assurances*	0.12%	0.12%
Retirement Solutions annuities in payment MAP	0.19%	0.14%
Retirement Solutions annuities in payment non-MAP	0.03%	0.14%
Heritage annuities in payment	0.11%	0.12%

* These expenses are netted down at 20% tax for life contracts written before 1 January 2013.

Mortality rate tables

	2017	2016
Non-profit temporary assurances (original LVFS)	AM80/AF80	AM80/AF80
Non-profit temporary assurances	TMN00/TMS00/TFN00/TFS00 *	TMN00/TMS00/TFN00/TFS00*
Whole of life assurances (50+)	AMC00 CMI_2016 1.5% LT/AF00 CMI_2016 1.25% LT*	AMC00/AF00 CMI_2013 1.5% LT*
Whole of life assurances (Lifetime+)	TMN00/TFN00/TMS00/TFS00 CMI_2016 1.5% LT/1.25% LT*	TMN00/TMS00/TFN00/TFS00 CMI_2013 1.5% LT*
Other assurances	AM92/AF92	AM92/AF92
Retirement Solutions annuities in payment	80.75% RMV00/RFV00 CMI_2016 1.5%/1.25% LT **	80.75% RMV00/RFV00 CMI_2013 1.5% LT**
Heritage annuities in payment	98.6% RMV00/RFV00 CMI_2016 1.5%/1.25% LT	93.5% RMV00/RFV00 CMI_2013 1.5% LT

A series of duration and age-related adjustment factors are applied to the base mortality rates. These adjustments vary by product line and smoking status.

** The mortality rates for enhanced annuity contracts are adjusted so as to allow for convergence to standard mortality at advanced ages. These adjustments vary according to lifestyle or medical condition, gender, age and duration in-force.

Morbidity rate tables

	2017	2016
Permanent health insurance		
a) active lives	CMIR12	CMIR12
b) claims reserves	CMIR12	CMIR12
Critical illness	Reinsurer rates	Reinsurer rates

A series of adjustments are made to the standard mortality and morbidity tables to take account of actual experience and publicly available market data. The adjustments for permanent health insurance vary by product line, age, smoking status, sickness duration, deferred periods and occupations.

Notes to the Financial Statements continued

Year ended 31 December 2017

24. Long-term insurance and investment contract liabilities valuation assumptions (continued)

Per policy expenses – regular premiums	2017	2016
Non-profit temporary assurances	£18.80	£16.29
Whole of life assurances	£18.80	£16.29
Permanent health insurance:		
a) active lives	£25.01	£22.02
b) claims reserves (per policy in claim)	£810.35	£677.46
Critical illness	£18.80	£16.29
Other assurances	£28.31	£47.63
Retirement Solutions annuities in payment (life annuity)	£44.67	£59.76
Retirement Solutions annuities in payment (fixed term)	£44.67	£65.13
Heritage annuities in payment	£40.71	£43.30

Options and guarantees

There are no significant options and guarantees in the non-participating business.

(iii) Investment and long-term linked insurance contracts

The provision for unit linked business is equal to the value of the assets to which the contracts are linked. This is classified as an investment product and the liability is included within the long-term investment contract liabilities.

Within insurance contract liabilities the provisions for index-linked permanent health insurance claims, index-linked temporary assurances and index-linked annuities in payment have been calculated using the same mortality and morbidity assumptions as used for the corresponding non-linked liabilities for both 2017 and 2016.

b) Society (originally Teachers)**(i) Participating insurance contracts**

As part of the Teachers acquisition in 2016, the Society purchased the non-participating business from Teachers Assurance. The Teachers Assurance participating business remains within the ring-fenced TA Fund (see section e).

ii) Non-participating insurance contracts

Interest rate	2017	2016
Teachers annuities in payment	2.11%	2.68%

Investment expenses	2017	2016
Teachers annuities in payment	0.19%	0.14%

Mortality rate tables	2017	2016
Teachers annuities in payment	65% RMV00 CMI_2016 1.5% LT/95% RFV00 CMI_2016 1.25% LT	68% PMA08/PFA08 CMI_2015 2% LT + 0.5% to the improvement rate for all ages

Per policy expenses	2017	2016
Teachers annuities in payment	£31.33	£29.77

Options and guarantees

There are no options and guarantees in the non-participating business.

(iii) Investment linked contracts

The provision for unit linked business is equal to the value of the assets to which the contracts are linked. This is classified as an investment product and the liability is included within the long-term investment contract liabilities. The provision for unit linked contracts is equal to the value of the units plus a non-unit liability consisting of a sterling reserve calculated by carrying out cash flow projections on appropriate bases.

Notes to the Financial Statements continued

Year ended 31 December 2017

24. Long-term insurance and investment contract liabilities valuation assumptions (continued)

c) Liverpool Victoria Life Company Limited – Ordinary Long-Term Fund**(i) Participating insurance contracts**

Liverpool Victoria Life Company Limited has no participating business.

(ii) Non-participating insurance contracts

Interest rate	2017	2016
Non-profit temporary assurances*	1.25%	1.65%
Other assurances*	1.33%	1.26%

* These interest rates are netted down at 20% tax for life contracts written before 1 January 2013.

Investment expenses	2017	2016
Non-profit temporary assurances*	0.12%	0.12%
Other assurances*	0.11%	0.11%

* These expenses are netted down at 20% tax for life contracts written before 1 January 2013.

Mortality rate tables	2017	2016
Non-profit temporary assurances	TMN00/TMS00/TFN00/TFS00	TMN00/TMS00/TFN00/TFS00
Other assurances	AM92/AF92	AM92/AF92

Appropriate adjustments were made to the standard mortality tables to take account of actual experience.

Per policy expenses – regular premiums	2017	2016
Non-profit temporary assurances	£18.80	£16.29
Other assurances	£29.99	£28.86

d) RNPFN fund

RNPFN denotes Royal National Pension Fund for Nurses, which is a ring-fenced fund. The free assets attributable to this fund are reported as insurance contract liabilities of the Society.

(i) Participating business

For participating insurance contracts, a market-consistent valuation is used to calculate the liability. This involves placing a value on liabilities similar to the market value of assets with similar cash flow patterns. The key assumptions used in this valuation are set out in the tables below.

Interest rates

The interest rates for RNPFN are set using an approach consistent with that described for the Society in section a(i).

Other assumptions

Best estimate assumptions are set for inflation, mortality, expenses and persistency. The future expense inflation assumption is modelled as RPI plus 0.5% (2016 RPI plus 0.5%), where RPI in both 2017 and 2016 is modelled stochastically.

Benchmark asset mix for assets backing

asset shares	2017	2016
Cash	4%	4%
Fixed interest	65%	65%
UK Equities	31%	31%

Mortality rate tables	2017	2016
Conventional Life Business	60% AM/F00 ult	60% AM/F00 ult
Life Deferred Annuities	50% AM/F00 ult	50% AM/F00 ult
Pension Deferred Annuities	50% AM/F00 ult	50% AM/F00 ult
Unitised with-profits business	60% AM/F00 ult	60% AM/F00 ult

Notes to the Financial Statements continued

Year ended 31 December 2017

24. Long-term insurance and investment contract liabilities valuation assumptions (continued)

Per policy expenses – regular premiums	2017	2016
Conventional Life Business	£25.74	£43.30
Pensions Deferred Annuities	£29.95	£33.85
Life Deferred Annuities	£25.74	£43.30
Unitised with-profits ISA	£25.74	£43.30
Unitised with-profits Bond	£25.74	£43.30

Persistence – lapses, surrenders and paid up rates

A review of persistence is carried out annually. Assumptions are adjusted where appropriate to reflect more recent experience.

Options and guarantees

The provisions held in respect of guaranteed annuity options are determined on a market consistent basis. The total amount provided in respect of the future costs of the guaranteed annuity options was £89m (2016: £90m).

(ii) Non-participating business

Interest rate	2017	2016
Non-profits assurances*	1.54%	1.54%
Non-profits general deferred annuities*	1.54%	1.54%
Annuities in Payment (Life)*	1.54%	1.54%
Annuities in Payment (Pension)	1.54%	1.54%
Pension Deferred Annuities	1.54%	1.54%

* These interest rates are netted down at 20% tax for life contracts written before 1 January 2013.

Investment expenses	2017	2016
Non-profits assurances*	0.17%	0.13%
Non-profits general deferred annuities*	0.17%	0.13%
Annuities in Payment (Life)*	0.17%	0.13%
Annuities in Payment (Pension)	0.17%	0.13%
Pension Deferred Annuities	0.17%	0.13%

* These expenses are netted down at 20% tax for life contracts written before 1 January 2013.

Mortality rate tables	2017	2016
Non-profits assurances	72.0% AM/F00 ult	72.0% AM/F00 ult
Non-profits general deferred annuities	42.5% AM/F00 ult	42.5% AM/F00 ult
Annuities in Payment (Male)	61.2% IML00 with CMI_2009 improvement model with a long-term improvement rate of 1.75%	61.2% IML00 with CMI_2009 improvement model with a long-term improvement rate of 1.75%
Annuities in Payment (Female)	72.3% IFL00 with CMI_2009 improvement model with a long-term improvement rate of 1.5%	72.3% IFL00 with CMI_2009 improvement model with a long-term improvement rate of 1.5%
Pension Deferred Annuities	42.5% AM/F00 ult	42.5% AM/F00 ult

Appropriate adjustments were made to the standard mortality tables to take account of actual experience and publicly available market data.

Notes to the Financial Statements continued

Year ended 31 December 2017

24. Long-term insurance and investment contract liabilities valuation assumptions (continued)

(iii) Linked fund

There are two main classes of contract included within the linked fund, one is classified as an insurance contract and the liability is included within the long-term unit linked insurance contract liabilities, the other is classified as an investment product and the liability is included within the investment contract liabilities. The provision for unit linked insurance contracts is equal to the value of the units. A non-unit liability consisting mainly of a sterling reserve calculated by carrying out cash flow projections on appropriate bases is included within the liability for insurance contracts only.

Interest rate	2017	2016
Unit linked assurances*	1.54%	1.54%

* This interest rate is netted down at 20% tax for life contracts written before 1 January 2013.

Investment expenses	2017	2016
Unit linked assurances*	0.17%	0.13%

* This expense is netted down at 20% tax for life contracts written before 1 January 2013.

Mortality rate tables	2017	2016
Unit linked assurances	72% AM/F00 ult	72% AM/F00 ult

e) TA fund

The TA fund denotes the Teachers Assurance Fund, which is a ring-fenced fund. The free assets attributable to this fund are reported as insurance and investment contract liabilities of the Society.

(i) Participating contracts

For participating contracts, a market consistent valuation is used to calculate the liability. This involves placing a value on liabilities similar to the market value of assets with similar cash flow patterns. The key assumptions used in this valuation are set out below.

Interest rates

The risk-free interest rates assumed are:

Year	2017	2016
5	0.94%	0.55%
15	1.33%	1.75%
25	1.37%	1.98%
35	1.30%	1.80%

The basis used for risk free interest rates was changed from gilts to swaps as at 31 December 2017.

Other assumptions

Best estimate assumptions are set for inflation, mortality, expenses and persistence. The future expense inflation assumption is modelled as RPI, where RPI in both 2017 and 2016 is modelled stochastically.

Benchmark asset mix for assets backing asset

shares at the valuation date:	2017	2016
Cash	5%	5%
Fixed interest	35%	35%
Equities	53%	53%
Property	7%	7%

Mortality rate tables	2017	2016
Conventional Life Business	50% AM92 / 65% AF92	55% AM92 / 80% AF92
Unitised Accumulating Life Business	50% AM92 / 65% AF92	60% AM92 / 45% AF92
Unitised Accumulating Bond Business	50% AM92 / 65% AF92	50% AM92 / 80% AF92
Unitised Accumulating Life ISA Business	50% AM92 / 65% AF92	50% AM92 / 80% AF92

Notes to the Financial Statements continued

Year ended 31 December 2017

24. Long-term insurance and investment contract liabilities valuation assumptions (continued)

Per policy expenses	2017	2016
Conventional Life Business	£38.84	£37.19
Unitised Accumulating Life Business*	£38.84	£37.19
Unitised Accumulating Bond Business	£38.84	£37.19
Unitised Accumulating Life ISA Business	£38.84	£37.19

* A lower percentage of these amounts is used for Series 3 policies.

Persistency – lapses, surrenders and paid up rates

A review of persistency is carried out annually. Assumptions for each product class are adjusted where necessary to reflect more recent experience.

Options and guarantees

There are no guaranteed annuity or financial options within the contracts participating in the TA Fund.

25. Non-participating value of in-force business valuation assumptions

a) Society

Non-participating contracts**Interest rates**

The earned rate and discount rate are set by reference to the risk free yield curve applicable at the valuation date with appropriate adjustments for an illiquidity premium and margins for risk and uncertainty, with the exception of Retirement Solutions annuities in payment where the earned rate is based on the IRR of the risk adjusted backing assets cashflows.

Mortality rate tables

	2017	2016
Non-profit temporary assurances (original LVFS)	AM80/AF80	AM80/AF80
Non-profit temporary assurances	TMN00/TMS00/TFN00/TFS00 CMI_2016 1.5%/1.25% LT *	TMN00/TMS00/TFN00/TFS00 CMI_2013 1.5% LT *
Whole of Life Assurances (50+)	AMC00 CMI_2016 1.5% LT/AFC00 CMI_2016 1.25% LT*	AMC00/AFC00 CMI_2013 1.5% LT*
Whole of Life Assurances (Lifetime+)	TMN00/TMS00/TFN00/TFS00 CMI_2016 1.5% LT/1.25% LT*	TMN00/TMS00/TFN00/TFS00 CMI_2013 1.5% LT*
Other assurances	AM92/AF92	AM92/AF92
Retirement Solutions annuities in payment	95% RMV00/RFV00 CMI_2016 1.5%/1.25% LT **	95% RMV00/RFV00 CMI_2013 1.5% LT**
Heritage annuities in payment	116% RMV00/RFV00 CMI_2016 1.5%/1.25% LT	110% RMV00/RFV00 CMI_2013 1.5% LT
Unit linked pensions (original LVFS)	80% AM92C20/AF92C20	80% AM92C20/AF92C20

* A series of duration and age-related adjustment factors are applied to the base mortality rates. These adjustments vary by product line and smoking status.

** The mortality rates for enhanced annuity contracts are adjusted so as to allow for convergence to standard mortality at advanced ages. These adjustments vary according to lifestyle or medical condition, gender, age and duration in-force.

Morbidity rate tables

	2017	2016
Permanent health insurance:		
a) active lives	CMIR12	CMIR12
b) claims reserves	CMIR12	CMIR12
Critical illness	Reinsurer rates	Reinsurer rates

A series of adjustments are made to the standard mortality and morbidity tables to take account of actual experience and publicly available market data. The adjustments for permanent health insurance vary by product line, age, smoking status, sickness duration, deferred periods and occupations.

Persistency and unit costs

Persistency and unit costs assumptions are based on our best estimate of future experience. A review of persistency is carried out annually. Assumptions for each product class are adjusted where appropriate to reflect more recent experience.

Notes to the Financial Statements continued

Year ended 31 December 2017

Fixed assets and investments

This section gives detail on the tangible, intangible and investment assets of the Society and Group that are used to generate profit for the business.

26. Property and equipment

Accounting for property and equipment

Operational property and equipment are held at cost less accumulated depreciation. Cost includes the original purchase price of the asset and the costs attributable to bringing the asset to its working condition for its intended use. Both property and equipment are depreciated to their estimated residual values on a straight line basis over their estimated useful lives. The periods used are as follows:

Freehold buildings and finance lease property	10 to 50 years
Leasehold property enhancements	10 years or lease term if shorter
Fixtures and fittings	3 to 10 years
IT equipment	3 to 8 years
Land is not depreciated.	

Assets are written down to their recoverable amount where this is less than the carrying value.

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each Statement of Financial Position date.

Group	Freehold and leasehold property £m	Leasehold property enhancements £m	Fixtures, fittings and IT equipment £m	Total £m
Cost:				
At 1 January 2017	43	15	28	86
Additions	–	1	1	2
Disposals	–	(2)	(2)	(4)
At 31 December 2017	43	14	27	84
Accumulated depreciation:				
At 1 January 2017	17	11	15	43
Provided in the year	2	1	4	7
Disposals	–	(2)	(1)	(3)
At 31 December 2017	19	10	18	47
Net book value at 31 December 2017	24	4	9	37
Cost:				
At 1 January 2016	39	15	22	76
Acquired through business combinations	4	–	–	4
Additions	–	–	6	6
At 31 December 2016	43	15	28	86
Accumulated depreciation:				
At 1 January 2016	16	9	12	37
Provided in the year	1	2	3	6
At 31 December 2016	17	11	15	43
Net book value at 31 December 2016	26	4	13	43

Included within the Freehold and leasehold property category above are assets held under finance leases with a net book value of £18m (2016: £20m).

Notes to the Financial Statements continued

Year ended 31 December 2017

27. Intangible assets

Accounting for goodwill and intangible assets

Goodwill

Goodwill represents the excess of the cost of an acquisition over the fair value of the Group's share of the identifiable net assets of the acquired subsidiary at the acquisition date and is included in intangible assets. Goodwill is reviewed for impairment at the end of the first full year of acquisition. Thereafter, it is tested at each Statement of Financial Position date for impairment against the recoverable amount (being the higher of value in use or fair value less costs of disposal) of the relevant cash generating unit and carried at cost less accumulated impairment losses.

Goodwill arising on acquisitions prior to 1998 has been eliminated against the Unallocated divisible surplus. Goodwill on acquisitions prior to 1 January 2006 (the date of transition to IFRS) is carried at its original cost less cumulative amortisation on that date, less any impairment subsequently incurred.

Gains and losses on the disposal of an entity include the carrying amount of goodwill relating to the entity sold.

Present value of acquired in-force business (PVIF)

On acquisition of a portfolio of long-term insurance and investment contracts, the net present value of the Group's interest in the expected post-tax cash flows of the in-force business is capitalised as an intangible asset.

The carrying value of the asset is amortised, in line with the original expected run-off over a period of 10 years, based on the anticipated lives of the majority of the related contracts. Amortisation is stated net of any unwind of the discount rate. The carrying value of the asset is assessed annually using current assumptions in order to determine whether any impairment has arisen, compared to the amortised acquired value.

Other intangibles

Where an acquisition takes place that gives access to existing customers, distribution channels or the right to charge for investment or policy administration services, the fair value of these is recognised as an intangible asset.

The carrying value of the asset is amortised, on a straight line basis over its expected economic life. The expected economic life of other intangibles carried by the Group is determined by reference to acquired business, considering factors such as the remaining terms of agreements, the normal lives of related products and the competitive position, and lies within the range of 10 to 20 years. The carrying value of the asset is assessed annually for indications of impairment.

IT Software

Costs directly attributable to the development of software for internal use are capitalised as intangible assets if it is probable that the asset created will generate future economic benefits. Costs incurred to establish technological feasibility or to maintain existing levels of performance are recognised as an expense.

Software costs, including computer application software licences, are amortised using the straight line method over their useful lives (three to eight years). The amortisation periods used are reviewed annually. Software values are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. Where the carrying amount is not recoverable the asset is written down immediately to the estimated recoverable amount, based on value in use calculations.

Any amortisation or impairment charges for all intangibles are recorded in the Statement of Comprehensive Income within Other operating and administrative expenses.

Significant accounting estimate Impairment assessment of goodwill

The Group determines whether goodwill is impaired at least on an annual basis. This requires an estimation of the recoverable amount of the cash generating unit to which the goodwill is allocated. The Group has allocated the goodwill to two single cash generating units based on the key operating segments of the Group.

Details of the key assumptions used in the estimation of the recoverable amounts and the carrying value at the reporting date are contained at the end of this note.

Notes to the Financial Statements continued

Year ended 31 December 2017

27. Intangible assets (continued)

Group	Goodwill £m	Other intangible assets £m	PVIF £m	Software and licence costs £m	Total £m
Cost:					
At 1 January 2017	241	51	3	59	354
Acquired through business combinations	-	1	-	-	1
Additions	-	-	-	36	36
At 31 December 2017	241	52	3	95	391
Accumulated amortisation:					
At 1 January 2017	21	37	-	5	63
Charge for the year	-	3	-	8	11
Impairment in year	-	-	-	2	2
At 31 December 2017	21	40	-	15	76
Net book value at 31 December 2017	220	12	3	80	315

Cost:

At 1 January 2016	241	95	63	21	420
Acquired through business combinations	-	7	3	-	10
Additions	-	-	-	38	38
Written off	-	(51)	(63)	-	(114)
At 31 December 2016	241	51	3	59	354

Accumulated amortisation:

At 1 January 2016	21	85	63	2	171
Charge for the year	-	3	-	3	6
Written off	-	(51)	(63)	-	(114)
At 31 December 2016	21	37	-	5	63

Net book value at 31 December 2016	220	14	3	54	291
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Other intangible assets comprise the value of the future benefit derived from the acquired customer bases of the Allianz Insurance plc personal lines business, Teachers business, Britannia Road Rescue, Highway and the value of the Tomorrow/Retirement Solutions distribution channel, which are being amortised over periods varying between 10 and 20 years from the original acquisition date. These intangible assets will be fully amortised by 2027.

Amortisation of £11m (2016: £6m) is presented within Other operating and administrative expenses in the Statement of Comprehensive Income. There was an impairment charge of £2m in 2017 (2016: £nil).

Goodwill has been allocated to the individual cash generating units which are based on the key segments of the Group as follows:

	Group	
	2017 £m	2016 £m
Long-term insurance business	54	54
General insurance business	166	166
	220	220

Notes to the Financial Statements continued

Year ended 31 December 2017

27. Intangible assets (continued)

Impairment testing of goodwill

Goodwill is reviewed annually for impairment, or more frequently when there are indicators that impairment may have occurred, by comparing the carrying value to its recoverable amount. The recoverable amount of the cash generating unit is based on value in use calculations. The calculations are based upon discounting expected pre-tax cash flows at a risk-adjusted interest rate appropriate to the cash generating unit, the determination of both of which requires the exercise of judgement. The estimation of pre-tax cash flows is sensitive to the periods for which forecasts are available and to assumptions regarding the long-term sustainable cash flows. While forecasts are compared with actual performance and external economic data, expected cash flows reflect management's view of future performance.

Key assumptions used in the annual impairment testing of intangible assets

The key assumptions used for impairment testing are set out below for both the long-term insurance business and the general insurance business. The long-term insurance business incorporates both the Heritage and Life businesses.

The recoverable amount of the long-term insurance business and of the general insurance business have each been determined using discounted cash flow predictions based on financial plans approved by management covering a five year period, with a terminal growth rate applied thereafter. Both the growth rates and the discount rates used are consistent with the ranges observed in the market place.

For the general insurance business the cash flows used in the financial plans are most sensitive to changes in the loss ratio, therefore sensitivities have been performed based on this measure. Key loss ratio assumptions are based on a combination of historic and current market place trends, and management judgement.

	2017		2016	
	Long-term insurance	General insurance	Long-term insurance	General insurance
Assumptions				
Terminal growth rate	1.5%	1.5%	2%	2%
Pre-tax discount rate	9%	9%	9%	9%
Recoverable amount in excess of carrying value	£169m	£1,309m	£462m	£1,238m
Sensitivities				
Impact on recoverable amount of a 2% increase in pre-tax discount rate	£69m	£466m	£129m	£494m
Pre-tax discount rate required to eliminate headroom	17%	20%	37%	18%
Impact on recoverable amount of an annual reduction in forecast cashflows				
– 10% cashflow reduction	£38m	£212m	£64m	£213m
– 1% loss ratio increase	n/a	£177m	n/a	£192m
Reduction required in annual forecast cashflows to eliminate headroom				
– cashflow reduction	44%	64%	73%	58%
– sustained increase in loss ratio	n/a	7.4%	n/a	6.5%

Notes to the Financial Statements continued

Year ended 31 December 2017

28. Investments in group undertakings

Accounting for investments in group undertakings

Shares in subsidiaries

The subsidiaries are held in the Society's Statement of Financial Position at cost less any provision for impairment. An assessment of the realisable value is made at the year end and, if the Directors assess that there has been a permanent fall in that value below the carrying value, a provision is made to bring the carrying value down to the assessed realisable value.

Loan stock in subsidiaries

Loan stock in subsidiaries is initially measured at fair value. Subsequent to initial recognition it is measured at amortised cost.

	2017 £m	2016 £m
Society		
Shares in subsidiaries		
Cost less provisions at 1 January	496	470
Acquired through business combinations	–	26
Additions	81	3
Conversion of loan stock to equity	326	–
Reduction in carrying value including impairment	(16)	(3)
	887	496
Loan stock in subsidiaries		
Cost at 1 January	306	300
Additions	4	6
Redemption	(300)	–
	10	306
Shares and loan stock in subsidiaries at 31 December	897	802

During the year £326m of loans and related interest owed to the Society by its subsidiary LV Capital PLC were converted to equity and a further £81m of capital was invested in subsidiaries of the Society.

The £26m acquisition in 2016 relates to the transfer in of the Teachers Provident Society Limited and its subsidiary companies on 1 June 2016.

The Society has examined the carrying value of its subsidiaries and concluded that a provision for impairment of £16m (2016: £3m) was required in regard to these investments.

Further details of the Group's loan stock are given in Note 49 and the Group's investments in Notes 42 and 43.

Notes to the Financial Statements continued

Year ended 31 December 2017

Other assets and liabilities

This section describes the other assets and liabilities arising from the life insurance business within the Society and the life insurance and general insurance businesses within the Group.

29. Insurance receivables

	Group		Society	
	2017 £m	2016 £m	2017 £m	2016 £m
Due from policyholders	190	178	10	5
Due from agents, brokers and intermediaries	82	87	–	–
Due from reinsurers	36	28	19	11
	308	293	29	16

The carrying amounts disclosed above reasonably approximate fair value at the Statement of Financial Position date.

30. Prepayments and accrued income

	Group		Society	
	2017 £m	2016 £m	2017 £m	2016 £m
Accrued interest	85	99	62	74
Other prepayments and accrued income	39	41	9	25
	124	140	71	99

31. Insurance payables

	Group		Society	
	2017 £m	2016 £m	2017 £m	2016 £m
Due to policyholders	18	19	15	18
Due to brokers and intermediaries	1	1	–	1
Due to reinsurers	31	31	7	2
	50	51	22	21

The carrying amounts disclosed above reasonably approximate fair value at the Statement of Financial Position date.

32. Trade and other payables

Accounting for trade and other payables

Trade and other payables are recognised as they fall due. They are measured initially at fair value and subsequently at amortised cost. Premiums received for contracts with an inception date after the end of the period are held as deferred revenue.

	Group		Society	
	2017 £m	2016 £m	2017 £m	2016 £m
Bank overdrafts	11	22	8	9
Trade payables	17	27	16	27
Amounts owed to group undertakings	–	–	21	11
Other taxes and social security costs	56	51	10	12
Other creditors	42	36	31	28
Finance lease liabilities	19	20	–	–
Accruals	143	114	73	68
	288	270	159	155

The carrying amounts disclosed above reasonably approximate fair value at the Statement of Financial Position date.

Notes to the Financial Statements continued

Year ended 31 December 2017

Taxation

This section presents information relating to the tax charge and movements in the corporation and deferred tax assets and liabilities held by the Society and Group.

33. Income tax expense

Income tax expense

Income tax expense recorded in the Statement of Comprehensive Income represents the current year corporation tax charge. As a mutual, the corporation tax charge for the Society relates to policyholder tax payable on the net investment return levied on certain types of business. Whereas for Group subsidiaries corporation tax is charged on trading profits arising in the year.

The current year tax charge excludes the deferred tax movement included within the re-measurement of the defined benefit pension scheme in Other Comprehensive Income.

Current income tax

Current income tax liabilities and assets are measured at the amount expected to be paid to or recovered from the taxation authorities. The tax rates and tax laws used to compute the amount are those that are enacted or substantively enacted at the Statement of Financial Position date.

Deferred income tax

Deferred income tax is recognised, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. Deferred income tax is determined using tax rates (and laws) that have been enacted or substantively enacted by the Statement of Financial Position date and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled. Deferred income tax assets are recognised to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised.

Deferred income tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets against current tax liabilities and when the deferred income taxes assets and liabilities relate to income taxes levied by the same taxation authority on either the taxable entity or different taxable entities where there is an intention to settle the balances on a net basis.

a) Current year tax charge

	Group		Society	
	2017 £m	2016 £m	2017 £m	2016 £m
Current tax charge:				
Current year	39	24	16	30
Adjustment in respect of prior years	–	1	(1)	1
Total current tax	39	25	15	31
Deferred tax				
Temporary differences	7	14	9	14
Tax losses	4	(4)	–	–
Total deferred tax	11	10	9	14
Total income tax expense	50	35	24	45

b) Reconciliation of tax charge

	Group		Society	
	2017 £m	2016 £m	2017 £m	2016 £m
Profit/(loss) before tax, mutual bonus and UDS transfer*	122	(49)	62	47
Tax calculated at the average standard rate of corporation tax in the UK at 19.25% (2016: 20%)	23	(10)	12	9
Permanent differences				
Income and expenses not subject to tax	13	6	–	–
Mutual profit not subject to tax	(12)	(9)	(12)	(9)
Unprovided deferred tax movement	1	3	–	–
Policyholder I-E tax	25	44	25	44
Adjustment to current tax charge in respect of prior years	–	1	(1)	1
Total charge	50	35	24	45

The standard rate of corporation tax in the UK changed from 20% to 19% with effect from 1 April 2017. Accordingly, the profits for this accounting period are taxed at an effective rate of 19.25%.

* As a Friendly Society, all net earnings are for the benefit of participating policyholders and are carried forward within the Unallocated divisible surplus (UDS), resulting in the profit for each financial year being zero. Therefore the resulting profit before tax required to be disclosed under IAS 12 will always be equal to the tax charge being £50m (2016: £35m) and £24m (2016: £45m) for the Group and Society respectively. In order to present a more meaningful disclosure the Profit before tax, mutual bonus and UDS transfer is disclosed in the tables above.

Notes to the Financial Statements continued

Year ended 31 December 2017

34. Corporation tax asset

	Group		Society	
	2017 £m	2016 £m	2017 £m	2016 £m
Corporation tax receivable	–	6	–	–
	–	6	–	–

35. Deferred tax liability

	Group		Society	
	2017 £m	2016 £m	2017 £m	2016 £m
Balance at 1 January 2017			(70)	(73)
Amounts recorded in the Statement of Comprehensive Income			(11)	(9)
Amounts recorded in pension scheme re-measurements within Other Comprehensive Income			(16)	(16)
Balance at 31 December 2017			(97)	(98)

	Group		Society	
	2017 £m	2016 £m	2017 £m	2016 £m
(i) Analysis of deferred taxation temporary differences				
Excess of depreciation	2	1	–	–
Temporary differences on expenses	3	8	4	9
Temporary differences arising on consolidation	–	(1)	–	–
Temporary differences on unrealised gains	(40)	(35)	(40)	(35)
Temporary difference on re-measurement of defined benefit pension scheme	(62)	(47)	(62)	(47)
Tax losses	–	4	–	–
Deferred tax liability	(97)	(70)	(98)	(73)

(ii) Deferred taxation asset not recognised

	2017 £m	2016 £m	2017 £m	2016 £m
Tax losses unrecognised	8	12	–	–
	8	12	–	–

The value of deferred tax liabilities expected to be settled after more than 12 months is £87m in the Group (2016: £67m) and £88m in the Society (2016: £69m).

The calculation of deferred tax balances at the year end takes into account the reduction in the UK main corporation tax rate to 17%, substantively enacted on 6 September 2016 and effective from 1 April 2020.

The valuation and recoverability of deferred tax assets relating to capital allowances in excess of depreciation, temporary differences on expenses and taxable losses carried forward is dependent on the availability of future taxable profits within the Society and Group. Management forecasts currently support the future recoverability of deferred tax assets recognised in the balance sheet as at 31 December 2017.

36. Corporation tax liability

	Group		Society	
	2017 £m	2016 £m	2017 £m	2016 £m
Corporation tax	20	–	9	6
	20	–	9	6

Notes to the Financial Statements continued

Year ended 31 December 2017

Employee benefits

This section details the costs and commitments associated with employing our staff.

37. Employee benefits expense

Accounting for staff costs under IAS 19

The Society and Group apply IAS 19 Employee benefits in accounting for staff costs.

Short-term employee benefits

Salaries, accrued bonuses and social security costs are recognised over the period in which the employees provide the services to which the payments relate.

	Group		Society	
	2017 £m	2016 £m	2017 £m	2016 £m
Wages and salaries	218	225	213	221
Social security costs	21	21	21	21
Pension costs	16	17	15	17
	255	263	249	259

Of the £249m (2016: £259m) employee benefit expense in the Society, £133m (2016: £137m) is recharged to other Group companies, leaving £116m (2016: £122m) of staff costs directly relating to the Society.

Wages and salaries include charges for ongoing in flight long-term incentive plans (LTIPs) for Life, General Insurance and Group employees of £6.0m in 2017 (2016: £5.7m). The Group LTIP plan terms are described in the Report on Directors' Remuneration on page 81.

For the 2015-17 scheme the Group has exceeded the targets for growth in adjusted average pre-tax profits resulting in the maximum payout for this measure. The Relative Investment Performance was below benchmark resulting in £nil payout for this measure. £7.3m will be paid to eligible employees in May 2018.

On 29 December 2017, 3,717 employees (excluding contractors and temporary staff) from the Society transferred to Liverpool Victoria General Insurance Group Limited under a TUPE arrangement.

The number of employees during the year, including executive directors, calculated on a monthly average basis, was as follows:

	Group		Society	
	2017 Number	2016 Number	2017 Number	2016 Number
Member and customer contact Administration	3,784	4,124	3,730	4,050
	2,080	2,137	2,045	2,120
	5,864	6,261	5,775	6,170

Notes to the Financial Statements continued

Year ended 31 December 2017

38. Pension benefit asset

Accounting for pension benefits under IAS 19

For defined benefit schemes, the net surplus or deficit is calculated annually with the assets measured at the fair value at the Statement of Financial Position date and the liabilities discounted at the rate of return available on high quality corporate bonds. The net surplus, to the extent recoverable, or deficit is recognised as a pension benefit asset or liability in the Statement of Financial Position. No separate liability for funding requirements is recognised as the Society has an unconditional right to any of the assets of the pension schemes which would remain following the schemes' termination.

The pension cost for the schemes is analysed between current service cost, past service cost, net interest on the net defined benefit liability and any gain or loss on settlement. Current service cost is the actuarially calculated present value of the benefits earned by the active employees in each period. Past service costs, relating to employee service in prior periods arising in the current period as a result of the introduction of, or improvement to, retirement benefits, are recognised in Other operating and administrative expenses on a straight-line basis over the period in which the increases in benefits vest or are earned.

All movements other than re-measurements in respect of the pension benefit obligation are recognised in Other operating and administrative expenses in the Statement of Comprehensive Income. Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are recognised as re-measurements in Other Comprehensive Income in the period in which they arise.

For defined contribution plans, the Group pays contributions to an independently administered pension fund. The Group has no further payment obligations once the contributions have been paid. The contributions are recognised as an employee benefit expense when they are due.

Significant accounting estimates and judgements

(i) Significant accounting estimate

Valuation of the defined benefit obligation

The valuations of the pension benefit obligations for the Group's three defined benefit schemes require actuarial assumptions about discount rates, inflation, future salary increases, longevity and future pension increases. Due to the long-term nature of these obligations, the estimates are subject to significant uncertainty.

Details of the principal assumptions used for each of the material defined benefit schemes are disclosed within the valuations of the individual schemes disclosed in sections (ii) and (iii).

(ii) Significant accounting judgements

Recognition of defined benefit asset

Management have applied judgement in evaluating whether the net pension asset can be recognised for each of the pension schemes in accordance with the existing IFRIC 14.

Recognising the asset under the current criteria of IFRIC 14, 'The limit on a defined benefit asset, minimum funding requirement and their interaction' is allowable for both the LV and Ockham Pension Schemes because the terms of the pension scheme trust deeds state that the Society has an unconditional right to any assets of the schemes which ultimately remain following the schemes' termination, assuming the gradual settlement of the scheme liabilities over time until all members have left the schemes. However this is not the case for the trust deed of the Teachers Assurance Group Pension Scheme, so the asset for this scheme is not recognised.

The IASB are expected to publish an amendment to IFRIC 14 during 2018. This amendment, once effective in future accounting periods, may impact the recognition of the pension fund surplus. Management will consider the implications of the amendment once it has been published.

Defined benefit pension schemes

The Group operates three pension schemes with defined benefit sections, the LV= Employee Pension Scheme ("LV Scheme"), the Ockham Pension Scheme (acquired as part of an earlier acquisition) and the Teachers Assurance Group Pension Scheme (acquired as part of the Teachers Assurance acquisition on 1 June 2016). The Society is the principal employer for the LV Scheme and the Ockham Pension Scheme. Teachers Management Services Limited, a subsidiary of the Society, is the principal employer for the Teachers Assurance Group Pension Scheme. The LV Scheme and the Ockham Pension Scheme are both hybrid schemes with a defined benefit section and a defined contribution section.

Defined contribution pension schemes

All employees are eligible to join the defined contribution section of the LV Scheme. Employees contribute a minimum of 3% of salary. The employee contribution is double matched by the Society up to a maximum employer contribution of 14%. The assets of this scheme are held separately from those of the Group in an independently administered fund. The Group's contribution under this scheme during the year amounted to £18m (2016: £19m).

From 29 December 2017, employees who moved to LVGIG under a TUPE arrangement ceased to be members of the LV Scheme and joined the new My LVGIG Savings Plan, a Group Personal Pension plan.

Notes to the Financial Statements continued

Year ended 31 December 2017

38. Pension benefit asset (continued)

(i) Summary of defined benefit schemes

	2017				2016			
	LV Scheme £m	Ockham £m	Teachers £m	Total £m	LV Scheme £m	Ockham £m	Teachers £m	Total £m
Pension benefit asset								
Asset	163	15	–	178	114	20	–	134
	163	15	–	178	114	20	–	134
Re-measurements								
Re-measurements	40	(5)	–	35	15	(1)	–	14
Income tax expense	(17)	1	–	(16)	(9)	(7)	–	(16)
Amount charged to Comprehensive Income	23	(4)	–	19	6	(8)	–	(2)
Cumulative re-measurements recognised in the Statement of Comprehensive Income	193	(10)	–	183	153	(5)	–	148

Teachers Assurance Group Pension Scheme

The Teachers Assurance Group Pension Scheme is a final salary pension scheme, which provides benefits to members in the form of a guaranteed level of pension payable for life. The level of benefits depends upon the member's length of service and their final salary. The fair value of the plan assets was £34m (2016: £33m) and the present value of the obligations was £30m (2016: £33m) as at 31 December 2017. The surplus of £4m (2016: £nil) has not been recognised because under IFRIC 14, the wording of the scheme trust deed does not allow the Society the right to the scheme's assets following the scheme's termination. The scheme is closed to new entrants and was closed to future accrual for existing members on 31 December 2015. Funding contributions of £20,000 were paid during the year (2016: £20,000) from the Teachers Assurance fund, a closed fund within the Society. The triennial valuation as at 30 September 2017 is in progress and has not yet concluded. Due to the immaterial nature of the Teachers scheme no detailed disclosures have been made.

Further details of the LV and Ockham schemes are disclosed separately within sections (ii) and (iii) of this note respectively.

(ii) LV Scheme

a) Information about the scheme

The final salary section of the LV scheme provides benefits to members in the form of a guaranteed level of pension payable for life. The level of benefits depends upon the member's length of service and their final salary.

The scheme assets are held in a separate trustee-administered fund to meet long-term pension liabilities to past and present employees.

The liabilities of the scheme are measured by discounting the best estimate of future cash flows to be paid out by the scheme using the projected unit method, which is an accrued benefits valuation method.

The scheme has a Corporate Trustee required to act in the best interests of the scheme's beneficiaries. The Trustee may be removed at the discretion of the Society, in its capacity as principal employer, provided that the board of any new trustee company comprises three directors representing the members, including one director who must be a pensioner and up to a further five directors selected by the Society.

The final salary section is closed to new entrants and was closed to future accrual for existing members on 30 June 2013, at which time they were eligible to join the defined contribution section of the scheme.

Notes to the Financial Statements continued

Year ended 31 December 2017

38. Pension benefit asset (continued)

	2017 £m	2016 £m
b) Net Statement of Financial Position		
Present value of defined benefit obligation	(1,331)	(1,308)
Fair value of plan assets	1,494	1,422
Pension benefit asset at the end of the year	163	114

c) The movement in the net defined benefit asset over the year is as follows:

	Present value of obligation £m	Fair value of plan assets £m	Total £m
At 1 January 2017	(1,308)	1,422	114
Pension costs:			
Current service cost	(1)	–	(1)
Interest (expense)/income	(37)	40	3
	(38)	40	2
Re-measurements:			
– Return on plan assets, excluding amounts included in interest (expense)/income	–	94	94
– Gain from changes in demographic assumptions	4	–	4
– Loss from changes in financial assumptions	(58)	–	(58)
	(54)	94	40
Other movements:			
– Contributions by employer	–	7	7
– Benefits paid	69	(69)	–
	69	(62)	7
At 31 December 2017	(1,331)	1,494	163
At 1 January 2016	(1,080)	1,167	87
Pension costs:			
Current service cost	(2)	–	(2)
Interest (expense)/income	(41)	45	4
	(43)	45	2
Re-measurements:			
– Return on plan assets, excluding amounts included in interest (expense)/income	–	253	253
– Gain from changes in demographic assumptions	2	–	2
– Loss from changes in financial assumptions	(264)	–	(264)
– Experience gains	24	–	24
	(238)	253	15
Other movements:			
– Contributions by employer	–	10	10
– Benefits paid	53	(53)	–
	53	(43)	10
At 31 December 2016	(1,308)	1,422	114

Notes to the Financial Statements continued

Year ended 31 December 2017

38. Pension benefit asset (continued)

(ii) LV Scheme (continued)

	2017	2016
d) Principal assumptions used		
Discount rate	2.50%	2.85%
RPI inflation	3.20%	3.30%
CPI inflation	2.20%	2.30%
Pension increases for in-payment benefits		
– RPI price inflation capped at 5% pa, floor of 3% pa	3.45%	3.45%
– RPI price inflation capped at 5% pa	3.40%	3.35%
– RPI price inflation capped at 2.5% pa	2.50%	2.45%
– CPI price inflation capped at 3.0% pa	2.35%	2.30%
Rate of (non-guaranteed minimum pension) increases in deferment	2.20%	2.30%
Cash commutation	20%	10%
Deferred at the time of scheme closure	20%	20%
Scheme member valuation date	31 March 2015	31 March 2015

The discount rate and inflation rate assumptions for 2017 and 2016 have been set with reference to yield curves. The single rates disclosed above represent the weighted average equivalent rate based on the yield curve used.

For 2017, mortality for members is assumed to follow LV specific Club Vita individual base tables, based on pooled experience during the period 2011 to 2013 (2016: LV specific Club Vita tables 2011 – 2013).

The table below shows the life expectancy assumptions used in the accounting assessments based on the average future life expectancy of a scheme member who is a pensioner aged 65 (non-pensioner is assumed to be 45 now).

	2017	2016
Future life expectancy assumptions (in years) as at 31 December		
Pensioner (currently aged 65)		
– Male	22.7	22.9
– Female	24.3	24.7
Non-pensioner (at age 65, currently aged 45)		
– Male	23.9	24.2
– Female	25.8	26.2

In all cases, as at 31 December 2017 CMI Core 2016 projections with a long-term trend of 1.50% have been applied (31 December 2016, CMI Core 2014 projections with a long-term trend of 1.25% have been applied).

e) Sensitivity analysis: Impact on defined benefit obligation of making changes to key assumptions

	Change in assumption	Impact on defined benefit obligation
Discount rate	Decrease by 0.5%	Increase by £138m (10%)
RPI rate	Decrease by 0.5%	Decrease by £78m (6%)
Life expectancy	Increase by 1 year	Increase by £44m (3%)

The sensitivity analysis has been calculated by valuing the defined benefit obligation using the amended assumptions shown in the table above and keeping the remaining assumptions the same as disclosed in the principal assumptions table for the scheme, except in the case of the inflation sensitivity where other assumptions that depend on assumed inflation have also been amended correspondingly.

Notes to the Financial Statements continued

Year ended 31 December 2017

38. Pension benefit asset (continued)

(ii) LV Scheme (continued)

f) Plan asset information

The following table shows a breakdown of the plan assets:

	2017				2016			
	Quoted £m	Unquoted £m	Total £m	%	Quoted £m	Unquoted £m	Total £m	%
Equities and unit trusts	99	7	106	7	92	9	101	7
Debt securities	1,687	–	1,687	113	1,594	–	1,594	112
Cash and cash equivalents	113	4	117	8	90	–	90	6
Real estate/property	–	5	5	–	–	5	5	–
Derivatives	21	(469)	(448)	(30)	9	(399)	(390)	(27)
Other	–	27	27	2	–	22	22	2
	1,920	(426)	1,494	100	1,785	(363)	1,422	100

The use of derivatives is predominantly gilt repos and swaps to hedge the interest and inflation exposure. In addition a proportion of the derivative exposure relates to a synthetic equity strategy used to gain exposure to the global equity markets.

In determining and reviewing the Scheme's investment strategy, the Trustee adopts a Pensions Risk Management Framework (PRMF). This framework translates the principal goal of paying member benefits into measurable funding objectives and risk constraints, agreed by the Trustee. The PRMF is reviewed and monitored by the Trustee on at least a quarterly basis. The Trustee's primary funding objective is to reach full funding on the Technical Provisions basis, with a long-term target of moving towards being fully funded on a Gilts +0.25% liability valuation basis by 2033 if possible. In setting the investment strategy, the Trustee aims to:

- Target an expected return on assets close to that required to meet the funding objectives within the PRMF;
- Manage the investment risk including that arising due to mismatch between assets and liabilities and limit the total risk on the Scheme below the risk budget set in the PRMF;
- Maintain suitable liquidity of assets such that the Scheme is not forced to buy and sell investments at particular times to pay member benefits or meet potential collateral calls.

Following the triennial scheme valuation which took place as at 31 March 2015, the Society as principal employer agreed, on behalf of participating employees, to make a one-off payment of £7,500,000 followed by monthly deficit reduction contributions of £416,667 from October 2016 until 31 March 2025 to meet the statutory funding objective*. In addition to these funding contributions, the Society continues to make payments of £169,525 per month towards the regular expenses of administering the defined benefit section of the Scheme plus payments equal to the pension protection fund (PPF) levies. The next formal valuation of the Scheme is due no later than 31 March 2018.

* The statutory funding objective is that the Scheme must have 'sufficient and appropriate' assets to meet the expected costs of providing members past service benefits.

g) Pension scheme risks

Through its defined benefit pension schemes the Group is exposed to a number of risks, the most significant of which are detailed below:

Asset volatility:	The plan liabilities are calculated using a discount rate set with reference to corporate bond yields; if plan assets underperform this yield, this will create a deficit. The plan assets are predominantly held in debt securities which match the liabilities with a small holding of equities that are expected to outperform corporate bonds in the long-term.
Changes in bond yields:	A decrease in corporate bond yields will increase plan liabilities, although this will be offset by an increase in the value of the scheme's bond holdings.
Inflation risk:	The majority of the scheme's benefit obligations are linked to inflation, therefore an increase in inflation will lead to an increase in liabilities. In most cases, caps on the level of inflationary increases and derivatives are in place to protect the scheme against significant rises in inflation.
Life expectancy:	The scheme's obligations are to provide benefits for the life of the member, so any increases in life expectancy will result in an increase in the scheme's liabilities. In 2012 the trustees of the LV Scheme entered into a longevity swap which mitigated the majority of this risk for the LV scheme.

h) Expected maturity analysis of undiscounted pension benefits:

	Less than a year £m	Between 1-2 years £m	Between 2-5 years £m	Over 5 years £m	Total £m
At 31 December 2017	56	41	130	2,051	2,278

The weighted average duration of the gross defined benefit obligation is 20 years. The expected contributions to the scheme for the year ending 31 December 2018 are £7m.

Notes to the Financial Statements continued

Year ended 31 December 2017

38. Pension benefit asset (continued)

(iii) Ockham Scheme

a) Information about the scheme

The final salary section of the Ockham scheme provides benefits to members in the form of a guaranteed level of pension payable for life. The level of benefits depends upon the members' length of service and their final salary. The scheme is closed to new entrants. The scheme assets are held in separate trustee-administered funds to meet long-term pension liabilities to past employees. The liabilities of the scheme are measured by discounting the best estimate of future cash flows to be paid out by the scheme using the projected unit method, which is an accrued benefits valuation method.

The scheme has a Board of Trustees who are required to act in the best interests of the scheme's beneficiaries. Two of the trustees are nominated by the members under the rules notified to the members of the scheme, to serve for a period of three years. In accordance with the trust deed, the Society, as principal employer, has the power to appoint and remove the other trustees of the scheme. The member-nominated trustees may be removed before the end of their three year term only by the agreement of all the remaining trustees.

b) Net Statement of Financial Position

	2017 £m	2016 £m
Present value of defined benefit obligation	(149)	(143)
Fair value of plan assets	164	163
Pension benefit asset at the end of the year	15	20

c) The movement in the net defined benefit asset/(obligation) over the year is as follows:

	Present value of obligation £m	Fair value of plan assets £m	Total £m
At 1 January 2017	(143)	163	20
Pension costs:			
Interest (expense)/income	(4)	4	–
	(4)	4	–
Re-measurements:			
– Return on plan assets, excluding amounts included in interest (expense)/income	–	3	3
– Loss from changes in financial assumptions	(8)	–	(8)
	(8)	3	(5)
Other movements:			
– Benefits paid	6	(6)	–
	6	(6)	–
At 31 December 2017	(149)	164	15
At 1 January 2016	(122)	119	(3)
Pension costs:			
Interest (expense)/income	(5)	5	–
	(5)	5	–
Re-measurements:			
– Return on plan assets, excluding amounts included in interest (expense)/income	–	20	20
– Loss from changes in financial assumptions	(27)	–	(27)
– Experience gains	6	–	6
	(21)	20	(1)
Other movements:			
– Contributions by employer	–	24	24
– Benefits paid	5	(5)	–
	5	19	24
At 31 December 2016	(143)	163	20

Notes to the Financial Statements continued

Year ended 31 December 2017

38. Pension benefit asset (continued)

(iii) Ockham Scheme (continued)

d) Principal assumptions used	2017	2016
Discount rate	2.50%	2.80%
RPI inflation	3.20%	3.30%
CPI inflation	2.20%	2.30%
Pension increases for in-payment benefits		
– RPI price inflation capped at 5% pa	3.35%	3.30%
– linked to RPI inflation	3.35%	3.30%
– fixed rate	in line with scheme rules	in line with scheme rules
Rate of (non-guaranteed minimum pension) increases in deferment	2.20%	2.30%
Cash commutation – Deferreds	20%	20%
Scheme member valuation date	31 March 2015	31 March 2015

The discount rate and inflation rate assumptions for 2017 and 2016 have been set with reference to yield curves. The single rates disclosed above represent the weighted average equivalent rate based on the yield curve used.

Mortality rate assumptions are based on the same mortality tables as disclosed within the LV Scheme, but using Ockham specific individual base tables.

Future life expectancy assumptions (in years) as at 31 December	2017	2016
Pensioner (currently aged 65)	23.5	23.7
– Male	24.5	24.9
– Female		
Non-pensioner (at age 65, currently aged 45)		
– Male	24.6	24.9
– Female	26.2	26.7

e) Sensitivity analysis: Impact on defined benefit obligation of making changes to key assumptions

	Change in assumption	Impact on defined benefit obligation
Discount rate	Decrease by 0.5%	Increase by £13m (9%)
RPI rate	Decrease by 0.5%	Decrease by £7m (5%)
Life expectancy	Increase by 1 year	Increase by £6m (4%)

The sensitivity analysis has been calculated by valuing the defined benefit obligation using the amended assumptions shown in the table above and keeping the remaining assumptions the same as disclosed in the principal assumptions table for the scheme, except in the case of the inflation sensitivity where other assumptions that depend on assumed inflation have also been amended correspondingly.

Notes to the Financial Statements continued

Year ended 31 December 2017

38. Pension benefit asset (continued)

f) Plan asset information

Plan assets are comprised as follows:

	2017				2016			
	Quoted £m	Unquoted £m	Total £m	%	Quoted £m	Unquoted £m	Total £m	%
Equities and unit trusts	71	–	71	43	68	–	68	42
Debt securities	91	–	91	56	90	–	90	55
Derivative swaps	–	2	2	1	–	2	2	1
Cash and cash equivalents	–	–	–	–	3	–	3	2
	162	2	164	100	161	2	163	100

In determining and reviewing the Scheme's investment strategy, the Trustee adopts an objectives based approach. This translates the principal goal of paying member benefits into measurable funding objectives and risk constraints, agreed by the Trustee. These objectives are reviewed and monitored by the Trustee on a regular basis.

The Trustee's primary funding objective is to reach full funding on the Technical Provisions basis, with a long-term target of moving towards being fully funded on a Gilts +0.50% liability valuation basis by 2034 if possible. In setting the investment strategy, the Trustee aims to:

- Target an expected return on assets close to that required to meet the funding objective;
- Manage the investment risk including that arising due to mismatch between assets and liabilities and limit the total risk on the Scheme below the risk budget;
- Maintain suitable liquidity of assets such that the Scheme is not forced to buy and sell investments at particular times to pay member benefits or meet potential collateral calls.

The Society continues to pay the expenses for administering the Scheme. The next formal valuation of the Scheme is due no later than 31 March 2018.

g) Pension scheme risks

Details of the pension scheme risks that the Group is exposed to are disclosed within the LV Scheme.

	Less than a year £m	Between 1-2 years £m	Between 2-5 years £m	Over 5 years £m	Total £m
h) Expected maturity analysis of undiscounted pension benefits: At 31 December 2017	7	5	17	203	232

The weighted average duration of the defined benefit obligation is 18 years.

No contributions are expected to be made to the Ockham pension scheme for the year ending 31 December 2018.

Notes to the Financial Statements continued

Year ended 31 December 2017

Provisions, contingent liabilities and commitments

This section describes the provisions, contingent liabilities and commitments of the Society and Group arising from the ongoing life and general insurance businesses and the exit from the banking and asset management businesses in prior years.

39. Provisions

Accounting for provisions

General

Provisions are recognised when the Group has a present legal or constructive obligation as a result of past events, it is more likely than not that an outflow of resources will be required to settle the obligation and the amount has been reliably estimated. Where the Group expects some or all of a provision to be reimbursed it is recognised as a separate asset when the reimbursement is certain.

Provisions are measured at the present value of the expenditure required to settle the obligation using a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the obligation.

The expense relating to provisions is presented in the Statement of Comprehensive Income.

Restructuring provisions

In assessing whether to recognise a restructuring provision, the Group evaluates whether communications made create an expectation that results in a constructive obligation for the Group. A provision is made for the direct expenditure associated with restructuring and not for expenditure related to future operations.

Onerous contracts

A provision is made for onerous contracts in which the unavoidable costs of meeting the obligation exceed the expected future economic benefits.

	Group £m	Society £m
Movement during the year on provisions		
Balance at 1 January 2017	12	11
Provided during the year	14	8
Released during the year	(1)	(1)
Utilised during the year	(5)	(5)
Balance at 31 December 2017	20	13

Provisions relate to:	Group		Society	
	2017 £m	2016 £m	2017 £m	2016 £m
Payment protection insurance	8	6	8	6
Restructuring	5	–	–	–
Onerous contracts on property leases	2	2	2	2
Compensation payable on customer complaints	1	1	–	1
Other	4	3	3	2
	20	12	13	11

The payment protection insurance (PPI) provision is held to cover future payments in respect of claims relating to PPI policies potentially mis-sold to customers. Given the assumptions made it is expected that up to £5m of payments will be set against this provision during 2018, with the remainder of the provision being utilised during 2019.

The restructuring provision relates to amounts provided for onerous contracts and dilapidations on property as a result of the sale of the Commercial Lines business to Allianz. The provision is expected to be utilised in 2018.

Notes to the Financial Statements continued

Year ended 31 December 2017

40. Contingent liabilities

Accounting for contingent liabilities

Contingent liabilities are disclosed if there is a possible future obligation as a result of a past event, or if there is a present obligation as a result of a past event but either a payment is not probable or the amount cannot be reasonably estimated.

The Society has granted a contingent loan facility to the RNPFN fund, a closed fund within the Society, up to a maximum of £100m (the value applying for 2017 was £63m), to be used in the event of a shortfall in the capital resources of that fund. The RNPFN fund is required to manage its capital in a manner so as not to require use of this facility and, if it is used, to repay it to the Society as soon as possible. While undrawn a charge for the facility is made at 1% per annum.

As part of the general insurance transaction with Allianz Holdings Plc, Liverpool Victoria Friendly Society Limited acts as guarantor to the obligations entered into by its wholly owned subsidiary, LV Capital PLC.

The Society has granted a guarantee to the trustees of the Teachers Assurance Group Pension Scheme, to guarantee the payment of certain contributions and payments to the scheme by Teachers Management Services Limited (TMS). TMS, a subsidiary of the Society, is the principal employer for the Scheme. Under the Instrument of Transfer executed by the Society and Teachers Provident Society Limited on 6 May 2016

(and effective from 1 June 2016) the Society has the ability to charge all liabilities relating to the scheme to the Teachers Assurance fund, a closed fund within the Society.

The Society has granted a guarantee to the landlord of one of its leased properties, to guarantee that the tenant, Frizzell Financial Services Limited, a subsidiary of the Society, shall pay the rents reserved by the lease and observe and perform the tenant covenants of the lease and that if the tenant fails to do so, the Society shall pay or observe and perform them.

The Society has provided a guarantee in relation to a mortgage purchase agreement between its subsidiary LV Equity Release Limited and Phoenix Life Limited. In the event that the subsidiary fails to pay any amount in connection with the agreement, the Society would cover the payment and any loss incurred by the counterparty as a result.

The Society has entered into a five year loan agreement with Wealth Wizards Limited, one of its subsidiaries, with a facility limit of £15m. Repayment is due by 2020 and £10m has been utilised by the borrower at 31 December 2017 (2016: £6m).

41. Commitments

Accounting for assets held under leases

Where assets are financed by leasing arrangements and the risks and rewards are substantially transferred to the Group, such finance leases are treated as if the assets had been purchased outright and the corresponding liability to the lessor is included as an obligation in trade and other payables. The liability is based on the present value of the minimum lease payments at the inception of the lease. Depreciation on leased assets is charged to the Statement of Comprehensive Income on a straight line basis over the lower of the term of the lease or its estimated useful life. The capital element on finance leases is shown in the property and equipment note.

Lease payments are treated as consisting of capital and interest elements and the interest is charged to the Statement of Comprehensive Income.

All other leases are operating leases and the costs in respect of operating leases are charged on a straight line basis over the lease term. The value of any lease incentive received to take on an operating lease (for example, rent free periods) is recognised as deferred income and is released over the life of the lease.

	Group		Society	
	2017 £m	2016 £m	2017 £m	2016 £m
Capital commitments	14	17	13	17
Operating lease commitments	14	19	8	17
Finance lease commitments	19	20	–	–
Other financial commitments	32	57	26	51
	79	113	47	85

Notes to the Financial Statements continued

Year ended 31 December 2017

41. Commitments (continued)

Capital commitments

Capital commitments relate to authorised and contracted commitments payable but not provided for regarding financial investment and property and equipment.

Operating lease commitments

The Group leases various properties under non-cancellable operating lease agreements. The leases have varying terms, escalation clauses and renewal rights.

Finance lease commitments

Finance lease commitments relate to a property with a remaining lease term of 23 years. The lease is on a fixed repayment basis and no arrangements have been entered into for contingent payments. The Group's obligations under finance leases are secured by the lessors' charges over the leased assets.

Group	2017			2016		
	Gross liability £m	Finance charge £m	Present value £m	Gross liability £m	Finance charge £m	Present value £m
Minimum lease payments						
Within one year	1	–	1	1	–	1
Between one and five years	5	(3)	2	5	(3)	2
Over five years	22	(6)	16	23	(6)	17
	28	(9)	19	29	(9)	20

Other financial commitments

The Group has entered into several long-term contracts following service outsourcing which will end no later than 2021. These contracted commitments have not been provided for in the financial statements.

Notes to the Financial Statements continued

Year ended 31 December 2017

Scope of consolidation

This section presents information on the Group's investments in subsidiaries, joint ventures, associates and structured entities. Detail is also given of the Unallocated divisible surplus of the Society and Group.

42. Subsidiary undertakings

All subsidiary undertakings are included in the consolidation. The proportion of the voting rights in the subsidiary undertakings held directly by the parent company do not differ from the proportion of ordinary shares held. The Group and all principal undertakings are incorporated and domiciled in England and Wales. All holdings are in relation to ordinary shares. The registered office is County Gates, Bournemouth BH1 2NF.

Name	Principal activity	Percentage held by Group	Percentage held by non-controlling interests
Subsidiaries directly owned by the Society			
Frizzell Financial Services Limited (Note 1)	Property management	100%	0%
LV Life Services Limited (Note 1)	Management services	100%	0%
LV Commercial Mortgages Limited (Note 1)	Commercial mortgages	100%	0%
NM Pensions Trustees Limited (Note 1)	Self-invested personal pension (SIPP) administrator	100%	0%
Liverpool Victoria Financial Advice Services Limited (Note 1)	Financial advice services	100%	0%
Liverpool Victoria Life Company Limited	Life insurance	100%	0%
LV Protection Limited	Insurance	100%	0%
LV Capital PLC (Note 1)	Holding company	100%	0%
LV Equity Release Limited (Note 1)	Origination of equity release lifetime mortgages	100%	0%
Teachers Property Limited (Note 1)	Property services	100%	0%
Teachers Financial Services Limited (Note 1)	Insurance and financial intermediary	100%	0%
Teachers Assurance Company Limited	General insurance	100%	0%
Teachers Management Services Limited (Note 1)	Management services	100%	0%
Sovereign Unit Trust Managers Limited	Portfolio manager	100%	0%
Liverpool Victoria Banking Services Limited (Note 2)	Dormant	100%	0%
Ayresbrook Limited (Note 2)	Dormant	100%	0%
Liverpool Victoria Asset Management Limited (Note 2)	Dormant	100%	0%
Highway Corporate Capital Limited (Note 2)	Dormant	100%	0%
Ockham Corporate Limited (Note 2)	Dormant	100%	0%
NLC Name No. 1 Limited (Note 2)	Dormant	100%	0%
NLC Name No. 2 Limited (Note 2)	Dormant	100%	0%
NLC Name No. 3 Limited (Note 2)	Dormant	100%	0%
NLC Name No. 4 Limited (Note 2)	Dormant	100%	0%
NLC Name No. 5 Limited (Note 2)	Dormant	100%	0%
NLC Name No. 7 Limited (Note 2)	Dormant	100%	0%
The LV= Pension Trustee Limited (Note 2)	Dormant trustee company	Note 3	
The LV= General Trustee Limited (Note 2)	Dormant trustee company	Note 3	
The Ockham Pension Trustee Limited (Note 2)	Dormant trustee company	Note 3	
Liverpool Victoria Trustees Limited (Note 2)	Dormant trustee company	Note 3	
Wealth Wizards Limited Group of Companies		70%	30%
Wealth Wizards Limited	IT software		
Wealth Wizards Benefits Limited * (Note 1)	Financial intermediary		
Wealth Wizards Advisers Limited * (Note 1)	Financial intermediary		
Opal IFA Limited * (Note 2)	Dormant		
Liverpool Victoria General Insurance Group of Companies		51%	49%
Liverpool Victoria General Insurance Group Limited *	General insurance holding company		
Liverpool Victoria Insurance Company Limited *	General insurance		
Highway Insurance Company Limited *	General insurance		
LV Repair Services Limited * (Note 1)	Repair services		
LV Assistance Services Limited * (Note 1)	Road Rescue - Pay on use		
LV Insurance Management Limited *	Management services		
Highway Insurance Group Limited *	General insurance holding company		
Highway Group Services Limited * (Note 2)	Dormant		

* Owned by a subsidiary undertaking of the Society

Note 1 – The financial statements of these subsidiary undertakings have not been audited for the year ended 31 December 2017. These subsidiary undertakings are exempt from the requirements of the Companies Act 2006 relating to the audit of individual financial statements by virtue of Section 479A of the Companies Act 2006.

Note 2 – The financial statements of these dormant companies have not been audited for the year ended 31 December 2017. These companies were entitled to exemption from audit under section 480 of the Companies Act 2006 relating to dormant companies.

Note 3 – These companies are limited by Guarantee and have no issued share capital.

Notes to the Financial Statements continued

Year ended 31 December 2017

42. Subsidiary undertakings (continued)

All the principal subsidiaries have the same year end as the Society and all have been included in the consolidation.

Non-controlling interest

Further details on the non-controlling interests in Liverpool Victoria General Insurance Group Limited and Wealth Wizards Limited are disclosed in Note 48.

Significant restrictions

Following the completion of the sale of a 49% stake in Liverpool Victoria General Insurance Group Limited to Allianz Holdings plc there are restrictions associated with this subsidiary and the subsidiaries it directly owns. The general insurance assets and liabilities identified in the Segmental analysis in note 2c) are ring-fenced and distributions from these subsidiaries can only be made in accordance with the dividend policy contractually agreed with Allianz as part of the sale. Allianz has a protective veto right over any dividends paid outside of policy.

Whilst the Society retains control over the LVGIG group, the shareholders agreement includes protective veto rights for the minority investor that restricts the Society's ability to make changes to the capital structure, initiate insolvency proceedings, make a further sale of the business or enter into a merger or acquisition.

Notes to the Financial Statements continued

Year ended 31 December 2017

43. Associates and joint ventures

The associates and joint ventures of the Society at 31 December 2017 are shown below. They are incorporated and domiciled in England and Wales.

Name	Class of shares	Year end	Principal activity	Percentage held
Joint ventures				
Great Victoria Partnership	*	31/03/2017	Investment property	50.0%

* The percentage held represents the share of the partnership capital and partner loans held by the Society as at 31 December 2017.

The Group holds 50% of the voting rights of its joint arrangement. The Group has joint control over this arrangement as, under the contractual agreement, unanimous consent is required from all parties to the agreement for all relevant activities.

The Group's joint arrangement is structured as a partnership and provides the Group and the other parties to the agreement with rights to the net assets of the partnership. Therefore, this arrangement is classified as a joint venture.

Commitments and contingent liabilities in respect of joint ventures

There are no commitments or contingent liabilities relating to the Group's interest in the joint venture.

Summarised financial information for joint ventures

In accordance with the provisions of IFRS 12 which states that an entity may present the summarised financial information on the basis of the joint venture's or associate's financial statements if:

- the entity measures its interest in the joint venture or associate at fair value in accordance with IAS 28; and
- the joint venture or associate does not prepare IFRS financial statements and preparation on that basis would be impracticable or cause undue cost.

The summarised financial information set out below is presented on the basis of the Great Victoria Partnership's financial statements for the year ended 31 March 2017.

Within the Group accounts this holding is accounted for as an investment at fair value in accordance with the exemptions permitted under IAS28 applicable to investment-linked insurance funds.

	31 March 2017 £m	31 March 2016 £m
Summarised Statement of Financial Position		
Assets		
Non-current		
– Investment properties	229	294
Current		
– Other assets	15	15
	244	309
Liabilities		
Non-current		
– Financial liabilities	(79)	(79)
Current		
– Other liabilities	(5)	(5)
	(84)	(84)
Net assets	160	225
Partners' capital	6	49
Retained earnings	154	176
Total partners' funds	160	225

Notes to the Financial Statements continued

Year ended 31 December 2017

43. Associates and joint ventures (continued)

	31 March 2017 £m	31 March 2016 £m
Summarised Statement of Comprehensive Income		
Net rental income	12	11
Revaluation (deficit)/surplus on investment properties	(13)	23
Loss on sale of investment properties	(9)	–
Operating (loss)/profit	(10)	34
Finance costs	(3)	(3)
(Loss)/profit for the year	(13)	31

44. Consolidated structured entities: Open ended investment companies

A structured entity is an entity that has been designed such that voting or similar rights are not the dominant factor in deciding who controls the entity, such as when voting rights relate to administrative tasks only, and the relevant activities are directed by means of contractual arrangements.

The Open Ended Investment Companies (OEICs) have been identified as structured entities. The shares held by the Group in the OEICs do have voting rights attached, however the Group does not have presence on the board of the OEICs. The Authorised Corporate Director (ACD) is Threadneedle Investment Services Limited. The Group's interest in the OEICs is bound by the OEIC prospectus and contractual arrangements.

Significant accounting judgement**Consolidation of Open Ended Investment Companies**

OEICs are structured entities as the relevant activities are directed by contractual arrangements rather than by voting rights. Management have applied judgement in determining whether the Group has control over an OEIC.

Where the Group is the dominant investor in an OEIC, the portfolio of funds that the OEIC invests in is directly influenced by the types of funds that the Group chooses to invest in. The Group is exposed to variable returns arising from the investments held in an OEIC and as a result of its dominant investor position has the ability to affect the variable returns from the OEIC. All OEICs are incorporated and domiciled in England and Wales and are included within the Group consolidation.

Year end 2017 reporting

During the year the Group divested its stake in the Threadneedle Investment Funds II ICVC which was reinvested in larger OEIC funds where the Group is no longer the dominant investor. These new OEIC investments have not been consolidated within the Group and have been disclosed as part of the unconsolidated structured entities within Note 45.

Non-controlling interest

The total Group non-controlling interest for the year is £nil (2016: £28m), of which £nil (2016: £28m) is for Threadneedle Investment Funds II ICVC. The summarised Statement of Financial Position on the following page gives additional disclosures on the non-controlling interests.

Significant restrictions

There are no significant restrictions in place regarding any of the OEICs above.

Summarised financial information on OEIC subsidiaries with material non-controlling interests

Set out below is the summarised financial information for each OEIC subsidiary that has a non-controlling interest that is material to the Group which includes Threadneedle Investment Funds II ICVC (2016 only).

Summarised financial information is presented in order to enable users to understand the interest that non-controlling interests have in the Group's activities and cash flows. The relevant financial information presented for the OEICs is a Statement of Financial Position and the line item within the Statement of Comprehensive Income that is impacted by the performance of the OEICs in the year. An analysis of the Cash and cash equivalents balance is presented; cash flow movements in the year primarily arise from investing activities.

Notes to the Financial Statements continued

Year ended 31 December 2017

44. Consolidated structured entities: Open ended investment companies (continued)

	2017 £m	2016 £m
Summarised Statement of Financial Position		
Assets		
Financial assets at Fair value through income	–	861
Loans and other receivables	–	3
Cash and cash equivalents	–	10
Total assets	–	874
Liabilities		
Trade and other payables	–	(2)
Total liabilities	–	(2)
Net assets	–	872

	2017 £m	2016 £m
Cash and cash equivalents comprise		
Bank balances	–	10
Cash and cash equivalents	–	10

	2017 £m	2016 £m
Summarised Statement of Comprehensive Income		
Net gains on investments	–	64

Movements on net assets in 2016 comprised Net gains on investments of £64m, plus reserve movements related to funds repaid/received for the cancellation/issue of units.

45. Investments in unconsolidated structured entities

The Group has interests in structured entities which are not consolidated as the definition of control has not been met based on the proportion of the investment of the structured entity held by the Group. As at 31 December 2017 the Group's interest in unconsolidated structured entities, which are classified as investments held at fair value through profit or loss, are shown below:

	2017 £m	2016 £m
Investment		
Open Ended Investment Companies	5,430	4,139
Unit trusts	343	293
Liquidity funds	1,017	438
	6,790	4,870

Included within the above are £2,995m (2016: £2,468m) of investments held to cover linked liabilities, other than these, the Group's exposure to financial loss from the interest in the unconsolidated structured entities is limited to the investment amount shown above. The Group is not required to provide financial support to the entities, nor does it sponsor the entities.

Notes to the Financial Statements continued

Year ended 31 December 2017

46. Sale of equity stake in group undertaking

Accounting for the general insurance business transaction

The Group has entered into a transaction whereby a majority stake in LVGIG is sold to Allianz in two stages based on an agreed valuation of 100% of LVGIG of £1.020bn. The first stage was completed on 28 December 2017 with a minority interest of 49% sold; the second stage will complete by 31 December 2019 following settlement of the forward contract for an additional 20.9% unless the Group exercises its Put Option over its remaining shareholding earlier. Allianz is not able to enact the second stage of the transaction any earlier than 31 December 2019.

At 31 December 2017 the Group has retained control of LVGIG and continues to consolidate these subsidiaries. The Group will reassess whether it retains control on an ongoing basis if facts and circumstances change. A non-controlling interest has been recognised as a liability in the Statement of Financial Position. The sale of the 49% non-controlling interest is reported directly within the Unallocated divisible surplus as a transaction with owners that does not result in a loss of control.

The forward contract for purchase of an additional 20.9% by Allianz on 31 December 2019 is valued at £nil as the LVGIG business plan is materially consistent with the plan upon which the overall valuation of LVGIG at £1.020bn was based.

The Group has a Put Option over its remaining 51% shareholding that if exercised before 31 December 2019, will be at the fixed valuation of £1.020bn for 100%. If this option is exercised after 31 December 2019, then the price will be based on the valuation of LVGIG at that time. This option is valued at £nil, based on the LVGIG business plan which does not indicate an impairment in the value of LVGIG from the agreed transaction value of £1.020bn.

As part of the transaction, on 28 December 2017 LVGIG and Allianz exchanged Personal and Commercial broker lines businesses through a transfer of renewal rights. Consideration of £52m was paid to the Group for the sale of the Commercial broker lines renewal rights. The Allianz Insurance plc Personal lines business was acquired by the Group at a cost of £1m. The Commercial lines broker business does not represent a separate major line of business for the LVFS Group as it is a subset of the general insurance business representing 11% of Group Gross earned premiums. It has therefore not been presented as a discontinued operation.

LVGIG will be presented as Held for Sale in the 31 December 2018 financial statements, when the IFRS 5 criteria for Held for Sale are met, unless the Group takes a decision to exercise the Put Option earlier.

Significant accounting judgements

The Group has concluded that it continues to control LVGIG following the sale of 49% of the voting rights to Allianz, through consideration of power to influence the variable returns that the Group is exposed to. The Group has appointed five of the eight members of the new LVGIG Board and holds 51% of the voting rights. Variable returns will be received in the form of dividends in proportion to shareholdings. Whilst Allianz does hold veto rights these are considered to be only protective in nature.

The sale of the Commercial broker lines business was recognised on 28 December 2017, which is the date upon which Allianz obtained control of the business. Until such time as Allianz is in a position to make new business invitations to new and existing customers, Allianz are exercising control of the Commercial broker business through a migration plan in which Allianz is directing LVGIG to continue to write and underwrite renewals and new business.

Renewal rights agreements

As part of the main sale and purchase agreement, the LV Group and Allianz entered into two renewal rights agreements whereby:

- The Commercial broker lines business of the LVGIG Group was transferred to Allianz by way of a transfer of renewal rights.
- The Personal lines business of Allianz Insurance plc was transferred to the LVGIG Group by way of a transfer of renewal rights.

The following table summarises the sale of the Commercial lines renewal rights:

	£m
Value of renewal rights in Statement of Financial Position	–
Consideration received	52
Gain on sale of Commercial business renewal rights	52

The purchase of the Personal lines renewal rights for consideration of £1m has been recognised as an intangible asset.

Net consideration of £51m was received from Allianz on 28 December 2017 for the above renewal right transactions.

Notes to the Financial Statements continued

Year ended 31 December 2017

46. Sale of equity stake in group undertaking (continued)

Sale and purchase agreement

The following table summarises the transaction at first completion:

	£m
Sales proceeds received for 49% stake	500
Less: 49% of net asset value of LVGIG Group (Non-controlling interest)	(376)
Gain on sale of non-controlling interest in LVGIG taken directly to UDS	124

The LV Group will cede control of the general insurance business to Allianz at the second completion date on 31 December 2019, although LV has an option to sell the stake, on the same terms as the first completion, at any date up to 31 December 2019.

Transaction costs of £11m were incurred in respect of the sale and have been included in the Statement of Comprehensive Income within Other operating and administrative expenses.

47. Unallocated divisible surplus

Accounting for the Unallocated divisible surplus

The Unallocated divisible surplus represents the excess of assets over and above the long-term insurance contract liabilities and other liabilities. It represents amounts that have yet to be formally declared as bonuses for the participating contract policyholders together with the free assets of the Society and Group. Any profit or loss for the year arising through the Statement of Comprehensive Income (for the Society and for the Group) is transferred to or from the Unallocated divisible surplus.

UK regulations, the Group's Principles and Practices of Financial Management, and the terms and conditions of participating contracts set out the bases for the determination of the amounts on which the participating additional discretionary contract benefits are based and within which the Group may exercise its discretion as to the quantum and timing of their payment to contract holders.

	Group		Society	
	2017 £m	2016 £m	2017 £m	2016 £m
Balance at 1 January	998	1,101	1,019	1,036
Transfer included within profit/(loss) for the year	48	(101)	12	(15)
Transfer included within other comprehensive income	19	(2)	19	(2)
Gain on sale of non-controlling interest in LVGIG (see Note 46)	124	–	–	–
Balance at 31 December	1,189	998	1,050	1,019

Notes to the Financial Statements continued

Year ended 31 December 2017

48. Non-controlling interest

The table below details the non-controlling interests held in subsidiaries of the Group as at 31 December:

	2017 £m	2016 £m
Liverpool Victoria General Insurance Group Limited	376	–
Wealth Wizards Limited	(3)	(1)
	373	(1)

Summarised financial information on subsidiaries with material non-controlling interests

Summarised financial information is presented in order to enable users to understand the interest that non-controlling interests have in the Group's activities and cash flows.

Set out below is the summarised financial information for each subsidiary that has a non-controlling interest that is material to the Group. For 2017 this includes the Liverpool Victoria General Insurance Group of companies (LVGIG Group). The Wealth Wizards Group of companies are not material to the Group.

	2017 £m
Assets	
Intangible assets	264
Property and equipment	6
Financial assets at fair value through income	1,437
Deferred acquisition costs	95
Reinsurance assets	558
Insurance receivables	279
Other assets	269
Cash and cash equivalents	540
Total assets	3,448
Liabilities	
Insurance contract liabilities	2,427
Subordinated liabilities	11
Other liabilities	242
Total liabilities	2,680
Equity	768
Total equity and liabilities	3,448

The relevant financial information presented for the LVGIG Group is a summary Consolidated Statement of Financial Position for 31 December 2017 only. Details of the Statement of Comprehensive Income and Cash Flow Statement for 2017 have not been presented as the Non-controlling interest only took effect at the end of December 2017 – see Note 46. No dividends were paid to the Non-controlling interests during the year.

Notes to the Financial Statements continued

Year ended 31 December 2017

Other disclosures

This section details other disclosure matters, comprising: related party transactions, directors' emoluments, with-profits actuary details and other relevant Society information.

49. Related party transactions

a) Key management compensation

Key management personnel of the Group comprise all executive and non-executive directors and senior management. The summary of the compensation of key management personnel for the year is as follows:

	Group	
	2017 £000	2016 £000
Short-term employment benefits	5,815	6,016
Other long-term benefits	2,606	2,999
Post-employment benefits	44	103
Termination benefits	1,202	1,348
Total compensation of key management personnel	9,667	10,466

The aggregate premiums payable for the year by the Group Executive and Non-Executive Directors in respect of the Group's products was £20,502 (2016: £40,978).

b) Transactions between the Society and other Group companies

	2017 £m	2016 £m
Management charge by the Society (see note 11)	215	227
Beneficial interest of subsidiary in loans sold to the Society	219	307
Investment expenses charge to the Society	(3)	(5)
Interest income from group undertakings	18	24
Dividend income from group undertakings	94	44

The Society performs administration and investment management activities for the entire Group. Subsidiary companies are charged fees for these services.

Balances outstanding between the Society and other Group companies:

	2017 £m	2016 £m
Payable by the Society	(21)	(11)
Receivable by the Society	25	103
Loans owed to the Society	10	306

c) Loans to related parties

Loans owed to the Society represents a five year loan agreement with Wealth Wizards Limited with a facility limit of £15m (see Note 40 for further details), at 31 December 2017 £10m of this loan had been drawn down (2016: £6m).

On 30 September 2017 the Society purchased £326,053,921 ordinary £1 shares in LV Capital PLC, in exchange for the cancellation of the £300m loan notes and the repayment of outstanding interest.

d) Other related party disclosure

The Society has granted a contingent loan facility to the RNPFN fund, a closed fund within the Group and a guarantee to the Trustees of the Teachers Assurance Group Pension Scheme. Further details of these are disclosed in Note 40.

50. With-Profits Actuary

The following information has been provided in accordance with section 77 of the Friendly Societies Act 1992.

- The With-Profits Actuary of the Society throughout 2017 was Mr A Walton, who is employed by Liverpool Victoria Friendly Society Limited.
- The total emoluments of Mr Walton during the year were £297,159 (2016: £227,249) including pension contributions, car allowance, LTIPs and other benefits. Mr Walton is a participant in the Society's long-term incentive plan and held one insurance policy issued by a subsidiary of the Society.
- Mr Walton did not receive, nor will receive, any other pecuniary benefit.

Notes to the Financial Statements continued

Year ended 31 December 2017

51. Directors' emoluments

a) Emoluments of individual directors, including emoluments of the Chairman and highest paid director were as follows for the Society:

	Annual remuneration £000						2016	Total remuneration £000		
	2017							2017		
	Salary and fees	Bonus	Deferred Bonus	Pension related benefits	Other benefits	Total		Total	LTIP 2015-17	Total
R.A. Rowney	505	557	49	111	17	1,239	930	480	1,719	1,166
S Treloar (resigned 28 December 2017)	380	272	108	40	15	815	488	–	815	488
P.W. Moore (resigned 29 June 2017) (1)	194	25	–	26	15	260	488	339	599	747
A. Parsons (appointed 30 June 2017) (2)	217	250	–	22	8	497	–	–	497	–
A.Cook (appointed 1 January 2017)	153	–	–	–	–	153	–	–	153	–
M.E. Austen (resigned 20 June 2017)	87	–	–	–	–	87	184	–	87	184
C. Burton	82	–	–	–	–	82	73	–	82	73
J. Dean	78	–	–	–	–	78	77	–	78	77
D. Neave	77	–	–	–	–	77	79	–	77	79
D. Barral	75	–	–	–	–	75	51	–	75	51
C. Keers (resigned 20 June 2017)	33	–	–	–	–	33	70	–	33	70
C. Ledlie (appointed 1 August 2017)	28	–	–	–	–	28	–	–	28	–
M.J. Rogers (resigned 28 July 2016) (3)	–	–	–	–	–	–	456	–	–	891
J.B. O'Roarke (resigned 5 May 2016)	–	–	–	–	–	–	131	–	–	131
	1,909	1,104	157	199	55	3,424	3,027	819	4,243	3,957

(1) Philip Moore resigned from the board on 29 June 2017. The remuneration for his period as a director is included in the table above. In addition Philip Moore received a payment in lieu of notice for the 12 months to 29 June 2018. Philip Moore remains entitled to participate in the 2016-2018 LTIP scheme on a pro rata basis to 29 June 2017. These amounts are included as 'Payments for contractual commitments on leaving office' and are disclosed in the Report on Directors' Remuneration on page 90.

(2) Andy Parsons participated in a number of incentive arrangements at his previous employer which the Remuneration Committee agreed to buy out as part of his offer to join the Society. The total amounts due to Mr. Parsons under this arrangement are £450k, further details of these are disclosed in the Report on Directors' Remuneration on page 89.

(3) Mike Rogers resigned from the board on 28 July 2016. The remuneration for his period as a director is included in the table above. On resignation Mike Rogers remained entitled to participate in the 2015-2017 and 2016-2018 LTIP schemes on a pro rata basis to 31 December 2016. For 2017 Mr Rogers was awarded a payout of £530k in relation to the 2015-2017 LTIP scheme. Further details of this payout are disclosed in the Report on Directors' Remuneration on page 89.

Pension related benefits include payments made to the Group's defined contribution pension scheme and payments in lieu of pension contributions.

Deferred bonus represents the amount of the 2017 performance bonus payable over the next three years.

Other benefits include car allowances, medical, relocation, life assurance and other benefits in kind or their equivalent monetary value.

b) Pension arrangements

The LV= Employee Pension Scheme is administered at Group level and incorporates both defined benefit and defined contribution sections. The defined benefit section was closed to future accrual in 2013 at which point existing members were eligible to join the defined contribution section.

The Society has made no contributions to personal pension arrangements during 2017 (2016: £nil). There were £15k of contributions to the defined contribution section in 2017 (2016: £34k).

R.A. Rowney is a deferred member of the defined benefit section.

	2017	2016
Deferred pension at end of year	£000	£000
R.A. Rowney	31	31

Notes to the Financial Statements continued

Year ended 31 December 2017

52. Cash generated from operating activities

	Group		Society	
	2017 £m	2016 £m	2017 £m	2016 £m
Profit/(loss) before tax, mutual bonus and UDS transfer	122	(49)	62	47
Investment income	(374)	(401)	(430)	(406)
Other interest income	(32)	(30)	–	–
Net gains on investments	(360)	(1,006)	(395)	(1,016)
Finance costs	24	24	23	23
Gain on sale of commercial business renewal rights	(52)	–	–	–
Gain on Teachers acquisition	–	(3)	–	(3)
Net (increase)/decrease in derivatives	(20)	(7)	14	(7)
Non-cash items				
Movement in deferred acquisition costs	7	(3)	–	–
Amortisation of intangible assets	11	6	2	–
Depreciation of property and equipment	7	6	3	3
Loss on disposal of property and equipment	1	–	1	–
Impairment of intangible assets	2	–	–	–
Increase/(decrease) in provisions	13	4	7	4
Increase in pension benefit asset	(9)	(36)	(9)	(36)
Impairment write-offs in subsidiaries	–	–	16	3
Mutual bonus	(26)	(17)	(26)	(17)
Changes in working capital				
Decrease/(increase) in loans and receivables	33	(201)	90	(66)
Increase in reinsurance assets	(1,215)	(185)	(1,146)	(94)
(Increase)/decrease in insurance receivables	(15)	(30)	(13)	4
Decrease in other prepayments and accrued income	2	–	16	4
Increase in participating insurance contract liabilities	280	805	280	804
Increase in non-participating insurance contract liabilities	280	729	209	476
Decrease/(increase) in non-participating value of in-force business	31	(3)	31	(3)
Increase in participating investment contract liabilities	56	16	56	16
Increase in non-participating investment contract liabilities	524	446	524	446
Increase in subordinated liabilities	1	1	1	–
(Decrease)/increase in other financial liabilities	(54)	20	(54)	21
(Decrease)/increase in insurance payables	(1)	(235)	1	(8)
Increase/(decrease) in trade and other payables	29	(45)	5	(42)
Cash (used in)/generated from operating activities	(735)	(194)	(732)	153

53. Solvency and Financial Condition Report

The Solvency and Financial Condition Report of the Group as at 31 December 2017 will be available on LV.com after it has been submitted to the Prudential Regulation Authority or on request from the Group Company Secretary, County Gates, Bournemouth, BH1 2NF.

54. Society information

Liverpool Victoria Friendly Society Limited is a UK-incorporated and domiciled Friendly Society registered under the Friendly Societies Act 1992.

LV= and Liverpool Victoria are trademarks of Liverpool Victoria Friendly Society Limited. LV= and LV= Liverpool Victoria are trading styles of the Liverpool Victoria group of companies. Liverpool Victoria is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and Prudential Regulation Authority, and is a member of the Association of British Insurers and the Investment and Life Assurance Group.

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