Dated 20 May 2013

LIVERPOOL VICTORIA FRIENDLY SOCIETY LIMITED

(incorporated in England as a friendly society with registered number 61COL)

£350,000,000 6.50 per cent.
Fixed Rate Reset Subordinated Notes
callable 2023 due 2043

Issue Price 100 per cent.

The £350,000,000 6.50 per cent. Fixed Rate Reset Subordinated Notes callable 2023 due 2043 (the "**Subordinated Notes**") will be issued by Liverpool Victoria Friendly Society Limited (the "**Issuer**") on or about 22 May 2013 (the "**Issue Date**"). The Subordinated Notes will constitute subordinated obligations of the Issuer. The Subordinated Notes will bear interest from (and including) the Issue Date at a fixed rate of 6.50 per cent. per annum up to (but excluding) 22 May 2023 (the "**First Call Date**"), and thereafter at the applicable Reset Rate (as defined in the terms and conditions of the Subordinated Notes (the "**Conditions**")). Interest on the Subordinated Notes is payable annually in arrear on 22 May in each year (commencing on 22 May 2014). The Issuer may elect to defer any interest payment at its sole discretion and must defer such interest payments, in certain circumstances, all as described in Condition 5. Any interest which is deferred will, for so long as it remains unpaid, constitute "**Arrears of Interest**". Arrears of Interest will not themselves bear interest.

The Subordinated Notes are scheduled to mature on 22 May 2043 (the "**Maturity Date**") but may be redeemed before then at the option of the Issuer in whole but not in part on the First Call Date or on any Interest Payment Date thereafter at their principal amount together with accrued interest up to (but excluding) the redemption date and any Arrears of Interest. Subject to certain pre-conditions including the satisfaction of the Regulatory Clearance Condition and continued compliance with the Regulatory Capital Requirements, the Subordinated Notes may also be redeemed, substituted or varied prior to such date (i) in the event of certain changes in the tax treatment of the Subordinated Notes or payments thereunder due to a change in applicable law or regulation or the official interpretation thereof or (ii) following the occurrence of (or if the Issuer satisfies the Trustee that there will occur within six months) a Capital Disqualification Event or a Ratings Methodology Event (provided that, (i) in the case of a Ratings Methodology Event, the Subordinated Notes will not be redeemed prior to the fifth anniversary of the Issue Date and (ii) in the case of any redemption prior to the fifth anniversary of the Issue Date, the approval of the Prudential Regulation Authority is required and such redemption must be funded out of the proceeds of a new issue of at least equivalent regulatory capital (unless Solvency II (as defined in the Conditions) is implemented without such requirements). The redemption of the Subordinated Notes on the Maturity Date or any other date fixed for the redemption of the Subordinated Notes shall be deferred in certain circumstances as set out in Condition 7. Payments by the Issuer will be subject to the Solvency Condition and/or the Regulatory Deficiency Redemption Deferral Event not having occurred or occurring if the Subordinated Notes were to be redeemed.

Application has been made to the Financial Conduct Authority under Part VI the Financial Services and Markets Act 2000 (the "**UK Listing Authority**") for the Subordinated Notes to be admitted to the official list of the UK Listing Authority (the "**Official List**") and to the London Stock Exchange plc (the "**London Stock Exchange**") for such Subordinated Notes to be admitted to trading on the London Stock Exchange's Regulated Market (the "**Market**"). References in this Prospectus to the Subordinated Notes being "listed" (and all related references) shall mean that the Subordinated Notes have been admitted to the Official List and have been admitted to trading on the Market. The Market is a regulated market for the purposes of Directive 2004/39/EC of the European Parliament and of the Council on markets in financial instruments.

The denomination of the Subordinated Notes shall be £100,000 and integral multiples of £1,000 in excess thereof. The Subordinated Notes will be issued in registered form and represented upon issue by a registered global certificate which will be registered in the name of a nominee for a common depository for Clearstream Banking, société anonyme and Euroclear Bank SA/NV on or about 22 May 2013. Save in limited circumstances, Subordinated Notes in definitive form will not be issued in exchange for interests in the registered global certificate.

The Subordinated Notes have been rated BBB- by Standard & Poor's Credit Market Services Europe Limited ("**S&P**"). A rating is not a recommendation to buy, sell or hold securities and may be subject to suspension, reduction or withdrawal at any time by the assigning rating agency. The credit ratings included or referred to in this Prospectus have been issued by S&P which is established in the European Union and registered under Regulation (EC) No. 1060/2009 (as amended) (the "**CRA Regulation**"). S&P is included in the list of credit rating agencies published by the European Securities and Markets Authority on its website in accordance with the CRA Regulation.

Prospective investors should have regard to the factors described under the section entitled "*Risk Factors*" in this Prospectus.

Joint Lead Managers and Joint Bookrunners

BARCLAYS **HSBC**

This Prospectus comprises a prospectus for the purposes of Directive 2003/71/EC, as amended (the "**Prospectus Directive**") and for the purpose of giving information with regard to Liverpool Victoria Friendly Society Limited, its subsidiaries and affiliates taken as a whole (the "**Group**"), and the £350,000,000 6.50 per cent. Fixed Rate Reset Subordinated Notes callable 2023 due 2043 (the "**Subordinated Notes**") which according to the particular nature of the Issuer and the Subordinated Notes, is necessary to enable investors to make an informed assessment of the assets and liabilities, financial position, profit and losses and prospects of the Issuer. The Issuer (the "**Responsible Person**") accepts responsibility for the information contained in this Prospectus. To the best of the knowledge and belief of the Issuer (which has taken all reasonable care to ensure that such is the case), the information contained in this Prospectus is in accordance with the facts and does not omit anything likely to affect the import of such information.

Words and expressions defined in "Terms and Conditions of the Subordinated Notes" and not otherwise defined in this Prospectus shall have the same meanings when used in the remainder of this Prospectus.

This Prospectus does not constitute an offer of, or an invitation by or on behalf of the Issuer or the Managers (as defined in the section entitled "*Subscription and Sale*" on page 116) to subscribe or purchase, any of the Subordinated Notes. The distribution of this Prospectus and the offering of the Subordinated Notes in certain jurisdictions may be restricted by law. Persons into whose possession this Prospectus comes are required by the Issuer, Barclays Bank PLC and HSBC Bank plc (together the "**Managers**") and HSBC Corporate Trustee Company (UK) Limited (the "**Trustee**") to inform themselves about and to observe any such restrictions.

For a description of further restrictions on offers and sales of Subordinated Notes and distribution of this Prospectus, see the section entitled "*Subscription and Sale*" on page 116.

No person is authorised to give any information or to make any representation not contained in this Prospectus and any information or representation not so contained must not be relied upon as having been authorised by or on behalf of the Issuer, the Managers or the Trustee. Neither the delivery of this Prospectus nor any sale made in connection herewith shall, under any circumstances, create any implication that there has been no change in the affairs of the Issuer since the date hereof or the date upon which this Prospectus has been most recently amended or supplemented or that there has been no adverse change in the financial position of the Issuer since the date hereof or the date upon which this Prospectus has been most recently amended or supplemented or that the information contained in it or any other information supplied in connection with the Subordinated Notes is correct as of any time subsequent to the date on which it is supplied or, if different, the date indicated in the document containing the same.

To the fullest extent permitted by law, the Managers accept no responsibility whatsoever for the contents of this Prospectus or for any other statement, made or purported to be made by a Manager or on its behalf in connection with the Issuer or the issue and offering of the Subordinated Notes. Each Manager accordingly disclaims all and any liability whether arising in tort or contract or otherwise (save as referred to above) which it might otherwise have in respect of this Prospectus or any such statement.

This Prospectus contains figures which relate to the Group's "underlying operating profit". Underlying operating profit is calculated as the Group's operating profit before one-off items such as basis and methodology changes, short-term investment fluctuations and amortisation of intangibles. The Group has included underlying operating profit figures because it believes they are a useful supplement to the audited financial reports and accounts of the Group. However, investors should note that underlying operating profit figures are not audited, and should not be considered in isolation or construed as an alternative to the financial reports and accounts of the Group.

The Subordinated Notes have not been and will not be registered under the U.S. Securities Act of 1933 (the "**Securities Act**") and are subject to U.S. tax law requirements. Subject to certain exceptions, Subordinated Notes may not be offered, sold or delivered within the United States or to U.S. persons.

Unless otherwise specified or the context requires, references to "**sterling**" and "**£**" are to the currency of the United Kingdom and all references to "**euro**" and "**€**" are to the currency introduced at the start of the Third Stage of European Economic and Monetary Union pursuant to the Treaty on the Functions of the European Union ("**EU**"), as amended.

In connection with the issue of the Subordinated Notes, Barclays Bank PLC (the "Stabilising Manager") (or any person acting on behalf of the Stabilising Manager) may over-allot Subordinated Notes or effect transactions with a view to supporting the market price of the Subordinated Notes at a level higher than that which might otherwise prevail. However, there is no assurance that the Stabilising Manager (or any person acting on behalf of the Stabilising Manager) will undertake stabilisation action. Any stabilisation action may begin on or after the date on which adequate public disclosure of the terms of the offer of the Subordinated Notes is made and, if begun, may be ended at any time, but it must end no later than the earlier of 30 days after the issue date of the Subordinated Notes and 60 days after the date of the allotment of the Subordinated Notes. Any stabilisation action or over-allotment must be conducted by the Stabilising Manager (or any person acting on behalf of the Stabilising Manager) in accordance with all applicable laws and rules.

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Overview of the Principal Features of the Subordinated Notes

The following overview refers to certain provisions of the terms and conditions of the Subordinated Notes and the Trust Deed and is qualified by the more detailed information contained elsewhere in this Prospectus. Capitalised terms which are defined in the section entitled "Terms and Conditions of the Subordinated Notes" on page 45 shall have the same meaning when used in this overview.

Issuer:	Liverpool Victoria Friendly Society Limited.
Description of the Subordinated Notes:	£350,000,000 6.50 per cent. Fixed Rate Reset Subordinated Notes callable 2023 due 2043.
Joint Lead Managers and Joint Bookrunners:	Barclays Bank PLC. HSBC Bank plc.
Trustee:	HSBC Corporate Trustee Company (UK) Limited.
Principal Paying Agent, Registrar and Transfer Agent:	HSBC Bank plc.
Risk Factors:	There are certain factors that may affect the Issuer's ability to fulfil its obligations under the Subordinated Notes. In addition, there are certain factors which are material for the purpose of assessing the market risks associated with the Subordinated Notes and certain risks relating to the structure of the Subordinated Notes. These are set out in the section entitled "*Risk Factors*" on page 11.
Status and Subordination of the Subordinated Notes:	The Subordinated Notes constitute direct, unsecured and subordinated obligations of the Issuer, and will rank *pari passu* and without any preference among themselves. The rights and claims of the Noteholders against the Issuer are subordinated in a Winding-Up as described in Condition 3*(b)*.
Maturity Date and Optional Redemption:	Unless previously redeemed or purchased and cancelled, the Issuer will (subject as provided under "*Deferral of Redemption at Maturity Date or on Optional Redemption*" below) redeem the Subordinated Notes on 22 May 2043. The Issuer may, subject as provided under "*Deferral of Redemption at Maturity Date or on Optional Redemption*" below, upon giving not less than 15 nor more than 30 days' notice to Noteholders, redeem all (but not some only) of the Subordinated Notes on the First Call Date or any Interest Payment Date thereafter at their principal amount together with any Arrears of Interest and any other accrued but unpaid interest to (but excluding) the date of redemption. The Subordinated Notes are not redeemable at the option of any Noteholder in any circumstances.
Redemption, variation or substitution upon a relevant tax law change, Capital Disqualification Event or a Ratings Methodology Event:	The Subordinated Notes may be redeemed prior to the First Call Date (i) in the event of certain changes in the tax treatment of the Subordinated Notes or payments thereunder due to a change in applicable law or regulation or the official interpretation

thereof or (ii) following the occurrence of (or if the Issuer satisfies the Trustee that there will occur within six months) a Capital Disqualification Event or a Ratings Methodology Event (provided that, (a) in the case of a Ratings Methodology Event, the Subordinated Notes will not be redeemed prior to the fifth anniversary of the Issue Date and (b) in the case of any redemption prior to the fifth anniversary of the Issue Date, the approval of the PRA is obtained and such redemption is funded out of the proceeds of a new issue of at least equivalent regulatory capital (unless Solvency II (as defined in the Conditions) is implemented without such requirements).

The Conditions also provide for the substitution or variation of the Subordinated Notes in certain circumstances relating to a relevant tax law change, Capital Disqualification Event or a Ratings Methodology Event, all as more particularly described in Condition 7.

Deferral of Redemption at Maturity Date or on Optional Redemption:

No Subordinated Notes shall be redeemed by the Issuer on the Maturity Date or on any other date fixed for redemption pursuant to Conditions 7*(d)*, 7*(e)* or 7*(f)* if (i) a Regulatory Deficiency Redemption Deferral Event has occurred and is continuing or would occur if the Subordinated Notes were to be redeemed or (ii) such payment could not be made in compliance with the Solvency Condition.

If redemption of the Subordinated Notes is deferred, the Issuer will redeem the Subordinated Notes as provided in Condition 7*(b)*.

Regulatory approval for early redemption, variation, substitution or purchase:

Prior to publishing any notice (a) that the Issuer intends to redeem the Subordinated Notes before the Maturity Date or (b) of any proposed substitution, variation or purchase of the Subordinated Notes, the Issuer will be required to have complied with the Regulatory Clearance Condition and be in continued compliance with Regulatory Capital Requirements as published by the PRA.

Interest:

The Subordinated Notes will bear interest from (and including) the Issue Date to (but excluding) the First Call Date at a fixed rate of 6.50 per cent. per annum payable (subject as provided under "*Interest Deferral*" below) annually in arrear on 22 May in each year. Thereafter, the Subordinated Notes will bear interest from (and including) the First Call Date at the applicable Reset Rate (subject as provided under "*Interest Deferral*" below) payable annually (subject as provided under "*Interest Deferral*" below) in arrear on 22 May in each year.

Interest Deferral:	The Issuer may in relation to any Interest Payment Date elect to defer payments of interest on the Subordinated Notes. The Issuer is required to defer any payment of interest on the Subordinated Notes on each Regulatory Deficiency Interest Deferral Date (being an Interest Payment Date (i) in respect of which a Regulatory Deficiency Interest Deferral Event has occurred and is continuing and/or (ii) on which such payment could not be made in compliance with the Solvency Condition).
Arrears of Interest:	Any interest which is deferred by the Issuer will, for so long as it remains unpaid, constitute Arrears of Interest. Arrears of Interest will not themselves bear interest and will be payable by the Issuer as provided in Condition 5*(e)*.
Restrictions following Deferral of Interest or Principal:	During any period starting from when notice is given (or, if earlier, the date on which the Issuer becomes obliged to give such notice) to defer any payments in respect of interest or principal under the Subordinated Notes and ending on the date on which the obligation to make payment of all such deferred interest or principal is satisfied in full (including any Arrears of Interest): (i) neither the Board of Directors of the Issuer nor any committee thereof shall resolve on or publicly declare any distribution to members, which distribution falls within the Mutual Bonus Arrangements; and (ii) the Issuer shall not (and shall procure no Subsidiary of the Issuer shall) purchase, redeem, cancel, reduce or otherwise acquire (directly or indirectly) any Subordinated Notes or any Junior Instruments, save where the Issuer or the relevant Subsidiary is not able to defer, pass or eliminate the relevant payment or other obligation in accordance with the terms of the Subordinated Notes or the relevant Junior Instruments.
Events of Default:	If default is made by the Issuer for a period of 14 days or more in the payment of any interest or principal due in respect of the Subordinated Notes or any of them, or a Winding-Up occurs, the Trustee on behalf of the Noteholders may (and, subject to certain conditions, if so directed by the requisite majority of Noteholders shall) institute proceedings for the winding-up of the Issuer in England and Wales (but not elsewhere), and/or (as applicable) prove in the winding-up or administration of the Issuer and/or claim in the liquidation of the Issuer but may take no further action to enforce, prove or claim for any payment by the Issuer in respect of the Subordinated Notes or the Trust Deed.

Upon the occurrence of a Winding-Up, the Trustee may (and, subject to certain conditions, if so directed by the requisite majority of the Noteholders shall) give notice to the Issuer that the Subordinated Notes are, and they shall accordingly become, immediately due and payable by the Issuer at their principal amount together with any Arrears of Interest and any other accrued and unpaid interest.

No amounts shall be due for payment by the Issuer in circumstances where payment of such amount could not be made in compliance with the Solvency Condition or is deferred by the Issuer in accordance with Conditions 5*(a)*, 5*(b)* or 7*(b)*.

Additional Amounts:

All payments in respect of the Subordinated Notes shall be made free and clear of, and without withholding or deduction for, or on account of, any Taxes of the United Kingdom, unless such withholding or deduction is required by law.

If any such withholding or deduction is made, additional amounts will be payable by the Issuer subject to certain exceptions as are more fully described in Condition 9.

Substitution of the Issuer and Transfer of Business of the Issuer:

The Conditions permit the Trustee to agree to the substitution in place of the Issuer of a Substituted Obligor or the addition of a Related Undertaking of the Issuer as a guarantor of the Issuer's Obligations in the circumstances described in Condition 14 without the consent of Noteholders.

In addition, the Issuer may, without any prior approval from the Noteholders or the Trustee, transfer the whole or a substantial part of its business in the circumstances provided in Condition 16, provided that all the liabilities and obligations of the Issuer under the Subordinated Notes are transferred to the relevant transferee.

Meetings of Noteholders:

The Conditions contain provisions for calling meetings of Noteholders to consider matters affecting their interests generally. These provisions permit defined majorities to bind all Noteholders including Noteholders who did not attend and vote at the relevant meeting and Noteholders who voted in a manner contrary to the relevant majority.

Form:

The Subordinated Notes will be issued in registered form and represented upon issue by a registered global certificate which will be registered in the name of a nominee for a common depository for Clearstream Banking, *société anonyme* and Euroclear Bank SA/NV on or about 22 May 2013. Save in limited circumstances, Subordinated Notes in definitive form will not be issued in exchange for interests in the registered global certificate. See the section of this Prospectus entitled "*Summary of Provisions relating to the Subordinated Notes while in Global Form*" on page 73 for further details.

Denomination:	The denomination of the Subordinated Notes shall be £100,000 and higher integral multiples of £1,000 in excess thereof.
Listing and Admission to Trading:	Application will be made to the Financial Conduct Authority under Part VI of the Financial Services and Markets Act 2000 for the Subordinated Notes to be admitted to the Official List and to the London Stock Exchange plc for such Subordinated Notes to be admitted to trading on the London Stock Exchange's Regulated Market.
Rating:	The Subordinated Notes have been rated BBB- by S&P. A rating is not a recommendation to buy, sell or hold securities and may be subject to suspension, reduction or withdrawal at any time by the assigning rating agency. A13.7.5 The credit ratings included or referred to in this Prospectus have been issued by S&P which is established in the European Union and registered under Regulation (EC) No. 1060/2009 (as amended) (the "**CRA Regulation**"). S&P is included in the list of credit rating agencies published by the European Securities and Markets Authority on its website in accordance with the CRA Regulation.
Governing Law:	The Subordinated Notes and the Trust Deed will be governed by, and construed in accordance with, English law.
Selling Restrictions:	The United States and the United Kingdom.
Use of Proceeds:	The net proceeds of the issue of the Subordinated Notes will be used by the Issuer for general corporate purposes.
Clearing Systems:	Clearstream Banking, *société anonyme* and Euroclear Bank SA/NV.
ISIN:	XS0935312057
Common Code:	093531205

Risk Factors

*Liverpool Victoria Friendly Society ("**LVFS**") believes that the following factors may affect its ability to fulfil its obligations under the Subordinated Notes. All of these factors are contingencies which may or may not occur and LVFS is not in a position to express a view on the likelihood of any such contingency occurring.*

Any of these risk factors, individually or in the aggregate, could have an adverse effect on the Group and the impact each risk could have on the Group is set out below. In addition, many of these factors are correlated and may increase the Group's overall capital requirements, and this could mean that, when combined, the adverse consequences of certain of the risks referred to below impacting on the Group could compound or exacerbate the impact of other risks. For example, the impact of the global financial crisis may reduce the value of investments and weaken the capital position of the Group and at the same time reduce the ability of the Group to offset insurance risks through reinsurance and derivatives due to reduced capacity in such markets or the failure of relevant counterparties. Further, a reduction in the financial strength of the Group as a result of weak investment markets may adversely impact its ability to market and provide competitive products for its general and life insurance businesses.

In line with other insurance groups, through both regulatory requirements and the Group's own risk appetite the Group holds capital to protect itself against such risk events, including the risk of aggregation of such risks. However, LVFS cannot be certain that its current capital and related solvency cover will be sufficient to enable the Group to continue to trade at current volumes following a significant risk event or an aggregation of such risk events.

LVFS believes that the factors described below represent the principal risks inherent in investing in the Subordinated Notes, but LVFS may be unable to pay interest, principal or other amounts on or in connection with the Subordinated Notes for other reasons, and LVFS does not represent that the statements below regarding the risks of holding the Subordinated Notes are exhaustive. Prospective investors should also read the detailed information set out elsewhere in this Prospectus and reach their own views prior to making any investment decision.

1. **Risks relating to the financial markets, the financial strength and financial condition of the Group, the valuation of assets and related risks.**

Continuing difficult conditions in the global financial markets and the UK and global economies as well as concerns over the Eurozone sovereign debt crisis may materially adversely affect the operations of the Group and its financial condition.

Like other insurance groups, the Group is impacted by UK and global economic conditions. Current volatility in the global capital markets, the UK and the global economy generally, described in the paragraph below, may have a materially adverse effect on the Group due to its exposure to asset prices and the market in which the Group operates.

Marked deterioration in global financial market conditions from mid-2007 led to severe dislocation of those markets and unprecedented levels of illiquidity. A number of governments including those of the US, the UK and other EU member states, had to intervene to stabilise financial markets through fiscal stimulus. In some cases the injection of funds was required to prevent the failure of financial institutions. While conditions in the global financial markets have improved, the ongoing Eurozone sovereign debt crisis, for example, continues to drive increased levels of uncertainty. As a result of the crisis it has been the policy of the Bank of England to maintain consistently low interest rates and support the UK economy with measures such as quantitative easing.

As a result of these uncertainties and the risk of a further downturn in financial markets and asset values, as well as significant movements in interest rates and credit spreads, the results of operations of the Group may be subject to significant volatility, and there can be no assurance as to the effects of this volatility, particularly if it is prolonged, on the financial condition of the Group. Specific effects may include:

- a general reduction in business activity and market volumes which affects revenues, such as premium income from sales of insurance products or margins earned on in-force business;
- an increased incidence of claims or surrenders of policies that could affect the current and future profitability of the business;
- market downturns resulting in a reduction in the valuations of assets held by the Group to meet policyholder liabilities;
- reduced market liquidity, limiting the Group's ability to trade in investment assets, access capital and manage risks;
- a reduction in the value of the assets which the Group holds for its own account;
- increased costs to the Group as a result of hedging against market risks such as equity, currency or interest rate exposure;
- pressure from regulators and risk management policies to reduce equity and corporate bond investments; and
- increased capital requirements applicable to the Group as a result of applying market related stress tests.

The following risks associated with the financial markets are of particular relevance for the Group due to its large investment portfolio of around £9.7bn (excluding the Group's staff pension scheme). The management of the Group's investment portfolio was substantially transferred to Threadneedle Asset Management in 2011 and is currently invested in UK equities, overseas equities, UK Gilts, bonds, property and cash assets. Accordingly, the Group is exposed to decreases in the value of such investments, and its sales of insurance products which are exposed to the performance of such investments. Such market risks are also potentially exacerbated as a result of the economic conditions described in the following risk factors.

Significant fluctuations or declines in investment values or property prices could adversely affect the Group's profitability and financial condition.

The value of investment assets fluctuates, which can impact the capital levels supporting the Group's business. A downturn in the equity, fixed income and/or other investment markets will depress the value of the Group's investments and have a negative impact on the Group's capital position.

The Group is also exposed to investment market volatility and decreases in asset values through its general and life insurance investment portfolios and also through the assets backing its obligations in relation to the Group's staff pension scheme. The Group looks to mitigate this risk through investment diversification and other risk management techniques such as derivatives and asset and liability matching. However, increased volatility and/or a substantial decline in the value of financial markets could result in a substantial loss in the value of the investments of the Group which could have an adverse impact on the capital position of the Group and its profitability.

In addition, the Group offers certain long-term insurance products with guarantees. In volatile or declining investment markets it may be necessary to increase provisions against liabilities in respect of future policyholder benefits, negatively impacting profitability.

The Group is subject to property price risk due to holdings of investment properties in a variety of locations in the UK and its exposure to the residential property market through its equity release products. These investments may be adversely affected by weakness in property markets in the UK.

Specific risk mitigation activity that the Group has undertaken in respect of declining and fluctuating financial markets include:

- approval from the directors of LVFS that equity holdings backing with-profits business can be reduced if the FTSE 100 index falls below certain levels;
- the purchase of a long-term (10 year) equity put option by the Group to mitigate costs of guarantees in the event of a significant fall in the FTSE 100 index; and
- a reduction in the equity exposure of the investment portfolio of the general insurance business of the Group to a maximum of 5 per cent. of the assets of the general insurance business.

The Group is exposed to widening credit spreads which may adversely affect the Group's capital and its profitability.

Credit spreads, along with defaults and the migrations of investments from one credit rating to another, have a direct impact on the value of certain assets of the Group, principally debt securities, whereby a widening credit spread will result in a decrease in the value of the relevant assets of the Group, which will negatively impact the Group's capital position.

The Group is most exposed to credit spread widening in the investment portfolio of its general insurance business and its life annuity business. In the general insurance business, the result is a fall in the value of the debt security assets which will reduce the investment return of the business and is likely to have an adverse effect on capital. In the annuity business, the fall in the value of the debt security assets will not be matched by an equivalent fall in the annuitant liabilities resulting in an adverse effect on capital.

If debt securities held by the Group are subject to default this will adversely impact on profitability. In the annuity investment portfolio, where a debt security is subject to a credit rating downgrade this may result in an adverse impact on profitability but may also reduce the Group's free capital through both the fall in the value of the debt security assets and the increased capital that the Group would need to hold. The Group holds a diversified portfolio of assets to help manage this risk.

The Group is also exposed to a widening of credit spreads in its guaranteed with-profits policies where there may be an increase in the cost of the guarantees due to the underlying fall in asset values.

Changes in interest rates may reduce the value of the Group's investment portfolio, adversely impact asset and liability matching, and cause policyholders to surrender their contracts.

Products with long term guarantees expose the Group to the risk that reductions in interest rates will reduce the difference between the return required to be paid under the policies and the rate of return the Group is able to earn on investments intended to support obligations under those policies, adversely impacting its profitability.

Due to the long-term nature of the liabilities associated with the life insurance business and guaranteed benefits on certain long-term insurance products, current low interest rates subject the Group to reinvestment risks. As interest rates remain at low levels, the Group may be forced to reinvest proceeds from investments that have matured or have been prepaid or sold at lower yields, reducing the investment margin, and profits of the Group.

The Group uses asset and liability matching techniques to reduce the adverse impacts of changes in interest rates, particularly under its annuity products. However, asset and liability duration mismatches may arise due to the uncertainty in liability cash flows and the possible lack of sufficient assets of matching duration. As a result, the Group may incorrectly estimate its true liability profile and may therefore be forced to reinvest proceeds from investments at lower yields or liquidate investments at a loss prior to maturity in order to cover any additional liability.

Changes in market interest rates could also negatively affect the Group's profitability. In periods of rapidly changing interest rates, the Group may not be able, in line with normal asset and liability matching techniques, to purchase investments capable of supporting the interest rates assumed when the product was sold. The Group may, therefore, have to accept a lower margin and, thus, lower profitability.

The Group's insurance business may also be exposed to the risk that policyholders may surrender their policies in a rising interest rate environment to fund higher repayment commitments of borrowings, requiring the Group to liquidate assets in an unrealised loss position to meet policyholder redemption requests.

The valuation basis for financial assets in the Group's accounts may include methodologies, estimations and assumptions which are subject to differing interpretations and, depending on the interpretation, could result in changes to the valuation of these financial assets that may materially affect its profitability and financial condition.

In the Group's audited and unaudited financial statements, financial assets are carried mainly at fair value. Fair values of financial instruments that are quoted in active markets are based on bid prices for the assets held. When independent prices are not available, fair values are determined by using comparisons with other similar financial instruments, or the use of valuation models. Establishing valuations where there are no quoted bid prices or where, for example, transaction volumes fall significantly, inherently involves the use of judgement.

Methods considered when determining fair values of unlisted shares and other variable securities include discounted cash flow techniques and net asset valuations. The value of derivative financial instruments is estimated by applying valuation techniques, using pricing models or discounted cash flow methods. Where pricing models are used, inputs, including projected estimated future dividends, swap rates and volatilities, based on market data at the balance sheet date are used to estimate derivative values. Where discounted cash flow techniques are used, estimated future cash flows and discount rates are based on current market swap rates. For units in unit trusts and shares in open ended investment companies, fair value is by reference to published bid-values and mid-values (in relation to OEICs). Other than property interests arising through equity release mortgage products, which are valued using an internal model, property is independently valued in accordance with the guidelines of the Royal Institute of Chartered Surveyors on the basis of open market values as at each year end.

During periods of market disruption, rapidly widening credit spreads or illiquidity, it may be difficult to value some assets using the above methodology and estimates and assumptions may prove to be incorrect. Further, rapidly changing credit and equity market conditions could materially impact the valuation of securities as reported within the Group's consolidated financial statements and the period-to-period changes in value could vary significantly. Decreases in value may have a material adverse effect on the Group's profits and capital requirements.

Adverse capital and credit market conditions may significantly affect the Group's ability to meet its liquidity needs. The Group's access to liquidity may deteriorate in such conditions, and, as a mutual insurer, the Group's ability to raise new liquidity or capital is limited.

The Group needs liquidity to pay claims and operating expenses, including commission to brokers and intermediaries. The principal sources of liquidity are insurance premiums, investment income and holdings of liquid assets. The availability of these sources may reduce in stressed market conditions and without sufficient liquidity, the Group may be forced temporarily to reduce new business volumes.

Traditional sources of liquidity for companies also include equity capital funding. In the case of LVFS, as a mutual friendly society, this option is not available since it has no share capital, and it is therefore more

exposed than insurers with share capital to risks in respect of its ability to access additional liquidity or capital.

In the event current resources do not satisfy the Group's needs, the Group may have to seek additional financing. The availability of additional financing will depend on a variety of factors such as market conditions, the general availability of credit, the volume of trading activities, the overall availability of credit to the financial services industry, the Group's credit ratings and credit capacity, as well as the possibility that customers or lenders could develop a negative perception of the Group's long or short-term financial prospects if the Group incurs large investment losses, if there is a prolonged decrease in the level of business activity due to a market downturn or for other reasons negatively affecting the perception of the Group in the market. Similarly, access to funds may be impaired if regulatory authorities or rating agencies take certain actions against or make adverse statements about the Group. Internal sources of liquidity may prove to be insufficient, and in such case, the Group may not be able to obtain additional financing on favourable terms, or at all.

Disruptions, uncertainty or volatility in the debt capital markets may also limit the Group's access to capital required to operate its business. Such market conditions may limit the Group's ability to satisfy statutory capital requirements, generate premiums and investment income to meet liquidity needs, and access the capital necessary to grow the business. As such, the Group may be forced to delay raising debt capital, issue shorter term securities than would be preferable, or bear an unattractive cost of capital which could decrease profitability and significantly reduce financial flexibility.

While the Group mitigates this risk by investing significant resources in liquid assets to meet short term liabilities and operating a liquidity risk management framework that includes active monitoring of the Group's liquidity position and contingency plans for accessing liquidity, if its internal sources of liquidity prove to be insufficient or if its liquidity requirements change so as to require additional funding, it may not be possible for it to successfully obtain additional financing (whether on favourable terms or otherwise).

Fluctuations in the rate of inflation or a sustained increase in the rate of inflation may adversely affect the Group's profitability.

Inflation, as measured by consumer price indices or other means, is a continuing risk for the Group. A sustained increase in the inflation rate may negatively affect the Group's business, solvency position, combined operating ratio[1] and results of operations. For example, a sustained increase in the inflation rate may result in an increase in market interest rates which may: (i) decrease the estimated fair value of certain fixed income securities held in the Group's investment portfolios resulting in reduced asset values that could negatively impact the solvency position and income of the Group; (ii) increase the benefits payable by the Group to policyholders where they are linked to inflation such as periodic payment order ("**PPO**") payments (referred to in "*Risks relating to the structure of the Group, the scope and nature of its business and products*" below in respect of assumptions that turn out not to match the actual claims experienced) which would have a negative impact on profits and increase capital requirements; (iii) increase the benefits payable by the Group's defined benefit pension schemes; and (iv) increase the level of future maintenance costs required to support the Group's life business in excess of the levels that would have been assumed when the product was originally priced.

In order to mitigate this risk, index-linked bonds are held to manage the risk of high inflation in respect of the Group's expenses and inflation linked benefits to policyholders.

[1] Combined operating ratio is defined as expenses (net of other income and excluding amortisation of goodwill and investment management costs) plus claims over net earned premiums.

A significant and sustained increase in inflation has historically also been associated with decreased prices for equity securities and sluggish performance of equity markets generally.

The Group is also exposed to "internal" inflation driven by diseconomies of scale arising in its with-profit business resulting in steadily increasing unit costs. This risk is managed through cost management controls, continued sales of new with-profits business and growth in general insurance and non-profit life insurance.

Derivative Instruments may prove to be inadequate in protecting the Group against the full extent of the exposure or losses the Group was seeking to mitigate which may negatively impact the results of operations of the Group and its financial condition.

The Group uses derivative instruments to hedge various risks, including, but not limited to, guaranteed minimum benefits contained in certain of the Group's with-profits products. The Group enters into a variety of derivative instruments, including options, forwards, interest rate and currency swaps with a number of counterparties. Obligations under guaranteed products are not changed by hedging activities and the Group is liable for obligations even if derivative counterparties do not perform their obligations under hedging contracts. This is a more pronounced risk to the Group in view of the stresses suffered by financial institutions during the financial crisis. Defaults by such counterparties could have a material adverse effect on the Group's financial condition by increasing the liabilities which are the subject of such hedging techniques.

Also, the availability and pricing of derivatives, including the amount of collateral which may be required to be provided by the Group and the ability of the Group to rely upon the posted collateral of its counterparties may result in derivative products becoming more expensive for the Group in periods of market stress. This may result in an increase in the risks which would previously have been off-set more efficiently using derivatives, which could further compound the losses to the Group by suffering a reduction in the value of its investments held to meet liabilities.

Derivative instruments held to manage product or market risks may not perform or provide returns to the Group as intended or expected resulting in higher realised losses and unforeseen liquidity requirements. In establishing such hedging instruments the Group makes assumptions including in relation to duration, persistency, take up of product guarantees and investment market performance. There can be no assurance that the actual experience will not materially differ from these assumptions, which could adversely impact the profitability and financial condition of the Group.

Losses due to defaults by financial institution counterparties and other third parties could negatively affect the value of the Group's investments and reduce profitability.

The Group has exposure to many different industries and counterparties, and routinely executes transactions with counterparties in the financial services industry, including insurance brokers and intermediaries, commercial banks, reinsurers, and other institutions. Many of these transactions expose the Group to credit risk in the event of default or delay in settlement of the amount due. The Group also has exposure to financial institutions in the form of derivative transactions, and equity and debt investments.

There can be no assurance that any such losses or impairments to the carrying value of these assets would not materially and adversely affect the Group's profitability. The Group manages this risk through establishing credit counterparty limits for all investment assets and through requiring an ongoing assessment of the financial strength of any material counterparty.

The Group may be required to make significant further contributions to its pension scheme if the value of pension fund assets is not sufficient to cover potential obligations.

The Group maintains defined benefit staff pension schemes. There are two defined benefit schemes which are closed to new members. From 1 July 2013, both of these schemes, and hence all of the Group's defined benefit schemes, will also be closed to future accrual.

There are inherent funding risks associated with the defined benefit schemes since the liabilities of a defined benefit pension scheme, which are long-term in nature, may at any time exceed the value of that scheme's assets. A deficit will arise in relation to an on-going pension scheme where there has been investment underperformance (i.e. where the value of the asset portfolios and returns from them are less than expected) and also where there are greater than expected increases in the estimated value of the scheme's liabilities, for example on account of increased longevity of participants in the pension scheme. Should a funding deficit arise, where necessary, appropriate actions, including possible further contributions from the Group, will be agreed with the scheme trustees.

As at 31 December 2012, the larger LV= employee pension scheme had an IAS19 pension benefit obligation (a deficit) of £7.7m and the smaller Ockham pension scheme had a pension scheme obligation (a deficit) of £2.5m.

The Ockham pension scheme has a first fixed charge over agreed assets of Liverpool Victoria Insurance Company Limited ("**LVIC**") in favour of the Ockham pension scheme trustees, pursuant to a deed of charge which would crystallise on the occurrence of an event of default. An event of default would occur under the deed of charge (i) if there was a breach by LVIC of its obligations under the deed of charge, (ii) upon the insolvency of LVFS, (iii) upon the insolvency of LVIC or (iv) proceedings being started by creditors of LVFS or LVIC. There is also a provision that if LVFS or LVIC were to cease, or threaten to cease, to carry on its respective business activities, the security granted under the deed of charge could be enforced, unless such cessation of business was the result of a genuine business reorganisation, merger, acquisition, or, in particular, part of a transfer of LVFS' engagements under the Friendly Societies Act 1992. The value of the charge at the end of 2012 was £24.7m.

In addition, the UK Pensions Regulator has powers to require members of the Group and their "connected" or "associated" persons to provide additional contributions or other forms of financial support in certain circumstances. Any such requests of the regulator may adversely affect the capital position of the Group by the amount of the required additional contributions.

The Group's business has some exposure to the Eurozone which could adversely affect the Group's profitability and financial condition.

The Group's investment portfolio includes some investments in the Eurozone (see the section entitled "*Description of the Issuer - Analysis of Assets and Investment Performance*" on page 94 for a table which shows the Group's exposure to the Eurozone). Recent developments surrounding the large debt to GDP ratios and/or fiscal deficits of several countries in Europe (primarily Cyprus, Greece, Ireland, Portugal and Spain) have led to fears of one or more Eurozone member states departing from European Monetary Union and/or the imposition of widespread capital and exchange controls. The exact nature of the risks that the Group faces as a result of such events are difficult to predict and to guard against, in view of (i) the inter-related nature of the risks involved, (ii) the severity of the recent financial crisis, (iii) the risk of contagion spreading throughout the Eurozone and, more broadly, the financial sector, (iv) difficulties in predicting the outcomes of austerity programmes and other crisis response measures in Europe, (v) the extent to which the Eurozone debt crisis, slowdown in growth or recession in Europe and elsewhere and loss of consumer confidence will impact on the global economy and (vi) the fact that the risks are totally or partially outside of the Group's control.

Accordingly, there is a risk that such events could adversely impact the Group's business and financial condition.

2. Risks relating to the structure of the Group, the scope and nature of its business and products.

The Group is centred in the UK, is structured as a mutual and has core business exposures in highly competitive environments such as the motor insurance market and the enhanced annuity market. This structure and strategic focus exposes the Group to a number of risks which are set out in the following paragraphs.

The Group's profits are derived substantially from its general insurance business.

93 per cent. of the underlying operating profit of the Group for the year ended 31 December 2012 is derived from its general insurance business. This leaves the Group more heavily exposed to the profits from such business and exposed to the risks of the general insurance market, particularly in respect of the UK motor insurance market with motor insurance representing 77 per cent. of the Group's general insurance business (based on 2012 gross written premiums). The general insurance market is susceptible to (i) fluctuations in investment income in line with financial markets; (ii) fraudulent claims risks; (iii) heightened competition from other providers; and (iv) cyclical downturns (each such risk is referred to in more detail in "*Risks relating to the financial markets, the financial strength and financial condition of the Group, the valuation of assets and related risks*" above and in this section of the risk factors. The Group is particularly exposed to the resulting fluctuations in profitability due to the concentration of its profit in this sector.

The Group is managing this risk through steady growth in its life insurance business and also by growing its exposure to non-motor related general insurance, especially the commercial insurance of small and medium enterprises.

Adverse claims experience relative to the assumptions used in pricing products and reporting business results could have a significant adverse impact on the results of operations of the Group and its financial condition.

The management of the Group's life insurance business requires the making of a number of assumptions in relation to the risks underwritten, including mortality rates (the rate of life policyholder deaths), longevity rates (the rate of annuitant survival), morbidity rates (the rate of health policyholder illnesses arising), the market expectation and ultimate performance of investment assets, interest rates, claims levels, persistency rates (the rate at which policies lapse) and future levels of expenses. These assumptions may turn out to be materially incorrect whether because of reliance on poor models or because actual experience differs from expectations.

When measuring their liabilities, life insurance companies monitor their experience against the actuarial assumptions used and assess the information gathered to refine their long term assumptions, together with taking actual claims experience into account. However, it is not possible to determine precisely the total amounts that will ultimately be required to satisfy benefits under the policies written by the business. Amounts may vary from estimates, particularly in light of the long term nature of life insurance. Changes in assumptions may also lead to changes in the level of reserves and capital required to be maintained to meet insurance liabilities. If the assumptions underlying the Group’s reserving methodology were to prove incorrect, it may be necessary to increase the level of reserves, which would have a corresponding negative impact on the profits of the Group and its financial condition.

The Group may also face losses if there are significant deviations from the assumptions regarding the persistency of certain types of life insurance policies. In setting reserves for in-force policies, assumptions have been made about the proportion of customers choosing to surrender contracts or exercise options

available to them under their policies. If more customers choose to exercise options at times when they are most valuable, then the Group's profits will be adversely affected.

Similarly, the management of the Group's general insurance business requires the making of a number of assumptions in relation to the business written. These assumptions include the costs of writing and administering the business and settling claims, and the frequency and severity of claims. The assumptions may turn out to be materially incorrect. In relation to certain key risks such as weather catastrophes (e.g. widespread flooding in the UK) or personal injury claims if the actual claims experience is less favourable than the underlying assumptions, this would have an adverse impact on the Group's underwriting ratios and profits.

As a motor insurer, the Group is particularly exposed to large personal injury claims, where the claim amounts can be significant due to the cost of the care required for the claimant. The Group uses excess of loss reinsurance contracts to reduce its exposure to such claims. Large personal injury claims can also be settled through the award of PPOs, in which indexed payments are made periodically over the lifetime of the injured party. Any changes in the number of personal injury claims and/ or the propensity for claimants to settle personal injury claims using a PPO, relative to the estimates made when setting the technical reserves, would have an effect on the Group's underwriting ratios and profits. The recent increase in the utilisation of PPOs to settle personal injury claims makes the estimation of reserves for general insurance business increasingly complex and uncertain due to the increased range of assumptions required, such as the future propensity of such settlement methods, rates of inflation and mortality trends for injured lives. Reinsurance recoveries will also occur many years into the future with a resultant increase in the associated credit or other non-payment risk. The fact that these claims take many years to ultimately settle increases the uncertainty around their estimation, which could have a material adverse effect on the Group's profits.

Furthermore, outstanding claims provisions for the general insurance business are based on the best-estimate ultimate cost of all claims incurred but not settled at a given date, both (i) reported and (ii) incurred but not reported ("**IBNR**"), together with the direct costs incurred in settling each claim (e.g. legal fees). A range of methods, including stochastic projections (i.e. simulations of future outcomes using probability based models), may be used to determine these provisions. Underlying these methods are a number of explicit or implicit assumptions relating to the expected settlement amount and settlement pattern of claims and a reliance on the accuracy of data. If the assumptions underlying the reserving basis were to prove incorrect, data used to estimate reserves proves inaccurate or actual claims experience were to be less favourable than the underlying assumptions, the Group may have to increase the amount of its general insurance provisions. If claims exceed insurance reserves, financial results could be significantly adversely affected.

To the extent that the Group's reserves are estimated to be insufficient to cover the future cost of claims or administrative expenses, it will have to increase its reserves and incur a corresponding reduction in its profits in the period in which the deficiency is identified. In addition, if the Group's reserves are excessive as a result of an over-estimation of risk, it may set premiums at levels which are too high and potentially may not be able to compete effectively, which may result in a loss of customers and premium income. Conversely, if the Group charges premiums that are insufficient for the cover provided, it will suffer underwriting losses, leading to a reduction in earnings.

In order to mitigate against this risk, the Group reviews the assumptions it has made on a regular basis using actuarial techniques, including stochastic modelling and also uses risk transfer mechanisms in order to spread certain risks to reinsurers and other counterparties (this is not without its own risks in respect of counterparty exposures, referred to below in this section of the risk factors in respect of reinsurer exposures in particular). In addition the Group has controls in place to review the quality of data used in making the assumptions, the accuracy and effectiveness of the models used to perform the calculations, and over changes to assumptions and reserves.

The Group has significant exposure to longevity risk as a result of its growing enhanced annuity business, its with-profit pension business and staff pension schemes.

Given the growth in the enhanced annuity business of the Group during recent years and the relatively recent entry of the Group through acquisition to that market, the significance of the Group's exposure to annuitant longevity risk has grown.

Enhanced annuity obligations represent 78 per cent. of the Group annuity obligations as at 31 December 2012. Enhanced annuities are particularly exposed to longevity risk through increased payments to policyholders relative to other business. Less data is also generally available in respect of enhanced annuity policies making risks and assumptions more difficult to assess and provide for both in adequate pricing of products and assets held to meet liabilities.

The Group anticipates a future level of longevity improvements which is informed by analysis of the causes of historic longevity improvements. It is possible that extreme developments as a result of socio-political or medical developments over time may have an impact on the estimates and assumptions made by the Group in relation to its longevity risks and may adversely affect the financial condition of LVFS (by, for example, increasing the required reserves held to meet long term liabilities as a result of higher than expected levels of longevity improvements amongst policyholders).

In the event that assumptions on the longevity of enhanced annuity and with-profit policyholders and members of the staff pension scheme prove to be materially incorrect this could result in a material increase in the liabilities of the Group under annuity policies to policyholders and an increase in the reserves required to meet such liabilities beyond the reserves currently held by the Group. This may have a material adverse effect on the financial resources available to the Group and the operations and profits of the Group as a result.

In order to improve the reliability of its assumptions in respect of longevity and as the Group's written enhanced annuity portfolio grows, the Group conducts experience analysis of that portfolio and monitors the experience from the in-force annuity portfolio of Reassure UK Limited, one of the most mature enhanced annuity portfolios in the UK, to which the Group has exclusive access following its acquisition of the former GE Life business from Swiss Re in 2008. The Group also monitors emerging industry insights on longevity and works closely with its reinsurer, Reinsurance Group of America, to whom it currently transfers 60 per cent. of the enhanced annuity longevity risk. Inevitably, there remains uncertainty about the development of future longevity that cannot be mitigated other than through higher levels of reinsurance.

To reduce the longevity exposure of the Group's staff pension scheme, the trustees purchased a longevity swap from Swiss Re in respect of all current pensioners and all deferred members aged 55 and over.

Catastrophic events, which are often unpredictable by nature, could result in material losses and abruptly and significantly interrupt the Group's business activities.

The Group's business is exposed to volatile natural and manmade disasters such as pandemics, floods, windstorms, terrorism, riots, fires and explosions. Over the past several years, changing weather patterns and climatic conditions have added to the unpredictability and frequency of natural disasters and created additional uncertainty as to future trends and exposure. The Group's general insurance business is exposed to extreme weather events which could result in a higher frequency/severity of losses than priced for, reducing the profits from such business.

The Group's general insurance business is exposed to extreme weather events which could result in a higher frequency/ severity of losses than priced for. The Group's life insurance business is exposed to the risk of catastrophic mortality, such as a pandemic or other event that causes a large number of deaths. Neither the likelihood and timing, nor the severity of any future pandemic can be predicted. Reinsurance is purchased by

the Group to reduce the impact of catastrophic events, but the impact of such an event could nonetheless have a material adverse impact on the results of operations.

Furthermore, pandemics, natural disasters and terrorism could disrupt operations and result in significant loss of property, key personnel and information about the Group and its customers. Business continuity plans are unlikely to provide effective contingencies for all such events which could therefore adversely affect the Group's business, results of operations, corporate reputation and financial condition.

Inability of reinsurers to meet their obligations, or the unavailability of adequate reinsurance coverage, may have an adverse impact on the Group's profitability and available capital.

The Group transfers certain of its exposure to insurance risks to others (reinsurers) through reinsurance arrangements such as (i) catastrophe risks in the general insurance business; and (ii) mortality (life insurance), morbidity (health insurance) and longevity (annuities) risks in the long term insurance business. It has also re-insured longevity risk in respect of pensioners and deferred pensioners aged over 55 in the staff pension scheme. Under such arrangements, reinsurers will compensate the Group against certain pre-defined losses in exchange for a premium. The availability, amount and cost of reinsurance depends on general market conditions and may vary significantly. Any decrease in the amount of reinsurance will increase the risk of loss.

Furthermore, market conditions beyond the Group's control determine the availability and cost of the reinsurance protection purchased. Accordingly, the Group may be forced to incur additional expenses for reinsurance or may not be able to obtain sufficient reinsurance on acceptable terms, which could adversely affect the ability to write future business.

When the Group obtains reinsurance, the Group still remains primarily liable for the reinsured risks without regard to whether the reinsurer will meet its reinsurance obligations to the Group. Therefore, the inability or unwillingness of the Group's reinsurers to meet their financial obligations or disputes in relation to and defects in reinsurance contract wording or processes, could materially affect operations. The Group is therefore exposed to settlement risk by its reinsurance counterparties, which is mitigated by the spread of reinsurance risks across reinsurers that meet the Group's financial strength and domicile criteria. In the life business, reinsurance is predominantly placed with the following reinsurers: Gen Re, Hannover Re, Swiss Re, Munich Re, RGA and Pacific Life Re. In the general insurance business, the principal reinsurers used include Hannover Re, Swiss Re, QBE, CCR, Munich Re, Faraday and Scor. See the sections entitled "*Description of the Issuer – Reinsurance*" on pages 86 and 92 for a description of the reinsurance programme of the general and life insurance businesses.

The Group conducts periodic reviews of the financial strength, reputation and domicile of reinsurance counterparties. Despite such reviews, reinsurers may become financially unsound by the time they are called upon to pay amounts due, which may not occur for many years, and the Group's business profitability could be significantly affected by having to meet its liabilities to policyholders out of its own assets whilst having paid premium to off-set risks in respect of such liabilities.

The Group's business is concentrated in the United Kingdom.

The Group is exposed to the economic, market, fiscal, regulatory, legislative, political and social conditions in the United Kingdom. In addition, the Group is exposed to the incidence and severity of catastrophic events in the United Kingdom, whether natural or man-made. The Group's investment portfolio is especially exposed to changes in United Kingdom economic and market conditions. The risks to the United Kingdom of current and expected future economic conditions, set out in "*Risks relating to the financial markets, the financial strength and financial condition of the Group, the valuation of assets and related risks*" above, could therefore have a material adverse effect on the Group's business, results of operations and financial position.

The Group’s businesses are conducted in highly competitive environments and continued profitability depends on management’s ability to respond to these pressures.

There are many factors which affect the Group’s ability to sell its products, including price and yields offered, financial strength and credit ratings, range of product lines and product quality, brand strength and name recognition, investment management performance and historical bonus levels. In the majority of the Group’s markets, the Group faces competitors that are larger, have greater financial resources or a greater market share, offer a broader range of products or have higher bonus rates or claims-paying ratios. This is seen by high levels of competition in general insurance for brand presence and competitive premiums and also in life insurance in respect of return on investment products and benefits payable compared with other investment products available.

The Group’s principal competitors in the life market include Just Retirement, Partnership Assurance, Legal & General, Aviva, Aegon, Ageas, Friends Life, Prudential, MGM, and Royal London. The Group’s principal competitors in the general insurance market include Admiral, Ageas, Aviva, AXA, Direct Line Group, Esure, and RSA.

Competition will intensify across all business lines in response to consumer demand, technological advances, the impact of consolidation, regulatory actions and other factors, with a particular increase in competition in pricing. The ability to generate an appropriate return depends significantly upon the Group’s capacity to anticipate and respond appropriately to these competitive pressures.

The cyclical nature of the general insurance industry may cause fluctuations in the operating and financial results of the Group and adversely affect its profits.

Historically, the general insurance industry has been cyclical and operating and financial results of insurers have fluctuated significantly because of volatile and sometimes unpredictable developments, many of which are beyond the direct control of any insurer. Although the Group has a geographically diverse group of general insurance businesses in the UK providing a diverse range of products, it is expected that the Group will experience the effects of the cyclical nature of the general insurance industry in the UK, including changes in sales and premium levels, which could have a material adverse effect on the results of its operations. The unpredictability and competitive nature of the general insurance business (see "*The Group’s businesses are conducted in highly competitive environments and continued profitability depends on management’s ability to respond to these pressures*" above) historically has contributed to significant quarter-to-quarter and year-to-year fluctuations in underwriting results and profitability in the general insurance industry.

This Group is particularly exposed to this risk by the concentration of its core business towards general insurance (referred to in "*The Group's profits are derived substantially from its general insurance business*" above).

Any downgrade or removal of the Group’s financial strength credit ratings could adversely affect the Group’s profitability.

LVFS has been assigned a financial strength rating of BBB+ by S&P. Any downgrade or removal of LVFSs rating could have a variety of negative impacts on the Group including (i) damaging its competitive position, (ii) negatively impacting its ability to underwrite new insurance policies, (iii) increasing the levels of surrenders and termination rates of its in-force policies, (iv) increasing its cost of obtaining reinsurance, (v) harming its relationships with creditors or trading counterparties and/or (vi) adversely affecting public confidence in it.

Insurance fraud and claims farming practices may adversely affect the Group’s financial results.

Fraudulent insurance claims may be made from time to time which the Group is unable to detect, despite having extensive fraud prevention systems and processes in place. Fraudulent insurance claims are prevalent in, but not confined to, the UK in general insurance, such as personal injury cover. The volume, value and frequency of fraudulent claims may increase from time to time for various reasons and if not detected and inadvertently paid, can impact on anticipated claims volumes and matching reserves resulting in adverse effects on the profits and results of operations of the Group.

The prevalence of claims management companies and "claims farming" practices in the UK may increase the frequency of invalid, fraudulent and valid claims, with the additional risk of the Group suffering increased administrative costs as a result.

Whilst not as prevalent, life insurance fraud in the form of fake death claims, policy takeover, pension liberation fraud (also known as pension busting), intermediary commission fraud, exaggerated protection claims and abuse of equity release facilities expose the Group to a greater risk of significant losses in respect of the individual cases and a heightened risk of regulatory censure in handling such cases.

The Group has anti-fraud and anti-money laundering measures in place to mitigate these risks in both the general and life insurance businesses and these measures are regularly reviewed.

The Group is dependent on the strength of its brand and the Group’s reputation with customers and agents in the sale of products and services.

While the Group is well recognised as a provider of life and general insurance by intermediaries and potential customers, it is vulnerable to adverse market and customer perception. It operates in an industry where integrity, customer trust and confidence are paramount. The Group is exposed to the risk that litigation, employee misconduct, operational failures, the outcome of regulatory investigations, press speculation and negative publicity, disclosure of confidential client information and inadequate services, amongst others, whether or not founded, could adversely affect brands or reputation. Any of the Group’s brands or the Group’s reputation could also be adversely affected if products or services recommended by the Group (or any intermediaries) do not perform in line with customer expectations which could reduce the profits of the Group from reduced sales.

The Group's short term business model could also be materially and adversely affected by the failure of service providers and business partners on which the Group relies or partially relies to provide services and grow the business.

The Group faces risks associated with the asset management of the Group's funds which was outsourced to a third party, Threadneedle Asset Management Limited, on 1 November 2011, and the holding of such assets by its custodian.

The Group may face financial or other exposure in the event that its asset manager, Threadneedle Asset Management Limited, fails to meet its obligations under the agreement with the Group or encounters financial difficulty.

A failure of the asset manager to perform its obligations or meet certain standards may result in a depreciation of investment assets managed by the asset manager. Notwithstanding the outsourced arrangements, the Group will remain liable to policyholders for investment guarantees and other commitments in relation to the performance of investment assets managed by the asset manager. Therefore a failure of the asset manager to provide satisfactory or appropriate investment returns in the future or to perform at the level of its competitors or benchmark performance measures may adversely affect the ability of the Group to perform its obligations to policyholders and the financial condition of the Group as a result.

Failure of the asset manager to comply correctly with the Group's investment mandates for the funds it manages may also result in increased capital requirements of the Group.

If the services of the asset manager were to prove insufficient or the asset manager ceased to provide the services, this could materially adversely affect the Group's business continuity and results of operations by reducing the investment return received from the funds which the Group relies on to meet its liabilities.

The assets of the Group are held, like any other asset management arrangement, with a custodian bank for safekeeping. The custodian for the Group is HSBC Bank plc. Any failure of HSBC Bank plc to properly administer the assets of the Group could lead to losses in the value or holding of assets by the Group and an insolvency of HSBC Bank plc could significantly impact the value of the assets of the Group but also the liquidity of the Group's investments. Losses upon insolvency of the custodian are mitigated by the trust structure under which the custodian holds assets in England and Wales (protecting the Group's assets against claims of other creditors of the custodian) but such structures may not be effective in respect of assets held outside England and Wales.

The Group's information and technology systems may be subject to intentional disruption which could adversely affect its business.

The Group, like other institutions, is subject to risks such as hacking, cyber-attack and similar malicious activities that may impair the information and technology systems on which the Group relies. Such attacks could result in the shut-down of core services relied upon by the Group and the use of information and technology systems by the Group, as a large financial institution, make the Group, along with other large insurers, susceptible to potentially significant disruptions that could be caused by attacks on such information and technology systems.

If an actual or perceived breach of the Group's information and technology systems (including external systems on which the Group relies) occurs, it could impair the Group's ability to operate parts of its business and provide products and services to its customers, including a loss of data on which the Group relies in order to provide these products and services, and to manage its liabilities and its investments. It may also have difficulties in meeting policyholder liabilities, attracting new customers and preserving its existing customer base. Consequently, the financial condition of the Group and its reputation could be harmed, its revenues could decline and its business could suffer.

Recognising this risk the Group has an active information security programme and operation which looks to ensure appropriate security controls and solutions are implemented and maintained to protect the Group's systems and information. This function monitors system compliance, information use and behavioural activity, continually assesses evolving and emerging threats and risks, applying new controls or solutions as required. The Group uses industry best practice to assess the effectiveness of its information security programme, focusing its compliance on regulatory best practice principles, and the UK Data Protection Act 1998. The Group has an ongoing project to continue to enhance its information security procedures and has already attained ISO (International Organisation for Standardization) 27001 accreditation across a number of its information management and protection systems.

The Group's businesses are reliant upon data management and administration which is subject to operational risks of information loss, inadequate processes and systems, human error and fraud both internal and external.

The nature of certain of the Group's business means that accurate records have to be maintained and for significant periods in respect of the Group's long term business. The Group is reliant on data management and efficient administration of policies and claims for its business efficiency, services to customers and its profits. The Group also outsources several operations, including asset management and certain servicing and IT

functions and is therefore at least partially reliant upon the operational processing performance of outsourcing partners.

The systems and processes on which the Group is dependent to serve customers are designed to ensure that the operational risks associated with the Group’s activities are appropriately identified and addressed; however, they may nonetheless fail due to IT malfunctions, human error, business interruptions, non-performance by third parties, fraud or other external events. This could disrupt business operations resulting in material reputational damage and the loss of customers, and have a consequent material adverse effect on the Group’s profits. Although appropriate steps have been taken to upgrade systems and processes to reduce these operational risks, the specifics or timing of all possible operational and systems failures which may adversely impact the Group’s business cannot be anticipated.

The information security programmes, the ongoing programme of further improvement and industry best practice implemented by the Group along with the ISO accreditation of a number of its information management and protection systems, referred to in "*The Group's information and technology systems may be subject to intentional disruption which could adversely affect its business*" above, also acts to mitigate against these risks of data loss and process errors.

The failure to attract or retain key personnel could have a material adverse effect on the Group’s results and/or financial condition.

The Group relies, to a considerable extent, on the quality of its managers and other senior staff. The success of operations is dependent, among other things, on the ability to attract and retain highly qualified professional people. Competition for such key people in the UK is intense. The Group’s continued ability to attract, develop and retain key people, and in particular directors, actuaries and underwriters, is dependent on a number of factors, including prevailing market conditions, brand and reputation, and compensation packages offered by companies competing for the same talent.

To manage this risk the Group invests considerable time and money into training and development of its staff. There are long term incentive plans offered to the majority of the most senior and critical staff.

Buy-out plans in respect of the remaining 5 per cent. interest in LV Insurance Management Limited, which was retained by five of the most senior staff members of the Group's general insurance business when LV Insurance Management Limited was acquired by LVFS in 2006, expired on 30 April 2013. A valuation of the remaining interest has been completed and the consideration payable does not exceed the amount provided for in the Group's accounts for the year ended 31 December 2012. In order to retain business expertise and experience, new incentive arrangements have been entered into with these senior staff members that commit them to (i) active succession planning, (ii) a minimum of one year’s notice and (iii) performance criteria directly linked to the future growth of the general insurance business. The new plans expire on 31 December 2015 and both the competition and the risk to the business of retaining these key staff may therefore increase considerably upon expiry of these incentive arrangements if no new incentive or succession plans are put in place thereafter.

The Group could be involved in various legal proceedings and regulatory investigations and examinations from time to time and any one or a combination of these could have a material adverse effect on its financial condition and results of operations.

The Group may be, in the future, subject to legal actions, disputes and regulatory investigations in the ordinary course of its insurance, and other business operations. Legal actions, disputes and investigations may relate to aspects of the Group’s businesses and operations that are specific to the Group, or that are common to companies that operate in the Group’s markets. Legal actions and disputes may arise under contracts, regulations (including tax) or from a course of conduct taken by the Group. Although the Group believes that

it has adequately provided in all current/known material aspects for the costs of litigation and regulatory matters, no assurance can be provided that such provisions are sufficient.

Given the large or indeterminate amounts of damages sometimes sought, and the inherent unpredictability of litigation and disputes, it is possible that an adverse outcome could, from time to time, have an adverse effect on the Group's results of operations or cash flows.

In particular, it is possible that the Financial Conduct Authority ("**FCA**") could seek to order the Group to compensate customers in relation to various mis-selling claims in relation to the payment protection insurance ("**PPI**") contracts sold by Liverpool Victoria Banking Services Limited which is no longer a trading entity. LVFS has assumed any such liabilities arising and had made provision for any such claims in its financial statements as at and for the year ended 31 December 2012 in an amount of £13.4m. There is a risk that the Group's liability exposure in respect of PPI mis-selling claims may further increase over time.

Additionally, it is possible that the FCA may conduct a review of products previously sold, either as part of an industry-wide review or a review specific to the Group. The result of this review may be to compensate customers for losses they have incurred as a result of the products they were sold.

Risk processes and procedures may leave the Group exposed to unidentified or unanticipated risk, which could negatively affect the business.

Management of risk requires, among other things, policies and procedures to record properly and verify a large number of transactions and events. The Group has devoted significant resources to develop risk management policies and procedures and expects these to evolve continually over time. Nonetheless, these policies and procedures may not be comprehensive, fully understood, or always complied with and, as a result, may not be universally followed across the Group. Many of the methods for managing risk and exposures are based upon the use of observed historical market behaviour or statistics based on historical models. As a result, although subject to expert judgement and oversight by the business, these methods may not fully predict future exposures, which can be significantly greater (or lower) than historical measures indicate, particularly in unusual markets and environments.

Other risk management methods depend upon the evaluation of information regarding markets, clients, catastrophe occurrence or other matters that is publicly available or otherwise accessible to the Group. This information may not always be accurate, complete, up-to-date or properly evaluated.

The implementation and accuracy issues referred to above in respect of risk processes and procedures could have a negative impact on the profitability of the Group and exacerbate the impact of other risks of the Group referred to in these risk factors if not properly monitored.

3. Risks relating to the regulatory and legislative environment, including those relating to accounting standards and taxation.

The Group's regulated business is subject to extensive regulatory supervision, with such regulation being subject to proposals for future changes which may result in adverse impacts for the Group, increasing its costs of securing compliance with such laws and regulations.

The Group's insurance business, as an insurance group operating in the UK, is subject to detailed and comprehensive regulation in the UK, flowing increasingly from EU directives and regulations as well as UK rules and implementing legislation, and is also subject to certain regulations governing motor insurance providers in the Republic of Ireland and Jersey. UK regulators have broad administrative powers over many aspects of the insurance business, which may include marketing and selling practices, advertising, licensing agents, policy forms, capital adequacy and permitted investments. Insurance laws, regulations and policies currently affecting the Group may change at any time in ways having an adverse effect on the Group's

business. Furthermore, it is difficult to predict the timing or form of future regulatory initiatives. A detailed description of the UK regulations governing the business of LVFS is set out in the section entitled "*Regulation of the Issuer*" on page 104.

The Group's business is mainly subject to regulation by the Prudential Regulation Authority ("**PRA**") and the FCA, which have broad powers under the Financial Services and Markets Act 2000, as amended, with implementing statutory instruments ("**FSMA**"), including the authority to grant, vary the terms of, or cancel a regulated firm's authorisation, (in respect of the FCA) to investigate marketing and sales practices and (in respect of the PRA) to require the maintenance of adequate financial resources. The regulators have the power to take a range of investigative, disciplinary or enforcement actions, including public censure, restitution, fines or sanctions and to award compensation. The regulators may make enquiries of the companies which they regulate regarding compliance with regulations governing the operation of business and like all UK regulated financial service companies, the Group faces the risk that one or more of the regulators could find that the Group has failed to comply with applicable regulations or has not undertaken corrective action as required.

Regulatory Actions

Regulatory issues and disputes may arise from time to time from the way in which the insurance industry has sold or administered an insurance policy or other product or in the way in which they have treated policyholders or customers, either individually or collectively. See also the risks in relation to policyholder redress following actions by the FCA referred to in this section of the risk factors.

In the UK, any such issues or disputes are typically resolved by the Financial Ombudsman Service ("**FOS**"), or by litigation by individual policyholders. The FCA may intervene directly, however, where larger groups or matters of public policy are concerned. There have been several industry-wide issues in recent years in which the predecessor to the FCA, the Financial Services Authority (the "**FSA**"), has intervened directly, including the sale of PPI, personal pensions, the sale of mortgage-related endowments and investments in split capital investment trusts.

The Office of Fair Trading (the "**OFT**") may also conduct investigations into the competition in certain insurance products and impose sanctions on firms. In respect of the UK's motor insurance market, the OFT made a market investigation reference to the Competition Commission in September 2012 with findings that it has reasonable grounds to consider that certain aspects of current practice amongst insurers in respect of credit repairs and replacement vehicles arranged in road traffic accident claims may prevent, restrict or distort competition. In respect of motor legal expenses insurance, the OFT has also expressed concerns about "the complexity of the product offering, and that the way it is being sold may make it difficult for car owners to assess the product's value for money". The OFT asked the FSA (now the FCA) to work with insurers to address its concerns. Future changes required, or regulatory actions/interventions, by the OFT or the FCA as a result may have adverse consequences for the general insurance business of the Group through increased compliance costs associated with new regulations or through a requirement to make redress payments or pay fines following any sanctions on the Group (or provisions made by the Group for possible regulatory actions/interventions in the future in this area).

The OFT also launched a study in January 2013 to examine whether defined contribution workplace pension schemes deliver the best value for money to savers and any anti-competitive elements to the provision of such Schemes. The study is in its early stages but adverse findings of the OFT on the distribution and/or management of such pension schemes could adversely impact the distribution of life insurance investment products and annuities by the Group and the financial condition of such business.

The Group is, and in the future may be, subject to legal and regulatory actions in the ordinary course of its business. These actions could involve a review of business sold in the past under what were perceived to be

acceptable market practices at the time, such as the requirement in the UK to provide redress to certain past purchasers of pension and mortgage endowment policies, changes to the tax regime affecting products and regulatory reviews on products sold and industry practices.

Prudential Requirements

The financial crisis has exposed a number of weaknesses in the current regulatory framework. Whilst these weaknesses are predominantly in the banking sector, the insurance industry potentially faces a number of regulatory initiatives aimed at addressing lessons learnt from the crisis. The Group could be impacted by global initiatives, European initiatives and national initiatives in the insurance sector.

LVFS is required currently to operate in accordance with the PRA's rules and principles which govern the prudential regulation of insurers and which are mainly found in GENPRU and INSPRU. The capital requirements are set out in "Pillar 1 rules (based on EU requirements) and "Pillar 2" rules (a risk sensitive enhancement prescribed by the PRA). The Group is also subject to current EU directives, including the EU Insurance Groups Directive ("**IGD**"), which requires European financial services groups to demonstrate net aggregate surplus capital in excess of solvency requirements at the Group level. These rules are described in detail in the section entitled "*Regulation of the Issuer*" on page 104.

Under the IGD rules the Group may need to maintain a higher amount of regulatory capital at the Group level, on a consolidated basis, than otherwise necessary in respect of some of its individual businesses to accommodate, for example, short-term movements in global foreign exchange rates, interest rates, deterioration in credit quality and equity markets. Under Pillar 2 the Group is required to satisfy the PRA of its solvency based on a "1 in 200" stress test scenario (see the section entitled "*Regulation of the Issuer*" on page 104 for more information on this regime). This "individual capital assessment" in the UK may require the Group to hold increased capital based on certain risks perceived by the PRA in implementing new policies from time to time, especially in implementing its remit as an intrusive and active regulator in preventing risks to the financial soundness of firms and pursuing its objective of protecting current and future policyholders. Further requirements of the PRA for the Group to increase the amount or quality of its capital may arise from implementing policies of the Financial Policy Committee of the Bank of England which has been created pursuant to the Financial Services Act 2012 to monitor risks in the financial system. Such policies could result in significant increases in the capital requirements of insurers or more specifically with-profits or mutual insurers (or another sector to which the Group is exposed). Pillar 1 requires insurers to maintain assets sufficient to meet their relevant capital requirement at all times, with the method of calculation set out in GENPRU (see the section entitled "*Regulation of the Issuer*" for more information on this regime). Failure to maintain the Pillar 1 required capital resources requirement (or any additional amounts imposed at Pillar 2) is one of the grounds on which wide powers of intervention conferred upon the PRA may be exercised. The failure of the Group to meet these capital requirements may have an adverse impact on the operations of the business and may result in an increase in the capital requirements of the Group.

Impact of Solvency II

The implementation of the "**Solvency II**" regime in the UK as currently proposed, (discussed in the section entitled "*Regulation of the Issuer*" on page 104), will significantly change the capital requirements for European based insurance companies by requiring the use of a risk based approach. Insurers will be permitted to make use of their own internal capital models to calculate their capital requirements subject to the models being approved by the PRA (in the case of LVFS). There will be a pre-approval process for such models and there is a risk that if the Group does not receive permission to use its internal model, or such permission is delayed, then the capital required to be maintained by the Group upon implementation of Solvency II will be higher. In addition, this could have an adverse impact on the operations of the Group and its ability to price business competitively.

A failure by the Group to implement the measures required by the Solvency II Directive in a timely manner could also lead to regulatory action and have a material adverse effect on the Group's reputation, the confidence of its customers and therefore its business.

Full implementation of Solvency II has been delayed until at least 2015 and the continued uncertainty around the impact of the detailed technical requirements could further increase the regulatory compliance costs of the Group and could still result in rules which are adverse to the Group and its business and/or which require a significant increase in the capital required to support the Group's business. Notwithstanding the delay in implementation, EIOPA are currently consulting on the phased introduction of specific aspects of the Solvency II requirements into national supervision from 2014, which could result in additional compliance costs for the Group. There is also a risk that, as an EU directive, inconsistent application of Solvency II by regulators in different EU member states could place the Group at a competitive disadvantage if in other EU member states the rules are implemented in a less onerous manner than in the UK (see "*Risks relating to the structure of the Group, the scope and nature of its business and products*" above for the risk of the Group's business being concentrated in the UK).

In addition to these generic risks, some particular aspects of Solvency II may have an adverse impact on the Group. Firstly, LVFS (similar to other such life insurance providers) relies upon applying an illiquidity premium to the discount rate applied to value long-term liabilities in relation to its annuity business and certain other long term guarantees. This reduces the liabilities compared to discounting them at a risk free rate. One of the key remaining areas of uncertainty is whether an illiquidity premium or an equivalent mechanism may be permitted or may only be permitted subject to satisfying certain criteria regarding the type of long term guarantee provided and the types of assets applied to match such liabilities. An inability to apply an illiquidity premium or similar mechanism (or a reduction in the amount of such premium which may be applied) may have an adverse impact upon the Group (which has a significant amount of annuity business); as the Group's capital requirement may increase leading to a lower excess capital position and it may lead to changes to the pricing and profitability of future annuity business. Also, as the rules are not yet finalised for Solvency II and it is not clear if there will be any grandfathering of existing asset rules, there is a risk that some of the investment decisions LVFS has made historically and is making currently may not be compliant with the final Solvency II rules. This would lead to a future increase in capital on in-force business and on business currently being written and the profitability of this business ultimately being lower than expected.

Secondly, Solvency II introduces the requirement for a risk margin to be applied to the value of technical provisions. A risk margin increases the overall value of the technical provisions from the discounted best estimate to an amount broadly equivalent to a theoretical level needed to transfer the obligations to another insurance undertaking. This requirement would increase the value of technical provisions and require the Group to hold more capital to meet liabilities.

Thirdly, the method under Solvency II for calculating the value of insurance subsidiary entities for the purposes of regulatory capital calculations (for LVFS this would include its general insurance subsidiaries Liverpool Victoria Insurance Company Limited and Highway Insurance Company Limited) may reduce the amount of credit that may be obtained for participations in subsidiaries of LVFS in its solvency calculations.

Finally, Solvency II is expected to apply the concept of ring-fenced funds to certain business of LVFS, in particular, its with-profits fund. The application of such a ring-fenced fund regime in the UK is currently uncertain but may impact the regulatory capital position and capital management within LVFS by imposing requirements on the use of policyholder funds within long term funds. Such risks are connected to and may be mitigated by, the response of the Group to issues in the with-profits and mutuals sectors referred to below (see "*New rules regarding the protection of with-profits policyholders generally and guidance relating to the fair treatment of with-profits policyholders by mutual insurance companies may adversely impact the operations of the Group and increase its costs*" below).

The final rules covering any of these issues may result in an increase in the Group's capital requirement. The Group is seeking to mitigate the impact of these risks, through, among other things, effective lobbying directly to the PRA and through industry groups. There is, however, a material risk that the Group will be unable to mitigate these risks effectively and that, as a result of the implementation, the solvency calculations of the Group may be adversely affected from time to time, resulting in changes to the business profile of the Group including the volume of business written, the mix of products and the terms upon which business can be written.

There is also a risk that under the Solvency II implementing measures once finalised, the Subordinated Notes will cease to be capable of counting as tier 2 capital to cover capital requirements or cease to be treated as own funds either fully or on a grandfathered basis. In these circumstances LVFS may be able to exercise its contractual right to redeem, substitute or vary the Subordinated Notes and there is a risk that refinancing the existing debt or issuing further regulatory capital could prove expensive, difficult or impossible on comparable terms, which could have a material adverse effect on the Group, including its business and financial condition. See further information on this risk in "*Risks Relating to the Subordinated Notes*" set out below.

The Group's projected general business costs for the Solvency II implementation measures for 2012 and 2013 are not expected to exceed £11.9m in total.

Financial Services Compensation Scheme

Insurers and other regulated firms in the UK are subject to the Financial Services Compensation Scheme (the "**FSCS**"), discussed in the section entitled "*Regulation of the Issuer*" on page 104. While it is anticipated that the substantial majority of compensation paid by the FSCS will be paid wholly from recoveries from the relevant institutions concerned, there is the risk of a shortfall, such that the FSCS may place additional levies on FSCS participants. Consequently, in the event that the FSCS raises funds, raises those funds more frequently or significantly increases the levies to be paid by firms, the associated costs to the companies operating in the financial services industry may be material.

FSA Reform

Following the onset of the recent financial crisis and prior to the implementation of the Financial Services Act 2012, the FSA had adopted a more intrusive and direct style of regulation which it has termed "intensive supervision". This strategy, combined with the FSA's outcomes-focused regulatory approach, had resulted in a more proactive approach to enforcement and a more punitive approach to penalties for infringements, meaning that FSA-authorised firms had been facing increasing supervisory intrusion and scrutiny (increasing internal compliance costs and FSA supervision fees) and in the event of a breach of their regulatory obligations had been likely to face harsher penalties. It is anticipated that this intensive approach to supervision will be continued by the PRA and the FCA following the recent implementation of the Financial Services Act 2012.

The implementation of the Financial Services Act 2012, in particular the replacement of the FSA with two new regulators with separate approaches and objectives, could result in (i) increased regulatory oversight of the activities of the Group, resulting in constraints in the business activities of the Group and/or (ii) increases in regulatory capital requirements, and/or increased amounts of time and resources of the Group committed to regulatory compliance, which could result in a material increase in compliance costs. In relation to LVFS in particular, the Financial Services Act 2012 provides for a memorandum of understanding between the two new regulators in relation to with-profits regulation, and the published draft of this memorandum envisages a joint approach in most cases. This may delay the ability of LVFS to take strategic decisions and add further uncertainty to its approach to regulatory change, including the treatment of its mutual capital and new business (see "*New rules regarding the protection of with-profits policyholders generally and guidance*

relating to the fair treatment of with-profits policyholders by mutual insurance companies may adversely impact the operations of the Group and increase its costs" below). The Financial Services Act 2012 and its relevant implications are described further in the section entitled "*Regulation of the Issuer*" on page 104.

Retail Distribution and Insurance Intermediation

Regulatory changes as a result of the FSA's Retail Distribution Review ("**RDR**") have resulted in commission structures used in the sale of retail investment products through financial advisers being heavily restricted. The RDR may reduce certain traditional sources of business, as product distributors may change business models and sales techniques, but also new sources of business may arise. However, the long term implications of RDR for the distribution of retail investment products in the UK remain uncertain.

In July 2012, the European Commission published a proposal for the revision of the Insurance Mediation Directive (2002/92/EC) which established an EU-wide supervisory regime for intermediaries involved in the promotion, sale and administration of certain insurance products ("**IMD2**") which would be implemented by additional rules in the UK. The proposals will, as currently provided in the draft published by the European Commission, introduce further conduct of business rules in the sale of insurance products by the Group including the extension of rules currently only applicable to intermediaries to direct sales of insurance, the requirement to consider the suitability of insurance products even in non-advised sales and the disclosure by sellers of insurance of the commissions and bonus arrangements for their sales staff. Professionalism requirements of staff will also change under IMD2 through increased requirements for continuing professional development and qualifications.

The European Commission also published its legislative proposals for retail investment products along with IMD2 which include proposals for new regulatory requirements for retail investment products and aim to harmonise pre-contractual disclosures and selling practices for such products (to be included within IMD2). Such changes will, largely, already be captured in the UK by the implementation of RDR. However, a proposed new European regulation on the publication of a key information document with the sale of each retail investment product (in addition to IMD2) will, if implemented, have a direct effect in the UK and will increase the pre-contractual disclosure requirements for the Group in its sales of such products.

These proposals are at an early stage with the European Parliament and Council yet to formally deliberate on them, but the proposals could be implemented in the UK during 2016 and could increase the regulatory compliance costs of the Group in implementing new regulations, adversely affect the distribution of insurance products by the Group and adversely impact on the operations of the Group as a result.

Adverse changes in the laws, regulations, policies and their interpretations may have an adverse effect on the Group's business.

The risk of further changes to and interpretations of laws and regulations in the UK may increase following the recent implementation of the Financial Services Act 2012 referred to above, whereby the Group could be deemed to be not in compliance with the regulations governing its business following a significant change in regulatory focus. An example of UK regulatory requirements subject to change is the interpretation of the current FCA principle of "treating customers fairly" which has evolved over time to increase requirements upon all regulated firms to ensure fair treatment to customers and such evolution of this principle may result in increased cases of non-compliance in the market in the future and subsequent regulatory compliance risk for the Group.

The Group will not be able to predict accurately the impact of future legislation or regulation or changes in the interpretation or operation of existing legislation or regulation on the Group's business, results of operations and/or financial condition.

The ECJ ruling in the recent "Test Achats" decision no longer allows EU member states to rely upon a derogation in Article 5(2) of the Gender Directive, to allow gender specific pricing of premiums, may result in reduced levels of insurance business and adversely affect the profits of the Group from both its general and life insurance businesses.

In the case of *Association Belge des Consommateurs Test-Achats ASBL and others* (Case C-236/09) the European Court of Justice declared Article 5(2) of the Gender Directive (2004/1213/EC) invalid. This means that sex-specific differences in premiums and benefits based on risk assessed by actuarial and statistical data are no longer permitted as an exception to the fundamental right of equal treatment for men and women.

The effect of this decision is that in determining levels of premiums for insurance policies (including in particular motor, life, health and annuities), the Group has not been able to use gender as a determining factor in the pricing of new policies from 21 December 2012. These recent changes may have an adverse impact upon the pricing and underwriting of certain insurance products in the future, such as annuities and motor insurance, which previously charged a lower premium for certain customers based partly on gender. This introduces a new business risk due to the actual gender mix of business written relative to that assumed, although this will be actively monitored. It could result in reduced demand for certain products by certain types of policyholder due to increased premiums and lapse and re-purchase by some policy types. There is also likely to be pricing volatility as insurers adjust to the new regime and underwriting costs could increase as alternative underwriting criteria are introduced.

The Group has monitored the impact of the Test Achats decision since the legislation came into force and no material negative impact on the Group's business has been observed to date.

New rules regarding the protection of with-profits policyholders generally and guidance relating to the fair treatment of with-profits policyholders by mutual insurance companies may adversely impact the operations of the Group and increase its costs.

A significant proportion of LVFS' business comprises with-profits business which is written in a common fund with LVFS' other life assurance business. This common fund is treated as a with-profit fund for the purposes of conduct of business rules.

The section entitled "*Regulation of the Issuer*" on page 104 describes recent changes to the conduct of business rules governing with-profits business. These rule changes and resulting changes to the conduct practices of LVFS in relation to with-profits business may increase the compliance and governance costs of the Group and may affect the strategy and operations of the Group.

The regulatory section below also describes further recent FSA proposals for with-profits business within mutual insurers such as LVFS. These recent and proposed regulatory changes as they affect mutuals may adversely affect LVFS' ability to accept new business, acquire and retain strategic investments (including its investment in its general insurance subsidiaries) and use surplus capital in its long term fund.

The Group has considered restructuring options for the sustainability of its business and operations in the future in response to previous changes to COBS 20 (see the section entitled "*Regulation of the Issuer*") and the recent, more positive, FSA proposals. These considerations have included a possible creation of a mutual capital fund within LVFS as envisaged by the FSA in its recent consultation paper 12/38 of December 2012. The creation of such a mutual capital fund would allow a separation of the with-profits business from non-profit business and LVFS' other strategic investments and would clarify the respective interests of LVFS' with-profits policyholders and its other members.

The recent FSA proposals for mutuals suggest that LVFS would need to apply for a waiver from the FCA (acting with the consent or in consultation with the PRA) to put such a restructuring into effect. Such a waiver would require certain conditions to be satisfied (as described in the section entitled "*Regulation of the Issuer*")

and under the current draft proposals any waiver, if granted, could be revoked, amended or subject to conditions which may be imposed by the regulator from time to time.

The current mutual structure of the Group coupled with the changing regulations could result in the Group being constrained, with respect to, among other things, its use of the inherited estate as working capital for the Group, its acquisition and retention of strategic investments, its management of regulatory capital and restrictions on its ability to write new business, along with additional compliance costs. However, in light of the recent, more positive, FSA proposals there are likely to be opportunities for the Group to respond to such issues, subject to those risks referred to above in respect of waiver applications under the current proposals.

Policyholders may attempt to seek redress against the Group where they allege that a product fails to meet the reasonable expectations of the policyholder, including where there are future changes in legislation.

The pricing of long-term insurance products is predicated on legislation (particularly tax legislation) extant at that time. However, future changes in legislation or interpretation of the legislation may, when applied to these products, have a material adverse effect on the financial condition of the relevant long-term funds of the Group in which the business was written.

Long-term product design, including new business, will take into account, among other things, risks, benefits, charges, expenses, investment return (including bonuses) and taxation. A policyholder or group of policyholders may seek legal redress where the product fails to meet their reasonable expectations. The increasing risks of regulatory and policyholder actions are referred to in "*FSA Reform*" and "*Regulatory Action*" above, as well as in "*Risks relating to the structure of the Group, the scope and nature of its business and products*" above in respect of legal proceedings and regulatory investigations. Adverse outcomes from policyholder actions could have a material adverse effect on the business reputation, results of operations and profits of the Group arising from the penalties imposed or compensation awarded, together with the costs of defending any action.

Impact of regulatory risks: conclusions for the Group.

A determination that the Group has failed to comply with applicable regulation could have a negative impact on the Group's reported results or on relations with current and potential customers. Regulatory action against a member of the Group could result in adverse publicity for, or negative perceptions regarding, the Group, or could have a material adverse effect on the Group's business results (for example by reduced sales) and divert management's attention from the day-to-day management of the business. Regulatory action could also result in large fines which could reduce the profits of the Group.

The Group may also face increased compliance costs due to the need to set up additional compliance controls or the direct cost of such compliance because of changes to financial services legislation or regulation both highlighted above and in the future. The Group faces significant compliance challenges because the regulatory environment is evolving rapidly and supervisory authorities are assuming an increasingly active and interventionist role in interpreting and enforcing regulations.

The Group's assets and liabilities as reported under IFRS will decrease and increase, respectively, if the yield curve used in valuing such assets and liabilities incorrectly reflects returns on assets with minimal credit risk, which could have a material adverse effect on the Group's IFRS results, financial condition or regulatory solvency.

In accordance with IFRS as adopted by the European Union, the Group's life insurance reserves and the provision for periodic payments orders in the general insurance business are calculated by discounting future policy cash flows predominantly based on market interest rates at the date of valuation. The interest rate used for valuing the liabilities is based on the interest rate of assets whose characteristics the Group believes to resemble most closely the characteristics of the liabilities.

There is a risk that the valuation yield curve does not optimally reflect returns on assets with minimal credit risk. It could be that some of the bond yields constituting the curve are increased by factors such as limited trading volumes or credit risk. Any lowering of the yield curve in the future is likely to reduce the discount rate used to value the liabilities which would increase their reported value under IFRS and have a material adverse effect on the Group's financial condition.

In addition, mismatches between valuations of assets and liabilities under IFRS (IAS 19) in relation to pension fund accounting could have a material adverse effect on its financial results. Financial results reported on an IFRS basis are treated separately from the information provided to the PRA in regulatory returns (see the section entitled "*Regulation of the Issuer*" on page 104).

Changes in standards, or in the interpretation of IFRS and other valuation rules and methodologies, both specifically in relation to insurance and more generally, could have a negative effect on the Group's financial results, distributable reserves, net assets or embedded value.

The Group's and LVFS' financial statements conform to International Financial Reporting Standards ("**IFRS**") and interpretations issued by the IFRS Interpretations Committee ("**IFRIC**") as published by the International Accounting Standards Board and adopted by the European Union. In addition LVFS' financial statements comply with the Friendly Societies (Accounts & Related Provisions) Regulations 1994.

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.

Insurance contracts are accounted for in accordance with the Statement of Recommended Practice issued by the Association of British Insurers in December 2005, and amended in December 2006. The Group measures the liability on insurance and with-profit contracts in line with the 'realistic' reporting regime of the PRA.

Changes in standards or the interpretation of IFRS or other valuation methodologies could have a negative effect on the Group's financial results, distributable reserves, net assets or embedded value. This is a particular risk currently for insurance companies as the IASB is planning to reissue, during 2013, Exposure Draft ED/2010/8 on Insurance Contracts, which, if adopted, would replace IFRS 4 on Insurance Contracts and would significantly change the manner in which insurers account for insurance contracts in their financial statements. The latest IASB timetable proposes the issue of the final standard during 2014, with a mandatory effective date of no earlier than January 2017. The new standard could have an adverse effect on the financial results, distributable reserves, net assets or embedded value of the Group as reported under IFRS.

A number of other new standards and amendments to standards and interpretations of IFRS are to become effective for annual periods beginning after 1 January 2013, and have not been applied in preparing the most recent consolidated financial statements of the Group. These changes include amendments to financial statements presentation regarding other comprehensive income, requirements to improve consistency and reduce complexity in respect of fair value measurement, changes to the calculation of employee benefit scheme liabilities and recognition of past service costs, updates to the classification, measurement and recognition of financial assets and financial liabilities and changes to disclosures of interests and investments in non-Group entities and joint ventures. The impact of these recent updates and amendments are currently being reviewed by the Group and may have a significant effect on the consolidated financial statements of the Group in the future and further information is provided on page 60 of the 2012 financial reports and accounts of the Group.

Changes in taxation law may impact the Group and may impact upon the decisions of policyholders and potential policyholders.

UK taxation law includes rules governing company taxes, business taxes, personal taxes, capital taxes and indirect taxes. LVFS is not able to predict the impact of changes announced in the future to UK tax legislation on its business. From time to time changes to existing UK and overseas tax laws (including as a result of changes in the interpretation of such tax laws), amendments to existing tax rates or the introduction of new tax legislation in the UK or overseas may adversely impact the business, results of operations and financial condition of the Group.

Further, there is specific UK legislation that governs the taxation of life assurance undertakings (including where life assurance business is carried on by friendly societies), changes to which might adversely affect life assurance undertakings. The Finance Act 2012 contains legislation (the "**New UK Life Tax Rules**") which, will impact the UK taxation of life insurance companies and friendly societies for accounting periods beginning on or after 1 January 2013. The New UK Life Tax Rules represent a wide ranging revision of both the basis on which life assurance profits are computed for UK tax purposes and the detailed rules by which those profits are taxed (in particular, two key changes are that, under the New UK Life Tax Rules, first, only basic life assurance and general annuity business will continue to be taxed on an I-E basis, with all other long-term business (including gross roll-up, permanent health and protection businesses) being taxed together on the basis of trading profits and secondly, the trading profits of all life assurance businesses will be calculated on the basis of the company's statutory accounts rather than on the basis of its regulatory returns). The New UK Life Tax Rules also include provisions to allow for adjustments to be made in connection with the transition from the existing basis of life assurance taxation to the New UK Life Tax Rules. Under the current interpretation of the New UK Life Tax Rules by HMRC it is considered that there will be no impact from the transitional rules on LVFS, but a change in HMRC's interpretation of the New UK Life Tax Rules could materially impact on this.

Whilst the introduction of the New UK Life Tax Rules is likely to impact the life assurance sector as a whole, the impact of any such changes on the Group in particular will depend on the mix of long-term business within its portfolios and other relevant circumstances at the time of such changes. As at the date of this Prospectus, based on the current HMRC interpretation of the New UK Life Tax Rules it is considered that there will not be an adverse material impact arising from the New UK Life Tax Rules. However, Noteholders should be aware that it is possible that a change in HMRC's interpretation of the New UK Life Tax Rules may result in an increase in the amount of tax payable by LVFS, (and as a result reduce the after-tax profits of the Group), and that they could also have a significant adverse effect on certain operations of LVFS, which may also adversely affect Group profitability.

The design of life insurance takes into account a number of factors, including risks, benefits, charges, expenses, investment returns (including bonuses) and taxation and is based on the legislation, including tax legislation, in force at that time. Changes in tax legislation or in the interpretation of tax legislation may, therefore, when applied to such products, have a material adverse effect on the financial condition of the relevant long-term business fund of LVFS in which the business was written.

There are also specific rules governing the taxation of policyholders. The Group is unable to predict the impact of changes announced in the future to tax law on the taxation of life assurance and pension policies in the hands of policyholders. Amendments to existing legislation (particularly if there is the withdrawal of any tax relief or an increase in tax rates) or the introduction of new rules may impact upon the future life assurance and pensions business and the decisions of policyholders and potential policyholders. The impact of any changes upon the Group thereafter might depend on the mix of in-force business at the time of the change.

There may be changes to the current VAT rules which result in VAT being chargeable on certain outsourcing agreements of the Group and such VAT suffered not being recoverable from HMRC as deductible VAT input tax.

Generally, the services supplied under the Group's outsourced policy administration services agreements are treated as exempt supplies for the purposes of VAT pursuant to the insurance intermediary exemption and so no VAT is generally payable by the Group in relation to services received under such agreements. If, however, the supplies currently treated as exempt were to be treated as taxable, the costs to the Group of such supplies would increase to the extent that any VAT payable by the Group in respect of such services was not recoverable as input tax.

In this regard, the scope of the insurance intermediary exemption is subject to possible change. In 2005, in the case of *Staatssecretaris van Financiën v Arthur Andersen & Co Accountants c.s.* (Case C-472/03), the ECJ interpreted the insurance intermediary exemption narrowly. Following a consultation, in December 2005 the UK Government announced that it would delay its decision on implementing the ECJ's decision in Arthur Andersen within the United Kingdom until the European Commission had undertaken its own review of the VAT treatment of financial services and insurance. The European Commission has carried out that review as a result of which it made a number of detailed proposals for changes to the relevant provisions of the Principal VAT Directive. Those proposals have not yet been accepted by the European Council. It is not known when any changes to the UK VAT treatment of insurance intermediation might become law, what form those changes might take and what their impact (if any) on the Group would be.

The Group maintains a conditional support fund to the RNPFN which could require additional payments in certain circumstances.

If the Royal National Pension Fund for Nurses (the "**RNPFN Fund**") (a ring-fenced closed sub-fund of LVFS) fails to meet its capital resource requirements under the PRA rules (see the section entitled "*Regulation of the Issuer*" on page 104) the Group is required to fund this deficit up to a capped amount (currently £64.8m), which may increase or decrease on an annual basis as the RNPFN Fund continues to be run off. This could have a material adverse effect on the Group's financial condition and results of operations. Further, in the event of the insolvency of LVFS, all ring-fencing arrangements would cease to apply and all policyholders of the RNPFN Fund (in their capacity as such) would rank alongside the preferred insurance creditors of the main LVFS fund (see the section entitled "*Regulation of the Issuer*" for the relevant rules applicable in a winding-up of LVFS).

Upon insolvency of LVFS there are no procedural insolvency rules for friendly societies, which may result in delays in the administration of a winding up and return of assets to Noteholders.

The Insolvency Rules 1986 and the Insurers (Winding Up) Rules 2001 do not apply to friendly societies such as LVFS (see the section entitled "*Regulation of the Issuer*" on page 104 for a description of the applicable regime governing the insolvency of LVFS) and no other procedural insolvency rules have been published which relate to LVFS. Calculations of amounts due to policyholders will be determined by reference to actuarial standards which are, by their nature, subject to different interpretations. As a result, upon insolvency of LVFS, there may be uncertainties governing the procedures for administration of the estate of LVFS, including the quantum and timing of any return of assets to subordinated creditors such as the Noteholders, which may lead to delays and reductions in the amounts available to Noteholders.

4. Risks relating to the Subordinated Notes.

Defined terms used in the following risk factors, unless otherwise stated, have the meaning given to them in the Conditions set out below in the section entitled "*Terms and Conditions of the Subordinated Notes*" on page 45.

The Subordinated Notes have features which entail particular risks for potential investors.

Redemption prior to the Maturity Date

The scheduled Maturity Date of the Subordinated Notes is 22 May 2043 and, although LVFS may redeem or purchase the Subordinated Notes in certain circumstances prior to that date, LVFS is under no obligation to do so. The Noteholders have no right to call for the redemption of the Subordinated Notes. Therefore, prospective investors should be aware that they may be required to bear the financial risks associated with an investment in long term securities.

The Subordinated Notes may, subject as provided in Condition 7*(h)*, at the option of LVFS, be redeemed before the Maturity Date at their principal amount, together with any Arrears of Interest and any other accrued but unpaid interest to (but excluding) the date of redemption, on any Interest Payment Date falling on or after the First Call Date, or prior to such date (i) in the event of certain changes in the tax treatment of the Subordinated Notes or payments thereunder due to a change in applicable law or regulation or the official interpretation thereof, or (ii) following the occurrence of (or if LVFS satisfies the Trustee that there will occur within six months) a Capital Disqualification Event or a Ratings Methodology Event (provided that, (i) in the case of a Ratings Methodology Event, the Subordinated Notes will not be redeemed prior to the fifth anniversary of the Issue Date and (ii) in the case of any redemption prior to the fifth anniversary of the Issue Date, the approval of the PRA is obtained and such redemption is funded out of the proceeds of a new issue of at least equivalent regulatory capital (unless Solvency II (as defined in the Conditions) is implemented without such requirements)). The cash paid to investors upon such a redemption may be less than the then current market value of the Subordinated Notes or the price at which investors purchased the Subordinated Notes. Subject to the contractual and regulatory restrictions on doing so set out in the Conditions, LVFS might be expected to redeem the Subordinated Notes when its cost of borrowing for an instrument with a comparable regulatory capital treatment at the time is lower than the interest payable on them. At those times, an investor generally would not be able to reinvest the redemption proceeds at an effective interest rate as high as the interest payable on the Subordinated Notes being redeemed and may only be able to do so at a significantly lower rate. Potential investors should consider reinvestment risk in the light of other investments available at that time.

In relation to a Capital Disqualification Event, it should be noted that Solvency II (described in the section entitled "*Regulation of the Issuer*" on page 104) will, among other things, stipulate the characteristics of regulatory capital and, accordingly, will set out the features which any such capital (including the Subordinated Notes) must have in order to qualify as regulatory capital. These features may be different and/or more onerous than those currently applicable to insurance companies in the UK and the details are not expected to be known until the implementation measures (Level 2) relating to Solvency II are presented to and finalised by the European Parliament and the Council (expected during 2013) and there can be no assurance that, following the initial publication of such details, the implementation measures will not be amended. Although, prior to the publication of the proposed Level 2 implementation measures, the Committee of European Insurance and Occupational Pensions Supervisors (now the European Insurance and Occupational Pensions Authority) has given indications as to what the required characteristics of regulatory capital might be, for example those set out in the QIS5 Technical Specifications (the "**Indicative Features**"), the Indicative Features are preliminary and lacking in detail and there can be no assurance that the Level 2 implementation measures and any rules and regulations to be adopted pursuant to such implementation measures will not require features which are wholly or substantially different from the Indicative Features. In addition, even though LVFS has given consideration to the Indicative Features in the Conditions, there is considerable uncertainty as to their precise requirements. Accordingly, there is a risk that after the issue of the Subordinated Notes, a Capital Disqualification Event may occur.

In relation to a Ratings Methodology Event, it should be noted that rating agency methodologies for rating subordinated notes have been evolving since the financial crisis and future evolutions could impact on the equity content of the Subordinated Notes and trigger a Ratings Methodology Event.

An investor may not be able to reinvest the redemption proceeds at an effective interest rate as high as the interest rate on the Subordinated Notes being redeemed and may only be able to do so at a significantly lower rate. Potential investors should consider reinvestment risk in light of other investments available at that time.

Subordination

LVFS' payment obligations (including in relation to any damages awarded for breach of any obligations) under the Subordinated Notes will be unsecured and subordinated in the event that (i) an order is made, or an effective resolution is passed, for the winding-up of LVFS, or (ii) an administrator of LVFS is appointed and gives notice that it intends to declare and distribute a dividend and, in each case, will rank junior in priority to the claims of Senior Creditors of LVFS.

LVFS' payment obligations (including in relation to any damages awarded for breach of any obligations) in relation to the Subordinated Notes will be unsecured and subordinated in the event that (i) an order is made, or an effective resolution is passed, for the winding-up of LVFS, or (ii) an administrator of LVFS is appointed and gives notice that it intends to declare and distribute a dividend or other distribution of the assets of LVFS and, in each case, will rank junior in priority to the claims of Senior Creditors of LVFS.

On a Winding-Up (as defined in the Conditions), payments to a Noteholder will only be made after all obligations of LVFS resulting from higher ranking claims have been satisfied. A Noteholder may therefore recover a lesser proportion of its claim than the holders of unsubordinated liabilities of LVFS. Furthermore, the Conditions will not limit the amount of the liabilities ranking senior to, or *pari passu* with, the Subordinated Notes which may be incurred or assumed by LVFS from time to time, whether before or after the Closing Date. Subject to applicable law, no Noteholder may exercise, claim or plead any right of set-off or counter-claim in respect of any amount owed to it by LVFS in respect of, or arising under or in connection with, the Subordinated Notes and each Noteholder shall, by virtue of its holding, be deemed to have waived all such rights of set-off and counter-claim.

Although the Subordinated Notes may pay a higher rate of interest than comparable notes which are not subordinated, there is a significant risk that an investor in the Subordinated Notes will lose all or some of its investment should LVFS become insolvent.

Interest payments under the Subordinated Notes may be deferred and under certain conditions must be deferred

LVFS may, in relation to any Interest Payment Date, elect to defer payments of interest on the Subordinated Notes. In addition, LVFS is required to defer any payment of interest on the Subordinated Notes on each Regulatory Deficiency Interest Deferral Date (being an Interest Payment Date in respect of which a Regulatory Deficiency Interest Deferral Event has occurred and is continuing or would occur if payment of interest was made by LVFS on such Interest Payment Date).

The deferral of interest as described above does not constitute a default under the Subordinated Notes for any purpose. Any interest so deferred shall, for so long as the same remains unpaid, constitute Arrears of Interest. Arrears of Interest do not themselves bear interest. Arrears of Interest may, subject to certain conditions including the satisfaction of the Solvency Condition described below, be paid by LVFS at any time upon notice to Noteholders by LVFS on the earliest to occur of (a) the next Interest Payment Date which is not a Regulatory Deficiency Interest Deferral Date on which payment of interest in respect of the Subordinated Notes is made, (b) a Winding-Up or (c) any redemption of the Subordinated Notes pursuant to Condition 7 or Condition 11.

Save when LVFS is in a Winding-Up, all payments under the Subordinated Notes shall be conditional upon LVFS being solvent at the time for payment by LVFS, and no amount shall be payable under or arising under the Subordinated Notes unless and until such time as LVFS could make such payment and still be solvent immediately thereafter (the "**Solvency Condition**"). For these purposes, LVFS will be "solvent" if (i) it is able to pay its debts owed to Senior Creditors of LVFS and Parity Creditors of LVFS as they fall due and (ii) its Assets exceed its Liabilities (other than Liabilities to persons who are Junior Creditors of LVFS). If any payment in respect of interest, Arrears of Interest and/or principal cannot be made by LVFS in compliance with the Solvency Condition, payment of such amounts will be deferred, and such deferral will not constitute a default under the Subordinated Notes for any purpose.

Any actual or anticipated deferral of interest payments will likely have an adverse effect on the market price of the Subordinated Notes. In addition, as a result of the interest deferral provision of the Subordinated Notes, the market price of the Subordinated Notes may be more volatile than the market prices of other debt securities on which interest accrues that are not subject to such deferral and may be more sensitive generally to adverse changes in LVFS' financial condition.

Deferral of Redemption

Notwithstanding the expected maturity of the Subordinated Notes on the Maturity Date, LVFS must defer redemption of the Subordinated Notes on the Maturity Date, or on any other date set for redemption of the Subordinated Notes pursuant to Conditions 7(*d*), 7(*e*) and 7(*f*), in the event that a Regulatory Deficiency Redemption Deferral Event has occurred and is continuing or would occur if the Subordinated Notes were redeemed by LVFS on such date.

The deferral of redemption of the Subordinated Notes does not constitute a default under the Subordinated Notes. Where redemption of the Subordinated Notes is deferred, subject to certain conditions, the Subordinated Notes will be redeemed by LVFS on the earliest of (a) the date falling 10 Business Days following cessation of the Regulatory Deficiency Redemption Deferral Event, (b) the date falling 10 Business Days after the PRA has agreed to the repayment or redemption of the Subordinated Notes or (c) the date on which a Winding-Up occurs.

Any actual or anticipated deferral of redemption of the Subordinated Notes will likely have an adverse effect on the market price of the Subordinated Notes. In addition, as a result of the redemption deferral provision of the Subordinated Notes, including with respect to deferring redemption on the scheduled Maturity Date, the market price of the Subordinated Notes may be more volatile than the market prices of other debt securities without such deferral feature, including dated securities where redemption on the scheduled maturity date cannot be deferred, and the Subordinated Notes may accordingly be more sensitive generally to adverse changes in LVFS' financial condition.

Modifications and waivers

The Conditions and the Trust Deed contain provisions for calling meetings of Noteholders to consider matters affecting their interests generally. These provisions permit defined majorities to bind all Noteholders including Noteholders who did not attend and vote at the relevant meeting and Noteholders who voted in a manner contrary to the majority. The Conditions and the Trust Deed also provide that, subject to the prior consent of the PRA being obtained (so long as such consent is required), the Trustee may, without the consent of Noteholders, agree to any modification of, or to the waiver or authorisation of any breach or proposed breach of, any of the Conditions or any of the provisions of the Trust Deed in the circumstances described in Condition 15.

Substitution of Issuer and transfer of business

The Conditions provide that the Trustee may, without the consent of the Noteholders, agree to the substitution of a Related Undertaking of LVFS or a successor in business of LVFS as principal debtor under the Subordinated Notes in place of LVFS, or the addition of a Related Undertaking as a guarantor (provided that in the case of a substitution of LVFS with a Related Undertaking, the Subordinated Notes are guaranteed by LVFS on an equally subordinated basis). A Related Undertaking is any subsidiary of LVFS, any future parent undertaking of LVFS and any subsidiary of such parent undertaking from time to time. The Trustee may only agree to such changes when several factors are met including the credit rating of the Subordinated Notes is not expected to be worse than immediately prior to the substitution, LVFS and the Substituted Obligor comply with such requirements as the Trustee may direct in the interests of the Noteholders and, overall, the Trustee shall be satisfied that the interests of the Noteholders will not be materially prejudiced by the relevant substitution. Such substitution will also be subject to prior approval of the PRA.

The Conditions also provide that should LVFS transfer the whole or a substantial part of its business to another body in accordance with statute or by exercise of statutory powers by the PRA or Financial Services Compensation Scheme, LVFS shall, subject to obtaining prior approval from the PRA, procure that the obligations of LVFS under the Subordinated Notes are also transferred to such other body, to the extent not restricted from so doing by direction of the PRA. There are some circumstances, however, where the Subordinated Notes would not transfer with the business of LVFS namely where the business transferred does not constitute the whole or a substantial part or the PRA directs a transfer of engagements using its statutory powers but excludes the Subordinated Notes from the direction.

No limitation on issuing senior or pari passu securities

There is no restriction on the amount of securities which LVFS may issue and which rank senior to, or *pari passu* with, the Subordinated Notes. The issue of any such securities may reduce the amount recoverable by Noteholders on a Winding-Up. In particular, the Subordinated Notes shall rank junior to the claims of Senior Creditors of LVFS. Accordingly, in such a winding-up and after payment of the claims of Senior Creditors of LVFS there may not be a sufficient amount to satisfy the amounts owing to the Noteholders.

Restricted remedy for non-payment when due

In accordance with the PRA's current requirements for tier 2 capital, the sole remedy against LVFS available to the Trustee or (where the Trustee has failed to proceed against LVFS as provided in the Conditions of the Subordinated Notes) any Noteholder for recovery of amounts which have become due in respect of the Subordinated Notes will be the institution of proceedings for the winding-up of LVFS and/or proving in such winding-up or administration and/or claiming in the liquidation of LVFS.

Variation or Substitution of the Subordinated Notes without Noteholder consent

Subject as provided in Condition 7, LVFS may, at its option and without the consent or approval of the Noteholders, elect to substitute the Subordinated Notes for, or vary the terms of the Subordinated Notes so that they become or remain, Qualifying Dated Tier 2 Securities or Rating Agency Compliant Securities (as the case may be) at any time in the event of certain changes in the tax treatment of the Subordinated Notes or payments thereunder due to a change in applicable law or regulation or the official interpretation thereof, or following the occurrence of (or if LVFS satisfies the Trustee that there will occur within six months) a Capital Disqualification Event or a Ratings Methodology Event.

Risk that investors will have to rely on the procedures of Euroclear and Clearstream, Luxembourg for transfer, payment and communication with LVFS.

The Subordinated Notes will be represented by a Global Certificate (as defined in the Trust Deed). The Global Certificate will be deposited with a common depositary for, and registered in the name of the common nominee of, Euroclear and Clearstream, Luxembourg. Except in certain limited circumstances described in the Global Certificate, investors will not be entitled to receive definitive registered notes. Euroclear and Clearstream, Luxembourg will maintain records of the beneficial interests in the Global Certificate.

While the Subordinated Notes are represented by the Global Certificate, investors will be able to trade their beneficial interests only through Euroclear and Clearstream, Luxembourg. LVFS will discharge its payment obligations under the Subordinated Notes by making payments to the common depositary for Euroclear and Clearstream, Luxembourg for distribution to their account holders. A holder of a beneficial interest in a Global Certificate must rely on the procedures of Euroclear or Clearstream, Luxembourg to receive payments under the Subordinated Notes. LVFS has no responsibility or liability for the records relating to, or payments made in respect of, beneficial interests in the Global Certificate.

EU Savings Directive.

Under European Council Directive 2003/48/EC on the taxation of savings income (the "**EU Savings Directive**"), each member state of the European Union (a "**Member State**") is required to provide to the tax authorities of another Member State details of payments of interest (or similar income) paid by a person within its jurisdiction to, or collected by such a person for, an individual resident in that other Member State or certain limited types of entities established in that other member state. However, for a transitional period, Luxembourg and Austria may instead operate a withholding system in relation to such payments, deducting tax at a rate of 35 per cent. with effect from 1 July 2011. The transitional period is to terminate at the end of the first full fiscal year following the latter of, broadly speaking, the date of entry into force of an agreement between the European Council and certain non-EU countries providing for the exchange of information relating to such payments and the date on which the European Council agrees on a unanimous basis that the United States of America is committed to the exchange of information relating to such payments upon request.

A number of non-European Union countries and certain dependent and associated territories have adopted similar measures (either provision of information or transitional withholding) in relation to payments made by a person within its jurisdiction to, or collected by such a person for, an individual resident or certain limited types of entity established in a Member State. In addition, the Member States have entered into provision of information or transitional withholding arrangements with certain of those dependent or associated territories in relation to payments made by a person in a Member State to, or collected by such a person for, an individual resident or certain limited types of entity established in one of those territories.

If a payment were to be made or collected through a Member State which has opted for a withholding system, or through another country that has adopted similar measures, and an amount of, or in respect of, tax were to be withheld from that payment pursuant to the EU Savings Directive or any other European Union Directive implementing the conclusions of the ECOFIN Council meeting of 26 – 27 November 2000 on the taxation of savings income or any law implementing or complying with, or introduced in order to conform to, such Directive, neither LVFS nor any paying agent nor any other person would be obliged to pay additional amounts with respect to any Subordinated Notes as a result of the imposition of such withholding tax. LVFS is required to maintain a Paying Agent in a Member State that is not obliged to withhold or deduct tax pursuant to the Directive or any other European Union Directive implementing the conclusions of the ECOFIN Council meeting of 26 – 27 November 2000 on the taxation of savings income or any law

implementing or complying with, or introduced in order to conform to, such Directive (see Condition 6(*f*)(iii) of the Subordinated Notes).

The European Commission has proposed certain amendments to the EU Savings Directive, which may, if implemented, amend or broaden the scope of the requirements described above. Prospective Noteholders who are in any doubt as to their position should consult their professional advisers.

Risks relating to the U.S. Foreign Account Tax Compliance Withholding.

LVFS and other non-U.S. financial institutions through which payments on the Subordinated Notes are made may be required to withhold U.S. tax at a rate of 30 per cent. on all, or a portion of, payments made after 31 December 2016 in respect of the Subordinated Notes if they are (i) materially modified on or after the date that is six (6) months after the date on which the final regulations that define "foreign passthru payments" are published or (ii) treated as equity for U.S. federal tax purposes, whenever issued, pursuant to sections 1471 through 1474 of the U.S. Internal Revenue Code and the regulations thereunder ("**FATCA**") This withholding tax may be triggered if (i) LVFS is a foreign financial institution ("**FFI**") (as defined in FATCA) which enters into and complies with an agreement with the U.S. Internal Revenue Service ("**IRS**") to provide certain information on its account holders (making LVFS a "**Participating FFI**"), (ii) payments on the Subordinated Notes are classified as "foreign passthru payments" (as defined in FATCA), and (iii)(a) an investor does not provide information sufficient for the relevant Participating FFI to determine whether the investor is subject to withholding under FATCA, or (b) any FFI to or through which payment on such Subordinated Notes is made is not a Participating FFI or otherwise exempt from FATCA withholding. The term "foreign passthru payment" has not yet been defined and it is unclear whether and in what situations payments on the Subordinated Notes may be classified as foreign passthru payments. The United States and the United Kingdom have entered into an intergovernmental agreement to implement FATCA (the "**IGA**"). Under the IGA, an FFI that is treated as resident in the United Kingdom and that complies with the requirements of the IGA, will not be required to withhold on payments of non-U.S. source income. LVFS expects be treated as an FFI and to comply with the requirements of the IGA. The application of FATCA withholding to interest, principal or other amounts paid with respect to the Subordinated Notes is not clear. If an amount in respect of U.S. withholding tax were to be deducted or withheld from interest, principal or other payments on the Subordinated Notes as a result of FATCA, none of LVFS, any paying agent or any other person would, pursuant to the Terms and Conditions of the Subordinated Notes be required to pay additional amounts as a result of the deduction or withholding of such tax. As a result, investors may receive less interest or principal than expected. Noteholders should consult their own tax advisers on how these rules may apply to payments they receive under the Subordinated Notes.

Change of law.

The Conditions of the Subordinated Notes are based on English law in effect as at the date of issue of the Subordinated Notes. No assurance can be given as to the impact of any possible judicial decision or change to English law or administrative practice after the date of issue of the Subordinated Notes.

Integral multiples of £100,000.

The Subordinated Notes are issued in the denomination of £100,000 and higher integral multiples of £1,000 thereafter and so it is possible that the Subordinated Notes may be traded in amounts in excess of £100,000 that are not integral multiples of £100,000 (or its equivalent). In such a case a Noteholder who, as a result of trading such amounts, holds a principal amount of less than £100,000 will not receive a definitive Note in respect of such holding (should definitive Subordinated Notes be printed) and would need to purchase a principal amount of Subordinated Notes such that it holds an amount equal to or greater than £100,000.

5. Risks relating to the market generally.

Set out below is a brief description of certain market risks, including liquidity risk, exchange rate risk, interest rate risk and credit risk.

The secondary market generally.

Although application has been made to admit the Subordinated Notes to trading on the London Stock Exchange's Regulated Market, the Subordinated Notes have no established trading market and one may never develop. If a market does develop, it may not be liquid. Therefore, investors may not be able to sell their Subordinated Notes easily or at prices that will provide them with a yield comparable to similar investments that have a developed secondary market. Illiquidity may have a severely adverse effect on the market value of the Subordinated Notes.

Fixed rate notes are exposed to specific market risks.

The Subordinated Notes will bear a fixed interest rate until the Maturity Date which shall be reset every 5 years. A holder of a security with a fixed interest rate is exposed to the risk that the price of such security falls as a result of changes in the current interest rate on the capital market (the "**Market Interest Rate**"). While the nominal rate of a security with a fixed interest rate is fixed for a specified period, the Market Interest Rate typically changes on a daily basis. As the Market Interest Rate changes, the price of such security is likely to change in the opposite direction. If the Market Interest Rate increases, the price of such security typically falls, until the yield of such security is approximately equal to the Market Interest Rate. If the Market Interest Rate falls, the price of a security with a fixed compensation rate typically increases, until the yield of such security is approximately equal to the Market Interest Rate. Investors should be aware that movements of the Market Interest Rate can adversely affect the price of the Subordinated Notes and can lead to losses for the Noteholders if they sell the Subordinated Notes.

In addition, the reset of the fixed interest rate in accordance with Condition 4 may also affect the market value of the Subordinated Notes in the secondary market and, following any such reset of the fixed interest rate, the new fixed interest rate on the Subordinated Notes may be lower than the previous fixed interest rate on the Subordinated Notes, thereby reducing the amount of interest payable to Noteholders.

Inflation risk.

The value of future payments of interest and principal may be reduced as a result of inflation as the real rate of interest on an investment in the Subordinated Notes will be reduced at rising inflation rates and may be negative if the inflation rate rises above the nominal rate of interest on the Subordinated Notes.

Credit ratings may not reflect all risks.

One or more independent credit rating agencies may assign credit ratings to the Subordinated Notes. The ratings may not reflect the potential impact of all risks related to structure, market, additional factors discussed above, and other factors that may affect the value of the Subordinated Notes. A credit rating is not a recommendation to buy, sell or hold securities and may be revised or withdrawn by the rating agency at any time. Credit rating methodologies for rating subordinated debt in particular may change in the future, any such change in methodology may lead to a reduction in the rating assigned to the Subordinated Notes or an increase in the rating assigned to unsubordinated debt instruments by comparison.

Legal investment considerations may restrict certain investments.

The investment activities of certain investors are subject to legal investment laws and regulations, or review or regulation by certain authorities. Each potential investor should consult its legal advisers to determine whether and to what extent (i) the Subordinated Notes are legal investments for it, (ii) the Subordinated Notes

can be used as collateral for various types of borrowing and (iii) other restrictions apply to its purchase or pledge of the Subordinated Notes. Financial institutions should consult their legal advisers or the appropriate regulators to determine the appropriate treatment of the Subordinated Notes under any applicable risk-based capital or similar rules.

Terms and Conditions of the Subordinated Notes

The following is the text of the terms and conditions of the Subordinated Notes which (subject to modification and except for the paragraphs in italics) will be endorsed on the Certificates issued in respect of the Subordinated Notes:

The issue of the £350,000,000 6.50 per cent. Fixed Rate Reset Subordinated Notes callable 2023 due 2043 (the "**Subordinated Notes**", which expression shall in these Conditions, unless the context otherwise requires, include any further notes issued pursuant to Condition 18 and forming a single series with the Subordinated Notes) was (save in respect of any such further notes) authorised by a resolution of the Board of Directors of Liverpool Victoria Friendly Society Limited (the "**Issuer**") passed on 18 April 2013 and a resolution of a committee of the Board of Directors of the Issuer passed on 1 May 2013. The Subordinated Notes are constituted by a Trust Deed (the "**Trust Deed**") dated 22 May 2013 between the Issuer and HSBC Corporate Trustee Company (UK) Limited (the "**Trustee**" which expression shall include all persons for the time being the trustee or trustees under the Trust Deed) as trustee for the holders of the Subordinated Notes. These terms and conditions include summaries of, and are subject to, the detailed provisions of the Trust Deed, which includes the form of the Subordinated Notes. Copies of the Trust Deed, and of the Agency Agreement (the "**Agency Agreement**") dated 22 May 2013 relating to the Subordinated Notes between the Issuer, the Trustee, HSBC Bank plc as registrar (the "**Registrar**"), transfer agent (the "**Transfer Agent**") and initial principal paying agent (the "**Principal Paying Agent**"), are available for inspection during usual business hours at the principal office of the Trustee (presently at 8 Canada Square, London E14 5HQ) and at the specified offices of the Principal Paying Agent for the time being, the Registrar and any Transfer Agent.

All capitalised terms that are not defined in these terms and conditions (the "**Conditions**") will have the meanings given to them in the Trust Deed.

1 Form, Denomination and Title

(a) Form and Denomination

The Subordinated Notes are issued in registered form in amounts of £100,000 and integral multiples of £1,000 in excess thereof (referred to as the "**principal amount**" of a Subordinated Note, and references in these Conditions to "**principal**" in relation to a Subordinated Note shall be construed accordingly). A note certificate (each a "**Certificate**") will be issued to each Noteholder in respect of its registered holding of Subordinated Notes. Each Certificate will be numbered serially with an identifying number which will be recorded on the relevant Certificate and in the register of Noteholders which the Issuer will procure to be kept by the Registrar (the "**Register**").

(b) Title

Title to the Subordinated Notes passes only by registration in the Register. The holder of any Subordinated Note will (except as otherwise required by law) be treated as its absolute owner for all purposes (whether or not it is overdue and regardless of any notice of ownership, trust or any interest or any writing on, or the theft or loss of, the Certificate issued in respect of it) and no person will be liable for so treating the holder. In these Conditions, "**Noteholder**" and (in relation to a Subordinated Note) "**holder**" means the person in whose name a Subordinated Note is registered in the Register (or, in the case of joint holders, the first named thereof).

2 Transfers of Subordinated Notes and Issue of Certificates

(a) Transfers

A Subordinated Note may be transferred by depositing the Certificate issued in respect of that Subordinated Note, with the form of transfer on the back duly completed and signed, at the specified office of the Registrar or any of the Agents.

(b) Delivery of new Certificates

Each new Certificate to be issued upon a transfer of Subordinated Notes will, within five Business Days of receipt by the Registrar or the relevant Agent of the duly completed form of transfer endorsed on the relevant Certificate, be mailed by uninsured mail at the risk of the holder entitled to the Subordinated Note to the address specified in the form of transfer.

Where some but not all of the Subordinated Notes in respect of which a Certificate is issued are to be transferred, a new Certificate in respect of the balance of Subordinated Notes not so transferred will, within five Business Days of receipt by the Registrar or the relevant Agent of the original Certificate, be mailed by uninsured mail at the risk of the holder of the Subordinated Notes not so transferred to the address of such holder appearing on the Register or as specified in the form of transfer.

(c) Formalities free of charge

Registration of transfer of any Subordinated Notes will be effected without charge by or on behalf of the Issuer or any Agent but upon payment (or the giving of such indemnity as the Issuer or any Agent may reasonably require) in respect of any tax or other governmental charges which may be imposed in relation to such transfer.

(d) Closed periods

No Noteholder may require the transfer of a Subordinated Note to be registered during the period of 15 days ending on the due date for any payment of principal or interest or during the period following delivery of a notice of a voluntary payment of Arrears of Interest in accordance with Condition 5(e) and Condition 13 and ending on the date referred to in such notice as having been fixed for such payment of Arrears of Interest.

(e) Regulations

All transfers of Subordinated Notes and entries on the Register will be made subject to the detailed regulations concerning transfer of Subordinated Notes scheduled to the Agency Agreement. The regulations may be changed by the Issuer with the prior written approval of the Registrar and the Trustee. A copy of the current regulations will be mailed (free of charge) by the Registrar to any Noteholder who requests one.

3 Status of the Subordinated Notes

(a) Status

The Subordinated Notes constitute direct, unsecured and subordinated obligations of the Issuer and rank *pari passu* and without any preference among themselves. The rights and claims of the Noteholders are subordinated as described in the Trust Deed and Condition 3*(b)*.

(b) Subordination

If:

(i) at any time an order is made, or an effective resolution is passed, for the winding-up in England and Wales of the Issuer (except, in any such case (a) a winding-up following the transfer of all its liabilities and obligations as issuer of the Subordinated Notes to a transferee in connection with a transfer of its business pursuant to Condition 16 or (b) a solvent winding-up solely for the purpose of a reconstruction or amalgamation or the substitution in place of the Issuer of a successor in business of the Issuer, the terms of which reconstruction, amalgamation or substitution (A) have previously been approved in writing by the Trustee or by an Extraordinary Resolution and (B) do not provide that the Subordinated Notes or any amount in respect thereof shall thereby become payable); or

(ii) an administrator of the Issuer is appointed and such administrator gives notice that it intends to declare and distribute a dividend or other distribution of the assets of the Issuer,

(the events in (i) and (ii) each being a "**Winding-Up**"), the rights and claims of the Trustee (on behalf of the Noteholders but not the rights and claims of the Trustee in its personal capacity under the Trust Deed) and the Noteholders against the Issuer in respect of or arising under the Subordinated Notes and the Trust Deed (including any damages awarded for breach of any obligations thereunder) will be subordinated in the manner provided in the Trust Deed to the claims of all Senior Creditors but shall rank: (A) at least *pari passu* with all claims of holders of all other subordinated obligations of the Issuer which constitute, and all claims relating to a guarantee or other like or similar undertaking or arrangement given or undertaken by the Issuer in respect of any obligations of any other person which constitute, or (in either case) would but for any applicable limitation on the amount of such capital constitute, Lower Tier 2 Capital (issued prior to Solvency II Implementation) or Tier 2 Capital (issued on or after Solvency II Implementation) and all obligations which rank, or are expressed to rank, *pari passu* therewith ("**Parity Securities**"); and (B) in priority to the claims of holders of (i) any subordinated obligations of the Issuer expressed to rank junior to the Subordinated Notes, (ii) all obligations of the Issuer which constitute, and all claims relating to a guarantee or other like or similar undertaking or arrangement given or undertaken by the Issuer in respect of any obligations of any other person which constitute, or (in either case) would but for any applicable limitation on the amount of such capital constitute, Upper Tier 2 Capital (issued prior to Solvency II Implementation) or Tier 1 Capital (including, without limitation, by virtue of the operation of any applicable grandfathering provisions under the Relevant Rules) and all obligations which rank, or are expressed to rank, *pari passu* therewith, and (iii) the claims of members of the Issuer (under any applicable legislation relating to the winding-up of incorporated friendly societies and the Rules of the Issuer) in their capacity as members of the Issuer including (without limitation) any claim or expectation of any member (in such member's capacity as a member) to receive distributions under the Mutual Bonus Arrangements (together, the "**Junior Securities**").

The liability of the Issuer under the Subordinated Notes and the Trust Deed shall not exceed the extent of its assets from time to time and no member of the Issuer shall be liable to make any contribution (whether on liquidation of the Issuer or otherwise) to satisfy any claim under the Subordinated Notes.

Nothing in this Condition 3(b) shall affect or prejudice the payment of the costs, fees, charges, expenses, liabilities or remuneration of the Trustee under the Trust Deed or the rights and remedies of the Trustee in respect thereof.

(c) *Solvency Condition*

Other than in the circumstances where Condition 3(b) applies, all payments under or arising from the Subordinated Notes shall be conditional upon the Issuer being solvent at the time for payment by the Issuer, and no amount shall be payable under or arising from the Subordinated Notes unless and until such time as the Issuer could make such payment and still be solvent immediately thereafter (the "**Solvency Condition**").

For the purposes of this Condition 3*(c)*, the Issuer will be solvent if (i) it is able to pay its debts owed to Senior Creditors and Parity Creditors as they fall due and (ii) its Assets exceed its Liabilities (other than Liabilities to persons in their capacity as Junior Creditors). A certificate as to solvency of the Issuer signed by two Directors of the Issuer or, if there is a winding-up or administration of the Issuer, the liquidator or, as the case may be, the administrator of the Issuer shall, in the absence of manifest error be treated and accepted by the Issuer, the Trustee, the Noteholders and all other interested parties as correct and sufficient evidence thereof, shall be binding on all such persons and the Trustee shall be entitled to rely on such certificate without liability to any person.

(d) *Set-off, etc.*

By acceptance of the Subordinated Notes, each Noteholder and the Trustee, on behalf of each Noteholder, will be deemed to have waived any right of set-off or counterclaim that such Noteholder might otherwise have against the Issuer in respect of or arising under the Subordinated Notes whether prior to or in liquidation, winding-up or administration. Notwithstanding the preceding sentence, if any of the rights and claims of any Noteholder in respect of or arising under the Subordinated Notes are discharged by set-off, such Noteholder will immediately pay an amount equal to the amount of such discharge to the Issuer or, if applicable, the liquidator, trustee, receiver or administrator of the Issuer and, until such time as payment is made, will hold a sum equal to such amount on trust for the Issuer or, if applicable, the liquidator, trustee, receiver or administrator in the Issuer's bankruptcy, winding-up or administration. Accordingly, such discharge will be deemed not to have taken place.

4 Interest

(a) *Interest Rate*

Each Subordinated Note bears interest on its principal amount at the applicable Interest Rate from (and including) the Issue Date in accordance with the provisions of this Condition 4.

Subject to Condition 5, interest shall be payable on the Subordinated Notes annually in arrear on each Interest Payment Date, in each case as provided in this Condition 4.

(b) *Interest Accrual*

Interest shall cease to accrue on each Subordinated Note on the due date for redemption (which due date shall, in the case of deferral of a redemption date in accordance with Condition 7*(b)*, be the latest date to which redemption of the Subordinated Notes is so deferred) unless payment is improperly withheld or refused, in which event interest shall continue to accrue (in each case, both before and after judgment) as provided in the Trust Deed.

(c) *Fixed Interest Rate and Reset Rate*

For each Interest Period ending on or before the First Call Date, the Subordinated Notes bear interest at the rate of 6.50 per cent. per annum (the "**Fixed Interest Rate**"). For each Interest Period commencing

on (and including) the First Call Date and ending on (but excluding) the Maturity Date, the Subordinated Notes will bear interest at the applicable Reset Rate.

Where it is necessary to compute an amount of interest in respect of any Subordinated Note during an Interest Period, such interest shall be calculated on the basis of the actual number of days in the period from (and including) the most recent Interest Payment Date (or, if none, the Issue Date) to (but excluding) the relevant payment date divided by the actual number of days in the period from (and including) the most recent Interest Payment Date (or, if none, the Issue Date) to (but excluding) the next (or first) scheduled Interest Payment Date.

(d) *Determination of Reset Rate*

The Principal Paying Agent will, as soon as practicable after 11:00 a.m. (London Time) on the date falling one (1) Business Day prior to each Reset Date, determine the applicable Reset Rate and shall promptly notify the Issuer thereof.

(e) *Publication of Reset Rate*

Once the Issuer has been notified of the Reset Rate by the Principal Paying Agent in accordance with Condition 4(d), the Issuer shall cause notice of the Reset Rate, and the amount of interest which will payable per Subordinated Note on each Interest Payment Date in respect of which the Reset Rate applies, to be given to the Noteholders in accordance with Condition 13 as soon as reasonably practicable after the determination of the Reset Rate in accordance with Condition 4(d), and in any event no later than the fourth Business Day thereafter. Such determination of the Reset Rate shall (in the absence of manifest error) be binding on the Issuer, the Trustee and the Noteholders.

(f) *Principal Paying Agent*

So long as any of the Subordinated Notes remains outstanding, the Issuer will maintain a Principal Paying Agent. The Issuer may, with the prior written approval of the Trustee, from time to time replace the Principal Paying Agent with another leading financial institution in London. If the Principal Paying Agent is unable or unwilling to continue to act as the Principal Paying Agent, the Issuer shall forthwith appoint another financial institution in London approved in writing by the Trustee to act as such in its place.

(g) *Determinations of Principal Paying Agent or Trustee binding*

All notifications, opinions, determinations, certificates, calculations, quotations and decisions given, expressed, made or obtained for the purposes of this Condition 4, whether by the Principal Paying Agent or the Trustee (or its agent), shall (in the absence of manifest error) be binding on the Issuer, the Principal Paying Agent, the Trustee, the Paying Agents and all Noteholders and (in the absence of wilful default and bad faith) no liability to the Noteholders or the Issuer shall attach to the Principal Paying Agent or the Trustee in connection with the exercise or non-exercise by them of any of their powers, duties and discretions.

5 Deferral of Interest

(a) *Optional Deferral of Interest*

The Issuer may elect in respect of any Interest Payment Date, by notice to the Noteholders, the Trustee and the Principal Paying Agent pursuant to Condition 5*(f)*, to defer payment (in whole or in part) of the interest accrued to that date and the Issuer shall not have any obligation to make such payment on that date.

(b) *Mandatory Deferral of Interest*

Payment of interest on the Subordinated Notes by the Issuer will be mandatorily deferred on each Regulatory Deficiency Interest Deferral Date. The Issuer shall notify the Noteholders, the Trustee and the Principal Paying Agent of any Regulatory Deficiency Interest Deferral Date in accordance with Condition 5*(f)* (provided that failure to make such notification shall not oblige the Issuer to make payment of such interest, or cause the same to become due and payable, on such date).

A certificate signed by two Directors of the Issuer confirming that (i) a Regulatory Deficiency Interest Deferral Event has occurred and is continuing, or would occur if payment of interest on the Subordinated Notes were to be made or (ii) a Regulatory Deficiency Interest Deferral Event has ceased to occur and/or payment of interest on the Subordinated Notes would not result in a Regulatory Deficiency Interest Deferral Event occurring, shall, in the absence of manifest error, be treated and accepted by the Issuer, the Trustee, the Noteholders and all other interested parties as correct and sufficient evidence thereof, shall be binding on all such persons and the Trustee shall be entitled to rely on such certificate without liability to any person.

(c) *No default*

Notwithstanding any other provision in these Conditions or in the Trust Deed the deferral by the Issuer of any payment of interest (i) in accordance with Condition 5*(a),* (ii) on a Regulatory Deficiency Interest Deferral Date in accordance with Condition 5*(b)* or (iii) as a result of the application of the Solvency Condition in accordance with Condition 3*(c)* will not constitute a default by the Issuer and will not give Noteholders or the Trustee any right to accelerate repayment of the Subordinated Notes or take any enforcement action under the Subordinated Notes or the Trust Deed.

(d) *Arrears of Interest*

Any interest on the Subordinated Notes not paid on an Interest Payment Date as a result of (i) the exercise by the Issuer of its discretion to defer such payment of interest pursuant to Condition 5*(a),* (ii) the obligation of the Issuer to defer such payment of interest pursuant to Condition 5*(b)* or (iii) the operation of the Solvency Condition described in Condition 3*(c)* shall (without double-counting), to the extent and so long as the same remains unpaid, constitute "**Arrears of Interest**".

Arrears of Interest shall not themselves bear interest.

(e) *Payment of Arrears of Interest*

Any Arrears of Interest may (subject to satisfaction of the Regulatory Clearance Condition) be paid by the Issuer in whole or in part at any time upon the expiry of not less than 14 days' notice to such effect given by the Issuer to the Trustee, the Principal Paying Agent and the Noteholders in accordance with Condition 13 and in any event will become due and payable by the Issuer (subject, in the case of (i) and (iii) below, to satisfaction of the Regulatory Clearance Condition) in whole (and not in part) upon the earliest of the following dates:

(i) the next Interest Payment Date which is not a Regulatory Deficiency Interest Deferral Date on which payment of interest in respect of the Subordinated Notes is made; or

(ii) the date on which a Winding-Up occurs; or

(iii) the date fixed for any redemption or purchase of Subordinated Notes pursuant to Condition 7 (subject to any deferral of such redemption date pursuant to Condition 7(b)) or Condition 11.

(f) *Notice of Deferral*

The Issuer shall notify the Trustee, the Principal Paying Agent and the Noteholders in writing in accordance with Condition 13:

(1) not less than 10 Business Days prior to an Interest Payment Date, if it is an Interest Payment Date in respect of which the Issuer elects to defer interest as provided in Condition 5*(a)* above; or

(2) not less than 5 Business Days prior to an Interest Payment Date, if that Interest Payment Date is a Regulatory Deficiency Interest Deferral Date specifying that interest will not be paid because a Regulatory Deficiency Interest Deferral Event has occurred and is continuing or would occur if payment of interest was made on such Interest Payment Date, provided that if a Regulatory Deficiency Interest Deferral Event occurs less than 5 Business Days prior to an Interest Payment Date, the Issuer shall give notice of the interest deferral in accordance with Condition 13 as soon as reasonably practicable following the occurrence of such event.

6 Payments

(a) *Payments in respect of Subordinated Notes*

Payment of principal and interest will be made by transfer to the registered account of the relevant Noteholder. Payments of principal, and payments of interest and Arrears of Interest due at the time of redemption of the Subordinated Notes, will only be made against surrender of the relevant Certificate at the specified office of any of the Agents. Save as provided in the previous sentence, interest and Arrears of Interest due for payment on the Subordinated Notes will be paid to the holder shown on the Register at the close of business on the date (the "**record date**") being the second day before the due date for the relevant payment.

For the purposes of this Condition 6, a Noteholder's registered account means the sterling account maintained by or on behalf of it with a bank that processes payments in sterling, details of which appear on the Register at the close of business, in the case of principal, and of interest and Arrears of Interest due at the time of redemption of the Subordinated Notes, on the second Business Day before the due date for payment and, in the case of any other payment of interest and Arrears of Interest, on the relevant record date.

(b) *Payments subject to applicable laws*

Payments on Subordinated Notes are subject in all cases to (i) any fiscal or other laws, regulations and directives in the place of payment, but without prejudice to the provisions of Condition 9 and (ii) any withholding or deduction required pursuant to an agreement described in Section 1471(b) of the U.S. Internal Revenue Code of 1986 (the "**Code**") or otherwise imposed pursuant to Sections 1471 through 1474 of the Code, any regulations or agreements thereunder, official interpretation thereof, or (without prejudice to the provisions of Condition 9) any law implementing an intergovernmental approach thereof.

(c) *No commissions*

No commissions or expenses shall be charged to the Noteholders in respect of any payments made in accordance with this Condition 6.

(d) *Payment on Business Days*

Where payment is to be made by transfer to a registered account, payment instructions (for value the due date or, if that is not a Business Day, for value the first following day which is a Business Day) will be initiated, in the case of a payment of principal, or of a payment of interest or Arrears of Interest due at the time of redemption of the Subordinated Notes, if later, on the Business Day on which the relevant Certificate is surrendered at the specified office of an Agent.

Noteholders will not be entitled to any interest or other payment for any delay after the due date in receiving the amount due if the due date is not a Business Day, if the Noteholder is late in surrendering its Certificate (in circumstances where it is required to do so).

(e) *Partial payments*

If the amount of principal or interest which is due on the Subordinated Notes is not paid in full, the Registrar will annotate the Register with a record of the amount of principal or interest in fact paid.

(f) *Agents*

The names of the initial Agents and their initial specified offices are set out at the end of these Conditions. The Issuer reserves the right, subject to the prior written approval of the Trustee, at any time to vary or terminate the appointment of any Agent and to appoint additional or other Agents, provided that they will at all times maintain:

(i) a Principal Paying Agent;

(ii) an Agent (which may be the Principal Paying Agent) having a specified office in a European city;

(iii) a Paying Agent in a Member State of the European Union that is not obliged to withhold or deduct tax pursuant to European Council Directive 2003/48/EC or any other European Union Directive implementing the conclusions of the ECOFIN Council meeting of 26 – 27 November 2000 on the taxation of savings income or any law implementing or complying with, or introduced in order to conform to, such Directive; and

(iv) a Registrar.

Notice of any termination or appointment and of any changes in specified offices of any of the Agents will be given to the Noteholders promptly by the Issuer in accordance with Condition 13.

7 Redemption, Substitution, Variation and Purchase

(a) *Redemption at Maturity*

Subject to Condition 7*(b)* and 7*(h)* and to the satisfaction of any Relevant Rule relating to such redemption at the relevant time, unless previously redeemed or purchased and cancelled as provided below, the Issuer will redeem the Subordinated Notes at their principal amount on 22 May 2043 (the "**Maturity Date**") together with any Arrears of Interest and any other accrued and unpaid interest to (but excluding) the Maturity Date.

(b) *Deferral of redemption date*

(i) No Subordinated Notes shall be redeemed on the Maturity Date pursuant to Condition 7*(a)* or prior to the Maturity Date pursuant to Conditions 7*(d)*, 7*(e)* or 7*(f)* if a Regulatory Deficiency

Redemption Deferral Event has occurred and is continuing or would occur if redemption is made pursuant to Condition 7.

(ii) The Issuer shall notify the Trustee, the Principal Paying Agent and the Noteholders in accordance with Condition 13 no later than 5 Business Days prior to any date set for redemption of the Subordinated Notes if such redemption is to be deferred in accordance with Condition 7*(b)*(i)), provided that if a Regulatory Deficiency Redemption Deferral Event occurs less than 5 Business Days prior to the date set for redemption, the Issuer shall give notice of such deferral in accordance with Condition 13 as soon as reasonably practicable following the occurrence of such event.

(iii) If redemption of the Subordinated Notes does not occur on the Maturity Date or, as appropriate, the date specified in the notice of redemption by the Issuer under Condition 7*(d)*, 7*(e)* or 7*(f)* as a result of Condition 7*(b)*(i) above, the Issuer shall (subject to satisfaction of the Regulatory Clearance Condition) redeem such Subordinated Notes at their principal amount together with any Arrears of Interest and any other accrued and unpaid interest upon the earliest of:

(1) the date falling 10 Business Days after the date the Regulatory Deficiency Redemption Deferral Event has ceased (unless on such 10th Business Day a further Regulatory Deficiency Redemption Deferral Event has occurred and is continuing or redemption of the Subordinated Notes on such date would result in a Regulatory Deficiency Redemption Deferral Event occurring, in which case the provisions of Condition 7*(b)*(i) and this Condition 7*(b)*(iii) will apply *mutatis mutandis* to determine the due date for redemption of the Subordinated Notes); or

(2) the date falling 10 Business Days after the PRA has agreed to the repayment or redemption of the Subordinated Notes; or

(3) the date on which a Winding-Up occurs.

(iv) If Condition 7*(b)*(i) does not apply, but the obligations of the Issuer under the Subordinated Notes to make payment of any amount in relation to the redemption of the Subordinated Notes are mandatorily deferred as a result of the Solvency Condition not being satisfied at such time, subject to satisfaction of the Regulatory Clearance Condition, such obligations shall be payable on the 10th Business Day immediately following the day that (A) the Issuer is solvent for the purposes of Condition 3*(c)* and (B) the payment of such amounts would not result in the Issuer ceasing to be solvent for the purposes of Condition 3*(c)*, provided that if on such Business Day specified for redemption a Regulatory Deficiency Redemption Deferral Event has occurred and is continuing, or would occur if such obligations were to be paid, then such obligations shall not be paid on such date and Condition 3*(c)* shall apply *mutatis mutandis* to determine the due date for payment of such amount.

(v) A certificate signed by two Directors of the Issuer confirming that (A) a Regulatory Deficiency Redemption Deferral Event has occurred and is continuing, or would occur if redemption of the Subordinated Notes were to be made or (B) a Regulatory Deficiency Redemption Deferral Event has ceased to occur and/or redemption of the Subordinated Notes would not result in a Regulatory Deficiency Redemption Deferral Event occurring, shall, in the absence of manifest error, be treated and accepted by the Issuer the Trustee, the Noteholders and all other interested parties as correct and sufficient evidence thereof, shall be binding on all such persons and the Trustee shall be entitled to rely on such certificate without liability to any person.

(c) *Deferral of redemption not a default*

Notwithstanding any other provision in these Conditions or in the Trust Deed, the deferral of redemption of the Subordinated Notes in accordance with Condition 7*(b)* will not constitute a default by the Issuer and will not give Noteholders or the Trustee any right to accelerate the Subordinated Notes or take any enforcement action under the Subordinated Notes or the Trust Deed.

(d) *Redemption at the option of the Issuer*

Subject to Conditions 7*(b)*(i) and 7*(h)* the Issuer may, having given:

(i) not less than 15 nor more than 30 days' notice to the Noteholders in accordance with Condition 13 (which notice shall be irrevocable and shall specify the date fixed for redemption); and

(ii) notice to the Registrar, the Principal Paying Agent and the Trustee not less than three days before the giving of the notice referred to in (i),

redeem all (but not some only) of the Subordinated Notes, on the First Call Date or on any following Interest Payment Date at their principal amount together with any Arrears of Interest and any other accrued and unpaid interest to (but excluding) the date of redemption.

(e) *Redemption, variation or substitution for taxation reasons*

Subject to Conditions 7*(b)*(i) and 7*(h)* if the Issuer satisfies the Trustee immediately before the giving of the notice referred to below that:

(i) as a result of any change in, or amendment to, the laws or regulations of a Relevant Jurisdiction, or any change in the application or official interpretation of the laws or regulations of a Relevant Jurisdiction, which change or amendment becomes effective after the Issue Date, on the next Interest Payment Date either (a) the Issuer would be required to pay additional amounts as provided or referred to in Condition 9; or (b) the payment of interest would be treated as a "distribution" for United Kingdom tax purposes or the Issuer would otherwise not be able to claim a tax deduction (for United Kingdom tax purposes) for interest payable on the Subordinated Notes; or (c) in respect of the payment of interest, the Issuer would not to any material extent be entitled to have any attributable loss or non-trading deficit set against the profits of companies with which it is grouped for applicable United Kingdom tax purposes (whether under the group relief system current as at the Issue Date or any similar system or systems having like effect as may from time to time exist); and

(ii) the effect of the foregoing cannot be avoided by the Issuer taking reasonable measures available to it,

the Issuer may at its option (without any requirement for the consent or approval of the Noteholders) and having given not less than 30 nor more than 60 days' notice to the Trustee, the Principal Paying Agent and, in accordance with Condition 13, the Noteholders (which notice shall be irrevocable) either:

(1) redeem all the Subordinated Notes, but not some only, at any time at their principal amount together with any Arrears of Interest and any other accrued and unpaid interest to (but excluding) the date of redemption, provided that no such notice of redemption shall be given earlier than 90 days prior to the earliest date on which (a) with respect to (i)(a) the Issuer would be obliged to pay such additional amounts; (b) with respect to (i)(b) above, the payment of interest would be so treated as a "distribution"; or (c) with respect to (i)(c), the Issuer would not

to any material extent be entitled to have the loss or non-trading deficit set against the profits as provided in (i)(c) above, in each case were a payment in respect of the Subordinated Notes then due; or

(2) substitute at any time all (but not some only) of the Subordinated Notes for, or vary the terms of the Subordinated Notes so that they become or remain, Qualifying Dated Tier 2 Securities, and the Trustee shall (subject to the receipt by it of the certificates of the Directors referred to in Condition 7*(h)* below and in the definition of Qualifying Dated Tier 2 Securities) agree to such substitution or variation.

Upon expiry of such notice the Issuer shall either redeem, vary or substitute the Subordinated Notes, as the case may be.

(f) Redemption, substitution or variation at the option of the Issuer due to a Capital Disqualification Event or Ratings Methodology Event

(i) Subject to Conditions 7*(b)*(i) and 7*(h)*, if a Capital Disqualification Event or a Ratings Methodology Event has occurred and is continuing, or the Issuer satisfies the Trustee that, as a result of any change in, or amendment to, or any change in the application or official interpretation of, any applicable law, regulation, ratings methodology or other official publication, the same will occur within a period of six months, then the Issuer may, having given not less than 30 nor more than 60 days' notice to the Noteholders in accordance with Condition 13, the Trustee and the Principal Paying Agent, which notice must be given during the Notice Period and shall be irrevocable, either:

(1) as soon as reasonably practicable (in the case of a Capital Disqualification Event), or on or as soon as reasonably practicable after the fifth anniversary of the Issue Date (in the case of a Ratings Methodology Event), redeem all (but not some only) of the Subordinated Notes at their principal amount, together with any Arrears of Interest and any other accrued and unpaid interest to (but excluding) the date of redemption; or

(2) at any time substitute all (and not some only) of the Subordinated Notes for, or vary the terms of the Subordinated Notes so that they become or remain (A) in the case of a substitution or variation in connection with a Capital Disqualification Event, Qualifying Dated Tier 2 Securities, or (B) in the case of a substitution or variation in connection with a Ratings Methodology Event, Rating Agency Compliant Securities, and in either case the Trustee shall (subject to the receipt by it of the certificates of the Directors referred to in Condition 7*(h)* below, in the definition of "Qualifying Dated Tier 2 Securities" and (in the case of a substitution or variation in connection with a Ratings Methodology Event) in the definition of 'Rating Agency Compliant Securities') agree to such substitution or variation.

Upon expiry of such notice the Issuer shall either redeem, vary or substitute the Subordinated Notes, as the case may be.

(ii) For the purposes of this Condition 7*(f)*, "**Notice Period**" means the period commencing on the date on which the relevant Capital Disqualification Event or relevant Ratings Methodology Event (as the case may be) first occurs (or, as applicable, the date on which the Issuer satisfies the Trustee that the same will occur within a period of six months) and ending on the thirtieth calendar day following satisfaction of the Regulatory Clearance Condition in respect of the redemption, substitution or variation which is the subject of the notice to which the Notice Period relates.

(iii) For the purposes of (ii) above, if a Ratings Methodology Event occurs at any time before the fifth anniversary of the Issue Date and the Issuer does not, at that time, elect to substitute or vary the terms of the Subordinated Notes in accordance with (i)(2) above, such Ratings Methodology Event shall, for the purposes of determining the Notice Period for exercising the Issuer's option to redeem the Subordinated Notes following a Ratings Methodology Event under (i)(1) above, be deemed to have first occurred on the date falling 30 days prior to the fifth anniversary of the Issue Date.

(g) Trustee role on redemption, variation or substitution; Trustee not obliged to monitor

The Trustee shall (at the expense of the Issuer) use its reasonable endeavours to co-operate with the Issuer (including, but not limited to, entering into such documents or deeds as may be necessary) to give effect to substitution or variation of the Subordinated Notes for or into Qualifying Dated Tier 2 Securities pursuant to Condition 7*(e)* or Qualifying Dated Tier 2 Securities or Rating Agency Compliant Securities (as the case may be) pursuant to Condition 7*(f)* above provided that the Trustee shall not be obliged to co-operate in any such substitution or variation of the terms if the securities into which the Subordinated Notes are to be substituted or are to be varied or the co-operation in such substitution or variation imposes, in the Trustee's opinion, more onerous obligations upon it or exposes it to liabilities or reduces its protections. If the Trustee does not so co-operate as provided above, the Issuer may, subject as provided above, redeem the Subordinated Notes as provided above.

The Trustee shall not be under any duty to monitor whether any event or circumstance has happened or exists for the purposes of this Condition 7 and will not be responsible to Noteholders for any loss arising from any failure by it to do so. Unless and until the Trustee has actual knowledge of the occurrence of any event or circumstance within this Condition 7, it shall be entitled to assume that no such event or circumstance exists.

(h) Preconditions to redemption, variation, substitution and purchases

(i) Prior to the publication of any notice of redemption, variation or substitution pursuant to Conditions 7*(e)* or 7*(f)*, the Issuer shall deliver to the Trustee a certificate signed by two Directors of the Issuer stating that, as the case may be:

(1) the requirement referred to in paragraph 7*(e)*(i) above will apply on the next Interest Payment Date and cannot be avoided by the Issuer taking reasonable measures available to it; or

(2) a Capital Disqualification Event or a Ratings Methodology Event has occurred and is continuing as at the date of the certificate or, as the case may be, will occur; and

(3) in the case of notice of a redemption before the fifth anniversary of the Issue Date, it would have been reasonable for the Issuer to conclude, judged at the time of issue of the Subordinated Notes, that the circumstance entitling the Issuer to exercise the right of redemption was unlikely to occur,

and the Trustee shall accept the certificate as sufficient evidence of the satisfaction of the conditions precedent set out above, in which event it shall be conclusive and binding on the Noteholders (it being declared that the Trustee may rely absolutely on such certification without liability to any person).

(ii) In addition, prior to the publication of any notice of redemption before the Maturity Date or any substitution, variation or purchase of the Subordinated Notes, the Issuer will be required to have complied with the Regulatory Clearance Condition and be in continued compliance with

Regulatory Capital Requirements. A certificate from any two Directors to the Trustee confirming such compliance shall be conclusive evidence of such compliance (it being declared that the Trustee may rely absolutely on such certification without liability to any person).

(iii) The Issuer shall not redeem any Subordinated Notes or purchase any Subordinated Notes unless at the time of such redemption or purchase (A) it is in compliance with all Regulatory Capital Requirements applicable to it and (B) the Solvency Condition is satisfied at the time of such payment or purchase and will be satisfied immediately thereafter. In addition, prior to any redemption or purchase of the Subordinated Notes within five years of the Issue Date, the approval of the PRA must be obtained and such redemption or purchase of the Subordinated Notes must be funded out of the proceeds of issue of at least equivalent regulatory capital. If, following Solvency II Implementation (on the basis that the Subordinated Notes are intended to qualify as Tier 2 Capital under Solvency II without the operation of any grandfathering provisions), Solvency II does not require a redemption or purchase that is within five years of the Issue Date of the Subordinated Notes to be with the approval of the PRA and/or funded out of the proceeds of a new issuance of capital of at least the same quality as the Subordinated Notes, such a redemption or purchase will not require such PRA approval and/or be required to be so funded but such a redemption or purchase will be subject to compliance with the Relevant Rules. A certificate from any two Directors of the Issuer to the Trustee confirming such compliance shall be conclusive evidence of such compliance (it being declared that the Trustee may rely absolutely on such certification without liability to any person).

(i) *Compliance with stock exchange rules*

In connection with any substitution or variation of the Subordinated Notes in accordance with Condition 7*(e)* or Condition 7*(f)*, the Issuer shall comply with the rules of any stock exchange or other relevant authority on which the Subordinated Notes are for the time being listed or admitted to trading, and (for so long as the Subordinated Notes are listed on the Official List of the FCA under Part VI of FSMA and admitted to trading on the London Stock Exchange's regulated market) shall publish a supplement in connection therewith if the Issuer is required to do so in order to comply with Section 87G of FSMA.

(j) *Purchases*

Subject to Condition 7*(h)*, the Issuer or any of the Issuer's Subsidiaries may at any time purchase Subordinated Notes in any manner and at any price. All Subordinated Notes purchased by or on behalf of the Issuer or any Subsidiary of the Issuer may be held, reissued, resold or, at the option of the Issuer and the relevant purchaser, surrendered for cancellation to the Principal Paying Agent.

(k) *Cancellations*

All Subordinated Notes redeemed or substituted by the Issuer pursuant to this Condition 7, and all Subordinated Notes purchased and surrendered for cancellation pursuant to Condition 7*(j)*, will forthwith be cancelled. Any Subordinated Notes so surrendered for cancellation may not be reissued or resold and the obligations of the Issuer in respect of any such Subordinated Notes shall be discharged.

(l) *Notices Final*

Upon the expiry of any notice of redemption as is referred to in Conditions 7*(d)*, 7*(e)* or 7*(f)* above the Issuer shall be bound to redeem the Subordinated Notes to which the notice refers in accordance with the terms of the relevant Condition.

8 Restrictions following Deferral of Interest or Principal

(a) During any period beginning on the earlier of (i) the date on which the Issuer gives notice in accordance with these Conditions or otherwise publicly announces that it intends to defer any forthcoming payment of interest or principal and (ii) the date on which the Issuer becomes obliged to give notice of such deferral of interest or principal pursuant to and in accordance with these Conditions and, in either case, ending on the date on which the obligation to make payment of all such deferred interest (including any Arrears of Interest) and/or principal is satisfied in full by the Issuer as the case may be, in accordance with these Conditions (each a "**Restriction Period**"):

(i) neither the Board of Directors of the Issuer nor any committee thereof shall resolve on or publicly declare any distribution to members which distribution falls within the Mutual Bonus Arrangements; and

(ii) the Issuer shall not and shall procure that no Subsidiary of the Issuer shall purchase, redeem, cancel, reduce or otherwise acquire (directly or indirectly) any Subordinated Notes or any Junior Instruments, save where the Issuer or the relevant Subsidiary is not able to defer, pass or eliminate the relevant payment or other obligation in accordance with the terms of the Subordinated Notes or the relevant Junior Instruments.

(b) For the avoidance of doubt, the restriction set out in Condition 8(a)(i) shall not apply to:

(i) any Asset Share based distribution declared in respect of a with-profits policy as contemplated in the PPFM of the Issuer, and any other rights of any policyholder to receive a contractual benefit under his policy, in the ordinary course of business or (following any Relevant Reorganisation) any distribution to with-profits policyholders out of the with-profits fund or funds of the Issuer;

(ii) any payment to members of a distribution which falls within the Mutual Bonus Arrangements but which is resolved upon, publicly declared or paid prior to the commencement of or following the end of the relevant Restriction Period; or

(iii) any distribution or dividend to members in respect of any instrument or item held directly or indirectly by such members or any of them which constitutes Tier 1 Capital or Tier 2 Capital.

9 Taxation

(a) Payment without withholding

All payments of principal and interest by or on behalf of the Issuer in respect of the Subordinated Notes shall be made free and clear of, and without withholding or deduction for, any taxes, duties, assessments or governmental charges of whatever nature imposed, levied, collected, withheld or assessed by the United Kingdom or any political sub-division thereof or any authority therein or thereof having power to tax, unless such withholding or deduction is required by law. In that event the Issuer shall pay such additional amounts as will result in receipt by the Noteholders of such amounts as would have been received by them had no such withholding or deduction been required, except that no such additional amounts shall be payable in respect of any Subordinated Note:

(i) *Other connection*: held by or on behalf of a holder who is liable to such taxes, duties, assessments or governmental charges in respect of such Subordinated Note by reason of his having some connection with the United Kingdom other than the mere holding of the Subordinated Note; or

(ii) *Surrender more than 30 days after the Relevant Date*: in respect of which the certificate representing it is presented for payment more than 30 days after the Relevant Date except to the extent that the holder of it would have been entitled to such additional amounts on surrendering the Certificate representing such Subordinated Note for payment on the last day of such period of 30 days; or

(iii) *Payment to individuals*: where such withholding or deduction is imposed on a payment to an individual and is required to be made pursuant to European Council Directive 2003/48/EC or any other European Union Directive implementing the conclusions of the ECOFIN Council meeting of 26-27 November 2000 on the taxation of savings income or any law implementing or complying with, or introduced in order to conform to, such Directive; or

(iv) *EU paying agent*: held by a holder who would have been able to avoid such withholding or deduction by arranging to receive the relevant payment through another Paying Agent in a member state of the European Union.

(b) Additional Amounts

Any reference in these Conditions to any amounts payable in respect of the Subordinated Notes shall be deemed also to refer to any additional amounts which may be payable under this Condition or under any undertakings given in addition to, or in substitution for, this Condition pursuant to the Trust Deed.

10 Prescription

Claims against the Issuer in respect of principal and interest will become prescribed unless made within 10 years (in the case of principal) and five years (in the case of interest) from the Relevant Date in respect of them.

11 Events of Default

(a) Rights to institute and/or prove in a winding-up of the Issuer

The right to institute winding-up proceedings in respect of the Issuer is limited to circumstances where a relevant payment by the Issuer under the Subordinated Notes or the Trust Deed has become due and is not duly paid. For the avoidance of doubt, no amount shall be due from the Issuer in circumstances where payment of such amount could not be made in compliance with the Solvency Condition or is deferred by the Issuer in accordance with Conditions 5(a) 5(b), or 7(b).

If:

(i) default is made by the Issuer for a period of 14 days or more in the payment of any interest or principal due in respect of the Subordinated Notes or any of them; or

(ii) a Winding-Up occurs,

the Trustee at its discretion may, and if so requested by Noteholders of at least one-fifth in principal amount of the Subordinated Notes then outstanding or if so directed by an Extraordinary Resolution shall (but in each case subject to it having been indemnified and/or secured and/or prefunded to its satisfaction):

(1) in the case of (i) above, institute proceedings or take any steps or actions for the winding-up of the Issuer in England and Wales (but not elsewhere) and prove in the winding-up; and/or

(2) in the case of (ii) above, prove in the winding-up or administration of the Issuer (whether in England and Wales or elsewhere) and/or claim in the liquidation of the Issuer (whether in England and Wales or elsewhere),

but (in either case) may take no further or other action to enforce, prove or claim for any payment by the Issuer in respect of the Subordinated Notes or the Trust Deed.

(b) *Amount payable on a winding-up or administration of the Issuer*

Upon the occurrence of a Winding-Up (including, for the avoidance of doubt, a winding-up initiated pursuant to Condition 11*(a)*(1)), the Trustee at its discretion may, and if so requested by Noteholders of at least one-fifth in principal amount of the Subordinated Notes then outstanding or if so directed by an Extraordinary Resolution shall (but in each case subject to it having been indemnified and/or secured and/or prefunded to its satisfaction), give notice to the Issuer that the Subordinated Notes are, and they shall accordingly forthwith become, immediately due and payable at the amount equal to their principal amount together with any Arrears of Interest and any other accrued and unpaid interest. Claims against the Issuer in respect of such amounts will be subordinated in accordance with Condition 3*(b)*.

(c) *Enforcement*

Without prejudice to Conditions 11*(a)* or *11(b),* the Trustee may at its discretion and without further notice institute such proceedings or take such steps or actions against the Issuer as it may think fit to enforce any term or condition binding on the Issuer under the Trust Deed or the Subordinated Notes (other than any payment obligation of the Issuer under or arising from the Subordinated Notes or the Trust Deed, including any payment of damages awarded for breach of any obligations thereunder) but in no event shall the Issuer, by virtue of the institution of any such proceedings or the taking of such steps or actions, be obliged to pay any sum or sums, in cash or otherwise, sooner than the same would otherwise have been payable by it. Nothing in this Condition 11*(c)* shall, however, prevent the Trustee subject to Condition 11*(a)*, instituting proceedings for the winding-up of the Issuer in England and Wales and/or proving in any winding-up or administration of the Issuer (whether in England and Wales or elsewhere) and/or claiming in any liquidation of the Issuer (whether in England and Wales or elsewhere) in respect of any payment obligation of the Issuer, in each case where such payment obligation arises from the Subordinated Notes or the Trust Deed (including, without limitation, payment of any principal, interest or Arrears of Interest in respect of the Subordinated Notes or any payment of damages awarded for breach of any obligations under the Subordinated Notes or the Trust Deed).

(d) *Entitlement of Trustee*

The Trustee shall not be bound to take any of the actions referred to in Condition 11*(a)*, *11(b),*or 11*(c)* above against the Issuer to enforce the terms of the Trust Deed, the Subordinated Notes or any other action under or pursuant to the Trust Deed unless (a) it shall have been so directed by an Extraordinary Resolution of the Noteholders or requested in writing by the holders of at least one-fifth in principal amount of the Subordinated Notes then outstanding and (b) it shall have been indemnified and/or secured and/or prefunded to its satisfaction.

(e) *Right of Noteholders*

No Noteholder shall be entitled to proceed directly against the Issuer or to institute proceedings for the winding-up or claim in the liquidation of the Issuer or to prove in such winding-up unless the Trustee, having become so bound to proceed or being able to prove in such winding-up or claim in such

liquidation, fails to do so within a reasonable period and such failure shall be continuing, in which case the Noteholder shall have only such rights against the Issuer as those which the Trustee is entitled to exercise as set out in this Condition 11.

(f) *Extent of Noteholders' remedy*

No remedy against the Issuer other than as referred to in this Condition 11, shall be available to the Trustee or the Noteholders, whether for the recovery of amounts owing in respect of the Subordinated Notes or under the Trust Deed or in respect of any breach by the Issuer of any of its other obligations under or in respect of the Subordinated Notes or under the Trust Deed.

12 Replacement of Certificates

If any Certificate is lost, stolen, mutilated, defaced or destroyed it may be replaced at the specified office of the Registrar upon payment by the claimant of the expenses incurred in connection with the replacement and on such terms as to evidence and indemnity as the Issuer may reasonably require. Mutilated or defaced Certificates must be surrendered before replacements will be issued.

13 Notices

All notices to the Noteholders will be valid if mailed to them at their respective addresses in the Register maintained by the Registrar. The Issuer shall also ensure that notices are duly given or published in a manner which complies with the rules and regulations of any stock exchange or other relevant authority on which the Subordinated Notes are for the time being listed. Any notice shall be deemed to have been given on the second day after being so mailed or on the date of publication or, if so published more than once or on different dates, on the date of the first publication.

14 Substitution of Issuer

Subject to the Issuer obtaining prior approval from the PRA in respect thereof, the Trustee may agree with the Issuer, without the consent of the Noteholders:

(i) to the substitution of a Related Undertaking of the Issuer (or any previous substitute or successor in business under this sub-paragraph) or a successor in business of the Issuer (or any previous substitute or successor in business under this sub-paragraph) in place of the Issuer (or of any previous substitute or successor in business under this sub-paragraph) as principal debtor under the Trust Deed and the Subordinated Notes, provided that (in the case of a substitution of a Related Undertaking of the Issuer (or any previous substitute or successor in business)) the Subordinated Notes are guaranteed by the Issuer (or any previous substitute or successor in business under this sub-paragraph) on a subordinated basis ranking equal with the ranking of the Subordinated Notes prior to such substitution; and/or

(ii) the addition of a Related Undertaking of the Issuer (or substitute Issuer) as a guarantor of the Issuer's (or substitute Issuer's) obligations under the Trust Deed and the Subordinated Notes,

(each such substitute or, where applicable, guarantor being hereinafter referred to as the "**Substituted Obligor**") provided that in each case:

(1) a trust deed or some other form of undertaking, supported by one or more legal opinions, is executed by the Substituted Obligor in a form and manner satisfactory to the Trustee, agreeing to be bound by the terms of the Trust Deed and the Subordinated Notes, with any consequential amendments which the Trustee may deem appropriate, as fully as if the Substituted Obligor has been named in the Trust

Deed and the Subordinated Notes, as the principal debtor in place of the Issuer in place of, or where applicable, as a guarantor of the Issuer (or any previous Substituted Obligor, as the case may be);

(2) the Substituted Obligor confirms to the Trustee in one or more legal opinions addressed to the Trustee and the Issuer in a form approved by and provided to the Trustee that (i) it has obtained all necessary governmental and regulatory approvals and consents necessary for its assumptions of the duties and liabilities as Substituted Obligor under the Trust Deed and the Subordinated Notes in place of the Issuer or as a guarantor of the Issuer or, as the case may be, any previous Substituted Obligor and (ii) such approvals and consents are at the time of substitution in full force and effect (it being declared that the Trustee may rely absolutely on such certification without liability to any person);

(3) two Directors (or other officers acceptable to the Trustee) of the Substituted Obligor certify that the Substituted Obligor is solvent at the time at which the substitution is proposed to be in effect, and immediately thereafter (it being declared that the Trustee may rely absolutely on such certification and shall not be bound to have regard to the financial condition, profits or prospects of the Substituted Obligor or to compare the same with those of the Issuer or any previous Substituted Obligor);

(4) (without prejudice to the generality of the foregoing) the Trustee may, in the event of such substitution agree, without the consent of the Noteholders, to a change in the law governing the Trust Deed and/or the Subordinated Notes if in the opinion of the Trustee such change would not be materially prejudicial to the interests of the Noteholders;

(5) if the Substituted Obligor is, or becomes, subject generally to the taxing jurisdiction of a territory or any authority of or in that territory with power to tax (the "**Substituted Territory**") other than the territory of the taxing jurisdiction of which (or to any such authority of or in which) the Issuer (or any previous Substituted Obligor) is subject generally (the "**Original Territory**"), the Substituted Obligor will (unless the Trustee otherwise agrees) give to the Trustee an undertaking satisfactory to the Trustee in terms corresponding to Condition 9 with the substitution for the references in that Condition and in Condition 7*(e)* to the Original Territory of references to the Substituted Territory whereupon the Trust Deed and the Subordinated Notes will be read accordingly;

(6) the Issuer and the Substituted Obligor comply with such other requirements as the Trustee may direct in the interests of the Noteholders; and

(7) in the case of a full substitution of the Issuer pursuant to Condition 14(i) only, if the Subordinated Notes are rated (where such rating was assigned at the request of the Issuer) by one or more credit rating agencies of international standing immediately prior to such substitution, the Subordinated Notes shall continue to be rated by each such rating agency immediately following such substitution, and the credit ratings assigned to the Subordinated Notes by each such rating agency immediately following such substitution are expected to be no less than those assigned to the Subordinated Notes immediately prior thereto.

15 Meetings of Noteholders, Modification, Waiver and Authorisation

(a) Meetings of Noteholders

Except as provided herein, any modification to these Conditions or any provisions of the Trust Deed will require the Issuer giving at least one month's prior written notice to, and receiving no objection from, the PRA (or such shorter period of notice as the PRA may accept and so long as there is a requirement to give such notice).

The Trust Deed contains provisions for convening meetings of the Noteholders to consider any matter affecting their interests, including the modification or abrogation by Extraordinary Resolution of any of these Conditions or any of the provisions of the Trust Deed. Such a meeting may be convened by the Issuer, the Trustee or Noteholders holding not less than 10 per cent. in principal amount of the Subordinated Notes for the time being outstanding. The quorum at any meeting for passing an Extraordinary Resolution will be two or more persons present holding or representing a clear majority in principal amount of the Subordinated Notes for the time being outstanding, or at any adjourned such meeting two or more persons present whatever the principal amount of the Subordinated Notes held or represented by him or them, except that, at any meeting the business of which falls within the proviso to paragraph 3 of Schedule 3 to the Trust Deed, the necessary quorum for passing an Extraordinary Resolution will be two or more persons present holding or representing not less than 75 per cent., or at any adjourned such meeting not less than 25 per cent., of the principal amount of the Subordinated Notes for the time being outstanding. An Extraordinary Resolution passed at any meeting of the Noteholders will be binding on all Noteholders, whether or not they are present at the meeting.

The Trust Deed also provides that a written resolution executed by or on behalf of the holders of 90 per cent. in principal amount of the Subordinated Notes outstanding who would have been entitled to vote upon it if it had been proposed at a meeting at which they were present shall take effect as if it were an Extraordinary Resolution.

The agreement or approval of the Noteholders shall not be required in the case of any variation of these Conditions and/or the Trust Deed required to be made in connection with the substitution or variation of the Subordinated Notes pursuant to Conditions 7*(e)* or 7*(f)* or any consequential amendments to these Conditions and/or the Trust Deed approved by the Trustee in connection with a substitution of the Issuer pursuant to Condition 14.

(b) *Modification, waiver, authorisation and determination*

The Trustee may agree, without the consent of the Noteholders, to any modification of, or to the waiver or authorisation of any breach or proposed breach of, any of these Conditions or any of the provisions of the Trust Deed, provided that, in any such case, it is not, in the opinion of the Trustee, materially prejudicial to the interests of the Noteholders, or may agree to any modification which, in its opinion, is of a formal, minor or technical nature or to correct a manifest error or to comply with mandatory provisions of the law of the jurisdiction in which the Issuer is incorporated. For the avoidance of doubt, such power shall not extend to any such modification as mentioned in the proviso to paragraph 3 of Schedule 3 to the Trust Deed.

(c) *Trustee to have regard to interests of Noteholders as a class*

In connection with the exercise by it of any of its trusts, powers, authorities and discretions (including, without limitation, any modification, waiver, authorisation, determination or substitution of obligor), the Trustee shall have regard to the general interests of the Noteholders as a class but shall not have regard to any interests arising from circumstances particular to individual Noteholders (whatever their number) and, in particular but without limitation, shall not have regard to the consequences of any such exercise for individual Noteholders (whatever their number) resulting from their being for any purpose domiciled or resident in, or otherwise connected with, or subject to the jurisdiction of, any particular territory or any political sub-division thereof and the Trustee shall not be entitled to require, nor shall any Noteholder be entitled to claim, from the Issuer, the Trustee or any other person any indemnification or payment in respect of any tax consequence of any such exercise upon individual Noteholders except to the extent already provided for in Condition 9 and/or any undertaking given in addition to, or in substitution for, Condition 9 pursuant to the Trust Deed.

(d) *Notifications to the Noteholders*

Any modification, abrogation, waiver, authorisation, determination or substitution shall be binding on the Noteholders and, unless the Trustee agrees otherwise, shall be notified by the Issuer to the Noteholders as soon as practicable thereafter in accordance with Condition 13.

A Relevant Reorganisation shall not require the consent of the Noteholders or the Trustee but shall be notified by the Issuer to the Noteholders (in accordance with Condition 13), the Principal Paying Agent and the Trustee, as soon as practicable thereafter.

16 Transfer of Business of the Issuer

In connection with any transfer of the whole or a substantial part of its business:

(i) to another body (whether or not part of the Insurance Group) in accordance with Part VIII of the Friendly Societies Act 1992 or, if applicable at the time of the transfer, Part VII of FSMA (a "**Successor**"); or

(ii) to a single legal entity where such transfer is pursuant to the exercise by the PRA or the Financial Services Compensation Scheme of its powers in connection with any applicable law, rule or regulation,

the Issuer shall procure that, subject to receiving the prior approval of the PRA, there be included in the transfer, all the liabilities and obligations of the Issuer as principal debtor under the Subordinated Notes and references in these Conditions and the Trust Deed to the Issuer shall be construed accordingly. Any such transfer may be made without prior approval from the Trustee or the Noteholders, but is without prejudice to any statutory right of the Trustee or the Noteholders to raise objections in respect of any such transfer.

In this Condition 16, "**a substantial part**" means any part which, as at the most recent valuation date by reference to the latest published financial statements of the Issuer and as certified in writing by two Directors of the Issuer to the Trustee, represents 50 per cent. or more of liabilities (where the amount of the liabilities of the Issuer is deemed to mean the same as the technical provisions of the Issuer, net of reinsurance) relating to policies underwritten by the Issuer.

17 Indemnification of the Trustee and its Contracting with the Issuer

(a) *Indemnification of the Trustee*

The Trust Deed contains provisions for the indemnification of the Trustee and for its relief from responsibility, including provisions relieving it from taking action unless indemnified and/or secured and/or prefunded to its satisfaction.

(b) *Trustee contracting with the Issuer*

The Trust Deed also contains provisions pursuant to which the Trustee is entitled, *inter alia*, (i) to enter into business transactions with the Issuer and/or any of the Issuer's Subsidiaries and to act as trustee for the holders of any other securities issued or guaranteed by, or relating to, the Issuer and/or any of the Issuer's Subsidiaries, (ii) to exercise and enforce its rights, comply with its obligations and perform its duties under or in relation to any such transactions or, as the case may be, any such trusteeship without regard to the interests of, or consequences for, the Noteholders, and (iii) to retain and not be liable to account for any profit made or any other amount or benefit received thereby or in connection therewith.

18 Further Issues

The Issuer may from time to time, without the consent of the Noteholders, create and issue further notes ranking *pari passu* in all respects (or in all respects save for the first payment of interest thereon) and so that the same shall be consolidated and form a single series with the outstanding Subordinated Notes. Any further notes which are to form a single series with the outstanding Subordinated Notes may (with the consent of the Trustee) be constituted by a deed supplemental to the Trust Deed.

19 Governing Law

The Trust Deed and the Subordinated Notes, and any non-contractual obligations arising out of or in connection with the Trust Deed and/or the Subordinated Notes are governed by, and shall be construed in accordance with, English law.

20 Rights of Third Parties

No rights are conferred on any person under the Contracts (Rights of Third Parties) Act 1999 to enforce any term or condition of the Subordinated Notes, but this does not affect any right or remedy of any person which exists or is available apart from that Act.

21 Defined Terms

In these Conditions:

"**5 Year Gilt Rate**" means the 5 year note generic bid yield for UK Government Bonds, as determined by the Principal Paying Agent in a commercially reasonable manner on the date falling one (1) Business Day prior to each Reset Date by reference to Bloomberg screen page "GUKG5" (*UK Govt Bonds 5 Year Generic Bid Yield*) or such other screen page, section or part of Bloomberg as may replace it;

"**Agency Agreement**" has the meaning given in the preamble to these Conditions;

"**Agents**" means the Principal Paying Agent, the Registrar and the Transfer Agent or any of them and shall include such other Paying Agents appointed from time to time under the Agency Agreement;

"**Arrears of Interest**" has the meaning given in Condition 5*(d)*;

"**Asset Share**" means in relation to a with-profits policy the accumulation at investment rates of return of premiums paid under the relevant with-profits policy less an allowance for expenses incurred, taxation, the cost of benefits provided under the relevant with-profits policy and any charges for the cost of guarantees and the use of capital;

"**Assets**" means the unconsolidated gross assets of the Issuer as shown in the latest published audited balance sheet of the Issuer, but adjusted for contingencies and subsequent events, all in such manner as the Directors of the Issuer may determine;

"**Business Day**" means (i) except for the purposes of Condition 2 and 6*(d)*, a day (other than a Saturday, Sunday or public holiday) on which commercial banks and foreign exchange markets are open for general business in London, (ii) for the purposes of Condition 2, a day (other than a Saturday, Sunday or public holiday) on which commercial banks are open for business in the city in which the specified office of the Agent with whom a Certificate is deposited in connection with a transfer is located and (iii) for the purpose of Condition 6*(d)*, a day (other than a Saturday, Sunday or public holiday) on which commercial banks are open for business in London and, in the case of surrender of a Certificate, in the place in which the Certificate is surrendered;

"**Capital Disqualification Event**" is deemed to have occurred if, as a result of any replacement of or change to (or change to the interpretation by any court or authority entitled to do so of) Solvency II or the Relevant Rules or following the implementation of Solvency II:

(a) the Subordinated Notes are fully excluded from counting; or

(b) in the circumstances where such capability derives only from transitional or grandfathering provisions under Solvency II or the Relevant Rules, as appropriate, less than the full principal amount (or, if such indebtedness was issued at a price below par, the principal amount that was capable of counting as at its issue date) of either (a) the Subordinated Notes outstanding at such time or (b) any indebtedness outstanding at such time and classified in the same category as the Subordinated Notes by the Insurance Group Supervisor, in either case, for the purposes of any transitional or grandfathering provisions under Solvency II or the Relevant Rules, as appropriate, is capable of counting,

as:

(x) cover for capital requirements or treated as own funds (however such terms might be described in Solvency II or the Relevant Rules) applicable to the Issuer, the Insurance Group or any insurance or reinsurance undertaking within the Insurance Group whether on a solo, group or consolidated basis; and

(y) Tier 2 Capital for the purposes of the Issuer, the Insurance Group, or any insurance or reinsurance undertaking within the Insurance Group whether on a solo, group or consolidated basis;

"**Certificate**" has the meaning given in Condition 1*(a)*;

"**Companies Act**" means the Companies Act 2006 (as amended or re-enacted from time to time);

"**Directors**" means the directors of the Issuer from time to time;

"**Extraordinary Resolution**" has the meaning given in the Trust Deed;

"**FCA**" means the Financial Conduct Authority, acting in consultation with or with the consent of the PRA where required under the Relevant Rules, or such successor or other authority having primary supervisory authority with respect to conduct of business matters in relation to the Issuer and/or the Insurance Group and/or (as applicable) its capacity as the relevant authority under Part 6 of FSMA with respect to the Official List;

"**Financial Services Compensation Scheme**" means the UK compensation scheme, established under FSMA, which commenced operations on 1 December 2001 as a fund of last resort to protect deposits and certain other obligations, within prescribed limits, of customers of authorised financial services firms which are unable, or likely to become unable, to meet their obligations in respect thereof, or any successor or replacement scheme;

"**First Call Date**" means 22 May 2023;

"**Fixed Interest Rate**" has the meaning given in Condition 4(c);

"**FSMA**" means the Financial Services and Markets Act 2000 (as amended or re-enacted from time to time including pursuant to the Financial Services Act 2012);

"**Initial Margin**" means 463 basis points;

"**Insurance Group**" means the Issuer (or its successor in business (as defined in the Trust Deed)) and its Subsidiaries;

"**Insurance Group Supervisor**" means the PRA or following Solvency II Implementation the regulatory authority exercising group supervision over the Insurance Group in accordance with the Solvency II Directive;

"**Interest Payment Date**" means 22 May in each year;

"**Interest Period**" means each period from (and including) the Issue Date to (but excluding) the first Interest Payment Date and thereafter from (and including) each Interest Payment Date to (but excluding) the next following Interest Payment Date or, in each such period, such other date as the Subordinated Notes are redeemed or purchased and cancelled pursuant to Condition 7 or pursuant to a Winding-Up in accordance with Condition 3;

"**Interest Rate**" means the Fixed Interest Rate or the relevant Reset Rate, as applicable;

"**Issue Date**" means 22 May 2013;

"**Issuer**" has the meaning given in the preamble to these Conditions;

"**Junior Creditors**" means creditors of the Issuer whose claims rank, or are expressed to rank junior to, the claims of the Noteholders including holders of Junior Securities;

"**Junior Instruments**" means any security or other instrument which:

(i) is issued by the Issuer and ranks *pari passu* with, or junior to, the obligations of the Issuer under the Subordinated Notes; or

(ii) is issued by a Subsidiary or subsidiary undertaking of the Issuer and is guaranteed by the Issuer where the Issuer's obligations under the relevant guarantee rank *pari passu* with, or junior to, the Issuer's obligations under the Subordinated Notes,

(including in relation to (i) and (ii), without limitation, any Parity Securities and any Junior Securities);

"**Junior Securities**" has the meaning given in Condition 3*(b)*;

"**Liabilities**" means the unconsolidated gross liabilities of the Issuer as shown in the latest published audited balance sheet of the Issuer, but adjusted for contingent liabilities and for subsequent events, all in such manner as the Directors of the Issuer may determine;

"**London Stock Exchange**" means the London Stock Exchange plc;

"**Lower Tier 2 Capital**" has the meaning given by the PRA from time to time and shall, following the implementation of Solvency II or any other change in law or any Relevant Rules such that Lower Tier 2 Capital ceases to be a recognised tier of capital resources, be deemed to be a reference to any Tier 2 Capital;

"**Maturity Date**" means 22 May 2043;

"**Member State**" means a member of the European Economic Area;

"**Mutual Bonus Arrangements**" means (i) at any time after the date of issue of the Subordinated Notes but prior to a Relevant Reorganisation, the declaration of a special bonus in favour of some or all members of the Issuer which allows such members in their capacity as such to participate in the trading results of the Issuer's group or other miscellaneous surplus arising in the Issuer which declaration is at the discretion of the Board of Directors of the Issuer (or a committee thereof) and is in addition to and unconnected with the rights and expectations of with-profits policyholders to receive an Asset Share based distribution declared in respect of a with-profits policy as contemplated in the relevant PPFM of the Issuer, and any other rights of any policyholder to receive a contractual benefit under such policyholder's policy, in the ordinary course of

business and (ii) at any time after the completion of a Relevant Reorganisation, the declaration of a special bonus payable to some or all members of the Issuer in their capacity as members which allows such members to participate in the trading results of the Issuer's group or other miscellaneous surplus arising in the Issuer and which declaration is at the discretion of the Board of Directors of the Issuer (or a committee thereof) having assessed inter alia the capital required to (a) satisfy the rights and expectations of with-profits policyholders to receive Asset Share based distributions in respect of their policies, (b) satisfy the Issuer's obligations to its other creditors and (c) support the conduct of the Issuer's business;

"**Noteholder**" has the meaning given in Condition 1*(b)*;

"**Official List**" means the official list of the UK Listing Authority maintained pursuant to Section 74 of FSMA;

"**Original Territory**" has the meaning given in Condition 14;

"**Parity Creditors**" means creditors of the Issuer whose claims rank, or are expressed to rank, *pari passu* with the claims of the Noteholders including holders of Parity Securities;

"**Parity Securities**" has the meaning given in Condition 3*(b)*;

"**Paying Agents**" means the Principal Paying Agent and the Registrar (and such term shall include any successor, replacement or additional paying agents appointed under the Agency Agreement);

"**Principal Paying Agent**" has the meaning given in the preamble to these Conditions;

"**PPFM**" means each relevant set of Principles and Practices of Financial Management of the Issuer setting out how the Issuer conducts with-profits business, as amended and updated from time to time;

"**PRA**" means the Prudential Regulation Authority, acting in consultation with or with the consent of the FCA where required under the Relevant Rules, or such successor or other authority having primary supervisory authority with respect to prudential matters in relation to the Issuer and/or the Insurance Group;

"**Qualifying Dated Tier 2 Securities**" means securities issued directly or indirectly by the Issuer that:

(a) have terms not materially less favourable to an investor than the terms of the Subordinated Notes (as reasonably determined by the Issuer in consultation with an independent investment bank of international standing, and provided that a certification to such effect (including as to the consultation with the independent investment bank and in respect of the matters specified below) signed by two Directors shall have been delivered to the Trustee (upon which the Trustee shall be entitled to rely without liability to any person prior to the issue of the relevant securities) provided that they shall (1) contain terms which comply with the current requirements of the PRA in relation to Tier 2 Capital (or, at any time prior to Solvency II Implementation, Lower Tier 2 Capital); (2) bear at least the same rate of interest from time to time applying to the Subordinated Notes and preserve the same Interest Payment Dates; (3) rank senior to, or *pari passu* with, the Subordinated Notes; (4) preserve the obligations of the Issuer as to redemption of the Subordinated Notes, including as to the timing of, and amounts payable upon redemption; and (5) preserve any existing rights under these Conditions to any accrued interest, any Arrears of Interest and any other amounts payable under the Subordinated Notes which, in each case, has accrued to Noteholders but not been paid; and

(b) are listed or admitted to trading on the London Stock Exchange's regulated market (for the purposes of Directive 2004/39/EC) or such other stock exchange as is a Recognised Stock Exchange at that time as selected by the Issuer and approved by the Trustee;

"**Rating Agency**" means Standard & Poor's Credit Market Services Europe Limited or any successor thereof;

"**Rating Agency Compliant Securities**" means securities issued directly or indirectly by the Issuer that are:

(c) Qualifying Dated Tier 2 Securities; and

(d) assigned substantially the same equity content or, at the absolute discretion of the Issuer, a lower equity content (provided such equity content is still higher than the equity content assigned to the Subordinated Notes after the occurrence of the Ratings Methodology Event) as that which was assigned by the Rating Agency to the Subordinated Notes on or around the Issue Date and provided that a certification to such effect of two Directors shall have been delivered to the Trustee prior to the issue of the relevant securities (upon which the Trustee shall be entitled to rely without liability to any person);

"**Ratings Methodology Event**" will be deemed to occur upon a change in methodology of the Rating Agency (or in the interpretation of such methodology) as a result of which the equity content assigned by the Rating Agency to the Subordinated Notes is, as notified by the Rating Agency to the Issuer or as published by the Rating Agency, reduced when compared to the equity content assigned by the Rating Agency to the Subordinated Notes on or around the Issue Date;

"**Recognised Stock Exchange**" means a recognised stock exchange as defined in section 1005 of the Income Tax Act 2007 as amended or re-enacted from time to time, and any provision, statute or statutory instrument replacing the same from time to time;

"**Register**" has the meaning given in Condition 1*(a)*;

"**Registrar**" has the meaning given in the preamble to these Conditions;

"**Regulatory Capital Requirements**" means any applicable capital resources requirement or applicable overall financial adequacy rule required by the PRA, as such requirements or rule are in force from time to time;

"**Regulatory Clearance Condition**" means, in respect of any proposed act on the part of the Issuer, the PRA having consented to, or having been given due notification of and having not within any applicable time-frame objected to, such act (in any case only if and to the extent required by the PRA or any applicable rule of the PRA at the relevant time);

"**Regulatory Deficiency Interest Deferral Date**" means each Interest Payment Date in respect of which a Regulatory Deficiency Interest Deferral Event has occurred and is continuing or would occur if payment of interest was made on such Interest Payment Date;

"**Regulatory Deficiency Interest Deferral Event**" means (i) any event which (including, without limitation, any event which causes the Solvency Capital Requirements applicable to the Issuer, the Insurance Group or any member of the Insurance Group to be breached and such breach is an event which) under Solvency II and/or under the Relevant Rules would require the Issuer to defer a payment in respect of the Subordinated Notes (on the basis that the Subordinated Notes are intended to qualify as Lower Tier 2 Capital (prior to Solvency II Implementation) and as Tier 2 Capital (following Solvency II Implementation and without the operation of any grandfathering provisions) or (ii) the PRA has notified the Issuer in writing that it has determined in accordance with the Relevant Rules at such time that the Issuer must defer a payment of interest in respect of the Subordinated Notes;

"**Regulatory Deficiency Redemption Deferral Event**" means any event which (including, without limitation, any event which causes the Solvency Capital Requirement applicable to the Issuer, the Insurance Group or any member of the Insurance Group to be breached and such breach is an event which) under Solvency II and/or under the Relevant Rules would require the Issuer to, defer or suspend a scheduled repayment or redemption of the Subordinated Notes (on the basis that the Subordinated Notes are intended to

qualify as Lower Tier 2 Capital (prior to Solvency II Implementation) and as Tier 2 Capital (following Solvency II Implementation and without the operation of any grandfathering provisions)) or (ii) the PRA has notified the Issuer in writing that it has determined in accordance with the Relevant Rules at such time that the Issuer must defer or suspend a scheduled repayment or redemption of the Subordinated Notes;

"**Related Undertaking**" means in relation to any person, (i) any subsidiary undertaking or parent undertaking of that person or (ii) any subsidiary undertaking of any such parent undertaking;

"**Relevant Date**" means the date on which the payment first becomes due but, if the full amount of the money payable has not been received by an Agent or the Trustee on or before the due date, it means the date on which, the full amount of the money having been so received, notice to that effect has been duly given to the Noteholders by the Issuer in accordance with Condition 13;

"**Relevant Jurisdiction**" means the United Kingdom or any political subdivision or any authority thereof or therein having power to tax or any other jurisdiction or any political subdivision or any authority thereof or therein having power to tax to which the Issuer becomes subject in respect of payments made by it of principal and interest (including Arrears of Interest) on the Subordinated Notes;

"**Relevant Reorganisation**" means any reorganisation of the Issuer involving the amendment of its Rules to provide for the creation of separate with profit fund(s), non profit fund(s) and/or a mutual capital fund as is contemplated in the UK Financial Services Authority's consultation paper "CP 12/38" dated 18 December 2012;

"**Relevant Rules**" means any legislation, rules or regulations (whether having the force of law or otherwise) applicable in the United Kingdom from time to time and applying to the Issuer or any insurance or reinsurance undertaking within the Insurance Group from time to time relating to the characteristics, features or criteria of own funds or capital resources and the requirement to retain capital resources in excess of a prescribed capital resources requirement and, for the avoidance of doubt and without limitation to the foregoing, includes any legislation, rules or regulations relating to such matters which are supplementary or extraneous to the obligations imposed on Member States by Solvency I or the Solvency II Directive;

"**Reset Date**" means the First Call Date and the Interest Payment Dates falling on 22 May 2028, 22 May 2033, 22 May 2038 and (in circumstances where Condition 7(b) applies) each fifth anniversary of 22 May 2038;

"**Reset Rate**" means, at any time on or after the First Call Date, the 5 Year Gilt Rate (as determined by the Principal Paying Agent on the date falling one (1) Business Day prior to each Reset Date), plus the Initial Margin and plus the Step-Up Margin;

"**Restriction Period**" has the meaning given in Condition 8*(a)*;

"**Rules**" means the rules of the Issuer as approved at its annual general meeting held on 21 May 2009 and registered by the UK Financial Services Authority on 3 June 2009 and as amended or replaced from time to time;

"**Senior Creditors**" means:

(a) any policyholders of the Issuer (and, for the avoidance of doubt, the claims of Senior Creditors who are policyholders shall include all amounts to which any such policyholder would be entitled in its capacity as policyholder under any applicable legislation or rules relating to a winding-up of an incorporated friendly society and/or a legal entity generally which is authorised to conduct general, long-term or composite insurance business to reflect any right to receive, or expectation of receiving, policyholder benefits which policyholders may have (including such expectations of policyholders to receive discretionary benefits

under with-profits policies as are consistent with the relevant PPFM of the Issuer and its obligations to treat customers fairly) but excluding any right or expectation to receive any future distributions under the Mutual Bonus Arrangements) and further including any amounts which the Board of Directors of the Issuer (or a committee thereof) has resolved prior to a Winding-Up shall be distributed to policyholders of the Issuer under the Mutual Bonus Arrangements but which amounts have not yet been paid to the relevant policyholders at the time of such Winding-Up;

(b) creditors of the Issuer (other than policyholders) who are unsubordinated creditors of the Issuer; and

(c) other creditors of the Issuer whose claims are, or are expressed to be, subordinated to the claims of other creditors of the Issuer (other than those whose claims constitute (or relate to a guarantee or other like or similar undertaking or arrangement given by the Issuer in respect of any obligation of any other person which constitute), or would but for any applicable limitation on the amount of any such capital constitute, Tier 1 Capital, Upper Tier 2 Capital (issued prior to Solvency II Implementation), Lower Tier 2 Capital (issued prior to Solvency II Implementation), or Tier 2 Capital (issued on or after Solvency II Implementation) or whose claims otherwise rank, or are expressed to rank, *pari passu* with, or junior to, the claims of the Noteholders);

"**Solvency I**" means the directives adopted by the Parliament and Council of the European Union relating to the taking-up and pursuit of insurance business within the European Union (excluding the Solvency II Directive) and including, without limitation, Directive 73/239/EEC of the European Union (as amended) and Directive 98/78/EC of the European Union (as amended) on the supplementary supervision of insurance undertakings in an insurance group;

"**Solvency II**" means the Solvency II Directive and any implementing measures adopted pursuant to the Solvency II Directive (for the avoidance of doubt, whether implemented by way of regulation or by further directives or otherwise);

"**Solvency II Directive**" means Directive 2009/138/EC of the European Union (as amended) on the taking-up and pursuit of the business of insurance and reinsurance (Solvency II) and which must be transposed by Member States pursuant to Article 309 of Directive 2009/138/EC;

"**Solvency II Implementation**" means the implementation by the PRA of Solvency II or any other change in law or any Relevant Rules if such implementation or other change in law results in Upper Tier 2 Capital and Lower Tier 2 Capital ceasing to be recognised as distinct tiers of capital (or, if later, the coming into effect of the same with respect to the Insurance Group);

"**Solvency Capital Requirement**" means the solvency capital requirement or the group solvency capital requirement referred to in Solvency II (howsoever described or defined in Solvency II) or such solvency capital requirement or group solvency capital requirement or any other capital requirement howsoever described in the Relevant Rules;

"**Solvency Condition**" has the meaning given in Condition 3*(c);*

"**Step Up Margin**" means 100 basis points;

"**sterling**" or "**£**" means the lawful currency of the United Kingdom from time to time;

"**Subordinated Notes**" has the meaning given in the preamble to these Conditions;

"**Subsidiary**" has the meaning given under section 1159 of the Companies Act;

"**Substituted Obligor**" has the meaning given in Condition 14;

"**Substituted Territory**" has the meaning given in Condition 14;

"**Successor**" has the meaning given in Condition 16;

"**successor in business**" has the meaning, with respect to the Issuer, given in the Trust Deed;

"**Taxes**" has the meaning given in Condition 9;

"**Tier 1 Capital**" has the meaning given by the PRA from time to time;

"**Tier 2 Capital**" has the meaning given by the PRA from time to time;

"**Trust Deed**" has the meaning given in the preamble to these Conditions;

"**Trustee**" has the meaning given in the preamble to these Conditions;

"**UK Listing Authority**" means the FCA under Part VI of FSMA;

"**Upper Tier 2 Capital**" has the meaning given by the PRA from time to time; and

"**Winding-Up**" has the meaning given in Condition 3*(b)*.

Summary of Provisions relating to the Subordinated Notes while in Global Form

1 Initial Issue of Certificates

The Global Certificate will be registered in the name of a nominee for a common depositary for Euroclear and Clearstream, Luxembourg (the "**Common Depositary**") and may be delivered on or prior to the original issue date of the Subordinated Notes.

Upon the registration of the Global Certificate in the name of any nominee for Euroclear and Clearstream, Luxembourg and delivery of the Global Certificate to the Common Depositary, Euroclear or Clearstream, Luxembourg will credit each subscriber with a nominal amount of Subordinated Notes equal to the nominal amount thereof for which it has subscribed and paid.

2 Relationship of Accountholders with Clearing Systems

Each of the persons shown in the records of Euroclear, Clearstream, Luxembourg or any other clearing system ("**Alternative Clearing System**") as the holder of a Subordinated Note represented by a Global Certificate must look solely to Euroclear, Clearstream, Luxembourg or any such Alternative Clearing System (as the case may be) for his share of each payment made by the Issuer to the holder of the Global Certificate and in relation to all other rights arising under the Global Certificate, subject to and in accordance with the respective rules and procedures of Euroclear, Clearstream, Luxembourg, or such Alternative Clearing System (as the case may be). Such persons shall have no claim directly against the Issuer in respect of payments due on the Subordinated Notes for so long as the Subordinated Notes are represented by the Global Certificate and such obligations of the Issuer will be discharged by payment to the holder of the Global Certificate in respect of each amount so paid.

3 Exchange

The following will apply in respect of transfers of Subordinated Notes held in Euroclear or Clearstream, Luxembourg or an Alternative Clearing System. These provisions will not prevent the trading of interests in the Subordinated Notes within a clearing system whilst they are held on behalf of such clearing system, but will limit the circumstances in which the Subordinated Notes may be withdrawn from the relevant clearing system.

Transfers of the holding of Subordinated Notes represented by the Global Certificate pursuant to Condition 2 may only be made in part:

(i) if the relevant clearing system is closed for business for a continuous period of 14 days (other than by reason of holidays, statutory or otherwise) or announces an intention permanently to cease business or does in fact do so; or

(ii) upon or following any failure to pay principal in respect of any Subordinated Notes when it is due and payable; or

(iii) with the consent of the Issuer,

provided that, in the case of the first transfer of part of a holding pursuant to paragraph (i) or (ii) above, the Registered Holder has given the Registrar not less than 30 days’ notice at its specified office of the Registered Holder’s intention to effect such transfer.

4 Amendment to Conditions

The Global Certificate contains provisions that apply to the Subordinated Notes that it represents, some of which modify the effect of the terms and conditions of the Subordinated Notes set out in this Prospectus. The following is a summary of certain of those provisions:

4.1 Payments

All payments in respect of Subordinated Notes represented by a Global Certificate will be made to, or to the order of, the person whose name is entered on the Register at the close of business on the Clearing System Business Day immediately prior to the date for payment, where Clearing System Business Day means Monday to Friday inclusive except 25 December and 1 January.

4.2 Meetings

For the purposes of any meeting of Noteholders, the holder of the Subordinated Notes represented by the Global Certificate shall (unless the Global Certificate represents only one Subordinated Note) be treated as two persons for the purposes of any quorum requirements of a meeting of Noteholders and as being entitled to one vote in respect of each integral currency unit of the currency of the Subordinated Notes.

4.3 Trustee's Powers

In considering the interests of Noteholders while the Global Certificate is held on behalf of, or registered in the name of any nominee for, a clearing system, the Trustee may have regard to any information provided to it by such clearing system or its operator as to the identity (either individually or by category) of its accountholders with entitlements to the Global Certificate and may consider such interests as if such accountholders were the holders of the Subordinated Notes represented by the Global Certificate.

5 Electronic Consent and Written Resolution

While any Global Certificate is registered in the name of any nominee for a clearing system, then:

(i) approval of a resolution proposed by the Issuer or the Trustee (as the case may be) given by way of electronic consents communicated through the electronic communications systems of the relevant Clearing System(s) in accordance with their operating rules and procedures by or on behalf of the holders of not less than 90 per cent. in nominal amount of the Subordinated Notes outstanding (an "**Electronic Consent**" as defined in the Trust Deed) shall, for all purposes (including matters that would otherwise require an Extraordinary Resolution to be passed at a meeting for which the special quorum was satisfied), take effect as an Extraordinary Resolution passed at a meeting of Noteholders duly convened and held, and shall be binding on all Noteholders whether or not they participated in such Electronic Consent; and

(ii) where Electronic Consent is not being sought, for the purpose of determining whether a Written Resolution (as defined in the Trust Deed) has been validly passed, the Issuer and the Trustee shall be entitled to rely on consent or instructions given in writing directly to the Issuer and/or the Trustee, as the case may be, by accountholders in the clearing system with entitlements to such Global Certificate or, where the accountholders hold any such entitlement on behalf of another person, on written consent from or written instruction by the person for whom such entitlement is ultimately beneficially held, whether such beneficiary holds directly with the accountholder or via one or more intermediaries and provided that, in each case, the Issuer and the Trustee have obtained commercially reasonable evidence to ascertain the validity of such holding and have taken reasonable steps to ensure that such holding does not alter following the giving of such consent or instruction and prior to the effecting of such

amendment. Any resolution passed in such manner shall be binding on all Noteholders, even if the relevant consent or instruction proves to be defective. As used in this paragraph, “commercially reasonable evidence” includes any certificate or other document issued by Euroclear, Clearstream, Luxembourg or any other relevant clearing system, or issued by an accountholder of them or an intermediary in a holding chain, in relation to the holding of interests in the Subordinated Notes. Any such certificate or other document shall, in the absence of manifest error, be conclusive and binding for all purposes. Any such certificate or other document may comprise any form of statement or print out of electronic records provided by the relevant clearing system (including Euroclear’s EUCLID or Clearstream, Luxembourg’s CreationOnline system) in accordance with its usual procedures and in which the accountholder of a particular principal or nominal amount of the Subordinated Notes is clearly identified together with the amount of such holding. Neither the Issuer nor the Trustee shall be liable to any person by reason of having accepted as valid or not having rejected any certificate or other document to such effect purporting to be issued by any such person and subsequently found to be forged or not authentic.

Description of the Issuer

Overview

Liverpool Victoria Friendly Society Limited ("**LVFS**" or the "**Issuer**") commenced business in Liverpool in 1843. It was incorporated as a friendly society under the Friendly Societies Act 1992 on 1 January 1994, and as such, is authorised and regulated by the Prudential Regulation Authority (the "**PRA**") with registered number 110035. It is also a member of the Association of Financial Mutuals, the trade body that represents friendly societies in the UK. LVFS and its subsidiary undertakings are referred to as the "**Group**". The principal activity of the Group is the carrying out of insurance and financial services business in the UK.

The registered office of LVFS and the business address of each of the directors for matters concerning LVFS' business is County Gates, Bournemouth, Dorset, BH1 2NF. The telephone number of the registered office is +44 (0)1202 292 333.

The Group comprises two strategic business units: the general insurance business and the life business. The Group also includes the heritage with-profits business. Each of these are described in detail below. The Group provides these businesses with a set of common infrastructure services, including information technology operations and specialist support functions, such as finance, risk management and human resources via a number of strategic support units, each of which is headed by a member of the Group Executive team. The management of the Group's investment portfolio, was substantially transferred to Threadneedle Asset Management in 2011.

Membership and Management of the Issuer

As a friendly society, LVFS has no shareholders and no share capital. It funds its activities through retained earnings and the investment income and capital gains on these.

The members of LVFS are customers who have purchased savings or investment policies, life insurance protection policies or annuities offered by LVFS. Voting rights on a show of hands or on a poll are one vote per member in attendance at a meeting of the members or voting by proxy at such meeting. As at 31 December 2012, LVFS had 1,133,000 members (2011: 1,127,000).

LVFS is governed by the Friendly Societies Act 1992 and its own Memorandum of Association and Rules. Both the Memorandum of Association and the Rules may be altered by members from time to time by resolution, passed by over 50% of members voting at a general meeting. The quorum at such meeting shall consist of such number of members entitled to vote at the meeting present in person or by proxy as is one more than the number of directors in office at the start of the meeting (there are currently 10 directors, therefore the quorum is currently 11 members).

No member is liable for the debts or sums due by LVFS (see a description of the insolvency regime for friendly societies set out in the section entitled "*Regulation of the Issuer*" on page 104). Creditors may only claim against the funds of LVFS. LVFS, as an incorporated friendly society, may be dissolved by the consent of its members or may be wound up voluntarily in accordance with the Friendly Societies Act 1992 and the Insolvency Act 1986. It may also be wound up by the court on the grounds set out in Section 22 (*Winding up by court: grounds and petitioners*) of the Friendly Societies Act 1992 which includes any winding up voluntarily, in circumstances where the number of members is reduced to below seven, where a society exists for an illegal purpose or where a society is unable to pay its debts. Upon a winding up, any surplus is distributable amongst the members after satisfying the claims of all other creditors in accordance with the Rules of LVFS. The current Rules of LVFS as approved at the Annual General Meeting held on 21 May 2009

and registered by the Financial Services Authority on 3 June 2009 can be located in the corporate governance section of the Group's website.

The management of LVFS is vested in the directors who are subject to election by the members at the Annual General Meeting and to re-election at least once every three years thereafter.

Asset Management

The Group closed its asset management business on 31 October 2011. Since 1 November 2011, the management of the majority of the Group's funds[2] has been carried out by an independent third party asset manager, Threadneedle Asset Management Ltd ("**Threadneedle**"), pursuant to investment management agreements entered into between five Group companies and Threadneedle (the "**Threadneedle IMAs**"). The closure of the Group's asset management business and the appointment of Threadneedle followed a strategic review by the Group where it was decided that the Group would focus on its core activities within general insurance, protection and retirement solutions.

The assets of the Group managed pursuant to the Threadneedle IMAs include assets supporting (i) the with-profits policies, (ii) other life policies and (iii) LVFS' inherited estate (to the extent that this is not invested in trading subsidiaries of the Group). In addition, Threadneedle manages the assets of the general insurance subsidiaries. There are a number of detailed provisions in the Threadneedle IMAs relating to the powers and obligations of Threadneedle.

The objectives of Threadneedle in managing the Group's assets are defined in the Threadneedle IMAs which set out detailed asset allocation mandates and asset class guidelines. Under the Threadneedle IMAs, Threadneedle manages each discretionary portfolio and the relevant customer funds subject to the guidelines and restrictions set out therein. Threadneedle also manages advised execution portfolios but does so on a non-active basis, meaning that Threadneedle provides reactive advice to the Group's instructions. In addition, Threadneedle is required to have regard to the Group's policy of shareholder activism. There are also provisions relating to securities lending and withdrawal of assets from the portfolio. In particular, the Group has the ability, under certain circumstances, to withdraw assets to meet reasonable business and financial needs. For example, the Group can withdraw assets from a fund or portfolio to meet its payment liabilities to its customers in connection with products and policies or in connection with payments under the mutual bonus payments.

The Threadneedle IMAs are each for a minimum term of seven years from the date of each agreement, although there are termination provisions allowing each Group company to terminate the applicable Threadneedle IMA within this minimum term, for example due to a fundamental key man trigger or for service level agreement cause. They can also withdraw a fund from management by Threadneedle due to under performance. All parties to the Threadneedle IMAs can terminate their contracts during the minimum term if there is a change of control of the other party or a resolution is passed for the winding up of the other party. After the minimum term of seven years, each agreement will continue but the parties may terminate it by giving six months notice in writing to the other.

HSBC Bank plc provides custodian services for the assets managed by Threadneedle, with services including the safe custody of assets, income collection, the set up and maintenance of securities records and cash accounts, custody and electronic reporting, collateral management and corporate action processing.

As a result of the transfer of investment management to Threadneedle, LVFS no longer performs asset management functions, although it continues to work closely with Threadneedle to ensure that it delivers

[2] Other assets, including equity release loans, assets held under self-invested pension plans, private equity and derivatives, are managed separately.

appropriate returns for LVFS customers and exercises oversight and governance of Threadneedle's compliance with the terms of each Threadneedle IMA.

Organisational Structure of the Group

The Issuer is the principal life assurance operating entity in the Group. It also acts as holding entity of all the subsidiaries in the Group (see "*Group Structure Chart*" below) and its assets include shares in and loans to such companies. Its income and profits derive, therefore, partly from the life assurance policies written by the Issuer and partly from revenues received from the subsidiaries, principally in the form of dividends and interest payments. The following table shows the principal operating subsidiaries of the Issuer, being those which are considered to be most likely to have a significant effect on the assessment of the assets and liabilities, financial position, profits and losses and prospects of the Issuer as at 31 December 2012:

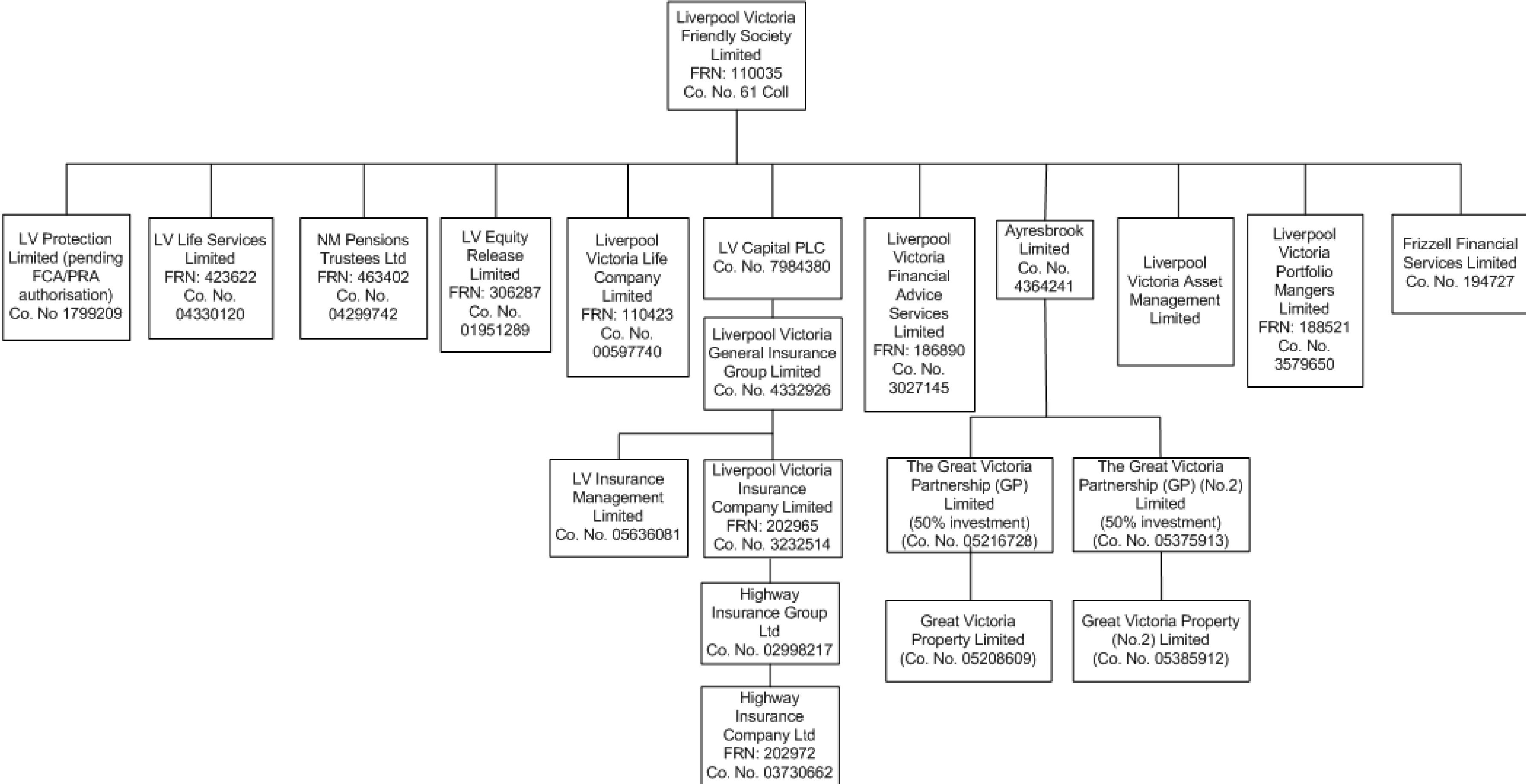
Name of Company	*Percentage Owned*[(1)]	*Country of Incorporation*	*Nature of Business*[(2)]
Liverpool Victoria Insurance Company Limited (LVIC) [(3)]	100%	England and Wales	General insurance
Highway Insurance Company Limited (HICL) [(3)]	100%	England and Wales	General insurance
Liverpool Victoria Life Company Limited (LVLC)	100%	England and Wales	Life assurance
Liverpool Victoria Financial Advice Services Limited (LVFAS)	100%	England and Wales	Intermediary
NM Pensions Trustees Limited (NMPTL)	100%	England and Wales	Pension fund trustee
LV Life Services Limited (LVLS)	100%	England and Wales	Service company
LV Equity Release Limited (LVER)	100%	England and Wales	Equity release

[(1)] Each subsidiary has one class of ordinary shares.

[(2)] Each subsidiary operates mainly in its country of incorporation.

[(3)] Wholly-owned subsidiary of LV General Insurance Group Limited ("**LVGIG**").

GROUP STRUCTURE CHART



Business of the Group

Overview

The Group provides a composite portfolio of general and life insurance businesses including various types of with-profits policy, life protection (both term, whole of life and income protection), annuities, equity release, SIPP, motor, home, road rescue, pet and travel insurance, including personal and commercial (small and medium enterprise) products, through a multi-channel distribution approach within the UK.

The Group has significantly enhanced its operations since 2006, increasing the contribution to Group profitability from non-life businesses, growing core areas of the life business and exiting unprofitable businesses such as its financial advisory and banking businesses.

The Group has transformed its brand since 2006 in both its life insurance and general insurance businesses following its rebranding from Liverpool Victoria to LV=. The Group acquired the LV.com domain in 2007. The "Heart" logo and slogans using "LV=" have created a distinctive brand icon in financial services in the UK.

The Group is led by an experienced management team with a previous track record at recognised financial institutions in the UK (see "*Management*" below). The Group has in excess of 5,600 employees working across its businesses and operates from several locations across the UK. These include: Exeter (protection centre); Bournemouth (head office and heritage centre); Hitchin (retirement solutions centre); Basildon, Brentwood, Bristol, Croydon, Huddersfield, Ipswich, Leeds and London.

The two main business areas of the Group (the General Insurance Business and the Life Business) have grown significantly since 2008, with the table below setting out gross earned premiums and financial assets over the period 2008 – 2012, demonstrating a compound annual growth rate ("**CAGR**") of 28% and 18%, respectively:

£m	**2008**	**2009**	**2010**	**2011**	**2012**	**CAGR (2008-2012)**
Gross Earned Premiums	917	1,251	1,732	2,197	2,446	**28%**
Financial Assets*	4,904	5,482	7,142	8,020	9,484	**18%**

*at fair value through income (excluding derivatives)

In 2012 the life and heritage businesses generated 39% of Group gross written premiums ("**GWP**") and the general insurance business generated 61%.

The Group is well positioned in some of its chosen markets as follows[3]:

- third largest personal motor insurer (3m motor policies in force); and
- top 5 positions in:
  - enhanced annuities (10% market share);

[3] *Sources: Life New Business Market share: 2012 LV interpretation of ABI Data, except in respect of Equity Release Council data for equity release; GI Market position: LV=.*

- income protection (16% market share); and
- equity release (10% market share).

The Group aims to be a leading specialist in selected life insurance markets and a "top five" insurer in its chosen general insurance markets in relation to market share.

The overall strategy of the Group is to enhance its value for the benefit of its members.

Throughout 2012 the Group operated against a backdrop of volatile financial markets, continued weakness in the UK economy and uncertainty in Europe. Despite this the business experienced another year of profitable growth from both the life and general insurance businesses, with the Group's underlying operating profit growing by approximately 19% by comparison with 2011 to £126.2m (2011: £105.8m). Due to this improvement in operating performance, the Group reported a profit before tax and mutual bonus for the year of £103.2m (2011: loss £16.9m).

Based on the improvement in operating performance, the Group declared a mutual bonus of £20.9m in 2012 (2011: £18.6m).

Profit before tax for the Group between 2010 and 2012 is shown below:

	2010*	**2011***	**2012**
	£m	£m	£m
General Insurance	41.3	76.4	117.1
Life	18.8	24.5	26.3
Group (including the Heritage business)	36.5	4.9	(17.2)
Underlying Operating Profit**	96.6	105.8	126.2
Additional margin for credit default and other risks***	-	(18.9)	(29.4)
Model and valuation changes****	(83.7)	(22.9)	(13.0)
Operating Profit	**12.9**	**64.0**	**83.8**
Accounting policy differences (IFRS)*****	(2.2)	(7.7)	(11.6)
Short Term Investment Fluctuations	(7.9)	(46.4)	65.7
Solvency II and Centrally Managed Costs	(7.3)	(10.8)	(7.7)
PPI Costs	-	(3.0)	(15.0)
Amortisation of intangibles	(13.8)	(13.0)	(12.0)
Profit/(loss) before tax and mutual bonus	**(18.3)**	**(16.9)**	**103.2**

* Restatements have been made to the prior year results to reflect the following changes:

- The heritage with-profit trading results are now reported within the Group result rather than within the life business. Heritage underlying operating profit mainly comprises expense under or over runs.
- Life results have been restated to reflect the change in the tax gross up rate applied to life value add (which is the value of new business plus the profitability of in-force business +/- expense variances) and additional margin for credit default risk. Previously these items were grossed up at 20%. Going forward the tax gross up will be based on the weighted average tax rate applicable. In 2012, this was calculated at 5%.
- Life and group underlying profit have been restated to reflect loss of earnings in the life business on funds which have been paid across to the Group as dividends of surplus capital held in Life subsidiaries in 2011 and 2012.

** Underlying operating profit is an unaudited figure and represents operating profit before one-off items such as basis and methodology changes, short-term investment fluctuations and amortisation of intangibles.

*** Additional margin for credit default and other risks represents the difference for new business between management's best estimate of credit default, which is used to calculate the value of new business reported within underlying operating profit, and the market consistent basis used for valuing policies. This is principally driven by the annuity business within life.

**** Model and valuation changes represent the impact on the in-force business of changes in valuation assumptions and improvements in the actuarial models used to value existing policies.

***** The life result includes changes in the present value of future profits expected to emerge from policies in-force during the year. Where this differs from the treatment under IFRS an adjustment is made in the Accounting policy differences (IFRS) line.

Heritage business

The Group's results include results attributed to its heritage business. This comprises LVFS' with-profits business (both ordinary branch and industrial branch) along with some non-profit business and unit-linked business, most of which was acquired from the Royal National Pension Fund for Nurses ("**RNPFN**"). Most of the Group's heritage products are no longer actively marketed, though the Group continues to sell newer with-profits products via the life business. The latter include a unitised with-profits bond and a with-profits pension annuity.

The majority of the Group's members are holders of heritage policies and one of the Group's key objectives is to maximise the return that with-profits policyholders achieve on their policies, while also ensuring that the Group provides a high standard of customer service to them at a competitive cost.

The results of the heritage business primarily reflect cost under-runs or over-runs, along with the value added by new business. The in-force with-profits book may also give rise to charges or credits for changes in actuarial assumptions and for the impact of short term investment fluctuations.

The total Peak 2 liability for with-profit policies, excluding ordinary branch pensions (a portfolio of legacy deferred and vested pension annuities), was £2,472m (see the section entitled "*Description of the Issuer – Solvency and capital position*" on page 98 for a definition of "Peak 2"). Within this figure, the cost of the underlying policy guarantees (in excess of the amount expected to be met from the policy asset share) was £65m, or 2.6% of the total. The liability for the ordinary branch pensions (deferred and vested pension annuities) was £766m. This figure is substantially in excess of the underlying policy asset share, due to the high level of the guaranteed policy benefits. These policies are managed as non-profit policies and are backed by an appropriate portfolio of fixed-interest assets. They remain with-profit and so they could in theory receive bonuses in the future should investment conditions be sufficiently buoyant. However, given the level of the policy benefits, this possibility is considered by the Group to be unlikely.

The heritage business includes RNPFN policies, which were acquired by the Group in 2001. The policies are held in a closed ring-fenced sub-fund, which is being run so as to distribute all of the surplus assets in the sub-fund to eligible policies as they discontinue. The RNPFN sub-fund benefits from cost synergies and from a contingent capital support facility provided by LVFS, enabling a greater degree of investment freedom to be pursued than would otherwise be possible. RNPFN policyholders have no rights to participate in any of LVFS' surplus.

General Insurance

History and Development

LV= entered the General Insurance business in 1996 following the acquisition of the Frizzell Group and the setting up of a new general insurance business, Liverpool Victoria Insurance Company Ltd ("**LVIC**"). This business failed to take a credible share of the general insurance market and was loss making in 2005, with

minimal brand awareness and reliance on one partnership deal with CSMA for a large proportion of premium income.

In 2006, following the appointment of Mike Rogers as CEO of the Group, the Group invested in ABC Insurance. ABC Insurance included a very experienced general insurance management team (all of whom remain in place as at the date of this Prospectus) who were tasked with the explicit responsibility of improving the Group's general insurance business. The new strategy for the business was presented to the LVFS Board in December 2006, with the main objective of the strategy being to become a top five general insurer, within chosen market segments, within five years. This objective was underpinned by a number of specific financial, people, channel, product and brand goals.

The period from 2006 to 2012 saw the fulfilment of these original goals, augmented by the acquisition of the Britannia road rescue business in 2007 and the creation and development of the broker division, which was further strengthened by the acquisition of Highway Insurance Group PLC in 2008.

The successful development of the general insurance business is demonstrated by the growth in GWP over the period 2008 to 2012 (a material amount of such growth being organic as opposed to being from acquisitions by the Group), with the business increasing GWP from £445m in 2008 to £1,485m in 2012, a 35% CAGR over the period:

Gross Written Premium 2008-2012

£m	2008	2009	2010	2011	2012
Direct	370.0	411.7	525.7	735.7	829.7
Broker	75.1	399.4	656.8	719.9	655.2
Total	**445.1**	**811.1**	**1,182.5**	**1,455.6**	**1,484.9**

This sales growth was achieved in a disciplined manner, which allowed the Group's general insurance operations also to improve their profitability continually during the period. Since 2008 (when a loss was reported) profits have increased consistently each year. Underlying operating profits of £117.1m were reported for 2012 and a dividend of £37.5m was paid up to the Group's holding company. Return on capital for the general insurance business was 17.7%[4] in 2012 (2011: 12.9%).

Underlying Operating Profit 2008-2012

£m	2008	2009	2010	2011	2012
Underlying Operating Profit[5]	-19.9	13.2	41.3	76.4	117.1

4 General insurance return on capital is calculated as profit before tax (adjusted for amortisation on intangibles and finance charges) divided by average capital (equity plus subordinated debt plus minority interest).

5 Underlying operating profit for General Insurance is an unaudited figure and is defined as profit before tax with amortisation of intangibles, finance costs and costs associated with the Solvency II project added back.

Expense / Loss / Combined Ratio 2008-2012

%	2008	2009	2010	2011	2012
Expense Ratio(1)	35.0%	31.5%	23.8%	23.2%	22.7%
Loss Ratio(2)	81.8%	72.6%	79.6%	74.5%	77.0%
Combined Ratio(3)	116.8%	104.1%	103.4%	97.7%	99.7%

(1) Expense ratio is defined as expenses (net of other income) excluding amortisation of goodwill and investment management costs over net earned premiums.
(2) Loss ratio is defined as claims over net earned premiums.
(3) Combined ratio is the sum of expense ratio plus loss ratio.

This profitability has been driven by increased investment returns and improvements in the combined ratio, which was below 100% in 2011 and 2012, reflecting the strength in management of the business. The slight worsening of the combined operating ratio in 2012 from 2011 was due to the loss ratio. The loss ratio was impacted by exceptional adverse weather event experience in 2012 (impact £25m). Other factors impacting the loss ratio were higher than expected large loss claims experience in Q4 and a number of actual and anticipated regulatory and legislative changes (i.e. a potential reduction in Ogden discount rate, general damages uplift, etc). The strength of this operating performance is highlighted by the fact that LV= is not heavily reliant on ancillary income, which is currently under close scrutiny and possible threat from various regulatory bodies, to achieve its results. Ancillary income contributed just 0.9% (£13.1m) to the 2012 combined ratio (2011: 1.1%). In 2012 the general insurance business entered into gilt hedge contracts, as a result of which a significant proportion of the general insurance asset portfolio is hedged against gilt yield movements. These contracts had a notional value of around £1.4bn at the 2012 year end and will expire in 2013 (unless they are rolled over, which is LV='s current intention).

Brands and Products

The general insurance business is underwritten by LVIC and Highway Insurance Company Limited ("**HICL**"), both of which are subsidiaries of LVGIG. The general insurance business operates under the brand name "LV=" for all direct business and for broker commercial lines. For broker personal lines, it operates under the Highway Insurance Ltd and ABC Insurance LV= Broker brands. Britannia Rescue operates as a separate brand for the road rescue business of the Group and is the UK's 4th largest road rescue provider[6].

The general insurance business concentrates on personal and commercial lines insurance through the provision of motor (including van and motorcycle), household, commercial (including SMEs), rescue, travel and pet coverage throughout the UK. As at 31 December 2012, the Group's total number of in force policies was 4.1m (2011: 3.9m).

LVIC underwrites mainly motor insurance policies (both direct business and business sold via a broker), household insurance policies, SME insurance policies and a small amount of other business. HICL underwrites broker distributed motor insurance policies in the UK and the Republic of Ireland and certain lines of business in run-off.

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6 *Source: LV=.*

In motor insurance, underwriting and pricing strategies have resulted in a shift in portfolio composition, moving away from younger, higher risk, and less affluent drivers to older, lower risk and more affluent drivers. This has had a consequential benefit on claims frequency and loss ratios.

2012 Gross Written Premium by Product

Product	**% 2012 GWP**
Direct – Motor	45%
Direct – Home	9%
Direct – Other	2%
Broker – Motor	32%
Broker - Home	1%
Broker – Commercial (including SME)	11%

Market Position

In 2012, the Group was the third largest personal motor insurer in the UK with total in force motor policies of 3m (2011: 2.9m)[7].

Distribution

The Group operates a multi-channel distribution strategy for its general insurance products. Organisationally, the business is separated into direct and broker distribution channels to achieve clarity of focus in the provision of its products and organisational responsibilities.

The Group has distribution agreements with, amongst others, brokers Budget, AA Insurance Services and Swinton and partnerships with Asda, Unison and CSMA. Other distribution channels include aggregators (comparison websites) such as gocompare.com and confused.com, as well as other agents and advisers.

The Group's online broker portal was the first in the market to allow brokers to obtain quotes and sales online, renew and adjust policies and report claims. This use of technology provides that new business is fully automated, resulting in lower handling costs and increased efficiency and ease of use for brokers. The Group has also been successful in exporting technology from the direct channel to the broker channel which has resulted in a better analysis of risks being underwritten at broker level.

The Group also sells general insurance products through "white label" partnership arrangements including with Nationwide Building Society, pursuant to which the Group's general insurance products are marketed under the name of the relevant partner. Partnerships and affinities accounted for 29% of 2012 direct GWP.

[7] This information is set out in more detail in the 2012 financial reports and accounts of the Group.

2012 Gross Written Premium by Channel

Channel	% 2012 GWP
Broker	44%
Direct	56%
of which Direct Renewals	62%
of which Direct new Business*	38%

*Direct Channel New Business Distribution	% 2012 Direct New Business
Call Centre	39%
Britannia Rescue	1%
Aggregator	43%
Internet	17%

Strategy

The Group's strategy in respect of its general insurance business is to achieve and/or maintain "Top 5" market share positions in its target markets in the UK, namely motor, home and SME insurance. The objectives of the general insurance business are to:

- focus on profit generation in order to deliver consistent returns on capital throughout the underwriting cycle;
- manage capital and liquidity in order to return funds to the Issuer for Group purposes;
- capture further market share in direct motor business; and
- grow the home insurance and SME insurance businesses to increase the revenue diversification of the Group and improve the predictability and quality of earnings.

The Group intends to continue its investment in growing brand awareness and increasing brand consideration, as well as developing a multi-platform system strategy which relates to multiple underwriting systems supporting different products.

A number of awards have been received in respect of its general insurance business. These include the following:

- 2013 Consumer Moneyfacts Award - Best Home Insurance Provider;
- 2012 British Insurance Awards – General Insurer of the Year and Marketing Initiative of the Year;
- 2012 Insurance Times Award - Insurance Brand Campaign of the Year;
- 2012 Customer Contact Association Global Excellence Awards – Great Place to Work and Director of the year;

- 2012 European Call Centre & Customer Service Award - Best Customer Service in Financial Services;
- 2012 Technology in Insurance Award – Best use of Analytics; and
- 2012 Moneywise Customer Service Award - Most Trusted Car Insurance Provider for Claims.

General insurance pricing, underwriting and claims handling

The general insurance business seeks to differentiate itself from its competitors through a combination of products, value and customer service. Underpinning this, however, is a focus on technical expertise, particularly in risk selection and claims cost control.

The direct motor personal lines business uses a highly complex risk rating model with over a billion risk combinations. This enables the business to price precisely in order to attract new business customers which fit within its defined lower-risk target segments. The overall pricing approach avoids 'quick win' price discounts or large online discounts as these often result in price hikes at renewal, leading to poor customer retention rates. A policy of fair pricing at renewal has helped to build lasting trust in the LV= brand, contributing to market-leading renewal retention rates.

In the broker channel, the general insurance business is able to exploit many of the advantages of its 'direct' motor pricing model for the benefit of its broker partners, helping them to remain competitive in the 'price comparison' world.

A similar approach to risk selection is operated in the non-motor lines of business with a clear focus on attracting and retaining low risk customers in the home and small business insurance segments.

The Group's approach to claims handling is to settle valid claims as rapidly as possible, while at the same time adopting a challenging approach to claims that may be exaggerated or fraudulent. This has resulted in the business generating strong positive feedback from customers and consumer interest groups, such as *Which*? for the quality and efficiency of its claims service. At the same time, the Group has been able to mitigate to a significant degree the activities of 'claims farmers' and personal injury lawyers and its average claims cost ranks amongst the lowest in the motor insurance industry.

The Group's pricing, risk selection and claims capabilities are a source of competitive advantage to the Group's general insurance business and a key factor underpinning its profitability.

Reinsurance

Reinsurance in the general insurance business is primarily used to transfer loss risk which is outside the risk profile of the business (based on the individual capital assessment ("**ICA**") model prepared for LVIC and HICL). Reinsurance is also used to transfer risks of which the business has limited experience, such as commercial legal expense insurance. The largest current reinsurance programmes of the general insurance business are in relation to (i) motor (third party loss), where payments on individual claims in excess of £5m for third party injury or property damage are covered by the reinsurer, and (ii) property catastrophe risk, where multiple small claims arising out of one event (i.e. a flood or a windstorm) which exceed £30m in aggregate are covered by the reinsurer (up to a limit of £270m). The reinsurer counterparties of the general insurance business include the following principal reinsurers: Hannover Re, Swiss Re, QBE, CCR, Munich Re, Faraday and Scor. These principal reinsurers provide both historic and on-going placement support. Each reinsurer on the liability programme has a credit rating of at least A from S&P, and a credit rating of A- from S&P for the shorter tail property reinsurance programmes. The reinsurance programmes are regularly reviewed by the risk committee of the Group's general insurance business.

Life

Brands and Products

The life insurance business operates under the single brand name "LV=" and is a recognised protection specialist and retirement solutions provider. Distribution is through financial advisors, working with some of the largest networks and national accounts through to smaller intermediaries. The business also distributes through corporate partners such as Asda and Standard Life, and has a growing direct to customer ("**D2C**") capability using the LV= brand and partner brands. The principal products offered are:

- Retirement plans – self invested personal pensions ("**SIPPs**"), income drawdown pension products (including "Fixed Term Annuities"), enhanced and with-profit annuities and equity release products. The Group has elected not to participate in the group pensions and stand-alone regular premium pension accumulation markets, which the Group believes to be low margin;
- Life protection - income protection, mortgage payment protection, life and critical illness, over 50s insurance and life insurance; and
- "New Style" with-profits investment products. These include a unitised with profit bond (Flexible Growth Bond) and, part of the retirement suite, a with-profit annuity (PIPA). The Group also continues to see top-ups to various with-profits savings and investment policies.

2012 Sales (APE[8]) by Product

Protection by Product	**% 2012 APE**
Critical Illness	23%
Income Protection	28%
Term	28%
50+	21%

Retirement by Product	**% 2012 APE**
Enhanced Annuities	35%
Fixed Term Annuities	10%
SIPP & Drawdown	42%
Equity Release(1)	7%
Savings & Investments	6%

(1) Equity release loans are reported internally on an APE basis. Actual loans advanced during the year were £89m (2011: £85m).

8 Annual premium equivalent ("**APE**") is a measure comprising new regular premium sales plus 10% of single premiums (equity release loans are treated as single premiums).

History and Development

The current protection business began substantially in 2000 when LVFS acquired Permanent Insurance Company Ltd ("**Permanent**") from Equitable Life; Permanent was subsequently renamed Liverpool Victoria Life Company Ltd and remains a wholly-owned subsidiary of LVFS. In 2009, almost all of this business was transferred to LVFS by a Part VII transfer under FSMA.

The foundations of the retirement solutions business began in January 2008 when LVFS acquired from Swiss Re the new business capability of GE Life, itself acquired by Swiss Re in mid 2007. This included the companies now known as LV Equity Release Ltd, LV Life Services Ltd and NM Pension Trustees Ltd. These companies focus on the ‘at retirement’ consolidation and decumulation markets, and provide SIPPs, including pension consolidation and drawdown, and equity release products. The annuity business also became part of LVFS directly.

Business Performance

In 2012 the Group's life business delivered a year on year increase in underlying operating profit of 7% to £26.3m (2011: £24.5m). The growth in underlying operating profit was driven by increased value of sales, with growth of 15% in both retirement and protection, and strong margin performance. This was achieved against a challenging regulatory backdrop for the life and pensions industry as a whole, driven by the implementation of a number of regulatory and legislative changes including the FSA's retail distribution review ("**RDR**"). The business produced a return on capital of 19.3% in 2012 (2011: 18.1%).[9]

The table below sets out the life business results for 2010 – 2012 (but excludes the heritage business results):

£m	**2010**	**2011**	**2012**
Sales (APE)			
Protection	23.7	28.0	32.2
Retirement*	94.6	108.2	124.4
Total Life sales	**118.3**	**136.2**	**156.6**
**of which enhanced annuity APE*	*31.7*	*39.7*	*46.2*
Sales (Premiums)[(1)]	**830.4**	**951.4**	**1,096.9**
Value of New Business[(2)]**	7.7	14.5	24.7
Underlying Operating Profit	18.8	24.5	26.3
Present Value of Future Profits[(3)]	197.8	357.0	396.4
Expense Overruns	-12.4	-11.3	-10.4
VNB / APE %	6.5%	10.7%	15.8%

(1) Including gross written premiums for investment contracts which are deposit accounted for and not included in IFRS gross written premiums.

(2) Value of new business is assessed on a "pricing" basis, based on the Group's management's view of best estimate assumptions. This basis is broadly aligned with that of Peak 2 except for credit default and liquidity premium. For

9 Life return on capital is calculated using life underlying profit and the average Peak 2 net assets and intangible assets attributable to the life business for 2012 was £136.2m (2011: £135.5m). The life business comprises the retirement and protection businesses and does not include the results or net assets on a Peak 2 basis attributable to the Group, including the heritage with-profits fund.

credit, a default assumption of 25% of spread applies for 3 years (equal to the Peak 2 valuation basis at the time), and thereafter a long term rate based on historic default experience and loss given default applies. This basis reflects the impact of holding capital on a Peak 1 basis and for annuities a further 2.5% of premium is held.

(3) Present value of future profits (or losses) on non-profit insurance contracts written in the fund, valued on a Pillar 1 basis.

**The annuity business represents approximately half of the value of new business. A sample enhanced annuity[10] sold on 30 June 2012 has an internal rate of return of 10.4% and a payback period of 8.3 years.

The growing in-force book of the life business is demonstrated in the table below setting out the percentage of new business premiums to life business Peak 1 reserves. As the in-force business has grown, new business premiums have constituted a decreasing percentage relative to Peak 1 reserves.

£m	**2010**	**2011**	**2012**
Life New Business Premiums	729.3	843.8	978.1
Life Peak 1 Reserves	1,613.3	2,347.4	3,025.5
Life New Business Premiums / Life Peak 1 Reserves	45%	36%	32%

Market Position

The Group holds top five UK market share positions in[11]:

- enhanced annuities (10% market share);
- income protection (16% market share); and
- equity release (10% market share).

The Group has chosen to participate in products and markets where it has expertise and competitive advantage (this is aided by the Group having a limited legacy book).

The Group believes it has a particular strength in income protection within the protection market, and this expertise provides the Group with the ability to manufacture additional products in the individual protection market. Accompanying this, the Group also markets over-50s whole of life insurance.

In the retirement market, the Group has established a strong position as a retirement income specialist, offering enhanced annuity, fixed term annuity, investment linked annuity and drawdown products as part of its retirement "waterfront". The entry to these products is from external pension funds or via the Group's SIPP product, which has been segmented to face-off to the personal pension and collective SIPP markets, as well as retaining a low risk position in the bespoke SIPP market. Equity release completes the retirement suite, however the with-profits bond has synergies in this space and is also distributed by the retirement team.

Several awards have been received in respect of the Group's life insurance business. These include the following:

[10] Typical values for a male, single life, smoker who is aged 65 and has a £50,000 single premium.

[11] *Source: LVFS interpretation of ABI Data 2012, Equity Release Council market share data for equity release 2012.*

- 2012 Financial Adviser Service Awards - 5 Star awards for Life and Pension Providers and Mortgage Providers & Packagers category;
- 2012 Financial Adviser Online Service Awards for Life and Pensions – 5 Star Award;
- 2012 LifeSearch Protection Awards 2012 - Best Service Provider, Most Improved Provider and Best Overall Provider;
- 2012 Money Marketing Award – Winner of Best Business Campaign; and
- 2012 Institute of Customer Service UK Customer Satisfaction Award - Employee Engagement Strategy of the Year.

Distribution

The Group's life business is predominately distributed through financial advisors. The main distribution route for retirement products is across a range of financial advisory firms. Protection products are sold through a mix of independent and non-independent brokers and financial advisers, direct sales and corporate partnerships. Savings and investment products are sold mainly through advised sales and IFA sales, but a proportion of products are sold directly.

For financial advisors, capabilities include face to face and telephone account managers, as well as national account and business development managers, all complemented by bespoke marketing. The established national account managers manage the largest distributor relationships, and the Group has distribution agreements with some of the larger networks and nationals, including Sesame Bankhall Group (the UK's largest retail IFA network), Tenet, Personal Touch Financial Services, Simply Biz, Hargreaves Lansdown, the Nationwide Annuity Panel and Intrinsic.

Direct sales are achieved through advised and non-advised sales, with these being through telephone, mail, online, press and television advertising. Over two thirds of the Group's direct sales are focused on the 50 plus age group which is currently dominated by direct mailing. Online sales are enhanced by the use of e-brokers and aggregator websites. These capabilities are also applied through corporate partners including Asda and Standard Life.

The Group considers that it is well positioned for the changes to sales of retail investment products as a result of the RDR and has delivered the required new functionality to time and quality. The Group believes that, among other things, the annuities market will be increasingly dominated by the market leading IFAs with whom the Group has a strong presence.

Strategy

The Group's life business strategy is to be the UK’s leading "in and at" retirement and protection specialist, focussing on market segments with attractive margins, strong growth forecasts and significant barriers to entry for prospective new players. Strategic goals include:

- sustaining a top 5 position in key protection market segments, including a leading position in Income Protection;
- sustaining a top 5 position in enhanced annuities, income drawdown and equity release;
- growing direct distribution to harness the post-RDR growth in this channel, supported by a range of simplified propositions designed for direct purchase; and
- driving cost productivity across the portfolio.

Strategic investments are prioritised around the sources of the Group's competitive advantage together with the core capabilities that underpin these. These strategic investments include:

- multi-channel distribution, spanning intermediary networks panels, portals, corporate partners and direct distribution through telephone and digital channels;
- talent and depth of management, evidenced by a senior leadership team with extensive experience of other life providers and supported by an established talent management programme;
- operational efficiency and cost discipline, underpinned by workflow, telephony and capacity management technology; and
- an investment strategy to optimise yields, managed by investment experts Threadneedle.

Life insurance pricing, underwriting and claims handling

The life business aims to gain competitive advantage through expertise in the core risk management capabilities of pricing, underwriting and claims handling. The Group has invested in and benefits from teams of pricing and product experts with backgrounds in financial services and life insurance.

For each product, pricing is targeted at specific age, social and lifestyle groups. Pricing for enhanced annuities is focused on delivering a top five position for specific medical and lifestyle conditions subject to achieving a minimum profit margin: for equity release, pricing reflects the quality of the underlying product; for SIPP/drawdown business, the pricing focus is value for money expert advice. The Group has a heritage business in the enhanced annuity market dating back to Stalwart Insurance (acquired by the Group via the acquisition of the new business operations of GE Life), which launched the first smoker annuity in 1983. This back book of data is used to inform pricing and includes 18 years of continuous mortality data, allowing the Group to price, reserve and push reinsurance arrangements to maximise value.

Pricing for the protection business supports the provision of market leading products (in terms of quality and breadth of cover) at competitive rates. Regular monitoring of profitability, capital consumption, claims / persistency experience and market movements helps ensure that pricing remains competitive and provides adequate returns for the Group’s members, whilst ensuring timely remedial action is taken. The pricing basis is formally reviewed on an annual basis, factoring in changes in historic and expected future experience as well as on an ad-hoc basis during the year as necessary.

Underwriting technology that allows risks to be efficiently assessed and differentiated is used, with high straight through processing rates for both protection and enhanced annuity business. The information gathering process is also structured to provide a more positive experience for customers and advisers. For example, the in-house tele-interview team gather information from customers on their medical conditions and this information has reduced the need for GP reports by over half, thus streamlining the speed and ease with which customers and IFAs can do business with the Group. This improves the chances that IFAs will place further business with the Group.

The Group’s claims and underwriting teams are highly experienced, and they are supported by an on-going programme of technical and professional development focused on ensuring that underwriting and claims decisions are accurately assessed to detect underwriting risks that fall outside of the risk appetite or the small percentage of claims which are not covered or involve fraud or non-disclosure. In 2011 and 2012, the Group's underwriting and claims areas were reviewed by a number of its reinsurers who consistently rated the quality of assessment as 'above industry standards', an important driver of quality reinsurance terms, which in turn supports competitive pricing.

Reinsurance

Reinsurance in the Group's life insurance business is used to manage risk exposures, to increase the competitiveness of products sold by using advantageous terms available under reinsurance contracts, to improve capital efficiency and to access the expertise and business intelligence of reinsurers in relation to certain risks. In relation to risks to which the Group's life insurance business is particularly exposed, a high proportion of mortality risk is reinsured and most health insurances, annuities and the RNPFN book related risks are also reinsured (see "*Risk Factors – Inability of reinsurers to meet their obligations, or the unavailability of adequate reinsurance coverage, may have an adverse impact on the Group's profitability and available capital*"). The reinsurance risks are spread between a number of the leading reinsurers in the market for the risks reinsured, including Gen Re, Hannover Life Re, Swiss Re, Munich Re, RGA and Pacific Life Re each taking between 50% and 100% of the risks reinsured with them as at 1 January 2013. Each reinsurer has a credit rating of between AA+ and A+ (Standard & Poor's). Reinsurance treaties are generally re-tendered every two years, with certain reinsurance treaties being tendered for a longer period. The Chief Actuary and Chief Risk Officer review appetite for total exposure and exposure by reference to the credit rating of the reinsurer counterparties throughout the year.

Financial Information

The Group made an IFRS profit before tax in 2012 of £103.2m showing an improvement on 2011 (2011: loss before tax £16.9m) reflecting:

- growth in underlying operating profit offset by increased prudence in valuation assumptions particularly credit risk;
- strong short-term investment performance reflecting market value gains, in particular benefiting from narrower credit spreads in the annuity business bond portfolio and improved equity performance; and
- centrally managed costs – the Group incurred non-recurring costs of £22.7m mainly in respect of regulatory projects (such as projects related to Solvency II) and the decision to reserve an additional £15m for PPI claims relating to the former banking business which closed in 2010. The net costs included a pension curtailment gain of £13m.

The pension scheme actuarial loss net of tax of £145.5m in 2012 (2011: gain £69.7m), calculated under IAS19, is primarily due to a reduction in the rate used to discount the scheme's liabilities, and also reflects the impact of 2012's triennial review. As at 31 December 2012 the scheme reported a net pension benefit obligation of £10.2m (2011: £106.9m net asset). On a funding basis, the Group had a funding deficit of £34m at the last triennial valuation on 31 March 2012 and, with further improvements in the funds' position, has made no deficit contributions from 1 April 2013.

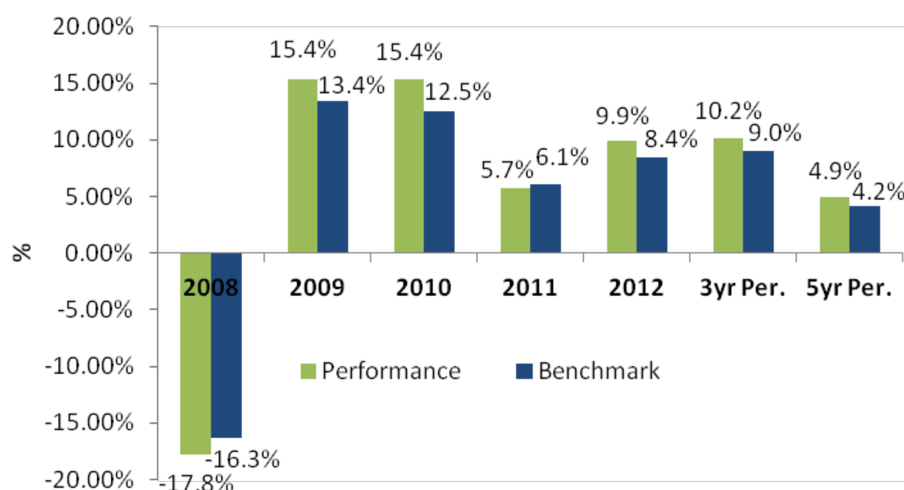
Statement of Comprehensive Income

	Group	
	2012	2011 (restated) [1]
	£m	£m
Gross earned premiums	**2,446.2**	2,196.5
Premiums ceded to reinsurers	**(108.8)**	(93.0)
Net earned premiums	**2,337.4**	2,103.5
Fee and commission income	**16.5**	18.5
Investment income	**320.2**	261.4
Net gains on investments	**374.7**	425.4
Other income	**41.7**	51.0
Total income	**3,090.5**	2,859.8
Gross benefits and claims	**(1,819.3)**	(1,669.3)
Claims ceded to reinsurers	**110.8**	86.4
Net benefits and claims	**(1,708.5)**	(1,582.9)
Gross change in long-term contract liabilities	**(711.3)**	(771.6)
Change in long-term contract liabilities ceded to reinsurers	**74.4**	96.0
Net change in contract liabilities	**(636.9)**	(675.6)
Finance costs	**(0.5)**	(0.5)
Investment return allocated to external unit holders	**(32.9)**	2.1
Other operating and administrative expenses	**(608.5)**	(619.8)
Other expenses	**(641.9)**	(618.2)
Total benefits, claims and expenses	**(2,987.3)**	(2,876.7)
Profit/(loss) before tax and mutual bonus	**103.2**	(16.9)
Mutual bonus	**(20.9)**	(18.6)
Income tax expense	**(34.3)**	(42.2)
Pension scheme actuarial (losses)/gains net of tax	**(145.5)**	69.7
Transfer from the Unallocated divisible surplus	**97.5**	8.0
Total comprehensive income for the year	**-**	-

(1) The Statement of Comprehensive Income has been restated to reclassify interest on loans secured on residential property from fee and commission income to investment income.

Analysis of Assets and Investment Performance

2012 was the first full calendar year with Threadneedle managing the Group's investments and this partnership proved successful, with the strongest performing fund, the LVFS with-profits fund, producing an absolute return of 9.9% (which was 1.5% ahead of benchmark). Investment performance for the with-profits fund over the last five years against its respective benchmark is outlined in the graph below:



The returns above are in respect of the £2.1bn LVFS with-profits fund. In total, £8.4bn of funds are managed by Threadneedle on behalf of the Group (this figure does not include £0.9bn of funds managed by Threadneedle on behalf of the staff pension scheme). In addition a further £1.3bn of assets are managed by the Group or other third parties, including equity release loans and assets held within self-invested pension plans.

In addition the staff pension scheme has a further £1.1bn of assets.

As at 31 December 2012, the funds managed by Threadneedle were allocated by asset class as follows:

Asset Class	With-Profits Fund (£2.1bn)	Other Assets (£6.3bn)	Staff Pension Scheme (£1.1bn)(1)
UK Equity	32%	5%	40%
Overseas Equity	13%	2%	13%
UK Gilts	29%	26%	35%
Bonds	12%	58%	2%
Property	8%	1%	4%
Alternatives	4%	1%	4%
Cash	2%	7%	2%
Total	100%	100%	100%

(1) Of these assets, £0.9bn are managed by Threadneedle and £0.1bn by Legal and General.

At the end of 2012, the majority of assets held in both the with-profits fund and other group assets are UK listed securities, with Europe, the US and Australia the next largest exposures by region. The Group had limited exposure to the Eurozone and no exposure to either Greece or Cyprus.

The following table shows the Group's exposure to the Eurozone by country of incorporation of the counterparty as at 31 December 2012.

	Sovereign	Non-Sovereign	Total
	£m	£m	£m
Ireland	-	332.8	332.8
Italy	0.4	35.9	36.3
Portugal	-	2.7	2.7
Spain	-	90.3	90.3
France	-	322.6	322.6
Other Eurozone	-	872.6	872.6
Total	0.4	1,656.9	1,657.3

The major exposure to Ireland is through an Insight managed Irish domiciled liquidity fund (£274m). The major exposure to Spain is through investment in companies including Santander UK (£48m exposure) and Telefonica (£27m exposure). Total non-sovereign exposure includes £74m of subordinated debt, equal to 4% of total non-sovereign exposure.

The credit profile of the Group's assets is of a high quality, with exposures mainly to BBB and higher rated assets, as outlined in the table below from 31 December 2012:

	AAA	AA	A	BBB	Below BBB	Not rated	Total
Credit risk exposure 2012	£m	£m	£m	£m	£m	£m	£m
Debt and other fixed income securities	3,006.2	402.0	1,712.3	1,126.5	33.6	32.5	6,313.1
Loans secured on residential property	-	-	-	-	-	415.3	415.3
Other	-	-	-	-	-	5.4	5.4
Deposits with credit institutions	-	-	-	-	-	14.6	14.6
Loans secured by policies	-	-	-	-	-	0.4	0.4
Other loans	-	-	-	-	-	0.3	0.3
Short-term deposits	-	37.5	250.2	-	-	50.9	338.6
	3,006.2	439.5	1,962.5	1,126.5	33.6	519.4	7,087.7
Reinsurance assets							
- non linked	-	285.0	89.7	1.0	-	36.0	411.7
- linked	-	35.5	-	-	-	-	35.5
	3,006.2	760.0	2,052.2	1,127.5	33.6	555.4	7,534.9

Operational cash generation

As at 31 December 2012, the Group had £0.4bn of cash and had substantial holdings of assets that are quoted on recognised markets of £2.5bn of listed shares and £6.3bn of listed debt securities. The Group only has £9.7m of third party debt as at 31 December 2012.

Increased profitability in the general insurance business meant that it was self funding in 2012, enabling it to return £38m of funds to the Group. The Group expects the general insurance business to continue to generate a cash surplus over and above its own funding requirements. This will be the main source of funds to cover the interest payments on the Subordinated Notes.

The table below summarises 2012 operational cash generation for LVFS on a standalone basis. Operational cash generation represents movements in free assets in the year (including cash and cash equivalents and surplus assets within funds in excess of matched liabilities). Operational cash generation excludes amounts attributable to RNPFN and also intra-group capital investments and repayments.

LVFS Operational Cash Generation	**2012 (£m)**
Life	(22)
GI surplus cash remitted in the year	38
Group items[(1)]	(16)
Tax paid	(13)
LVFS outflow before non recurring items and mutual bonus	**(13)**
Non recurring items[(2)]	22
LVFS net inflow before mutual bonus	**9**
Mutual Bonus	(21)
LVFS net outflow[(3)]	**(12)**

(1) Group items comprise centrally managed costs and also the net impact of the heritage with-profits business.

(2) Includes net impact of assumption changes and investment gains £51m, additional pension scheme contributions of £(21)m and PPI redress costs of £(8)m.

(3) Excludes intra-group capital investments and repayments.

New business strain on the Group's life business in 2012 resulted in a funding requirement for the business of £22m. This strain is expected to reduce going forward as a result of improvements in the Group's asset and liability matching process. Additionally, new business strain is expected to be increasingly offset by operational cash generation from the growing amount of in-force business. These changes should enable the life business to move towards being self financing and, in later years, cash generating.

Solvency and capital position

Capital position

As a regulated entity the Group's capital requirements are prescribed by PRA rules, which implement EU Insurance Directives and provide additional standards specific to the UK. These rules are explained in detail in the section entitled "*Regulation of the Issuer*" on page 104. Broadly, PRA regulatory capital rules define two different basis:

- "Pillar 1" which refers to the capital requirements an organisation must meet and is divided into "Peak 1" rules (based on EU minimum requirements and reflecting strict contractual liabilities) and

"Peak 2" rules (a realistic excess capital requirement specific to with-profits business, ascertained by a calculation of the "realistic" present value of the firm's expected future contractual liabilities together with projected "fair" discretionary bonus payments to policyholders and appropriate margin for risk); and

- "Pillar 2" which refers to a risk sensitive capital enhancement prescribed by the PRA which requires a firm to assess its capital requirements comparable to a 99.5% confidence level over a one year timeframe that the value of assets exceeds the value of liabilities (i.e. a "1 in 200" chance of insolvency).

The Group manages its capital resources to ensure it has capital to meet its business ambitions but also to ensure it can continue to trade through periods of market volatility.

The historic position on capital is shown below.

Capital Position, Pillar 1

	2010 (£m)	**2011 (£m)**	**2012 (£m)**	**2012 Proforma (£m)***
Available Capital Resources	1051	924	1080	1120
Capital Resources Requirement	760	689	894	894
Peak 2 Excess Capital Resources (excluding RNPFN surplus)	291	235	186	226
Capital Coverage[(1)]	138%	134%	121%	125%

**2012 proforma including a £40m post balance sheet increase in capital resources due to an asset previously held in an inadmissible service entity as at 31 December 2012. This asset is now admissible and the current capital position has increased by £40m as a result.*

(1) Capital coverage is capital resources over capital requirements.

Capital policy

The Group's capital management policy is to retain sufficient capital to meet the following key objectives:

- to ensure financial stability;
- to enable the Group's strategy to be developed;
- to give confidence to consumers and other stakeholders who have relationships with the Group; and
- to comply with capital requirements imposed by its UK regulator, the PRA.

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 the required benchmarks to ensure that sufficient capital is available to the Group. In the event that sufficient capital is not available, the Group has developed plans and management actions to improve the capital position.

Solvency II

Prior to recent announcements of delays to the UK implementation of Solvency II, the Group had worked with implementation and assurance partners (professional advisers providing additional resource and

expertise) to implement a full internal model submission to the FSA (its then regulator). The internal model and the embedding of the associated processes within the business had been taking place across the Group, with the FSA data audit (a review of the internal model) targeted to complete ahead of the submission. The Group was a participant in the QIS5 process and has representation on the Solvency II Internal Models Expert Group hosted by the FSA (now the PRA).

The Group is continuing to monitor the developments in the implementation of Solvency II following the announcement of the delay to implementation of the Solvency II rules. The Group is intending to apply for internal model approval once a clear implementation timetable is put in place by the EU Commission.

Risk Management

The Group's approach to risk management includes a statement of its risk appetite. This statement, *inter alia*, defines a corridor of capital that it wishes to maintain by risk and entity, and the Group regularly monitors and reports the position against risk appetite. If the Group's capital position moves outside of the defined risk appetite (such appetite being between 1.25x and 1.5x the ICA), the Group has a pre-determined and documented series of management options which it can take to restore the position.

During 2012 the Group undertook a number of actions to improve its capital position and to reduce the sensitivity of the capital position to market movements. Examples of actions taken include:

- refining the investment strategy in the Group's annuity book;
- hedging fixed interest exposure for the Group's ordinary branch pension annuity book within the with-profits business;
- hedging the majority of the Group's longevity risk in the Group's staff pension scheme; and
- hedging the majority of the Group's economic exposure to interest rates and inflation risk for the staff pension scheme.

In general, assets are matched to the emerging cashflows arising from insurance contract liabilities (calculated under Pillar 1), with reference to the nature of benefits under these insurance contracts. Volatility of capital is controlled through matching but also through risk management techniques such as equity derivatives to reduce exposure to potential falls in equity markets.

Summary of the key sensitivities to market risks and changes in assumptions

The table below sets out the impact as at 31 December 2012 on Pillar 1, Peak 2 working capital for key market risk movements and changes in assumptions for long-term insurance contracts. The figures exclude the impact of short term equity hedges and also any impact from the staff pension scheme.

Sensitivity analysis to movements in key market sectors	**Impact on Peak 2 working capital (£m)**
Equity values fall by 20%	**(43)**
Property values fall by 12.5%	**(9)**
Credit spreads increase by 100bps	**(41)**
15 year Gilt yields fall by 40bps	**(12)**

Sensitivity analysis for the change in assumptions used in long-term insurance contracts	**Impact on Peak 2 working capital (£m)**
Longevity: reduction in base mortality rates of 10% (gross of reinsurance)	**(57)**
Longevity: reduction in base mortality rates of 10% (net of reinsurance)	**(39)**
Increase in assured lives mortality rates of 10%	**(5)**
Increase in morbidity rates by 20%	**(32)**
Reduction in withdrawal rates (persistency) by 25%	**(13)**

Reserving

The Group holds technical reserves to ensure it has sufficient funds available to pay its technical liabilities when they fall due.

For investment and long-term insurance contracts, the liability is based on assumptions reflecting the best estimate at the time, allowing for a margin of risk and adverse deviation. The assumptions used for mortality, morbidity and longevity are based on standard industry or reinsurers' tables, adjusted where appropriate to reflect the Group's own experience. In particular, for impaired annuities, the mortality assumptions are based on reinsurers' tables and the Group's own experience with an individual loading applied depending on the nature of the impairment. The assumptions used for investment returns, expenses, lapse and surrender rates are based on current market yields, product characteristics and relevant claims experience. The assumptions used for discount rates are based on current industry risk rates, adjusted for the Group's own risk exposure. Due to the long term nature of these obligations, the estimates are subject to significant uncertainty.

For general insurance contracts, estimates are made for the expected ultimate cost of claims reported and the cost of claims incurred but not yet reported ("**IBNR**") 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. 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 developments in earlier years and expected loss ratios. Allowance for one-off occurrences or changes in legislation, policy conditions or portfolio mix, are 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.

The methodology and assumptions used to calculate the technical reserves are reviewed and approved by LVFS' Audit Committee.

Mutual Bonus Scheme

The Group declared a mutual bonus of £20.9m in March 2013 in respect of 2012. This followed its first mutual bonus for 2011, which was declared in two tranches: £10m was declared in May 2011 and £8.6m was declared in April 2012, totalling £18.6m for 2011.

The decisions as to whether to declare a mutual bonus, the level of the mutual bonus, and how the mutual bonus is to be allocated among categories of member of the Group, are made by the Board of the Issuer, based on a recommendation from management. This has regard, *inter alia*, to both the level of underlying operating profits during the year and the Group's prevailing financial position. The declaration of a mutual bonus does not entail an immediate cash payment. Instead, any mutual bonus forms part of the proceeds paid when the policy is discontinued (or, in the case of annuities, part of each payment of the annuity), or such other trigger points for distribution as the Board may determine occur.

Ratings

The Issuer's rating from Standard & Poor's Credit Market Services Europe Limited ("**S&P**") is BBB+.

A rating is not a recommendation to buy, sell or hold securities and may be subject to suspension, reduction or withdrawal at any time by the assigning rating agency. The credit ratings included or referred to in this Prospectus have been issued by S&P which is established in the European Union and registered under Regulation (EC) No. 1060/2009 of the European Parliament and of the Council of 16 September 2009 of credit rating agencies.

Potential Restructuring

The Group has considered restructuring options for the sustainability of its business and operations in the future in response to previous changes to COBS 20 and the recent FSA proposals (see the section entitled "*Regulation of the Issuer*" on page 104 which describes recent FSA proposals for with-profits business within mutual insurers such as the Issuer). These have included a possible creation of a mutual capital fund within the Issuer as envisaged by the FSA in its recent consultation paper 12/38 of December 2012. However, at the present time, the Group is not actively considering restructuring options. Any such restructuring resulting in the creation of a mutual capital fund would not impact the terms of the Subordinated Notes (including the degree of subordination), which would remain as set out in the Terms and Conditions, or have any material adverse effect on the cash flows of LVFS available to service the Subordinated Notes.

Management

Directors

The Issuer is committed to maintaining a majority of independent non-executive directors on its Board. The Board’s composition is kept under review with a view to maintaining this balance as additional executive appointments are made. The Issuer's Board of directors is composed as follows:

Dennis Holt, Chairman, Non-Executive Director

Dennis’ experience in banking and insurance spans 36 years as an executive and a further seven as a non-executive director, involving a wide-range of economic and competitive environments. He spent 31 years at Lloyds TSB including as retail banking director on the main board. This was followed by five years at AXA as UK chief executive and a member of the global executive committee. In his six years as LVFS’ chairman he has led the Board as it has repositioned the business and delivered on its growth and profit ambitions. Dennis is also chairman of Beazley plc.

Member of the Risk Committee and the Remuneration and Nomination Committees.

Dennis will be replaced as chairman on 23 May 2013 by Mark Austen (see below).

Michael John Rogers, Group Chief Executive, Executive Director

After graduating from Cambridge University in 1986 Mike spent 20 years working for Barclays Bank where he carried out a variety of roles in the UK and overseas. Among his senior appointments at Barclays, Mike was managing director of Small Business, Premier Banking and UK Retail Banking, achieving a post-graduate Diploma in Leadership from Exeter University in 1995. In May 2006 he joined LVFS as chief executive, helping to transform the business and leading it into profitability.

Member of the Investment and Nomination Committees

Philip Wynford Moore, Group Finance Director, Executive Director

Having held executive positions at several leading financial institutions, Philip's career in insurance has spanned over 30 years. He has extensive knowledge in areas such as risk management, finance, actuarial functions and asset management, and was group finance director and latterly chief executive at Friends Provident plc. He was appointed group finance director at LVFS in 2010 joining from the Pensions Corporation where he was group finance partner and chief risk officer. As well as being part of the board and executive team at LVFS, Philip is also a non-executive director of Towergate Partnership Ltd.

Member of the Investment Committee.

Richard Rowney, Managing Director of Life and Pensions, Executive Director

Richard has a first class honours degree and spent 14 years at Barclays Bank, holding a number of senior positions across corporate and retail banking which included overseeing the integration of the Woolwich and Barclays' retail banks. He joined LVFS in 2007 as chief operating officer, transforming the operational support areas to ensure the growing trading businesses would be better supported going forward. Richard was appointed managing director of LVFS' life business in 2010 and is also vice-chairman of Bournemouth and Poole College, the eighth largest education college in the UK.

Member of the Investment Committee.

John O'Roarke, Managing Director of General Insurance

John qualified as a chartered accountant and has spent 25 years in the insurance industry. He worked for Churchill Insurance for 13 years where he was finance director and then managing director, leading the company to become one of the UK's best known insurers. John was appointed chief operating officer of RBS Insurance in 2003 but left RBS in 2005 to set up ABC Insurance, which was acquired by LVFS in 2006. He became managing director of LVFS' general insurance group in the same year.

Mark Austen, Senior Independent Non-Executive Director

Mark qualified as a chartered management accountant in 1972 and spent the majority of his career at PricewaterhouseCoopers managing their global financial services consulting business. His broad range of skills across several disciplines includes advising organisations on their strategies, acquisitions, operations, HR policies and technology. As well as being nominated as LVFS' next chairman, Mark is also a non-executive director of Standard Bank plc and Mott McDonald Group Ltd.

Chairman of the Risk Committee and a member of the Audit, Investment and Remuneration and Nomination Committees.

John Edwards, Non-Executive Director

John's career in the insurance and investment sector spans over 35 years. His past roles include chief executive of Clerical Medical Investment Group, chief executive of the HBOS Insurance and Investment

Division and chief executive of International Financial Services at Lloyds Banking Group. He has also served as a non-executive director of St James's Place and Esure. As well as his position on the LVFS board, he is a non-executive director of Nottingham Building Society and he also chairs their Risk Committee.

Chairman of the Investment Committee and member of the Risk Committee.

Caroline Burton, Non-Executive Director

Caroline has a strong 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 is also a non-executive director of Rathbone Brothers plc, TR Property Investment Trust plc and Blackrock Small Companies Investment Trust plc.

Member of the Audit Committee and the Investment Committee.

Cath Keers, Non-Executive Director

Cath has over 20 years marketing and sales experience having worked at O2, BskyB, Next and Avon. In 2008 she won a lifetime achievement award for her outstanding impact during her career at O2, where she was customer director in charge of refocusing the organisation's customer strategy. She brings a wealth of retail industry expertise to the LVFS board and holds other non-executive positions at Telefonica O2 Europe, Royal Mail and the Home Retail Group (for Homebase and Argos).

Chairman of the Remuneration and Nomination Committees and a member of the With-Profits Committee.

James Dean, Non-Executive Director

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 Ernst & Young, he dealt with clients such as AXA, Prudential, Legal & General, RSA and Aviva, 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.

Chairman of the Audit Committee and member of the Risk Committee.

Conflicts of Interest

There are no conflicts of interest between the duties of the directors listed above to the Issuer and their private interests or other duties.

Regulation of the Issuer

Introduction

The Issuer is a United Kingdom authorised life insurance undertaking and is subject to the regulation and supervision of the PRA and FCA under a regulatory regime prescribed in the Financial Services and Markets Act 2000, as amended, with implementing statutory instruments ("**FSMA**"). The Issuer must also comply with the rules made by the PRA and FCA under powers granted by FSMA. There are a number of regulatory handbooks, but some important sources of these rules, and accompanying guidance, include (but are not limited to) the General Prudential Sourcebook ("**GENPRU**") and the Prudential Sourcebook for Insurers ("**INSPRU**"), the Conduct of Business Sourcebook ("**COBS**") and the Insurance: Conduct of Business Sourcebook ("**ICOBS**"), and the PRA and FCA's principles for businesses which apply to all firms regulated by those regulators.

Permission to transact business

Subject to certain exemptions, no person may carry on insurance business in the United Kingdom, unless permitted to do so by the PRA (acting with the consent of the FCA). The PRA and FCA, in deciding whether to grant permission, are required to determine whether the applicant satisfies the threshold conditions set out in Schedule 6 of FSMA to be engaged in insurance business and, in particular, whether the applicant has and will continue to have appropriate resources and that it is and will continue to be a fit and proper person having regard to the objectives of the PRA and the FCA (including in both cases whether those who manage the applicant's affairs have adequate skills and experience and that such affairs are conducted soundly and with probity). A permission to carry on insurance business may be subject to such requirements as the PRA (with consent to the FCA) considers appropriate.

In specific circumstances, the PRA and/or FCA may vary or cancel an insurer's FSMA permission to carry on a particular class or classes of business or insurance business generally. The circumstances in which the PRA and/or FCA can vary or cancel a FSMA permission include a failure to meet the threshold conditions or where such action is desirable in order to protect the interests of consumers or potential consumers.

The Group also carries out other activities, including arranging deals in investment products for advisers, which require permission from the FCA under FSMA.

Regulatory Reporting

Friendly societies incorporated in the UK have to prepare their accounts in accordance with special provisions applicable to them under the Friendly Societies Act 1992 ("**FSAct**"), and are required to file audited financial statements and related reports. Each insurance company in the Group is separately required to deposit with the PRA an annual return comprising audited accounts and other prescribed documents for the end of each financial year which provides a separate analysis of regulatory capital resources of the relevant insurance company and the Group (see "*Prudential Regime*" below). Both the annual accounts and PRA returns are made available on the Group's website.

Principles and Practices of Financial Management

All UK providers of with-profits life policies, such as the Issuer, are required by the FCA to document and make available the principles and practices of financial management ("**PPFM**") that describe how they operate their UK with-profits business. The areas that need to be covered in the PPFM are prescribed by the FCA in COBS 20.3 and must be set out in terms of "principles" (enduring statements of the overarching standards that apply) and "practices" (more detailed statements on the current approach adopted). The PPFM must cover, among other things, amounts payable under a with-profits policy, investment strategy, exposures to business risk and charges and expenses. In addition, the Issuer must publish Consumer Friendly Principles

and Practices of Financial Management, which provide information to with-profits policyholders or potential policyholders in a format that they can more readily understand.

Prudential Regime

The PRA's rules which govern the prudential regulation of insurers are found mainly in GENPRU and INSPRU. Overall, the requirements are intended to align the capital adequacy requirements for insurance businesses more closely with those of banking and investment firms and building societies, for example, by addressing tiers of capital, rather than looking at net admissible assets. The capital requirements are set out in "**Pillar 1**" rules (based on EU and PRA requirements) and "**Pillar 2**" rules (a risk sensitive approach prescribed by the PRA).

The Pillar 1 rules require that insurance companies maintain assets sufficient to meet their relevant capital requirement at all times in respect of both any long-term insurance and general insurance business undertaken by the insurance company, the calculation of the requirement in any particular case being dependent on the type and amount of insurance business that the company writes. The method of calculation of the Pillar 1 capital requirement is set out in GENPRU and INSPRU, and the level of an insurer's capital resources is also determined in accordance with the rules set out in those Sourcebooks. Failure to maintain the Pillar 1 capital resources requirement (or any additional requirements imposed at Pillar 2) is one of the grounds on which wide powers of intervention conferred upon the PRA may be exercised.

Under the Pillar 1 rules, an insurer must hold capital resources equal at least to the minimum capital requirement (the "**MCR**"). Insurers with with-profits liabilities of £500m or more ("realistic basis firms") must hold capital equal to the higher of the MCR and the Enhanced Capital Requirement (the "**ECR**"). The ECR is intended to provide a more risk responsive and ''realistic'' measure of a with-profits insurer's capital requirements, whereas the MCR is broadly speaking equivalent to the minimum EU standards.

Further explanations of the MCR and ECR as they affect long term insurers are set out below.

Minimum Capital Requirement

MCR represents the minimum EU standard and is the higher of (i) the base capital requirement and (ii) the sum of the "long term insurance capital requirement" ("**LTICR**") and the "resilience capital requirement".

The base capital requirement for a life insurance undertaking is an EU specified minimum capital requirement (expressed as an absolute amount in Euro); which is relevant only for smaller insurers regulated by the PRA. The precise formula for the calculation of the LTICR varies for different classes of business, but normally the most significant component is calculated as a percentage of the mathematical reserves held by the insurer. The risk components comprising the LTICR are: death risk, health risk, insurance expense risk and market risk. Mathematical reserves are, in effect, the insurer's provisions for its life insurance liabilities setting off expected future cash flows (premium income) from in-force business. The general principle is that mathematical reserves must be set using an actuarial valuation on prudent assumptions.

*Enhanced Capital Requirement ("**ECR**")*

This is intended to operate as a separate, more risk sensitive measure than the MCR. In overview, the ECR for long term insurers only applies as a prudential requirement if the firm has with-profits liabilities of £500m or more (as referred to above, such firms, the Issuer being an example, are known as "realistic basis firms"). Determination of the ECR for realistic basis firms involves the comparison of two separate measurements of the firm's financial resources requirements, which the PRA refers to as the "twin peaks" approach. The term twin peaks reflects the fact that capital is determined by reference to the more onerous of the two bases ("regulatory" and "realistic") for calculating liabilities and excess capital required by the firm. The regulatory basis reflects strict contractual liabilities whereas the realistic basis includes discretionary but expected benefits, including those required to treat customers fairly.

The "**Peak 1**" or regulatory excess capital is determined by calculating the excess of the regulatory value of assets of the fund over the sum of (A) the regulatory value of the liabilities of the fund and (B) the LTICR. This is essentially the financial resources of the firm measured on the EU basis.

The "**Peak 2**" or realistic excess capital is determined by reference to the "realistic" present value of the firm's expected future contractual liabilities together with projected "fair" discretionary bonus payments to policyholders. The assessment of what is a "fair" discretionary bonus payment will reflect what is required to treat the policyholders fairly. With-profits insurers have to publish their PPFM setting out how they intend to exercise their discretion under with-profits policies. In addition, the PRA requires a margin or buffer to be added to the realistic liabilities to cater for risk. This is called the risk capital margin ("**RCM**"), and addresses risk factors such as market, credit and persistency risks, the effect of which could otherwise render the realistic calculation insufficient. The realistic liabilities and RCM are added together and subtracted from the realistic value of assets.

If the realistic excess capital is lower than the regulatory excess capital for any of an insurer's with-profits funds, then the difference will give rise to a capital requirement known as the "with-profits insurance capital component" ("**WPICC**") to cover the difference. In this case, the ECR for a realistic basis firm is the sum of the LTICR and the WPICC for each fund (which will be aggregated to provide an overall WPICC). Otherwise, there will be no WPICC and the EU-based MCR approach will be applicable.

For a realistic basis firm, whether the regulatory or the realistic approach produces the higher overall financial resources requirement for any given with-profits fund depends largely on the prevailing market conditions and the degree of prudence in the calculation of the mathematical reserves.

Pillar 2 - Individual Capital Assessment

In addition to the Pillar 1 capital resources requirement, the PRA's rules require an insurer to prepare and submit to the PRA its own assessment of its capital requirements, known as an Individual Capital Assessment ("**ICA**"), based on the risks it faces. Firms are required to conduct stress and scenario testing to determine the overall adequacy of their financial resources and make a reasonable assessment of the capital needs for their business overall. The ICA rules require firms to include an assessment comparable to a 99.5% confidence level over a one year timeframe that the value of assets will exceed the value of liabilities (i.e. a "1 in 200" chance of insolvency), whether or not this is the confidence level otherwise used in the firm's own assessment of its risks.

The PRA will use the ICA in order to form its own view (at Pillar 2) of a firm's capital requirements and, if it disagrees with the ICA, it will issue Individual Capital Guidance ("**ICG**") which it can impose as a requirement in addition to those under Pillar 1. ICG is only guidance (and not a formal prudential requirement) although the PRA has indicated that it would expect to be notified of a failure to maintain capital at a level advised in the ICA (or ICG, if applicable) and, on becoming aware of such a failure, the PRA has indicated that it expects to require firms to set out a plan to restore adequate capital.

Separation of assets requirement

Long-term business assets and liabilities – those assets and liabilities relating to, broadly, life and health insurance policies – must be segregated from the assets and liabilities attributable to non-life insurance business, if conducted in the same company, or to shareholders of a proprietary company. Separate accounting and other records must be maintained and a separate fund must be established to hold all receipts of long-term business. The extent to which long-term fund assets may be used for purposes other than long-term business is restricted by the rules in INSPRU. Only the "established surplus" – the excess of assets over liabilities in the long-term fund, as determined by an actuarial investigation – may be transferred so as to be available for other purposes. The Issuer maintains its non-life insurance business in subsidiary companies. As a mutual there are no shareholder funds within the Issuer and its long term business is comprised in one common fund

along with its other assets and liabilities. As the single fund contains with-profits business, it qualifies as a with-profits fund for regulatory purposes and is subject to additional regulation under the FCA Conduct of Business Rules (see further below).

Admissible Assets and Capital Adequacy Rules

PRA rules govern the types of assets that can be used by an insurer to meet its regulatory capital requirements, along with the maximum permitted exposure levels to certain assets and counterparties. In addition the capital that makes up an insurer's capital resources is classified into "Tiers" based on the quality of capital in terms of factors such as its persistency and loss-absorbency.

Tier 1 capital typically comprises permanent share capital and certain perpetual preference shares issued by the firm, or in respect of the Issuer, certain reserves and member contributions and deposits. Tier 2 capital is broadly other types of preference shares and subordinated debt issued by the firm, with a split between upper Tier 2 for perpetual instruments and lower Tier 2 for fixed term instruments. The rules in GENPRU provide several requirements for capital instruments to qualify as upper or lower Tier 2 and it is intended that the Subordinated Notes qualify as lower Tier 2 capital for the Issuer. The calculation of capital resources excludes both the amount of Tier 2 capital which exceeds the amount of total Tier 1 capital after deductions together with the amount of lower Tier 2 capital which exceeds 50% of the amount of total Tier 1 capital after deductions.

PRA rules require that the Issuer must ensure that at least 50% of the MCR is constituted by total Tier 1 capital after deductions and 75% of the MCR is constituted by Tier 1 and upper Tier 2 capital. One third of the LTICR of the Issuer must be met by Tier 1 and Tier 2 capital.

The Insurance Groups Directive ("IGD")

The IGD (as amended by the Financial Groups Directive and the Reinsurance Directive) sets out supervisory arrangements (implemented in the UK via INSPRU) for insurance companies falling within a group. The IGD contains further provisions for monitoring intra-group transactions, including at least annual reporting of significant transactions. Insurers are also required to have appropriate internal control mechanisms to allow the production of data/information relevant to supervision under the IGD.

Solvency II

The Solvency II Directive (2009/138/EC), an insurance industry directive adopted by the EU in November 2009 ("**Solvency II**") and subsequently amended in September 2012 (2012/23/EU), will provide a new prudential framework for insurance companies. The new approach will be based on the concept of three pillars - minimum capital requirements, supervisory review of firms' assessment of risk, and enhanced disclosure requirements - and will cover valuations, the treatment of insurance groups, the definition of capital and the overall level of capital requirements. A key aspect of Solvency II is that the assessment of risks and capital requirements will be aligned more closely with economic capital methodologies, and will allow insurers to make use of internal capital models, if approved by the PRA. There remains considerable uncertainty surrounding the interpretation of the provisions of Solvency II with more detailed level 2 implementing measures, binding technical standards and non-binding standards, guidance at level 3 and/or delegated acts yet to be finalised. The "Omnibus II Directive" is expected to be adopted by the EU during 2013 (the European Parliament have scheduled the plenary vote on the Omnibus II Directive for 22 October 2013) which will, amongst other things, amend Solvency II in respect of the powers of the European Insurance and Occupational Pensions Authority ("**EIOPA**"), the new European Supervisory Authority, responsible for insurance. Although full implementation of Solvency II has been delayed until at least 2015, EIOPA are currently consulting on the phased introduction of specific aspects of the Solvency II requirements into national supervision from 1 January 2014, in advance of the full implementation of the Solvency II regime. These include systems of governance and the forward looking assessment of the undertaking's own

risks, but not the capital calculations themselves. One of the key reasons for delay, and still causing uncertainty, is the treatment of long term guarantees. EIOPA launched an impact study in respect of the current proposals at the end of January 2013 and the results of this are expected to be reflected in the Omnibus II proposals.

Conduct of Business Regulation

Conduct of Business; General regulation

The Conduct of Business Rules issued by the FCA, set out in ICOBS and COBS, apply differing requirements to the sale of (i) general and (ii) long-term insurance contracts respectively. More stringent requirements apply where the contract has an investment value or otherwise gives rise to mis-selling problems. Authorised firms which advise and sell packaged products (such as life insurance policies) are subject to detailed conduct of business obligations relating to product disclosure, assessment of suitability for private customers, the range and scope of the advice which the firm provides, and fee and remuneration arrangements. These conduct of business rules are supplemented by the FCA's principles for businesses of which the FCA maintains the principle that firms should provide information to consumers which is clear, fair and not-misleading and treat customers fairly (see below). The principles are actionable as rules by the FCA and/or PRA following a perceived breach by the firm. In recent years, conduct of sales of insurance products have come under greater scrutiny from the FSA resulting in an increase in the fines levied on firms by the FSA and compensation orders made against firms from the financial ombudsman service (the "**FOS**") for breaches of conduct of business rules and the principles. The prime example is the extensive regulatory review and subsequent fines levied and compensations orders made in relation to the sales of PPI products.

In general, the Conduct of Business Rules govern the sale of new policies. They also include, however, rules applicable in the course of administration of insurance by the Group relating to:

- information to be provided to existing policyholders;
- cancellation rights;
- the handling of claims;
- treating with profit policyholders fairly; and
- pensions transfers and the open market option,

which may apply regardless of whether or not the insurer is actively selling its products.

Conduct of Business; Treating customers fairly and with-profits

One of the operational objectives of the FCA, as established by FSMA, is securing the appropriate degree of protection for consumers. Consequently the fair treatment of customers is a key objective for the FCA and all authorised insurance companies are under a regulatory duty to pay due regard to the interests of their customers and treat them fairly. This duty exists alongside other, more specific, rules contained in the prudential regime and is increasingly being seen by the regulator and authorised insurance companies as governing all aspects of an insurance company's dealings with its customers. Except in relation to with-profits policyholders, the meaning of the duty has not been further defined beyond the ordinary English meaning of the word "fair" although the regulator has published examples of what in their view constitutes fair treatment in a series of case studies.

In relation to with-profits business, detailed rules to ensure with-profits policyholders are treated fairly are set out in COBS 20.2. The rules govern, among other things:

- the calculation of amounts payable to with-profits policyholders;

- distributions from the with-profits fund (including the "required percentage" of distributions which must be made to policyholders) and excess surplus;
- market value reductions to units of a with-profits policy;
- charges which may be made to with-profits funds;
- new business and material changes to the fund (the requirement to ensure new business or material changes are not detrimental to existing with-profits policyholders);
- investment strategy of fund assets; and
- the process for revaluations of the surplus assets maintained in the fund and available to meet policyholder expectations (reattributions).

There is also the obligation to maintain written PPFM for each with-profits fund which ensures fairness to policyholders by setting out the firm's principles and practice in managing the fund (see "*Principles and Practices of Financial Management*" above). The COBS rules governing with-profits business have been amended to enhance protection for policyholders, as set out below.

More recently rules were introduced from April 2012 which seek to establish more clarity regarding the participation of with-profits policyholders in surpluses arising within the fund (see "*Risk Factors – New rules regarding the protection of with-profits policyholders generally and guidance relating to the fair treatment of with-profits policyholders by mutual insurance companies may adversely impact the operations of the Group and increase its costs*"). A default position is established for both mutual and proprietary companies being an interest of 90 per cent. of the total available for distribution. Firms are required to take reasonable care to ensure all aspects of operating practice are fair to the interests of with-profits policyholders and do not lead to an undisclosed, or otherwise unfair, benefit to shareholders or to other persons with an interest in the with-profits fund, including in the case of mutuals, the members of the mutual.

When accepting new business in a with-profits fund, such new business should have "no adverse effect" on with-profits policyholders' interests. Firms must provide appropriate analysis and evidence to support their conclusions. Guidance states, however, that new business is not automatically adverse and certain factors (such as new business being financially self-supporting) indicate that new business is not adverse, whilst others (such as business priced on loss making terms) indicate that the new business will be adverse.

Restrictions on strategic investments for with-profits firms require that the firm's governing body must be satisfied, so far as it reasonably can be, and can demonstrate, that the purchase or retention of strategic investments is likely to have "no adverse effect" on the interests of with-profits policyholders. Guidance to this rule requires analysis of, amongst other things, the relative size of the investment, rate of return, investment risks, costs of divestment and the view of the with-profits actuary. This could present challenges for an insurer where its with-profits fund holds a "strategic investment" which is connected in some way with the firm's business, e.g. an office building used by the firm, or stakes in businesses whose commercial interests are aligned with those of the firm's owners, such as investment management companies or general insurance subsidiaries and advisory businesses, and will increase the amount of scrutiny required to maintain and invest in such strategic investments. This may cause particular difficulties for mutuals such as the Issuer which have no other funds in which those investments can be held. As a result of these requirements the Board of Directors of the Issuer formally reviews its strategic investments, which, at the current time have been determined by the Board of Directors to consist in its general insurance subsidiaries, annually in order to assess whether the continued retention of such strategic investments is in the interests of with-profits policyholders.

Rules and guidance also regulate possible conflicts between with-profits policyholders and members of a mutually-owned firm, for example, the Supervision Sourcebook requires active management and minimisation of these conflicts by the firm.

Impact on Mutual Insurers, such as the Issuer

COBS 20 applies to mutual with-profits insurers in the same way as it does to proprietary insurers. In 2008 the FSA launched what was termed "Project Chrysalis" and, in this context, published "Dear CEO" letters in October 2009 and September 2010 which related to the fair treatment of with-profits policyholders in mutually-owned with-profits funds. Many mutual firms have expressed concerns to the FSA that the proposed amendments to COBS 20 would cause particular difficulties for mutuals. The industry also questioned the reasoning applied by the FSA in Project Chrysalis in determining the interests of policyholders in the with-profits fund.

In December 2012 the FSA published a consultation paper (CP12/38) entitled "Mutuality and with-profits: a way forward", which dealt with the issues faced by mutual insurers under the COBS 20 regime. The consultation proposes a more positive outcome for the Issuer, including within COBS 20 detailed provisions whereby mutuals operating a single common fund, such as the Issuer, may apply to the FCA for a modification (under the statutory procedure set out in FSMA, as modified) to modify the application of COBS 20 to the conduct of their business. The proposals suggest a mutual will have to satisfy several tests in addition to the statutory requirements under FSMA which include demonstrating the modification will not amount to a reattribution, will be fair to policyholders and consistent with their due benefits, will comply with the constitutional documents of the mutual and will not disadvantage policyholders compared to those of a proprietary (i.e. non-mutual) with-profits fund. The firm would also require the report of an independent expert and engagement with policyholders. In order to obtain any modification consultation with the PRA will also be required. These proposals are at an early stage but should provide a mechanism for separating the working capital of a mutual writing business other than with profits business from its with profits fund. See "*Risk Factors – New rules regarding the protection of with-profits policyholders generally and guidance relating to the fair treatment of with-profits policyholders by mutual insurance companies may adversely impact the operations of the Group and increase its costs*" for a description of the risks involved in the process for obtaining the waiver and the risks of being dependent on such a waiver not being revoked by the FCA.

Data Protection

The Group's business involves the management of data from policyholders and other third parties and the provisions of the Data Protection Act 1998 regulate the use of such data by the Group, including requirements upon the gathering and holding of personal data and restrictions on disclosure. The UK Information Commissioner's Office ("**ICO**") oversees and enforces this legislation, along with the supervision of the FCA in the conduct of the Group in relation to certain data security matters, and the Group is therefore subject to the regulatory oversight of the ICO and FCA in its compliance.

Supervision and Enforcement

The PRA and FCA have extensive powers to supervise and intervene in the affairs of an insurance company under FSMA. For example, they can require firms to provide information or documents to it or prepare a ‘‘skilled persons’’ report (a power which has recently increased in scope under FSMA and is likely to be increasingly used). They can also formally investigate a firm. The PRA and FCA have the power to take a range of disciplinary enforcement actions, including public censure, restitution, fines or sanctions and the award of compensation. From recent publications of the PRA and FCA, the method of supervision will shift to a key risks approach by each regulator and the "ARROW" supervisory process will change to a form of continuous supervision. Such ongoing supervision is intended to become more intrusive, for example, in the

FCA's remit, by analysis of an insurer's product development and a new business model assessment procedure.

Compensation Scheme

Insurance companies are subject to the Financial Services Compensation Scheme (the "**FSCS**"), which seeks to protect policyholders when a UK authorised firm is unable or is likely to be unable to meet its financial obligations. Most claims made in respect of insurance business will also be protected if the business was carried out from the UK or, in another EEA State, from a branch of an insurer authorised by the PRA. The FSCS is funded by levies on authorised UK firms. Generally, companies subject to the FSCS make provisions for their share of the levies. Such provisions are often based on estimates of a company's market participation in the relevant charging periods and the interest the FSCS will pay on the facilities provided by the UK Treasury in support of its obligations.

In relation to insurance business in particular, there are detailed provisions which govern the amount to be paid on a failure by the firm and with-profits policyholders will obtain only a percentage (usually 90%) of their guaranteed benefits. The FSCS, on a failure of an insurer, is obligated to attempt to transfer the insurance business to another insurer before paying compensation.

Recent Regulatory Developments in the UK

The provisions of the Financial Services Act 2012 (the "**Act**") came into force on 1 April 2013. For the purposes of the regulation of insurers, the Act splits the regulatory parameter previously covered by the FSA between the PRA, a new prudential regulator, and the FCA, a conduct regulator as successor to the FSA. For insurance mediation the FCA is the prudential and conduct regulator. New powers for the PRA and FCA implemented by amendments to FSMA will allow them to take judgment focused pro-active intervention to avoid risks of financial instability and consumer and market detriment. For example, the FCA has extensive product banning powers which will allow it to intervene by making orders (in some cases at short notice without approval of Parliament or pre-publication to the market) and stop the issue of insurance products which are causing, or likely to cause, consumer or market detriment. As regards with-profits business, there is a separate memorandum of understanding between the FCA and the PRA which recognises the difficult balance in the allocation of discretionary awards to with-profits policyholders. The memorandum sets out in detail how the regulators will reach decisions and set rules in respect of with-profits regulation and broadly allocates responsibility of ensuring fairness to policyholders to the FCA and ensuring the overall financial soundness of decisions in respect of the liabilities of the with-profits firm to the PRA. However, it is clear that each regulator will assess the firm against the relevant objectives of the regulator, which may increase time and compliance costs in the regulation of with-profits along with the ability of the firm to take strategic decisions. The PRA has a special overriding power in respect of with-profits under FSMA, whereby the PRA may stop the FCA from exercising its powers in relation to a with-profits firm where the PRA considers it necessary to advance the PRA's general or insurance objective, which would resolve any deadlock. The Financial Services Act 2012 (Mutual Societies) Order 2013 has amended the Friendly Societies Acts 1974 and 1992 to reflect the move of the responsibilities of the FSA in relation to friendly societies to the PRA and FCA. Other changes, by way of statutory instruments and updates to the regulatory handbooks, are expected to fully implement the new regulatory regime.

Insolvency Regime

The Issuer is an incorporated friendly society and is therefore governed by a special insolvency regime under the FSAct. Section 23 of the FSAct applies parts of the companies winding-up legislation contained in the Insolvency Act 1986 ("**IA**") to the winding-up of a friendly society, subject to certain modifications under Part II and Schedule 10 of the FSAct. Consequently, an incorporated friendly society (such as the Issuer) may be wound-up voluntarily or by the court, as if it were a registered company. Friendly societies are not able to

have an administrative receiver appointed. The administration or creditor voluntary arrangement regimes may be applied to friendly societies, but only by an order made by the UK Treasury with the concurrence of the Secretary of State. To date, no such orders have been made. On the insolvency of an incorporated friendly society, every present member is liable to contribute to the assets of the friendly society, to the extent necessary for payment of the society's debts and liabilities and the expenses of the winding-up (section 74 IA). However, members are only liable to contribute the amount of any subscription to the society which is still outstanding (paragraph 8, schedule 3, FSAct). Under the IA, various provisions set out the statutory order for payment of debts on a winding-up, which state that the order of priority is as follows: fixed charge holders, expenses of the winding up, preferential debts (employee's remuneration and occupational pension scheme contributions) and floating charge holders will be paid ahead of unsecured creditors and, following satisfaction of unsecured creditors' claims, any surplus will be distributed amongst shareholders by way of dividend.

As general insolvency law applies to friendly societies, the members of the Issuer (in their rights as members rather than policyholders) will be treated in the same way as shareholders and will be paid last in the event of a winding-up, behind all other unsecured creditors. This is also reflected in the constitution of the Issuer.

In addition, the Issuer is also governed by the Insurers (Reorganisation and Winding Up) Regulations 2004 (the "**Regulations**") in its capacity as an insurer. These Regulations implement the Insurers (Reorganisation and Winding-up) Directive 2001/17/EC (the "**Directive**").

On the winding-up of an insurer, the order of priority of claims is modified from the normal position under UK general insolvency law, such that the debts of the insurer must be paid in the following order: preferential debts, followed "insurance debts" followed by all other debts.

An "insurance debt" is defined as a debt to which a UK insurer is, or may become liable, pursuant to a contract of insurance, to any person who has a direct right of action against that insurer, including policyholders. This also covers any premium paid in connection with a contract of insurance, which the insurer is liable to refund. Insurance debts will rank *pari passu* and, if there are sufficient assets remaining after payment of the preferential debts, must be paid in full (or in equal proportions in circumstances where there are insufficient assets). Claims of policyholders of the Issuer, including with-profit policyholders' reasonable expectations (calculated on an actuarial basis) will rank ahead of any other unsecured creditors on a winding-up on this basis. This principle does not apply to reinsurance contracts.

Further provisions under the FSAct govern friendly societies undertaking life insurance, such as the Issuer. Section 24 provides that on the winding-up of an incorporated friendly society carrying on long-term business, the liquidator shall ensure the continuation of this business, with the intention of it being transferred as a going concern to another insurance undertaking. In doing so, the liquidator cannot create any new contracts of insurance, although they may effect variations to existing contracts.

The FSAct also enables the creation of "rules" under section 411 IA in relation to friendly societies, for the purposes of giving effect to applicable winding-up legislation. Neither the Insolvency Rules 1986 nor the Insurance (Winding Up) Rules 2001 apply to friendly societies and, at the present date, no separate set of rules have been created for friendly societies under section 411 IA.

Furthermore, on the winding-up of an insurer, policyholders are likely to be protected by the FSCS to the extent described above. The FSCS does not, however, cover claims under the Subordinated Notes.

Use of Proceeds

The net proceeds of the issue of the Subordinated Notes will be used by the Issuer for general corporate purposes.

The expenses in connection with the transaction are expected to amount to £5,040.00.

Taxation

United Kingdom Taxation

The following is a summary of the United Kingdom withholding taxation treatment as at the date of this Prospectus in relation to payments of interest in respect of the Subordinated Notes. It is based on current United Kingdom tax law, as applied in England and Wales, and published practice of Her Majesty's Revenue and Customs ("**HMRC**"), which may be subject to change, sometimes with retrospective effect. The comments do not deal with other United Kingdom tax aspects of acquiring, holding or disposing of the Subordinated Notes. The comments relate only to the position of persons who are absolute beneficial owners of the Subordinated Notes, hold such Subordinated Notes as investments and are not connected to the Issuer. The following is a general guide for information purposes and should be treated with appropriate caution. It is not intended as tax advice and it does not purport to describe all of the tax considerations that may be relevant to a prospective purchaser. Prospective Noteholders who are in any doubt as to their tax position should consult their professional advisers. Prospective Noteholders who may be liable to taxation in jurisdictions other than the United Kingdom in respect of their acquisition, holding or disposal of the Subordinated Notes are particularly advised to consult their professional advisers as to whether they are so liable (and if so under the laws of which jurisdictions), since the following comments relate only to United Kingdom withholding taxation treatment of payments of interest and information sharing requirements in respect of the Subordinated Notes. In particular, prospective Noteholders should be aware that they may be liable to taxation under the laws of other jurisdictions in relation to payments in respect of Subordinated Notes even if such payments may be made without withholding or deduction for or on account of taxation under the laws of the United Kingdom.

The summary of the United Kingdom withholding tax position below assumes that there will be no substitution of LVFS as Issuer pursuant to Condition 14 of the Subordinated Notes or otherwise and does not consider the tax consequences of any such substitution(s).

UK Withholding Tax on UK Source Interest

The Subordinated Notes issued by the Issuer, which carry a right to interest, will constitute "quoted Eurobonds" provided they are and continue to be listed on a recognised stock exchange within the meaning of section 1005 of the Income Tax Act 2007. Whilst the Subordinated Notes are and continue to be quoted Eurobonds, payments of interest on the Subordinated Notes may be made without withholding or deduction for or on account of United Kingdom income tax.

Securities will be "listed on a recognised stock exchange" for this purpose if they are admitted to trading on an exchange designated as a recognised stock exchange by an order made by the Commissioners for HMRC and either they are included in the United Kingdom official list (within the meaning of Part 6 of the Financial Services and Markets Act 2000) or they are officially listed, in accordance with provisions corresponding to those generally applicable in European Economic Area states, in a country outside the United Kingdom in which there is a recognised stock exchange.

The London Stock Exchange is a recognised stock exchange, and accordingly the Subordinated Notes will constitute quoted Eurobonds provided they are and continue to be included in the United Kingdom official list and admitted to trading on the Regulated Market of that Exchange.

In all cases falling outside the exemption described above, interest on the Subordinated Notes may fall to be paid under deduction of United Kingdom income tax at the basic rate (currently 20%) subject to such relief as may be available following a direction from HMRC pursuant to the provisions of any applicable double taxation treaty, or to any other exemption which may apply.

Provision of Information

Noteholders should note that, in certain circumstances, HMRC has power to obtain information (including the name and address of the beneficial owner of the interest) from any person in the United Kingdom who either pays or credits interest to or receives interest for the benefit of a Noteholder. In certain circumstances, the information so obtained may be passed by HMRC to the tax authorities of certain other jurisdictions.

Information may also be required to be reported in accordance with regulations made pursuant to the EU Savings Directive (see "*EU Savings Directive*" below).

EU Savings Directive

Under EC Council Directive 2003/48/EC on the taxation of savings income, each Member State is required to provide to the tax authorities of another Member State details of payments of interest or other similar income paid by a person within its jurisdiction to, or collected by such a person for, an individual resident or certain limited types of entity established in that other Member State; however, for a transitional period, Austria and Luxembourg may instead apply a withholding system in relation to such payments, deducting tax at a rate of 35%. The transitional period is to terminate at the end of the first full fiscal year following the latter of, broadly speaking, the date of entry into force of an agreement between the European Council and certain non-EU countries providing for the exchange of information relating to such payments and the date on which the European Council agrees on a unanimous basis that the United States of America is committed to the exchange of information relating to such payments upon request.

A number of non-EU countries and certain dependent or associated territories of certain Member States, have adopted similar measures (either provision of information or transitional withholding) in relation to payments made by a person within its jurisdiction to, or collected by such a person for, an individual resident or certain limited types of entity established in a Member State. In addition, the Member States have entered into provision of information or transitional withholding arrangements with certain of those dependent or associated territories in relation to payments made by a person in a Member State to, or collected by such a person for, an individual resident or certain limited types of entity established in one of those territories.

The European Commission has proposed certain amendments to the Directive, which may, if implemented, amend or broaden the scope of the requirements described above. Investors who are in any doubt as to their position should consult their professional advisers.

Other Rules Relating to United Kingdom Withholding Tax

The Subordinated Notes are issued at an issue price of less than 100 per cent. of their principal amount. Any discount element on any such Subordinated Notes should not generally be subject to any United Kingdom withholding tax pursuant to the provisions mentioned in "*UK Withholding Tax on UK Source Interest*" above, but may be subject to reporting requirements as outlined above.

Where interest has been paid under deduction of United Kingdom income tax, Noteholders who are not resident in the United Kingdom may be able to recover all or part of the tax deducted if there is an appropriate provision in any applicable double taxation treaty.

The references to "interest" in this section "*Taxation*" mean "interest" as understood in United Kingdom tax law. The statements in this section "*Taxation*" do not take any account of any different definitions of "interest" which may prevail under any other law or which may be created by the terms and conditions of the Subordinated Notes or any related documentation. Prospective Noteholders should seek their own professional advice as regards the withholding tax treatment of any payment on the Subordinated Notes which does not constitute "interest" as those terms are understood in United Kingdom tax law.

Subscription and Sale

Barclays Bank PLC and HSBC Bank plc (the "**Managers**") have, pursuant to a Subscription Agreement dated 20 May 2013, jointly and severally agreed with the Issuer, subject to the satisfaction of certain conditions, to subscribe the Subordinated Notes at 6.50 per cent. of their principal amount. The Issuer has agreed to pay to the Managers a combined management and underwriting commission. In addition, the Issuer has agreed to reimburse the Managers for certain of their expenses in connection with the issue of the Subordinated Notes. The Subscription Agreement entitles the Managers to terminate it in certain circumstances prior to payment being made to the Issuer.

The yield of the Subordinated Notes to the First Call Date is 6.50 per cent. on an annual basis. The yield is calculated as at the date of this Prospectus on the basis of the issue price. It is not an indication of future yield.

General

Neither the Issuer nor any Manager has made any representation that any action will be taken in any jurisdiction by the Managers or the Issuer that would permit a public offering of the Subordinated Notes, or possession or distribution of this Prospectus (in preliminary, proof or final form) or any other offering or publicity material relating to the Subordinated Notes (including roadshow materials and investor presentations), in any country or jurisdiction where action for that purpose is required. Each Manager has agreed that it will comply to the best of its knowledge and belief in all material respects with all applicable laws and regulations in each jurisdiction in which it acquires, offers, sells or delivers Subordinated Notes or has in its possession or distributes this Prospectus (in preliminary, proof or final form) or any such other material, in all cases at its own expense. It will also ensure that no obligations are imposed on the Issuer or any other Manager in any such jurisdiction as a result of any of the foregoing actions.

United States

The Subordinated Notes have not been and will not be registered under the Securities Act and the Subordinated Notes are subject to U.S. tax law requirements. Subject to certain exceptions, the Subordinated Notes may not be offered, sold or delivered within the United States or to U.S. persons. Each Manager has represented and agreed that it has not offered, sold or delivered and will not offer, sell or deliver any Subordinated Notes within the United States or to U.S. persons, except as permitted by the Subscription Agreement.

In addition, until 40 days after the commencement of the offering, an offer or sale of the Subordinated Notes within the United States by any dealer (whether or not participating in the offering) may violate the registration requirements of the Securities Act.

United Kingdom

Each Manager has represented and agreed that:

(a) it has only communicated or caused to be communicated and will only communicate or cause to be communicated an invitation or inducement to engage in investment activity (within the meaning of Section 21 of FSMA) received by it in connection with the issue or sale of the Subordinated Notes in circumstances in which Section 21(1) of FSMA would not, if the Issuer was not an authorised person, apply to the Issuer; and

(b) it has complied and will comply with all applicable provisions of FSMA with respect to anything done by it in relation to the Subordinated Notes in, from or otherwise involving the United Kingdom.

General Information

1. The listing of the Subordinated Notes on the Official List will be expressed as a percentage of their nominal amount (exclusive of accrued interest). It is expected that listing of the Subordinated Notes on the Official List and admission of the Subordinated Notes to trading on the Market will be granted on or before 23 May 2013, subject only to the issue of a temporary or permanent Global Certificate. Prior to official listing and admission to trading, however, dealings will be permitted by the London Stock Exchange in accordance with its rules. Transactions will normally be effected for delivery on the third working day after the day of the transaction.

2. The Issuer has obtained all necessary consents, approvals and authorisations in the United Kingdom in connection with the issue and performance of the Subordinated Notes. The issue of the Subordinated Notes was authorised by a resolution of the Board of Directors of LVFS passed on 18 April 2013 and resolutions of a committee of the Board of Directors of LVFS passed on 1 May 2013 and 15 May 2013.

3. There has been no material adverse change in the financial position or prospects of the Issuer or the Group since 31 December 2012 and there has been no significant change in the financial or trading position of the Issuer or of the Group since 31 December 2012 (the date to which the latest financial information incorporated into this prospectus has been prepared).

4. There are no governmental, legal or arbitration proceedings (including any such proceedings which are pending or threatened of which the Issuer is aware) with respect to any member of the Group during the 12 months preceding the date of this Prospectus which may have or has had in the recent past significant effects on the financial position or profitability of the Issuer and/or the Group.

5. The Subordinated Notes have been accepted for clearance through the Euroclear and Clearstream, Luxembourg systems (which are the entities in charge of keeping the records) with a Common Code of 093531205. The International Securities Identification Number (ISIN) for the Subordinated Notes is XS0935312057.

   The address of Euroclear is 1 Boulevard du Roi Albert II, B-1210 Brussels, Belgium and the address of Clearstream, Luxembourg is 42 Avenue JF Kennedy L-1855 Luxembourg.

6. The following are the material contracts (not being contracts entered into in the ordinary course of business which could result in the Issuer being under an obligation or entitlement that is material to the Issuer's ability to meet its obligations to Noteholders in respect of the Subordinated Notes being issued) that have been entered into by the Group:

   (a) The Group closed its asset management business on 31 October 2011 and since 1 November 2011, the management of the Group's funds has been carried out by Threadneedle Asset Management Ltd, an independent third party asset manager. For further detail see the section entitled "*Description of the Issuer – Membership and Management of the Issuer*" on page 75.

   (b) The Group has a number of key IT contracts, managed by the Group's CIO Commercial Services department through monthly reviews, external information security business continuity and financial assessments. The major contracts are:

      (i) The Innovation Group ("**TIG**") provide hosting and data centre management for the Group's non-mainframe infrastructure. TIG are a multinational company focusing on insurance business transformation and work with over 800 insurers.

(ii) ATOS Origin IT Services provide mainframe infrastructure support services for the general insurance business and are one of the largest IT outsource suppliers in the UK and Europe, operating out of 42 countries globally.

(iii) Sapiens provide and support the Lifelite application used to manage the Group's closed book business. Sapiens are a multinational company operating across Europe, EMEA, Asia Pacific and North America.

(iv) Cable and Wireless Communications PLC ("**C&W**") provide wide-area network connectivity for the entire Group. C&W is one of the world's leading international communications companies.

(v) Fujitsu provide mainframe infrastructure support services and maintenance for the mainframe computers used to administer the life protection business. Fujitsu Services Limited is a leading IT systems, services and products company and is part of the global Fujitsu Group operating across 70 countries.

(vi) The Logic Group ("**TLG**") provide secure, multichannel card payment solutions to the majority of the Group. TLG's clients include many household names across Europe and they handle in excess of 2.5bn transactions a year.

7. Where information in this Prospectus has been sourced from third parties, this information has been accurately reproduced and, as far as the Issuer is aware and is able to ascertain from the information published by such third parties, no facts have been omitted which would render the reproduced information inaccurate or misleading. The source of third-party information is identified where used.

8. For the period of 12 months starting on the date on which this Prospectus is made available to the public, copies of the following documents will be available, during usual business hours on any weekday (Saturdays and public holidays excepted), for inspection at the office of the Issuer, County Gates, Bournemouth, Dorset, BH1 2NF:

(a) the Trust Deed (which includes the form of the Global Certificate and the Certificates);

(b) the Memorandum of Association and Rules of the Issuer;

(c) the published annual report and audited consolidated annual accounts of the Issuer for the years ended 31 December 2011 and 31 December 2012; and

(d) a copy of this Prospectus together with any Supplement to this Prospectus or further Prospectus. This Prospectus will be published on the website of the Regulatory News Service operated by the London Stock Exchange at *http://www.londonstockexchange.com/exchange/prices-and-news/news/market-news/market-news-home.html*.

9. PricewaterhouseCoopers LLP of 31 Great George Street, Bristol BS1 5QD (Chartered Accountants and Statutory Auditors) audited without qualification the financial statements contained in the Annual Report and Accounts of the Issuer for the financial years ended 31 December 2011 and 2012.

10. Certain of the Lead Managers and their affiliates have engaged, and may in the future engage, in investment banking and/or commercial banking transactions with, and may perform services to the Issuer and/or its affiliates in the ordinary course of business.

Financial Statements and Auditors' Reports

Contents

Auditors' report and consolidated financial statements of the Issuer for the financial year ended 31 December 2011 ....

Auditors' report and consolidated financial statements of the Issuer for the financial year ended 31 December 2012

....

DIRECTORS' REPORT

The directors of Liverpool Victoria Friendly Society Limited present their annual report together with the financial statements for the year ended 31 December 2011.

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. These activities cover with-profit assurance, life protection (both term and whole of life), annuities, equity release, motor, home, pet, travel and commercial insurance. LV= closed its asset management business on 31 October 2011 when it entered into a contract with Threadneedle Investments for the management of all of its funds. The directors consider that all the activities undertaken by the group during the year were within its rules and any relevant regulatory permissions.

A review of the business for the year ending 31 December 2011, recent events and likely future developments is included below.

The board sets key objectives and performance indicators (KPIs), which it monitors on a regular basis throughout the year. These objectives and KPIs may change from time to time to reflect changing objectives and priorities. During 2011, the key objectives set by the board were as follows:

- Achieving the profit and enterprise value target results for each business unit.
- Moving the General Insurance business into a mature cash generative business.
- Sharing the financial returns from our trading businesses with members via a mutual bonus scheme.
- Implementing a major new system for the management of general insurance claims.
- Enhancing our enterprise risk management framework, operating at all times to required regulatory standards.
- Making material progress on the programme to achieve compliance with the requirements of Solvency II and getting ready to meet the new regime established by the Retail Distribution Review.

The key financial performance indicators currently used to monitor business performance are as follows:

- Premiums received and earned. For the Life business - Annual Premium Equivalent (APE) being annual premiums plus 10% of single premiums received. For General Insurance – Gross Written Premium (GWP).
- Profitability measures, particularly underlying profit and profit before tax. Underlying profit represents the profits of the group's business units excluding:
    - the prior year impact on life reserves of changes in assumptions, models and data,
    - the impact of fluctuations in group-managed investment and market outcomes compared to the assumptions used to calculate underlying profit, including the performance of any centrally managed hedges,
    - exceptional or one-off items.
- For General Insurance – the combined ratio of expenses and claims as a percentage of premiums earned.
- For the with-profits assets, investment performance against external benchmarks.
- Capital measures, including Pillar 1, Peak 1 and Peak 2 capital and Peak 2 surplus capital.
- Enterprise value – our internal estimate of the market value of an equivalent quoted company.

Overview

The group's financial focus has remained unchanged. We aim to deliver strong returns to our members, whilst managing and protecting our capital position and continuing to develop our ongoing businesses.

Despite the economic turmoil of 2011, LV= delivered a strong sales performance. Underlying profit in 2011 grew by 10% to £99.4m (2010: £90.7m) reflecting strong performances from both the General Insurance and Life businesses, offset by a reduction in the return from the group's free assets. Despite the positive underlying performance, the group reported a loss before tax and mutual bonus for the year of £16.9m (2010: loss £18.3m) as a result of basis and other reserve changes of £43.1m (2010: £86.7m), primarily reflecting improvements in data and changes in the basis of the valuation of life liabilities, and short-term investment fluctuations of £65.0m (2010: credit £6.5m). These included the impact of changes in the value of guarantees and the impact of widening credit spreads. The result was also affected by exceptional costs of £13.8m, mainly the cost of the group's preparation for Solvency II regulatory changes.

After a taxation charge of £42.2m (2010: credit £3.0m) and a pension fund gain of £69.7m (2010: £36.6m), the group achieved a surplus of £10.6m (2010: £21.3m). The taxation charge reflects higher gains on fixed rate assets within the Life business and increased profitability in the General Insurance business. The pension fund gain primarily reflects an increase in the discount rate applied to future liabilities.

In the light of LV='s continued strong underlying performance, and as a reflection of the board's confidence in the Society's financial future, we declared our first Mutual Bonus of £10m at the May 2011 Annual General Meeting. The board has since declared a further Mutual Bonus of £8.6m in respect of 2011, totalling £18.6m for the year.

We continued to deliver good investment performance for our members; a return in 2011 of 5.7%, broadly in line with the market benchmark of 6.1%, albeit significantly lower than the 15.4% achieved in 2010.

Results for 2011

The table below summarises underlying trading profit by business and other items reported in loss before tax and total comprehensive income.

Profit £m	2011	2010(**)
Life	33.7	28.0
General Insurance	72.1	30.7
Asset Management	0.6	(2.9)
Group	(7.0)	34.9
Underlying profit	**99.4**	**90.7**
Basis and other reserve changes	(43.1)	(86.7)
Exceptional items	(13.8)	(0.6)
Amortisation of intangibles	(13.0)	(13.8)
Operating profit/(loss)	**29.5**	**(10.4)**
Gain/(loss) on equity protection derivatives	18.6	(14.4)
Short-term investment fluctuations	(65.0)	6.5
Loss before tax and mutual bonus	**(16.9)**	**(18.3)**
Taxation (charge)/credit	(42.2)	3.0
Pension scheme actuarial gains net of tax	69.7	36.6
Mutual bonus	(18.6)	-
Result after tax and mutual bonus	**(8.0)**	**21.3**
Transfer from/(to) UDS (*)	8.0	(21.3)
Total comprehensive income	**-**	**-**

(*) UDS (Unallocated divisible surplus): The amounts that have yet to be formally declared as bonuses for participating policyholders together with the free assets of the group.
(**) 2010 underlying profit has been reduced by £5.5m to reflect enhancements made in 2011 to the calculation of experience variances which were previously reported in other reserve changes.

Results by business

Life business

2011 was another successful year for the Life business, delivering a 20% increase in underlying profit to £33.7m (2010: £28.0m) driven by sales of £142m APE*, a 15% increase compared to 2010.

We have built on the strong foundations established over the last three years and this, combined with our focus on delivering what customers and their advisers want, has enabled us to grow sales and gain market share across both our Retirement and Protection businesses.

Total annuity sales increased 20% to £530m of single premiums including a 25% growth in our enhanced annuity proposition, affirming our 'top three' market position in this segment.

We have maintained our 'top three' market position for our equity release products with £85m of loans issued during the year.

Pension sales rose 12% despite the stock market volatility throughout the year which delayed consumer investment decisions. Success continues in the drawdown market where we are again top three.

Protection sales grew 18% to £28m of regular premiums. This was driven by strong growth in our Income Protection product with sales up 34%. We continue to hold our position as market leader in this area, where Critical Illness sales are up 52%.

With-profits investment bond sales were up 15% on 2010 at £46m, demonstrating the continued consumer demand for with-profits investments with guarantees.

The external environment remains challenging. Regulatory change is unprecedented and converges on the end of 2012. However, because of our specialist focus on the retirement, protection and with-profits investment sectors we are well positioned to continue to grow profitably.

* Annual Premium Equivalent – annual premiums plus 10% of single premiums received.

General Insurance business

2011 was the most successful year to date for our General Insurance business. Business volumes grew by 23% to £1.46 billion and underlying profits more than doubled to £72.1m. Our combined operating ratio, which measures claims plus expenses as a proportion of premium income, fell to 97.7%, representing a 6.5 percentage point improvement on 2010 (104.2%) mainly reflecting improvements in both our loss and expense ratios.

2011 did not bring a repeat of the adverse weather events experienced in 2010, but the results were impacted by lower investment returns as interest rates and bond and equity market returns were depressed by harsh economic conditions. The total return on our invested assets fell from 5.7% in 2010 to 2.8% in 2011.

The claims environment also remained challenging, with a further increase in the frequency of third party personal injury claims. This was despite a marked reduction in the number of road accidents reported as motorists cut back on miles travelled in the face of sharply rising fuel costs.

Our distribution strategy, which provides tailored products and service to both the direct and the broker channels, continued to prove successful.

Motor sales benefited from an increase in personal recommendations generated by high levels of customer satisfaction. In our direct business, we increased the number of car insurance policies in force by 36% to 1,519,000 and grew car insurance written premiums by 53% to £578m. A significant proportion of this growth came from direct new business sales, which rose by 50% to more than 700,000 policies.

In home insurance, direct new business sales rose by 24% to 133,000 policies and the in-force portfolio grew by 8% to 500,000.

In our broker channel, written premiums grew by 10% to £720m. Motor personal lines sales grew by just 5% as we sought to protect margins in a challenging claims environment. In commercial lines we experienced another year of above market growth in premium income, as written premiums rose by 29% to £138m.

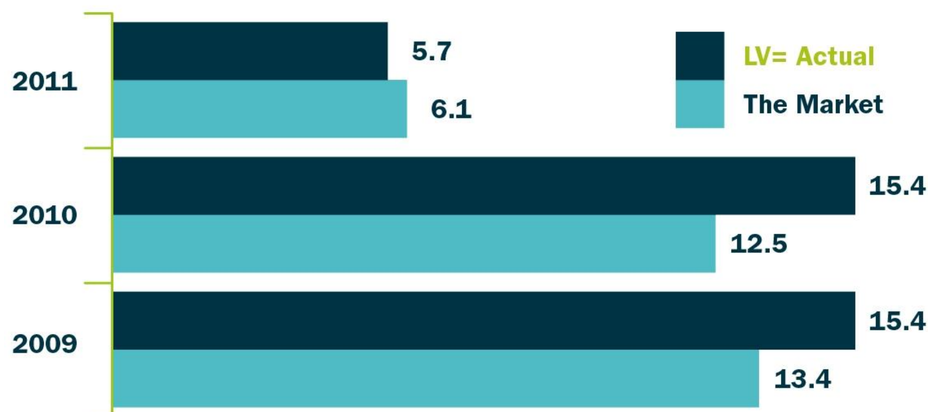
LV= with-profits performance

The performance of the with-profits assets is detailed in the table below, comparing against the relevant market indices. Despite turbulent market conditions, LV= delivered a positive return for members of 5.7% after returns of over 15% in both 2010 and 2009. The return in the year was driven by a strong performance in gilts and bonds which now account for 40% of total assets compared to 30% as at 31 December 2010.

The overall performance is measured and reviewed against weighted benchmarks set by the board:

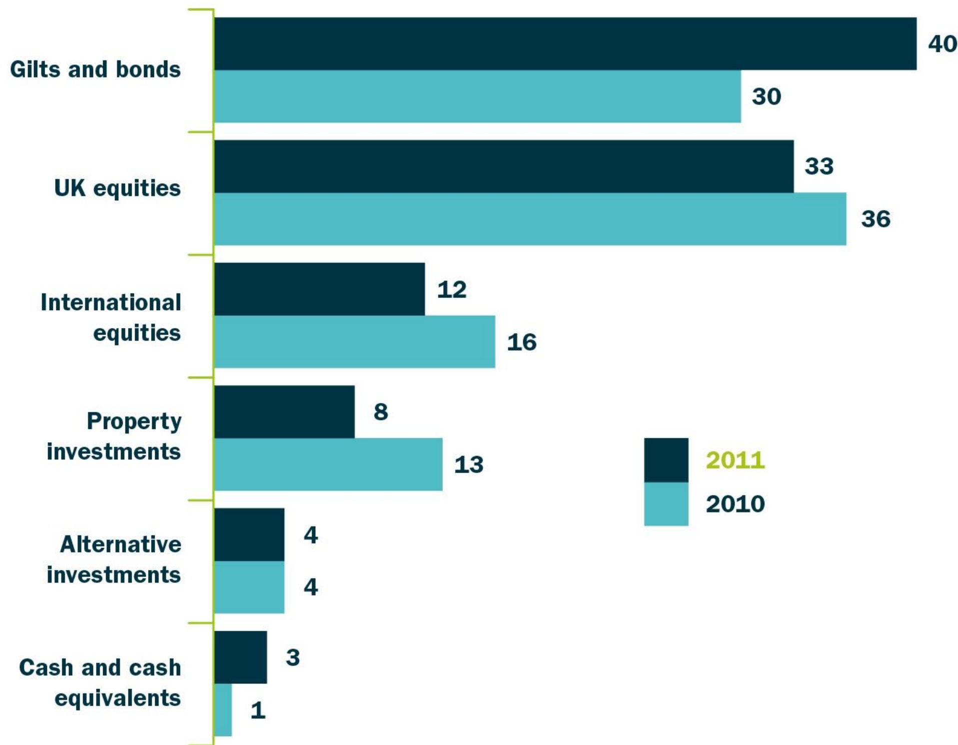
Return on investments %	2011 LV= actual	2011 The market	2010 LV= actual	2010 The market
UK equities	**(3.2%)**	**(3.5%)**	18.9%	14.5%
International equities	**(8.3%)**	**(8.0%)**	17.7%	14.8%
Property investments	**4.3%**	**7.7%**	16.0%	14.5%
Gilts and bonds	**16.6%**	**16.9%**	10.0%	9.2%
Cash and cash equivalents	**0.7%**	**0.5%**	0.5%	0.4%
Alternative equities	**18.9%**	**5.0%**	12.1%	5.4%
Total return	**5.7%**	**6.1%**	15.4%	12.5%

The market for each asset class is a pre-determined benchmark derived from the most relevant external measure of how the fund or asset type might have been expected to perform. For example, the market for UK equities is the FTSE All Share Total Return Index.

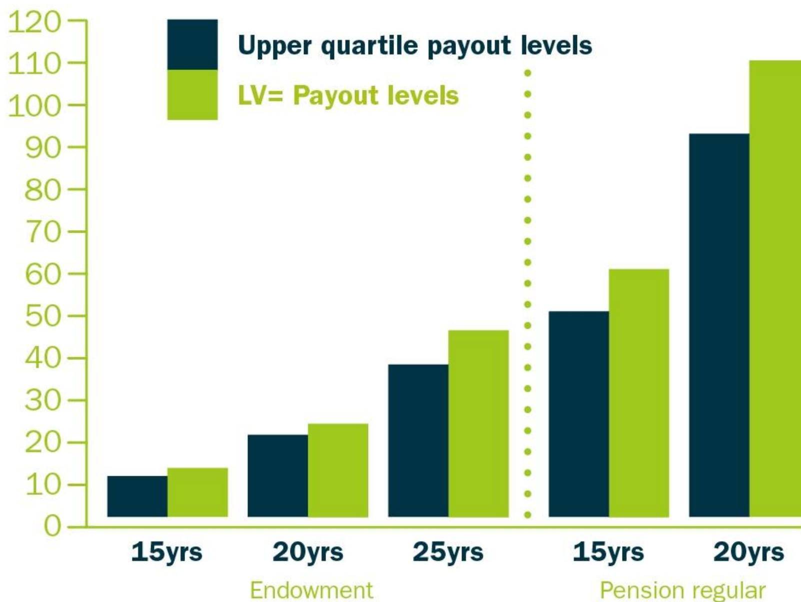


Cumulative total return on investments for the five year period to 31 December 2011 was 22.5% for LV=. This compares with a cumulative return across the market for the corresponding period of 17.6%.

At the end of 2011 and 2010, the with-profits asset shares were invested as shown in the chart below:



LV='s strong investment performance over time has translated into high payouts for members. The chart below compares 2011 payouts with upper quartile payout levels.



All payouts are in £ sterling and are based on the following policies:
Endowment - £50 per month premium, age 30 at entry (2011 payouts as at 1 September 2011).
Pension - regular - £200 per month premium, retiring at age 65 (2011 payouts as at 1 July 2011).
Source: Money Management November 2011.

Regulatory developments

The UK insurance sector continues to face a high degree of regulatory change, in particular the expected implementation of Solvency II, the Retail Distribution Review (RDR) and the Gender Directive, all of which will require significant work during 2012.

The introduction of Solvency II, expected to take place in 2014, will change the rules governing the management of capital for UK insurance firms. Although some of the final details for this new regulatory regime remain uncertain, LV= is making good progress through a dedicated, company-wide programme and is working closely with our regulator, the FSA, to ensure smooth implementation of the new Solvency rules.

The RDR will drive significant change in the distribution landscape, with many advisers expected to either retire or retrench to a much more limited panel-based advice proposition. RDR is designed to increase the transparency in retail financial services and to raise professional standards by improved advice. This will mainly impact the way we remunerate distributors in retirement products and the way we produce literature. LV= is ready for the change and fully supports the aims of RDR and is looking forward to growing its business as a result.

The Gender Directive will prohibit insurance companies from taking gender into account when assessing risk levels of their customers. The full impact to the market is still uncertain. However, LV= will be ready to continue providing all customers with competitive, good-value products.

Key financial performance indicators

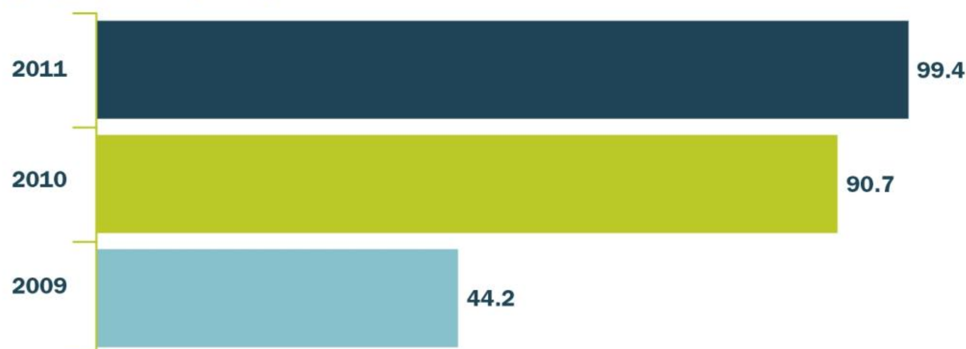
As noted above, the board continually monitors our performance against a number of performance indicators. This enables the business to measure and report on key financial and non-financial objectives.

The key financial indicators are:

- profit
- capital management
- enterprise value

Profit

From 2009 to 2011 we have seen underlying profits grow by 125% with both the Life and General Insurance businesses contributing strongly. We continually strive to improve our revenue generation, while maintaining active control over our costs. In 2011 there was a loss before tax and mutual bonus of £16.9m (2010 loss: £18.3m) reflecting short-term investment fluctuations and basis and reserve changes (which also affected 2010). The group remains focused on delivering profit and capital growth going forward.

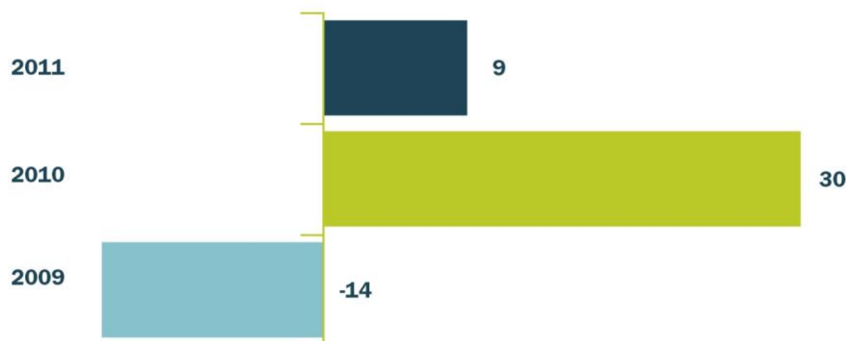


Capital management

This reflects the regulatory Pillar I Peak 2 surplus capital within the LV= group and is a measure of financial strength of our business. LV= manages capital to support the businesses efficiently but prudently. The reduction in surplus assets in 2011 includes the impact of the taxation charge for the year, additional pension contributions and an increase in the capital resource required for the General Insurance business.

Enterprise value

The 9% increase in enterprise value in 2011 (11% before the Mutual Bonus) follows a 30% increase in 2010 and reflects an 11% growth in the combined value of the Life and General Insurance businesses.



Board directors and interests

The current members of the board, together with their dates of appointment and details of its various committees are shown on pages 11 to 12.

We continued to maintain liability insurance cover for our directors and officers during the year.

With-profits bonus declaration

We have declared an annual bonus for the year ended 31 December 2011 at 1% of the sum assured for Industrial Branch business and at 2% of the sum assured for conventional Ordinary Branch Life business. Interim bonus rates will also be at these levels. Terminal bonus rates in 2011 maintained our highly competitive position.

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. The directors are satisfied that the group has adequate resources to continue in business for the foreseeable future and that accordingly the going concern basis is appropriate. Further details about the directors' responsibilities for the financial statements are described below.

Fixed assets

Changes in our fixed assets are shown in note 21 of these financial statements.

Margin of solvency

Throughout the year and at 31 December 2011 we held the required capital resources for each business class as prescribed by the Financial Services Authority.

Independent auditors

A resolution for the reappointment of PricewaterhouseCoopers LLP as auditors will be proposed at the 2012 Annual General Meeting.

Managing risk and return

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.

The group's risk appetite is a statement of the amount of risk that the group is prepared to take in pursuit of its business objectives. The chief risk officer reports to the board at each meeting on our performance against the agreed risk appetite. During the year the board has continued to enhance its statement of risk appetite to include a variety of quantitative and qualitative measures which are used to measure the progress of the group. The key elements of the risk appetite framework include:

- Capital: the adequacy of the group's capital to meet all regulatory requirements and cover unfavourable movements in operating results.
- Liquidity: the adequacy of the group's liquid and readily realisable assets to meet customer claims and the costs of running our business.
- Earnings volatility: the extent to which operating profit may vary from planned levels.
- Enterprise value: the appropriateness of the size of the group's investment in future growth opportunities.
- Capability and stretch: the appropriateness of the group's strategic change agenda given the size and capabilities of its staff.
- Regulatory: a wide-ranging measure covering all aspects of our relationship with the Financial Services Authority including our performance in terms of the FSA's Treating Customers Fairly initiative.
- Brand and reputation: another wide-ranging measure designed to cover behaviours that would be likely to cause unacceptable reputational damage and adverse brand associations. This measure includes complaint levels and customer service levels.

To manage risk levels on a day-to-day basis, a system of capital budgets has been put in place for each business. Each business is expected to manage its position in line with its capital budget and risk appetite position.

Note 3 of these financial statements also provides further detail about our risk management and control.

We recognise the critical importance of having efficient and effective risk management systems in place. Specifically we have:

- Board and executive committees with clear terms of reference as described in the Corporate governance report including a Risk Committee which was established at the start of 2011.
- A clear organisational structure with documented apportionment of responsibilities.
- A common methodology of risk assessment that is implemented within all group companies so that they operate within agreed tolerances and with appropriate controls in place.
- Regular reviews of risks by senior managers, where the frequency of review is determined by the potential impact of the risk and its likelihood.

Internal control

The board has overall responsibility for the group's internal control systems and for monitoring their effectiveness. 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 Audit Committee, which takes reports from the internal audit, compliance and risk functions.

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.

In 2011, the board undertook a full annual review of the effectiveness of the material controls, as recommended by the UK Corporate Governance Code and in compliance with the Turnbull guidance. The review incorporated an evaluation of the group's framework and an assessment of any significant internal control issues that were raised during the year in relation to financial, operational and compliance risk controls. Whenever any significant control weaknesses are identified, corrective actions are put in place and then monitored by the board. The system was in place throughout the year and up to the date this report was approved.

Charitable contributions

We made charitable donations during 2011 as follows:

- £192,400 was donated through the Charities Aid Foundation (CAF).
- £20,000 was paid to Great Ormond Street Hospital for Children based on proxy votes received at the AGM.

In addition:

- £75,000 was given as grants to members from the Member Support Fund.
- The members' telephone helpline was provided at a cost of £28,000.

No political donations were made.

Equal opportunities

We are committed to equal opportunities and the fair treatment of all our employees. In line with our corporate values we undertake to treat all our employees with dignity, respect and consideration.

We recognise our commitments under the law and are committed to providing equal opportunities by ensuring that our practices and procedures follow legal requirements and good practice, as recommended by the Commission for Racial Equality, the Equal Opportunities Commission, and the Disability Rights Commission.

Our policy is to treat all employees and applicants fairly and equitably regardless of gender, racial or cultural grounds, disability, age, marital status, religious beliefs, sexual orientation, trade union activity or any other category where discrimination cannot be reasonably justified. We will ensure that no requirement or condition will be imposed without justification that could disadvantage individuals on any of these grounds. The board is committed to increasing the proportion of women at senior management levels and has established a medium term project to meet this objective.

We provide employees with information on issues relevant to their employment and our performance through meetings, regular magazines and an interactive employee intranet. The management team actively engages with an employee consultative forum on issues important to employees, including their working environment, facilities, terms of employment and safety.

People employed by the group and its subsidiaries

The average number of people we employed during 2011 and our total employee costs are shown in note 14 of the financial statements.

Membership

As at 31 December 2011 we had 1,127,000 (2010: 1,119,000) members.

We make all reasonable and cost-effective attempts to trace and contact members if we believe their address details are incorrect. When all reminder or tracing techniques have been exhausted we maintain a record of the relevant member and if they have an unpaid claim, the policy remains open for payment until we can re-establish contact.

Statement of disclosure of information to the auditors

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

1) so far as (s)he is aware, there is no information relevant to the audit of the Society's financial statements for the year ending 31 December 2011 of which the auditors are unaware;
2) (s)he has taken all steps that (s)he ought to have taken in his/her duty as a director to make him/herself aware of any relevant audit information and to establish that the Society's auditors are aware of that information.

Responsibilities of the board of directors for the financial statements

The Friendly Societies Act 1992 (1992 Act) requires a friendly society's Committee of Management to prepare financial statements 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 financial statements.

These financial statements 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.

Legislation in the United Kingdom that governs the preparation and publication of financial statements may differ from legislation in other jurisdictions.

DIRECTORS' REPORT

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

- select suitable accounting policies and ensure they are applied consistently.
- prepare the financial statements on a going concern basis, unless it is inappropriate to presume that the Society and the group will continue in business.
- 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 and the group's financial position and financial performance.
- state that the Society and the group have complied with applicable IFRS, subject to any material departures disclosed and explained in the financial statements.

The directors are also responsible for maintaining:

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

Further details of our internal controls are more fully described above.

By order of the board of directors
P B Cassidy, Company Secretary
28 March 2012

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF LIVERPOOL VICTORIA FRIENDLY SOCIETY LIMITED

We have audited the financial statements of Liverpool Victoria Friendly Society Limited for the year ended 31 December 2011 which comprise the Statement of Comprehensive Income, Statement of Financial Position, Statement of Cash Flows and the related notes for the Society and the Group. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

Respective responsibilities of the Board of Directors and auditors

As explained more fully in the Responsibilities of the Board of Directors' set out on pages 8 and 9, the Board of Directors is responsible for preparing financial statements which give a true and fair view. The Society has chosen to comply with the Annotated UK Corporate Governance Code specified by the Association of Financial Mutuals. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

This report, including the opinions, has been prepared for and only for the Society's members as a body in accordance with the Friendly Societies Act 1992 and the Regulations made under it and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Scope of the audit of the financial statements

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

Opinion on financial statements

In our opinion the financial statements:

- give a true and fair view of the state of the Society's and the Group's affairs as at 31 December 2011 and of the income, expenditure and cash flows of the Society and the Group for the year then ended;
- have been properly prepared in accordance with IFRSs as adopted by the European Union; and
- have been properly prepared in accordance with the Friendly Societies Act 1992 and the Regulations made under it.

Opinion on other matters prescribed by the Friendly Societies Act 1992

In our opinion the Directors' Report has been prepared in accordance with the Friendly Societies Act 1992 and the Regulations made under it, and the information given therein is consistent with the financial statements for the financial year.

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Friendly Societies Act 1992 requires us to report to you if, in our opinion:

- proper accounting records have not been kept; or
- the financial statements are not in agreement with the accounting records; or
- we have not received all the information and explanations and access to documents that we require for our audit.

Other matters

In accordance with our instructions from the Society, we review whether the Corporate Governance Statement reflects the Society's compliance with the eight provisions of the Annotated UK Corporate Governance Code specified by the Association of Financial Mutuals. We have nothing to report in respect of this review.

Notes:

(a) The maintenance and integrity of the Liverpool Victoria Friendly Society Limited Group website is the responsibility of the directors; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the website.

(b) Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

David Roper
Senior Statutory Auditor
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
31 Great George Street
Bristol
BS1 5QD
28 March 2012

STATEMENT OF COMPREHENSIVE INCOME

Year ended 31 December 2011

		Group		Society	
		2011	2010	**2011**	2010
	Notes	**£m**	£m	**£m**	£m
Gross earned premiums	4	**2,196.5**	1,732.1	**862.8**	759.7
Premiums ceded to reinsurers	4	**(93.0)**	(84.6)	**(99.7)**	(94.9)
Net earned premiums	4	**2,103.5**	1,647.5	**763.1**	664.8
Fee and commission income	6	**30.2**	36.5	**5.2**	11.3
Investment income	7	**249.7**	227.7	**284.9**	178.4
Net gains on investments	8	**425.4**	467.6	**372.9**	359.4
Other income		**51.0**	30.9	**19.1**	2.0
Total income		**2,859.8**	2,410.2	**1,445.2**	1,215.9
Gross benefits and claims	9	**(1,669.3)**	(1,416.2)	**(657.3)**	(655.4)
Claims ceded to reinsurers	9	**86.4**	51.8	**102.4**	243.3
Net benefits and claims	9	**(1,582.9)**	(1,364.4)	**(554.9)**	(412.1)
Gross change in contract liabilities	10	**(771.6)**	(646.6)	**(773.4)**	(647.5)
Change in contract liabilities ceded to reinsurers	10	**96.0**	58.7	**7.1**	(84.4)
Net change in contract liabilities	10	**(675.6)**	(587.9)	**(766.3)**	(731.9)
Finance costs	11	**(0.5)**	(0.9)	**-**	(0.1)
Investment return allocated to external unit holders		**2.1**	(12.1)	**-**	-
Other operating and administrative expenses	12	**(619.8)**	(463.2)	**(171.7)**	(145.0)
Other expenses		**(618.2)**	(476.2)	**(171.7)**	(145.1)
Total benefits, claims and expenses		**(2,876.7)**	(2,428.5)	**(1,492.9)**	(1,289.1)
Loss before tax and mutual bonus		**(16.9)**	(18.3)	**(47.7)**	(73.2)
Mutual bonus	18	**(18.6)**	-	**(18.6)**	-
Income tax (expense)/credit	17	**(42.2)**	3.0	**(26.9)**	12.0
Pension scheme actuarial gains net of tax	15	**69.7**	36.6	**69.7**	26.9
Transfer from/(to) the Unallocated divisible surplus	33	**8.0**	(21.3)	**23.5**	34.3
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.

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 as the Society is a mutual organisation.

STATEMENT OF FINANCIAL POSITION

As at 31 December 2011

		Group		Society	
		2011	2010	**2011**	2010
	Notes	**£m**	£m	**£m**	£m
Assets					
Intangible assets	19	**261.5**	269.2	**4.6**	9.3
Deferred acquisition costs	20	**94.7**	138.8	**-**	-
Pension benefit asset	15	**108.1**	15.9	**108.1**	15.9
Property and equipment	21	**20.6**	20.1	**5.0**	5.5
Investment properties	22	**219.9**	315.4	**151.4**	246.6
Investments in group undertakings	23	**-**	-	**957.6**	971.5
Financial assets					
- Fair value through income	24	**8,020.3**	7,141.5	**6,016.1**	5,221.8
- Derivative financial instruments	25	**143.8**	46.1	**143.8**	46.1
- Loans and other receivables	26	**116.0**	79.2	**117.2**	77.3
Reinsurance assets	27	**336.9**	213.6	**223.0**	216.0
Insurance receivables	28	**216.5**	193.2	**10.2**	14.9
Corporation tax asset	29	**-**	1.5	**-**	3.1
Deferred tax asset	30	**31.0**	29.2	**17.7**	14.9
Prepayments and accrued income	31	**61.3**	62.6	**48.1**	45.1
Cash and cash equivalents	32	**652.3**	536.2	**216.6**	277.8
Total assets		**10,282.9**	9,062.5	**8,019.4**	7,165.8
Liabilities					
Unallocated divisible surplus	33	**958.4**	966.4	**1,055.1**	1,078.6
Insurance contract liabilities	34	**7,748.0**	6,616.1	**5,946.2**	5,124.9
Investment contract liabilities	35	**800.9**	741.2	**800.9**	741.2
Net asset value attributable to external unit holders		**429.1**	449.2	**-**	-
Provisions	37	**55.5**	51.6	**52.0**	38.5
Corporation tax liability	38	**28.4**	-	**13.0**	-
Financial liabilities					
- Derivative financial instruments	25	**3.8**	28.9	**3.8**	28.8
- Borrowings		**-**	-	**5.6**	-
- Other financial liabilities	39	**10.4**	10.7	**0.3**	-
Pension benefit obligation	15	**1.2**	8.8	**1.2**	8.8
Insurance payables	40	**41.6**	32.6	**31.6**	23.7
Trade and other payables	41	**205.6**	157.0	**109.7**	121.3
Total liabilities		**10,282.9**	9,062.5	**8,019.4**	7,165.8

The financial statements on pages 24 to 97 were approved by the Board of Directors on 28 March 2012 and signed on its behalf by:

P.B.Cassidy
Secretary

STATEMENT OF CASH FLOWS

Year ended 31 December 2011

		Group		Society	
		2011	2010	**2011**	2010
	Notes	**£m**	£m	**£m**	£m
Cash and cash equivalents at 1 January	32	**536.2**	646.8	**277.8**	405.1
Cash flows arising from:					
Operating activities					
Cash used in operating activities	42	**(212.4)**	(435.5)	**(407.8)**	(995.0)
Dividend income received		**119.5**	46.7	**152.0**	34.9
Interest and other income received		**125.3**	170.0	**123.4**	122.4
Rental income on investment properties		**7.3**	17.3	**7.1**	15.5
Purchase of investment properties	22	**(12.5)**	(15.6)	**(2.9)**	(0.5)
Proceeds from sale of investment properties		**106.1**	100.0	**96.2**	98.8
Finance cost paid	11	**(0.5)**	(0.9)	**-**	(0.1)
Income tax (paid)/received		**(13.6)**	10.2	**(13.6)**	3.8
Net cash flows generated from/(used in) operating activities		**119.2**	(107.8)	**(45.6)**	(720.2)
Investing activities					
Proceeds from sale of property and equipment		**-**	0.1	**-**	0.1
Increase in investment in group undertakings		**-**	-	**(15.2)**	(64.5)
Capital reduction in group undertakings		**-**	-	**-**	564.7
Repayments received from loans to group undertakings		**-**	-	**-**	94.3
Purchase of property and equipment	21	**(3.1)**	(2.9)	**(0.4)**	(1.7)
Net cash flows (used in)/generated from investing activities		**(3.1)**	(2.8)	**(15.6)**	592.9
Net increase/(decrease) in cash and cash equivalents		**116.1**	(110.6)	**(61.2)**	(127.3)
Cash and cash equivalents at 31 December	32	**652.3**	536.2	**216.6**	277.8

1. Accounting policies

Basis of presentation

The Group financial statements consolidate the results of the Society and its subsidiary companies. The Group's and Society's financial statements conform to International Financial Reporting Standards (IFRS) and interpretations issued by the IFRS Interpretations Committee (IFRIC) 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 policy b. 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) at fair value through income.

The principal accounting policies applied in the preparation of these consolidated financial statements are set out below. These policies have been consistently applied to all years presented, unless otherwise stated.

Significant accounting judgements, estimates and assumptions

In applying the Group's accounting policies, management has made the following significant judgements.

Valuation of investment and long-term insurance contract liabilities

The liability is based on assumptions reflecting the best estimate at the time allowing for a margin of risk and adverse deviation. All contracts are subject to a liability adequacy test, which reflects management's best current estimate of future cash flows.

The assumptions used for mortality, morbidity and longevity are based on standard industry or reinsurers' tables, adjusted where appropriate to reflect the Group's own experience. In particular, for impaired annuities, the mortality assumptions are based on reinsurers' tables with an individual loading applied depending on the nature of the impairment. The assumptions used for investment returns, expenses, lapse and surrender rates are based on current market yields, product characteristics, and relevant claims experience. The assumptions used for discount rates are based on current industry risk rates, adjusted for the Group's own risk exposure. Due to the long term nature of these obligations, the estimates are subject to significant uncertainty.

Valuation of general insurance contract liabilities

For general insurance contracts, estimates are made for the expected ultimate cost of claims reported as at the Statement of Financial Position date and the cost of claims incurred but not yet reported (IBNR) 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. 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 is used to project ultimate claims costs. Allowance for one off occurrences or changes in legislation, policy conditions or portfolio mix, are 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 gross benefits and claims within the Statement of Comprehensive Income in future years.

Fair value of financial assets

Market observable inputs are used wherever possible. 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 Note 3 (iv).

Valuation of pension benefit obligations

The valuations of the pension benefit obligations for the two defined benefit schemes are determined using actuarial valuations. These involve making assumptions about discount rates, expected future returns on assets, 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 key assumptions used in the estimates are contained in Note 15.

Impairment of goodwill and other intangible assets

The Group determines whether goodwill and other intangible assets are 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 in Note 19.

PRINCIPAL ACCOUNTING POLICIES

a. Consolidation

Subsidiaries
Subsidiaries are all entities, including Open Ended Investment Companies (OEICs), over which the Group (directly or indirectly) has the power to govern the financial and operating policies generally accompanying a shareholding of more than one half of the voting rights. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Group controls another entity. 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.

Where the Group invests in specialised investment vehicles (such as OEICs) and owns greater than 50% of the unit shareholding, they 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.

Associates and joint ventures in property holding companies
The Group invests in associate companies and jointly controlled entities that hold investment properties, with holdings ranging between 25% and 99%.

Associates are all entities over which the Group has significant influence but not control, generally accompanying a shareholding of between 20% and 50% of the voting rights.

The investments in associates and the Group's interests in jointly controlled entities have not been consolidated under the equity method but are designated as investments at fair value through income under UK unlisted investments in accordance with the exemptions permitted under IAS28 and IAS31 applicable to investment-linked insurance funds.

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 participating contracts have been classified as participating insurance 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.

Insurance contracts are accounted for in accordance with the Statement of Recommended Practice issued by the Association of British Insurers in December 2005, and amended in December 2006. In certain businesses, the accounting policies or accounting estimates have been changed, to measure designated insurance liabilities using current market interest rates and allowing for other changes to regulatory reporting practices. In other words, the Group measures the liability on insurance and with-profit contracts in line with the 'realistic' reporting regime of the Financial Services Authority ("FSA"). More detail on the valuation of insurance and investment contracts is given in accounting policies s. and t.

c. Earned premiums

Long-term insurance contracts
Regular premiums on long-term insurance contracts are recognised as income when due for payment. For single premium business, recognition occurs on the date from which the policy is effective. Reinsurance premiums payable are accounted for when due for payment.

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.

Investment contracts
Premiums and claims relating to investment contracts are not recognised in the Statement of Comprehensive Income but are recorded as contributions to and deductions from the investment contract liabilities recorded in the Statement of Financial Position.

d. Reinsurance contracts

The Group cedes insurance risk in the normal course of business for its long-term and general insurance businesses. Reinsurance assets represent balances recoverable from reinsurance companies. Recoverable amounts are estimated in a manner consistent with the outstanding claims provision. Reinsurance premiums are recognised in the same period as the underlying contract that they relate to.

e. Claims

Long-term insurance 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 insurance contracts includes bonuses paid or payable. Claims values include related internal and external claims handling costs. Reinsurance recoveries are accounted for in the same period as the related claim.

General insurance contracts
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.

The estimated cost of claims includes expenses to be incurred in settling claims and a deduction for the expected value of recoveries. However, 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.

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 previous claims development experience can be used to project ultimate claims costs. Allowance for one-off occurrences or changes in legislation, policy conditions or portfolio mix, are 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.

f. Fee and commission income

Fees from investment contracts for investment management, other policy administration charges and fund management fees are recognised as income when earned. Commission earned from financial intermediary services is taken to income when receivable.

g. Investment income

Investment income includes dividends, interest on deposits, interest on loans and receivables, interest on loans secured on residential property and rents. Dividends are included on an ex-dividend basis. Interest receivable on loans and receivables is calculated on an effective interest rate basis. Interest on deposits, rents and expenses are included on an accruals basis. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability.

h. Net gains or losses on investments

- Realised gains or losses
Realised gains and losses on investments are calculated as the difference between net sales proceeds and original cost.

- Fair value gains or losses on investments
Unrealised gains and losses on investments represent the difference between the valuation of fair value investments at the Statement of Financial Position date and their purchase price or, if they have been previously revalued, their valuation at the last Statement of Financial Position date. An adjustment is made to unrealised gains and losses for the prior year's unrealised element included in the current year's realised gains and losses.

i. Other operating and administrative expenses

Other operating and administrative expenses are accounted for as incurred and are disclosed within Note 12.

j. Income taxes

- 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.

k. Foreign currencies

Monetary 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 respective transactions. Exchange gains and losses are dealt with in that part of the Statement of Comprehensive Income in which the underlying transaction is reported.

l. Intangible assets

Deferred acquisition costs
The costs of acquiring new business, other than for participating business, which are incurred during the financial year, but where the benefit of such costs will be obtained in subsequent accounting periods, are deferred and recognised as an asset to the extent that they are recoverable out of margins in future matching revenues.

In respect of insurance contracts, acquisition costs comprise of all direct and indirect costs incurred in writing new contracts. Deferred acquisition costs for insurance contracts 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.

For investment contracts, the costs of acquiring investment contracts, is limited to the direct transaction costs associated with the acquisition of the business. Deferred acquisition costs for investment contracts are amortised over the expected contract period.

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.

Goodwill
Goodwill represents the excess of the cost of an acquisition over the fair value of the Group's share of the net identifiable assets of the acquired subsidiary/associate 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 cost) of the relevant cash generating unit and carried in the Statement of Financial Position at cost less accumulated impairment losses. Gains and losses on the disposal of an entity include the carrying amount of goodwill relating to the entity sold.

Goodwill arising on acquisitions prior to 1998 has been eliminated against the Unallocated divisible surplus. This goodwill would be recognised in the Statement of Comprehensive Income should there be a subsequent disposal of the business to which it relates.

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 present 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, and is assessed annually for impairment.

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.

Present value of acquired in-force business (PVIF)
On acquisition of a portfolio of long-term insurance contracts, the net present value of the Group's interest in the expected cash flows of the in-force business is capitalised in the Statement of Financial Position as an asset and is amortised, in line with the original expected run-off of 20 years, based on the anticipated lives of the related contracts

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.

Any amortisation or impairment charge is recorded in the Statement of Comprehensive Income within other operating and administrative expenses.

m. 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 on a straight line basis over their estimated useful lives. The periods used are as follows:

Land*	Not depreciated
Freehold buildings including finance lease property*	50 years
Leasehold property*	10 years or lease term if shorter
Fixtures, fittings and motor vehicles	3 to 10 years
IT hardware (spend over £1m)	3 years

Provision is made for any impairment in property and equipment.

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each Statement of Financial Position date.

Assets under construction represent the cost of assets under development. These assets are not depreciated, the total cost is transferred to the appropriate asset class on completion and then depreciated over their estimated useful lives.

*These are properties used by the Group for operational purposes and are not investment properties which are dealt with below.

n. Investment properties

Investment properties are freehold and leasehold land and buildings held for long term rental yields and capital growth. They are held at fair value and changes in fair value are recorded as fair value gains or losses in the Statement of Comprehensive Income. Fair value is determined annually by independent professional valuers based on market conditions.

o. Investments in group undertakings

The subsidiaries are held in the Society's Statement of Financial Position at cost less any provision for permanent diminution in value. 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.

p. Financial assets and liabilities

The Group classifies its financial assets and liabilities upon initial recognition into the following categories:
- financial assets and liabilities at fair value through income
- derivative financial instruments
- loans and receivables
- other financial liabilities

Financial assets and liabilities at fair value through income
All investments of the Group classified as fair value are designated as fair value through income at inception. This is in accordance with the Group's documented investment strategy and consistent with investment risk being assessed on a portfolio basis. Such assets are measured at fair value with gains and losses recognised in the Statement of Comprehensive Income.

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 property and other investments.

Financial liabilities at fair value through income include derivative financial instruments and investment contract liabilities.

These assets and liabilities are categorised into the IFRS7 “fair value hierarchy” as follows:
- Level 1 – where the fair value is determined based on quoted bid prices in an active market for identical assets or liabilities. An example would include an actively traded share in the UK FTSE 100 index.
- Level 2 – where the fair value is determined based on inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices). An example would include a share on the AIM which is not actively traded.
- Level 3 – where the fair value is determined using valuation techniques with unobservable inputs. An example would include an investment in an unquoted company which is valued based on either net asset value or discounted cash flows.

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 held for trading.

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.

Loans and receivables
Loans and receivables are initially measured at fair value and then subsequently measured at amortised cost using the effective interest rate method.

The Group assesses at each Statement of Financial Position date whether a loan or receivable, or a group of loans or receivables, is impaired. For loans and receivables, the amount of any impairment loss is measured as the difference between the carrying amount and the present value of future cash flows. The carrying amount of the asset is reduced by the impairment loss and the loss is recorded in the Statement of Comprehensive Income.

Provision for impairment
Provisions for impairment of loans and receivables are based on appraisals of loans and receivables both collectively and individually. Provisions are made to reflect the estimated net realisable amount, taking into account potential future recoveries and the original effective interest rate. Balances are written off in full when the debt is considered irrecoverable.

Specific provisions have been made in respect of all identified impaired advances. In calculating the required provision an appropriate factor is applied based on the present value of expected future cash flows, which is subject to periodic review to ensure its continuing applicability based on current experience, to reflect the probability that not all such loans will result in eventual loss. Collective provisions have been made in respect of losses which, although not yet specifically identified are expected from experience to arise.

Derecognition of financial assets and liabilities
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
  - has transferred control of the asset.

A financial liability is derecognised when the obligation under the liability is discharged or cancelled or expires.

q. No Negative Equity Guarantees

A group undertaking provides ‘No Negative Equity Guarantee’ contracts to customers on Equity Release Mortgages. The contractual terms of these guarantees require the company to make payments equivalent to any shortfall between the market value of customers’ property and the value of the loan plus accrued interest at the date of redemption.

The guarantee is initially recognised at the fair value of the liability on the date the guarantee is given, and is subsequently measured at fair value. The fair value is calculated by applying stochastic scenario models applying assumptions for interest rates, future house price inflation and its volatility, mortality rates and early loan repayment rates, to give management’s best estimate of the discounted value of cash flows required to settle any future financial obligation arising at the Statement of Financial Position date.

The guarantee is included within Financial assets – Fair value through income in the Statement of Financial Position. The movement in the fair value of the guarantee is taken to the Statement of Comprehensive Income.

r. 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 consolidated cash flow statement, cash and cash equivalents are as defined above but are shown net of outstanding bank overdrafts.

s. Long-term insurance contract liabilities

Participating business
The liability is calculated in accordance with the FSA's 'realistic' liability regime. 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 liability includes an allowance for the time and intrinsic value of options and guarantees granted to policyholders and for possible future management actions.

The realistic 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.

Since the realistic liabilities include an allowance for future bonuses to participating contract policyholders that will be payable out of returns on non participating business, an amount within the participating contract fund is recognised representing the value of non participating business. Such an amount is not recognised for business written outside participating contract funds.

In determining the realistic value of liabilities for participating contracts, indirect account is taken of the value of future profits on non participating business written out of participating contract funds. This is separately identifiable and is all in respect of policyholder liabilities. The excess of the value of those future profits has been deducted from the realistic liabilities rather than recognising it as an asset.

Non participating business
The liability is calculated to comply with the reporting requirements under the FSA's Integrated Prudential Sourcebook using a gross premium valuation method or a method at least as prudent as the gross premium method. The principal assumptions are given in the notes to the financial statements. 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.

t. Investment contract liabilities

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.

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 fund assets and liabilities 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 discounted 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.

The liability is derecognised when the contract expires, is discharged or is cancelled.

When contracts contain both a financial risk component and a significant insurance risk component, and the cash flows are distinct and can be measured reliably, the underlying amounts are unbundled. Any premiums relating to the insurance risk component are accounted for on the same basis as long-term insurance contracts and the remaining element is accounted for as a deposit, as described above.

u. Unexpired risks

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.

v. 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 PPFM, 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.

w. 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.

Onerous contracts
A provision is made for onerous contracts in which the unavoidable costs of meeting the obligation exceed the expected future economic benefits.

x. Liability adequacy testing

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 Statement of Financial Position 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 initially by writing off deferred acquisition costs and by subsequently establishing a provision for losses arising from liability adequacy tests. Any deferred acquisition cost written off as a result of this test cannot subsequently be reinstated.

y. 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.

z. Employee benefits

Pensions
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.

The pension cost for the schemes is analysed between current service cost, past service cost and net return on pension scheme assets. 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 administrative expenses on a straight-line basis over the period in which the increases in benefits vest, or are earned.

All movements other than actuarial gains and losses 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 are recognised in the Statement of Comprehensive Income after profit/(loss) before tax and are disclosed net of tax.

Contributions to defined contribution schemes are recognised as employee benefit expenses when they are due.

aa. 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.

ab. 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. 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.

ac. 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.

Changes in accounting policies

(i) Standards, amendments to published standards and interpretations effective in 2011

There are no new, or amendments to, published standards, mandatory for the Group's accounting periods beginning on or after 1 January 2011, which had a material impact on the Group.

ii) Standards, amendments to published standards and interpretations early adopted by the Group

In 2011, the Group did not early adopt any new, revised or amended standards.

iii) Standards and interpretations effective in 2011 but not relevant to the Group's operations

IAS 24 (revised), 'Related party disclosures'
IAS 32 (amendment), 'Classification of rights issues'
IFRS 1 (amendment), 'First time adoption on financial instrument disclosures'
IFRIC 14 (amendment), 'Prepayments of a minimum funding requirement'
IFRIC 19, 'Extinguishing financial liabilities with equity instruments'

iv) Standards, amendments and interpretations to existing standards that are not yet effective and have not been early adopted by the Group

The following standards and amendments to existing standards have been published and are mandatory for the Group's accounting periods beginning on or after 1 January 2012 or later periods, and the Group has not early adopted them:

Amendments to IFRS 7, 'Financial Instruments: Disclosures on derecognition', issued in October 2010. The amendment applies to annual periods beginning on or after 1 July 2011. Earlier application is permitted. These amendments are as part of the IASBs comprehensive review of off balance sheet activities. The amendments will promote transparency in the reporting of transfer transactions and improve users' understanding of the risk exposures relating to transfers of financial assets and the effect of those risks on an entity's financial position, particularly those involving securitisation of financial assets. The change is not expected to have a material impact on the Group's financial statements.

IFRS 9 'Financial Instruments' on 'classification and measurement' of financial assets, issued in November 2009. This is the first part of a new standard on classification and measurement of financial assets that will replace IAS 39. IFRS 9 has two measurement categories: amortised cost and fair value. All equity instruments are measured at fair value. A debt instrument is held at amortised cost only if the entity is holding the instrument to collect contractual cash flows and the cash flows represent principal and interest. Otherwise it is held at fair value through profit or loss.

IFRS 9 'Financial Instruments' on 'classification and measurement' of financial liabilities, issued in October 2010. These are further additions to IFRS 9 dealing with financial liabilities. The additions, which are part of the IASB's plan to replace IAS 39, retain most of the IAS 39 requirements. These include amortised cost accounting for most financial liabilities, with bifurcation of embedded derivatives. The main change in the additions is that in cases where the fair value option is taken for financial liabilities, the part of a fair value change due to an entity's own credit risk is recorded in other comprehensive income rather than the income statement, unless this creates an accounting mismatch. This change will mainly affect financial institutions. The Group is yet to assess IFRS 9's full impact and intends to adopt IFRS 9 no later than the accounting period beginning on or after 1 January 2013.

IFRS 10 'Consolidated financial statements', issued in May 2011. This standard builds on existing principles by identifying the concept of control as the determining factor in whether an entity should be included within the consolidated financial statements. The standard provides additional guidance to assist in determining control where this is difficult to assess. This new standard might impact the entities that a group consolidates as its subsidiaries. The Group is yet to assess IFRS 10's full impact and intends to adopt IFRS 10 no later than the accounting period beginning on or after 1 January 2013.

IFRS 11 'Joint arrangements', issued in May 2011. This standard provides for a more realistic reflection of joint arrangements by focusing on the rights and obligations of the arrangement, rather than its legal form. There are two types of joint arrangements: joint operations and joint ventures. Joint operations arise where a joint operator has rights to the assets and obligations relating to the arrangement and hence accounts for its interest in assets, liabilities, revenue and expenses. Joint ventures arise where the joint operator has rights to the net assets of the arrangement and hence equity accounts for its interest. Proportional consolidation of joint ventures is no longer allowed. The Group is yet to assess IFRS 11's full impact and intends to adopt IFRS 11 no later than the accounting period beginning on or after 1 January 2013.

IFRS 12 'Disclosure of interests in other entities' This standard includes the disclosure requirements for all forms of interests in other entities, including joint arrangements, associates, special purpose vehicles and other off balance sheet vehicles. The Group is yet to assess IFRS 12's full impact and intends to adopt IFRS 12 no later than the accounting period beginning on or after 1 January 2013.

IFRS 13 'Fair value measurement', issued in May 2011. This standard aims to improve consistency and reduce complexity by providing a precise definition of fair value and a single source of fair value measurement and disclosure requirements for use across IFRSs. The requirements, which are largely aligned between IFRSs and US GAAP, do not extend the use of fair value accounting but provide guidance on how it should be applied where its use is already required or permitted by other standards within IFRSs or US GAAP. The Group is yet to assess IFRS 13's full impact and intends to adopt IFRS 13 no later than the accounting period beginning on or after 1 January 2013.

Amendment to IAS 1 'Financial statement presentation', on other comprehensive income (OCI), issued in June 2011. This amendment changes the disclosure of items presented in other comprehensive income (OCI) in the statement of comprehensive income. The IASB originally proposed that

all entities should present profit or loss and OCI together in a single statement of comprehensive income. The proposal has been withdrawn and IAS 1 will still permit profit or loss and OCI to be presented in either a single statement or in two consecutive statements. The Group is yet to assess the full impact of amendments and intends to adopt the amended IAS 1 no later than the accounting period beginning on or after 1 January 2013.

Amendment to IAS 12 'Income taxes' on deferred tax, issued in December 2010. Currently IAS 12, 'Income taxes', requires an entity to measure the deferred tax relating to an asset depending on whether the entity expects to recover the carrying amount of the asset through use or sale. It can be difficult and subjective to assess whether recovery will be through use or through sale when the asset is measured using the fair value model in IAS 40 Investment Property. Hence this amendment introduces an exception to the existing principle for the measurement of deferred tax assets or liabilities arising on investment property measured at fair value. As a result of the amendments, SIC 21, 'Income taxes - recovery of revalued non-depreciable assets', would no longer apply to investment properties carried at fair value. The amendments also incorporate into IAS 12 the remaining guidance previously contained in SIC 21, which is accordingly withdrawn. The amendments apply to annual periods beginning on or after 1 January 2012 and are not expected to have any impact on the Group's financial statements.

IAS 19 (revised 2011) 'Employee benefits', issued in June 2011. This amendment makes significant changes to the recognition and measurement of defined benefit pension expense and termination benefits, and to the disclosures for all employee benefits. The changes will affect most entities that apply IAS 19. They could significantly change a number of performance indicators and might also significantly increase the volume of disclosures. The Group is yet to assess the full impact of amendments and intends to adopt the amended IAS 19 no later than the accounting period beginning on or after 1 January 2013.

IAS 27 (revised) 'Separate financial statements', issued in May 2011. This standard includes the provisions on separate financial statements that are left after the control provisions of IAS 27 have been included in the new IFRS 10. The Group is yet to assess the full impact of the amendments and intends to adopt the amended IAS 27 no later than the accounting period beginning on or after 1 January 2013.

IAS 28 (revised) 'Investments in associates and joint ventures', issued in May 2011. This standard includes the requirements for joint ventures, as well as associates, to be equity accounted following the issue of IFRS 11. The Group is yet to assess the full impact of the amendments and intends to adopt the amended IAS 28 no later than the accounting period beginning on or after 1 January 2013.

2. Capital management

The Society retains capital within its Unallocated divisible surplus to meet the key objectives:

(i) To ensure financial stability;
(ii) To enable the Group's strategy to be developed;
(iii) To give confidence to consumers and other stakeholders who have relationships with the Group; and
(iv) To comply with capital requirements imposed by its UK regulator, the FSA.

At least annually, these objectives are reviewed 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. In the event that sufficient capital is not available, plans would be developed either to raise additional capital through, for example, subordinated loans, or to reduce the quantum of risk accepted thereby reducing the capital requirement through, for example, reinsurance or a change in investment strategy. If it becomes apparent that excess capital is available to the Group above its potential needs, plans would be developed to return such excess to participating contract policyholders.

The Group complied with all externally imposed capital requirements to which it was subject throughout the reporting period. The capital requirements for the year on a Pillar 1 Peak 2 basis were £688.5m (2010: £760.3m).

Capital statement
The tables below set out the capital resources available to the individual life funds and other activities of the Group. All funds are UK funds.

Available Capital Resources 2011	Society's participating contract business (1) £m	RNPFN participating contract business (2) £m	Other UK non participating (3) £m	Total long-term Business £m	Other Activities £m	Consolidation Adjustments £m	Group Total £m
Unallocated divisible surplus	**1,055.1**	**-**	**-**	**1,055.1**	**-**	**(96.7)**	**958.4**
Shareholdings in related undertakings	**-**	**-**	**103.2**	**103.2**	**1,536.0**	**(1,639.2)**	**-**
Adjustments onto regulatory basis:							
Adjustment from regulatory to realistic peak	**221.5**	**164.5**	**-**	**386.0**	**-**	**-**	**386.0**
Inadmissible assets	**(130.4)**	**-**	**-**	**(130.4)**	**(23.4)**	**-**	**(153.8)**
Adjustment to cost of investment in subsidiaries	**(362.2)**	**-**	**-**	**(362.2)**	**-**	**350.1**	**(12.1)**
Other adjustments	**(24.9)**	**-**	**-**	**(24.9)**	**-**	**-**	**(24.9)**
RNPFN Fund not available to the Group	**-**	**(164.5)**	**-**	**(164.5)**	**-**	**-**	**(164.5)**
Total Available Capital Resources	**759.1**	**-**	**103.2**	**862.3**	**1,512.6**	**(1,385.8)**	**989.1**

Available Capital Resources 2010	Society's participating contract business (1) £m	RNPFN participating contract business (2) £m	Other UK non participating (3) £m	Total long-term Business £m	Other Activities £m	Consolidation Adjustments £m	Group Total £m
Unallocated divisible surplus	1,078.6	-	-	1,078.6	-	(112.2)	966.4
Shareholdings in related undertakings	-	-	159.5	159.5	1,483.1	(1,642.6)	-
Adjustments onto regulatory basis:							
Adjustment from regulatory to realistic peak	291.8	183.9	-	475.7	-	-	475.7
Inadmissible assets	(43.4)	-	(54.6)	(98.0)	(35.3)	-	(133.3)
Adjustment to cost of investment in subsidiaries	(444.8)	-	-	(444.8)	-	432.8	(12.0)
Other adjustments	(15.2)	-	-	(15.2)	-	-	(15.2)
RNPFN Fund not available to the Group	-	(183.9)	-	(183.9)	-	-	(183.9)
Total Available Capital Resources	867.0	-	104.9	971.9	1,447.8	(1,322.0)	1,097.7

2. Capital management (continued)

Movements in capital during the year are analysed below.

Movements in capital 2011	Society's participating contract business (1) £m	RNPFN participating contract business (2) £m	Other UK non participating (3) £m	Total long-term Business £m	Other Activities £m	Consolidation Adjustments £m	**Group Total £m**
Capital at 1 January 2011	**867.0**	**-**	**104.9**	**971.9**	**1,447.8**	**(1,322.0)**	**1,097.7**
Effect of investment variations	**23.9**	**-**	**-**	**23.9**	**-**	**-**	**23.9**
Effect of changes in market conditions	**(9.5)**	**-**	**2.6**	**(6.9)**	**-**	**-**	**(6.9)**
Effect of changes in assumptions	**(13.9)**	**-**	**(11.2)**	**(25.1)**	**-**	**-**	**(25.1)**
Effect of changes in regulatory requirements	**(96.7)**	**-**	**-**	**(96.7)**	**11.9**	**-**	**(84.8)**
New business	**(94.2)**	**-**	**(6.9)**	**(101.1)**	**-**	**-**	**(101.1)**
Other	**152.8**	**-**	**13.8**	**166.6**	**52.9**	**(63.8)**	**155.7**
Adjustment from regulatory to realistic peak	**(70.3)**	**(19.4)**	**-**	**(89.7)**	**-**	**-**	**(89.7)**
Removal of RNPFN fund	**-**	**19.4**	**-**	**19.4**	**-**	**-**	**19.4**
Capital at 31 December 2011	**759.1**	**-**	**103.2**	**862.3**	**1,512.6**	**(1,385.8)**	**989.1**

Movements in capital 2010	Society's participating contract business (1) £m	RNPFN participating contract business (2) £m	Other UK non participating (3) £m	Total long-term Business £m	Other Activities £m	Consolidation Adjustments £m	**Group Total** £m
Capital at 1 January 2010	604.7	-	700.6	1,305.3	1,293.0	(1,736.4)	861.9
Effect of investment variations	170.8	-	3.9	174.7	-	-	174.7
Effect of changes in market conditions	(20.7)	-	-	(20.7)	-	-	(20.7)
Effect of changes in assumptions	(19.1)	-	(11.1)	(30.2)	-	-	(30.2)
Effect of changes in regulatory requirements	(14.2)	-	-	(14.2)	10.1	82.3	78.2
New business	(65.9)	-	(8.8)	(74.7)	-	-	(74.7)
Subsidiary capital restructure	-	-	(612.0)	(612.0)	-	612.0	-
Other	(8.1)	-	32.3	24.2	144.7	(279.9)	(111.0)
Adjustment from regulatory to realistic peak	219.5	16.6	-	236.1	-	-	236.1
Removal of RNPFN fund	-	(16.6)	-	(16.6)	-	-	(16.6)
Capital at 31 December 2010	867.0	-	104.9	971.9	1,447.8	(1,322.0)	1,097.7

Notes:

1) Included within the Society's participating contract fund are the non participating contracts written within this fund

2) RNPFN denotes Royal National Pension Fund for Nurses

3) Included within the Other UK non participating fund is the reinsured business from the Society to its subsidiary company Liverpool Victoria Life Company Limited

2. Capital management (continued)

In aggregate the Group has at its disposal total available capital of £989.1m (2010: £1,097.7m), representing the aggregation of the solvency capital of all group undertakings. This capital is available to meet risks and regulatory requirements set by reference to regulatory guidance as prescribed by the FSA.

For the Group's participating contract funds the available capital is determined in accordance with the 'realistic balance sheet' regime prescribed by the FSA's regulations under which liabilities to policyholders include both declared bonuses and the constructive obligation for future bonuses not yet declared. The available capital resources include an estimate of the value of their respective estates, which is the surplus in the fund in excess of any constructive obligations to policyholders. The unallocated capital represents the capital resources of the individual participating contract fund to which it relates and is available to meet regulatory and other solvency requirements of the fund. For these participating contract funds the liabilities included in the Statement of Financial Position comprise only amounts relating to policyholders.

The other activities of the Group have total available capital which is significantly higher than the minimum requirements established by the FSA for each of the regulated entities and, in principle, the excess is available to the Society. In practice, higher levels of capital are held within each business operation to provide appropriate cover for risk.

All available capital is ultimately available to support the Society's participating contract fund. However the available capital resources of each regulated entity are generally subject to restrictions as to their availability to meet requirements that may arise elsewhere in the Group. The principal restrictions are:

a) The RNPFN participating contract and non participating funds capital is generally available to support the RNPFN participating contract fund only. It is comfortably in excess of the required capital margin and, therefore, the Society is not required to provide further capital support to this business.

b) For other non participating funds, the available surplus held in the fund is attributable to Society policyholders and, subject to meeting the regulatory requirements of these businesses, this capital is available to meet requirements elsewhere in the Group.

Available capital

i) Long-term insurance contracts
For the long-term insurance contract funds the Group is required to hold sufficient capital to meet the FSA capital requirements based on the risk capital margin (RCM) determined in accordance with the FSA's regulatory rules under its realistic capital regime together with the Individual Capital Assessment (ICA) which takes into account certain business risks not reflected in the RCM. The determination of the RCM depends on various actuarial and other assumptions about potential changes in market prices, future operating experience and the actions management would take in the event of particular adverse changes in market conditions.

Management intends to maintain surplus capital in excess of the RCM and ICA to meet the FSA's total requirements and to maintain an appropriate additional margin over this to absorb changes in both capital and capital requirements.

ii) Non participating insurance contracts
For non participating business the relevant capital requirement is the minimum solvency requirement determined in accordance with FSA regulations. For this business a lower capital surplus is targeted by management since the capital requirement is less subject to fluctuation and the capital amount is after deducting liabilities that include additional prudential margins.

2. Capital management (continued)

Sensitivity analysis

i) Sensitivity of Society liabilities

The sensitivity of the Society's participating insurance contract liabilities at 31 December 2011 to a 20% fall in global equity markets or a fall in fixed interest yields of 17.5% is as follows:

	2011	Equities down 20%	Fixed interest yields down 17.5%	2010	Equities down 20%	Fixed interest yields down 17.5%
	£m	£m	£m	£m	£m	£m
Contract liabilities (excluding investment and insurance linked contracts)	**4,583.4**	**4,376.2**	**4,747.3**	3,768.5	3,672.4	3,939.4

In determining the percentage rates to use in the sensitivity analysis the Group has regard to those sensitivities set by the regulators and the view of the Directors is that these percentage movements reflect appropriate levels of volatility.

These sensitivities assume a tax charge or credit on market value appreciation or falls.

Further disclosure of the impact on the unallocated divisible surplus from sensitivity analysis is provided in Note 3.

ii) Sensitivity of long-term insurance contract liabilities
Long-term insurance contract liabilities are sensitive to changes in market conditions and other assumptions which have been factored into their calculation, such as mortality or persistency rates. In some cases allowance is also made when calculating liabilities for the effect of management and/or policyholder actions in different economic conditions on future assumptions such as asset mix, bonus rates and surrender values.

Market conditions – assumptions are made about investment returns and interest rates. Any adverse change in either variable will have the effect of reducing available capital as they will also impact corresponding asset valuations, changes in which may offset the impact of liability movements or in certain cases may result in further decreases in available capital.

Assumptions – long-term trend differences in mortality, morbidity, expense or persistency rates will result in the need to change assumptions. This may require a strengthening or release of reserves. Depending on policy type this sensitivity will differ; for example a change in mortality rates will have a different impact for annuity contract liabilities when compared to term assurance liabilities. In addition to persistency, assumptions are made about policyholders' behaviour in relation to guarantees and options. In turn these assumptions are sensitive to both investment return and interest rates.

Financial guarantees and options

a) Participating insurance contracts
As a normal part of operating activities, various group companies have given guarantees and options, including interest rate guarantees, in respect of certain long-term insurance contracts.

In the calculation of FSA liabilities for the participating insurance contract funds the Group is required to apply the FSA's realistic reporting regime. Provision is made for such guarantees and options within the FSA realistic liabilities of the Group's participating insurance contract funds. Under the FSA's rules these must be measured at fair value using market consistent stochastic models. A stochastic approach includes measuring the time value of guarantees and options, which represents the additional cost arising from uncertainty surrounding future economic conditions. The time value is evaluated by projecting a large number of possible future outcomes under a wide range of economic scenarios, for example possible outcomes for interest rates and equity returns. These realistic liabilities have been included within the Statement of Financial Position.

The material guarantees and options in the participating insurance contract funds are:

i) Guaranteed annuity options - the RNPFN participating insurance contract fund has written individual pensions which contain guaranteed annuity rate options (GAOs), where the policyholder has the option to take the benefits from a policy in the form of an annuity based on guaranteed conversion rates. The RNPFN fund also has exposure to GAOs and similar options on deferred annuities.

ii) Maturity value guarantees - many of the Group's participating insurance contracts have minimum maturity values reflecting the sums assured plus declared annual bonus.

iii) Money-back guarantees - some of the policies written within the Group provide a guarantee or option to pay out all the premiums paid in (at a certain point in time).

iv) While these do not constitute contractual guarantees, the Group has made promises to certain policyholders in relation to equity release mortgages that payments on these policies will meet the mortgage value covered.

2. Capital management (continued)

b) Non participating insurance contracts
The Group has also written contracts which include guarantees and options within its non participating insurance contract funds. These funds are not subject to the requirements of the FSA's realistic reporting regime and liabilities are evaluated by reference to statutory reserving rules. Provision for guarantees and options in the non participating funds has been included within liabilities.

The material guarantees and options in the non participating insurance contract funds are guaranteed annuity options. Similar options to those written in the participating insurance contract fund have been written in relation to non participating contracts. Provision for these guarantees does not materially differ from a provision based on a market consistent stochastic model.

3. Risk management and control

The Group seeks to create value for its members by maintaining an appropriate balance between the capital available to support risk and the level and type of risk it takes on in order to achieve returns for policyholders. The principal types of risk, which are detailed below, have been identified and risk appetite for each of these has been set based on the amount necessary to meet the FSA's capital requirements. The Group recognises the critical importance of having efficient and effective risk management systems in place and these take the form of:

- Board and Executive committees with clear terms of reference.
- Financial and non-Financial committees.
- A clear organisation structure with documented allocation of responsibilities.
- A uniform methodology of risk assessment, which is embedded within all companies in the Group so that they operate within agreed tolerances and with appropriate controls in place.
- Regular reviews of risks by senior managers, where frequency of review is determined by the potential impact of the risk and its likelihood.

a) Insurance risk
Insurance risk is the risk that arises from the inherent uncertainties as to the occurrence, amount and timing of insurance liabilities. Long-term insurance risk arises from mortality, morbidity, persistency and expense variances. General insurance risk arises from risks in general insurance contracts which lead to significant claims in terms of quantity or value. These would include significant weather events, subsidence, substantial medical claims and major accidents on a single policy. Systems are in place to measure, monitor and control exposure to all these risks. These are documented in policies for underwriting, pricing, claims and reinsurance. To mitigate risk in the life and general insurance businesses the Group places reinsurance.

Long-term insurance contracts
Protection and annuity business is at risk from adverse changes in mortality experience from the time when the policies were underwritten. In the case of policies that pay out on death, the risk is that mortality experience worsens, whereas for annuities, the risk is that mortality experience improves. These two types of business therefore to some extent offset each other in a risk sense. On protection business, the Group uses underwriting procedures, backed up with medical screening if appropriate, designed to price accurately for such risks and reinsurance is in place to limit the quantum of risk retained on each policy. The Group's annuity business is partially reassured.

Income protection and critical illness business is at risk from changes in morbidity rates. Where there is an increased incidence of ill health or an increase in the duration of such ill health, the Group is exposed to higher claims than expected. The Group has underwriting procedures, including medical and financial screening if appropriate, to price accurately for such risks and reinsurance is in place to limit the risk retained on each policy.

Persistency risk influences the ability to recover acquisition costs from margins within the products. The risk is greater in early years but reduces significantly as time passes. For long-term insurance contract liabilities there is an allowance built in to allow for future withdrawals. Exposure in future years occurs where withdrawals are lower than assumed resulting in higher future guaranteed payouts.

Higher than expected expense costs will increase the reserves required. The Group is exposed to the risk that the charges it deducts from policyholder benefits are not sufficient to cover future expenses.

3. Risk management and control (continued)

The table below sets out the concentration of long-term insurance and investment contract liabilities on a realistic basis by type of contract. All business is written in the UK.

	2011			2010		
	Gross	**Reinsurance**	**Net**	Gross	Reinsurance	Net
Group	**£m**	**£m**	**£m**	£m	£m	£m
Whole life	**1,426.7**	**(18.6)**	**1,408.1**	1,404.6	7.5	1,412.1
Endowment	**758.9**	**-**	**758.9**	553.9	-	553.9
Term assurance	**45.0**	**(77.2)**	**(32.2)**	81.6	(68.8)	12.8
Guaranteed annuity pension	**1,269.7**	**(21.2)**	**1,248.5**	1,175.1	(13.6)	1,161.5
Pure endowment pensions	**2,108.4**	**(24.1)**	**2,084.3**	1,438.4	(6.2)	1,432.2
Critical illness	**59.1**	**(38.1)**	**21.0**	51.6	(25.9)	25.7
Income protection	**96.3**	**(40.8)**	**55.5**	83.0	(16.8)	66.2
ISA	**68.7**	**-**	**68.7**	67.5	-	67.5
Other	**91.9**	**(3.0)**	**88.9**	228.5	(3.2)	225.3
	5,924.7	**(223.0)**	**5,701.7**	5,084.2	(127.0)	4,957.2
Long-term claims liabilities	**40.0**	**-**	**40.0**	44.6	-	44.6
Unit linked	**806.9**	**-**	**806.9**	763.7	-	763.7
	6,771.6	**(223.0)**	**6,548.6**	5,892.5	(127.0)	5,765.5

The table below sets out the impact on long-term insurance contract liabilities, the Unallocated divisible surplus and Profit before tax for movements in key assumptions.

Sensitivity analysis for the change in assumptions used in long-term insurance contract liabilities	Impact on Profit before tax £m	Impact on the Unallocated divisible surplus £m	Impact on long-term insurance contract liabilities £m
Increase in mortality rates by 5%	**32.6**	**32.6**	**(7.2)**
Increase in morbidity rates by 5%	**(8.8)**	**(8.8)**	**23.1**
Reduction in persistency by 5%	**(3.5)**	**(3.5)**	**8.7**
Increase in expenses by 10%	**(30.8)**	**(30.8)**	**30.6**

General Insurance

Property business suffers from the risk of significant weather events or subsidence which can result in large claims in a single area. The Group has entered into reinsurance contracts to reduce exposure to catastrophe claims.

The motor business is exposed to the risk of large personal injury claims, where the claims amounts can be significant due to the cost of care for the claimant. The Group has entered into reinsurance contracts which reduce its exposure to large claims.

The table below sets out the concentration of General Insurance claims liabilities by type of contract.

	2011			2010		
	Gross	**Reinsurance**	**Net**	Gross	Reinsurance	Net
Group	**£m**	**£m**	**£m**	£m	£m	£m
Motor	**857.3**	**(94.3)**	**763.0**	749.7	(76.4)	673.3
Household	**53.9**	**-**	**53.9**	63.4	-	63.4
Other	**118.7**	**(6.6)**	**112.1**	27.0	-	27.0
	1,029.9	**(100.9)**	**929.0**	840.1	(76.4)	763.7

3. Risk management and control (continued)

The claims provision is the estimated cost of outstanding claims from expired risks. The provision is calculated largely from using our own 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. Periodic Payment Orders ('PPOs'), Ministry of Justice reform, Ogden discount rate, etc)
- Changes in other external factors (e.g. claims farming / accident management firms)

It is therefore very 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 Group has identified the exposure to PPOs as the key area of uncertainty relating to the claims provision as at 31 December 2011. The claims provision includes a specific allowance for claims identified as having the potential to settle on a PPO basis. This allowance is based on the mean cost of claims derived from a range of scenarios based on the PPO settlement rate for the claims. If all of these claims settled as PPOs, the reserves would deteriorate by £23m from the position shown below.

The claims provision is also sensitive to the number and cost of large motor claims (defined as greater than £1m), which have been incurred but not reported and reserved. We would typically expect a number of large claims from expired risks to be identified in the future, either from being newly reported or from existing claims increasing in magnitude above the £1m threshold. Again, whilst the claims provision allows for an expected level of late reported / reserved large claims, a higher number observed will lead to a deterioration in reserves.

The table below incorporates all general insurance products and reflects the cumulative incurred claims, including both claims notified and IBNR for each successive accident year at each Statement of Financial Position date, together with cumulative payments to date. The Group aims to maintain strong reserves in order to protect against adverse future claims experience and developments. As claims develop and the ultimate cost becomes more certain, adverse claims experiences are eliminated which results in a release of reserves from earlier accident years.

Analysis of claims development – gross of reinsurance	2002 £m	2003 £m	2004 £m	2005 £m	2006 £m	2007 £m	2008 £m	2009 £m	2010 £m	2011 £m	Total £m
Initial estimate of net provision	273.1	397.0	500.9	521.5	551.0	560.2	539.6	601.2	776.6	917.4	
One year later	278.7	402.8	487.2	523.6	527.5	512.6	540.2	592.3	822.7		
Two years later	259.6	385.4	466.3	494.5	505.1	489.4	500.2	585.9			
Three years later	252.1	356.3	450.0	472.1	490.2	485.9	490.0				
Four years later	240.6	346.4	437.8	462.6	477.2	487.6					
Five years later	241.6	343.6	434.7	457.3	477.5						
Six years later	240.9	342.8	436.0	457.6							
Seven years later	240.8	342.9	435.9								
Eight years later	238.9	342.4									
Nine years later	238.5										
Current estimate of cumulative claims	238.5	342.4	435.9	457.6	477.5	487.6	490.0	585.9	822.7	917.4	5,255.5
Cumulative payments to date	(238.1)	(335.7)	(428.0)	(449.8)	(465.9)	(449.2)	(443.4)	(474.4)	(578.5)	(406.2)	(4,269.2)
Liability recognised in the Statement of Financial Position for 2002 to 2011 accident years	0.4	6.7	7.9	7.8	11.6	38.4	46.6	111.5	244.2	511.2	986.3
Liability recognised in the Statement of Financial Position in respect of prior accident years											20.6
Claims handling provision											23.0
Gross general insurance claims liabilities as at 31 December 2011											**1,029.9**

3. Risk management and control (continued)

Analysis of claims development – net of reinsurance	2002 £m	2003 £m	2004 £m	2005 £m	2006 £m	2007 £m	2008 £m	2009 £m	2010 £m	2011 £m	Total £m
Initial estimate of net provision	271.0	357.4	445.6	484.2	513.4	505.8	506.8	577.9	767.5	908.0	
One year later	272.6	364.3	437.1	473.8	474.7	462.9	482.9	564.1	802.8		
Two years later	253.6	352.8	415.8	439.2	467.0	440.2	464.0	561.1			
Three years later	247.9	328.1	407.0	429.5	451.4	441.1	456.7				
Four years later	237.3	327.5	393.2	423.4	443.7	430.1					
Five years later	235.7	316.6	391.5	421.9	441.9						
Six years later	235.6	314.7	392.7	421.1							
Seven years later	235.3	315.2	389.4								
Eight years later	233.7	316.6									
Nine years later	235.4										
Current estimate of cumulative claims	235.4	316.6	389.4	421.1	441.9	430.1	456.7	561.1	802.8	908.0	4,963.1
Cumulative payments to date	(235.1)	(314.2)	(388.1)	(416.0)	(431.0)	(414.9)	(416.1)	(465.4)	(578.5)	(406.1)	(4,065.4)
Liability recognised in the Statement of Financial Position for 2002 to 2011 accident years	0.3	2.4	1.3	5.1	10.9	15.2	40.6	95.7	224.3	501.9	897.7
Liability recognised in the Statement of Financial Position in respect of prior accident years											8.3
Claims handling provision											23.0
Net general insurance claims liabilities as at 31 December 2011											**929.0**

b) Financial risk

i) Market risk
Market risk is the risk of adverse or favourable impacts due to fluctuations in bond yield, equity prices, interest rates, exchange rates or property prices. It arises due to fluctuations in liabilities arising from products sold and the value of investments held. The Group has defined policies and procedures in place to control the major components of market risk. The Group has appointed Threadneedle Investments as its investment manager. All dealings with Threadneedle Investments are transacted on an arm's length basis. Exposures to individual companies and to equity shares in aggregate are monitored by Investment and Risk Committees in order to ensure compliance with the relevant regulatory limits for solvency purposes and with guidelines set for each fund. Investments held are primarily listed on recognised stock exchanges.

Limits on the Group's exposure to equities are defined both in aggregate terms and by geography, industry and counterparty. Tactical asset allocation meetings are held weekly, and strategic asset allocation meetings quarterly, to discuss investment return and concentration and to agree any changes required.

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.

Property price risk
The Group is exposed to property price risk on the commercial properties it holds as investments. Values of properties are determined from the future value of cash flows and the Group enters into leases following an assessment of the tenant's ability to pay the rent and service charges.

Interest rate risk
The Group monitors interest rate risk by calculating the mean duration of the investment portfolio and the liabilities issued. The mean duration is an indicator of the sensitivity of the assets and liabilities to changes in current interest rates. The mean duration of the liabilities is determined by means of projecting expected cash flows from the contracts using best estimates of mortality and voluntary terminations. The mean duration of the assets is calculated in a consistent manner.

3. Risk management and control (continued)

Asset liability matching
The Group manages its financial positions with an asset liability management (ALM) framework that has been developed to achieve long term investment returns in excess of its obligations under insurance and investment contracts. The principal technique of the Group's ALM is to match assets to the liabilities arising from insurance contracts by reference to the type of benefits payable to contract holders.

The Group's ALM is integrated with the management of the financial risks associated with the Group's other financial assets and liabilities not directly associated with insurance and investment liabilities.

Currency risk
The Group is exposed to foreign exchange risk within the investment portfolio supporting the Group's operations from purchased investments that are denominated or payable in currencies other than sterling. There is no other exposure to currency risk.

The table below summarises the Group's exposure after hedging to foreign currency exchange risk in sterling.

	2011					2010				
	Euro	**US Dollar**	**Yen**	**Other**	**Total**	Euro	US Dollar	Yen	Other	Total
	£m	**£m**	**£m**	**£m**	**£m**	£m	£m	£m	£m	£m
Derivatives	**(13.1)**	**(32.4)**	**-**	**(4.1)**	**(49.6)**	-	(5.0)	(1.1)	(3.9)	(10.0)
Equity securities	**105.1**	**205.3**	**59.0**	**90.6**	**460.0**	158.9	102.4	98.8	153.9	514.0
Debt securities	**8.9**	**32.3**	**3.3**	**0.5**	**45.0**	7.2	3.6	4.5	0.7	16.0
Other investments	**2.7**	**-**	**-**	**-**	**2.7**	2.7	-	-	-	2.7
Cash and cash equivalents	**21.7**	**3.7**	**0.1**	**0.4**	**25.9**	18.3	110.8	1.3	0.9	131.3
	125.3	**208.9**	**62.4**	**87.4**	**484.0**	187.1	211.8	103.5	151.6	654.0

The sensitivity of investment assets to a 10% increase/decrease in Euro and US Dollar exchange rates, net of derivatives, is £12.5m and £20.9m respectively. In determining the percentage rates to use in this sensitivity analysis the movements in actual market rates of Euro and US Dollars during 2011 was 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 £48.4m.

Some foreign debt securities are denominated in sterling so bear no currency risk and have not been included within the above table.

Derivative risk
Derivatives are used to reduce exposure to fluctuations in interest rates, exchange rates and for efficient portfolio management purposes. The principal 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.

Summary of market risk sensitivities
The table below sets out the impact on long-term insurance contract liabilities, the Unallocated divisible surplus and Profit before tax for movements in sectors of the market that the Group is invested in, net of derivatives.

Sensitivity analysis to movements in key market sectors	**Impact on Profit before tax £m**	**Impact on the Unallocated divisible surplus £m**	**Impact on gross long-term insurance contract liabilities £m**
Equity values fall by 20%	**(27.9)**	**(27.9)**	**(192.5)**
Equity values increase by 20%	**56.8**	**56.8**	**178.7**
Property values fall by 12.5%	**(9.4)**	**(9.4)**	**(19.8)**
Property values increase by 12.5%	**15.0**	**15.0**	**14.1**
15 year Gilt yields fall by 17.5%	**12.2**	**12.2**	**229.4**
15 year Gilt yields increase by 17.5%	**(8.2)**	**(8.2)**	**(207.2)**

In determining the percentage rates to use in the sensitivity analysis the Group has made reference to those set by the regulators for calculating the risk capital margin.

Asset values and, where appropriate, asset shares are adjusted to reflect the change in each sensitivity. 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.

3. Risk management and control (continued)

ii) Credit risk

Credit risk is the risk of loss due to counterparties failing to meet all or part of their obligations in a timely fashion.

The principal credit risks arise from exposure to counterparties through exposure to corporate bonds, reinsurers' share of insurance liabilities, amounts due from reinsurers in respect of claims already paid, amounts due from insurance contract holders, amounts due from insurance intermediaries and counterparty risk with respect to derivative transactions.

Policies are in place to control the major components of credit risk, including counterparty default and concentration risk. The Group places limits on its exposure to a single counterparty, or groups of counterparty, and to geographical and industry segments.

Reinsurance is used to manage insurance risk. This does not, however, discharge the Group's liability as primary insurer. If a reinsurer fails to pay a claim, the Group remains liable for the payment to the policyholder. The creditworthiness of reinsurers is considered by reviewing their financial strength prior to finalisation of any contract and on an annual basis.

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.

Credit risk exposure 2011	**AAA £m**	**AA £m**	**A £m**	**BBB £m**	**Below BBB £m**	**Not rated £m**	**Total £m**
Debt and other fixed income securities	**2,947.1**	**392.1**	**1,236.0**	**698.4**	**33.7**	**33.7**	**5,341.0**
Loans secured on residential property	**-**	**-**	**-**	**-**	**-**	**334.2**	**334.2**
Other	**-**	**-**	**-**	**-**	**-**	**1.7**	**1.7**
Loans secured by policies	**-**	**-**	**-**	**-**	**-**	**0.6**	**0.6**
Other loans	**-**	**-**	**-**	**-**	**-**	**0.4**	**0.4**
Short term deposits	**-**	**55.0**	**501.9**	**1.0**	**-**	**4.3**	**562.2**
	2,947.1	**447.1**	**1,737.9**	**699.4**	**33.7**	**374.9**	**6,240.1**
Reinsurance assets							
- non linked	**3.5**	**185.5**	**88.9**	**-**	**-**	**36.0**	**313.9**
- linked	**-**	**23.0**	**-**	**-**	**-**	**-**	**23.0**
	2,950.6	**655.6**	**1,826.8**	**699.4**	**33.7**	**410.9**	**6,577.0**

Credit risk exposure 2010	AAA £m	AA £m	A £m	BBB £m	Below BBB £m	Not rated £m	Total £m
Debt and other fixed income securities	2,728.3	399.8	1,002.0	571.0	30.2	36.9	4,768.2
Loans secured on residential property	-	-	-	-	-	187.0	187.0
Other	-	-	-	-	-	2.7	2.7
Loans secured by policies	-	-	-	-	-	0.9	0.9
Other loans	-	-	-	-	-	0.5	0.5
	2,728.3	399.8	1,002.0	571.0	30.2	228.0	4,959.3
Reinsurance assets							
- non linked	2.2	72.7	106.3	-	-	15.7	196.9
- linked	-	6.5	-	-	-	-	6.5
	2,730.5	479.0	1,108.3	571.0	30.2	243.7	5,162.7

In 2010 no rating information was available for short term deposits totalling £365.5m

3. Risk management and control (continued)

The tables below show the age analysis of the Group's past due and/or impaired assets.

Age analysis of assets past due but not impaired 2011	<30 days	31 to 60 days	61 to 90 days	>90 days	Total past due but not impaired	Past due and impaired	Total
	£m	£m	£m	£m	£m	£m	£m
Financial assets - loans and other receivables	**0.1**	**-**	**-**	**-**	**0.1**	**0.1**	**0.2**
Insurance receivables	**6.4**	**2.7**	**0.1**	**0.7**	**9.9**	**0.6**	**10.5**
	6.5	**2.7**	**0.1**	**0.7**	**10.0**	**0.7**	**10.7**

Age analysis of assets past due but not impaired 2010	<30 days	31 to 60 days	61 to 90 days	>90 days	Total past due but not impaired	Past due and impaired	Total
	£m	£m	£m	£m	£m	£m	£m
Financial assets - loans and other receivables	1.1	0.2	0.1	0.2	1.6	0.2	1.8
Insurance receivables	10.8	2.4	0.8	3.0	17.0	1.9	18.9
	11.9	2.6	0.9	3.2	18.6	2.1	20.7

The table below summarises the impairment losses on loans and receivables.

	Group	
	2011	2010
	£m	£m
Amounts written off during the year as uncollectable	**-**	16.7
Amounts received on claims previously written off	**(0.1)**	(1.5)
Utilisation of provision brought forward	**-**	(12.1)
Total impairment losses on loans and receivables	**(0.1)**	3.1

Collateral

For securities lending the amount and type of collateral required depend on an assessment of the credit risk of the type of security lent. All securities lent are indemnified subject to the conditions of a Stock Lending Authorisation Agreement. Guidelines are implemented regarding the acceptability of types of collateral and the valuation parameters. Collateral is mainly obtained for securities lending. Credit risk is also mitigated by entering into the collateral agreement. Operations monitor the market value of the collateral, request additional collateral when needed and perform an impairment valuation when applicable. The collateral can be sold or repledged by the Group and is repayable if the contract terminates or the contract's fair value decreases. At 31 December 2011, the collateral held was £nil (2010: £265.7m). No collateral received from the counterparty has been sold or repledged (2010: £nil).

For over-the-counter derivative transactions undertaken by the Group, collateral is received from the counterparty. The collateral can be sold or repledged by the Group and is repayable if the contract terminates or the contract's fair value decreases. At 31 December 2011, the fair value of such collateral held was £131.4m (2010: £15.5m). No collateral received from the counterparty has been sold or repledged (2010: £nil).

Eurozone exposure

The Group has no significant exposure to the main countries involved in the ongoing difficulties being experienced within the Eurozone.

The following table shows the Group's exposure by country of incorporation of the counterparty at 31 December 2011.

	Sovereign	Non-Sovereign	Total
	£m	£m	£m
Ireland	**-**	**95.1**	**95.1**
Italy	**0.2**	**17.3**	**17.5**
Greece	**-**	**-**	**-**
Portugal	**-**	**1.2**	**1.2**
Spain	**-**	**56.1**	**56.1**
France	**9.4**	**197.8**	**207.2**
Other Eurozone	**2.6**	**814.7**	**817.3**
Total	**12.2**	**1,182.2**	**1,194.4**

3. Risk management and control (continued)

iii) Liquidity risk

Liquidity risk is the risk that the Group does not have sufficient available liquid assets to meet its obligations as they fall due.

Sources of liquidity risk have been identified and systems are in place to measure, monitor and control liquidity exposures. These are documented in liquidity policies.

Liquidity is maintained at a prudent level, with a buffer to cover contingencies including the provision of temporary liquidity to subsidiary companies.

The table below summarises the maturity profile of the financial liabilities of the Group based on remaining undiscounted contractual obligations, except for long term insurance participating (commonly referred to as "with-profits") contracts where maturity profiles are determined on the discounted estimated timing of net cash outflows.

Group	**Within 1 year**	**1-3 years**	**3-5 years**	**Over 5 years**	**No term**	**Linked**	**Total**
Maturity profile of financial liabilities 2011	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**
Unallocated divisible surplus	**-**	**-**	**-**	**-**	**958.4**	**-**	**958.4**
Insurance contract liabilities	**1,187.0**	**619.6**	**364.1**	**5,519.7**	**-**	**57.6**	**7,748.0**
Investment contract liabilities	**-**	**-**	**-**	**-**	**-**	**800.9**	**800.9**
Net asset value attributable to unit holders	**429.1**	**-**	**-**	**-**	**-**	**-**	**429.1**
Provisions	**6.5**	**48.1**	**0.8**	**0.7**	**-**	**-**	**56.1**
Financial liabilities							
- Derivative financial instruments	**-**	**3.8**	**-**	**-**	**-**	**-**	**3.8**
- Other financial liabilities	**0.3**	**-**	**-**	**10.1**	**-**	**-**	**10.4**
Insurance payables	**41.6**	**-**	**-**	**-**	**-**	**-**	**41.6**
Trade and other payables	**201.7**	**2.3**	**2.4**	**89.4**	**-**	**-**	**295.8**
	1,866.2	**673.8**	**367.3**	**5,619.9**	**958.4**	**858.5**	**10,344.1**

Group	Within 1 year	1-3 years	3-5 years	Over 5 years	No term	Linked	Total
Maturity profile of financial liabilities 2010	£m	£m	£m	£m	£m	£m	£m
Unallocated divisible surplus	-	-	-	-	966.4	-	966.4
Insurance contract liabilities	1,170.8	445.1	271.1	4,660.4	-	68.7	6,616.1
Investment contract liabilities	-	-	-	-	-	741.2	741.2
Net asset value attributable to unit holders	449.2	-	-	-	-	-	449.2
Provisions	6.4	43.0	2.2	1.1	-	-	52.7
Financial liabilities							
- Derivative financial instruments	1.0	27.9	-	-	-	-	28.9
- Other financial liabilities	0.5	-	-	10.2	-	-	10.7
Insurance payables	8.9	23.7	-	-	-	-	32.6
Trade and other payables	153.1	2.3	2.4	90.6	-	-	248.4
	1,789.9	542.0	275.7	4,762.3	966.4	809.9	9,146.2

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. Therefore the Group is not exposed to price, currency, credit or interest risk in respect of these contracts. 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.

3. Risk management and control (continued)

Society **Maturity profile of financial liabilities 2011**	**Within 1 year** **£m**	**1-3 years** **£m**	**3-5 years** **£m**	**Over 5 years** **£m**	**No term** **£m**	**Linked** **£m**	**Total** **£m**
Unallocated divisible surplus	**-**	**-**	**-**	**-**	**1,055.1**	**-**	**1,055.1**
Insurance contract liabilities	**107.8**	**190.3**	**184.7**	**5,405.8**	**-**	**57.6**	**5,946.2**
Investment contract liabilities	**-**	**-**	**-**	**-**	**-**	**800.9**	**800.9**
Provisions	**5.1**	**46.8**	**0.4**	**-**	**-**	**-**	**52.3**
Financial liabilities							
- Derivative financial instruments	**-**	**3.8**	**-**	**-**	**-**	**-**	**3.8**
- Borrowings	**-**	**5.6**	**-**	**-**	**-**	**-**	**5.6**
- Other financial liabilities	**-**	**0.3**	**-**	**-**	**-**	**-**	**0.3**
Insurance payables	**31.6**	**-**	**-**	**-**	**-**	**-**	**31.6**
Trade and other payables	**109.7**	**-**	**-**	**-**	**-**	**-**	**109.7**
	254.2	**246.8**	**185.1**	**5,405.8**	**1,055.1**	**858.5**	**8,005.5**

Society Maturity profile of financial liabilities 2010	Within 1 year £m	1-3 years £m	3-5 years £m	Over 5 years £m	No term £m	Linked £m	Total £m
Unallocated divisible surplus	-	-	-	-	1,078.6	-	1,078.6
Insurance contract liabilities	116.6	73.8	105.1	4,760.7	-	68.7	5,124.9
Investment contract liabilities	-	-	-	-	-	741.2	741.2
Provisions	0.5	38.4	-	-	-	-	38.9
Financial liabilities							
- Derivative financial instruments	0.9	27.9	-	-	-	-	28.8
Insurance payables	-	23.7	-	-	-	-	23.7
Trade and other payables	121.3	-	-	-	-	-	121.3
	239.3	163.8	105.1	4,760.7	1,078.6	809.9	7,157.4

3. Risk management and control (continued)

The tables below summarise the expected recovery or settlement of assets:

	2011			2010		
	Within 1 year	**Over 1 year**	**Total**	Within 1 year	Over 1 year	Total
Group	**£m**	**£m**	**£m**	£m	£m	£m
Deferred acquisition costs	**94.7**	**-**	**94.7**	87.2	51.6	138.8
Investment properties	**-**	**219.9**	**219.9**	-	315.4	315.4
Financial assets						
- Fair value through income	**1,852.3**	**6,168.0**	**8,020.3**	1,792.3	5,349.2	7,141.5
- Derivative financial instruments	**6.7**	**137.1**	**143.8**	3.1	43.0	46.1
- Loans and other receivables	**112.4**	**3.6**	**116.0**	77.2	2.0	79.2
Reinsurance assets	**253.6**	**83.3**	**336.9**	169.4	44.2	213.6
Insurance receivables	**216.5**	**-**	**216.5**	193.2	-	193.2
Prepayments and accrued income	**61.3**	**-**	**61.3**	60.7	1.9	62.6
Cash and cash equivalents	**652.3**	**-**	**652.3**	536.2	-	536.2
Total assets	**3,249.8**	**6,611.9**	**9,861.7**	2,919.3	5,807.3	8,726.6

	2011			2010		
	Within 1 year	**Over 1 year**	**Total**	Within 1 year	Over 1 year	Total
Society	**£m**	**£m**	**£m**	£m	£m	£m
Investment properties	**-**	**151.4**	**151.4**	-	246.6	246.6
Financial assets						
- Fair value through income	**2,114.1**	**3,902.0**	**6,016.1**	2,145.3	3,076.5	5,221.8
- Derivative financial instruments	**6.7**	**137.1**	**143.8**	3.1	43.0	46.1
- Loans and other receivables	**116.3**	**0.9**	**117.2**	77.3	-	77.3
Reinsurance assets	**223.0**	**-**	**223.0**	216.0	-	216.0
Insurance receivables	**10.2**	**-**	**10.2**	14.9	-	14.9
Prepayments and accrued income	**48.1**	**-**	**48.1**	45.1	-	45.1
Cash and cash equivalents	**216.6**	**-**	**216.6**	277.8	-	277.8
Total assets	**2,735.0**	**4,191.4**	**6,926.4**	2,779.5	3,366.1	6,145.6

iv) Fair value estimation

The following fair value estimation tables, as required by IFRS7, 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 2011.

The fair value of financial instruments included in the Level 1 category is based on published quoted bid market prices in an active market at the year end date. A market 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 financial instruments are not traded in an active market or 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 3 include:

- Quoted market prices or dealer quotes for similar instruments (unlisted shares).
- The fair value of interest rate swaps is calculated as the present value of the estimated future cash flows based on observable yield curves.
- The fair value of forward exchange contracts is determined using forward exchange rates at the Statement of Financial Position date, with the resulting value discounted back to present value.
- The fair value of the loans secured on residential property is determined using discounted cash flows. The swap rate used as an input to the discount rate is matched to the expected term of the underling policies. The No negative equity guarantee liability is fair valued using discounted cash flows and is netted off against the fair value of the assets.
- Other techniques, such as discounted cash flow analysis, are used to determine fair value for the remaining other financial instruments.

If one or more of the significant inputs is not based on observable market data, the instrument is included in level 3.

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 8 and 10 respectively.

3. Risk management and control (continued)

iv) Fair Value estimation

	2011				2010			
	Level 1	Level 2	Level 3	Total fair value	Level 1	Level 2	Level 3	Total fair value
Group	£m	£m	£m	£m	£m	£m	£m	£m
Financial assets								
Derivative financial instruments								
Interest rate swaps	-	-	64.2	64.2	-	-	10.7	10.7
Swaptions	-	-	29.6	29.6	-	-	33.0	33.0
Forward exchange contracts	-	-	-	-	-	0.2	-	0.2
Equity/index derivatives	10.3	-	39.7	50.0	2.2	-	-	2.2
	10.3	-	133.5	143.8	2.2	0.2	43.7	46.1
Financial assets held at fair value through income								
Shares, other variable yield securities and units in unit trusts								
– UK listed	1,095.6	629.7	-	1,725.3	1,008.0	454.0	-	1,462.0
– UK unlisted	-	-	113.9	113.9	-	-	146.1	146.1
– Overseas listed	378.7	30.8	-	409.5	468.0	12.5	-	480.5
– Overseas unlisted	-	-	94.7	94.7	-	-	95.0	95.0
Debt and other fixed income securities								
– UK listed	2,302.9	1,537.6	0.7	3,841.2	2,351.5	1,188.8	2.2	3,542.5
– Overseas listed	7.9	1,490.8	1.1	1,499.8	122.9	1,102.8	-	1,225.7
Loans secured on residential property	-	-	334.2	334.2	-	-	187.0	187.0
Other	1.7	-	-	1.7	2.7	-	-	2.7
	3,786.8	3,688.9	544.6	8,020.3	3,953.1	2,758.1	430.3	7,141.5
	3,797.1	3,688.9	678.1	8,164.1	3,955.3	2,758.3	474.0	7,187.6
Financial liabilities								
Investment contract liabilities	-	687.5	113.4	800.9	-	603.8	137.4	741.2
Derivative financial instruments								
Swaptions	-	-	-	-	-	-	27.6	27.6
Forward exchange contracts	-	-	-	-	-	1.3	-	1.3
Equity/index derivatives	3.6	-	-	3.6	-	-	-	-
Property index swap	-	-	0.2	0.2	-	-	-	-
	3.6	-	0.2	3.8	-	1.3	27.6	28.9
	3.6	687.5	113.6	804.7	-	605.1	165.0	770.1

3. Risk management and control (continued)

iv) Fair Value estimation

	2011				2010			
	Level 1	Level 2	Level 3	Total fair value	Level 1	Level 2	Level 3	Total fair value
Society	£m	£m	£m	£m	£m	£m	£m	£m
Financial assets								
Derivative financial instruments								
Interest rate swaps	-	-	64.2	64.2	-	-	10.7	10.7
Swaptions	-	-	29.6	29.6	-	-	33.0	33.0
Forward exchange contracts	-	-	-	-	-	0.2	-	0.2
Equity/index derivatives	10.3	-	39.7	50.0	2.2	-	-	2.2
	10.3	-	133.5	143.8	2.2	0.2	43.7	46.1
Financial assets held at fair value through income								
Shares, other variable yield securities and units in unit trusts								
– UK listed	727.2	2,029.1	-	2,756.3	722.1	1,726.3	-	2,448.4
– UK unlisted	-	-	113.9	113.9	-	-	140.3	140.3
– Overseas listed	48.5	-	-	48.5	129.5	4.5	-	134.0
– Overseas unlisted	-	-	91.5	91.5	-	-	88.1	88.1
Debt and other fixed income securities								
– UK listed	1,670.5	527.7	0.7	2,198.9	1,592.2	351.8	2.2	1,946.2
– UK unlisted	-	-	-	-	-	-	-	-
– Overseas listed	7.5	523.4	1.1	532.0	25.3	305.1	-	330.4
Loan to group undertaking	-	-	162.2	162.2	-	-	131.7	131.7
Loans secured on residential property	-	-	111.1	111.1	-	-	-	-
Other	1.7	-	-	1.7	2.7	-	-	2.7
	2,455.4	3,080.2	480.5	6,016.1	2,471.8	2,387.7	362.3	5,221.8
	2,465.7	3,080.2	614.0	6,159.9	2,474.0	2,387.9	406.0	5,267.9
Financial liabilities								
Investment contract liabilities	-	687.5	113.4	800.9	-	603.8	137.4	741.2
Derivative financial instruments								
Swaptions	-	-	-	-	-	-	27.6	27.6
Forward exchange contracts	-	-	-	-	-	1.2	-	1.2
Equity/index derivatives	3.6	-	-	3.6	-	-	-	-
Property index swap	-	-	0.2	0.2	-	-	-	-
	3.6	-	0.2	3.8	-	1.2	27.6	28.8
	3.6	687.5	113.6	804.7	-	605.0	165.0	770.0

3. Risk management and control (continued)

iv) Fair value estimation

The table below presents the movements in level 3 financial instruments for the year ended 31 December 2011:

Group	At 1 January 2011 £m	Total gains/ (losses) recognised through income £m	Purchases £m	Sales* £m	At 31 December 2011 £m
Financial assets					
Derivative financial instruments					
Interest rate swaps	**10.7**	**53.5**	**-**	**-**	**64.2**
Swaptions	**33.0**	**8.9**	**-**	**(12.3)**	**29.6**
Equity/index derivatives	**-**	**9.7**	**30.0**	**-**	**39.7**
	43.7	**72.1**	**30.0**	**(12.3)**	**133.5**
Financial assets held at fair value through income					
Shares, other variable yield securities and units in unit trusts					
– UK unlisted	**146.1**	**(25.8)**	**4.1**	**(10.5)**	**113.9**
– Overseas unlisted	**95.0**	**14.1**	**1.8**	**(16.2)**	**94.7**
Debt and other fixed income securities					
– UK listed	**2.2**	**0.4**	**-**	**(1.9)**	**0.7**
– Overseas listed	**-**	**(3.1)**	**4.2**	**-**	**1.1**
Loans secured on residential property	**187.0**	**70.3**	**87.3**	**(10.4)**	**334.2**
	430.3	**55.9**	**97.4**	**(39.0)**	**544.6**
	474.0	**128.0**	**127.4**	**(51.3)**	**678.1**
Financial liabilities					
Investment contract liabilities	**137.4**	**-**	**-**	**(24.0)**	**113.4**
Derivative financial instruments					
Swaptions	**27.6**	**-**	**-**	**(27.6)**	**-**
Property index swap	**-**	**-**	**0.2**	**-**	**0.2**
	27.6	**-**	**0.2**	**(27.6)**	**0.2**
	165.0	**-**	**0.2**	**(51.6)**	**113.6**

* In relation to Loans secured on residential property, sales represents loans repaid.

3. Risk management and control (continued)

iv) Fair value estimation

Group	At 1 January 2010 £m	Total gains/ (losses) recognised through income £m	Purchases £m	Sales £m	At 31 December 2010 £m
Financial assets					
Derivative financial instruments					
Interest rate swaps	47.7	(16.8)	-	(20.2)	10.7
Swaptions	72.1	(57.0)	40.2	(22.3)	33.0
	119.8	(73.8)	40.2	(42.5)	43.7
Financial assets held at fair value through income					
Shares, other variable yield securities and units in unit trusts					
– UK listed	0.3	(4.4)	4.4	(0.3)	(0.0)
– UK unlisted	116.6	37.1	2.2	(9.8)	146.1
– Overseas unlisted	147.4	(15.5)	2.6	(39.5)	95.0
Debt and other fixed income securities					
– UK listed	2.8	1.2	-	(1.8)	2.2
Loans secured on residential property	78.1	24.0	88.9	(4.0)	187.0
Other	1.2	-	-	(1.2)	-
	346.4	42.4	98.1	(56.6)	430.3
	466.2	(31.4)	138.3	(99.1)	474.0
Financial liabilities					
Investment contract liabilities	133.6	-	3.8	-	137.4
Derivative financial instruments					
Swaptions	4.8	(9.5)	32.3	-	27.6
	4.8	(9.5)	32.3	-	27.6
	138.4	(9.5)	36.1	-	165.0

3. Risk management and control (continued)

iv) Fair value estimation

Society	At 1 January 2011 £m	Total gains/ (losses) recognised through income £m	Purchases £m	Sales £m	At 31 December 2011 £m
Financial assets					
Derivative financial instruments					
Interest rate swaps	**10.7**	**53.5**	**-**	**-**	**64.2**
Swaptions	**33.0**	**8.9**	**-**	**(12.3)**	**29.6**
Equity/index derivatives	**-**	**9.7**	**30.0**	**-**	**39.7**
	43.7	**72.1**	**30.0**	**(12.3)**	**133.5**
Financial assets held at fair value through income					
Shares, other variable yield securities and units in unit trusts					
– UK unlisted	**140.3**	**(25.8)**	**4.1**	**(4.7)**	**113.9**
– Overseas unlisted	**88.1**	**14.3**	**1.8**	**(12.7)**	**91.5**
Debt and other fixed income securities					
– UK listed	**2.2**	**0.4**	**-**	**(1.9)**	**0.7**
– Overseas listed	**-**	**(3.1)**	**4.2**	**-**	**1.1**
Loan to group undertaking	**131.7**	**29.1**	**6.4**	**(5.0)**	**162.2**
Loans secured on residential property	**-**	**25.6**	**87.3**	**(1.8)**	**111.1**
	362.3	**40.5**	**103.8**	**(26.1)**	**480.5**
	406.0	**112.6**	**133.8**	**(38.4)**	**614.0**
Financial liabilities					
Investment contract liabilities	**137.4**	**-**	**-**	**(24.0)**	**113.4**
Derivative financial instruments					
Swaptions	**27.6**	**-**	**-**	**(27.6)**	**-**
Property index swap	**-**		**0.2**		**0.2**
	27.6	**-**	**0.2**	**(27.6)**	**0.2**
	165.0	**-**	**0.2**	**(51.6)**	**113.6**

3. Risk management and control (continued)

iv) Fair value estimation

Society	At 1 January 2010 £m	Total gains/ (losses) recognised through income £m	Purchases £m	Sales £m	At 31 December 2010 £m
Financial assets					
Derivative financial instruments					
Interest rate swaps	47.7	(16.8)	-	(20.2)	10.7
Swaptions	72.1	(57.0)	40.2	(22.3)	33.0
	119.8	(73.8)	40.2	(42.5)	43.7
Financial assets held at fair value through income					
Shares, other variable yield securities and units in unit trusts					
– UK listed	0.2	(4.4)	4.4	(0.2)	-
– UK unlisted	112.8	36.4	0.9	(9.8)	140.3
– Overseas unlisted	105.6	(11.2)	2.6	(8.9)	88.1
Debt and other fixed income securities					
– UK listed	2.8	1.2	-	(1.8)	2.2
Loan to group undertaking	43.3	6.9	83.6	(2.1)	131.7
	264.7	28.9	91.5	(22.8)	362.3
	384.5	(44.9)	131.7	(65.3)	406.0
Financial liabilities					
Investment contract liabilities	133.6	-	3.8	-	137.4
Derivative financial instruments					
Swaptions	4.8	(9.5)	32.3	-	27.6
	4.8	(9.5)	32.3	-	27.6
	138.4	(9.5)	36.1	-	165.0

If the inputs for the Group and Society level 3 assets and liabilities were changed they would not significantly change the fair value.

v) Other risk types

Operational risk
Operational risk is the risk of loss, resulting from inadequate or failed internal processes, people and systems, or from external events, including legal and regulatory risk.

Senior managers are responsible for the identification, assessment, control and monitoring of operational risks and for reporting these to the Risk Committee in accordance with the Group's escalation criteria. Operational risks are assessed in terms of their probability and impact in accordance with Group policy.

Group risk
Group risk is the risk of contagion that the Society incurs from its membership of a group of firms. The Group Risk Committee oversees the management of such risks.

Strategic risk
Strategic risk is the risk arising from the implementation of agreed strategy. It includes risks arising from political, economic, sociological and technological changes, competitor actions and capital adequacy.

Executive management identifies strategic risks when drawing up business plans for approval by the Board and monitors these, ensuring that excess risk is reported to the Group Risk Committee and Board.

4. Net earned premiums

Gross written premiums		Group 2011 £m	Group 2010 £m	Society 2011 £m	Society 2010 £m
Long-term insurance contracts - participating business					
Investments and savings	- single premium	**45.7**	40.3	**45.7**	40.3
Pensions and annuities	- single premium	**8.7**	56.8	**8.7**	56.8
Investments and savings	- regular premium	**52.9**	63.1	**52.9**	63.1
Pensions and annuities	- regular premium	**16.9**	18.5	**16.9**	18.5
Long-term insurance contracts - non participating business					
Pensions and annuities	- single premium	**601.1**	454.8	**601.1**	454.8
Investments and savings	- regular premium	**0.5**	0.2	**0.2**	-
Pensions and annuities	- regular premium	**7.7**	8.4	**7.7**	8.4
Life and health protection	- regular premium	**116.9**	103.2	**116.4**	102.6
Long-term linked insurance contracts					
Investments and savings	- regular premium	**0.9**	2.3	**0.9**	2.3
Pensions and annuities	- regular premium	**1.8**	0.5	**1.8**	0.5
Life and health protection	- regular premium	**10.5**	12.4	**10.5**	12.4
General insurance contracts					
Motor		**1,124.9**	973.0	**-**	-
Household		**128.8**	114.8	**-**	-
Other		**201.9**	94.7	**-**	-
Change in unearned premiums provision		**(122.7)**	(210.9)	**-**	-
Gross earned premiums		**2,196.5**	1,732.1	**862.8**	759.7
Premiums ceded to reinsurers					
Long term insurance premiums		**(68.1)**	(61.8)	**(99.7)**	(94.9)
General insurance business		**(27.7)**	(20.7)	**-**	-
Change in unearned premiums provision		**2.8**	(2.1)	**-**	-
		(93.0)	(84.6)	**(99.7)**	(94.9)
Net earned premiums		**2,103.5**	1,647.5	**763.1**	664.8
Gross written premiums for investment contracts which are deposit accounted for and not included above		**214.0**	206.5	**214.0**	206.5

All contracts are written in the UK apart from Highway Insurance Company Limited which writes a proportion of its general insurance business in Ireland. These Irish net earned premiums totalled £10.1m in 2011 (2010: £11.7m).

5. New business premiums

		Group		Society	
		2011	2010	**2011**	2010
Gross new business premiums - long-term contracts		**£m**	£m	**£m**	£m
Long-term insurance contracts - participating business					
Investments and savings	- single premium	**45.7**	40.3	**45.7**	40.3
Pensions and annuities	- single premium	**8.7**	56.8	**8.7**	56.8
Investments and savings	- regular premium	**1.1**	1.2	**1.1**	1.2
Long-term insurance contracts - non participating business					
Pensions and annuities	- single premium	**601.1**	454.8	**601.1**	454.8
Life and health protection	- regular premium	**23.8**	17.0	**23.8**	17.0
Long-term linked insurance contracts					
Pensions and annuities	- regular premium	**0.4**	-	**0.4**	-
Life and health protection	- regular premium	**3.2**	6.0	**3.2**	6.0
		684.0	576.1	**684.0**	576.1
Investment contracts					
Pensions and annuities	- regular premium	**214.0**	206.5	**214.0**	206.5
		898.0	782.6	**898.0**	782.6

Gross written premiums for investment contracts are deposit accounted for and not included within net earned premiums.
All gross new business premiums relate to individual business.
Recurrent single premium rebates from the Department for Works and Pensions are included as new business single premiums.
Where periodic premiums are received other than annually, the periodic new business premiums are stated on an annualised basis.

	2011	2010
Group gross premiums earned – general business	**£m**	£m
Motor	**1,030.5**	775.1
Household	**120.6**	112.0
Other	**181.8**	84.4
	1,332.9	971.5

6. Fee and commission income

	Group		Society	
	2011	2010	**2011**	2010
	£m	£m	**£m**	£m
Policy administration fees	**11.6**	17.1	**4.9**	10.9
Fund management fees	**2.7**	7.9	**-**	-
Accrued mortgage interest	**11.7**	8.3	**-**	-
Commission income	**4.2**	3.1	**0.3**	0.3
Reinsurance commission income	**-**	0.1	**-**	0.1
	30.2	36.5	**5.2**	11.3

During 2011, rebates of service charges received from external fund managers have been credited to Other Income in the Statement of Comprehensive Income. In prior periods, this was treated as Policy administration fees.

7. Investment income

	Group		Society	
	2011	2010	**2011**	2010
	£m	£m	**£m**	£m
Rental income from investment properties	**7.4**	18.9	**7.4**	18.9
Income from investments at fair value through income:				
- Interest income	**123.2**	158.1	**126.8**	123.0
- Dividend income	**117.4**	48.1	**71.2**	34.6
Interest on loans and receivables	**1.7**	2.6	**0.9**	1.9
Dividend income from group undertakings	**-**	-	**78.6**	-
	249.7	227.7	**284.9**	178.4

8. Net gains / (losses) on investments

	Group		Society	
	2011	2010	**2011**	2010
	£m	£m	**£m**	£m
Investment properties	**(1.9)**	20.4	**(1.9)**	20.4
Investments at fair value through income:				
- Debt securities	**350.3**	121.9	**335.1**	98.6
- Equity securities	**(33.1)**	308.0	**(34.5)**	238.8
- Derivatives at fair value through income	**110.1**	17.3	**108.6**	16.5
Investments in group undertakings	**-**	-	**(34.4)**	(14.9)
	425.4	467.6	**372.9**	359.4

Included within net gains on investments are realised gains of £174.4m (2010: £349.9m) for the Group and realised gains of £114.9m (2010: £237.1m) for the Society.

9. Net benefits and claims

	Group		Society	
	2011	2010	**2011**	2010
	£m	£m	**£m**	£m
Gross benefits and claims				
Long-term insurance contracts				
Benefits and claims paid	**667.7**	663.2	**661.8**	659.2
Change in the provision for claims	**(4.6)**	(3.8)	**(4.5)**	(3.8)
General insurance contracts				
Claims paid	**816.5**	654.9	**-**	-
Change in the provision for claims	**189.7**	101.9	**-**	-
	1,669.3	1,416.2	**657.3**	655.4
Claims ceded to reinsurers				
Long-term insurance contracts				
Benefits and claims paid	**(54.5)**	(50.1)	**(102.4)**	(243.3)
General insurance contracts				
Claims paid	**(7.4)**	(8.5)	**-**	-
Change in the provision for claims	**(24.5)**	6.8	**-**	-
	(86.4)	(51.8)	**(102.4)**	(243.3)
	1,582.9	1,364.4	**554.9**	412.1
Net benefits and claims for investment contracts which are deposit accounted for and not included above	**120.5**	119.5	**120.5**	119.5

10. Net (increase) / decrease in long-term contract liabilities

	Group		Society	
	2011	2010	**2011**	2010
	£m	£m	**£m**	£m
Gross (increase) / decrease in contract liabilities				
(Increase) / decrease in long-term insurance contract liabilities	**(814.8)**	(578.6)	**(816.6)**	(579.5)
(Increase) / decrease in long-term linked insurance contract liabilities	**(9.2)**	7.8	**(9.2)**	7.8
(Increase) / decrease in investment contract liabilities	**33.8**	(75.8)	**33.8**	(75.8)
	(790.2)	(646.6)	**(792.0)**	(647.5)
Mutual bonus (disclosed separately in Note 18)	**18.6**	-	**18.6**	-
	(771.6)	(646.6)	**(773.4)**	(647.5)
Increase / (decrease) in contract liabilities ceded to reinsurers				
Increase / (decrease) in long-term insurance contract liabilities	**79.5**	49.3	**34.4**	(98.9)
Increase / (decrease) in long-term linked insurance contract liabilities	**16.5**	9.4	**(27.3)**	14.5
	96.0	58.7	**7.1**	(84.4)
	(675.6)	(587.9)	**(766.3)**	(731.9)

11. Finance costs

	Group		Society	
	2011	2010	**2011**	2010
	£m	£m	**£m**	£m
Interest expense on banking and other activities	**-**	0.4	**-**	0.1
Interest expense on loans and borrowings	**0.5**	0.5	**-**	-
	0.5	0.9	**-**	0.1

12. Other operating and administrative expenses

	Group		Society	
	2011	2010	**2011**	2010
	£m	£m	**£m**	£m
Acquisition costs	**283.6**	253.0	**69.9**	66.9
Movement in deferred acquisition costs	**(14.0)**	(35.9)	**-**	-
Write-off following termination of PHI reinsurance contract (see note 20)	**58.1**	-	**-**	-
Amortisation of intangible assets	**13.0**	13.8	**4.7**	4.6
Depreciation on property and equipment - owned	**1.7**	1.3	**0.8**	0.9
Depreciation on property and equipment - finance leases	**0.9**	0.9	**-**	-
Loss on disposal of property and equipment	**-**	0.1	**0.1**	-
Operating lease rental charges on land and buildings	**6.2**	6.5	**5.1**	4.6
Investment management expenses and charges	**3.8**	2.5	**23.6**	15.8
Auditors' remuneration	**1.4**	1.3	**0.7**	0.5
Employee benefits expense	**209.7**	173.5	**209.7**	173.5
Impairment of financial assets	**(0.4)**	4.8	**0.1**	-
Management charge allocated to group undertakings	**-**	-	**(79.8)**	(78.7)
Administrative expenses	**55.8**	41.4	**(63.2)**	(43.1)
	619.8	463.2	**171.7**	145.0

Acquisition costs relates to the costs of acquiring new business during the financial year. These included all commission and incentive payments to sales staff and third parties incurred in writing new contracts. Where the benefit of these costs will be recognised in future accounting periods the costs are deferred.

13. Auditors' remuneration

	2011	2010
	£m	£m
Fees payable to the Society's auditors for the audit of parent company and consolidated financial statements	**0.5**	0.2
Fees payable to the Society's auditors and its associates for other services:		
- The audit of the Society's subsidiaries pursuant to legislation	**0.3**	0.4
- Other services pursuant to legislation	**0.2**	0.3
- Other services	**0.4**	0.4
	1.4	1.3

14. Employee benefits expense

	Group		Society	
	2011	2010	2011	2010
	£m	£m	£m	£m
Wages and salaries	**172.7**	142.6	**172.7**	142.6
Social security costs	**16.1**	12.3	**16.1**	12.3
Defined benefit and defined contribution pension costs	**20.9**	18.6	**20.9**	18.6
	209.7	173.5	**209.7**	173.5

The number of employees during the year, including executive directors, calculated on a monthly average basis, was as follows:

	Group		Society	
	2011	2010	2011	2010
	Number	Number	Number	Number
Member and customer contact	**3,269**	2,790	**3,269**	2,790
Administration	**1,513**	1,315	**1,513**	1,315
	4,782	4,105	**4,782**	4,105

15. Pension benefit asset/(obligation)

i) Summary

Pension benefit asset/(obligation)	**2011**			2010		
	LV Scheme	**Ockham**	**Total**	LV Scheme	Ockham	Total
	£m	**£m**	**£m**	£m	£m	£m
Asset	**108.1**	**-**	**108.1**	15.9	-	15.9
Obligation	**-**	**(1.2)**	**(1.2)**	-	(8.8)	(8.8)
	108.1	**(1.2)**	**106.9**	15.9	(8.8)	7.1

Actuarial net gain/(loss)	**2011**			2010		
	LV Scheme	**Ockham**	**Total**	LV Scheme	Ockham	Total
	£m	**£m**	**£m**	£m	£m	£m
Actuarial net gain/(loss)	**66.5**	**3.9**	**70.4**	55.5	(1.2)	54.3
Income tax credit/(expense)	**-**	**(0.7)**	**(0.7)**	(14.6)	(3.1)	(17.7)
Amount charged to total comprehensive income	**66.5**	**3.2**	**69.7**	40.9	(4.3)	36.6
Cumulative actuarial gain recognised in the Statement of Comprehensive Income	**182.0**	**6.8**	**188.8**	115.5	2.9	118.4

ii) LV Scheme

a) Information about the scheme
The Society is responsible for the LV= Employee Pension Scheme (LV Scheme), a defined benefit pension scheme. The scheme closed to new entrants on 31 December 2009. From 1 January 2010 the Society has operated a defined contribution scheme for new entrants. Proposed legislation changes have changed the rate of increase in deferred pensions from being related to RPI to CPI, with effect from 1 January 2011. The impact has been a reduction in the calculation of liabilities. Other pension liabilities are unaffected by this change.

b) Net Statement of Financial Position	**2011 £m**	2010 £m
Present value of defined benefit obligation	**(942.0)**	(854.4)
Fair value of plan assets	**1,050.1**	870.3
Pension benefit asset at the end of the year	**108.1**	15.9

The movement in the defined benefit obligation over the year is as follows:	**2011 £m**	2010 £m
Beginning of year	**854.4**	813.9
Current service cost	**19.1**	20.3
Interest cost	**46.2**	45.4
Actuarial losses	**64.4**	8.4
Benefits paid	**(39.2)**	(32.2)
Past service cost	**0.5**	0.1
Administrative expenses paid	**(3.4)**	(1.5)
End of year	**942.0**	854.4

The movement in the fair value of plan assets over the year is as follows:	**2011 £m**	2010 £m
Beginning of year	**870.3**	729.7
Expected return on plan assets	**47.9**	46.5
Actuarial gains	**130.9**	63.9
Employer contributions	**43.6**	63.9
Benefits paid	**(39.2)**	(32.2)
Administrative expenses paid	**(3.4)**	(1.5)
End of year	**1,050.1**	870.3

15. Pension benefit asset/(obligation) (continued)

ii) LV Scheme (continued)

c) Amounts recognised in the Statement of Comprehensive Income	2011 £m	2010 £m
Current service cost	**19.1**	20.3
Interest cost	**46.2**	45.4
Expected return on assets	**(47.9)**	(46.5)
Past service cost	**0.5**	0.1
Amount charged to income	**17.9**	19.3
Actuarial net gain	**(66.5)**	(55.5)
Total amount credited to comprehensive income	**(48.6)**	(36.2)

The actual return on plan assets was £178.8m (2010: £110.4m).

d) Principal assumptions used	2011	2010
Discount rate	**4.7%**	5.4%
Rate of salary increase	**3.65%**	4.15%
Expected return on plan assets	**4.1%**	5.5%
RPI Inflation	**2.9%**	3.4%
CPI Inflation	**2.0%**	2.65%
Pension increases for in-payment benefits		
- RPI price inflation capped at 5% pa, floor of 3% pa	**3.5%**	3.7%
- RPI price inflation capped at 5% pa	**2.9%**	3.3%
- RPI price inflation capped at 2.5% pa	**2.1%**	2.2%
- CPI price inflation capped at 3.0% pa	**1.9%**	2.2%
Pension increases for deferred benefits		
- pre 6 April 2009 accrual	**2.0%**	2.65%
- post 6 April 2009 accrual	**2.0%**	2.5%
Scheme member valuation date	**31 March 2009**	31 March 2009

Mortality for members is assumed to follow the tables below as at 31 December 2011.

Pre-retirement mortality: Deferred pensioners	
- Males	1NMA x 0.95 table
- Females	1NFA x 0.98 table
Post-retirement mortality: Non-pensioners	
- Males	1NMA x 0.95 table
- Females (former employees)	1NFA x 0.98 table
- Females (dependants)	1NFA x 1.12 table
Post-retirement mortality: current pensioners and dependants	
- Males	1NMA x 0.85 table
- Females (former employees)	1NFA x 0.88 table
- Females (dependants)	1NFA x 1.02 table

In all cases medium cohort improvements have been applied and from 2009 a minimum annual rate of improvement of 1.25% has been applied.

15. Pension benefit asset/(obligation) (continued)

ii) LV Scheme (continued)

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 £89.5m (9.5%)
	Increase by 0.5%	Decrease by £78.2m (-8.3%)
Inflation rate	Decrease by 0.5%	Decrease by £49.9m (-5.3%)
	Increase by 0.5%	Increase by £60.3m (6.4%)
Rate of salary increase	Decrease by 0.5%	Decrease by £2.8m (-0.3%)
	Increase by 0.5%	Increase by £2.8m (0.3%)
Rate of mortality	Use life expectancy of a person one year younger	Increase by £27.3m (2.9%)

f) Plan asset information
Plan assets are comprised as follows:

	Expected return on assets 2011	**Allocation percentage 2011**	Allocation percentage 2010
Equities	**6.3%**	**11.3%**	19.8%
Debt securities	**3.7%**	**69.0%**	66.3%
Real estate/property	**5.8%**	**8.9%**	11.9%
Other	**2.9%**	**10.8%**	2.0%
Total	**4.1%**	**100.0%**	100.0%

The expected return on assets has been derived as the weighted average of the expected returns from each of the main asset classes. The expected return for each asset class reflects a combination of historical performance analysis, the forward looking views of the financial markets and the views of investment organisations.

Expected contributions to the scheme for the year ending 31 December 2012 are £42.9m.

g) Historical disclosure information	**2011 £m**	2010 £m	2009 £m	2008 £m	2007 £m
Asset experience					
Asset (gains)/losses during year	**(130.9)**	(63.9)	(30.4)	107.6	7.2
Liability experience					
Obligation (gains)/losses during year	**3.2**	(14.6)	(15.5)	-	3.0
Funded status					
Defined benefit obligation	**(942.0)**	(854.4)	(813.9)	(667.1)	(725.9)
Fair value of assets	**1050.1**	870.3	729.7	671.7	745.8
Net asset/(obligation)	**108.1**	15.9	(84.2)	4.6	19.9

h) Defined contribution pension schemes
New employees since 1 January 2010 have been eligible to join a new defined contribution scheme. 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 amounted to £4.2m (2010: £2.0m).

15. Pension benefit asset/(obligation) (continued)

iii) Ockham Pension Scheme

a) Information about the scheme
During 2010 the defined benefit obligation of the Ockham pension scheme was transferred to the Society from a subsidiary undertaking. The Ockham defined benefit scheme is closed to new entrants.

Proposed legislation changes have changed the rate of increase in deferred pensions from being related to RPI to CPI, with effect from 1 January 2011. The impact has been a reduction in the calculation of liabilities. Other pension liabilities are unaffected by this change.

b) Net Statement of Financial Position	2011 £m	2010 £m
Present value of defined benefit obligation	**(107.0)**	(97.6)
Fair value of plan assets	**105.8**	88.8
Pension benefit obligation at the end of the year	**(1.2)**	(8.8)

The movement in the defined benefit obligation over the year is as follows:	2011 £m	2010 £m
Beginning of year	**97.6**	88.6
Interest cost	**5.2**	5.0
Actuarial losses	**4.8**	7.7
Benefits paid	**(3.7)**	(3.7)
Past service cost	**3.1**	-
End of year	**107.0**	97.6

The movement in the fair value of plan assets over the year is as follows:	2011 £m	2010 £m
Beginning of year	**88.8**	75.2
Expected return on plan assets	**5.0**	4.7
Actuarial gains	**8.7**	6.5
Employer contributions	**7.0**	6.1
Benefits paid	**(3.7)**	(3.7)
End of year	**105.8**	88.8

c) Amounts recognised in the Statement of Comprehensive Income	2011 £m	2010 £m
Interest cost	**5.2**	5.0
Expected return on assets	**(5.0)**	(4.7)
Past service cost	**3.1**	-
Amount charged to income	**3.3**	0.3
Actuarial net (gain)/loss	**(3.9)**	1.2
Total amount charged to comprehensive income	**(0.6)**	1.5

The actual return on plan assets was £13.7m (2010: £11.2m).

d) Principal assumptions used	2011	2010
Discount rate	**4.7%**	5.4%
Rate of salary increase	**3.65%**	4.15%
Expected return on plan assets	**3.7%**	5.5%
Pension increases		
- linked to inflation	**2.9%**	3.4%
- fixed rate	**5.0%**	5.0%
Price inflation		
- RPI	**2.9%**	3.4%
- CPI	**2.0%**	2.65%

Mortality rate assumptions are based on the following mortality tables:
Standard PNA00 tables with medium cohort improvements from 2000 with a 1.25% pa underpin.

15. Pension benefit asset/(obligation) (continued)

iii) Ockham Pension Scheme (continued)

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 £10.2m (9.1%)
	Increase by 0.5%	Decrease by £9.0m (-8.0%)
Inflation rate	Decrease by 0.5%	Decrease by £6.0m (-5.4%)
	Increase by 0.5%	Increase by £6.7m (6.0%)
Rate of mortality	Use life expectancy of a person one year younger	Increase by £3.2m (2.9%)

f) Plan asset information

Plan assets are comprised as follows:

	Expected return on assets 2011	Allocation percentage 2011	Allocation percentage 2010
Equities	**6.3%**	**8.3%**	32.7%
Debt securities	**3.4%**	**63.9%**	53.9%
Derivative swaps	**2.9%**	**16.8%**	11.0%
Cash	**2.9%**	**4.1%**	2.4%
Property	**6.3%**	**0.7%**	0.0%
Other	**4.7%**	**6.2%**	0.0%
Total	**3.7%**	**100.0%**	100.0%

The expected return on assets has been derived as the weighted average of the expected returns from each of the main asset classes. The expected return for each asset class reflects a combination of historical performance analysis, the forward looking views of the financial markets and the views of investment organisations.

Expected contributions to the scheme for the year ending 31 December 2012 are £4.0m.

g) Historical disclosure information	2011 £m	2010 £m	2009 £m
Asset experience			
Asset gains during year	**(8.7)**	(6.5)	(6.2)
Liability experience			
Obligation loss during year	**-**	1.1	3.7
Funded status			
Defined benefit obligation	**(107.0)**	(97.6)	(88.6)
Fair value of assets	**105.8**	88.8	75.2
Net obligation	**(1.2)**	(8.8)	(13.4)

16. Directors' emoluments

The aggregate amount of directors' emoluments was as follows:

a) Aggregate emoluments including pension contributions and LTIPs	**2011** **£m**	2010 £m
Aggregate emoluments	**4.6**	3.1

b) Emoluments of individual directors, including emoluments of the Chairman and highest paid director were as follows for the Society:

	Annual Remuneration £000					LTIP Schemes £000	
	2011				2010		
	Salary	**Bonus**	**Other Benefits**	**Total**	Total	**2009-11**	2008-10
M.J. Rogers	491	517	123	**1,131**	1,247	**1,046**	nil
P.W. Moore (appointed 10 November 2010)	347	250	12	**609**	136	**-**	nil
R.A. Rowney	325	230	13	**568**	506	**375**	nil
D. Holt	150	-	-	**150**	148	**n/a**	n/a
M.E. Austen	68	-	-	**68**	62	**n/a**	n/a
D.I.W. Reynolds	64	-	-	**64**	55	**n/a**	n/a
J. Edwards (appointed 21 October 2010)	58	-	-	**58**	9	**n/a**	n/a
C. Keers (appointed 14 December 2010)	57	-	-	**57**	3	**n/a**	n/a
J.B. O'Roarke (appointed 23 November 2011)*	32	21	1	**54**	-	**260**	nil
C. Burton (appointed 9 November 2011)	15	-	-	**15**	-	**n/a**	n/a
G. Nott (resigned 26 May 2011)	28	-	-	**28**	62	**n/a**	n/a
K.W. Abercromby (resigned 9 November 2010)**	-	-	-	**-**	692	**See ****	nil
S. Sinclair (resigned 22 September 2010)	-	-	-	**-**	44	**n/a**	n/a
Total	1,635	1,018	149	**2,802**	2,964	**1,681**	nil

* Pro rata for the part of year since appointment. The LTIP amount relates to the full entitlement for the 2009-2011 scheme.

** A payment of £412,000 is due to Mr Abercromby in relation to the 2009-2011 LTIP scheme.

Other benefits include cash allowance in lieu of pension, car allowances, medical, relocation, life assurance and other benefits in kind or their equivalent monetary value.

c) Pension arrangements

R.A. Rowney and J.B O'Roarke are members of the LV= Employee Pension Scheme, which is a defined benefit scheme. P.W. Moore is a member of the defined contribution scheme.

The directors' emoluments table above excludes the Society contributions to defined benefit and defined contribution pension schemes. The Society makes contributions to the LV= Employee Pension Scheme of an average 17.1% of pensionable salaries (2010: 19.0% of pensionable salaries) in respect of all permanent staff. This included amounts on behalf of executive directors of £0.1m (2010: £0.1m)

The Society has made no contributions to personal pension arrangements during 2011 (2010: £nil).

There were £42,542 of contributions to defined contribution pension schemes in 2011 (2010: £11,000).

M.J. Rogers is a member of the staff pension scheme for life assurance only.

Accrued pension at end of period	**2011** **£'000**	2010 £'000
R.A. Rowney	**23**	18
J.B. O'Roarke	**26**	N/A

17. Income tax expense/(credit)

a) Current year tax charge

Group	**2011 £m**	2010 £m
Current tax charge:		
Current year	**39.3**	13.9
Prior year adjustment	**5.4**	(11.8)
Total current tax	**44.7**	2.1
Deferred tax		
Excess of depreciation	**1.0**	(1.3)
Prior year adjustments	**(10.5)**	1.4
Temporary differences	**(7.5)**	(14.6)
Tax losses	**14.5**	9.4
Total deferred tax	**(2.5)**	(5.1)
Total income tax expense/(credit)	**42.2**	(3.0)

Society	**2011 £m**	2010 £m
Current tax charge:		
Current year	**23.9**	12.1
Prior year adjustment	**6.6**	(11.9)
Total current tax	**30.5**	0.2
Deferred tax		
Excess of depreciation	**-**	(0.3)
Temporary differences	**3.3**	(13.9)
Prior year adjustments	**(6.9)**	2.0
Total deferred tax	**(3.6)**	(12.2)
Total income tax expense/(credit)	**26.9**	(12.0)

b) Reconciliation of tax charge

Group	**2011 £m**	2010 £m
Loss before tax	**(16.9)**	(18.3)
Tax calculated at the average standard rate of corporation tax in the UK at 26.5% (2010: 28%)	**(4.5)**	(5.1)
Permanent differences		
Income and expenses not subject to tax	**13.2**	(5.4)
Impact of change in UK corporation tax rate on deferred tax	**0.7**	0.4
Unprovided deferred tax asset	**22.1**	(27.7)
Transfer pricing	**-**	(1.7)
Policyholder tax	**15.8**	46.9
Adjustment to current tax charge in respect of prior years	**5.4**	(11.8)
Adjustment to deferred tax charge in respect of prior years	**(10.5)**	1.4
Total tax charge/(credit) for the year	**42.2**	(3.0)

Society	**£m**	£m
Loss before tax	**(47.7)**	(73.2)
Tax calculated at the average standard rate of corporation tax in the UK at 26.5% (2010: 28%)	**(12.7)**	(20.5)
Permanent differences		
Income and expenses not subject to tax	**1.7**	1.3
Unprovided deferred tax asset	**22.1**	(24.2)
Transfer pricing	**-**	(2.4)
Policyholder tax	**16.1**	43.6
Adjustment to current tax charge in respect of prior years	**6.6**	(11.9)
Adjustment to deferred tax charge in respect of prior years	**(6.9)**	2.1
Total tax charge/(credit) for the year	**26.9**	(12.0)

17. Income tax expense/(credit) (continued)

The standard rate of Corporation Tax in the UK changed from 28% to 26% with effect from 1 April 2011. Accordingly, the profits for this accounting period are taxed at an effective rate of 26.5%.

In addition to the changes in rates of Corporation Tax disclosed above, a number of further changes to the UK Corporation Tax system were announced in the March 2012 UK Budget Statement. Further reductions to the main rate are proposed to reduce the rate to 22% by 1 April 2014. These further changes had not been substantively enacted at the balance sheet date and, therefore, are not included in these financial statements.

18. Mutual Bonus

The Board declared an initial Mutual Bonus of £10.0m in May 2011 and a final bonus of £8.6m in respect of the year ended 31 December 2011 in January 2012.

19. Intangible assets

Group	Goodwill £m	Other intangible assets £m	PVIF £m	Total £m
Cost:				
At 1 January 2011	230.7	95.1	63.4	389.2
Increase in earnout value	5.3	-	-	5.3
At 31 December 2011	**236.0**	**95.1**	**63.4**	**394.5**
Accumulated amortisation:				
At 1 January 2011	20.6	59.8	39.6	120.0
Charge for the year	-	8.5	4.5	13.0
At 31 December 2011	**20.6**	**68.3**	**44.1**	**133.0**
Net book value at 31 December 2011	**215.4**	**26.8**	**19.3**	**261.5**
Cost:				
At 1 January 2010	231.1	95.1	63.4	389.6
Reduction in earnout value	(0.4)	-	-	(0.4)
At 31 December 2010	230.7	95.1	63.4	389.2
Accumulated amortisation:				
At 1 January 2010	20.6	50.8	34.8	106.2
Charge for the year	-	9.0	4.8	13.8
At 31 December 2010	20.6	59.8	39.6	120.0
Net book value at 31 December 2010	210.1	35.3	23.8	269.2

Refer to Note 37 for details on the earnout value.

19. Intangible assets (continued)

Society	Goodwill £m	Other intangible assets £m	PVIF £m	Total £m
Cost:				
At 1 January 2011	-	50.9	-	50.9
At 31 December 2011	**-**	**50.9**	**-**	**50.9**
Accumulated amortisation:				
At 1 January 2011	-	41.6	-	41.6
Charge for the year	-	4.7	-	4.7
At 31 December 2011	**-**	**46.3**	**-**	**46.3**
Net book value at 31 December 2011	**-**	**4.6**	**-**	**4.6**
Cost:				
At 1 January 2010	-	50.9	-	50.9
At 31 December 2010	-	50.9	-	50.9
Accumulated amortisation:				
At 1 January 2010	-	37.0	-	37.0
Charge for the year	-	4.6	-	4.6
At 31 December 2010	-	41.6	-	41.6
Net book value at 31 December 2010	-	9.3	-	9.3

Present Value of acquired In-Force business (PVIF) is amortised in line with the original expected run off of 20 years, ending in 2018, based on the market value of the life policies.

Other intangible assets comprise the value of the future benefit derived from the customer bases of RNPFN, Britannia Road Rescue and Highway, and the value of the Tomorrow/Retirement Solutions distribution channel.

Amortisation of £13.0m (2010: £13.8m) is presented within Other operating and administrative expenses in the Statement of Comprehensive Income. There is no impairment in 2011 (2010: £nil).

Goodwill has been allocated to the individual cash generating units which are based on the key segments of the Group as follows:

	Group	
	2011	2010
	£m	£m
Long-term insurance business	**66.7**	66.7
General insurance business	**169.3**	164.0
	236.0	230.7

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
The key assumptions used for impairment testing are set out below for both the long-term insurance business and the general insurance business.

Long-term insurance business
The recoverable amount of the long-term insurance business has been determined using cash flow predictions based on financial plans approved by management covering a five-year period, with a terminal growth rate of 2% applied thereafter. The forecast cashflows have been discounted at a pre-tax rate of 10%. Based on the above assumptions, the recoverable amount exceeded the carrying amount including goodwill by £94.8m. A two percentage point increase in the discount rate would reduce the recoverable amount by £38.5m; the discount rate would need to be increased to 18% to reduce the recoverable amount to zero.
A reduction in the forecast cash flows of 10% per annum would reduce the recoverable amount by £34.6m; the forecast cash flows would need to be reduced by 30% per annum to reduce the recoverable amount to zero.

19. Intangible assets (continued)

General insurance business
The recoverable amount of the general insurance business has been determined using cash flow predictions based on financial plans approved by management covering a five-year period, with a terminal growth rate of 2% applied thereafter. The forecast cashflows have been discounted at a pre-tax rate of 10%. Based on the above assumptions, the recoverable amount exceeded the carrying amount including goodwill by £431.6m. A two percentage point increase in the discount rate would reduce the recoverable amount by £154.0m; the discount rate would need to be increased to 20% to reduce the recoverable amount to zero.
A reduction in the forecast cash flows of 10% per annum would reduce the recoverable amount by £87.0m; the forecast cash flows would need to be reduced by 50% per annum to reduce the recoverable amount to zero.

20. Deferred acquisition costs

Group	Long-term insurance contracts £m	General insurance contracts £m	Total £m
At 1 January 2011	54.6	84.2	138.8
Acquisition costs deferred	17.7	185.6	203.3
Amortisation and impairment	(14.2)	(175.1)	(189.3)
Write-off following termination of PHI reinsurance contract	(58.1)	-	(58.1)
At 31 December 2011	**-**	**94.7**	**94.7**
At 1 January 2010	51.6	51.3	102.9
Acquisition costs deferred	14.7	160.0	174.7
Amortisation and impairment	(11.7)	(127.1)	(138.8)
At 31 December 2010	54.6	84.2	138.8

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 2011 (2010: £nil).

In 2011 the £58.1m write off in relation to the termination of the PHI contract is offset by a £57.4m movement in long term insurance contract liabilities disclosed within Note 34. The overall impact on the Statement of Comprehensive Income is a loss of £0.7m.

21. Property and equipment

Group	Freehold and leasehold property £m	Leasehold property enhancements £m	Fixtures, fittings and motor vehicles £m	IT Hardware £m	Assets under construction £m	Total £m
Cost:						
At 1 January 2011	41.1	7.9	7.4	-	0.9	57.3
Additions	-	1.2	0.7	1.2	-	3.1
Disposals	-	-	(0.2)	-	-	(0.2)
Transfers	-	-	-	0.9	(0.9)	-
At 31 December 2011	**41.1**	**9.1**	**7.9**	**2.1**	**-**	**60.2**
Accumulated depreciation:						
At 1 January 2011	31.1	2.8	3.3	-	-	37.2
Provided in the year	1.0	0.8	0.6	0.2	-	2.6
Disposals	-	-	(0.2)	-	-	(0.2)
At 31 December 2011	**32.1**	**3.6**	**3.7**	**0.2**	**-**	**39.6**
Net book value at 31 December 2011	**9.0**	**5.5**	**4.2**	**1.9**	**-**	**20.6**
Cost:						
At 1 January 2010	41.1	7.3	6.2	-	-	54.6
Additions	-	0.8	1.2	-	0.9	2.9
Disposals	-	(0.2)	-	-	-	(0.2)
At 31 December 2010	41.1	7.9	7.4	-	0.9	57.3
Accumulated depreciation:						
At 1 January 2010	30.1	2.2	2.7	-	-	35.0
Provided in the year	1.0	0.6	0.6	-	-	2.2
At 31 December 2010	31.1	2.8	3.3	-	-	37.2
Net book value at 31 December 2010	10.0	5.1	4.1	-	0.9	20.1

Included within the Freehold and leasehold property category are assets held under finance leases with a net book value of £5.7m (2010: £6.2m).

During the year £0.9m of assets were transferred from Assets under construction to IT Hardware representing the development cost of the claims centre computer system that became operational in 2011.

21. Property and equipment (continued)

Society	Leasehold property enhancements £m	Fixtures, fittings and motor vehicles £m	Total £m
Cost:			
At 1 January 2011	4.5	6.0	10.5
Additions	0.2	0.2	0.4
Disposals	-	(0.2)	(0.2)
At 31 December 2011	**4.7**	**6.0**	**10.7**
Accumulated depreciation:			
At 1 January 2011	1.9	3.1	5.0
Provided in the year	0.4	0.4	0.8
Disposals	-	(0.1)	(0.1)
At 31 December 2011	**2.3**	**3.4**	**5.7**
Net book value at 31 December 2011	**2.4**	**2.6**	**5.0**
Cost:			
At 1 January 2010	3.3	5.6	8.9
Additions	0.1	0.3	0.4
Intra-group transfers	1.2	0.1	1.3
Disposals	(0.1)	-	(0.1)
At 31 December 2010	4.5	6.0	10.5
Accumulated depreciation:			
At 1 January 2010	1.2	2.7	3.9
Provided in the year	0.5	0.4	0.9
Intra-group transfers	0.2	-	0.2
At 31 December 2010	1.9	3.1	5.0
Net book value at 31 December 2010	2.6	2.9	5.5

22. Investment properties

	Group		Society	
	2011	2010	**2011**	2010
	£m	£m	**£m**	£m
Freeholds	**183.8**	266.0	**115.3**	197.2
Long leaseholds	**36.1**	49.4	**36.1**	49.4
	219.9	315.4	**151.4**	246.6

All investment properties held by the Group and the Society are occupied by third party tenants. All properties occupied by Group undertakings are shown separately within note 21.

The market value movements in the year on land and buildings were:

	Group		Society	
	2011	2010	**2011**	2010
	£m	£m	**£m**	£m
Balance at 1 January	**315.4**	379.4	**246.6**	324.5
Additions	**12.5**	15.6	**2.9**	0.5
Disposals	**(89.2)**	(100.9)	**(89.2)**	(100.9)
Net fair value adjustment	**(18.8)**	21.3	**(8.9)**	22.5
Balance at 31 December	**219.9**	315.4	**151.4**	246.6

All investment properties are valued annually at fair value. They were valued as at 31 December 2011, by qualified professional valuers working for Colliers International (UK) Plc and Savills Plc who are professional, third party, independent Chartered Surveyors. All valuations were carried out in accordance with the RICS Appraisal and Valuation Standards.

The Group and Society enter into operating leases for all investment properties. All rents are payable in advance and the rental income arising during the year amounted to £8.9m (2010: £21.1m) for the Group and the Society, which is included in investment income.

Non recoverable expenses are deducted from rental income for investment properties and amounted to £1.8m (2010: £2.7m) for the Group and the Society.

The future aggregate minimum lease payments expected to be received in respect of these leases are:

	Group		Society	
	2011	2010	**2011**	2010
	£m	£m	**£m**	£m
Within one year	**15.5**	21.3	**15.5**	21.3
Between two and five years	**55.4**	79.1	**55.4**	79.1
Over five years	**82.0**	128.3	**82.0**	128.3
	152.9	228.7	**152.9**	228.7

23. Investments in group undertakings

Society	**2011** **£m**	2010 £m
Shares in subsidiaries		
Cost less provisions at 1 January	**748.3**	1,264.3
Additions	**4.0**	64.0
Reduction in share capital	**-**	(564.7)
Increase / (reduction) in earnout provision	**5.3**	(0.4)
Impairment write off	**(34.4)**	(14.9)
	723.2	748.3
Loan stock in subsidiaries		
Cost at 1 January	**223.2**	317.0
Additions	**11.2**	0.5
Redemption	**-**	(94.3)
	234.4	223.2
Shares and loan stock in subsidiaries at 31 December	**957.6**	971.5

The Society has examined the carrying value of its subsidiaries and concluded that a provision for impairment was necessary in regard to its investment in Liverpool Victoria Life Company Ltd (£28.1m), Liverpool Victoria Asset Management Ltd (£1.3m), Liverpool Victoria Financial Advice Services Ltd (£2.8m) and Liverpool Victoria Banking Services Ltd (£2.2m). The impairment in Liverpool Victoria Life Company Ltd primarily arose due to the payment of a dividend to, and the termination of the reinsurance agreement with, the Society reducing the value of the company.

The Society made capital contributions during 2011 of £4m to Liverpool Victoria General Insurance Group Limited (2010: £60m to Liverpool Victoria General Insurance Group Limited, £2m to Liverpool Victoria Equity Release Limited and £2m to Liverpool Victoria Asset Management Limited). The capital contributions are disclosed within additions in the table above.

Further details of the Group's loan stock are given in note 45 and the Group's investments in notes 48 and 49.

24. Financial assets - Fair value through income

	Group		**Society**	
	2011 **£m**	2010 £m	**2011** **£m**	2010 £m
Financial assets - Fair value through income				
Shares, other variable yield securities and units in unit trusts				
– UK listed	**1,725.3**	1,462.0	**2,756.3**	2,448.4
– UK unlisted	**113.9**	146.1	**113.9**	140.3
– Overseas listed	**409.5**	480.5	**48.5**	134.0
– Overseas unlisted	**94.7**	95.0	**91.5**	88.1
Debt and other fixed income securities				
– UK listed	**3,841.2**	3,542.5	**2,198.9**	1,946.2
– Overseas listed	**1,499.8**	1,225.7	**532.0**	330.4
Loans secured on residential property	**334.2**	187.0	**111.1**	-
Other	**1.7**	2.7	**1.7**	2.7
Loan to group undertaking	**-**	-	**162.2**	131.7
	8,020.3	7,141.5	**6,016.1**	5,221.8
Assets held to cover linked liabilities included above	**855.8**	803.4	**855.8**	759.6

The loan to group undertaking has been designated at fair value through income within the Society to avoid an accounting mismatch across the Group.

25. Derivative financial instruments

	2011			2010		
	Contract/ notional amount	**Fair value - asset**	**Fair value - liability**	Contract/ notional amount	Fair value - asset	Fair value - liability
Group	**£m**	**£m**	**£m**	£m	£m	£m
Interest rate swaps	**486.9**	**64.2**	**-**	503.5	10.7	-
Swaptions	**196.7**	**29.6**	**-**	304.9	33.0	(27.6)
Forward exchange contracts	**3.5**	**-**	**-**	58.7	0.2	(1.3)
Equity/index derivatives	**1,111.4**	**50.0**	**(3.6)**	148.1	2.2	-
Property index swap	**20.0**	**-**	**(0.2)**	-	-	-
	1,818.5	**143.8**	**(3.8)**	1,015.2	46.1	(28.9)

The Group uses derivatives to hedge the effect of changes in variable rate borrowings on its fixed rate loan portfolio, to reduce exposure to payouts under guaranteed annuity contracts and to protect against falls in the FTSE 100.

	2011			2010		
	Contract/ notional amount	**Fair value - asset**	**Fair value - liability**	Contract/ notional amount	Fair value - asset	Fair value - liability
Society	**£m**	**£m**	**£m**	£m	£m	£m
Interest rate swaps	**486.9**	**64.2**	**-**	503.5	10.7	-
Swaptions	**196.7**	**29.6**	**-**	304.9	33.0	(27.6)
Forward exchange contracts	**-**	**-**	**-**	47.6	0.2	(1.2)
Equity/index derivatives	**1,110.0**	**50.0**	**(3.6)**	148.1	2.2	-
Property index swap	**20.0**	**-**	**(0.2)**	-	-	-
	1,813.6	**143.8**	**(3.8)**	1,004.1	46.1	(28.8)

26. Loans and other receivables

	Group		Society	
	2011	2010	**2011**	2010
	£m	£m	**£m**	£m
Loans secured by policies	**0.6**	0.9	**0.6**	0.8
Other loans	**0.4**	0.5	**0.4**	0.5
Amounts due from Group undertakings	**-**	-	**71.9**	60.3
Trade and other receivables	**115.0**	77.8	**44.3**	15.7
	116.0	79.2	**117.2**	77.3

The carrying amounts disclosed above reasonably approximate fair value at the Statement of Financial Position date.

27. Reinsurance assets

		Group		Society	
		2011	2010	**2011**	2010
	Notes	**£m**	£m	**£m**	£m
Reinsurers' share of provision for unearned premiums	34 a	**13.0**	10.2	**-**	-
Reinsurers' share of long-term insurance contract liabilities	34 a	**200.0**	120.5	**200.0**	165.6
Reinsurers' share of long-term linked insurance contract liabilities	34 a	**23.0**	6.5	**23.0**	50.4
Reinsurers' share of claims liabilities	34 a	**100.9**	76.4	**-**	-
		336.9	213.6	**223.0**	216.0

The carrying amounts disclosed above reasonably approximate fair value at the Statement of Financial Position date.

28. Insurance receivables

	Group		Society	
	2011	2010	**2011**	2010
	£m	£m	**£m**	£m
Due from policyholders	**135.1**	99.9	**3.8**	4.1
Due from agents, brokers and intermediaries	**74.8**	83.1	**-**	0.9
Due from reinsurers	**6.6**	10.2	**6.4**	9.9
	216.5	193.2	**10.2**	14.9

The carrying amounts disclosed above reasonably approximate fair value at the Statement of Financial Position date.

29. Corporation tax asset

	Group		Society	
	2011	2010	**2011**	2010
	£m	£m	**£m**	£m
Corporation tax receivable	**-**	1.5	**-**	3.1
	-	1.5	**-**	3.1

30. Deferred tax asset

	Group	Society
	£m	**£m**
Balance at 1 January 2011	29.2	14.9
Amounts recorded in the Statement of Comprehensive Income	1.8	2.8
Balance at 31 December 2011	**31.0**	**17.7**

	Group		Society	
	2011	2010	**2011**	2010
i) Analysis of deferred taxation temporary differences	**£m**	£m	**£m**	£m
Excess of depreciation	**3.0**	2.9	**0.5**	0.4
Temporary differences on expenses	**18.5**	13.2	**19.2**	13.9
Temporary differences arising on consolidation	**(2.3)**	(3.0)	**-**	-
Temporary differences on unrealised gains	**8.0**	-	**(2.0)**	-
Temporary difference for changes in actuarial base	**-**	0.6	**-**	0.6
Tax losses	**3.8**	15.5	**-**	-
Deferred tax asset	**31.0**	29.2	**17.7**	14.9
ii) Deferred taxation asset not recognised				
Temporary differences on expenses	**9.6**	3.7	**9.6**	3.7
Temporary differences on unrealised gains	**(4.8)**	0.2	**(4.8)**	0.2
Temporary difference for changes in actuarial base	**(5.9)**	(1.0)	**(5.9)**	(1.0)
Tax losses	**33.6**	11.9	**27.6**	6.4
	32.5	14.8	**26.5**	9.3

The value of deferred tax assets expected to be recovered after more than 12 months is £9.8m in the Group (2010: £9.4m) and £12.4m in the Society (2010: £8.1m).

Deferred tax balances have been measured taking into account the change in the rate of UK Corporation Tax from 26% to 25%. This change was substantively enacted on 5 July 2011 and will be effective from 1 April 2012.

The valuation and recoverability of deferred tax assets relating to capital allowances in excess of depreciation, differences on expenses and gains and tax losses, is dependent on the availability of future taxable profits within the company and Group. Management forecasts currently support the future recoverability of the deferred tax asset recognised in the balance sheet as at 31 December 2011.

31. Prepayments and accrued income

	Group		Society	
	2011	2010	**2011**	2010
	£m	£m	**£m**	£m
Accrued dividends	**3.5**	5.6	**1.1**	3.2
Accrued interest	**45.2**	45.6	**38.6**	35.3
Other prepayments and accrued income	**12.6**	11.4	**8.4**	6.6
	61.3	62.6	**48.1**	45.1

32. Cash and cash equivalents

	Group		Society	
	2011	2010	**2011**	2010
	£m	£m	**£m**	£m
Bank balances	**90.1**	170.7	**40.7**	63.9
Short term bank deposits	**562.2**	365.5	**175.9**	213.9
Cash and cash equivalents	**652.3**	536.2	**216.6**	277.8

The carrying amounts disclosed above reasonably approximate fair value at the Statement of Financial Position date.

33. Unallocated divisible surplus

	Group		Society	
	2011	2010	**2011**	2010
	£m	£m	**£m**	£m
Balance at 1 January	**966.4**	945.1	**1,078.6**	1,112.9
Transfer (to)/from Statement of Comprehensive Income	**(8.0)**	21.3	**(23.5)**	(34.3)
Balance at 31 December	**958.4**	966.4	**1,055.1**	1,078.6

Cumulative goodwill of £199.8m in the Group (£62.2m in the Society) arising on acquisitions prior to 1998 has been eliminated against the Unallocated divisible surplus. This goodwill would be recognised in the Statement of Comprehensive Income should there be a subsequent disposal of the business to which it relates.

34. Insurance contract liabilities

a) Analysis of insurance contract liabilities and reinsurance assets

		2011			2010		
		Gross	Reinsurance	Net	Gross	Reinsurance	Net
Group	Notes	£m	£m	£m	£m	£m	£m
Long-term insurance contract liabilities	34 b	**5,852.8**	**(200.0)**	**5,652.8**	5,038.0	(120.5)	4,917.5
Long-term linked insurance contract liabilities	34 c	**77.9**	**(23.0)**	**54.9**	68.7	(6.5)	62.2
Long-term claims liabilities	34 d	**40.0**	**-**	**40.0**	44.6	-	44.6
		5,970.7	**(223.0)**	**5,747.7**	5,151.3	(127.0)	5,024.3
General insurance unearned premiums	34 e	**747.4**	**(13.0)**	**734.4**	624.7	(10.2)	614.5
General insurance claims liabilities	34 f	**1,029.9**	**(100.9)**	**929.0**	840.1	(76.4)	763.7
		1,777.3	**(113.9)**	**1,663.4**	1,464.8	(86.6)	1,378.2
		7,748.0	**(336.9)**	**7,411.1**	6,616.1	(213.6)	6,402.5

		2011			2010		
		Gross	Reinsurance	Net	Gross	Reinsurance	Net
Society	Notes	£m	£m	£m	£m	£m	£m
Long-term insurance contract liabilities	34 b	**5,828.4**	**(200.0)**	**5,628.4**	5,011.8	(165.6)	4,846.2
Long-term linked insurance contract liabilities	34 c	**77.9**	**(23.0)**	**54.9**	68.7	(50.4)	18.3
Long-term claims liabilities	34 d	**39.9**	**-**	**39.9**	44.4	-	44.4
		5,946.2	**(223.0)**	**5,723.2**	5,124.9	(216.0)	4,908.9

Included within the "Other" category disclosed in tables 34b and 34c are amounts totalling £48.4m, as at 31 December 2011, in relation to the termination of the PHI reinsurance agreement between the Society and Liverpool Victoria Life Company Limited. Further details on this transaction are disclosed in Note 45.

b) Movement in long-term insurance contract liabilities

	2011			2010		
	Gross	Reinsurance	Net	Gross	Reinsurance	Net
Group	£m	£m	£m	£m	£m	£m
Balance at 1 January	**5,038.0**	**(120.5)**	**4,917.5**	4,459.4	(71.2)	4,388.2
Premiums received	**207.7**	**(27.6)**	**180.1**	154.5	(24.4)	130.1
Liabilities paid for death maturities, surrenders, benefits & claims	**(543.6)**	**24.5**	**(519.1)**	(502.4)	48.6	(453.8)
New business	**572.8**	**(42.1)**	**530.7**	485.0	(25.8)	459.2
Benefits and claims variation	**2.5**	**(3.4)**	**(0.9)**	(56.3)	(5.3)	(61.6)
Fees deducted	**(17.4)**	**-**	**(17.4)**	(23.6)	-	(23.6)
Accretion of investment income or change in unit prices	**613.9**	**(0.1)**	**613.8**	449.8	(20.6)	429.2
Adjustment due to changes in assumptions:						
- Mortality/morbidity	**(2.9)**	**9.5**	**6.6**	43.2	(25.5)	17.7
- Investment return	**(18.0)**	**-**	**(18.0)**	(13.7)	-	(13.7)
- Expense	**0.7**	**3.0**	**3.7**	(14.9)	-	(14.9)
- Lapse and surrender rates	**11.2**	**(0.3)**	**10.9**	18.1	(1.5)	16.6
- Discount rate	**76.8**	**(18.9)**	**57.9**	11.8	(3.3)	8.5
- Model changes	**(49.5)**	**10.6**	**(38.9)**	77.4	9.3	86.7
- Other	**(58.0)**	**(34.7)**	**(92.7)**	(50.3)	(0.8)	(51.1)
Mutual bonus	**18.6**	**-**	**18.6**	-	-	-
Balance at 31 December	**5,852.8**	**(200.0)**	**5,652.8**	5,038.0	(120.5)	4,917.5

34. Insurance contract liabilities (continued)

b) Movement in long-term insurance contract liabilities (continued)

Society	2011 Gross £m	2011 Reinsurance £m	2011 Net £m	2010 Gross £m	2010 Reinsurance £m	2010 Net £m
Balance at 1 January	**5,011.8**	**(165.6)**	**4,846.2**	4,432.3	(264.5)	4,167.8
Premiums received	**215.7**	**(53.8)**	**161.9**	161.3	(48.4)	112.9
Liabilities paid for death maturities, surrenders, benefits & claims	**(547.5)**	**37.3**	**(510.2)**	(505.8)	60.8	(445.0)
New business	**569.8**	**(32.2)**	**537.6**	484.1	(22.5)	461.6
Benefits and claims variation	**0.9**	**1.8**	**2.7**	(58.2)	154.1	95.9
Fees deducted	**(18.4)**	**3.1**	**(15.3)**	(24.6)	3.6	(21.0)
Accretion of investment income or change in unit prices	**614.4**	**(1.9)**	**612.5**	450.2	(22.2)	428.0
Adjustment due to changes in assumptions:						
- Mortality/morbidity	**0.2**	**(0.6)**	**(0.4)**	43.2	(25.6)	17.6
- Investment return	**(18.0)**	**-**	**(18.0)**	(13.7)	-	(13.7)
- Expense	**(0.2)**	**6.2**	**6.0**	(14.0)	(3.2)	(17.2)
- Lapse and surrender rates	**11.2**	**(0.3)**	**10.9**	18.8	(3.8)	15.0
- Discount rate	**81.0**	**(32.8)**	**48.2**	13.2	(8.2)	5.0
- Model changes	**(51.4)**	**16.7**	**(34.7)**	76.1	13.7	89.8
- Other	**(59.7)**	**22.1**	**(37.6)**	(51.1)	0.6	(50.5)
Mutual Bonus	**18.6**	**-**	**18.6**	-	-	-
Balance at 31 December	**5,828.4**	**(200.0)**	**5,628.4**	5,011.8	(165.6)	4,846.2

c) Movement in long-term linked insurance contract liabilities

Group	2011 Gross £m	2011 Reinsurance £m	2011 Net £m	2010 Gross £m	2010 Reinsurance £m	2010 Net £m
Balance at 1 January	**68.7**	**(6.5)**	**62.2**	76.5	2.8	79.3
Premiums received	**31.9**	**(10.0)**	**21.9**	41.2	(9.6)	31.6
Liabilities paid for death maturities, surrenders, benefits & claims	**(35.8)**	**8.8**	**(27.0)**	(46.3)	8.6	(37.7)
New business	**(0.1)**	**(8.7)**	**(8.8)**	0.1	(7.5)	(7.4)
Benefits and claims variation	**(3.8)**	**(1.2)**	**(5.0)**	(4.0)	(1.3)	(5.3)
Fees deducted	**(2.4)**	**-**	**(2.4)**	(4.7)	-	(4.7)
Accretion of investment income or change in unit prices	**0.5**	**-**	**0.5**	4.7	(0.5)	4.2
Adjustment due to changes in assumptions:						
- Mortality/morbidity	**3.2**	**3.4**	**6.6**	12.7	(10.0)	2.7
- Expense	**(4.8)**	**1.1**	**(3.7)**	(2.4)	-	(2.4)
- Lapse and surrender rates	**0.2**	**(0.1)**	**0.1**	6.2	(0.6)	5.6
- Discount rate	**16.2**	**(4.1)**	**12.1**	6.5	(1.3)	5.2
- Model changes	**(8.7)**	**3.8**	**(4.9)**	(13.4)	3.6	(9.8)
- Other	**12.8**	**(9.5)**	**3.3**	(8.4)	9.3	0.9
Balance at 31 December	**77.9**	**(23.0)**	**54.9**	68.7	(6.5)	62.2

34. Insurance contract liabilities (continued)

c) Movement in long-term linked insurance contract liabilities (continued)

Society	2011 Gross £m	2011 Reinsurance £m	2011 Net £m	2010 Gross £m	2010 Reinsurance £m	2010 Net £m
Balance at 1 January	**68.7**	**(50.4)**	**18.3**	76.5	(35.9)	40.6
Premiums received	**23.9**	**(19.4)**	**4.5**	34.4	(19.0)	15.4
Liabilities paid for death maturities, surrenders, benefits & claims	**(31.7)**	**13.6**	**(18.1)**	(42.9)	13.4	(29.5)
New business	**2.9**	**(5.1)**	**(2.2)**	1.1	(6.3)	(5.2)
Benefits and claims variation	**(2.2)**	**0.6**	**(1.6)**	(2.1)	1.3	(0.8)
Fees deducted	**(1.5)**	**1.1**	**(0.4)**	(3.7)	1.4	(2.3)
Accretion of investment income or change in unit prices	**-**	**(0.7)**	**(0.7)**	4.2	(1.1)	3.1
Adjustment due to changes in assumptions:						
- Mortality/morbidity	**0.1**	**(0.2)**	**(0.1)**	12.7	(10.1)	2.6
- Expense	**(3.9)**	**2.2**	**(1.7)**	(3.3)	(1.2)	(4.5)
- Lapse and surrender rates	**0.2**	**(0.1)**	**0.1**	5.2	(3.2)	2.0
- Discount rate	**11.9**	**(9.1)**	**2.8**	5.5	(1.5)	4.0
- Model changes	**(6.8)**	**6.0**	**(0.8)**	(12.1)	5.4	(6.7)
- Other	**16.3**	**38.5**	**54.8**	(6.8)	6.4	(0.4)
Balance at 31 December	**77.9**	**(23.0)**	**54.9**	68.7	(50.4)	18.3

d) Movement in long-term claims liabilities

Group	2011 Gross £m	2011 Reinsurance £m	2011 Net £m	2010 Gross £m	2010 Reinsurance £m	2010 Net £m
Balance at 1 January	**44.6**	**-**	**44.6**	48.4	-	48.4
Claims incurred	**663.1**	**(54.5)**	**608.6**	659.4	(50.1)	609.3
Claims paid during the year	**(667.7)**	**54.5**	**(613.2)**	(663.2)	50.1	(613.1)
Balance at 31 December	**40.0**	**-**	**40.0**	44.6	-	44.6

Society	2011 Gross £m	2011 Reinsurance £m	2011 Net £m	2010 Gross £m	2010 Reinsurance £m	2010 Net £m
Balance at 1 January	**44.4**	**-**	**44.4**	48.2	-	48.2
Claims incurred	**657.3**	**(102.4)**	**554.9**	655.4	(243.3)	412.1
Claims paid during the year	**(661.8)**	**102.4**	**(559.4)**	(659.2)	243.3	(415.9)
Balance at 31 December	**39.9**	**-**	**39.9**	44.4	-	44.4

e) Movement in general insurance unearned premiums

Group	2011 Gross £m	2011 Reinsurance £m	2011 Net £m	2010 Gross £m	2010 Reinsurance £m	2010 Net £m
Balance at 1 January	**624.7**	**(10.2)**	**614.5**	413.8	(12.3)	401.5
Premiums written in the year	**1,455.6**	**(27.7)**	**1,427.9**	1,182.5	(20.7)	1,161.8
Premiums earned during the year	**(1,332.9)**	**24.9**	**(1,308.0)**	(971.6)	22.8	(948.8)
Balance at 31 December	**747.4**	**(13.0)**	**734.4**	624.7	(10.2)	614.5

34. Insurance contract liabilities (continued)

f) Movement in general insurance claims liabilities

Group	2011			2010		
	Gross	Reinsurance	Net	Gross	Reinsurance	Net
	£m	£m	£m	£m	£m	£m
Balance at 1 January	**840.1**	**(76.4)**	**763.7**	739.9	(83.3)	656.6
Movement in claims incurred in prior accident years	**35.0**	**(22.7)**	**12.3**	(72.6)	(0.2)	(72.8)
Claims incurred in the current accident year	**927.5**	**(9.2)**	**918.3**	792.8	(9.9)	782.9
Claims paid during the year	**(772.7)**	**7.4**	**(765.3)**	(620.0)	17.0	(603.0)
Balance at 31 December	**1,029.9**	**(100.9)**	**929.0**	840.1	(76.4)	763.7

35. Investment contract liabilities

	Group		Society	
	2011	2010	2011	2010
	£m	£m	£m	£m
Balance at 1 January	**741.2**	578.4	**741.2**	578.4
Deposits received from policyholders	**214.0**	206.5	**214.0**	206.5
Payments made to policyholders and fees deducted	**(120.5)**	(119.5)	**(120.5)**	(119.5)
Change in contract liabilities as shown in the Statement of Comprehensive Income	**(33.8)**	75.8	**(33.8)**	75.8
Balance at 31 December	**800.9**	741.2	**800.9**	741.2

Investment contracts are not reinsured

36. 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 FSA's realistic capital regime, adjusted to exclude the shareholder's share of the future bonuses (in subsidiaries) and the associated tax liability. 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 most significant of these are changes to bonus assumptions and level of payouts.

The assumptions used to calculate the liability depend on the circumstances prevailing in each of the life operations. The assumptions used in determining the liability are estimated to give a result within the normal range of outcomes. To the extent that the ultimate cost differs to the amounts provided, for example where experience is worse than that assumed, the surplus or deficit will be credited or charged to the Statement of Comprehensive Income in future years.

When valuing options and guarantees the asset model used was the Barrie and Hibbert 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 2011 representative of the nature and term of the guarantees inherent in participating insurance contracts within the participating insurance contract funds.

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 in the tables below.

Interest Rates

The risk-free interest rates assumed are:

Year	**2011**	2010
5	**1.14%**	2.51%
15	**2.81%**	4.36%
25	**3.37%**	4.60%
35	**3.48%**	4.48%

Other assumptions

Best estimate assumptions are set for inflation, mortality, expenses and persistency. The future expense inflation assumption is modelled as RPI plus 0.7% (2010: RPI plus 0.7%), where RPI in both 2011 and 2010 is modelled stochastically.

Asset mix for assets backing asset shares at the valuation date:	**2011**	2010
Cash	**2.73%**	3.00%
Fixed interest	**39.75%**	36.00%
Equities	**49.45%**	50.00%
Property	**8.07%**	11.00%

36. Long-term insurance and investment contract liabilities valuation assumptions (continued)

Mortality rate tables	2011	2010
Conventional Life Business	**75% AM80 Females -3**	75% AM80 Females -3
Conventional Pensions Business	**65% AM80 Females -3**	65% AM80 Females -3
Conventional Industrial Branch Business	**80% up to age 80, rising linearly to 100% at age 100 ELT16**	55% ELT14M
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
Annuities in Payment	**Males: RMV00 CMI_2009 2% LT Females: RFV00 CMI_2009 1.5% LT**	Males: RMV00 CMI_2009 2% LT Females: RFV00 CMI_2009 1.5% LT

Per policy expenses – regular premiums	2011	2010
Conventional Life Business	**£32.60**	£28.50
Conventional Pensions Business	**£42.00**	£39.20
Conventional Industrial Branch Business	**£6.90**	£6.20
Non Unitised Accumulating Pensions Business	**£26.30**	£24.50
Unitised Accumulating Life Business	**£36.50**	£34.20
Unitised Accumulating Pensions Business	**£42.00**	£39.20
Unitised Accumulating Bond Business	**£37.50**	£40.00
Unitised Accumulating Life ISA Business	**£43.40**	£43.70
Annuities in Payment	**£43.40**	£45.50

A percentage of these amounts is used for single premium and paid up 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 as evidenced in the persistency trend analysis, or to reflect expected future trends as a result of anticipated future events.

Options and guarantees
There are no guaranteed annuity or financial options within the Society participating contract funds. There is an additional reserve calculated on a market consistent basis to cover market value restricter (MVR) free guarantees on with-profits bonds.

Bonuses
The cost of bonuses incurred during the year ended 31 December 2011 was £84.6m (2010: £70.9m) of which £22.5m (2010: £32.3m) was included in the long-term insurance contract liabilities and £62.1m (2010: £38.6m) was included in Gross benefits and claims paid in the Statement of Comprehensive Income.

36. Long-term insurance and investment contract liabilities valuation assumptions (continued)

ii) Non participating insurance contracts

Interest rate	2011	2010
Non-profit temporary assurances (original LVFS)	**1.90%**	2.75%
Non-profit temporary assurances	**1.88%**	2.80%
Whole of life assurances	**1.88%**	2.80%
Permanent health insurance:		
a) active lives	**2.35%**	3.50%
b) claims reserves	**1.65%**	2.50%
Critical illness	**2.35%**	3.50%
Other assurances	**1.88%**	2.80%
Annuities in payment	**3.40%**	4.50%

Mortality rate tables	2011	2010
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	**AMC00/AFC00**	AMC00/AFC00
Other assurances	**AM92/AF92**	AM92/AF92
Annuities in payment	**100% RGA 2011 tables with CMI_2009 1.25% LT**	97% RGALV2008M 100% medium cohort improvements with a 1.5% floor

Appropriate adjustments were made to the standard mortality tables to take account of actual experience and publicly available market data.

Morbidity rate tables	2011	2010
Permanent health insurance		
a) active lives	**CMIR12**	CMIR12
b) claims reserves	**CMIR12**	CMIR12
Critical illness	**Reinsurer rates**	Reinsurer rates

Appropriate adjustments were made to the standard morbidity tables to take account of actual experience.

Per policy expenses – regular premiums	2011	2010
Non-profit temporary assurances	**£19.92**	£20.51
Whole of life assurances	**£17.66**	£15.57
Permanent health insurance:		
a) active lives	**£27.68**	£28.84
b) claims reserves (per policy in claim)	**£607.51**	£499.54
Critical illness	**£32.84**	£31.73
Other assurances	**£35.79**	£33.00
Annuities in payment	**£38.00**	£40.00

Options and guarantees

There are no significant options and guarantees in the non participating business.

36. Long-term insurance and investment contract liabilities valuation assumptions (continued)

iii) Investment and long-term linked insurance contracts

The provision for unit linked pensions is equal to the value of the assets to which the contracts are linked. There is one product included within the linked fund which is classified as an investment product and the liability is included within the long-term linked insurance contract liabilities.
The provision for property-linked liabilities is equal to the value of the assets to which the contracts are linked and is included within investment contract liabilities.
The provisions for index-linked permanent health insurance claims and index-linked temporary assurances have been calculated using the same mortality and morbidity assumptions as used for the corresponding non-linked liabilities for both 2011 and 2010.

Interest rate	2011	2010
Unit linked pensions (original LVFS)	**1.90%**	2.75%

Mortality rate tables	2011	2010
Unit linked pensions (original LVFS)	**80% AX92C20**	80% AX92C20

b) 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	2011	2010
Non-profit temporary assurances	**1.88%**	2.80%
Other assurances	**1.88%**	2.80%

Mortality rate tables	2011	2010
Non-profit temporary assurances	**TMN00/TMS00 TFN00/TFS00 AM92/AF92**	TMN00/TMS00 TFN00/TFS00 AM92/AF92
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	2011	2010
Non-profit temporary assurances	**£19.92**	£20.51
Other assurances	**£35.79**	£33.00

Options and guarantees

There are no significant options and guarantees in the non participating business.

36. Long-term insurance and investment contract liabilities valuation assumptions (continued)

c) RNPFN fund

i) Participating business
For participating business, 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 risk free interest rates assumed are:

Year	2011	2010
5	**1.14%**	2.51%
15	**2.81%**	4.36%
25	**3.37%**	4.60%
35	**3.48%**	4.48%

Other assumptions
Best estimate assumptions are set for inflation, mortality, expenses and persistency. The future expense inflation assumption is modelled as RPI plus 0.7% (2010: RPI plus 0.7%), where RPI in both 2011 and 2010 is modelled stochastically.

Asset mix for assets backing asset shares at the valuation date:	2011	2010
Cash	**14.03%**	8.12%
Fixed interest	**57.86%**	65.50%
Equities	**25.40%**	23.64%
Property	**2.71%**	2.74%

Mortality rate tables	2011	2010
Conventional Life Business	**100% AM/F92 ult**	100% AM/F92 ult
Life Deferred Annuities	**100% AM/F92 ult**	100% AM/F92 ult
Pension Deferred annuities	**100% AM/F92 ult**	100% AM/F92 ult
Unitised with-profits Business	**100% A67/70 ult**	100% A67/70 ult

Per policy expenses – regular premiums	2011	2010
Conventional Life Business	**£32.53**	£15.35
Pensions Deferred annuities	**£42.06**	£28.75
Life Deferred annuities	**£32.51**	£14.78
Unitised with-profits ISA	**£43.06**	£15.01
Unitised with-profits bond	**£38.14**	£15.35

36. Long-term insurance and investment contract liabilities valuation assumptions (continued)

Persistency - lapses, surrenders and paid up rates
A review of persistency is carried out annually. Assumptions are adjusted where necessary to reflect more recent experience as evidenced in the persistency trend analysis, or to reflect expected future trends as a result of anticipated future events.

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 £86.6m (2010: £60.4m).

Bonuses
The cost of bonuses incurred during the year ended 31 December 2011 was £21.0m (2010: £18.0m) of which £0.8m (2010: £0.9m) was included in the long-term insurance contract liabilities and £20.2m (2010: £17.1m) was included in gross benefits and claims paid in the Statement of Comprehensive Income.

ii) Non participating business

Interest rate	**2011**	2010
Non-profits assurances	**1.44%**	2.40%
Non-profits general deferred annuities	**1.44%**	2.40%
Annuities in Payment (post 31/12/91)	**1.44%**	2.40%
Annuities in Payment (other)	**1.80%**	3.00%
Pension Deferred Annuities	**1.80%**	3.00%

Mortality rate tables	**2011**	2010
Non-profits assurances	**115% AM/F92 ult**	115% AM/F92 ult
Non-profits general deferred annuities	**85% AM/F92 ult**	85% AM/F92 ult
Annuities in Payment (Male)	**61.2% IML00 with improvements of 120% medium cohort over 2000 to 2004 and future improvements 120% medium cohort sbt a floor of 1.5%**	61.2% IML00 with improvements of 120% medium cohort over 2000 to 2004 and future improvements 120% medium cohort sbt a floor of 1.5%
Annuities in Payment (Female)	**72.3% IFL00 with improvements of greater of 90% of medium cohort and CMIR17 over 2000 to 2004 and future improvements of greater of 90% medium cohort and CMIR17 subject to a 1.5% floor**	72.3% IFL00 with improvements of greater of 90% of medium cohort and CMIR17 over 2000 to 2004 and future improvements of greater of 90% medium cohort and CMIR17 subject to a 1.5% floor
Pension Deferred Annuities	**85% AM/F92 ult**	85% AM/F92 ult

Appropriate adjustments were made to the standard mortality tables to take account of actual experience and publicly available market data.

The provision for linked and unitised with-profits contracts is equal to the value of the units. A non-unit liability consisting mainly of a sterling reserve calculated by carrying out cashflow projections on appropriate bases is included within the liability.

Options and guarantees
There are no significant options or guarantees in the non participating business.

iii) Linked fund
The provision for unit linked assurances is equal to the value of the assets to which the contracts are linked. There are two products included within the linked fund, one is classified as an investment product and the liability is included within the life and pension unit linked insurance contract liabilities, the other is classified as an insurance product and the liability is included within the investment contract liabilities.

Interest rate	**2011**	2010
Unit linked assurances	**1.44%**	2.40%

Mortality rate tables	**2011**	2010
Unit linked assurances	**115% AM/F92 ult**	115% AM/F92 ult

37. Provisions

Movement during the year on other provisions

	Group			Society		
	Earnout payments	Other provisions	Total	Earnout payments	Other provisions	Total
	£m	£m	£m	£m	£m	£m
Balance at 1 January 2011	**37.9**	**13.7**	**51.6**	**37.9**	**0.6**	**38.5**
Charge to the Statement of Comprehensive Income	**0.7**	**0.7**	**1.4**	**0.7**	**0.4**	**1.1**
Capitalised within goodwill	**5.3**	**-**	**5.3**	**5.3**	**-**	**5.3**
Transfers from other Group Companies	**-**	**-**	**-**	**-**	**7.8**	**7.8**
Utilised during the year	**-**	**(2.8)**	**(2.8)**	**-**	**(0.7)**	**(0.7)**
Balance at 31 December 2011	**43.9**	**11.6**	**55.5**	**43.9**	**8.1**	**52.0**

Other provisions relate to:	Group		Society	
	2011	2010	**2011**	2010
	£m	£m	**£m**	**£m**
Losses on uneconomic contracts related to banking and losses on banking products	**7.2**	7.8	**7.2**	-
Vacant property	**1.8**	3.6	**0.4**	0.6
Compensation payable on customer complaints	**1.9**	2.1	**-**	-
Other	**0.7**	0.2	**0.5**	-
	11.6	13.7	**8.1**	0.6

Earnout payments are payable in respect of the period ending on 31 December 2012 and relate to the acquisition of LV Insurance Management Limited (then known as ABC Insurance Solutions Limited) in 2006. The Society has entered into a contract with the vendors of LV Insurance Management Limited to acquire the remaining interest on 31 December 2012 based on the market value of the general insurance business. Management's current best estimate of the cost of the remaining interest is included within earnout payments.

38. Corporation tax liability

	Group		Society	
	2011	2010	**2011**	2010
	£m	£m	**£m**	£m
Corporation tax	**28.4**	-	**13.0**	-
	28.4	-	**13.0**	-

39. Other financial liabilities

	Group		Society	
	2011	2010	**2011**	2010
	£m	£m	**£m**	£m
Subordinated note (EUR12m - interest payable at the 3 month Euro Deposit Rate plus a margin of 3.65%)	**10.0**	10.3	**-**	-
Other	**0.4**	0.4	**0.3**	-
	10.4	10.7	**0.3**	-

The carrying amounts disclosed above reasonably approximate fair value at the Statement of Financial Position date.

40. Insurance payables

	Group		Society	
	2011	2010	**2011**	2010
	£m	£m	**£m**	£m
Due to policyholders	**30.1**	18.6	**30.1**	18.6
Due to brokers and intermediaries	**0.8**	1.0	**0.8**	1.0
Due to reinsurers	**10.7**	13.0	**0.7**	4.1
	41.6	32.6	**31.6**	23.7

The carrying amounts disclosed above reasonably approximate fair value at the Statement of Financial Position date.

41. Trade and other payables

	Group		Society	
	2011	2010	**2011**	2010
	£m	£m	**£m**	£m
Trade payables	**0.7**	2.2	**-**	-
Amounts owed to group undertakings	**-**	-	**-**	42.4
Other taxes and social security costs	**32.2**	26.8	**10.1**	10.4
Other creditors	**70.0**	39.7	**32.2**	16.0
Deferred income	**3.3**	3.4	**2.2**	2.5
Finance lease liabilities	**5.1**	5.4	**-**	-
Accruals and deferred income	**94.3**	79.5	**65.2**	50.0
	205.6	157.0	**109.7**	121.3

The carrying amounts disclosed above reasonably approximate fair value at the Statement of Financial Position date.

42. Cash (used in)/generated from operating activities

	Group		Society	
	2011	2010	**2011**	2010
	£m	£m	**£m**	£m
Loss before tax	**(16.9)**	(18.3)	**(47.7)**	(73.2)
Investment income	**(249.7)**	(227.7)	**(284.9)**	(178.4)
(Gains)/losses on investments	**(425.4)**	(467.6)	**(407.3)**	(359.4)
Finance costs	**0.5**	0.9	**-**	0.1
Purchase of investments at fair value through income	**(4,684.5)**	(13,534.1)	**(3,441.7)**	(7,698.4)
Sales of investments at fair value through income	**4,101.6**	12,686.4	**2,949.0**	6,953.9
(Purchases)/sales of financial derivatives	**(12.7)**	110.4	**(14.1)**	11.2
Non-cash items				
Expenses deferred during the year	**44.1**	(35.9)	**-**	-
Amortisation of intangible assets	**13.0**	13.8	**4.6**	4.6
Depreciation on property and equipment	**2.6**	2.2	**0.8**	1.1
Loss on disposal of property and equipment	**-**	0.1	**0.1**	-
(Increase)/decrease in capitalised goodwill	**(5.3)**	0.4	**(5.3)**	0.4
Decrease in provisions and pension obligation	**(25.5)**	(44.5)	**(16.6)**	(48.3)
Impairment write-offs in subsidiaries	**-**	-	**34.4**	14.9
Mutual bonus	**(18.6)**	-	**(18.6)**	-
Changes in working capital				
(Increase)/decrease in loans and receivables	**(36.8)**	124.1	**(39.9)**	181.5
(Increase)/decrease in reinsurance assets	**(123.3)**	(49.6)	**(7.0)**	84.4
(Increase)/decrease in insurance receivables	**(23.3)**	(41.8)	**4.7**	6.3
(Increase)/decrease in other prepayments and accrued income	**(1.2)**	1.1	**(1.8)**	2.7
Increase in insurance contract liabilities	**1,131.9**	878.1	**821.3**	567.9
Increase in investment contract liabilities	**59.7**	162.8	**59.7**	162.8
Increase in borrowings	**-**	-	**5.6**	-
(Decrease)/increase in other financial liabilities	**(0.3)**	(4.2)	**0.3**	-
Increase/(decrease) in insurance payables	**9.0**	(0.7)	**7.9**	1.1
Increase/(decrease) in trade and other payables	**48.7**	8.6	**(11.3)**	(630.2)
Cash (used in)/generated from operating activities	**(212.4)**	(435.5)	**(407.8)**	(995.0)

The Group classifies the cash flows for the acquisition and disposal of financial assets as operating cash flows, as the purchases are funded from the cash flows associated with the origination of insurance and investment contracts.

43. Commitments

a) Capital commitments

	Group		Society	
	2011	2010	**2011**	2010
	£m	£m	**£m**	£m
Authorised and contracted commitments payable after 31 December not provided for in respect of:				
– property investments	**1.4**	4.7	**1.4**	4.7
– other financial investments	**49.5**	40.1	**49.5**	40.1
– property and equipment	**0.9**	-	**0.9**	-
	51.8	44.8	**51.8**	44.8

b) Operating lease commitments

The Group leases various properties under non-cancellable operating lease agreements. The leases have varying terms, escalation clauses and renewal rights. The future aggregate minimum lease payments net of income under non-cancellable operating leases are as follows:

	Group		Society	
	2011	2010	**2011**	2010
	£m	£m	**£m**	£m
Within one year	**6.7**	6.8	**5.0**	5.0
Between two and five years	**19.6**	19.3	**13.8**	13.4
Over five years	**5.7**	7.5	**3.3**	4.6
	32.0	33.6	**22.1**	23.0

The Group has entered into commercial subleases for some of its properties that are unoccupied. These leases have varying terms and escalation clauses. Where these subleases are insufficient to cover the Group's operating lease agreements an onerous contract provision for unused premises is set up. The future aggregate minimum sublease payments expected to be received under operating subleases:

	Group		Society	
	2011	2010	**2011**	2010
	£m	£m	**£m**	£m
Within one year	**0.4**	0.4	**0.1**	0.1
Between two and five years	**0.7**	1.1	**-**	0.1
	1.1	1.5	**0.1**	0.2

43. Commitments (continued)

c) Finance lease commitments

It is the Group's policy to lease certain of its properties under finance leases. The average lease term is 99 years. Interest rates are fixed at the contract rate. All leases are 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	
	2011	2010
	£m	£m
Gross finance lease liabilities - minimum lease payments		
Within one year	**1.1**	1.1
Between two and five years	**4.7**	4.7
Over five years	**89.4**	90.6
	95.2	96.4
Future finance charges on finance leases	**(90.1)**	(91.0)
Present value of financial lease liabilities	**5.1**	5.4

	Group	
	2011	2010
	£m	£m
The present value of finance lease liabilities is as follows:		
Within one year	**0.2**	0.2
Between two and five years	**0.7**	0.8
Over five years	**4.2**	4.4
	5.1	5.4

d) Other financial commitments

The Group has entered into several long-term contracts following service outsourcing. These contracts will end no later than 2018. An option to withdraw from some of these commitments in 2012 is available. The present value of the remaining commitment is estimated at £89.1m (2010: £27.2m) for the Group and the Society.

These amounts have not been provided for in the financial statements.

44. Contingent liabilities

The Society has granted a contingent loan facility to the RNPFN fund, a closed fund within the Group, up to a maximum of £100.0m, to be used in the event of a shortfall in the capital resources of that fund. No drawdown of this facility is anticipated.

As part of the arrangements whereby the Society transferred responsibility for the management of its investment portfolio to Threadneedle Asset Management Ltd and Threadneedle Investment Services Ltd ("Threadneedle"), Liverpool Victoria Portfolio Managers Ltd ("LVPM") resigned, and Threadneedle was appointed, as the Authorised Corporate Director ("ACD") of the LV= Property OEIC. Simultaneous with the change in ACD, the Society provided an indemnity to Threadneedle for any losses incurred by Threadneedle as a result of any actual or suspected mis-pricing of the LV= Property OEIC by LVPM, including any costs of rectification or investor compensation. No claims have been made under this indemnity.

45. Related party transactions

The Group and Society enter into transactions with key management personnel in the normal course of business. All transactions are carried out on an arm's length basis. Details of significant transactions carried out during the year with related parties are as follows:

a) The Group has related party transactions with the LV= Employee Pension Scheme. Until 31 October 2011 the Society provided fund management and administration services to the Scheme.

During the year the following amounts were charged to the Pension Scheme for the following services:

	Fund Management Services		Administration Services		Total	
	2011	2010	**2011**	2010	**2011**	2010
	£m	£m	**£m**	£m	**£m**	£m
Liverpool Victoria Friendly Society Limited	**-**	-	**2.4**	1.4	**2.4**	1.4
Liverpool Victoria Asset Management Limited	**1.1**	1.2	**-**	-	**1.1**	1.2

As at 31 December 2011 the LV= Employee Pension Scheme owed the Society £1.8m in respect of administration services (2010: the Society owed the LV= Employee Pension Scheme £0.1m).

b) The aggregate premiums payable for the year by the Group Executive and Non-Executive Directors in respect of the Group's products was £58,756 (2010: £67,608).

c) As disclosed in note 44, the Society has granted a contingent loan facility to the RNPFN fund, a closed fund within the Group, which is disclosed in contingent liabilities.

d) 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	
	2011	2010
	£'000	£'000
Short-term employment benefits	**6,740**	6,874
Other long-term benefits	**2,746**	-
Post-employment benefits	**440**	270
Termination benefits	**240**	292
Total compensation of key management personnel	**10,166**	7,436

The Society makes contributions to the LV= Employee Pension Scheme of an average of 17% of pensionable salaries (2010: 19% of pensionable salaries) in respect of all permanent staff, including executive directors.

Included within key management personnel are all the vendors of ABC Insurance Solutions Limited who, as part of the acquisition in 2006, entered into a contract with the Society. Further details are disclosed within Note 37.

e) The following transactions have taken place between the Society and other Group companies:

	2011	2010
	£m	£m
Management charge by the Society	**79.8**	78.7
Investment management charge to the Society	**(7.9)**	(7.7)
Reinsurance ceded by the Society - claims recoveries	**47.9**	193.2
Reinsurance ceded by the Society - premiums paid	**(31.5)**	(33.2)
Intra group loans - net interest received by the Society	**3.8**	4.5

Balances outstanding between the Society and other Group companies:

	2011	2010
	£m	£m
Payable by the Society	**-**	(42.4)
Receivable by the Society	**71.9**	60.3
Reinsurance ceded by the Society	**-**	88.9
Loans owed to the Society	**234.5**	354.9

Loans owed to the Society represent a subordinated loan of £183m (2010: £183m) to Liverpool Victoria General Insurance Group Limited and secured loans of £51.4m (2010: £40.2m) to Liverpool Victoria Equity Release Limited disclosed within loan stock in note 23.

In addition the Society has a loan of £162.2m (2010: £131.7m) to Liverpool Victoria Equity Release Limited designated at fair value through income disclosed in note 24.

The subordinated loan to Liverpool Victoria General Insurance Group Limited bears interest at 1% above UK six month LIBOR and is of a medium to long term nature. The loans to Liverpool Victoria Equity Release Limited have guaranteed interest and repayment terms established at the outset of each advance.

On 30 November 2011 the Critical Illness and Income Protection reinsurance agreement between the Society and Liverpool Victoria Life Company Limited was terminated. Assets totalling £34.4m were transferred to the Society in settlement of £91.8m of insurance contract liabilities less the value of the estimated future profits for the business stream. A loss of £0.7m was recorded in the Statement of Comprehensive Income as a result of this transfer.

In December 2010 the With-Profits Bond reinsurance agreement between the Society and Liverpool Victoria Life Company Limited was terminated resulting in the insurance risk being fully transferred back to the Society. Assets totalling £133.0m were transferred to the Society in settlement of outstanding insurance contract liabilities totalling £98.1m and the fourth quarter reinsurance creditor balance of £34.9m. No gain or loss was recorded as a result of this transfer. This payment is included within Claims ceded to reinsurers, benefits and claims paid within Note 9.

46. With-profits Actuary

The following information has been provided in accordance with section 77 of the Friendly Societies Act 1992.

a) The With-profits Actuary of the Society throughout 2011 was Mr P M Downey, who is employed by Liverpool Victoria Friendly Society Limited.

b) The total emoluments of Mr Downey during the year were £175,312 including car allowance and medical benefits and Mr Downey participates in the Society's long term incentive plan.

c) Mr Downey did not receive, nor will receive, any other pecuniary benefit.

d) On 16 February 2012, Mr N J Dumbreck took over as the Society's With-Profits Actuary from Mr Downey. Mr Dumbreck is Life Practice Leader and a Principal with the London office of Milliman, an external consultancy firm.

e) Mr Downey was appointed as With-profits Actuary on 29 March 2010. His total emoluments in 2010 were £123,521. Prior to 29 March 2010 the With-profits Actuary was Mrs T Abbey, a partner in Deloitte LLP. In 2010, the Society paid Deloitte LLP £82,414 in respect of Mrs Abbey's professional services.

47. Valuation

The latest published report on the valuation of Assets and Liabilities of the Society (the Annual FSA Insurance Return) was made at 31 December 2011 and is available on request from the Group Company Secretary, County Gates, Bournemouth, BH1 2NF and LV.com.

48. Subsidiary undertakings

The principal subsidiary undertakings of the Society at 31 December 2011 are shown below.
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
Subsidiaries		
Frizzell Financial Services Limited	Property Management	100.0%
Highway Insurance Group Ltd *	Insurance Intermediary	100.0%
Highway Insurance Company Limited *	General Insurance	100.0%
Liverpool Victoria Asset Management Limited	Fund Management	100.0%
Liverpool Victoria Financial Advice Services Limited	Financial Advice Services	100.0%
Liverpool Victoria General Insurance Group Limited	General Insurance Holding Company	100.0%
Liverpool Victoria Insurance Company Limited *	General Insurance	100.0%
Liverpool Victoria Life Company Limited	Life Insurance	100.0%
Liverpool Victoria Portfolio Managers Limited	Investment Management	100.0%
LV Insurance Management Limited *	Management Services	95.0%
LV Life Services Limited	Management Services	100.0%
LV Equity Release Limited	Equity Release Lifetime Mortgages	100.0%
NM Pensions Trustees Limited	Self Invested Personal Pension (SIPP) Administrator	100.0%

* Owned by a subsidiary undertaking of the Society

All the principal subsidiaries have the same year end as the Society and all have been included in the consolidation.

49. Associates and joint ventures

The associates and joint ventures of the Society at 31 December 2011 are shown below.
They are incorporated and domiciled in England and Wales.

Name	Class of shares	Year end	Principal Activity	Percentage Held
Joint ventures				
Vista Limited Partnership	*	31/03/2011	Investment property	90.0%
Great Victoria Partnership	*	31/03/2011	Investment property	50.0%

* The percentage held represents the share of the partnership capital and partner loans held by Liverpool Victoria Friendly Society as at 31 December 2011.

50. Open ended investment companies

The open ended investment companies (OEICs) of the Society and Group at 31 December 2011 are shown below.
All OEICs are incorporated and domiciled in England and Wales.

Name	Principal Activity	Year end	Percentage of Units Held *
Threadneedle Investment Funds II ICVC (formerly LV= Investment Funds I ICVC)	Open Ended Investment Company	31/12/2011	95.41%
which consists of:			
Threadneedle European ex-UK Growth Fund			95.12%
Threadneedle Japan Growth Fund			100.00%
Threadneedle Pacific ex-Japan Growth Fund			100.00%
Threadneedle UK Equity Income Fund			89.62%
Threadneedle US Equity Income Fund			99.99%
Threadneedle UK Growth Fund			92.54%
Threadneedle Investment Funds III ICVC (formerly LV= Investment Funds II ICVC)	Open Ended Investment Company	31/12/2011	87.10%
which consists of:			
Threadneedle UK Corporate Bond Fund			90.60%
Threadneedle UK Fixed Interest Fund			99.65%
Threadneedle UK Index Linked Fund			97.18%
Threadneedle UK Money Market Fund			98.87%
Threadneedle Balanced Managed Fund			96.30%
Threadneedle Short Dated Gilt Fund			100.00%
Threadneedle Medium Long Corporate Bond Fund			43.29%
Threadneedle Short-Dated Corporate Bond			99.82%
Threadneedle Worldwide Select Fund			72.40%
Threadneedle Investment Funds IV ICVC (formerly LV= Investment Funds III ICVC)	Open Ended Investment Company	31/03/2011	84.33%
which consists of:			
Threadneedle Diversified Income Fund			38.98%
Threadneedle Managed Portfolio 3			82.74%
Threadneedle Managed Portfolio 4			86.37%
Threadneedle Managed Portfolio 5			86.02%
Threadneedle Managed Portfolio 6			90.08%
Threadneedle Managed Portfolio 7			87.90%
Threadneedle UK Property Fund II ICVC (formerly LV= UK Property Fund ICVC)	Open Ended Investment Company	31/12/2011	33.45%
which consists of:			
Threadneedle UK Property Fund			33.45%

* excludes units held by the LV= Employee Pension Scheme.

51. Society information

Liverpool Victoria Friendly Society is a UK-incorporated 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 and regulated by the Financial Services Authority and is a member of the ABI, AFS and ILAG.

Registered office:
County Gates
Bournemouth
BH1 2NF.
Telephone: 01202 292333

Directors' Report

Rachel Small
Company Secretary

The directors of Liverpool Victoria Friendly Society Limited present their annual report together with the accounts for the year ended 31 December 2012.

Our members

+6,000

2012	1,133,000
2011	1,127,000

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 cover with-profits assurance, life protection (both term and whole of life), annuities, equity release, motor, home, pet and travel insurance. The directors consider that all the activities undertaken by the group during the year were within its rules and any relevant regulatory permissions.

A review of the business for the year ending 31 December 2012, recent events and likely future developments is included below.

The board sets objectives and priorities supported by key performance indicators (KPIs) and targets, which it monitors on a regular basis throughout the year.

During 2012, the key objectives and priorities were:

- Achieving the profit and enterprise value target results for each business unit;
- Completing the transformation of the general insurance business into a mature cash generative business;
- Sharing the financial returns from our trading businesses with members via a mutual bonus scheme;
- Completing the implementation of a major new system for the management of general insurance claims;
- Further enhancing our enterprise risk management framework, operating at all times to required regulatory standards;
- Completing our programme to achieve compliance with the requirements of Solvency II and the new regime established by the Retail Distribution Review; and
- Achieving progress towards our goal to be Britain's best-loved insurer.

Board directors and interests

The current members of the board and details of its various committees are shown on pages 32 to 35 together with their dates of appointment.

John O'Roarke is a minority shareholder in LV Insurance Management Limited with a 1.11% shareholding and is a party to the contract for LVFS to acquire the remaining interest in that company. Further details are given in note 40 to the Financial Statements.

We continued to maintain liability insurance cover for our directors and officers during the year.

With-profits bonus declaration

We have declared an annual bonus for the year ending 31 December 2012 at 1% of the sum assured for Industrial Branch business and at 2.0% of the sum assured for conventional Ordinary Branch life business. Interim bonus rates will also be at these levels. Terminal bonus rates in 2012 maintain our highly competitive position.

Basis of accounting

These accounts are presented using International Financial Reporting Standards (IFRS), as adopted by the European Union, drawn up on a going concern basis. The directors are satisfied that the group has adequate resources to continue in business for the foreseeable future and that accordingly the going concern basis is appropriate. Further details about the directors' responsibilities for the accounts are described below.

Fixed assets

Changes in our fixed assets are shown in note 27 of these accounts.

Margin of solvency

Throughout the year and at 31 December 2012 we held the required capital resources for each business class as prescribed by the Financial Services Authority.

Independent auditor

A resolution for the re-appointment of PricewaterhouseCoopers LLP as auditor will be proposed at the 2013 AGM.

Managing risk and return

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.

To better manage risk levels on a day to day basis a system of capital budgets is in place for each business. Each business is expected to manage its position in line with its capital budget and risk appetite position.

A full overview of our risk management can be found on page 26. Note 3 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. 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 take reports from the internal audit, compliance and risk functions.

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.

In 2012, the board undertook a full annual review of the effectiveness of the material controls, as recommended by the UK Corporate Governance Code. The review incorporated an evaluation of the group's framework and an assessment of any significant internal control issues that were raised during the year in relation to financial, operational and compliance risk controls. Whenever any significant control weaknesses are identified actions are taken, or agreed plans are put in place and tracked by the board to implementation. The system was in place throughout the year and as at the date this Report was approved.

Charitable donations

A full view of our charitable donations and corporate social responsibility activities can be found on page 43. In 2012 no political donations were made.

People employed by the group and its subsidiaries

The average number of people we employ and our total employee costs are shown in note 38 of the accounts.

Membership

As at 31 December 2012, we had 1,133,000 (2011: 1,127,000) members.

We make all reasonable and cost effective attempts to trace and contact members if we believe their address details are incorrect. When all reminder or tracing techniques have been exhausted we maintain a record of the relevant member and, if they have an unpaid claim, the policy remains open for payment until we can re-establish contact.

Statement of disclosure of information to the auditor

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

1) so far as (s)he is aware, there is no information relevant to the audit of the Society's financial statements for the year ending 31 December 2012 of which the auditor is unaware;
2) (s)he has taken all steps that (s)he ought to have taken in his/her duty as a director to make him/herself aware of any relevant audit information and to establish that the Society's auditor is aware of that information.

Responsibilities of the board of directors for the accounts

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.

Legislation in the UK that governs the preparation and publication of accounts may differ from legislation in other jurisdictions. 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 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.

The directors are responsible for the maintenance and integrity of the group's website. 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 page 32, confirm that to the best of their knowledge and belief:

- 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 group;
- The Business Review on pages 12 to 16 includes a fair review of the development and performance of the business and the position of the group; and
- A description of the group's principal risks and details of the group's risk governance structure are provided on pages 26 to 28.

By order of the Board of Directors

Rachel S Small, Company Secretary
27 March 2013

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

We have audited the financial statements of Liverpool Victoria Friendly Society Limited for the year ended 31 December 2012 which comprise the Statement of Comprehensive Income, the Statement of Financial Position, the Statement of Cash Flows and the related notes for the Society and the Group. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

Respective responsibilities of the Board of Directors and auditors

As explained more fully in the Responsibilities of the Board of Directors for the financial statements set out on page 39, the Board of Directors is responsible for preparing financial statements which give a true and fair view. The Society has also chosen to comply with the Annotated UK Corporate Governance Code specified by the Association of Financial Mutuals. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

This report, including the opinions, has been prepared for and only for the Society's members as a body in accordance with the Friendly Societies Act 1992 and the Regulations made under it and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Scope of the audit of the financial statements

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

Opinion on financial statements

In our opinion the financial statements:

- give a true and fair view, in accordance with IFRSs as adopted by the European Union, of the state of the Society's and the Group's affairs as at 31 December 2012 and of the income and expenditure and cash flows of the Society and the Group for the year then ended; and
- have been properly prepared in accordance with the Friendly Societies Act 1992.

Opinion on other matters prescribed by the Friendly Societies Act 1992

In our opinion the Directors' Report has been prepared in accordance with the Friendly Societies Act 1992 and the regulations made under it, and the information given therein is consistent with the financial statements for the financial year.

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Friendly Societies Act 1992 requires us to report to you if, in our opinion:

- proper accounting records have not been kept; or
- the financial statements are not in agreement with the accounting records; or
- we have not received all the information and explanations and access to documents that we require for our audit.

In accordance with our instructions from the Society we review whether the Corporate Governance Statement reflects the Society's compliance with the eight provisions of the Annotated UK Corporate Governance Code specified by the Association of Financial Mutuals. We have nothing to report in respect of this review.

David Roper
Senior Statutory Auditor
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
Bristol
27 March 2013

Statement of Comprehensive Income

Year ended 31 December 2012

	Notes	Group 2012 £m	Group 2011 Restated see Note 1 £m	Society 2012 £m	Society 2011 £m
Gross earned premiums	4	**2,446.2**	2,196.5	**959.1**	862.8
Premiums ceded to reinsurers	4	**(108.8)**	(93.0)	**(75.6)**	(99.7)
Net earned premiums	4	**2,337.4**	2,103.5	**883.5**	763.1
Fee and commission income	6	**16.5**	18.5	**6.6**	5.2
Investment income	7	**320.2**	261.4	**337.0**	284.9
Net gains on investments	8	**374.7**	425.4	**214.1**	372.9
Other income	9	**41.7**	51.0	**5.9**	19.1
Total income		**3,090.5**	2,859.8	**1,447.1**	1,445.2
Gross benefits and claims	10	**(1,819.3)**	(1,669.3)	**(646.6)**	(657.3)
Claims ceded to reinsurers	10	**110.8**	86.4	**61.8**	102.4
Net benefits and claims	10	**(1,708.5)**	(1,582.9)	**(584.8)**	(554.9)
Gross change in long-term contract liabilities	22	**(711.3)**	(771.6)	**(714.8)**	(773.4)
Change in long-term contract liabilities ceded to reinsurers	22	**74.4**	96.0	**74.4**	7.1
Net change in contract liabilities	22	**(636.9)**	(675.6)	**(640.4)**	(766.3)
Finance costs	11	**(0.5)**	(0.5)	**–**	–
Investment return allocated to external unit holders		**(32.9)**	2.1	**–**	–
Other operating and administrative expenses	12	**(608.5)**	(619.8)	**(218.6)**	(171.7)
Other expenses		**(641.9)**	(618.2)	**(218.6)**	(171.7)
Total benefits, claims and expenses		**(2,987.3)**	(2,876.7)	**(1,443.8)**	(1,492.9)
Profit/(loss) before tax and mutual bonus		**103.2**	(16.9)	**3.3**	(47.7)
Mutual bonus	14	**(20.9)**	(18.6)	**(20.9)**	(18.6)
Income tax expense	34	**(34.3)**	(42.2)	**(13.4)**	(26.9)
Pension scheme actuarial (losses)/gains net of tax	39	**(145.5)**	69.7	**(145.5)**	69.7
Transfer from the Unallocated divisible surplus	46	**97.5**	8.0	**176.5**	23.5
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 as the Society is a mutual organisation.

Statement of Financial Position

as at 31 December 2012

		Group		Society	
		2012	2011	**2012**	2011
			Restated see Note 1		Restated see Note 1
	Notes	**£m**	£m	**£m**	£m
Assets					
Intangible assets	26	**251.9**	261.5	**–**	4.6
Deferred acquisition costs	23	**100.1**	94.7	**–**	–
Pension benefit asset	39	**–**	108.1	**–**	108.1
Property and equipment	27	**23.9**	20.6	**6.9**	5.0
Investment properties	28	**164.7**	219.9	**131.7**	151.4
Investments in group undertakings	29	**–**	–	**902.3**	957.6
Corporation tax asset	35	**–**	–	**2.0**	–
Deferred tax asset	36	**14.2**	31.0	**13.0**	17.7
Prepayments and accrued income	31	**106.6**	61.3	**64.3**	48.1
Financial assets					
– Fair value through income	15	**9,484.1**	8,020.3	**7,058.9**	6,016.1
– Derivative financial instruments	16	**70.8**	143.8	**68.5**	143.8
Loans and other receivables	19	**103.0**	116.0	**128.6**	154.9
Reinsurance assets	24	**447.2**	336.9	**297.4**	223.0
Insurance receivables	30	**227.3**	216.5	**12.6**	10.2
Cash and cash equivalents		**436.6**	719.1	**123.3**	283.4
Total assets		**11,430.4**	10,349.7	**8,809.5**	8,123.9
Liabilities					
Unallocated divisible surplus	46	**860.9**	958.4	**878.6**	1,055.1
Insurance contract liabilities	21	**8,657.4**	7,748.0	**6,603.3**	5,946.2
Investment contract liabilities	17	**959.3**	800.9	**959.3**	800.9
Net asset value attributable to external unit holders		**503.9**	429.1	**–**	–
Pension benefit obligation	39	**10.2**	1.2	**10.2**	1.2
Provisions	40	**66.0**	55.5	**63.1**	52.0
Corporation tax liability	37	**7.6**	28.4	**–**	13.0
Financial liabilities					
– Derivative financial instruments	16	**51.2**	3.8	**51.2**	3.8
– Other financial liabilities	20	**75.5**	77.2	**81.4**	72.7
Insurance payables	32	**44.7**	41.6	**26.2**	31.6
Trade and other payables	33	**193.7**	205.6	**136.2**	147.4
Total liabilities		**11,430.4**	10,349.7	**8,809.5**	8,123.9

The financial statements on page 55 to 125 were approved by the Board of Directors on 27 March 2013 and signed on its behalf by:

R.S. Small
Secretary

Statement of Cash Flows
Year ended 31 December 2012

		Group		Society	
		2012	2011 Restated see Note 1	2012	2011 Restated see Note 1
	Notes	£m	£m	£m	£m
Cash and cash equivalents at 1 January		**719.1**	547.4	**283.4**	289.0
Cash flows arising from:					
Operating activities					
Cash generated from operating activities	50	**411.8**	414.4	**272.5**	140.5
Net increase in investments held at fair value through income		**(985.0)**	(582.9)	**(720.6)**	(497.2)
Purchase of investment properties		**(0.2)**	(12.5)	**(0.2)**	(2.9)
Proceeds from sale of investment properties		**54.2**	106.1	**18.7**	96.2
Dividend income received		**96.1**	119.5	**165.2**	152.0
Interest and other income received		**180.4**	137.0	**150.9**	123.4
Rental income on investment properties		**6.1**	7.3	**6.5**	7.1
Finance cost paid	11	**(0.5)**	(0.5)	–	–
Income tax paid		**(38.3)**	(13.6)	**(23.7)**	(13.6)
Net cash flows (used in)/generated from operating activities		**(275.4)**	174.8	**(130.7)**	5.5
Investing activities					
Proceeds from sale of property and equipment		**(0.1)**	–	**–**	–
Increase in investment in group undertakings		**–**	–	**(45.1)**	(15.2)
Redemption of loans to subsidiaries		**–**	–	**13.0**	–
Repayment in long–term loan from subsidiary		**–**	–	**5.8**	4.5
Purchase of property and equipment	27	**(7.0)**	(3.1)	**(3.1)**	(0.4)
Net cash flows (used in)/generated from investing activities		**(7.1)**	(3.1)	**(29.4)**	(11.1)
Net (decrease)/increase in cash and cash equivalents		**(282.5)**	171.7	**(160.1)**	(5.6)
Cash and cash equivalents at 31 December		**436.6**	719.1	**123.3**	283.4
Cash and cash equivalents comprise:					
Bank balances		**98.0**	156.9	**22.4**	107.5
Short–term bank deposits		**338.6**	562.2	**100.9**	175.9
		436.6	719.1	**123.3**	283.4

The Group classifies the cash flows for the acquisition and disposal of financial assets 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

31 December 2012

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.

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 (IFRIC) 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.

Insurance contracts are accounted for in accordance with the Statement of Recommended Practice issued by the Association of British Insurers in December 2005, and amended in December 2006. In certain businesses, the accounting policies or accounting estimates have been changed, to measure designated insurance liabilities using current market interest rates and allowing for other changes to regulatory reporting practices. The Group measures the liability on insurance and with-profit contracts in line with the 'realistic' reporting regime of the Financial Services Authority (FSA). More detail on the valuation of insurance and investment contracts is given in the accounting policies disclosed within Notes 17 and 21.

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) at fair value through income.

The principal accounting policies applied in the preparation of these consolidated financial statements are set out below. These policies have been consistently applied to all years presented, unless otherwise stated.

After making enquiries, the directors have a reasonable expectation that the Group has adequate resources to continue in operational existence for the foreseeable future. The Group therefore continues to adopt the going concern basis in preparing its consolidated financial statements.

Restatements

The Statement of Comprehensive Income has been restated to reclassify interest on loans secured on residential property from Fee and commission income to Investment income.

The Statement of Financial Position and Statement of Cash Flows have been restated to gross up Bank balances and Other financial liabilities to reflect cash collateral received.

1.2 Significant accounting estimates and judgements

The preparation of financial statements in accordance with IFRS requires the use of estimates. It also requires management to exercise judgement in applying the accounting policies. The key areas involving a high degree of judgement or complexity, or areas where assumptions are significant to the financial statements are highlighted under the relevant note.

Significant accounting estimates and judgements are disclosed in:

- Fair value of financial assets (Note 15)
- Insurance contract liabilities (Note 21)
- Goodwill and intangible assets (Note 26)
- Pension benefit asset/(obligation) (Note 39)

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 the power to govern the financial and operating policies generally accompanying a shareholding of more than one half of the voting rights. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Group controls another entity. 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.

Where the Group invests in specialised investment vehicles (such as OEICs) and owns greater than 50% of the unit shareholding, they 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.

Details of the Society's principal subsidiaries are given in Note 43.

Notes to the Financial Statements continued

31 December 2012

1. Significant accounting policies (continued)

Associates and joint ventures in property holding companies
The Group invests in associate companies and jointly controlled entities that hold investment properties, with holdings ranging between 25% and 99%.

Associates are all entities over which the Group has significant influence but not control, generally accompanying a shareholding of between 20% and 50% of the voting rights.

The investments in associates and the Group's interests in jointly controlled entities have not been consolidated under the equity method but are designated as investments at fair value through income under UK unlisted investments in accordance with the exemptions permitted under IAS 28 and IAS 31 applicable to investment-linked insurance funds.

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 participating contracts have been classified as participating insurance 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.

c. Foreign currencies
Monetary 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 into the following categories:
- Financial assets and liabilities at fair value through income
- Derivative financial instruments
- Loans and receivables
- Other financial liabilities

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
  - has transferred control of the asset.

A financial liability is derecognised when the obligation under the liability is discharged or cancelled or expires.

e. Liability adequacy testing
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 Statement of Financial Position 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 initially by writing off deferred acquisition costs and by subsequently establishing an unexpired risk provision. Any deferred acquisition cost written off as a result of this test cannot subsequently be reinstated.

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 consolidated cash flow statement, cash and cash equivalents are as defined above but are shown net of outstanding bank overdrafts.

Notes to the Financial Statements continued

31 December 2012

1. Significant accounting policies (continued)

1.4 Changes and future developments in accounting policies

(i) New and amended standards adopted by the Group

There are no IFRSs or IFRIC interpretations that are effective for the first time for the financial year beginning on or after 1 January 2012, that would be expected to have a material impact on the Group.

(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 2013, and have not been applied in preparing these consolidated financial statements. None of these is expected to have a significant effect on the consolidated financial statements of the Group, except the following set out below:

Amendment to IAS 1, 'Financial statement presentation' regarding other comprehensive income. The main change resulting from these amendments is a requirement for entities to group items presented in 'other comprehensive income' (OCI) on the basis of whether they are potentially reclassifiable to profit or loss subsequently (reclassification adjustments). The amendments do not address which items are presented in OCI.

IFRS 13, 'Fair value measurement', aims to improve consistency and reduce complexity by providing a precise definition of fair value and a single source of fair value measurement and disclosure requirements for use across IFRSs. The requirements, which are largely aligned between IFRSs and US GAAP, do not extend the use of fair value accounting but provide guidance on how it should be applied where its use is already required or permitted by other standards within IFRSs or US GAAP.

IAS 19, 'Employee benefits', was amended in June 2011. The impact on the Society will be as follows: to immediately recognise all past service costs; and to replace interest cost and expected return on plan assets with a net interest amount that is calculated by applying the discount rate to the net defined benefit liability (asset). The Group is yet to assess the full impact of the amendments.

IFRS 9, 'Financial instruments', addresses the classification, measurement and recognition of financial assets and financial liabilities. IFRS 9 was issued in November 2009 and October 2010. It replaces the parts of IAS 39 that relate to the classification and measurement of financial instruments. IFRS 9 requires financial assets to be classified into two measurement categories: those measured as at fair value and those measured at amortised cost. The determination is made at initial recognition. The classification depends on the entity's business model for managing its financial instruments and the contractual cash flow characteristics of the instrument. For financial liabilities, the standard retains most of the IAS 39 requirements. The main change is that, in cases where the fair value option is taken for financial liabilities, the part of a fair value change due to an entity's own credit risk is recorded in other comprehensive income rather than the income statement, unless this creates an accounting mismatch. The Group is yet to assess IFRS 9's full impact and intends to adopt IFRS 9 no later than the accounting period beginning on or after 1 January 2015, subject to endorsement by the EU. The Group will also consider the impact of the remaining phases of IFRS 9 when completed by the Board.

IFRS 10, 'Consolidated financial statements', builds on existing principles by identifying the concept of control as the determining factor in whether an entity should be included within the consolidated financial statements of the parent company. The standard provides additional guidance to assist in the determination of control where this is difficult to assess. The Group is yet to assess IFRS 10's full impact and intends to adopt IFRS 10 no later than the accounting period beginning on or after 1 January 2013, subject to endorsement by the EU.

IFRS 12, 'Disclosures of interests in other entities', includes the disclosure requirements for all forms of interests in other entities, including joint arrangements, associates, special purpose vehicles and other off balance sheet vehicles. The Group is yet to assess IFRS 12's full impact and intends to adopt IFRS 12 no later than the accounting period beginning on or after 1 January 2013, subject to endorsement by the EU.

IAS 27 (revised) 'Separate financial statements', issued in May 2011. This standard includes the provisions on separate financial statements that are left after the control provisions of IAS 27 have been included in the new IFRS 10. The Group is yet to assess the full impact of the amendments and intends to adopt the amended IAS 27 no later than the accounting period beginning on or after 1 January 2013.

IAS 28 (revised) 'Investments in associates and joint ventures', issued in May 2011. This standard includes the requirements for joint ventures, as well as associates, to be equity accounted following the issue of IFRS 11. The Group is yet to assess the full impact of the amendments and intends to adopt the amended IAS 28 no later than the accounting period beginning on or after 1 January 2013.

IFRS 11 'Joint arrangements', issued in May 2011. This standard provides for a more realistic reflection of joint arrangements by focusing on the rights and obligations of the arrangement, rather than its legal form. There are two types of joint arrangements: joint operations and joint ventures. Joint operations arise where a joint operator has rights to the assets and obligations relating to the arrangement and hence accounts for its interest in assets, liabilities, revenue and expenses. Joint ventures arise where the joint operator has rights to the net assets of the arrangement and hence equity accounts for its interest. Proportional consolidation of joint ventures is no longer allowed. The Group is yet to assess IFRS 11's full impact and intends to adopt IFRS 11 no later than the accounting period beginning on or after 1 January 2013.

There are no other IFRSs or IFRIC interpretations that are not yet effective that would be expected to have a material impact on the Group.

Notes to the Financial Statements continued

31 December 2012

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 maintaining an appropriate balance between the capital available to support risk and the level and type of risk it takes on in order to achieve returns. The risk appetite for each type of principal risk is set based on the amount necessary to meet the FSA's capital requirements.

2. Capital management

The Society retains capital within its Unallocated divisible surplus to meet the key objectives:

(i) To ensure financial stability and to support the risks it takes on as part of its business;
(ii) To enable the Group's strategy to be implemented;
(iii) To give confidence to policyholders and other stakeholders who have relationships with the Group; and
(iv) To comply with capital requirements imposed by its UK regulator, the FSA.

At least annually, these objectives are reviewed 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. In the event that sufficient capital is not available, actions would be taken either to raise additional capital or to reduce the amount of risk accepted thereby reducing the capital requirement through, for example, reinsurance, reducing business volumes or a change in investment strategy.

The Group complied with all externally imposed capital requirements to which it was subject throughout the reporting period.

Capital statement

The tables below set out the capital resources available to the individual life funds and other activities of the Group.

Reconciliation of Available Capital Resources

The following table reconciles the Unallocated divisible surplus presented in the Statement of Financial Position and total available capital resources calculated on a regulatory basis.

	2012 £m	2011 £m
Unallocated divisible surplus	**878.6**	1,055.1
Regulatory adjustments		
- Adjustment to reserves to realistic basis	**355.1**	196.6
- Adjustment to cost of investment in subsidiaries (note 1)	**(319.8)**	(362.1)
- Inadmissible assets (note 2)	**(13.2)**	(130.4)
	900.7	759.2
RNPFN Fund not available to the Group (note 3)	**179.5**	164.5
Total Available Capital Resources	**1,080.2**	923.7

Notes:
1. Represents the difference between the cost of investment in subsidiaries and the value for regulatory purposes net of the capital requirement.
2. Inadmissible assets include pension scheme, deferred tax and goodwill.
3. 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.

Movements in capital are analysed below:

	2012 £m	2011 £m
Capital at 1 January	**923.7**	1,050.9
Effect of investment variations	**199.2**	23.9
Effect of changes in market conditions	**(52.6)**	(9.5)
Effect of changes in assumptions	**166.3**	(13.9)
New business	**(128.6)**	(94.3)
Other	**(27.8)**	(33.4)
Capital as at 31 December	**1,080.2**	923.7

Notes to the Financial Statements continued

31 December 2012

2. Capital management (continued)

Regulatory Capital	2012 £m	2011 £m
Admissible assets	**7,865.7**	7,185.9
Add back capital requirements of regulated related undertakings	**253.9**	241.5
Mathematical reserves (after distribution of surplus)	**(6,686.0)**	(6,123.1)
Regulatory current liabilities	**(353.4)**	(380.6)
Available capital resources	**1,080.2**	923.7
Capital requirements of regulated related undertakings	**(253.9)**	(241.5)
Capital resources of RNPFN fund	**(179.5)**	(164.4)
Peak 1 capital requirement	**(239.6)**	(218.0)
Peak 1 excess regulatory capital (excluding RNPFN surplus)	**407.2**	299.8
With-profits insurance capital component	**(220.8)**	(64.6)
Peak 2 excess capital resources (excluding RNPFN surplus)	**186.4**	235.2

The RNPFN fund's capital is available to support the RNPFN participating contract fund only. It is comfortably in excess of the required capital margin and, therefore, the Society is not required to provide further capital support to this business.

Available capital - Long-term insurance contracts

For the long-term insurance contract funds the Group is required to hold sufficient capital to meet the FSA capital requirements based on the risk capital margin (RCM) determined in accordance with the FSA's regulatory rules under its realistic capital regime together with the Individual Capital Assessment (ICA) which takes into account certain business risks not reflected in the RCM. The determination of the RCM depends on various actuarial and other assumptions about potential changes in market prices, future operating experience and the actions management would take in the event of particular adverse changes in market conditions.

Management intends to maintain surplus capital in excess of the RCM and ICA to meet the FSA's total requirements and to maintain an appropriate additional margin over this to absorb changes in both capital and capital requirements.

i) Participating insurance contracts

For the Group's participating contract (with-profits) funds the available capital is determined in accordance with the 'realistic balance sheet' regime prescribed by the FSA's regulations under which liabilities to policyholders include both declared bonuses and the constructive obligation for future bonuses not yet declared. The available capital resources include an estimate of the value of their respective estates, which is the surplus in the fund in excess of any constructive obligations to policyholders. The unallocated capital represents the capital resources of the individual participating contract fund to which it relates and is available to meet regulatory and other solvency requirements of the fund. For these participating contract funds the liabilities included in the Statement of Financial Position comprise only amounts relating to policyholders.

ii) Non participating insurance contracts

For non participating business the relevant capital requirement is the minimum solvency requirement determined in accordance with FSA regulations. For this business a lower capital surplus is targeted by management since the capital requirement is less subject to fluctuation and the capital amount is after deducting liabilities that include additional prudential margins.

The other activities of the Group have total available capital which is significantly higher than the minimum requirements established by the FSA for each of the regulated entities and, in principle, the excess is available to the Society. In practice, higher levels of capital are held within each business operation to provide appropriate cover for risk and new business growth.

All available capital within LVFS is ultimately available to support the Society's participating contract fund. However the available capital resources of each regulated entity are generally subject to restrictions as to their availability to meet requirements that may arise elsewhere in the Group. For other non participating funds, the available surplus held in the fund is attributable to Society policyholders and, subject to meeting the regulatory requirements of these businesses, this capital is available to meet requirements elsewhere in the Group.

Sensitivity of long-term insurance contract liabilities

Long-term insurance contract liabilities are sensitive to changes in market conditions and other assumptions which have been factored into their calculation, such as mortality or persistency rates. In some cases allowance is also made when calculating liabilities for the effect of management and/or policyholder actions in different economic conditions on future assumptions such as asset mix, bonus rates and surrender values.

Market conditions – assumptions are made about investment returns and interest rates when valuing liabilities. Any adverse change in either variable may have the effect of reducing available capital as they may also impact corresponding asset valuations.

Assumptions – long-term trend differences in mortality, morbidity, expense or persistency rates will result in the need to change assumptions. This may require a strengthening or release of reserves. Depending on policy type this sensitivity will differ; for example a change in mortality rates will have a different impact for annuity contract liabilities when compared to term assurance liabilities. In addition to persistency, assumptions are made about policyholders' behaviour in relation to guarantees and options. In turn these assumptions are sensitive to both investment return and interest rates.

Further disclosure of the impact on the Unallocated divisible surplus from sensitivity analysis is provided in Note 3 Risk management and control.

Notes to the Financial Statements continued
31 December 2012

2. Capital management (continued)

Financial guarantees and options

a) Participating insurance contracts
As a normal part of operating activities, the Society has given guarantees and options, including interest rate guarantees, in respect of certain long-term insurance contracts.

Provision is made for such guarantees and options within the FSA realistic liabilities of the Group's participating insurance contract funds. Under the FSA's rules these must be measured at fair value using market consistent stochastic models. A stochastic approach includes measuring the time value of guarantees and options, which represents the additional cost arising from uncertainty surrounding future economic conditions. The time value is evaluated by projecting a large number of possible future outcomes under a wide range of economic scenarios, for example possible outcomes for interest rates and equity returns. These realistic liabilities have been included within the Statement of Financial Position.

The material guarantees and options in the participating insurance contract funds are:

i) Guaranteed annuity options - the RNPFN participating insurance contract fund has written individual pensions which contain guaranteed annuity rate options (GAOs), where the policyholder has the option to take the benefits from a policy in the form of an annuity based on guaranteed conversion rates.

ii) Maturity value guarantees - many of the Group's participating insurance contracts have minimum maturity values reflecting the sums assured plus declared annual bonus.

iii) Money-back guarantees - some of the policies written within the Group provide a guarantee or option to pay out all the premiums paid in (at a certain point in time).

b) Non participating insurance contracts
The Group has also written contracts which include guarantees and options within its non participating insurance contract funds. These funds are not subject to the requirements of the FSA's realistic reporting regime and liabilities are evaluated by reference to statutory reserving rules. Provision for guarantees and options in the non participating funds has been included within liabilities.

The material guarantees and options in the non participating insurance contract funds are guaranteed annuity options. Similar options to those written in the participating insurance contract fund have been written in relation to non participating contracts. Provision for these guarantees does not materially differ from a provision based on a market consistent stochastic model.

c) No Negative Equity Guarantees
The Group has made promises to certain policyholders in relation to equity release mortgages that payments on these policies will meet the mortgage value covered. Further details on these are disclosed within Note 15.

3. Risk management and control

The Group seeks to create value for its members by maintaining an appropriate balance between the capital available to support risk and the level and type of risk it takes on in order to achieve returns for policyholders. The principal types of risk, which are detailed below, have been identified and risk appetite for each of these has been set based on the amount necessary to meet the FSA's capital requirements. The Group recognises the critical importance of having efficient and effective risk management systems in place and these take the form of:

- Board and Executive committees with clear terms of reference
- Financial and non-financial committees
- A clear organisation structure with documented allocation of responsibilities
- A uniform methodology of risk assessment, which is embedded within all companies in the Group so that they operate within agreed tolerances and with appropriate controls in place
- Regular reviews of risks by senior managers, where frequency of review is determined by the potential impact of the risk and its likelihood.

a) Insurance risk
Insurance risk is the risk that arises from the inherent uncertainties as to the occurrence, amount and timing of insurance liabilities. Long-term insurance risk arises from mortality, morbidity, persistency and expense variances. General insurance risk arises from risks in general insurance contracts which lead to significant claims in terms of quantity or value. These would include significant weather events, subsidence, substantial medical claims and major accidents on a single policy. Systems are in place to measure, monitor and control exposure to all these risks. These are documented in policies for underwriting, pricing, claims and reinsurance. To mitigate risk in the life and general insurance businesses the Group places reinsurance.

Long-term insurance contracts
Protection and annuity business is at risk from adverse changes in mortality experience from the time when the policies were underwritten. In the case of policies that pay out on death, the risk is that mortality experience worsens, whereas for annuities, the risk is that mortality experience improves. These two types of business therefore to some extent offset each other in a risk sense. On protection business, the Group uses underwriting procedures, backed up with medical screening if appropriate, designed to price accurately for such risks and reinsurance is in place to limit the quantum of risk retained on each policy. The Group's annuity business is partially reassured.

Notes to the Financial Statements continued

31 December 2012

3. Risk management and control (continued)

Income protection and critical illness business is at risk from changes in morbidity rates. Where there is an increased incidence of ill health or an increase in the duration of such ill health, the Group is exposed to higher claims than expected. The Group has underwriting procedures, including medical and financial screening if appropriate, to price accurately for such risks and reinsurance is in place to limit the risk retained on each policy.

Persistency risk influences the ability to recover acquisition costs from margins within the products. The risk is greater in early years but reduces significantly as time passes. For long-term insurance contract liabilities there is an allowance built in to allow for future withdrawals.

Higher than expected expense costs will increase the reserves required. The Group is exposed to the risk that the charges it deducts from policyholder benefits are not sufficient to cover future expenses.

The table below sets out the concentration of long-term insurance and investment contract liabilities on a realistic basis by type of contract. All business is written in the UK.

	2012			2011		
	Gross	**Reinsurance**	**Net**	Gross	Reinsurance	Net
Group	**£m**	**£m**	**£m**	£m	£m	£m
Whole life	**1,462.6**	**(44.7)**	**1,417.9**	1,426.7	(18.6)	1,408.1
Endowment	**678.7**	**–**	**678.7**	758.9	–	758.9
Term Assurance	**83.4**	**(116.3)**	**(32.9)**	45.0	(77.2)	(32.2)
Guaranteed annuity pensions	**1,281.9**	**(22.5)**	**1,259.4**	1,269.7	(21.2)	1,248.5
Pure endowment pensions	**2,797.7**	**(19.9)**	**2,777.8**	2,108.4	(24.1)	2,084.3
Critical illness	**48.6**	**(33.3)**	**15.3**	59.1	(38.1)	21.0
Income protection	**67.0**	**(55.9)**	**11.1**	96.3	(40.8)	55.5
ISA	**69.8**	**–**	**69.8**	68.7	–	68.7
Other	**86.9**	**(4.8)**	**82.1**	91.9	(3.0)	88.9
	6,576.6	**(297.4)**	**6,279.2**	5,924.7	(223.0)	5,701.7
Long-term claims liabilities	**42.4**	**–**	**42.4**	40.0	–	40.0
Unit linked	**964.6**	**–**	**964.6**	806.9	–	806.9
	7,583.6	**(297.4)**	**7,286.2**	6,771.6	(223.0)	6,548.6

The table below sets out the impact on long-term insurance contract liabilities, the Unallocated divisible surplus and Profit before tax for movements in key assumptions.

Sensitivity analysis for the change in assumptions used in long-term insurance contract liabilities	**Impact on Profit before tax £m**	**Impact on the Unallocated divisible surplus £m**	**Impact on gross long-term insurance contract liabilities £m**
Increase in mortality rates by 5%	**42.8**	**42.8**	**(14.7)**
Increase in morbidity rates by 5%	**(8.0)**	**(8.0)**	**24.4**
Reduction in persistency by 5%	**0.1**	**0.1**	**6.3**
Increase in expenses by 10%	**(15.6)**	**(15.6)**	**21.6**

Notes to the Financial Statements continued

31 December 2012

3. Risk management and control (continued)

General Insurance

The Group's general insurance ('GI') activities are primarily concerned with the pricing, accepting and management of risks from its policyholders. In accepting risks the Group is committing 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 principal risk that the Group faces under its insurance contracts is the risk that actual claims exceed the carrying value of the Group's insurance liabilities. 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 significant weather events, subsidence and large single claims arising from either the motor business (injury claims) or SME business (liability and/or property claims). Procedures are in place to measure, monitor and control exposure to all these risks.

Experience shows that the larger the portfolio of similar 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 strategy 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.

Property business (domestic and commercial) is exposed to catastrophic risks such as result from storms or floods as well as risks such as subsidence. The Group has entered into reinsurance contracts which provide protection against catastrophic weather events.

Motor business is exposed to the risk of large personal injury claims, where the claim amounts can be significant due to the cost of care required for the claimant. The Group has entered into excess of loss reinsurance contracts which reduce its exposure to large claims. The reinsurance retention is £5.0m per claim (2011: £5.0m per claim).

Commercial business is exposed to large individual property losses and also to liabilities arising from employment and commercial activities. The Group has entered into reinsurance contracts which provide protection against these liabilities.

The Group has historic Quota share and Excess of loss reinsurance contracts which reduce the Group's exposure to large claims.

The table below sets out the concentration of General Insurance contract liabilities by type of contract:

	2012			2011		
	Gross	**Reinsurance**	**Net**	Gross	Reinsurance	Net
Group	**£m**	**£m**	**£m**	£m	£m	£m
Motor	**1,071.5**	**(117.8)**	**953.7**	857.3	(94.3)	763.0
Household	**57.8**	**(0.2)**	**57.6**	53.9	–	53.9
Travel	**1.0**	**–**	**1.0**	1.0	–	1.0
Commercial	**153.4**	**(17.0)**	**136.4**	114.8	(6.6)	108.2
Other	**3.4**	**–**	**3.4**	2.9	–	2.9
	1,287.1	**(135.0)**	**1,152.1**	1,029.9	(100.9)	929.0

The claims provision is the estimated cost of outstanding claims from expired risks. The provision is calculated largely from using our own 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. Periodic Payment Orders ('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 very 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 Group has identified two specific areas of uncertainty that it has explicitly allowed for within the claims provision but where the outcome could be worse than the amount allowed for. These are:

- Uncertainty in the proportion of claims identified by the Group as being likely to settle on a PPO basis that actually settle on a PPO basis.
- Uncertainty in relation to the Ogden discount rate.

The claims provision includes a specific allowance for claims identified as having the potential to settle on a PPO basis. This allowance is based on the mean cost of claims derived from a range of scenarios based on the PPO settlement rate for the claims. If all of these claims settled as PPOs, the reserves would deteriorate by an estimated £8.6m from the position shown above.

Notes to the Financial Statements continued

31 December 2012

3. Risk management and control (continued)

The Ogden discount rate is set by the Lord Chancellor. It is currently 2.5% but a revision is under consideration with a decision possible by late 2013. Whilst there are many views across the industry in terms of what the change should be, the general consensus is that a reduction in the rate is likely. The claims provision has included an allowance for a change in the Ogden discount rate, using a scenario based approach as for PPOs. The allowance is broadly equivalent to a reduction in the discount rate to 1.75%. If the discount rate was to reduce to 1.5%, the claims provision would deteriorate by £4.4m. A reduction to 1% would lead to a deterioration of £14.3m.

The claims provision is also sensitive to the number and cost of large motor claims (defined as greater than £1m), which have been incurred but not reported and reserved. We would typically expect a number of large claims from expired risks to be identified in the future, either from being newly reported or from existing claims increasing in magnitude above the £1m threshold. The claims provision allows for £23.7m of late reported/reserved large claims. Therefore, if six new claims at £5m each were reported, for example, this would lead to a £6.3m deterioration in the reserves, whereas four new £5m claims would lead to a £3.7m improvement.

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	2003 £m	2004 £m	2005 £m	2006 £m	2007 £m	2008 £m	2009 £m	2010 £m	2011 £m	2012 £m	Total £m
Initial estimate of gross provision	396.9	500.9	521.5	551.0	560.2	539.6	606.9	771.2	906.4	1,086.2	
One year later	402.8	487.2	523.6	527.5	512.6	540.2	589.2	823.0	912.5		
Two years later	385.4	466.3	494.5	505.1	489.4	500.2	589.2	838.5			
Three years later	356.3	450.0	472.1	490.2	485.9	490.0	587.9				
Four years later	346.4	437.8	462.6	477.2	487.6	491.0					
Five years later	343.6	434.7	457.3	477.5	492.5						
Six years later	342.8	436.0	457.6	476.6							
Seven years later	342.9	435.9	454.7								
Eight years later	342.4	436.1									
Nine years later	344.6										
Current estimate of cumulative claims	344.6	436.1	454.7	476.6	492.5	491.0	587.9	838.5	912.5	1,086.2	6,120.6
Cumulative payments to date	(336.6)	(428.2)	(451.2)	(469.5)	(461.3)	(461.5)	(515.3)	(654.6)	(650.7)	(455.2)	(4,884.1)
Liability recognised in the Statement of Financial Position for 2003 to 2012 accident years	8.0	7.9	3.5	7.1	31.2	29.5	72.6	183.9	261.8	631.0	1,236.5
Liability recognised in the Statement of Financial Position in respect of prior accident years											33.8
Claims handling provision											16.8
Gross General Insurance claims liabilities as at 31 December 2012											**1,287.1**

Notes to the Financial Statements continued

31 December 2012

3. Risk management and control (continued)

Analysis of claims development – net of reinsurance	2003 £m	2004 £m	2005 £m	2006 £m	2007 £m	2008 £m	2009 £m	2010 £m	2011 £m	2012 £m	Total £m
Initial estimate of net provision	357.4	445.6	484.2	513.4	505.8	506.8	584.0	762.1	897.2	1,060.6	
One year later	364.3	437.1	473.8	474.7	462.9	482.9	578.0	802.9	897.1		
Two years later	352.8	415.8	439.2	467.0	440.2	464.0	564.7	818.9			
Three years later	328.1	407.0	429.5	451.4	441.1	456.7	562.1				
Four years later	327.5	393.2	423.4	443.7	430.1	457.6					
Five years later	316.6	391.5	421.9	441.9	431.3						
Six years later	314.7	392.7	421.1	441.2							
Seven years later	315.2	389.4	419.8								
Eight years later	316.6	391.0									
Nine years later	319.9										
Current estimate of cumulative claims	319.9	391.0	419.8	441.2	431.3	457.6	562.1	818.9	897.1	1,060.6	5,799.5
Cumulative payments to date	(315.3)	(388.6)	(417.2)	(434.3)	(420.3)	(434.4)	(506.8)	(653.5)	(645.8)	(455.2)	(4,671.4)
Liability recognised in the Statement of Financial Position for 2003 to 2012 accident years	4.6	2.4	2.6	6.9	11.0	23.2	55.3	165.4	251.3	605.4	1,128.1
Liability recognised in the Statement of Financial Position in respect of prior accident years											7.2
Claims handling provision											16.8
Net General Insurance claims liabilities as at 31 December 2012											**1,152.1**

b) Financial risk

i) Market risk

Market risk is the risk of adverse or favourable impacts due to fluctuations in equity prices, interest rates (including credit spreads and bond yields), exchange rates or property prices. It arises due to fluctuations in liabilities arising from products sold and the value of investments held. The Group has defined policies and procedures in place to control the major components of market risk. Threadneedle Asset Management Ltd is our investment manager who operates under contractual Investment Management Agreements. Assets are invested under agreed investment guidelines that reflect the Group's investment risk appetite. Investment performance is monitored closely by the Group Chief Investment Officer and the Investment Committee in order to ensure compliance with the relevant regulatory limits for solvency purposes and with guidelines set for each fund. Investments held are primarily listed on recognised stock exchanges.

Limits on the Group's exposure to equities are defined both in aggregate terms and by geography, industry and counterparty. Tactical asset allocation meetings are held weekly, and strategic asset allocation meetings quarterly, to discuss investment return and concentration and to agree any changes required.

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. The associated risk is hedged using derivatives. For general insurance contracts, equities are held to achieve an investment return. The associated risk is mitigated by investing in a diverse portfolio of high quality securities. Holdings are diversified across industries and concentrations in any one company or industry are limited by parameters established by the Investment Committee.

Interest rate risk

The Group monitors interest rate risk by calculating the mean duration of the investment portfolio and the liabilities issued. The mean duration is an indicator of the sensitivity of the assets and liabilities to changes in current interest rates. The mean duration of the liabilities is determined by means of projecting expected cash flows from the contracts using best estimates of mortality and voluntary terminations. The mean duration of the assets is calculated in a consistent manner. During 2012 the Group managed this risk through an active use of gilt yield hedges, in the form of contracts for differences.

Credit spread risk

In addition to Interest rate risk, described above, a widening of corporate bonds spreads over and above risk-free yields will lead to a fall in the fair value of the Group's portfolio of corporate bonds and vice-versa. For the investment and long-term linked insurance contracts this movement is matched with corresponding movements in contractual liabilities, for the general insurance business liabilities are undiscounted and so unaffected in current value by changes in credit spreads. The Group monitors Credit spread risk by regularly reviewing its exposure to corporate bonds by both credit rating and duration.

Notes to the Financial Statements continued
31 December 2012

3. Risk management and control (continued)

Currency risk
The Group is exposed to foreign currency exchange risk within the investment portfolio supporting the Group's operations from purchased investments that are denominated or payable in currencies other than sterling. There is no other exposure to currency risk.

The table below summarises the Group's exposure, after hedging, to foreign currency exchange risk in sterling.

	2012					2011				
	Euro £m	US Dollar £m	Yen £m	Other £m	Total £m	Euro £m	US Dollar £m	Yen £m	Other £m	Total £m
Derivatives	**(34.6)**	**(46.6)**	**–**	**(6.1)**	**(87.3)**	(13.1)	(32.4)	–	(4.1)	(49.6)
Equity securities	**87.9**	**136.8**	**60.9**	**103.5**	**389.1**	105.1	205.3	59.0	90.6	460.0
Debt securities	**24.0**	**43.0**	**–**	**–**	**67.0**	8.9	32.3	3.3	0.5	45.0
Other investments	**14.6**	**–**	**–**	**–**	**14.6**	2.7	–	–	–	2.7
Cash and cash equivalents	**11.3**	**5.6**	**–**	**0.2**	**17.1**	21.7	3.7	0.1	0.4	25.9
	103.2	**138.8**	**60.9**	**97.6**	**400.5**	125.3	208.9	62.4	87.4	484.0

The sensitivity of investment assets to a 10% increase/decrease in Euro and US Dollar exchange rates, net of derivatives, is £10.3m and £13.9m respectively. In determining the percentage rates to use in this sensitivity analysis the movements in actual market rates of Euro and US Dollars during 2012 was 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 £40.1m.

Some foreign debt securities are denominated in sterling so bear no currency risk and have not been included within the above table.

Eurozone exposure
The Group has some exposure to the main countries involved in the ongoing difficulties being experienced within the Eurozone as disclosed below, the table shows the Group's exposure by country of incorporation of the counterparty at 31 December 2012.

	Sovereign £m	Non-Sovereign £m	Total £m
Ireland	**–**	**332.8**	**332.8**
Italy	**0.4**	**35.9**	**36.3**
Portugal	**–**	**2.7**	**2.7**
Spain	**–**	**90.3**	**90.3**
France	**–**	**322.6**	**322.6**
Other Eurozone	**–**	**872.6**	**872.6**
Total	**0.4**	**1,656.9**	**1,657.3**

The Group has no exposure to either Greece or Cyprus. Non-sovereign exposure includes £74m of subordinated debt.

Property price risk
The Group is exposed to property price risk on the commercial properties it holds as investments. Values of properties are determined from the future value of cash flows and the Group enters into leases following an assessment of the tenant's ability to pay the rent and service charges. 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. The associated risk is mitigated by investing in a diverse portfolio of high quality properties.

Derivative risk
Derivatives are used to reduce exposure to fluctuations in interest rates, exchange rates and for efficient portfolio management purposes. The principal 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. This risk is managed through the Group Asset and Liability Committee.

Asset and liability matching
The Group manages its financial positions with an asset liability management (ALM) framework that has been developed to achieve long-term investment returns in excess of its obligations under insurance and investment contracts. The principal technique of the Group's ALM is to match assets to the liabilities arising from insurance contracts by reference to the type of benefits payable to contract holders.

The Group's ALM is integrated with the management of the financial risks associated with the Group's other financial assets and liabilities not directly associated with insurance and investment liabilities.

Notes to the Financial Statements continued
31 December 2012

3. Risk management and control (continued)

Summary of market risk sensitivities
The table below sets out the impact on long-term insurance contract liabilities, the Unallocated divisible surplus and Profit before tax for movements in sectors of the market that the Group is invested in, net of derivatives.

Sensitivity analysis to movements in key market sectors	Impact on Profit before tax £m	Impact on the Unallocated divisible surplus £m	Impact on gross long-term insurance contract liabilities £m
Equity values fall by 20%	(36.5)	(35.8)	(190.5)
Equity values increase by 20%	50.9	50.1	180.8
Property values fall by 12.5%	(10.3)	(10.3)	(15.7)
Property values increase by 12.5%	10.1	10.1	17.3
Credit spreads fall by 100bps	70.9	60.4	169.1
Credit spreads increase by 100bps	(66.4)	(56.4)	(157.1)
15 year Gilt yields fall by 17.5%	24.6	23.2	264.3
15 year Gilt yields increase by 17.5%	(21.2)	(20.0)	(240.8)

In determining the percentage rates to use in the sensitivity analysis the Group has made reference to those set by the regulators for calculating the risk capital margin.

Asset values and, where appropriate, asset shares are adjusted to reflect the change in each sensitivity. 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.

ii) Credit risk
Credit risk is the risk of loss due to counterparties failing to meet all or part of their obligations in a timely fashion.

The principal credit risks arise from exposure to counterparties through exposure to corporate bonds, reinsurers' share of insurance liabilities, amounts due from reinsurers in respect of claims already paid, amounts due from insurance contract holders, amounts due from insurance intermediaries and counterparty risk with respect to derivative transactions.

Policies are in place to control the major components of credit risk, including counterparty default and concentration risk. The Group places limits on its exposure to a single counterparty, or groups of counterparties, and to geographical and industry segments.

Reinsurance is used to manage insurance risk. This does not, however, discharge the Group's liability as primary insurer. If a reinsurer fails to pay a claim, the Group remains liable for the payment to the policyholder. The creditworthiness of reinsurers is considered by reviewing their financial strength prior to finalisation of any contract and on an annual basis.

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.

Credit risk exposure 2012	AAA £m	AA £m	A £m	BBB £m	Below BBB £m	Not rated £m	Total £m
Debt and other fixed income securities	3,006.2	402.0	1,712.3	1,126.5	33.6	32.5	6,313.1
Loans secured on residential property	–	–	–	–	–	415.3	415.3
Other	–	–	–	–	–	5.4	5.4
Deposits with credit institutions	–	–	–	–	–	14.6	14.6
Loans secured by policies	–	–	–	–	–	0.4	0.4
Other loans	–	–	–	–	–	0.3	0.3
Short-term deposits	–	37.5	250.2	–	–	50.9	338.6
	3,006.2	439.5	1,962.5	1,126.5	33.6	519.4	7,087.7
Reinsurance assets							
- non linked	–	285.0	89.7	1.0	–	36.0	411.7
- linked	–	35.5	–	–	–	–	35.5
	3,006.2	760.0	2,052.2	1,127.5	33.6	555.4	7,534.9

Notes to the Financial Statements continued

31 December 2012

3. Risk management and control (continued)

Credit risk exposure 2011	AAA £m	AA £m	A £m	BBB £m	Below BBB £m	Not rated £m	Total £m
Debt and other fixed income securities	2,947.1	392.1	1,236.0	698.4	33.7	33.7	5,341.0
Loans secured on residential property	–	–	–	–	–	334.2	334.2
Other	–	–	–	–	–	1.7	1.7
Loans secured by policies	–	–	–	–	–	0.6	0.6
Other loans	–	–	–	–	–	0.4	0.4
Short-term deposits	–	55.0	501.9	1.0	–	4.3	562.2
	2,947.1	447.1	1,737.9	699.4	33.7	374.9	6,240.1
Reinsurance assets							
- non linked	3.5	185.5	88.9	–	–	36.0	313.9
- linked	–	23.0	–	–	–	–	23.0
	2,950.6	655.6	1,826.8	699.4	33.7	410.9	6,577.0

The tables below show the age analysis of the Group's past due and/or impaired assets.

Age analysis of assets past due but not impaired 2012	**<30 days £m**	**31 to 60 days £m**	**61 to 90 days £m**	**>90 days £m**	**Total past due but not impaired £m**	**Past due and impaired £m**	**Total £m**
Loans and other receivables	–	–	–	–	–	–	–
Insurance receivables	**5.5**	**3.9**	**1.8**	**5.6**	**16.8**	**0.6**	**17.4**
	5.5	**3.9**	**1.8**	**5.6**	**16.8**	**0.6**	**17.4**

Age analysis of assets past due but not impaired 2011	<30 days £m	31 to 60 days £m	61 to 90 days £m	>90 days £m	Total past due but not impaired £m	Past due and impaired £m	Total £m
Loans and other receivables	0.1	–	–	–	0.1	0.1	0.2
Insurance receivables	6.4	2.7	0.1	0.7	9.9	0.6	10.5
	6.5	2.7	0.1	0.7	10.0	0.7	10.7

Collateral

For over-the-counter derivative transactions undertaken by the Group, collateral is received from the counterparty. The collateral can be sold or repledged by the Group and is repayable if the contract terminates or the contract's fair value decreases. At 31 December 2012, the fair value of such collateral held was £65.5m (2011: £131.4m). No collateral received from the counterparty has been sold or repledged (2011: £nil).
In addition the Group has pledged £67.0m (2011: £nil) of corporate bonds as collateral in relation to cash flow swaps entered into during the year.

Notes to the Financial Statements continued

31 December 2012

3. Risk management and control (continued)

iii) Liquidity risk

Liquidity risk is the risk that the Group does not have sufficient available liquid assets to meet its obligations as they fall due.

Sources of liquidity risk have been identified and systems are in place to measure, monitor and control liquidity exposures. These are documented in liquidity policies.

Liquidity is maintained at a prudent level, with a buffer to cover contingencies including the provision of temporary liquidity to subsidiary companies.

The maturity of the financial assets of the Group has been disclosed within the individual notes to the financial statements.

The table below summarises the maturity profile of the financial liabilities of the Group based on remaining undiscounted contractual obligations, except for long-term insurance participating (commonly referred to as "with-profits") contracts where maturity profiles are determined on the discounted estimated timing of net cash outflows.

Group **Maturity profile of financial liabilities 2012**	**Within 1 year £m**	**1-3 years £m**	**3-5 years £m**	**Over 5 years £m**	**Linked £m**	**Total £m**
Insurance contract liabilities	**497.1**	**646.0**	**340.7**	**6,350.6**	**77.0**	**7,911.4**
Investment contract liabilities	**–**	**–**	**–**	**–**	**959.3**	**959.3**
Net asset value attributable to unit holders	**503.9**	**–**	**–**	**–**	**–**	**503.9**
Provisions	**59.0**	**7.3**	**0.3**	**–**	**–**	**66.6**
Financial liabilities						
- Derivative financial instruments	**–**	**–**	**–**	**51.2**	**–**	**51.2**
- Other financial liabilities	**65.5**	**0.3**	**–**	**9.7**	**–**	**75.5**
Insurance payables	**44.7**	**–**	**–**	**–**	**–**	**44.7**
Trade and other payables	**190.0**	**2.4**	**2.4**	**88.2**	**–**	**283.0**
	1,360.2	**656.0**	**343.4**	**6,499.7**	**1,036.3**	**9,895.6**

Group Maturity profile of financial liabilities 2011	Within 1 year £m	1-3 years £m	3-5 years £m	Over 5 years £m	Linked £m	Total £m
Insurance contract liabilities	443.9	619.6	364.1	5,515.4	57.6	7,000.6
Investment contract liabilities	—	–	–	–	800.9	800.9
Net asset value attributable to unit holders	429.1	–	–	–	–	429.1
Provisions	6.5	48.1	0.8	0.7	–	56.1
Financial liabilities						
- Derivative financial instruments	–	3.8	–	–	–	3.8
- Other financial liabilities	67.1	–	–	10.1	–	77.2
Insurance payables	41.6	–	–	–	–	41.6
Trade and other payables	201.7	2.3	2.4	89.4	–	295.8
	1,189.9	673.8	367.3	5,615.6	858.5	8,705.1

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. Therefore the Group is not exposed to price, currency, credit or interest risk in respect of these contracts. 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

31 December 2012

3. Risk management and control (continued)

Society **Maturity profile of financial liabilities 2012**	**Within 1 year £m**	**1-3 years £m**	**3-5 years £m**	**Over 5 years £m**	**Linked £m**	**Total £m**
Insurance contract liabilities	**77.3**	**104.0**	**164.4**	**6,180.6**	**77.0**	**6,603.3**
Investment contract liabilities	**–**	**–**	**–**	**–**	**959.3**	**959.3**
Provisions	**57.8**	**5.0**	**0.3**	**–**	**–**	**63.1**
Financial liabilities						
- Derivative financial instruments	**–**	**–**	**–**	**51.2**	**–**	**51.2**
- Other financial liabilities	**65.6**	**0.6**	**0.5**	**14.7**	**–**	**81.4**
Insurance payables	**26.2**	**–**	**–**	**–**	**–**	**26.2**
Trade and other payables	**136.2**	**–**	**–**	**–**	**–**	**136.2**
	363.1	**109.6**	**165.2**	**6,246.5**	**1,036.3**	**7,920.7**

Society Maturity profile of financial liabilities 2011	Within 1 year £m	1-3 years £m	3-5 years £m	Over 5 years £m	Linked £m	Total £m
Insurance contract liabilities	107.8	190.3	184.7	5,405.8	57.6	5,946.2
Investment contract liabilities	–	–	–	–	800.9	800.9
Provisions	5.1	46.8	0.4	–	–	52.3
Financial liabilities						
- Derivative financial instruments	–	3.8	–	–	–	3.8
- Other financial liabilities	66.8	5.9	–	–	–	72.7
Insurance payables	31.6	–	–	–	–	31.6
Trade and other payables	147.4	–	–	–	–	147.4
	358.7	246.8	185.1	5,405.8	858.5	7,054.9

iv) Other risk types

Operational risk

Operational risk is the risk of loss, resulting from inadequate or failed internal processes, systems, human error or from external events, including legal and regulatory risk.

Senior managers are responsible for the identification, assessment, control and monitoring of operational risks and for reporting these to the Risk Committee in accordance with the Group's escalation criteria. Operational risks are assessed in terms of their probability and impact in accordance with Group policy.

Group risk

Group risk is the risk of contagion that the Society incurs from its membership of a group of firms. The Group Risk Committee oversees the management of such risks.

Strategic risk

Strategic risk is the risk arising from the implementation of agreed strategy. It includes risks arising from political, economic, sociological and technological changes, competitor actions and capital adequacy.

Executive management identifies strategic risks when drawing up business plans for approval by the Board and monitors these, ensuring that excess risk is reported to the Group Risk Committee and Board.

Notes to the Financial Statements continued

31 December 2012

Performance

The notes included within this section focus on the performance and results of the Society and Group. Information on the income generated, benefits and claims paid, expenditure incurred and mutual bonus declared are presented here.

4. Net earned premiums

Accounting for net earned premiums

Long-term insurance contracts

Regular premiums on long-term insurance contracts are recognised as income when due for payment. For single premium business, recognition occurs on the date from which the policy is effective. Reinsurance premiums payable are accounted for when due for payment.

Annual premium equivalent (APE), a measure of new business activity that is calculated as the sum of annualised regular premiums from new business plus ten per cent of single premiums on new business written during the period.

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.

Investment contracts

Premiums and claims relating to investment contracts are not recognised in the Statement of Comprehensive Income but are recorded as contributions to and deductions from the investment contract liabilities recorded in the Statement of Financial Position.

		Group		Society	
Gross written premiums		**2012 £m**	2011 £m	**2012 £m**	2011 £m
Long-term insurance contracts - participating business					
Investments and savings	- single premium	**61.5**	45.7	**61.5**	45.7
Pensions and annuities	- single premium	**10.8**	8.7	**10.8**	8.7
Investments and savings	- regular premium	**44.3**	52.9	**44.3**	52.9
Pensions and annuities	- regular premium	**15.2**	16.9	**15.2**	16.9
Long-term insurance contracts - non participating business					
Pensions and annuities	- single premium	**677.3**	601.1	**677.3**	601.1
Investments and savings	- regular premium	**0.3**	0.5	**0.1**	0.2
Pensions and annuities	- regular premium	**6.8**	7.7	**6.8**	7.7
Life and health protection	- regular premium	**131.7**	116.9	**131.2**	116.4
Long-term linked insurance contracts					
Investments and savings	- regular premium	**0.3**	0.9	**0.3**	0.9
Pensions and annuities	- regular premium	**0.4**	1.8	**0.4**	1.8
Life and health protection	- regular premium	**11.2**	10.5	**11.2**	10.5
General insurance contracts					
Motor		**1,109.1**	1,124.9	–	–
Household		**140.3**	128.8	–	–
Other		**235.5**	201.9	–	–
Change in unearned premiums provision		**1.5**	(122.7)	–	–
Gross earned premiums		**2,446.2**	2,196.5	**959.1**	862.8
Premiums ceded to reinsurers					
Long-term insurance premiums		**(75.6)**	(68.1)	**(75.6)**	(99.7)
General insurance business		**(35.0)**	(27.7)	–	–
Change in unearned premiums provision		**1.8**	2.8	–	–
		(108.8)	(93.0)	**(75.6)**	(99.7)
Net earned premiums		**2,337.4**	2,103.5	**883.5**	763.1
Gross written premiums for investment contracts which are deposit accounted for and not included above		**270.0**	214.0	**270.0**	214.0

All contracts are written in the UK apart from Highway Insurance Company Limited which writes a proportion of its general insurance business in Ireland. These Irish net earned premiums totalled £3.9m in 2012 (2011: £10.1m).

Notes to the Financial Statements continued

31 December 2012

5. New business premiums

Gross new business – long-term contracts		Group 2012 £m	Group 2011 £m	Society 2012 £m	Society 2011 £m
Long-term insurance contracts - participating business					
Investments and savings	- single premium	**61.5**	45.7	**61.5**	45.7
Pensions and annuities	- single premium	**10.8**	8.7	**10.8**	8.7
Investments and savings	- regular premium	**0.9**	1.1	**0.9**	1.1
Long-term insurance contracts - non participating business					
Pensions and annuities	- single premium	**677.3**	601.1	**677.3**	601.1
Life and health protection	- regular premium	**26.5**	23.8	**26.5**	23.8
Long-term linked insurance contracts					
Pensions and annuities	- regular premium	**–**	0.4	**–**	0.4
Life and health protection	- regular premium	**4.3**	3.2	**4.3**	3.2
		781.3	684.0	**781.3**	684.0
Investment contracts					
Pensions and annuities	- regular premium	**270.0**	214.0	**270.0**	214.0
		1,051.3	898.0	**1,051.3**	898.0

Gross written premiums for investment contracts are deposit accounted for and not included within net earned premiums.
All gross new business premiums relate to individual business and are disclosed on an APE basis.

Recurrent single premium rebates from the Department for Works 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.

Group gross premiums earned – general business	2012 £m	2011 £m
Motor	**1,133.3**	1,030.5
Household	**135.2**	120.6
Commercial	**151.9**	128.0
Other	**66.0**	53.8
	1,486.4	1,332.9

6. Fee and commission income

Accounting for fee and commission income

Fees from investment contracts for investment management, other policy administration charges and fund management fees are recognised as income when earned. Commission earned from financial intermediary services is taken to income when earned. This primarily comprises initial commission income receivable on services provided to clients during the year when policies have gone on risk and renewal commission received during the year on an accruals basis.

	Group 2012 Restated £m	Group 2011 £m	Society 2012 £m	Society 2011 £m
Policy administration fees	**13.3**	11.6	**6.3**	4.9
Fund management fees	**–**	2.7	**–**	–
Commission income	**3.2**	4.2	**0.3**	0.3
	16.5	18.5	**6.6**	5.2

Notes to the Financial Statements continued

31 December 2012

7. Investment income

Accounting for investment income

Investment income includes dividends, interest from investments at fair value, interest on loans and receivables, interest on loans secured on residential property and rents. Dividends are included on an ex-dividend basis. Interest receivable on loans and receivables is calculated on an effective interest rate basis. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability.

	Group		Society	
	2012	2011	**2012**	2011
		Restated		
	£m	£m	**£m**	£m
Rental income from investment properties	**6.1**	7.4	**6.1**	7.4
Income from investments at fair value through income:				
- Interest income	**204.6**	123.2	**165.0**	126.8
- Dividend income	**96.6**	117.4	**71.6**	71.2
Interest on loans and receivables	**0.8**	1.7	**0.3**	0.9
Interest on loans secured on residential property	**12.1**	11.7	**–**	–
Dividend income from group undertakings	**–**	–	**94.0**	78.6
	320.2	261.4	**337.0**	284.9

8. Net gains/(losses) on investments

Accounting for net gains / (losses) on investments

- Realised gains or 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. An adjustment is made to unrealised gains and losses for the prior year's unrealised element included in the current year's realised gains and losses.

	Group		Society	
	2012	2011	**2012**	2011
	£m	£m	**£m**	£m
Investment properties	**(1.2)**	(1.9)	**(1.2)**	(1.9)
Investments at fair value through income:				
- Debt securities	**109.0**	350.3	**86.4**	335.1
- Equity securities	**295.0**	(33.1)	**241.5**	(34.5)
- Derivatives at fair value through income	**(28.1)**	110.1	**(22.6)**	108.6
Investments in group undertakings	**–**	–	**(90.0)**	(34.4)
	374.7	425.4	**214.1**	372.9

Included within net gains on investments are realised gains of £148.8m (2011: £174.4m) for the Group and realised gains of £126.0m (2011: £114.9m) for the Society.

9. Other income

Accounting for other income

Other income primarily relates to interest receivable and unit linked income.

	Group		Society	
	2012	2011	**2012**	2011
	£m	£m	**£m**	£m
Interest receivable	**22.1**	17.6	**0.1**	0.2
Unit linked income	**5.5**	3.8	**5.5**	3.8
Other income	**14.1**	29.6	**0.3**	15.1
	41.7	51.0	**5.9**	19.1

Notes to the Financial Statements continued
31 December 2012

10. Net benefits and claims

Accounting for net benefits and claims

Long-term insurance 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 insurance contracts includes bonuses paid or payable. Claims values include related internal and external claims handling costs. Reinsurance recoveries are accounted for in the same period as the related claim.

General insurance contracts
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.
The estimated cost of claims includes expenses to be incurred in settling claims and a deduction for the expected value of recoveries. However, 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		Society	
	2012	2011	**2012**	2011
	£m	£m	**£m**	£m
Gross benefits and claims				
Long-term insurance contracts				
Benefits and claims paid	**649.3**	667.7	**644.2**	661.8
Change in the provision for claims	**2.4**	(4.6)	**2.4**	(4.5)
General insurance contracts				
Claims paid	**910.3**	816.5	**–**	–
Change in the provision for claims	**257.3**	189.7	**–**	–
	1,819.3	1,669.3	**646.6**	657.3
Claims ceded to reinsurers				
Long-term insurance contracts				
Benefits and claims paid	**(61.8)**	(54.5)	**(61.8)**	(102.4)
General insurance contracts				
Claims paid	**(14.9)**	(7.4)	**–**	–
Change in the provision for claims	**(34.1)**	(24.5)	**–**	–
	(110.8)	(86.4)	**(61.8)**	(102.4)
	1,708.5	1,582.9	**584.8**	554.9
Net benefits and claims for investment contracts which are deposit accounted for and not included above (refer to Note 17)	**192.6**	120.5	**192.6**	120.5

11. Finance costs

	Group		Society	
	2012	2011	**2012**	2011
	£m	£m	**£m**	£m
Interest expense on loans and borrowings	**0.5**	0.5	**–**	–
	0.5	0.5	**–**	–

Notes to the Financial Statements continued
31 December 2012

12. 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. Where the benefit of these costs will be recognised in future accounting periods the costs are deferred.

	Group		Society	
	2012	2011	**2012**	2011
	£m	£m	**£m**	£m
Commission paid on acquisition of business	**195.6**	184.2	**57.7**	50.1
Movement in deferred acquisition costs	**(5.4)**	(14.0)	**–**	–
Write–off following termination of reinsurance contract (see Note 23)	**–**	58.1	**–**	–
Amortisation of intangible assets	**12.0**	13.0	**4.6**	4.7
Depreciation on property and equipment - owned	**2.5**	1.7	**0.8**	0.8
Depreciation on property and equipment - finance leases	**0.9**	0.9	**–**	–
Loss on disposal of property and equipment	**0.4**	–	**0.4**	0.1
Investment management expenses and charges	**12.8**	3.8	**16.5**	23.6
Auditors' remuneration	**2.2**	1.4	**1.6**	0.7
Employee benefits expense	**216.4**	209.7	**216.4**	209.7
Impairment of financial assets	**0.4**	(0.4)	**–**	0.1
Management charge allocated to group undertakings	**–**	–	**(191.1)**	(186.8)
Rent, rate and other facilities expense	**28.6**	18.2	**21.1**	13.2
Marketing and advertising	**45.9**	40.4	**19.2**	15.8
Other staff costs	**30.7**	29.0	**13.1**	14.3
IT costs	**39.4**	45.8	**21.6**	23.7
Fees	**58.3**	61.1	**25.0**	27.9
Other expenses	**27.8**	14.0	**17.7**	5.0
Claims handling cost recognised in Gross benefits and claims	**(60.0)**	(47.1)	**(6.0)**	(31.2)
	608.5	619.8	**218.6**	171.7

13. Auditors' remuneration

	2012 £m	2011 £m
Audit of Society	**0.4**	0.5
Fees payable to the Society's auditors and its associates for other services:		
- Audit of subsidiaries	**0.5**	0.3
- Audit-related assurance services	**0.2**	0.2
- Tax advisory services	**0.1**	0.1
- Other non-audit services not covered above	**1.0**	0.3
	2.2	1.4

14. Mutual Bonus

The Board declared a mutual bonus of £20.9m (2011: £18.6m) in respect of the year ended 31 December 2012.

Notes to the Financial Statements continued

31 December 2012

Financial assets and liabilities

This section presents information relating to the financial assets and liabilities (excluding insurance contract-related assets and liabilities which are disclosed in Note 20) held by the Society and Group. These financial asset and liabilities are held at either fair value or amortised cost as defined by the Group's accounting policies.

15. Financial assets – Fair value through income

Accounting for financial assets and liabilities at fair value through income.

Financial assets at fair value through income has two sub categories:

- Financial assets held for trading; and
- Those designated at fair value through income at inception.

All investments of the Group classified as fair value are designated as fair value through income at inception. Such assets are measured at market prices, or prices consistent with market ratings should no price be available. 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 property and other investments.

Financial liabilities at fair value through income include derivative financial instruments and investment contract liabilities; see Notes 16 and 17 respectively.

The IFRS "fair value hierarchy" levels for financial assets and liabilities required under IFRS7 are disclosed within Note 18.

Loans secured on residential property
The fair value of the loans secured on residential property is determined using discounted cash flows which take into account the interest rolled up on the loans, maturity profiles and expected future funding costs. The swap rate used as an input to the discount rate is matched to the expected term of the underlying loans. A 'No Negative Equity Guarantee' liability is fair valued using discounted cash flows and is netted off against the fair value of the assets.

A Group undertaking provides 'No Negative Equity Guarantee' contracts to customers on equity release mortgages. The contractual terms of these guarantees require the company to make payments equivalent to any shortfall between the market value of customers' property and the value of the loan plus accrued interest at the date of redemption.

The guarantee is initially recognised at the fair value of the liability on the date the guarantee is given and is subsequently measured at fair value. The fair value is calculated by applying stochastic scenario models, applying assumptions for interest rates, future house price inflation and its volatility, mortality rates and early loan repayment rates, to give management's best estimate of the discounted value of cash flows required to settle any future financial obligation arising at the Statement of Financial Position date.

The guarantee is included within Financial assets – Fair value through income in the Statement of Financial Position. The movement in the fair value of the guarantee is taken to the Statement of Comprehensive Income.

Significant accounting estimates and judgements

Fair value of financial assets
Market observable inputs are used wherever possible. 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 IFRS7, disclosed in Note 18.

Notes to the Financial Statements continued

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15. Financial assets – Fair value through income (continued)

	Group		Society	
	2012	2011	**2012**	2011
	£m	£m	**£m**	£m
Financial assets - Fair value through income				
Shares, other variable yield securities and units in unit trusts				
– UK listed	**2,107.8**	1,725.3	**3,051.7**	2,756.3
– UK unlisted	**112.3**	113.9	**112.3**	113.9
– Overseas listed	**437.3**	409.5	**70.5**	48.5
– Overseas unlisted	**92.9**	94.7	**92.0**	91.5
Debt and other fixed income securities				
– UK listed	**4,189.9**	3,841.2	**2,595.7**	2,198.9
– Overseas listed	**2,123.2**	1,499.8	**765.2**	532.0
Loans secured on residential property	**415.3**	334.2	**366.2**	111.1
Other	**5.4**	1.7	**5.3**	1.7
Loan to group undertaking	**–**	–	**–**	162.2
	9,484.1	8,020.3	**7,058.9**	6,016.1
Within one year	**3,186.2**	1,852.3	**3,510.4**	2,114.1
Over one year	**6,297.9**	6,168.0	**3,548.5**	3,902.0
	9,484.1	8,020.3	**7,058.9**	6,016.1
Assets held to cover linked liabilities included above	**1,000.8**	855.8	**1,000.8**	855.8

The loan to group undertaking was designated at fair value through income within the Society to avoid an accounting mismatch across the Group, the loan was repaid in 2012.

16. 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.

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.

	2012			2011		
Group	**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	**635.0**	**20.0**	**–**	486.9	64.2	–
Gilt hedges	**1,417.1**	**1.0**	**–**	–	–	–
Cash flow swaps	**79.4**	**–**	**(51.2)**	–	–	–
Swaptions	**151.9**	**17.9**	**–**	196.7	29.6	–
Forward exchange contracts	**3.3**	**–**	**–**	3.5	–	–
Equity/index derivatives	**233.6**	**31.9**	**–**	1,111.4	50.0	(3.6)
Property index swap	**–**	**–**	**–**	20.0	–	(0.2)
	2,520.3	**70.8**	**(51.2)**	1,818.5	143.8	(3.8)

Notes to the Financial Statements continued

31 December 2012

16. Derivative financial instruments (continued)

The Group uses derivatives to hedge the effect of changes in variable rate borrowings on its fixed rate loan portfolio, to reduce exposure to payouts under guaranteed annuity contracts and to protect against falls in the FTSE 100. In 2012, the general insurance business entered into gilt hedge contracts for differences, as a result a significant proportion of the general insurance asset portfolio is hedged against stock market and gilt yield movements.

	2012			2011		
Society	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	**635.0**	**20.0**	**–**	486.9	64.2	–
Cash flow swaps	**79.4**	**–**	**(51.2)**	–	–	–
Swaptions	**151.9**	**17.9**	**–**	196.7	29.6	–
Equity/index derivatives	**153.6**	**30.6**	**–**	1,110.0	50.0	(3.6)
Property index swap	**–**	**–**	**–**	20.0	–	(0.2)
	1,019.9	**68.5**	**(51.2)**	1,813.6	143.8	(3.8)

17. Investment contract liabilities

Accounting for investment contract liabilities

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.

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 fund assets and liabilities 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 discounted 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.

The liability is derecognised when the contract expires, is discharged or is cancelled.

	Group		Society	
	2012 £m	2011 £m	2012 £m	2011 £m
Balance at 1 January	**800.9**	741.2	**800.9**	741.2
Deposits received from policyholders	**270.0**	214.0	**270.0**	214.0
Payments made to policyholders and fees deducted	**(192.6)**	(120.5)	**(192.6)**	(120.5)
Change in contract liabilities as shown in the Statement of Comprehensive Income	**81.0**	(33.8)	**81.0**	(33.8)
Balance at 31 December	**959.3**	800.9	**959.3**	800.9

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. Investment contracts are not reinsured.

Notes to the Financial Statements continued
31 December 2012

18. Fair value estimation

The following fair value estimation tables, as required by IFRS7, 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 2012.

The fair value of financial instruments included in the Level 1 category is based on published quoted bid market prices in an active market at the year-end date. A market 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 financial instruments are not traded in an active market or 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 3 include:

- Quoted market prices or dealer quotes for similar instruments (unlisted shares).
- The fair value of interest rate swaps is calculated as the present value of the estimated future cash flows based on observable yield curves.
- The fair value of forward exchange contracts is determined using forward exchange rates at the Statement of Financial Position date, with the resulting value discounted back to present value.
- The fair value of the loans secured on residential property is determined using discounted cash flows which take into account the interest rolled up on the loans, maturity profiles and expected future funding costs. The swap rate used as an input to the discount rate is matched to the expected term of the underlying loans. The No Negative Equity Guarantee liability is fair valued using discounted cash flows and is netted off against the fair value of the assets.
- The fair value of Investment contract liabilities are calculated on a consistent basis to the underlying investments as described in Note 17.
- Other techniques, such as discounted cash flow analysis, are used to determine fair value for the other financial instruments.

If one or more of the significant inputs is not based on observable market data, the instrument is included in Level 3.

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 8 and 22 respectively.

Notes to the Financial Statements continued

31 December 2012

18. Fair value estimation (continued)

Group	2012 Level 1 £m	2012 Level 2 £m	2012 Level 3 £m	2012 Total fair value £m	2011 Level 1 £m	2011 Level 2 £m	2011 Level 3 £m	2011 Total fair value £m
Financial assets								
Derivative financial instruments								
Interest rate swaps	–	–	20.0	20.0	–	–	64.2	64.2
Gilt hedges	–	–	1.0	1.0	–	–	–	–
Swaptions	–	–	17.9	17.9	–	–	29.6	29.6
Equity/index derivatives	1.2	–	30.7	31.9	10.3	–	39.7	50.0
	1.2	–	69.6	70.8	10.3	–	133.5	143.8
Financial assets held at fair value through income								
Shares, other variable yield securities and units in unit trusts								
– UK listed	1,284.6	823.2	–	2,107.8	1,095.6	629.7	–	1,725.3
– UK unlisted	–	–	112.3	112.3	–	–	113.9	113.9
– Overseas listed	395.7	41.6	–	437.3	378.7	30.8	–	409.5
– Overseas unlisted	–	–	92.9	92.9	–	–	94.7	94.7
Debt and other fixed income securities								
– UK listed	2,155.1	2,034.8	–	4,189.9	2,302.9	1,537.6	0.7	3,841.2
– Overseas listed	2.9	2,120.3	–	2,123.2	7.9	1,490.8	1.1	1,499.8
Loans secured on residential property	–	–	415.3	415.3	–	–	334.2	334.2
Other	5.4	–	–	5.4	1.7	–	–	1.7
	3,843.7	5,019.9	620.5	9,484.1	3,786.8	3,688.9	544.6	8,020.3
	3,844.9	5,019.9	690.1	9,554.9	3,797.1	3,688.9	678.1	8,164.1
Financial liabilities								
Investment contract liabilities	–	844.6	114.7	959.3	–	687.5	113.4	800.9
Derivative financial instruments								
Cash flow swaps	–	–	51.2	51.2	–	–	–	–
Equity/index derivatives	–	–	–	–	3.6	–	–	3.6
Property index swap	–	–	–	–	–	–	0.2	0.2
	–	–	51.2	51.2	3.6	–	0.2	3.8
	–	844.6	165.9	1,010.5	3.6	687.5	113.6	804.7

Notes to the Financial Statements continued

31 December 2012

18. Fair value estimation (continued)

Society	2012 Level 1 £m	2012 Level 2 £m	2012 Level 3 £m	2012 Total fair value £m	2011 Level 1 £m	2011 Level 2 £m	2011 Level 3 £m	2011 Total fair value £m
Financial assets								
Derivative financial instruments								
Interest rate swaps	–	–	20.0	20.0	–	–	64.2	64.2
Swaptions	–	–	17.9	17.9	–	–	29.6	29.6
Equity/index derivatives	–	–	30.6	30.6	10.3	–	39.7	50.0
	–	–	68.5	68.5	10.3	–	133.5	143.8
Financial assets held at fair value through income								
Shares, other variable yield securities and units in unit trusts								
– UK listed	668.3	2,383.4	–	3,051.7	727.2	2,029.1	–	2,756.3
– UK unlisted	–	–	112.3	112.3	–	–	113.9	113.9
– Overseas listed	68.7	1.8	–	70.5	48.5	–	–	48.5
– Overseas unlisted	–	–	92.0	92.0	–	–	91.5	91.5
Debt and other fixed income securities								
– UK listed	1,716.5	879.2	–	2,595.7	1,670.5	527.7	0.7	2,198.9
– Overseas listed	2.8	762.4	–	765.2	7.5	523.4	1.1	532.0
Loan to group undertaking	–	–	–	–	–	–	162.2	162.2
Loans secured on residential property	–	–	366.2	366.2	–	–	111.1	111.1
Other	5.3	–	–	5.3	1.7	–	–	1.7
	2,461.6	4,026.8	570.5	7,058.9	2,455.4	3,080.2	480.5	6,016.1
	2,461.6	4,026.8	639.0	7,127.4	2,465.7	3,080.2	614.0	6,159.9
Financial liabilities								
Investment contract liabilities	–	844.6	114.7	959.3	–	687.5	113.4	800.9
Derivative financial instruments								
Cash flow swaps	–	–	51.2	51.2	–	–	–	–
Equity/index derivatives	–	–	–	–	3.6	–	–	3.6
Property index swap	–	–	–	–	–	–	0.2	0.2
	–	–	51.2	51.2	3.6	–	0.2	3.8
	–	844.6	165.9	1,010.5	3.6	687.5	113.6	804.7

Notes to the Financial Statements continued

31 December 2012

18. Fair value estimation (continued)

The table below presents the movements in Level 3 financial instruments for the year ended 31 December 2012:

Group	At 1 January 2012 £m	Total gains/ (losses) recognised through income £m	Purchases £m	Sales* £m	Transfers to level 1 and level 2 £m	At 31 December 2012 £m
Financial assets						
Derivative financial instruments						
Interest rate swaps	64.2	(0.1)	–	(44.1)	–	20.0
Gilt hedges	–	1.0	–	–	–	1.0
Swaptions	29.6	(2.3)	–	(9.4)	–	17.9
Equity/index derivatives	39.7	(9.0)	–	–	–	30.7
	133.5	(10.4)	–	(53.5)	–	69.6
Financial assets held at fair value through income						
Shares, other variable yield securities and units in unit trusts						
– UK unlisted	113.9	11.6	0.8	(14.0)	–	112.3
– Overseas unlisted	94.7	1.0	0.6	(3.4)	–	92.9
Debt and other fixed income securities						
– UK listed	0.7	–	–	–	(0.7)	–
– Overseas listed	1.1	–	–	–	(1.1)	–
Loans secured on residential property	334.2	10.8	89.0	(18.7)	–	415.3
	544.6	23.4	90.4	(36.1)	(1.8)	620.5
	678.1	13.0	90.4	(89.6)	(1.8)	690.1
Financial liabilities						
Investment contract liabilities	113.4	1.3	–	–	–	114.7
Derivative financial instruments						
Cash flow swaps	–	(4.3)	55.5	–	–	51.2
Property index swap	0.2	–	–	(0.2)	–	–
	0.2	(4.3)	55.5	(0.2)	–	51.2
	113.6	(3.0)	55.5	(0.2)	–	165.9

* In relation to Loans secured on residential property, sales represents loans repaid.

Notes to the Financial Statements continued

31 December 2012

18. Fair value estimation (continued)

Group	At 1 January 2011 £m	Total gains/(losses) recognised through income £m	Purchases £m	Sales £m	At 31 December 2011 £m
Financial assets					
Derivative financial instruments					
Interest rate swaps	10.7	53.5	–	–	64.2
Swaptions	33.0	8.9	–	(12.3)	29.6
Equity/index derivatives	–	9.7	30.0	–	39.7
	43.7	72.1	30.0	(12.3)	133.5
Financial assets held at fair value through income					
Shares, other variable yield securities and units in unit trusts					
– UK unlisted	146.1	(25.8)	4.1	(10.5)	113.9
– Overseas unlisted	95.0	14.1	1.8	(16.2)	94.7
Debt and other fixed income securities					
– UK listed	2.2	0.4	–	(1.9)	0.7
– Overseas listed	–	(3.1)	4.2	–	1.1
Loans secured on residential property	187.0	70.3	87.3	(10.4)	334.2
	430.3	55.9	97.4	(39.0)	544.6
	474.0	128.0	127.4	(51.3)	678.1
Financial liabilities					
Investment contract liabilities	137.4	–	–	(24.0)	113.4
Derivative financial instruments					
Swaptions	27.6	–	–	(27.6)	–
Property index swap	–	–	0.2	–	0.2
	27.6	–	0.2	(27.6)	0.2
	165.0	–	0.2	(51.6)	113.6

Notes to the Financial Statements continued

31 December 2012

18. Fair value estimation (continued)

Society	At 1 January 2012 £m	Total gains/ (losses) recognised through income £m	Purchases £m	Sales* £m	Transfers to level 1 and level 2 £m	At 31 December 2012 £m
Financial assets						
Derivative financial instruments						
Interest rate swaps	64.2	(0.1)	–	(44.1)	–	20.0
Swaptions	29.6	(2.3)	–	(9.4)	–	17.9
Equity/index derivatives	39.7	(9.1)	–	–	–	30.6
	133.5	(11.5)	–	(53.5)	–	68.5
Financial assets held at fair value through income						
Shares, other variable yield securities and units in unit trusts						
– UK unlisted	113.9	11.6	0.8	(14.0)	–	112.3
– Overseas unlisted	91.5	0.4	0.6	(0.5)	–	92.0
Debt and other fixed income securities						
– UK listed	0.7	–	–	–	(0.7)	–
– Overseas listed	1.1	–	–	–	(1.1)	–
Loan to group undertaking	162.2	(22.1)	–	(140.1)	–	–
Loans secured on residential property (note 1)	111.1	43.0	219.4	(7.3)	–	366.2
	480.5	32.9	220.8	(161.9)	(1.8)	570.5
	614.0	21.4	220.8	(215.4)	(1.8)	639.0
Financial liabilities						
Investment contract liabilities	113.4	1.3	–	–	–	114.7
Derivative financial instruments						
Cash flow swaps	–	(4.3)	55.5	–	–	51.2
Property index swap	0.2	–	–	(0.2)	–	–
	0.2	(4.3)	55.5	(0.2)	–	51.2
	113.6	(3.0)	55.5	(0.2)	–	165.9

Note 1: The £219.4m included as purchases of Loans secured on residential properties includes amounts transferred from a subsidiary, Liverpool Victoria Equity Release Limited as part of a December 2012 loan restructure with the Society.

* In relation to Loans secured on residential property, sales represents loans repaid.

Notes to the Financial Statements continued

31 December 2012

18. Fair value estimation (continued)

Society	At 1 January 2011 £m	Total gains/(losses) recognised through income £m	Purchases £m	Sales £m	At 31 December 2011 £m
Financial assets					
Derivative financial instruments					
Interest rate swaps	10.7	53.5	–	–	64.2
Swaptions	33.0	8.9	–	(12.3)	29.6
Equity/index derivatives	–	9.7	30.0	–	39.7
	43.7	72.1	30.0	(12.3)	133.5
Financial assets held at fair value through income					
Shares, other variable yield securities and units in unit trusts					
– UK unlisted	140.3	(25.8)	4.1	(4.7)	113.9
– Overseas unlisted	88.1	14.3	1.8	(12.7)	91.5
Debt and other fixed income securities					
– UK listed	2.2	0.4	–	(1.9)	0.7
– Overseas listed	–	(3.1)	4.2	–	1.1
Loan to group undertaking	131.7	29.1	6.4	(5.0)	162.2
Loans secured on residential property	–	25.6	87.3	(1.8)	111.1
	362.3	40.5	103.8	(26.1)	480.5
	406.0	112.6	133.8	(38.4)	614.0
Financial liabilities					
Investment contract liabilities	137.4	–	–	(24.0)	113.4
Derivative financial instruments					
Swaptions	27.6	–	–	(27.6)	–
Property index swap	–	–	0.2	–	0.2
	27.6	–	0.2	(27.6)	0.2
	165.0	–	0.2	(51.6)	113.6

Notes to the Financial Statements continued

31 December 2012

19. Loans and other receivables

Accounting for loans and other receivables

Loans are initially measured at fair value and then subsequently measured at amortised cost using the effective interest rate method.

Receivables are recognised when due and comprise amounts due to the Society from group undertakings and other receivables. They are initially recognised at fair value and then subsequently held at amortised cost.

The Group assesses at each Statement of Financial Position date whether 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.

Provision for impairment of loans

Provisions for impairment of loans and receivables are based on appraisals of loans and receivables both collectively and individually. Provisions are made to reflect the estimated net realisable amount, taking into account potential future recoveries and the original effective interest rate. Balances are written off in full when the debt is considered irrecoverable.

Specific provisions have been made in respect of all identified impaired advances. In calculating the required provision an appropriate factor is applied based on the present value of expected future cash flows, which is subject to periodic review to ensure its continuing applicability based on current experience, to reflect the probability that not all such loans will result in eventual loss. Collective provisions have been made in respect of losses which, although not yet specifically identified, are expected from experience to arise.

	Group		Society	
	2012	2011	**2012**	2011
	£m	£m	**£m**	£m
Deposits with credit institutions	**14.6**	–	**–**	–
Loans secured by policies	**0.4**	0.6	**0.4**	0.6
Other loans	**0.3**	0.4	**0.3**	0.4
Amounts due from group undertakings	**–**	–	**87.4**	109.6
Managing agents rental receivable	**12.5**	17.0	**12.5**	17.0
Investments receivable	**16.5**	13.2	**16.5**	13.2
Other receivables	**58.7**	84.8	**11.5**	14.1
	103.0	116.0	**128.6**	154.9
Within one year	**98.8**	112.4	**126.0**	154.0
Over one year	**4.2**	3.6	**2.6**	0.9
	103.0	116.0	**128.6**	154.9

The carrying amounts disclosed above reasonably approximate fair value at the Statement of Financial Position date.

20. Other financial liabilities

	Group		Society	
	2012	2011 Restated	**2012**	2011 Restated
	£m	£m	**£m**	£m
Collateral received	**65.5**	66.8	**65.5**	66.8
Subordinated note (EUR12m - interest payable at the 3 month Euro Deposit Rate plus a margin of 3.65%)	**9.7**	10.0	–	–
Amounts due to group undertakings	**–**	–	**15.7**	5.6
Other	**0.3**	0.4	**0.2**	0.3
	75.5	77.2	**81.4**	72.7

The carrying amounts disclosed above reasonably approximate fair value at the Statement of Financial Position date.

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Insurance contract-related assets and liabilities

This section presents information relating to insurance contract-related assets and liabilities held by the Society and Group. The assumptions used in the valuation of the insurance contract liabilities are disclosed within Note 25 with sensitivities to these assumptions disclosed separately within Note 3.

21. Insurance contract liabilities

Accounting for insurance contract liabilities

Participating business

The liability is calculated in accordance with the FSA's 'realistic' liability regime. 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 liability includes an allowance for the time and intrinsic value of options and guarantees granted to policyholders and for possible future management actions.

The realistic 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.

Since the realistic liabilities include an allowance for future bonuses to participating contract policyholders that will be payable out of returns on non participating business, an amount within the participating contract fund is recognised representing the value of non-participating business. Such an amount is not recognised for business written outside participating contract funds.

In determining the realistic value of liabilities for participating contracts, indirect account is taken of the value of future profits on non-participating business written out of participating contract funds. This is separately identifiable and is all in respect of policyholder liabilities. The excess of the value of those future profits has been deducted from the realistic liabilities rather than recognising it as an asset.

Non-participating business

The liability is calculated to comply with the reporting requirements under the FSA's Integrated Prudential Sourcebook using a gross premium valuation method or a method at least as prudent as the gross premium method. The principal assumptions are given in the notes to the financial statements. 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.

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.

Unexpired risks

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.

Significant accounting estimates and judgements

Valuation of investment and long-term insurance contract liabilities

The liability is based on assumptions reflecting the best estimate at the time allowing for a margin of risk and adverse deviation. All contracts are subject to a liability adequacy test, which reflects management's best current estimate of future cash flows.

The assumptions used for mortality, morbidity and longevity are based on standard industry or reinsurers' tables, adjusted where appropriate to reflect the Group's own experience. In particular, for impaired annuities the mortality assumptions are based on reinsurers' tables with an individual loading applied depending on the nature of the impairment. The assumptions used for investment returns, expenses, lapse and surrender rates are based on current market yields, product characteristics, and relevant claims experience. The assumptions used for discount rates are based on current market risk rates, adjusted for the Group's own risk exposure. Due to the long-term nature of these obligations, the estimates are subject to significant uncertainty.

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21. Insurance contract liabilities (continued)

Valuation of general insurance contract liabilities

For general insurance contracts, estimates are made for the expected ultimate cost of claims reported as at the Statement of Financial Position date and the cost of claims incurred but not yet reported (IBNR) 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. 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 is used to project ultimate claims costs. Allowance for one-off occurrences or changes in legislation, policy conditions or portfolio mix are 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 gross benefits and claims within the Statement of Comprehensive Income in future years.

a) Analysis of insurance contract liabilities and reinsurance assets

		2012			2011		
Group	**Notes**	**Gross £m**	**Reinsurance £m**	**Net £m**	Gross £m	Reinsurance £m	Net £m
Long-term insurance contract liabilities	21 b	**6,504.9**	**(261.9)**	**6,243.0**	5,852.8	(200.0)	5,652.8
Long-term linked insurance contract liabilities	21 c	**77.0**	**(35.5)**	**41.5**	77.9	(23.0)	54.9
Long-term claims liabilities	21 d	**42.4**	**–**	**42.4**	40.0	–	40.0
		6,624.3	**(297.4)**	**6,326.9**	5,970.7	(223.0)	5,747.7
General insurance unearned premiums	21 e	**746.0**	**(14.8)**	**731.2**	747.4	(13.0)	734.4
General insurance claims liabilities	21 f	**1,287.1**	**(135.0)**	**1,152.1**	1,029.9	(100.9)	929.0
		2,033.1	**(149.8)**	**1,883.3**	1,777.3	(113.9)	1,663.4
		8,657.4	**(447.2)**	**8,210.2**	7,748.0	(336.9)	7,411.1

		2012			2011		
Society	**Notes**	**Gross £m**	**Reinsurance £m**	**Net £m**	Gross £m	Reinsurance £m	Net £m
Long-term insurance contract liabilities	21 b	**6,484.0**	**(261.9)**	**6,222.1**	5,828.4	(200.0)	5,628.4
Long-term linked insurance contract liabilities	21 c	**77.0**	**(35.5)**	**41.5**	77.9	(23.0)	54.9
Long-term claims liabilities	21 d	**42.3**	**–**	**42.3**	39.9	–	39.9
		6,603.3	**(297.4)**	**6,305.9**	5,946.2	(223.0)	5,723.2

Included within the "Other" category disclosed in tables 21b and 21c are amounts totalling £48.4m, as at 31 December 2011, in relation to the termination of the reinsurance agreement between the Society and Liverpool Victoria Life Company Limited. Further details on this transaction are disclosed in Note 47.

b) Movement in long-term insurance contract liabilities

	2012			2011		
Group	**Gross £m**	**Reinsurance £m**	**Net £m**	Gross £m	Reinsurance £m	Net £m
Balance at 1 January	**5,852.8**	**(200.0)**	**5,652.8**	5,038.0	(120.5)	4,917.5
Premiums received	**105.7**	**(26.1)**	**79.6**	207.7	(27.6)	180.1
Liabilities paid for death maturities, surrenders, benefits & claims	**(624.6)**	**23.7**	**(600.9)**	(543.6)	24.5	(519.1)
New business	**652.4**	**(33.2)**	**619.2**	572.8	(42.1)	530.7
Benefits and claims variation	**98.8**	**(0.1)**	**98.7**	2.5	(3.4)	(0.9)
Fees deducted	**(36.4)**	**–**	**(36.4)**	(17.4)	–	(17.4)
Accretion of investment income or change in unit prices	**404.1**	**(1.9)**	**402.2**	613.9	(0.1)	613.8
Adjustment due to changes in assumptions:						
- Mortality/morbidity	**30.1**	**(13.3)**	**16.8**	(2.9)	9.5	6.6
- Investment return	**35.6**	**(1.3)**	**34.3**	(18.0)	–	(18.0)
- Expense	**(16.7)**	**1.9**	**(14.8)**	0.7	3.0	3.7
- Lapse and surrender rates	**(30.2)**	**–**	**(30.2)**	11.2	(0.3)	10.9
- Discount rate	**(28.3)**	**(4.1)**	**(32.4)**	76.8	(18.9)	57.9
- Model changes	**63.2**	**–**	**63.2**	(49.5)	10.6	(38.9)
- Other	**(22.5)**	**(7.5)**	**(30.0)**	(58.0)	(34.7)	(92.7)
Mutual bonus	**20.9**	**–**	**20.9**	18.6	–	18.6
Balance at 31 December	**6,504.9**	**(261.9)**	**6,243.0**	5,852.8	(200.0)	5,652.8

Notes to the Financial Statements continued

31 December 2012

21. Insurance contract liabilities (continued)

b) Movement in long-term insurance contract liabilities (continued)

Society	2012 Gross £m	2012 Reinsurance £m	2012 Net £m	2011 Gross £m	2011 Reinsurance £m	2011 Net £m
Balance at 1 January	**5,828.4**	**(200.0)**	**5,628.4**	5,011.8	(165.6)	4,846.2
Premiums received	**104.9**	**(26.1)**	**78.8**	215.7	(53.8)	161.9
Liabilities paid for death maturities, surrenders, benefits & claims	**(619.9)**	**23.7**	**(596.2)**	(547.5)	37.3	(510.2)
New business	**652.4**	**(33.2)**	**619.2**	569.8	(32.2)	537.6
Benefits and claims variation	**99.1**	**(0.1)**	**99.0**	0.9	1.8	2.7
Fees deducted	**(36.4)**	**–**	**(36.4)**	(18.4)	3.1	(15.3)
Accretion of investment income or change in unit prices	**404.0**	**(1.9)**	**402.1**	614.4	(1.9)	612.5
Adjustment due to changes in assumptions:						
- Mortality/morbidity	**30.1**	**(13.3)**	**16.8**	0.2	(0.6)	(0.4)
- Investment return	**35.6**	**(1.3)**	**34.3**	(18.0)	-	(18.0)
- Expense	**(16.7)**	**1.9**	**(14.8)**	(0.2)	6.2	6.0
- Lapse and surrender rates	**(30.2)**	**–**	**(30.2)**	11.2	(0.3)	10.9
- Discount rate	**(28.5)**	**(4.1)**	**(32.6)**	81.0	(32.8)	48.2
- Model changes	**62.7**	**–**	**62.7**	(51.4)	16.7	(34.7)
- Other	**(22.4)**	**(7.5)**	**(29.9)**	(59.7)	22.1	(37.6)
Mutual bonus	**20.9**	**–**	**20.9**	18.6	–	18.6
Balance at 31 December	**6,484.0**	**(261.9)**	**6,222.1**	5,828.4	(200.0)	5,628.4

c) Movement in long-term linked insurance contract liabilities

Group	2012 Gross £m	2012 Reinsurance £m	2012 Net £m	2011 Gross £m	2011 Reinsurance £m	2011 Net £m
Balance at 1 January	**77.9**	**(23.0)**	**54.9**	68.7	(6.5)	62.2
Premiums received	**81.2**	**(15.7)**	**65.5**	31.9	(10.0)	21.9
Liabilities paid for death maturities, surrenders, benefits & claims	**(40.8)**	**14.2**	**(26.6)**	(35.8)	8.8	(27.0)
New business	**(12.9)**	**(22.5)**	**(35.4)**	(0.1)	(8.7)	(8.8)
Benefits and claims variation	**(9.5)**	**(0.1)**	**(9.6)**	(3.8)	(1.2)	(5.0)
Fees deducted	**(6.4)**	**–**	**(6.4)**	(2.4)	–	(2.4)
Accretion of investment income or change in unit prices	**3.5**	**(1.2)**	**2.3**	0.5	–	0.5
Adjustment due to changes in assumptions:						
- Mortality/morbidity	**(9.1)**	**(8.0)**	**(17.1)**	3.2	3.4	6.6
- Expense	**(15.4)**	**1.1**	**(14.3)**	(4.8)	1.1	(3.7)
- Lapse and surrender rates	**–**	**–**	**–**	0.2	(0.1)	0.1
- Discount rate	**8.6**	**(2.5)**	**6.1**	16.2	(4.1)	12.1
- Model changes	–	–	–	(8.7)	3.8	(4.9)
- Other	**(0.1)**	**22.2**	**22.1**	12.8	(9.5)	3.3
Balance at 31 December	**77.0**	**(35.5)**	**41.5**	77.9	(23.0)	54.9

Notes to the Financial Statements continued

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21. Insurance contract liabilities (continued)

c) Movement in long-term linked insurance contract liabilities (continued)

Society	2012 Gross £m	2012 Reinsurance £m	2012 Net £m	2011 Gross £m	2011 Reinsurance £m	2011 Net £m
Balance at 1 January	**77.9**	**(23.0)**	**54.9**	68.7	(50.4)	18.3
Premiums received	**81.2**	**(15.7)**	**65.5**	23.9	(19.4)	4.5
Liabilities paid for death maturities, surrenders, benefits & claims	**(40.8)**	**14.2**	**(26.6)**	(31.7)	13.6	(18.1)
New business	**(12.9)**	**(22.5)**	**(35.4)**	2.9	(5.1)	(2.2)
Benefits and claims variation	**(9.5)**	**(0.1)**	**(9.6)**	(2.2)	0.6	(1.6)
Fees deducted	**(6.4)**	**–**	**(6.4)**	(1.5)	1.1	(0.4)
Accretion of investment income or change in unit prices	**3.5**	**(1.2)**	**2.3**	–	(0.7)	(0.7)
- Mortality/morbidity	**(9.1)**	**(8.0)**	**(17.1)**	0.1	(0.2)	(0.1)
- Expense	**(15.4)**	**1.1**	**(14.3)**	(3.9)	2.2	(1.7)
- Lapse and surrender rates	**–**	**–**	**–**	0.2	(0.1)	0.1
- Discount rate	**8.6**	**(2.5)**	**6.1**	11.9	(9.1)	2.8
- Model changes	**–**	**–**	**–**	(6.8)	6.0	(0.8)
- Other	**(0.1)**	**22.2**	**22.1**	16.3	38.5	54.8
Balance at 31 December	**77.0**	**(35.5)**	**41.5**	77.9	(23.0)	54.9

d) Movement in long-term claims liabilities

Group	2012 Gross £m	2012 Reinsurance £m	2012 Net £m	2011 Gross £m	2011 Reinsurance £m	2011 Net £m
Balance at 1 January	**40.0**	**–**	**40.0**	44.6	–	44.6
Claims notified	**651.7**	**(61.8)**	**589.9**	663.1	(54.5)	608.6
Claims paid during the year	**(649.3)**	**61.8**	**(587.5)**	(667.7)	54.5	(613.2)
Balance at 31 December	**42.4**	**–**	**42.4**	40.0	–	40.0

Society	2012 Gross £m	2012 Reinsurance £m	2012 Net £m	2011 Gross £m	2011 Reinsurance £m	2011 Net £m
Balance at 1 January	**39.9**	**–**	**39.9**	44.4	–	44.4
Claims notified	**646.6**	**(61.8)**	**584.8**	657.3	(102.4)	554.9
Claims paid during the year	**(644.2)**	**61.8**	**(582.4)**	(661.8)	102.4	(559.4)
Balance at 31 December	**42.3**	**–**	**42.3**	39.9	–	39.9

e) Movement in general insurance unearned premiums

Group	2012 Gross £m	2012 Reinsurance £m	2012 Net £m	2011 Gross £m	2011 Reinsurance £m	2011 Net £m
Balance at 1 January	**747.4**	**(13.0)**	**734.4**	624.7	(10.2)	614.5
Premiums written in the year	**1,484.9**	**(35.0)**	**1,449.9**	1,455.6	(27.7)	1,427.9
Premiums earned during the year	**(1,486.3)**	**33.2**	**(1,453.1)**	(1,332.9)	24.9	(1,308.0)
Balance at 31 December	**746.0**	**(14.8)**	**731.2**	747.4	(13.0)	734.4

f) Movement in general insurance claims liabilities

Group	2012 Gross £m	2012 Reinsurance £m	2012 Net £m	2011 Gross £m	2011 Reinsurance £m	2011 Net £m
Balance at 1 January	**1,029.9**	**(100.9)**	**929.0**	840.1	(76.4)	763.7
Movement in claims incurred in prior accident years	**32.7**	**(23.5)**	**9.2**	35.0	(22.7)	12.3
Claims incurred in the current accident year	**1,080.1**	**(25.5)**	**1,054.6**	927.5	(9.2)	918.3
Claims paid during the year	**(855.6)**	**14.9**	**(840.7)**	(772.7)	7.4	(765.3)
Balance at 31 December	**1,287.1**	**(135.0)**	**1,152.1**	1,029.9	(100.9)	929.0

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22. Net (increase) / decrease in long-term contract liabilities

	Group		Society	
	2012	2011	**2012**	2011
	£m	£m	**£m**	£m
Gross (increase) / decrease in long-term contract liabilities				
(Increase) / decrease in long-term insurance contract liabilities	**(652.1)**	(814.8)	**(655.6)**	(816.6)
Decrease / (increase) in long-term linked insurance contract liabilities	**0.9**	(9.2)	**0.9**	(9.2)
(Increase) / decrease in investment contract liabilities	**(81.0)**	33.8	**(81.0)**	33.8
	(732.2)	(790.2)	**(735.7)**	(792.0)
Mutual bonus (disclosed separately in Note 14)	**20.9**	18.6	**20.9**	18.6
	(711.3)	(771.6)	**(714.8)**	(773.4)
Increase / (decrease) in long-term contract liabilities ceded to reinsurers				
Increase / (decrease) in long-term insurance contract liabilities	**61.9**	79.5	**61.9**	34.4
Increase / (decrease) in long-term linked insurance contract liabilities	**12.5**	16.5	**12.5**	(27.3)
	74.4	96.0	**74.4**	7.1
	(636.9)	(675.6)	**(640.4)**	(766.3)

23. Deferred acquisition costs

Accounting for deferred acquisition costs

The costs of acquiring new business, other than for participating business, which are incurred during the financial year, but where the benefit of such costs will be obtained in subsequent accounting periods are deferred and recognised as an asset to the extent that they are recoverable out of margins in future matching revenues.

In respect of insurance contracts, acquisition costs comprise all direct and indirect costs incurred in writing new contracts. Deferred acquisition costs for insurance contracts 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.

For investment contracts, the costs of acquiring investment contracts are limited to the direct transaction costs associated with the acquisition of the business. Deferred acquisition costs for investment contracts are amortised over the expected contract period.

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	Long-term insurance contracts £m	General insurance contracts £m	Total £m
At 1 January 2012	–	94.7	94.7
Acquisition costs deferred	–	199.0	199.0
Amortisation and impairment	–	(193.6)	(193.6)
At 31 December 2012	**–**	**100.1**	**100.1**
At 1 January 2011	54.6	84.2	138.8
Acquisition costs deferred	17.7	185.6	203.3
Amortisation and impairment	(14.2)	(175.1)	(189.3)
Write-off following termination of reinsurance contract	(58.1)	–	(58.1)
At 31 December 2011	–	94.7	94.7

Deferred acquisition costs are all due within one year for both 2011 and 2012.

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 2012 (2011: £nil).

In 2011 the £58.1m write off in relation to the termination of the reinsurance contract was offset by a £57.4m movement in long-term insurance contract liabilities disclosed within Note 21. The overall impact on the Statement of Comprehensive Income was a loss of £0.7m.

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24. Reinsurance assets

Accounting for reinsurance assets
The Group cedes insurance risk in the normal course of business for its long-term and general insurance businesses. Reinsurance assets represent balances recoverable from reinsurance companies. Recoverable amounts are estimated in a manner consistent with the outstanding claims provision. Reinsurance premiums are recognised in the same period as the underlying contract that they relate to.

		Group		Society	
		2012	2011	**2012**	2011
	Notes	**£m**	£m	**£m**	£m
Reinsurers' share of provision for unearned premiums	21 a	**14.8**	13.0	**–**	–
Reinsurers' share of long-term insurance contract liabilities	21 a	**261.9**	200.0	**261.9**	200.0
Reinsurers' share of long-term linked insurance contract liabilities	21 a	**35.5**	23.0	**35.5**	23.0
Reinsurers' share of claims liabilities	21 a	**135.0**	100.9	**–**	–
		447.2	336.9	**297.4**	223.0
Within one year		**(107.7)**	(33.1)	**(141.5)**	(63.7)
Over one year		**554.9**	370.0	**438.9**	286.7
		447.2	336.9	**297.4**	223.0

The carrying amounts disclosed above reasonably approximate fair value at the Statement of Financial Position date.

25. Long-term insurance and investment contract liabilities valuation assumptions

The basis of the calculation of the long-term insurance contract liabilities is described in the accounting policies. The liability is calculated separately for each life operation. Material judgement is required in calculating the liability. In particular there is discretion over the assumptions used. For participating business, the liability is calculated in accordance with the FSA's realistic capital regime adjusted to exclude the associated tax liability. 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 most significant of these are changes to bonus assumptions and level of payouts.

The assumptions used to calculate the liability depend on the circumstances prevailing in each of the life operations. The assumptions used in determining the liability are estimated to give a result within the normal range of outcomes. To the extent that the ultimate cost differs to the amounts provided, for example where experience is worse than that assumed, the surplus or deficit will be credited or charged to the Statement of Comprehensive Income in future years.

When valuing options and guarantees the asset model used was the Barrie and Hibbert 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 2012 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 21 and 17 respectively, sensitivities to changes in assumptions are included within Note 3.

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 in the tables below.

Interest Rates
The risk-free interest rates assumed are:

Year	**2012**	2011
5	**0.91%**	1.14%
15	**2.60%**	2.81%
25	**3.39%**	3.37%
35	**3.62%**	3.48%

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% (2011: RPI plus 0.7%), where RPI in both 2012 and 2011 is modelled stochastically.

Asset mix for assets backing asset shares at the valuation date:	**2012**	2011
Cash	**2.38%**	2.73%
Fixed interest	**40.68%**	39.75%
Equities	**48.79%**	49.45%
Property	**8.15%**	8.07%

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25. Long-term insurance and investment contract liabilities valuation assumptions (continued)

Mortality rate tables	2012	2011
Conventional Life Business	**75% AM80 Females -3**	75% AM80 Females -3
Conventional Pensions Business	**60% AM80 Females -3**	65% AM80 Females -3
Conventional Industrial Branch Business	**80% up to age 80, rising linearly to 100% at age 100 ELT16**	80% up to age 80, rising linearly to 100% at age 100 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
Annuities in Payment	**Males: RMV00 CMI_2009 2% LT Females: RFV00 CMI_2009 1.5% LT**	Males: RMV00 CMI_2009 2% LT Females: RFV00 CMI_2009 1.5% LT

Per policy expenses – regular premiums	2012	2011
Conventional Life Business	**£34.90**	£32.60
Conventional Pensions Business	**£45.30**	£42.00
Conventional Industrial Branch Business	**£6.80**	£6.90
Non Unitised Accumulating Pensions Business	**£28.30**	£26.30
Unitised Accumulating Life Business	**£40.50**	£36.50
Unitised Accumulating Pensions Business	**£45.30**	£42.00
Unitised Accumulating Bond Business	**£42.80**	£37.50
Unitised Accumulating Life ISA Business	**£49.20**	£43.40
Annuities in Payment	**£48.20**	£43.40

A percentage of these amounts is used for single premium and paid up 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 as evidenced in the persistency trend analysis or to reflect expected future trends as a result of anticipated future events.

Options and guarantees

There are no guaranteed annuity or financial options within the Society participating contract funds. There is an additional reserve calculated on a market consistent basis to cover market value restricter (MVR) free guarantees on with-profits bonds.

Bonuses

The cost of bonuses incurred during the year ended 31 December 2012 was £96.3m (2011: £84.6m) of which £19.6m (2011: £22.5m) was included in the long-term insurance contract liabilities and £76.7m (2011: £62.1m) was included in Gross benefits and claims paid in the Statement of Comprehensive Income.

ii) Non participating insurance contracts

Interest rate	2012	2011
Non-profit temporary assurances (original LVFS)	**2.40%**	1.90%
Non-profit temporary assurances	**Yield Curve***	2.50%*
Whole of life assurances	**Yield Curve***	2.50%*
Permanent health insurance:		
a) active lives	**Yield Curve***	2.50%*
b) claims reserves	**Yield Curve***	2.50%*
Critical illness	**Yield Curve***	2.50%*
Other assurances	**Yield Curve***	2.50%*
Annuities in payment	**Yield Curve* + 1.2%**	4.00%

* Adjusted by a margin for risk and uncertainty which varies by product line.

Notes to the Financial Statements continued

31 December 2012

25. Long-term insurance and investment contract liabilities valuation assumptions (continued)

Mortality rate tables	**2012**	2011
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	**AMC00/AFC00**	AMC00/AFC00
Other assurances	**AM92/AF92**	AM92/AF92
Annuities in payment	**Males: 100% RGA 2011 tables with CMI_2009 1.25% LT Females: 100% RGA 2011 tables with CMI_2009 1% LT**	Males: 100% RGA 2011 tables with CMI_2009 1.25% LT Females: 100% RGA 2011 tables with CMI_2009 1% LT

Appropriate adjustments were made to the standard mortality tables to take account of actual experience and publicly available market data.

Morbidity rate tables	**2012**	2011
Permanent health insurance		
a) active lives	**CMIR12**	CMIR12
b) claims reserves	**CMIR12**	CMIR12
Critical illness	**Reinsurer rates**	Reinsurer rates

Appropriate adjustments were made to the standard morbidity tables to take account of actual experience and publicly available market data.

Per policy expenses – regular premiums	**2012**	2011
Non-profit temporary assurances	**£18.15**	£18.11
Whole of life assurances	**£14.71**	£16.06
Permanent health insurance:		
a) active lives	**£27.54**	£25.16
b) claims reserves (per policy in claim)	**£650.49**	£552.29
Critical illness	**£27.61**	£29.86
Other assurances	**£34.93**	£32.54
Annuities in payment	**£48.00**	£38.00

Other assumptions
Best estimate assumptions are set for inflation, mortality, expenses and persistency. The future expense inflation assumption is modelled as RPI (2011: RPI + 0.7%).

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 pensions is equal to the value of the assets to which the contracts are linked. There is one product included within the linked fund which is classified as an investment product and the liability is included within the long-term linked insurance contract liabilities.

The provision for property-linked liabilities is equal to the value of the assets to which the contracts are linked and is included within investment contract liabilities.

The provisions for index-linked permanent health insurance claims and index-linked temporary assurances have been calculated using the same mortality and morbidity assumptions as used for the corresponding non-linked liabilities for both 2012 and 2011.

Interest rate	**2012**	2011
Unit linked pensions (original LVFS)	**Gilt yield + risk premium + margin for risk and uncertainty**	1.90%

Mortality rate tables	**2012**	2011
Unit linked pensions (original LVFS)	**92% AX92C20**	80% AX92C20

b) Liverpool Victoria Life Company Limited - Ordinary Long Term Fund

i) Participating insurance contracts
Liverpool Victoria Life Company Limited has no participating business.

Notes to the Financial Statements continued

31 December 2012

25. Long-term insurance and investment contract liabilities valuation assumptions (continued)

ii) Non participating insurance contracts

Interest rate	2012	2011
Non-profit temporary assurances	**1.76%**	1.88%
Other assurances	**1.76%**	1.88%

Mortality rate tables	2012	2011
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	2012	2011
Non-profit temporary assurances	**£27.17**	£19.92
Other assurances	**£27.17**	£35.79

Options and guarantees

There are no significant options and guarantees in the non-participating business.

c) 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 business, 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 risk-free interest rates assumed are:

Year	2012	2011
5	**0.91%**	1.14%
15	**2.60%**	2.81%
25	**3.39%**	3.37%
35	**3.62%**	3.48%

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% (2011: RPI plus 0.7%), where RPI in both 2012 and 2011 is modelled stochastically.

Asset mix for assets backing asset shares at the valuation date:	2012	2011
Cash	**16.32%**	14.03%
Fixed interest	**57.59%**	57.86%
Equities	**23.47%**	25.40%
Property	**2.62%**	2.71%

Mortality rate tables	2012	2011
Conventional Life Business	**60% AM/F00 ult**	100% AM/F92 ult
Life Deferred Annuities	**50% AM/F00 ult**	100% AM/F92 ult
Pension Deferred Annuities	**50% AM/F00 ult**	100% AM/F92 ult
Unitised with-profits Business	**60% AM/F00 ult**	100% A67/70 ult

Per policy expenses – regular premiums	2012	2011
Conventional Life Business	**£34.84**	£32.53
Pensions Deferred Annuities	**£45.34**	£42.06
Life Deferred Annuities	**£34.84**	£32.51
Unitised with-profits ISA	**£49.30**	£43.06
Unitised with-profits Bond	**£41.18**	£38.14

Notes to the Financial Statements continued

31 December 2012

25. Long-term insurance and investment contract liabilities valuation assumptions (continued)

Persistency - lapses, surrenders and paid up rates

A review of persistency is carried out annually. Assumptions are adjusted where necessary to reflect more recent experience as evidenced in the persistency trend analysis or to reflect expected future trends as a result of anticipated future events.

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 £92.3m (2011: £86.6m).

Bonuses

The cost of bonuses incurred during the year ended 31 December 2012 was £15.9m (2011: £21.0m) of which £0.7m (2011: £0.8m) was included in the long-term insurance contract liabilities and £15.2m (2011: £20.2m) was included in gross benefits and claims paid in the Statement of Comprehensive Income.

ii) Non participating business

Interest rate	2012	2011
Non-profits assurances	**1.68%**	1.44%
Non-profits general deferred annuities	**1.68%**	1.44%
Annuities in Payment (post 31/12/91)	**1.68%**	1.44%
Annuities in Payment (other)	**2.10%**	1.80%
Pension Deferred Annuities	**2.10%**	1.80%

Mortality rate tables	2012	2011
Non-profits assurances	**72.0% AM/F00 ult**	115% AM/F92 ult
Non-profits general deferred annuities	**42.5% AM/F00 ult**	85% AM/F92 ult
Annuities in Payment (Male)	**61.2% as 2011 basis up to 2007, then CMI_2009, with a long-term improvement rate of 2.0%**	61.2% IML00 with improvements of 120% medium cohort over 2000 to 2004 and future improvements 120% medium cohort subject to a floor of 1.5%
Annuities in Payment (Female)	**72.3% as 2011 basis up to 2007, then CMI_2009, with a long-term improvement rate of 1.5%**	72.3% IFL00 with improvements of greater of 90% of medium cohort and CMIR17 over 2000 to 2004 and future improvements of greater of 90% medium cohort and CMIR17 subject to a floor of 1.5%
Pension Deferred Annuities	**42.5% AM/F00 ult**	85% AM/F92 ult

Appropriate adjustments were made to the standard mortality tables to take account of actual experience and publicly available market data.

The provision for linked and unitised with-profits 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.

Options and guarantees

There are no significant options or guarantees in the non participating business.

iii) Linked fund

The provision for unit linked assurances is equal to the value of the assets to which the contracts are linked. There are two products included within the linked fund, one is classified as an insurance product and the liability is included within the life and pension unit linked insurance contract liabilities, the other is classified as an investment product and the liability is included within the investment contract liabilities.

Interest rate	2012	2011
Unit linked assurances	**1.68%**	1.44%

Mortality rate tables	2012	2011
Unit linked assurances	**72% AM/F00 ult**	115% AM/F92 ult

Notes to the Financial Statements continued
31 December 2012

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. Intangible assets

Accounting for goodwill and other intangible assets
Goodwill
Goodwill represents the excess of the cost of an acquisition over the fair value of the Group's share of the net identifiable assets of the acquired subsidiary/associate 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 cost) of the relevant cash generating unit and carried in the Statement of Financial Position at cost less accumulated impairment losses. Gains and losses on the disposal of an entity include the carrying amount of goodwill relating to the entity sold.

Goodwill arising on acquisitions prior to 1998 has been eliminated against the Unallocated divisible surplus. This goodwill would be recognised in the Statement of Comprehensive Income should there be a subsequent disposal of the business to which it relates.

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 present 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, and is assessed annually for impairment.

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.

Present value of acquired in-force business (PVIF)
On acquisition of a portfolio of long-term insurance contracts, the net present value of the Group's interest in the expected cash flows of the in-force business is capitalised in the Statement of Financial Position as an asset and is amortised, in line with the original expected run-off of 20 years, based on the anticipated lives of the related contracts.

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.

Any amortisation or impairment charge is recorded in the Statement of Comprehensive Income within other operating and administrative expenses.

Significant accounting estimates and judgements

The Group determines whether goodwill and other intangible assets are 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.

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.

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
31 December 2012

26. Intangible assets (continued)

Group	Goodwill £m	Other intangible assets £m	PVIF £m	Total £m
Cost:				
At 1 January 2012	236.0	95.1	63.4	394.5
Additions	-	-	-	-
Disposals	-	-	-	-
Increase in buy out value (see Note 40)	2.4	-	-	2.4
At 31 December 2012	**238.4**	**95.1**	**63.4**	**396.9**
Accumulated amortisation:				
At 1 January 2012	20.6	68.3	44.1	133.0
Charge for the year	-	8.1	3.9	12.0
Disposals	-	-	-	-
Impairment in year	-	-	-	-
At 31 December 2012	**20.6**	**76.4**	**48.0**	**145.0**
Net book value at 31 December 2012	**217.8**	**18.7**	**15.4**	**251.9**
Cost:				
At 1 January 2011	230.7	95.1	63.4	389.2
Increase in buy out value	5.3	-	-	5.3
At 31 December 2011	236.0	95.1	63.4	394.5
Accumulated amortisation:				
At 1 January 2011	20.6	59.8	39.6	120.0
Charge for the year	-	8.5	4.5	13.0
At 31 December 2011	20.6	68.3	44.1	133.0
Net book value at 31 December 2011	215.4	26.8	19.3	261.5

Present Value of acquired In-Force business (PVIF) is amortised in line with the original expected run off of 20 years, ending in 2018, based on the market value of the life policies.

Other intangible assets comprise the value of the future benefit derived from the customer bases of RNPFN (in the Society), Britannia Road Rescue and Highway, and the value of the Tomorrow/Retirement Solutions distribution channel.

Amortisation of £12.0m (2011: £13.0m) is presented within Other operating and administrative expenses in the Statement of Comprehensive Income. There is no impairment in 2012 (2011: £nil).

Goodwill has been allocated to the individual cash generating units which are based on the key segments of the Group as follows:

	Group	
	2012 £m	2011 £m
Long-term insurance business	**66.7**	66.7
General insurance business	**171.7**	169.3
	238.4	236.0

Notes to the financial statements continued

31 December 2012

26. Intangible assets (continued)

Society	Other intangible assets £m
Cost:	
At 1 January 2012	50.9
At 31 December 2012	**50.9**
Accumulated amortisation:	
At 1 January 2012	46.3
Charge for the year	4.6
At 31 December 2012	**50.9**
Net book value at 31 December 2012	**-**
Cost:	
At 1 January 2011	50.9
At 31 December 2011	50.9
Accumulated amortisation:	
At 1 January 2011	41.6
Charge for the year	4.7
At 31 December 2011	46.3
Net book value at 31 December 2011	4.6

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.

Long-term insurance business

The recoverable amount of the long-term insurance business has been determined using cash flow predictions based on financial plans approved by management covering a five-year period, with a terminal growth rate of 2% applied thereafter. The forecast cash flows have been discounted at a pre-tax rate of 10%. Based on the above assumptions, the recoverable amount exceeded the carrying amount including goodwill by £156.8m.
A two percentage point increase in the discount rate would reduce the recoverable amount by £52.3m; the discount rate would need to be increased to 23% to reduce the recoverable amount to zero.
A reduction in the forecast cash flows of 10% per annum would reduce the recoverable amount by £55.7m; the forecast cash flows would need to be reduced by 25% per annum to reduce the recoverable amount to zero.

General insurance business

The recoverable amount of the general insurance business has been determined using cash flow predictions based on financial plans approved by management covering a five-year period, with a terminal growth rate of 2% applied thereafter. The forecast cash flows have been discounted at a pre-tax rate of 10%. Based on the above assumptions, the recoverable amount exceeded the carrying amount including goodwill by £755.1m.
A two percentage point increase in the discount rate would reduce the recoverable amount by £285.9m; the discount rate would need to be increased to 20% to reduce the recoverable amount to zero.
A reduction in the forecast cash flows of 10% per annum would reduce the recoverable amount by £151.4m; the forecast cash flows would need to be reduced by 50% per annum to reduce the recoverable amount to zero.

Notes to the financial statements continued

31 December 2012

27. Property and equipment

Accounting for property and equipment

Operational property and equipment are held at cost less accumulated depreciation. Cost includes the original purchase price of the asset and the costs attributable to bringing the asset to its working condition for its intended use. Both property and equipment are depreciated on a straight line basis over their estimated useful lives. The periods used are as follows:

Freehold buildings and finance lease property*	50 years
Leasehold property enhancements*	10 years or lease term if shorter
Fixtures, fittings and motor vehicles	3 to 10 years
IT systems (spend over £1m)	3 years

Provision is made for any impairment in property and equipment.

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each Statement of Financial Position date.

Assets under construction represent the cost of assets under development. These assets are not depreciated, the total cost is transferred to the appropriate asset class on completion and then depreciated over their estimated useful lives.

*These are properties used by the Group for operational purposes and are not investment properties which are dealt with in Note 28.

Group	Freehold and leasehold property £m	Leasehold property enhancements £m	Fixtures, fittings and motor vehicles £m	IT systems £m	Assets under construction £m	Total £m
Cost:						
At 1 January 2012	41.1	9.1	7.9	2.1	-	60.2
Additions	0.2	3.5	2.3	1.0	-	7.0
Disposals	-	(0.5)	(0.1)	-	-	(0.6)
At 31 December 2012	**41.3**	**12.1**	**10.1**	**3.1**	**-**	**66.6**
Accumulated depreciation:						
At 1 January 2012	32.1	3.6	3.7	0.2	-	39.6
Provided in the year	1.0	1.0	0.7	0.7	-	3.4
Disposals	-	(0.2)	(0.1)	-	-	(0.3)
At 31 December 2012	**33.1**	**4.4**	**4.3**	**0.9**	**-**	**42.7**
Net book value at 31 December 2012	**8.2**	**7.7**	**5.8**	**2.2**	**-**	**23.9**
Cost:						
At 1 January 2011	41.1	7.9	7.4	-	0.9	57.3
Additions	-	1.2	0.7	1.2	-	3.1
Disposals	-	-	(0.2)	-	-	(0.2)
Transfers	-	-	-	0.9	(0.9)	-
At 31 December 2011	41.1	9.1	7.9	2.1	-	60.2
Accumulated depreciation:						
At 1 January 2011	31.1	2.8	3.3	-	-	37.2
Provided in the year	1.0	0.8	0.6	0.2	-	2.6
Disposals	-	-	(0.2)	-	-	(0.2)
At 31 December 2011	32.1	3.6	3.7	0.2	-	39.6
Net book value at 31 December 2011	9.0	5.5	4.2	1.9	-	20.6

Included within the Freehold and leasehold property category are assets held under finance leases with a net book value of £5.2m (2011: £5.7m).

During 2011 £0.9m of assets were transferred from Assets under construction to IT systems representing the development cost of the claims centre computer system that became operational in 2011.

Notes to the financial statements continued

31 December 2012

27. Property and equipment (continued)

Society	Leasehold property enhancements £m	Fixtures, fittings and motor vehicles £m	Total £m
Cost:			
At 1 January 2012	4.7	6.0	10.7
Additions	1.6	1.5	3.1
Disposals	(0.5)	(0.1)	(0.6)
At 31 December 2012	**5.8**	**7.4**	**13.2**
Accumulated depreciation:			
At 1 January 2012	2.3	3.4	5.7
Provided in the year	0.4	0.4	0.8
Disposals	(0.2)	-	(0.2)
At 31 December 2012	**2.5**	**3.8**	**6.3**
Net book value at 31 December 2012	**3.3**	**3.6**	**6.9**
Cost:			
At 1 January 2011	4.5	6.0	10.5
Additions	0.2	0.2	0.4
Disposals	-	(0.2)	(0.2)
At 31 December 2011	4.7	6.0	10.7
Accumulated depreciation:			
At 1 January 2011	1.9	3.1	5.0
Provided in the year	0.4	0.4	0.8
Disposals	-	(0.1)	(0.1)
At 31 December 2011	2.3	3.4	5.7
Net book value at 31 December 2011	2.4	2.6	5.0

Notes to the financial statements continued
31 December 2012

28. Investment properties

Accounting for investment properties
Investment properties are freehold and leasehold land and buildings held for long-term rental yields and capital growth. They are held at fair value and changes in fair value are recorded as fair value gains or losses in the Statement of Comprehensive Income. Fair value is determined annually by independent professional valuers based on market conditions.

	Group		Society	
	2012 £m	2011 £m	**2012 £m**	2011 £m
Freeholds	**129.1**	183.8	**96.1**	115.3
Long leaseholds	**35.6**	36.1	**35.6**	36.1
	164.7	219.9	**131.7**	151.4

All investment properties held by the Group and the Society are occupied by third party tenants. All properties occupied by Group undertakings are shown separately within Note 27.

The market value movements in the year on land and buildings were:

	Group		Society	
	2012 £m	2011 £m	**2012 £m**	2011 £m
Balance at 1 January	**219.9**	315.4	**151.4**	246.6
Additions	**0.2**	12.5	**0.2**	2.9
Disposals	**(49.1)**	(89.2)	**(16.4)**	(89.2)
Net fair value adjustment	**(6.3)**	(18.8)	**(3.5)**	(8.9)
Balance at 31 December	**164.7**	219.9	**131.7**	151.4
Due within one year	**47.5**	-	**14.5**	-
Over one year	**117.2**	219.9	**117.2**	151.4
	164.7	219.9	**131.7**	151.4

Investment properties due within one year represent £33m of properties held within the Threadneedle UK Property Fund II ICVC that is in the process of being wound up (refer Note 45) and an additional property held directly by the Society that is in the process of being sold.

All investment properties are valued annually at fair value. They were valued as at 31 December 2012 by qualified professional valuers working for Colliers International (UK) Plc who are professional, third party, independent Chartered Surveyors. All valuations were carried out in accordance with the RICS Appraisal and Valuation Standards.

The Group and Society enter into operating leases for all investment properties. All rents are payable in advance and the rental income arising during the year amounted to £8.1m (2011: £8.9m) for the Group and the Society, which is included in investment income.

Non recoverable expenses are deducted from rental income for investment properties and amounted to £2.0m (2011: £1.8m) for the Group and the Society.

Notes to the financial statements continued

31 December 2012

29. Investments in group undertakings

Accounting for investments in group undertakings

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.

Society	2012 £m	2011 £m
Shares in subsidiaries		
Cost less provisions at 1 January	**723.2**	748.3
Additions	**399.6**	4.0
Sale of LVGIG Group to subsidiary undertaking	**(484.6)**	-
Increase / (reduction) in buy out provision (refer to Note 40)	**2.4**	5.3
Impairment write-off	**(90.0)**	(34.4)
	550.6	723.2
Loan stock in subsidiaries		
Cost at 1 January	**234.4**	223.2
Additions	**300.3**	11.2
Redemption	**(183.0)**	-
	351.7	234.4
Shares and loan stock in subsidiaries at 31 December	**902.3**	957.6

During the year the Society sold its investment in Liverpool Victoria General Insurance Group Limited (LVGIG) to LV Capital PLC, a subsidiary undertaking at cost. In addition the Society invested in £300m of loan notes issued by LV Capital PLC.

The Society made capital contributions during 2012 of £nil to Liverpool Victoria General Insurance Group Limited (2011: £4m), these are disclosed within additions in the table above.

The Society has examined the carrying value of its subsidiaries and concluded that a provision for impairment of £90m was necessary in regard to its investment in Liverpool Victoria Life Company Limited (2011: £28.1m), this impairment arose due to the payment of dividends to the Society thereby reducing the value of the company.

Further details of the Group's loan stock are given in Note 47 and the Group's investments in Notes 43 and 44.

Notes to the financial statements continued

31 December 2012

Other assets and liabilities

This section describes the other assets and liabilities arising from the life insurance business within the Society and the life insurance and general insurance businesses within the Group.

30. Insurance receivables

	Group		Society	
	2012 £m	2011 £m	**2012 £m**	2011 £m
Due from policyholders	**148.1**	135.1	**1.0**	3.8
Due from agents, brokers and intermediaries	**67.5**	74.8	**-**	-
Due from reinsurers	**11.7**	6.6	**11.6**	6.4
	227.3	216.5	**12.6**	10.2

Insurance receivables are all due within one year for both the Group and the Society.
The carrying amounts disclosed above reasonably approximate fair value at the Statement of Financial Position date.

31. Prepayments and accrued income

	Group		Society	
	2012 £m	2011 £m	**2012 £m**	2011 £m
Accrued dividends	**4.0**	3.5	**1.5**	1.1
Accrued interest	**82.3**	45.2	**52.7**	38.6
Other prepayments and accrued income	**20.3**	12.6	**10.1**	8.4
	106.6	61.3	**64.3**	48.1

Prepayment and accrued income balances are all due within one year for both the Group and the Society.

32. Insurance payables

	Group		Society	
	2012 £m	2011 £m	**2012 £m**	2011 £m
Due to policyholders	**33.2**	30.1	**25.5**	30.1
Due to brokers and intermediaries	**0.4**	0.8	**0.4**	0.8
Due to reinsurers	**11.1**	10.7	**0.3**	0.7
	44.7	41.6	**26.2**	31.6

The carrying amounts disclosed above reasonably approximate fair value at the Statement of Financial Position date.

33. Trade and other payables

Accounting for trade and other payables
Trade and other payables are recognised as they fall due. They are measured initially at fair value and subsequently at amortised cost.

	Group		Society	
	2012 £m	2011 £m	**2012 £m**	2011 £m
Trade payables	**15.8**	11.2	**15.4**	10.5
Amounts owed to group undertakings	**-**	-	**37.1**	37.7
Other taxes and social security costs	**31.3**	32.2	**9.4**	10.1
Other creditors	**49.8**	59.5	**15.8**	21.7
Deferred rental income	**3.3**	3.3	**2.6**	2.2
Finance lease liabilities	**5.0**	5.1	**-**	-
Accruals and deferred income	**88.5**	94.3	**55.9**	65.2
	193.7	205.6	**136.2**	147.4

The carrying amounts disclosed above reasonably approximate fair value at the Statement of Financial Position date.

Notes to the financial statements continued
31 December 2012

Taxation
This section presents information relating to tax charge and movements in the corporation and deferred tax assets and liabilities held by the Society and Group.

34. Income tax expense

- 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.

a) Current year tax charge

	Group		Society	
	2012 £m	2011 £m	**2012 £m**	2011 £m
Current tax charge:				
Current year	**20.0**	39.3	**8.5**	23.9
Adjustment in respect of prior years	**(2.5)**	5.4	**0.2**	6.6
Total current tax	**17.5**	44.7	**8.7**	30.5
Deferred tax				
Excess of depreciation	**0.2**	1.0	**(0.3)**	-
Adjustment in respect of prior years	**-**	(10.5)	**-**	(6.9)
Temporary differences	**12.8**	(7.5)	**5.0**	3.3
Tax losses	**3.8**	14.5	**-**	-
Total deferred tax	**16.8**	(2.5)	**4.7**	(3.6)
Total income tax expense	**34.3**	42.2	**13.4**	26.9

b) Reconciliation of tax charge

	Group		Society	
	2012 £m	2011 £m	**2012 £m**	2011 £m
Profit/(loss) before tax	**103.2**	(16.9)	**3.3**	(47.7)
Tax calculated at the average standard rate of corporation tax in the UK at 24.5% (2011: 26.5%)	**25.3**	(4.5)	**0.8**	(12.7)
Income and expenses not subject to tax	**(1.8)**	13.2	**(2.7)**	1.7
Impact of change in UK corporation tax rate on deferred tax	**0.5**	0.7	**-**	-
Unprovided deferred tax asset	**(11.1)**	22.1	**(11.1)**	22.1
Transfer pricing	**-**	-	**2.5**	-
Policyholder tax	**23.9**	15.8	**23.7**	16.1
Adjustment to current tax charge in respect of prior years	**(2.5)**	5.4	**0.2**	6.6
Adjustment to deferred tax charge in respect of prior years	**-**	(10.5)	**-**	(6.9)
Total charge	**34.3**	42.2	**13.4**	26.9

The standard rate of Corporation Tax in the UK changed from 26% to 24% with effect from 1 April 2012. Accordingly, the profits for this accounting period are taxed, where applicable, at an effective rate of 24.5%.

35. Corporation tax asset

	Group		Society	
	2012 £m	2011 £m	**2012 £m**	2011 £m
Corporation tax receivable	**-**	-	**2.0**	-
	-	-	**2.0**	-

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31 December 2012

36. Deferred tax asset

	Group	Society
	£m	£m
Balance at 1 January 2012	31.0	17.7
Amounts recorded in the Statement of Comprehensive Income	(16.8)	(4.7)
Balance at 31 December 2012	**14.2**	**13.0**

	Group		Society	
i) Analysis of deferred taxation temporary differences	**2012 £m**	2011 £m	**2012 £m**	2011 £m
Excess of depreciation	**3.0**	3.0	**0.8**	0.5
Temporary differences on expenses	**11.4**	18.5	**12.2**	19.2
Temporary differences arising on consolidation	**(1.6)**	(2.3)	**-**	-
Temporary differences on unrealised gains	**1.4**	8.0	**-**	(2.0)
Tax losses	**-**	3.8	**-**	-
Deferred tax asset	**14.2**	31.0	**13.0**	17.7

	Group		Society	
	2012	2011	**2012**	2011
ii) Deferred taxation asset not recognised	**£m**	£m	**£m**	£m
Temporary differences on expenses	**22.3**	9.6	**22.3**	9.6
Temporary differences on unrealised gains	**(14.9)**	(4.8)	**(14.9)**	(4.8)
Temporary difference for changes in actuarial base	**0.8**	(5.9)	**0.8**	(5.9)
Tax losses unrecognised	**19.2**	33.6	**13.9**	27.6
	27.4	32.5	**22.1**	26.5

The value of deferred tax assets expected to be recovered after more than 12 months is £7.6m in the Group (2011: £9.8m) and £7.7m in the Society (2011: £12.4m).

Deferred tax balances have been measured taking into account the change in the rate of UK Corporation Tax from 24% to 23%. This change was substantively enacted on 3 July 2012 and will be effective from 1 April 2013.

In addition to the changes in rates of Corporation Tax disclosed above, a number of further changes to the UK Corporation Tax system were announced in the 2013 draft Finance Bill and the March 2013 Budget Statement. Further reductions to the main rate are proposed to reduce the rate to 21% by 1 April 2014 and then to 20% by 1 April 2015. These further changes had not been substantively enacted at the balance sheet date and, therefore, are not included in these financial statements. Furthermore, the Finance Act 2012 introduced changes to the taxation of UK life companies, which will take effect from 1 January 2013. These changes have been taken into account in calculating the deferred tax position of the Society as at 31 December 2012. The impact of these changes has been to reduce the value of deferred tax assets by £5.1m when compared to the value of these assets had the changes not taken place.

The valuation and recoverability of deferred tax assets relating to capital allowances in excess of depreciation, differences on expenses and gains and tax losses, is dependent on the availability of future taxable profits within the Society and Group. Management forecasts currently support the future recoverability of the deferred tax asset recognised in the balance sheet as at 31 December 2012.

37. Corporation tax liability

	Group		Society	
	2012 £m	2011 £m	**2012 £m**	2011 £m
Corporation tax	**7.6**	28.4	**-**	13.0
	7.6	28.4	**-**	13.0

Notes to the financial statements continued
31 December 2012

Employee benefits
This section details the costs and commitments associated with employing our staff.

38. Employee benefits expense

Accounting for staff costs under IAS19
The Society and Group applies IAS 19 Employee benefits in its 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.

Post retirement benefits
The accounting policies and significant accounting judgements relating to pension benefits are disclosed within Note 39.

	Group		Society	
	2012 £m	2011 £m	**2012 £m**	2011 £m
Wages and salaries	**181.9**	172.7	**181.9**	172.7
Social security costs	**17.2**	16.1	**17.2**	16.1
Defined benefit and defined contribution pension costs	**17.3**	20.9	**17.3**	20.9
	216.4	209.7	**216.4**	209.7

The number of employees during the year, including executive directors, calculated on a monthly average basis, was as follows:

	Group		Society	
	2012 Number	2011 Number	**2012 Number**	2011 Number
Member and customer contact	**3,782**	3,269	**3,782**	3,269
Administration	**1,670**	1,513	**1,670**	1,513
	5,452	4,782	**5,452**	4,782

Notes to the financial statements continued

31 December 2012

39. Pension benefit asset / (obligation)

Accounting for pension benefits under IAS19

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.

The pension cost for the schemes is analysed between current service cost, past service cost and net return on pension scheme assets. 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 actuarial gains and losses 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 are recognised in the Statement of Comprehensive Income after profit/(loss) before tax and are disclosed net of tax.

Contributions to defined contribution schemes are recognised as employee benefit expenses when they are due.

Significant accounting estimates and judgements

The valuations of the pension benefit obligations for the two defined benefit schemes are determined using actuarial valuations. These involve making assumptions about discount rates, expected future returns on assets, 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 defined benefit schemes are disclosed within the valuations of the individual schemes disclosed in sections (ii) and (iii) below.

i) Summary

Pension benefit asset/(obligation)

	2012			2011		
	LV Scheme £m	Ockham £m	Total £m	LV Scheme £m	Ockham £m	Total £m
Asset	-	-	-	108.1	-	108.1
Obligation	(7.7)	(2.5)	(10.2)	-	(1.2)	(1.2)
	(7.7)	(2.5)	(10.2)	108.1	(1.2)	106.9

Actuarial net (loss)/gain

	2012			2011		
	LV Scheme £m	Ockham £m	Total £m	LV Scheme £m	Ockham £m	Total £m
Actuarial net (loss) / gain	(138.0)	(7.5)	(145.5)	66.5	3.9	70.4
Income tax credit/(expense)	-	-	-	-	(0.7)	(0.7)
Amount charged to total comprehensive income	(138.0)	(7.5)	(145.5)	66.5	3.2	69.7
Cumulative actuarial gain/(loss) recognised in the Statement of Comprehensive Income	44.0	(0.7)	43.3	182.0	6.8	188.8

Notes to the financial statements continued

31 December 2012

39. Pension benefit asset/(obligation) (continued)

ii) LV Scheme

a) Information about the scheme

The Society is responsible for the LV= Employee Pension Scheme (LV Scheme), a defined benefit pension scheme. The scheme closed to new entrants on 31 December 2009 and on 1 November 2012 it was announced that the scheme would close to future accrual for existing members from July 2013. Accordingly allowance has been made for the closure to future accrual within the 31 December 2012 figures with a curtailment gain being recognised as a remeasurement event at the year end reporting date.

On 6 December 2012 the Trustees of the LV Scheme entered into a Longevity Swap to mitigate the future mortality risk. Further details on this are included within the Business Review section.

From 1 January 2011 the rate of increase in deferred pensions changed from being related to RPI to CPI. The impact of this was a reduction in the calculation of the liabilities.

b) Net Statement of Financial Position

	2012 £m	2011 £m
Present value of defined benefit obligation	**(1,059.0)**	(942.0)
Fair value of plan assets	**1,051.3**	1,050.1
Pension benefit (obligation)/asset at the end of the year	**(7.7)**	108.1

The movement in the defined benefit obligation over the year is as follows:	2012 £m	2011 £m
Beginning of year	**942.0**	854.4
Current service cost	**22.0**	19.1
Interest cost	**44.4**	46.2
Gain on curtailment	**(13.0)**	-
Actuarial losses	**104.3**	64.4
Benefits paid	**(37.1)**	(39.2)
Past service cost	**0.1**	0.5
Administrative expenses paid	**(3.7)**	(3.4)
End of year	**1,059.0**	942.0

The movement in the fair value of plan assets over the year is as follows:	2012 £m	2011 £m
Beginning of year	**1,050.1**	870.3
Expected return on plan assets	**42.9**	47.9
Actuarial (losses)/gains	**(33.7)**	130.9
Employer contributions	**32.8**	43.6
Benefits paid	**(37.1)**	(39.2)
Administrative expenses paid	**(3.7)**	(3.4)
End of year	**1,051.3**	1,050.1

Notes to the financial statements continued

31 December 2012

39. Pension benefit asset/(obligation) (continued)

ii) LV Scheme (continued)

c) Amounts recognised in the Statement of Comprehensive Income	2012 £m	2011 £m
Current service cost	**22.0**	19.1
Interest cost	**44.4**	46.2
Expected return on assets	**(42.9)**	(47.9)
Curtailment gain	**(13.0)**	-
Past service cost	**0.1**	0.5
Amount charged to income	**10.6**	17.9
Actuarial net loss/(gain)	**138.0**	(66.5)
Total amount charged/(credited) to comprehensive income	**148.6**	(48.6)

The actual return on plan assets was £9.2m (2011: £178.8m).

d) Principal assumptions used	2012	2011
Discount rate	**4.1%**	4.7%
Rate of salary increase	**3.0%**	3.65%
Expected return on plan assets	**n/a**	4.1%
RPI Inflation	**3.0%**	2.9%
CPI Inflation	**2.0%**	2.0%
Pension increases for in-payment benefits		
- RPI price inflation capped at 5% pa, floor of 3% pa	**3.5%**	3.5%
- RPI price inflation capped at 5% pa	**3.0%**	2.9%
- RPI price inflation capped at 2.5% pa	**2.2%**	2.1%
- CPI price inflation capped at 3.0% pa	**1.9%**	1.9%
Pension increases for deferred benefits		
- pre 6 April 2009 accrual	**2.0%**	2.0%
- post 6 April 2009 accrual	**2.0%**	2.0%
Scheme member valuation date	**31 March 2012**	31 March 2009

Mortality for members is assumed to follow the tables below as at 31 December 2012

	2012	2011
Pre-retirement mortality: Deferred pensioners		
- Males	1NMA x 0.95 table	1NMA x 0.95 table
- Females	1NFA x 0.98 table	1NFA x 0.98 table
Post-retirement mortality: Non-pensioners		
- Males	LV specific tables from Club Vita	1NMA x 0.95 table
- Females (former employees)	LV specific tables from Club Vita	1NFA x 0.98 table
- Females (dependants)	LV specific tables from Club Vita	1NFA x 1.12 table
Post-retirement mortality: current pensioners and dependants		
- Males	LV specific tables from Club Vita	1NMA x 0.85 table
- Females (former employees)	LV specific tables from Club Vita	1NFA x 0.88 table
- Females (dependants)	LV specific tables from Club Vita	1 NFA x 1.02 table

In all cases as at 31 December 2012 CMI Core 2011 projections with a long term trend of 1.25% have been applied (31 December 2011 medium cohort improvements have been applied from 2002 onwards and from 2009 a minimum annual rate of improvement of 1.25%pa has been applied).

Notes to the financial statements continued
31 December 2012

39. Pension benefit asset/(obligation) (continued)

ii) LV Scheme (continued)

e) Sensitivity analysis: Impact on defined benefit obligation of making changes to key assumptions

	Change in assumption	Impact on defined benefit obligation
Discount rate	Increase by 0.25%	Decrease by £48.0m (4.6%)
Inflation rate	Increase by 0.25%	Increase by £30.5m (2.9%)
Cash commutation	Nil	Increase by £16.1m (1.5%)
Mortality improvements long term rate	Increase by 0.25%	Increase by £14.0m (1.3%)

f) Plan asset information
Plan assets are comprised as follows:

	Allocation percentage 2012	Allocation percentage 2011
Equities	**14.5%**	11.3%
Debt securities	**73.4%**	69.0%
Real estate/property	**8.6%**	8.9%
Other	**3.5%**	10.8%
Total	**100.0%**	100.0%

Expected contributions to the scheme for the year ending 31 December 2013 are £20m.

g) Historical disclosure information	2012 £m	2011 £m	2010 £m	2009 £m	2008 £m
Asset experience					
Asset (gains)/losses during year	**33.7**	(130.9)	(63.9)	(30.4)	107.6
Liability experience					
Obligation (gains)/losses during year	**17.2**	3.2	(14.6)	(15.5)	-
Funded status					
Defined benefit obligation	**(1,059.0)**	(942.0)	(854.4)	(813.9)	(667.1)
Fair value of assets	**1,051.3**	1,050.1	870.3	729.7	671.7
Net asset/(obligation)	**(7.7)**	108.1	15.9	(84.2)	4.6

h) Defined contribution pension schemes
New employees are eligible to join the defined contribution scheme. 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 amounted to £5.8m (2011: £4.2m).

Notes to the financial statements continued

31 December 2012

39. Pension benefit asset/(obligation) (continued)

iii) Ockham Pension Scheme

a) Information about the scheme

The Society is responsible for the Ockham Pension Scheme, a defined benefit scheme that is closed to new entrants.

b) Net Statement of Financial Position	2012 £m	2011 £m
Present value of defined benefit obligation	(117.5)	(107.0)
Fair value of plan assets	115.0	105.8
Pension benefit obligation at the end of the year	(2.5)	(1.2)

The movement in the defined benefit obligation over the year is as follows:	2012 £m	2011 £m
Beginning of year	107.0	97.6
Interest cost	4.9	5.2
Actuarial losses	9.6	4.8
Benefits paid	(4.0)	(3.7)
Past service cost	-	3.1
End of year	117.5	107.0

The movement in the fair value of plan assets over the year is as follows:	2012 £m	2011 £m
Beginning of year	105.8	88.8
Expected return on plan assets	4.0	5.0
Actuarial gains	2.1	8.7
Employer contributions	7.1	7.0
Benefits paid	(4.0)	(3.7)
End of year	115.0	105.8

c) Amounts recognised in the Statement of Comprehensive Income	2012 £m	2011 £m
Interest cost	4.9	5.2
Expected return on assets	(4.0)	(5.0)
Past service cost	-	3.1
Amount charged to income	0.9	3.3
Actuarial net loss/(gain)	7.5	(3.9)
Total amount charged/(credited) to comprehensive income	8.4	(0.6)

The actual return on plan assets was £6.1m (2011: £13.7m).

Notes to the financial statements continued

31 December 2012

39. Pension benefit asset/(obligation) (continued)

iii) Ockham Pension Scheme (continued)

d) Principal assumptions used	2012	2011
Discount rate	**4.1%**	4.7%
Rate of salary increase	**3.00%**	3.65%
Expected return on plan assets	**n/a**	3.7%
Pension increases		
– linked to inflation	**3.0%**	2.9%
– fixed rate	**5.0%**	5.0%
Price inflation		
– RPI	**3.0%**	2.9%
– CPI	**2.0%**	2.0%

Mortality rate assumptions are based on the same mortality tables as disclosed within the LV Scheme.

e) Sensitivity analysis: Impact on defined benefit obligation of making changes to key assumptions

	Change in assumption	Impact on defined benefit obligation
Discount rate	Increase by 0.25%	Decrease by £4.8m (4.1%)
Inflation rate	Increase by 0.25%	Increase by £3.3m (2.8%)
Cash commutation	Nil	Increase by £3.7m (3.2%)
Mortality improvements long term rate	Increase by 0.25%	Increase by £1.6m (1.4%)

f) Plan asset information

Plan assets are comprised as follows:

	Allocation percentage 2012	Allocation percentage 2011
Equities	**41.2%**	8.3%
Debt securities	**29.0%**	63.9%
Derivative swaps	**14.9%**	16.8%
Cash	**3.6%**	4.1%
Property	**0.8%**	0.7%
Other	**10.5%**	6.2%
Total	**100.0%**	100.0%

Expected contributions to the scheme for the year ending 31 December 2013 are £7m.

g) Historical disclosure information	2012 £m	2011 £m	2010 £m	2009 £m
Asset experience				
Asset gains during year	**(2.1)**	(8.7)	(6.5)	(6.2)
Liability experience				
Obligation loss during year	**2.0**	-	1.1	3.7
Funded status				
Defined benefit obligation	**(117.5)**	(107.0)	(97.6)	(88.6)
Fair value of assets	**115.0**	105.8	88.8	75.2
Net obligation	**(2.5)**	(1.2)	(8.8)	(13.4)

Notes to the financial statements continued

31 December 2012

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.

40. Provisions

Accounting for provisions

Provisions are recognised when the Group has a present legal or constructive obligation as a result of past events, it is more likely than not that an outflow of resources will be required to settle the obligation and the amount has been reliably estimated. Where the Group expects some or all of a provision to be reimbursed it is recognised as a separate asset when the reimbursement is certain.
Provisions are measured at the present value of the expenditure required to settle the obligation using a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the obligation.

The expense relating to provisions is presented in the Statement of Comprehensive Income.

Onerous contracts

A provision is made for onerous contracts in which the unavoidable costs of meeting the obligation exceed the expected future economic benefits.

Movement during the year on provisions

	Group				Society			
	Buy out payments £m	PPI provision £m	Other provisions £m	Total £m	Buy out payments £m	PPI provision £m	Other provisions £m	Total £m
Balance at 1 January 2012	38.6	6.6	10.3	55.5	38.6	6.6	6.8	52.0
Charge to the Statement of Comprehensive Income	-	15.0	3.3	18.3	-	15.0	3.0	18.0
Capitalised within goodwill	2.4	-	-	2.4	2.4	-	-	2.4
Utilised during the year	-	(8.2)	(2.0)	(10.2)	-	(8.2)	(1.1)	(9.3)
Balance at 31 December 2012	**41.0**	**13.4**	**11.6**	**66.0**	**41.0**	**13.4**	**8.7**	**63.1**

Other provisions relate to:

	Group		Society	
	2012 £m	2011 £m	2012 £m	2011 £m
Employer taxes	5.7	5.3	5.7	5.3
Onerous contracts on property leases	3.0	1.8	2.1	0.4
Compensation payable on customer complaints	2.0	1.9	-	-
Other	0.9	1.3	0.9	1.1
	11.6	10.3	8.7	6.8

The buy out payments provision relates to the acquisition in 2006 by the Society of 95% of LV Insurance Management Limited (then known as ABC Insurance Solutions Limited). The 2006 contract provides for the Society to purchase the remaining 5% of LV Insurance Management Limited from its vendors, who include John O'Roarke, for a price based on the market value of the general insurance business at 31 December 2012. The consideration under this contract is being determined but was provisioned on 31 December 2012 at £41m. Mr O'Roarke has a 22% interest in this liability.

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. Following a review of outstanding PPI claims carried out during the year LV= increased the provision by £15m to cover the costs of expected future redress and administration. At 31 December 2012, following payments made during the year of £8.2m, the provision was £13.4m. Given the assumptions made it is expected that up to £10m of payments will be set against this provision during 2013, with the remainder of the provision utilised within five years.
There are a large number of inter-dependent assumptions underpinning the PPI provision. When considering the key assumptions separately, the most significant driver of the provision is complaint flow. If the level of complaints were 10% higher (lower) than the estimated level for all policies, assuming no change in other assumptions, then the provision would have increased (decreased) by approximately £1.2m.

The Group will re-evaluate the assumptions underlying its analysis at each reporting date as more information becomes available.

Notes to the financial statements continued

31 December 2012

41. Contingent liabilities

Accounting for contingent liabilities

Contingent liabilities are disclosed if there is a possible future obligation as a result of a past event, or if there is a present obligation as a result of a past event but either a payment is not probable or the amount cannot be reasonably estimated.

The Society has granted a contingent loan facility to the RNPFN fund, a closed fund within the Group, up to a maximum of £100m, to be used in the event of a shortfall in the capital resources of that fund. No drawdown of this facility is anticipated. The Society has also granted a capital facility of £20m to the board of Liverpool Victoria General Insurance Group Limited to be used in the event of a shortfall in the capital solvency.

As part of the arrangements whereby the Society transferred responsibility for the management of its investment portfolio to Threadneedle Asset Management Ltd and Threadneedle Investment Services Ltd ("Threadneedle"), Liverpool Victoria Portfolio Managers Ltd ("LVPM") resigned, and Threadneedle was appointed, as the Authorised Corporate Director ("ACD") of the LV= Property OEIC. Simultaneous with the change in ACD, the Society provided an indemnity to Threadneedle for any losses incurred by Threadneedle as a result of any actual or suspected mis-pricing of the LV= Property OEIC by LVPM, including any costs of rectification or investor compensation. No claims have been made under this indemnity.

42. Commitments

Accounting for assets held under leases

Where assets are financed by leasing arrangements and the risks and rewards are substantially transferred to the Group, such finance leases are treated as if the assets had been purchased outright and the corresponding liability to the lessor is included as an obligation in trade and other payables. 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.

a) Capital commitments

	Group		Society	
	2012 £m	2011 £m	2012 £m	2011 £m
Authorised and contracted commitments payable after 31 December not provided for in respect of:				
– property investments	**0.7**	1.4	**0.7**	1.4
– other financial investments	**35.2**	49.5	**35.2**	49.5
– property and equipment	**-**	0.9	**-**	0.9
	35.9	51.8	**35.9**	51.8

Notes to the financial statements continued

31 December 2012

42. Commitments (continued)

b) Operating lease commitments

The Group leases various properties under non-cancellable operating lease agreements. The leases have varying terms, escalation clauses and renewal rights. The future aggregate minimum lease payments net of income under non-cancellable operating leases are as follows:

	Group		Society	
	2012 £m	2011 £m	**2012 £m**	2011 £m
Within one year	**6.7**	6.7	**4.8**	5.0
Between one and five years	**19.4**	19.6	**14.3**	13.8
Over five years	**3.3**	5.7	**2.1**	3.3
	29.4	32.0	**21.2**	22.1

The Group has entered into commercial subleases for some of its properties that are unoccupied. These leases have varying terms and escalation clauses. Where these subleases are insufficient to cover the Group's operating lease agreements an onerous contract provision for unused premises is set up. The future aggregate minimum sublease payments expected to be received under operating subleases is as follows:

	Group		Society	
	2012 £m	2011 £m	**2012 £m**	2011 £m
Within one year	**1.0**	0.4	**0.7**	0.1
Between one and five years	**2.6**	0.7	**2.3**	-
	3.6	1.1	**3.0**	0.1

c) Finance lease commitments

It is the Group's policy to lease certain of its properties under finance leases. The average lease term is 99 years. Interest rates are fixed at the contract rate. All leases are 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	
	2012 £m	**2011 £m**
Gross finance lease liabilities - minimum lease payments		
Within one year	**1.1**	1.1
Between one and five years	**4.8**	4.7
Over five years	**88.2**	89.4
	94.1	95.2
Future finance charges on finance leases	**(89.1)**	(90.1)
Present value of financial lease liabilities	**5.0**	5.1

	Group	
	2012 £m	**2011 £m**
The present value of finance lease liabilities is as follows:		
Within one year	**0.2**	0.2
Between one and five years	**0.7**	0.7
Over five years	**4.1**	4.2
	5.0	5.1

d) Other financial commitments

The Group has entered into several long-term contracts following service outsourcing. These contracts will end no later than 2018. An option to withdraw from some of these commitments in 2013 is available. The present value of the remaining commitment is estimated at £89.5m (2011: £89.1m) for the Group and the Society. These amounts have not been provided for in the financial statements.

Notes to the financial statements continued

31 December 2012

Scope of consolidation

This section presents information on the Group's investments in subsidiaries, joint ventures, associates and open ended investment companies (OEICs).

Detail is also given of the unallocated divisible surplus of the Society and Group.

43. Subsidiary undertakings

The principal subsidiary undertakings of the Society at 31 December 2012 are shown below.
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
Subsidiaries		
Frizzell Financial Services Limited	Property management	100.0%
Highway Insurance Company Limited *	General insurance	100.0%
Highway Insurance Group Ltd * (Note 1)	General insurance holding company	100.0%
Liverpool Victoria Financial Advice Services Limited (Note 1)	Financial advice services	100.0%
Liverpool Victoria General Insurance Group Limited *	General insurance holding company	100.0%
Liverpool Victoria Insurance Company Limited *	General insurance	100.0%
Liverpool Victoria Life Company Limited	Life insurance	100.0%
Liverpool Victoria Portfolio Managers Limited	Investment management	100.0%
LV Capital PLC	Holding company	100.0%
LV Equity Release Limited	Equity release lifetime mortgages	100.0%
LV Insurance Management Limited * (Note 1)	Management services	95.0%
LV Life Services Limited (Note 1)	Management services	100.0%
NM Pensions Trustees Limited (Note 1)	Self invested personal pension (SIPP) administrator	100.0%

* 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 2012. These subsidiary undertakings are exempt from the requirements of the Companies Act 2006 relating to the audit of individual accounts by virtue of Section 479 of the Companies Act 2006. The following other subsidiaries are also taking advantage of this exemption from the audit requirement: LV Protection Limited, Liverpool Victoria Asset Management Limited, Ayresbrook Limited, NLC Name No.2 Limited, NLC Name No.7 Limited and Liverpool Victoria Banking Services Limited.

All the principal subsidiaries have the same year end as the Society and all have been included in the consolidation.

44. Associates and joint ventures

The associates and joint ventures of the Society at 31 December 2012 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	*	31/03/2012	Investment property	50.0%

* The percentage held represents the share of the partnership capital and partner loans held by Liverpool Victoria Friendly Society as at 31 December 2012.

Notes to the financial statements continued

31 December 2012

45. Open ended investment companies

The Open ended investment companies (OEICs) of the Society and Group at 31 December 2012 are shown below.

All OEICs are incorporated and domiciled in England and Wales.

Name	Principal Activity	Year end	Percentage of Units Held*
Threadneedle Investment Funds II ICVC	Open Ended Investment Company	31/12/2012	96.21%
which consists of:			
Threadneedle European ex-UK Growth Fund			97.16%
Threadneedle Japan Growth Fund			100.00%
Threadneedle Pacific ex-Japan Growth Fund			100.00%
Threadneedle UK Equity Income Fund			92.31%
Threadneedle US Equity Income Fund			99.99%
Threadneedle UK Growth Fund			93.11%
Threadneedle Investment Funds III ICVC	Open Ended Investment Company	31/12/2012	72.03%
which consists of:			
Threadneedle UK Corporate Bond Fund			95.61%
Threadneedle UK Fixed Interest Fund			99.70%
Threadneedle UK Index Linked Fund			96.01%
Threadneedle UK Money Market Fund			99.52%
Threadneedle Balanced Managed Fund			96.11%
Threadneedle Medium Long Corporate Bond Fund			40.47%
Threadneedle Short-Dated Corporate Bond			88.74%
Threadneedle Worldwide Select Fund			69.58%
Threadneedle Investment Funds IV ICVC	Open Ended Investment Company	31/03/2012	83.34%
which consists of:			
Threadneedle Diversified Income Fund			40.10%
Threadneedle Managed Portfolio 3			79.28%
Threadneedle Managed Portfolio 4			84.51%
Threadneedle Managed Portfolio 5			85.43%
Threadneedle Managed Portfolio 6			89.50%
Threadneedle Managed Portfolio 7			86.21%
Threadneedle UK Property Fund II ICVC	Open Ended Investment Company	31/12/2012	31.41%
which consists of:			
Threadneedle UK Property Fund			31.41%

In December 2012 it was announced that the Threadneedle UK Property Fund II ICVC was to close. Threadneedle have consequently obtained permission from the Financial Services Authority to close the Company and have commenced the winding up process, which is expected to be completed in 2013.

* excludes units held by the LV= Employee Pension Scheme.

Notes to the financial statements continued
31 December 2012

46. Unallocated divisible surplus

Accounting for the Unallocated divisible surplus

The Unallocated divisible surplus represents the excess of assets over and above the long-term insurance contract liabilities and other liabilities. It represents amounts that have yet to be formally declared as bonuses for the participating contract policyholders together with the free assets of the Society and Group. Any profit or loss for the year arising through the Statement of Comprehensive Income (for the Society and for the Group) is transferred to or from the Unallocated divisible surplus.

UK regulations, the Group's Principles and Practices of Financial Management, and the terms and conditions of participating contracts set out the bases for the determination of the amounts on which the participating additional discretionary contract benefits are based and within which the Group may exercise its discretion as to the quantum and timing of their payment to contract holders.

	Group		Society	
	2012 £m	2011 £m	**2012 £m**	2011 £m
Balance at 1 January	**958.4**	966.4	**1,055.1**	1,078.6
Transfer to the Statement of Comprehensive Income	**(97.5)**	(8.0)	**(176.5)**	(23.5)
Balance at 31 December	**860.9**	958.4	**878.6**	1,055.1

Cumulative goodwill of £199.8m in the Group (£62.2m in the Society) arising on acquisitions prior to 1998 has been eliminated against the Unallocated divisible surplus. This goodwill would be recognised in the Statement of Comprehensive Income should there be a subsequent disposal of the business to which it relates.

Notes to the financial statements continued

31 December 2012

Other disclosures

This section details other disclosure matters, comprising: related party transactions, directors' emoluments, with-profit actuary details and other relevant Society information.

47. Related party transactions

The Group and Society enter into transactions with key management personnel in the normal course of business. All transactions between group companies took place in accordance with relevant agreements. Details of significant transactions carried out during the year with related parties are as follows:

a) Sales of insurance contracts and other services

The Group has related party transactions with the LV= Employee Pension Scheme. Until 31 October 2011 the Society provided fund management and administration services to the Scheme.

In 2012 and 2011 the following amounts were charged to the Pension Scheme for the following services:

	Fund Management Services		Administration Services		Total	
	2012 £m	2011 £m	**2012 £m**	2011 £m	**2012 £m**	2011 £m
Liverpool Victoria Friendly Society Limited	**–**	–	**–**	2.4	**–**	2.4
Liverpool Victoria Asset Management Limited	**–**	1.1	**–**	–	**–**	1.1

As at 31 December 2012 the LV= Employee Pension Scheme owed the Society £nil in respect of administration services (2011: £1.8m).

b) Other related parties disclosure

As disclosed in Note 41, the Society has granted a contingent loan facility to the RNPFN fund, a closed fund within the Group, which is disclosed in contingent liabilities.

c) 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	
	2012 £'000	2011 £'000
Short-term employment benefits	**6,139**	6,740
Other long-term benefits	**2,865**	2,746
Post-employment benefits	**216**	440
Termination benefits	**-**	240
Total compensation of key management personnel	**9,220**	10,166

The Society makes contributions to the LV= Employee Pension Scheme of an average of 17.8% of pensionable salaries (2011: 17.1% of pensionable salaries), subject to annual allowance limits, in respect of all permanent staff, including executive directors.

Included within key management personnel are all the vendors of ABC Insurance Solutions Limited who, as part of the acquisition in 2006, entered into a contract with the Society. Further details are disclosed within Note 40.

The aggregate premiums payable for the year by the Group Executive and Non-Executive Directors in respect of the Group's products was £57,827 (2011: £58,756).

Notes to the financial statements continued
31 December 2012

47. Related party transactions (continued)

d) The following transactions have taken place between the Society and other group companies:

	2012 £m	2011 £m
Management charge by the Society	191.1	186.8
Investment management charge to the Society	-	(7.9)
Reinsurance ceded by the Society - claims recoveries	-	47.9
Reinsurance ceded by the Society - premiums paid	-	(31.5)
Deferred margin (included in other financial liabilities)	10.1	5.6
Beneficial interest of subsidiary in loans sold to the Society	225.6	90.4
Intra-group loans - net interest received by the Society	5.8	3.8

Balances outstanding between the Society and other Group companies:

	2012 £m	2011 £m
Payable by the Society	(52.8)	(43.3)
Receivable by the Society	87.4	109.6
Loans owed to the Society	351.7	396.6

e) Loans to related parties

Loans owed to the Society represent a subordinated loan of £nil (2011: £183m) to Liverpool Victoria General Insurance Group Limited, secured loans of £51.7m (2011: £51.4m) to Liverpool Victoria Equity Release Limited and two new loans of £130m (unsecured subordinated loan) and £170m (unsecured senior loan note) to LV Capital PLC issued on 21 December 2012. All these loans are disclosed within loan stock in Note 29.

In addition the Society has a loan of £nil (2011: £162.2m) to Liverpool Victoria Equity Release Limited designated at fair value through income disclosed in Note 15. This loan was repaid in December 2012 as part of the loan restructure with the Society.

In March 2013 the remaining loan balance of £51.7m to Liverpool Victoria Equity Release Limited was repaid.

The subordinated loan to Liverpool Victoria General Insurance Group Limited bore interest at 1% above UK six month LIBOR and was of a medium to long-term nature, this loan was repaid in full in December 2012.
The terms of the loans to LV Capital PLC are:
(i) A £130m unsecured subordinated loan note repayable in 2015 with an interest rate of LIBOR plus 8.5%.
(ii) A £170m unsecured senior loan note repayable in 2047 with an interest rate of 9%.
LV Capital may, subject to one month's notice and obtaining written agreement of the Society repay all or part of these loans.
In addition to the loan notes disclosed above a £300m loan note was issued to LV Capital PLC by the Society on 10 December 2012 and subsequently cancelled on 21 December 2012.

The loans to Liverpool Victoria Equity Release Limited have fixed interest and repayment terms established at the outset of each advance.

On 30 November 2011 the Critical Illness and Income Protection reinsurance agreement between the Society and Liverpool Victoria Life Company Limited was terminated. Assets totalling £34.4m were transferred to the Society in settlement of £91.8m of insurance contract liabilities less the value of the estimated future profits for the business stream. A loss of £0.7m was recorded in the Statement of Comprehensive Income as a result of this transfer.

48. With-Profits Actuary

The following information has been provided in accordance with section 77 of the Friendly Societies Act 1992.
a) The With-Profits Actuary of the Society until 16 February 2012 was Mr P M Downey, who is employed by Liverpool Victoria Friendly Society. The total emoluments of Mr Downey during this period on a pro rata basis were £23,604 (2011: £175,312) including car allowance and medical benefits. Mr Downey is a participant in the Society's long term incentive plan and holds one insurance policy issued on normal staff terms by a subsidiary of the Society.
b) On 16 February 2012, Mr N J Dumbreck took over as the Society's With-Profits Actuary from Mr P M Downey. Mr Dumbreck is a Principal with the London office of Milliman LLP, an external consultancy firm. The Society paid fees of £388,491, inclusive of VAT and expenses, to Milliman LLP during 2012 in respect of Mr Dumbreck's professional services. It also paid fees of £54,000, inclusive of VAT and expenses, to Milliman LLP during 2012 in respect of services unrelated to Mr Dumbreck's role as With-Profits Actuary.
c) Mr Dumbreck held four insurance policies issued on standard terms by one of the Society's subsidiaries. He had no other pecuniary interest in any transactions with the Society at any time during the year.

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49. Directors' emoluments

The aggregate amount of directors' emoluments was as follows:

a) Aggregate emoluments including pension contributions and LTIPs	2012 £m	2011 £m
Aggregate emoluments	6.3	4.6

b) Emoluments of individual directors, including emoluments of the Chairman and highest paid director were as follows for the Society:

	Annual remuneration £'000						Total remuneration £'000		
	Salary	Bonus	Deferred bonus	Other benefits	Total 2012	Total 2011	LTIP 2010-12	Total 2012	Total 2011
M.J. Rogers	505	427	132	127	1,191	1,131	1,431	2,622	2,177
P.W. Moore	346	208	52	55	661	609	732	1,393	609
R.A. Rowney	306	240	–	51	597	568	585	1,182	943
J.B. O'Roarke (appointed 23 November 2011)	281	220	–	45	546	54	–	546	314
D. Holt	153	–	–	–	153	150	n/a	153	150
M.E. Austen	72	–	–	–	72	68	n/a	72	68
J. Edwards	62	–	–	–	62	58	n/a	62	58
C. Keers	61	–	–	–	61	57	n/a	61	57
D.I.W. Reynolds (resigned 31 October 2012)	60	–	–	–	60	64	n/a	60	64
C. Burton (appointed 9 November 2011)	56	–	–	–	56	15	n/a	56	15
J. Dean (appointed 26 July 2012)	22	–	–	–	22	–	n/a	22	–
G. Nott (resigned 26 May 2011)	–	–	–	–	–	28	n/a	–	28
Total	1,924	1,095	184	278	3,481	2,802	2,748	6,229	4,483

Deferred bonus represents the amount of the 2012 performance bonus payable over the next three years. Further details are disclosed within the Directors' Remuneration Report.

Other benefits include cash allowance in lieu of pension, car allowances, medical, relocation, life assurance and other benefits in kind or their equivalent monetary value.

c) Pension arrangements

R.A. Rowney and J.B. O'Roarke are members of the LV= Employee Pension Scheme, which is a defined benefit scheme. P.W. Moore left the defined contribution scheme during the year.

The directors' emoluments table above excludes the Society contributions to defined benefit and defined contribution pension schemes.

The Society makes contributions to the LV= Employee Pension Scheme of an average of 17.8% of pensionable salaries (2011: 17.1% of pensionable salaries), subject to annual allowance limits, in respect of all permanent staff. This included amounts on behalf of executive directors of £0.1m (2011: £0.1m).

The Society has made no contributions to personal pension arrangements during 2012 (2011: £nil).

There were £8,500 of contributions to defined contribution pension schemes in 2012 (2011: £42,542).

Accrued pension at end of period	2012 £'000	2011 £'000
R.A. Rowney	27	23
J.B. O'Roarke	30	26

Notes to the financial statements continued
31 December 2012

50. Cash generated from operating activities

	Group		Society	
	2012 £m	2011 Restated £m	2012 £m	2011 Restated £m
Profit/(loss) before tax and mutual bonus	**103.2**	(16.9)	**3.3**	(47.7)
Investment income	**(320.2)**	(261.4)	**(337.0)**	(284.9)
Net gains on investments	**(374.7)**	(425.4)	**(304.1)**	(407.3)
Finance costs	**0.5**	0.5	**-**	-
Net decrease/(increase) in derivatives	**92.3**	(12.7)	**100.1**	(14.1)
Non-cash items				
Expenses deferred during the year	**(5.4)**	44.1	**-**	-
Amortisation of intangible assets	**12.0**	13.0	**4.6**	4.6
Depreciation on property and equipment	**3.4**	2.6	**0.8**	0.8
Loss on disposal of property and equipment	**0.4**	-	**0.4**	0.1
Increase in capitalised goodwill	**(2.4)**	(5.3)	**(2.4)**	(5.3)
Decrease in provisions and pension obligation	**(17.9)**	(25.5)	**(17.3)**	(16.6)
Impairment write-offs in subsidiaries	**-**	-	**90.0**	34.4
Mutual bonus	**(20.9)**	(18.6)	**(20.9)**	(18.6)
Changes in working capital				
Decrease/(increase) in loans and receivables	**13.0**	(36.8)	**26.3**	(77.6)
Increase in reinsurance assets	**(110.3)**	(123.3)	**(74.4)**	(7.0)
(Increase)/decrease in insurance receivables	**(10.8)**	(23.3)	**(2.4)**	4.7
Increase in other prepayments and accrued income	**(7.7)**	(1.2)	**(1.7)**	(1.8)
Increase in insurance contract liabilities	**909.4**	1,131.9	**657.1**	821.3
Increase in investment contract liabilities	**158.4**	59.7	**158.4**	59.7
Increase in borrowings	**-**	-	**-**	5.6
(Decrease)/increase in other financial liabilities	**(1.7)**	55.3	**8.7**	55.9
Increase/(decrease) in insurance payables	**3.1**	9.0	**(5.4)**	7.9
(Decrease)/increase in trade and other payables	**(11.9)**	48.7	**(11.6)**	26.4
Cash generated from operating activities	**411.8**	414.4	**272.5**	140.5

51. Valuation

The latest published report on the valuation of Assets and Liabilities of the Society (the Annual FSA Insurance Return) was made at 31 December 2012 and is available on request from the Group Company Secretary, County Gates, Bournemouth, BH1 2NF and LV.com.

52. Society information

Liverpool Victoria Friendly Society 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 and regulated by the Financial Services Authority and is a member of the ABI, AFS and ILAG.

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