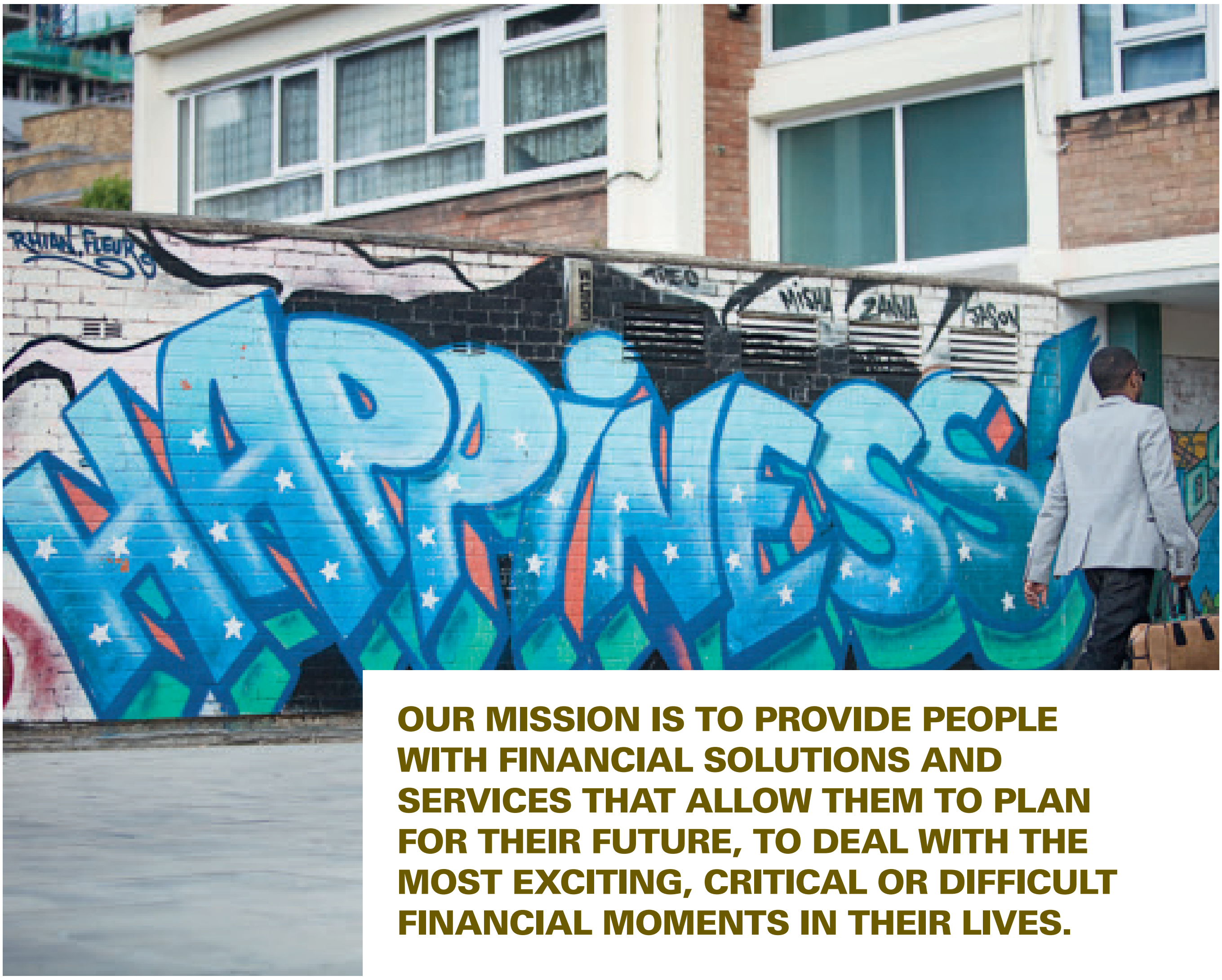
**LEGAL & GENERAL GROUP PLC**
ANNUAL REPORT AND ACCOUNTS 2012

# Stepping up.

**FOR SHAREHOLDERS, CUSTOMERS AND SOCIETY.**

**EVERY DAY MATTERS.**

Legal & General




## OUR MISSION IS TO PROVIDE PEOPLE WITH FINANCIAL SOLUTIONS AND SERVICES THAT ALLOW THEM TO PLAN FOR THEIR FUTURE, TO DEAL WITH THE MOST EXCITING, CRITICAL OR DIFFICULT FINANCIAL MOMENTS IN THEIR LIVES.

## CONTENTS



For an online version of our Annual Report please visit our website
**legalandgeneralgroup.com**

The report is also available as an iPad app. You can download it from the AppStore.

* These sections make up the Directors' Report. This section of the Annual Report sets out information on the Group's principal activities together with a review of the development and performance of the Group, including financial performance, in accordance with Section 417 Companies Act 2006.

# CHAIRMAN'S STATEMENT.

**Legal & General again performed strongly in 2012. My colleagues delivered higher sales, providing vital financial products and services for millions of customers. Strong earnings growth meanwhile enables us to further increase dividends to shareholders.**

## KEY INFORMATION FOR SHAREHOLDERS

### FULL YEAR DIVIDEND

**7.65p**

(2011: 6.40p)

### FINAL DIVIDEND

**5.69p**

To be paid on 29 May 2013

(2011: 4.74p)

### ANNUAL GENERAL MEETING

**2013**

**11.00am on Wednesday 22 May 2013 at the Honourable Artillery Company, Armoury House, City Road, London EC1Y 2BQ**

## A RECORD YEAR IN 2012

All our UK operating business divisions performed strongly and international contributions grew, particularly from the US. 2012 also highlighted our ability to adapt to changing distribution through the Retail Distribution Review (RDR) and pension auto enrolment, where we are one of the market leaders among large employers.

Our efficient operating model drove a 12% growth in earnings per share, which underpins the further recommended 20% increase in the final dividend.

## TOTAL SHAREHOLDER RETURN AND DIVIDEND

TSR for 2012 was 50.4% – among the top four European life insurers and the top dozen performers in the FTSE 100. Over the last three years our TSR is 112%, the highest in our sector in the world of major life insurance companies.

The Board is recommending a final dividend of 5.69p per share, payable on 29 May 2013. This is an increase of 20% on the prior year reflecting our strong performance in 2012 and positive outlook for the Company in 2013.

## APPOINTMENT OF NEW CHIEF EXECUTIVE

Following a thorough internal and external process, the Board was delighted to appoint Dr Nigel Wilson, formerly Group Chief Financial Officer (CFO), as Group Chief Executive, effective from 30 June 2012. Nigel's experience as CFO and his extensive external experience means he is very well qualified to lead the Company through the next stage of its growth.

In September 2012 we welcomed Mark Zinkula, CEO LGIM, to the Board to bring greater knowledge and experience of investment management, and the US market.

The Board is currently engaged in a process to identify and appoint a new Chief Financial Officer.

## OUR STAFF

Our employees again contributed hugely in 2012. Our employee survey during the year showed record levels of engagement and reflected the very strong commitment shown at all levels of the Company to delivering the best possible outcomes for customers and shareholders. I was once again proud to recognise the outstanding charitable endeavours of our employees at the Chairman's Community Awards and the Board remains very grateful to all our employees for their contribution during the year.

## OUTLOOK

Our focus on financial and operational discipline underpins value for customers and returns to shareholders. The resulting financial strength positions us well for expansion.

**JOHN STEWART**
**CHAIRMAN**

# HIGHLIGHTS FOR 2012.

## OUR KEY PERFORMANCE INDICATORS

### OPERATING PROFIT BEFORE TAX
**£1,087m** (2011: £1,053m)

### NET CASH GENERATION
**£865m** (2011: £846m)

See page 30 for a full breakdown of net cash generation.

### RETURN ON EQUITY
**15.5%** (2011: 14.9%)

### FULL YEAR DIVIDEND
**7.65p**
(2011: 6.40p)

### TOTAL SHAREHOLDER RETURN (TSR)
**50%** (2011: 11%)

### INSURANCE GROUPS DIRECTIVE (IGD) CAPITAL SURPLUS
**£4.1bn** (2011: £3.8bn)

Figures after accrual of proposed dividend, based on draft unaudited regulatory returns.

### EUROPEAN EMBEDDED VALUE (EEV) PER SHARE
**173p** (2011: 167p)

Figures including embedded value of LGIM.

### EMPLOYEE ENGAGEMENT INDEX
**78%** (2011: 73%)

## OTHER GROUP INFORMATION

### PROFIT BEFORE TAX
**£1,036m** (2011: £953m)

IFRS profit before tax attributed to shareholders.

### FINANCIAL STRENGTH
**AA-** (2011: AA-)

Standard & Poor's Financial Strength rating for Legal & General Assurance Society Limited.

## BUSINESS HIGHLIGHTS

### PROTECTION AND ANNUITIES

#### SAFEGUARDS CUSTOMERS AGAINST FINANCIAL RISKS
Our Protection and Annuities businesses assume customers' financial risks arising from defined events such as death, injury, unemployment, illness or household damage, while our annuities products protect individuals from the risk of outliving their savings in retirement. We continue to be at the forefront of pension schemes de-risking after over 25 years in the market.

FOR MORE INFORMATION SEE PAGE 27

**ANNUITIES NEW BUSINESS APE**
**£234m**
(2011: £251m)

**GROUP PROTECTION NEW BUSINESS APE**
**£70m**
(2011: £46m)

### INVESTMENT MANAGEMENT

#### INVESTING ON BEHALF OF INSTITUTIONAL AND RETAIL CUSTOMERS
Legal & General Investment Management (LGIM) is the largest manager of UK sourced pension assets and one of the largest investors in the UK stock market with responsibility for approximately 4% of all London-listed equities on behalf of its customers.

FOR MORE INFORMATION SEE PAGE 27

**TOTAL ASSETS UNDER MANAGEMENT (AUM)**
**£406bn**
(2011: £371bn)

**INTERNATIONAL ASSETS UNDER MANAGEMENT (AUM)**
**£42.7bn**
(2011: £31.5bn)

### SAVINGS

#### FINANCIAL PLANNING, SAVINGS AND INVESTMENTS
Our Savings business is a manufacturer and assembler of modern, flexible investment products, allowing individuals to save to meet the costs of specific future events or to give a planned income in retirement.

FOR MORE INFORMATION SEE PAGE 27

**TOTAL ASSETS UNDER ADMINISTRATION (AUA)**
**£70.1bn**
(2011: £64.9bn)

**NEW BUSINESS APE**
**£1,456m**
(2011: £1,262m)

### US PROTECTION

#### OUR SCALE PROTECTION BUSINESS OVERSEAS
Our US Protection business is a top five term assurance provider in the US, and has grown its core term product over 12 consecutive quarters. Our core market consists of higher net worth customers, serviced through the Broker General Agent distribution channel.

FOR MORE INFORMATION SEE PAGE 27

**PROTECTION APE**
**£90m**
(2011: £69m)

**GROSS PREMIUM INCOME**
**£584m**
(2011: £522m)

# CHANGES TO OUR REPORT

This year we have changed the structure of our Annual Report to better reflect the way we operate and the increase in synergies of resources and objectives across the Group. We believe that to operate as one company with one vision we need to have shared objectives within our strategy where appropriate.

A number of our strategic objectives require input from several areas of the Company. For example, Retirement Solutions involves the annuities, savings and investment management businesses. We provide solutions for employers across our protection, savings, annuities and investment management businesses and we can use our expertise of all of these areas in the UK to deliver our international expansion ambition.

The main change is a move away from the business segment-led reporting that we have used in previous years towards a more holistic view of our business. We believe that this new structure better highlights and demonstrates the synergies and progress across the Group.

This should make it easier to find the information you are looking for and give a better overview of how our business divisions work together to deliver value for our customers and shareholders.

This means that you will now find all of our strategic progress and achievements information in the **What we are doing section** on pages 14 to 23.


Information on our social purpose and sustainability can be found in the **Our Social Purpose section** on pages 36 to 43.


An overview of our 2012 performance can be found in the **Highlights section** (on the opposite page).

The detail relating to our financial performance can now be found in the new **Financial Review** section. This section gives more details on our KPIs and the financial results of each of our business divisions.

This section also includes an explanation of why the measure is used by management.

The **Financial Review** can be found on pages 26 to 33.


Full in depth disclosure is then provided in the **Financial Statements** pages 109 to 237.

We believe that this new structure means that we focus on the measures used to manage the business and reduces the duplication of information within the document. We welcome your feedback on these changes.

# "It's protecting the homes of millions of customers."

"The best thing is helping each other when you come off the phone, because you do unfortunately have some circumstances where people are not in the best situation. You know when you come off the phone that you've helped them and it makes you feel like you've done something good for the day. You do have to listen to some horrible stories, but that is what we're here for. To help them out and get them back to where they were as quickly as possible."

**YASIN,** IPSWICH

For more information please visit
**legalandgeneralgroup.com**

IN THIS SECTION



# GROUP CHIEF EXECUTIVE'S REVIEW.

**EARNINGS PER SHARE**
**13.9p**
(2011: 12.42p)

**RETURN ON EQUITY**
**15.5%**
(2011: 14.9%)

**UK PENSIONERS WHO DEPEND ON US FOR THEIR INCOME**
**705,000**
(2011: 661,000)

**EMPLOYEE ENGAGEMENT INDEX**
**78%**
(2011: 76%)

Go online to see a video presentation from CEO Nigel Wilson
**legalandgeneralgroup.com**

**Legal & General's strong earnings per share (EPS) and cash flow growth underpin our 20% growth in dividend. Double-digit sales growth showed the strength and value of the products we provide for consumers, companies and institutions.**

Our strong performance reflects the importance and resilience of insurance, savings and investment across all our markets. Our performance was particularly strong in the UK – a zero-growth economy, with falling real wages, huge structural imbalances and a rapidly ageing population. We also performed well in similarly challenged economies such as the US and France, as well as making good progress in high-growth economies such as the Gulf, China and India.

### WHAT 'EVERY DAY MATTERS' MEANS TO MY COLLEAGUES

During 2012 we worked hard to embed our 'Every Day Matters' organising thought, which sits at the heart of our brand, into everything we do. This included a 'One Day' exercise in September where we asked employees to tell us about their interactions with customers and each other on that day. Throughout this report you will find examples of their experiences and the difference we make to our millions of customers every day.

This year we also undertook several broader pieces of research looking at changes to demographics and life stages, the low levels of savings and protection in the UK and the impact this can have on people's lives if they find themselves unable to work. In our '35Cubed' review we saw a changing and complex network of financial transactions within families. Our 'Deadline to the Breadline' report highlighted that the average UK family still has only 19 days before their savings run out.

### INCREASING OUR OPERATIONAL EFFECTIVENESS

During the year we made changes to management structures to bring international operations closer to the main UK operating divisions, so as to benefit from their scale and expertise. Our operations in France and the Netherlands now sit under John Pollock in Protection and Annuities, whilst our joint venture in India has been moved to our Savings business under Mark Gregory. We also rotated many of our senior managers into new roles.

## USING TECHNOLOGY TO IMPROVE CUSTOMER SERVICE

We have also focused on harnessing technology to provide better services to customers. Colleagues successfully implemented challenging technical projects, including our successful Retail Distribution Review (RDR) and pensions auto enrolment propositions.

## MAXIMISING THE POTENTIAL OF CHANGING MARKETS

2012 saw significant regulatory changes, which will impact our industry and its customers. These included the RDR, ending the payment of commission on retail investment products, the unwelcome abolition of gender-based pricing for insurance products following a European Court ruling, and the introduction of pensions auto enrolment.

We responded effectively to these changes, introducing new RDR-compliant propositions for advisers, growing our distribution capability through new partnerships particularly with building societies, and implementing gender-neutral pricing ahead of the deadline. Pensions auto enrolment was a particular success: the Government should be congratulated for driving this through. We expect to auto-enrol 500,000 employees of major companies, including the Co-op, Boots, Asda, Barclays and Marks & Spencer by the end of 2013.

The timetable for the EU's Solvency II legislation has slipped further, with implementation now unlikely before 2017. We submitted our internal capital model to the regulator in November. The cost of this programme for Legal & General is almost £140m, and for the UK industry, estimated at £3bn-£4bn. We regard these costs as indefensible during a period of financial crisis.

## FROM PROFIT TO PURPOSE

**"Legal & General's 12% growth in EPS reflects our improving business strengths in project execution, operational scale and efficient manufacturing and distribution. We have plenty of ambition, capability and opportunity to grow earnings further in 2013...**

"Beyond this, as a socially useful company, we play a wide role in providing financial services to our customers at the most exciting, critical or difficult moments in their lives... providing investment and associated growth for the wider economy... and through our CSR work in many of the communities in which we operate."

## TRIANGLE OF AUSTERITY

Developed economies are locked in a 'Triangle of Austerity':

- Fiscal austerity as governments cut spending.
- Regulatory austerity as risk is reduced.
- Funding austerity as banks shrink balance sheets and cut lending.

Each of these is creating opportunities for Legal & General.

Fiscal austerity – the UK Government has debt of over £1tn, and an unsustainable deficit of £120bn – and falling government spending on welfare means that more individuals will need to make greater use of protection. Greater longevity and an ageing population requires greater pension saving through auto enrolment and more flexibility in decumulation mechanisms including annuities.

Regulatory austerity and de-risking, including for pension funds in the UK and internationally, will enable us to extend our established £64bn business delivering liability-driven investment, and in pension buyouts.

Funding austerity and shrinking bank balance sheets create new long term investment opportunities, for example in infrastructure and housing, for insurers including Legal & General. We have already invested over £1.2bn in these sectors in the UK.

## STRATEGY AND OUTLOOK: 'ACCELERATED EVOLUTION'

Opportunities to accelerate our evolution include further internationalisation of LGIM. We have already succeeded in winning new investment mandates in the US, Europe, the Gulf, and Asia, and are well positioned to access some of the major pools of funds available for investment internationally.

We also see opportunities to extend our experience in the provision of protection and retirement solutions for companies and individuals into further international markets, and expand our role as a principal investor in infrastructure, property and businesses.

Digital technology creates improved opportunities for customer servicing and interaction, as well as further efficiency gains in processing. We have delivered successfully on digital projects in 2012, but more remains to be done, and this is an area of strategic focus for us.

Our strong balance sheet moreover gives us additional options to grow through disciplined, selective acquisitions, and we have recently increased our in-house M&A capability.

Nigel D Wilson

**NIGEL WILSON**
**GROUP CHIEF EXECUTIVE**

# MARKET ENVIRONMENT.


**Hopes for a sustained global economic recovery continue to be thwarted by ongoing austerity programmes, fears over sovereign debt and the inability or unwillingness of banks to lend. Yet at the same time, UK insurance companies need to build growth against a backdrop of relentless regulatory change.**

## POLITICAL AND ECONOMIC ENVIRONMENT

The current global political and economic environment is dominated, to a large extent, by how governments and central banks drive economies out of recession by stimulating growth, while reducing unsustainably high debt levels. In the UK:

- Growth has been much weaker than most commentators expected
- Unemployment, of almost 8%, is markedly higher than before the crisis
- Inflation, despite falling from 5% in October 2011 to around 2.5% today, remains above the 2% target
- Living standards have been squeezed for longer than at any time in living memory, with the real value of wages falling by 3% over the last three years, taking earnings back to 2003 levels.

Whilst the recession and resulting austerity create a tough environment, they have also given us some advantages, including a greater need for risk sharing by helping pension schemes de-risk their liabilities, providing guaranteed retirement income for pensioners and providing affordable protection plans for companies and individuals.

We also believe that we have an important role to play in helping governments manage central spending budgets through greater take-up of products that provide protection for people who might otherwise have to rely on state benefits.

Recent announcements on the introduction of a simplified single state pension in 2017 could mean that consumers now have greater incentives to save for retirement, knowing that the level of private pensions will not affect their entitlement to state benefits. In the same way, the government's reform of unemployment and disability benefits may encourage individuals to consider private income protection cover.

### Economic overview

The global economy has managed to muddle through significant challenges over the past 12 months. But there has been a stark divergence in performance between advanced and developing economies. Demand in advanced economies has barely grown – with the euro area particularly weak, reflecting concerns about the solvency of several member states. But demand in emerging economies continued to grow rapidly in the year as a whole. Given emerging economies are far more important today than a few years ago (almost 40% of global demand in 2011 compared with 25% in 2004), global growth was only slightly below its long-run average of 3% last year.

### Global growth

World trade and industrial production stalled last summer, partly reflecting concerns about the future of the euro, but also the delayed effect of previous policy tightening in emerging economies to combat inflation pressures. A combination of the European Central Bank's president promising to do 'whatever it takes' to save the euro, and policy easing in emerging economies, led to a recovery in industrial confidence by the end of the year.

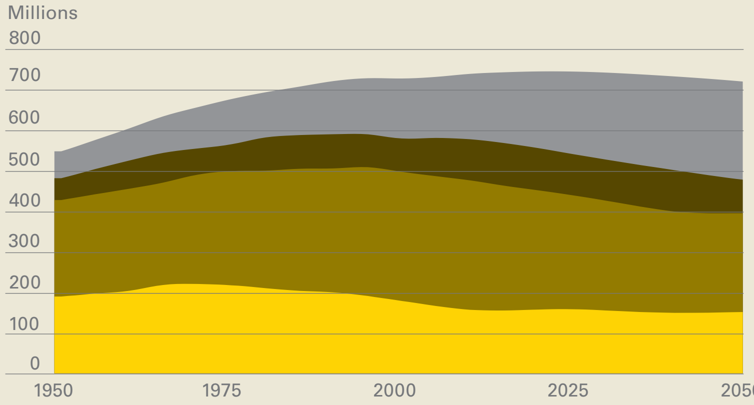
## LEGAL AND REGULATORY

The impact of regulation on the Group's strategy is likely to continue to increase; the current pace and depth of regulatory reform and supervisory activity is already high and there are indications that this may further intensify. The changes fall into three categories:

- Delivery of current/known UK and EU regulatory initiatives.
- Adapting to the changed UK regulatory architecture.
- Adapting the way we do business under the new regulatory culture.

## GREY MATTERS – OUR AGEING POPULATION

### European population growth 1950-2050




Source: United Nations Population Division

**The ageing of most western populations poses considerable challenges for governments. In the UK, by 2030, over-60s will have grown from 22.6% of the population to 27.8% in just 20 years and the average 60-year-old woman will live until 88. Longevity and an ageing population are impacting UK government policy in three significant ways:**

- The reduced ratio of the working population to the retired population makes it difficult to raise sufficient revenue from income-related taxes to finance central spending. This has been partially remedied by raising the retirement age.
- The state finds it difficult to finance retirement pensions. Solutions for this problem include the encouragement of private pension saving and changes in the retirement age and state pensions.
- Central government and local authorities are already finding it difficult to finance the costs of social care for elderly people. While the current generation is potentially able to contribute towards the costs through releasing housing equity, future generations may find this more difficult.

Again we believe that a partnership between insurance companies and the state can help to solve many of these problems. Auto enrolment should enable many millions of people to build better retirement pensions. The insurance industry can also work with the government to encourage people to plan much earlier in life for long-term care costs. We see the recent government announcement on social care funding reform as an important first step and we look forward to helping the government find solutions to this difficult problem.

The new pensions auto enrolment rules mean more lower and middle earners will have access to a private pension. This, together with the expected reduction in pension allowances, should mean that a greater, fairer, proportion of available pensions tax relief will benefit these lower and middle earners. We believe that retaining pension tax relief to encourage people in saving for retirement remains important.

# MARKET ENVIRONMENT CONTINUED

**Delivery of current/known UK and EU regulatory initiatives:**
**Solvency II:** Current indications suggest that the implementation of the long-awaited EU-wide requirements on capital adequacy and risk management rules is unlikely before 2017. The final details of Solvency II are still to be resolved and the overall timeline for development of the full rules remains challenging. We remain particularly concerned that there should be appropriate stabilising measures to dampen volatility and pro-cyclicality for providers of long-dated financial products and we are encouraged by the progress made to develop these measures, including the matching adjustment for annuity products.

**Retail Distribution Review (RDR):** The RDR changes, which applied to advised sales of retail investment products, came into force on 31 December 2012. The RDR banned product providers from paying commission to advisers. It also required advisers to change the way they describe their services to customers, including the way they will be charged for advice. Furthermore, it required advisers to meet new professional qualification standards.

**Pensions reform:** From 1 October 2012, the first tranche of employers were required to enrol most of their current and future employees into a workplace pension scheme. This requirement will be rolled out across all employers over several years. Auto enrolment is a significant act of Government intervention into pensions. With full implementation, the Department of Work and Pensions expects between six and nine million new participants in pension saving.

**Gender directive:** The implementation of the EU's gender directive, which forbids price discrimination on the basis of gender, was implemented in December 2012.

**Mortgage Market Review (MMR):** The FSA recently consulted on a major package of regulatory reforms for the mortgage market, setting out new standards for, among other things, responsible lending, disclosure, suitability and distribution of mortgage products. In its response to this consultation, the FSA has indicated that MMR reforms will be implemented in April 2014.

**Retail Conduct EU Directives:** The Commission's reviews of the Markets in Financial Instruments Directive (MiFID), Insurance Mediation Directive (IMD), Undertakings for Collective Investments in Transferable Securities (UCITS) and the new Packaged Retail Investment Products (PRIPs) proposals may bring about changes to the way most insurance and investment products are sold in the UK.

**Adapting to the changed UK regulatory architecture**
The Financial Services Act 2012 means the FSA will be replaced with the Prudential Regulation Authority (PRA), the Financial Conduct Authority (FCA) and the Financial Policy Committee (FPC), from 1 April 2013. These changes give rise to:

**Regulatory culture and focus:** We expect the new regulators to use their powers both more assertively and frequently to deliver their objectives, act more quickly and be more judgement-based, with a lower risk appetite than the FSA.

**Enhanced regulatory powers:** The Financial Services Act provides the new regulators with fresh powers to support their regulation and supervision of firms.

## OUTLOOK

Although some of the current key regulatory initiatives will, over time, become business as usual, they represent only a proportion of the wide-ranging suite of more detailed regulatory change initiatives and new overarching standards and themes that we see currently unfolding. Our business will need to understand and respond to each as they take shape and crystallise. As a result, over the coming years, we expect to operate in an environment of continued regulatory change. For example:

- Implementation reviews of flagship policy initiatives: Given the volume of new regulation that has been formulated, we expect both UK and EU regulators to make further changes to these regimes in the light of, for example, post-implementation reviews.
- The EU increasing harmonisation through more direct conduct regulation with initiatives such as the new PRIPs proposals and the reviews of the MiFID and IMD regimes being examples. Corporate Governance is also given greater emphasis, in both specific Directives and new dedicated proposals.

# WHAT MAKES US DIFFERENT?

**The expertise within our businesses and the synergies that exist between them allow us to maximise the use of our resources to deliver growth and value.**

**We believe this expertise and experience gives us a number of competitive advantages. These include:**

### Financial and strategic discipline
We operate with high operational efficiency. This is underpinned by our strong solvency and asset de-risking.

### Scale positions in attractive markets
We use our experience and scale in our existing markets to grow in attractive international markets.

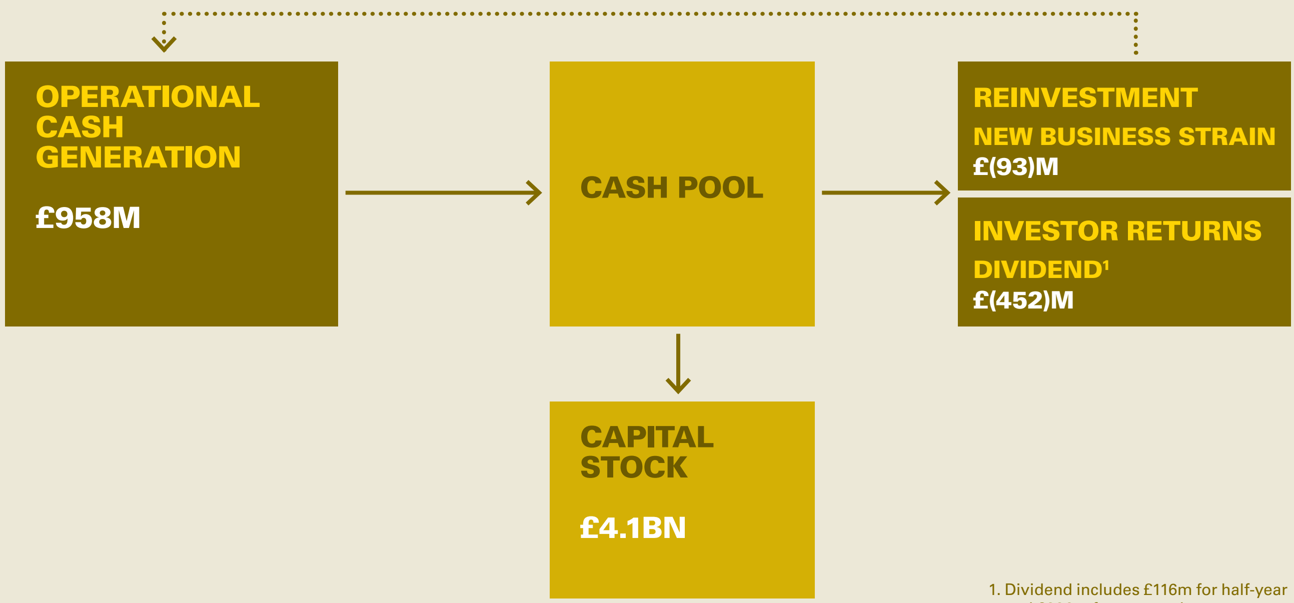
### Corporate relationships and diverse distribution
We are a leading pensions solutions provider to UK corporations and the principal provider of protection, savings and investment products to UK Building Societies. Our Group synergies across insurance and asset management enable us to provide comprehensive client solutions.

### Risk selection
Scale of data, long experience and market leading expertise increases certainty of risk outcomes and supports sophisticated pricing. The Group benefits from strong diversification of risk.

### Ambition
By rotating many of our senior managers into new roles at the end of 2012 we are widening the skill base of our senior management team, improving the potential for information sharing and talent development.

## HOW WE GENERATE CASH
All of our businesses generate operational cash which we use to reinvest in new business, pay dividends to shareholders and strengthen our balance sheet.

### OUR FINANCIAL MODEL




1. Dividend includes £116m for half-year and £336m for year-end.

## HOW OUR PRODUCTS SUPPORT OUR CUSTOMERS
In the next two pages you will find an explanation of how our products and services help customers throughout their lives.

## We provide people with financial solutions and services that allow them to plan for their future, to deal with the most exciting, critical or difficult financial moments in their lives.

### BOUGHT BY INDIVIDUALS

**JUNIOR ISA** Investment plan with an annual tax-free allowance for the under-18s

**CONTENTS INSURANCE –** Insurance plan that covers your personal belongings if you are renting or a homeowner

**CONTENTS & BUILDINGS INSURANCE –**

**ISA –** Investment plan with an annual tax-free allowance linked to a broad range of funds

**LIFE PROTECTION (TERM) –**

**CRITICAL ILLNESS COVER –**

### PRODUCTS AND SERVICES

Our product range is designed to reflect the risk, savings and investment needs of our customers at various key stages of their lives. The provision of benefits enables individuals to cope with the financial consequences of unforeseen events and save for the medium and long term and are provided directly to individuals or through their employers.

**KEY**

Savings

Protection and Annuities

### LIFE STAGES

**Birth**

**Leave home**

**First job**

**Buy own home**


### BOUGHT BY EMPLOYERS

**WORKPLACE PENSION* –** Pension scheme run by your employer

**GROUP LIFE PROTECTION –** Plan provided by your employer offering life cover. Can also provide benefits for your dependants

**WORKPLACE ISA* –** Stocks and shares ISA offering tax-efficient savings for employees

**WORKPLACE INCOME PROTECTION –**

**CRITICAL ILLNESS –**

* Selected by employers and made available to employees.

### LEGAL & GENERAL INVESTMENT MANAGEMENT (LGIM)

In addition to the manufacture and distribution of the products above, as a Group we invest and manage the premiums to ensure delivery of these promises. We also work with some of the largest corporates in the UK to ensure that their assets (pension and other) are properly invested.

Insurance plan that covers your home and personal belongings if you are a homeowner

Insurance plan that protects your family or mortgage if you should die within a defined period

Plan that protects you by providing you with a cash benefit if you suffer a critical condition covered by the policy

**UNIT TRUSTS –** Medium-term investment plan providing income or growth, often started after you have used up your ISA allowance

**INDIVIDUAL PERSONAL PENSION** – From stakeholder to SIPPs, these plans allow you to save for retirement outside a workplace scheme

**ANNUITY–** Plan that enables you to turn your pensions savings into a lifelong, guaranteed income

**LIFE PROTECTION** (WHOLE LIFE) – Insurance plan that pays out a cash sum whenever you die

**INSURANCE BONDS –** Lump sum medium-term investment plan, which can be used for tax planning

**INCOME DRAWDOWN –** Plan that enables you to keep your pension invested while receiving some income.

**Start family**

**Raise family**

**Children leave home**

**Become a grandparent**

**Retirement**

Includes defined benefit and defined contribution schemes. Increasing in popularity as more employees are auto-enrolled

Plan provided by your employer to protect your income if you suffer a long-term illness or injury. Can include treatment and assistance to help you return to work

Plan provided by your employer to provide a cash benefit if you suffer a critical condition covered by the scheme

## INVEST ASSETS/PREMIUMS TO ENSURE DELIVERY OF PROMISES.

## IN ADDITION, WE USE OUR INVESTMENT EXPERTISE TO MANAGE ASSETS FOR OTHER COMPANIES.

**But LGIM does much more:**

- De-risking solutions for pension schemes **(see page 18)**
- Investment in infrastructure and property **(see page 22)**
- As a holder of 4% of the FTSE, we engage with companies to encourage best practice **(see page 40)**

# WHAT WE ARE DOING.



## PUTTING CUSTOMERS AT THE HEART OF OUR BUSINESS

We recognise that our customers are at the heart of our business and that we must work hard to build long term positive relationships with them.

Our customer engagement strategy is based upon putting customers at the heart of everything we do. This strategy, which we outlined last year, enabled us to achieve some notable successes in 2012:

- Improving our customer satisfaction scores.
- Making it easier for customers to deal with us, by simplifying application procedures.
- Improving the quality of our customer communications, whether digital or traditional.
- Maintaining a broad choice of ways to buy our products, such as receiving advice through independent advisers, banks, building societies or estate agents or direct via digital online applications.
- Ensuring that we provide an efficient and compassionate claims service.
- Helping our customers to talk about us using social media and access our products through digital applications.
- Enhancing our digital investment platforms to help customers manage their assets throughout life.

We want to provide our customers with products and services that have a real relevance to their lives, helping them to achieve financial security. In return, we want our customers to engage with us, stay with us throughout life and recommend us to others.

### IMPROVING CUSTOMER RELATIONSHIPS

Because we often touch our customers' lives at times when they are under severe emotional difficulties, we understand the importance of efficient service.

In 2012, our life protection, annuities and general insurance service teams improved their customer satisfaction scores from 77% in 2011 to 85% at the end of 2012. We also increased our 'customer ease' score (measurement of how easy customers find us to deal with) from 71% in January to 76% in December against a stretching target of 75%.

## How we made it easier for customers to deal with us

- We introduced a coaching programme for our managers to build improved skills when dealing with customers.
- We re-wrote 18 regularly used letters for new customers and eliminated 1.5 million duplicate letters.
- We made our online quotation and application processes quicker and less stressful.

## We have delivered a better claims service

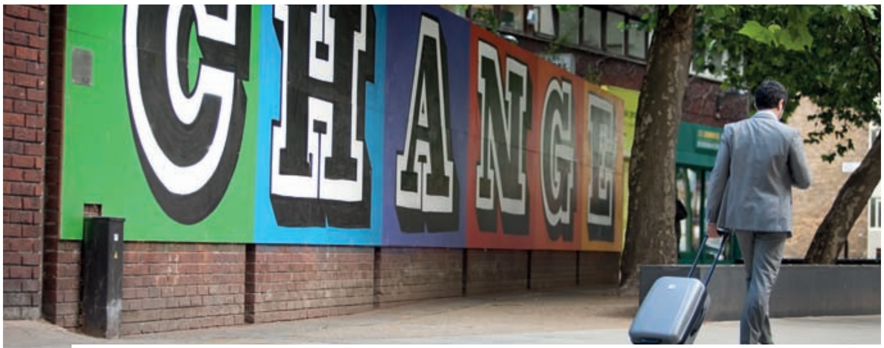
Our underlying purpose is to provide customers with peace of mind, while being there to help them if they need to make a claim by ensuring that all valid claims are paid efficiently and compassionately.

- We substantially reduced the average life claims turnaround time from 32 days in January 2012 to 23 days at the end of December 2012.
- For critical illness claims, which are more complex, we improved average claims turnaround times from 49 days in January 2012 to 42 days by the end of the year.

## How we did this

- Issuing claims forms within 24 hours of being told about a claim and aiming to complete all claims work within 48 hours.
- Using text messages to update customers on the progress of their claim.
- Phoning customers and medical specialists to check that they have received our documents.
- We improved our general insurance fraud processes, focused our effort on resolving our oldest claims, reduced our open claims by around 36% and released £5m of reserves.

## EVERY DAY MATTERS – BEING THERE FOR PEOPLE WHEN THEY NEED US




**We conduct our business through the lens of Every Day Matters. This includes our broader social purpose, building on our corporate social responsibility agenda and driving our business results.**

This purpose focuses our attention and gives us direction. It helps us design products people actually want and need and motivates employees with a purpose they can believe in. 87% of our staff now believe that they work for an ethical company (2011: 84%).

Our 'One Day' initiative, an innovative and successful campaign, helped drive employee engagement and embedded Every Day Matters into employees' lives. This day celebrated everything that happens in one working day all over the organisation. One of the benefits was employees, in very different areas, could share their experiences of making a real difference to customers' lives. Whether it was dealing compassionately with customers suffering bereavement or simply buying food for a colleague who had to work through lunch on an especially complex customer enquiry. These experiences are featured throughout this report.

## Transforming our savings customer communications

We have used the guiding principles of Every Day Matters to ensure that our communications are easy to understand, using simple jargon-free language explaining clearly how the plan works and its value. We have now significantly improved annual statements throughout for our savings businesses. For workplace savings, 89% of customers agreed that our new statements are 'simple and easy to understand'.

## IMPROVING OUR PRODUCTS AND SERVICES

2012 proved to be an exceptionally busy year for delivering new or enhanced products and services. Regulatory changes drove many developments such as the FSA's Retail Distribution Review, auto enrolment of workplace pensions and gender-neutral pricing.

# WHAT WE ARE DOING CONTINUED

**Delivering changes for auto enrolment and the Retail Distribution Review**
In 2012, much of the effort of our Savings division was dedicated to ensuring that these two massive projects were delivered on time. Both the RDR and auto enrolment required fundamental changes to the way customers buy our products. We changed the pricing structures for most of our savings products and delivered projects to upgrade our administration systems and processes.

**Introducing gender-neutral pricing**
We introduced gender-neutral pricing on 21 November 2012 for annuities and on 21 December 2012 for individual protection, becoming the first provider to do so in the UK protection market.

A Gender Response Team was introduced to manage and process the pipeline effectively, supported by a new in-house pipeline management tool called Pipetrack. Over 93,000 reviews were completed.

This was supported by the 'Time waits for no woman' campaign that received positive feedback from advisers.

**Diversifying our general insurance business**
Over the year we introduced three product enhancements to support our vision to be an outstanding, innovative and responsible provider of personal insurance solutions:

- Home Insurance Enhanced, our premium offering, was launched in September 2012.
- Favourites Rewards Club for existing customers, launched in October 2012.
- Pet Insurance was launched in November 2012.

In 2013, we aim to introduce additional major general insurance products, giving us a product range that is comparable with many of our main competitors.

## HOW WE WILL CONTINUE TO PROVIDE ACCESS TO ADVICE FOR CUSTOMERS


**We have established relationships with the majority of UK building societies. Eighty seven per cent of UK building society customers now have exclusive access to our products and investment platforms. This covers over 20 million members, with total assets of £270bn. We are very well placed to help building society customers protect their mortgages and families and to help them build savings assets.**

Customers can receive advice on their financial needs from our specialist salesforce in high-street branches of a number of building societies.

We can also help customers through our direct business processes. We are already seeing increased sales of retail protection and general insurance from direct customers.

## HOW WE HAVE RESPONDED TO CHANGING DISTRIBUTION PATTERNS

RDR involved changing existing new business policy, administration and accounting systems, building a completely new point of advice system for banks and building societies and our own salesforce, developing and launching new 'RDR-friendly' products, upgrading our investment platforms and re-training our own salesforce and back-office teams.

While we have seen many high-street banks only continuing to offer advice to those customers with high levels of savings, we remain committed to continuing to give advice to less affluent customers.

### Helping customers who prefer to deal directly with us

In 2012, we expanded our direct annuity service for a growing number of customers who feel comfortable making their own decisions. Many customers now use the internet for annuity information and have the confidence to buy direct. We routinely health-screen every annuity customer and offer them the best rate from the information they provide. While this service is non-advised we can offer advice to those customers who need it. We also ensure that our own maturing pension customers have access to our enhanced annuity product.

We also developed new direct facilities in Group Protection and Liability Driven Investments (LDI).

### Our mortgage network

We continue to attract good quality advisers to our mortgage network. In 2012, we successfully won a major Appointed Representative deal in the sector, by recruiting the Spicer Haart Group, which sells mortgages and related financial services through the largest independent chain of estate agents in the UK. In addition, 65 former Co-operative Financial Services advisers have joined firms in our network, spread across a number of firms, and some new firms have been established from groups of advisers.

We successfully delivered RDR training to our active wealth advisers. One hundred per cent of our advisers passed the residential course assessments, enabling the network to go live in December ahead of the 1 January 2013 deadline. The network offers a strong proposition to Appointed Representative firms, and against a backdrop of other networks raising their fees for advisory firms, we announced a 'fee freeze', promising to keep our mortgage and protection fees unchanged, until at least January 2014.

## ACCELERATED EVOLUTION

Our scale and expertise in our major markets gives us the potential to accelerate our growth further, driven in part by social and economic conditions. Austerity remains the watchword in Europe, the US and Japan and continues to influence the spending decisions of both retail consumers and corporates.

Our focus in 2012 has been on:

- Retirement Solutions;
- Corporate Customer Solutions; and
- International Growth.

In addition, we are focusing on our digital capabilities in order to enable us to accelerate our evolution, giving us advantages in customer servicing and customer engagement and to help us build a more efficient organisation.

### RETIREMENT SOLUTIONS

Greater longevity and ageing populations in most Western economies enables us to offer competitive and flexible solutions to employers and individual consumers to protect them from the consequences of death, disability or long-term sickness. Our expertise and market-leading positions in the UK also mean that we can export these skills and experience to international markets.

There is an unprecedented crisis facing traditional UK pension schemes. Not only are we living longer, but the fact that recent gilt yields have fallen below 2%, means that many UK companies are struggling to fund pension payments from their defined benefit (DB) schemes. The Pensions Protection Fund reported that the aggregate deficit for UK schemes covering nearly 12 million members was £245bn at the end of 2012. That's an average of £39m for each scheme.

The UK's largest 350 companies paid £20bn into their pension schemes in the year to 31 March 2012, with 40% of companies giving up more than a month's earnings to meet pension obligations.

### Innovative solutions to ensure UK pension schemes can meet their liabilities

We believe we are the market leader in retirement solutions, which helps DB pension schemes and their corporate sponsors increase the likelihood of meeting current and future liabilities.

We are well placed to provide solutions to help pension trustees pay current and future pensioners. Because of our diverse range of businesses and expertise, we can offer solutions to pension trustees that are specifically designed for them. Our businesses work together to ensure that pension scheme risk is managed in the most appropriate way.

### Using insurance solutions to manage longevity risk

As well as managing investment risk, we help DB schemes guarantee pension payments through buyouts, buy-ins and longevity insurance. Our annuity and investment management teams work together to evaluate whether certain schemes can benefit from transferring to us the liability to pay future pensions.

In 2012, we took over the responsibility of paying the pensions for a number of UK pension schemes for a total value of over £1bn, including a £347m 'buy-in' for the Tate & Lyle pension scheme. We estimate that there are still £1.7tn of pension liabilities that could potentially benefit from a transfer. Similar funding problems for DB schemes exist in North American and European countries and we have been active in seeking opportunities in these regions.

# WHAT WE ARE DOING CONTINUED

We also help schemes remove the risk of their members living longer than expected through longevity insurance contracts. Earlier this year, we agreed a £3.2bn transaction with BAE Systems to remove the longevity risk associated with 31,000 pensioners.

### Moving to defined contribution (DC)

As part of an overall pensions restructuring solution, we are also able to help UK companies set up new DC schemes. Where scheme trustees wind up their DB scheme, we have been able to help them set up a new DC scheme.

We attribute our success here to our expertise in providing competitive charging structures, our experience in administering workplace schemes together with our flexible range of workplace investment funds, including many diverse index tracker and fixed interest funds. In 2012, we helped a number of DB schemes reduce risk as well as setting up new DC schemes.

## HOW WE EXPANDED OUR RETIREMENT SOLUTIONS

**"Legal & General Investment Management (LGIM) is at the forefront in providing Liability Driven Investment (LDI) solutions for pension schemes, both in the UK and the US. The business has grown rapidly, with LDI AUM more than doubling over the last five years to £64bn."**
**MARK ZINKULA, CHIEF EXECUTIVE OFFICER (LGIM)**

Since establishing our first LDI mandate in 2001, we have built up a significant level of expertise in helping schemes match their liabilities to their scheme assets. Initially, we worked mainly with large-scheme trustees and advisers, using hedging instruments varying from traditional interest rate swaps and inflation swaps to more complex 'non-traditional' hedging instruments.

In the last year, we have developed a similar approach for our smaller and generally more governance constrained pension schemes and we will be rolling this out more widely over 2013. In the past these schemes have relied heavily on the results of their actuarial valuation every three years and have used the results of this to drive their investment strategy decisions. We can use our digital expertise to provide these schemes with more frequent online modelling which help them to understand the risk inherent in their assets and liabilities, thereby facilitating more timely reviews of their investment strategy. We are now leveraging our UK reputation and skills in the US market, winning both the UK and US LDI manager of the year awards.

## CORPORATE CUSTOMER SOLUTIONS

Our aim as an employee benefits market leader is to help all types of employers develop flexible and affordable solutions that simplify the task of protecting and enhancing the financial wellbeing of their staff, both in work and after retirement.

Over the last year we have also developed a number of innovative solutions that help both large and small UK companies manage the consequences of long term staff sickness and help an employee's dependants overcome the financial consequences of death.

### Workplace Savings solutions

With the launch of the Government's auto enrolment (AE) programme in October 2012, our strength as a provider of workplace schemes means that we are expecting over 500,000 employees to have joined our schemes through AE.

Since the roll-out of AE began in October 2012, we have been chosen by many well-known organisations such as Ladbrokes, the Co-op, Boots, Asda, Barclays, Thales, the National Trust, Marks & Spencer and the University of Nottingham.

Our proposition for these companies is at the forefront of the market, with competitive charging structures and a highly efficient managed service. Employers and their employees benefit from a complete end-to-end proposition, encompassing payroll integration, customer communications and flexible investment solutions, which use many of our low-cost funds developed by LGIM. Our innovative Mastertrust proposition is also an attractive option for employers seeking to reduce the burdens of complexity and governance overheads in their pension arrangements.

We have enhanced the facilities available on WorkSave, our digital corporate platform, to drive customer engagement, increase retention and build customer pension assets. The digital corporate platform enables access to educational resources and the opportunities that are available to them through the use of the online 'Manage you account' service. Account valuations, range of funds and planning tools are available to assist in planning their retirement income.

## THE UNIQUE SERVICE WE OFFER EMPLOYERS

**We are able to offer a unique integrated service for employers that no other UK financial services group can match. We have solutions for corporate schemes that cover pension saving, life assurance, income protection, investment management, annuities and pension scheme de-risking.**

The scale of our corporate businesses and the synergies between them create benefits for employers, their staff and our businesses. Recent examples of our integrated approach are our desire to offer preferential rates on individual life insurance to members of group protection schemes and the simplified protection application processes for corporate customers who are already workplace pension customers, where life cover is linked to pensions.

### Extending the reach of Group Protection

We see helping employers keep their staff healthy as a key goal, which not only contributes to the growth of our own and our corporate customers' businesses, but helps UK employees and UK society. We have developed a reputation for success in early intervention and rehabilitation treatments, which help long-term absentees return to work more quickly. Our aim is to help all types of companies to de-risk, by simplifying processes and cutting costs.

The role of our Group Protection business is to build solutions for our corporate customers, whether it's specialist support for the complex requirements of a UK FTSE 100 company or a simplified solution for a small firm with as few as ten workers.

We've now developed a range of health and wellbeing initiatives, including:

- The 'Healthy Living' online health tool to encourage employers and their staff to assess, monitor and improve their health. This is available to over two million Group Protection customers.
- An enhanced employee assistance programme, with free face-to-face counselling for Group Income Protection customers and bereavement counselling for employees covered by our Group Life insurance policies and their dependants.
- Our stress in the City campaign aims to reduce stigma in the workplace related to mental health. We've partnered with 'Rethink Mental Illness' to support companies and individuals affected by mental illness.

We also use technology to make life easier for our corporate customers. Our recently launched new online 'Quote and buy' portal enables small and medium-sized businesses to benefit from our group protection products, helping them to manage staff who are off sick, and giving access to a free employee assistance programme as well as our 'Healthy Living' online application. In addition, we use online technology to make death claims quicker and easier. We are now also working on the technology to integrate this into back-office processes.

# WHAT WE ARE DOING CONTINUED

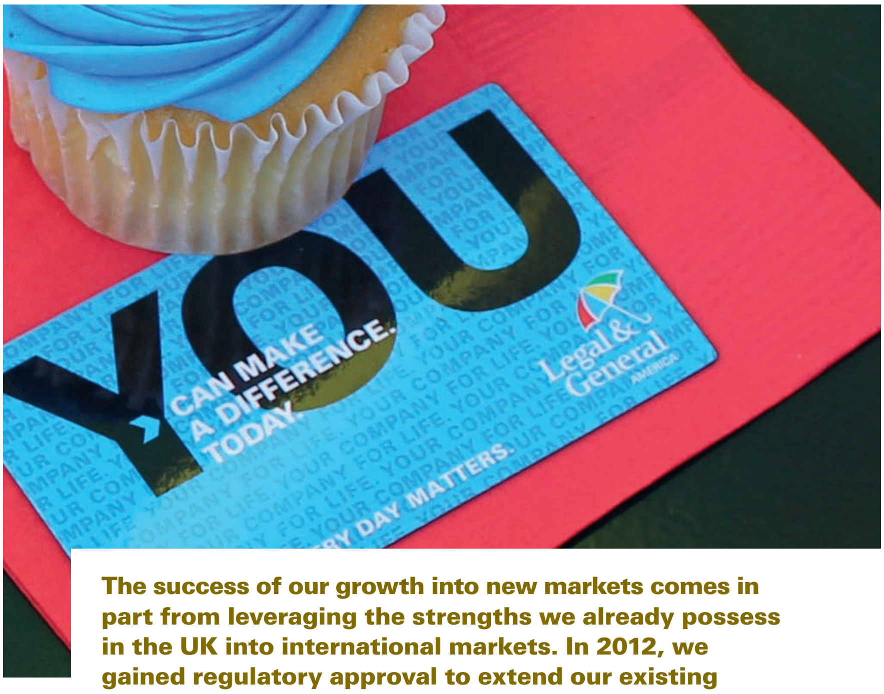
## INTERNATIONAL GROWTH

In 2012, one of our strategic objectives was to increase the pace with which we diversify our business internationally. We had notable successes in meeting this objective. Firstly, our US protection business achieved 28% growth in sales and is becoming a more significant contributor to Group profits. Secondly, we managed to export the success of our investment management business into a number of important international markets, most notably in the US and Middle East, but also in Europe and Asia.

At the same time, we changed the management structure of our international businesses in France, the Netherlands and India to take advantage of the huge expertise and scale that exists in our UK savings and insurance teams.

In the US, we have built a reputation for high quality servicing and innovative solutions, by building superior insight into the needs of our customers and distributors. Our disciplined underwriting approach means that we can give very competitive products to those customers who pose the lowest mortality risks.

## EXTENDING OUR US PRESENCE




**The success of our growth into new markets comes in part from leveraging the strengths we already possess in the UK into international markets. In 2012, we gained regulatory approval to extend our existing capability in index funds into the US. And because we had a market-leading strength in pension de-risking in the UK, we were able to establish a position in the US as an industry leader in liability-driven investment strategy (LDI). Our long-established credibility and ability to drive thought leadership meant that we were the 2012 winner of the Asset International CIO Innovation award.**

Our US insurance business has been transformed, becoming a vital part of the Group, sharing the same brand and commitment to the needs of customers. It has now become a major player in the US life insurance market, with a higher level of coverage than many well-known US brands. In 2012, we saw 28% growth in sales, in a relatively flat market and at a time when US middle class incomes were continuing to fall. Legal & General America now has the fifth largest market share out of term providers, with over 900,000 policies in force and total coverage of $500bn.

## STRUCTURING AND DEVELOPING OUR ORGANISATION

The success of our Company depends upon the quality of our staff and our Leadership Team to drive growth. Our focus in 2012 has been on:

- developing our digital capabilities;
- increasing employee engagement;
- training and developing our people; and
- ensuring that talented individuals are developed to be our future leaders.

Our aim is to provide our customers with easily accessible online information about us and our products, regardless of whether they go on to make a direct online application or seek advice. As well as developing online application processes, we intend to build two-way communications processes, delivered in a variety of digital formats.

We recognise that in the 21st century, as well as developing lifetime relationships with our customers we need to go one step further and foster their potential for promoting our products to their friends and family.

## PLATFORMS AND OTHER DIGITAL DEVELOPMENTS

The recent development of investment platforms has enabled customers to use flexible, digital applications, helping them to manage all their financial assets in one place, access a wide range of investment funds and ultimately, be better placed to achieve their financial goals.

Once the preserve of affluent consumers, we have differentiated ourselves from many of our competitors by opening up the platform market to mass-affluent high-street customers. Our investors might start off using our IPS platform to manage a single ISA investment, but eventually can choose to have a permanent home for a full range of investment plans.

One of the benefits of RDR is that it is now much easier for customers to understand separately what charges they pay for advice, fund management and platform facilities. We implemented a completely transparent 'unbundled' charging structure for our customers well before it was required by legislation.

## DIGITAL APPLICATIONS AND SOCIAL MEDIA

We have built a number of smaller applications for individual customers:

- In 2012, we launched 'Deadline to the Breadline' on Facebook and other digital media. This promotion highlighted that on average people in Britain could be on the breadline in just 19 days. We put videos and digital content onto Facebook to help people understand their own family's protection gap.
- We ran a number of campaigns highlighting to women the consequences of price rises under gender-neutral pricing. The results we received through digital media for the 'Time waits for no Woman' campaign were six times higher than we had expected.

## USING TECHNOLOGY TO BUILD OUR PLATFORM

**"Investment in technology is crucial to the success, efficiency and scalability of our business model. Our Investor Portfolio Service platform (IPS) provides a convenient means for over 400,000 of our customers to manage £8.6 billion of their savings. Our Workplace Savings platform (Worksave) gives us the flexibility to welcome and engage with employers and their employees. We have also launched technology solutions to enable our financial advisers to provide high quality financial advice to customers in an efficient way in a post RDR world."**

**MARK GREGORY, CHIEF EXECUTIVE OFFICER (SAVINGS)**

Some of our customers choose to manage their investments online in their own homes. Those who register with our platform to help manage their savings tend to have greater engagement with us and greater connection with their money. This is likely to make them return to us for repeat business. Indeed, 79% of last year's ISA business came from customers already registered with IPS. Our platform success is helping us to transform and modernise our savings business and has the following benefits:


- Our Healthy Living application was launched in April 2012.
- We are continuing to build quotation 'apps' for IFAs and our tied advisers.
- We built a digital game that was launched in March 2013, which highlights the need for protection in a fun way. The game is available for mobile devices via iTunes and Google play.

# WHAT WE ARE DOING CONTINUED

## GROWTH THROUGH INVESTING IN INFRASTRUCTURE


**Shrinking bank balance sheets and increasing regulatory pressure on banks' capital requirements means that insurance companies and pension funds can fill the gap in capital lending for infrastructure.**

We are well placed to accelerate our growth through investing in UK infrastructure. This helps stimulate local economies by providing employment in the building industries and encouraging local businesses to expand.

In addition, we have helped contribute to our communities at a national and local level. In 2012, we provided development funding for a sale and leaseback scheme to finance the building of the new National Football Centre at St George's Park in Burton-on-Trent. We also established a joint venture with Imperial College to build student accommodation with a 45-year lease, in Clapham, South London. We have provided a £121m commercial loan to the Unite Group, who are also responsible for building new student accommodation.

## EMPLOYEE ENGAGEMENT

At the heart of Every Day Matters is a promise to our customers. We will help them achieve financial security. It is this promise that drives our employees' dedication to delivering positive and socially useful outcomes. Over the last few years, we have accelerated our commitment to Every Day Matters and, despite a very difficult economic backdrop, we have seen a significant improvement in employee engagement.

This improvement is vitally important for our ambition to accelerate the growth of our business. We have a committed and motivated workforce. This gives us a competitive advantage in a market where some of our competitors are undergoing the disruption of restructuring. The increased commitment that our people feel towards the Company is also demonstrated by Legal & General entering the '*Sunday Times* Top 25 Best Big Companies to Work For' list. Joining this prestigious group means that we are even better placed to recruit and develop the type of future leaders who will help us fulfil our ambitious plans.

Like other successful FTSE 100 companies, we embrace change at the highest level. In 2012, Nigel Wilson was appointed as our new CEO. Nigel is committed to ensuring engagement levels continue to rise. To do this he has held sessions with a large number of our 8,000 plus global employees in a series of interactive staff presentations. These sessions were based around the themes of talent, teamwork and technology, with the customer firmly at the heart of discussions.

## TALENT AND PEOPLE DEVELOPMENT

### Using talent to accelerate our evolution

Our Leadership Academy was launched in the second quarter of 2012, offering a range of programmes to support all levels of leaders in the organisation. As part of this academy we established a new programme to accelerate the development of people with future leadership potential. This further strengthens our leadership capacity and succession plans for the future.

In late 2012, a re-structuring exercise took place where the roles of many of our business managing directors were rotated to broaden experience and extend synergies across the business.

### Learning and development

We have also refreshed our range of learning and development activities to align with our business priorities and have established a more sophisticated learning intranet site, called Every Day Learning. This learning site enables all employees, irrespective of location and role, to access learning. It has been designed to enhance personal performance and support career planning.

### Next steps

During 2013, we want to make a stronger connection between our performance management approach and talent development activities, which are now well established. In addition, a key initiative will be launched to look at how we might broaden the involvement of our diverse workforce so that we make the best use of all our talent.

## MANAGING OUR CAPITAL

The efficient management of our capital creates a solid base for us to enhance shareholder value. Furthermore, it enables us to deliver on the promises we make to our customers and allows us to invest in the future growth of our businesses. We remain one of the strongest UK insurance groups based on financial strength ratings, with a robust capital surplus above minimum regulatory requirements.

We aim to manage our capital in a way that delivers strong returns for customers and shareholders whilst operating within the risk appetite of the Group. We balance the need to invest in future growth, with rigorous cost management.

### SOLVENCY II

We have been successful in working with other insurers in the UK and Europe to ensure that the European Union's Solvency II regime represents an appropriate approach to prudential regulation from the perspective of customers, shareholders and the wider economy.

Good progress has been made in developing Solvency II rules, including the 'Matching Adjustment' that will reduce the impact of short-term market volatility on insurers' balance sheets. Some uncertainty remains, however, and we continue to be heavily engaged in the debate, including the response to EIOPA's (the European insurance regulator) 'Long Term Guarantees Assessment'. Implementation of the rules before 2017 is unlikely.

Given this delay, we welcome the initiative (known as ICA+) taken by the FSA to permit firms to use capability developed for Solvency II to meet current prudential requirements.

During 2013, we expect to further embed the use of our Economic Capital results in business decision-making, helping us to continue managing our risk profile within risk appetite limits and ensuring good returns relative to the risk-based capital employed.

### CAPITAL RESTRUCTURING

The major activity in 2012 focused on capital restructuring in our US business. On 31 December 2012 we completed a further phase of our capital efficiency programme. Through the use of a capital-efficient reinsurance solution, this phase improved the capital position of Legal & General America (LGA) and replaced the need for temporary financing, resulting in a total benefit of $345m. As a result, our Group IGD surplus capital increased by £172m.

In total, the programme, which started in 2010, has delivered $735m of capital benefit for LGA and a total benefit to L&G Group IGD surplus capital of £402m. We are pleased to have delivered these two phases in 2012, ahead of the schedule indicated at the 2012 half year results.

The capital programme has contributed to increased sales in the US of our term life insurance products and has helped to more than double our new business margins over the last three years.

In January 2012, Standard & Poor's raised the financial strength rating for LGA from A+ to AA-, reflecting its strong competitive position, conservative investment portfolio and strong liquidity position, coupled with the stable outlook of the parent company.

### OUR BALANCE SHEET STRENGTH

Our capital management policies and our strong risk controls have enabled us to keep our balance sheet robust. Under a Pillar 1 capital basis the Group has a surplus over the capital resources requirement of £4.1bn compared to £3.8bn at the end of 2011. This gives us an improved coverage ratio of 234% compared with 220% at the end of 2011.

This capital buffer is in addition to the £1.7bn of LGPL (the Group's main annuity subsidiary) credit default provision. During the year we have demonstrated that we remain committed to optimising the Group's worldwide capital structure for the benefit of our shareholders.

## ENGAGING OUR EMPLOYEES

**In 2012, our annual employee survey illustrated how engagement is advancing rapidly.**

- We had the highest ever participation score, with 7,000 people worldwide responding to the survey.
- Our employee engagement score improved from 73% to 78%.
- Our leadership index, which measures how our employees value their management, increased from 68% to 72%.
- Legal & General America had some of the highest ever engagement scores; despite Hurricane Sandy hitting the East coast during the survey period.

# "It's about dealing with difficult situations where customers are having a tough time and aren't in the best of circumstances."

"In this job you have to be empathetic to the people who are calling in, putting yourself in the customers' shoes, be it someone who has been bereaved or someone who is critically ill, someone who's lost their job... there are all sorts of situations that we help people with."

**KATE,** KINGSWOOD

For more information please visit
**legalandgeneralgroup.com**

## IN THIS SECTION

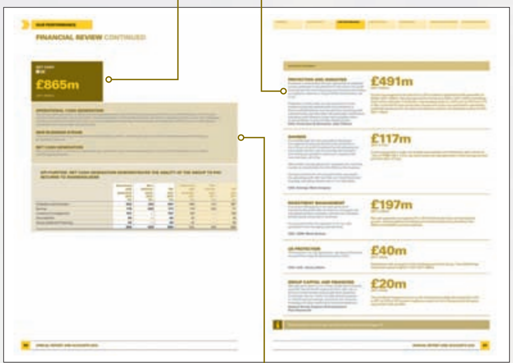


## HOW TO NAVIGATE THIS REVIEW

In this section we have included our KPIs and explicitly outlined the measurements that are used in deciding executive remuneration, and other financial results, which we believe are integral to our performance. We have amended the way we present this information to better reflect the measurements used by management to improve the transparency of our financial performance with detailed financial disclosures.

**Measure used by management**

**Explanation of why the measure is used by management**



**Accounting policy**

### GUIDE TO SYMBOLS:

Key performance indicator (KPI)

Key measure in the remuneration of executives

# FINANCIAL REVIEW.

**WORLDWIDE SALES (APE)**

**£2.1bn**

(2011: £1.8bn)

**LGIM ASSETS UNDER MANAGEMENT (AUM)**

**£406bn**

(2011: £371bn)

**SAVINGS ASSETS UNDER ADMINISTRATION (AUA)**

**£70bn**

(2011: £65bn)

## WORLDWIDE ANNUAL PREMIUM EQUIVALENT (APE)

Annual Premium Equivalent is an industry measure of new business that is common in the UK. It is the total value of regular premiums, plus 10% of any new single premiums written for the year.

| | Annual premiums 2012 £m | Single premiums 2012 £m | APE 2012 £m | Annual premiums 2011 £m | Single premiums 2011 £m | APE 2011 £m |
|---|---|---|---|---|---|---|
| Retail protection | 151 | – | 151 | 131 | – | 131 |
| Group protection | 70 | – | 70 | 46 | – | 46 |
| Annuities | – | 2,339 | 234 | – | 2,515 | 251 |
| Netherlands (LGN) | 13 | 82 | 21 | 5 | 95 | 15 |
| France (LGF) | 38 | 233 | 61 | 24 | 232 | 47 |
| France (LGF) retail investment business | – | 105 | 11 | – | 46 | 5 |
| **Total Protection and Annuities** | **272** | **2,759** | **548** | 206 | 2,888 | 495 |
| Investments | 69 | 5,285 | 598 | 68 | 6,200 | 688 |
| Insured | 519 | 2,383 | 757 | 244 | 2,015 | 445 |
| With-profits | 58 | 342 | 92 | 69 | 525 | 122 |
| India (26% share) | 7 | 24 | 9 | 5 | 22 | 7 |
| **Total Savings** | **653** | **8,034** | **1,456** | 386 | 8,762 | 1,262 |
| **US Protection** | **90** | **–** | **90** | 69 | – | 69 |
| **Other (Egypt and the Gulf)** | **18** | **6** | **19** | 11 | 5 | 11 |
| **Worldwide APE** | **1,033** | **10,799** | **2,113** | 672 | 11,655 | 1,837 |

## LGIM ASSETS UNDER MANAGEMENT (AUM)

Assets under management is the total amount of money investors have trusted to our fund managers to invest across all of our investment products.

| | 2012 £m | 2011 £m |
|---|---|---|
| Index tracking funds | 243,185 | 224,168 |
| Actively managed funds | 98,830 | 88,684 |
| Liability-driven investments | 63,957 | 58,359 |
| **LGIM funds under management** | **405,972** | 371,211 |

## SAVINGS ASSETS UNDER ADMINISTRATION (AUA)

Assets under administration is the total amount of money held within all of our Savings products. These funds are managed by a number of investment managers, including LGIM.

| | 2012 £m | 2011 £m |
|---|---|---|
| Investments | 28.4 | 25.3 |
| Insured | 21.6 | 19.1 |
| With-profits | 20.1 | 20.5 |
| **Savings assets under administration** | **70.1** | 64.9 |

BUSINESS SEGMENT

## PROTECTION AND ANNUITIES

### RETAIL PROTECTION – continues to deliver outstanding performance with sales up 15%

Retail Protection sales were up 15% to £151m (2011: £131m), the highest level since 2007, with gross premiums now 4% higher at £947m (2011: £914m). Our market-leading business benefits from diversified distribution through IFAs and tied distribution agreements with Nationwide, Yorkshire and Leeds Building Societies (among others). We continue to diversify our product offering with our non-mortgage related protection products, which now account for over 50% of sales.

### GROUP PROTECTION – high quality proposition has achieved sales growth of 52%

Group Protection's high quality proposition has achieved sales growth of 52% to £70m (2011: £46m) and gross premiums are up by 12% to £321m (2011: £286m) as a result. Auto enrolment has encouraged companies to review employee benefits and a number have taken Legal & General's Group Protection products alongside our Workplace pensions proposition and we continue to see strong demand for our public sector products.

### ANNUITIES – record Individual Annuity sales up 26%

Individual Annuity sales were up 26% to a record £132m (2011: £105m) benefiting from growth in average pension pots. The final quarter of 2012 saw record sales of £45m, more than double those for the same period in 2011. This was delivered through maintenance of gender specific rates until 20 December 2012. Capability in bulk purchase annuities is demonstrated through sales of £102m (2011: £146m) and the completion of a £347m partial buy-in with respect to Tate & Lyle's defined benefit pension scheme in December 2012. Note that the 2011 comparative included £110m from the Turner & Newell deal.

### FRANCE AND NETHERLANDS – progress on Protection business

France and Netherlands sales have grown significantly during the year. France APE is up by 38% and Netherlands by 40%. This reflects a successful re-launch of the Netherlands term products and a 72% increase in France Group Protection new business sales.

### GENERAL INSURANCE – distribution reach increased and sales up 15%

General Insurance gross premiums increased by 15% to £349m (2011: £304m) benefiting from 27% growth from our broker accounts and 36% from direct sales. General Insurance still delivered a healthy operating profit of £30m (2011: £42m) despite less favourable weather conditions in 2012, through effective management of costs and selection of risk.

### LEGAL & GENERAL NETWORK – market share of 25% of intermediated mortgages

The Network facilitated lending of £19bn in 2012 (2011: £16bn) and was responsible for 1 in 8 UK mortgages.

## SAVINGS

### INVESTMENTS – net inflows of £1.2bn on our bancassurance IPS platform

Savings Investments operating profit of £16m (2011: £23m) reflects the investment in our RDR proposition to our IFA and Building Society partners. The retail savings market has nevertheless been challenging. The current low interest rate environment made structured products less attractive to customers, and as a result sales of the product reduced to £25m (2011: £102m). This, coupled with adviser focus on preparing for RDR and constraints on customers' disposable income, resulted in Savings Investments sales reducing to £598m (2011: £688m).

### INSURED – Workplace platform gained £1.6bn net inflows

Insured Savings operating profit grew by 41% to £48m (2011: £34m). Net cash generation increased to £46m (2011: £38m) and operational cash generation increased to £108m (2011: £101m). New business strain was broadly flat at £62m (2011: £63m) despite the 69% growth in Insured Savings sales. This reflects the benefits of our automated and scalable Workplace Pensions platform. The growth in our Workplace business offset outflows from insured bonds business, resulting in total Insured Savings net inflows of £0.6bn (2011: £0.4bn) and record APE sales of £766m (2011: £452m).

### WITH PROFITS – maturing endowments in line with expectation

With-profit Savings operating profit was £69m (2011: £69m) with net cash generation of £52m (2011: £51m). Assets under administration reduced marginally to £20.1bn (2011: £20.5bn) where net outflows of £2.2bn reflect the ageing profile of the book as endowments sold in the 1980s mature.

### ASSETS UNDER ADMINISTRATION – up 8% to a record £70bn

Assets under administration (AUA) increased to £70bn, up 8% on 2011. In 2012, our Workplace platform grew 58% to £6.0bn (2011: £3.8bn) and will continue to grow as more schemes are transferred to the platform and employees auto enrol. Investor Portfolio Services (IPS), our bancassurance platform, now has £8.6bn of assets (2011: £6.8bn) and is positioned to take advantage of the changes the Retail Distribution Review (RDR) will bring.

## INVESTMENT MANAGEMENT – international expansion driving net flows of £7.1bn, up 139%

LGIM's net inflows of £7.1bn were over double the £3.0bn of 2011, benefiting from record gross inflows of £34.2bn. This has led to an increase in assets under management (AUM) of 9% to £406bn (2011: £371bn). LGIM's total revenue increased 7% to £446m (2011: £417m) reflecting the growth in AUM, whilst operating profit increased to £243m (2011: £234m). The cost:income ratio was an excellent 46%, although it increased marginally on 2011 as LGIM invested in resources to deliver its strategies for growth. We continue to deliver on our international growth strategy with net inflows from international clients of £7.8bn (2011: £4.5bn). International assets have increased 34% to £43bn (2011: £32bn) and now account for over 10% of LGIM's AUM.

## US PROTECTION – sales up 28% to $142m; core term product grown over 12 consecutive quarters

Legal & General America (LGA) delivered record sales with 28% growth to $142m (2011: $111m) where a focus on promoting LGA's products to key brokerage agents in the US market has allowed sales to increase significantly. LGA is now a top five provider of term assurance in the US, from outside the top ten just three years ago. Growth in sales resulted in gross premiums increasing 10% to $922m (2011: $836m).

More details of new business can be found on page 126.

# FINANCIAL REVIEW CONTINUED

## OPERATING PROFIT BEFORE TAX

**£1,087m**

(2011: £1,053m)

## OPERATING PROFIT BEFORE TAX

Operating profit information provides further analysis of the results reported under IFRS and we believe gives shareholders a better understanding of the underlying performance of the business. Operating profit measures the pre-tax result using a smoothed longer-term investment return. Any variance between actual and smoothed investment returns is reported below operating profit.

## KPI PURPOSE: OPERATING PROFIT GIVES AN INSIGHT INTO THE GROUP'S ABILITY TO GENERATE CASH FLOWS TO SUPPORT DIVIDENDS.

| | Net cash[1] 2012 £m | Experience variances 2012 £m | Changes in valuation assumptions 2012 £m | Non-cash items and other[2] 2012 £m | IFRS profit/(loss) after tax 2012 £m | Tax expense/ (credit) 2012 £m | IFRS profit/(loss) before tax 2012 £m |
|---|---|---|---|---|---|---|---|
| Protection and annuities | 491 | 14 | (2) | (22) | 481 | 159 | 640 |
| Savings | 117 | (39) | 20 | 2 | 100 | 33 | 133 |
| Investment management | 197 | – | – | – | 197 | 46 | 243 |
| US protection | 40 | – | – | 22 | 62 | 37 | 99 |
| Group capital and financing | 20 | – | – | (2) | 18 | 4 | 22 |
| Investment projects | – | – | – | (38) | (38) | (12) | (50) |
| Operating profit | 865 | (25) | 18 | (38) | 820 | 267 | 1,087 |
| Investment variance and other | – | – | – | (19) | (19) | (32) | (51) |
| **Total** | 865 | (25) | 18 | (57) | 801 | 235 | 1,036 |

| | Net cash[1] 2011 £m | Experience variances 2011 £m | Changes in valuation assumptions 2011 £m | Non-cash items and other[2] 2011 £m | IFRS profit/(loss) after tax 2011 £m | Tax expense/ (credit) 2011 £m | IFRS profit/(loss) before tax 2011 £m |
|---|---|---|---|---|---|---|---|
| Protection and annuities | 467 | 22 | 24 | (74) | 439 | 162 | 601 |
| Savings | 111 | (12) | (5) | (2) | 92 | 34 | 126 |
| Investment management | 189 | – | – | – | 189 | 45 | 234 |
| US protection | 35 | – | – | 28 | 63 | 34 | 97 |
| Group capital and financing | 44 | – | – | (1) | 43 | 8 | 51 |
| Investment projects | – | – | – | (41) | (41) | (15) | (56) |
| Operating profit | 846 | 10 | 19 | (90) | 785 | 268 | 1,053 |
| Investment variance and other | – | – | – | (64) | (64) | (36) | (100) |
| **Total** | 846 | 10 | 19 | (154) | 721 | 232 | 953 |

1. Net cash is defined in the Glossary on pages 251 and 252, and further analysis is provided on page 30.
2. Investment gains and losses, international, and other.

| BUSINESS SEGMENT | OPERATING PROFIT BEFORE TAX |
|---|---|
| **PROTECTION AND ANNUITIES** Operating profit for the Protection and Annuities segment represents the profit from the annuities business (individual and bulk purchase Annuities and longevity insurance), profit from the Housing and Protection businesses (general insurance, and retail and group protection business) and profit from our France and Netherlands businesses. Operating profit reflects the investment returns that the business expects to make on the financial investments that back this business and on shareholder funds retained within our general insurance business. **CEO, Protection and Annuities: John Pollock** | **£640m** (2011: £601m) Operating profit for Protection and Annuities increased by 6% to £640m (2011: £601m), with particularly strong results in Protection as a result of management of reinsurance and the use of automated underwriting in the Retail Protection business. The Protection and Annuities products also benefit from high quality analysis of risk factors and scale of customer data that enables more accurate pricing of risk at inception. |
| **SAVINGS** Operating profit for the Savings segment represents the profit from the Insured Savings businesses, (non-profit investment bonds and non-profit pensions, including SIPPs), the with-profits transfer and the profit from our Savings Investments business. Operating profit for the Insured Savings business reflects the investment returns that the business expects to make on the financial investments that back this business. **CEO, Savings: Mark Gregory** | **£133m** (2011: £126m) Savings operating profit before tax is up 6% in 2012. This is a result of continuing growth in scale with our Workplace Savings platform growing 58% to £6.0bn (2011: £3.8bn) and our Investment Portfolio Service (IPS) platform for bancassurance growing 26% to £8.6bn (2011: £6.8bn). This growth was achieved whilst investing to maximise the opportunities arising from two significant changes to UK regulation (Auto enrolment and the Retail Distribution Review). |
| **INVESTMENT MANAGEMENT** Operating profit for the Investment Management segment represents the operating profit before tax on our managed and segregated pension business, institutional mandates, private equity, property business and internal funds. **CEO, LGIM: Mark Zinkula** | **£243m** (2011: £234m) LGIM's operating profit before tax grew 4% in 2012 driven by an increase in AUM of 9%, from £371bn at the end of 2011 to £406bn at the end of 2012, and a growth in the proportion of international assets. |
| **US PROTECTION** Operating profit for the US Protection business principally represents profit on our protection and universal life products written by Legal & General America (LGA). **CEO, LGA: Jimmy Atkins** | **£99m** (2011: £97m) Operating profit grew by 2% in 2012. The significant driver for the increase in profit was an increase of 10% in gross premium driven by a record sales year. |
| **GROUP CAPITAL AND FINANCING** Operating profit represents the expected return on Group invested assets using longer-term expected investment returns. It also includes interest expense on total Group borrowings (excluding non-recourse financing and other unallocated corporate expenses), and our joint ventures in Egypt and the Gulf. Investment returns and group expenses are before the impact of tax. **Head of Group Treasury & Investments: Paul Stanworth** | **£22m** (2011: £51m) The smoothed investment return of £168m (2011: £191m) is calculated asset class by asset class and equates to an annualised average smoothed investment return of 3.9% (2011: 4.7%) on the average balance of invested assets of £4.3bn (2011: £4.0bn). The fall in the average investment return is predominantly due to a reduction in the assumed returns on UK equities to 5.8% (2011: 7.5%). Interest expense of £127m (2011: £123m) reflects the average cost of debt of 4.9% per annum (2011: 4.8%) on the average debt balance of £2.6bn (2011: £2.6bn). |

More details of operating profit can be found on page 118.

# FINANCIAL REVIEW CONTINUED

## NET CASH

# £865m

(2011: £846m)

## OPERATIONAL CASH GENERATION

Operational cash generation is defined as the expected release from the in-force business for the UK non-profit Protection and Annuities and Savings businesses, the shareholders' share of bonuses on with-profits business, the post-tax operating profit on other UK businesses, including an expected investment return on Group Capital and Financing invested assets, and dividends remitted from our international businesses from sustainable cash generation.

## NEW BUSINESS STRAIN

This is the impact of writing new business on the regulatory position, including the cost of acquiring new business and the setting up of regulatory reserves.

## NET CASH GENERATION

Net cash generation is defined as operational cash generation less new business strain for UK non-profit Protection and Annuities and Savings businesses.

## KPI PURPOSE: NET CASH GENERATION DEMONSTRATES THE ABILITY OF THE GROUP TO PAY RETURNS TO SHAREHOLDERS

| | **Operational cash generation 2012 £m** | **New business strain 2012 £m** | **Net cash 2012 £m** | Operational cash generation 2011 £m | New business strain 2011 £m | Net cash 2011 £m |
|---|---|---|---|---|---|---|
| Protection and Annuities | **522** | **(31)** | **491** | 498 | (31) | 467 |
| Savings | **179** | **(62)** | **117** | 174 | (63) | 111 |
| Investment management | **197** | **–** | **197** | 189 | – | 189 |
| US protection | **40** | **–** | **40** | 35 | – | 35 |
| Group capital and financing | **20** | **–** | **20** | 44 | – | 44 |
| | **958** | **(93)** | **865** | 940 | (94) | 846 |

BUSINESS SEGMENT

## PROTECTION AND ANNUITIES

Protection and Annuities net cash represents the expected surplus generated in the period from the in-force non profit business less the cost of acquiring new business and setting up regulatory reserves in respect of the new business, net of tax.

Protection and Annuities net cash generation further includes dividends received from our businesses in France and Netherlands and the net of tax operating profit reported in the year from other UK businesses. Netherlands operating profit reflects a longer-term expected return on shareholders' funds and index linked policies.

**CEO, Protection & Annuities: John Pollock**

**£491m**

(2011: £467m)

Continuing progression in scale led to a 5% increase in operational cash generation to £522m (2011: £498m). Net cash generation increased to £491m (2011: £467m) benefiting from further reduction in Protection new business strain to a 20% ratio to APE from 37% in 2011, achieved through economies of scale and continuous optimisation generating profitable new business. Annuities maintained a positive new business surplus of £14m (2011: £35m).

## SAVINGS

Insured Savings net cash generation represents the expected surplus generated in the period from the in-force non profit investment bonds and pensions businesses less the cost of acquiring new business and setting up regulatory reserves in respect of the new business, net of tax.

With-profits net cash generation represents the net of tax transfer to shareholders from the With-profits business.

Savings Investments net cash generation represents the operating profit after tax from our retail investment business, excluding movements in non cash items.

**CEO, Savings: Mark Gregory**

**£117m**

(2011: £111m)

Continuing growth in scale and writing new business more efficiently, with a strain of 1.6% of PVNBP (2011: 2.7%), has led to record net cash generation in the Savings division of £117m (2011: £111m).

## INVESTMENT MANAGEMENT

Investment Management net cash generation represents the profit after tax from our managed and segregated pension business, institutional mandates, private equity and property business.

Incorporated within this segment is the net cash generation from managing internal funds.

**CEO, LGIM: Mark Zinkula**

**£197m**

(2011: £189m)

Net cash generation increased 4.2% in 2012 driven by the focus on international growth, retaining defined benefit pension funds and attracting new flows into defined contribution pension schemes.

## US PROTECTION

US Protection net cash generation represents dividends received from Legal & General America (LGA).

**CEO, LGA: Jimmy Atkins**

**£40m**

(2011: £35m)

Operational cash generation is the dividends paid to the Group. This dividend has continued to grow to $63m in 2012 (2011: $58m).

## GROUP CAPITAL AND FINANCING

Net cash generation for our Group Capital and Financing segment represents the expected return after tax on Group invested assets using longer-term expected investment returns. It also includes interest expense on total Group borrowings, excluding non-recourse financing and other unallocated corporate expenses.

**Head of Group Treasury & Investments: Paul Stanworth**

**£20m**

(2011: £44m)

The smoothed investment return on the investment portfolio decreased from 4.7% in 2011 to 3.9% in 2012 predominately as a result of a fall in the assumed UK equity return (from 7.5% to 5.8%).

i More details of cash generation for protection and annuities and savings can be found on pages 119 and 122 respectively.

# FINANCIAL REVIEW CONTINUED

| PROFIT BEFORE TAX | RETURN ON EQUITY |
|---|---|
| £1,036m | 15.5% |
| (2011: £953m) | (2011: 14.9%) |

| EARNINGS PER SHARE | FULL YEAR DIVIDEND |
|---|---|
| 13.90p | 7.65p |
| (2011: 12.42p) | (2011: 6.40p) |

## GROUP METRICS

### PROFIT BEFORE TAX (PBT)

Profit before tax measures profit attributable to shareholders incorporating actual investment returns experienced during the year.

**£1,036m**
(2011: £953m)

IFRS profit before tax is up 8.7% on 2011 despite a £39m adverse investment variance and £12m losses relating to non-controlling interests.

### RETURN ON EQUITY (ROE)

ROE measures the return by shareholders on shareholder capital retained within the business. ROE is calculated as IFRS profit after tax divided by average IFRS shareholders' funds.

**KPI Purpose: ROE provides a link between performance and balance sheet management and ensures an appropriate balance is maintained between the two.**

**15.5%**
(2011: 14.9%)

The Group has generated a strong return on equity, demonstrating the careful use of capital by the business units, offsetting the impact on ROE from the low returns on the £6.5bn of Group shareholder assets.

### EARNINGS PER SHARE (EPS)

EPS is a common financial metric, which can be used to measure the profitability and strength of a company over time. It is the total earnings divided by the number of shares outstanding. Basic EPS uses a weighted average of shares outstanding during the year.

**13.90p**
(2011: 12.42p)

The Group has delivered outstanding EPS growth of 12% driven by the growth in the underlying profits of the business units. This demonstrates the clear linkage between cash generation and returns.

### FULL YEAR DIVIDEND

Full year dividend is the total dividends for the year (including interim dividends) divided by the number of outstanding ordinary shares in issue.

**KPI Purpose: Full year dividend per share demonstrates the level of distribution to shareholders.**

**7.65p**
(2011: 6.40p)

Double digit growth in earnings per share and a robust capital position coupled with the high level of visibility of future cash flows has led the Board to recommend an increase of 20% in the final dividend to 5.69p (2011: 4.74p) bringing the full year dividend to 7.65p (2011: 6.40p). The cost of the full year dividend is £452m (2011: £375m) and is covered 1.91 times by the net cash generation.

| TOTAL SHAREHOLDER RETURN | IGD SURPLUS | EEV PER SHARE |
|---|---|---|
| 50% | £4.1bn | 173p |
| (2011: 11%) | (2011: £3.8bn) | (2011: 167p) |

GROUP METRICS

## TOTAL SHAREHOLDER RETURN (TSR)

TSR is a measure used to compare the performance of different companies' stocks and shares over time. It combines the share price appreciation and dividends paid to show the total return to shareholders.

**KPI Purpose: TSR measures total return to shareholders including dividends and share price movements.**

**50%**
(2011: 11%)

Based on TSR performance, we are in the top quartile of the FTSE 100 (12th position as at 31 December 2012) after giving our investors a 50% return on their investment. On a longer-term view, our three-year TSR performance is 112% (over the three years to 31 December 2012).

## INSURANCE GROUP DIRECTIVE (IGD) SURPLUS

The IGD surplus is an FSA regulatory measure, which calculates surplus capital within the Group. IGD surplus is defined as Group regulatory capital less the Group regulatory capital requirement, after accrual for proposed dividends. Surplus capital held within Society's Long Term Fund cannot be included in the IGD definition of capital employed.

**KPI Purpose: IGD surplus is the Group regulatory surplus capital measure.**

**£4.1bn**
(2011: £3.8bn)

The Group has a very strong IGD surplus of £4.1bn with a coverage ratio of 234%, after allowing for accrual of final dividend (2011: £3.8bn; 220% coverage). This surplus supports us in our ability to grow the business. The growth in surplus reflects the strong cash generation of the Group and the benefits of the US capital efficiency programme, which through the use of reinsurance solutions has benefited the Group surplus by £260m in 2012. The LGPL credit default provision of £1.7bn (2011: £1.6bn) remains in place to fund against the risk of credit defaults and is equivalent to 60bps (2011: 61bps) of defaults over the life of the portfolio.

## EUROPEAN EMBEDDED VALUE (EEV) PER SHARE

EEV per share is used to measure value creation over time. It is the Group EEV including LGIM, divided by the closing number of shares in issue.

**KPI Purpose: EEV per share provides shareholders with an insight into the value of the existing book of business at the balance sheet date.**

**173p**
(2011: 167p)

The Group has delivered £734m (2011: £1,231m) of EEV profit after tax, which after external dividend payments of £394m and foreign exchange, pension deficit and other adjustments of £(48)m, increased EEV shareholders' equity to £8,900m (2011: £8,608m). The number of shares increased to 5,913m (2011: 5,872m) principally due to the vesting of three-year Save As You Earn (SAYE) options granted to our employees in 2009. This movement in equity coupled with the increase in the number of shares equates to a shareholder's equity per share of 151p (2011: 147p).

Including the external assets of LGIM on an embedded value basis increases the Group EEV shareholders' equity by £1.3bn, resulting in an EEV per share of 173p (2011: 167p).

# "It's knowing that millions of people rely on us for their pensions."

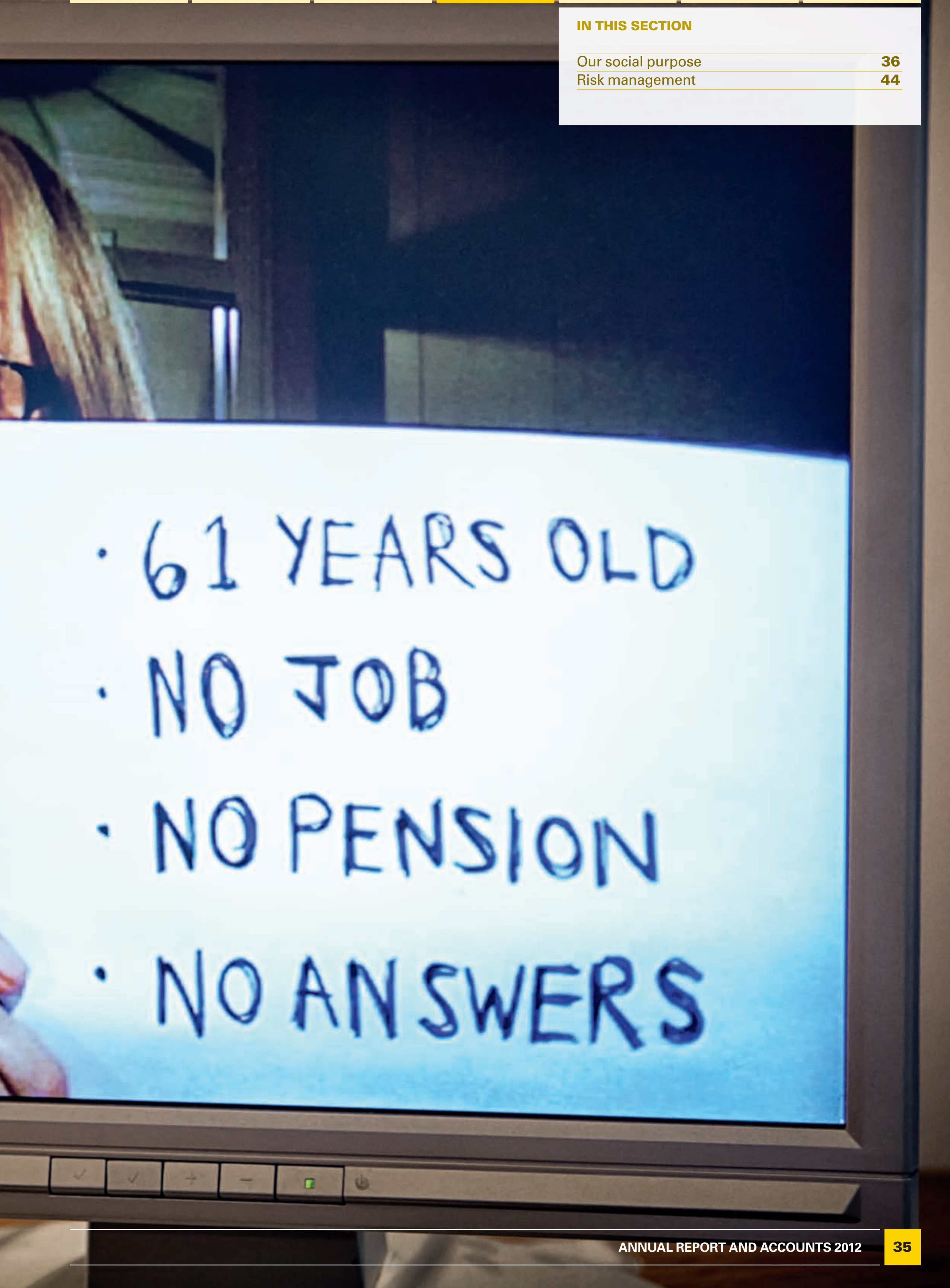
"We speak to a lot of older people, some who are quite lonely, they tell us a lot about their children, how their life is going. We get to know people more than even some of their friends do because we ask about their finances, their mortgages, their life cover and their hopes and dreams."

**TRISH,** HOVE

For more information please visit
**legalandgeneralgroup.com**

## IN THIS SECTION





# OUR SOCIAL PURPOSE.

**JOHN POLLOCK, CHIEF EXECUTIVE OFFICER (PROTECTION AND ANNUITIES)**

**"Insurance has a powerful social purpose. We make a promise to our customers that we will be there to stand behind that promise when disaster or tragedy strikes. Our clear aim is to be a force for good in society, make every day matter for our customers and staff and live by the promises we make in our high quality products."**

## OUR ROLE IN SOCIETY

Although our business priorities are ensuring that we deliver value to our shareholders and customers, we also believe that our role in society is broader than simply the financial impact of what we do.

In its simplest form, we believe that our purpose is to help make financial security easier to achieve. To do this, we aim to provide good value, high quality products for our customers.

There are a number of issues central to the wellbeing of society where we have an interest and a degree of influence, and therefore a responsibility to engage in broader debate. A better informed business that interacts with experts in the outside world is a better run business.

To do this we:
- talk to the specialists who understand how we can help our customers more effectively;
- play an active role in the communities that we are part of; and
- share our resources to help charities who benefit society.

In this section of our report we will outline a variety of social issues, explain the relevance to us as a business and then outline the work we have undertaken and the relationships we have made to work towards improving outcomes.

## HOUSING MATTERS

Housing needs are a key issue in the UK with increasing costs and a lack of supply in many areas. We interact with the housing sector on a number of levels: as a provider of insurance policies that cover people's homes, their income or perhaps the value of their mortgage upon death; as a point of access to the mortgage market; and as a provider of funding for residential and commercial property.

### WORKING WITH SHELTER

Our long term partnership with Shelter continues. With their input we have developed a home contents insurance product for social housing providers after discovering that access to contents insurance was an issue for many social housing residents.

We have also developed a new Capital Loans business through our investment arm, LGIM, which provides much needed loans to social housing providers who need capital to grow their housing stock. Our aim is to lend to these organisations as banks deleverage their balance sheets and withdraw from this sector. This matches our need for fixed income investments, which allow us to pay our annuity customers their pension.

During the year we have hosted a number of industry debates on the 'Economic Case for Housing', bringing together a range of experts from this sector to discuss the many aspects of this issue from lack of supply to the pressures that estate agency fees have on the landlord and the impacts that has on the tenant. We have also worked with the charity HACT on the social impact of housing.

We have also funded front line practical services for Shelter. Their West Sussex Shelter is a walk-in and outreach service, giving advice to tenants and homeowners who are facing housing difficulties. Each quarter this valuable service provides around 60 people with someone who stands side by side with them in court to help them avoid losing their home and around 300 people with face-to-face advisory sessions to help with housing issues.

### FLOODING AND THE RNLI

We have begun working with the RNLI and Association of British Insurers (ABI) to understand the true impact of flooding in the UK and the impact of the Government's schemes to address this.

We are providing training for front line home insurance employees at the RNLI's flood training centre so that they can better understand and empathise with our customers about what it's really like to be affected by a flood.

We are planning a number of initiatives in 2013, which will enable us to further understand the real impacts that flooding has on our customers.

## PENSIONER POVERTY MATTERS

Financial security in retirement largely depends on having a stable income, which our products and services aim to provide. We help people to save for retirement through a pension, either individually or through their employer, and then provide an income through an annuity. We have been actively involved in Government consultations on changes to the state pension and auto enrolment and on the issue of long term care funding.

### WORKING WITH THE ELDERLY ACCOMMODATION COUNSEL (EAC)

We continue to support the EAC's National 'Housing for Older People Awards', which are designed to help residents of retirement housing to independently rank how their landlords support and provide for them.

We have also provided joint research and insights into the impact that longevity is having on retirement housing supply through Joseph Lu, Legal & General's Longevity Expert.

The EAC team have also provided valuable training and understanding for Legal & General employees called 'Helping Mum and Dad – Anticipating Needs and Aspirations in Later Life' to enable them to understand the challenges that our employees may face as the children of ageing parents when looking at retirement housing needs and options for their loved ones.

We have worked with EAC to research the needs of older people when they select their annuity provider. The outcome of this research, the HOOP (Housing Options for Older People), was relaunched in 2012 and provides valuable insights into the ways that the over-55s are living their lives.

EAC and its partners have also provided some valuable insights into the long term needs in retirement housing to our home insurance, commercial property and mortgage club businesses.

### WORKING WITH AGE UK

We continue to work with Age UK to train front line employees on the needs and requirements of older customers and the different level of service that they may require from us.

We have provided front line employees with access to the Age UK Befriending Scheme. This means employees can work with older people on a weekly basis, providing regular contact and help to alleviate loneliness.

Working with Age UK we jointly created the 'Living on £70 a week' initiative where 130 of our employees

# OUR SOCIAL PURPOSE CONTINUED

lived on the State pension to understand some of the pressures that our customers would face without a pension. This coincided with the roll-out of auto enrolment which has provided a valuable way to get a younger workforce to understand the needs for pensions.

Through our joint venture, IndiaFirst, we have worked with HelpAge India to support their Mumbai-based Mobile Medicare Unit (MMU) in providing valuable front line services to the elderly who find it hard to access medical services. The MMU covers 22 slum areas of Mumbai giving free treatment to over 2,000 patients over the age of 65 each month.

## TAX AND OUR CUSTOMERS

During 2012, we have continued to work with Tax Help for Older People (TaxHelp), a charity providing free, expert, independent tax advice for people over 60 who live in a household with a net income of less than £17,000 a year. We are delighted to work in partnership with TaxHelp, financially supporting their valuable work and in return receiving assistance and training for our customer services teams to better understand the needs of our older customers. We've also been able to refer some of our customers with more complex tax affairs to TaxHelp for advice.

## SAVINGS MATTERS

Our Savings Business provides investment and savings products that allow people to plan for the future and for retirement. Saving isn't always easy. We have a range of community projects to help people take the first steps to save for their future. As the economic climate continues to challenge all of us financially, more and more consumers are aware of the need to save – while having more calls on their income than ever. As a financial services company, we believe it is part of our role to support a cross-generational savings culture and to help people at the fringes of our traditional marketplace. Our products are aimed at people who regularly save. But we also need to understand the attitudes of the next generation and guide them into adopting a prudent attitude to savings.

## WORKING WITH WEST SUSSEX AND SURREY SAVE CREDIT UNIONS

Following our four year commitment to provide marketing support to certain Credit Unions, we have seen more success within these organisations in attracting savers and advancing loans. Our initial work with the East Sussex Credit Union and West Sussex Credit Union has now extended to Surrey save who have, in their first year of trading, attracted 409 savers and provided loans to 55 people. We provide direct support on the development of their marketing materials. In return, we have learned more about the issues and challenges of encouraging people to start saving.

Our work together has been shortlisted for the Financial Services Forum Awards for marketing effectiveness in 2013 and recent discussions show a real parallel between the issues faced by our customers and those customers walking into a credit union.

## WORKING WITH CHARITIES AID FOUNDATION (CAF) AND NESTA

In 2012, we secured a joint venture with CAF Bank and the charity NESTA to provide much needed loans, mentoring and consultancy for the social enterprise sector in Brighton and Hove. We are providing interest-free loans, where an independent community board decides which organisations within their community receive funding.

This has provided us with valuable insight into the way that we can provide alternative sources of finance to small businesses.

Our plan in 2013 is to expand this to more cities to highlight this important part of the economy.

## WORKING WITH MAGNIFIED LEARNING

Throughout 2012 we have developed our 'Money, Money, Money' Programme into a movement providing practical financial education that has reached over 5,800 young people in 18 schools and involved over 300 Legal & General employees over the last three years.

We have learnt a lot along the way, which has big implications for the way we run our business. In 2012, our research showed that 71% of young people expected to buy financial products face to face and that cars, university and holidays would be the top areas of spend if 14 to 16 year-olds were given £10,000.

We also created the 'Step up for Success' (SUFS) programme providing 60 young people who were predicted borderline grades C-E for GCSE with an intensive work placement programme, a level 2 GCSE Young Consultant qualification and a FTSE 100 company reference. In exchange, we gained valuable insight into the ways in which Legal & General can attract a younger consumer through the effective use of social media.

This programme achieved great outcomes against the national benchmarks for work placements:

- All of SUFS students (100%) said that "The work I undertook was meaningful" versus the national benchmark of 58% on work placements.
- Of the SUFS students that took part, 98% agreed that "I was given some responsibility during my placement" against a national benchmark of 68%.

## HEALTH MATTERS

Understanding health challenges and developments allows us to develop better products and improve customer service. Deeper insight about the health of the nation also enables us to set pricing and premiums more effectively. Health care systems around the world are facing enormous challenges as they try to cope with ageing populations and continuing economic and financial pressures.

In the coming decades the demographic composition of nearly all populations in the developed world will change significantly with dramatic increases in the numbers of elderly people. This will lead to major changes in healthcare and welfare provision.

Working with a number of charities, we have provided valuable training for employees handling calls from customers with a critical illness. Our claims teams have been working with a number of charities to enhance the service we offer to our customers. We also direct customers to relevant charities for additional support where appropriate.

Organisations who have provided training and expertise to our front line teams include the Samaritans, Macmillan and Friendly Faces.

### ADVICE FROM MACMILLAN

We are working with Macmillan and Legacare, a small social enterprise in the northwest of the UK, to actively campaign around issues of the right to free legal advice in the last few weeks of life. This new pilot will look to see whether a missing part of people's palliative care can be delivered in key hospitals or remotely to all beneficiaries including Legal & General's customers.

### HELPING EMPLOYERS WITH THE BRITISH HEART FOUNDATION

In 2012, we provided Health and Wellbeing seminars to 12 major UK employers as well as running joint Health at Work regional seminars for employers interested in creating healthy workplaces. This has resulted in a movement with over 4,300 members interested in creating better and healthier workplaces.

### IMPROVING MENTAL HEALTH IN THE WORKPLACE

We work with a number of mental health charities to inform the services we offer our customers. We have asked Rethink Mental Illness to independently review our services to clients and endorse them if they thought we had produced something good. They challenge us on our approach to providing services to our clients and help us to continuously improve through training for our employees and customers on the latest tools and techniques to deal with stress. We also have regular policy discussions on the latest mental health issues and run joint branding and marketing activity at key events and seminars.

In September, we launched a new campaign, 'Stress in the City', aimed at raising awareness of stress and mental health illnesses in the financial services sector. The campaign won praise from Charles Walker MP, Chair of the All Party Parliamentary Group for Mental Health, who, speaking at the Second Reading of the Mental Health (Discrimination) Bill, congratulated us for addressing mental health and tackling stigma.

### OUR INDEPENDENT CLAIMS PANEL

We have created an independent claims panel to provide independent reviews of the critical illness payout decisions for our customers.

### ENCOURAGING DIVERSITY

Our policy is to treat employees without discrimination and to operate equal opportunity employment practices designed to achieve this end. The Group's policy on diversity includes giving full and fair consideration to applications for employment made by all persons; to continue, wherever possible, the employment of staff who become disabled and to provide equal opportunities for the training and career development of all employees.

### LOOKING FORWARD

For 2013 to 2016, our executive committee has looked at the longer-term issues that matter to society and our customers in the form of a materiality analysis.

# OUR SOCIAL PURPOSE CONTINUED

## SHAREHOLDER MATTERS

Corporate governance is about protecting shareholders, aligning the interests of companies with investors as well as maximising shareholders' long term interests.

### WHAT WE KNOW

Corporate governance covers a broad remit, from how a company is managed to relations with shareholders. For us, it's about looking after the long term success of the businesses we invest in and voting and engaging directly with their senior management and making sure they have the right structure in place to manage their own risks and opportunities. We're committed to using our position of influence to help improve board practices and performance in the markets in which we invest. This involves engagement with investee companies directly and collaboratively with other institutional investors, Government and regulators.

### EXECUTIVE REMUNERATION

Excessive executive remuneration has been under public scrutiny for many years, but the spotlight has particularly intensified recently. We voted against 126 UK remuneration related resolutions in 2012. Of those where we recommended changes, over 40% amended their plans.

We pushed for pay packages to be simpler, aligned with shareholder interests and to support the long term strategy of the business. We have actively participated in numerous industry consultations including the Department for Business Innovation and Skills (BIS) Executive Remuneration consultation.

### WHAT WE ARE DOING TO IMPROVE EVERYDAY CORPORATE GOVERNANCE

We have expanded our team over recent years; the team now consists of seven professionals with an average of 14 years' investment experience.

## ENGAGEMENT EXAMPLE – GLENCORE/XSTRATA

**As one of the largest institutional asset managers in Europe, we use our scale to bring about change and represent our clients in the most powerful manner. This is an important differentiator when communicating and voting on companies. We also work with other major shareholders, as our consolidated voice adds significant weight to our views.**

The terms of the proposed merger between Glencore and Xstrata originally envisaged a tie-up based on a 2.8 share ratio and included 'Management Incentive Arrangements' (MIAs).

There was effective pressure from shareholders to oppose this and revised terms were subsequently put forward with a 3.05 share ratio and MIAs which would only take effect if approved by Xstrata shareholders.

During this process LGIM met with the management of both companies 15 times. We consistently disagreed with the additional incentive arrangements and voted for the deal without the MIAs. The deal was eventually completed without the controversial MIAs which were voted down at the extraordinary general meeting of Xstrata (EGM). Just over 78% of shareholders voted against the MIAs at the EGM.

The Xstrata chairman stood down following this vote. LGIM is helping with the new Chairman appointment process and did not go public with any of this throughout the 11-month period.

We voted at 2,616 general meetings of 2,541 companies, covering all major developed markets. We followed up with companies on our against votes in key markets. This allowed us to explain our voting policy and rationale as well as to build relationships with companies in these regions.

We signed up to international investor network groups including the International Corporate Governance Network, the Council of Institutional Investors (US) and the Institutional Investor Group on Climate Change.

### SHAPING THE FUTURE

As a major shareholder in global companies, we consider it important to try to shape the future of corporate governance and to improve best practice. One of the most constructive ways to achieve this is to voice our views through submissions to industry consultations. We responded to the following consultations during 2012: BIS on Executive Pay, ESM on the Role of Proxy Advisers, FSA Enhancing Listing Rules, Kay Review, FRC Corporate Governance and Stewardship Review, and the Japan Ministry of Justice on Corporate Governance.

### OUR FOCUS

In 2012, we changed our engagement target from monitoring the number of individual companies we hold meetings with to measuring the total number of meetings held. We have found we get the best results through repeated meetings with company boards and executives. Our target for 2012 was to engage with companies on 300 occasions[1], and in fact we held 425 meetings[2].

Key focuses for 2013 in our engagements will include:

- ensuring better alignment with shareholders on executive pay across UK Plc;
- improving Gender Diversity in UK boardrooms especially in Mid-Cap listed companies;
- in the US, liaising with technology companies on issues such as human rights in the supply chain and political spending;
- seeking better board independence on Japanese listed companies;
- improving UK reporting standards for shareholders with more concise and clearer disclosures;
- raising issue of auditor rotation for UK Plc; and
- sustainability issues impacting UK listed mining companies.

## ENVIRONMENTAL MATTERS

Climate change is something that impacts the very core of what we do from annuities, life insurance, institutional investment, commercial property investment and savings to home insurance. There has been lots of work across the Group in 2012 to help our customers cope with climate change through our products and services. We have been recognised as a leader in this field, scoring 100% in this year's ClimateWise Index.

### ADDRESSING CLIMATE CHANGE

Climate change affects many parts of our business – from health to commercial property assets and our customers' investment holdings. We need to adapt to the effects of climate change, both in developing products (including pricing and who we insure) and the services that we deliver to our customers.

We are on the managing committee of ClimateWise, the global insurance industry's leadership group to drive action on climate change risk, which gives us the chance to talk to policymakers about business, investment and climate change.

The physical environment has a significant influence upon how we do business in two main ways:

- How we provide our customers with products that mitigate climate-related risks in the design of our products and services.
- How we consider the use of natural resources to run our own business.

### NATURAL RESOURCES USED TO RUN OUR BUSINESS

Traditionally we have collected our environmental data by calendar year, but because of new legislation we've decided to consolidate our environmental data collection to run from April to April going forward. This report therefore updates the information provided in April 2012 and includes our environmental performance from April 2011 to April 2012. Information from April 2012 to April 2013 will be available from August 2013 in our online CSR Report.

At Legal & General, we have a strong commitment to the environment and high expectations of our employees. This is set out in our Group Environmental Policy statement. We recognise that our operations impact the environment:

- directly, through our buildings and business travel in the UK and overseas;
- indirectly, through our investment assets; and
- indirectly, through our supply chain.

We have measured our direct environmental impacts for over ten years, focusing on energy, transport, water and waste, as well as addressing the risks and opportunities associated with climate change.

To do this, we operate certified Environmental Management Systems (EMS) covering the areas where we can make a difference:

- UK facilities
- UK procurement
- Legal & General Property

1. 25% of which covering environmental and/or social topics.
2. 30% of which covered environmental and/or social topics.

# OUR SOCIAL PURPOSE CONTINUED

| | 2011/12 | 2010 | 2009 | 2008 |
|---|---|---|---|---|
| $CO_2$ (UK occupied properties) per employee[1] | 1.77 | 2.74 | 2.69 | 2.60 |
| Car based business miles per UK policy | 0.87 | 0.88 | 1.04 | 1.44 |
| Waste to landfill per UK employee (kgs) | 53 | 58 | 70 | 76 |
| Estimated water per UK employee (CuM) | 8.68 | 12.82 | 10.98 | 10.96 |

1. Energy per UK employee and per UK policy includes UK occupied offices, Suffolk Life (occupied properties), Legal & General Surveying Services and Estate Agency Franchising offices (including voids).

## EXTERNAL RECOGNITION

**Business in the Community (BITC) Corporate Responsibility Index 2012**
We retained our Platinum status having first achieved this in 2011.

**SIG Watch**
We scored -9 in the Corporate Reputations Index with NGOs in 2012. This was an improvement on our score of -28 in 2011.

**FTSE4Good**
We achieved a score of 89% in 2012, down from 94% in 2011. This score reflects the belief of FTSE 4900 that we should do more in harder to reach markets.

**ClimateWise**
We have improved our ClimateWise rating to 100%, an increase of 1% from 2011, we are now joint first in the insurance sector globally.

**Dow Jones Sustainability Index**
We scored 73% in 2012 up from 71% in 2011. The sector leader scored 81%.

**OEKOM**
We are rated as a prime stock by Oekom in their investment universe.

We were one of the first financial services companies to become certified to ISO 14001 and this programme has expanded to cover our supply chain and property investments. We don't offset our impacts or make claims of 'carbon neutrality'; our priority is to actually reduce our impacts. During 2012, there were no notifiable environmental incidents as a result of our operations.

### WORKING WITH OUR SUPPLIERS

Management of our supply chain is an important aspect of running our business efficiently and in a sustainable way. Terms and conditions for business transactions are agreed with suppliers and payment is made in accordance with these terms provided the suppliers' obligations are met. The Company has no trade creditors. As at 31 December 2012, the average number of days of payments outstanding for the Legal & General Group of companies was 20 days (2011: 36 days). Suppliers are regularly assessed to ensure that they comply with our environmental, social and ethical policies.

### OUTLOOK

Our strategy remains to reduce year-on-year use of resources to run our business. Our focus for environmental targets includes:

- further reduction of Group Operations $CO_2$ emissions;
- UK waste reductions;
- reductions in energy use in our commercial property portfolio; and
- reduce UK paper use and increase the online servicing of our customers from current level of 2.7%

## TAX MATTERS

Paying and collecting taxes is an important part of our role as a business, and our contribution to society.

### TAX GOVERNANCE

Responsibility for the tax policy and management of tax risks rests with the Group Chief Financial Officer and Group Tax Director who report regularly on tax matters to the Group Audit Committee. In light of the current public interest in corporation tax, this year the Committee reviewed the Company's tax strategy in the context of the Group's corporate social responsibility and shareholder stewardship objectives and the Company's approach to tax disclosures.

### TAX AUTHORITIES

We have transparent and positive relationships with all relevant tax authorities. During 2012, we continued to strengthen our 'real-time' working relationship with HMRC in the UK and have been rated by HMRC as Low Risk.

### TAX ENVIRONMENT

We welcome the current debate about companies' tax policies and transparency and are participating in this discussion with Action Aid and Transparency International Corporate Network amongst others. We include information on our UK corporation tax paid in 2012 below. Our success in moving towards increased corporate tax transparency is reflected in our winning of PwC's 'Building Public Trust' award for tax reporting in the FTSE 100 in 2012. The award recognises transparency and excellence in corporate reporting.

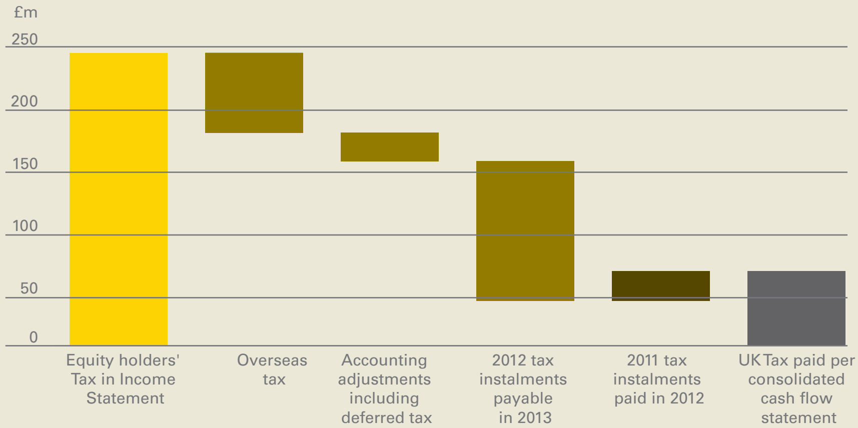
## COUNTRY BY COUNTRY ANALYSIS

The total taxes borne and collected in 2012 and paid to UK and overseas governments amounted to £660m (2011: £615m). This comprised UK taxes of £561m (2011: £535m) and overseas taxes of £99m (2011: £80m). For this first time, this year the analysis below shows the main taxes borne and collected in each of the main countries where we operate. Taxes borne and collected in Ireland are less than £1m (2011: less than £1m) and have therefore been included in the UK segment. We have not included our taxes borne and collected by any of our joint venture operations.

## CASH TAX RECONCILIATION

The chart below provides a summary reconciliation between the equity holders' tax charge disclosed in the income statement of £235m (an effective tax rate of 22.7%) and the UK corporation tax paid of £60m, in the cash flow statement.

### Reconciliation of tax charge in income statement to UK tax paid in the cash flow statement




### Country by country analysis of total tax contribution


## TAX STRATEGY

We are committed to meeting all legal requirements and making all appropriate tax payments in the territories in which we operate. When evaluating tax planning, we will also always consider the Group's reputation, brand and corporate and social responsibilities.

We will:

- not pursue arrangements which are not in line with our Group Code of Ethics;
- avoid tax pitfalls by considering tax as part of every major business decision and ensuring appropriate controls are in place to manage our tax risks;
- not undertake transactions whose sole purpose is to create an abusive tax result;
- discuss in real-time our interpretation of the law with HMRC where we pursue tax planning;
- include Board-level oversight as part of our tax risk governance processes;
- be transparent in respect of our tax affairs and provide disclosure in our Annual Report and Accounts about our tax approach, tax rate and cash tax payments; and
- contribute to the development of UK tax policy and legislation. where appropriate.

# RISK MANAGEMENT.

## Understanding the risks implicit in our business and the markets in which we operate provides us with real competitive advantage.

### MISSION AND PURPOSE OF RISK MANAGEMENT

Our risk management framework seeks to support our business ambitions, enabling us to select those risks that can give us sustainable returns and closely managing those risks that are unrewarded, and to optimise the capital that we hold so that we can deliver our strategy.

We have structured our reporting around four sections:

1 **Setting our overall approach to risk – OUR RISK CULTURE**

2 **Discussion of risk profile – OUR RISK LANDSCAPE**

3 **How we manage risks – OUR RISK MANAGEMENT FRAMEWORK**

4 **The residual risks that remain – OUR PRINCIPAL RISKS AND UNCERTAINTIES**

"As well as providing objective challenge, my role as Group Chief Risk Officer is to provide the framework, processes and tools that help Legal & General managers to take informed risks. By helping managers to understand the Group's risk appetite, how it relates to their business and our target returns, we can be confident in our risk taking."

**SIMON GADD**
**GROUP CHIEF RISK OFFICER**

### 1 OUR RISK CULTURE

We consider effective risk management to be integral to our business operations.

We encourage managers to have a positive attitude to risk and to understand the risks that are inherent in our business so that they can ensure we:

- take advantage of business opportunities;
- meet our business objectives;
- control our areas of greatest risk;
- act promptly to fix any weakness and failure in our processes; and
- are confident that we hold the right capital for the risks to which we are exposed.

As well as having the right tools and processes, effective risk taking requires the right culture and behaviours across our businesses and we seek to promote an environment where:

- there is openness and transparency in how we make decisions and manage risks;
- significant business decisions are aligned with our strategy, our capital performance target and our expected returns, and consider the effect on our reputation and customers;
- managers make decisions in the light of the impact on the entire Group; and
- business managers own the risks and risk management processes associated with the activities for which they are responsible.

We know that no system of control is fail-safe and we encourage managers to report weaknesses and deficiencies as soon as they are identified.

## 2 OUR RISK LANDSCAPE

The products that we write, the investment assets we hold to meet our obligations to our customers and the environment in which we operate give rise to a broad range of risks. To ensure that these risk are managed within acceptable tolerances, our risk framework, which we describe overleaf, seeks to ensure that we are only exposed to those residual risks for which we have an appetite.

| | | |
|---|---|---|
| **MARKET RISK** | **Investment performance** | We invest in a range of investment assets including equities, bonds and property to meet the obligations from our insurance products; however, there is a risk that the income and value of these investment assets may fluctuate relative to required targets. |
| | **Interest rates and inflation** | Interest rate movements and inflation can impact the value of the investment assets we hold to meet our obligations, as well as the value of the obligations themselves. |
| | **Currency** | Fluctuations in exchange rates can vary both the value and income from investment assets denominated in foreign currencies, as well as the profits and value of our overseas businesses. |
| **CREDIT RISK** | **Bond default** | We hold a significant portfolio of corporate bonds to back our annuity business. The portfolio is diversified across a range of sectors and geographies, but inherently is exposed to the risk of default. |
| | **Property counterparties** | We also hold property lending and sales and leaseback investments and are inherently exposed to the risk of default by a borrower or tenant, although we protect our interests by taking security over underlying property. |
| | **Banks and the issuers of financial instruments** | Banking and money market counterparties, the issuers of financial instruments and the providers of settlement and custody services may default on their obligations to us. |
| | **Reinsurance contracts** | A reinsurer default would require business written with the counterparty to be re-brokered potentially on less advantageous terms, or for the reinsured risks to be borne directly. |
| **INSURANCE RISK** | **Longevity, mortality and morbidity** | The pricing of long-term life insurance business requires assumptions to be made for future trends in the life expectancy and general health of those that we insure; with the risk that actual experience may diverge to our assumptions. |
| | **Catastrophe** | We also make assumptions about the likelihood of catastrophic events that could cause a widespread loss of life or disability within the pool of the lives that we insure. |
| | **Persistency** | We are exposed to the risks that acquisition costs may not be recovered from product margins if policies lapse earlier than we anticipated within our pricing assumptions. |
| | **Expense** | Product pricing must also take account of the future costs of product servicing, with deviations in actual costs presenting the risk of reduced product profitability. |
| | **Weather events** | In the pricing of our household insurance products, we make assumptions about the likelihood of weather events, with the risk that actual experience may diverge from our assumptions. |
| **OPERATIONAL RISK** | **People, process, systems and external events** | Our business processes can be complex, with significant reliance placed upon a combination of IT systems and manual processes. Weakness or failure of these systems or processes could result in financial loss or adversely affect our customers. |
| | **Regulation and legislation** | The markets in which we operate are highly regulated. A breach of legislative or regulatory requirements may expose us to financial penalties and damage our reputation. |
| **LIQUIDITY RISK** | **Contingent events** | Low probability and typically extreme events that if not adequately planned for can result in unanticipated requirements for liquidity. |
| | **Collateral** | Failure to hold sufficient cash or suitable liquid assets to meet collateral requirements for financial instruments. |

Notes 7 ('Asset risk'), 15 ('Insurance risk') and 25 ('Operational risk') to the financial statements further describe how the above risks relate to our core products and the specific control techniques we apply to ensure that the risks are appropriately managed.

# RISK MANAGEMENT CONTINUED

## 3 OUR RISK MANAGEMENT FRAMEWORK

Our framework enables the Group Board to draw assurance that the risks to which the Group may be exposed are being appropriately identified and managed, and that risks that may present significant financial loss or damage to our reputation are being minimised. The core elements of our framework are as follows:

| | |
|---|---|
| **RISK APPETITE** | Sets out our overall attitude to risk, and the ranges and limits of acceptable risk taking. |
| **RISK TAKING AUTHORITIES** | Cascade our risk appetite to our business managers and empower managers to make decisions that are consistent with our appetite for risk. |
| **RISK POLICIES** | Formal policies define our approaches to risk management and the necessary control standards to ensure these risks are managed in line with risk appetite. |
| **RISK IDENTIFICATION AND ASSESSMENT** | Tools that help business managers to identify and evaluate the risks to which we may be exposed and formulate appropriate risk mitigation plans. |
| **RISK MANAGEMENT INFORMATION** | Our framework to report and support the review of ongoing and emerging risks, and assess actual risk positions relative to the risk targets and limits that we set. |
| **RISK OVERSIGHT** | Review and challenge by the Group Chief Risk Officer team of the effectiveness of our risk identification and management processes. |
| **RISK COMMITTEES** | Group-level committees that oversee the management of risks and challenge how the risk framework is working. |

### Our risk appetite

Our risk appetite framework expresses the types of risk that we are prepared to be exposed to in pursuit of our business strategy, the minimum capital requirements that we wish to maintain and the degree of volatility of earnings that we are prepared to accept. The Group's risk appetite is approved by the Group Board upon the recommendation of the Group Risk Committee (see page 68) and Group Chief Executive. The management information received by the Risk Committee and the Group Board includes our risk appetite dashboard setting out actual positions relative to the targets and limits set in our risk appetite.

| Risk Appetite | Principles | Key Measures |
|---|---|---|
| **STRATEGY** | We manage a diversified portfolio in which we accept risk in the normal course of business and aim to deliver sustainable returns on risk-based capital in excess of cost of capital. | Return on capital |
| | We have an appetite for risks we understand and are rewarded for, and which are consistent with delivery of our strategic objectives. | Capital allocation |
| **CAPITAL** | We aim to maintain an appropriate buffer of capital resources over the minimum regulatory capital requirements. | Capital coverage ratio |
| **VOLATILITY** | We have a low appetite for unexpected volatility in excess of disclosed sensitivities. | Variance in earnings to plan |
| **CONDUCT, CUSTOMER & REPUTATION** | We treat our customers with integrity and act in a manner that protects or enhances the Group franchise. | Customer and reputation risk dashboard |
| **LIQUIDITY** | We expect to be able to meet our payment and collateral obligations under extreme, but plausible, liquidity scenarios. | Liquidity ratio |

We further express our appetite for the specific risks to which we are exposed as follows:

| | | |
|---|---|---|
| **MARKET RISK** | We have an appetite for market risk within our annuities and with-profits businesses, and our shareholder funds, where we are rewarded for it. | We have limited appetite for significant losses or volatility from market risk and so we set clear risk limits which must be adhered to by Group businesses. |
| **CREDIT RISK** | We have appetite for credit risk to the extent that accepting this risk enables us to optimise policyholder and Group risk adjusted returns. | We have limited appetite for significant losses from counterparty failures and we therefore establish clear risk limits which must be adhered to by Group businesses. |
| **INSURANCE RISK** | We have an appetite for longevity, mortality and morbidity risk together with selected household insurance risks as we expect to add value by accepting such risks. | We have a low appetite for persistency and expense risks. We manage these risks by investigations and monitoring experience and reflect the conclusions in our product design and reserving strategies. We have limited appetite for exposure to weather events and purchase excess of loss reinsurance to protect against this risk. |
| **OPERATIONAL RISK** | We have very limited appetite for large operational losses due to the likely customer impact, reputational damage and opportunity costs. | We aim to implement effective controls to reduce operational risk exposures except where the costs of such controls exceed the expected benefits. |
| **LIQUIDITY RISK** | We have no appetite to fail to meet our obligations when they fall due or to incur material losses on forced asset sales to meet obligations. | We maintain at Group level sufficient liquid assets and standby facilities to meet a prudent estimate of the Group's cash outflows, as identified through annual planning processes. |

### Cascading our risk appetite

An important element of effective risk management is ensuring business managers understand the parameters of acceptable risk taking. We continue to evolve our risk appetite framework for each of our business units, putting in place 'Risk & Capital Mandates' that set out the ranges of acceptable risk taking and exposure limits for the risks that are implicit in each of these businesses.

### Risk policies

We have well established strategies for managing market, insurance, credit, liquidity and operational risk. Formal policies define our approaches to risk management and the minimum control standards.

We set limits for our material risk exposures, which we monitor on a continuous basis. We also deploy a range of risk management techniques to manage and mitigate risks, thereby controlling our risk exposures in line with these limits. For example, we use derivative instruments to hedge unrewarded risks as part of our asset liability management activity and reinsurance programmes to transfer significant aggregations and concentrations of insurance risk exposures. Our framework of controls includes documented underwriting policies and structured delegated pricing and underwriting authorities. It also includes investment policies which take into account the nature of our liabilities, guarantees and other embedded options given to policyholders.

Our policies also set out our framework to ensure there is full consideration of new risks to the Group. For example, any new product or an amendment to an existing product that presents a new form of insurance risk to the Group, or includes an option or guarantee that is to be underwritten by Legal & General, must be approved by the executive-level Group Insurance Risk Committee prior to its launch. Similarly, approval must be received from the Group's Investment and Market Risk Committee for the use of any new asset classes or innovative investment assets prior to their use within the funds backing the Group's insurance liabilities. This ensures that there is direct line of sight to new risk taking and that appropriate exposure limits are set having regard to the Group's risk appetite.

# RISK MANAGEMENT CONTINUED

### Continuous risk assessment

We operate a risk identification and assessment process under which our businesses regularly consider changes in the profile of existing and emerging risks. The assessment process evaluates the risks that are inherent in our products as well as those that are presented from changes in the environments that we operate; for example changes in regulation or legislation, competitor actions and broader economic and market conditions. Our risk assessment process considers both current factors and matters that may emerge over our planning cycle.

We record the risks we have identified and allocate responsibility to an owner to manage them within agreed tolerances. Risk mitigation plans are developed and implemented to manage and respond to these risks. As the nature, probability or impact of risks may change over time, these plans are kept under regular review. Significant risks identified through our risk assessment process are escalated to our Group-level risk committees.

### Risk management information

Adequate and appropriate management information is a key tool in the effective management of risk. We have structured and continue to evolve our risk management information to:

- enable all significant risk positions to be monitored;
- compare actual risk exposures and capital positions to targets, limits and tolerances established as part of our risk appetite framework;
- assess the delivery of our target customer outcomes;
- consider changes in the profile of existing risks and emerging risk matters;
- monitor the resolution of control failures and the remediation of control weaknesses;
- aggregate risk exposures and concentrations of risks; and
- assess the adequacy of capital relative to the risks to which the organisation may be exposed.

## OWN RISK & SOLVENCY ASSESSMENT

Our risk identification and assessment process forms part of our broader 'Own Risk & Solvency Assessment' process, designed to evaluate the resilience of our balance sheet to a range of market conditions and external events and to ensure that we maintain our target levels of capital. During 2012, extreme stresses included evaluation of a 'Prolonged UK Stagnation' and 'Disorderly European Restructure', together with a range of equity and property stresses and bond market downgrades. We also considered a range of 'Reverse' stress tests, including severe prolonged investment market disruption and defaults; significant improvements in annuitant longevity; the failure of reinsurance during an epidemic/pandemic; emergence of a new debilitating disease; and reputational shocks.

## OUR INTERNAL MODEL

Over the last three years, as part of our preparations for Solvency II, we have significantly enhanced our economic capital and risk framework through the development of our Internal Model. Although the regulatory implementation of Solvency II has now been deferred, we believe economic capital to be an important measure in our assessment of the amount of capital that we need to hold to meet our objectives and an important metric in managing our business performance; for example, using the output as one of our decision analysis tools in areas such as capital allocation, product pricing, and the assessment of significant transactions. Whilst uncertainty remains over the final calibrations for the regulatory capital requirement under Solvency II, we believe our continued focus on our Internal Model and an economic capital calibration, alongside our IMAP submission which we made in November 2012, will position us well for a subsequent transition to a Solvency II capital regime.

## Risk oversight

The Group Board has ultimate oversight responsibility for the Group's risk management framework. The Group Risk Committee, supported by the Group Chief Risk Officer, serves as the focal point for Board oversight of risk management activities. The report of the Group Risk Committee is set out at page 68. The table below summarises our 'three lines of defence' risk governance model.

<table>
<tr><th>Our three lines of defence</th><th>Roles and responsibilities</th><th>Associated Committees and their role</th></tr>
<tr><td>RISK TAKING</td><td>Business Management<br>The Group's business divisions are responsible for risk taking and accountable for effective risk management.</td><td>Divisional Committees<br>Risk management committees established within each of our business divisions provide a forum for the review of material risk exposures and risk mitigation activities.</td></tr>
<tr><td>RISK CONTROL AND OVERSIGHT</td><td>Group Chief Risk Officer<br>The Group Chief Risk officer, who is independent of the business line, leads the Group's risk management function. Key activities include:<br>• Advising the Board on setting risk appetite and limits.<br>• Establishing the Group's risk and capital management framework, and its risk management strategies and policies.<br>• Leading the Board evaluation of changes in significant Group level risks.<br>• Forming independent views and advising on risk matters and risk:reward trade-offs.<br>• Evaluating the adequacy of the management of key risks and their controls.<br>• Ensuring the overall design, validation and effective operation of the Group's Internal Model.<br>• Assessing and reporting upon the sufficiency of the Group's capital to deliver the Group's strategic plans.</td><td>Group Risk Committee<br>The Committee's primary role is to provide guidance to the Board in relation to the Group's risk management policies and procedures and advice on what constitutes acceptable risk taking. The members of the Committee are non-executive directors of the Group Board.<br><br>Executive Risk Committee<br>The role of the Executive Risk Committee is to ensure that an appropriate framework is in place across the Group to identify, assess, and manage the Group's principal risks and to oversee the effective operation of the framework. The Committee, which is chaired by the Group Chief Executive, meets quarterly. Its membership comprises the executive directors of the Group and the Group Chief Risk Officer. The Committee delegates oversight of specific aspects of the Group's risk framework and responsibility for limit setting to the following sub-committees:<br>• Group Insurance Risk Committee;<br>• Investment and Market Risk Committee; and<br>• Counterparty Credit Committee.</td></tr>
<tr><td>INDEPENDENT ASSURANCE</td><td>Group Internal Audit<br>Group Internal Audit provide Independent assurance on the effectiveness of both business risk management and the Group risk oversight and challenge processes.</td><td>Group Audit Committee<br>The responsibilities of the Committee include advising the Board on the effectiveness of the Group's internal control environment and risk management systems.</td></tr>
</table>

As set out on page 69 during 2012 the Board commissioned an externally facilitated review to assess the Group's risk management framework against industry best practice in readiness for Solvency II.

# RISK MANAGEMENT CONTINUED

## 4 OUR PRINCIPAL RISKS & UNCERTAINTIES

Set out below is an analysis of current principal risks and uncertainties. A detailed review of the Group's inherent risk exposures and high level control processes are set out at Notes 7, 15 and 25 to the financial statements.

| Risks and uncertainties | Trend and outlook | Mitigation |
|---|---|---|
| Changes in regulation or legislation may have a detrimental effect on our strategy or profitability. Legislation and government fiscal policy can influence our product design, the period of retention of products and our required reserves for future liabilities. Regulation defines the overall framework for the design, marketing and distribution of our products; and the prudential capital that we hold. The nature of long term business can result in some changes in regulation having a retrospective effect on our businesses. | 2012 has seen the successful delivery of our Retail Distribution Review (RDR) proposition together with the transition of our business partners to the new regime. We have also delivered the core components of our Solvency II (SII) programme. However, there remains much uncertainty both to the implementation timescales of SII and the final calibrations that will be used for long term business. The regulatory change agenda also continues with the transition of the FSA into the Prudential Regulatory Authority and Financial Conduct Authority. Whilst the high level approaches of the respective bodies have been published, potential remains that their new rule books present unintended consequences to the insurance sector and that a more aggressive supervision and enforcement regime leads to increased capital requirements and increased compliance costs. Other areas of significant regulatory change include further regulation of the UK mortgage market and the EU Packaged Retail Investment Products directive. | We seek to actively participate with Government and regulatory bodies in the UK and Europe to assist in the evaluation of change so as to develop outcomes that meet the needs of all stakeholders. Internally, we evaluate the impact of all legislative and regulatory change as part of our formal risk identification and assessment processes, with material matters being considered at the Group Risk Committee and the Group Board. |
| Investment market performance or conditions in the broader economy may adversely impact our earnings and profitability. The performance and liquidity of investment markets, interest rate movements and inflation can impact the value of the investment assets we hold to meet the obligations arising from insurance business as well as the value of the obligations themselves, resulting in mismatches in the profile of cash flows of our assets and liabilities. In addition, significant falls in investment values can also impact the fee income of our investment management business. Broader economic conditions can impact the timing of the purchase and the period of retention of retail financial services products. | Although investment markets have shown a strong recovery in 2012 and early 2013, the outlook for the global economy continues to remain uncertain. Rates of economic growth look set to be subdued and macro-economic policy responses are likely to drive a prolonged period of low interest rates. While EU governments have acted to stabilise the Euro zone, there remains potential for shocks to global financial markets, which, in the extreme, could impact our ability to execute hedging strategies that ensure the profile of our assets and liability/cash flows are appropriately matched. | As illustrated on page 8 we model our business plans across a broad range of economic scenarios and take account of alternative economic outlooks within our overall business strategy. As part of our medium-term plan we have sought to ensure focus upon those market segments that will be resilient in projected conditions. Details of our business strategy are set out on pages 11 to 13. Sensitivities to interest rate mismatches, exposure to worldwide equity markets and currencies are set out on pages 164, 150 and 153 respectively. |
| In dealing with issuers of debt and other types of counterparty the Group is exposed to the risk of default. A default event within the banking sector, or a major Sovereign debt event, could result in dislocation of bond markets, significantly widening credit spreads, and in extreme conditions may result in default of strongly rated issuers of debt, requiring us to increase our default provisions. We also have exposures to banking, money market and reinsurance counterparties, and the providers of settlement, custody and other bespoke business services to the Group, a failure of which could expose us either to financial loss or short-term operational disruption of our business processes. | Over 2012 credit spreads have begun to normalise, reflecting increased market confidence in the issuers of investment grade bonds and at L&G we continue to experience a very low level of actual defaults. However, while we assess the occurrence of a major bank default or Sovereign event as being a more extreme outcome than in previous years, the risk and associated uncertainties remain. The current economic environment also presents an increased risk that suppliers of business services may be unable to meet their obligations. | We actively manage our exposure to default risks, setting robust counterparty selection criteria and exposure limits. We continue to diversify the asset classes backing our annuities business, to include the use of property lending, sale and leaseback and infrastructure assets. Details of our default provisions are set out at page 23. Exposures to credit risk are set out on page 154 and sensitivities to changes in credit spreads on page 164. Our service providers are also subject to rigorous selection criteria. |

| Risk/uncertainty | Trend and outlook | Mitigation |
|---|---|---|
| As a UK-based Group, our earnings are influenced by the performance and perception of the UK financial services sector as a whole. The financial crisis, subsequent investment performance and low interest rate environment together with consumers' perceptions of the robustness of financial institutions may impact consumer attitudes to long-term savings. Recent regulatory actions, for example in the banking sector with regard to Payment Protection Insurance (PPI), may also adversely impact consumers' perception of the value of insurance products and result in changes to the regulatory and legislative environment in which we operate. | As a significant participant in the long-term savings markets, we are inherently exposed to the risk of a downturn in new business volumes and changes in policy persistency as a consequence of consumer sentiment. We are also exposed to the risk of increased costs of regulatory compliance through regulatory and legislative responses to events in the banking sector being read across to insurers without reference to the different business models. | We actively manage our brand and seek to differentiate our business model from that of our competitors, focusing on our customers' needs through a diversified portfolio of risk, savings and investment businesses. We also actively engage with our regulators to support understanding of the risk drivers in the markets in which we operate. |
| Reserves for long-term business may require revision as a result of changes in experience, regulation or legislation. The writing of long-term insurance business necessarily requires the setting of assumptions for long-term trends in factors such as mortality, persistency, valuation interest rates, expenses and credit defaults. The frequency of extreme events may result in the need to recalibrate these assumptions. Forced changes in reserves can also be required because of regulatory or legislative intervention in the way that products are priced. | Whilst we regularly appraise the assumptions underpinning the business that we write using both external and our own mortality data, extreme events, such as a rapid advance in medical science leading to significantly enhanced annuitant longevity or an event causing widespread mortality/morbidity remain inherent risks to our business. Following the implementation of EU gender-neutral pricing legislation in the UK, there also remains potential for further legislation to price insurance products irrespective of other risk factors, such as age or health. | We undertake significant analysis of longevity and mortality risks to ensure an appropriate premium is charged for the risks we take on and that our reserves remain appropriate. We remain focused on developing a comprehensive understanding of annuitant mortality and we continue to evolve and develop our underwriting capabilities. The sensitivities of our UK long term business to annuitant mortality are set out on page 164. We also continue to ensure that legislators recognise the benefits to consumers of pricing insurance products based on the risk factors that each policy presents. |
| The Group may not maximise opportunities from structural and other changes within the financial services sector. The financial services sector continues to go through a period of change. Significant changes in the markets in which we operate may require the review and realignment of elements of our business strategy. A failure to be sufficiently responsive to potential change and understand the implication to our businesses, or the incorrect execution of change may impact the achievement of our strategic objectives. | The UK Government continues to focus on a broad range of changes to the provision of State benefits and the encouragement of self-provision, for example, the introduction of auto enrolment. Such changes will impact the way in which consumers approach protecting their income and planning for their retirement. The distribution landscape is also expected to continue to evolve post the implementation of RDR presenting a range of opportunities. | We seek to ensure we have market-leading expertise in the core fields in which we operate, and actively focus on retaining the best personnel with the knowledge to design and support our products. As set out on pages 14 to 23 we have re-aligned our internal organisation to fully support our ambition, including the development of our digital capabilities. |
| A material failure in our business processes may result in unanticipated loss or reputation damage. We have constructed our framework of internal controls to minimise the risk of unanticipated loss or damage to our reputation. However, no system of internal control can completely eliminate the risk of error, financial loss, fraudulent actions or reputational damage. | As our business grows we continue to invest in our system capabilities and business processes to ensure that we meet the expectations of our customers; comply with regulatory, legal and financial reporting requirements; and mitigate the risks of loss or reputational damage from operational risk events. | Our 'three lines of defence' risk governance model set out on page 37 seeks to ensure that business management take an active part in developing an appropriate control environment for the risks implicit in the business processes they manage, with expert advice and guidance from the Group Chief Risk Officer team. Our Internal Audit function provides independent assurance on the adequacy and effectiveness of our controls. The report of the Group Audit Committee on page 66 outlines its work during the year in reviewing our internal control system. |

# "It's believing that our jobs mean more than just pay slips and 9 to 5."

"We've been working on a case where we had a customer who'd died, but we had no next of kin details. We could have just left it, but from the post mortem we found out details of some tattoos he had with names and what seemed to be dates of birth. Using systems we have access to, we were able to trace those people and send out paperwork for a claim. It's not the kind of thing we do every day, but we do always try and get the money to its rightful owner. And we always try and deliver on the promises we make."

**SVEN,** HOVE

For more information please visit
**legalandgeneralgroup.com**

## IN THIS SECTION

# BOARD OF DIRECTORS.


### 1 JOHN STEWART
CHAIRMAN

**Skills and experience:** John was appointed Chairman of the Company on 1 March 2010. He has extensive experience of financial services. He is a member of the Court of the Bank of England and was also appointed as Chairman of Guide Dogs for the Blind in November 2012. He was previously a director of the Telstra Corporation, a member of the Australian Federal Attorney General's Business Government Advisory Group on National Security and a Member of the Australian Prime Minister's Task Group on Emissions Trading. Other former roles include: Chief Executive of Woolwich (1996-2000), Deputy CEO of Barclays (2000-2003) and Chief Executive of National Australia Bank (2004-2008).

**External appointments:**
- The Court of the Bank of England
- Southern Cross Stud LLP
- Guide Dogs for the Blind

**Committee membership:**
- Nominations Committee (Chair)

### 2 NIGEL WILSON
GROUP CHIEF EXECUTIVE

**Skills and experience:** Nigel was appointed Group Chief Executive Designate in May 2012 and succeeded Tim Breedon as Group Chief Executive in June having joined as Group Chief Financial Officer in 2009. Prior to joining Legal & General, Nigel was Deputy Chief Executive and Chief Financial Officer of United Business Media plc. Nigel was until 31 December 2012 a Senior Independent Director (SID) of The Capita Group plc and was SID/ Chairman of Halfords Group Plc until 31 March 2011. Previous appointments include, McKinsey & Co, (where clients included BP, Citibank, Cadbury's, Santander, Kingfisher, Courtaulds, Whitbread and Globe Investment Trust). Group Commercial Director of Dixons Group Plc, Managing Director of Stanhope Properties Plc, Chief Executive, Corporate, Guinness Peat Aviation (G.P.A.), Managing Director, Viridian Capital. Qualifications include a PhD from the Massachusetts Institute of Technology where he was a Kennedy Scholar, a recipient of the Alfred P Sloan research scholarship, and worked at the National Bureau of Economic Research (NBER). Nigel has won numerous athletics championships including the 800m British Masters.

**External appointments:**
- ABI

### 3 HENRY STAUNTON
VICE CHAIRMAN AND SENIOR INDEPENDENT NON-EXECUTIVE DIRECTOR

**Skills and experience:** Henry was appointed to the Board in May 2004. Henry is an experienced finance professional and well regarded dealmaker with a long history of large corporate transactions. Former roles include: Finance Director of ITV Plc and Granada Group Plc, Chairman of Ashtead Group Plc and non-executive director of EMAP Plc, New Look Retail Group Ltd, Independent Television News Limited, Vector Hospitality Plc and Ladbrokes Plc.

**External appointments:**
- Merchants Trust Plc (The)
- WH Smith Plc
- Capital & Counties Properties Plc

**Committee membership:**
- Audit Committee (Chair)
- Nominations Committee
- Group Risk Committee

### 4 JOHN POLLOCK
CHIEF EXECUTIVE OFFICER (PROTECTION & ANNUITIES)

**Skills and experience:** John was appointed to the Board in December 2003, having joined Legal & General in 1980. John's former roles include: Director, UK Operations; Managing Director, Legal & General Asia based in Sydney Australia and various posts in Customer Services and IT. John holds a BSc from Strathclyde University and is a Fellow of the Royal Geographical Society.

**External appointments:**
- The Financial Services Practitioner Panel
- ABI Long Term Savings & Life Insurance Committee

### 5 MARK GREGORY
CHIEF EXECUTIVE OFFICER (SAVINGS)

**Skills and experience:** Mark was appointed to the Board in January 2009. He joined Legal & General in 1998 and has held a variety of divisional finance director roles and served as Group Financial Controller, Communications and Resources Director, Resources and International Director and UK Service Operations Director. From 2006, he was Managing Director, With-Profits. Prior to joining Legal & General, he had worked in senior financial and business development roles at companies including Kingfisher Plc and ASDA. Mark is a qualified chartered accountant.

**External appointments:**
- Westdown Park Management Company Limited

### 6 MARK ZINKULA
CHIEF EXECUTIVE OFFICER (LGIM)

**Skills and experience:** Mark was appointed to the Board in September 2012, having been appointed as Chief Executive Officer of Legal & General Investment Management in March 2011. Prior to that, he was CEO of Legal & General Investment Management America (LGIMA) since 2008 and played an integral part in the establishment and successful expansion of LGIMA. Prior to joining LGIMA, Mark was at Aegon Asset Management where he was Global Head of Fixed Income.

**External appointments:**
- ABI Advisory Panel
- Investment Management Association

### 7 STUART POPHAM
INDEPENDENT NON-EXECUTIVE DIRECTOR

**Skills and experience:** Stuart was appointed to the Board in July 2011. Stuart has extensive legal knowledge and business acumen. He was previously the Senior Partner of Clifford Chance LLP from 2003-2011. Stuart is Chairman of The Royal Institute of International Affairs ('Chatham House') and was from 2008 to 2012 Chairman of TheCityUK, the body created to promote financial services. Stuart is also a member of the Business Advisory Forum of the Saïd Business School, Oxford University. Stuart is on the Council of Birkbeck College, University of London, the Royal National Lifeboat Institution and the Barbican Trust.

**External appointments:**
- Citigroup, Vice Chair of EMEA Banking

**Committee membership:**
- Nominations Committee
- Remuneration Committee
- Group Risk Committee

### 8 MIKE FAIREY
INDEPENDENT NON-EXECUTIVE DIRECTOR

**Skills and experience:** Mike was appointed to the Board in May 2011. He has significant experience in the UK financial services sector. He was previously Deputy Group Chief Executive, Lloyds TSB Group Plc from 1998-2008 and is Chairman of APR Energy Plc.

**External appointments:**
- Vertex Group Limited
- APR Energy Plc
- Danske Bank A/S
- The Energy Saving Trust Limited
- Lloyds TSB Group Pension Trust Ltd

**Committee membership:**
- Audit Committee
- Nominations Committee
- Remuneration Committee







**9 DAME CLARA FURSE**
INDEPENDENT NON-EXECUTIVE DIRECTOR
**Skills and experience:** Clara was appointed to the Board in June 2009. Her career has spanned a broad range of global financial markets during 33 years in financial services and she was Chief Executive of the London Stock Exchange between 2001 and 2009. Former roles and directorships include: non-executive director of LCH Clearnet Group Limited, Euroclear Plc, Fortis and a member of the Shanghai International Financial Advisory Committee. She was also Chairman of the Lead Expert Group for the UK Government Office for Science's Foresight project on the future computer trading in financial markets and is a member of the Panel of Senior Advisors to Chatham House.

**External appointments:**
- Nomura Holdings Inc
- Amadeus IT Holdings S.A.
- UK Department for Work and Pensions

**Committee membership:**
- Nominations Committee
- Group Risk Committee

**10 RUDY MARKHAM**
INDEPENDENT NON-EXECUTIVE DIRECTOR
**Skills and experience:** Rudy was appointed to the Board in October 2006. Rudy is a Fellow of the Chartered Institute of Management Accountants and the Association of Corporate Treasurers. He was awarded the CIMA Lifetime Contribution to Management Accounting Award in 2005. Former roles include: Chief Financial Officer, Director of Strategy and Technology and Treasurer of Unilever Plc, Chair and CEO of Unilever Japan and Chair of Unilever Australia.

**External appointments:**
- Standard Chartered Plc
- AstraZeneca Plc
- United Parcel Service Inc
- CSM NV

**Committee membership:**
- Nominations Committee
- Remuneration Committee (Chair)

**11 JULIA WILSON**
INDEPENDENT NON-EXECUTIVE DIRECTOR
**Skills and experience:** Julia was appointed to the Board in November 2011. She has significant corporate finance, tax and accounting experience. She is the Group Finance Director of 3i Group Plc and a member of its Board since 2008. Previously, she was the Group Director of Corporate Finance at Cable & Wireless plc. At Cable & Wireless plc she held a number of finance roles and was responsible for the Finance, Treasury, and Tax functions. Julia is a member of the ICAEW (ACA) and the Chartered Institute of Taxation.

**External appointments:**
- 3i Group Plc

**Committee membership:**
- Audit Committee
- Nominations Committee

**12 NICK PRETTEJOHN**
INDEPENDENT NON-EXECUTIVE DIRECTOR
**Skills and experience:** Nick was appointed to the Board in November 2010. He has extensive knowledge and experience of the UK and international insurance industry. Former roles include: Chief Executive of Lloyd's of London, Chief Executive Officer of Prudential UK & Europe, and Executive Director of Prudential Plc. Nick is a Trustee of the Royal Opera House, Chairman of the Britten-Pears Foundation and Chairman of the Board of Governors of the Royal Northern College of Music.

**External appointments:**
- Brit Insurance Holdings B.V.

**Committee membership:**
- Audit Committee
- Nominations Committee
- Remuneration Committee
- Group Risk Committee (Chair)

**WADHAM DOWNING**
Wadham has acted as the Interim Chief Financial Officer from July 2012. Previously he was the Group Financial Controller and prior to that he was Finance Director for the Risk division. Before joining Legal & General in 2009, he held a variety of finance roles including Finance Director at Resolution Management Services Division and Head of Corporate Development at Britannic Group plc. Wadham is a chartered accountant.

**GEOFFREY TIMMS**
Geoffrey was appointed as Group General Counsel and Company Secretary in 2008 and has been the Group's Chief Legal Officer since 1999. Prior to joining Legal & General, Geoffrey was a solicitor with Clifford Chance and then Clyde & Co.

# LETTER FROM THE CHAIRMAN.

**"We believe that good corporate governance underpins the long-term success and sustainability of the Company creating trust and engagement between the Company and its shareholders."**

**JOHN STEWART**
**CHAIRMAN**

For more information visit our website:
**investor.legalandgeneral.com/corporate-governance.cfm**

## CHAIRMAN'S LETTER

The Board aspires to the highest standards of corporate governance and this year has dedicated a significant amount of time to considering emerging corporate governance practice in line with our belief that this is fundamental to sound decision making processes and delivering the Company's strategy. As Chairman, my leadership of the Board is critical to encouraging open and transparent discussion, constructive challenge and support.

The last five years have seen unprecedented challenges for the global and UK economies and, in particular, financial services companies. This has rightly heightened the importance and visibility of good corporate governance. As a major investor in UK and global companies, we are aware of our responsibility both to practise high standards of corporate governance and to contribute to promoting an environment where such standards inform our engagement with companies in which we invest. We regularly review and refresh our approach to corporate governance to ensure that it is robust, well embedded and at the forefront of best practice. We firmly support LGIM's engagement with the companies in which it invests, with a view to driving best practice and enhancing corporate governance practices, as detailed on page 40.

Our statement of compliance with the provisions of the UK Corporate Governance Code is set out in the Corporate Governance Report. I am pleased to report that the Company has complied with all principles of the Code throughout the year ended 31 December 2012 and from that date up to the date of publication of this Annual Report.

## CHANGES TO THE BOARD

The Board was extremely pleased to announce the appointment of Nigel Wilson as the Group Chief Executive in June 2012 following the retirement of Tim Breedon as Group Chief Executive. On behalf of the Board, I would like to thank Tim for his contribution to the success of the Company and welcome Nigel to his new role. I am pleased to report that we have seen a smooth transition during the succession period and I have enjoyed working closely with Nigel since his appointment. Nigel and I have spent time visiting various business locations and considering the prospects for further growth. Nigel continues to bring an evolutionary approach to the execution of the next stage of the Group's strategy and provides continued focus on delivering for our customers, business partners and shareholders.

Following Nigel's appointment, the Board reviewed the balance of skills and experience represented on the Board and determined that greater knowledge of the LGIM business would further strengthen the Board.

In September 2012, we were pleased to welcome Mark Zinkula, CEO LGIM, to the Board as an executive director. Mark is an excellent addition to the Board, bringing detailed knowledge of LGIM and also the US market.

Following almost nine years of service, Henry Staunton has decided to retire from the Board and will be stepping down as a director following this year's AGM. Henry has been a great asset to the Company and I would like to thank him for his service.

The Board is currently engaged in a process to identify and appoint a new Chief Financial Officer.

## BOARD DIVERSITY

Last year I highlighted the importance of a diverse Board and set out the Board's diversity statement. This year the Board has built on this statement and adopted a Board diversity policy which also sets out the key principles that must be considered when making Board appointments. The diversity policy is available to view on our website.

We welcome the benefits of greater Board diversity, including gender diversity, and the Board remains committed to ensuring that the Company's directors bring a wide range of skills, knowledge, experience, backgrounds and perspectives. Although we do not have a set target for the number of women on our Board, we endorse Lord Davies' recommendations in relation to diversity. The Board continues to incorporate board diversity considerations into its thinking on the composition of the Board; however, all appointments will continue to be made on merit against objective criteria, in the context of the overall balance of skills and backgrounds that the Board needs to maintain in order to remain effective.

The Board believes that diversity at all levels of the organisation is important and is working towards strengthening the representation of women among the non-Board senior management cadre – the Board directors of tomorrow. The Board places great importance on talent development in the organisation and I am pleased to say that Board members play an active role in mentoring individuals and sponsoring and attending talent development programmes. Outside of the organisation I also devote time to furthering talent development through my involvement in the FTSE 100 Cross-Company Mentoring Programme and the 30% Club, which is a group of Chairman voluntarily committed to bringing more women on to UK Corporate Boards.

The Nominations Committee report sets out in more detail how diversity is considered when making appointments to the Board.

## BOARD EVALUATION

This year the Board undertook an evaluation facilitated by an external evaluator, KPMG LLP and the Board is pleased to confirm that the evaluation concluded that the Board was overall effective. The Board recognises that good corporate governance continues to evolve and consequently that there are steps that it could take to continue to remain fully effective in the future. I am pleased to report that many of the recommendations made by the evaluator have already been implemented by the Board. The review was extremely comprehensive and included a review of over a year's Board and Committee papers, interviews with all Board members and meetings with the Executive Committee members and other senior management. A more detailed report on the Board evaluation is set out in the Corporate Governance Report on page 61.

## EXECUTIVE REMUNERATION

Executive remuneration has recently been subject to intense public debate. We support initiatives to make executive remuneration as transparent and simple as possible. You will see that in anticipation of the revised remuneration regulations coming into force we have split the Remuneration Report into two parts: a forward-looking section outlining the Company's remuneration policy and a section reporting on implementation during 2012.

## COMMUNICATIONS WITH SHAREHOLDERS AND ANNUAL GENERAL MEETING (AGM)

We value open, constructive and effective communication with our shareholders and I have enjoyed meeting with shareholders throughout the year. I look forward to sharing with you in person the successes of the Company during 2012 at the AGM on 22 May 2013. The AGM is an important forum for engagement with all shareholders and gives shareholders an opportunity to raise questions on this report and any other questions they may have on the resolutions to be put to the meeting. At the 2013 AGM all Board directors will be available, as usual, to meet shareholders after the meeting to discuss issues on a face-to-face basis. We would like our investors to find attending our AGM an interesting and rewarding experience, to hear about the performance of the Company over the last year and have the opportunity to meet members of the Board and I would encourage as many shareholders as possible to attend.

**JOHN STEWART**
**CHAIRMAN**

# CORPORATE GOVERNANCE.

## OUR APPROACH TO CORPORATE GOVERNANCE

As a Company, we are committed to the highest standards of corporate governance. This year the Board has considered in detail the most recent additions to the UK Corporate Governance Code (the Code) in relation to diversity, which has resulted in the adoption of a Board diversity policy.

We have carried out an annual review of our Corporate Governance framework, which included the review of a number of corporate governance policies along with the terms of reference for each of the Board Committees, the Group conflicts of interest policy, the share ownership policy for non-executive directors and all Board and subsidiary directors' conflicts of interest. The Board is pleased to report that the Company was fully compliant with the principles and provisions of the Code throughout the year under review.

## THE DIRECTORS

The Board is led by the Chairman, John Stewart, and the day-to-day management of the organisation is led by the Group Chief Executive, Nigel Wilson, previously Chief Financial Officer, who succeeded Tim Breedon on 30 June 2012. The composition of the Board is reviewed regularly to ensure the right combination of skills and experience is in place to lead the Company. The latest review recognised the desirability of greater representation on the Board from the Group's investment management business, LGIM, and in September 2012, the Board was pleased to announce the appointment of Mark Zinkula, Chief Executive Officer of LGIM, as an executive director.

In accordance with the recommendations of the Code, Mark Zinkula will stand for election by shareholders at the 2013 AGM and all other Board directors, with the exception of Henry Staunton who intends to retire as a director, will stand for re-election as was the case at the 2012 AGM.

Following Nigel's appointment as Chief Executive and whilst we have been undertaking the process to identify a new Chief Financial Officer, Wadham Downing has acted as Interim Chief Financial Officer and attended all meetings of the Board.

### Training and development

On appointment to the Board, directors participate in a comprehensive induction programme which continues to improve and evolve as new directors join the Board. As part of the induction programme each director is provided with a detailed induction pack containing key business information, the Group's governance policies and investor reports. Each director also attends an extensive series of structured meetings with other directors and senior management to gain an in-depth understanding of all business areas, the challenges they face and strategies for growth. The induction programmes are tailored to meet the needs of the appointee.

On Mark Zinkula's appointment to the Board, an induction programme was developed for him focusing in particular on business areas other than LGIM to ensure that Mark has an in-depth understanding of the Group as a whole. As part of this programme, Mark has also participated in training sessions detailing advanced directors' duties with a particular emphasis on the specific obligations of a director of a UK listed company.

The Chairman meets regularly with each director to agree training and development goals and personal development plans are in place for each of the non-executive directors, which include business-related training sessions and UK and overseas site visits.

The executive and non-executive directors are invited to attend regular Executive Business Awareness sessions following the scheduled Board meetings with the key focus during 2012 having been Solvency II and Conduct Risk.

### OFFICE LOCATION SITE VISITS

During the course of 2012, Board meetings were held in several different Company locations; central London, Kingswood and Hove. The Board meetings held in Kingswood and Hove included site visits to the business areas operating at these locations and gave the Board members a great opportunity to meet with employees to discuss new business ideas and initiatives and experience customer service first-hand. Employees greatly valued the opportunity to ask questions and gain insights from Board members in small group sessions.

**"I really valued the opportunity to discuss new customer service initiatives with several Board members. The insights they gave from their experience of how other companies operate was extremely useful and informative."**

**QUOTE FROM EMPLOYEE**

## The Board

The Board meets formally on a regular basis and the meeting agenda, which was refreshed following the Board Effectiveness Review in 2012, prioritises strategic issues, the Company's financial and operational performance, key stakeholder matters and the performance of the individual business areas.

The specific duties of the Board and those decisions which can only be made by the Board are clearly defined in the schedule of matters reserved. The matters requiring Board approval include, amongst others:

- Group annual strategic plans and any changes to such plans.
- Mergers, acquisitions and disposals of a material size.
- Changes to Group structure and capital.
- Financial reporting and dividends.
- Group risk appetite and internal controls.
- Executive director remuneration.
- The approach to corporate governance.

The Group Chief Executive, who is responsible for the day-to-day management of the organisation, is supported by the executive management team and an Executive Committee, which comprises all of the Executive Directors, the Group Chief Risk Officer, the Group Regulatory Risk and Compliance Director, the Group HR Director, the Head of Group Treasury and Investments, the Director of Shared Services and the Group General Counsel and Company Secretary. The Committee acts as an advisory group to the Group Chief Executive and exists to inform executive decision-making within the authority delegated by the Board. The Executive Committee aims to meet in advance of each Group Board meeting and reviews matters to be proposed to the Group Board for approval in order to ensure that the Executive Committee is supportive of such matters, that they have been fully stress tested and that information provided to the Board is comprehensive, transparent and sufficiently focused.

## BOARD AGENDA: KEY AREAS OF FOCUS IN 2012

| STRATEGIC OPPORTUNITIES AND GROWTH | RISK APPETITE | SUCCESSION PLANNING AND TALENT MANAGEMENT | STAKEHOLDER REVIEW |
|---|---|---|---|
| The Board continues to focus on accelerated evolution and the Board's agenda prioritises strategic growth opportunities to facilitate time for discussion of these key matters. | The Board is accountable for ensuring that risk is effectively managed across the Group. The Board has focused on formulating and refining the Group's risk appetite statement to ensure that strategic proposals brought to the Board are debated within the context of the Company's risk appetite. | The Board recognises the importance of developing talent throughout the organisation. The Board receives regular talent management updates and supports the development of individuals. Several Board members mentor individuals participating in a 'Future Leaders' programme. | The Board recognises the importance of understanding the views of all key stakeholders and regularly dedicates time to focus on a particular stakeholder group. This year the Board specifically considered:<br>• institutional Investors and retail shareholders;<br>• customers;<br>• employees;<br>• Government bodies; and<br>• regulators. |

# CORPORATE GOVERNANCE CONTINUED

## STRATEGY AWAY DAYS

The Board dedicates time to considering the Company's future strategy, in light of the previous year's performance against set targets, the continuing challenges that face the UK and global economies and financial services companies, and the opportunities for growth. A two day strategy event was held in 2012 at which the Board considered the growth and future development of the Group as a whole and how greater synergies could be driven across the Group. This year there were focused discussions on expansion of the LGIM business, the growing need for retirement solutions, connecting better with customers and improving digital presence. The directors found this to be a particularly interactive, thought provoking and helpful event.

**"This was my first strategy day since joining the Board last November and I was very impressed with the openness of all the participants to robust and constructive debate, and the breadth of opportunities we have as a business. It was also good to be able to interact with many in the wider management team in a less formal setting than the Boardroom."**

**JULIA WILSON**
**NON-EXECUTIVE DIRECTOR**

## ENGAGEMENT WITH STAKEHOLDERS

During the year we have continued to promote greater direct engagement with both our retail and institutional shareholders and the Chairman and the Group Chief Executive have held regular meetings with institutional investors and analysts throughout the year. The Group General Counsel and Company Secretary facilitates communication with retail shareholders on behalf of the Board.

The Company's Investor Relations department is also dedicated to facilitating engagement with shareholders to ensure that the Company's performance is clearly understood and the Board is well informed of shareholder opinion in response. The Investor Relations department holds regular meetings with investors and aims to meet with the Company's top 20 investors twice per year. The team aims to be available on request and, where possible, facilitates access to the Board and senior management. The Board received regular reports from the Investor Relations department on its activities, and in particular feedback received throughout the year from investors, analysts and advisers.

## BOARD AND BOARD COMMITTEE EVALUATION

In 2012, an externally facilitated evaluation of the Board's performance, the performance of its individual directors and that of its Committees was carried out by KPMG LLP (KPMG) who were chosen following a selection process that considered a range of potential external evaluators. The Board agreed detailed terms of reference for the review and considered the merits of each evaluator against those terms. The Board concluded that KPMG demonstrated the most appropriate skill set.

In particular, the Board believed KPMG's significant expertise in the areas of Solvency II and RDR would be useful to the evaluation process given that these matters have required significant consideration and input from the Board. KPMG do not currently have any material relationships with the Company, they are not the Company's auditors, but are on a panel of numerous service providers who may be considered to assist the Company with various projects, from time to time.

The aim of the Board Effectiveness Review was to assess the effectiveness of the Board's processes, composition and structure in order to identify and implement any actions required to improve effectiveness. In order to best meet this objective, the review focused on five related areas:

- Board Leadership
- Board Structure & Composition
- Oversight of Strategy, Risk and Control
- Decision Making
- Development and Culture.

The Board Effectiveness Review process comprised:

- A desktop assessment of Board papers, Board and management information and other relevant documentation.
- Meetings with Executive Committee members and other key individuals within the organisation.
- Case study reviews in order to gain practical insight into the functioning of the governance process.
- Formal structured interviews with all Board directors focusing on all aspects of the Board's composition; Board oversight of strategy, risk and controls; decision-making and the roles and performance of the Chairman, the senior independent director, executive directors and other non-executive directors.

The evaluation concluded that the Board was overall effective and recommendations, incorporating feedback from the directors' interviews, were provided to ensure the Board remained fully effective as Corporate Governance continues to evolve. The Board has considered the recommendations and an update on progress made against some of the key recommendations is set out below.

| RECOMMENDATION FROM 2012 BOARD EVALUATION | ACTION TAKEN |
|---|---|
| Board Considerations | |
| **BOARD AGENDAS**<br>Consider and refine the Board agendas to enhance focus on strategic opportunities and growth. | The Board agenda was reviewed and a revised agenda was trialled by the Board. The revised agenda prioritised strategic proposals to allow more time for discussion, debate and challenge. The revised format received positive feedback and has been in place since July 2012. |
| **BOARD PAPERS**<br>Consider improvements to the form and focus of Board papers. | To ensure that all papers submitted to the Board are consistent and focused, a guide to the drafting of Board papers and presenting at the Board has been developed and we have significantly reduced the volume of paper used in Board packs through the introduction of electronic Board papers. |
| **MANAGEMENT INFORMATION**<br>Improving the provision of information to allow more effective scrutiny and challenge. | The Board management information packs have been reviewed and refreshed to highlight progress against key performance indicators, strategic initiatives and risk appetite along with a consolidated business performance dashboard. |
| Director Considerations | |
| **TRAINING**<br>Consider improvements to the format and content of the Board Training Programme. | The Board Training Programme has been tailored to the needs of each director. The programme has been enhanced to include site visits to the various business locations including Kingswood, Hove, France and the Netherlands. The programme also includes regular one-to-one and group training sessions on relevant topics, with recent examples of Balance Sheet and Reserving and With Profit Bonds. |
| **BOARD PARTICIPATION**<br>Consider how to further increase the contribution of all executive directors and how to promote greater open discussion of issues, including bringing ideas to the Board at an earlier stage. | Each executive director provides an update at each Board meeting on their respective business areas, including bringing early stage proposals to the Board; for example, new initiatives as part of the Group's digital strategy. Following implementation of this recommendation, each individual director's contribution to discussion, debate and challenge has significantly increased. |

# CORPORATE GOVERNANCE CONTINUED

## COMPLIANCE WITH THE UK CORPORATE GOVERNANCE CODE

For the year ended 31 December 2012, the Board believes that the Company has complied with the principles and provisions of the UK Corporate Governance Code. A full version of the UK Corporate Governance Code can be found on the Financial Reporting Council's website: www.frc.org.uk

### A. LEADERSHIP

**A1 The Board's role**
The Board meets formally on a regular basis in order to review the Company's performance and strategy against set objectives. There is a clear schedule of matters reserved for the Board as further described on page 59.

**A2 A clear division of responsibilities**
The Company has both a Chairman, who is responsible for the leadership and effectiveness of the Board and a Group Chief Executive who is responsible for leading the day-to-day management of the Company within the strategy set by the Board.

**A3 Role of the Chairman**
The Chairman sets the agendas for meetings, manages the meeting timetable and facilitates open and constructive dialogue during the meetings.

**A4 Role of the non-executive directors**
The Chairman promotes an open and constructive environment in the boardroom and actively invites the non-executive directors' views.

Regular meetings are held between the non-executive directors in the absence of the executive directors providing an opportunity for any concerns to be discussed.

### B. EFFECTIVENESS

**B1 The Board's composition**
The composition of the Board is reviewed regularly by the Nominations Committee to ensure that the there is an appropriate mix of skills on the Board and a range of diverse experience.

**B2 Board appointments**
The appointment of new directors to the Board is led by the Nominations Committee. Further details of the appointments undertaken during the year and succession planning can be found on page 64.

**B3 Time commitments**
The time commitments of non-executive directors are defined on appointment and regularly evaluated. In practice, the time commitments go beyond those set out in the letters of appointment. The Chairman gives consideration to new directorships which may impact existing time commitments.

**B4 Training and development**
An induction programme is in place. The Chairman reviews each of the non-executive director's training needs and tailored programmes are in place to meet these needs.

**B5 Provision of information and support**
The Chairman, in conjunction with the Company Secretary, ensures that all Board members receive accurate and timely information.

**B6 Board and Committee Performance Evaluation**
An externally facilitated evaluation was undertaken during 2012 and is described in detail on page 61.

**B7 Re-election of the directors**
All directors were subject to shareholder re-election at the 2012 AGM as will be the case at the 2013 AGM.

## BOARD AND COMMITTEE MEETINGS ATTENDANCE

| Director | Appointment Date | Board (9) | Audit Committee (5) | Nominations Committee (7) | Remuneration Committee (8) | Group Risk Committee (7) |
|---|---|---|---|---|---|---|
| J Stewart | 1 January 2010 | 9 (9) | | 7 (7) | | |
| T J Breedon[1] | 1 January 2002 | 4 (4) | | | | |
| M Fairey | 1 May 2011 | 9 (9) | 3 (5) | 6 (7) | 6 (8) | |
| Dame C Furse | 1 June 2009 | 8 (9) | | 6 (7) | | 6 (7) |
| M J Gregory | 28 January 2009 | 9 (9) | | | | |
| R Markham | 4 October 2006 | 9 (9) | | 7 (7) | 8 (8) | |
| J B Pollock | 11 December 2003 | 9 (9) | | | | |
| S Popham | 1 July 2011 | 9 (9) | | 7 (7) | 7 (8) | 7 (7) |
| N Prettejohn | 2 November 2010 | 9 (9) | 5 (5) | 7 (7) | 8 (8) | 7 (7) |
| H E Staunton | 1 May 2004 | 9 (9) | 5 (5) | 7 (7) | | 7 (7) |
| J Wilson | 9 November 2011 | 8 (9) | 5 (5) | 6 (7) | | |
| N D Wilson | 1 September 2009 | 9 (9) | | | | |
| M Zinkula | 18 September 2012 | 3 (3) | | | | |

1. Retired with effect from 30 June 2012.
2. Appointed as a director on 18 September 2012.

## C. ACCOUNTABILITY

**C1 Financial and business Reporting**
The Directors' Report can be located on pages 1 to 100, and this sets out the performance of the Company, the business model, strategy and the risks and uncertainties relating to the Company's future prospects.

**C2 Risk management and internal control systems**
The Board sets the Company's risk appetite and annually reviews the effectiveness of the Company's risk management and internal control systems. The activities of the Audit and Group Risk Committees, which assist the Board with its responsibilities in relation to risk setting and management, are set out on page 44.

**C3 Role and responsibilities of the Audit Committee**
The Board has delegated a number of responsibilities to the Audit and Group Risk Committees which undertake the day-to-day oversight of the risk management framework on behalf of the Board. The Chairmen of each of the Committees provide regular reports to the Board.

## D. REMUNERATION

**D1 Levels and elements of remuneration**
The levels of remuneration of directors and how the Company promotes an alignment of interests between directors and shareholders by linking reward to performance are explained in the Directors' Remuneration Report on page 70.

**D2 Development of remuneration policy and packages**
The activities of the Remuneration Committee and the way in which it sets executive remuneration policy are set out in the Directors' Remuneration Report on page 70.

## E. RELATIONS WITH SHAREHOLDERS

**E1 Shareholder engagement and dialogue**
The Board seeks to actively engage with both institutional and retail shareholders. Details of the shareholder engagement programme are set out on page 60.

**E2 Constructive use of the AGM**
The Board values the AGM as an important opportunity to engage with investors. Attendees at the AGM have the opportunity to ask questions to the Board and to speak to individual directors following the formal business of the meeting.

# NOMINATIONS COMMITTEE REPORT.

## THE COMMITTEE

The Nominations Committee leads the process for the appointment of new directors to the Board and reviews on a regular basis the succession plans in place for executive directors and key senior management, Board composition, the suitability of the directors standing for re-election at the AGM and whether the Chairman and the non-executive directors continue to be able to meet their commitments to the Company.

| Members | |
|---|---|
| John Stewart | Rudy Markham |
| Nick Prettejohn | Stuart Popham |
| Dame Clara Furse | Mike Fairey |
| Henry Staunton | Julia Wilson |

The Nominations Committee is chaired by the Chairman, and all non-executive directors are members of the Committee. The executive directors, as well as the Group General Counsel and Group HR Director, may attend meetings by invitation. The Committee is currently chaired by Henry Staunton, the Senior Independent Director, when it is considering matters relating to the Chairman. The Nominations Committee met formally seven times in 2012.

## GROUP CHIEF EXECUTIVE SUCCESSION

During 2012 the Committee met regularly to consider the plans for the Group Chief Executive succession. The Committee assessed the skills, competencies and qualities required for the position and produced a detailed candidate brief setting out in detail the responsibilities of the role. The Committee then engaged external search consultants, Odgers Berndtson, who are signatories to the Voluntary Code of Conduct for Executive Search Firms, to undertake a search that considered both external and internal candidates. The Committee considered a long list of applicants of appropriate merit, which included female candidates and candidates from a diverse range of backgrounds and then rigorously interviewed a refined list of candidates for the position. The Committee assessed and compared the merits of each of these candidates before recommending to the Board the appointment of Nigel Wilson as Group Chief Executive.

## APPOINTMENT OF MARK ZINKULA

Following the appointment of the Group Chief Executive the Nominations Committee met to further examine the range of competencies and experience on the Board along with the importance of a diverse Board both in terms of thought, background, experience and gender and determined that it would be in the best interests of the Board and the Company as a whole for LGIM to be represented at the Board. The Committee evaluated the skills, knowledge and experience required for the role and determined that Mark Zinkula, CEO, LGIM met these requirements and should be appointed to the Board. The Committee believes that this appointment greatly contributes to the diversity of the Board as Mark brings international insight from his breadth of experience in the US.

## SEARCH FOR CHIEF FINANCIAL OFFICER

The Committee is currently engaged in a process to identify and appoint a Chief Financial Officer following the appointment of Nigel Wilson, previous CFO, as Group Chief Executive.

## DIVERSITY

Under its terms of reference, the Nominations Committee must review regularly the structure, size, and composition of the Board (including the balance of skills, knowledge, and experience) and make recommendations to the Board for any changes. This year the Board built on its previous diversity statement and adopted a Board diversity policy. The Nominations Committee will consider the policy in future appointments to the Board.

In accordance with the policy the Committee will encourage the emergence of female candidates and candidates of diverse backgrounds by: (i) engaging an executive search firm that is a signatory to the Executive Search Firms' Voluntary Code of Conduct; (ii) liaising with the search firm to produce a brief that includes an appropriate emphasis on diversity of skills and background, independence of approach and other personal qualities in addition to career experience and compatibility with the values and behaviours of existing Board Members, with a view to enhancing the overall effectiveness of the Board; and (iii) encouraging the search firm to produce long lists which include female and other diverse candidates of appropriate merit. The Committee will also consider high-performing female and other senior executives from a diverse range of backgrounds who may not have previous Board experience in executive and non-executive directorship roles subject to the requirements for potential candidates to meet FSA approved person requirements for a Board director of a financial services firm.

The Committee believes that diversity at all levels of the organisation is important and is working to further strengthen the representation of women among the non-Board senior management who may be the Board directors of tomorrow. Board members play an active role in supporting and contributing to various employee talent development programmes by mentoring individual employees and meeting with groups of employees who take part in the programmes.

## INDEPENDENCE

The Committee and the Board evaluate the independence of all non-executive directors, in particular any non-executive director serving over six years. A full review of each of the non-executive directors' interests was carried out in September 2012. The Board was satisfied with the findings of this review and concluded that each non-executive director remained independent.

In October 2012, Rudy Markham reached six years of service on the Board and accordingly, the Committee met again to consider the independence of each non-executive director. The Committee was requested to give particular consideration as to whether Rudy remained independent in character and judgement given his length of tenure and to report back to the Board on its findings. As part of the assessment process, the Committee reviewed each of Rudy's external business interests and other relationships which could materially interfere with the exercise of objective and independent judgement or could affect Rudy's ability to act in the best interests of the Company. The Committee was satisfied that there were no circumstances which would affect Rudy's judgement and determined that Rudy remained independent and continued to provide a valuable contribution to the Board's deliberations.

## DIRECTORS' TIME COMMITMENT

All directors may serve on a number of other Boards, provided they can demonstrate that any such appointment will not interfere with their time commitment to the Company and that they obtain the agreement of the Chairman to the appointment before accepting. Executive directors must also obtain the permission of the Group Chief Executive. The major commitments of our executive and non-executive directors are outlined in their biographies on pages 54-55. Currently, non-executive directors are contractually obliged to commit circa 25 days per year. However, in practice their time commitment is significantly in excess of 25 days. The Chairman's time commitment is two to two and a half days per week. The Committee remains satisfied that all non-executive directors have sufficient time to meet their commitments to the Company and was also satisfied that during 2012 the Chairman's other commitments did not interfere with the day-to-day performance of his duties for the Company.

The terms of reference for all Board Committees can be viewed on our website.

# AUDIT COMMITTEE REPORT.

**"The Committee is primarily responsible for overseeing the Group's internal control and risk management framework, financial reporting and the work undertaken by, and the relationship with, the Group's external auditors."**

**HENRY STAUNTON**
**CHAIRMAN OF THE AUDIT COMMITTEE**

## THE COMMITTEE

All members of the Committee are independent non-executive directors and a finding of the Board's externally facilitated evaluation was that the Committee members have the knowledge and skills to effectively fulfil their responsibilities.

| Members | |
|---|---|
| Henry Staunton | Committee member since 1 May 2004, Chair since 27 April 2005 |
| Mike Fairey | Committee member since 1 May 2011 |
| Nick Prettejohn | Committee member since 15 March 2011 |
| Julia Wilson | Committee member since 9 November 2011 |

Other attendees at Committee meetings include: the Group Chairman, Group Chief Executive, Group Chief Financial Officer, Group Chief Risk Officer, Group Financial Controller, Group Chief Internal Auditor, UK Actuary and representatives of the external auditor, PricewaterhouseCoopers LLP.

The Committee met five times during 2012. The Committee's terms of reference are reviewed annually and the current terms of reference, reviewed in November 2012 are available on our website.

## THE COMMITTEE'S ROLE

During 2012, the Committee focused on:

### Internal control and risk management framework

The Committee considers control environment issues, root causes and management's responses and follow up activities and is assisted by the work of both internal audit and the external auditor. During 2012, the Committee considered and sought assurance on the controls around the financial management processes for the With Profits fund, the technology infrastructure for strategic asset data within the Group's asset management business and the processes for assumption setting for the Legal & General America business. It also considered the asset exposures of international subsidiaries and how these are being managed. In particular, the Committee has been assisted by the evolution of an internal audit performance scorecard and control theme reporting. With the implementation of the RDR from 1 January 2013, the Committee has been focused during 2012 on the governance structure and controls in place for the RDR implementation programme. The Committee has received regular reports from the programme sponsor on key programme risks.

In conjunction with the Group Risk Committee, the Committee assists the Board in ensuring the Group operates within a framework of prudent and effective controls that allows risk to be identified, assessed and managed. Implementation and maintenance of the internal control systems are the responsibility of the executive directors and senior management. Where failings or weaknesses have been identified, actions have been taken to remedy these. The Group's control policies and procedures, which are in accordance with Turnbull Guidance, have been in place during 2012 and up to the date this report was approved. The Group's system of internal control is designed to manage rather than eliminate risk and can only provide reasonable and not absolute assurance against material loss. The internal control and risk management systems cover the Company's financial reporting process and the Group's process for preparation of consolidated financial statements. For 2012, the Board was able to conclude, with reasonable assurance, that appropriate internal control and risk management systems were maintained throughout the year.

### Financial reporting

In conjunction with the external auditors, the Committee considers and approves significant assumptions and areas of accounting judgement for the Group's consolidated accounts and for subsidiary accounts. During 2012, the Committee has focused on mortality and longevity assumptions, annuity valuation interest rate which is used to discount actuarial liabilities, the methodology for calculation of default reserves in light of market conditions and changes in credit ratings of assets within the portfolio, reinvestment and disinvestment rate assumptions for the setting of the level of reserve for the annuities business, guarantees and options provided within international products, US deferred acquisition costs policy and the assumed return on Group capital and financing assets. The Committee reviews compliance with International Financial Reporting Standards within the Group and considered management's assessment when determining the basis for preparation of the financial statements. The Committee evaluated the consistency of the 2011 preliminary results announcement and 2011 Directors' Report, and the 2012 half year results announcement with the financial statements. In light of the current focus on corporates' UK tax contributions, this year the Committee reviewed the Company's tax policy in the context of the Group's corporate social responsibility and shareholder stewardship objectives and the Company's approach to tax disclosure.

**Internal audit**

The Committee received quarterly reports from the Group Chief Internal Auditor on internal audits undertaken, the detailed findings on areas assessed as high risk and where the Committee determined it required further information and assurance, detailed discussions with the management of those areas took place on management's responses to the internal audit actions. The Committee reviewed and approved the annual internal audit plan for 2012-2013 and reviewed both the level and quality of resources available to the Group Chief Internal Auditor, the allocation of resources between traditional internal audit cycle work and project work and the risk based approach underlying the internal audit annual plan. The Committee held two private meetings with the Group Chief Internal Auditor in the absence of management during 2012.

**External auditor**

Each year, the Committee reviews the external auditor's audit plan to ensure it aligns with the Committee's view of the significant risk areas of financial misstatement.

The Committee judges the external auditor on the quality of their audit findings, management's response and stakeholder feedback. We conducted a review of their performance and effectiveness by way of a structured questionnaire which was distributed to Committee members, attendees and divisional Finance Directors. A number of the criteria for judging the effectiveness of the external auditors are set out below:

- Provision of timely and accurate industry specific and technical knowledge.
- Maintaining a professional and open dialogue with the Committee chairman and members at all times.
- Delivery of an efficient audit and the ability to meet objectives within the agreed timeframes.
- Provision of high quality and consistent advice at all times.

Having reviewed and discussed the feedback, the Committee continues to believe that PricewaterhouseCoopers is the appropriate audit firm for the Group taking into account their performance during 2012, the audit needs of the Group and our principal business areas, the regulatory landscape and our footprint. PricewaterhouseCoopers has been our statutory auditor for a number of years and the Committee is cognisant of the new requirement of the UK Corporate Governance Code in relation to the tendering of the external audit contract every ten years. The Group audit was last tendered in full in 2006 with a partial tender process undertaken in 2009. In accordance with the new requirements of the Code, the Audit Committee recognises the need to carry out a review of the audit service provider within ten years from the date of the last tender and accordingly following the appointment of a new Chief Financial Officer, the Committee intends to carry out a review at an appropriate time between now and the 2017 year-end audit. There are no contractual obligations to the external auditor which restrict the Committee's choice of statutory auditor.

In 2012, the Group spent £3m on non-audit services provided by PricewaterhouseCoopers. Further details can be found in Note 32 to the Group Consolidated Financial Statements.

Analysis of current and prior year spend on audit, other assurance and non-assurance services:

| | 2012 | 2011 | 2010 | 2009 |
|---|---|---|---|---|
| Audit and Related | 4.6 | 4.5 | 4.1 | 4.5 |
| Other Assurance | 1.8 | 0.9 | 0.0 | 0.1 |
| Non Assurance | 1.1 | 1.0 | 1.1 | 1.0 |
| Total | 7.5 | 6.4 | 5.2 | 5.6 |

A significant proportion of the Other Assurance fees in 2011 and 2012 relate to quality assurance work undertaken by the external auditor on the RDR implementation programme and Solvency II regulatory assurance. The external auditor was selected to undertake this work following a competitive tender process and was selected because of their expertise and experience. Separate teams from PwC undertake audit and non-audit work in order to ensure independence and objectivity of the audit team and this control is monitored internally.

The Group's policy requires that all services with an anticipated cost in excess of a specified amount are subject to a full competitive tender involving at least two other alternate parties in addition to the external auditor. If the external auditor is selected following the tender process, the Committee is responsible for approving the external auditor's fees on the engagement. For services with an anticipated cost below the specified amount, the Group Chief Financial Officer has authority to approve the engagement. The external auditor and management report regularly to the Committee on the nature and fees relating to non-audit services provided under this authority.

The external auditor is required to rotate the audit engagement partner every five years. The current audit partner commenced his engagement in 2008 and therefore stepped down as the audit engagement partner following the 2012 audit.

# GROUP RISK COMMITTEE REPORT.

**"The Committee's role is to provide guidance to the Board in relation to the Group's risk management policies and procedures, and to provide advice on what constitutes acceptable risk taking."**

**NICK PRETTEJOHN**
**CHAIRMAN OF THE GROUP RISK COMMITTEE**

## THE COMMITTEE

| Members | |
|---|---|
| Nick Prettejohn | Committee member since 2 November 2010, Chair since 6 April 2011 |
| Dame Clara Furse | Committee member since 14 April 2010 |
| Henry Staunton | Committee member since 14 April 2010 |
| Stuart Popham | Committee member since 1 July 2011 |

Other attendees at Committee meetings include: the Group Chairman, Group Chief Executive, Group Chief Risk Officer, Group Chief Internal Auditor and representatives of the external auditor, PricewaterhouseCoopers LLP.

All members of the Committee are independent non-executive directors. The Board reviewed the composition of the Committee during 2012 and concluded that the composition is appropriate and that Committee members have the knowledge and skills to effectively fulfil their responsibilities.

The Committee met seven times during 2012. The Committee's terms of reference are reviewed annually and the current terms of reference reviewed in November 2012 are available on our website. The terms of reference expressly confirm that the Committee's remit covers the full spectrum of major risks facing the business of the Group, including operational and conduct risk.

The Chairman of the Committee reports back to the Board on the outcome of meetings, and the Board receives the minutes of all Committee meetings.

## THE COMMITTEE'S ROLE

The Group's approach to the management of risk is explained in detail on pages 44 to 51. The Committee's role is to provide guidance to the Board in relation to the Group's risk management policies and procedures, and to provide advice on what constitutes acceptable risk taking. The Committee provides input on and assistance to the Board in the formulation and definition of the Group's Risk Appetite statements. The Committee is assisted by the work of the Group Chief Risk Officer who reports, and has unfettered access, to the Committee. The Committee must approve the appointment or removal of the Group Chief Risk Officer.

### Risk management review

During 2012, the Board commissioned an externally facilitated review to assess the Group's risk management framework against industry best practice in readiness for Solvency II. The review has been overseen by the Committee and has been a major focus during 2012. KPMG were appointed to facilitate the review. The Committee considered the findings of the review and is overseeing the implementation of a target operating model designed in response to the review recommendations to meet the needs of the Group's future strategy.

### Risk appetite statements

An additional major focus of the Committee during 2012 has been the review of risk appetite and the Group's risk-based capital requirements, committing an entire meeting in July to debating these topics, alongside consideration of the profile of strategic and emerging risks to the Group.

### Solvency II internal model submission

The Group's application to the FSA for approval to use a partial internal model to calculate the Group's solvency capital requirement under Solvency II was submitted in November 2012. The Committee reviewed the application before it was submitted to the Board for final approval.

### Focused business reviews

A cycle of focused business reviews during the course of 2012 has enabled the Committee to undertake 'deep dives' into the risk profiles of core business lines through discussion with the relevant managing directors.
Key reviews during the year included:

- Legal & General Investments, the Group's collective investment schemes business.
- Workplace Savings.
- General Insurance business.

Additionally, as part of a cycle of risk management reviews, the Committee has considered the frameworks in place across the Group for the management of:

- Insurance risk.
- Market and credit risk.
- Customer and conduct risk.

### Group Chief Risk Officer's regular report

The Group Chief Risk Officer provides a detailed report to the Committee at each meeting. Each report highlights key matters in the environments in which the Group is operating, the risks that these may present and potential mitigation. Areas considered include global, eurozone and UK economic conditions and the political and regulatory environment. The report also focuses on specific company risks and issues and emerging risks, the nature of the risks and how they may have changed. The report provides the Committee with an opportunity to debate key issues and review mitigating actions.

## RELATIONSHIP BETWEEN THE AUDIT COMMITTEE AND GROUP RISK COMMITTEE

The Chairman of the Audit Committee is a member of the Group Risk Committee. The areas of responsibility of each of the Audit Committee and the Group Risk Committee are defined. The Group Risk Committee provides guidance to the Board on risk management policies and procedures and what constitutes acceptable risk taking, while the Audit Committee looks at the adequacy and effectiveness of the internal control framework encapsulated within those policies and procedures, including financial control. There is active consideration of areas of potential overlap between the Committees and where it would be helpful for an issue considered by one committee to also be considered by the other. The Audit Committee receives input from the Group Risk Committee in the preparation of the internal audit programme and external audit plan.

# DIRECTORS' REPORT ON REMUNERATION.

## LETTER FROM THE CHAIRMAN OF THE REMUNERATION COMMITTEE

I am pleased to present the Directors' Report on Remuneration for 2012.

### OUR APPROACH TO REMUNERATION

Our remuneration philosophy applies throughout the Company and aims to fairly reward employees and recognise performance that is achieved against the backdrop of our Company values, taking into consideration our risk appetite and having due regard to customer outcomes. You can read more about our philosophy on page 76 of the Policy Section.

We define core remuneration as base salary, annual bonus pay, and other benefits such as pension, car allowance, health cover and life assurance. In addition, for the executive directors, Leadership Team and other key employees there is a long term incentive plan – the Performance Share Plan (PSP). Participation in the PSP has been extended in the 2013 grant to include more employees in key roles below the executive directors as well as the Leadership Group. This includes employees in LGIM whose roles cross business divisions and whose participation encourages synergy and teamwork across the Company.

### ANNOUNCED PLANNED RETIREMENT OF TIM BREEDON, FORMER GROUP CHIEF EXECUTIVE

During 2012, Tim Breedon announced his desire to retire at the end of the year. His early announcement allowed plenty of time for the Company to consider and appoint his successor. He remained as Group Chief Executive until the appointment of Nigel Wilson and then stood down from the Board on 30 June 2012. Between 1 July and 31 December Tim had specific objectives relating to Solvency II and a smooth handover to the new Group Chief Executive Nigel Wilson. He continued to be paid in line with our remuneration policy and contractual terms until he retired from the Company on 31 December 2012. The Remuneration Committee confirmed his good leaver status. His shares deferred under the Share Bonus Plan and other employee share plans vested in accordance with the rules of the plans. Awards granted under the PSP were tested at the date of his retirement in accordance with the plan rules and, to the extent that performance conditions were met, vested and were paid on a pro-rata basis. Please see page 90 for more details.

There were no payments made outside of his contractual terms and the share plan rules.

The Committee would like to acknowledge Tim's contribution to the Company and wish him the best in his retirement.

### BOARD APPOINTMENTS

Nigel Wilson, formerly Chief Financial Officer, was appointed as Group Chief Executive on 30 June 2012. In line with our policy of base salary progression into new roles, Nigel's base salary was set at a level that was £70,000 less than the former Group Chief Executive, Tim Breedon. Mark Zinkula, CEO LGIM, was appointed to the Board as an executive director on 18 September 2012. The Remuneration Committee carefully assessed his remuneration in relation to this role which is set out in more detail on page 84 of the Implementation Section. In November 2012, John Pollock and Mark Gregory increased their international responsibilities following a change to the management structure of our international businesses.

### THE 2012 PAY REVIEW

In establishing its pay review budgets, the Company takes into consideration Company performance and the external market. The challenging economic environment continued in 2012 but the Company succeeded in meeting many areas of its plans. For 2013, UK core pay review budgets have been set at 2.5% for managers and staff grades across the Company including LGIM.

The Remuneration Committee takes into consideration the remuneration – base pay and annual bonus budgets – for employees below Board level when determining the remuneration for the executive directors.

### BASE SALARIES

For 2013, base salary increases for John Pollock, Mark Gregory and Mark Zinkula are in line with the general base salary review budget for employees below Board level and they have each received 2.5%. When appointed Group Chief Executive, the Remuneration Committee agreed that the next base salary review for Nigel Wilson would be in March 2014, after he has spent 20 months in the position. His base salary therefore remains the same for 2013.

### ANNUAL BONUS

The executive directors' bonus awards are assessed by a combination of financial results against key Group performance indicators and the achievement of personal and strategic objectives. To calculate bonus in relation to 2012 performance, pro-rated salaries were used to recognise the changes to base salary that had taken place during the year. Under the bonus plans, awards of between 106% and 122.4% out of the maximum potential (125% of base salary) were awarded to the executive directors (including the former Group Chief Executive) but excluding the CEO LGIM who received 160.4% out of the maximum potential (175% of base salary). Tim Breedon's bonus was assessed both on his objectives as Group Chief Executive for the period 1 January up to 30 June and on his specific objectives outlined earlier for the period 1 July to 31 December 2012. Further details of how these awards were determined are set out on pages 86 and 90. The Committee considers these levels of bonus to be appropriate in light of the strong results, in particular increases over 2011 in profit before tax and return on equity. The Group's KPI results are shown on page 2.

### PERFORMANCE SHARE PLAN (PSP)

After due consideration of Company performance and other factors, it was considered that the appropriate level for awards under the PSP was 200% of base salary for 2013.

### CLEAR AND TRANSPARENT REPORTING

During 2012, the Committee continued to contribute its views and pay close attention to the BIS consultations and outcomes on narrative reporting and executive remuneration. While there are a number of issues that are still under debate, we have decided to adopt some of the new guidance earlier than required to try and further enhance the reporting within this Directors' Remuneration Report. We will have due regard to the ongoing discussions and developments during 2013 in order to become fully compliant with new legislation for our 2014 report. However, we have included two sections on Policy and Implementation which we hope will demonstrate our commitment to transparency of reporting, highlight our remuneration philosophy and help clearly summarise the key remuneration issues for 2012 and beyond.

### EXECUTIVE REMUNERATION REVIEW – 2013 AND BEYOND

We believe that our remuneration structure should be closely aligned to shareholder returns and customer outcomes, reflect best practice and guidelines, be set against a backdrop of our Company values and risk appetite and take into consideration the economic environment. It also needs to be appropriately competitive in the market to allow us to attract and retain key talent. However, we do not believe in making 'piecemeal' changes on a regular basis. Our executive remuneration structure has therefore remained largely unchanged: Bonus potential has not increased for five years (since January 2008) and the long term Performance Share Plan (PSP) potential of 200% of base salary has been in place for nearly ten years (since April 2004).

During 2012, an in-depth review of executive remuneration structure was started with a view to further strengthening the alignment of business strategy and shareholder returns to executive reward. Our aim is to ensure we retain a simple and straightforward remuneration structure which can continue to be cascaded throughout the organisation.

We are also aware that further models and thoughts around executive remuneration structure are emerging from commentators and industry groups and we will take account of these in our thinking. However, we are mindful that some may bring conflicting objectives and the Committee will therefore continue to discuss and debate different approaches to compensation during 2013 and will have an open dialogue with shareholders.

Our intention is to have any reward changes that we consider appropriate in place for 2014; this will include a revised PSP programme as the current plan lapses in early 2014. This will form part of our consultation.

I sincerely hope you find this report of the Committee's work comprehensive, clear and understandable. I hope you will support the resolution to vote for this Directors' Remuneration Report (pages 70 to 99).

**RUDY MARKHAM**
**CHAIRMAN OF THE REMUNERATION COMMITTEE**

**Our Remuneration Report is organised into the following sections:**

# KEY AREAS OF FOCUS FOR 2012.

## Key areas of focus for 2012

| Board changes | Summary | Where to find further information |
|---|---|---|
| **APPOINTMENT OF NIGEL WILSON AS GROUP CHIEF EXECUTIVE** | Appointed Group Chief Executive in June 2012.<br><br>The Committee determined the remuneration package for his new role. | Implementation Section page 84. |
| **APPOINTMENT OF MARK ZINKULA TO THE BOARD** | Appointed to the Board in September 2012.<br><br>The Committee determined the remuneration package for his new role. | Implementation Section page 84. |
| **RETIREMENT OF FORMER GROUP CHIEF EXECUTIVE TIM BREEDON** | Tim Breedon stepped down from the Board on 30 June 2012. | Details of his remuneration while Group Chief Executive and remuneration paid as an ex-director between 30 June and his retirement are given on pages 82 and 90. |
| **INTEGRATION OF THE INTERNATIONAL BUSINESS** | During 2012, a reorganisation took place to fully integrate our international business into our core business areas. To recognise their increased responsibilities, John Pollock and Mark Gregory had an interim base salary increase of approximately 7% with effect from 1 November 2012. | More details of the integration can be found on page 20 of the full Report & Accounts. |

| Issue | Summary | Where to find further information |
|---|---|---|
| **SALARY AND BONUS AWARDS** | Executive Directors excluding the Group Chief Executive received a base salary increase similar to the budget for employees below Board. The Group Chief Executive's base salary will remain the same for 2013 with his next review in March 2014.<br><br>Annual bonus awards for 2012 were carefully assessed by the Committee and ranged from 84.8% to 97.9% of the maximum potentials. | Implementation Section page 84.<br><br>Implementation Section page 86. |
| **INCREASED PARTICIPATION IN THE PERFORMANCE SHARE PLAN (PSP)** | For 2013, participation in the PSP has been extended to include more participants who hold key roles below the Leadership Group. In addition, key LGIM employees whose roles cross divisions have been included to encourage synergy and teamwork across the Company. For the 2013 PSP there are therefore approximately 55 participants in addition to the executive directors. | |
| **REVIEW OF TERMS OF REFERENCE** | The Committee's remit had grown over the years to include the individual review of approximately 350 employees below Board. During 2012, the Terms of Reference for the Committee were reviewed to clarify its focus on key employees in the Company below Board. These continue to include the Heads of the Control Functions, an oversight of Code staff, roles linked to the delivery of the Group's strategy, and any other high earners. | More details of the review can be found on page 73. |

# GOVERNANCE AND APPROACH.

## GENERAL GOVERNANCE

The Directors' Report on Remuneration has been prepared in accordance with the requirements of the Companies Act 2006 and Schedule 8 of the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008. It also describes the Group's compliance with the UK Corporate Governance Code in relation to remuneration. The Company is an active member of the ABI and the Committee, consistent with its approach of operating within the highest standards of corporate governance, takes account of guidelines issued by the ABI and shareholder bodies (such as the NAPF) when setting the remuneration strategy for the Company.

## TERMS OF REFERENCE

The Committee's Terms of Reference are available on our website or on request. The remit of the Committee embraces the remuneration strategy and policy for the whole Company as well as the executive directors. During 2012 the Terms of Reference were revised to clarify the focus of the Committee on:

- determining the individual remuneration of executive directors and senior management whose roles are linked to the delivery of the Group's strategy or who are discharging a Head of Control function;
- undertaking direct oversight on the remuneration of other high earners in the Group;
- undertaking oversight on an exceptions basis on the remuneration of Code staff and employees in the Control and oversight functions; and
- determining the framework of the remuneration policy for all other employees in the Group. This continues to include the approval of any new bonus plan or benefit or any material change to an existing bonus plan or benefit, as well as firm-wide base salary and bonus budgets.

The Committee retains the ability to exercise powers under the share plans to claw back or reduce awards where it determines there has been fraud or malice or a breach of Group risk appetite.

## MEETINGS IN 2012

The Committee normally meets at least three times per year. During 2012 it met eight times. The additional meetings were principally held to discuss the following key issues :

- The appointment of Nigel Wilson as Group Chief Executive to succeed Tim Breedon (see page 84).
- The appointment of Mark Zinkula to the Board (see page 84).
- The review of the executive directors' remuneration structure (see Chairman of the Remuneration Committee's letter on page 71).

In addition, a sub group of the Committee met to consider the appointment of a new independent adviser to the Committee (see below).

Regular meetings were held to review and discuss base salary adjustments for 2012, bonus awards in relation to performance in 2011, budgets for the Company 2013 pay review, adjustments to any bonus plans and approval of any share awards in relation to recruitment.

## ADVISERS TO THE REMUNERATION COMMITTEE

FIT Remuneration Consultants LLP continued to be the independent advisers to the Remuneration Committee until May 2012. FIT did not supply any other services to the Company.

During 2012, a full tender process was carried out to review the adviser to the Committee. A review of the market identified seven potential companies. One of these was PwC with whom it was agreed it would not be appropriate for them to tender as they are the Group's independent auditors. A full Request for Information (RFI) was sent out to the other six candidates. Criteria for selection included the fact that the adviser had to be:

- independent from the business;
- able to provide market context and be well versed in corporate governance with a strong awareness of shareholder values and understanding of market perception;
- pragmatic in approach; and
- able to demonstrate strategic and technical knowledge in all the key areas of concern – all areas of executive remuneration, bonus and LTIP structures, share schemes, LGIM, pensions and corporate governance.

In addition, the candidates were asked to give examples of their approach to Corporate Social Responsibility to ensure their values were aligned with those of the Company.

## DIRECTORS' REPORT ON REMUNERATION CONTINUED

# GOVERNANCE AND APPROACH.

Following a full tender process, the Committee appointed Kepler Associates Partnership LLP as their independent advisers with Helen Beck as lead adviser. Kepler is also engaged by Legal & General's Finance team to provide independent accounting valuations of the SAYE and PSP share schemes in accordance with IFRS2. The fee for this work for 2012 was £6,000 excluding VAT. This work is carried out by a separate group within Kepler Associates and is not felt to be in conflict with the work carried out for the Committee.

Kepler Associates are signatories to the Remuneration Consultants' Group Code of Conduct in relation to Executive Remuneration Consulting in the UK.

During 2012, Kepler Associates have principally assisted the Committee with the remuneration structure for Mark Zinkula on his appointment to the Board and the review of the overall executive directors' remuneration structure.

### ENGAGEMENT WITH SHAREHOLDERS

The Committee seeks to maintain an active and productive dialogue with investors on developments in the remuneration aspects of corporate governance generally and any changes to the Company's executive pay arrangements in particular.

### Committee Members, Attendees and Advice

| Remuneration Committee Members | Position | Comments |
|---|---|---|
| Rudy Markham | Chairman of the Remuneration Committee | Independent |
| Nick Prettejohn | Member from 2 November 2010 | Independent |
| Mike Fairey | Member from 1 May 2011 | Independent |
| Stuart Popham | Member from 1 July 2011 | Independent |

| Remuneration Committee Attendees | Position | Comments |
|---|---|---|
| John Stewart | Standing attendee by invitation | Independent upon appointment on 1 March 2010 |
| Nigel Wilson | Group Chief Executive | Attends by invitation |
| Elaine MacLean | Group HR Director | Attends as an executive responsible for advising on the remuneration policy |
| Rosemary Lemon | Group Head of Reward & Executive Remuneration | Attends as an executive responsible for advising on the remuneration policy |
| Tim Breedon | Former Group Chief Executive | Attended by invitation until he stood down from the Board on 30 June 2012 |
| Kaye Maguire | Secretariat | Attends as secretary to the Committee |
| Helen Beck<br>Peter Smith | Kepler Associates Partnership LLP | Attend by invitation as the Committee's independent adviser |
| John Lee | FIT Remuneration Consultants | Attended by invitation up to May 2012 as the former independent adviser to the Committee |

No person is present during any discussion relating to his or her own remuneration.

## CONSIDERING RISK

The Bonus Steering Committee (BSC), the Chief Risk Officer (CRO) and the Group Director of Regulatory Risk and Compliance play key roles in the process of setting reward structures and evaluating whether achievement of objectives and any payment from plans have taken into account the overall risk profile of the Company.

### Bonus Steering Committee

Reporting to the Remuneration Committee, the BSC has continued to review and 'challenge' all bespoke bonus schemes on a regular basis. They ensure they support business strategy while delivering within our risk appetite and highlight any factors that the Committee should consider. The BSC is trying to reduce the number and complexity of bonus plans and therefore always considers whether the general discretionary bonus plan would be more appropriate. Its Terms of Reference are reviewed and agreed by the Remuneration Committee and its members include the Group HR Director and Group Head of Reward and Executive Remuneration as well as the Group Remuneration Team, Business Heads of HR, the CRO and Group Director of Regulatory Risk and Compliance. Members of the businesses also attend as necessary to provide support or provide context for any remuneration proposals. Bonus schemes must be agreed by the BSC prior to submission to the Remuneration Committee which retains overall discretion and approval.

### Role of the Chief Risk Officer and Group Director of Regulatory Risk and Compliance

The Remuneration Committee also works closely with the CRO and Group Director of Regulatory Risk and Compliance in relation to remuneration proposals. In particular, the Group Director of Regulatory Risk and Compliance reports to the Committee on an annual basis regarding payment of bonus schemes for the year and provides input into how those schemes operate for the following year. The Group Director of Regulatory Risk and Compliance confirms whether any risks have been taken outside of pre-agreed parameters that may lead the Committee to consider whether it should impact the payment of bonus schemes and confirms that all plans for the following year meet business objectives without encouraging undue risk. The CRO specifically looks at the overall risk profile of the Company and whether executive directors have achieved objectives within the Company's accepted risk appetite. The CRO also reviews the executive directors' objectives for the forthcoming year to ensure they are in line with the risk parameters.

# DIRECTORS' REPORT ON REMUNERATION CONTINUED

# POLICY SECTION.

## INTRODUCTION

**This section sets out the principles behind our remuneration policies and the remuneration structure for the executive directors. During 2012, we have clarified our principles and we are now considering carefully our remuneration structure to ensure it continues to align with shareholder value while being underpinned by our values and customer outcomes. This review will continue during 2013.**

### Note

While we have recognised the BIS guidance and started to structure this Remuneration Report into Policy and Implementation Sections, this year the following pages are designed more to help explain how our philosophy and policies have been considered. This report is not designed for shareholder voting and the format will evolve as further guidance is provided from BIS and prior to the binding vote in 2014.

## REMUNERATION PRINCIPLES

During 2012, we reviewed our overall remuneration principles to ensure they were aligned to our strategy. The strategic objectives are to grow the business in several key areas: LGIM international expansion, Retirement Solutions, Protection, Digital Technology and Direct Investments. To deliver the growth requires a much stronger performance culture. The revised remuneration principles take this into consideration.

We also want to ensure we operate within the appropriate culture and therefore the principles support and reinforce customer outcomes, our values, behaviours and risk appetite. Our revised principles aim to be clear and simple, strengthen the link of reward for exceptional performance, as well as emphasise the importance of teamwork.

The revised principles of our Remuneration Policy are summarised below:

### Remuneration Principles

1. The structure should be fair, simple and transparent, with targets objectively set and independently reviewed by the CRO.
2. It should be reflective of external best practice. We should never be laggards and where appropriate we should take a leadership position.
3. Overall remuneration should be competitively positioned around the mid-market range in relation to the FTSE 100 and consistent with executives' experience. It should be sufficient to ensure that we can recruit and retain the best talent to support our strategy.
4. Strong performance will be rewarded, but only if consistent with living and respecting Legal & General's values and behaviours, ensuring that we deliver results within our risk parameters and that we have desired customer outcomes.
5. Remuneration should have a balance of reward for short term (one year or less) delivery as well as long term (three plus years) delivery.
6. Executives' interests should be aligned to those of shareholders.
7. Both at Board level and below, the reward structure should recognise teamwork and the proportion of an individual's reward that is linked to overall Legal & General performance as opposed to business unit performance should increase with seniority. At executive level this reinforces the collective responsibility across divisions including LGIM.

## EXECUTIVE DIRECTORS

### General Approach

The remuneration of the Group's executive directors comprises base salary, participation in an annual bonus plan (paid partly in cash and partly deferred via the Share Bonus Plan (SBP)) and the Group's PSP, which is a long term incentive plan, plus pension and ancillary benefits.

When setting remuneration for the executive directors, the Committee takes into account the market sector, function, job size, and individual and Company performance. In addition, the pay, employment conditions and base salary budgets set for other employees in the Company are taken into consideration. Data is obtained from a variety of independent sources.

We are currently reviewing the executive remuneration structure and this review will continue during 2013. We want to ensure that any change, should we indeed consider change appropriate, continues to:

- be simple, competitive and drive performance against the backdrop of our values;
- place emphasis on long term variable compensation;
- be recognisable for good corporate governance; and
- provide a linkage to our business strategy.

However, for 2013 our current policy remains unchanged and this is set out in the table below.

## CURRENT POLICY

The following table sets out our current policy.

### BASE SALARY

To help recruit and retain key employees.

To pay at around the mid-market range relative to the FTSE 100, with particular regard to other relevant financial institutions. Regard is given to individual skills and experience.

In specific circumstances (for example, a new appointment) we may set salaries below mid-market range, with a view to reaching mid-market range within two to three years provided the individual has progressed into the role.

Increases in base salary for executive directors broadly follow the base salary budgets for the rest of the organisation.

Normally reviewed by the Committee annually and fixed for the 12 months commencing 1 March, and paid in cash.

### PENSION AND BENEFITS

The policy aims to provide competitive post-retirement benefits and reward sustained contribution.

Salary is the only element of pensionable remuneration.

From 2009, increases in pensionable base salary for the defined benefit pension plan have been limited to a maximum of 2.5% each year.

New executive directors receive 15% of base salary into the defined contribution pension plan (they contribute 5%).

Cash alternative in line with the defined contribution levels for executive directors opting for fixed protection above the lifetime allowance or for benefits in excess of the £50,000 annual limit. For executive directors who took enhanced protection in 2006, they are given a cash contribution of 22% of base salary. All cash contributions are subject to normal payroll deductions of income tax and National Insurance.

Normal benefits available to senior managers including car allowance and medical insurance. Legal & General products can be acquired by executive directors on the terms available to other members of staff.

Executive directors are entitled to participate on the same terms as all UK employees in the Savings-Related Share Option Scheme and the Employee Share Plan, both of which are approved by HMRC.

There is no compensation for public policy or tax changes.

# DIRECTORS' REPORT ON REMUNERATION CONTINUED

# POLICY SECTION.

## ANNUAL BONUS

**PURPOSE AND LINK TO STRATEGY**

Incentivise executives to achieve specific financial, strategic and personal predetermined goals during a one-year period.

Reward ongoing stewardship and contribution to core values.

Deferred proportion of bonus, awarded in shares, provides a retention element, alignment with shareholders and the ability to claw back.

**OPPORTUNITY**

Maximum bonus potential set by reference to market comparators (currently 125% of base salary (175% for CEO LGIM)).

On-target bonus of 75% of base salary (60% of maximum of 125% of base salary) for all executive directors excluding CEO LGIM. (CEO LGIM on target is 60% of maximum i.e. 105% of base salary).

**PERFORMANCE**

In setting bonus targets, the Committee seeks to link targets to areas of the business in which the executive has particular influence and responsibility, while also seeking to maintain a team ethos. All executive directors have objectives related to Group Key Performance Indicators (KPIs), plus individual (where relevant) divisional and strategic targets. The objectives also embrace the importance of customer care, employee engagement and Company culture and values.

Executive directors' bonus targets were weighted as follows for 2012:

| Name | Group KPIs | Other financial targets | Other strategic targets |
|---|---|---|---|
| Tim Breedon | 50% | 20% | 30% |
| Nigel Wilson | 50% | 20% | 30% |
| John Pollock | 40% | 30% | 30% |
| Mark Gregory | 40% | 30% | 30% |
| Mark Zinkula | 20% | 40% | 40% |

The targets for 2012 are broadly outlined below:

**Group Key Performance Indicators (KPIs)**
Common to all executive directors.
The TSR KPI is addressed through the PSP.

**Other financial targets**
- Key divisional metrics.
- Managing capital requirements.

**Other strategic targets**
- Building a diversified business.
- Delivering a positive customer experience.
- Building a high expectation culture.
- Risk management.
- Improving products and services.

**OPERATION**

Bonus result is determined by the Committee after the year end, based on performance against targets. The Committee has both upwards and downwards discretion to adjust the overall bonus award but may not exceed the maximum potential.

Normally, 62.5% of the bonus is paid in cash and 37.5% is paid in deferred shares or nil cost options, subject to continued employment, under the SBP to be held for three years.

The deferred element may be subject to forfeiture if the performance which led to a bonus being paid is found to be incorrect or in the event of personal misconduct.

As the shares have been earned prior to award, any dividends occurring on these shares are paid to the executives during the vesting period. If the executive has chosen nil cost options no dividends are paid until exercise post vesting. The value of the shares awarded to directors is reported in the year of performance and shown in the directors' remuneration table on page 82.

## PERFORMANCE SHARE PLAN (PSP)

**PURPOSE AND LINK TO STRATEGY**

Incentivise executives to achieve superior returns to shareholders.

Align interests of executives and shareholders through building a shareholding.

Retain key executives over a three-year performance period.

**OPPORTUNITY**

Executive directors receive annual grants of up to 200% of base salary. The award is made in nil cost options.

**PERFORMANCE**

TSR was chosen to align outcomes with shareholder interests. The number of shares that vest is dependent on Legal & General's relative TSR performance over a three-year period as follows:

| Legal & General's TSR relative to the comparator group | % of award which vests |
|---|---|
| Below median | 0% |
| Median (threshold) | 25% |
| Between median and 20th percentile | 25%–100% |
| 20th percentile or above | 100% |

Vesting condition for half of the award measures the Group's TSR versus the FTSE 100. Vesting condition for the other half measures TSR versus the insurance constituents in the FTSEurofirst 300 plus any FTSE 350 Life Insurance companies not in the FTSEurofirst 300. The constituents for this group are determined at the date of grant.

The two conditions are measured independently.
Performance against TSR conditions is independently reviewed by the advisers to the Committee.

The Remuneration Committee will also assess whether the TSR out-turn is reflective of the underlying financial performance of the Company and may scale back vesting if deemed appropriate. The Committee has discretion only to reduce the level of award and may not increase it. The parameters which the Committee uses in making this assessment include, but are not limited to, market share, partnerships entered into and maintained, cost constraint, capital management, risk and shareholder perception.

Any award vesting may be exercised at the end of the three-year performance period or at any time (excepting close periods) during the two-year period following vesting.

**OPERATION**

The Committee reviews the quantum of awards made each year to ensure that it is in line with the market.

When making awards, the Committee will also consider wider factors such as Company performance in determining whether to grant at the normal policy level.

The PSP was approved by shareholders in 2004.

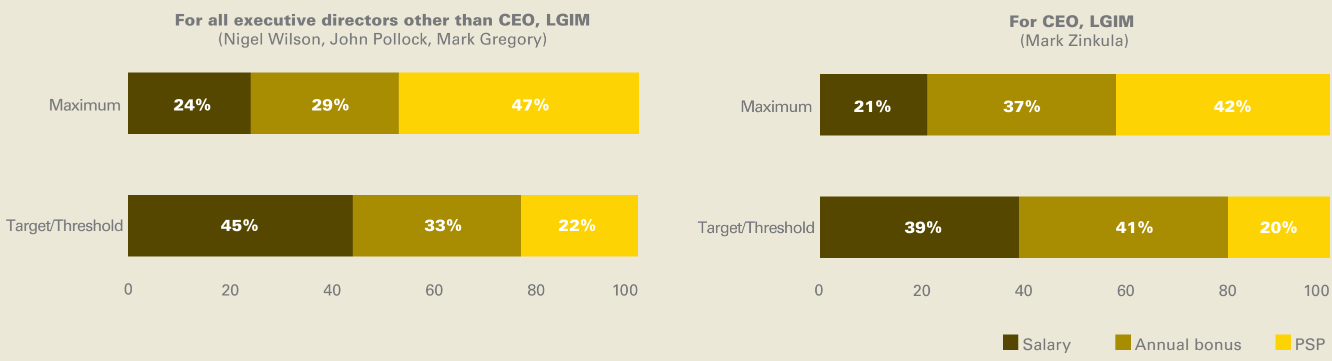
# DIRECTORS' REPORT ON REMUNERATION CONTINUED

# POLICY SECTION.

| SHARE OWNERSHIP GUIDELINES | |
|---|---|
| **PURPOSE AND LINK TO STRATEGY** | To align the interests of executive directors and shareholders. |
| **OPERATION** | The Group Chief Executive is required to build and maintain a shareholding of 200% of base salary and, for other executive directors, 100% of base salary.<br><br>Executives are expected to build a shareholding through the vesting of shares under the Group's share incentive plans. Existing shareholdings and shares acquired in the market are also taken into account.<br><br>Although share ownership guidelines are not contractually binding, the Committee retains the discretion to withhold future grants under the PSP if executives do not comply with the guidelines. |

The table below shows the relative split of base salary, bonus and PSP for executive directors at target and stretch performance in line with the current policy and for 2013.

## Current pay mix




See Policy section on annual bonus and PSP for target and maximum details.

## SERVICE CONTRACTS AND TERMINATION POLICY

### Executive Directors

| Executive Director | Contract commencement date | Continuous service date |
|---|---|---|
| Tim Breedon[1] | January 2002 | September 1987 |
| Nigel Wilson | September 2009 | September 2009 |
| John Pollock | November 2003 | September 1980 |
| Mark Gregory | January 2009 | August 1998 |
| Mark Zinkula | September 2012 | June 2008 |

1. Tim Breedon stepped down from the Board on 30 June 2012. He retired from the Company on 31 December 2012.

### Termination

The Company's policy is to limit severance payments on termination to pre-established contractual arrangements. In the event that the employment of an executive director is terminated, any compensation payable will be determined in accordance with the terms of the service contract between the Company and the employee, as well as the rules of any incentive plans. The notice periods and termination arrangements for the executive directors are given below.

John Pollock has a notice period of six months on either side and would be entitled to an additional six months' base salary, pension and car allowance entitlement if his employment was terminated by the Company (except where termination is for gross misconduct).

Mark Gregory and Nigel Wilson have notice periods of 12 months. However, they have no entitlement to any additional contractual payment on termination of employment. Any payment in lieu of notice will consist solely of base salary and the cost of providing benefits for the outstanding notice period and will be subject to deductions for income tax and National Insurance as appropriate.

Mark Zinkula has a notice period of six months on either side. Any payment in lieu of notice will consist solely of base salary.

Tim Breedon had a notice period of six months on either side and would have been entitled to an additional six months' base salary, pension and car allowance entitlement if his employment had been terminated by the Company (except where termination is for gross misconduct). However, Tim retired from the Company on 31 December 2012. In line with policy above, no payments were made to him other than contractual entitlements or those under the share scheme or incentive plan rules.

Copies of the executive directors' service contracts are available for inspection at the Company's registered office.

## EXTERNAL APPOINTMENTS

The Company considers that certain external appointments can help to broaden the experience and contribution to the Board of the executive directors. Any such appointments are subject to annual agreement by the Company and must not be with competing companies. Subject to the Company's agreement, any fees may be retained by the individual.

During 2012, Nigel Wilson was the Senior Independent Director (SID) at Capita with a fee of £70,000 pa. He resigned from Capita with effect from 31 December 2012.

Mark Gregory is an unpaid Director of Westdown Park Management Company Ltd.

John Pollock is on the Financial Services Practitioner Panel and sits on the ABI Long Term Savings and Life Insurance Committee.

Mark Zinkula sits on the IMA Board and ABI Advisory Panel.

Tim Breedon was chairman and an unpaid Board member of the ABI up until July 2012. He was also an ex officio (ABI) member of the Takeover Panel.

# DIRECTORS' REPORT ON REMUNERATION CONTINUED

# IMPLEMENTATION SECTION.

## 'SINGLE FIGURE' OF REMUNERATION

In order to help shareholders' understanding and in recognition of the draft BIS proposals, in 2011 we provided a 'single figure' of remuneration for each of our executive directors. Since our last report was published, BIS has clarified the methodology for how the single figure should be calculated and therefore we have revised our disclosure for 2012 in line with their guidance. We have also adjusted the single figures published for 2011. The notes explain the changes.

### Single figure £000s

| Executive Director | Salary | Benefits – note 1 | Pension – note 2 | Bonus – note 3 | LTIPs – note 4 | Total remuneration |
|---|---|---|---|---|---|---|
| 2012 | | | | | | |
| Tim Breedon[a] | 408 | 42 | 186 | 435 | 2,209 | 3,280 |
| Nigel Wilson | 653 | 46 | 99 | 779 | 1,617 | 3,194 |
| John Pollock | 424 | 42 | 213 | 520 | 1,062 | 2,261 |
| Mark Gregory | 420 | 43 | 92 | 472 | 889 | 1,916 |
| Mark Zinkula[b] | 126 | 150 | 20 | 205 | n/a | 501 |
| 2011 | | | | | | |
| Tim Breedon | 808 | 50 | 418 | 804 | 245 | 2,325 |
| Nigel Wilson | 550 | 28 | 87 | 456 | 0 | 1,121 |
| John Pollock | 412 | 33 | 251 | 472 | 118 | 1,286 |
| Mark Gregory | 400 | 33 | 102 | 308 | 55 | 898 |
| Mark Zinkula | n/a | n/a | n/a | n/a | n/a | n/a |

**2012 notes**
a. Tim Breedon stepped down from the Board on 30 June 2012. His remuneration reflects the period 1 January 2012 to 30 June 2012.
b. Mark Zinkula joined the Board on 18 September 2012. His remuneration, including bonus, reflects the period 18 September 2012 to 31 December 2012.

### Benefits £000s

| Executive Director | Car and PMI (plus relocation assistance for Mark Zinkula) | Dividends – note i | Gain on SAYE – note ii | Matching shares – note iii | Total benefits shown in the table above |
|---|---|---|---|---|---|
| 2012 | | | | | |
| Tim Breedon | 10 | 31 | 0 | 1 | 42 |
| Nigel Wilson | 20 | 25 | 0 | 1 | 46 |
| John Pollock | 20 | 21 | 0 | 1 | 42 |
| Mark Gregory | 20 | 22 | 0 | 1 | 43 |
| Mark Zinkula | 141 | 9 | 0 | 0 | 150 |
| 2011 | | | | | |
| Tim Breedon | 20 | 29 | 0 | 1 | 50 |
| Nigel Wilson | 20 | 7 | 0 | 1 | 28 |
| John Pollock | 20 | 12 | 0 | 1 | 33 |
| Mark Gregory | 20 | 12 | 0 | 1 | 33 |
| Mark Zinkula | n/a | n/a | n/a | n/a | n/a |

### Components of Benefits and how calculated

| Footnote | Explanation |
|---|---|
| Dividends – note i | Value of all dividends received in 2012 or 2011 in respect of outstanding SBP awards, unvested matching shares under the Employee Share Plan (ESP) and Group Performance Shares, under the ESP. |
| Gain on SAYE – note ii | Any gain on SAYE vesting in the year – nothing vested in 2011 or 2012 for the directors. |
| Matching shares – note iii | Value of matching shares at date of purchase and Group Performance Shares awarded in the year valued at the date of award (does not include the amounts that vested). |

The regular table of remuneration for 2012 required under the existing legislation can be found under the section Other Information on page 96.

## Components of the Single Figure and how the calculations vary from 2011

| Footnote | Explanation |
|---|---|
| Benefits – note 1 | In 2011, benefits included car allowance and private medical insurance (PMI). Benefits now include the elements shown in the table below the single figure. For Mark Zinkula, benefits also include the proportion of schooling, housing and flights relating to the period 18 September to 31 December 2012 resulting from his relocation package to the UK. |
| Pension – note 2 | The value of any registered pension using the HMRC formula for assessing the annual and lifetime allowance limits (i.e. 20 times the post inflation benefit for defined benefit provisions (the figure for 2011 has been adjusted to be consistent with this approach) or for the defined contribution pensions the employer defined contributions as set out on page 91. It does not necessarily represent the economic value of the pension accrual and is not money immediately available to the person.<br><br>For the defined contribution arrangements (applicable to Mark Gregory), any balance over and above the Annual Allowance limit is paid in cash. During 2012, Nigel Wilson took fixed protection and takes a cash allowance of 15% of base salary. Following enhanced protection in 2006 and changes to the pension plans in 2008, John Pollock receives a cash allowance of 22% of base salary in lieu of pension contributions. Tim Breedon also received a cash allowance of 22% of base salary until 31 December 2012. Mark Zinkula receives a cash contribution of 15% of base salary in lieu of joining the UK pension plan. He participates in the Legal & General America 401K plan and cash savings plan. All cash allowances are subject to normal payroll deductions of income tax and National Insurance. |

| Executive Director | Cash in lieu | Defined benefit | Defined contribution | Total pension |
|---|---|---|---|---|
| **2012** | | | | |
| Tim Breedon | 90 | 96 | 0 | 186 |
| Nigel Wilson | 97 | 0 | 2 | 99 |
| John Pollock | 93 | 120 | 0 | 213 |
| Mark Gregory | 37 | 26 | 29 | 92 |
| Mark Zinkula[1] | 19 | 0 | 1 | 20 |
| **2011** | | | | |
| Tim Breedon | 178 | 240 | 0 | 418 |
| Nigel Wilson | 34 | 0 | 53 | 87 |
| John Pollock | 91 | 160 | 0 | 251 |
| Mark Gregory | 19 | 60 | 23 | 102 |
| Mark Zinkula | n/a | n/a | n/a | n/a |

1. Mark Zinkula contributes to a 401K plan, which is included in the defined contribution figure in the table above. His figures represent the period 18 September to 31 December 2012.

| Footnote | Explanation |
|---|---|
| Bonus – note 3 | The total bonus awarded in relation to performance in the year including the portion that is deferred. For bonus awarded in relation to 2011, 37.5% of this figure was deferred into shares for three years. In the 2011 Report & Accounts the element that was awarded for performance in the year but deferred was taken out of the single figure on the basis that it was not immediately available to the recipient. Instead, the single figure for 2011 included deferred bonus that vested in 2011. The figure has now been adjusted to show the total bonus payable for 2011 performance.<br><br>For bonus awarded in relation to performance in 2012, the figure shown includes the 37.5% of the award, which is deferred for three years. In line with current policy, the bonus for Tim Breedon is paid in cash due to his retirement. |
| LTIPs – note 4 | Value of PSP awards that vested (as of the date of vest) during the year. The vesting of awards is dependent on the TSR performance conditions as set out on page 79. Note that Nigel Wilson, John Pollock and Mark Gregory chose not to exercise their award upon vesting. They have the ability to exercise up to 5 May 2014. Note: the performance period ran from 6 May 2009 to 6 May 2012. |

# DIRECTORS' REPORT ON REMUNERATION CONTINUED

# IMPLEMENTATION SECTION.

## CHANGES TO THE BOARD OF DIRECTORS

During 2012, the following changes to the Board of Directors occurred:

Nigel Wilson, former Chief Financial Officer, was appointed as Group Chief Executive with effect from 30 June 2012; and Mark Zinkula, CEO LGIM, was appointed to the Board with effect from 18 September 2012.

Details of their remuneration are outlined below.

### Nigel Wilson

| Remuneration Element | As Chief Financial Officer | Group Chief Executive wef 30 June 2012 |
|---|---|---|
| Base salary | £558,500 pa. | £750,000 pa. Base Salary to be reviewed in 2014 as agreed by the Committee on his appointment to Group Chief Executive. |
| Annual Bonus | Maximum potential of 125% of base salary. | No change. |
| PSP | 2012 grant of 200% of base salary. | Grant was 'topped up' from 200% of his CFO base salary to 200% of his increased base salary – see page 88. |
| Benefits (e.g. car allowance, private health insurance) | In line with existing policy. | No change. |
| Pension | In line with existing policy. | No change. |

Note: The Group Chief Executive incorporates the direct reporting of major regulatory functions and country heads.

### Mark Zinkula

| Remuneration Element | Upon appointment to the Board |
|---|---|
| Base salary | £450,000 pa. |
| Annual Bonus | Maximum potential of 175% of base salary. |
| PSP | Will participate in the PSP in line with other executive directors. Mark has outstanding awards under the LGIM LTIP and these are shown on page 88. He no longer participates in this plan. |
| Benefits (e.g. car allowance, private health insurance) | In line with existing policy for UK benefits.<br>Mark and his family are also covered under the US Company medical plan in line with normal US policy conditions. Mark contributes towards this cost from his base salary. |
| Pension | In line with UK policy levels, a cash contribution of 15% of base salary which is subject to normal payroll deductions of income tax and National Insurance. He participates in the Company US 401K plan. |
| Other allowances | To provide support in his relocation to the UK to take up the position of CEO LGIM, the Company provides assistance for housing, school fees and economy flights home. Schooling costs will reduce and his housing contribution will decrease over a period of time. |

## BASE SALARY AND 2013 PAY REVIEW

Over the last few years, the Company has exercised restraint in adjusting salaries, reflecting the wider economic situation, which continues to be challenging, although the Company performance has continued to show good and broad progress.

The Committee will consider base salary levels as part of its overall continuing review on executive remuneration. For 2013 base salaries for executive directors excluding the Group Chief Executive have been adjusted in line with the budgets for employees below Board. In line with his conditions on appointment, the Group Chief Executive's base salary will remain the same for 2013 with his next review in March 2014.

The table below shows the changes to salaries for 2013.

| Name | Salary at 31 December 2012 | Salary with effect from 1 March 2013 | **% increase from December 2012** |
|---|---|---|---|
| Nigel Wilson | £750,000 | £750,000 | 0% |
| John Pollock | £450,000 | £461,250 | 2.5% |
| Mark Gregory | £450,000 | £461,250 | 2.5% |
| Mark Zinkula | £450,000 | £461,250 | 2.5% |

# VARIABLE PAY

## Bonus for 2012

### Targets

For 2012, the bonus for executive directors was based on a number of targets which were weighted as follows:

| Name | Group KPIs | Other financial targets | Other strategic targets |
|---|---|---|---|
| Tim Breedon[1] | 50% | 20% | 30% |
| Nigel Wilson[2] | 50% | 20% | 30% |
| John Pollock[3] | 40% | 30% | 30% |
| Mark Gregory[3] | 40% | 30% | 30% |
| Mark Zinkula[4] | 20% | 40% | 40% |
| **Broad explanation of targets** | Common to all executive directors.<br><br>The TSR KPI is addressed through the PSP. | Key divisional metrics.<br><br>Managing capital requirements. | Building a diversified business.<br><br>Delivering a positive customer experience.<br><br>Building a high expectation culture.<br><br>Improving products and services. |

1. Tim Breedon stood down from the Board in June 2012. His bonus for 2012 was awarded based on the above weighting for the period January to June. From July to December he was assessed on Group KPIs and post-Board objectives primarily relating to issues surrounding Solvency II and a smooth handover of his Group Chief Executive responsibilities.
2. Nigel Wilson was appointed Group Chief Executive on 30 June 2012. While the weighting of his objectives did not change, his bonus was assessed on his objectives as Chief Financial Officer for the period January to June and his objectives as Group Chief Executive from July to December.
3. John Pollock and Mark Gregory were given increased responsibilities in November relating to the International divisions. Their objectives were adjusted to take this into consideration.
4. Mark Zinkula was appointed to the Board on 18 September 2012. For the period 1 January to 17 September his bonus was based on his responsibilities as CEO LGIM and calculated in accordance with the base salary and bonus potential for this role. For the period 18 September to 31 December his bonus was based on his base salary and bonus potential as a Board member.

# DIRECTORS' REPORT ON REMUNERATION CONTINUED

# IMPLEMENTATION SECTION.

### Bonus awarded for 2012

The Committee carefully assessed the performance against the Group KPIs, other financial and strategic targets to determine the associated bonus. The total bonus that resulted from the delivery of these objectives was reviewed by the Committee based on its view of the executive's overall performance and regulatory compliance. In reviewing results, approach to risk (including environmental, social or governance (ESG) risks) is monitored.

The Committee reviewed a comprehensive report from the Chief Risk Officer to ascertain that the executive directors' objectives had been fulfilled within the risk appetite of the Company. In addition, the Committee received feedback from the Group Regulatory Risk and Compliance Director and Group Legal Counsel that there were no material issues to consider around regulatory breaches, customer outcomes or litigation that would prevent payment of bonuses or trigger any clawback. The Committee was satisfied that the bonuses should be paid.

In recognition of base salary adjustments made during 2012, bonuses were calculated using pro-rated salaries as follows :

| Name | Base salary pro-rating used |
|---|---|
| Tim Breedon | Pro-rated base salary for the six-month period 1 January to 30 June 2012. |
| Nigel Wilson | Pro-rated base salary for period 1 January to 30 June as CFO and pro-rated base salary for period 1 July to 31 December as Group Chief Executive. |
| John Pollock | Pro-rated base salary from 1 January to 30 October pre international responsibilities and pro-rated base salary from 1 November to 31 December using adjustment made for assuming international business responsibilities. |
| Mark Gregory | Pro-rated base salary from 1 January to 30 October pre international responsibilities and pro-rated base salary from 1 November to 31 December using adjustment made for assuming international business responsibilities. |
| Mark Zinkula | Pro-rated base salary for period he was a Board member i.e. 18 September to 31 December. |

The Committee has applied discretion in the assessment of the bonuses. This is to acknowledge the successful management of the business during the changes to the Executive and Leadership Group, the review of the international businesses and successfully maintaining employee engagement and motivation throughout the organisation.

Bonus awarded for 2012 performance:

| Name | Performance in relation to 2012 Total bonus £000s |
|---|---|
| Tim Breedon[1] | 435 |
| Nigel Wilson | 779 |
| John Pollock | 520 |
| Mark Gregory | 472 |
| Mark Zinkula[2] | 205 |

Maximum bonus potential is 125% of base salary other than for Mark Zinkula where it is 175% of base salary.

1. The bonus awarded to Tim Breedon reflects his time on the Board from 1 January to 30 June 2012.
2. The bonus awarded to Mark Zinkula reflects his time as a Board member from 18 September to 31 December 2012.

### Deferral

Of the bonus awarded in relation to 2012, 37.5% was deferred for three years into shares under the SBP, and is subject to clawback.

In accordance with our current policy, there was no bonus deferral for Tim Breedon due to his retirement.

## PERFORMANCE SHARE PLAN (PSP)

### Details of how the 2009 award vested

The 2009 PSP award vested in full in May 2012. As stated in the 2011 Remuneration Report, in line with policy, the Committee had already carefully reviewed the Company's underlying performance over the performance period to March 2012. It reassessed the position in May prior to agreeing the vesting. The review included considerations of partnerships entered into and maintained, cost management, capital management and risk. The Committee felt the Company performance had been strong over the period and saw no reason not to allow the PSP to vest in accordance with the TSR out-turn.

## Final 2009 PSP results

| Grant date | Performance period | Legal & General's TSR | % of award vesting against FTSE 100 | % of award vesting against Bespoke Comparator Group | Percentage of total award vesting |
|---|---|---|---|---|---|
| 6 May 2009 | 6 May 2009 – 6 May 2012 | 172.50% | 50.00% | 50.00% | 100.00% |
| 16 October 2009 (Nigel Wilson recruitment award) | 6 May 2009 – 6 May 2012[1] | 172.50% | 50.00% | 50.00% | 100.00% |

1. Nigel Wilson's recruitment award followed the same performance period as the main 6 May 2009 grant. However, the award was not released until three years from the date of grant i.e. 16 October 2012. See 2009 Directors' Remuneration Report on page 64 for full details.

The table below shows the numbers of nil cost options that vested and the value at the date of vest.

| | No. of shares that vested | Vesting date | Share price at vest | Value at date of vest |
|---|---|---|---|---|
| Tim Breedon | 1,984,536 | 8 May 2012 | 1.11325 | £2,209,285 |
| Nigel Wilson[1] | 1,194,539 | 16 Oct 2012 | 1.354 | £1,617,406 |
| John Pollock[1] | 953,608 | 8 May 2012 | 1.11325 | £1,061,604 |
| Mark Gregory[1] | 798,969 | 8 May 2012 | 1.11325 | £889,452 |
| Mark Zinkula | 0 | n/a | n/a | n/a |

1. Nigel Wilson, John Pollock and Mark Gregory chose not to exercise their options at the time of vesting. They have the ability to exercise up to 5 May 2014.

## Position of awards outstanding as at 31 December 2012

The tables below show the vesting position of the outstanding PSP cycles as of 31 December 2012.

| | % of base salary | Max no. of shares | L&G TSR as at 31.12.12 | % of award vesting against FTSE 100 as at 31.12.12 | % of award vesting against Bespoke Group as at 31.12.12 | Percentage of total award vesting as at 31.12.12 |
|---|---|---|---|---|---|---|
| Grant date 4 May 2010 | | | | | | |
| Nigel Wilson | 200% | 1,256,004 | 85.30% | 50.00% | 50.00% | 100.00% |
| John Pollock | 200% | 937,316 | 85.30% | 50.00% | 50.00% | 100.00% |
| Mark Gregory | 200% | 843,585 | 85.30% | 50.00% | 50.00% | 100.00% |
| Mark Zinkula | 0 | N/A | N/A | N/A | N/A | N/A |
| Grant date 27 April 2011 | | | | | | |
| Nigel Wilson | 200% | 943,396 | 36.30% | 50.00% | 50.00% | 100.00% |
| John Pollock | 200% | 706,003 | 36.30% | 50.00% | 50.00% | 100.00% |
| Mark Gregory | 200% | 686,106 | 36.30% | 50.00% | 50.00% | 100.00% |
| Mark Zinkula[1] | 80% | 274,442 | 36.30% | 50.00% | 50.00% | 100.00% |
| Grant date 24 April 2012 | | | | | | |
| Nigel Wilson | 200% | 947,949 | 21.70% | 50.00% | 28.10% | 78.10% |
| John Pollock | 200% | 712,871 | 21.70% | 50.00% | 28.10% | 78.10% |
| Mark Gregory | 200% | 709,476 | 21.70% | 50.00% | 28.10% | 78.10% |
| Mark Zinkula[1] | 80% | 278,359 | 21.70% | 50.00% | 28.10% | 78.10% |

1. Mark Zinkula's award, prior to his board appointment, was 200% of base salary split between the PSP and LGIM LTIP – see table on page 88 for LGIM LTIP details.

## DIRECTORS' REPORT ON REMUNERATION CONTINUED

# IMPLEMENTATION SECTION.

In line with established policies, an additional grant was made to Nigel Wilson on appointment as Group Chief Executive – it follows the 24 April 2012 performance period but vests on 14 August 2015. This top up grant was made on the increase in base salary he received upon his appointment to Group Chief Executive.

| | Max no. of shares | L&G TSR as at 31.12.12 | % of award vesting against FTSE 100 as at 31.12.12 | % of award vesting against Bespoke Comparator Group as at 31.12.12 | Percentage of total award vesting as at 31.12.12 |
|---|---|---|---|---|---|
| Nigel Wilson | 291,765 | 21.70% | 50.00% | 28.10% | 78.10% |

### LGIM LONG TERM INCENTIVE PLAN (LGIM LTIP) AWARDS

Between March 2010 and March 2012 Mark Zinkula was granted LGIM LTIP awards as part of his remuneration as CEO LGIMA and CEO LGIM. Following his appointment as an executive director, Mark will receive no further awards under this plan. Under the LGIM LTIP annual awards of notional shares in LGIM are granted to participants. The vesting of these notional shares is subject to the satisfaction of the cumulative growth in PBT over the three-year performance period. The value of the notional LGIM shares is delivered in cash after the end of the three-year performance period.

| Grant date | % of base salary | No. of notional shares | Face value at grant £ | Maximum value of award on vesting £ | Value at 31.12.12 £ |
|---|---|---|---|---|---|
| 15 March 2010 | 140% | 135,798 | 338,000 | 676,000 | 577,982 |
| 28 March 2011[1] | 120% | 126,850 | 480,000 | 960,000 | 348,528 |
| 1 March 2012[1] | 120% | 92,877 | 492,000 | 984,000 | 162,448 |

1. Mark Zinkula's award was 200% of base salary split between the LGIM LTIP and PSP. See page 87 for PSP award.

### 2013 AWARDS

For 2013, 'annual bonus' will be referred to as Annual Variable Pay (AVP).

#### AVP weighting

For 2013, executive director AVP will continue to be based on a number of key financial targets linked to Group and individual business performance, customer outcomes, teamwork, Company values, risk appetite and employee engagement. Weightings and targets will be reviewed annually and changed as appropriate.

The weighting will be as follows for 2013:

| Name | Group KPIs | Other/ Divisional financial targets | Strategic and Consumer outcomes, values and behaviours |
|---|---|---|---|
| Nigel Wilson | 50% | 30% | 20% |
| John Pollock | 50% | 30% | 20% |
| Mark Gregory | 50% | 30% | 20% |
| Mark Zinkula | 50% | 30% | 20% |

#### Broad explanation of targets for 2013

Group Key Performance Indicators (KPIs)

- Common to all executive directors
- The TSR KPI is addressed through the PSP

#### Other financial targets

- Key divisional metrics
- Capital requirements

#### Other strategic and consumer outcomes

- Growth of the business
- Delivering a positive customer experience
- Capital management
- Organisational capability
- Diversification
- Risk management

#### 2013 PSP award

After due consideration of business performance and share price, the Remuneration Committee decided that for 2013, executive directors should be granted awards of performance shares equivalent to 200% of 2013 base salaries. The maximum award value is shown below:

Nigel Wilson £1,500,000
John Pollock £922,500
Mark Gregory £922,500
Mark Zinkula £922,500

## SHARE OWNERSHIP

To align the interests of executive directors and shareholders, the Group Chief Executive and other executive directors are expected to build and maintain a shareholding in the Company. Executive directors are expected to build up the shareholding through the vesting of shares under the Group's share incentive plans. Existing shareholdings and shares acquired in the market are also taken into account. The Group Chief Executive is expected to hold the equivalent of 200% of base salary and the other executive directors 100% of base salary.

Although share ownership guidelines are not contractually binding, the Committee retains the discretion to withhold future grants under the PSP if executives do not comply with the guidelines.

As at 31 December 2012, the executive directors' share ownership against the guidelines were:

### Executive directors' shareholding as at 31 December 2012

| | Actual share ownership as % of base salary: vested shares | Actual share ownership as % of base salary: vested and unvested shares (excludes any shares with performance conditions) | Guidelines on share ownership as a % of base salary | Guideline met |
|---|---|---|---|---|
| Nigel Wilson | 478.92% | 606.65% | 200% | Yes |
| John Pollock | 496.86% | 632.49% | 100% | Yes |
| Mark Gregory | 419.25% | 538.59% | 100% | Yes |
| Mark Zinkula | 0.00% | 154.89% | 100% | Yes |

Share price used for calculations: 145.6p as at 31 December 2012.

Shares with performance conditions are excluded from the calculation as they have not yet vested and vesting cannot be guaranteed.

### Total shareholding of executive directors

The lowest share price during 2012 was 102.8p and highest share price was 147.9p.

| | Type | Owned outright/ vested shares | Value of owned outright/ vested shares | Subject to deferral/ holding period | Value of shares subject to deferral/ holding period | Total vested and unvested shares (excludes any shares with performance conditions) | Value of total vested and unvested shares (excludes any shares with performance conditions) |
|---|---|---|---|---|---|---|---|
| Nigel Wilson | Shares | 1,268,246 | £1,846,566 | 655,156 | £953,907 | 1,923,402 | £2,800,473 |
| | ESP | 4,156 | £6,051 | 2,835 | £4,128 | 6,991 | £10,179 |
| | Options | 1,194,539[1] | £1,739,249 | 0 | £0 | 1,194,539 | £1,739,249 |
| | | **2,466,941** | **£3,591,866** | **657,991** | **£958,035** | **3,124,932** | **£4,549,901** |
| John Pollock | Shares | 559,993 | £815,350 | 396,557 | £577,387 | 956,550 | £1,392,737 |
| | ESP | 22,029 | £32,074 | 5,586 | £8,133 | 27,615 | £40,207 |
| | Options | 953,608[1] | £1,388,453 | 17,038[2] | £24,807 | 970,646 | £1,413,261 |
| | | **1,535,630** | **£2,235,877** | **419,181** | **£610,328** | **1,954,811** | **£2,846,205** |
| Mark Gregory | Shares | 475,871 | £692,868 | 335,613 | £488,653 | 811,484 | £1,181,521 |
| | ESP | 20,923 | £30,464 | 5,468 | £7,961 | 26,391 | £38,425 |
| | Options | 798,969[1] | £1,163,299 | 27,767[2] | £40,429 | 826,736 | £1,203,728 |
| | | **1,295,763** | **£1,886,631** | **368,848** | **£537,043** | **1,664,611** | **£2,423,674** |
| Mark Zinkula | Shares | 0 | £0 | 478,704 | £696,993 | 478,704 | £696,993 |
| | ESP | 0 | £0 | 0 | £0 | 0 | £0 |
| | Options | 0 | £0 | 0 | £0 | 0 | £0 |
| | | **0** | **£0** | **478,704** | **£696,993** | **478,704** | **£696,993** |

1. Nil cost options under the PSP that have vested but not yet been exercised.
2. SAYE options.

# DIRECTORS' REPORT ON REMUNERATION CONTINUED

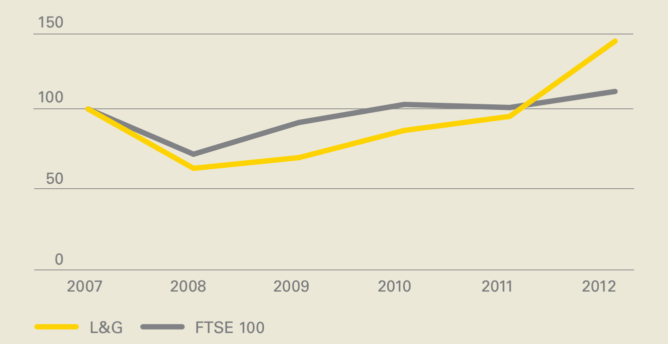
# IMPLEMENTATION SECTION.

## FIVE-YEAR TOTAL SHAREHOLDER RETURN

The chart shows the value, as at 31 December 2012, of £100 investment in Legal & General shares on 31 December 2007, compared to £100 invested in the FTSE 100 on the same date. The other points plotted are the values at the intervening financial year-ends. The FTSE 100 Index was chosen as the Company is a member of this index.

For further information on shares, please see Section 4: Other Information.

### Total shareholder return (at 31 December 2012)




## TERMINATION PAYMENTS

Our policy on termination or in the event that an executive leaves for reasons of death, disability, ill health, redundancy or retirement are set out on page 81 of the Policy Section.

### Retirement of Tim Breedon

Tim Breedon stepped down from the Board on 30 June 2012. From 1 July to 31 December 2012, he continued to work on specific objectives relating to Solvency II and a smooth handover of his Chief Executive role to Nigel Wilson. He retired from the Company on 31 December 2012. In line with normal policy, he received base salary and normal benefits up to and including 31 December 2012. These then ceased with effect from this date. His shares were dealt with in line with the share scheme rules.

The table below shows the remuneration paid to him during the period after he stepped down from the Board from 1 July to 31 December 2012.

### Remuneration for period 1 July 2012 to 31 December 2012 £000s

| Executive Director | Salary | Benefits[1] | Cash in lieu of pension[2] | Annual Bonus[3] Cash | Total |
|---|---|---|---|---|---|
| Tim Breedon | 410 | 10 | 90 | 473 | 983 |

1. Car allowance and private medical insurance.
2. In line with contractual terms, Tim Breedon received a cash allowance of 22% of base salary in lieu of pension contributions. See page 77 of the Policy Section. This is subject to normal payroll deductions of income tax and National Insurance.
3. Annual Bonus awarded to Tim Breedon between the period 1 July and 31 December 2012 was based on specific objectives relating to handover of Group Chief Executive duties and the outcome of issues relating to Solvency II. The Remuneration Committee determined that these objectives had been fully achieved. His bonus relating to this period is paid in cash, in line with our policy.

### Deferred shares

Outstanding shares under the share plans were dealt with under the plan rules. The Committee determined Tim to be a 'Good Leaver' upon his retirement and therefore the following shares vested:

### Share Bonus Plan (SBP)

| Plan cycle | Number of shares | Value at date of vest – note 1 |
|---|---|---|
| 2010 | 338,312[1] | £492,582 |
| 2011 | 283,827 | £413,252 |
| 2012 | 255,799 | £372,443 |
| **Total SBP shares vesting** | **877,938** | **£1,278,277** |
| **1. Nil Cost Options:** part of deferred annual variable pay under the Share Bonus Plan. Tim has six months in which to exercise these options from date of leaving. Value shown is at 31 December 2012 using share price of 145.6p. The figure shown above includes these. | **35,149** | **£51,177** |

| | Number of shares | Value at date of vest |
|---|---|---|
| **Employee share plan (ESP) – note 1** | **27,712** | **£40,349** |

Note 1: Share price used was 145.6p as at the date of vest 31 December 2012

### Performance Share Plan (PSP)

Under the rules of the plan, the performance conditions were tested as at the date of his retirement 31 December 2012. The Remuneration Committee also looked at the underlying Company performance. To the extent that the performance conditions were met, the Remuneration Committee agreed that Tim's outstanding awards should vest. The number of shares vesting were then paid on a pro-rata basis in line with his service during the performance periods. The number of shares that vested together with the share price and value on the date of vesting is shown below.

| Plan cycle | Pro-rated shares vesting | Value at date of vest |
|---|---|---|
| **2010 Award** | | |
| Pro-rated Nil Cost Options vesting | 1,631,367 | £2,375,270 |
| **2011 Award** | | |
| Pro-rated Nil Cost Options vesting | 776,427 | £1,130,478 |
| **2012 Award** | | |
| Pro-rated Nil Cost Options vesting | 249,165 | £362,784 |
| **Total PSP shares vesting** | **2,656,959** | **£3,868,532** |

Share price used for indicating value is 145.6p as at the date of vest 31 December 2012

The performance of the plans as at 31 December 2012 is shown on page 87. Note that Tim Breedon has not yet exercised any of the above options at time of reporting. Under the plan rules, he has six months from date of leaving, i.e. to 30 June 2013, to exercise.

## PENSION ENTITLEMENTS AND OTHER BENEFITS

On retirement from Legal & General at age 60 and subject to statutory limits, executive directors have pension entitlement as follows:

**Mark Gregory:** one-sixtieth of his eligible pensionable base salary (which is lower than actual base salary as only the lower of actual base salary increases and 2.5% has been credited since January 2009) for each year of eligible service subject to him continuing his 5% of pensionable base salary contribution. Mark left these defined benefit arrangements at the end of April 2011 and joined the defined contribution scheme. He is entitled to a Company contribution of 15% of his pensionable base salary if he also contributes 5%. Any balance over and above the Annual Allowance limit is paid in cash and is subject to normal payroll deductions of income tax and National Insurance. This cash allowance is shown in the table on page 83.

**Tim Breedon and John Pollock:** one-sixtieth of eligible pensionable base salary for each year of service through to the date they opted for enhanced protection in 2006. They received a cash allowance in lieu of pension equivalent to 22% of base salary. This is subject to normal payroll deductions of income tax and National Insurance.

**Nigel Wilson:** Nigel was a member of the Group's defined contribution arrangements. During his participation, he was entitled to a Company contribution of 15% of his pensionable base salary if he also contributed 5%. Any balance over and above the Annual Allowance limit was paid in cash and was subject to normal payroll deductions of income tax and National Insurance. During 2012, he took fixed protection. Since this time he has received a cash contribution of 15% of base salary which is subject to normal payroll deductions. The cash allowance received is shown in the table on page 91.

**Mark Zinkula:** He is entitled to a cash allowance of 15% of his base salary. This is subject to normal payroll deductions of income tax and National Insurance. He uses part of his cash allowance to contribute into a 401K pension. He also participates in a cash balance plan in the US.

### Bonus sacrifice into pension

Executive directors, like all managers, may elect, before its award, to sacrifice all or part of their cash bonus into pension. The opportunity for bonus sacrifice is at the discretion of the Company and is reviewed each year. None of the executive directors elected for bonus sacrifice. Over 150 employees elected for some bonus sacrifice in relation to the March 2013 pay review.

### Death in service

On death in service, a capital sum equal to four times base salary is payable, together with a spouse's pension of four-ninths of the member's annualised salary. Protection is also offered in the event of serious ill health. This latter benefit has no transfer value in the event of the member leaving service.

### Executive director pension information

| Name | Age at 31 December 2012 | Increase/ (decrease) in accrued pension in 2012 £000s | Accumulated accrued pension at 31 December 2012 £000s | Transfer value of accrued benefits at 31 December 2012 £000s | Transfer value of accrued benefits at 31 December 2011 £000s | Increase/ (decrease) net of employee contribution in 2012 £000s |
|---|---|---|---|---|---|---|
| Tim Breedon – note 1 | 54 | 18 | 305 | 8,312 | 6,407 | 1,713 |
| Nigel Wilson – note 2 | 56 | – | – | – | – | – |
| John Pollock – note 3 | 54 | 11 | 191 | 5,128 | 3,954 | 1,055 |
| Mark Gregory – note 4 | 49 | 2 | 39 | 806 | 641 | 146 |
| Mark Zinkula – note 5 | 45 | – | – | – | – | – |

The information in this table has been audited by the independent auditors, PricewaterhouseCoopers LLP.

Note 1 – Tim Breedon resigned from the Board on 30 June 2012 and retired from the Company on 31 December 2012. The figures above show the full year 2012. He has enhanced protection and receives a cash allowance of 22% of base salary which is subject to normal payroll deductions. This is shown on page 83.
Note 2 – Nigel Wilson was a member of the defined contribution arrangement but took fixed protection during 2012. The Company contributed £4,589 into his fund in 2012 (includes his 5% contribution). Nigel now receives a cash allowance of 15% of base salary which is subject to normal payroll deductions. This is shown on page 83.
Note 3 – John Pollock has enhanced protection. He receives a cash allowance of 22% of base salary that is subject to normal payroll deductions. This is shown on page 83.
Note 4 – Mark Gregory left the defined benefit plan on 30 April 2011 and joined the defined contribution (DC) plan. The Company contributed £51,073 into his DC fund in 2012 (includes his 5% contribution). Mark receives 15% of base salary contribution towards his pension with any balance over the £50,000 annual allowance paid as a cash allowance subject to normal payroll deductions. This is shown on page 83.
Note 5 – Mark Zinkula receives 15% of base salary as a cash contribution towards his pension which is subject to normal payroll deductions of income tax and National Insurance. This is shown on page 83. He contributes towards a 401K provision in the US and the Company put in $6,767 in 2012. He also participates in a cash balance plan in the US.

# DIRECTORS' REPORT ON REMUNERATION CONTINUED

# IMPLEMENTATION SECTION.

## NON-EXECUTIVE DIRECTORS

Appointment letters are currently for three years but all directors are subject to annual re-election. Appointments may be terminated by either party without notice.

Fees for the non-executive directors (NEDs) are determined by the Board (but NEDs do not vote on the resolution), based on a range of external information and advice set within the aggregate limits contained in the Articles of Association. The current aggregate limit for fees paid to NEDs is £1,500,000 per annum.

| NED | Date of initial appointment | Current letter of appointment start date | Current letter of appointment end date |
|---|---|---|---|
| John Stewart | January 2010 | January 2010 | AGM 2013 |
| Henry Staunton | May 2004 | May 2010 | AGM 2013 |
| Rudy Markham | October 2006 | October 2009 | AGM 2013 |
| Nick Prettejohn | November 2010 | November 2010 | November 2013 |
| Mike Fairey | May 2011 | May 2011 | May 2014 |
| Dame Clara Furse | June 2009 | June 2012 | June 2015 |
| Stuart Popham | July 2011 | July 2011 | July 2014 |
| Julia Wilson | November 2011 | November 2011 | November 2014 |

## FEES

The fee structure for the NEDs is set out below. This is subject to periodic review.

| | **Henry Staunton** Chairman of Audit Committee; SID; Member of Nominations and Risk Committees | **Rudy Markham** Chairman of Remuneration Committee; Member of the Nominations Committee | **Nick Prettejohn** Chairman of Risk Committee; Member of Nominations, Remuneration and Audit Committees | **Mike Fairey** Member of Nominations, Remuneration and Audit Committees | **Dame Clara Furse** Member of Nominations and Risk Committees | **Stuart Popham** Member of Nominations, Risk and Remuneration Committees | **Julia Wilson** Member of Nominations and Audit Committees | **John Stewart** Chairman |
|---|---|---|---|---|---|---|---|---|
| Base | £65, 000 | £65,000 | £65,000 | £65,000 | £65,000 | £65,000 | £65,000 | £340,000 |
| Committee fee if sitting on two or more committees, excluding Nominations Committee | £10,000 | | £10,000 | £10,000 | | £10,000 | | |
| Committee Chairman | £30,000 | £30,000 | £30,000 | | | | | |
| SID | £20,000 | | | | | | | |
| **Total fee** | **£125,000** | **£95,000** | **£105,000** | **£75,000** | **£65,000** | **£75,000** | **£65,000** | **£340,000** |
| Comments | Assumed role of SID wef 26 May 2011 | Assumed role of Chair of RemCo wef 26 May 2011 | Assumed role of Chair of Risk wef 26 May 2011 | Sits on two committees, excluding Nominations | | Sits on two committees, excluding Nominations | | |

## SHAREHOLDING POLICY

In 2011, a minimum shareholding requirement was introduced for NEDs. They are required to hold the equivalent of one year's base fee in Legal & General shares to be retained until the end of office. NEDs generally have a proportion of their fees (normally 50%) paid in Legal & General shares until this level is reached. Once this level is reached, they may take all their fee in cash. Their shareholdings can be seen in the table on page 93.

## NON EXECUTIVE DIRECTORS (NEDS)

The total remuneration for non-executive directors for 2012 is shown below:

| Name | Fees £000s | Benefits £000s – note 1 | Total 2012 £000s | Total 2011 £000s |
|---|---|---|---|---|
| John Stewart | 340 | 0 | 340 | 333 |
| Henry Staunton | 125 | 0 | 125 | 108 |
| Rudy Markham | 95 | 0 | 95 | 80 |
| Dame Clara Furse | 65 | 1 | 66 | 67 |
| Nick Prettejohn | 105 | 1 | 106 | 85 |
| Mike Fairey | 75 | 0 | 75 | 48 |
| Stuart Popham | 75 | 0 | 75 | 38 |
| Julia Wilson | 65 | 0 | 65 | 9 |
| **TOTAL** | **945** | **2** | **947** | **768** |

Note 1 – benefits include travel costs.

The information in this table has been audited by the independent auditors, PricewaterhouseCoopers LLP.

## NED SHAREHOLDING REQUIREMENT

The following table shows the current level of holdings:

| Name | Shareholding | Value of holding | Total Fee | Base Fee | Holding as a % of base fee | Met criteria of 1 x base fee |
|---|---|---|---|---|---|---|
| John Stewart | 230,776 | £336,010 | £340,000 | £340,000 | 98.83% | No |
| Henry Staunton | 314,069 | £457,284 | £125,000 | £65,000 | 703.51% | Yes |
| Rudy Markham | 199,250 | £290,108 | £95,000 | £65,000 | 446.32% | Yes |
| Nick Prettejohn | 53,013 | £77,187 | £105,000 | £65,000 | 118.75% | Yes |
| Mike Fairey | 27,239 | £39,660 | £75,000 | £65,000 | 61.02% | No |
| Stuart Popham | 27,445 | £39,960 | £75,000 | £65,000 | 61.48% | No |
| Dame Clara Furse | 67,975 | £98,972 | £65,000 | £65,000 | 152.26% | Yes |
| Julia Wilson | 22,305 | £32,476 | £65,000 | £65,000 | 49.96% | No |

Share price used for calculations: 145.6p as at 31 December 2012.

The table includes shares purchased with December fees on 2 January 2013.

# DIRECTORS' REPORT ON REMUNERATION CONTINUED

# IMPLEMENTATION SECTION.

## REMUNERATION FOR EMPLOYEES BELOW BOARD

### General remuneration policy

The Group's remuneration policy is applied broadly consistently for all employees and, in line with our remuneration principles, is designed to support recruitment, motivation and retention as well as to reward high performance in a framework of approved risk management. Remuneration is considered within the overall context of the Group's sector and the markets in which the divisions operate. The policy for the majority of employees continues to be to pay around the relevant mid-market range with a competitive package designed to align the interests of employees with those of shareholders, and with an appropriate proportion of total remuneration dependent upon performance.

We define core remuneration as base salary, annual bonus that is closely aligned to performance and other benefits such as pension. There is also a Long Term Incentive Plan that currently measures TSR.

### Summary of remuneration structure for employees below Board

| Element | Current situation | Any changes |
|---|---|---|
| **BASE SALARY** | We aim to attract and retain key employees by paying salaries which deliver competitive total remuneration, taking into account market pay levels at companies of similar size, scale and scope as well as overall business performance. A key factor is also the ability, experience and performance of the individual. | There is no change to this approach.<br><br>For 2013, base salary budgets have been set at 2.5% for all management and staff employees below Board, including LGIM. However, this does not mean a flat increase for everyone. Increases to base salary are in line with position in base salary band and other criteria. |
| **ANNUAL BONUS** | The majority of employees have a discretionary bonus scheme based on individual performance against objectives. For the management populations and above, 35% of this bonus is deferred into shares.<br><br>There are some bespoke bonus schemes, where business appropriate, but the Remuneration Committee has ultimate discretion over all bonus plans.<br><br>Separate plans operate within LGIM consistent with industry practice. | For 2013, 'annual bonus' will be referred to as 'Annual Variable Pay' (AVP). In the past, deferral has extended to management grade employees which included junior management. Any bonus awarded of £5,000 or above was subject to 35% deferral and therefore deferral extended widely throughout the Company and to an inappropriate level when considering risk. Therefore, deferral has been adjusted and for any discretionary bonus awarded in relation to 2012, progressive deferral will follow the table below. This ensures that deferral is proportionate to the level of responsibility of the employee and allows a higher deferral as bonuses increase.<br><br>Bonus (£000s) / Deferral of portion:<br>0-25: 0%<br>25-50: 25%<br>50-75: 35%<br>75-100: 45%<br>100-200: 50%<br>>200: 60%<br><br>The above will exclude LGIM employees where deferral for discretionary bonus is currently set at 25%. This will be reviewed during 2013.<br><br>The Company reserves the right to adjust deferral levels for Code staff as deemed appropriate. |
| **PERFORMANCE SHARE PLAN (PSP)** | The PSP has been awarded to approximately 30 employees, mainly comprising the Leadership Group.<br><br>Where appropriate, grants under the PSP may also be made for new employees who join the Company during the year in key roles. | Participation in the PSP has been extended in the 2013 grant to include other employees in key roles as well as the Leadership Group. This includes employees in LGIM whose roles cross business divisions and whose participation encourages synergy and teamwork across the Company.<br><br>Participation in the plan for one year does not guarantee participation in future years. |
| **PENSION** | All employees are given opportunity to participate in a Group pension scheme. | No change. |
| **SHAREHOLDING REQUIREMENTS** | The Leadership Group is asked to build up a voluntary shareholding of 50% of base salary. | No change. |

## ANNUAL EQUAL PAY AUDIT

Management seeks to ensure that our pay policies and practices are free from unfair bias. Part of the pay review process is an annual equal pay audit that reviews pay and bonus decisions by gender, ethnicity, age and full-time versus part-time working. In addition, it considers the pay of the Control Function departments (Risk, Compliance and Internal Audit) as well as the 'oversight departments' of Finance and Human Resources and looks at decisions for employees who report directly to the business versus those who report to the function head. The review extends to all employees, including those in LGIM.

### All employee share schemes

There are share schemes for all UK employees. Executive directors are entitled to participate on the same terms as all UK employees in the Savings-Related Share Option Scheme (SAYE) and the ESP, both of which are approved by HMRC. Each year the Committee considers a grant of Group Performance Shares (Freeshares) after the annual results are known to tie any award more closely to Company performance. For performance in relation to 2012, the Committee has agreed a grant of 372 shares to each employee (for 2011 performance this was 410 shares).

The SAYE allows employees to enter into a regular savings contract over either three or five years, coupled with a corresponding option over shares of the Group. The grant price is equal to 80% of the quoted market price of the Group shares on the invitation date.

Under the ESP, approved by HMRC, permanent UK employees may elect to purchase Group shares from the market at the prevailing market price on a monthly basis. The Group supplements the number of shares, purchased by matching the first £20 of each employee's contribution. From February 2013 the Company will also match employee contributions between £20 and £125 on a one matching share for every two purchased. From time to time, the Group may make a grant of Freeshares (see above). Both the free and matching shares must be held in trust for three years before they may vest to the employee.

# DIRECTORS' REPORT ON REMUNERATION CONTINUED

# OTHER INFORMATION.

While we have structured this Remuneration Report broadly under the BIS guidelines, there are a number of tables that are still required under current legislation. These can be found below.

## EXECUTIVE DIRECTORS' REMUNERATION FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2012

| £000s | | | | Annual Bonus | | | |
|---|---|---|---|---|---|---|---|
| Executive Director | Salary | Benefits – note 1 | Cash in lieu of pension – note 2 | Cash | Deferred | Total 2012 | Total 2011 |
| Tim Breedon – note A | 408 | 10 | 90 | 435 | – | 943 | 1,810 |
| Nigel Wilson – note B | 653 | 20 | 97 | 487 | 292 | 1,549 | 1,060 |
| John Pollock | 424 | 20 | 93 | 325 | 195 | 1,057 | 995 |
| Mark Gregory | 420 | 20 | 37 | 295 | 177 | 949 | 747 |
| Mark Zinkula – note C | 126 | 150 | 19 | 128 | 77 | 500 | n/a |

The information in this table has been audited by the independent auditors, PricewaterhouseCoopers LLP.

| | |
|---|---|
| Note A | Tim Breedon stepped down from the Board on 30 June 2012. His remuneration reflects the period 1 January 2012 to 30 June 2012. |
| Note B | Nigel Wilson was appointed as Group Chief Executive on 30 June 2012. His remuneration reflects the period he was Chief Financial Officer from 1 January to 30 June 2012 and Group Chief Executive from 1 July to 31 December 2012. |
| Note C | Mark Zinkula joined the Board on 18 September 2012. His remuneration reflects the period 18 September 2012 to 31 December 2012. |
| Note 1 | Car allowance and private medical insurance.<br><br>For Mark Zinkula, benefits also include the proportion of schooling, housing and flights relating to the period 18 September to 31 December 2012 and resulting from his relocation package to the UK. |
| Note 2 | For the defined contribution arrangements (applicable to Mark Gregory and to Nigel Wilson prior to him taking fixed protection), any balance over and above the Annual Allowance limit is paid in cash and is subject to normal payroll deductions of income tax and National Insurance. Following fixed protection, Nigel Wilson receives a cash contribution of 15% of base salary subject to normal payroll deductions.<br><br>Tim Breedon and John Pollock took enhanced protection in 2006 and now receive a cash allowance of 22% of base salary in lieu of pension contributions. This is subject to normal payroll deductions of income tax and National Insurance. Mark Zinkula receives a cash contribution of 15% of base salary in lieu of joining the UK pension plan. This is subject to normal payroll deductions of income tax and National Insurance. |

The following tables provide further information on shares.

### Directors' share interests

The holdings of directors in office at the end of the year in the shares of the Company, including unvested shares awarded under the ESP, SBP and the Nigel Wilson recruitment award are shown in the adjacent table. These exclude unvested awards made by the Company under the PSP and SAYE but include awards that have vested in 2012 under the PSP but have not yet been exercised. Please see page 90 for the treatment of Tim Breedon's shares upon retiring from the Company.

| | 01 Jan 2012 | 31 Dec 2012 |
|---|---|---|
| Tim Breedon[1] | 2,497,216 | 905,553 |
| Nigel Wilson | 1,783,303 | 3,124,932 |
| Mark Gregory | 758,045 | 1,636,844 |
| John Pollock | 830,912 | 1,937,773 |
| Mark Zinkula | 403,233 | 478,704 |
| John Stewart | 161,133 | 230,776 |
| Henry Staunton | 309,574 | 314,069 |
| Rudy Markham | 172,228 | 199,250 |
| Nick Prettejohn | 23,164 | 53,013 |
| Dame Clara Furse | 52,012 | 67,975 |
| Mike Fairey | 11,181 | 27,239 |
| Stuart Popham | 8,699 | 27,445 |
| Julia Wilson | 0 | 22,305 |

1. Tim Breedon's closing balance at 31 Dec 2012 excludes shares that vested at retirement (see page 90). Tim maintained his shareholding requirements while Group Chief Executive and sold shares only after he stepped down from the Board on 30 June 2012.

## Share options

Executive directors' options outstanding under the Company Share Option Plan (CSOP), Executive Share Option Scheme (ESOS) and/or the Savings-Related Option Scheme (SAYE) comprise:

### Movements in year

| Name | | **Share options 1 January 2012** | Options lapsed/ granted | **Share options 31 December 2012** | Exercise price (p) | Earliest exercise date | Latest exercise date |
|---|---|---|---|---|---|---|---|
| Tim Breedon | SAYE | **–** | – | **–** | 0.00 | | |
| | CSOP | **35,149** | – | **35,149** | 85.35 | 24/05/2013 | 23/06/2013 |
| | ESOS | **–** | – | **–** | 0.00 | | |
| Nigel Wilson | CSOP | **35,149** | – | **35,149** | 85.35 | 24/05/2013 | 23/06/2013 |
| Mark Gregory | SAYE | **27,767** | – | **27,767** | 56.00 | 01/10/2014 | 31/03/2015 |
| | CSOP | **35,149** | – | **35,149** | 85.35 | 24/05/2013 | 23/06/2013 |
| | ESOS | **–** | – | **–** | 0.00 | | |
| John Pollock | SAYE | **17,038** | – | **17,038** | 98.60 | 01/052013 | 31/10/2013 |
| | CSOP | **35,149** | – | **35,149** | 85.35 | 24/05/2013 | 23/06/2013 |
| | ESOS | **–** | – | **–** | 0.00 | | |

The SAYE scheme is approved by HMRC and, in accordance with the relevant legislation, has no performance conditions.
The CSOP options are linked to SBP and do not represent additional value to the participant.
No share options lapsed or were exercised in 2012. The Company's register of directors' interests, which is open to inspection, contains full details of directors' shareholdings and share options.

Tim Breedon has six months from the date of him retiring from the Company to exercise his CSOP – see page 90.
The information in this table has been audited by the independent auditors, PricewaterhouseCoopers LLP.

### Share bonus plan (SBP) – outstanding awards

| | Awards outstanding at 1 January 2012 | Awards granted in 2012 | Awards vesting in 2012 | Awards outstanding at 31 December 2012 |
|---|---|---|---|---|
| Tim Breedon | 622,139 | 255,799 | 877,938 | 0 |
| Nigel Wilson | 763,859 | 144,946 | 253,649 | 655,156 |
| John Pollock | 246,418 | 150,139 | 0 | 396,557 |
| Mark Gregory | 278,681 | 98,169 | 41,237 | 335,613 |
| Mark Zinkula | 403,233 | 75,471 | 0 | 478,704 |

The above table contains outstanding SBP awards which include the Company's annual variable pay deferral arrangements and Nigel Wilson's outstanding recruitment award. Participants receive dividends on outstanding awards.

Tim Breedon's deferred SBP vested on the date of his retirement from the Company – see page 90.

### Nigel Wilson's recruitment award

| Date of award | Number of shares | Date of vesting | Comments |
|---|---|---|---|
| 16 October 2009 | 253,649 | 16 October 2011 | Price at vesting was 102.65 pence.<br><br>On vesting Nigel Wilson retained the shares. |
| 16 October 2009 | 253,649 | 16 October 2012 | Price at vesting was 135.40 pence.<br><br>On vesting Nigel Wilson retained the shares. |
| 16 October 2009 | 253,650 | 16 October 2013 | |

The awards are generally contingent on Nigel Wilson retaining the 760,948 shares he bought on 16 October 2009.
The awards were made when the share price was 88 pence.
Full details of the rationale for these awards are set out on page 64 of the 2009 Report.

# DIRECTORS' REPORT ON REMUNERATION CONTINUED

# OTHER INFORMATION.

## Performance Share Plan

The table below shows the number of shares that could be released if awards were to vest in full. Performance conditions are based on TSR outcomes – see page 79. Participants do not receive dividends on unvested awards.

| | Grant Date | Maximum award receivable for stretch performance | Awards vesting | Awards lapsing | Maximum outstanding awards as at 31 December 2012 |
|---|---|---|---|---|---|
| Tim Breedon | 6 May 2009 | 1,984,536 | 1,984,536 | 0 | 0 |
| | 4 May 2010 | 1,839,484 | 0 | 0 | 1,839,484[1] |
| | 27 Apr 2011 | 1,385,934 | 0 | 0 | 1,385,934[1] |
| | 24 Apr 2012 | 1,391,796 | 0 | 0 | 1,391,796[1] |
| Nigel Wilson | 16 Oct 2009 | 1,194,539 | 1,194,539 | 0 | 0 |
| | 4 May 2010 | 1,256,004 | 0 | 0 | 1,256,004 |
| | 27 Apr 2011 | 943,396 | 0 | 0 | 943,396 |
| | 24 Apr 2012 | 947,949 | 0 | 0 | 947,949 |
| | 14 Aug 2012 | 291,765 | 0 | 0 | 291,765 |
| Mark Gregory | 6 May 2009 | 798,969 | 798,969 | 0 | 0 |
| | 4 May 2010 | 843,585 | 0 | 0 | 843,585 |
| | 27 Apr 2011 | 686,106 | 0 | 0 | 686,106 |
| | 24 Apr 2012 | 709,476 | 0 | 0 | 709,476 |
| John Pollock | 6 May 2009 | 953,608 | 953,608 | 0 | 0 |
| | 4 May 2010 | 937,316 | 0 | 0 | 937,316 |
| | 27 Apr 2011 | 706,003 | 0 | 0 | 706,003 |
| | 24 Apr 2012 | 712,871 | 0 | 0 | 712,871 |
| Mark Zinkula | 27 Apr 2011 | 274,442 | 0 | 0 | 274,442 |
| | 24 Apr 2012 | 278,359 | 0 | 0 | 278,359 |

1. Tim Breedon's awards were tested at the date of him leaving and to the extent the performance conditions were met, vested and were awarded on a pro-rata basis – see page 90. Under the plan rules, he has until 30 June 2013 to exercise.

The share price on the date of grant for the April 2012 awards was 117.83p and 131.27p for the August 2012 award.

These awards vest on the third anniversary of the award date subject to the satisfaction of performance conditions.

The awards granted in 2009, 2010 and 2011 were restructured as Nil Cost Options during 2011 to permit exercise of the options at any point between the vesting date and the fifth anniversary of grant. There was no amendment to the original performance conditions or performance period as a result of this change. The 2012 grant was also made in Nil Cost Options in the same way.

Nigel Wilson, Mark Gregory and John Pollock's 2009 PSP awards have vested but have not been exercised.

The information in this table has been audited by the independent auditors, PricewaterhouseCoopers LLP.

## Other share purchases

The table below shows changes in the directors' share interests between 31 December 2012 and 5 March 2013, being the date of approval of this report. The executive directors' share purchases were made pursuant to their participation in the Employee Share Plan.

### 2013 share purchases

| | Shares | | |
|---|---|---|---|
| Name | 2 Jan | 1 Feb | 1 Mar |
| Nigel Wilson | 97 | 95 | 124 |
| Mark Gregory | 97 | 95 | 124 |
| John Pollock | 97 | 95 | 124 |
| Mark Zinkula | 0 | 0 | 0 |

The following non-executive directors acquired shares pursuant to the regular monthly purchase of shares as part of their remuneration.

| | Shares | | |
|---|---|---|---|
| Name | 2 Jan | 1 Feb | 1 Mar |
| John Stewart | 4,577 | 4,459 | 4,273 |
| Rudy Markham | 1,358 | 1,323 | 1,268 |
| Mike Fairey | 1,001 | 975 | 935 |
| Dame Clara Furse | 1,049 | 1,022 | 979 |
| Stuart Popham | 1,212 | 1,181 | 1,132 |

Nick Prettejohn and Henry Staunton have chosen to take their fees fully in cash having reached their shareholding requirements.

## Dilution limits

The Company's all-employee plans and the now-closed ESOS operate within the ABI's dilution limit of 5% of issued capital in ten years for executive schemes and all its plans will operate within the 10% of issued capital in ten years limit for all schemes.

As at 31 December 2012, the Company had 4.77% of share capital available under the 5% in ten years limit, and 9.07% of share capital under the 10% in ten years limit.

As at 31 December 2012, 33,244,805 shares were held by the Employee Benefit Trust to hedge outstanding awards of 63,206,646 shares for the PSP and SBP. This means that the Trust holds shares sufficient to cover 52.6% of outstanding awards.

**RUDY MARKHAM**
**CHAIRMAN OF THE REMUNERATION COMMITTEE**

# OTHER STATUTORY AND REGULATORY INFORMATION.

## ARTICLES OF ASSOCIATION
The Company's Articles of Association may only be amended by a special resolution at a general meeting of shareholders. The Articles of Association are available on the Company's website.

## CONFLICTS OF INTEREST
In accordance with the Companies Act 2006, the Board has adopted a policy and procedure for the disclosure and authorisation (if appropriate) of conflicts of interest, and these have been followed during 2012.

## POWERS OF DIRECTORS
The directors may exercise all powers of the Company subject to applicable legislation and regulation and the Company's Articles of Association.

## SHARE CAPITAL
As at 31 December 2012, the Company's issued share capital comprised 5,912,782,826 Ordinary shares each with a nominal value of 2.5p. Details of the Ordinary share capital can be found in Note 45 to the Group Consolidated Financial Statements.

At the 2012 AGM, the Company was granted authority by shareholders to purchase up to 587,289,985 Ordinary shares, being 10% of the issued share capital of the Company as at 23 March 2012. In the year to 31 December 2012, no shares were purchased by the Company. This authority will expire at this year's AGM. As such, a special resolution is proposed in the Notice of AGM seeking shareholder approval to renew this authority.

At the 2012 AGM, the directors were given the power to allot shares up to an amount of £48,940,832, being 33% of the issued share capital of the Company as at 23 March 2012. This authority will also expire at this year's AGM. As such, an ordinary resolution is proposed in the Notice of AGM seeking shareholder approval to renew this authority.

A further resolution is proposed, as set out in the Notice of AGM, that will, if approved by shareholders, authorise the directors to issue shares up to the equivalent of 5% of the Company's issued share capital as at 27 March 2013 for cash without offering the shares first to existing shareholders in proportion to their holdings.

Detailed explanatory notes to these resolutions are set out in the Notice of AGM.

Other than the above, the directors have no current intention of issuing further share capital and no issue will be made which would effectively alter control of the Company without prior approval of shareholders in a general meeting.

## INTERESTS IN VOTING RIGHTS
As at 1 March 2013, the Company had been advised of the following significant direct and indirect interests in the issued share capital of the Company:

| | Number of Ordinary shares of 2.5p | % of capital* | Total interest in issued share capital |
|---|---|---|---|
| Schroders Plc | 295,651,535 | 5.0% | Indirect |
| BlackRock, Inc | 291,923,475 | 4.9% | Indirect |
| AXA S.A. and its group of companies | 252,247,724 | 4.3% | Direct and indirect |

* Using the voting rights figure announced to the London Stock Exchange on 1 March 2013 of 5,912,959,168.

## DIVIDEND
The Company may, by ordinary resolution in a general meeting, declare dividends in accordance with the respective rights of the members, but no dividend can exceed the amount recommended by the Board. The directors propose a final dividend for the year ended 31 December 2012 of 5.69p per Ordinary share which, together with the interim dividend of 1.96p per Ordinary share paid to shareholders on 1 October 2012, will make a total dividend for the year of 7.65p (2011: 6.40p). Subject to shareholder approval at the AGM, the final dividend will be paid on 29 May 2013 to shareholders on the share register on 26 April 2013.

## RELATED PARTY TRANSACTIONS
Details of related party transactions are set out in Note 49 to the Group Consolidated Financial Statements.

## RIGHTS AND OBLIGATIONS ATTACHING TO SHARES
The rights and obligations relating to the Company's Ordinary shares are set out in the Articles of Association. A copy of the Articles of Association can be requested from the Company Secretary at the Company's registered office.

Holders of Ordinary shares are entitled to attend, speak and vote at general meetings. In a vote on a show of hands, every member present in person or every proxy present, who has been duly appointed by a member, will have one vote and on a poll every member present in person or by proxy shall have one vote for every Ordinary share held. These rights are subject to any special terms as to voting upon which any shares may be issued or may at the relevant time be held and to any other provisions of the Company's Articles of Association. Under the Companies Act 2006 and the Articles of Association, directors have the power to suspend voting rights and, in certain circumstances, the right to receive dividends in respect of shares where the holder of those shares fails to comply with a notice issued under section 793 of the Companies Act 2006.

The Board can decline to register a transfer of any share which is not a fully paid share. In addition, registration of a transfer of an uncertificated share may be refused in the circumstances set out in the uncertificated securities rules and where the number of joint holders exceeds four. The Board may also refuse to register the transfer of a certificated share unless:

(a) the instrument of transfer is duly stamped and is left at the Company's registered office or such other place as the Board may from time to time determine accompanied by the certificate for the share to which it relates and such evidence as the Board may reasonably require to show the right of the transferor to make the transfer;
(b) the instrument of transfer is in respect of only one class of share; and
(c) the number of joint holders does not exceed four.

Subject to the provisions of the Companies Act 2006, all or any of the rights attaching to an existing class of shares may be varied from time to time either with the consent in writing of the holders of not less than three-fourths in nominal value of the issued shares of that class (excluding any treasury shares) or with the sanction of a special resolution passed at a separate general meeting of the holders of those shares.

Shares acquired through the employee share schemes rank equally with all other Ordinary shares in issue. Barclays Private Bank & Trust (Isle of Man) Limited, as trustee of the Legal & General Employees' Share Ownership Trust, holds 0.55% of the issued share capital of the Company as at 1 March 2013 in trust for the benefit of the executive directors, senior executives and managers of the Group. This includes shares held as nominee on behalf of Legal & General Share Scheme Trustees Limited, as trustee of the Legal & General Employee Share Trust, which is in the process of being wound up. The voting rights in relation to these shares are exercised by the trustee. The trustee may vote or abstain from voting, or accept or reject any offer relating to shares, in any way it sees fit, without incurring any liability and without being required to give reasons for its decision.

Under the rules of the Legal & General Group Employee Share Plan (Plan), eligible employees are entitled to acquire shares in the Company. Plan shares are held in trust for participants by Capita IRG Trustees Limited, which holds 0.47% of the issued share capital of the Company as at 1 March 2013. Voting rights are exercised by the trustees on receipt of the participants' instructions. If a participant does not submit an instruction to the trustees, no vote is registered. In addition, the trustees do not vote on any unawarded shares held under the Plan as surplus assets.

The Company is not aware of any agreements between shareholders which may result in restrictions on the transfer of securities and/or voting rights.

## CHANGE OF CONTROL

There are no agreements between the Company and its directors or employees for compensation providing for loss of office or employment (whether through resignation, purported redundancy or otherwise) in the event of a takeover bid, except for those relating to normal notice periods. The rules of the Company's share plans contain provisions under which options and awards to participants, including executive directors, may vest on a takeover or change of control of the Company or transfer of undertakings.

The Company has a committed £1bn bank syndicated credit facility which is terminable if revised terms cannot be agreed with the syndicate of banks in a 30 day period following a change of control. As at 1 March 2013, the Company has no borrowings under this facility.

There are no change of control conditions in the terms of any of the Company's outstanding debt securities. The terms of the Company's agreements with its banking counterparties, under which derivative transactions are undertaken, include the provision for termination of transactions upon takeover/merger if the resulting merged entity has a credit rating materially weaker than the Company. There are no other committed banking arrangements either drawn or undrawn that incorporate any change of control conditions.

# OTHER STATUTORY AND REGULATORY INFORMATION CONTINUED

## USE OF FINANCIAL INSTRUMENTS

Information on the Group's risk management process is set out on pages 44 to 51. More details on risk management and the financial instruments used are set out in Notes 7 and 15 of the Financial Statements.

## INDEMNITIES

The Company has agreed to indemnify, to the extent permitted by law, each of the directors against any liability incurred by a director in respect of acts or omissions arising in the course of their office. Qualifying pension scheme indemnities (as defined in section 235 of the Companies Act 2006) have been granted, to the extent permitted by law, to certain trustees of the Company's pension schemes. The indemnities were in force throughout 2012 and remain so. Copies of the deeds of indemnity are available for inspection at the Company's registered office and will also be available at the AGM.

## CHARITABLE DONATIONS

During the period, the Group made UK charitable donations amounting to £3.8m. Details of the Company's charitable activities are set out on pages 36-43.

## POLITICAL DONATIONS

No political donations were made during 2012.

## FORWARD-LOOKING STATEMENTS

The Directors' Report is prepared for the members of the Company and should not be relied upon by any other party or for any other purpose. Where the Directors' Report includes forward-looking statements, these are made by the directors in good faith based on the information available to them at the time of their approval of this report. Such statements should be treated with caution due to the inherent uncertainties underlying such forward-looking statements.

## INSURANCE

The Company has arranged appropriate Directors' and Officers' Liability insurance for directors. This is reviewed annually.

## INDEPENDENT AUDITORS

The Company's auditors have expressed their willingness to continue in office and the Audit Committee has recommended their reappointment to the Board. Resolutions to re-appoint PricewaterhouseCoopers LLP as auditors to the Company and to authorise the directors to determine their remuneration are proposed for the forthcoming AGM.

## DIRECTORS' INTERESTS

The Directors' Report on Remuneration on pages 70 to 99 provides details of the interests of each director, including details of current incentive schemes and long-term incentive schemes, the interests of directors in the share capital of the Company and details of their share options, as at 31 December 2012 and the changes in those interests that have occurred between 1 January 2013 and 5 March 2013 (being the date of approval of the Directors' Report on Remuneration).

## GOING CONCERN STATEMENT

The Group's business activities, together with the factors likely to affect its future development, performance and position in the current economic climate are set out in the Directors' Report on pages 1 to 100. The financial position of the Group, its cash flows, liquidity position and borrowing facilities are described in the Group Results on page 25. Principal risks are detailed on pages 50-51. In addition, the financial statements include, amongst other things, notes on the Group's objectives, policies and processes for managing its capital (Note 26), its financial risk management objectives (Notes 7 and 15), details of its financial instruments and hedging activities (Notes 10 and 11) and its exposures to credit risk and liquidity risk (Note 7).

The 2013 economic climate remains uncertain. However, based on the available information on the future, the directors consider that the Group has the plans and resources to manage its business risks successfully, as it has a diverse range of businesses and remains financially strong.

After making enquiries, the directors have a reasonable expectation that the Company and the Group have adequate resources to continue their operations for the foreseeable future. For that reason, they continue to adopt the going concern basis in preparing the accounts.

## ANNUAL GENERAL MEETING

The Company's Annual General Meeting will be held at 11.00am on Wednesday 22 May 2013 at The Honourable Artillery Company, Armoury House, City Road, London EC1Y 2BQ.

## STATEMENT OF DIRECTORS' RESPONSIBILITIES

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

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have prepared the Group financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union, and the Company financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law). In preparing the Group financial statements, the directors have also elected to comply with IFRSs issued by the International Accounting Standards Board (IASB).

Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Group and the Company and of the profit or loss of the Group for that period. In preparing these financial statements, the directors are required to:

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

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

The directors are responsible for the maintenance and integrity of the Company's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

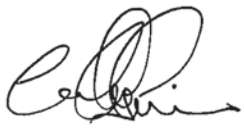
## RESPONSIBILITY STATEMENT

Each of the directors, whose names and functions are listed in the Board of Directors section confirms that, to the best of his knowledge:

- the financial statements, which have been prepared in accordance with the applicable set of accounting standards, give a true and fair view of the assets, liabilities, financial position and profit of the Company and the Group as a whole; and
- the Directors' Report includes a fair review of the development and performance of the business and the position of the Company and the Group as a whole, together with a description of the principal risks and uncertainties that they face.

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

By order of the Board



**G J TIMMS**
**COMPANY SECRETARY**
5 March 2013


# "It's showing that we care about the same stuff you do."

"Before we started talking about Every Day Matters and putting ourselves in our customers' shoes, we decided to start with us and say "OK what is important to us and what matters every day?" If I go back two or three years, I didn't have a mortgage, I didn't have a wife and I didn't have a family so my needs are totally different now. For me in my life journey, Every Day Matters rings true."

**MATTHEW,** HOVE

For more information please visit
**legalandgeneralgroup.com**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## CHANGES TO OUR FINANCIAL REPORTING

In this year's annual report we have adopted a different approach to presenting our financial information. We believe that organising the information in this way will enable greater understanding of our business.

The Group financial statements have been divided into three sections:

- The **Primary Statements and Performance** section includes the Group primary statements and other notes which we believe are integral to understanding our financial performance.
- The **Balance Sheet Management** section provides further details on our financial position and approach to risk management.
- The **Additional Financial Information** includes disclosures required to be compliant with accounting standards or the Companies Act. We view this information as important, but less significant in understanding our business and performance.

## CONTENTS

## INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF LEGAL & GENERAL GROUP PLC

We have audited the group financial statements of Legal & General Group Plc for the year ended 31 December 2012 which comprise the Consolidated Income Statement, the Consolidated Statement of Comprehensive Income, the Consolidated Balance Sheet, the Consolidated Statement of Changes in Equity, the Consolidated Cash Flow Statement and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

### Respective responsibilities of directors and auditors

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

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

### Scope of the audit of the financial statements

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

### Opinion on financial statements

In our opinion the group financial statements:

- give a true and fair view of the state of the group's affairs as at 31 December 2012 and of its profit and cash flows for the year then ended;
- have been properly prepared in accordance with IFRSs as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Companies Act 2006 and Article 4 of the IAS Regulation.

### Separate opinion in relation to IFRSs as issued by the IASB

As explained in Note 1 to the group financial statements, the group in addition to complying with its legal obligation to apply IFRSs as adopted by the European Union, has also applied IFRSs as issued by the International Accounting Standards Board (IASB).

In our opinion the group financial statements comply with IFRSs as issued by the IASB.

### Opinion on other matters prescribed by the Companies Act 2006

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

## INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF LEGAL & GENERAL GROUP PLC (CONTINUED)

### Matters on which we are required to report by exception

We have nothing to report in respect of the following:

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

- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

Under the Listing Rules we are required to review:

- the directors' statement in relation to going concern included in the Corporate Governance Statement;
- the part of the Corporate Governance Statement relating to the Company's compliance with the nine provisions of the UK Corporate Governance Code specified for our review; and
- certain elements of the report to shareholders by the Board on directors' remuneration.

### Other matters

We have reported separately on the parent company financial statements of Legal & General Group Plc for the year ended 31 December 2012 and on the information in the Directors' Report on Remuneration that is described as having been audited.

**Richard Keers** (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
London
5 March 2013

**Notes:**

(a) The financial statements are published on the website of Legal & General Group Plc, legalandgeneralgroup.com. The maintenance and integrity of the Legal & General Group Plc 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.

# PRIMARY STATEMENTS AND PERFORMANCE

## CONSOLIDATED INCOME STATEMENT

| For the year ended 31 December 2012 | Notes | 2012 £m | 2011 Restated[1] £m |
|---|---|---|---|
| **Revenue** | | | |
| Gross written premiums | 27(iv) | **5,668** | 5,719 |
| Outward reinsurance premiums | | **(718)** | (620) |
| Net change in provision for unearned premiums | | **(25)** | (18) |
| **Net premiums earned** | | **4,925** | 5,081 |
| Fees from fund management and investment contracts | 28 | **875** | 897 |
| Investment return | 29 | **28,834** | 12,143 |
| Operational income | 31 | **342** | 196 |
| **Total revenue** | 27(ii) | **34,976** | 18,317 |
| | | | |
| **Expenses** | | | |
| Claims and change in insurance liabilities | | **8,588** | 7,173 |
| Reinsurance recoveries | | **(779)** | (493) |
| Net claims and change in insurance liabilities | 30 | **7,809** | 6,680 |
| Change in provisions for investment contract liabilities | | **23,656** | 9,306 |
| Acquisition costs | | **784** | 783 |
| Finance costs | | **165** | 165 |
| Other expenses | 31 | **1,194** | 1,010 |
| Transfers to/(from) unallocated divisible surplus | 20 | **158** | (402) |
| **Total expenses** | | **33,766** | 17,542 |
| | | | |
| **Profit before tax** | | **1,210** | 775 |
| Tax (expense)/income attributable to policyholder returns | 35 | **(174)** | 178 |
| **Profit before tax attributable to equity holders of the Company** | | **1,036** | 953 |
| Total tax expense | 35 | **(409)** | (54) |
| Tax expense/(income) attributable to policyholder returns | 35 | **174** | (178) |
| Tax expense attributable to equity holders | 35 | **(235)** | (232) |
| **Profit for the year** | | **801** | 721 |
| | | | |
| Attributable to: | | | |
| Non-controlling interests | | **(12)** | (3) |
| Equity holders of the Company | | **813** | 724 |
| | | | |
| Dividend distributions to equity holders of the Company during the year | 3 | **394** | 298 |
| Dividend distributions to equity holders of the Company proposed after the year end | 3 | **336** | 279 |
| | | **p** | Restated[1] p |
| **Earnings per share** | | | |
| Based on profit attributable to equity holders of the Company | 4 | **13.90** | 12.42 |
| | | | |
| **Diluted earnings per share** | | | |
| Based on profit attributable to equity holders of the Company | 4 | **13.66** | 12.22 |

1. The consolidated income statement has been restated to reflect the retrospective adoption of ASU 2010-26, issued by the FASB, which specifies the accounting for deferred acquisition costs under US GAAP. Details of this adjustment are outlined in Note 1. The impact is to reduce Profit before tax by £3m and Profit for the year by £2m for 2011.

## PRIMARY STATEMENTS AND PERFORMANCE (CONTINUED)

### CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

| For the year ended 31 December 2012 | Notes | 2012 £m | 2011 Restated £m |
|---|---|---|---|
| **Profit for the year** | | **801** | 721 |
| **Other comprehensive income after tax** | | | |
| Exchange differences on translation of overseas operations | | **(13)** | – |
| Actuarial (losses) on defined benefit pension schemes | 23(ii) | **(107)** | (121) |
| Actuarial losses on defined benefit pension schemes transferred to unallocated divisible surplus | 20/23(ii) | **41** | 48 |
| Net change in financial investments designated as available-for-sale | | **32** | 15 |
| **Total comprehensive income for the year** | | **754** | 663 |
| | | | |
| Total comprehensive income attributable to: | | | |
| Non-controlling interests | | **(12)** | (3) |
| Equity holders of the Company | | **766** | 666 |

# PRIMARY STATEMENTS AND PERFORMANCE (CONTINUED)

## CONSOLIDATED BALANCE SHEET

| As at 31 December 2012 | Notes | 2012 £m | 2011 Restated[1] £m |
|---|---|---|---|
| **Assets** | | | |
| Purchased interest in long term businesses and other intangible assets | 39 | **211** | 148 |
| Deferred acquisition costs | 40 | **1,904** | 1,833 |
| Investment in associates | 53 | **87** | 60 |
| Property, plant and equipment | | **92** | 78 |
| Investment property | 9 | **5,143** | 4,894 |
| Financial investments | 10 | **316,748** | 300,604 |
| Reinsurers' share of contract liabilities | | **2,499** | 2,289 |
| Deferred tax asset | 41 | **316** | 493 |
| Current tax recoverable | 42 | **194** | 94 |
| Other assets | 43 | **1,564** | 1,893 |
| Assets of operations classified as held for sale | 44 | **891** | – |
| Cash and cash equivalents | 12 | **16,652** | 14,113 |
| **Total assets** | 27(iii) | **346,301** | 326,499 |
| | | | |
| **Equity** | | | |
| Share capital | 45 | **148** | 147 |
| Share premium | 45 | **956** | 941 |
| Employee scheme treasury shares | 45 | **(43)** | (48) |
| Capital redemption and other reserves | | **153** | 117 |
| Retained earnings | | **4,227** | 3,899 |
| **Shareholders' equity** | | **5,441** | 5,056 |
| Non-controlling interests | 46 | **39** | 66 |
| **Total equity** | 27(iii) | **5,480** | 5,122 |
| | | | |
| **Liabilities** | | | |
| Subordinated borrowings | 22 | **1,890** | 1,921 |
| | | | |
| Participating insurance contracts | 18 | **8,116** | 8,750 |
| Participating investment contracts | 19 | **7,403** | 7,276 |
| Unallocated divisible surplus | 20 | **1,153** | 1,038 |
| Value of in-force non-participating contracts | 21 | **(242)** | (242) |
| **Participating contract liabilities** | | **16,430** | 16,822 |
| Non-participating insurance contracts | 18 | **37,728** | 34,006 |
| Non-participating investment contracts | 19 | **264,958** | 251,345 |
| **Non-participating contract liabilities** | | **302,686** | 285,351 |
| Senior borrowings | 22 | **1,475** | 1,329 |
| Provisions | 23 | **983** | 891 |
| Deferred tax liabilities | 41 | **382** | 327 |
| Current tax liabilities | 42 | **68** | 1 |
| Payables and other financial liabilities | 24 | **8,083** | 7,643 |
| Other liabilities | 47 | **959** | 933 |
| Net asset value attributable to unit holders | 48 | **7,702** | 6,159 |
| Liabilities of operations classified as held for sale | 44 | **163** | – |
| **Total liabilities** | 27(iii) | **340,821** | 321,377 |
| **Total equity and liabilities** | | **346,301** | 326,499 |

1. The consolidated balance sheet has been restated to reflect the retrospective adoption of ASU 2010-26, issued by the FASB, which specifies the accounting for deferred acquisition costs under US GAAP. Details of this adjustment are outlined in Note 1.

The notes on pages 115 to 213 form an integral part of these financial statements.

The financial statements on pages 109 to 213 and the supplementary financial statements on pages 214 to 237 were approved by the board of directors on 5 March 2013 and were signed on their behalf by:

**John Stewart**
Chairman

**Nigel Wilson**
Group Chief Executive

**Mark Gregory**
Chief Executive Officer (Savings)

## PRIMARY STATEMENTS AND PERFORMANCE (CONTINUED)

### CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

| For the year ended 31 December 2012 | Share capital £m | Share premium £m | Employee scheme treasury shares £m | Capital redemption and other reserves £m | Retained earnings £m | Total £m | Non-controlling interests £m | Total equity £m |
|---|---|---|---|---|---|---|---|---|
| **As at 1 January** | **147** | **941** | **(48)** | **117** | **3,899** | **5,056** | **66** | **5,122** |
| Profit for the year | – | – | – | – | 813 | 813 | (12) | 801 |
| Exchange differences on translation of overseas operations | – | – | – | (13) | – | (13) | – | (13) |
| Actuarial (losses) on defined benefit pension schemes | – | – | – | – | (107) | (107) | – | (107) |
| Actuarial losses on defined benefit pension schemes transferred to unallocated divisible surplus | – | – | – | – | 41 | 41 | – | 41 |
| Net change in financial investments designated as available-for-sale | – | – | – | 32 | – | 32 | – | 32 |
| Total comprehensive income/(expense) for the year | – | – | – | 19 | 747 | 766 | (12) | 754 |
| Options exercised under share option schemes: | | | | | | | | |
| – Executive share option schemes | – | 1 | – | – | – | 1 | – | 1 |
| – Savings related share option scheme | 1 | 14 | – | – | – | 15 | – | 15 |
| Shares purchased | – | – | (3) | – | – | (3) | – | (3) |
| Shares vested | – | – | 8 | (21) | – | (13) | – | (13) |
| Employee scheme treasury shares: | | | | | | | | |
| – Value of employee services | – | – | – | 19 | – | 19 | – | 19 |
| Share scheme transfers to retained earnings | – | – | – | – | (6) | (6) | – | (6) |
| Dividends | – | – | – | – | (394) | (394) | – | (394) |
| Movement in third party interests | – | – | – | – | – | – | (15) | (15) |
| Currency translation differences | – | – | – | 19 | (19) | – | – | – |
| **As at 31 December** | **148** | **956** | **(43)** | **153** | **4,227** | **5,441** | **39** | **5,480** |

## PRIMARY STATEMENTS AND PERFORMANCE (CONTINUED)

| For the year ended 31 December 2011 (Restated) | Share capital £m | Share premium £m | Employee scheme treasury shares £m | Capital redemption and other reserves £m | Retained earnings £m | Total £m | Non-controlling interests £m | Total equity £m |
|---|---|---|---|---|---|---|---|---|
| **As at 1 January** | 147 | 938 | (41) | 91 | 3,546 | 4,681 | 47 | 4,728 |
| Profit for the year | – | – | – | – | 724 | 724 | (3) | 721 |
| Exchange differences on translation of overseas operations | – | – | – | – | – | – | – | – |
| Actuarial (losses) on defined benefit pension schemes | – | – | – | – | (121) | (121) | – | (121) |
| Actuarial losses on defined benefit pension schemes transferred to unallocated divisible surplus | – | – | – | – | 48 | 48 | – | 48 |
| Net change in financial investments designated as available-for-sale | – | – | – | 15 | – | 15 | – | 15 |
| Total comprehensive income/(expense) for the year | – | – | – | 15 | 651 | 666 | (3) | 663 |
| Options exercised under share option schemes: | | | | | | | | |
| – Executive share option schemes | – | 1 | – | – | – | 1 | – | 1 |
| – Savings related share option scheme | – | 2 | – | – | – | 2 | – | 2 |
| Shares purchased | – | – | (15) | – | – | (15) | – | (15) |
| Shares vested | – | – | 8 | (19) | – | (11) | – | (11) |
| Employee scheme treasury shares: | | | | | | | | |
| – Value of employee services | – | – | – | 27 | – | 27 | – | 27 |
| Share scheme transfers to retained earnings | – | – | – | – | 3 | 3 | – | 3 |
| Dividends | – | – | – | – | (298) | (298) | – | (298) |
| Movement in third party interests | – | – | – | – | – | – | 22 | 22 |
| Currency translation differences | – | – | – | 3 | (3) | – | – | – |
| **As at 31 December** | 147 | 941 | (48) | 117 | 3,899 | 5,056 | 66 | 5,122 |

## PRIMARY STATEMENTS AND PERFORMANCE (CONTINUED)

### CONSOLIDATED CASH FLOW STATEMENT

| For the year ended 31 December 2012 | Notes | 2012 £m | 2011 Restated £m |
|---|---|---|---|
| **Cash flows from operating activities** | | | |
| **Profit for the year** | | **801** | 721 |
| **Adjustments for non cash movements in net profit for the year** | | | |
| Realised and unrealised gains on financial investments and investment properties | | **(18,429)** | (3,014) |
| Investment income | | **(9,470)** | (8,971) |
| Interest expense | | **165** | 165 |
| Tax expense | | **409** | 54 |
| Other adjustments | | **67** | 68 |
| **Net (increase)/decrease in operational assets** | | | |
| Investments held for trading or designated as fair value through profit or loss | | **(1,118)** | 3,736 |
| Investments designated as available-for-sale | | **30** | (29) |
| Other assets | | **(3,008)** | (1,678) |
| **Net increase in operational liabilities** | | | |
| Insurance contracts | | **3,221** | 2,075 |
| Transfer to/(from) unallocated divisible surplus | | **115** | (431) |
| Investment contracts | | **13,795** | (2,068) |
| Value of in-force non-participating contracts | | **–** | 135 |
| Other liabilities | | **7,026** | 2,258 |
| **Cash used in operations** | | **(6,396)** | (6,979) |
| Interest paid | | **(164)** | (164) |
| Interest received | | **5,013** | 5,021 |
| Tax paid[1] | | **(193)** | (193) |
| Dividends received | | **4,539** | 3,872 |
| **Net cash flows from operating activities** | | **2,799** | 1,557 |
| **Cash flows from investing activities** | | | |
| Net acquisition of plant, equipment and intangibles | | **(59)** | (41) |
| Acquisitions (net of cash acquired)[2] | 38 | **(27)** | (11) |
| Capital injection into overseas joint ventures | 53 | **–** | (5) |
| **Net cash flows from investing activities** | | **(86)** | (57) |
| **Cash flows from financing activities** | | | |
| Dividend distributions to ordinary equity holders of the Company during the year | | **(394)** | (298) |
| Proceeds from issue of ordinary share capital | | **16** | 3 |
| Purchase of employee scheme shares | | **(3)** | (15) |
| Proceeds from borrowings | | **1,318** | 1,327 |
| Repayment of borrowings | | **(1,105)** | (1,428) |
| **Net cash flows from financing activities** | | **(168)** | (411) |
| **Net increase in cash and cash equivalents** | | **2,545** | 1,089 |
| Exchange (losses) on cash and cash equivalents | | **(6)** | (12) |
| Cash and cash equivalents at 1 January | | **14,113** | 13,036 |
| **Cash and cash equivalents at 31 December** | 12 | **16,652** | 14,113 |

1. Tax comprises UK corporation tax paid of £60m (2011: £80m), overseas corporate taxes of £8m (2011: £8m) and withholding tax of £125m (2011: £105m).
2. Net cash flows from acquisitions include total net identifiable assets acquired of £33m (2011: £15m) less cash and cash equivalents acquired of £6m (2011: £4m).

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

# PRIMARY STATEMENTS AND PERFORMANCE (CONTINUED)

## 1 BASIS OF PREPARATION

### Significant accounting policies

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

The Group has selected accounting policies which state fairly its financial position, financial performance and cash flows for a reporting period. The accounting policies have been consistently applied to all years presented, unless otherwise stated. Accounting policies that relate specifically to a balance or transaction are presented above the relevant numerical disclosure.

The Group presents its balance sheet in order of liquidity. This is considered to be more relevant than a before and after 12 months presentation, given the long term nature of the Group's core business. However, for each asset and liability line item which combines amounts expected to be recovered or settled before and after 12 months from the balance sheet date, disclosure of the split is made by way of a note. The presentation of the order of the notes to the financial statements has been amended to enable greater understanding of the Group's financial position and performance, details of which are outlined in the contents page to this report.

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

Foreign currency transactions are translated into the functional currency using the exchange rate prevailing at the date of the transactions. The functional currency of the Group's foreign operations is the currency of the primary economic environment in which the entity operates. The assets and liabilities of all of the Group's foreign operations are translated into sterling, the Group's presentational currency, at the closing rate at the date of the balance sheet. The income and expenses for each income statement are translated at average exchange rates. On consolidation, exchange differences arising from the translation of the net investment in foreign entities, and of borrowings and other currency instruments designated as hedges of such investments, are taken to a separate component of shareholders' equity.

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

Certain standards, amendments and interpretations to existing standards have been published which are mandatory for the Group's accounting periods beginning on or after 1 January 2012 or later periods but which the Group has not adopted early. Details of these are contained within Note 10 (Financial investments), Note 52 (Subsidiaries) and Note 23 (Provisions).

### Use of estimates

The preparation of the financial statements includes the use of estimates and assumptions which affect items reported in the consolidated balance sheet and income statement and the disclosure of contingent assets and liabilities at the date of the financial statements. Although these estimates are based on management's best knowledge of current circumstances and future events and actions, actual results may differ from those estimates, possibly significantly. This is particularly relevant for the determination of fair values of investment property (Note 9) and unquoted and illiquid financial investments (Note 10); the estimation of deferred acquisition costs (Note 40); tax balances (Notes 35, 41 and 42); and the estimation of insurance and investment contract liabilities (Notes 18 and 19). The basis of accounting for these areas, and the significant judgements used in determining them, are outlined in the respective notes to the financial statements.

### Reportable segments

During the year, the Group has changed the management lines of the international subsidiaries to reflect the development of our international strategy. This has had the consequence of changing the reportable segments of the Group. Details of the Group's reportable segments are included in Note 27. In accordance with the requirements of IFRS 8, 'Operating segments', the prior period segmental information has been restated to reflect these changes.

## PRIMARY STATEMENTS AND PERFORMANCE (CONTINUED)

### 1 BASIS OF PREPARATION (CONTINUED)

#### Consolidation principles

Subsidiary undertakings

The consolidated financial statements incorporate the assets, liabilities, equity, revenues, expenses and cash flows of the Company and of its subsidiary undertakings drawn up to 31 December each year. All intra-group balances, transactions, income and expenses are eliminated in full. Subsidiaries are those entities (including special purpose entities, mutual funds and unit trusts) over which the Group directly or indirectly has the power to govern the operating and financial policies in order to gain economic benefits (Note 52). Profits or losses of subsidiary undertakings sold or acquired during the period are included in the consolidated results up to the date of disposal or from the date of gaining control. The interests of parties, other than the Group, in investment vehicles, such as unit trusts, are classified as liabilities and appear as 'Net asset value attributable to unit holders' (Note 48) in the consolidated balance sheet. The assets and liabilities of all of the Group's foreign operations are translated into sterling, the Group's presentational currency, at the closing exchange rate at the date of the balance sheet. The income and expenses for each income statement are translated at average exchange rates. On consolidation, exchange differences arising from the translation of the net investment in foreign entities, and the borrowings and other currency instruments designated as hedges of such investments, are taken to a separate component of shareholders' equity.

Associates and joint ventures

The Group has interests in associates and joint ventures (Note 53) which form part of an investment portfolio held through private equity partnerships, mutual funds, unit trusts and similar entities. In accordance with the choices permitted by IAS 28, 'Investments in associates', and IAS 31, 'Interests in joint ventures', these interests have been classified as fair value through profit or loss and measured at fair value within financial investments, with changes in fair value recognised in the income statement.

Associates which do not form part of an investment portfolio are initially recognised in the balance sheet at cost. The carrying amount of the associate is increased or decreased to reflect the Group's share of the profit or loss after the date of the acquisition.

#### Product classification

The Group's products are classified for accounting purposes as either insurance contracts (participating and non-participating) or investment contracts (participating and non-participating). The basis of accounting for these products is outlined in Notes 18 and 19 respectively.

#### Fiduciary activities

Assets associated with fiduciary activities and the income arising from those assets, together with associated commitments to return such assets to customers, are not included in these financial statements. Where the Group acts in a fiduciary capacity, for instance as a trustee or agent, it has no contractual rights over the assets concerned.

#### Change to accounting policy – US deferred acquisition costs

During 2012, the Group has changed its accounting policy for deferred acquisition costs in the US. This follows the FASB's pronouncement on deferral methodology, applying to reporting periods starting after 15 December 2011. This has been applied to IFRS as an improvement in accounting policy, as allowed under IFRS 4, 'Insurance contracts'.

In October 2010, the Emerging Issues Task Force of the US Financial Accounting Standards Board issued Update 2010-26 on 'Accounting for costs associated with acquiring or renewing insurance contracts'. Under US GAAP, costs that can be deferred and amortised are those that 'vary with and are primarily related to the acquisition of insurance contracts'. The Update requires insurers to capitalise only those incremental costs directly related to acquiring a contract, charging all other indirect acquisition expenses to the income statement as incurred. The main impact of the update is therefore to disallow insurers from deferring indirect acquisition costs and those costs relating to unsuccessful sales.

We currently apply US GAAP to value the insurance assets and liabilities of our US operations, as allowed under IFRS 4 'Insurance contracts'. As a result of the FASB's pronouncement we are applying the change in deferral methodology for our US business for deferred acquisition costs retrospectively, restating the comparatives as required under IAS 8, 'Accounting policies, changes in accounting estimates and errors'.

The impact of the restatement on 2012 was to reduce operating profit and profit before tax by £8m and profit after tax by £5m.

## PRIMARY STATEMENTS AND PERFORMANCE (CONTINUED)

The impact of this change upon the 2011 Group consolidated income statement and Group consolidated statement of comprehensive income, together with the Group consolidated balance sheet at 31 December 2011 and 31 December 2010 is shown below.

The 2010 consolidated balance sheet has not been re-presented as it is not considered material to the understanding of the Group consolidated financial statements.

| Consolidated Income Statement | As reported 2011 £m | Change in US DAC treatment 2011 £m | Restated 2011 £m |
|---|---|---|---|
| Acquisition costs | 780 | 3 | 783 |
| **Profit before tax** | 778 | (3) | 775 |
| Tax expense | (55) | 1 | (54) |
| **Profit for the period** | 723 | (2) | 721 |
| **Consolidated Statement of Comprehensive Income** | | | |
| Exchange differences on translation of overseas operations | 1 | (1) | – |
| Net change in financial investments designated as available-for-sale | 10 | 5 | 15 |
| **Total comprehensive income for the period** | 661 | 2 | 663 |

The restatement of US DAC reduces operating profit by £3m for the 12 months ended 31 December 2011.

| Earnings per share | As reported 2011 p | Change in US DAC treatment 2011 p | Restated 2011 p |
|---|---|---|---|
| Based on profit attributable to equity holders of the Company | 12.46 | (0.04) | 12.42 |
| **Diluted earnings per share** | | | |
| Based on profit attributable to equity holders of the Company | 12.25 | (0.03) | 12.22 |

| Consolidated Balance Sheet | As reported 2011 £m | Changes in US DAC treatment 2011 £m | Restated 2011 £m | As reported 2010 £m | Changes in US DAC treatment 2010 £m | Restated 2010 £m |
|---|---|---|---|---|---|---|
| **Assets** | | | | | | |
| Deferred acquisition costs | 2,053 | (220) | 1,833 | 2,000 | (225) | 1,775 |
| **Equity** | | | | | | |
| Capital redemption and other reserves | 101 | 16 | 117 | 79 | 12 | 91 |
| Retained earnings | 4,059 | (160) | 3,899 | 3,704 | (158) | 3,546 |
| **Liabilities** | | | | | | |
| Deferred tax liabilities | 403 | (76) | 327 | 356 | (79) | 277 |

## PRIMARY STATEMENTS AND PERFORMANCE (CONTINUED)

### 2 SUPPLEMENTARY OPERATING PROFIT INFORMATION

#### (i) Reconciliation between operating profit and profit from ordinary activities after income tax

| | Notes | 2012 £m | 2011[1] £m |
|---|---|---|---|
| **From continuing operations** | | | |
| Protection and Annuities | (ii)(a) | **640** | 601 |
| Savings | (iii)(a) | **133** | 126 |
| Investment management | (iv) | **243** | 234 |
| US Protection | | **99** | 97 |
| Group capital and financing | (v) | **22** | 51 |
| Investment projects[2] | | **(50)** | (56) |
| **Operating profit** | | **1,087** | 1,053 |
| Investment variances[3] | | **(39)** | (97) |
| Losses attributable to non-controlling interests | | **(12)** | (3) |
| **Profit before income tax attributable to equity holders of the Company** | | **1,036** | 953 |
| Tax expense attributable to equity holders of the Company | (vi) | **(235)** | (232) |
| **Profit for the year** | | **801** | 721 |

1. Supplementary operating profit has been adjusted to reflect the retrospective adoption of ASU 2010-26, issued by the FASB, which specifies the accounting for deferred acquisition costs under US GAAP. Details of this adjustment are outlined in Note 1. The impact is to reduce US Protection operating profit by £3m for 2011.
2. Investment projects predominantly relate to Solvency II and other strategic investments.
3. Investment variances include £18m of restructuring costs relating to a number of reorganisation initiatives around the Group, including the restructure of the International segment.

This supplementary operating profit information (one of the Group's key performance indicators) provides further analysis of the results reported under IFRS and we believe gives shareholders a better understanding of the underlying performance of the business.

During the year, the Group has changed the management lines of the international subsidiaries to reflect the development of our international strategy. This has had the consequence of changing the reportable segments of the Group as outlined below. In accordance with the requirements of IFRS 8, 'Operating Segments', the prior period segmental information has been restated to reflect these changes.

Operating profit for the Protection and Annuities segment represents the profit from the annuities business (individual and bulk purchase annuities and longevity insurance) and the profit from the housing and protection businesses (general insurance, and individual and group protection business). It also includes Legal & General France (LGF) and Legal & General Netherlands (LGN). Operating profit reflects the investment returns that the business expects to make on the financial investments that back this business and on shareholder funds retained within our general insurance business. LGN operating profit reflects a longer term expected return on shareholders' funds and index linked policies.

Operating profit for the Savings segment represents the profit from the insured savings businesses (non profit investment bonds and non profit pensions (including SIPPs)), the with-profits transfer, the profit of our savings investments business, and our joint venture operation in India. Operating profit for the insured savings business reflects the investment returns that the business expects to make on the financial investments that back this business.

Operating profit for the Investment management segment includes a longer term expected investment return on the shareholders' funds within the segment, and operating profit for the US Protection segment comprises the profit before tax from Legal & General America (LGA).

Investment return on Group capital incorporates a longer term expected investment return using longer term investment return assumptions applied to the average balance of Group invested assets (including interest bearing intra-group balances) calculated on a monthly basis. Profits or losses arising from actuarial movements on annuities held by the Group's defined benefit pension schemes are excluded from operating profit. Profits or losses arising on the elimination of own debt holdings are also excluded from operating profit. The Group capital and financing segment also includes our joint ventures in Egypt and Gulf.

## PRIMARY STATEMENTS AND PERFORMANCE (CONTINUED)

### (ii) Protection and Annuities

(a) Protection and Annuities operating profit

| | Notes | 2012 £m | 2011 £m |
|---|---|---|---|
| **Annuities** | | **281** | 287 |
| Protection | | **289** | 242 |
| General insurance | (ii)(f) | **30** | 42 |
| Other | | **(3)** | (10) |
| **Total UK Housing and Protection operating profit** | | **316** | 274 |
| **Total UK Protection and Annuities operating profit** | (ii)(b) | **597** | 561 |
| Netherlands | | **28** | 20 |
| France | | **15** | 20 |
| **Total Protection and Annuities operating profit** | | **640** | 601 |

(b) Analysis of UK Protection and Annuities operating profit

| | Notes | Annuities 2012 £m | Housing and Protection 2012 £m | Total 2012 £m | Annuities 2011 £m | Housing and Protection 2011 £m | Total 2011 £m |
|---|---|---|---|---|---|---|---|
| UK Protection and Annuities business segment operating profit comprises: | | | | | | | |
| Operational cash generation | | **243** | **265** | **508** | 227 | 255 | 482 |
| New business strain | | **14** | **(45)** | **(31)** | 35 | (66) | (31) |
| Net cash generation | | **257** | **220** | **477** | 262 | 189 | 451 |
| Experience variances | (ii)(c) | | | **14** | | | 22 |
| Changes to valuation assumptions | (ii)(d) | | | **(2)** | | | 24 |
| Movements in non-cash items | (ii)(e) | | | **(41)** | | | (86) |
| Other | | | | **2** | | | – |
| | | | | **450** | | | 411 |
| Tax gross up | | | | **147** | | | 150 |
| **Total UK Protection and Annuities operating profit** | | | | **597** | | | 561 |

During the year, Netherlands and France paid £14m (2011: £16m) of sustainable dividends to the Group, which has been included in net cash generation for the Protection and Annuities segment.

The UK protection and annuities (non profit business) operational cash generation represents the expected surplus to be generated in the period from the in-force non profit business which is broadly equivalent to the expected release of profit from the non profit UK protection and annuities business using best estimate assumptions. The experience variances are calculated with reference to embedded value assumptions, including the apportionment of investment return and tax in the EEV model.

Both new business strain and operational cash generation exclude required solvency margin from the liability calculation.

## PRIMARY STATEMENTS AND PERFORMANCE (CONTINUED)

### 2 SUPPLEMENTARY OPERATING PROFIT INFORMATION (CONTINUED)

#### (ii) Protection and Annuities (continued)

An analysis of the experience variances, valuation assumption changes and non-cash items, all net of tax, is provided below:

#### (c) Experience variances

| | 2012 £m | 2011 £m |
|---|---|---|
| Persistency | **(4)** | (4) |
| Mortality/morbidity[1] | **3** | (32) |
| Expenses | **2** | (2) |
| Bulk purchase annuity data loading | **37** | 42 |
| Project and development costs | **(10)** | (7) |
| Tax[2] | **(14)** | 33 |
| Other | **–** | (8) |
| | **14** | 22 |

1. Mortality/morbidity in 2011 relates to a number of high value claims in group protection. This has trended back to assumptions in 2012.
2. This relates to 2012 unrelieved expenses carried forward for tax purposes. In 2011 there was a net utilisation of brought forward expenses.

#### (d) Changes to valuation assumptions

| | 2012 £m | 2011 £m |
|---|---|---|
| Persistency | **(8)** | (1) |
| Mortality/morbidity[1] | **(14)** | (1) |
| Expenses[2] | **(2)** | 28 |
| Other[3] | **22** | (2) |
| | **(2)** | 24 |

1. This primarily relates to the update of assumptions in the annuities business.
2. Prior year expenses relate to efficiency improvements in Protection and Annuities.
3. Other valuation assumption changes primarily relates to a reduction to the retail protection reserve for reinsurance default and a reduction in reserves applying PS06/14 (or regulatory pronouncement) to a retail protection product.

#### (e) Movements in non-cash items

| | 2012 £m | 2011 £m |
|---|---|---|
| Deferred tax[1] | **(32)** | (77) |
| Other | **(9)** | (9) |
| | **(41)** | (86) |

1. This amount includes £(72)m (2011: £(80)m) for the utilisation of trading losses within net cash generation. The offsetting items comprise movements in deferred tax from creation of carried forward unrelieved expenses for tax purposes.

#### (f) General insurance operating profit

| | Net cash generation 2012 £m | Tax 2012 £m | Operating profit 2012 £m | Net cash generation 2011 £m | Tax 2011 £m | Operating profit 2011 £m |
|---|---|---|---|---|---|---|
| Household | **22** | **7** | **29** | 27 | 10 | 37 |
| Other business | **1** | **–** | **1** | 4 | 1 | 5 |
| | **23** | **7** | **30** | 31 | 11 | 42 |

# PRIMARY STATEMENTS AND PERFORMANCE (CONTINUED)

## (g) General insurance underwriting result

| | 2012 £m | 2011 £m |
|---|---|---|
| Household[1] | 16 | 23 |
| Other business | 1 | 4 |
| | 17 | 27 |

1. The 2012 household underwriting result reflects weather experience consistent with our assumptions. The 2011 result reflects the benign weather experienced during the year.

## (h) General insurance combined operating ratio[1]

| | 2012 % | 2011 % |
|---|---|---|
| Household | 95 | 91 |
| Other business | 95 | 78 |
| | 95 | 90 |

1. The calculation of the general insurance combined operating ratio has been amended to incorporate commission and expenses as a percentage of earned premiums, as opposed to premium written. Prior year comparatives have been amended accordingly.

## (iii) Savings

### (a) Savings operating profit

| | Note | 2012 £m | 2011 £m |
|---|---|---|---|
| Savings investments[1] | | 16 | 23 |
| Insured savings[2] | | 48 | 34 |
| With-profits[3] | | 69 | 69 |
| **Total Savings operating profit** | (iii)(b) | **133** | 126 |

1. Savings investments operating profit includes retail and institutional unit trusts and Suffolk Life.
2. Insured savings includes non profit investment bonds and pensions (including workplace savings and SIPPs), Nationwide Life savings business, International (Ireland) and our joint venture operation in India.
3. With-profits business operating profit is the shareholders' share of total with-profits bonuses.

### (b) Analysis of Savings operating profit

| | Notes | Insured savings 2012 £m | With-profits 2012 £m | Savings investments 2012 £m | Total 2012 £m |
|---|---|---|---|---|---|
| **Savings business segment operating profit comprises:** | | | | | |
| Operational cash generation | | 108 | 52 | 19 | 179 |
| New business strain | | (62) | – | – | (62) |
| Net cash generation | | 46 | 52 | 19 | 117 |
| **Insured savings** | | | | | |
| Experience variances | (iii)(c) | | | | (39) |
| Changes to valuation assumptions | (iii)(d) | | | | 20 |
| Movements in non-cash items and other | (iii)(e) | | | | 11 |
| **Savings investments** | | | | | |
| Movements in non-cash items and other | | | | | (9) |
| | | | | | 100 |
| Tax gross up | | | | | 33 |
| **Total Savings operating profit** | | | | | **133** |

## PRIMARY STATEMENTS AND PERFORMANCE (CONTINUED)

### 2 SUPPLEMENTARY OPERATING PROFIT INFORMATION (CONTINUED)

**(iii) Savings (continued)**

(b) Analysis of Savings operating profit (continued)

| | Notes | Insured savings 2011 £m | With profits 2011 £m | Savings investments 2011 £m | Total 2011 £m |
|---|---|---|---|---|---|
| **Savings business segment operating profit comprises:** | | | | | |
| Operational cash generation | | 101 | 51 | 22 | 174 |
| New business strain | | (63) | – | – | (63) |
| Net cash generation | | 38 | 51 | 22 | 111 |
| **Insured savings** | | | | | |
| Experience variances | (iii)(c) | | | | (12) |
| Changes to valuation assumptions | (iii)(d) | | | | (5) |
| Movements in non-cash items and other | (iii)(e) | | | | 4 |
| **Savings investments** | | | | | |
| Movements in non-cash items and other | | | | | (6) |
| | | | | | 92 |
| Tax gross up | | | | | 34 |
| **Total Savings operating profit** | | | | | 126 |

The insured savings operational cash generation represents the expected surplus generated in the period from the in-force investment bonds and pensions business (non profit savings) which is broadly equivalent to the expected release of profit from non profit savings business using best estimate assumptions and the IFRS profit after tax of the Nationwide Life savings business and International (Ireland). The experience variances are calculated with reference to embedded value assumptions, including the apportionment of investment return and tax in the EEV model.

Both new business strain and operational cash generation exclude required solvency margin from the liability calculation.

An analysis of the experience variances, valuation assumption changes and non-cash items, all net of tax, is provided below:

(c) Experience variances

| | **2012 £m** | 2011 £m |
|---|---|---|
| Persistency | **(3)** | (1) |
| Mortality/morbidity | **–** | 2 |
| Expenses | **(1)** | 1 |
| Project and development costs[1] | **(33)** | (12) |
| Tax | **1** | (4) |
| Other | **(3)** | 2 |
| | **(39)** | (12) |

1. The 2012 project and development costs are primarily driven by the Retail Distribution Review £18m (2011: £3m) with additional expenditure on our workplace proposition (including auto-enrolment) of £12m (2011: £7m). Other costs are £3m (2011: £2m).

# PRIMARY STATEMENTS AND PERFORMANCE (CONTINUED)

## (d) Changes to valuation assumptions

| | 2012 £m | 2011 £m |
|---|---|---|
| Persistency | – | (2) |
| Mortality/morbidity | – | 1 |
| Expenses[1] | 17 | (2) |
| Other | 3 | (2) |
| | 20 | (5) |

1. Expense valuation assumptions relate to efficiency improvements in workplace pensions.

## (e) Movements in non-cash items and other

| | Note | 2012 £m | 2011 £m |
|---|---|---|---|
| Deferred tax | | (6) | (6) |
| Deferred acquisition costs (DAC)[1] | (iii)(f) | (9) | (20) |
| Deferred income liabilities (DIL)[1] | | 14 | 27 |
| Other[2] | | 12 | 3 |
| | | 11 | 4 |

1. Fluctuations to the DAC and DIL movement are caused by changes to economic assumptions and the associated impact on the trail commission asset within the DAC balance and the trail commission liability in the DIL balance.
2. Other includes the operating profit/(loss) attributable to our joint venture in India.

## (f) Deferred acquisition cost movement, net of associated deferred tax

| | 2012 £m | 2011 £m |
|---|---|---|
| **As at 1 January** | 592 | 612 |
| Amortisation through income[1] | (28) | (74) |
| Acquisition costs deferred | 42 | 54 |
| **As at 31 December** | 606 | 592 |

1. The DAC amortisation incorporates a one-off increase of £23m relating to the accounting for Trail Commission DOC where estimation techniques used to determine the amortisation profile has been revised and strengthened.

The Group's balance sheet deferred acquisition costs of £1.9bn (2011: £1.8bn) is presented gross of associated deferred tax. The main contributors to the balance are LGA £0.8bn (2011: £0.7bn), non profit savings of £0.7bn (2011: £0.7bn), retail investments £0.1bn (2011: £0.1bn), savings with-profits £0.1bn (2011: £0.1bn) and other business totalling £0.2bn (2011: £0.2bn).

### Expected amortisation profile:

| | 2012 £m | 2011 £m |
|---|---|---|
| Expected to be amortised within one year | 76 | 65 |
| Expected to be amortised between one year and five years | 305 | 271 |
| Expected to be amortised in over five years | 225 | 256 |
| | 606 | 592 |

## (iv) Investment management

| | 2012 £m | 2011 £m |
|---|---|---|
| Pension funds (managed and segregated) | 181 | 172 |
| Other non-pension[1] | 22 | 25 |
| Investment management services for internal funds | 40 | 37 |
| **Total Investment management operating profit** | 243 | 234 |

1. Other non-pension includes institutional segregated mandates, private equity and property (both in the UK and overseas). Interest income on shareholder funds of £6m (2011: £9m) on an average asset balance of £0.4bn (2011: £0.4bn) has been included within other non-pension operating profit.

## PRIMARY STATEMENTS AND PERFORMANCE (CONTINUED)

### 2 SUPPLEMENTARY OPERATING PROFIT INFORMATION (CONTINUED)

(v) Group capital and financing

| | 2012 £m | 2011 £m |
|---|---|---|
| Investment return | **168** | 191 |
| Interest expense[1] | **(127)** | (123) |
| Investment expenses | **(5)** | (5) |
| Unallocated corporate expenses[2] | **(14)** | (12) |
| **Total Group capital and financing operating profit** | **22** | 51 |

1. Interest expense excludes interest on non recourse financing (see Note 22).
2. Unallocated corporate expenses includes the operating profit/(loss) attributable to our joint venture operations in Egypt and the Gulf.

(vi) Analysis of tax attributable to equity holders

| | Profit/ (loss) before tax 2012 £m | Tax (expense)/ credit 2012 £m | Profit/ (loss) before tax 2011 Restated[1] £m | Tax (expense)/ credit 2011 Restated[1] £m |
|---|---|---|---|---|
| Protection and Annuities | **640** | **(159)** | 601 | (162) |
| Savings | **133** | **(33)** | 126 | (34) |
| Investment management | **243** | **(46)** | 234 | (45) |
| US Protection | **99** | **(37)** | 97 | (34) |
| Group capital and financing | **22** | **(4)** | 51 | (8) |
| Investment projects | **(50)** | **12** | (56) | 15 |
| **Operating profit/Tax expense** | **1,087** | **(267)** | 1,053 | (268) |
| Investment variances | **(39)** | **39** | (97) | 42 |
| Impact of change in UK tax rates | **–** | **(7)** | – | (6) |
| Losses attributable to non-controlling interests | **(12)** | **–** | (3) | – |
| **Profit for the year/Tax expense for the year** | **1,036** | **(235)** | 953 | (232) |

1. Operating profit/Tax expense has been restated to reflect the retrospective adoption of ASU 2010-26, issued by the FASB, which specifies the accounting for deferred acquisition costs under US GAAP. Details of this restatement are outlined in Note 1.

The equity holders' effective tax rate for the period is 22.7% (2011: 24.4%). The Group's effective tax rate remains slightly below the UK corporation tax rate due to a number of differences between the measurement of accounting and taxable profits.

### 3 DIVIDENDS

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

| | Per share 2012 p | Total 2012 £m | Per share 2011 p | Total 2011 £m |
|---|---|---|---|---|
| Ordinary share dividends paid in the year | | | | |
| – Prior year final dividend | **4.74** | **278** | 3.42 | 201 |
| – Current year interim dividend | **1.96** | **116** | 1.66 | 97 |
| | **6.70** | **394** | 5.08 | 298 |
| Ordinary share dividend proposed[1] | **5.69** | **336** | 4.74 | 279 |

1. The dividend proposed has not been included as a liability in the balance sheet.

## PRIMARY STATEMENTS AND PERFORMANCE (CONTINUED)

### 4 EARNINGS PER SHARE

Earnings per share is a measure of the portion of the Group's profit allocated to each outstanding share. It is calculated by dividing net income attributable to ordinary equity holders by the weighted average number of ordinary shares in issue during the year, excluding employee scheme treasury shares. For this purpose, net income is defined as the profit after tax derived from continuing operations.

For diluted earnings per share, the weighted average number of ordinary shares in issue, excluding employee scheme treasury shares, is adjusted to assume conversion of all dilutive potential ordinary shares, such as share options granted to employees. Potential or contingent share issuances are treated as dilutive when their conversion to shares would decrease net earnings per share.

A reconciliation of the earnings and weighted average number of shares used in the calculations is provided below:

#### (i) Earnings per share

| | Profit before tax 2012 £m | Tax expense 2012 £m | Profit after tax 2012 £m | Earnings per share 2012 p | Profit before tax 2011 Restated £m | Tax expense 2011 Restated £m | Profit after tax 2011 Restated £m | Earnings per share 2011 Restated p |
|---|---|---|---|---|---|---|---|---|
| **Operating profit** | **1,087** | **(267)** | **820** | **14.01** | 1,053 | (268) | 785 | 13.47 |
| Investment variances | **(39)** | **39** | **–** | **0.01** | (97) | 42 | (55) | (0.94) |
| Impact of change in UK tax rates | **–** | **(7)** | **(7)** | **(0.12)** | – | (6) | (6) | (0.11) |
| **Earnings per share based on profit attributable to equity holders** | **1,048** | **(235)** | **813** | **13.90** | 956 | (232) | 724 | 12.42 |

#### (ii) Diluted earnings per share

(a) Based on operating profit after tax

| | Profit after tax 2012 £m | Number of shares[1] 2012 m | Earnings per share 2012 p | Profit after tax 2011 Restated £m | Number of shares[1] 2011 m | Earnings per share 2011 Restated p |
|---|---|---|---|---|---|---|
| **Operating profit after tax** | **820** | **5,851** | **14.01** | 785 | 5,828 | 13.47 |
| Net shares under options allocable for no further consideration | **–** | **99** | **(0.23)** | – | 97 | (0.22) |
| **Diluted earnings per share** | **820** | **5,950** | **13.78** | 785 | 5,925 | 13.25 |

(b) Based on profit attributable to equity holders

| | Profit after tax 2012 £m | Number of shares[1] 2012 m | Earnings per share 2012 p | Profit after tax 2011 Restated £m | Number of shares[1] 2011 m | Earnings per share 2011 Restated p |
|---|---|---|---|---|---|---|
| **Profit attributable to equity holders of the Company** | **813** | **5,851** | **13.90** | 724 | 5,828 | 12.42 |
| Net shares under options allocable for no further consideration | **–** | **99** | **(0.24)** | – | 97 | (0.20) |
| **Diluted earnings per share** | **813** | **5,950** | **13.66** | 724 | 5,925 | 12.22 |

1. Weighted average number of shares.

The number of shares in issue at 31 December 2012 was 5,912,782,826 (31 December 2011: 5,872,166,893).

## PRIMARY STATEMENTS AND PERFORMANCE (CONTINUED)

### 5 NEW BUSINESS (GROSS OF REINSURANCE)

New business premiums reflect income arising from the sale of new contracts during the reporting period and any changes to existing contracts, which were not anticipated at the outset of the contract. This is presented below for all long term business written by the Group including both insurance and investment contracts.

New annual premiums arise where the terms and conditions of a policy anticipate more than one premium being paid over its lifetime; new single premiums comprise all premiums which are not categorised as new annual premiums.

| | Annual 2012 £m | Single 2012 £m | Annual 2011 £m | Single 2011 £m |
|---|---|---|---|---|
| Protection | 221 | – | 177 | – |
| Annuities[1] | – | 2,339 | – | 2,515 |
| Netherlands (LGN) | 13 | 82 | 5 | 95 |
| France (LGF) | 38 | 338 | 24 | 278 |
| **Total Protection and Annuities[2]** | 272 | 2,759 | 206 | 2,888 |
| | | | | |
| Investments[3] | 69 | 5,285 | 68 | 6,200 |
| Insured | 519 | 2,383 | 244 | 2,015 |
| With–profits | 58 | 342 | 69 | 525 |
| India (26% share) | 7 | 24 | 5 | 22 |
| **Total Savings** | 653 | 8,034 | 386 | 8,762 |
| **US Protection (LGA)** | 90 | – | 69 | – |
| | | | | |
| Egypt (55% share) | 14 | – | 9 | – |
| Gulf (50% share) | 4 | 6 | 2 | 5 |
| | 1,033 | 10,799 | 672 | 11,655 |
| **Investment management** | | | | |
| Index funds | | 22,400 | | 22,182 |
| Liability driven investments | | 5,678 | | 5,809 |
| Active | | | | |
| – Active fixed income | | 6,042 | | 4,580 |
| – Property | | 125 | | 265 |
| – Equity | | 1 | | 8 |
| **Total LGIM new funds** | | 34,246 | | 32,844 |
| Institutional unit trust | | 424 | | 637 |
| **Total new funds[4]** | – | 34,670 | – | 33,481 |
| **Total new business** | 1,033 | 45,469 | 672 | 45,136 |
| | | | | |
| Comprising: | | | | |
| **Insurance contracts[5]** | | | | |
| – Participating | 4 | 239 | 3 | 325 |
| – Non–participating | 381 | 2,405 | 289 | 2,619 |
| **Investment contracts** | | | | |
| – Participating | 1 | 271 | 2 | 280 |
| – Non–participating | 578 | 3,337 | 310 | 3,062 |
| Savings – investments (including France retail investment business) | 69 | 4,547 | 68 | 5,369 |
| Investment management | – | 34,670 | – | 33,481 |
| **Total new business** | 1,033 | 45,469 | 672 | 45,136 |

1. Protection and Annuities annuity new business includes those premiums written in the with-profits fund of £12m (2011: £24m). For segmental profit reporting these contracts are incorporated with all other with-profits business in the Savings segment.
2. Total Protection and Annuities new business excludes £nil (2011: £70m) of annual premiums in relation to longevity insurance transactions. It has been excluded due to the unpredictable deal flow from this type of business.
3. Savings investments excludes institutional investments which are disclosed separately within Institutional unit trust new business above.
4. New monies from Legal & General Investment Management (LGIM) excludes £4.8bn (2011: £4.1bn) which is received during the year on a temporary basis, generally as part of portfolio reconstructions.
5. The comparative disclosures have been restated to allocate compulsory purchase annuities into the non-participating category to reflect the underlying nature of the policies. The new business premiums in relation to this business amount to £972m (2011: £747m).

There are three classes of new business for conventional individual protection where there is a material difference between gross and net of reinsurance annualised new business premiums: term assurance, which is 24.6% reinsured (2011: 26.8%); whole of life assurance, which is 18.4% reinsured (2011: 21.5%); and income protection, which is 67.2% reinsured (2011: 62.0%).

# BALANCE SHEET MANAGEMENT

## 6 PRINCIPAL PRODUCTS

A significant part of the Group's business involves the acceptance and management of risk.

A description of the principal products offered by the Group's segments is outlined below. The Group seeks to manage its exposure to risk through control techniques which ensure that the residual exposures are within acceptable tolerances agreed by the board. The Group's risk appetite framework and the methods used to monitor risk exposures can be found on pages 44 to 51.

Details of the risks associated with the Group's principal products and the control techniques used to manage these risks can be found in Notes 7 and 15.

### Protection and Annuities

The Group's Protection and Annuities business comprises annuities, individual and group protection, general insurance products and the businesses in France (LGF) and Netherlands (LGN). The majority of Protection and Annuity products are non-participating contracts and as such profits on this business accrue solely to shareholders.

#### Annuities

Annuity products provide guaranteed income for a specified time, usually the life of the policyholder, in exchange for a lump sum capital payment. No surrender value is available under any of these products. Immediate and deferred annuity contracts are offered. Immediate annuities provide a regular income stream to the policyholder, purchased with a lump sum investment, where the income stream starts immediately after the purchase. The income stream from a deferred annuity is delayed until a specified future date. Bulk annuities are also offered, where the Group accepts the assets and liabilities of a company pension scheme or a life fund. A small portfolio of immediate annuities has been written as participating business. Some non-participating deferred annuities sold by the Group contain guaranteed cash options, predominantly minimum factors for commuting part of the annuity income into cash at the date of vesting. The value of such guaranteed options are currently immaterial. There is a block of immediate and deferred annuities within the UK non profit business with benefits linked to changes in the RPI or for a minority the CPI, but with contractual maximum or minimum increases. In particular, most of these annuities have a provision that the annuity will not reduce if RPI, or for a minority CPI, becomes negative. The total of such annuities in payment at 31 December 2012 was £301m (2011: £271m). Thus, 1% negative inflation, which was reversed in the following year, would result in a guarantee cost of approximately £3m (2011: £3m). Negative inflation sustained over a longer period would give rise to significantly greater guarantee costs. Some of these guarantee costs have been partially matched through the purchase of negative inflation hedges and limited price indexation swaps.

#### Deferred annuity contracts

The Group has written some deferred annuity contracts with guaranteed minimum pensions. These options expose the Group to interest rate and longevity risk as the cost would be expected to increase with decreasing interest rates and improved longevity. The market consistent value of these guarantees carried in the balance sheet is £175m (2011: £185m).

#### Protection business (individual and group)

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

#### General insurance

The Group offers Household and Accident, Sickness and Unemployment (ASU) products:

- Household. These contracts provide cover in respect of policyholders' homes, investment properties, contents, personal belongings and incidental liabilities which they may incur as a property owner, occupier and individual. Exposure is normally limited to the rebuilding cost of the home, the replacement cost of belongings and a policy limit in respect of liability claims.
- Accident, Sickness and Unemployment (ASU). These contracts provide cover in respect of continuing payment liabilities incurred by customers when they are unable to work as a result of accident, sickness or unemployment. They protect predominantly mortgage payments. Exposure is limited to the monthly payment level selected by the customer sufficient to cover the payment and associated costs, up to the duration limit specified in the policy, usually 12 months.

## BALANCE SHEET MANAGEMENT (CONTINUED)

### 6 PRINCIPAL PRODUCTS (CONTINUED)

In addition, there are portfolios of Motor Insurance and Domestic Mortgage Indemnity Insurance (DMI) in run off. Since 1993, the DMI contract has included a maximum period of cover of ten years, and a cap on the maximum claim. For business accepted prior to 1993, cover is unlimited and lasts until the insured property is remortgaged or redeemed. During 2012 the Group also commenced the sale of pet insurance products.

Legal & General France (LGF) and Legal & General Netherlands (LGN)

In addition to protection products, LGF and LGN also write savings business.

In LGF this includes unit linked savings, including shares of open ended investment vehicles (SICAVS), risks for which are borne by unit holders of these funds, Euro denominated funds with 100% profit sharing clause and bank based investment accounts.

In LGN this includes unit linked and index linked savings products, bank based investment accounts and corporate pension products.

Certain savings products include an exposure to interest rate and credit risk, managed through an active asset-liability management programme.

**Savings**

A range of contracts are offered in a variety of different forms to meet customers' long term savings objectives. Policyholders may choose to include a number of protection benefits within their savings contracts. Typically, any guarantees under the contract would only apply on maturity or earlier death. On certain older contracts there may be provisions guaranteeing surrender benefits. Savings contracts may or may not guarantee policyholders an investment return. The contracts fall into three main types:

– Non-participating savings, pensions and endowment contracts;
– Participating savings business, comprising endowment contracts and with-profits bonds;
– Unit linked savings contracts, unit trusts and collective investment savings products.

Non-participating business is written in the non profit part of the Society Long Term Fund (LTF). Profits accrue solely to shareholders. Participating contracts are supported by the with-profits part of the Society LTF. They offer policyholders the possibility of payment of benefits in addition to those guaranteed by the contract. The amount and timing of the additional benefits (usually called bonuses) are contractually at the discretion of the Group.

For unit linked savings contracts, unit trusts and collective investment savings products, there is a direct link between the investments and the obligations. The financial risk on these contracts is borne by the policyholders and therefore detailed risk disclosures have not been presented in respect of the associated assets and liabilities. Unit linked business is written in the Society LTF. Unit trust and collective investment business is administered by Legal & General (Unit Trust Managers) Limited and Legal & General (Portfolio Management Services) Limited, respectively.

Pensions (individual and corporate)

These are long term savings contracts through which policyholders accumulate pension benefits. Some older contracts contain a basic guaranteed benefit expressed as an amount of pension payable or a guaranteed annuity option. Other options provided by these contracts include an open market option on maturity, early retirement and late retirement. The Group would generally have discretion over the terms on which the latter types of options are offered.

Endowment policies

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

With-profits bonds

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

## BALANCE SHEET MANAGEMENT (CONTINUED)

### Participating contracts

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

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

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

Following the movement in the expected cost of guarantees and options and the value of the associated funds up to 31 December 2012, and in accordance with the Society's PPFM, a refund of 0.75% was made to the asset shares. This followed a deduction of 0.75% made in respect of the year to 31 December 2011. In the technical provisions, allowance was also made for future deductions in respect of the expected costs of meeting future guarantees and options not covered by the current year deduction. For policyholders who decide to surrender, a charge will generally be made in respect of the expected cost of guarantees and options not covered by the charge already taken. Some older participating contracts include a guaranteed minimum rate of roll up of the policyholder's fund up to the date of retirement or maturity.

The distribution of surplus to shareholders depends upon the bonuses declared for the period. Typically, bonus rates are set having regard to investment returns, although the Group has some discretion setting rates and would normally smooth bonuses over time. The volatility of investment returns could impact the fund's capital position and its ability to pay bonuses. If future investment conditions were less favourable than anticipated, the lower bonus levels resulting would also reduce future distributions to shareholders. Business which is written in the with-profits part of the Society LTF is managed to be self-supporting. The unallocated divisible surplus in the fund would normally be expected to absorb the impact of these investment risks. Only in extreme scenarios, where shareholders were required to provide support to the with-profits part of the Society LTF to meet its liabilities, would these risks affect equity. As part of the 2007 Society LTF restructure, the 1996 Sub-fund (£321m) was merged into the Shareholder Retained Capital (SRC). As a result, Society's Board of Directors undertook to initially maintain £500m of assets within Society to support the with-profits business. The amount of the commitment reduced to £300m in 2012 and will then gradually reduce to zero over a period not exceeding six years. The Group's approach to setting bonus rates is designed to treat customers fairly. The approach is set out in the Society's PPFM for the with-profits part of the Society LTF. In addition, bonus declarations are also affected by FSA regulations relating to Treating Customers Fairly (TCF), which limit the discretion available when setting bonus rates.

## BALANCE SHEET MANAGEMENT (CONTINUED)

### 6 PRINCIPAL PRODUCTS (CONTINUED)

**Investment management**

LGIM offers both active and passive management on either a pooled or segregated basis. Assets are managed on behalf of pension funds, institutional clients, sovereign wealth clients, retail funds and subsidiary companies within the Legal & General Group. The core products are set out below.

Index Fund Management

LGIM provides a diversified range of pooled index funds, providing a wide choice and the ability to pursue specific benchmarks efficiently. In addition, segregated solutions are offered to institutional clients providing large scale customisation against established market capitalisation weighted and alternative indices.

Active Fixed Income and Liquidity Management

A range of pooled and segregated active fixed income funds. The LGIM liquidity funds offers institutional investors seeking an optimal solution for their cash management across a range of core currencies. The fund aims to deliver competitive returns with a high level of diversification, while focusing on capital preservation through portfolios of high quality, liquid assets.

Solution and Liability Driven Investment (LDI)

A wide variety of solutions to help de-risk defined benefit pension schemes and replace them with appropriate defined contribution or workplace savings schemes.

Active Equity

An active equity management business comprising focused teams managing stock selection across different regions.

Property and Venture Capital

A range of pooled or segregated real estate funds to both UK and overseas investors, offered via a mixture of pooled funds, specialist funds and partnerships. The business is based around in-house sector specialists with a dedicated research team. In addition LGIM provides institutional clients with private equity investment funds offered via a partnership structure.

**US Protection**

Protection business

Protection consists of individual term assurance, which provide death benefits over the medium to long term. The contracts have level premiums for an initial period with premiums set annually thereafter. During the initial period, there is generally an option to convert the contract to a universal life contract. After the initial period, the premium rates are not guaranteed, but cannot exceed the age related guaranteed premium.

Reinsurance is used within the protection businesses to manage exposure to large claims. These practices lead to the establishment of reinsurance assets on the Group's balance sheet. Within LGA, reinsurance and securitisation is also used to provide regulatory solvency relief (including relief from regulation Triple X (term insurance reserves) and regulation AXXX (universal life reserves)).

Universal life

Universal life contracts written by LGA provide savings and death benefits over the medium to long term. The savings element has a guaranteed minimum growth rate. LGA has exposure to loss in the event that interest rates decrease and it is unable to earn enough on the underlying assets to cover the guaranteed rate. LGA is also exposed to loss should interest rates increase, as the underlying market value of assets will generally fall without a change in the surrender value. The reserves for universal life totalled $679m at 31 December 2012 ($688m at 31 December 2011). The guaranteed interest rates associated with those reserves ranged from 1.5% to 6%, with the majority of the policies having guaranteed rates ranging from 3% to 4% (2011: 3% to 4%).

Annuities

Immediate annuities have similar characteristics as products sold by the Protection and Annuities division. Deferred annuity contracts written by LGA contain a provision that, at maturity, a policyholder may move the account value into an immediate annuity, at rates which are either those currently in effect, or rates guaranteed in the contract. The reserves for immediate annuities and deferred annuities totalled $12m and $195m respectively at 31 December 2012 ($12m and $200m at 31 December 2011 respectively).

# BALANCE SHEET MANAGEMENT (CONTINUED)

## 7 ASSET RISK

The Group is exposed to the following categories of risk as a consequence of offering the principal products outlined in Note 6.

### Market risk

Exposure to loss as a direct or indirect result of fluctuations in the value of, or income from, specific assets.

### Credit risk

Exposure to loss if another party fails to perform its financial obligations to the Group.

### Liquidity risk

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

The Group seeks to manage its exposures to risk through control techniques which ensure that the residual risk exposures are within acceptable tolerances agreed by the Board. A description of the risks associated with the Group's principal products and the associated control techniques is detailed below.

## Protection and Annuities

**Market Risk**

| Risk | Product | Control |
|---|---|---|
| ***Investment Performance Risk*** The Group is exposed to the risk that the income from, and value of, assets held to back insurance liabilities do not perform in line with investment and product pricing assumptions leading to a mismatch with contractual cash flows. | All | Stochastic models are used to assess the impact of a range of future return scenarios on investment values and associated liabilities in order to determine optimum portfolios of invested assets. For immediate annuities, which are sensitive to interest rate risk, analysis of the liabilities is undertaken to create a portfolio of securities, the value of which changes in line with the value of liabilities when interest rates change. |
| ***Currency Risk*** To diversify credit risk within the annuities business corporate bond portfolio, investments are held in corporate bonds denominated in Euros and US Dollars. Fluctuations in the value of, or income from, these assets relative to liabilities denominated in Sterling could result in unforeseen loss. | Annuities | To mitigate the risk of loss from currency fluctuations, currency swaps are used to hedge exposures to corporate bonds denominated in currencies other than Sterling. Hedging arrangements are placed only with strongly rated counterparties with collateral requirements being subject to regular review and reconciliation with the counterparties. |
| ***Inflation Risk*** Inflation risk is the potential for loss as a result of relative or absolute changes in inflation rates. Annuity contracts may provide for future benefits to be paid taking account of changes in the level of inflation. Annuity contracts in payment may include an annual adjustment for movements in prices indices. | Annuities | The investment strategy for annuities business takes explicit account of the effect of movements in price indices on contracted liabilities. Significant exposures that may adversely impact profitability are hedged using inflation swaps. Annuity contracts also typically provide for a cap on the annual increase in inflation linked benefits in payment. |

**Credit Risk**

| Risk | Product | Control |
|---|---|---|
| ***Bond Default Risk*** A significant portfolio of corporate bonds is held to back the liabilities arising from writing general insurance and annuities business. Whilst the portfolio is diversified, the asset class is inherently exposed to the risk of issuer default. | Annuities and General insurance | Issuer limits are set by financial strength rating, sector and geographic region so as to limit exposure from a default event. Issuer limits are regularly reviewed to take account of changes in market conditions, sector performance and the re-assessment of financial strength by rating agencies and the Group's own internal analysts. Exposures are monitored relative to limits. Financial instruments are also used to mitigate the impact of rating downgrades and defaults. |
| ***Reinsurance Counterparty Risk*** Exposure to insurance risk is mitigated by ceding part of the risks assumed to the reinsurance market. Default of a reinsurer would require the business to be re-brokered potentially on less advantageous terms, or for the risks to be borne directly. | All | When selecting new reinsurance partners, the Group considers only companies which have a minimum credit rating equivalent to A- from Standard & Poor's. For each reinsurer, exposure limits are determined based on credit ratings and projected exposure over the term of the treaty. Actual exposures are regularly monitored relative to these limits. |

## BALANCE SHEET MANAGEMENT (CONTINUED)

### 7 ASSET RISK (CONTINUED)

#### Protection and Annuities (continued)

**Liquidity Risk**

| Risk | Product | Control |
|---|---|---|
| ***Contingent Event Risk*** Events that result in liquidity risk may include a flu pandemic or natural disaster leading to significantly higher levels of claims than would normally be expected, or extreme market conditions impacting the timing of cash flows or the ability to realise investments at a given value within a specified timeframe. | Protection and General insurance | A limited level of contingent liquidity risk is an accepted element of writing contracts of insurance. However, the Group's insurance businesses seek to maintain sufficient liquid assets and standby facilities to meet a prudent estimate of the cash outflows that may arise from contingent events. The level of required liquidity is identified using techniques including stress tests for shock events, with the profile of actual liquid assets being regularly compared to the required profile. The Group's treasury function provides formal facilities to the Group to cover contingent liquidity requirements arising from more extreme events and where investment assets may not be readily realisable. The level of insurance funds held in cash and other readily realisable assets at 31 December 2012 was £2.9bn (2011: £2.3bn). |
| ***Property Counterparty Risk*** As part of our asset diversification strategy, we hold property lending and sale & leaseback investments. We are inherently exposed to the risk of default by a borrower or tenant. | Annuities | Each property lending and sale & leaseback investment transaction is subject to a due diligence process to assess the credit risks implicit in the transaction and confirm that any risk of default has been appropriately mitigated. We also protect our interests through taking security over the underlying property associated with the investment transaction. |
| ***Collateral Liquidity Risk*** Within the Annuities business, the use of financial instruments to hedge default, interest rate, currency and inflation risks can require the posting of collateral with counterparties, and as such an appropriate pool of the asset types specified by counterparties must either be held or readily available. | Annuities | Liquidity requirements to meet potential collateral calls are actively managed. Typically within the overall fund of investment assets held to meet the long term liabilities arising from annuity business, £500m is held in cash and other highly liquid investment types for general liquidity purposes. As at 31 December 2012 eligible assets worth 6.8 times the outstanding collateral were held (using the most onerous definition of collateral contained within the company's different collateral agreements). |

#### Savings

**Market Risk**

| Risk | Product | Control |
|---|---|---|
| ***Investment Performance Risk*** The financial risk exposure for participating contracts is different from that for non-participating business. Greater emphasis is placed on investing to maximise future investment returns rather than matching assets to liabilities. This results in holding significant equity and property investments. Lower investment returns increase the costs associated with maturity and investment guarantees provided on these contracts. | With-profits | These risks are managed by maintaining capital sufficient to cover the consequences of mismatch under a number of adverse scenarios. In addition, different investment strategies are followed for assets backing policyholder asset shares and assets backing other participating liabilities and surplus. The former include significant equity and property holdings, whilst the latter are invested largely in fixed interest securities. The assets held are managed so as to provide a partial hedge to movements in fixed interest yields and equity markets. The methodology used to calculate the liabilities for participating contracts makes allowance for the possibility of adverse changes in investment markets on a basis consistent with the market cost of hedging the guarantees provided. The methodology also makes allowance for the cost of future discretionary benefits, guarantees and options. The value of future discretionary benefits depends on the return achieved on assets backing these contracts. The asset mix varies with investment conditions reflecting the Group's investment policy, which aims to optimise returns to policyholders over time whilst limiting capital requirements for this business. |
| For unit linked contracts, there is a risk of volatility in asset management fee income due to the impact of interest rate and market price movements on the fair value of the assets held in the linked funds, on which investment management fees are based. There is also the risk of expense over-runs should the market depress the level of charges which could be imposed. | Unit linked | The risk is managed through maintaining a diversified range of funds in which customers may invest. The performance of linked investment funds relative to their investment objectives are subject to regular monitoring. Periodic assessment is also made of the long term profitability to Group of these funds. For some contracts the Group has discretion over the level of management charges levied. |

## BALANCE SHEET MANAGEMENT (CONTINUED)

**Liquidity Risk**

| Risk | Product | Control |
|---|---|---|
| ***Investment Liquidity Risk*** | | |
| Within the with-profit fund, exposure to liquidity risk may arise if the profile of investment assets held to meet obligations to policyholders is not aligned with the maturity profile of policies, or the profile does not adequately take account of the rights of policyholders to exercise options or guarantees to specified early surrender terms or minimum rates of return. | With-profits | Liquidity risk is managed ensuring that an appropriate proportion of the fund is held in cash or other readily realisable assets to meet each tranche of maturities and anticipated early withdrawals as they fall due. Where policyholders have discretion to require early payment of policy proceeds, contractual safeguards are in place to ensure that the fund and remaining policyholders are not disadvantaged should a material number of policyholders exercise this discretion. |
| Non-participating savings contracts are exposed to liquidity risk in that certain asset classes in which underlying funds invest, such as property, may not be readily realisable in certain market conditions, or only realisable at a diminution of value. | Non-par savings | Liquidity risks associated with non-participating savings contracts are documented and communicated to customers within product terms and conditions. The terms also highlight that for certain asset classes such as property, the Group retains the right to defer the processing of fund withdrawal requests for up to six months, should underlying assets need to be realised to meet payment requests. |

The financial risks associated with LGIM's businesses are directly borne by the investors in its funds. Therefore detailed risk disclosures have not been presented. The approach to the management of operational risks, including loss arising from trading errors, breach of fund management guidelines or valuation errors, where a breakdown in controls could lead to successful litigation against the company by one or more clients, is set out in Note 25.

The principal risks and associated controls relevant to our US Protection business are consistent with those identified for our Protection and Annuities and Savings businesses and therefore have not been repeated here.

Balance sheet foreign exchange currency translation exposure in respect of the Group's international subsidiaries is actively managed in accordance with a policy, agreed by the Group Board, which allows net foreign currency assets to be hedged through the use of derivatives. The Group is exposed to asset risk on shareholder's equity supporting the non profit Protection and Annuities and Savings businesses and capital within the Group's treasury function. Risks attributable to Group capital and financing assets are outlined below.

### Shareholder Funds

Shareholder assets include portfolios of equity, property, bond and other investments, not directly required to meet contractual obligations to policyholders. The value of, and income from, these assets is sensitive to conditions within investment markets and the broader economy. Potential volatility in returns are managed using a range of techniques, including performance benchmarks and limits on concentrations of exposures by asset type and geographic region.

### Group Treasury and Liquidity Management

The Group's treasury function manages the Group's banking relationships, capital raising activities, overall cash and liquidity position and the payment of dividends. The Group seeks to manage its corporate funds and liquidity requirements on a pooled basis and to ensure the Group maintains sufficient liquid assets and standby facilities to meet a prudent estimate of its net cash outflows. In addition, it ensures that, even under adverse conditions, the Group has access to the funds necessary to cover surrenders, withdrawals and maturing liabilities. As at 31 December 2012, the Group had in place a £1bn syndicated committed revolving credit facility provided by a number of its key relationship banks, maturing in October 2017. The facility provides flexibility in the management of the Group's liquidity. No drawings were made under these facilities during 2012.

## BALANCE SHEET MANAGEMENT (CONTINUED)

### 8 ASSETS ANALYSIS

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

**• Unit linked**

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

**• With-profits**

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

**• Non profit non-unit linked**

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

**• Shareholder**

All other assets are classified as shareholder assets. Shareholders of the Group are directly exposed to market and credit risk on these assets. This includes the assets and liabilities of our overseas insurance operations.

The table below presents an analysis of the balance sheet by category. All of the quantitative risk disclosures in Note 7 (Asset risk) have been provided using this categorisation.

## BALANCE SHEET MANAGEMENT (CONTINUED)

| As at 31 December 2012 | Shareholder £m | Non profit non–unit linked £m | With–profits £m | Unit linked £m | Total £m |
|---|---|---|---|---|---|
| **Assets** | | | | | |
| Purchased interests in long term business | **104** | **20** | **87** | **–** | **211** |
| Investment in associates | **60** | **–** | **27** | **–** | **87** |
| Plant and equipment | **64** | **17** | **11** | **–** | **92** |
| Investments[1] | **9,323** | **33,364** | **18,605** | **277,149** | **338,441** |
| Reinsurers' share of participating insurance contracts | **–** | **–** | **1** | **–** | **1** |
| Reinsurers' share of non-participating insurance contracts | **310** | **1,961** | **–** | **14** | **2,285** |
| Reinsurers' share of participating investment contracts | **–** | **–** | **2** | **–** | **2** |
| Reinsurers' share of non-participating investment contracts | **–** | **–** | **–** | **211** | **211** |
| Other operational assets | **2,198** | **971** | **340** | **1,360** | **4,869** |
| **Total assets** | **12,059** | **36,333** | **19,073** | **278,734** | **346,199** |
| **Liabilities** | | | | | |
| Subordinated borrowings | **1,907** | **–** | **–** | **(17)** | **1,890** |
| Participating contract liabilities | **–** | **19** | **16,097** | **314** | **16,430** |
| Non-participating contract liabilities | **2,051** | **31,763** | **2,378** | **266,494** | **302,686** |
| Senior borrowings | **1,228** | **2** | **173** | **72** | **1,475** |
| Other liabilities[1] | **2,559** | **3,447** | **449** | **11,783** | **18,238** |
| **Total liabilities** | **7,745** | **35,231** | **19,097** | **278,646** | **340,719** |

| As at 31 December 2011 (Restated) | Shareholder £m | Non profit non–unit linked £m | With–profits £m | Unit linked £m | Total £m |
|---|---|---|---|---|---|
| **Assets** | | | | | |
| Purchased interests in long term business | 107 | 4 | 37 | – | 148 |
| Investment in associates | 60 | – | – | – | 60 |
| Plant and equipment | 69 | – | 9 | – | 78 |
| Investments[1] | 9,104 | 30,314 | 18,927 | 261,063 | 319,408 |
| Reinsurers' share of participating insurance contracts | – | – | 1 | – | 1 |
| Reinsurers' share of non-participating insurance contracts | 311 | 1,788 | 8 | 8 | 2,115 |
| Reinsurers' share of non-participating investment contracts | – | – | 11 | 162 | 173 |
| Other operational assets | 2,190 | 965 | 279 | 879 | 4,313 |
| **Total assets** | 11,841 | 33,071 | 19,272 | 262,112 | 326,296 |
| **Liabilities** | | | | | |
| Subordinated borrowings | 1,934 | – | – | (13) | 1,921 |
| Participating contract liabilities | 1 | 23 | 16,583 | 215 | 16,822 |
| Non-participating contract liabilities | 2,368 | 27,966 | 2,110 | 252,907 | 285,351 |
| Senior borrowings | 1,147 | – | 97 | 85 | 1,329 |
| Other liabilities[1] | 2,788 | 3,631 | 450 | 8,882 | 15,751 |
| **Total liabilities** | 8,238 | 31,620 | 19,240 | 262,076 | 321,174 |

1. For risk management purposes, bespoke consolidated CDOs are considered on a net basis. Accordingly, the table above presents derivative liabilities of £102m (2011: £203m) as a deduction to non profit non–unit linked investments and other liabilities.

## BALANCE SHEET MANAGEMENT (CONTINUED)

### 9 INVESTMENT PROPERTY

Investment property comprises land and buildings which are held for long term rental yields and capital growth. It is carried at fair value with changes in fair value recognised in the income statement within investment return.

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

| | Shareholder 2012 £m | Non profit non–unit linked 2012 £m | With–profits 2012 £m | Unit linked 2012 £m | Total 2012 £m |
|---|---|---|---|---|---|
| **Fair value at 1 January** | **120** | **486** | **1,223** | **3,065** | **4,894** |
| Additions | **12** | **160** | **119** | **407** | **698** |
| Improvements | **–** | **–** | **3** | **11** | **14** |
| Disposals | **(13)** | **–** | **(156)** | **(187)** | **(356)** |
| Fair value (loss)/gain | **(2)** | **10** | **(10)** | **(105)** | **(107)** |
| **Fair value at 31 December** | **117** | **656** | **1,179** | **3,191** | **5,143** |

| | Shareholder 2011 £m | Non profit non–unit linked 2011 £m | With–profits 2011 £m | Unit linked 2011 £m | Total 2011 £m |
|---|---|---|---|---|---|
| **Fair value at 1 January** | 145 | 130 | 1,383 | 2,913 | 4,571 |
| Additions | 1 | 356 | 11 | 430 | 798 |
| Improvements | – | – | – | 5 | 5 |
| Disposals | (25) | – | (169) | (327) | (521) |
| Fair value gain/(loss) | (1) | – | (2) | 44 | 41 |
| **Fair value at 31 December** | 120 | 486 | 1,223 | 3,065 | 4,894 |

### 10 FINANCIAL INVESTMENTS

The Group holds financial investments to back insurance contracts on behalf of policyholders and as Group capital.

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

The Group's policy is to measure investments at FVTPL except for certain overseas assets where the related liability is valued on a passive basis (not using current information), in which case investments are classified as AFS. All derivatives other than those designated as hedges are classified as HFT.

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

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

# BALANCE SHEET MANAGEMENT (CONTINUED)

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

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

Financial investments classified as AFS are measured at fair value with unrealised gains and losses recognised in a separate reserve within equity. Realised gains and losses, impairment losses, dividends, interest and foreign exchange movements on non–equity instruments are reflected in the income statement. Directly attributable transaction costs are included in the initial measurement of the investment.

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

### Future developments

IFRS 9, 'Financial Instruments' issued in November 2009 (effective for annual periods commencing on or after 1 January 2015) 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 at amortised cost only if the entity is holding it to collect contractual cash flows and the cash flows represent principal and interest, otherwise it must be measured at fair value through profit or loss. Further amendments to IFRS 9, dealing with financial liabilities, were published in October 2010. These include amortised cost accounting for most financial liabilities, with bifurcation of embedded derivatives. The main change in the amendment 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 does not intend to early adopt this standard.

IFRS 13, 'Fair Value Measurement' (effective for periods beginning on or after 1 January 2013) provides clarity over the definition and disclosure of fair value, which can then be applied across all accounting standards. This standard is not expected to have a material impact on the Group's consolidated financial statements.

| | Notes | Shareholder 2012 £m | Non profit non–unit linked 2012 £m | With–profits 2012 £m | Unit linked 2012 £m | Total 2012 £m |
|---|---|---|---|---|---|---|
| **Financial investments at fair value designated as:** | | | | | | |
| Fair value through profit or loss | | 4,980 | 29,091 | 15,889 | 258,032 | 307,992 |
| Available–for–sale | | 1,954 | – | – | 5 | 1,959 |
| Held for trading | | 160 | 2,913 | 46 | 3,296 | 6,415 |
| Financial investments at fair value | (i) | 7,094 | 32,004 | 15,935 | 261,333 | 316,366 |
| Loans and receivables | (iii) | 54 | – | 22 | 306 | 382 |
| **Total financial investments** | | 7,148 | 32,004 | 15,957 | 261,639 | 316,748 |
| Expected to be received within 12 months | | | | | | 43,791 |
| Expected to be received after 12 months | | | | | | 272,957 |

## BALANCE SHEET MANAGEMENT (CONTINUED)

### 10 FINANCIAL INVESTMENTS (CONTINUED)

| | Notes | Shareholder 2011 £m | Non profit non-unit linked 2011 £m | With-profits 2011 £m | Unit linked 2011 £m | Total 2011 £m |
|---|---|---|---|---|---|---|
| **Financial investments at fair value designated as:** | | | | | | |
| Fair value through profit or loss | | 4,692 | 26,406 | 16,406 | 243,920 | 291,424 |
| Available-for-sale | | 2,068 | – | – | 5 | 2,073 |
| Held for trading | | 308 | 3,107 | 167 | 3,174 | 6,756 |
| Financial investments at fair value | (i) | 7,068 | 29,513 | 16,573 | 247,099 | 300,253 |
| Loans and receivables | (iii) | 85 | – | 1 | 265 | 351 |
| **Total financial investments** | | 7,153 | 29,513 | 16,574 | 247,364 | 300,604 |
| Expected to be received within 12 months | | | | | | 33,770 |
| Expected to be received after 12 months | | | | | | 266,834 |

Investment risks on unit linked assets are borne by the policyholders. The remaining risks associated with financial investments are outlined in Note 7.

Financial investments include £746m (2011: £771m) of debt securities pledged as collateral against derivative liabilities. The assets used as collateral are Treasury Gilts, Foreign Government Bonds, AAA Supranational Bonds and AAA Corporate Bonds (2011: Treasury Gilts, Foreign Government Bonds, AAA Supranational Bonds and AAA Corporate Bonds) having a residual maturity of over 43 years (2011: over 44 years). The Group is entitled to receive all of the cash flows from the asset during the period when it is pledged as collateral. Further, there is no obligation to pay or transfer these cash flows to another entity. The Group can decide to substitute an asset which is designated as collateral at any time, provided the relevant terms and conditions of the International Swap Dealers Association agreement are met.

Financial investments have been allocated between those expected to be settled within 12 months and after 12 months in line with the expected settlement of the backed liabilities. Assets in excess of the insurance and investment contract liabilities have been classified as expected to be settled after 12 months.

#### (i) Financial investments at fair value

| | Note | Shareholder 2012 £m | Non profit non-unit linked 2012 £m | With-profits 2012 £m | Unit linked 2012 £m | Total 2012 £m |
|---|---|---|---|---|---|---|
| Equity securities | | **1,235** | **–** | **4,159** | **150,332** | **155,726** |
| Debt securities[1] | | **5,608** | **28,712** | **11,557** | **106,649** | **152,526** |
| Accrued interest | | **61** | **379** | **173** | **1,056** | **1,669** |
| Derivative assets | 11 | **190** | **2,913** | **46** | **3,296** | **6,445** |
| **Total investments at fair value** | | **7,094** | **32,004** | **15,935** | **261,333** | **316,366** |

| | Note | Shareholder 2011 £m | Non profit non-unit linked 2011 £m | With-profits 2011 £m | Unit linked 2011 £m | Total 2011 £m |
|---|---|---|---|---|---|---|
| Equity securities | | 913 | – | 4,264 | 136,904 | 142,081 |
| Debt securities[1] | | 5,771 | 26,018 | 11,924 | 105,998 | 149,711 |
| Accrued interest | | 76 | 388 | 218 | 1,023 | 1,705 |
| Derivative assets | 11 | 308 | 3,107 | 167 | 3,174 | 6,756 |
| **Total investments at fair value** | | 7,068 | 29,513 | 16,573 | 247,099 | 300,253 |

1. Non profit non-unit linked debt securities includes £327m (2011: £nil) of commercial loans designated as fair value through profit and loss.

## BALANCE SHEET MANAGEMENT (CONTINUED)

Non–consolidated private equity investments are included within equity securities. A loss of £2m (2011: loss of £2m) has been recognised in the consolidated income statement in respect of the movement in fair value of these investments.

Property investments which are held via partnerships or unit trust vehicles are also included within equity securities. A loss £nil (2011: loss of £nil) has been recognised in the income statement in respect of the movement in fair value of these investments.

Included within unit linked equity securities are £244m (2011: £182m) of debt instruments which incorporate an embedded derivative linked to the value of the Group's share price.

### (ii) CDOs

The Group holds collateralised debt obligations (CDOs) with a market value of £1,097m at 31 December 2012 (2011: £998m).

These holdings include £948m (2011: £846m) relating to four CDOs that were constructed in 2007 and 2008 in accordance with terms specified by Legal & General as part of a strategic review of the assets backing the annuity portfolio. These CDOs mature in 2017 and 2018. The Group selected at outset and manages the reference portfolios underlying the CDOs to give exposure to globally diversified portfolios of investment grade corporate bonds. The Group is able to substitute the constituents of the original reference portfolios with new reference assets, allowing the management of the underlying credit risk although substitutions in 2011 were limited and there have been no substitutions in 2012. A breakdown of the underlying CDO reference portfolio by sector is provided below:

| Sector | 2012 % | 2011 % |
|---|---|---|
| Banks | **14** | 14 |
| Utilities | **10** | 10 |
| Consumer Services & Goods | **25** | 25 |
| Financial Services | **6** | 6 |
| Technology & Telecoms | **9** | 9 |
| Insurance | **6** | 6 |
| Industrials | **20** | 20 |
| Oil & Gas | **6** | 6 |
| Health Care | **4** | 4 |
| | **100** | 100 |

The CDOs are termed as super senior since default losses on the reference portfolio have to exceed 27.6%, on average across the four CDOs, before the CDOs incur any default losses. Assuming an average recovery rate of 30%, then over 39% of the reference names would have to default before the CDOs incur any default losses.

Beyond 27.6% of default losses on the reference portfolio, losses to the CDO would occur at a rate that is a multiple of the loss rate on the reference portfolio. For illustration a £200m loss could be incurred if default losses to the reference portfolios exceeded 30.5% or if 43.6% of the names in the diversified global investment grade portfolio defaulted, with an average 30% recovery rate. (All figures are averages across the four CDOs.)

The underlying reference portfolio has had no reference entity defaults in 2011 or 2012.

Losses are limited under the terms of the CDOs to assets and collateral invested.

These CDOs also incorporate features under which, in certain circumstances, the Group can choose either to post additional cash collateral or to allow wind up of the structures. These features are dependant on the portfolios' weighted average spreads, default experience to date and time to maturity. No additional collateral was posted to any of the CDOs during the year ended 31 December 2012 (2011: £nil). During the period, the Group received £nil (2011: £nil) of previously posted collateral.

These CDOs are valued using an external valuation which is based on observable market inputs. This is then validated against the internal valuation.

## BALANCE SHEET MANAGEMENT (CONTINUED)

### 10 FINANCIAL INVESTMENTS (CONTINUED)

#### (ii) CDOs (continued)

For the purposes of valuing the non profit annuity regulatory and IFRS liabilities the yield on the CDOs is included within the calculation of the yield used to calculate the valuation discount rate for the annuity liabilities. An allowance for the risks, including default, is also made. For EEV purposes, the yield on the CDOs, reduced by the realistic default assumption, is similarly included in assumed future investment returns.

The balance of £149m (2011: £152m) of CDO holdings includes a £27m (2011: £26m) exposure to an equity tranche of a bespoke CDO.

#### (iii) Loans and receivables

| | Shareholder 2012 £m | Non profit non-unit linked 2012 £m | With-profits 2012 £m | Unit linked 2012 £m | Total 2012 £m |
|---|---|---|---|---|---|
| Deposits with credit institutions | **4** | **–** | **–** | **306** | **310** |
| Policy loans | **43** | **–** | **21** | **–** | **64** |
| Other loans | **7** | **–** | **1** | **–** | **8** |
| **Total loans and receivables** | **54** | **–** | **22** | **306** | **382** |

| | Shareholder 2011 £m | Non profit non-unit linked 2011 £m | With-profits 2011 £m | Unit linked 2011 £m | Total 2011 £m |
|---|---|---|---|---|---|
| Deposits with credit institutions | 9 | – | – | 265 | 274 |
| Policy loans | 71 | – | – | – | 71 |
| Other loans | 5 | – | 1 | – | 6 |
| **Total loans and receivables** | 85 | – | 1 | 265 | 351 |

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

#### (iv) Fair value hierarchy

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

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

The levels of fair value measurement bases are defined as follows:
Level 1: fair values measured using quoted prices (unadjusted) in active markets for identical assets or liabilities;
Level 2: fair values measured using valuation techniques for all inputs significant to the measurement other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices);
Level 3: fair values measured using valuation techniques for any input for the asset or liability significant to the measurement that is not based on observable market data (unobservable inputs).

## BALANCE SHEET MANAGEMENT (CONTINUED)

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

| For the year ended 31 December 2012 | Total £m | Level 1 £m | Level 2 £m | Level 3 £m | Amortised cost £m |
|---|---|---|---|---|---|
| **Shareholder** | | | | | |
| Equity securities | 1,235 | 972 | 162 | 101 | – |
| Debt securities | 5,608 | 2,623 | 2,984 | 1 | – |
| Accrued interest | 61 | 38 | 23 | – | – |
| Derivative assets | 190 | 44 | 146 | – | – |
| Loans and receivables | 54 | – | – | – | 54 |
| **Non profit non-unit linked** | | | | | |
| Debt securities | 28,712 | 3,973 | 24,648 | 91 | – |
| Accrued interest | 379 | 29 | 349 | 1 | – |
| Derivative assets | 2,913 | 111 | 2,802 | – | – |
| Loans and receivables | – | – | – | – | – |
| **With-profits** | | | | | |
| Equity securities | 4,159 | 3,551 | 9 | 599 | – |
| Debt securities | 11,557 | 4,733 | 6,819 | 5 | – |
| Accrued interest | 173 | 76 | 97 | – | – |
| Derivative assets | 46 | 14 | 32 | – | – |
| Loans and receivables | 22 | – | – | – | 22 |
| **Unit linked** | | | | | |
| Equity securities | 150,332 | 148,244 | 1,823 | 265 | – |
| Debt securities | 106,649 | 66,571 | 40,077 | 1 | – |
| Accrued interest | 1,056 | 325 | 731 | – | – |
| Derivative assets | 3,296 | 445 | 2,851 | – | – |
| Loans and receivables | 306 | – | – | – | 306 |
| **Total financial investments** | **316,748** | **231,749** | **83,553** | **1,064** | **382** |

## BALANCE SHEET MANAGEMENT (CONTINUED)

### 10 FINANCIAL INVESTMENTS (CONTINUED)
#### (iv) Fair value hierarchy (continued)

| For the year ended 31 December 2011 | Total £m | Level 1 £m | Level 2 £m | Level 3 £m | Amortised cost £m |
|---|---|---|---|---|---|
| **Shareholder** | | | | | |
| Equity securities | 913 | 564 | 221 | 128 | – |
| Debt securities | 5,771 | 2,020 | 3,745 | 6 | – |
| Accrued interest | 76 | 38 | 38 | – | – |
| Derivative assets | 308 | 14 | 294 | – | – |
| Loans and receivables | 85 | – | – | – | 85 |
| **Non profit non–unit linked** | | | | | |
| Debt securities | 26,018 | 3,415 | 22,603 | – | – |
| Accrued interest | 388 | 25 | 363 | – | – |
| Derivative assets | 3,107 | 255 | 2,820 | 32 | – |
| Loans and receivables | – | – | – | – | – |
| **With–profits** | | | | | |
| Equity securities | 4,264 | 3,584 | 22 | 658 | – |
| Debt securities | 11,924 | 4,001 | 7,919 | 4 | – |
| Accrued interest | 218 | 58 | 160 | – | – |
| Derivative assets | 167 | 21 | 143 | 3 | – |
| Loans and receivables | 1 | – | – | – | 1 |
| **Unit linked** | | | | | |
| Equity securities | 136,904 | 134,993 | 1,559 | 352 | – |
| Debt securities | 105,998 | 70,221 | 35,776 | 1 | – |
| Accrued interest | 1,023 | 315 | 708 | – | – |
| Derivative assets | 3,174 | 231 | 2,943 | – | – |
| Loans and receivables | 265 | – | – | – | 265 |
| **Total financial investments** | 300,604 | 219,755 | 79,314 | 1,184 | 351 |

All of the Group's level 2 assets have been valued using standard market pricing sources, such as iBoxx, IDC and Bloomberg except for bespoke CDO and swaps holdings (see below). Following consultation with our pricing providers and a number of their contributing brokers, we have considered that these prices are not from a suitably active market and have classified them as level 2.

These CDOs are valued using an external valuation which is based on observable market inputs. This is then validated against the internal valuation. Accordingly, these assets have also been classified in level 2.

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

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

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

## BALANCE SHEET MANAGEMENT (CONTINUED)

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

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

### (a) Significant transfers between level 1 and level 2

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

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

| | Equity securities 2012 £m | Other financial investments[1] 2012 £m | Total 2012 £m | Equity securities 2011 £m | Other financial investments[1] 2011 £m | Total 2011 £m |
|---|---|---|---|---|---|---|
| **As at 1 January** | **1,138** | **46** | **1,184** | 997 | 10 | 1,007 |
| Total gains or (losses) for the period recognised: | | | | | | |
| – in profit | **(50)** | **–** | **(50)** | 147 | – | 147 |
| – in other comprehensive (expense)/income | **–** | **–** | **–** | – | (1) | (1) |
| Purchases | **14** | **87** | **101** | 236 | – | 236 |
| Sales | **(137)** | **(6)** | **(143)** | (256) | (2) | (258) |
| Settlements | **–** | **–** | **–** | – | – | – |
| Transfers into level 3 | **2** | **1** | **3** | 17 | 40 | 57 |
| Transfers out of level 3 | **–** | **(35)** | **(35)** | (3) | (1) | (4) |
| Other | **(2)** | **6** | **4** | – | – | – |
| **As at 31 December** | **965** | **99** | **1,064** | 1,138 | 46 | 1,184 |

1. Other financial investments comprise debt securities and derivative assets.

There have been no significant transfers to or from level 3 during both 2011 and 2012.

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

## BALANCE SHEET MANAGEMENT (CONTINUED)

### 10 FINANCIAL INVESTMENTS (CONTINUED)

#### (iv) Fair value hierarchy (continued)

(c) Effect on changes in significant unobservable inputs (level 3) to reasonably possible alternative assumptions

| For the year ended 31 December 2012<br>Financial instruments | Main assumptions | Current fair value 2012 £m | Reasonably possible alternative assumptions<br>Increase in fair value 2012 £m | <br>Decrease in fair value 2012 £m |
|---|---|---|---|---|
| **Assets** | | | | |
| **Shareholder** | | | | |
| – Private equity investment vehicles[1] | Price earnings multiple | **14** | **1** | **(1)** |
| – Unquoted investments in property vehicles[2] | Property yield; occupancy | **87** | **4** | **(4)** |
| – Asset backed securities | Cash flows; expected defaults | **1** | **–** | **–** |
| **Non profit non–linked** | | | | |
| – Unquoted investments in property vehicles[2] | Property yield; occupancy | **92** | **5** | **(5)** |
| **With-profits** | | | | |
| – Private equity investment vehicles[1] | Price earnings multiple | **220** | **20** | **(20)** |
| – Unquoted investments in property vehicles[2] | Property yield; occupancy | **384** | **19** | **(19)** |
| **Unit linked** | | | | |
| – Unquoted investments in property vehicles[2] | Property yield; occupancy | **233** | **12** | **(12)** |
| – Suspended securities | Estimated recoverable amount | **13** | **2** | **(2)** |
| – Asset backed securities | Cash flows; expected defaults | **20** | **7** | **(7)** |
| **Total** | | **1,064** | **70** | **(70)** |

1. Private equity investments are valued in accordance with the International Private Equity and Venture Capital Valuation Guidelines. Reasonably possible alternative valuations have been determined using alternative price earnings multiples.
2. Unquoted investments in property vehicles are valued by independent valuers on the basis of open market value as defined in the appraisal and valuation manual of the Royal Institute of Chartered Surveyors. Reasonably possible alternative valuations have been determined using alternative yield and occupancy assumptions.

| For the year ended 31 December 2011<br>Financial instruments | Main assumptions | Current fair value 2011 £m | Reasonably possible alternative assumptions<br>Increase in fair value 2011 £m | <br>Decrease in fair value 2011 £m |
|---|---|---|---|---|
| **Assets** | | | | |
| **Shareholder** | | | | |
| – Private equity investment vehicles[1] | Price earnings multiple | 13 | 1 | (1) |
| – Unquoted investments in property vehicles[2] | Property yield; occupancy | 115 | 8 | (8) |
| – Asset backed securities | Cash flows; expected defaults | 6 | – | – |
| **Non profit non–linked** | | | | |
| – Derivative assets (interest rate contracts) | Cash flows | 32 | 2 | (2) |
| **With-profits** | | | | |
| – Private equity investment vehicles[1] | Price earnings multiple | 146 | 7 | (7) |
| – Unquoted investments in property vehicles[2] | Property yield; occupancy | 516 | 40 | (40) |
| – Derivative assets (equity/index derivatives) | Cash flows | 3 | – | – |
| **Unit linked** | | | | |
| – Unquoted investments in property vehicles[2] | Property yield; occupancy | 317 | 14 | (14) |
| – Suspended securities | Estimated recoverable amount | 8 | 6 | (6) |
| – Asset backed securities | Cash flows; expected default | 28 | 1 | (1) |
| **Total** | | 1,184 | 79 | (79) |

1. Private equity investments are valued in accordance with the International Private Equity and Venture Capital Valuation Guidelines. Reasonably possible alternative valuations have been determined using alternative price earnings multiples.
2. Unquoted investments in property vehicles are valued by independent valuers on the basis of open market value as defined in the appraisal and valuation manual of the Royal Institute of Chartered Surveyors. Reasonably possible alternative valuations have been determined using alternative yield and occupancy assumptions.

# BALANCE SHEET MANAGEMENT (CONTINUED)

## 11 DERIVATIVE ASSETS AND LIABILITIES

The Group's activities expose it to the financial risks of changes in foreign exchange rates and interest rates. The Group uses derivatives such as foreign exchange forward contracts and interest rate swap contracts to hedge these exposures. The Group uses hedge accounting, provided the prescribed criteria in IAS 39 are met, to recognise the offsetting effects of changes in the fair value or cash flow of the derivative instrument and the hedged item. The Group's principal uses of hedge accounting are to:

(i) recognise in shareholders' equity the changes in the fair value of derivatives designated as hedges of a net investment in a foreign operation. Any cumulative gains and/or losses are recognised in the income statement on disposal of the foreign operation;
(ii) defer in equity the changes in the fair value of derivatives designated as the hedge of a future cash flow attributable to a recognised asset or liability, a highly probable forecast transaction, or a firm commitment until the period in which the future transaction affects profit or loss or is no longer expected to occur; and
(iii) hedge the fair value movements in loans due to interest rate and exchange rate fluctuations. Any gain or loss from remeasuring the hedging instrument at fair value is recognised immediately in the income statement. Any gain or loss on the hedged item attributable to the hedged risk is adjusted against the carrying amount of the hedged item and recognised in the income statement.

The relationship between the hedging instrument and the hedged item, together with the risk management objective and strategy for undertaking the hedge transaction, are documented at the inception of the transaction. The effectiveness of the hedge is documented and monitored on an ongoing basis. Hedge accounting is only applied for highly effective hedges (between 80% and 125% effectiveness) with any ineffective portion of the gain or loss recognised in the income statement, within other expenses, in the current period.

Certain derivative instruments do not qualify for hedge accounting. Changes in the fair value of any derivative instruments which do not qualify for hedge accounting are recognised immediately in the income statement.

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

## BALANCE SHEET MANAGEMENT (CONTINUED)

### 11 DERIVATIVE ASSETS AND LIABILITIES (CONTINUED)

| | Contract/ notional amount 2012 £m | Fair values | | Contract/ notional amount 2011 £m | Fair values | |
|---|---|---|---|---|---|---|
| | | Assets 2012 £m | Liabilities[1] 2012 £m | | Assets 2011 £m | Liabilities[1] 2011 £m |
| **Shareholder derivatives:** | | | | | | |
| Interest rate contracts – fair value hedges | – | – | – | 600 | 123 | – |
| Interest rate contracts – held for trading | 2,637 | 75 | 100 | 3,040 | 50 | 207 |
| Forward foreign exchange contracts – net investment hedges | 710 | 2 | – | 884 | – | 9 |
| Forward foreign exchange contracts – held for trading | 488 | 104 | – | 578 | 118 | 11 |
| Equity/index derivatives – held for trading | (349) | 6 | 1 | 107 | 10 | – |
| Credit derivatives – held for trading | 109 | 3 | 5 | 185 | 7 | 3 |
| **Total shareholder derivatives** | | 190 | 106 | | 308 | 230 |
| **Non profit non-unit linked derivatives:** | | | | | | |
| Interest rate contracts – held for trading | 26,461 | 2,621 | 2,539 | 27,702 | 2,750 | 2,910 |
| Forward foreign exchange contracts – held for trading | – | 90 | 24 | – | 88 | 71 |
| Equity/index derivatives – held for trading | 97 | 22 | – | 97 | 169 | – |
| Currency swap contracts – held for trading | 3,384 | 32 | 2 | 3,539 | – | 65 |
| Inflation swap contracts – held for trading | 6,256 | 132 | 393 | 6,402 | 83 | 211 |
| Credit derivatives – held for trading | 1,476 | 3 | 83 | 1,333 | 17 | 198 |
| Other derivatives – held for trading | 1,577 | 13 | 116 | 994 | – | 14 |
| **Total non profit non-unit linked derivatives** | | 2,913 | 3,157 | | 3,107 | 3,469 |
| **With-profits derivatives:** | | | | | | |
| Interest rate contracts – held for trading | 1,068 | 10 | 3 | 1,426 | 110 | 102 |
| Forward foreign exchange contracts – held for trading | – | 11 | 3 | – | 18 | 7 |
| Equity/index derivatives – held for trading | (357) | 25 | 6 | 622 | 39 | 4 |
| Other derivatives – held for trading | 1 | – | – | 1 | – | – |
| **Total with-profits derivatives** | | 46 | 12 | | 167 | 113 |
| **Unit linked derivatives:** | | | | | | |
| Interest rate contracts – held for trading | 23,282 | 2,812 | 1,185 | 22,542 | 2,692 | 1,141 |
| Forward foreign exchange contracts – held for trading | – | 428 | 126 | – | 190 | 205 |
| Credit derivatives – held for trading | (682) | 2 | 5 | (774) | 7 | 16 |
| Equity/index derivatives – held for trading | 3,133 | 27 | 659 | 4,219 | 207 | 739 |
| Other derivatives – held for trading | 28 | – | – | 5 | – | – |
| Inflation rate contracts – held for trading | 6,108 | 27 | 479 | 5,827 | 78 | 207 |
| **Total unit linked derivatives** | | 3,296 | 2,454 | | 3,174 | 2,308 |
| **Total derivative assets and liabilities** | | 6,445 | 5,729 | | 6,756 | 6,120 |

1. Derivative liabilities are reported in the balance sheet within Payables and other financial liabilities (Note 24).

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

## BALANCE SHEET MANAGEMENT (CONTINUED)

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

| As at 31 December 2012 | Fair values £m | Maturity profile of undiscounted cash flows<br>Within 1 year £m | 1-5 years £m | 5-15 years £m | 15-25 years £m | Over 25 years £m | Total £m |
|---|---|---|---|---|---|---|---|
| **Cash inflows** | | | | | | | |
| **Shareholder derivatives** | | | | | | | |
| Derivative assets | 190 | 1,549 | 536 | – | – | – | 2,085 |
| Derivative liabilities | (106) | 155 | 5 | 2 | – | – | 162 |
| **Non profit non-unit linked derivatives** | | | | | | | |
| Derivative assets | 2,913 | 9,296 | 2,703 | 4,281 | 4,171 | 4,665 | 25,116 |
| Derivative liabilities | (3,157) | 2,586 | 1,320 | 3,382 | 2,794 | 3,026 | 13,108 |
| **With-profits derivatives** | | | | | | | |
| Derivative assets | 46 | 741 | 67 | 68 | 20 | 2 | 898 |
| Derivative liabilities | (12) | 437 | 6 | 14 | 10 | – | 467 |
| **Total** | (126) | 14,764 | 4,637 | 7,747 | 6,995 | 7,693 | 41,836 |
| **Cash outflows** | | | | | | | |
| **Shareholder derivatives** | | | | | | | |
| Derivative assets | 190 | (1,514) | (415) | – | – | – | (1,929) |
| Derivative liabilities | (106) | (180) | (47) | (2) | – | – | (229) |
| **Non profit non-unit linked derivatives** | | | | | | | |
| Derivative assets | 2,913 | (8,850) | (1,668) | (3,164) | (3,402) | (3,799) | (20,883) |
| Derivative liabilities | (3,157) | (3,021) | (2,803) | (4,291) | (3,339) | (3,273) | (16,727) |
| **With-profits derivatives** | | | | | | | |
| Derivative assets | 46 | (715) | (29) | (85) | (27) | (3) | (859) |
| Derivative liabilities | (12) | (446) | (5) | (17) | (15) | – | (483) |
| **Total** | (126) | (14,726) | (4,967) | (7,559) | (6,783) | (7,075) | (41,110) |
| **Net shareholder derivatives cash flows** | | 10 | 79 | – | – | – | 89 |
| **Net non profit non-unit linked derivatives cash flows** | | 11 | (448) | 208 | 224 | 619 | 614 |
| **Net with-profits derivatives cash flows** | | 17 | 39 | (20) | (12) | (1) | 23 |

## BALANCE SHEET MANAGEMENT (CONTINUED)

### 11 DERIVATIVE ASSETS AND LIABILITIES (CONTINUED)

| As at 31 December 2011 | Fair values £m | Maturity profile of undiscounted cash flows: Within 1 year £m | 1-5 years £m | 5-15 years £m | 15-25 years £m | Over 25 years £m | Total £m |
|---|---|---|---|---|---|---|---|
| **Cash inflows** | | | | | | | |
| **Shareholder derivatives** | | | | | | | |
| Derivative assets | 308 | 634 | 662 | 13 | – | – | 1,309 |
| Derivative liabilities | (230) | 1,253 | 10 | 6 | 3 | – | 1,272 |
| **Non profit non-unit linked derivatives** | | | | | | | |
| Derivative assets | 3,107 | 3,518 | 1,715 | 3,720 | 4,454 | 5,646 | 19,053 |
| Derivative liabilities | (3,469) | 4,925 | 4,330 | 2,782 | 3,375 | 3,676 | 19,088 |
| **With-profits derivatives** | | | | | | | |
| Derivative assets | 167 | 552 | 134 | 36 | 115 | 5 | 842 |
| Derivative liabilities | (113) | 360 | 30 | 20 | 58 | 2 | 470 |
| **Total** | (230) | 11,242 | 6,881 | 6,577 | 8,005 | 9,329 | 42,034 |
| **Cash outflows** | | | | | | | |
| **Shareholder derivatives** | | | | | | | |
| Derivative assets | 308 | (570) | (441) | – | – | – | (1,011) |
| Derivative liabilities | (230) | (1,321) | (153) | (20) | (4) | (1) | (1,499) |
| **Non profit non-unit linked derivatives** | | | | | | | |
| Derivative assets | 3,107 | (2,894) | (724) | (3,027) | (3,462) | (4,326) | (14,433) |
| Derivative liabilities | (3,469) | (5,393) | (5,775) | (3,839) | (4,265) | (3,841) | (23,113) |
| **With-profits derivatives** | | | | | | | |
| Derivative assets | 167 | (512) | (38) | (30) | (83) | (4) | (667) |
| Derivative liabilities | (113) | (389) | (79) | (36) | (90) | (3) | (597) |
| **Total** | (230) | (11,079) | (7,210) | (6,952) | (7,904) | (8,175) | (41,320) |
| **Net shareholder derivatives cash flows** | | (4) | 78 | (1) | (1) | (1) | 71 |
| **Net non profit non-unit linked derivatives cash flows** | | 156 | (454) | (364) | 102 | 1,155 | 595 |
| **Net with-profits derivatives cash flows** | | 11 | 47 | (10) | – | – | 48 |

Cash inflows and outflows are presented on a net basis where the Group is required to settle net or has a legally enforceable right of offset and the intention is to settle on a net basis.

Future cash flows on the floating legs of interest rate and exchange derivatives are calculated using current spot rates, which may differ from the market expectation incorporated in the fair value.

Cash flows arising from implied events covered by credit derivatives are presented in the table above on an expected basis as cash flows within one year.

#### Forward foreign exchange contracts – net investment hedges

The Group hedges part of the foreign exchange translation exposure on its net investment in its overseas subsidiaries, using forward foreign exchange contracts. It recognises the portion of the gain or loss which is determined to be an effective hedge through reserves within shareholders' equity, along with the gain or loss on translation of the foreign subsidiaries.

#### Interest rate swap contracts – fair value hedges

The Group uses interest rate swap contracts to hedge fixed rate loans in particular to hedge the movement in the fair value of a loan due to interest rates. All such contracts were terminated during 2012.

Fair value gains and losses arising from fair value hedging relationships are as follows:
Fair value losses of £7m arose on hedging instruments (2011: gains of £31m).
Fair value gains of £6m arose on the hedged item attributable to the hedged risk (2011: losses of £31m).

# BALANCE SHEET MANAGEMENT (CONTINUED)

The total fair value gain on hedging instruments shown above excludes fair value gains arising from factors which are outside the designated hedging relationship of £nil (2011: £nil).

### Derivative contracts – held for trading

The Group uses certain derivative contracts which are effective hedges of economic exposures in accordance with the Group's risk management policy, but for various reasons are not designated within a formal hedge accounting relationship. Therefore, these contracts must be designated as held for trading, and gains and losses on these contracts are recognised immediately in the income statement.

## 12 CASH AND CASH EQUIVALENTS

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

| | Shareholder 2012 £m | Non profit non-unit linked 2012 £m | With-profits 2012 £m | Unit linked 2012 £m | Total 2012 £m |
|---|---|---|---|---|---|
| Cash at bank and in hand | **728** | **176** | **107** | **941** | **1,952** |
| Cash equivalents | **1,329** | **631** | **1,362** | **11,378** | **14,700** |
| **Cash and cash equivalents** | **2,057** | **807** | **1,469** | **12,319** | **16,652** |

| | Shareholder 2011 £m | Non profit non-unit linked 2011 £m | With-profits 2011 £m | Unit linked 2011 £m | Total 2011 £m |
|---|---|---|---|---|---|
| Cash at bank and in hand | 489 | 245 | 74 | 887 | 1,695 |
| Cash equivalents | 1,342 | 273 | 1,056 | 9,747 | 12,418 |
| **Cash and cash equivalents** | 1,831 | 518 | 1,130 | 10,634 | 14,113 |

Included within cash equivalents is £265m (2011: £178m) of collateral posted to CDOs which is not available for shareholder liquidity requirements.

## BALANCE SHEET MANAGEMENT (CONTINUED)

### 13 MARKET RISK

#### (i) Investment performance risk

(a) Equity securities

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

| Exposure to worldwide equity markets | Shareholder 2012 £m | Non profit non–unit linked 2012 £m | With–profits 2012 £m | Total 2012 £m | Shareholder 2011 £m | Non profit non–unit linked 2011 £m | With–profits 2011 £m | Total 2011 £m |
|---|---|---|---|---|---|---|---|---|
| United Kingdom | 523 | – | 1,411 | 1,934 | 458 | – | 1,392 | 1,850 |
| North America | 129 | – | 416 | 545 | – | – | 746 | 746 |
| Europe | 177 | – | 883 | 1,060 | 117 | – | 558 | 675 |
| Japan | – | – | 254 | 254 | – | – | 402 | 402 |
| Asia Pacific | 169 | – | 647 | 816 | 50 | – | 566 | 616 |
| Other | 60 | – | 125 | 185 | – | – | 39 | 39 |
| **Listed equities** | 1,058 | – | 3,736 | 4,794 | 625 | – | 3,703 | 4,328 |
| Unlisted UK equities | 11 | – | 59 | 70 | 15 | – | 82 | 97 |
| Holdings in unit trusts | 166 | – | 364 | 530 | 273 | – | 479 | 752 |
| **Total equities** | 1,235 | – | 4,159 | 5,394 | 913 | – | 4,264 | 5,177 |

The Group holds shareholder and non profit non–unit linked property investments totalling £773m (2011: £606m), of which £769m (2011: £601m) are located in the UK.

A 10% reduction in the value of listed equities would result in a reduction in pre–tax profit attributable to shareholders of £106m (2011: £63m). The impact on the with–profits fund has not been provided as the reduction would be offset by a change in the unallocated divisible surplus.

(b) Debt securities

| Total debt securities and accrued interest[1] | Note | Shareholder 2012 £m | Non profit non–unit linked 2012 £m | With–profits 2012 £m | Total 2012 £m | Shareholder 2011 £m | Non profit non–unit linked 2011 £m | With–profits 2011 £m | Total 2011 £m |
|---|---|---|---|---|---|---|---|---|---|
| United Kingdom | | 1,009 | 11,569 | 5,547 | 18,125 | 1,309 | 10,449 | 5,001 | 16,759 |
| USA | | 2,462 | 8,394 | 1,085 | 11,941 | 2,508 | 8,040 | 1,076 | 11,624 |
| Netherlands | | 606 | 1,661 | 543 | 2,810 | 604 | 1,226 | 580 | 2,410 |
| France | | 429 | 1,313 | 1,729 | 3,471 | 399 | 1,124 | 2,023 | 3,546 |
| Italy | | 108 | 636 | 104 | 848 | 109 | 543 | 108 | 760 |
| Germany | | 335 | 316 | 696 | 1,347 | 316 | 445 | 805 | 1,566 |
| Ireland | | 18 | 1,315 | 219 | 1,552 | 12 | 1,163 | 262 | 1,437 |
| Spain | | 68 | 192 | 59 | 319 | 49 | 187 | 185 | 421 |
| Belgium | | 57 | 27 | 47 | 131 | 56 | 23 | 124 | 203 |
| Portugal | | 3 | 13 | – | 16 | 4 | 41 | 4 | 49 |
| Greece | | – | – | – | – | – | – | 5 | 5 |
| Europe – Other | | 388 | 1,164 | 1,023 | 2,575 | 330 | 994 | 1,328 | 2,652 |
| Rest of World | | 186 | 2,654 | 678 | 3,518 | 151 | 2,146 | 641 | 2,938 |
| | | 5,669 | 29,254 | 11,730 | 46,653 | 5,847 | 26,381 | 12,142 | 44,370 |
| **Analysed as[1]** | | | | | | | | | |
| Debt Securities | 10(i) | 5,608 | 28,875 | 11,557 | 46,040 | 5,771 | 25,993 | 11,924 | 43,688 |
| Accrued Interest | 10(i) | 61 | 379 | 173 | 613 | 76 | 388 | 218 | 682 |
| | | 5,669 | 29,254 | 11,730 | 46,653 | 5,847 | 26,381 | 12,142 | 44,370 |

1. For risk management purposes, bespoke consolidated CDOs are considered net. For presentation in the balance sheet the components of the CDOs are shown within non profit non–unit linked investments (2012: £812m; 2011: £897m), cash equivalents (2012: £265m; 2011: £178m) and derivative liabilities (2012: £(102)m; 2011: £(203)m).

# BALANCE SHEET MANAGEMENT (CONTINUED)

## (bi) Additional disclosures on shareholder and non profit non–unit linked debt securities exposure

| Analysed by sector | 2012 £m | 2012 % | 2011 £m | 2011 % |
|---|---|---|---|---|
| Sovereigns, Supras and Sub–Sovereigns | **6,328** | **18** | 6,188 | 19 |
| Banks: | | | | |
| – Tier 1[1] | **223** | **1** | 259 | 1 |
| – Tier 2 and other subordinated | **776** | **2** | 1,338 | 4 |
| – Senior | **2,243** | **6** | 2,234 | 7 |
| Utilities | **4,177** | **12** | 3,722 | 12 |
| Consumer Services and Goods | **3,040** | **9** | 2,928 | 9 |
| Financial Services | **1,198** | **3** | 1,179 | 4 |
| Technology and Telecoms | **2,337** | **7** | 2,209 | 7 |
| Insurance | **1,362** | **4** | 1,120 | 3 |
| Industrials | **1,816** | **5** | 1,515 | 5 |
| Oil and Gas | **2,009** | **6** | 1,837 | 6 |
| Health Care | **926** | **3** | 786 | 2 |
| Property | **698** | **2** | 640 | 2 |
| Traditional and secured asset backed securities | **6,693** | **19** | 5,275 | 16 |
| CDO | **1,097** | **3** | 998 | 3 |
| **Total** | **34,923** | **100** | 32,228 | 100 |

1. Tier 1 holdings include £56m (2011: £49m) of preference shares.

| Analysis of sovereign debt exposures | 2012 £m | 2011 £m |
|---|---|---|
| **Market value by region** | | |
| United Kingdom | **3,552** | 3,205 |
| USA | **470** | 782 |
| Netherlands | **423** | 468 |
| France | **299** | 317 |
| Italy | **312** | 281 |
| Germany | **380** | 386 |
| Ireland | **6** | 4 |
| Spain | **47** | 29 |
| Belgium | **38** | 40 |
| Portugal | **4** | 3 |
| Greece | **–** | – |
| Europe – Other | **631** | 602 |
| Rest of World | **166** | 71 |
| **Total** | **6,328** | 6,188 |

## BALANCE SHEET MANAGEMENT (CONTINUED)

### 13 MARKET RISK (CONTINUED)

#### (i) Investment performance risk (continued)

(b) Debt securities (continued)

(bi) Additional disclosures on shareholder and non profit non–unit linked debt securities exposure (continued)

| Group subordinated bank exposures | 2012 £m | 2012 % | 2011 £m | 2011 % |
|---|---|---|---|---|
| **Tier 1** | | | | |
| United Kingdom[1] | **161** | **16** | 139 | 9 |
| USA | **10** | **1** | 47 | 3 |
| Europe | **52** | **5** | 61 | 4 |
| Others | **–** | **–** | 12 | 1 |
| **Total tier 1** | **223** | **22** | 259 | 17 |
| | | | | |
| **Lower tier 2** | | | | |
| United Kingdom | **235** | **24** | 586 | 36 |
| USA | **312** | **31** | 394 | 25 |
| Europe | **100** | **10** | 142 | 9 |
| Others | **26** | **3** | 68 | 4 |
| | | | | |
| **Upper tier 2** | | | | |
| United Kingdom | **66** | **7** | 63 | 4 |
| USA | **2** | **–** | 1 | – |
| Europe | **–** | **–** | 39 | 2 |
| Others | **–** | **–** | 2 | – |
| | | | | |
| **Other subordinated** | | | | |
| United Kingdom | **1** | **–** | – | – |
| USA | **32** | **3** | 43 | 3 |
| Europe | **2** | **–** | – | – |
| Others | **–** | **–** | – | – |
| **Total tier 2 and other subordinated** | **776** | **78** | 1,338 | 83 |
| **Total** | **999** | **100** | 1,597 | 100 |

1. The exposure to UK tier 1 debt includes issuances from the UK subsidiaries of European banks where there is no explicit parental guarantee.

| Traditional and secured asset backed securities summary – by security | 2012 £m | 2012 % | 2011 £m | 2011 % |
|---|---|---|---|---|
| **Traditional asset backed securities:** | | | | |
| Residential Mortgage–Backed Securities – Prime[1] | **674** | **10** | 680 | 13 |
| Residential Mortgage–Backed Securities – Sub–prime[2] | **17** | **–** | 20 | – |
| Commercial Mortgage–Backed Securities | **457** | **7** | 450 | 9 |
| Credit Card | **162** | **2** | 134 | 3 |
| Auto | **113** | **2** | 113 | 2 |
| Consumer Loans | **30** | **–** | 40 | 1 |
| Student Loans | **59** | **1** | 26 | – |
| | **1,512** | **22** | 1,463 | 28 |
| **Securitisations and debentures:** | | | | |
| Secured Bond | **2,294** | **34** | 1,975 | 37 |
| Commercial Property Backed Bonds | **575** | **9** | 236 | 5 |
| Infrastructure/Private Finance Initiative/Social housing | **1,570** | **24** | 1,168 | 22 |
| Whole Business Securitisation | **431** | **6** | 302 | 6 |
| Other secured holdings | **311** | **5** | 131 | 2 |
| | **5,181** | **78** | 3,812 | 72 |
| **Total traditional and secured asset backed securities** | **6,693** | **100** | 5,275 | 100 |

1. 54% (2011: 56%) of Prime RMBS holdings relate to UK mortgages.
2. 60% (2011: 55%) of Sub–prime RMBS holdings have a credit rating of AAA and 94% (2011: 71%) relate to the UK.

The two categories above are based on the following definitions: Traditional asset backed securities are securities, often with variable expected redemption profiles issued by Special Purpose Vehicles and typically backed by pools of receivables from loans or personal credit. Debentures are securities with fixed redemption profiles issues by firms typically secured on property and Securitisations are securities with fixed redemption profiles that are issued by Special Purpose Vehicles and secured on revenues from specific assets or operating companies.

## BALANCE SHEET MANAGEMENT (CONTINUED)

### (ii) Currency risk

The table below summarises the Group's exposure to foreign currency exchange risk, in Sterling. The functional currency represents the currency of the primary economic environment in which each of the Group's subsidiaries operates.

| As at 31 December 2012 | Euro £m | US Dollar £m | Japanese Yen £m | Other £m | Functional currency £m | Carrying value £m |
|---|---|---|---|---|---|---|
| **Shareholder** | | | | | | |
| Total assets | **865** | **(151)** | **55** | **352** | **10,938** | **12,059** |
| Total liabilities | **884** | **152** | **–** | **–** | **6,709** | **7,745** |
| **Net assets/(liabilities)** | **(19)** | **(303)** | **55** | **352** | **4,229** | **4,314** |
| **Non profit non-unit linked** | | | | | | |
| Total assets | **1,805** | **1,292** | **–** | **27** | **33,209** | **36,333** |
| Total liabilities[1] | **1,825** | **1,279** | **–** | **–** | **32,127** | **35,231** |
| **Net assets/(liabilities)** | **(20)** | **13** | **–** | **27** | **1,082** | **1,102** |

1. For risk management purposes, bespoke consolidated CDOs are considered on a net basis. Accordingly, the table above presents derivative liabilities of £102m as a deduction to non profit non-unit linked investments and other liabilities.

| **With-profits** | Euro £m | US Dollar £m | Japanese Yen £m | Other £m | Functional currency £m | Carrying value £m |
|---|---|---|---|---|---|---|
| Total assets | **800** | **466** | **259** | **1,115** | **16,433** | **19,073** |
| Total liabilities | **248** | **30** | **2** | **16** | **18,801** | **19,097** |
| **Net assets/(liabilities)** | **552** | **436** | **257** | **1,099** | **(2,368)** | **(24)** |

| As at 31 December 2011 (Restated) | Euro £m | US Dollar £m | Japanese Yen £m | Other £m | Functional currency £m | Carrying value £m |
|---|---|---|---|---|---|---|
| **Shareholder** | | | | | | |
| Total assets | 721 | 592 | 43 | 81 | 10,404 | 11,841 |
| Total liabilities | 737 | 1,272 | – | – | 6,229 | 8,238 |
| **Net assets/(liabilities)** | (16) | (680) | 43 | 81 | 4,175 | 3,603 |
| **Non profit non-unit linked** | | | | | | |
| Total assets | 127 | 9,728 | – | 19 | 23,197 | 33,071 |
| Total liabilities[1] | 148 | 9,795 | – | – | 21,677 | 31,620 |
| **Net assets/(liabilities)** | (21) | (67) | – | 19 | 1,520 | 1,451 |

1. For risk management purposes, bespoke consolidated CDOs are considered on a net basis. Accordingly, the table above presents derivative liabilities of £203m as a deduction to non profit non-unit linked investments and other liabilities.

| **With-profits** | Euro £m | US Dollar £m | Japanese Yen £m | Other £m | Functional currency £m | Carrying value £m |
|---|---|---|---|---|---|---|
| Total assets | 320 | 1,039 | 411 | 825 | 16,677 | 19,272 |
| Total liabilities | (17) | 301 | 2 | 3 | 18,951 | 19,240 |
| **Net assets/(liabilities)** | 337 | 738 | 409 | 822 | (2,274) | 32 |

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

### Currency sensitivity analysis

| **Currency sensitivity test** | **Impact on pre-tax profit 2012 £m** | **Impact on equity 2012 £m** | Impact on pre-tax profit 2011 £m | Impact on equity 2011 £m |
|---|---|---|---|---|
| 10% Euro appreciation | (4) | (3) | (4) | (3) |
| 10% US Dollar appreciation | (29) | (22) | (75) | (55) |

The credit profile of the Group's assets exposed to credit risk is shown in Note 14. The credit rating bands are provided by independent rating agencies. For unrated assets, the Group maintains internal ratings which are used to manage exposure to these counterparties. Unit linked assets have not been included as shareholders are not directly exposed to risk.

## BALANCE SHEET MANAGEMENT (CONTINUED)

### 14 CREDIT RISK

| As at 31 December 2012 | Notes | AAA £m | AA £m | A £m | BBB £m | BB and below £m | Unrated bespoke CDOs £m | Unrated other £m | Total £m |
|---|---|---|---|---|---|---|---|---|---|
| **Shareholder** | | | | | | | | | |
| Government securities | | 1,125 | 223 | – | 154 | 26 | – | 8 | 1,536 |
| Other fixed rate securities | | 485 | 503 | 1,305 | 789 | 24 | – | 21 | 3,127 |
| Variable rate securities | | 417 | 177 | 335 | 12 | 4 | – | – | 945 |
| **Total debt securities** | 10(i) | 2,027 | 903 | 1,640 | 955 | 54 | – | 29 | 5,608 |
| Accrued interest | 10(i) | 16 | 9 | 14 | 13 | – | – | 9 | 61 |
| Loans and receivables | 10(iii) | – | 2 | 6 | – | – | – | 46 | 54 |
| Derivative assets | 11 | – | 2 | 157 | – | – | – | 31 | 190 |
| Cash and cash equivalents[1] | 12 | 206 | 820 | 687 | 9 | – | – | 335 | 2,057 |
| **Financial assets** | | 2,249 | 1,736 | 2,504 | 977 | 54 | – | 450 | 7,970 |
| Reinsurers' share of non-participating insurance contracts | | – | 88 | 119 | – | – | – | 103 | 310 |
| Other assets | 43 | 9 | 31 | 71 | 3 | – | – | 462 | 576 |
| | | 2,258 | 1,855 | 2,694 | 980 | 54 | – | 1,015 | 8,856 |

1. 'A' rated cash and cash equivalents include £5m (2011: £nil) holdings in commercial paper which are short term instruments which carry a short term rating of A1+/A1 from Standard & Poor's.

| As at 31 December 2012 | Notes | AAA £m | AA £m | A £m | BBB £m | BB and below £m | Unrated bespoke CDOs £m | Unrated other £m | Total £m |
|---|---|---|---|---|---|---|---|---|---|
| **Non profit non-unit linked** | | | | | | | | | |
| Government securities | | 3,246 | 44 | 3 | 286 | – | – | – | 3,579 |
| Other fixed rate securities | | 1,089 | 2,574 | 8,459 | 7,638 | 460 | – | 992 | 21,212 |
| Variable rate securities[1] | | 530 | 581 | 1,204 | 559 | – | 975 | 235 | 4,084 |
| **Total debt securities** | 10(i) | 4,865 | 3,199 | 9,666 | 8,483 | 460 | 975 | 1,227 | 28,875 |
| Accrued interest | 10(i) | 34 | 41 | 147 | 141 | 7 | – | 9 | 379 |
| Loans and receivables | 10(iii) | – | – | – | – | – | – | – | – |
| Derivative assets | 11 | – | 315 | 2,598 | – | – | – | – | 2,913 |
| Cash and cash equivalents | 12 | 17 | 256 | 250 | – | – | – | 19 | 542 |
| **Financial assets** | | 4,916 | 3,811 | 12,661 | 8,624 | 467 | 975 | 1,255 | 32,709 |
| Reinsurers' share of non-participating insurance contracts | | – | 1,282 | 508 | – | – | – | 171 | 1,961 |
| Other assets | 43 | – | – | 6 | – | – | – | 299 | 305 |
| | | 4,916 | 5,093 | 13,175 | 8,624 | 467 | 975 | 1,725 | 34,975 |

1. For risk management purposes, bespoke consolidated CDOs are considered net. For presentation in the balance sheet the components of the CDOs are shown within investments (£812m), cash equivalents (£265m) and derivative liabilities (£(102)m).

## BALANCE SHEET MANAGEMENT (CONTINUED)

| As at 31 December 2012 | Notes | AAA £m | AA £m | A £m | BBB £m | BB and below £m | Unrated bespoke CDOs £m | Unrated other £m | Total £m |
|---|---|---|---|---|---|---|---|---|---|
| **With-profits** | | | | | | | | | |
| Government securities | | 2,879 | 373 | – | 30 | – | – | – | 3,282 |
| Other fixed rate securities | | 2,335 | 1,582 | 1,962 | 2,018 | 125 | – | 171 | 8,193 |
| Variable rate securities | | 26 | 27 | 21 | 3 | – | – | 5 | 82 |
| **Total debt securities** | 10(i) | 5,240 | 1,982 | 1,983 | 2,051 | 125 | – | 176 | 11,557 |
| Accrued interest | 10(i) | 64 | 29 | 34 | 44 | 1 | – | 1 | 173 |
| Loans and receivables | 10(iii) | – | – | – | – | – | – | 22 | 22 |
| Derivative assets | 11 | – | 3 | 43 | – | – | – | – | 46 |
| Cash and cash equivalents | 12 | 212 | 651 | 603 | 3 | – | – | – | 1,469 |
| **Financial assets** | | 5,516 | 2,665 | 2,663 | 2,098 | 126 | – | 199 | 13,267 |
| Reinsurers' share of participating insurance contracts | | – | 1 | – | – | – | – | – | 1 |
| Reinsurers' share of participating investment contracts | | – | – | – | – | – | – | 2 | 2 |
| Other assets | 43 | – | 9 | – | – | – | – | 191 | 200 |
| | | 5,516 | 2,675 | 2,663 | 2,098 | 126 | – | 392 | 13,470 |

At the year end, the Group held £429m (2011: £419m) of collateral in respect of non-unit linked derivative assets.

## BALANCE SHEET MANAGEMENT (CONTINUED)

### 14 CREDIT RISK (CONTINUED)

| As at 31 December 2011 | Notes | AAA £m | AA £m | A £m | BBB £m | BB and below £m | Unrated bespoke CDOs £m | Unrated other £m | Total £m |
|---|---|---|---|---|---|---|---|---|---|
| **Shareholder** | | | | | | | | | |
| Government securities | | 1,643 | 139 | 80 | 3 | 4 | – | 3 | 1,872 |
| Other fixed rate securities | | 442 | 455 | 1,278 | 738 | 53 | – | 7 | 2,973 |
| Variable rate securities | | 468 | 159 | 202 | 91 | 6 | – | – | 926 |
| **Total debt securities** | 10(i) | 2,553 | 753 | 1,560 | 832 | 63 | – | 10 | 5,771 |
| Accrued interest | 10(i) | 28 | 7 | 20 | 14 | 1 | – | 6 | 76 |
| Loans and receivables | 10(iii) | – | – | 11 | – | – | – | 74 | 85 |
| Derivative assets | 11 | – | 55 | 244 | – | – | – | 9 | 308 |
| Cash and cash equivalents | 12 | 258 | 842 | 598 | 4 | – | – | 129 | 1,831 |
| **Financial assets** | | 2,839 | 1,657 | 2,433 | 850 | 64 | – | 228 | 8,071 |
| Reinsurers' share of non-participating insurance contracts | | 6 | 91 | 97 | – | – | – | 117 | 311 |
| Other assets | 43 | 85 | 23 | 85 | 5 | – | – | 407 | 605 |
| | | 2,930 | 1,771 | 2,615 | 855 | 64 | – | 752 | 8,987 |
| **Non profit non-unit linked** | | | | | | | | | |
| Government securities | | 2,795 | 3 | 200 | 39 | – | – | – | 3,037 |
| Other fixed rate securities | | 1,301 | 2,565 | 8,007 | 6,372 | 412 | – | 616 | 19,273 |
| Variable rate securities[1] | | 614 | 286 | 1,341 | 331 | 1 | 872 | 238 | 3,683 |
| **Total debt securities** | 10(i) | 4,710 | 2,854 | 9,548 | 6,742 | 413 | 872 | 854 | 25,993 |
| Accrued interest | 10(i) | 36 | 43 | 162 | 133 | 5 | – | 9 | 388 |
| Loans and receivables | 10(iii) | – | – | – | – | – | – | – | – |
| Derivative assets | 11 | 1 | 438 | 2,667 | – | 1 | – | – | 3,107 |
| Cash and cash equivalents | 12 | 20 | 140 | 140 | – | – | – | 40 | 340 |
| **Financial assets** | | 4,767 | 3,475 | 12,517 | 6,875 | 419 | 872 | 903 | 29,828 |
| Reinsurers' share of non-participating insurance contracts | | – | 1,244 | 393 | – | – | – | 151 | 1,788 |
| Other assets | 43 | – | 14 | – | – | – | – | 259 | 273 |
| | | 4,767 | 4,733 | 12,910 | 6,875 | 419 | 872 | 1,313 | 31,889 |

1. For risk management purposes, bespoke consolidated CDOs are considered net. For presentation in the balance sheet the components of the CDOs are shown within investments (£897m), cash equivalents (£178m) and derivative liabilities (£(203)m).

| | Notes | AAA £m | AA £m | A £m | BBB £m | BB and below £m | Unrated bespoke CDOs £m | Unrated other £m | Total £m |
|---|---|---|---|---|---|---|---|---|---|
| **With-profits** | | | | | | | | | |
| Government securities | | 2,251 | 24 | 30 | – | 17 | – | 1 | 2,323 |
| Other fixed rate securities | | 3,717 | 1,334 | 2,260 | 1,851 | 127 | – | 203 | 9,492 |
| Variable rate securities | | 33 | 9 | 45 | 14 | 3 | – | 5 | 109 |
| **Total debt securities** | 10(i) | 6,001 | 1,367 | 2,335 | 1,865 | 147 | – | 209 | 11,924 |
| Accrued interest | 10(i) | 92 | 26 | 51 | 45 | 2 | – | 2 | 218 |
| Loans and receivables | 10(iii) | – | – | – | – | – | – | 1 | 1 |
| Derivative assets | 11 | – | 10 | 155 | – | – | – | 2 | 167 |
| Cash and cash equivalents | 12 | 474 | 490 | 163 | – | 3 | – | – | 1,130 |
| **Financial assets** | | 6,567 | 1,893 | 2,704 | 1,910 | 152 | – | 214 | 13,440 |
| Reinsurers' share of participating insurance contracts | | – | 1 | – | – | – | – | – | 1 |
| Reinsurers' share of participating investment contracts | | – | – | – | – | – | – | – | – |
| Other assets | 43 | – | – | – | – | – | – | 169 | 169 |
| | | 6,567 | 1,894 | 2,704 | 1,910 | 152 | – | 391 | 13,618 |

# BALANCE SHEET MANAGEMENT (CONTINUED)

## Impairment

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

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

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

## Ageing of financial assets that are past due but not impaired

| | | Financial assets that are past due but not impaired | | | | | |
|---|---|---|---|---|---|---|---|
| **As at 31 December 2012** | **Neither past due nor impaired £m** | **0-3 months £m** | **3-6 months £m** | **6 months-1 year £m** | **Over 1 year £m** | **Financial assets that have been impaired £m** | **Carrying value £m** |
| Shareholder | **8,104** | **22** | **1** | **1** | **–** | **–** | **8,128** |
| Non profit non-unit linked[1] | **34,574** | **207** | **1** | **6** | **9** | **–** | **34,797** |
| With-profits | **13,350** | **12** | **–** | **–** | **1** | **–** | **13,363** |

1. For risk management purposes, bespoke consolidated CDOs are considered net. For presentation in the balance sheet the components of the CDOs are shown within investments (£812m), cash equivalents (£265m) and derivative liabilities (£(102)m).

| | | Financial assets that are past due but not impaired | | | | | |
|---|---|---|---|---|---|---|---|
| As at 31 December 2011 | Neither past due nor impaired £m | 0-3 months £m | 3-6 months £m | 6 months-1 year £m | Over 1 year £m | Financial assets that have been impaired £m | Carrying value £m |
| Shareholder | 8,475 | 22 | 1 | – | – | – | 8,498 |
| Non profit non-unit linked[1] | 31,518 | 107 | 8 | 2 | 9 | – | 31,644 |
| With-profits | 13,535 | 19 | – | – | 1 | – | 13,555 |

1. For risk management purposes, bespoke consolidated CDOs are considered net. For presentation in the balance sheet the components of the CDOs are shown within investments (£897m), cash equivalents (£178m) and derivative liabilities (£(203)m).

## BALANCE SHEET MANAGEMENT (CONTINUED)

### 15 INSURANCE RISK

The Group is exposed to insurance risk as a consequence of offering the principal products outlined in Note 6. Insurance risk is the exposure to loss arising from claims experience being different to that anticipated. Detailed below are the risks associated with each of the Group's segments and the associated controls operated.

### Protection and Annuities

**Insurance Risk**

| Risk | Product | Control |
|---|---|---|
| *Mortality & Morbidity Risks*<br>For contracts providing death benefits, higher mortality rates would lead to an increase in claims costs. The cost of health related claims depends on both the incidence of policyholders becoming ill and the duration over which they remain ill. Higher than expected incidence or duration would increase costs over the level currently assumed in the calculation of liabilities. | Protection | The pricing of protection business is based on assumptions as to future trends in mortality and morbidity having regard to past experience. Underwriting criteria are defined setting out the risks that are unacceptable and the terms for non-standard risks presented by the lives to be insured. Extensive use of reinsurance is made within individual protection business, placing a proportion of all risks meeting prescribed criteria. Mortality and morbidity experience is compared to that assumed within the pricing basis with variances subject to actuarial investigation. |
| For annuity contracts, the Group is exposed to the risk that mortality experience is lower than assumed; lower than expected mortality would require payments to be made for longer and increase the cost of benefits provided. | Annuities | Annuity business is priced having regard to trends in improvements in future mortality. Enhanced annuities, which are priced taking account of impairments to life expectancy, are subject to specific underwriting criteria. Certain annuitant mortality risks, including enhanced annuities, are placed with reinsurers. The Group regularly reviews its mortality experience and industry projections of longevity and adjusts the pricing and valuation assumptions accordingly. |
| *Persistency Risk*<br>In the early years of a policy, lapses may result in a loss to the Group, as the acquisition costs associated with the contract would not have been recovered from product margins. | Protection | The pricing basis for protection business includes provision for policy lapses. Following the adoption of PS06/14 in 2006 the persistency assumption for non-participating protection business allows for the expected pattern of persistency, adjusted to incorporate a margin for adverse deviation. Actual trends in policy lapse rates are monitored with adverse trends being subject to actuarial investigation. |
| *Expense Risk*<br>In pricing long term insurance business, assumptions are made as to the future cost of product servicing. A significant adverse divergence in actual expenses experience could reduce product profitability. | Protection and annuities | In determining pricing assumptions, account is taken of changes in price indices and the costs of employment, with stress testing used to evaluate the effect of significant deviations. Product servicing costs are monitored relative to the costs assumed with the product pricing basis. |
| *Concentration Risk*<br>Insurance risk may be concentrated in geographic regions, altering the risk profile of the Group. The most significant exposure of this type arises for group protection business, where a single event could result in a large number of related claims. | Protection and General insurance | Group protection business contracts include an 'event limit' capping the total liability under the policy from a single event. Excess of loss reinsurance further mitigates the exposure. For general insurance business, the risk acceptance policy, terms and premiums reflect expected claims cost associated with a location and avoids adverse selection. Additionally, exposure by location is monitored to ensure there is a geographic spread of risk. Catastrophe reinsurance cover also reduces concentrations of risk. |
| *Epidemics*<br>The spread of an epidemic could cause large aggregate claims across the Group's portfolio of protection businesses. | Protection | The pricing basis for protection business includes an assessment of potential claims as a result of epidemic risks. Quota share and excess of loss reinsurance contracts are used by individual and group protection, respectively, to further mitigate the risk. Depending on the nature of an epidemic, mortality experience may lead to a reduction in the cost of claims for annuity business. |
| *Weather events*<br>Significant weather events such as windstorms, and coastal and river floods can lead to significant claims. | General insurance | The impact of events are mitigated by excess of loss catastrophe treaties, under which the cost of claims from a weather event in excess of an agreed retention level, is recovered from insurers. The reinsurance is designed to protect against a modelled windstorm and coastal flood event with a return probability of 1 in 200 years. |
| *Subsidence*<br>The incidence of subsidence can have a significant impact on the level of claims on household policies. | General insurance | Underwriting criteria for general insurance business includes assessment of subsidence risk, with an appropriate premium being charged for the risk accepted. Reinsurance arrangements are used to further mitigate the risk. |

## BALANCE SHEET MANAGEMENT (CONTINUED)

### Savings

**Insurance Risk**

| Risk | Product | Control |
|---|---|---|
| *Persistency*<br>In the early years of a policy, lapses and surrenders are likely to result in a loss to the Group, as the acquisition costs associated with the contract would not have been recovered from product margins. | All | For insured contracts, terms and conditions typically include surrender deductions to mitigate the risk. In later periods, once the acquisition costs have been recouped, the effect of lapses and surrenders depends upon the relationship between the exit benefit, if any, and the liability for that contract. Exit benefits are not generally guaranteed and the Group has some discretion in determining the amount of the payment. As a result, the effect on profit in later periods is expected to be broadly neutral. |
| *Expense Risk*<br>In pricing long term savings business, assumptions are made as to the future cost of product servicing. A significant adverse divergence in actual expenses experience could reduce product profitability. | All | In determining pricing assumptions, account is taken of changes in price indices and the costs of employment, with stress testing used to evaluate the effect of significant deviations. Actual product servicing costs are actively monitored relative to the costs assumed with the product pricing basis, with variances investigated. |
| *Mortality Risks*<br>For savings contracts providing minimum assured death benefits, higher mortality rates may result in an increase in claims costs. | All | The pricing basis for contracts providing minimum assured death benefits include provision for future trends in mortality based on past experience. The level of mortality risk accepted within each contract is not sufficiently material to warrant formal underwriting at an individual policy level. |
| Older contracts containing a basic guaranteed benefit expressed as an amount of pension payable or a guaranteed annuity option, expose the Group to interest rate and longevity risk. The cost of guarantees increases during periods when interest rates are low or when annuitant mortality improves faster than expected. | Pensions | The ultimate cost of basic guarantees provided on older contracts will depend on the take up rate of any option and the final form of annuity selected by the policyholder. The Group has limited ability to control the take up of these options. However, the book of business itself is diminishing in size. As at 31 December 2012 the value of guarantees is estimated to be £51m (31 December 2011: £57m). |

The financial risks associated with LGIM's businesses are directly borne by the investors in its funds. Therefore detailed risk disclosures have not been presented. The approach to the management of operational risks, including loss arising from trading errors, breach of fund management guidelines or valuation errors, where a breakdown in controls could lead to successful litigation against the company by one or more clients, is set out in Note 25.

The principal risks and associated controls relevant to our US Protection business are consistent with those identified for our Protection and Annuities and Savings businesses and therefore have not been repeated here.

### Accumulation of risks

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

## 16 LONG TERM INSURANCE VALUATION ASSUMPTIONS

The Group's insurance assumptions, described below, relate exclusively to the UK insurance business. The non-UK businesses do not constitute a material component of the Group's operations and consideration of geographically determined assumptions is therefore not included.

### Non-participating business

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

### Valuation rates of interest and discount rates

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

## BALANCE SHEET MANAGEMENT (CONTINUED)

### 16 LONG TERM INSURANCE VALUATION ASSUMPTIONS (CONTINUED)

In 2012, the Group continued to hold an additional reserve to protect against the risk of an uplift in defaults in the current economic environment and also maintained the level of the long term default allowance at 40bps (2011: 40bps) per annum for unapproved securities backing non profit business, 35bps (2011: 35bps) per annum for unapproved securities backing with-profits business, 5bps (2011: 3bps) per annum for approved securities and swaps backing non profit business, 3bps (2011: 3bps) per annum for approved securities and swaps backing with-profit business. For unapproved securities backing non profit annuity business, the credit default allowances equate to 60bps (2011: 61bps) per annum when experienced over the duration of the assets held, leading to an overall total default provision of £1.7bn (2011: £1.6bn). A similar methodology has been used for assets backing non-participating with-profits business.

The Group believes the total default allowance is prudent to cover all reasonably foreseeable circumstances.

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

For property holdings, yields are based on the rental income payable calculated by considering different categories of tenant separately, adjusted for the possibility of default. Default rates used in the calculations vary by tenant category.

#### Mortality and morbidity

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

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

#### Persistency

The Group monitors its persistency experience and carries out detailed investigations annually. Persistency can be volatile and past experience may not be an appropriate future indicator.

The Group tries to balance past experience and future conditions by making prudent assumptions about the future expected long term average persistency levels.

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

#### Expenses

The Group monitors its expense experience and carries out detailed investigations regularly to determine the expenses incurred in writing and administering the different products and classes of business. Adjustments may be made for known future changes in the administration processes, in line with the Group's business plan. An allowance for expense inflation in the future is also made, taking account of both salary and price information.

#### Participating business

For its participating business, the Group seeks to establish its liabilities at their realistic value in line with the requirements set out in FRS 27.

Non-economic assumptions are set to represent the Group's best estimates of future experience.

## BALANCE SHEET MANAGEMENT (CONTINUED)

### Economic assumptions

The FSA's realistic reporting regime requires a market consistent economic model. The model is calibrated using market data from a variety of market sources. This enables assumptions to be determined for the term structure of risk free interest rates, property and equity volatility. Risk free interest rates are determined with reference to the gilt yield curve on the valuation date increased by ten basis points.

Property volatility is set with reference to historic variations in property prices. Equity volatility is set so that the model reproduces observed market prices of traded equity derivatives. Correlations between asset classes are based on historic data.

Each investment scenario contains a consistent set of assumptions for investment returns and inflation.

### Future bonuses

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

### Value of in-force non-participating contracts

The Group makes a deduction from the liabilities for the expected value of future profits arising on non-participating contracts written in the with-profits part of the Society LTF.

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

### Guaranteed annuity options

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

### Guaranteed cash options

The liability is determined assuming that policyholders choose the most valuable alternative between the annuity and cash available at retirement.

The table below sets out the current valuation assumptions used to establish the long term liabilities for Society, Legal & General Pensions Limited (LGPL) and Legal & General Assurance (Pensions Management) Limited.

## BALANCE SHEET MANAGEMENT (CONTINUED)

### 16 LONG TERM INSURANCE VALUATION ASSUMPTIONS (CONTINUED)

| | 2012 | 2011 |
|---|---|---|
| **Rate of interest/discount rates** | | |
| **Non-participating business** | | |
| Life assurances | **2.00% pa and 6.60% pa[1]** | 2.25% pa and 6.60% pa[1] |
| Pension assurances | **2.00% pa and 6.60% pa[1]** | 2.25% pa and 6.60% pa[1] |
| Annuities in deferment | **3.750% pa** | 4.601% pa |
| Annuities in deferment (RPI-linked; net rate after allowance for inflation) | **0.75% pa** | 0.86% pa |
| Vested annuities | **1.00%-3.750% pa** | 1.75%-4.601% pa |
| Vested annuities (RPI-linked; net rate after allowance for inflation) | **-0.50%-0.75% pa** | -0.40%-0.86% pa |
| **Participating business** | | |
| Risk free rate (10 years) | **2.00% pa** | 2.23% pa |
| Future bonuses | **Determined stochastically in line with bonus policy as stated in PPFM** | Determined stochastically in line with bonus policy as stated in PPFM |
| UK equity volatility (10 year option term) | **26.2%** | 27.2% |
| Property volatility | **15.0%** | 15.0% |
| **Mortality tables** | | |
| **Non-participating business** | | |
| Non-linked individual term assurances: | | |
| Smokers | **83% TMS00/TFS00 Sel 5** | 78% TMS00/TFS00 Sel 5 |
| Non-smokers | **89% TMN00/TFN00 Sel 5** | 90% TMN00/TFN00 Sel 5 |
| Non-linked individual term assurances with terminal illness | | |
| Smokers | **86%-108% TMS00/TFS00 Sel 5[2]** | 90%-112% TMS00/TFS00 Sel 5[2] |
| Non-smokers | **85%-114% TMN00/TFN00 Sel 5[2]** | 85%-115% TMN00/TFN00 Sel 5[2] |
| Non-linked individual term assurances with critical illness | | |
| Smokers | **85%-102% CIBT93M/F Ult Comb[3]** | 91%-101% CIBT93M/F Ult Comb[3] |
| Non-smokers | **60%-67% CIBT93M/F Ult Comb[3]** | 57%-67% CIBT93M/F Ult Comb[3] |
| Other non-linked non profit life assurances | **100% of A67/70 ultimate tables** | 100% of A67/70 ultimate tables |
| Annuities in deferment | **83.5%-88.6% PNMA00/PNFA00[4]** | 82.5%-89.4% PNMA00/PNFA00[4] |
| Vested annuities[5] | | |
| Bulk purchase annuities | **85.3%-89.5% PCMA00/PCFA00[6]** | 84.3%-90.4% PCMA00/PCFA00 |
| Other annuities | **67.4%-114.3% PCMA00/PCFA00[6]** | 62.2%-115.4% PCMA00/PCFA00 |

1. For product groups where liabilities are positive, the lower interest rate of 2.0% is used. However, for product groups where liabilities are negative, the higher rate of 6.60% is used.
2. The percentage of the table varies with the duration that the policy has been in-force for the first five years.
3. The percentage of the table varies with the duration that the policy has been in-force for the first two years. For term assurance with critical illness, morbidity rates are assumed to deteriorate at a rate of 0.50% p.a. for males and 0.75% p.a. for females (2011: 0.50% p.a. for males and 0.75% p.a. for females). There is an additive loading of 1% (2011: 1%) for guaranteed term contracts post policy duration 5.
4. Table created by blending PCXA00 with PNXA00 tables. The base table to be used for BPA policies in deferment is PNMA00 up to and including age 55 and PCMA00 for age 65 and above for males. The identical method is applied to females using PNFA00 and PCFA00.
5. For vested annuities, mortality rates are assumed to reduce according to CMIB's mortality improvement model; CMI 2011 (2011: CMI 2009) with the following parameters:
   Males: Long Term Rate of 2% p.a. (2011: 2% p.a.) up to age 85 tapering to 0% at 120
   Females: Long Term Rate of 1.5% p.a. (2011: 1.5% p.a.) up to age 85 tapering to 0% at 120
   For certain annuities, a further allowance is made for the effect of initial selection.
6. For 2012, the basis above is applicable up to age 90. After age 90 the basis is blended towards a bespoke table from age 100 onwards.

## BALANCE SHEET MANAGEMENT (CONTINUED)

### Premiums – non-participating business

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

### Persistency – non-participating business

Lapse rates are used in the valuation of certain classes of long term business. Where this is the case, the valuation persistency basis is set by applying a prudential margin over the best estimate assumptions. The tables below show the major products where lapse rates have been used.

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

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

A summary of the lapse basis for major classes of business (participating and non-participating), as defined by the requirements of the annual returns to the FSA, is shown below.

| | 2012 Average lapse rate for the policy years | | | |
|---|---|---|---|---|
| **Product** | 1-5<br>% | 6-10<br>% | 11-15<br>% | 16-20<br>% |
| Level term | 13.2 | 9.0 | 6.6 | 4.7 |
| Decreasing term | 13.3 | 9.1 | 6.9 | 6.8 |
| Accelerated critical illness cover | 20.8 | 11.7 | 5.7 | 5.7 |
| Pensions term | 11.8 | 8.0 | 6.1 | 6.1 |
| Whole of Life (conventional non profit) | 7.4 | 2.2 | – | – |
| Savings endowment (unitised with-profits) | – | 0.8 | 2.4 | 3.9 |
| Target cash endowment (unitised with-profits) | – | 4.7 | 3.0 | 2.3 |
| Savings endowment (unit linked) | – | 0.8 | 2.4 | 3.9 |
| Target cash endowment (unit linked) | – | 4.7 | 3.0 | 2.3 |
| Bond (unitised with-profits) | 0.9 | 2.2 | 2.4 | 1.7 |
| Bond (unit linked) | 2.4 | 6.1 | 3.8 | 3.3 |
| Individual pension regular premium (unitised with-profits) | 1.2 | 1.2 | 1.2 | 1.2 |
| Individual pension regular premium (unit linked) | 1.8 | 1.8 | 1.2 | 1.2 |
| Group pension regular premium (unitised with-profits) | 2.1 | 2.1 | 2.0 | 2.0 |
| Group pension regular premium (unit linked) | 1.0 | 1.2 | 1.1 | 1.0 |
| Individual pension single premium (unitised with-profits) | 3.3 | 3.3 | 3.1 | 3.1 |
| Individual pension single premium (unit linked) | 4.7 | 4.2 | 2.9 | 2.8 |
| Group pension single premium (unitised with-profits) | 12.3 | 12.3 | 12.3 | 12.3 |
| Group pension single premium (unit linked) | 5.6 | 5.6 | 5.6 | 5.6 |
| Trustee Investment Plan single premium (unitised with-profits) | 3.6 | 7.8 | 4.5 | 4.3 |
| Trustee Investment Plan single premium (unit linked) | 3.8 | 7.7 | 4.7 | 4.4 |

## BALANCE SHEET MANAGEMENT (CONTINUED)

### 16 LONG TERM INSURANCE VALUATION ASSUMPTIONS (CONTINUED)

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

#### Endowment reserve

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

#### Overseas business

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

### 17 SENSITIVITY ANALYSIS

#### UK long term business IFRS sensitivity analysis

| | **Impact on pre-tax Group profit net of reinsurance 2012 £m** | **Impact on Group equity net of reinsurance 2012 £m** | Impact on pre-tax Group profit net of reinsurance 2011 £m | Impact on Group equity net of reinsurance 2011 £m |
|---|---|---|---|---|
| **Sensitivity test** | | | | |
| 1% increase in interest rates | **47** | **36** | 49 | 36 |
| 1% decrease in interest rates | **(85)** | **(64)** | (142) | (104) |
| Credit spread widens by 100 bps with no change in expected defaults | **(79)** | **(59)** | (52) | (38) |
| 1% increase in inflation | **(17)** | **(13)** | 37 | 28 |
| Default of largest reinsurer | **(676)** | **(511)** | (694) | (510) |
| 1% decrease in annuitant mortality | **(96)** | **(73)** | (76) | (55) |

The interest rate sensitivities reflect the impact of the regulatory restrictions on the reinvestment rate used to value the liabilities of the UK long term business. This scenario does not reflect management action which could be taken to reduce the impact of a decrease in interest rates.

## BALANCE SHEET MANAGEMENT (CONTINUED)

UK long term business sensitivity analysis is based on the Group's long term insurance valuation assumptions disclosed in Note 16.

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

Details of IGD sensitivity analysis can be found in Table 2 of Note 26.

The Group also uses embedded value financial statements information to manage risk. The effect of alternative assumptions on the long term embedded value, prepared in accordance with the guidance issued by the European Insurance CFO Forum in October 2005 are contained within the Supplementary Financial Statements on page 233 of the Annual Report and Accounts.

### General insurance sensitivity analysis

| | **Impact on pre-tax profit net of reinsurance 2012 £m** | **Impact on equity net of reinsurance 2012 £m** | Impact on pre-tax profit net of reinsurance 2011 £m | Impact on equity net of reinsurance 2011 £m |
|---|---|---|---|---|
| **Sensitivity test** | | | | |
| Single storm event with 1 in 200 year probability | **(63)** | **(47)** | (90) | (66) |
| Subsidence event – worst claims ratio in last 30 years | **(50)** | **(37)** | (41) | (30) |
| Economic downturn | **(41)** | **(31)** | (43) | (32) |
| 5% decrease in overall claims ratio | **8** | **6** | 9 | 7 |
| 5% surplus over claims liabilities | **5** | **4** | 5 | 3 |

For any single event with claims in excess of £36m (2011: £30m) but less than £360m (2011: £265m), the ultimate cost to Legal & General Insurance Limited (LGI) would be £36m (2011: £30m). The ultimate cost to the Group is greater as a proportion of the catastrophe reinsurance cover is placed with Legal & General Assurance Society Limited, which is exposed to 70% of claims between £36m and £70m, 50% of claims between £70m and £160m and 20% of claims between £160m and £360m. The impact of a 1 in 500 year modelled windstorm and coastal flood event would exceed the upper limit of the catastrophe cover by approximately £180m (2011: £192m), with an estimated total cost to LGI of £246m (2011: £245m) and to the Group of £346m (2011: £317m).

## BALANCE SHEET MANAGEMENT (CONTINUED)

### 18 INSURANCE CONTRACT LIABILITIES

Insurance contracts are contracts which transfer significant insurance risk to the insurer at the inception of the contract.

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

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

Contracts with DPF are referred to as participating contracts. With-profits contracts in the UK and most Garantie Long Terme contracts in France are classified as participating.

#### Long term insurance

Under current IFRS requirements, insurance contract liabilities are measured using local Generally Accepted Accounting Principles (GAAP), as permitted by IFRS 4, 'Insurance contracts'.

#### UK

In the UK, insurance contract liabilities are determined following an annual investigation of the long term funds (LTFs) in accordance with regulatory requirements.

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

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

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

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

#### Overseas

The long term insurance contract liabilities for business transacted by overseas subsidiaries are determined on the basis of recognised actuarial methods which reflect local supervisory principles or, in the case of the US, on the basis of US GAAP.

#### General insurance

Liabilities, together with related reinsurance recoveries, are established on the basis of current information. Such liabilities can never be definitive as to their timing or the amount of claims and are therefore subject to subsequent reassessment on a regular basis. Claims and related reinsurance recoveries are accounted for in respect of all incidents up to the year end. Provision is made on the basis of available information for the estimated ultimate cost, including claims settlement expenses, claims reported but not yet settled and claims incurred but not yet reported. An unexpired risk provision is made for any overall excess of expected claims and deferred acquisition costs over unearned premiums and after taking account of investment return.

## BALANCE SHEET MANAGEMENT (CONTINUED)

### Liability adequacy tests

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

### Reinsurance

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

### (i) Analysis of insurance contract liabilities

| | Notes | Gross 2012 £m | Reinsurance 2012 £m | Gross 2011 £m | Reinsurance 2011 £m |
|---|---|---|---|---|---|
| Participating insurance contracts | (iii) | **8,116** | **(1)** | 8,750 | (1) |
| Non-participating insurance contracts[1] | (iv) | **37,445** | **(2,277)** | 33,761 | (2,110) |
| General insurance contracts | (v) | **283** | **(8)** | 245 | (6) |
| **Insurance contract liabilities** | | **45,844** | **(2,286)** | 42,756 | (2,117) |

1. Excluding General insurance contracts.

During the year, the Group continued utilising prospective reinsurance arrangements which resulted in a reduction of IFRS reserves of £231m (2011: £173m). This profit has been reflected in the consolidated income statement for the year.

### (ii) Expected insurance contract liability cash flows

| | Date of undiscounted cash flow | | | | | |
|---|---|---|---|---|---|---|
| **As at 31 December 2012** | **0-5 years £m** | **5-15 years £m** | **15-25 years £m** | **Over 25 years £m** | **Total £m** | **Carrying value £m** |
| Participating insurance contracts | **4,631** | **2,967** | **886** | **403** | **8,887** | **8,116** |
| Non-participating insurance contracts | **8,476** | **16,307** | **14,126** | **15,777** | **54,686** | **26,779** |
| General insurance contracts[1] | **104** | **–** | **–** | **–** | **104** | **104** |
| **Insurance contract liabilities** | **13,211** | **19,274** | **15,012** | **16,180** | **63,677** | **34,999** |

| | Date of undiscounted cash flow | | | | | |
|---|---|---|---|---|---|---|
| As at 31 December 2011 | 0-5 years £m | 5-15 years £m | 15-25 years £m | Over 25 years £m | Total £m | Carrying value £m |
| Participating insurance contracts | 5,387 | 2,954 | 841 | 377 | 9,559 | 8,750 |
| Non-participating insurance contracts | 7,413 | 14,992 | 13,046 | 16,260 | 51,711 | 21,939 |
| General insurance contracts[1] | 93 | – | – | – | 93 | 93 |
| **Insurance contract liabilities** | 12,893 | 17,946 | 13,887 | 16,637 | 61,363 | 30,782 |

1. Excludes unearned premium reserve of £179m (2011: £152m) for which there are no cash flows.

## BALANCE SHEET MANAGEMENT (CONTINUED)

### 18 INSURANCE CONTRACT LIABILITIES (CONTINUED)

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

Amounts under unit linked contracts are generally repayable on demand and the 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. However, the terms of funds investing in less liquid assets permit the deferral of redemptions for predefined periods in circumstances where there are not sufficient liquid assets within the fund to meet the level of requested redemptions. Accordingly, unit linked liabilities have been excluded from the table.

#### (iii) Movement in participating insurance contract liabilities

| | Notes | Gross 2012 £m | Reinsurance 2012 £m | Gross 2011 £m | Reinsurance 2011 £m |
|---|---|---|---|---|---|
| **As at 1 January** | | **8,750** | **(1)** | 9,383 | (1) |
| New liabilities in the year | | **262** | **–** | 374 | – |
| Liabilities discharged in the year | | **(1,413)** | **–** | (1,435) | – |
| Unwinding of discount rates | | **78** | **–** | 85 | – |
| Effect of change in non-economic assumptions | 16 | **4** | **–** | (26) | – |
| Effect of change in economic assumptions | 16 | **329** | **–** | 357 | – |
| Other | | **106** | **–** | 12 | – |
| **As at 31 December** | | **8,116** | **(1)** | 8,750 | (1) |
| Expected to be settled within 12 months (net of reinsurance) | | **1,539** | | 1,551 | |
| Expected to be settled after 12 months (net of reinsurance) | | **6,576** | | 7,198 | |

#### (iv) Movement in non-participating insurance contract liabilities

| | Notes | Gross 2012 £m | Reinsurance 2012 £m | Gross 2011 £m | Reinsurance 2011 £m |
|---|---|---|---|---|---|
| **As at 1 January** | | **33,761** | **(2,110)** | 31,064 | (2,096) |
| New liabilities in the year | | **2,667** | **(392)** | 2,687 | (309) |
| Liabilities discharged in the year | | **(2,271)** | **213** | (2,018) | 144 |
| Unwinding of discount rates | | **1,311** | **(118)** | 1,321 | (123) |
| Effect of change in non-economic assumptions | 16 | **(124)** | **132** | (403) | 389 |
| Effect of change in economic assumptions[1] | 16 | **2,229** | **(17)** | 1,133 | (111) |
| Foreign exchange adjustments | | **(128)** | **15** | (23) | (4) |
| **As at 31 December** | | **37,445** | **(2,277)** | 33,761 | (2,110) |
| Expected to be settled within 12 months (net of reinsurance) | | **3,573** | | 2,105 | |
| Expected to be settled after 12 months (net of reinsurance) | | **31,595** | | 29,546 | |

1. The economic assumptions changes in 2012 principally reflect the narrowing of credit spreads. Movements in credit spreads also increased the value of the corresponding backing assets.

#### (v) Analysis of General insurance contract liabilities

| | Gross 2012 £m | Reinsurance 2012 £m | Gross 2011 £m | Reinsurance 2011 £m |
|---|---|---|---|---|
| Outstanding claims | **74** | **–** | 76 | (1) |
| Claims incurred but not reported | **30** | **–** | 17 | – |
| Unearned premiums | **179** | **(8)** | 152 | (5) |
| **General insurance contract liabilities** | **283** | **(8)** | 245 | (6) |

# BALANCE SHEET MANAGEMENT (CONTINUED)

## (vi) Movement in General insurance claim liabilities

| | Gross 2012 £m | Reinsurance 2012 £m | Gross 2011 £m | Reinsurance 2011 £m |
|---|---|---|---|---|
| **As at 1 January** | 93 | (1) | 127 | (1) |
| Claims arising | 181 | – | 172 | – |
| Claims paid | (172) | 1 | (207) | – |
| Adjustments to prior year liabilities | 2 | – | 1 | – |
| **As at 31 December** | 104 | – | 93 | (1) |
| Expected to be settled within 12 months (net of reinsurance) | 72 | | 63 | |
| Expected to be settled after 12 months (net of reinsurance) | 32 | | 29 | |

## (vii) Unearned premiums

| | Gross 2012 £m | Reinsurance 2012 £m | Gross 2011 £m | Reinsurance 2011 £m |
|---|---|---|---|---|
| **As at 1 January** | 152 | (5) | 134 | (5) |
| Earned in the period | (152) | 5 | (134) | 6 |
| Gross written premiums in respect of future periods | 179 | (8) | 152 | (6) |
| **As at 31 December** | 179 | (8) | 152 | (5) |
| Expected to be earned within 12 months (net of reinsurance) | 171 | | 147 | |
| Expected to be earned after 12 months (net of reinsurance) | – | | – | |

## (viii) Claims development – General insurance

Changes may occur in the amount of the Group's obligations at the end of a contract period. The top section of each table below illustrates how the estimate of total claims outstanding for each accident year developed over time. The bottom section of the table reconciles the cumulative claims to the amount appearing in the balance sheet.

### Gross of reinsurance

| **Accident year** | 2008 £m | 2009 £m | 2010 £m | 2011 £m | 2012 £m | Total £m |
|---|---|---|---|---|---|---|
| Estimate of ultimate claims costs: | | | | | | |
| – At end of accident year | 191 | 164 | 174 | 124 | 167 | 820 |
| – One year later | 189 | 157 | 188 | 117 | – | 651 |
| – Two years later | 189 | 156 | 185 | – | – | 530 |
| – Three years later | 189 | 156 | – | – | – | 345 |
| – Four years later | 189 | – | – | – | – | 189 |
| Estimate of cumulative claims | 189 | 156 | 185 | 117 | 167 | 814 |
| Cumulative payments | (185) | (152) | (174) | (111) | (95) | (717) |
| Outstanding claims provision | 4 | 4 | 11 | 6 | 72 | 97 |
| Prior period outstanding claims | | | | | | 3 |
| Claims handling provision | | | | | | 4 |
| **Total claims liabilities recognised in the balance sheet** | | | | | | 104 |

## BALANCE SHEET MANAGEMENT (CONTINUED)

### 18 INSURANCE CONTRACT LIABILITIES (CONTINUED)

**Net of reinsurance**

| Accident year | 2008 £m | 2009 £m | 2010 £m | 2011 £m | 2012 £m | Total £m |
|---|---|---|---|---|---|---|
| Estimate of ultimate claims costs: | | | | | | |
| – At end of accident year | 189 | 162 | 173 | 123 | 166 | 813 |
| – One year later | 188 | 155 | 187 | 115 | – | 645 |
| – Two years later | 188 | 154 | 184 | – | – | 526 |
| – Three years later | 188 | 154 | – | – | – | 342 |
| – Four years later | 188 | – | – | – | – | 188 |
| Estimate of cumulative claims | 188 | 154 | 184 | 115 | 166 | 807 |
| Cumulative payments | (185) | (150) | (172) | (111) | (95) | (713) |
| Outstanding claims provision | 3 | 4 | 12 | 4 | 71 | 94 |
| Prior period outstanding claims | | | | | | 6 |
| Claims handling provision | | | | | | 4 |
| **Total claims liabilities recognised in the balance sheet** | | | | | | **104** |

### 19 INVESTMENT CONTRACT LIABILITIES

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

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

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

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

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

| | Notes | Gross 2012 £m | Reinsurance 2012 £m | Gross 2011 £m | Reinsurance 2011 £m |
|---|---|---|---|---|---|
| Participating investment contracts | | 7,403 | (2) | 7,276 | – |
| Non-participating investment contracts | 19 (iii) | 264,958 | (211) | 251,345 | (172) |
| **Investment contract liabilities** | 19 (ii) | **272,361** | **(213)** | 258,621 | (172) |
| Expected to be settled within 12 months (net of reinsurance) | | 38,356 | | 29,855 | |
| Expected to be settled after 12 months (net of reinsurance) | | 233,792 | | 228,594 | |

# BALANCE SHEET MANAGEMENT (CONTINUED)

### (ii) Movement in investment contract liabilities

| | Gross 2012 £m | Reinsurance 2012 £m | Gross 2011 £m | Reinsurance 2011 £m |
|---|---|---|---|---|
| **As at 1 January** | **258,621** | **(172)** | 260,749 | (233) |
| Reserves in respect of new business | **28,347** | **(2,045)** | 28,500 | (1,431) |
| Amounts paid on surrenders and maturities during the year | **(37,699)** | **704** | (39,419) | 744 |
| Investment return and related benefits | **23,469** | **1,300** | 9,168 | 748 |
| Management charges | **(300)** | **–** | (315) | – |
| Foreign exchange adjustments | **(55)** | **–** | (59) | – |
| Other | **(22)** | **–** | (3) | – |
| **As at 31 December** | **272,361** | **(213)** | 258,621 | (172) |

Fair value movements of £(16,305)m (2011: £(9,813)m) are included within the income statement arising from movements in investment contract liabilities designated as FVTPL.

### (iii) Non-participating investment contract liability fair value hierarchy

| As at 31 December 2012 | Total £m | Level 1 £m | Level 2 £m | Level 3 £m | Amortised cost £m |
|---|---|---|---|---|---|
| **Non-participating investment contracts** | **264,958** | **263,491** | **1,433** | **34** | **–** |

| As at 31 December 2011 | Total £m | Level 1 £m | Level 2 £m | Level 3 £m | Amortised cost £m |
|---|---|---|---|---|---|
| **Non-participating investment contracts** | 251,345 | 250,446 | 886 | 13 | – |

The fair value of financial liabilities are, in certain circumstances, measured using valuation techniques that incorporate assumptions that are not evidenced by prices from observable current market transactions in the same instrument and are not based on observable market data.

Non-participating unit linked investment contracts include £34m (2011: £13m) valued using significant unobservable inputs and have been classified as level 3. These liabilities have limited transactions and are backed by property investments.

There have been no significant transfers between any of the levels.

### (iv) Expected investment contract liability cash flows

| | Date of undiscounted cash flow | | | | | |
|---|---|---|---|---|---|---|
| **As at 31 December 2012** | **0-5 years £m** | **5-15 years £m** | **15-25 years £m** | **Over 25 years £m** | **Total £m** | **Carrying value £m** |
| **Participating investment contracts** | **2,941** | **3,723** | **1,435** | **440** | **8,539** | **7,403** |

| | Date of undiscounted cash flow | | | | | |
|---|---|---|---|---|---|---|
| As at 31 December 2011 | 0-5 years £m | 5-15 years £m | 15-25 years £m | Over 25 years £m | Total £m | Carrying value £m |
| **Participating investment contracts** | 2,970 | 3,699 | 1,531 | 520 | 8,720 | 7,276 |

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

## BALANCE SHEET MANAGEMENT (CONTINUED)

### 19 INVESTMENT CONTRACT LIABILITIES (CONTINUED)

Amounts under unit linked contracts are generally repayable on demand and 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. However, the terms of funds investing in less liquid assets permit the deferral of redemptions for predefined periods in circumstances where there are not sufficient liquid assets within the fund to meet the level of requested redemptions. Accordingly unit linked liabilities have been excluded from the reported cash flows.

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

### 20 UNALLOCATED DIVISIBLE SURPLUS

The participating funds operate with an excess of assets over the amount required to meet the policyholder liabilities.

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

| | 2012 £m | 2011 £m |
|---|---|---|
| **As at 1 January** | **1,038** | 1,469 |
| Transferred from the income statement | **158** | (402) |
| Actuarial (losses) on defined benefit pension schemes transferred from the statement of comprehensive income | **(41)** | (48) |
| Foreign exchange adjustments | **–** | 1 |
| Other | **(2)** | 18 |
| **As at 31 December** | **1,153** | 1,038 |

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

### 21 VALUE OF IN-FORCE NON-PARTICIPATING CONTRACTS

#### (i) Movement in value of in-force non-participating contracts

| | 2012 £m | 2011 £m |
|---|---|---|
| **As at 1 January** | **242** | 377 |
| Unwinding of the discount rates | **8** | 19 |
| Investment return | **(46)** | (79) |
| Other | **38** | (75) |
| **As at 31 December** | **242** | 242 |
| Expected to be settled within 12 months | **62** | 63 |
| Expected to be settled after 12 months | **180** | 179 |

# BALANCE SHEET MANAGEMENT (CONTINUED)

### (ii) Expected net cash flows

| As at 31 December 2012 | Date of undiscounted cash flow 0-5 years £m | 5-15 years £m | 15-25 years £m | Over 25 years £m | Total £m | Carrying value £m |
|---|---|---|---|---|---|---|
| **Value of in-force non-participating contracts** | **119** | **105** | **49** | **23** | **296** | **242** |

| As at 31 December 2011 | Date of undiscounted cash flow 0-5 years £m | 5-15 years £m | 15-25 years £m | Over 25 years £m | Total £m | Carrying value £m |
|---|---|---|---|---|---|---|
| **Value of in-force non-participating contracts** | 143 | 127 | 56 | 34 | 360 | 242 |

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

## 22 BORROWINGS

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

Borrowings comprise unsecured subordinated debt such as tier 1 and tier 2 bond issues, short and long term unsecured senior debt such as long dated bond issues, commercial paper issuance and bank borrowings under both committed and uncommitted debt facilities including bank overdrafts. Borrowings secured on specific assets/cash flows such as Triple X securitisations and private equity fund linked partnership assets are included as non recourse borrowings. Mortgage loans raised by SIPP clients secured on those properties invested in their portfolio of linked SIPP investments which we manage on their behalf are treated as unit linked borrowings.

### (i) Analysis by type

| | Borrowings excluding unit linked borrowings 2012 £m | Unit linked borrowings 2012 £m | Total 2012 £m | Borrowings excluding unit linked borrowings 2011 £m | Unit linked borrowings 2011 £m | Total 2011 £m |
|---|---|---|---|---|---|---|
| Subordinated borrowings | **1,907** | **–** | **1,907** | 1,934 | – | 1,934 |
| Senior borrowings | **1,403** | **125** | **1,528** | 1,244 | 136 | 1,380 |
| Client fund holdings of Group debt[1] | **(70)** | **–** | **(70)** | (64) | – | (64) |
| **Total borrowings** | **3,240** | **125** | **3,365** | 3,114 | 136 | 3,250 |

1. £70m (2011: £64m) of the Group's subordinated and senior debt, £17m and £53m respectively, (2011: £13m and £51m) is currently held by Legal & General customers through unit linked products. These borrowings are shown as a deduction from total borrowings in the table above.

## BALANCE SHEET MANAGEMENT (CONTINUED)

### 22 BORROWINGS (CONTINUED)

Unit linked borrowings are excluded from the analysis below as the risk is retained by the policyholders.

#### (ii) Borrowings excluding unit linked borrowings – Analysis by nature

| | Carrying amount 2012 £m | Coupon rate 2012 % | Fair value 2012 £m | Carrying amount 2011 £m | Coupon rate 2011 % | Fair value 2011 £m |
|---|---|---|---|---|---|---|
| **Subordinated borrowings** | | | | | | |
| 6.385% Sterling perpetual capital securities (Tier 1) | **700** | **6.39** | **636** | 721 | 6.39 | 487 |
| 5.875% Sterling undated subordinated notes (Tier 2) | **419** | **5.88** | **425** | 421 | 5.88 | 329 |
| 4.0% Euro subordinated notes 2025 (Tier 2) | **479** | **4.00** | **502** | 483 | 4.00 | 432 |
| 10% Sterling subordinated notes 2041 (Tier 2) | **309** | **10.00** | **425** | 309 | 10.00 | 361 |
| Client fund holdings of Group debt | **(17)** | **–** | **(17)** | (13) | – | (13) |
| **Total subordinated borrowings** | **1,890** | | **1,971** | 1,921 | | 1,596 |
| | | | | | | |
| **Senior borrowings** | | | | | | |
| Sterling medium term notes 2031-2041 | **608** | **5.88** | **767** | 608 | 5.87 | 642 |
| Euro Commercial paper | **333** | **0.16** | **333** | 246 | 1.46 | 246 |
| Bank loans/other | **4** | **0.47** | **4** | 8 | 1.75 | 8 |
| Non recourse | | | | | | |
| – US Dollar Triple X securitisation 2037 | **272** | **0.58** | **272** | 286 | 0.65 | 238 |
| – LGV 6/LGV 7 Private Equity Fund Limited Partnership | **128** | **3.93** | **128** | 96 | 4.57 | 96 |
| – Consolidated Property Limited Partnerships | **58** | **1.16** | **58** | – | – | – |
| Client fund holdings of Group debt | **(53)** | **–** | **(53)** | (51) | – | (51) |
| **Total senior borrowings** | **1,350** | | **1,509** | 1,193 | | 1,179 |
| **Total borrowings excluding unit linked borrowings** | **3,240** | | **3,480** | 3,114 | | 2,775 |
| **Total borrowings (excluding unit linked borrowings and non recourse)** | **2,782** | | **3,022** | 2,732 | | 2,441 |

£127m of interest expense was incurred during the period (2011: £123m) on borrowings excluding non recourse and unit linked borrowings.

#### Subordinated borrowings

##### 6.385% Sterling perpetual capital securities

In 2007, Legal & General Group Plc issued £600m of 6.385% Sterling perpetual capital securities. Simultaneous with the issuance, the fixed coupon was swapped into six month LIBOR plus 0.94% pa. These securities are callable at par on 2 May 2017 and every three months thereafter. If not called, the coupon from 2 May 2017 will be reset to three month LIBOR plus 1.93% pa. For regulatory purposes these securities are treated as innovative tier 1 capital. These securities have been classified as liabilities as the interest payments become mandatory in certain circumstances.

##### 5.875% Sterling undated subordinated notes

In 2004, Legal & General Group Plc issued £400m of 5.875% Sterling undated subordinated notes. These notes are callable at par on 1 April 2019 and every five years thereafter. If not called, the coupon from 1 April 2019 will be reset to the prevailing five year benchmark gilt yield plus 2.33% pa. These notes are treated as upper tier 2 capital for regulatory purposes. These securities have been classified as liabilities as the interest payments become mandatory in certain circumstances.

##### 4.0% Euro subordinated notes 2025

In 2005, Legal & General Group Plc issued €600m of 4.0% Euro dated subordinated notes. The proceeds were swapped into sterling. The notes are callable at par on 8 June 2015 and each year thereafter. If not called, the coupon from 8 June 2015 will reset to a floating rate of interest based on prevailing three month Euribor plus 1.7% pa. These notes mature on 8 June 2025 and are treated as lower tier 2 capital for regulatory purposes.

##### 10% Sterling subordinated notes 2041

On 16 July 2009, Legal & General Group Plc issued £300m of 10% dated subordinated notes. The notes are callable at par on 23 July 2021 and every five years thereafter. If not called, the coupon from 23 July 2021 will be reset to the prevailing five year benchmark gilt yield plus 9.325% pa. These notes mature on 23 July 2041 and are treated as lower tier 2 capital for regulatory purposes.

# BALANCE SHEET MANAGEMENT (CONTINUED)

### Non recourse financing

US Dollar Triple X securitisation 2037

In 2006, a subsidiary of LGA issued US$450m of non recourse debt in the US capital markets to meet the Triple X reserve requirements of part of the US term insurance written after 2005 and 2006. It is secured on the cash flows related to that tranche of business.

LGV6/LGV7 Private Equity Fund Limited Partnerships

These borrowings are non recourse bank borrowings.

Consolidated Property Limited Partnerships

These borrowings are non recourse bank borrowings.

### (iii) Borrowings excluding unit linked borrowings – Analysis by maturity

| As at 31 December 2012 | Carrying amount £m | Maturity profile of undiscounted cash flows: Within 1 year £m | 1-5 years £m | 5-15 years £m | 15-25 years £m | Over 25 years £m | Total £m |
|---|---|---|---|---|---|---|---|
| **Subordinated borrowings** | | | | | | | |
| 6.385% Sterling perpetual capital securities (Tier 1) | 700 | – | – | – | – | (600) | (600) |
| 5.875% Sterling undated subordinated notes (Tier 2) | 419 | – | – | – | – | (400) | (400) |
| 4.0% Euro subordinated notes 2025 (Tier 2) | 479 | – | – | (488) | – | – | (488) |
| 10% Sterling subordinated notes 2041 (Tier 2) | 309 | – | – | – | – | (300) | (300) |
| **Senior borrowings** | | | | | | | |
| Sterling medium term notes 2031-2041 | 608 | – | – | – | (590) | (10) | (600) |
| Euro Commercial paper | 333 | (333) | – | – | – | – | (333) |
| Bank loans/other | 4 | (4) | – | – | – | – | (4) |
| Non recourse | | | | | | | |
| – US Dollar Triple X securitisation 2037 | 272 | – | – | – | (276) | – | (276) |
| – LGV 6/LGV 7 Private Equity Fund Limited Partnership | 128 | (35) | (58) | (35) | – | – | (128) |
| – Consolidated Property Limited Partnerships | 58 | (58) | – | – | – | – | (58) |
| Client fund holdings of Group debt | (70) | – | – | – | – | – | – |
| **Total borrowings excluding unit linked borrowings** | 3,240 | (430) | (58) | (523) | (866) | (1,310) | (3,187) |
| Contractual undiscounted interest payments | | (153) | (605) | (1,451) | (1,106) | (107) | (3,422) |
| **Total contractual undiscounted cash flows** | | (583) | (663) | (1,974) | (1,972) | (1,417) | (6,609) |

## BALANCE SHEET MANAGEMENT (CONTINUED)

### 22 BORROWINGS (CONTINUED)

| | | Maturity profile of undiscounted cash flows | | | | | |
|---|---|---|---|---|---|---|---|
| As at 31 December 2011 | Carrying amount £m | Within 1 year £m | 1-5 years £m | 5-15 years £m | 15-25 years £m | Over 25 years £m | Total £m |
| **Subordinated borrowings** | | | | | | | |
| 6.385% Sterling perpetual capital securities (Tier 1) | 721 | – | – | – | – | (600) | (600) |
| 5.875% Sterling undated subordinated notes (Tier 2) | 421 | – | – | – | – | (400) | (400) |
| 4.0% Euro subordinated notes 2025 (Tier 2) | 483 | – | – | (500) | – | – | (500) |
| 10% Sterling subordinated notes 2041 (Tier 2) | 309 | – | – | – | – | (300) | (300) |
| **Senior borrowings** | | | | | | | |
| Sterling medium term notes 2031-2041 | 608 | – | – | – | (590) | (10) | (600) |
| Euro Commercial paper | 246 | (246) | – | – | – | – | (246) |
| Bank loans/other | 8 | (8) | – | – | – | – | (8) |
| Non recourse | | | | | | | |
| – US Dollar Triple X securitisation 2037 | 286 | – | – | – | – | (290) | (290) |
| – LGV 6/LGV 7 Private Equity Fund Limited Partnership | 96 | (6) | (49) | (41) | – | – | (96) |
| – Consolidated Property Limited Partnerships | – | – | – | – | – | – | – |
| Client fund holdings of Group debt | (64) | – | – | – | – | – | – |
| **Total borrowings excluding unit linked borrowings** | 3,114 | (260) | (49) | (541) | (590) | (1,600) | (3,040) |
| Contractual undiscounted interest payments | | (153) | (608) | (1,480) | (1,143) | (140) | (3,524) |
| **Total contractual undiscounted cash flows** | | (413) | (657) | (2,021) | (1,733) | (1,740) | (6,564) |

As at 31 December 2012, the Group had in place a £1.00bn syndicated committed revolving credit facility provided by a number of its key relationship banks, maturing in October 2017. No drawings were made under this facility during 2012.

The maturity profile above is calculated on the basis that a facility to refinance a maturing loan is not recognised unless the facility and loan are related. If refinancing under the Group's credit facilities was recognised, then all amounts shown as repayable within one year would be reclassified as repayable between one and five years.

Undiscounted interest payments are estimated based on the year end applicable interest rate and spot exchange rates.

Short term assets available at the holding company level exceeded the amount of non-unit linked short term borrowings of £337m (2011: £254m). They comprise Euro Commercial paper and bank loans.

## BALANCE SHEET MANAGEMENT (CONTINUED)

### 23 PROVISIONS

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

#### (i) Analysis of provisions

| | Note | 2012 £m | 2011 £m |
|---|---|---|---|
| Retirement benefit obligations[1] | (ii) | **969** | 871 |
| Other provisions | | **14** | 20 |
| | | **983** | 891 |

1. Retirement benefit obligations are presented gross of £636m of annuity obligations insured by Society (2011: £583m).

#### (ii) Retirement benefit obligations

**Future developments**
Amendment to IAS 19, 'Employee Benefits' issued in June 2011 (effective for annual periods commencing on or after 1 January 2013). This makes certain changes to the recognition and measurement of defined benefit pension expense and termination benefits, and to the disclosures for all employee benefits. The Group does not intend to early adopt this standard and when adopted it is expected to reduce IFRS profit after tax by approximately £4m per annum. This will be offset by a corresponding benefit in other comprehensive income.

**Defined contribution plans**
The Group operates the following principal defined contribution pension schemes in the UK and overseas:

- Legal & General Group Personal Pension Plan (UK).
- Legal & General Staff Stakeholder Pension Scheme (UK).
- Legal & General America Inc. Savings Plan (US).
- Régime de Retraite Professionnel (France).
- Legal & General Nederland Stichting Pensioenfonds (Netherlands); replacing the early retirement scheme previously part of the defined benefit plan.
- Legal & General International (Ireland) Limited Retirement Solution Plan (Ireland).

The Group pays contractual contributions in respect of defined contribution schemes. The Group has no further payment obligations once the contributions have been paid. The contributions are recognised as employee benefit expenses when they are due. Prepaid contributions are recognised as an asset to the extent that a cash refund or a reduction in future payments is available.

Contributions of £40m (2011: £37m) were charged as expenses during the year in respect of defined contribution plans.

**Defined benefit plans**
The Group operates the following defined benefit pension schemes in the UK and overseas:

- Legal & General Group UK Pension and Assurance Fund (the Fund). The Fund was closed to new members from January 1995; last full actuarial valuation as at 31 December 2009.
- Legal & General Group UK Senior Pension Scheme (the Scheme). The Scheme was, with a few exceptions (principally transfers from the Fund), closed to new members from August 2000 and finally closed to new members from April 2007; last full actuarial valuation as at 31 December 2009.
- Legal & General America Inc. Cash Balance Plan (US); last full actuarial valuation as at 31 December 2011.
- Legal & General Nederland Stichting Pensioenfonds (Netherlands); last full actuarial valuation as at 31 December 2012.
- Régime de Retraite à Prestations Définies de Legal & General (France); last full actuarial valuation as at 31 December 2011.

The assets of all UK defined benefit schemes are held in separate trustee administered funds which are subject to regular actuarial valuation every three years, updated by formal reviews at reporting dates.

## BALANCE SHEET MANAGEMENT (CONTINUED)

### 23 PROVISIONS (CONTINUED)

#### (ii) Retirement benefit obligations (continued)

The liability recognised in the balance sheet in respect of defined benefit pension schemes is the present value of the defined benefit obligation at the balance sheet date less the fair value of plan assets, provided any surplus in the fund is not restricted. Plan assets exclude any insurance contracts issued by the Group. The defined benefit obligation is calculated actuarially each year using the projected unit credit method. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows. The discount rate is based on market yields of high quality corporate bonds which are denominated in the currency in which the benefits will be paid, and that have terms to maturity which approximate to those of the related pension liability.

Where the unallocated divisible surplus or equity holders' funds are affected as a result of actuarial gains and losses on the defined benefit pension scheme, the charge or credit is not recognised in the income statement but through the statement of comprehensive income.

The benefits paid from the defined benefit schemes are based on percentages of the employees' final pensionable salary for each year of credited service. The Group has no liability for retirement benefits other than for pensions, except for a small scheme in LGF (Indemnités de Fin de Carrière), which provides lump sum benefits on retirement. The Fund and Scheme account for all of the UK and over 97% of worldwide assets of the Group's defined benefit schemes.

The principal actuarial assumptions for the UK defined benefit schemes were:

| | **Fund and Scheme 2012 %** | Fund and Scheme 2011 % |
|---|---|---|
| Rate used to discount liabilities | **4.40** | 4.70 |
| Expected return on plan assets | **5.35** | 5.60 |
| Rate of increase in salaries[1] | **2.20** | 2.20 |
| Rate of increase in pensions in payment | **3.30** | 3.20 |
| Rate of increase in deferred pensions | **3.50** | 3.50 |
| Rate of general inflation (RPI) | **2.80** | 2.80 |
| Rate of wage inflation | **2.20** | 2.20 |

| Post retirement mortality |
|---|
| **2012: 100% (Fund) / 85% (Scheme) of PCMA/PCFA 00 with improvement at CMI 2011 base date 2000 with long term rates 1.5% pa males and 1.0% pa females, with tapering linearly down to nil between ages 90 and 120.** |
| 2011: 100% (Fund) / 85% (Scheme) of PCMA/PCFA 00 with improvement at 100% MC males, 75% MC females, minimum improvement 1.5% pa males and 1.0% pa females, with tapering of minimum improvement rate linearly down to nil between ages 90 and 120. |

1. On 1 December 2008, the conditions of the Fund and Scheme were amended to cap future pensionable salary increases at a maximum of 2.5% each year with effect from 1 January 2009; benefits accrued before that date have an underpin of the early leaver benefits.

#### Average life expectancy:

| | **Fund and Scheme 2012 years** | Fund and Scheme 2011 years |
|---|---|---|
| Normal retirement age | **60.0** | 60.0 |
| Male life expectancy at retirement age | **88.8** | 88.3 |
| Female life expectancy at retirement age | **90.2** | 89.4 |
| Male life expectancy at 20 years younger than retirement age | **91.3** | 91.0 |
| Female life expectancy at 20 years younger than retirement age | **91.9** | 91.1 |

## BALANCE SHEET MANAGEMENT (CONTINUED)

| | Fund and Scheme 2012 £m | Overseas 2012 £m | Fund and Scheme 2011 £m | Overseas 2011 £m |
|---|---|---|---|---|
| **Movement in present value of defined benefit obligations** | | | | |
| **As at 1 January** | **(1,663)** | **(32)** | (1,497) | (30) |
| Current service cost | **(11)** | **(1)** | (10) | (1) |
| Interest expense | **(77)** | **(2)** | (81) | (2) |
| Actuarial loss (recognised in statement of comprehensive income) | **(157)** | **(13)** | (129) | – |
| Benefits paid | **57** | **1** | 54 | 1 |
| Exchange differences | **–** | **1** | – | – |
| Curtailment | **–** | **7** | – | – |
| **As at 31 December** | **(1,851)** | **(39)** | (1,663) | (32) |
| **Movement in fair value of plan assets** | | | | |
| **As at 1 January** | **793** | **36** | 748 | 32 |
| Expected return on plan assets | **44** | **2** | 45 | 2 |
| Actuarial gain/(loss) (recognised in statement of comprehensive income) | **45** | **2** | (4) | 1 |
| Employer contributions | **59** | **2** | 58 | 2 |
| Benefits paid | **(57)** | **(1)** | (54) | (1) |
| Exchange differences | **–** | **(1)** | – | – |
| **As at 31 December** | **884** | **40** | 793 | 36 |
| Gross pension obligations | **(967)** | **1** | (870) | 4 |
| Restricted surplus not recognised | **–** | **(3)** | – | (5) |
| Gross pension obligations included in provisions | **(967)** | **(2)** | (870) | (1) |
| Annuity obligations insured by Society | **636** | **–** | 583 | – |
| **Gross defined benefit pension deficit** | **(331)** | **(2)** | (287) | (1) |
| Deferred tax on defined benefit pension deficit | **76** | **–** | 72 | – |
| **Net defined benefit pension deficit** | **(255)** | **(2)** | (215) | (1) |

The total amount of actuarial (losses) net of tax recognised in the statement of comprehensive income for the year was £(107)m; cumulative £(508)m (2011: £(121)m); cumulative £(401)m). Actuarial (losses) net of tax relating to with-profits policyholders of £(41)m (2011: £(48)m) have been allocated to the unallocated divisible surplus.

In line with the requirements of IFRS, the surplus in the Legal & General Nederland Stichting Pensioenfonds of £3m (2011: £5m) has not been reflected in the net defined benefit deficit. A curtailment has been recognised with regard to employees in the Legal & General Nederland Stichting Pensioenfonds scheme, where future indexation accrued to existing pension rights has become conditional.

The mortality base assumptions are aligned with those used by the scheme's trustees at the last valuation, but a more up to date improvement rate is used. The effect of assuming reasonable alternative assumptions in isolation to the gross defined benefit pension deficit are shown below. Opposite sensitivities are broadly symmetrical, but larger sensitivities are not necessarily broadly proportionate due to the existence of maxima and minima for inflation linked benefits.

| | 2012 £m | 2011 £m |
|---|---|---|
| 1 year increase in longevity | **(38)** | (32) |
| 0.1% decrease in the rate used to discount liabilities | **(27)** | (24) |
| 0.1% increase in the rate of general inflation (RPI) | **(33)** | (29) |
| 0.1% increase in the rate of wage inflation | **–** | – |

## BALANCE SHEET MANAGEMENT (CONTINUED)

### 23 PROVISIONS (CONTINUED)

#### (ii) Retirement benefit obligations (continued)

The historic funding and experience adjustments are as follows:

| | 2012 £m | 2011 £m | 2010 £m | 2009 £m | 2008 £m |
|---|---|---|---|---|---|
| Present value of defined benefit obligations | **(1,890)** | (1,695) | (1,527) | (1,474) | (1,187) |
| Fair value of plan assets | **924** | 829 | 781 | 728 | 636 |
| Restricted surplus not recognised | **(3)** | (5) | (2) | – | – |
| **Gross pension obligations included in provisions** | **(969)** | (871) | (748) | (746) | (551) |
| Experience adjustments on plan liabilities | **(10)** | (17) | (8) | 18 | 3 |
| Experience adjustments on plan assets | **45** | (3) | 11 | 46 | (222) |

The fair value of the plan assets and expected return at the end of the year is made up as follows:

| **As at 31 December 2012** | UK £m | Expected return % | Overseas £m | Expected return % |
|---|---|---|---|---|
| Equities | **420** | **6.3** | **11** | **7.5** |
| Bonds | **418** | **4.4** | **25** | **3.6** |
| Properties | **46** | **5.3** | **–** | **–** |
| Other investments | **–** | **–** | **4** | **1.5** |
| | **884** | | **40** | |

| As at 31 December 2011 | UK £m | Expected return % | Overseas £m | Expected return % |
|---|---|---|---|---|
| Equities | 377 | 6.5 | 9 | 8.2 |
| Bonds | 371 | 4.7 | 21 | 3.7 |
| Properties | 45 | 5.5 | – | – |
| Other investments | – | – | 6 | 1.5 |
| | 793 | | 36 | |

The average credit rating of the bond portfolio is A (2011: A).

The expected rate of return for bonds is based on the current yield on a medium to long term AA bond index. The expected rates of return on equities and properties are based on margins over bond yields reflecting risk premiums. In 2012, the return on plan assets, excluding annuity obligations, was £91m (2011: £43m).

Employer contributions of £61m (2011: £60m) include a pension deficit reduction payment of £47m (2011: £47m). Employer contributions of £50m are expected to be paid to the plan during 2013.

The following amounts have been charged/(credited) to the income statement:

| | 2012 £m | 2011 £m |
|---|---|---|
| Current service costs | **12** | 11 |
| Interest expense | **79** | 83 |
| Expected return on plan assets | **(46)** | (47) |
| Curtailment | **(7)** | – |
| **Total included in other expenses** | **38** | 47 |

# BALANCE SHEET MANAGEMENT (CONTINUED)

## 24 PAYABLES AND OTHER FINANCIAL LIABILITIES

### Trail commission

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

| | Note | 2012 £m | 2011 £m |
|---|---|---|---|
| Derivative liabilities | 11 | **5,729** | 6,120 |
| Collateral received from banks | | **21** | 165 |
| Other | | **2,333** | 1,358 |
| **Payables and other financial liabilities** | | **8,083** | 7,643 |
| Settled within 12 months | | **4,766** | 3,970 |
| Settled after 12 months | | **3,317** | 3,673 |

Other includes future commission payments which have contingent settlement provisions of £189m (2011: £182m). This liability has been determined using the net present value of the future commission which will be payable on fund values. This valuation technique uses assumptions which are consistent with the Group's effective rate of interest, investment return assumptions and persistency assumptions used in other valuations, but it is not determined by reference to published price quotations.

The undiscounted value which is expected to be paid at maturity in respect of such commission is £248m (2011: £259m).

Payables and other financial liabilities settled after 12 months are expected to be settled within five years with the exception of derivative liabilities, as disclosed in Note 11.

### Fair value hierarchy

| As at 31 December 2012 | Total £m | Level 1 £m | Level 2 £m | Level 3 £m | Amortised cost £m |
|---|---|---|---|---|---|
| Derivative liabilities[1] | **5,729** | **214** | **5,515** | **–** | **–** |
| Collateral received from banks | **21** | **21** | **–** | **–** | **–** |
| Other | **2,333** | **108** | **29** | **189** | **2,007** |
| **Payables and other financial liabilities** | **8,083** | **343** | **5,544** | **189** | **2,007** |

| As at 31 December 2011 | Total £m | Level 1 £m | Level 2 £m | Level 3 £m | Amortised cost £m |
|---|---|---|---|---|---|
| Derivative liabilities[1] | 6,120 | 309 | 5,608 | 203 | – |
| Collateral received from banks | 165 | 165 | – | – | – |
| Other | 1,358 | 132 | 116 | 182 | 928 |
| **Payables and other financial liabilities** | 7,643 | 606 | 5,724 | 385 | 928 |

1. In 2011, derivative liabilities of £203m classified as Level 3 comprised non profit non-linked interest rate contracts, which were transferred into Level 3 during the year due to the use of measurement inputs that were not based on observable market data. The pricing of these derivatives was dependant on interest rate assumptions. Using reasonably alternative assumptions would have resulted in an increase or decrease in fair value of £10m.

Trail commissions are modelled using expected cash flows, incorporating expected future persistency. They have therefore been classified as Level 3 liabilities. The entire movement in the balance has been reflected in the income statement during the year. A reasonably possible alternative persistency assumption would have the effect of increasing or decreasing the liability by £6m (2011: £5m).

## BALANCE SHEET MANAGEMENT (CONTINUED)

### 25 OPERATIONAL RISK

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

Potential for exposure to operational risk extends to all the Group's businesses. All business managers are required to confirm regularly the adequacy of controls to mitigate those operational risks relevant to their responsibilities. Significant control issues are escalated to senior and executive management through the Group's risk management framework. The framework is supported by the Operational Risk Management teams which facilitates the identification, assessment, monitoring and control of risks across the Group's businesses.

There are a number of categories under which operational risk and its management across the Group can be considered, and these are outlined in the following paragraphs.

#### Internal process failure

The Group is potentially exposed to the risk of loss from failure of the internal processes with which it transacts its business. Each business division is responsible for ensuring the adequacy of the controls over its processes. Regular reviews are undertaken of their appropriateness and effectiveness.

#### People

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

#### Outsourcing

The Group is potentially exposed to the actions or failure of suppliers contracted to provide services on an outsourced basis. The Group has defined minimum standards of control to be applied for all outsourced arrangements within a formal outsourcing and critical supplier policy.

#### Legal

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

#### Compliance

Compliance risk within the Group relates to the risk of non-adherence to legislative requirements, regulations and internal policies and procedures. Responsibility for ensuring adherence to relevant legal and regulatory requirements is vested in individual business managers. A Group Regulatory Risk and Compliance function has oversight of the Group's compliance with conduct of business requirements and standards, providing policy advice and guidance and oversight of compliance arrangements and responsibilities.

#### Event

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

## BALANCE SHEET MANAGEMENT (CONTINUED)

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

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

### Contagion
The potential for contagion risk arises as a consequence of the use of a common brand across the majority of the Group and the provision of intra-group loans and indemnities. The Group has defined policies and procedures for managing matters that may have reputational implications, to ensure that Legal & General's position is correctly understood. The Group also has defined policies for the provision of guarantees, indemnities and letters of comfort.

## 26 MANAGEMENT OF CAPITAL RESOURCES
### Capital structure
The Group's total capital resources of £8.4bn (2011: £7.9bn) on an IFRS basis comprise equity holders capital, £5.4bn (2011: £5.1bn), subordinated debt £1.8bn (2011: £1.8bn), and unallocated divisible surplus, £1.2bn (2011: £1.0bn).

From a regulatory perspective the Group is required to measure and monitor its capital resources on an ongoing basis and to comply with the minimum capital requirements of regulators in each territory in which we operate. At 31 December 2012, Legal & General's unaudited Insurance Group Directive (IGD) capital resources were £4.1bn (2011: £3.8bn) in excess of capital requirements of £3.1bn (2011: £3.1bn), representing a solvency coverage ratio of 234% (2011: 220%). This surplus capital is after accruing for a 2012 final dividend of £336m (2011: £279m).

The Group writes a range of long term insurance and investment business in the long term fund (LTF) of its main operating insurance subsidiary, Legal & General Assurance Society Limited (Society). This fund is segregated from the Group's other assets. The fund includes participating (with-profits) business where policyholders and shareholders share in the risks and rewards, and non-participating (non profit) business, where the shareholders receive profits or incur losses. Capital in excess of the amount required to cover the liabilities is currently held within Society. This capital provides support for new and existing non profit business within our UK non profit Protection and Annuities and Savings businesses.

The non-linked, non profit pensions and annuity business of Society is ceded, on arm's length terms, to a wholly owned Insurance Special Purpose Vehicle (ISPV), Legal & General Pensions Limited (LGPL). Whilst an ISPV is not required to segregate policyholder assets within a LTF, LGPL continues to manage policyholder and shareholder assets separately for internal purposes.

Managed pension fund business is written through Legal & General Assurance (Pensions Management) Limited (PMC), which is a life company writing predominantly non-participating group pension business effected by trustees of occupational schemes in the UK (or their equivalent overseas). The assets are held in a LTF and are separate from other assets within the Group.

In addition, the Group operates two UK long term insurance businesses acquired in 2008 (Nationwide Life Limited and Suffolk Life Annuities Limited). General insurance business is written in the UK by Legal & General Insurance Limited, and long term insurance business is also written by LGA, LGN and LGF.

## BALANCE SHEET MANAGEMENT (CONTINUED)

### 26 MANAGEMENT OF CAPITAL RESOURCES (CONTINUED)

**Capital management policies and objectives**

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

**Capital measures**

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

• Accounting bases

Management use the primary financial statements prepared on an IFRS basis to manage capital and cash flow usage and to determine dividend paying capacity. In addition, the supplementary accounts prepared using EEV principles provide further insight into the value of the business to shareholders. Accordingly the Group's net asset value and total capital employed are also analysed and measured on this basis.

• Regulatory bases

The financial strength of the Group's insurance subsidiaries is measured under various local regulatory requirements (see below). One of these regulatory measures, Individual Capital Assessment (ICA), measures capital using risk based stochastic techniques, and provides a measure of the level of economic capital required to run the Group's business.

**Basis of regulatory capital and corresponding regulatory capital requirements**

In each country in which the Group operates, the local insurance regulator specifies rules and guidance for the minimum amount and type of capital which must be held by long term insurance subsidiaries in excess of their insurance liabilities. The minimum required capital must be maintained at all times throughout the year. This helps to ensure that payments to policyholders can be made as they fall due.

The required capital is calculated by either assessing the additional assets which would be required to meet the insurance company's liabilities in specified, stressed financial conditions, or by applying fixed percentages to the insurance company's liabilities and risk exposures. The requirements in the different jurisdictions in which the Group operates are detailed below:

*UK regulatory basis*

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

The public pillar 1 capital calculation is calculated by applying fixed percentages to liabilities and sums assured at risk or setting aside a proportion of expenses (Peak 1). There are further stress tests for participating business, as measured in the Realistic Balance Sheet (Peak 2), which may increase the required capital under Peak 1 calculations.

The private pillar 2 capital calculation is an assessment of the economic capital required to ensure that the Company can meet its liabilities, with a high likelihood, as they fall due. This is achieved by application of stochastic modelling and scenario testing. The result is reviewed and may be modified by the FSA.

Regulatory capital for the general insurance business is also calculated using FSA pillar 1 and pillar 2 requirements. The pillar 1 calculation applies fixed percentages to premiums and claims. Pillar 2 creates a higher capital requirement and is therefore applied in this business.

*US regulatory basis*

Required capital is determined to be the Company Action Level Risk Based Capital (RBC) based on the National Association of Insurance Commissioners RBC model. RBC is a method of measuring the minimum amount of capital appropriate for an insurance company to support its overall business operations, taking into account its size and risk profile. The calculation is based on applying factors to various asset, premium, claim, expense and reserve items, with higher factors used for those items with greater underlying risk and lower factors for less risky items.

# BALANCE SHEET MANAGEMENT (CONTINUED)

*French and Dutch regulatory bases*

The minimum required capital is defined by the French Ministry of Finance's 'Code des Assurances' and the 'De Nederlandsche Bank N.V.' (Dutch Supervisory Body) respectively. The basis of the calculation is a percentage of the liabilities plus a percentage of the sum assured at risk and, for some contracts, the premium. The percentages depend on the guarantees given and the amount of reinsurance cover.

*Group regulatory basis*

In addition to the regulatory capital calculations for the individual firms, the Group is required to comply with the requirements of the Insurance Group's Directive (IGD).

**Available regulatory capital resources**

Capital resources available to meet regulatory UK capital requirements are determined using FSA valuation rules. The asset valuation rules are based on UK GAAP, adjusted for admissibility, counterparty exposure limits and specific valuation differences.

The Group's regulatory capital position statement in Table 1 sets out the different sources of capital held within the Group. The Group's total available capital resources, based on unaudited FSA returns, are £6.6bn (2011: £6.0bn) of which £4.2bn (2011: £4.1bn) is held by the life businesses. The use of capital held by the UK and overseas life businesses is generally constrained by local regulatory requirements, and may not be available to provide funding for other businesses.

The total available capital resources of the Group's with-profits business (with-profits estate) is determined in accordance with the Realistic Balance Sheet rules prescribed by the FSA.

At 31 December 2012, the realistic value of the UK participating liabilities was £14.0bn (2011: £14.6bn) under the FSA realistic capital regime. The excess of realistic assets over realistic liabilities was £0.7bn (2011: £0.7bn). The capital resources reflect the surplus in that part of the fund which is in excess of any constructive obligation to policyholders. The liabilities within the consolidated balance sheet do not include the amount representing the shareholders' share of future bonuses.

## BALANCE SHEET MANAGEMENT (CONTINUED)

### 26 MANAGEMENT OF CAPITAL RESOURCES (CONTINUED)

**Table 1 – Regulatory capital position statement**

| As at 31 December 2012 | UK with-profits £m | UK non profit and SRC[1] £m | LGPL £m | Overseas and PMC £m | Total life £m | Shareholders' equity and other activities £m | Total £m |
|---|---|---|---|---|---|---|---|
| Ordinary shareholders' equity outside the LTF | – | 41 | 1,243 | 1,494 | 2,778 | 1,004 | 3,782 |
| Ordinary shareholders' equity held in the LTF | – | 1,629 | – | 30 | 1,659 | – | 1,659 |
| **Capital and reserves attributable to equity holders of the Company** | – | 1,670 | 1,243 | 1,524 | 4,437 | 1,004 | 5,441 |
| Adjustments onto regulatory basis: | | | | | | | |
| Unallocated divisible surplus | 959 | – | – | 194 | 1,153 | – | 1,153 |
| Other[2] | (300) | (531) | – | (595) | (1,426) | (13) | (1,439) |
| Other qualifying capital: | | | | | | | |
| Subordinated borrowings | – | – | – | – | – | 1,777 | 1,777 |
| Internal loans | – | – | – | – | – | – | – |
| Proposed dividend | – | – | – | – | – | (336) | (336) |
| **Total available capital resources** | 659 | 1,139 | 1,243 | 1,123 | 4,164 | 2,432 | 6,596 |
| | | | | | | | |
| **IFRS liability analysis:** | | | | | | | |
| UK participating liabilities on realistic basis | | | | | | | |
| – Options and guarantees | 919 | – | – | – | 919 | – | 919 |
| – Other policyholder obligations | 12,088 | 19 | – | – | 12,107 | – | 12,107 |
| Overseas participating liabilities | – | – | – | 2,493 | 2,493 | – | 2,493 |
| Unallocated divisible surplus | 959 | – | – | 194 | 1,153 | – | 1,153 |
| Value of in-force non-participating contracts | (242) | – | – | – | (242) | – | (242) |
| **Participating contract liabilities** | 13,724 | 19 | – | 2,687 | 16,430 | – | 16,430 |
| Unit linked non-participating life assurance liabilities | 504 | 474 | – | 1,241 | 2,219 | – | 2,219 |
| Non-linked non-participating life assurance liabilities | 2,325 | 30,734 | – | 2,167 | 35,226 | – | 35,226 |
| Unit linked non-participating investment contract liabilities | 8,219 | 23,634 | – | 233,105 | 264,958 | – | 264,958 |
| General insurance liabilities | – | – | – | – | – | 283 | 283 |
| **Non-participating contract liabilities** | 11,048 | 54,842 | – | 236,513 | 302,403 | 283 | 302,686 |

1. UK non profit and SRC includes Nationwide Life Limited and Suffolk Life Annuities Limited.
2. Other consists of shareholders' share in realistic liabilities of £238m and changes to the values of assets and liabilities on a regulated basis of £1,201m.

## BALANCE SHEET MANAGEMENT (CONTINUED)

| As at 31 December 2011 (Restated) | UK with-profits £m | UK non profit and SRC[1] £m | LGPL £m | Overseas and PMC £m | Total life £m | Shareholders' equity and other activities £m | Total £m |
|---|---|---|---|---|---|---|---|
| Ordinary shareholders' equity outside the LTF | – | 56 | 1,250 | 1,339 | 2,645 | 828 | 3,473 |
| Ordinary shareholders' equity held in the LTF | – | 1,440 | – | 143 | 1,583 | – | 1,583 |
| **Capital and reserves attributable to equity holders of the Company** | – | 1,496 | 1,250 | 1,482 | 4,228 | 828 | 5,056 |
| Adjustments onto regulatory basis: | | | | | | | |
| Unallocated divisible surplus | 1,050 | – | – | (12) | 1,038 | – | 1,038 |
| Other[2] | (317) | (496) | – | (624) | (1,437) | (156) | (1,593) |
| Other qualifying capital: | | | | | | | |
| Subordinated borrowings | – | – | – | – | – | 1,787 | 1,787 |
| Internal loans[3] | – | – | 222 | – | 222 | (222) | – |
| Proposed dividend | – | – | – | – | – | (279) | (279) |
| **Total available capital resources** | 733 | 1,000 | 1,472 | 846 | 4,051 | 1,958 | 6,009 |
| | | | | | | | |
| **IFRS liability analysis:** | | | | | | | |
| UK participating liabilities on realistic basis | | | | | | | |
| – Options and guarantees | 1,153 | – | – | – | 1,153 | – | 1,153 |
| – Other policyholder obligations | 12,418 | 23 | – | – | 12,441 | – | 12,441 |
| Overseas participating liabilities | – | – | – | 2,432 | 2,432 | – | 2,432 |
| Unallocated divisible surplus | 1,050 | – | – | (12) | 1,038 | – | 1,038 |
| Value of in-force non-participating contracts | (242) | – | – | – | (242) | – | (242) |
| **Participating contract liabilities** | 14,379 | 23 | – | 2,420 | 16,822 | – | 16,822 |
| Unit linked non-participating life assurance liabilities | 506 | 477 | – | 1,281 | 2,264 | – | 2,264 |
| Non-linked non-participating life assurance liabilities | 2,102 | 27,164 | – | 2,231 | 31,497 | – | 31,497 |
| Unit linked non-participating investment contract liabilities | 8,044 | 20,962 | – | 222,339 | 251,345 | – | 251,345 |
| General insurance liabilities | – | – | – | – | – | 245 | 245 |
| **Non-participating contract liabilities** | 10,652 | 48,603 | – | 225,851 | 285,106 | 245 | 285,351 |

1. UK non profit and SRC includes Nationwide Life Limited and Suffolk Life Annuities Limited.
2. Other consists of shareholders' share in realistic liabilities of £195m and changes to the values of assets and liabilities on a regulated basis of £1,398m.
3. Internal loans wholly comprises the contingent loan (£222m) from Society shareholders' equity to LGPL, which is reflected in the value of LGPL for regulatory purposes.

### Available regulatory capital resource risks

The Group's available capital resources are sensitive to changes in market conditions, both to changes in the value of the assets and to the impact which changes in investment conditions may have on the value of the liabilities. Capital resources are also sensitive to assumptions and experience relating to mortality and morbidity and, to a lesser extent, expenses and persistency. The most significant sensitivities arise from the following four risks:

- market risk in relation to UK participating business which would crystallise if adverse changes in the value of the assets supporting this business could not be fully reflected in payments to policyholders because of the effect of guarantees and options. The capital position of this business would also deteriorate if increases to the market cost of derivatives resulted in an increase in the liability for guarantees and options in the realistic balance sheet.
- market risk in relation to the UK annuity business, which would crystallise if the return from the fixed interest investments supporting this business were lower than that assumed for reserving.
- mortality risk in relation to the UK annuity business, which would crystallise if the mortality of annuitants improved more rapidly than the assumptions used for reserving.
- mortality risk in relation to the UK and US term assurance businesses, which would crystallise if mortality of the lives insured was higher than that assumed, possibly because of an epidemic.

A range of management actions is available to mitigate any adverse impact from changing market conditions and experience, including changes to with-profits bonus rates, changes to discretionary surrender terms and charging for guarantees. To the extent that management actions are expected only to offset partially adverse experience, then liabilities would be increased to anticipate the future impact of the adverse experience and total capital resources would be reduced.

## BALANCE SHEET MANAGEMENT (CONTINUED)

### 26 MANAGEMENT OF CAPITAL RESOURCES (CONTINUED)

Table 2 below provides management estimates of the impact on IGD surplus to changes in market conditions:

#### Table 2 – IGD sensitivity analysis

| | **Impact on surplus capital 2012 £bn** | Impact on surplus capital 2011 £bn |
|---|---|---|
| **Sensitivity test** | | |
| 20% fall in equity values | **(0.3)** | (0.4) |
| 40% fall in equity values | **(0.7)** | (0.7) |
| 15% fall in property values | **(0.1)** | (0.1) |
| 100bp increase in interest rates | **(0.1)** | – |
| 100bp increase in credit spreads | **(0.1)** | – |

Details of IFRS sensitivity analysis can be found in Note 17. EEV sensitivity analysis can be found in Note 16 to the supplementary financial statements.

#### Movements in life business regulatory capital resources

The movement in the life business regulatory capital resources is shown in Table 3.

#### Table 3 – Movements in life business regulatory capital resources

| | **UK with-profits £m** | **UK non profit and SRC[1] £m** | **LGPL £m** | **Overseas and PMC £m** | **Total life £m** |
|---|---|---|---|---|---|
| **As at 1 January 2012** | **733** | **1,000** | **1,472** | **846** | **4,051** |
| Effect of investment variations | **20** | **50** | **(65)** | **198** | **203** |
| Effect of changes in valuation assumptions | **(34)** | **8** | **(7)** | **–** | **(33)** |
| Changes in management policy | **–** | **5** | **–** | **–** | **5** |
| Changes in regulatory requirements | **(37)** | **12** | **–** | **–** | **(25)** |
| New business | **(16)** | **(51)** | **(42)** | **(62)** | **(171)** |
| Cash distributions | **–** | **(50)** | **–** | **(190)** | **(240)** |
| Other factors | **(7)** | **165** | **(115)** | **331** | **374** |
| **As at 31 December 2012** | **659** | **1,139** | **1,243** | **1,123** | **4,164** |

| | UK with-profits £m | UK non profit and SRC[1] £m | LGPL £m | Overseas and PMC £m | Total life £m |
|---|---|---|---|---|---|
| **As at 1 January 2011** | 952 | 908 | 1,512 | 1,124 | 4,496 |
| Effect of investment variations | (101) | 36 | 132 | (32) | 35 |
| Effect of changes in valuation assumptions | 5 | 43 | (40) | – | 8 |
| Changes in management policy | (4) | 4 | – | – | – |
| New business | (17) | (76) | (16) | (64) | (173) |
| Cash distributions | – | (196) | – | (224) | (420) |
| Other factors | (102) | 281 | (116) | 42 | 105 |
| **As at 31 December 2011** | 733 | 1,000 | 1,472 | 846 | 4,051 |

1. UK non profit and SRC includes Nationwide Life Limited and Suffolk Life Annuities Limited.

# ADDITIONAL FINANCIAL INFORMATION

## 27 SEGMENTAL ANALYSIS

The Group provides a segmental analysis to enhance the understanding of the financial statements.

Under the requirements of IFRS 8, 'Operating segments', operating and reportable segments are presented in a manner consistent with the internal reporting provided to the chief operating decision maker, which has been identified as the Board of Legal & General Group Plc.

### Reportable segments

During the year, the Group has changed the management lines of the international subsidiaries to reflect the development of our international strategy. This has had the consequence of changing the reportable segments of the Group as outlined below. In accordance with the requirements of IFRS 8, 'Operating Segments', the prior period segmental information has been restated to reflect these changes.

The Group has five reporting segments comprising Protection and Annuities, Savings, Investment management, US Protection, and Group capital and financing.

The Protection and Annuities segment comprises individual and group protection, individual and bulk purchase annuities, longevity and general insurance, together with estate agencies and the housing related business conducted through our regulated mortgage network. It also includes Legal & General France (LGF) and Legal & General Netherlands (LGN).

The Savings segment comprises non profit investment bonds, non profit pensions (including SIPPs), ISAs, retail unit trusts, retail platform businesses, all with-profits products, as well as our joint venture operation in India.

The Investment management segment comprises institutional fund management and LGIM America (LGIMA).

The US Protection segment comprises individual protection and universal life contracts written by Legal & General America (LGA).

Shareholders' equity supporting the non profit Protection and Annuities and Savings businesses is held within Legal & General Assurance Society Limited and Legal & General Pensions Limited and is managed on a groupwide basis within Group capital and financing. This also includes capital within the Group's treasury function and unit trust funds and property partnerships, which are managed on behalf of clients but are required to be consolidated under IFRS, which do not constitute a separately reportable segment. The Group capital and financing segment also includes our joint ventures in Egypt and the Gulf.

Transactions between reportable segments are on normal commercial terms, and are included within the reported segments.

The Group assesses performance and allocates resources on the basis of IFRS supplementary operating profit before tax. Segmental IFRS supplementary operating profit before tax is reconciled to the consolidated profit from continuing operations before tax attributable to equity holders and consolidated profit from ordinary activities after income tax.

## ADDITIONAL FINANCIAL INFORMATION (CONTINUED)

### 27 SEGMENTAL ANALYSIS (CONTINUED)

#### (i) Operating profit/(loss)

| For the year ended 31 December 2012 | Protection and Annuities £m | Savings £m | Investment management £m | US Protection £m | Group capital and financing[1] £m | Total £m |
|---|---|---|---|---|---|---|
| **Operating profit/(loss)** | **640** | **133** | **243** | **99** | **(28)** | **1,087** |
| Investment variances | (3) | (11) | (5) | – | (20) | (39) |
| Losses attributable to non-controlling interests | – | – | – | – | (12) | (12) |
| **Profit/(loss) from continuing operations before tax** | **637** | **122** | **238** | **99** | **(60)** | **1,036** |
| Tax (expense)/credit attributable to equity holders of the Company | (158) | (25) | (44) | (37) | 29 | (235) |
| **Profit for the year after tax** | **479** | **97** | **194** | **62** | **(31)** | **801** |

| For the year ended 31 December 2011 (Restated) | Protection and Annuities £m | Savings £m | Investment management £m | US Protection £m | Group capital and financing[1] £m | Total £m |
|---|---|---|---|---|---|---|
| **Operating profit/(loss)** | 601 | 126 | 234 | 97 | (5) | 1,053 |
| Investment variances | 151 | (34) | (7) | – | (207) | (97) |
| Losses attributable to non-controlling interests | – | – | – | – | (3) | (3) |
| **Profit/(loss) from continuing operations before tax** | 752 | 92 | 227 | 97 | (215) | 953 |
| Tax (expense)/credit attributable to equity holders of the Company | (199) | (22) | (44) | (34) | 67 | (232) |
| **Profit/(loss) for the year after tax** | 553 | 70 | 183 | 63 | (148) | 721 |

1. For segmental purposes, Investment projects of £50m (2011: £56m) have been included in Group capital and financing.

#### (ii) Revenue

| For the year ended 31 December 2012 | Protection and Annuities £m | Savings £m | Investment management £m | US Protection £m | Group capital and financing £m | Total £m |
|---|---|---|---|---|---|---|
| Internal revenue | **69** | **–** | **149** | **(54)** | **(164)** | **–** |
| External revenue | **6,790** | **5,457** | **20,804** | **1,461** | **464** | **34,976** |
| **Total revenue** | **6,859** | **5,457** | **20,953** | **1,407** | **300** | **34,976** |

| For the year ended 31 December 2011 | Protection and Annuities £m | Savings £m | Investment management £m | US Protection £m | Group capital and financing £m | Total £m |
|---|---|---|---|---|---|---|
| Internal revenue[1] | 78 | – | 145 | (50) | (173) | – |
| External revenue | 5,967 | 1,569 | 9,447 | 1,079 | 255 | 18,317 |
| **Total revenue** | 6,045 | 1,569 | 9,592 | 1,029 | 82 | 18,317 |

1. The presentation of the LGA Internal Reinsurance Arrangement has been amended to better reflect the actual cash flows between the divisions. This has impacted the Protection and Annuities and US Protection segments. The intra-segment revenue within the Savings division has been removed from previously reported numbers.

Total revenue includes investment return of £28,834m (2011: £12,143m).

# ADDITIONAL FINANCIAL INFORMATION (CONTINUED)

## (iii) Consolidated balance sheet

| As at 31 December 2012 | Protection and Annuities £m | Savings £m | Investment management £m | US Protection £m | Group capital and financing[2] £m | Total £m |
|---|---|---|---|---|---|---|
| **Assets** | | | | | | |
| Deferred acquisition costs | **128** | **947** | **–** | **829** | **–** | **1,904** |
| Investment in associates | **4** | **78** | **–** | **–** | **5** | **87** |
| Investment property | **660** | **2,075** | **1,265** | **–** | **1,143** | **5,143** |
| Financial investments | **37,110** | **41,971** | **235,234** | **2,012** | **421** | **316,748** |
| Reinsurers' share of contract liabilities | **1,897** | **3,273** | **–** | **287** | **(2,958)** | **2,499** |
| Other assets | **1,912** | **671** | **1,386** | **1,164** | **(1,865)** | **3,268** |
| Cash and cash equivalents | **817** | **2,379** | **2,015** | **139** | **11,302** | **16,652** |
| **Total assets** | **42,528** | **51,394** | **239,900** | **4,431** | **8,048** | **346,301** |
| | | | | | | |
| **Shareholders' equity** | **550** | **190** | **360** | **919** | **3,422** | **5,441** |
| Non-controlling interests | **–** | **–** | **–** | **–** | **39** | **39** |
| **Total equity** | **550** | **190** | **360** | **919** | **3,461** | **5,480** |
| | | | | | | |
| **Liabilities** | | | | | | |
| Subordinated borrowings | **–** | **–** | **–** | **–** | **1,890** | **1,890** |
| Participating contract liabilities | **2,686** | **13,744** | **–** | **–** | **–** | **16,430** |
| Non-participating contract liabilities | **33,483** | **35,320** | **233,069** | **1,644** | **(830)** | **302,686** |
| Senior borrowings[1] | **3** | **250** | **2** | **272** | **948** | **1,475** |
| Other liabilities | **5,806** | **1,890** | **6,469** | **1,596** | **2,579** | **18,340** |
| **Total liabilities** | **41,978** | **51,204** | **239,540** | **3,512** | **4,587** | **340,821** |
| **Total equity and liabilities** | **42,528** | **51,394** | **239,900** | **4,431** | **8,048** | **346,301** |

1. Includes non recourse financing.
2. Group capital and financing includes inter-segmental eliminations.

| As at 31 December 2011 (Restated) | Protection and Annuities £m | Savings £m | Investment management £m | US Protection £m | Group capital and financing[2] £m | Total £m |
|---|---|---|---|---|---|---|
| **Assets** | | | | | | |
| Deferred acquisition costs | 117 | 908 | – | 808 | – | 1,833 |
| Investment in associates | 4 | 50 | – | – | 6 | 60 |
| Investment property | 491 | 2,146 | 1,077 | – | 1,180 | 4,894 |
| Financial investments | 33,921 | 41,059 | 223,135 | 2,131 | 358 | 300,604 |
| Reinsurers' share of contract liabilities | 1,737 | 1,717 | – | 301 | (1,466) | 2,289 |
| Other assets | 1,786 | 639 | 1,115 | 1,084 | (1,918) | 2,706 |
| Cash and cash equivalents | 682 | 2,378 | 2,024 | 127 | 8,902 | 14,113 |
| **Total assets** | 38,738 | 48,897 | 227,351 | 4,451 | 7,062 | 326,499 |
| | | | | | | |
| **Shareholders' equity** | 468 | 184 | 351 | 910 | 3,143 | 5,056 |
| Non-controlling interests | – | – | – | – | 66 | 66 |
| **Total equity** | 468 | 184 | 351 | 910 | 3,209 | 5,122 |
| | | | | | | |
| **Liabilities** | | | | | | |
| Subordinated borrowings | – | – | – | – | 1,921 | 1,921 |
| Participating contract liabilities | 2,420 | 14,402 | – | – | – | 16,822 |
| Non-participating contract liabilities | 29,741 | 32,311 | 222,342 | 1,699 | (742) | 285,351 |
| Senior borrowings[1] | – | 240 | – | 286 | 803 | 1,329 |
| Other liabilities | 6,109 | 1,760 | 4,658 | 1,556 | 1,871 | 15,954 |
| **Total liabilities** | 38,270 | 48,713 | 227,000 | 3,541 | 3,853 | 321,377 |
| **Total equity and liabilities** | 38,738 | 48,897 | 227,351 | 4,451 | 7,062 | 326,499 |

1. Includes non recourse financing.
2. Group capital and financing includes inter-segmental eliminations.

## ADDITIONAL FINANCIAL INFORMATION (CONTINUED)

### 27 SEGMENTAL ANALYSIS (CONTINUED)

#### (iv) Gross written premiums on insurance contracts

Gross written premium is the total written by the Group before deductions for reinsurance.

Long term insurance premiums are recognised as revenue when due for payment. General insurance premiums are accounted for in the period in which the risk commences. Estimates are included for premiums not notified by the year end and provision is made for the anticipated lapse of renewals not yet confirmed. Those proportions of premiums written in a year which relate to periods of risk extending beyond the end of the year are carried forward as unearned premiums.

Premiums received relating to investment contracts are not recognised as revenue, but are included in the balance sheet investment contract liability.

| | 2012 £m | 2011 £m |
|---|---|---|
| **From continuing operations** | | |
| **Protection and Annuities** | | |
| Non-participating UK business | **3,782** | 3,778 |
| Netherlands (LGN) | **172** | 194 |
| France (LGF) | **406** | 393 |
| General insurance | | |
| – Household | **327** | 283 |
| – Other business | **22** | 21 |
| **Total Protection and Annuities** | **4,709** | 4,669 |
| | | |
| **Savings** | | |
| Non-participating Savings business | **39** | 40 |
| Participating business | **336** | 488 |
| **Total Savings** | **375** | 528 |
| | | |
| **US Protection** | **584** | 522 |
| **Total gross written premiums** | **5,668** | 5,719 |

### 28 FEES FROM FUND MANAGEMENT AND INVESTMENT CONTRACTS

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

The Group earns fees from the provision of investment management services, typically based on the level of assets under management.

# ADDITIONAL FINANCIAL INFORMATION (CONTINUED)

## 29 INVESTMENT RETURN

Investment return includes fair value gains and losses, excluding fair value movements attributable to available-for-sale (AFS) investments, dividends, rent and interest. Dividends are accrued on an ex-dividend basis. Interest and rent are included on an accruals basis. Interest income for financial assets which are not classified as fair value through profit or loss (FVTPL) is recognised using the effective interest method.

The Group earns an investment return from holdings in financial instruments and property investments, held to back insurance and investment contracts on behalf of policyholders, and as Group capital.

| | **2012 £m** | 2011 £m |
|---|---|---|
| Dividend income | **4,445** | 3,945 |
| Interest income on financial investments at fair value through profit or loss | **4,913** | 4,833 |
| Other investment income | **120** | 49 |
| Gains on financial investments at fair value through profit or loss | **18,418** | 1,685 |
| Gains on derivative instruments (designated as held for trading) | **653** | 1,221 |
| Realised gains on available-for-sale financial assets | **39** | 43 |
| Losses on loans and receivables | **(1)** | (7) |
| **Financial investment return[1]** | **28,587** | 11,769 |
| | | |
| Rental income | **366** | 334 |
| Fair value (losses)/gains on properties | **(119)** | 40 |
| **Property investment return** | **247** | 374 |
| **Investment return** | **28,834** | 12,143 |

1. Interest income of £64m (2011: £71m) arose on financial investments designated as AFS. There were no impairments on assets classified as AFS during the year (2011: £nil).

## 30 NET CLAIMS AND CHANGE IN INSURANCE LIABILITIES

Insurance claims are paid in accordance with the individual policy terms typically arising from an insured event.

### Long term insurance

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

The change in the insurance liability reflects the reduction in liabilities due to the payment of claims in the year, offset by liabilities arising from new business. The movement also reflects assumption changes relating to variables such as claims expectations, expenses and the unwind of the previous period's expectations.

### General insurance

Claims and related reinsurance recoveries are accounted for in respect of all incidents up to the year end. Provision is made on the basis of available information for the estimated ultimate cost, including claims settlement expenses, claims reported but not yet settled and claims incurred but not yet reported. An unexpired risk provision is made for any overall excess of expected claims and deferred acquisition costs over unearned premiums and after taking account of investment return.

## ADDITIONAL FINANCIAL INFORMATION (CONTINUED)

### 30 NET CLAIMS AND CHANGE IN INSURANCE LIABILITIES (CONTINUED)

| | Long term insurance 2012 £m | General insurance 2012 £m | Total 2012 £m | Long term insurance 2011 £m | General insurance 2011 £m | Total 2011 £m |
|---|---|---|---|---|---|---|
| Claims paid | | | | | | |
| – gross | **5,165** | **155** | **5,320** | 4,823 | 179 | 5,002 |
| – reinsurance recoveries | **(585)** | **(1)** | **(586)** | (485) | (1) | (486) |
| | **4,580** | **154** | **4,734** | 4,338 | 178 | 4,516 |
| Change in insurance liabilities | | | | | | |
| – gross | **3,256** | **12** | **3,268** | 2,205 | (34) | 2,171 |
| – reinsurance recoveries | **(193)** | **–** | **(193)** | (7) | – | (7) |
| **Net claims and change in insurance liabilities** | **7,643** | **166** | **7,809** | 6,536 | 144 | 6,680 |

The roll-forward of the insurance contract liabilities is provided in Note 18.

### 31 OTHER OPERATIONAL INCOME AND EXPENSE

Operational income comprises fee income from estate agency operations, agency fee income relating to distribution services and revenue of £295m (2011: £164m) from consolidated private equity investments. Operational income is accounted for when due.

| **Other expenses comprise:** | Notes | 2012 £m | 2011 £m |
|---|---|---|---|
| Staff costs (including pensions and share-based payments) | 33 | **489** | 479 |
| Redundancy costs | | **17** | 6 |
| Operating lease rentals[1] | | **25** | 24 |
| Auditors' remuneration | 32 | **8** | 6 |
| Depreciation of plant and equipment | | **11** | 13 |
| Amortisation of purchased interest in long term businesses and other intangibles | 39 | **23** | 26 |
| Reinsurance commissions | | **(7)** | (7) |
| Direct operating expenses arising from investment properties which generate rental income | | **33** | 35 |
| Expenses attributable to consolidated private equity investment vehicles | | **292** | 174 |
| Other administrative expenses | | **303** | 254 |
| **Total other expenses** | | **1,194** | 1,010 |

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

# ADDITIONAL FINANCIAL INFORMATION (CONTINUED)

## 32 AUDITORS' REMUNERATION

| | 2012 £m | 2011[1] £m |
|---|---|---|
| Remuneration receivable by the Company's auditor for the audit of the consolidated and Company financial statements | **1.1** | 1.0 |
| Remuneration receivable by the Company's auditor and its associates for the supply of other services to the Company and its associates, including remuneration for the audit of the financial statements of the Company's subsidiaries: | | |
| The audit of the Company's subsidiaries | **2.2** | 2.2 |
| Audit related assurance services | **1.3** | 1.3 |
| Other assurance services | **1.8** | 0.9 |
| Tax compliance services | **0.2** | 0.1 |
| Other tax services | **0.3** | 0.5 |
| Services related to corporate finance transactions | **0.4** | – |
| Other services not covered above | **0.2** | 0.4 |
| **Total remuneration** | **7.5** | 6.4 |

1. The prior year remuneration has been analysed to reflect the categories required under statutory instrument 2011/2198 pertaining to the disclosure of auditors remuneration. Total remuneration is unchanged.

In addition to the above, fees payable to the Company's auditor and its associates for audit services supplied to the Company's associated pension schemes amounted to £22k (2011: £32k).

## 33 EMPLOYEE INFORMATION

| | 2012 | 2011 |
|---|---|---|
| **Average number of staff employed during the year:** | | |
| UK | **7,396** | 7,231 |
| Europe | **442** | 405 |
| USA | **491** | 422 |
| **Total excluding consolidated private equity investment vehicles** | **8,329** | 8,058 |
| Consolidated private equity investment vehicles[1] | **1,535** | 1,080 |
| **Worldwide employees** | **9,864** | 9,138 |

| | Notes | 2012 £m | 2011 £m |
|---|---|---|---|
| Salaries | | **346** | 332 |
| Social security costs | | **44** | 41 |
| Share-based incentive awards | 37 | **22** | 22 |
| Defined benefit pension costs | 23 | **38** | 47 |
| Defined contribution pension costs | 23 | **39** | 37 |
| **Total excluding consolidated private equity investment vehicles** | | **489** | 479 |
| Consolidated private equity investment vehicles[1] | | **37** | 24 |
| | | **526** | 503 |

1. The private equity investment vehicles are controlled by virtue of majority holdings owned by the with-profits part of the LTF. The increase in average employees during the year was driven by the acquisition of ABI (UK) Group Limited in November 2011. The £37m (2011: £24m) costs of employment for private equity investment subsidiaries primarily comprise salaries and £1m of defined contribution pension costs (2011: £nil).

## ADDITIONAL FINANCIAL INFORMATION (CONTINUED)

### 34 FOREIGN EXCHANGE AND EXCHANGE RATES

Foreign exchange gains and losses are recognised in the income statement, except when recognised in equity as qualifying cash flow or net investment hedges.

Principal rates of exchange used for translation are:

| Year end exchange rates | At 31.12.12 | At 31.12.11 |
|---|---|---|
| United States Dollar | **1.63** | 1.55 |
| Euro | **1.23** | 1.20 |

| Average exchange rates | 01.01.12 -31.12.12 | 01.01.11 -31.12.11 |
|---|---|---|
| United States Dollar | **1.58** | 1.60 |
| Euro | **1.23** | 1.15 |

### 35 TAX

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

#### Current Tax

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

#### Deferred Tax

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

The tax shown in the income statement has been apportioned between that attributable to policyholders and that attributable to equity holders.

The judgements made in arriving at tax balances in the financial statements are discussed in Notes 41 and 42 where relevant.

#### Tax Rates

The table below provides a summary of the current tax and deferred tax rates for the year.

| | 2012 | | 2011 | |
|---|---|---|---|---|
| | Current tax | Deferred tax | Current tax | Deferred tax |
| UK | **24.5%** | **23.0%** | 26.5% | 25.0% |
| USA | **35.0%** | **35.0%** | 35.0% | 35.0% |
| France | **36.1%** | **34.4%** | 34.4% | 34.4% |
| Netherlands | **25.0%** | **25.0%** | 25.0% | 25.0% |
| Ireland | **12.5%** | **12.5%** | 12.5% | 12.5% |

## ADDITIONAL FINANCIAL INFORMATION (CONTINUED)

| | Note | 2012 £m | 2011 Restated £m |
|---|---|---|---|
| **Current tax** | | **183** | 89 |
| **Deferred tax** | | | |
| – Movement in temporary differences | | **225** | (7) |
| – Reduction in UK corporate tax rate to 23% (2011: 25%) | | **7** | 6 |
| **Total deferred tax[1]** | 41 | **232** | (1) |
| **Adjustment to equity holders tax in respect of prior years** | | **(6)** | (34) |
| **Total tax** | | **409** | 54 |
| Less tax attributable to policyholder returns | | **(174)** | 178 |
| **Tax attributable to equity holders** | | **235** | 232 |

1. The total movement in deferred tax of £232m disclosed above differs from the amount of £241m disclosed in Note 41 by £9m (2011: £60m) being the deferred tax prior year adjustment included within the 'Adjustment to equity holders' tax in respect of prior years' line.

The tax attributable to equity holders differs from the tax calculated at the standard UK corporation tax rate as follows:

| | 2012 £m | 2011 Restated £m |
|---|---|---|
| Profit before tax attributable to equity holders | **1,036** | 953 |
| Tax calculated at 24.5% (2011: 26.5%) | **254** | 253 |
| Effects of: | | |
| Adjustments in respect of prior years, mainly relating to resolution of tax issues with HMRC | **(6)** | (34) |
| Lower tax on Shareholder Retained Capital | **(30)** | (20) |
| Income not subject to tax, such as dividends | **(3)** | (5) |
| Change in valuation of tax losses | **8** | 15 |
| Higher rate of tax on profits taxed overseas | **14** | 11 |
| Expenses not deductible for tax purposes | **(5)** | 5 |
| Impact of reduction in UK corporate tax rate to 23% (2011: 25%) on deferred tax balances | **7** | 6 |
| Differences between taxable and accounting investment gains, e.g. RPI relief | **(5)** | – |
| Other | **1** | 1 |
| **Tax attributable to equity holders** | **235** | 232 |

Tax calculated on profit before tax at 24.5% (2011: 26.5%) would amount to £296m (2011: £205m). The difference between this number and the total tax of £409m (2011: £54m) is made up of the reconciling items above, which total £(19)m (2011: £(21)m), and the effect of the apportionment methodology on tax applicable to policyholder returns of £132m (2011: £(130)m).

| | 2012 % | 2011 % |
|---|---|---|
| **Equity holders' effective tax rate** | **22.7** | 24.4 |

Equity holders' effective tax rate is calculated by dividing the tax attributable to equity holders over profit before tax attributable to equity holders.

| **Deferred tax recognised directly in equity** | 2012 £m | 2011 Restated £m |
|---|---|---|
| Relating to net gains or losses recognised directly in equity | **(22)** | (91) |
| Exchange gains | **13** | 5 |
| **Deferred tax recognised directly in equity** | **(9)** | (86) |

## ADDITIONAL FINANCIAL INFORMATION (CONTINUED)

### 36 DISCLOSURE OF TAX EFFECTS RELATING TO EACH COMPONENT OF OTHER COMPREHENSIVE INCOME

| | Before tax 2012 £m | Tax credited/ (charged) 2012 £m | After tax 2012 £m | Before tax 2011 Restated £m | Tax credited/ (charged) 2011 Restated £m | After tax 2011 Restated £m |
|---|---|---|---|---|---|---|
| Exchange differences on translation of overseas operations | **(13)** | **–** | **(13)** | – | – | – |
| Actuarial (losses)/gains on defined benefit pension schemes | **(120)** | **13** | **(107)** | (136) | 15 | (121) |
| Actuarial losses/(gains) on defined benefit pension schemes transferred to unallocated divisible surplus | **46** | **(5)** | **41** | 54 | (6) | 48 |
| Net change in financial investments designated as available-for-sale | **58** | **(26)** | **32** | 21 | (6) | 15 |
| **Other comprehensive income** | **(29)** | **(18)** | **(47)** | (61) | 3 | (58) |

### 37 SHARE-BASED PAYMENTS

The fair value at the date of grant of the equity instrument is recognised as an expense, spread over the vesting period of the instrument. The total amount to be expensed is determined by reference to the fair value of the awards, excluding the impact of any non-market vesting conditions. At each balance sheet date, the Group revises its estimate of the number of equity instruments which are expected to become exercisable. It recognises the impact of the revision of original estimates, if any, in the income statement, and a corresponding adjustment is made to equity. On vesting or exercise, the difference between the expense charged to the income statement and the actual cost to the Group is transferred to retained earnings. Where new shares are issued, the proceeds received are credited to share capital and share premium.

#### (i) Description of schemes

The Group provides a number of equity settled share-based long term incentive plans for directors and eligible employees. Options are normally forfeited if the employee leaves the Group.

The Savings related share option scheme (SAYE) allows employees to enter into a regular savings contract over either three, five or seven years, coupled with a corresponding option over shares of the Group. The grant price is equal to 80% of the quoted market price of the Group shares on the invitation date. Fair value is calculated using the Black-Scholes model.

Conditional shares can be granted to top managers under the Performance share plan (PSP), based upon individual and Company performance. Under the PSP, the number of performance shares transferred to the individual at the end of the three year vesting period is dependent on the Group's relative Total Shareholder Return (TSR).

The Company share option scheme (CSOP), approved by HMRC, and unapproved Executive share option scheme (ESOS) are designed to provide a long term incentive to directors and managers of the Group. The number of options granted is based on the manager's grade, salary and performance. In order for the options to be exercisable, Legal & General's TSR must exceed the median TSR of the FTSE 100 for a period of at least three years commencing on the date of the grant. Fair value is calculated using a binomial model, reflecting the historic exercise patterns.

The Share bonus plan (SBP) awards restricted shares and nil-paid options. Recipients of restricted shares are entitled to both vote and receive dividends. Fair value is calculated as the market value on the grant date, adjusted to reflect the eligibility for dividend payments.

Under the Employee share plan (ESP), approved by HMRC, permanent UK employees may elect to purchase Group shares from the market at the prevailing market price on a monthly basis. The Group supplements the number of shares purchased by matching the first £20 of the employees' contributions. From time to time, the Group may make a grant of free shares. Both the free and matching shares must be held in trust for three years before they may vest to the employee. The fair value of granted shares is equal to the market value at grant date.

## ADDITIONAL FINANCIAL INFORMATION (CONTINUED)

The fair values of the share grants made during the year have been calculated using the following assumptions:

| | SAYE | SAYE | PSP | PSP |
|---|---|---|---|---|
| Award date | 13-Apr-12 | 6-Sep-12 | 24-Apr-12 | 14-Aug-12 |
| Weighted average share price | 123p | 134p | 118p | 132p |
| Weighted average exercise price | 108p | 106p | n/a | n/a |
| Expected volatility | 42%-45% | 40%-44% | n/a | n/a |
| Expected life | 3-7 years | 3-7 years | 3 years | 3 years |
| Risk free investment rate | 0.5%-1.4% | 0.2%-1.1% | n/a | n/a |
| Dividend yield | 4.5% | 4.9% | n/a | n/a |

### (ii) Total recognised expense

The total recognised expense relating to share-based payments in 2012 was £22m (2011: £22m) before tax, all of which related to equity settled share schemes. This is broken down between the Group's plans as detailed below.

| | 2012 £m | 2011 £m |
|---|---|---|
| Share bonus plan (SBP) | 10 | 9 |
| Performance share plan (PSP) | 6 | 5 |
| Employee share plan (ESP) | 3 | 4 |
| Savings related share option scheme (SAYE) | 3 | 4 |
| **Total share-based payment expense** | 22 | 22 |

### (iii) Outstanding share options

| | SAYE Options 2012 | Weighted average exercise price 2012 p | CSOP/ESOS Options 2012 | Weighted average exercise price 2012 p | SBP Options 2012 | Weighted average exercise price 2012 p |
|---|---|---|---|---|---|---|
| **Outstanding at 1 January** | 73,775,654 | 41 | 18,155,486 | 107 | 376,214 | – |
| Granted during the year | 8,772,329 | 107 | 3,167,110 | 118 | 162,595 | – |
| Forfeited during the year | (2,004,502) | 70 | (452,465) | 108 | – | – |
| Exercised during the year | (38,989,455) | 37 | (2,157,446) | 85 | (64,021) | – |
| Expired during the year | (358,254) | 57 | (5,018,526) | 141 | (14,054) | – |
| **Outstanding at 31 December** | 41,195,772 | 58 | 13,694,159 | 101 | 460,734 | – |
| **Exercisable at 31 December** | 131,609 | 59 | 1,532,327 | 83 | – | – |
| **Weighted average remaining contractual life (years)** | 2 | | 1 | | 8 | |

Exercised during the year includes 530,968 of options, which are predominantly CSOP options linked to SBP which have been settled using employee scheme shares.

| | SAYE Options 2011 | Weighted average exercise price 2011 p | CSOP/ESOS Options 2011 | Weighted average exercise price 2011 p | SBP Options 2011 | Weighted average exercise price 2011 p |
|---|---|---|---|---|---|---|
| **Outstanding at 1 January** | 79,030,152 | 39 | 23,678,393 | 115 | 325,787 | – |
| Granted during the year | 5,116,868 | 83 | 3,937,136 | 116 | 79,907 | – |
| Forfeited during the year | (1,704,792) | 56 | (643,719) | 114 | – | – |
| Exercised during the year | (3,760,680) | 44 | (2,006,892) | 83 | (16,109) | – |
| Expired during the year | (4,905,894) | 43 | (6,809,432) | 143 | (13,371) | – |
| **Outstanding at 31 December** | 73,775,654 | 41 | 18,155,486 | 107 | 376,214 | – |
| **Exercisable at 31 December** | 96,201 | 89 | 8,139,062 | 119 | – | – |
| **Weighted average remaining contractual life (years)** | 2 | | 2 | | 9 | |

Exercised during the year includes 270,002 of options which are predominantly CSOP options linked to SBP which have been settled using employee scheme shares.

## ADDITIONAL FINANCIAL INFORMATION (CONTINUED)

### 37 SHARE-BASED PAYMENTS (CONTINUED)

**(iv) Total options**

Options over 55,350,665 shares (2011: 92,307,354 shares) are outstanding under CSOP, ESOS, SAYE and SBP as at 31 December 2012. These options have a range of exercise prices between 0p and 150p (2011: 0p and 150p) and maximum remaining contractual life up to 2022 (2011: 2021).

### 38 ACQUISITIONS OF PRIVATE EQUITY INVESTMENT VEHICLES

Business combinations are accounted for using the purchase method, under which the acquirer recognises the acquiree's fair value of the identifiable assets, liabilities and contingent liabilities at the acquisition date. Purchased goodwill is recognised as an asset on the balance sheet and is carried at cost less any accumulated impairment losses in accordance with IAS 36, 'Impairment of Assets'.

Private equity investment vehicles classified as subsidiaries are those entities over which the Group directly or indirectly has the power to govern the operating and financial policies in order to gain economic benefits. Profits or losses of subsidiary undertakings sold or acquired during the period are included in the consolidated results up to the date of disposal or the date of gaining control.

On 5 October 2012, the Group acquired 55% of the ordinary share capital and £32m of loan notes issued by intermediate holding companies investing in Air Energi Holdings Limited, a provider of specialist services to the oil and gas industry. No goodwill has arisen in respect of this transaction. Since 5 October 2012, Air Energi Holdings Limited has contributed £(3)m to Group consolidated profit before tax, before the offsetting change in the unallocated divisible surplus (UDS), due to the company being owned by the UK with-profits fund. Air Energi Holdings Limited would have contributed £4m to Group consolidated profit before tax (excluding the impact on UDS) if the acquisition had occurred on 1 January 2012.

In 2011, the Group acquired ABI (UK) Group Limited, with no goodwill arising on acquisition. Investment property acquired is stated at fair value on the acquisition date.

Acquisition related costs of £5m (2011: £3m) have been recognised within Other expenses in the Consolidated Income Statement.

| | 2012 £m | 2011 £m |
|---|---|---|
| **Consideration at date of acquisition** | | |
| Cash | **33** | 15 |
| **Total consideration** | **33** | 15 |
| Consideration attributable to purchase of debt instruments | **32** | 14 |
| Consideration attributable to net assets | **1** | 1 |
| | **33** | 15 |
| **Recognised amounts of identifiable assets transferred and liabilities assumed at fair value** | | |
| Intangibles – brand value | **54** | 19 |
| Property, plant and equipment | **1** | – |
| Investment property | **–** | 3 |
| Other assets | **64** | 26 |
| Cash and cash equivalents | **6** | 4 |
| Other liabilities | **(31)** | (14) |
| Senior borrowings | **(44)** | (16) |
| Other long term liabilities | **(17)** | (7) |
| **Total identifiable net assets** | **33** | 15 |
| Debt instruments issued to consolidated investment vehicles | **(32)** | (14) |
| **Net assets attributable to equity holders of the Company** | **1** | 1 |

# ADDITIONAL FINANCIAL INFORMATION (CONTINUED)

## 39 PURCHASED INTEREST IN LONG TERM BUSINESSES (PILTB) AND OTHER INTANGIBLE ASSETS

Portfolios of in-force insurance or investment contracts acquired either directly or through the acquisition of a subsidiary undertaking are capitalised at fair value. The value of business acquired represents the present value of anticipated future profits in acquired contracts. These amounts are amortised over the anticipated lives of the related contracts in the portfolio.

Intangible assets acquired via business combinations, such as the value of customer relationships, are recognised at fair value and are subsequently amortised over their useful life in line with the expected emergence of profit from the business. Where software costs are separately identifiable and measurable they are capitalised at cost and amortised over their expected useful life.

Purchased interest in long term businesses and other intangible assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use.

| | **PILTB insurance contracts 2012 £m** | **PILTB investment contracts 2012 £m** | **Other intangible assets 2012 £m** | **Total 2012 £m** | PILTB insurance contracts 2011 £m | PILTB investment contracts 2011 £m | Other intangible assets 2011 £m | Total 2011 £m |
|---|---|---|---|---|---|---|---|---|
| **Cost** | | | | | | | | |
| **As at 1 January** | **340** | **77** | **88** | **505** | 339 | 77 | 54 | 470 |
| Acquisition of subsidiaries | **–** | **–** | **54** | **54** | – | – | 19 | 19 |
| Additions | **–** | **–** | **32** | **32** | – | – | 15 | 15 |
| Net exchange difference | **(9)** | **–** | **–** | **(9)** | 1 | – | – | 1 |
| **As at 31 December** | **331** | **77** | **174** | **582** | 340 | 77 | 88 | 505 |
| **Amortisation and impairment** | | | | | | | | |
| **As at 1 January** | **(302)** | **(32)** | **(23)** | **(357)** | (286) | (25) | (2) | (313) |
| Amortisation for the year | **(10)** | **(6)** | **(7)** | **(23)** | (13) | (7) | (6) | (26) |
| Impairment loss[1] | **–** | **–** | **–** | **–** | – | – | (15) | (15) |
| Net exchange difference | **9** | **–** | **–** | **9** | (3) | – | – | (3) |
| **As at 31 December** | **(303)** | **(38)** | **(30)** | **(371)** | (302) | (32) | (23) | (357) |
| **Net book value as at 31 December** | **28** | **39** | **144** | **211** | 38 | 45 | 65 | 148 |
| To be amortised within 12 months | | | | **33** | | | | 28 |
| To be amortised after 12 months | | | | **178** | | | | 120 |

1. During 2011 the impairment loss of £15m represented a diminution of the value in use of the Snow + Rock Sports Limited brand arising from the deterioration in the retail sales environment. The impairment charge is presented on the face of the consolidated income statement within other expenses and is largely offset by transfers to the unallocated divisible surplus as the Group's control of the vehicle arises from holdings within the with-profits part of the UK LTF. The value in use was estimated using a discounted cash flow model using a discount rate of 12%.

## ADDITIONAL FINANCIAL INFORMATION (CONTINUED)

### 40 DEFERRED ACQUISITION COSTS

The Group incurs costs to obtain and process new business. These are accounted for in line with the appropriate accounting standards as follows:

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

**General insurance**
A proportion of commission and other acquisition costs relating to unearned premiums is carried forward as deferred acquisition costs or, in respect of reinsurance outwards, as deferred income.

**Investment contracts**
For participating investment contracts, acquisition costs comprise direct costs such as initial commission and the indirect costs of obtaining and processing new business. These costs are charged to the income statement when incurred. For non-participating investment contracts, only directly attributable costs relating to investment management services which vary with, and are related to, securing new contracts and renewing existing contracts, are capitalised and amortised over the period during which the costs are expected to be recoverable from future revenue. All other costs are recognised as expenses when incurred.

#### (i) Analysis of deferred acquisition costs

| | Notes | Gross 2012 £m | Re-insurance 2012 £m | Gross 2011 Restated[1] £m | Re-insurance 2011 £m |
|---|---|---|---|---|---|
| Insurance contract deferred acquisition costs | (ii) | **906** | **(71)** | 875 | (78) |
| Investment contract deferred acquisition costs | (iii) | **998** | **–** | 958 | – |
| **Deferred acquisition costs** | | **1,904** | **(71)** | 1,833 | (78) |

1. Deferred acquisition cost has been restated to reflect the retrospective adoption of ASU 2010-26, issued by the FASB, which specifies the accounting for deferred acquisition costs under US GAAP. Details of this are outlined in Note 1.

#### (ii) Insurance contract deferred acquisition costs

| | Gross 2012 £m | Re-insurance 2012 £m | Gross 2011 Restated £m | Re-insurance 2011 £m |
|---|---|---|---|---|
| **As at 1 January** | **875** | **(78)** | 810 | (81) |
| Acquisition costs deferred | **202** | **(6)** | 161 | – |
| Amortisation charged to income | **(155)** | **14** | (137) | 7 |
| Increase/(decrease) due to currency translation | **(46)** | **4** | 11 | (1) |
| Other | **30** | **(5)** | 30 | (3) |
| **As at 31 December** | **906** | **(71)** | 875 | (78) |
| To be amortised within 12 months | **102** | **(4)** | 114 | (4) |
| To be amortised after 12 months | **804** | **(67)** | 761 | (74) |

Of the total gross deferred acquisition costs £829m (2011: £808m) relates to the LGA insurance business.

## ADDITIONAL FINANCIAL INFORMATION (CONTINUED)

### (iii) Investment contract deferred acquisition costs

| | Gross 2012 £m | Re-insurance 2012 £m | Gross 2011 £m | Re-insurance 2011 £m |
|---|---|---|---|---|
| **As at 1 January** | **958** | **–** | 968 | – |
| Acquisition costs deferred | **99** | **–** | 123 | – |
| Amortisation charged to income | **(101)** | **–** | (122) | – |
| Decrease due to currency translation | **(1)** | **–** | (1) | – |
| Other | **43** | **–** | (10) | – |
| **As at 31 December** | **998** | **–** | 958 | – |
| To be amortised within 12 months | **206** | **–** | 198 | – |
| To be amortised after 12 months | **792** | **–** | 760 | – |

## 41 DEFERRED TAX

Deferred tax assets and (liabilities) have been recognised/(provided) for the temporary differences and unused tax losses. The recognition of a deferred tax asset in respect of tax losses is supported by management's best estimate of future taxable profits to absorb the losses in future years. These taxable profit projections are based on assumptions consistent with those used for EEV reporting purposes. Deferred tax assets and (liabilities) have been offset to the extent it is permissible under the accounting standard. The net movement in deferred tax assets and liabilities during the year is as follows:

### (i) UK deferred tax asset

| | Net tax asset as at 1 January 2012 £m | Tax (charged)/ credited to the income statement £m | Tax (charged)/ credited to equity £m | Net tax asset as at 31 December 2012 £m |
|---|---|---|---|---|
| Realised and unrealised losses on investments | **147** | **(133)** | **–** | **14** |
| Excess of depreciation over capital allowances | **43** | **–** | **–** | **43** |
| Excess expenses | **233** | **1** | **–** | **234** |
| Deferred acquisition expenses | **(80)** | **6** | **(3)** | **(77)** |
| Difference between the tax and accounting value of insurance contracts | **(72)** | **(27)** | **–** | **(99)** |
| Accounting provisions | **9** | **–** | **–** | **9** |
| Trading losses | **159** | **(31)** | **–** | **128** |
| Pension fund deficit | **72** | **(7)** | **11** | **76** |
| Purchased interest in long term business | **(18)** | **6** | **–** | **(12)** |
| **UK deferred tax asset** | **493** | **(185)** | **8** | **316** |

| | Net tax asset as at 1 January 2011 £m | Tax (charged)/ credited to the income statement £m | Tax (charged)/ credited to equity £m | Net tax asset as at 31 December 2011 £m |
|---|---|---|---|---|
| Realised and unrealised losses on investments | 31 | 116 | – | 147 |
| Excess of depreciation over capital allowances | 43 | – | – | 43 |
| Excess expenses | 284 | (57) | 6 | 233 |
| Deferred acquisition expenses | (87) | 7 | – | (80) |
| Difference between the tax and accounting value of insurance contracts | (66) | (6) | – | (72) |
| Accounting provisions | 8 | 1 | – | 9 |
| Trading losses | 239 | (80) | – | 159 |
| Pension fund deficit | 66 | (9) | 15 | 72 |
| Purchased interest in long term business | (23) | 5 | – | (18) |
| **UK deferred tax asset** | 495 | (23) | 21 | 493 |

## ADDITIONAL FINANCIAL INFORMATION (CONTINUED)

### 41 DEFERRED TAX (CONTINUED)

#### (ii) Overseas deferred tax liabilities

| | Net tax liability as at 1 January 2012 £m | Tax (charged)/ credited to the income statement £m | Tax (charged)/ credited to equity £m | Net tax liability as at 31 December 2012 £m |
|---|---|---|---|---|
| Realised and unrealised gains on investments | **(57)** | **(7)** | **(20)** | **(84)** |
| Deferred acquisition expenses | **(217)** | **(22)** | **17** | **(222)** |
| Difference between the tax and accounting value of insurance contracts | **(303)** | **17** | **22** | **(264)** |
| Trading losses | **246** | **(43)** | **(18)** | **185** |
| Pension fund deficit | **4** | **(1)** | **–** | **3** |
| **Overseas deferred tax liabilities** | **(327)** | **(56)** | **1** | **(382)** |

| | Net tax liability as at 1 January 2011 £m | Tax (charged)/ credited to the income statement Restated £m | Tax (charged)/ credited to equity Restated £m | Net tax liability as at 31 December 2011 Restated £m |
|---|---|---|---|---|
| Realised and unrealised gains on investments | (58) | 5 | (4) | (57) |
| Deferred acquisition expenses | (268) | (20) | 71 | (217) |
| Difference between the tax and accounting value of insurance contracts | (51) | (244) | (8) | (303) |
| Trading losses | 15 | 225 | 6 | 246 |
| Pension fund deficit | 6 | (2) | – | 4 |
| **Overseas deferred tax liabilities** | (356) | (36) | 65 | (327) |

#### Unrecognised deferred tax assets

The Group has the following unrelieved tax losses carried forward as at 31 December 2012. No deferred tax asset has been recognised in respect of these tax losses as at 31 December 2012 (or 31 December 2011), as it is not probable that there will be suitable taxable profits emerging in future periods against which to relieve them. Relief for these tax losses will only be recognised if it becomes probable that suitable taxable profits will arise in future periods. The potential deferred tax asset unrecognised as at 31 December 2012 is £51m (2011: £44m).

| | Gross 2012 £m | Tax 2012 £m | Gross 2011 £m | Tax 2011 £m |
|---|---|---|---|---|
| Trading losses | **24** | **3** | – | – |
| Realised and unrealised losses on investments | **186** | **40** | 154 | 34 |
| Post cessation losses | **19** | **4** | 19 | 5 |
| Unrelieved expenses | **5** | **1** | 5 | 1 |
| Unrelieved interest payments on debt instruments | **14** | **3** | 16 | 4 |
| **Unrecognised deferred tax asset** | **248** | **51** | 194 | 44 |

### 42 CURRENT TAX

| | 2012 £m | 2011 £m |
|---|---|---|
| Tax due within 12 months | **8** | 12 |
| Tax due after 12 months | **186** | 82 |
| **Current tax assets** | **194** | 94 |

| | 2012 £m | 2011 £m |
|---|---|---|
| Tax due within 12 months | **68** | 1 |
| Tax due after 12 months | **–** | – |
| **Current tax liabilities** | **68** | 1 |

# ADDITIONAL FINANCIAL INFORMATION (CONTINUED)

## 43 OTHER ASSETS

| | Note | Shareholder 2012 £m | Non profit non-unit linked 2012 £m | With-profits 2012 £m | Unit linked 2012 £m | Total 2012 £m |
|---|---|---|---|---|---|---|
| Reinsurance receivables | | **33** | **7** | **–** | **–** | **40** |
| Receivables under finance leases | 43(i) | **–** | **118** | **–** | **–** | **118** |
| Accrued interest and rent | | **1** | **11** | **36** | **116** | **164** |
| Prepayments and accrued income | | **164** | **5** | **1** | **218** | **388** |
| Other receivables | | **378** | **164** | **163** | **149** | **854** |
| **Other assets** | | **576** | **305** | **200** | **483** | **1,564** |
| Due within 12 months | | | | | | **1,333** |
| Due after 12 months | | | | | | **231** |

| | Note | Shareholder 2011 £m | Non profit non-unit linked 2011 £m | With-profits 2011 £m | Unit linked 2011 £m | Total 2011 £m |
|---|---|---|---|---|---|---|
| Reinsurance receivables | | 31 | 10 | – | – | 41 |
| Receivables under finance leases | 43(i) | – | 93 | – | – | 93 |
| Accrued interest and rent | | 1 | 3 | 40 | 107 | 151 |
| Prepayments and accrued income | | 171 | 8 | 1 | 323 | 503 |
| Other receivables | | 402 | 159 | 128 | 416 | 1,105 |
| **Other assets** | | 605 | 273 | 169 | 846 | 1,893 |
| Due within 12 months | | | | | | 1,785 |
| Due after 12 months | | | | | | 108 |

### (i) Receivables under finance leases

On creation of a finance lease, the leased asset is derecognised from the balance sheet and replaced with a receivable equivalent to the net investment in the lease at the balance sheet date. Finance income is recognised in the income statement on a pattern reflecting a constant periodic rate of return on the Group's net investment in the lease.

The Group acts as a lessor of two finance leases, which are both of 45 years duration and relate to the provision of student accommodation. The other party, as lessee, is regarded to be the economic owner of the leased assets.

The future minimum lease payments under these arrangements, together with their present value, are disclosed below:

| | Total future payments 2012 £m | Unearned interest income 2012 £m | Present value 2012 £m | Total future payments 2011 £m | Unearned interest income 2011 £m | Present value 2011 £m |
|---|---|---|---|---|---|---|
| Not later than 1 year | **6** | **(1)** | **5** | 4 | – | 4 |
| Between 1 and 5 years | **23** | **(4)** | **19** | 18 | (3) | 15 |
| Later than 5 years | **278** | **(184)** | **94** | 224 | (150) | 74 |
| **Total** | **307** | **(189)** | **118** | 246 | (153) | 93 |

No allowance has been recognised for uncollectable future minimum lease payments in the period (2011: £nil).

Total contingent rents recognised in rental income under these arrangements amounted to £nil (2011: £nil).

## ADDITIONAL FINANCIAL INFORMATION (CONTINUED)

### 44 ASSETS AND LIABILITIES OF OPERATIONS CLASSIFIED AS HELD FOR SALE

The Group provides seed capital to newly established funds which may result in such funds becoming newly acquired subsidiaries of the Group. Where the Group is actively seeking to reduce its investment in a subsidiary and it is considered highly probable that the Group will relinquish control of the subsidiary within 12 months of classification, the subsidiary is classified as held for sale.

During the year, two funds (2011: nil) were seeded in this manner and met the above classification. Consequently the assets and liabilities of these funds have been classified as held for sale. The assets of these subsidiaries primarily comprise financial investments and the liabilities comprise third party interest in the consolidated funds.

The financial investments of £891m comprise £780m of investment grade bonds with an average credit rating of BBB and £111m invested in USD denominated treasury securities with an average credit rating of AA. Both are classified as Tier 1 in the fair value hierarchy as defined in Note 10.

### 45 SHARE CAPITAL, SHARE PREMIUM AND EMPLOYEE SCHEME TREASURY SHARES

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

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

Where any Group entity purchases the Company's equity share capital, the consideration paid, including any directly attributable incremental costs (net of income taxes), is deducted from equity attributable to shareholders. Where such shares are subsequently sold, reissued or otherwise disposed of, any consideration received is included in equity attributable to shareholders, net of any directly attributable incremental transaction costs and the related income tax effects. Shares held on behalf of employee share schemes are disclosed as such on the balance sheet.

#### (i) Share capital and share premium

| Authorised share capital | 2012 Number of shares | 2012 £m | 2011 Number of shares | 2011 £m |
|---|---|---|---|---|
| At 31 December: ordinary shares of 2.5p each | **9,200,000,000** | **230** | 9,200,000,000 | 230 |

| Issued share capital, fully paid | Number of shares | Share capital £m | Share premium £m |
|---|---|---|---|
| **As at 1 January 2012** | **5,872,166,893** | **147** | **941** |
| Options exercised under share option schemes | | | |
| – Executive share option scheme | **1,626,478** | **–** | **1** |
| – Savings related share option scheme | **38,989,455** | **1** | **14** |
| **As at 31 December 2012** | **5,912,782,826** | **148** | **956** |

| Issued share capital, fully paid | Number of shares | Share capital £m | Share premium £m |
|---|---|---|---|
| **As at 1 January 2011** | 5,866,669,323 | 147 | 938 |
| Options exercised under share option schemes | | | |
| – Executive share option scheme | 1,736,890 | – | 1 |
| – Savings related share option scheme | 3,760,680 | – | 2 |
| **As at 31 December 2011** | 5,872,166,893 | 147 | 941 |

There is one class of ordinary shares of 2.5p each. All shares issued carry equal voting rights.

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

# ADDITIONAL FINANCIAL INFORMATION (CONTINUED)

### (ii) Employee scheme treasury shares

The Group uses the Employee Share Ownership Trust (ESOT) and the Legal & General Group Employee Share Plan (ESP) to purchase and hold shares of the Group for delivery to employees under various employee share schemes. Shares owned by these vehicles are included at cost in the consolidated balance sheet and are shown as a deduction from shareholders' equity. They are disclosed as employee scheme treasury shares until they vest to employees. Share-based liabilities to employees may also be settled via purchases directly from the market or by the issue of new shares.

The ESOT has waived its voting rights and its rights to some of the dividends payable on the shares it holds. Employees are entitled to dividends on the shares held on their behalf within the ESP.

| | 2012 Number of shares | 2012 £m | 2011 Number of shares | 2011 £m |
|---|---|---|---|---|
| **As at 1 January** | **45,554,040** | **48** | 38,954,087 | 41 |
| Shares purchased | **3,318,136** | **3** | 13,349,285 | 15 |
| Shares vested | **(8,471,917)** | **(8)** | (6,749,332) | (8) |
| **As at 31 December** | **40,400,259** | **43** | 45,554,040 | 48 |

## 46 NON-CONTROLLING INTERESTS

Non-controlling interests represent third party interests in private equity and property investment vehicles which are consolidated in the Group's results. The net decrease in the non-controlling interests in 2012 arises from the Group's acquisition of the non-controlling interest in the Performance Retail Limited Partnership less the revaluation of the third party interests in the UK Property Ungeared Fund Limited Partnership.

Performance Retail Limited Partnership is now a wholly owned subsidiary of the Group. The Group's ownership of the UK Property Ungeared Fund Limited Partnership remains above 50%.

## 47 OTHER LIABILITIES

| | 2012 £m | 2011 £m |
|---|---|---|
| Accruals | **231** | 224 |
| Reinsurers' share of deferred acquisition costs | **71** | 78 |
| Deferred income liabilities | **379** | 385 |
| Other | **278** | 246 |
| **Other liabilities** | **959** | 933 |
| Settled within 12 months | **467** | 476 |
| Settled after 12 months | **492** | 457 |

Other liabilities settled after 12 months are expected to be settled within five years.

## ADDITIONAL FINANCIAL INFORMATION (CONTINUED)

### 48 NET ASSET VALUE ATTRIBUTABLE TO UNIT HOLDERS

| As at 31 December 2012 | Total £m | Level 1 £m | Level 2 £m | Level 3 £m | Amortised cost £m |
|---|---|---|---|---|---|
| **Net asset value attributable to unit holders** | **7,702** | **7,702** | **–** | **–** | **–** |

| As at 31 December 2011 | Total £m | Level 1 £m | Level 2 £m | Level 3 £m | Amortised cost £m |
|---|---|---|---|---|---|
| Net asset value attributable to unit holders | 6,159 | 6,159 | – | – | – |

Amounts attributable to unit holders are repayable on demand and the Group is responsible for ensuring there is sufficient liquidity within the corresponding asset portfolio to enable the liability to be met as it falls due.

### 49 RELATED PARTY TRANSACTIONS

There were no material transactions between key management and the Legal & General group of companies. All transactions between the Group and its key management are on commercial terms which are no more favourable than those available to employees in general. Contributions to the post-employment defined benefit plans were £61m (2011: £60m), for all employees.

At 31 December 2012 and 31 December 2011 there were no loans outstanding to officers of the Company.

#### Key management personnel compensation

The aggregate compensation for key management personnel, including executive and non-executive directors, is as follows:

| | 2012 £m | 2011 £m |
|---|---|---|
| Salaries | **7** | 7 |
| Social security costs | **1** | 1 |
| Post-employment benefits | **3** | 1 |
| Share-based incentive awards | **4** | 4 |
| **Key management personnel compensation** | **15** | 13 |
| Number of key management personnel | **17** | 18 |

The UK defined benefit pension schemes have purchased annuity contracts issued by Society for consideration of £60m (2011: £58m) during the period, priced on an arm's length basis.

The Group's investment portfolio includes investments in venture capital, property and financial investments which are held via collective investment vehicles. Net investments into associate investment vehicles totalled £690m during the period (2011: £1,286m). The Group has outstanding loans to these associates of £1m (2011: £5m) and received investment management fees of £26m during the year (2011: £29m). Distributions from these investment vehicles to the Group totalled £49m (2011: £58m).

During the period, the Group paid platform hosting fees to Cofunds (Holdings) Limited, a 25% owned associate, of £12m (2011: £10m). Creditors outstanding at the end of the period were £1m (2011: £3m).

## ADDITIONAL FINANCIAL INFORMATION (CONTINUED)

### 50 CONTINGENT LIABILITIES, GUARANTEES AND INDEMNITIES

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

Various Group companies receive claims and become involved in actual or threatened litigation and regulatory issues from time to time. The relevant members of the Group ensure that they make prudent provision as and when circumstances calling for such provision become clear, and that each has adequate capital and reserves to meet reasonably foreseeable eventualities. The provisions made are regularly reviewed. It is not possible to predict, with certainty, the extent and the timing of the financial impact of these claims, litigation or issues.

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

Group companies have given indemnities and guarantees as a normal part of their business and operating activities or in relation to capital market transactions. Legal & General Group Plc has provided indemnities and guarantees in respect of the liabilities of Group companies in support of their business activities, including Pension Protection Fund compliant guarantees in respect of certain Group companies' liabilities under the Group pension fund and scheme.

### 51 COMMITMENTS

#### (i) Capital commitments

| | 2012 £m | 2011 £m |
|---|---|---|
| Authorised and contracted commitments not provided for in respect of investment property development, payable after 31 December | | |
| – Long term business | **188** | 13 |

## ADDITIONAL FINANCIAL INFORMATION (CONTINUED)

### 51 COMMITMENTS (CONTINUED)

#### (ii) Operating lease commitments

| | 2012 £m | 2011[1] £m |
|---|---|---|
| The future aggregate minimum lease payments under non-cancellable operating leases are as follows: | | |
| – Not later than 1 year | **26** | 27 |
| – Later than 1 year and not later than 5 years | **92** | 91 |
| – Later than 5 years | **362** | 388 |
| | **480** | 506 |
| Future aggregate minimum sublease payments expected to be received under operating subleases | **10** | 10 |
| The future aggregate minimum lease receivables under non-cancellable operating leases are as follows: | | |
| – Not later than 1 year | **297** | 284 |
| – Later than 1 year and not later than 5 years | **987** | 1,018 |
| – Later than 5 years | **2,648** | 2,475 |
| | **3,932** | 3,777 |

1. The presentation of operating lease commitments has been amended to include minimum lease receivables associated with investment property owned by the UK LTF and operating lease payments associated with Suffolk Life Group Plc.

The Group leases offices and other premises under non-cancellable operating lease agreements. The leases have varying terms, escalation clauses and renewal rights.

### 52 SUBSIDIARIES

Subsidiaries are those entities (including special purpose entities, mutual funds and unit trusts) over which the Group directly or indirectly has the power to govern the operating and financial policies in order to gain economic benefits. Profits or losses of subsidiary undertakings sold or acquired during the period are included in the consolidated results up to the date of disposal or from the date of gaining control. The interests of parties, other than the Group, in investment vehicles, such as unit trusts, are classified as liabilities and appear as 'Net asset value attributable to unit holders' in the consolidated balance sheet. The basis by which subsidiaries are consolidated in the Group financial statements is outlined in the basis of preparation (Note 1).

#### Future developments

IFRS 10, 'Consolidated Financial Statements', IFRS 11, 'Joint Arrangements' and IFRS 12, 'Disclosure of Interests in Other Entities' (effective in the EU for periods beginning on or after 1 January 2014). This suite of standards:

- provides enhanced guidance when determining whether an entity is controlled and is therefore included within the consolidated financial statements;
- provides a more realistic reflection of joint arrangements by focusing on the rights and obligations of the arrangement, rather than its legal form; and
- enhances the disclosure requirements around interests in other entities.

We are currently assessing the impact which these new standards will have on the Group's financial statements.

## ADDITIONAL FINANCIAL INFORMATION (CONTINUED)

### (i) Operating subsidiaries

In the opinion of the directors, the following subsidiaries principally affected the Company's results as set out in the annual accounts and are consolidated in these financial statements. The information required to be provided under section 409 of the Companies Act 2006 is provided only in relation to these undertakings and the undertakings listed under Notes 52(ii) and 53. A complete list of undertakings will be annexed to the Company's annual return which will be available from Companies House.

| Company name | Nature of business | Country of incorporation |
|---|---|---|
| Legal & General Finance PLC[1] | Treasury operations | England and Wales |
| Legal & General Resources Limited[1] | Provision of services | England and Wales |
| Legal & General Assurance Society Limited | Long term and general insurance | England and Wales |
| Legal & General Insurance Limited | General insurance | England and Wales |
| Legal & General Investment Management Limited | Institutional fund management | England and Wales |
| Legal & General Assurance (Pensions Management) Limited | Long term business | England and Wales |
| Legal & General Pensions Limited | Reinsurance | England and Wales |
| Legal & General Partnership Services Limited | Provision of services | England and Wales |
| Legal & General (Portfolio Management Services) Limited | Institutional fund management | England and Wales |
| Legal & General Property Limited | Property management | England and Wales |
| Legal & General (Unit Trust Managers) Limited | Unit trust management | England and Wales |
| Nationwide Life Limited | Long term business | England and Wales |
| Suffolk Life Annuities Limited | Long term business | England and Wales |
| Suffolk Life Pensions Limited | Long term business | England and Wales |
| LGV Capital Limited | Private equity | England and Wales |
| Legal & General (France) SA | Long term business | France |
| Legal & General Bank (France) SA | Financial services | France |
| Legal & General Risques Divers (France) SA | Insurance company | France |
| Legal & General International (Ireland) Limited | Long term business | Ireland |
| Legal & General Nederland Levensverzekering Maatschappij NV | Long term business | Netherlands |
| Banner Life Insurance Company Inc | Long term business | USA |
| William Penn Life Insurance Company of New York Inc | Long term business | USA |
| Legal & General Investment Management America Inc | Institutional fund management | USA |
| First British American Reinsurance Company II | Reinsurance | USA |
| First British Vermont Reinsurance Company | Reinsurance | USA |
| First British Vermont Reinsurance Company II | Reinsurance | USA |
| First British Bermuda Reinsurance Company II Limited | Reinsurance | Bermuda |

1. Directly held by Legal & General Group Plc. All other subsidiaries are held through intermediate holding companies.

The main territory of operation of subsidiaries incorporated in England and Wales is the UK. For overseas subsidiaries the principal country of operation is the same as the country of incorporation. All operating subsidiaries have a 31 December year end reporting date and are 100% owned.

## ADDITIONAL FINANCIAL INFORMATION (CONTINUED)

### 52 SUBSIDIARIES (CONTINUED)

#### (ii) Investment vehicles

The following mutual funds and partnerships have been consolidated as a result of the Group's ability to exert control over the financial and operating activities of the investment vehicle so as to obtain economic benefits.

| Vehicle name | Vehicle type | Territory | Year end reporting date | % of equity shares held by the Group |
|---|---|---|---|---|
| Chineham Shopping Centre Limited Partnership | Limited partnership | England and Wales | 31/12/2012 | 100.0 |
| Ealing Shopping Centre Limited Partnership | Limited partnership | England and Wales | 31/12/2012 | 100.0 |
| Gresham Street Limited Partnership | Limited partnership | England and Wales | 31/12/2012 | 100.0 |
| Legal & General City Offices Limited Partnership | Limited partnership | England and Wales | 31/12/2012 | 100.0 |
| Legal & General Emerging Markets Government Bond (US$) Index Fund | Debt security unit trust | England and Wales | 10/11/2012 | 100.0 |
| Legal & General Investment Management Global Macro Fund Plc | Open ended investment company | Ireland | 31/12/2012 | 100.0 |
| Legal & General Investment Management (Ireland) Risk Management Solutions Plc | Open ended investment company | Ireland | 31/12/2012 | 100.0 |
| Legal & General Life Fund Limited Partnership | Limited partnership | England and Wales | 31/12/2012 | 100.0 |
| Northampton Shopping Centre Limited Partnership | Limited partnership | England and Wales | 31/12/2012 | 100.0 |
| Performance Retail Limited Partnership | Limited partnership | England and Wales | 31/12/2012 | 100.0 |
| Performance Retail Unit Trust | Property unit trust | Jersey | 31/12/2012 | 100.0 |
| Performance Shopping Centre Limited Partnership | Limited partnership | England and Wales | 31/12/2012 | 100.0 |
| Legal & General Investment Management UK Smaller Companies Alpha Fund Plc | Open ended investment company | Ireland | 31/12/2012 | 99.9 |
| Legal & General UK Special Situations Trust | Equity unit trust | England and Wales | 14/09/2012 | 99.9 |
| LGV 7 Private Equity Fund Limited Partnership | Private equity partnership | England and Wales | 31/12/2012 | 99.7 |
| LGV 6 Private Equity Fund Limited Partnership | Private equity partnership | England and Wales | 31/12/2012 | 99.5 |
| Legal & General Global Environmental Enterprises Fund | Equity unit trust | England and Wales | 01/12/2012 | 95.9 |
| Legal & General Sterling Corporate Bond Index Fund | Debt security unit trust | England and Wales | 20/05/2012 | 94.1 |
| Legal & General Global Macro Themes Fund | Mixed asset unit trust | England and Wales | 14/09/2012 | 93.6 |
| Legal & General UK Absolute Fund | Mixed asset unit trust | England and Wales | 30/01/2012 | 93.2 |
| Legal & General European Absolute Fund | Mixed asset unit trust | England and Wales | 30/01/2012 | 85.8 |
| Legal & General Asian Income Trust | Equity unit trust | England and Wales | 10/09/2012 | 85.7 |
| Legal & General North American Trust | Equity unit trust | England and Wales | 16/01/2012 | 85.6 |
| Legal & General Growth Trust | Equity unit trust | England and Wales | 15/05/2012 | 84.5 |
| Legal & General Pacific Growth Trust | Equity unit trust | England and Wales | 18/09/2012 | 81.9 |
| ARC Property Fund Unit Trust | Property unit trust | Jersey | 31/12/2012 | 80.0 |
| Legal & General Global Emerging Market Index Fund | Equity unit trust | England and Wales | 31/07/2012 | 74.3 |
| Legal & General Equity Trust | Equity unit trust | England and Wales | 15/08/2012 | 71.0 |
| Legal & General European Trust | Equity unit trust | England and Wales | 28/07/2012 | 67.8 |
| Legal & General Pacific Index Trust | Equity unit trust | England and Wales | 25/03/2012 | 67.4 |
| Legal & General Global Growth Trust | Equity unit trust | England and Wales | 15/01/2012 | 65.8 |
| Legal & General European Index Trust | Equity unit trust | England and Wales | 31/07/2012 | 61.3 |
| Legal & General High Income Trust | Fixed interest unit trust | England and Wales | 05/09/2012 | 60.1 |
| Legal & General US Index Trust | Equity unit trust | England and Wales | 05/12/2012 | 58.3 |
| Legal & General Investment Management Liquidity Funds Plc | Open ended investment company | Ireland | 31/12/2012 | 57.2 |
| Legal & General UK Smaller Companies Trust | Equity unit trust | England and Wales | 18/06/2012 | 56.5 |
| Legal & General UK Property Ungeared Fund Limited Partnership | Limited partnership | England and Wales | 31/12/2012 | 55.1 |
| Legal & General UK Active Opportunities Trust | Equity unit trust | England and Wales | 14/04/2012 | 52.5 |
| Legal & General UK Equity Income Fund | Equity unit trust | England and Wales | 24/01/2012 | 52.5 |
| Lagoon Finance Limited[1] | Limited liability company | Ireland | 31/12/2012 | – |
| Trees S.A.[1] | Limited liability company | Luxembourg | 31/12/2012 | – |

1. Lagoon Finance Limited and Trees S.A. are consolidated on the basis that the Group has the power to govern the financial and operating policies and has the rights to receive 100% of the economic benefits. Only the controlled cell of the Trees S.A. investment vehicle is consolidated.

# ADDITIONAL FINANCIAL INFORMATION (CONTINUED)

## 53 ASSOCIATES AND JOINT VENTURES

Associates are entities over which the Group has significant influence but which it does not control. Consistent with IAS 28, 'Investments in associates', it is presumed that the Group has significant influence where it has between 20% and 50% of the voting rights in the investee. Joint ventures are entities where the Group and other parties undertake an activity which is subject to joint control. The basis by which associates and joint ventures are consolidated in the Group financial statements is outlined in the basis of preparation (Note 1).

The Group has the following significant holdings which have been included as financial investments or investments in associates. The gross assets of these companies are in part funded by borrowings which are non recourse to the Group.

| Company name | Country of incorporation | Accounting treatment | Year end reporting date | % of equity shares held by the Group |
|---|---|---|---|---|
| **Bracknell Property Unit Trust[1]** | **Jersey** | **FVTPL** | **31/03/2012** | **50.4** |
| **Central St Giles Unit Trust** | **Jersey** | **FVTPL** | **31/12/2012** | **50.0** |
| **Legal & General Gulf BSC[2]** | **Bahrain** | **Equity method** | **31/03/2012** | **50.0** |
| **Mithras Capital Fund Limited Partnership** | **Scotland** | **FVTPL** | **31/12/2012** | **50.0** |
| **Warrington Retail Unit Trust** | **Jersey** | **FVTPL** | **31/12/2012** | **50.0** |
| **Meteor Industrial Partnership** | **England and Wales** | **FVTPL** | **31/12/2012** | **49.9** |
| **Investment Discounts Online Limited** | **England and Wales** | **Equity method** | **31/12/2012** | **49.0** |
| **Legal & General Japanese Index Trust** | **England and Wales** | **FVTPL** | **24/10/2012** | **48.1** |
| **Legal & General Ethical Trust** | **England and Wales** | **FVTPL** | **12/12/2012** | **47.6** |
| **Arlington Business Parks Unit Trust** | **Jersey** | **FVTPL** | **31/12/2012** | **41.3** |
| **Novus Leisure Limited** | **England and Wales** | **FVTPL** | **30/06/2012** | **40.5** |
| **Legal & General UK Alpha Trust** | **England and Wales** | **FVTPL** | **18/06/2012** | **38.1** |
| **English Cities Fund** | **England and Wales** | **FVTPL** | **31/12/2012** | **37.5** |
| **LGV 2 Private Equity Fund Limited Partnership** | **England and Wales** | **FVTPL** | **31/12/2012** | **37.1** |
| **Legal & General Fixed Interest Trust** | **England and Wales** | **FVTPL** | **05/09/2012** | **36.2** |
| **The Leisure Fund Unit Trust** | **Jersey** | **FVTPL** | **31/12/2012** | **35.1** |
| **IndiaFirst Life Insurance Company Limited[2]** | **India** | **Equity method** | **31/03/2012** | **26.0** |
| **Cofunds (Holdings) Limited** | **England and Wales** | **Equity method** | **31/12/2012** | **25.4** |

1. The Bracknell Property Unit Trust is not consolidated as the Group does not have the power to control the entity.
2. Legal & General Gulf BSC and IndiaFirst Life Insurance Company Limited are joint venture operations. During the year, the Group provided no further capital contribution to IndiaFirst Life Insurance Company Limited (2011: £5m).

Summarised financial information for associates which are classified as FVTPL is shown below.

| 2012 | Private equity £m | Property partner-ships £m | Unit trusts £m | Total £m |
|---|---|---|---|---|
| Aggregate revenues | **142** | **104** | **154** | **400** |
| Aggregate (loss)/profit | **(6)** | **50** | **78** | **122** |
| Gross assets | **206** | **1,983** | **1,958** | **4,147** |
| Gross liabilities | **133** | **770** | **46** | **949** |

| 2011 | Private equity £m | Property partner-ships £m | Unit trusts £m | Total £m |
|---|---|---|---|---|
| Aggregate revenues | 6 | 112 | 200 | 318 |
| Aggregate profit/(loss) | 5 | 76 | 90 | 171 |
| Gross assets | 86 | 2,417 | 3,618 | 6,121 |
| Gross liabilities | – | 939 | 59 | 998 |

## EUROPEAN EMBEDDED VALUE BASIS

### CONSOLIDATED INCOME STATEMENT

| For the year ended 31 December 2012 | Notes | 2012 £m | 2011 £m |
|---|---|---|---|
| **From continuing operations** | | | |
| Protection and Annuities | 2 | **668** | 808 |
| Savings | 2 | **89** | 226 |
| Investment management | 5 | **216** | 210 |
| US Protection | 2 | **98** | 238 |
| Group capital and financing | 6 | **20** | 43 |
| Investment projects[1] | | **(50)** | (56) |
| **Operating profit** | | **1,041** | 1,469 |
| Investment variances[2] | 2 | **(32)** | (111) |
| Effect of economic assumption changes | 7 | **(162)** | (21) |
| Losses attributable to non-controlling interests | | **(12)** | (3) |
| **Profit before tax** | | **835** | 1,334 |
| Tax expense attributable to equity holders of the Company | 9 | **(168)** | (259) |
| Effect of tax rate changes and other taxation impacts | 9 | **67** | 156 |
| **Profit for the year** | | **734** | 1,231 |
| **Losses attributable to non-controlling interests** | | **12** | 3 |
| **Profit attributable to equity holders of the Company** | | **746** | 1,234 |
| | | **p** | p |
| **Earnings per share** | 10 | | |
| Based on operating profit after tax attributable to equity holders of the Company | | **14.01** | 19.08 |
| Based on profit attributable to equity holders of the Company | | **12.75** | 21.17 |
| **Diluted earnings per share** | 10 | | |
| Based on operating profit after tax attributable to equity holders of the Company | | **13.78** | 18.77 |
| Based on profit attributable to equity holders of the Company | | **12.54** | 20.83 |

1. Investment projects predominantly relates to Solvency II and other strategic investments.
2. Investment variances include £18m of restructuring costs relating to a number of reorganisation initiatives around the Group, including the restructuring of the International segment.

During the year, the Group has changed the management lines of the international subsidiaries to reflect the development of our international strategy. This has had the consequence of changing the reportable segments of the Group as outlined in Note 27 to the Group consolidated financial statements. The prior period segmental information has been restated accordingly.

## EUROPEAN EMBEDDED VALUE BASIS (CONTINUED)

### CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

| For the year ended 31 December 2012 | 2012 £m | 2011 £m |
|---|---|---|
| **Profit for the year** | **734** | 1,231 |
| **Other comprehensive income after tax** | | |
| Exchange differences on translation of overseas operations | **(22)** | (1) |
| Actuarial (losses) on defined benefit pension schemes | **(59)** | (70) |
| Actuarial losses on defined benefit pension schemes transferred to unallocated divisible surplus | **41** | 48 |
| **Total comprehensive income for the year** | **694** | 1,208 |
| | | |
| Total comprehensive income/(expense) attributable to: | | |
| Non-controlling interests | **(12)** | (3) |
| Equity holders of the Company | **706** | 1,211 |

# EUROPEAN EMBEDDED VALUE BASIS (CONTINUED)

## CONSOLIDATED BALANCE SHEET

| As at 31 December 2012 | Notes | 2012 £m | 2011 Restated[1] £m |
|---|---|---|---|
| **Assets** | | | |
| Investments | | **338,630** | 319,671 |
| Long term in-force business asset | | **3,670** | 3,700 |
| Other assets | | **7,460** | 6,680 |
| **Total assets** | | **349,760** | 330,051 |
| | | | |
| **Equity** | | | |
| Shareholders' equity | 13/14 | **8,900** | 8,608 |
| Non-controlling interests | | **39** | 66 |
| **Total equity** | | **8,939** | 8,674 |
| | | | |
| **Liabilities** | | | |
| Subordinated borrowings | | **1,890** | 1,921 |
| Unallocated divisible surplus | | **1,153** | 1,038 |
| Participating contract liabilities | | **15,277** | 15,784 |
| Non-participating contract liabilities | | **302,686** | 285,351 |
| Senior borrowings | | **1,475** | 1,329 |
| Other liabilities and provisions | | **18,340** | 15,954 |
| **Total liabilities** | | **340,821** | 321,377 |
| **Total equity and liabilities** | | **349,760** | 330,051 |

1. The consolidated balance sheet has been restated to reflect the retrospective adoption of ASU 2010-26, issued by the FASB, which specifies the accounting for deferred acquisition costs under US GAAP. Details of this restatement are outlined in Note 1.

# EUROPEAN EMBEDDED VALUE BASIS (CONTINUED)

## NOTES TO THE SUPPLEMENTARY FINANCIAL STATEMENTS

### 1 METHODOLOGY

#### Basis of preparation

The supplementary financial statements have been prepared in accordance with the European Embedded Value (EEV) Principles issued in May 2004 by the European Insurance CFO Forum.

The supplementary financial statements have been audited by PricewaterhouseCoopers LLP and prepared with assistance from our consulting actuaries, Towers Watson in the UK and Milliman in the USA.

#### Change to accounting policy – US deferred acquisition costs

During 2012 the Group has changed its accounting policy for deferred acquisition costs in the US, details of which can be found within Note 1 of the Group consolidated financial statements. There is no impact on European Embedded Value reported profit resulting from this change. The impact on the consolidated balance sheet in is outlined below for 2011:

| Consolidated Balance Sheet | As reported 2011 £m | Change in US DAC treatment 2011 £m | Restated 2011 £m |
|---|---|---|---|
| **Assets** | | | |
| Long term in-force business asset | 3,556 | 144 | 3,700 |
| Other assets (Deferred acquisition costs) | 6,900 | (220) | 6,680 |
| **Liabilities** | | | |
| Other liabilities and provisions (Deferred tax) | 16,030 | (76) | 15,954 |
| **Total equity** | 8,674 | – | 8,674 |

#### Covered business

The Group uses EEV methodology to value individual and group life assurance, pensions and annuity business written in the UK, Continental Europe and the US. The UK covered business also includes non-insured self invested personal pension (SIPP) business.

The managed pension funds business has been excluded from covered business and is reported on an IFRS basis.

All other businesses are accounted for on the IFRS basis adopted in the primary financial statements.

There is no distinction made between insurance and investment contracts in our covered business as there is under IFRS.

#### Description of methodology

The objective of EEV is to provide shareholders with realistic information on the financial position and current performance of the Group.

The methodology requires assets of an insurance company, as reported in the primary financial statements, to be attributed between those supporting the covered business and the remainder. The method accounts for assets in the covered business on an EEV basis and the remainder of the Group's assets on the IFRS basis adopted in the primary financial statements.

The EEV methodology recognises profit from the covered business as the total of:

i. cash transfers during the relevant period from the covered business to the remainder of the Group's assets; and
ii. the movement in the present value of future distributable profits to shareholders arising from the covered business over the relevant reporting period.

#### Embedded value

Shareholders' equity on the EEV basis comprises the embedded value of the covered business plus the shareholders' equity of other businesses, less the value included for purchased interests in long term business.

The embedded value is the sum of the shareholder net worth (SNW) and the value of the in-force business (VIF). SNW is defined as those amounts, within covered business (both within the long term fund and held outside the long term fund but used to support long term business), which are regarded either as required capital or which represent free surplus.

The VIF is the present value of future shareholder profits arising from the covered business, projected using best estimate assumptions, less an appropriate deduction for the cost of holding the required level of capital and the time value of financial options and guarantees (FOGs).

## EUROPEAN EMBEDDED VALUE BASIS (CONTINUED)

### 1 METHODOLOGY (CONTINUED)

**Service companies**

All services relating to the UK covered business are charged on a cost recovery basis, with the exception of investment management services provided to Legal & General Pensions Limited (LGPL) and to Legal & General Assurance Society Limited (Society). Profits arising on the provision of these services are valued on a look through basis.

As the EEV methodology incorporates the future capitalised cost of these internal investment management services, the equivalent IFRS profits have been removed from the Investment management segment and are instead included in the results of the Protection and Annuities and Savings segments on an EEV basis.

The capitalised value of future profits emerging from internal investment management services are therefore included in the embedded value and new business contribution calculations for the Protection and Annuities and Savings segments. However, the historical profits which have emerged continue to be reported in the shareholders' equity of the Investment management segment on an IFRS basis. Since the look through into service companies includes only future profits and losses, current intra-group profits or losses must be eliminated from the closing embedded value and in order to reconcile the profits arising in the financial period within each segment with the net assets on the opening and closing balance sheet, a transfer of IFRS profits for the period from the UK SNW is deemed to occur.

**New business**

New business premiums reflect income arising from the sale of new contracts during the reporting period and any changes to existing contracts, which were not anticipated at the outset of the contract.

In-force business comprises previously written single premium, regular premium, recurrent single premium contracts and payments in relation to existing longevity insurance. Department of Work and Pensions rebates have not been treated as recurring and are included in single premium new business when received. Longevity insurance product comprises the exchange of a stream of fixed leg payments for a stream of floating payments, with the value of the income stream being the difference between the two legs. New business annual premiums have been excluded for longevity insurance due to the unpredictable deal flow from this type of business.

New business contribution arising from the new business premiums written during the reporting period has been calculated on the same economic and operating assumptions used in the embedded value at the end of the financial period. This has then been rolled forward to the end of the financial period using the risk discount rate applicable at the end of the reporting period.

The present value of future new business premiums (PVNBP) has been calculated and expressed at the point of sale. The PVNBP is equivalent to the total single premiums plus the discounted value of regular premiums expected to be received over the term of the contracts using the same economic and operating assumptions used for the embedded value at the end of the financial period, with the exception of longevity insurance. For longevity insurance, PVNBP is not an appropriate measure of expected income stream and as such, the PVNBP has not been applied for this product.

The new business margin is defined as new business contribution at the end of the reporting period divided by the PVNBP, with the exception of longevity insurance. The new business margin has not been applied to longevity insurance for the reason above. The premium volumes and projection assumptions used to calculate the PVNBP are the same as those used to calculate new business contribution.

Intra-group reinsurance arrangements are in place between the US and UK businesses, and it is expected that these arrangements will be periodically extended to cover recent new business. US new business premiums and contribution reflect the groupwide expected impact of US directly-written business.

**Projection assumptions**

Cash flow projections are determined using best estimate assumptions for each component of cash flow and for each policy group. Future economic and investment return assumptions are based on conditions at the end of the financial period. Future investment returns are projected by one of two methods. The first method is based on an assumed investment return attributed to assets at their market value. The second, which is used by US Protection, where the investments of that subsidiary are substantially all fixed interest, projects the cash flows from the current portfolio of assets and assumes an investment return on reinvestment of surplus cash flows. The assumed discount and inflation rates are consistent with the investment return assumptions.

Detailed projection assumptions including mortality, morbidity, persistency and expenses reflect recent operating experience and are normally reviewed annually. Allowance is made for future improvements in annuitant mortality based on experience and externally published data. Favourable changes in operating experience are not anticipated until the improvement in experience has been observed.

All costs relating to the covered business, whether incurred in the covered business or elsewhere in the Group, are allocated to that business. The expense assumptions used for the cash flow projections therefore include the full cost of servicing this business.

## EUROPEAN EMBEDDED VALUE BASIS (CONTINUED)

### Tax
The projections take into account all tax which is expected to be paid, based on best estimate assumptions, applying current legislation and practice together with known future changes. The impact of the changes to the UK taxation regime for life assurance companies has been calculated to increase embedded value by £14m.

### Allowance for risk
Aggregate risks within the covered business are allowed for through the following principal mechanisms:

i. setting required capital levels with reference to both the Group's internal risk based capital models, and an assessment of the strength of regulatory reserves in the covered business;
ii. allowing explicitly for the time value of financial options and guarantees within the Group's products; and
iii. setting risk discount rates by deriving a Group level risk margin to be applied consistently to local risk free rates.

### Required capital and free surplus
Regulatory capital for the UK Protection and Annuities and Savings businesses is provided by assets backing the with-profits business or by the SNW. The SNW comprises all shareholders' capital within Society, including those funds retained within the long term fund and the excess assets in LGPL (collectively Society shareholder capital).

Society shareholder capital is either required to cover EU solvency margin or is free surplus as its distribution to shareholders is not restricted.

For UK with-profits business, the required capital is covered by the surplus within the with-profits part of the fund and no effect is attributed to shareholders except for the burn-through cost, which is described later. This treatment is consistent with the Principles and Practices of Financial Management for this part of the fund.

For UK non profit business, the required capital will be maintained at no less than the level of the EU minimum solvency requirement. This level, together with the margins for adverse deviation in the regulatory reserves, is, in aggregate, in excess of internal capital targets assessed in conjunction with the Individual Capital Assessment (ICA) and the with-profits support account.

The initial strains relating to new non profit business, together with the related EU solvency margin, are supported by releases from existing non profit business and the Society shareholder capital. As a consequence, the writing of new business defers the release of capital to free surplus. The cost of holding required capital is defined as the difference between the value of the required capital and the present value of future releases of that capital. For new business, the cost of capital is taken as the difference in the value of that capital assuming it was available for release immediately and the present value of the future releases of that capital. As the investment return, net of tax, on that capital is less than the risk discount rate, there is a resulting cost of capital which is reflected in the value of new business.

For US Protection, the Company Action Level (CAL) of capital has been treated as required capital for modelling purposes. The CAL is the regulatory capital level at which the company would have to take prescribed action, such as submission of plans to the State insurance regulator, but would be able to continue operating on the existing basis. The CAL is currently twice the level of capital at which the regulator is permitted to take control of the business.

For LGN, required capital has been set at 100% of EU minimum solvency margin for all products without FOGs. For those products with FOGs, capital of between 100% and 281% of the EU minimum solvency margin has been used. The level of capital has been determined using risk based capital techniques.

For LGF, 100% of EU minimum solvency margin has been used for EV modelling purposes for all products both with and without FOGs. The level of capital has been determined using risk based capital techniques.

The contribution from new business for our international businesses reflects an appropriate allowance for the cost of holding the required capital.

### Financial options and guarantees
Under the EEV Principles an allowance for time value of FOGs is required where a financial option exists which is exercisable at the discretion of the policyholder. These types of option principally arise within the with-profits part of the fund and their time value is recognised within the with-profits burn-through cost described below. Additional financial options for non profit business exist only for a small amount of deferred annuity business where guaranteed early retirement and cash commutation terms apply when the policyholders choose their actual retirement date.

## EUROPEAN EMBEDDED VALUE BASIS (CONTINUED)

### 1 METHODOLOGY (CONTINUED)

Further financial guarantees exist for non profit business, in relation to index-linked annuities where capped or collared restrictions apply. Due to the nature of these restrictions and the manner in which they vary depending on the prevailing inflation conditions, they are also treated as FOGs and a time value cost recognised accordingly.

The time value of FOGs has been calculated stochastically using a large number of real world economic scenarios derived from assumptions consistent with the deterministic EEV assumptions and allowing for appropriate management actions where applicable. The management action primarily relates to the setting of bonus rates. Future regular and terminal bonuses on participating business within the projections are set in a manner consistent with expected future returns available on assets deemed to back the policies within the stochastic scenarios.

In recognising the residual value of any projected surplus assets within the with-profits part of the fund in the deterministic projection, it is assumed that terminal bonuses are increased to exhaust all of the assets in the part of the fund over the future lifetime of the in-force with-profits policies. However, under stochastic modelling, there may be some extreme economic scenarios when the total projected assets within the with-profits part of the fund are insufficient to pay all projected policyholder claims and associated costs. The average additional shareholder cost arising from this shortfall has been included in the time value cost of financial options and guarantees and is referred to as the with-profits burn-through cost.

Economic scenarios have been used to assess the time value of the financial guarantees for non profit business by using the inflation rate generated in each scenario. The inflation rate used to project index-linked annuities will be constrained in certain real world scenarios, for example, where negative inflation occurs but the annuity payments do not reduce below pre-existing levels. The time value cost of FOGs allows for the projected average cost of these constrained payments for the index-linked annuities. It also allows for the small additional cost of the guaranteed early retirement and cash commutation terms for the minority of deferred annuity business where such guarantees have been written.

US Protection FOGs relate to guaranteed minimum crediting rates and surrender values on a range of contracts. The guaranteed surrender value of the contract is based on the accumulated value of the contract including accrued interest. The crediting rates are discretionary but related to the accounting income for the amortising bond portfolio. The majority of the guaranteed minimum crediting rates are between 3% and 4%. The assets backing these contracts are invested in US Dollar denominated fixed interest securities.

LGN separately provides for two types of guarantees: interest rate guarantees and maturity guarantees. Certain contracts provide an interest rate guarantee where there is a minimum crediting rate based on the higher of 1-year Euribor and the policy guarantee rate. This guarantee applies on a monthly basis. Certain unit linked contracts provide a guaranteed minimum value at maturity where the maturity amount is the higher of the fund value and a guarantee amount. The fund values for both these contracts are invested in Euro denominated fixed interest securities.

For LGF, FOGs which have been separately provided for relate to guaranteed minimum crediting rates and surrender values on a range of contracts. The guaranteed surrender value of the contract is the accumulated value of the contract including accrued bonuses. The bonuses are based on the accounting income for the amortising bond portfolios plus income and releases from realised gains on any equity type investments. Policy liabilities equal guaranteed surrender values. Local statutory accounting rules require the establishment of a specific liability when the accounting income for a company is less than 125% of the guaranteed minimum credited returns, although this has never been required. In general, the guaranteed annual bonus rates are between 0% and 4.5%.

#### Risk free rate

The risk free rate is set to reflect both the pattern of the emerging profits under EEV and the relevant duration of the liabilities where backing assets reflect this assumption (e.g. equity returns). For the UK, it is set by reference to the gross redemption yield on the 15 year gilt index. For LGA, the risk free rate is the 10 year US Treasury effective yield, while the 10 year ECB AAA-rated Euro area central government bond par yield is used for LGN and LGF.

#### Risk discount rate

The risk discount rate (RDR) is a combination of the risk free rate and a risk margin, which reflects the residual risks inherent in the Group's covered businesses, after taking account of prudential margins in the statutory provisions, the required capital and the specific allowance for FOGs.

The risk margin has been determined based on an assessment of the Group's weighted average cost of capital (WACC). This assessment incorporates a beta for the Group, which measures the correlation of movements in the Group's share price to movements in a relevant index. Beta values therefore allow for the market's assessment of the risks inherent in the business relative to other companies in the chosen index.

## EUROPEAN EMBEDDED VALUE BASIS (CONTINUED)

The WACC is derived from the Group's cost of equity and debt, and the proportion of equity to debt in the Group's capital structure measured using market values. Each of these three parameters is forward looking, although informed by historic information and appropriate judgements where necessary. The cost of equity is calculated as the risk free rate plus the equity risk premium for the chosen index multiplied by the Company's beta. Forward looking or adjusted betas make allowance for the observed tendency for betas to revert to 1 and therefore a weighted average of the historic beta and 1 tends to be a better estimate of the Company's beta for the future period. We have computed the WACC using an arithmetical average of forward looking betas against the FTSE 100 index.

The cost of debt used in the WACC calculations takes account of the actual locked-in rates for our senior and subordinated long term debt. All debt interest attracts tax relief at a rate of 21.3%.

Whilst the WACC approach is a relatively simple and transparent calculation to apply, subjectivity remains within a number of the assumptions. Management believes that the chosen margin, together with the levels of required capital, the inherent strength of the Group's regulatory reserves and the explicit deduction for the cost of options and guarantees, is appropriate to reflect the risks within the covered business.

### Analysis of profit

Operating profit is identified at a level which reflects an assumed longer term level of investment return.

The contribution to operating profit in a period is attributed to four sources:

i. new business;
ii. the management of in-force business;
iii. development costs; and
iv. return on shareholder net worth.

Further profit contributions arise from actual investment return differing from the assumed long term investment return (investment return variances), and from the effect of economic assumption changes.

The contribution from new business represents the value recognised at the end of each period from new business written in that period, after allowing for the actual cost of acquiring the business and of establishing the required technical provisions and reserves and after making allowance for the cost of capital. New business contributions are calculated using closing assumptions.

The contribution from in-force business is calculated using opening assumptions and comprises:

i. expected return – the discount earned from the value of business in-force at the start of the year;
ii. experience variances – the variance in the actual experience over the reporting period from that assumed in the value of business in-force as at the start of the year; and
iii. operating assumption changes – the effects of changes in future assumptions, other than changes in economic assumptions from those used in valuing the business at the start of the year. These changes are made prospectively from the end of the year.

Development costs relate to investment in strategic systems and development capability.

The contribution from shareholder net worth comprises the increase in embedded value based on assumptions at the start of the year in respect of the expected investment return on the Society shareholder capital.

Further profit contributions arise from investment return variances and the effect of economic assumption changes.

Investment return variances represent the effect of actual investment performance and changes to investment policy on SNW and VIF business from that assumed at the beginning of the period.

Economic assumption changes comprise the effect of changes in economic variables on SNW and VIF business from that assumed at the beginning of the period, which are beyond the control of management, including associated changes to valuation bases to the extent that they are reflected in revised assumptions.

## EUROPEAN EMBEDDED VALUE BASIS (CONTINUED)

### 2 PROFIT/(LOSS) FOR THE YEAR

| For the year ended 31 December 2012 | Notes | P&A and Savings £m | Investment management £m | US Protection £m | Group capital and financing £m | Total £m |
|---|---|---|---|---|---|---|
| **Business reported on an EEV basis:** | | | | | | |
| Contribution from new business after cost of capital | 3 | 377 | | 98 | | 475 |
| Contribution from in-force business: | | | | | | |
| – expected return[1] | | 372 | | 76 | | 448 |
| – experience variances | 4 | 12 | | (59) | | (47) |
| – operating assumption changes | 4 | (11) | | (18) | | (29) |
| Development costs | | (37) | | – | | (37) |
| Contribution from shareholder net worth | | 6 | | 5 | 134 | 145 |
| **Operating profit on covered business** | | 719 | – | 102 | 134 | 955 |
| **Business reported on an IFRS basis:** | | | | | | |
| Protection and Annuities non-covered business[2] | | 27 | | | | 27 |
| Savings non-covered business[3] | | 11 | | | | 11 |
| Investment management[4] | 5 | | 216 | | | 216 |
| Group capital and financing | 6 | | | | (114) | (114) |
| Investment projects[5] | | | | | (50) | (50) |
| US Protection non-covered business[6] | | | | (4) | | (4) |
| **Total operating profit** | | 757 | 216 | 98 | (30) | 1,041 |
| Investment variances[7] | | 7 | (5) | 6 | (40) | (32) |
| Effect of economic assumption changes | 7 | (164) | – | 2 | – | (162) |
| Losses attributable to non-controlling interests | | – | – | – | (12) | (12) |
| **Profit/(loss) before tax** | | 600 | 211 | 106 | (82) | 835 |
| Tax (expense)/credit on profit from ordinary activities | 9 | (128) | (39) | (28) | 27 | (168) |
| Effect of tax rate changes and other taxation impacts[8] | 9 | 89 | – | (22) | – | 67 |
| **Profit/(loss) for the year** | | 561 | 172 | 56 | (55) | 734 |
| | | | | | | |
| Operating profit attributable to: | | | | | | |
| Protection and Annuities | | 668 | | | | |
| Savings | | 89 | | | | |

1. The expected return on in-force is based on the unwind of the risk discount rate on the opening, adjusted base value of in-force (VIF). The opening base VIF of the UK Protection and Annuities and Savings business was £4,247m in 2012 (2011: £3,886m). This is adjusted for the effects of opening model changes of £86m (2011: £200m) to give an adjusted opening base VIF of £4,333m (2011: £4,086m). This is then multiplied by the opening risk discount rate of 6.2% (2011: 7.3%) and the result grossed up at the notional attributed tax rate of 21% (2011: 23%) to give a return of £340m (2011: £387m). The same approach has been applied for the overseas Protection and Annuities businesses.
2. Protection and Annuities non-covered business primarily reflects GI operating profit of £30m (2011: £42m). See Note 2(ii)(f) in the Group consolidated financial statements.
3. Savings non-covered business mainly comprises Savings investments on an IFRS basis, adjusted for Suffolk Life, International (Ireland), Nationwide and our joint venture operation in India.
4. Investment management operating profit excludes £27m (2011: £24m) of profits arising from the provision of investment management services at market referenced rates to the covered business. These are reported on a look through basis and as a consequence are included in the Protection and Annuities, Savings and Group capital and financing covered business on an EEV basis.
5. Investment projects predominantly relate to Solvency II and other strategic investments.
6. US Protection non-covered business includes business unit costs of £4m (2011: £4m) allocated to the US Protection segment.
7. Investment variances include £18m of restructuring costs relating to a number of reorganisation initiatives around the Group, including the restructuring of the International segment.
8. Primarily reflects the implementation of the UK planned future reductions in corporation tax to 21% on 1 April 2014, and improvements in the US to the recognition of tax losses and DAC tax assets.

## EUROPEAN EMBEDDED VALUE BASIS (CONTINUED)

| For the year ended 31 December 2011 | Notes | P&A and Savings £m | Investment management £m | US Protection £m | Group capital and financing £m | Total £m |
|---|---|---|---|---|---|---|
| **Business reported on an EEV basis:** | | | | | | |
| Contribution from new business after cost of capital | 3 | 372 | | 69 | | 441 |
| Contribution from in-force business: | | | | | | |
| – expected return[1] | | 421 | | 73 | | 494 |
| – experience variances | 4 | 87 | | 150 | | 237 |
| – operating assumption changes | 4 | 95 | | (62) | | 33 |
| Development costs | | (10) | | – | | (10) |
| Contribution from shareholder net worth | | 9 | | 12 | 157 | 178 |
| **Operating profit on covered business** | | 974 | – | 242 | 157 | 1,373 |
| **Business reported on an IFRS basis:** | | | | | | |
| Protection and Annuities non-covered business[2] | | 35 | | | | 35 |
| Savings non-covered business[3] | | 25 | | | | 25 |
| Investment management[4] | 5 | | 210 | | | 210 |
| Group capital and financing | 6 | | | | (114) | (114) |
| Investment projects[5] | | | | | (56) | (56) |
| US Protection non-covered business[6] | | | | (4) | | (4) |
| **Total operating profit** | | 1,034 | 210 | 238 | (13) | 1,469 |
| Investment variances | | 102 | (7) | 16 | (222) | (111) |
| Effect of economic assumption changes | 7 | 16 | – | (37) | – | (21) |
| Losses attributable to non-controlling interests | | – | – | – | (3) | (3) |
| **Profit/(loss) before tax** | | 1,152 | 203 | 217 | (238) | 1,334 |
| Tax (expense)/credit on profit from ordinary activities | 9 | (266) | (38) | (76) | 121 | (259) |
| Effect of tax rate changes and other taxation impacts[7] | 9 | 156 | – | – | – | 156 |
| **Profit/(loss) for the year** | | 1,042 | 165 | 141 | (117) | 1,231 |
| | | | | | | |
| Operating profit attributable to: | | | | | | |
| Protection and Annuities | | 808 | | | | |
| Savings | | 226 | | | | |

1. The expected return on in-force is based on the unwind of the risk discount rate on the opening, adjusted base value of in-force (VIF). The opening base VIF of the UK Protection and Annuities and Savings business was £3,886m. This is adjusted for the effects of opening model changes of £200m to give an adjusted opening base VIF of £4,086m. This is then multiplied by the opening risk discount rate of 7.3% and the result grossed up at the notional attributed tax rate of 23% to give a return of £387m. The same approach has been applied for the overseas Protection and Annuities businesses.
2. Protection and Annuities non-covered business primarily reflects GI operating profit of £42m. (See Note 2(ii)(f) of the Group consolidated financial statements).
3. Savings non-covered business mainly comprises Savings investments on an IFRS basis, adjusted for Suffolk Life, International (Ireland), Nationwide and our joint venture operation in India.
4. Investment management operating profit excludes £24m of profits arising from the provision of investment management services at market referenced rates to the covered business. These are reported on a look through basis and as a consequence are included in the Protection and Annuities, Savings and Group capital and financing covered business on an EEV basis.
5. Investment projects predominantly relate to Solvency II and other strategic investments.
6. US Protection non-covered business includes business unit costs of £4m allocated to the US Protection segment.
7. Primarily reflects the implementation of the UK planned future reductions in corporation tax to 23% on 1 April 2014.

## EUROPEAN EMBEDDED VALUE BASIS (CONTINUED)

### 3 NEW BUSINESS[1]

| For the year ended 31 December 2012 | Annual premiums £m | Present value of annual premiums £m | Capitalisation factor[2] | Single premiums £m | PVNBP[3] £m | Contribution from new business[4] £m | New business margin[5] % |
|---|---|---|---|---|---|---|---|
| Protection and Annuities[6] | **272** | **1,585** | **5.8** | **2,654** | **4,239** | **350** | **8.3** |
| Savings | **577** | **2,117** | **3.7** | **3,002** | **5,119** | **27** | **0.5** |
| US Protection | **90** | **830** | **9.2** | **–** | **830** | **98** | **11.8** |
| | **939** | **4,532** | **4.8** | **5,656** | **10,188** | **475** | **4.7** |

| For the year ended 31 December 2011 | Annual premiums £m | Present value of annual premiums £m | Capitalisation factor[2] | Single premiums £m | PVNBP[3] £m | Contribution from new business[4] £m | New business margin[5] % |
|---|---|---|---|---|---|---|---|
| Protection and Annuities[6] | 206 | 1,141 | 5.5 | 2,842 | 3,983 | 341 | 8.4 |
| Savings | 313 | 1,128 | 3.6 | 2,768 | 3,896 | 31 | 0.8 |
| US Protection | 69 | 637 | 9.3 | – | 637 | 69 | 10.7 |
| | 588 | 2,906 | 4.9 | 5,610 | 8,516 | 441 | 5.1 |

1. Covered business only.
2. The capitalisation factor is the present value of annual premiums divided by the amount of annual premiums.
3. The present value of new business premiums (PVNBP) on the EEV basis is defined as the present value of annual premiums plus single premiums for any given period. It is calculated using the same assumptions as for the contribution from new business but determined as at the point of sale.
4. The contribution from new business is defined as the present value at point of sale of assumed profits from new business written in the period and then rolled forward to the end of the financial period using the risk discount rate applicable at the end of the reporting period.
5. The new business margin is defined as the contribution from new business (including the cost of solvency capital) divided by the PVNBP.
6. Longevity insurance has only been included in the contribution from new business and has been excluded from all other Protection and Annuities new business measures. See Note 1.

### 4 ANALYSIS OF EXPERIENCE VARIANCES AND OPERATING ASSUMPTION CHANGES

| | P&A and Savings | | | US Protection | | |
|---|---|---|---|---|---|---|
| For the year ended 31 December 2012 | Experience variances £m | Operating assumption changes £m | Total £m | Experience variances £m | Operating assumption changes £m | Total £m |
| Persistency | **(18)** | **(6)** | **(24)** | **(14)** | **–** | **(14)** |
| Mortality/morbidity | **12** | **(15)** | **(3)** | **(4)** | **(18)** | **(22)** |
| Expenses | **(11)** | **(17)** | **(28)** | **–** | **–** | **–** |
| Other | **29** | **27** | **56** | **(41)** | **–** | **(41)** |
| | **12** | **(11)** | **1** | **(59)** | **(18)** | **(77)** |

2012 P&A and Savings negative persistency experience reflects higher than expected lapses in unit linked bonds.

2012 operating assumption changes in P&A and Savings have been driven by negative mortality and demorgraphic assumption changes in the annuity business and higher investment expense assumptions, largely offset by positive impacts reflecting changes in UK tax legislation.

2012 US Protection modelling and other experience variances mostly relate to additional reserving associated with the introduction of AG38 regulatory requirements.

2012 operating assumption changes in US Protection mostly relate to higher mortality assumptions on unit linked secondary guarantee business.

## EUROPEAN EMBEDDED VALUE BASIS (CONTINUED)

| | P&A and Savings | | | US Protection | | |
|---|---|---|---|---|---|---|
| For the year ended 31 December 2011 | Experience variances £m | Operating assumption changes £m | Total £m | Experience variances £m | Operating assumption changes £m | Total £m |
| Persistency | (1) | 6 | 5 | 9 | (21) | (12) |
| Mortality/morbidity | (35) | (10) | (45) | (17) | (52) | (69) |
| Expenses | (7) | 56 | 49 | – | – | – |
| Other | 130 | 43 | 173 | 158 | 11 | 169 |
| | 87 | 95 | 182 | 150 | (62) | 88 |

2011 P&A and Savings mortality experience variances primarily relates to our group protection business which was impacted by a number of high value claims which predominantly occurred during H1 11.

2011 P&A and Savings expense operating assumption changes reflects the change in long term expense assumptions in protection business and changes in the modelled long term unit cost and investment expenses assumptions in non profit savings and pensions.

Adverse US Protection persistency and mortality operating assumptions changes mainly relate to term assurances in the period after the end of the guaranteed level premium period when premiums increase.

The domicile of a US captive structure was moved from Bermuda to Vermont which results in an acceleration of the emergence of surplus, and as a consequence increases the present value of the in-force business.

### 5 INVESTMENT MANAGEMENT OPERATING PROFIT

| | **2012 £m** | 2011 £m |
|---|---|---|
| Pension funds (managed and segregated)[1] | **181** | 172 |
| Other non-pension[2] | **22** | 25 |
| Investment management services for internal funds[3] | **13** | 13 |
| **Total Investment management operating profit** | **216** | 210 |

1. The managed pension funds business within Investment management has been reported on an IFRS basis as is consistent with prior years.
2. Other non-pension includes institutional segregated mandates, private equity and property (both in the UK and overseas). Interest income on shareholder funds of £6m (2011: £9m) on an average asset balance of £0.4bn (2011: £0.4bn) has been included within other non-pension operating profit.
3. Investment management services for internal funds excludes £27m (2011: £24m) of profits arising from the provision of investment management services at market referenced rates to the covered business. These are reported on a look through basis within the Protection and Annuities and Savings covered business on an EEV basis.

### 6 GROUP CAPITAL AND FINANCING OPERATING PROFIT[1]

| | **2012 £m** | 2011 £m |
|---|---|---|
| Investment return | **168** | 191 |
| Interest expense[2] | **(127)** | (123) |
| Investment expenses | **(5)** | (5) |
| Unallocated corporate expenses[3] | **(14)** | (12) |
| Other | **(2)** | (8) |
| **Total Group capital and financing operating profit** | **20** | 43 |
| | | |
| **Analysed as:** | | |
| On an EEV basis | **134** | 157 |
| On an IFRS basis | **(114)** | (114) |

1. Group capital and financing represents operating profit on the shareholder assets held within the covered business, reported on an embedded value basis, and operating profit on the shareholder assets held outside the covered business reported on an IFRS basis.
2. Interest expense excludes non recourse financing (see Note 22 of the Group consolidated financial statements).
3. Unallocated corporate expenses includes the operating profit/(loss) attributable to our joint venture operations in Egypt and the Gulf.

## EUROPEAN EMBEDDED VALUE BASIS (CONTINUED)

### 7 EFFECT OF ECONOMIC ASSUMPTION CHANGES

| | 2012 £m | 2011 £m |
|---|---|---|
| **Business reported on an EEV basis:** | | |
| Protection and Annuities and Savings[1] | **(164)** | 16 |
| US Protection | **2** | (37) |
| | **(162)** | (21) |

1. Protection and Annuities and Savings primarily reflect the impact of changes in reinvestment and disinvestment rates, higher costs of capital on increasing reserves mainly due to narrowing credit spreads, and other consequential impacts within lower yielding environments, partially offset by a lower risk discount rate.

### 8 TIME VALUE OF FINANCIAL OPTIONS AND GUARANTEES

| | 2012 £m | 2011 £m |
|---|---|---|
| Protection and Annuities and Savings[1] | **30** | 27 |
| US Protection | **–** | 4 |
| | **30** | 31 |

1. Includes £18m (2011: £16m) relating to UK with-profits business, and £5m (2011: £5m) relating to UK non profit business.

### 9 TAX

| | Profit/(loss) before tax 2012 £m | Tax (expense)/credit 2012 £m | Profit/(loss) before tax 2011 £m | Tax (expense)/credit 2011 £m |
|---|---|---|---|---|
| **From continuing operations** | | | | |
| Protection and Annuities | **668** | **(145)** | 808 | (189) |
| Savings | **89** | **(19)** | 226 | (54) |
| Investment management | **216** | **(40)** | 210 | (40) |
| US Protection | **98** | **(25)** | 238 | (83) |
| Group capital and financing | **20** | **(4)** | 43 | (6) |
| Investment projects | **(50)** | **12** | (56) | 15 |
| **Operating profit** | **1,041** | **(221)** | 1,469 | (357) |
| Investment variances | **(32)** | **14** | (111) | 87 |
| Effect of economic assumption changes | **(162)** | **39** | (21) | 11 |
| Losses attributable to non-controlling interests | **(12)** | **–** | (3) | – |
| Effect of tax rate changes and other taxation impacts[1] | **–** | **67** | – | 156 |
| **Profit/(loss) before tax/Tax** | **835** | **(101)** | 1,334 | (103) |

1. Primarily reflects the implementation of the UK planned future reductions in corporation tax to 21% on 1 April 2014, and improvements in the US to the recognition of tax losses and DAC tax assets.

The UK EEV calculations assume a tax basis which reflects the annualised current tax rate of 24.5% and the planned future reductions in corporation tax to 23% from 1 April 2013, and 21% from 1 April 2014. The tax rate used for grossing up in the income statement is based on a UK corporation tax rate of 21% (2011: 23%).

US, Netherlands and France covered business profits are also grossed up using the long term corporate tax rates of the respective territories i.e. US is 35% (2011: 35%), France is 34.3% (2011: 34.3%) and Netherlands is 25% (2011: 25%).

## EUROPEAN EMBEDDED VALUE BASIS (CONTINUED)

### 10 EARNINGS PER SHARE

#### (i) Earnings per share

| | Profit before tax 2012 £m | Tax (expense)/ credit 2012 £m | Profit after tax 2012 £m | Per share 2012 p | Profit before tax 2011 £m | Tax (expense)/ credit 2011 £m | Profit after tax 2011 £m | Per share 2011 p |
|---|---|---|---|---|---|---|---|---|
| **Operating profit** | **1,041** | **(221)** | **820** | **14.01** | 1,469 | (357) | 1,112 | 19.08 |
| Investment variances | **(32)** | **14** | **(18)** | **(0.30)** | (111) | 87 | (24) | (0.41) |
| Effect of economic assumption changes | **(162)** | **39** | **(123)** | **(2.11)** | (21) | 11 | (10) | (0.17) |
| Effect of tax rate changes and other taxation impacts | **–** | **67** | **67** | **1.15** | – | 156 | 156 | 2.67 |
| **Earnings per share based on profit attributable to equity holders** | **847** | **(101)** | **746** | **12.75** | 1,337 | (103) | 1,234 | 21.17 |

#### (ii) Diluted earnings per share

(a) Based on operating profit after tax

| | Profit after tax 2012 £m | Number of shares[1] 2012 m | Per share 2012 p | Profit after tax 2011 £m | Number of shares[1] 2011 m | Per share 2011 p |
|---|---|---|---|---|---|---|
| **Operating profit after tax** | **820** | **5,851** | **14.01** | 1,112 | 5,828 | 19.08 |
| Net shares under options allocable for no further consideration | **–** | **99** | **(0.23)** | – | 97 | (0.31) |
| **Diluted earnings per share** | **820** | **5,950** | **13.78** | 1,112 | 5,925 | 18.77 |

(b) Based on profit attributable to equity holders of the Company

| | Profit after tax 2012 £m | Number of shares[1] 2012 m | Per share 2012 p | Profit after tax 2011 £m | Number of shares[1] 2011 m | Per share 2011 p |
|---|---|---|---|---|---|---|
| **Profit attributable to equity holders of the Company** | **746** | **5,851** | **12.75** | 1,234 | 5,828 | 21.17 |
| Net shares under options allocable for no further consideration | **–** | **99** | **(0.21)** | – | 97 | (0.34) |
| **Diluted earnings per share** | **746** | **5,950** | **12.54** | 1,234 | 5,925 | 20.83 |

1. Weighted average number of shares.

The number of shares in issue at 31 December 2012 was 5,912,782,826 (31 December 2011: 5,872,166,893).

## EUROPEAN EMBEDDED VALUE BASIS (CONTINUED)

### 11 GROUP EMBEDDED VALUE RECONCILIATION – SUMMARY

| For the year ended 31 December 2012 | Covered business UK business £m | P&A overseas business £m | US Protection £m | Non-covered business £m | Total £m |
|---|---|---|---|---|---|
| **At 1 January** | | | | | |
| Value of in-force business (VIF) | 4,247 | 217 | 913 | – | 5,377 |
| Shareholder net worth (SNW) | 3,218 | 252 | 149 | (388) | 3,231 |
| | 7,465 | 469 | 1,062 | (388) | 8,608 |
| Exchange rate movements | – | (12) | (50) | 40 | (22) |
| Operating profit after tax for the year | 653 | 19 | 77 | 71 | 820 |
| Non-operating (loss)/profit for the year | (23) | (20) | (18) | (25) | (86) |
| Profit for the year | 630 | (1) | 59 | 46 | 734 |
| Capital movements | – | – | – | – | – |
| Intra-group distributions[2] | (473) | (14) | (40) | 527 | – |
| Dividends to equity holders of the Company | – | – | – | (394) | (394) |
| Transfer to non-covered business[3] | (22) | – | – | 22 | – |
| Other reserve movements including pension deficit[4] | (20) | – | (57) | 51 | (26) |
| **Embedded value** | 7,580 | 442 | 974 | (96) | 8,900 |
| Value of in-force business | 4,402 | 146 | 735 | – | 5,283 |
| Shareholder net worth | 3,178 | 296 | 239 | (96) | 3,617 |

| For the year ended 31 December 2011 | Covered business UK business £m | P&A overseas business £m | US Protection £m | Non-covered business £m | Total £m |
|---|---|---|---|---|---|
| **At 1 January** | | | | | |
| Value of in-force business (VIF) | 3,886 | 253 | 762 | – | 4,901 |
| Shareholder net worth (SNW) | 3,035 | 290 | 458 | (954) | 2,829 |
| | 6,921 | 543 | 1,220 | (954) | 7,730 |
| Exchange rate movements | – | (13) | 9 | 3 | (1) |
| Operating profit after tax for the year | 859 | 8 | 156 | 89 | 1,112 |
| Non-operating profit/(loss) for the year | 222 | (33) | (15) | (55) | 119 |
| Profit for the year | 1,081 | (25) | 141 | 34 | 1,231 |
| Capital movements[1] | – | 9 | (271) | 262 | – |
| Intra-group distributions[2] | (437) | (45) | (37) | 519 | – |
| Dividends to equity holders of the Company | – | – | – | (298) | (298) |
| Transfer to non-covered business[3] | (19) | – | – | 19 | – |
| Other reserve movements including pension deficit[4] | (81) | – | – | 27 | (54) |
| **Embedded value** | 7,465 | 469 | 1,062 | (388) | 8,608 |
| Value of in-force business | 4,247 | 217 | 913 | – | 5,377 |
| Shareholder net worth | 3,218 | 252 | 149 | (388) | 3,231 |

1. The 2011 capital movement of £262m primarily reflects the capital contribution made to LGA to enable the repurchase of Potomac securities of £271m. There is no corresponding movement in 2012.
2. UK intra-group distributions reflect a £525m (2011: £500m) dividend paid from Society to Group and dividends of £40m (2011: £20m) paid to Society from subsidiaries (primarily Nationwide Life). Dividends of $63m from LGA, €15m from LGN and €3m from LGF were also paid to the group (2011: $57m from LGA, €50m from LGN and €2m from LGF).
3. The transfer to non-covered business represents the IFRS profits arising in the period from the provisions of investment management services by Legal & General Investment Management to the UK covered business, which have been included in the operating profit of the covered business on the look through basis.
4. The other reserve movements reflects the pension deficit movement, the movement of investment project costs from covered to non-covered business and the effect of reinsurance arrangement transactions between UK and US covered business.

Further analysis of the Protection and Annuities and Savings UK covered business can be found in Note 12.

## EUROPEAN EMBEDDED VALUE BASIS (CONTINUED)

### 12 UK EMBEDDED VALUE RECONCILIATION

| For the year ended 31 December 2012 | Free surplus £m | Required capital £m | Shareholder net worth £m | Value of in-force £m | Total £m |
|---|---|---|---|---|---|
| **At 1 January** | | | | | |
| Value of in-force business (VIF) | – | – | – | 4,247 | 4,247 |
| Shareholder net worth (SNW) | 1,461 | 1,757 | 3,218 | – | 3,218 |
| | 1,461 | 1,757 | 3,218 | 4,247 | 7,465 |
| Operating profit/(loss) for the year: | | | | | |
| – New business contribution[1] | (275) | 182 | (93) | 386 | 293 |
| – Expected return on VIF | – | – | – | 270 | 270 |
| – Expected transfer from non profit VIF to SNW[2] | 762 | (171) | 591 | (591) | – |
| – With-profits transfer | 52 | – | 52 | (52) | – |
| – Expected return on SNW | 53 | 63 | 116 | – | 116 |
| Generation of embedded value | 592 | 74 | 666 | 13 | 679 |
| – Experience variances | (26) | 18 | (8) | 20 | 12 |
| – Operating assumption changes | 13 | 1 | 14 | (23) | (9) |
| – Development costs | (29) | – | (29) | – | (29) |
| Variances | (42) | 19 | (23) | (3) | (26) |
| Operating profit after tax for the year | 550 | 93 | 643 | 10 | 653 |
| Non-operating profit/(loss) for the year: | | | | | |
| – Investment variances | (72) | 11 | (61) | 3 | (58) |
| – Economic assumption changes | (110) | 96 | (14) | (40) | (54) |
| – Effect of tax rate changes and other taxation impacts | – | – | – | 89 | 89 |
| Non-operating (loss)/profit for the year | (182) | 107 | (75) | 52 | (23) |
| Profit for the year | 368 | 200 | 568 | 62 | 630 |
| Intra-group distributions[3] | (473) | – | (473) | – | (473) |
| Transfer to non-covered business[4] | (22) | – | (22) | – | (22) |
| Other reserve movements including pension deficit[5] | (124) | 11 | (113) | 93 | (20) |
| **Embedded value** | 1,210 | 1,968 | 3,178 | 4,402 | 7,580 |
| Represented by: | | | | | |
| – Non profit | | | | 4,008 | |
| – With-profits | | | | 394 | |
| Value of in-force business | – | – | – | 4,402 | 4,402 |
| Shareholder net worth | 1,210 | 1,968 | 3,178 | – | 3,178 |

1. The free surplus reduction of £275m to finance new business includes £93m IFRS new business strain and £182m additional required capital.
2. The increase in free surplus of £762m from the expected transfer from the in-force non profit business includes £591m of IFRS operational cash generation and a £171m reduction in required capital.
3. UK intra-group distributions reflect a £525m dividend paid from Society to Group and dividends of £40m paid to Society from subsidiaries (primarily Nationwide Life). Dividends of €15m from LGN were also paid to Society.
4. The transfer to non-covered business represents the IFRS profits arising in the period from the provisions of investment management services by Legal & General Investment Management to the UK covered business, which have been included in the operating profit of the covered business on the look through basis.
5. The other reserve movements reflects the pension deficit movement, the movement of investment project costs from covered to non-covered business and the effect of reinsurance arrangement transactions between UK and US covered business.

## EUROPEAN EMBEDDED VALUE BASIS (CONTINUED)

### 12 UK EMBEDDED VALUE RECONCILIATION (CONTINUED)

| For the year ended 31 December 2011 | Free surplus £m | Required capital £m | Shareholder net worth £m | Value of in-force £m | Total £m |
|---|---|---|---|---|---|
| **At 1 January** | | | | | |
| Value of in-force business (VIF) | – | – | – | 3,886 | 3,886 |
| Shareholder net worth (SNW) | 1,395 | 1,640 | 3,035 | – | 3,035 |
| | 1,395 | 1,640 | 3,035 | 3,886 | 6,921 |
| Operating profit/(loss) for the year: | | | | | |
| – New business contribution[1] | (258) | 167 | (91) | 381 | 290 |
| – Expected return on VIF | – | – | – | 298 | 298 |
| – Expected transfer from non profit VIF to SNW[2] | 745 | (185) | 560 | (560) | – |
| – With-profits transfer | 51 | – | 51 | (51) | – |
| – Expected return on SNW | 58 | 67 | 125 | – | 125 |
| Generation of embedded value | 596 | 49 | 645 | 68 | 713 |
| – Experience variances | (52) | 20 | (32) | 108 | 76 |
| – Operating assumption changes | 34 | 3 | 37 | 41 | 78 |
| – Development costs | (8) | – | (8) | – | (8) |
| Variances | (26) | 23 | (3) | 149 | 146 |
| Operating profit after tax for the year | 570 | 72 | 642 | 217 | 859 |
| Non-operating profit/(loss) for the year: | | | | | |
| – Investment variances | 81 | – | 81 | (47) | 34 |
| – Economic assumption changes | (65) | 45 | (20) | 53 | 33 |
| – Effect of tax rate changes and other taxation impacts | – | – | – | 155 | 155 |
| Non-operating profit/(loss) for the year | 16 | 45 | 61 | 161 | 222 |
| Profit for the year | 586 | 117 | 703 | 378 | 1,081 |
| Intra-group distributions[3] | (437) | – | (437) | – | (437) |
| Transfer to non-covered business[4] | (19) | – | (19) | – | (19) |
| Other reserve movements including pension deficit[5] | (64) | – | (64) | (17) | (81) |
| **Embedded value** | 1,461 | 1,757 | 3,218 | 4,247 | 7,465 |
| Represented by: | | | | | |
| – Non profit | | | | 3,808 | |
| – With-profits | | | | 439 | |
| Value of in-force business | – | – | – | 4,247 | 4,247 |
| Shareholder net worth | 1,461 | 1,757 | 3,218 | – | 3,218 |

1. The free surplus reduction of £258m to finance new business includes £94m IFRS new business strain and £167m additional required capital. Other items have a net negative impact of £3m.
2. The increase in free surplus of £745m from the expected transfer from the in-force non profit business includes £560m of IFRS operational cash generation and a £185m reduction in required capital.
3. UK intra-group distributions reflect a £500m dividend paid from Society to Group and dividends of £20m paid to Society from subsidiaries (primarily Nationwide Life). Dividends of €50m from LGN were also paid to Society.
4. The transfer to non-covered business represents the IFRS profits arising in the period from the provisions of investment management services by Legal & General Investment Management to the UK covered business, which have been included in the operating profit of the covered business on the look through basis.
5. The other reserve movements reflects the pension deficit movement, the movement of investment project costs from covered to non-covered business and the effect of reinsurance arrangement transactions between UK and US covered business.

# EUROPEAN EMBEDDED VALUE BASIS (CONTINUED)

## 13 ANALYSIS OF SHAREHOLDERS' EQUITY

| As at 31 December 2012 | P&A and Savings £m | Investment management £m | US Protection £m | Group capital and financing £m | Total £m |
|---|---|---|---|---|---|
| Analysed as: | | | | | |
| IFRS basis shareholders' equity[1] | 740 | 360 | 919 | 3,422 | 5,441 |
| Additional retained profit/(loss) on an EEV basis | 4,484 | – | 55 | (1,080) | 3,459 |
| **Shareholders' equity on an EEV basis** | 5,224 | 360 | 974 | 2,342 | 8,900 |
| Comprising: | | | | | |
| Business reported on an IFRS basis | 380 | 360 | – | (836) | (96) |
| Business reported on an EEV basis: | | | | | |
| Shareholder net worth | | | | | |
| – Free surplus[2] | 57 | | 206 | 1,210 | 1,473 |
| – Required capital to cover solvency margin | 239 | | 33 | 1,968 | 2,240 |
| Value of in-force | | | | | |
| – Value of in-force business | 5,054 | | 745 | | 5,799 |
| – Cost of capital | (506) | | (10) | | (516) |

| As at 31 December 2011 (Restated) | P&A and Savings £m | Investment management £m | US Protection £m | Group capital and financing £m | Total £m |
|---|---|---|---|---|---|
| Analysed as: | | | | | |
| IFRS basis shareholders' equity[1] | 652 | 351 | 910 | 3,143 | 5,056 |
| Additional retained profit/(loss) on an EEV basis | 4,402 | – | 152 | (1,002) | 3,552 |
| **Shareholders' equity on an EEV basis** | 5,054 | 351 | 1,062 | 2,141 | 8,608 |
| Comprising: | | | | | |
| Business reported on an IFRS basis | 338 | 351 | – | (1,077) | (388) |
| Business reported on an EEV basis: | | | | | |
| Shareholder net worth | | | | | |
| – Free surplus[2] | 37 | | 111 | 1,461 | 1,609 |
| – Required capital to cover solvency margin | 215 | | 38 | 1,757 | 2,010 |
| Value of in-force | | | | | |
| – Value of in-force business | 4,907 | | 924 | | 5,831 |
| – Cost of capital | (443) | | (11) | | (454) |

1. Shareholders' equity supporting the UK non profit Protection and Annuities and Savings businesses is held within Legal & General Assurance Society Limited and Legal & General Pensions Limited and is managed on a groupwide basis within the Group capital and financing segment.
2. Free surplus is the value of any capital and surplus allocated to, but not required to support, the in-force covered business at the valuation date.

Further analysis of shareholders' equity is included in Note 14.

## EUROPEAN EMBEDDED VALUE BASIS (CONTINUED)

### 14 SEGMENTAL ANALYSIS OF SHAREHOLDERS' EQUITY

| | **Covered business EEV basis 2012 £m** | **Other business IFRS basis 2012 £m** | **Total 2012 £m** | Covered business EEV basis 2011 £m | Other business IFRS basis 2011 £m | Total 2011 £m |
|---|---|---|---|---|---|---|
| **Protection and Annuities** | | | | | | |
| – P&A reported on an EEV basis | **3,131** | **–** | **3,131** | 2,995 | – | 2,995 |
| – General insurance | **–** | **180** | **180** | – | 148 | 148 |
| – Netherlands (LGN) | **248** | **–** | **248** | 271 | – | 271 |
| – France (LGF) | **194** | **–** | **194** | 198 | – | 198 |
| – Other | **–** | **10** | **10** | – | 6 | 6 |
| **Total Protection and Annuities** | **3,573** | **190** | **3,763** | 3,464 | 154 | 3,618 |
| **Savings** | | | | | | |
| – Savings reported on an EEV basis | **1,271** | **–** | **1,271** | 1,252 | – | 1,252 |
| – Savings investments | **–** | **138** | **138** | – | 136 | 136 |
| – Other | **–** | **52** | **52** | – | 48 | 48 |
| **Total Savings** | **1,271** | **190** | **1,461** | 1,252 | 184 | 1,436 |
| **Investment management** | **–** | **360** | **360** | – | 351 | 351 |
| **US Protection** | **974** | **–** | **974** | 1,062 | – | 1,062 |
| **Group capital and financing** | **3,178** | **(836)** | **2,342** | 3,218 | (1,077) | 2,141 |
| | **8,996** | **(96)** | **8,900** | 8,996 | (388) | 8,608 |

### 15 RECONCILIATION OF SHAREHOLDER NET WORTH

| | **UK covered business 2012 £m** | **Total 2012 £m** | UK covered business 2011 £m | Total 2011 Restated £m |
|---|---|---|---|---|
| SNW of long term operations (IFRS basis) | **4,294** | **5,537** | 4,209 | 5,444 |
| Other liabilities (IFRS basis) | **–** | **(96)** | – | (388) |
| **Shareholders' equity on the IFRS basis** | **4,294** | **5,441** | 4,209 | 5,056 |
| Purchased interest in long term business | **(63)** | **(64)** | (76) | (77) |
| Deferred acquisition costs/deferred income liabilities | **(235)** | **(1,093)** | (252) | (1,071) |
| Contingent loan[1] | **–** | **–** | (210) | (210) |
| Deferred tax[2] | **(253)** | **74** | (235) | 87 |
| Other[3] | **(565)** | **(741)** | (218) | (554) |
| **Shareholder net worth on the EEV basis** | **3,178** | **3,617** | 3,218 | 3,231 |

1. During H1 12, the contingent loan was settled between Society and LGPL. On an EEV basis, the contingent loan was modelled within the VIF. On an IFRS basis, the contingent loan asset was included within the Group capital and financing net assets.
2. Deferred tax represents all tax which is expected to be paid under current legislation.
3. Other in the P&A and Savings covered business relates primarily to the different treatment of annuities and non profit pension results under EEV compared with IFRS. Other total business also includes the different treatment of the LGA Triple X securitisation on an EEV and IFRS basis.

## EUROPEAN EMBEDDED VALUE BASIS (CONTINUED)

### 16 SENSITIVITIES

In accordance with the guidance issued by the European Insurance CFO Forum in October 2005 the table below shows the effect of alternative assumptions on the long term embedded value and new business contribution.

#### Effect on embedded value as at 31 December 2012

| | As published £m | 1% lower risk discount rate £m | 1% higher risk discount rate £m | 1% lower interest rate £m | 1% higher interest rate £m | 1% higher equity/ property yields £m |
|---|---|---|---|---|---|---|
| Protection and Annuities and Savings[1] | 8,022 | 595 | (507) | 230 | (191) | 109 |
| US Protection | 974 | 119 | (99) | 40 | (41) | – |
| **Total covered business** | **8,996** | **714** | **(606)** | **270** | **(232)** | **109** |

| | As published £m | 10% lower equity/ property values £m | 10% lower maintenance expenses £m | 10% lower lapse rates £m | 5% lower mortality (UK annuities) £m | 5% lower mortality (other business) £m |
|---|---|---|---|---|---|---|
| Protection and Annuities and Savings[1] | 8,022 | (240) | 106 | 83 | (260) | 83 |
| US Protection | 974 | – | 9 | 1 | n/a | 137 |
| **Total covered business** | **8,996** | **(240)** | **115** | **84** | **(260)** | **220** |

#### Effect on new business contribution for the year

| | As published £m | 1% lower risk discount rate £m | 1% higher risk discount rate £m | 1% lower interest rate £m | 1% higher interest rate £m | 1% higher equity/ property yields £m |
|---|---|---|---|---|---|---|
| Protection and Annuities and Savings[1] | 377 | 59 | (49) | 1 | 2 | 12 |
| US Protection | 98 | 19 | (16) | 1 | (3) | – |
| **Total covered business** | **475** | **78** | **(65)** | **2** | **(1)** | **12** |

| | As published £m | 10% lower equity/ property values £m | 10% lower maintenance expenses £m | 10% lower lapse rates £m | 5% lower mortality (UK annuities) £m | 5% lower mortality (other business) £m |
|---|---|---|---|---|---|---|
| Protection and Annuities and Savings[1] | 377 | (6) | 16 | 18 | (14) | 14 |
| US Protection | 98 | – | 1 | 3 | n/a | 17 |
| **Total covered business** | **475** | **(6)** | **17** | **21** | **(14)** | **31** |

1. Includes Group capital and financing.

Opposite sensitivities are broadly symmetrical.

Sensitivity to changes in assumptions may not be linear, and as such, they should not be extrapolated to changes of a much larger order. A 2% higher risk discount rate would result in a £888m negative impact on UK embedded value and a £82m negative impact on UK new business contribution for the year.

## EUROPEAN EMBEDDED VALUE BASIS (CONTINUED)

### 17 ASSUMPTIONS

#### UK assumptions

The assumed future pre-tax returns on fixed interest and RPI linked securities are set by reference to the portfolio yield on the relevant backing assets held at market value at the end of the reporting period. The calculated return takes account of derivatives and other credit instruments in the investment portfolio. Indicative yields on the portfolio, excluding annuities within Legal & General Pensions Limited (LGPL), but after allowance for long term default risk, are shown below.

For LGPL annuities, separate returns are calculated for new and existing business. Indicative combined yields, after allowance for long term default risk and the following additional assumptions, are also shown below. These additional assumptions are:

i. Where cash balances and debt securities are held at the reporting date in excess of, or below strategic investment guidelines, then it is assumed that these cash balances or debt securities are immediately invested or disinvested at current yields.
ii. Where interest rate swaps are used to reduce risk, it is assumed that these swaps will be sold before expiry and the proceeds reinvested in corporate bonds with a redemption yield 0.70% p.a. (0.70% p.a. at 31 December 2011) greater than the swap rate at that time (i.e. the long term credit rate).
iii. Where reinvestment or disinvestment is necessary to rebalance the asset portfolio in line with projected outgo, this is also assumed to take place at the long term credit rate above the swap rate at that time.

The returns on fixed and index-linked securities are calculated net of an allowance for default risk which takes account of the credit rating, outstanding term of the securities, and increase in the expectation of credit defaults over the economic cycle. The allowance for corporate securities expressed as a level rate deduction from the expected returns for annuities was 26bps at 31 December 2012 (26bps at 31 December 2011).

#### UK covered business

i. Assets are valued at market value.
ii. Future bonus rates have been set at levels which would fully utilise the assets supporting the policyholders' portion of the with-profits business in accordance with established practice. The proportion of profits derived from with-profits business allocated to shareholders amounts to almost 10% throughout the projection.
iii. The value of in-force business reflects the cost, including administration expenses, of providing for benefit enhancement or compensation in relation to certain products.
iv. Other actuarial assumptions have been set at levels commensurate with recent operating experience, including those for mortality, morbidity, persistency and maintenance expenses (excluding the development costs referred to below). These are normally reviewed annually.

    An allowance is made for future mortality improvement, commencing 1 January 2009 as per CMIB's mortality improvement model (CMI 2011) with the following parameters:
    Males: Long Term Rate of 1.5% p.a. for future experience and 2.0% p.a. for statutory reserving, up to age 85 tapering to 0% at 120;
    Females: Long Term Rate of 1.0% p.a. for future experience and 1.5% p.a. for statutory reserving, up to age 85 tapering to 0% at 120.
    Future improvements are generally assumed to converge to the long term rate in 2026.

    On this basis, the best estimate of the expectation of life for a new 65 year old Male CPA annuitant is 24.1 years (31 December 2011: 24.2 years). The expectation of life on the regulatory reserving basis is 25.7 years (31 December 2011: 25.8 years).

v. Development costs relate to investment in strategic systems and development capability that are charged to the covered business. Projects charged to the non-covered business are included within Investment projects in Group capital and financing.

#### Overseas covered business

vi. Other actuarial assumptions have been set at levels commensurate with recent operating experience, including those for mortality, morbidity, persistency and maintenance expenses.

# EUROPEAN EMBEDDED VALUE BASIS (CONTINUED)

## Economic assumptions

| As at 31 December | 2012 % p.a. | 2011 % p.a. | 2010 % p.a. |
|---|---|---|---|
| Risk margin | **3.7** | 3.7 | 3.3 |
| Risk free rate[1] | | | |
| – UK | **2.3** | 2.5 | 4.0 |
| –Europe | **1.7** | 2.6 | 3.2 |
| –US | **1.8** | 1.9 | 3.3 |
| Risk discount rate (net of tax) | | | |
| – UK | **6.0** | 6.2 | 7.3 |
| – Europe | **5.4** | 6.3 | 6.5 |
| – US | **5.5** | 5.6 | 6.6 |
| Reinvestment rate (US) | **4.3** | 4.2 | 5.5 |
| **Other UK business assumptions** | | | |
| Equity risk premium | **3.3** | 3.3 | 3.5 |
| Property risk premium | **2.0** | 2.0 | 2.0 |
| Investment return (excluding annuities in LGPL) | | | |
| – Gilts: | | | |
| – Fixed interest | **1.9 – 2.3** | 1.8 – 2.5 | 3.4 – 4.0 |
| – RPI linked | **2.7** | 2.6 | 4.1 |
| – Non gilts: | | | |
| – Fixed interest | **1.9 – 2.9** | 3.0 – 4.6 | 3.6 – 5.0 |
| – Equities | **5.6** | 5.8 | 7.5 |
| – Property | **4.3** | 4.5 | 6.0 |
| Long-term rate of return on non profit annuities in LGPL | **4.3** | 5.0 | 5.5 |
| Inflation | | | |
| – Expenses/earnings | **3.4** | 3.5 | 4.1 |
| – Indexation | **2.9** | 3.0 | 3.6 |

1. The risk free rate is the gross redemption yield on the 15 year gilt index. The Europe risk free rate is the 10 year ECB AAA-rated euro area central government bond par yield. The LGA risk free rate is the 10 year US Treasury effective yield.

## Tax

vii. The profits on the covered business, except for the profits on the Society shareholder capital held outside the long term fund, are calculated on an after tax basis and are grossed up by the notional attributed tax rate for presentation in the income statement. For the UK, the after tax basis assumes the annualised current tax rate of 24.5% and the subsequent planned future reductions in corporation tax to 23% from 1 April 2013, and 21% from 1 April 2014. The tax rate used for grossing up is the long term corporate tax rate in the territory concerned, which for the UK is 21% (31 December 2011: 23%) taking into account the expected further rate reductions to 21% by 1 April 2014. The profits on the Society shareholder capital held outside the long term fund are calculated before tax and therefore tax is calculated on an actual basis.

US, Netherlands and France covered business profits are also grossed up using the long term corporate tax rates of the respective territories i.e. US is 35% (2011: 35%), France is 34.3% (2011: 34.3%) and Netherlands is 25% (2011: 25%).

## Stochastic calculations

viii. The time value of options and guarantees is calculated using economic and non-economic assumptions consistent with those used for the deterministic embedded value calculations.

This section describes the models used to generate future investment simulations, and gives some sample statistics for the simulations used. A single model has been used for UK and international business, with different economic assumptions for each territory.

Government nominal interest rates are generated using a LIBOR Market Model projecting full yield curves at annual intervals. The model provides a good fit to the initial yield curve.

The total annual returns on equities and property are calculated as the return on 1 year bonds plus an excess return. The excess return is assumed to have a lognormal distribution. Corporate bonds are modelled separately by credit rating using stochastic credit spreads over the risk free rates, transition matrices and default recovery rates. The real yield curve model assumes that the real short rate follows a mean-reverting process subject to two normally distributed random shocks.

### Asset classes

The significant asset classes are:

– UK with-profits business – equities, property and fixed rate bonds of various durations;
– UK annuity business – fixed rate and index-linked bonds of various durations; and
– International business – fixed rate bonds of various durations.

## EUROPEAN EMBEDDED VALUE BASIS (CONTINUED)

### 17 ASSUMPTIONS (CONTINUED)

Summary statistics:

The following table sets out means and standard deviations (StDev) of future returns as at 31 December 2012 for the most significant asset classes. Correlations between asset classes have been set based on an internal assessment of historical data.

| | 10-year return | | 20-year return | |
|---|---|---|---|---|
| | Mean[1] | StDev[2] | Mean[1] | StDev[2] |
| **UK Business (Sterling)** | | | | |
| Government bonds | 1.9% | 3.2% | 3.3% | 3.6% |
| Corporate bonds | 3.5% | 3.7% | 4.6% | 4.0% |
| Property (excess returns) | 2.0% | 14.9% | 2.1% | 15.1% |
| Equities (excess returns) | 3.2% | 20.0% | 3.4% | 20.5% |
| **European Business (Euro)** | | | | |
| Long Government bonds[3] | 1.8% | 3.2% | 2.7% | 3.3% |
| Short Government bonds[4] | 1.8% | 2.3% | 2.7% | 5.3% |
| **US Business (US Dollar)** | | | | |
| Long Government bonds[3] | 1.9% | 4.3% | 3.0% | 4.5% |

1. For asset classes other than for equities and property, mean returns are calculated as the mean return in excess of 1 year government bonds plus the mean return on 1 year government bonds. Mean excess returns for the equities and property are calculated as the mean return in excess of 1 year government bonds. Each mean return is derived by calculating the accumulated value of a unit asset invested to time n years for each simulation, averaging the resultant values across all simulations, then calculating the equivalent annual return required to give this average accumulation (by taking the nth root of the average accumulation and deducting 1).
2. Standard deviations are calculated by accumulating a unit investment for n years in each simulation, taking the natural logarithm of the result, calculating the variance of this statistic, dividing by n and taking the square root. Equities and property values use excess returns. The results are comparable to implied volatilities quoted in investment markets.
3. Long term bonds are defined to be 10 year par-coupon bonds.
4. Short term bonds are defined to be 1 year duration bonds.

Risk discount rate:

The risk discount rate is scenario dependent within the stochastic projection. It is calculated by applying the deterministic risk margin to the risk free rate in each stochastic projection.

Sensitivity calculations

ix. A number of sensitivities have been produced on alternative assumption sets to reflect the sensitivity of the embedded value and the new business contribution to changes in key assumptions. Relevant details relating to each sensitivity are:

- 1% variation in discount rate – a one percentage point increase/decrease in the risk margin has been assumed in each case (for example a 1% increase in the risk margin would result in a 4.7% risk margin).
- 1% variation in interest rate environment – a one percentage point increased/decreased parallel shift in the risk free curve with consequential impacts on fixed asset market values, investment return assumptions, risk discount rate, including consequential changes to valuation bases.
- 1% higher equity/property yields – a one percentage point increase in the assumed equity/property investment returns, excluding any consequential changes, for example, to risk discount rates or valuation bases, has been assumed in each case (for example a 1% increase in equity returns would increase assumed total equity returns from 5.6% to 6.6%).
- 10% lower equity/property market values – an immediate 10% reduction in equity and property asset values.
- 10% lower maintenance expenses, excluding any consequential changes, for example, to valuation expense bases or potentially reviewable policy fees (a 10% decrease on a base assumption of £10 per annum would result in a £9 per annum expense assumption).
- 10% lower assumed persistency experience rates, excluding any consequential changes to valuation bases, incorporating a 10% decrease in lapse, surrender and premium cessation assumptions (a 10% decrease on a base assumption of 7% would result in a 6.3% lapse assumption).
- 5% lower mortality and morbidity rates, excluding any consequential changes to valuation bases but including assumed product repricing action where appropriate (for example if base experienced mortality is 90% of a standard mortality table then, for this sensitivity, the assumption is set to 85.5% of the standard table).

The sensitivities for covered business allow for any material changes to the cost of financial options and guarantees but do not allow for any changes to reserving bases or capital requirements within the sensitivity calculation, unless indicated otherwise above.

# INDEPENDENT AUDITORS' REPORT TO THE DIRECTORS OF LEGAL & GENERAL GROUP PLC ON THE SUPPLEMENTARY FINANCIAL STATEMENTS – EUROPEAN EMBEDDED VALUE BASIS

We have audited the supplementary financial statements – European Embedded Value Basis of Legal & General Group Plc ('the Company') for the year ended 31 December 2012 which comprise the Consolidated Income Statement – European Embedded Value Basis, Consolidated Statement of Comprehensive Income – European Embedded Value Basis, Consolidated Balance Sheet – European Embedded Value Basis and the related notes ('the supplementary financial statements') which have been prepared in accordance with the European Embedded Value ('EEV') basis set out in Note 1 – Methodology and which should be read in conjunction with the Group's financial statements.

## Respective responsibilities of directors and auditors

The directors are responsible for preparing the supplementary financial statements on the EEV basis in accordance with the EEV basis set out in Note 1 – Methodology. Our responsibility, as set out in our letter of engagement agreed with you dated 15 February 2013 is to audit and express an opinion on the supplementary 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 opinion, has been prepared for and only for the Company's directors as a body in accordance with our letter of engagement dated 15 February 2013 and for no other purpose. We do not, in giving this opinion, 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 supplementary financial statements

An audit involves obtaining evidence about the amounts and disclosures in the supplementary financial statements sufficient to give reasonable assurance that the supplementary 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 circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the supplementary financial statements. In addition, we read all the financial and non-financial information in the annual report and accounts to identify material inconsistencies with the audited financial statements. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

## Opinion on the supplementary financial statements

In our opinion, the supplementary financial statements for the year ended 31 December 2012 have been properly prepared in all material respects in accordance with the EEV basis set out in Note 1 – Methodology.

PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP
Chartered Accountants
London
5 March 2013

Notes:
(a) The financial statements are published on the website of Legal & General Group Plc, www.legalandgeneralgroup.com. The maintenance and integrity of the Legal & General Group Plc 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.

## INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF LEGAL & GENERAL GROUP PLC

We have audited the parent company financial statements of Legal & General Group Plc for the year ended 31 December 2012 which comprise the Company Balance Sheet, the Company Statement of Total Recognised Gains and Losses, the Company Reconciliation of Movements in Total Shareholders' Funds and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

### Respective responsibilities of directors and auditors

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

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

### Scope of the audit of the financial statements

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

### Opinion on financial statements

In our opinion the parent company financial statements:

- give a true and fair view of the state of the company's affairs as at 31 December 2012;
- have been properly prepared in accordance with the United Kingdom Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

### Opinion on other matters prescribed by the Companies Act 2006

In our opinion:

- the part of the Directors' Report on Remuneration to be audited has been properly prepared in accordance with the Companies Act 2006; and
- the information given in the Directors' Report for the financial year for which the parent company financial statements are prepared is consistent with the parent company financial statements.

### Matters on which we are required to report by exception

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

- adequate accounting records have not been kept by the parent company, or returns adequate for our audit have not been received from branches not visited by us; or
- the parent company financial statements and the part of the Directors' Report on Remuneration to be audited are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

### Other matters

We have reported separately on the group financial statements of Legal & General Group Plc for the year ended 31 December 2012.

Richard Keers

**Richard Keers** (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
London
5 March 2013

Notes:
(a) The financial statements are published on the website of Legal & General Group Plc, legalandgeneralgroup.com. The maintenance and integrity of Legal & General Group Plc 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.

# COMPANY FINANCIAL STATEMENTS

## COMPANY BALANCE SHEET

| | Notes | 2012 £m | 2011 £m |
|---|---|---|---|
| **Fixed assets** | | | |
| Investments | 7 | **6,290** | 6,382 |
| **Current assets** | | | |
| Debtors | 8 | **1,632** | 1,293 |
| Derivative assets | 11 | **139** | 278 |
| **Current liabilities** | | | |
| Creditors: amounts falling due within one year | 9 | **(52)** | (35) |
| Derivative liabilities | 11 | **(49)** | (172) |
| **Net current assets** | | **1,670** | 1,364 |
| **Total assets less current liabilities** | | **7,960** | 7,746 |
| **Creditors: amounts falling due after more than one year** | 10 | **(2,529)** | (2,555) |
| **Net assets** | | **5,431** | 5,191 |
| **Capital and reserves** | | | |
| Called up share capital | 13/14 | **148** | 147 |
| Share premium account | 14 | **956** | 941 |
| Revaluation reserve | 14 | **2,644** | 2,614 |
| Capital redemption and other reserves | 14 | **63** | 62 |
| Profit and loss account | 14 | **1,620** | 1,427 |
| **Total shareholders' funds** | | **5,431** | 5,191 |

The notes on pages 241 to 248 form an integral part of these financial statements.

The financial statements on pages 239 to 248 were approved by the directors on 5 March 2013 and were signed on their behalf by:

**John Stewart**
Chairman

**Nigel Wilson**
Group Chief Executive

**Mark Gregory**
Chief Executive Officer (Savings)

## COMPANY FINANCIAL STATEMENTS (CONTINUED)

### COMPANY STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES

| For the year ended 31 December 2012 | Note | 2012 £m | 2011 £m |
|---|---|---|---|
| Profit for the financial year | | **592** | 558 |
| Gains on revaluation of investments in subsidiary undertakings | 7 | **30** | 93 |
| **Total recognised gains and losses relating to the year** | | **622** | 651 |

### COMPANY RECONCILIATION OF MOVEMENTS IN TOTAL SHAREHOLDERS' FUNDS

| For the year ended 31 December 2012 | Note | 2012 £m | 2011 £m |
|---|---|---|---|
| **As at 1 January** | | **5,191** | 4,827 |
| Total recognised gains and losses | | **622** | 651 |
| Dividend distributions to equity holders of the Company during the year | 2 | **(394)** | (298) |
| Issue of share capital | | **16** | 3 |
| Net movement in share-based payments reserve | | **(4)** | 8 |
| **As at 31 December** | | **5,431** | 5,191 |

# COMPANY FINANCIAL STATEMENTS (CONTINUED)

## NOTES TO THE COMPANY FINANCIAL STATEMENTS

### 1 ACCOUNTING POLICIES

#### Basis of preparation

These financial statements are prepared on the going concern basis, under the historical cost convention, as modified by the revaluation of fixed asset investments and financial assets and financial liabilities (including derivative instruments) at fair value through profit or loss, and in accordance with the Companies Act 2006 and applicable accounting standards in the United Kingdom. The principal accounting policies, which have been applied consistently throughout the year, are set out below.

The Company's financial statements have been prepared in compliance with Section 394 and 396 of the Companies Act 2006 adopting the exemption of omitting the profit and loss account conferred by Section 408 of that Act.

#### Investment income

Investment income includes dividends and interest. Dividends receivable from group companies are recognised in the period in which the dividends are declared and approved at the general meeting or paid. Interest income is recognised using the effective interest method.

#### Distributions

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

#### Interest expense

Interest expense reflects the underlying cost of borrowing, based on the effective interest method, and includes payments and receipts made under derivative instruments which are amortised over the interest period to which they relate.

#### Investment in subsidiary undertakings

Shares in subsidiary undertakings are stated at current value. Unrealised gains or losses arising on investments in subsidiary undertakings are taken to the revaluation reserve.

#### Loans and receivables

Loans and receivables are held at amortised cost using the effective interest method.

#### Derivative financial instruments and hedge accounting

The Company's activities expose it to the financial risks of changes in foreign exchange rates and interest rates. The Company uses derivatives such as foreign exchange forward contracts and interest rate swap contracts to hedge these exposures. The Company uses hedge accounting, provided the prescribed criteria are met, to recognise the offsetting effects of changes in the fair value or cash flow of the derivative instrument and the hedged item. The Company's principal use of hedge accounting is to hedge the fair value movements in loans due to interest rate and exchange rate fluctuations. Any gain or loss from remeasuring the hedging instrument at fair value is recognised immediately in the profit and loss account. Any gain or loss on the hedged item attributable to the hedged risk is adjusted against the carrying amount of the hedged item and recognised in the profit and loss account.

Certain derivative instruments do not qualify for hedge accounting. Changes in the fair value of any derivative instruments which do not qualify for hedge accounting are recognised immediately in the profit and loss account.

#### Borrowings

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

#### Deferred tax

Deferred tax is recognised in respect of all timing differences that have originated but not reversed at the balance sheet date, where transactions or events that result in an obligation to pay more tax in the future or a right to pay less tax in the future have occurred at the balance sheet date.

A net deferred tax asset is recognised as recoverable and therefore recognised only when, on the basis of all available evidence, it can be regarded as more likely than not that there will be suitable taxable profits against which to recover carried forward tax losses and from which the future reversal of underlying timing differences can be deducted.

Deferred tax is measured at the average tax rates that are expected to apply in the periods in which the timing differences are expected to reverse, based on tax rates and laws that have been enacted or substantively enacted by the balance sheet date. Deferred tax is measured on an undiscounted basis.

Deferred tax is recognised in respect of the retained earnings of overseas subsidiaries only to the extent that, at the balance sheet date, dividends have been accrued as receivable or a binding agreement to distribute past earnings in future periods has been entered into by the subsidiary.

## COMPANY FINANCIAL STATEMENTS (CONTINUED)

### 1 ACCOUNTING POLICIES (CONTINUED)

#### Foreign currencies

Transactions denominated in foreign currencies are translated into sterling at the rates of exchange prevailing at the time of the transactions. Monetary assets and liabilities expressed in foreign currencies are translated into sterling at the rates of exchange ruling at the balance sheet date. Non-monetary items are maintained at historic rates. Exchange gains or losses are recognised in the profit and loss account, except those arising upon the revaluation of fixed assets, which are included in the revaluation reserve.

#### Pension costs

The Company participates in multi-employer defined benefit schemes, within the meaning of FRS 17, 'Retirement Benefits', which, as its share of the underlying assets and liabilities cannot be identified, have been treated for reporting purposes as defined contribution schemes. In addition to these schemes the Company also contributes to defined contribution schemes. The Company charges the costs of its pension schemes against profit as incurred. Any difference between the cumulative amounts charged against profits and contribution amounts paid is included as a provision or prepayment in the balance sheet.

The assets of the defined benefit schemes and the defined contribution schemes are held in separate trustee administered funds, which have been subject to regular valuation every three years and updated by formal reviews at reporting dates by qualified actuaries who were employees of the Group.

#### Related Party Transactions

The Company has taken advantage of the exemptions of FRS 8, 'Related Party Transactions', not to disclose transactions with other group companies.

#### Share-based payments

The Company operates a number of share-based payment plans on behalf of its subsidiaries. The fair value of the equity instruments granted is spread over the vesting period of the instrument and treated as a capital contribution to the respective subsidiary. The total capital contribution is determined by reference to the fair value of the awards, excluding the impact of any non-market vesting conditions. The capital contribution to the subsidiaries is accounted for as an increase in the investment in the parent company's financial statements.

At each balance sheet date, the Company revises its estimate of the number of equity instruments which are expected to become exercisable. It recognises the impact of the revision of original estimate, if any, in the cost of the investment in the subsidiary and a corresponding adjustment is made to equity over the remaining vesting period. On vesting or exercise, the difference between the accumulated capital contribution and the actual cost to the Company is transferred to retained earnings. Where new shares are issued, the proceeds received are credited to share capital and share premium. Any capital contribution is subsequently recharged to the respective subsidiary as incurred and the corresponding cost of investment is reduced.

#### Risk Management

The Company has taken advantage of the exemptions provided in FRS 29, 'Financial Instruments: Disclosures', which states that disclosure of financial instruments is not required in parent company financial statements where these are included in publicly available Consolidated Financial Statements.

# COMPANY FINANCIAL STATEMENTS (CONTINUED)

## 2 DIVIDENDS

| | Per share 2012 p | Total 2012 £m | Per share 2011 p | Total 2011 £m |
|---|---|---|---|---|
| Ordinary share dividends paid in the year | | | | |
| – Prior year final dividend | **4.74** | **278** | 3.42 | 201 |
| – Current year interim dividend | **1.96** | **116** | 1.66 | 97 |
| | **6.70** | **394** | 5.08 | 298 |
| Ordinary share dividend proposed[1] | **5.69** | **336** | 4.74 | 279 |

1. The dividend proposed has not been included as a liability in the balance sheet.

## 3 DIRECTORS' EMOLUMENTS AND OTHER EMPLOYEE INFORMATION

Full disclosures of Legal & General Group Plc directors' emoluments are contained within those parts of the Directors' Report on Remuneration which are described as having been audited. At 31 December 2012 there were no loans outstanding with directors of the Company (2011: £nil). The Company has no other employees (2011: nil).

## 4 PENSIONS

There were no contributions prepaid or outstanding at either 31 December 2012 or 31 December 2011 in respect of these schemes, and there were no current service costs incurred in respect of these schemes for year ended 31 December 2012 (2011: £nil). The Company had no liability for retirement benefits at 31 December 2012 (2011: £nil).

### Defined contribution plans

The Company operates the following defined contribution pension schemes in the UK:

- Legal & General Group Personal Pension Plan (UK).
- Legal & General Staff Stakeholder Pension Scheme (UK).

### Defined benefit plans

The Company operates the following defined benefit pension schemes in the UK:

- Legal & General Group UK Pension and Assurance Fund (the Fund). The Fund was closed to new members from January 1995; last full actuarial valuation as at 31 December 2009.
- Legal & General Group UK Senior Pension Scheme (the Scheme). The Scheme was, with a few exceptions (principally transfers from the Fund), closed to new members from August 2000 and finally closed to new members from April 2007; last full actuarial valuation as at 31 December 2009.

In the UK, the Fund and the Scheme are multi-employer defined benefit schemes, which, as the Company's share of the underlying assets and liabilities cannot be identified, have been treated for reporting purposes as defined contribution schemes. There was a deficit in respect of these schemes for the year ended 31 December 2012 of £255m (2011: £215m) and the contributions in respect of them for the year were £59m (2011: £58m). Further information is given in Note 23 of the Group's consolidated financial statements.

## 5 SHARE-BASED PAYMENTS

Legal & General Group Plc grants share-based payments to employees within the Legal & General Group. The Group recognises an expense for these payments measured indirectly by reference to the fair value of the equity instruments granted. The expense is recognised over the vesting period as the services are received. The relevant company is recharged its share of this expense with reference to the benefits it receives from the employees. The full disclosures required by FRS 20 are provided in the Group's consolidated financial statements.

The total expense recharged to the Company in relation to share-based payments was £nil (2011: £nil).

## COMPANY FINANCIAL STATEMENTS (CONTINUED)

### 6 AUDITORS' REMUNERATION

Remuneration receivable by the Company's auditor for the audit of the Company's financial statements is not presented. The Group's consolidated IFRS financial statements disclose the aggregate remuneration receivable by the Company's auditor for the audit of the Group's annual accounts, which include the Company's financial statements.

The disclosure of fees payable to the auditor and its associates for other (non-audit) services has not been made because the Group's consolidated financial statements are required to disclose such fees on a consolidated basis.

### 7 INVESTMENTS

| | Shares in Group companies 2012 £m | Loans to Group companies 2012 £m | Total 2012 £m | Shares in Group companies 2011 £m | Loans to Group companies 2011 £m | Total 2011 £m |
|---|---|---|---|---|---|---|
| **At valuation, 1 January** | **5,519** | **863** | **6,382** | 5,648 | 801 | 6,449 |
| Additions | **–** | **–** | **–** | 11 | 66 | 77 |
| Repayment | **–** | **(86)** | **(86)** | (233) | – | (233) |
| Revaluation | **30** | **(36)** | **(6)** | 93 | (4) | 89 |
| **At valuation, 31 December** | **5,549** | **741** | **6,290** | 5,519 | 863 | 6,382 |
| **At cost, 31 December** | **2,939** | **746** | **3,685** | 2,939 | 832 | 3,771 |

Additions represent capital injections into Group undertakings.

Full disclosure of the Company's investments in subsidiary undertakings is contained in Note 52 of the Group's consolidated financial statements.

### 8 DEBTORS

| | 2012 £m | 2011 £m |
|---|---|---|
| Amounts owed by Group undertakings | **1,583** | 1,230 |
| Corporation tax | **31** | 41 |
| Deferred tax | **14** | 15 |
| Other debtors | **4** | 7 |
| | **1,632** | 1,293 |

Amounts owed by Group undertakings are repayable at the request of either party and include a £338m (2011: £88m) interest bearing balance with a current interest rate of LIBOR -12.5 bps.

At 31 December 2012, there is an unrecognised deferred tax asset in respect of timing differences of £3m (2011: £3m).

# COMPANY FINANCIAL STATEMENTS (CONTINUED)

## 9 CREDITORS: AMOUNTS FALLING DUE WITHIN ONE YEAR

| | 2012 £m | 2011 £m |
|---|---|---|
| Amounts owed to Group undertakings | **35** | 22 |
| Other creditors | **17** | 13 |
| | **52** | 35 |

Amounts owed to Group undertakings falling due within one year are interest free and repayable at the request of either party.

## 10 CREDITORS: AMOUNTS FALLING DUE AFTER MORE THAN ONE YEAR

| | Note | 2012 £m | 2011 £m |
|---|---|---|---|
| Subordinated borrowings | 12 | **1,907** | 1,934 |
| Amounts owed to Group undertakings | | **622** | 621 |
| | | **2,529** | 2,555 |

Amounts owed to Group undertakings falling due after more than one year are unsecured and include £601m (2011: £601m) of interest bearing balances with current interest rates between 5.71% and 6.12% (2011: 5.71% and 6.12%).

## 11 DERIVATIVE ASSETS AND LIABILITIES

| | Contract/ notional amount 2012 £m | Fair values Assets 2012 £m | Fair values Liabilities 2012 £m |
|---|---|---|---|
| Interest rate contracts – held for trading | **1,118** | **45** | **49** |
| Interest rate contracts – fair value hedges | **–** | **–** | **–** |
| Forward foreign exchange contracts – net investment hedges | **710** | **2** | **–** |
| Forward foreign exchange contracts – held for trading | **488** | **92** | **–** |
| **Derivative assets and liabilities** | | **139** | **49** |

| | Contract/ notional amount 2011 £m | Fair values Assets 2011 £m | Fair values Liabilities 2011 £m |
|---|---|---|---|
| Interest rate contracts – held for trading | 1,760 | 41 | 162 |
| Interest rate contracts – fair value hedges | 600 | 122 | – |
| Forward foreign exchange contracts – net investment hedges | 884 | – | 9 |
| Forward foreign exchange contracts – held for trading | 578 | 115 | 1 |
| **Derivative assets and liabilities** | | 278 | 172 |

The descriptions of each type of derivative are given in Note 11 of the Group's consolidated financial statements.

## COMPANY FINANCIAL STATEMENTS (CONTINUED)

### 12 BORROWINGS

**Analysis by nature**

| | Carrying amount 2012 £m | Coupon rate 2012 % | Fair value 2012 £m | Carrying amount 2011 £m | Coupon rate 2011 % | Fair value 2011 £m |
|---|---|---|---|---|---|---|
| **Subordinated borrowings** | | | | | | |
| 6.385% Sterling perpetual capital securities (Tier 1) | **700** | **6.39** | **636** | 721 | 6.39 | 487 |
| 5.875% Sterling undated subordinated notes (Tier 2) | **419** | **5.88** | **425** | 421 | 5.88 | 329 |
| 4.0% Euro subordinated notes 2025 (Tier 2) | **479** | **4.00** | **502** | 483 | 4.00 | 432 |
| 10% Sterling subordinated notes 2041 (Tier 2) | **309** | **10.00** | **425** | 309 | 10.00 | 361 |
| **Total borrowings** | **1,907** | | **1,988** | 1,934 | | 1,609 |

As at 31 December 2012, the Company had in place a £1.00bn (2011: £1.00bn) syndicated committed revolving credit facility provided by a number of its key relationship banks, maturing in October 2017. No drawings were made under this facility during 2012.

#### 6.385% Sterling perpetual capital securities

In 2007, Legal & General Group Plc issued £600m of 6.385% Sterling perpetual capital securities. Simultaneous with the issuance, the fixed coupon was swapped into six month LIBOR plus 0.94% pa. These securities are callable at par on 2 May 2017 and every three months thereafter. If not called, the coupon from 2 May 2017 will be reset to three month LIBOR plus 1.93% pa. For regulatory purposes these securities are treated as innovative tier 1 capital. These securities have been classified as liabilities as the interest payments become mandatory in certain circumstances.

#### 5.875% Sterling undated subordinated notes

In 2004, Legal & General Group Plc issued £400m of 5.875% Sterling undated subordinated notes. These notes are callable at par on 1 April 2019 and every five years thereafter. If not called, the coupon from 1 April 2019 will be reset to the prevailing five year benchmark gilt yield plus 2.33% pa. These notes are treated as upper tier 2 capital for regulatory purposes. These securities have been classified as liabilities as the interest payments become mandatory in certain circumstances.

#### 4.0% Euro subordinated notes 2025

In 2005, Legal & General Group Plc issued €600m of 4.0% Euro dated subordinated notes. The proceeds were swapped into sterling. The notes are callable at par on 8 June 2015 and each year thereafter. If not called, the coupon from 8 June 2015 will reset to a floating rate of interest based on prevailing three month Euribor plus 1.7% pa. These notes mature on 8 June 2025 and are treated as lower tier 2 capital for regulatory purposes.

#### 10% Sterling subordinated notes 2041

On 16 July 2009, Legal & General Group Plc issued £300m of 10% dated subordinated notes. The notes are callable at par on 23 July 2021 and every five years thereafter. If not called, the coupon from 23 July 2021 will be reset to the prevailing five year benchmark gilt yield plus 9.325% pa. These notes mature on 23 July 2041 and are treated as lower tier 2 capital for regulatory purposes.

# COMPANY FINANCIAL STATEMENTS (CONTINUED)

## 13 CALLED UP SHARE CAPITAL

| Authorised share capital | 2012 Number of shares | 2012 £m |
|---|---|---|
| At 31 December: ordinary shares of 2.5p each | **9,200,000,000** | **230** |

| Authorised share capital | 2011 Number of shares | 2011 £m |
|---|---|---|
| At 31 December: ordinary shares of 2.5p each | 9,200,000,000 | 230 |

| Issued share capital, fully paid | Number of shares | Called up share capital £m |
|---|---|---|
| **As at 1 January 2012** | **5,872,166,893** | **147** |
| Options exercised under share option schemes | | |
| – Executive share option scheme | **1,626,478** | **–** |
| – Savings related share option scheme | **38,989,455** | **1** |
| **As at 31 December 2012** | **5,912,782,826** | **148** |

| Issued share capital, fully paid | Number of shares | Called up share capital £m |
|---|---|---|
| **As at 1 January 2011** | 5,866,669,323 | 147 |
| Options exercised under share option schemes | | |
| – Executive share option scheme | 1,736,890 | – |
| – Savings related share option scheme | 3,760,680 | – |
| **As at 31 December 2011** | 5,872,166,893 | 147 |

Options over the ordinary share capital of the Company are disclosed in Note 37 of the Group's consolidated financial statements.

## COMPANY FINANCIAL STATEMENTS (CONTINUED)

### 14 MOVEMENT IN RESERVES

| | Called up share capital £m | Share premium account £m | Capital redemption reserve £m | Hedging reserve £m | Share-based payment reserve £m | Revaluation reserve £m | Profit and loss account £m | Total £m |
|---|---|---|---|---|---|---|---|---|
| **As at 1 January 2012** | **147** | **941** | **17** | **(1)** | **46** | **2,614** | **1,427** | **5,191** |
| Retained profit after tax and dividends | **–** | **–** | **–** | **–** | **–** | **–** | **198** | **198** |
| Increase in the net assets of subsidiaries | **–** | **–** | **–** | **–** | **–** | **30** | **–** | **30** |
| Value of employee services | **–** | **–** | **–** | **–** | **22** | **–** | **–** | **22** |
| Shares vested and transferred from share-based payments reserve | **–** | **–** | **–** | **–** | **(21)** | **–** | **(5)** | **(26)** |
| Options exercised under share option schemes | **1** | **15** | **–** | **–** | **–** | **–** | **–** | **16** |
| **As at 31 December 2012** | **148** | **956** | **17** | **(1)** | **47** | **2,644** | **1,620** | **5,431** |

| | Called up share capital £m | Share premium account £m | Capital redemption reserve £m | Hedging reserve £m | Share-based payment reserve £m | Revaluation reserve £m | Profit and loss account £m | Total £m |
|---|---|---|---|---|---|---|---|---|
| **As at 1 January 2011** | 147 | 938 | 17 | (1) | 43 | 2,521 | 1,162 | 4,827 |
| Retained profit after tax and dividends | – | – | – | – | – | – | 260 | 260 |
| Increase in the net assets of subsidiaries | – | – | – | – | – | 93 | – | 93 |
| Value of employee services | – | – | – | – | 22 | – | – | 22 |
| Shares vested and transferred from share-based payments reserve | – | – | – | – | (19) | – | 5 | (14) |
| Options exercised under share option schemes | – | 3 | – | – | – | – | – | 3 |
| **As at 31 December 2011** | 147 | 941 | 17 | (1) | 46 | 2,614 | 1,427 | 5,191 |

# SHAREHOLDER INFORMATION.

## ANNUAL GENERAL MEETING

The 2013 Annual General Meeting (AGM) will be held on Wednesday, 22 May 2013 at 11.00am at The Honourable Artillery Company, Armoury House, City Road, London EC1Y 2BQ. The AGM provides Legal & General with the opportunity to meet its shareholders. The Board regards the AGM as an important opportunity to communicate directly with private investors. The Notice of Meeting and all other details for the AGM are available at legalandgeneralgroup.com (the website).

## DIVIDEND INFORMATION

### Dividend per share

This year the directors are recommending the payment of a final dividend of 5.69p per share. If you add this to your interim dividend of 1.96p per share, the total dividend recommended for 2012 will be 7.65p per share (2011: 6.40p per share). The key dates for the payment of dividends are set out in the Important Dates section on the next page.

## DIVIDEND PAYMENTS

Legal & General is keen to encourage all its shareholders to have their dividends paid directly into a Bank or Building Society Account. If you would like more details or a dividend mandate form, please contact our Registrar. Details of how to contact the Registrar can be found on the opposite page and on our website.

## DIVIDEND REINVESTMENT PLAN

The Legal & General Dividend Reinvestment Plan (DRIP) enables shareholders to use their cash dividends to purchase Legal & General Group Plc shares. If you would like more details, please contact our Registrar. Alternatively, the DRIP booklet and mandate form can be found in the Investors Section of the website.

## COMMUNICATIONS

### Internet

Information about the Company, including details of the current share price, is available on the website, legalandgeneralgroup.com.

### Investor relations

Private investors should contact the Registrar with any queries.

Institutional investors can contact the Investor Relations Team by telephone on: 020 3124 2345 or email: investor.relations@group.landg.com.

Over the last year many companies have become aware that their shareholders have received unsolicited phone calls or correspondence concerning investment matters which imply a connection to the company concerned. These are typically from overseas-based 'brokers' who target UK shareholders offering to sell them what often turn out to be worthless or high risk shares in US or UK investments.

They can be very persistent and extremely persuasive. A 2006 survey by the Financial Services Authority (FSA) has reported that the average amount lost by investors is around £20,000. It is not just the novice investor that has been duped in this way; many of the victims had been successfully investing for several years. Shareholders are advised to be wary of any unsolicited advice, offers to buy shares at a discount or offers of free reports into the Company.

If you receive any unsolicited investment advice, make sure you get the correct name of the person and organisation and make a record of any other information they give you, e.g. telephone number, address, etc.

Check that they are properly authorised by the FSA before getting involved. You can check at fsa.gov.uk/register/.

The FSA also maintains on its website a list of unauthorised overseas firms who are targeting, or have targeted, UK investors and any approach from such organisations should be reported to the FSA so that this list can be kept up to date and any other appropriate action can be considered. If you deal with an unauthorised firm, you would not be eligible to receive payment under the Financial Services Compensation Scheme. The FSA can be contacted by completing an online form at http://www.fsa.gov.uk/Pages/Doing/Regulated/Law/Alerts/form.shtml or, if you do not have access to the internet, on 0845 606 1234.

Inform our Registrar, Capita Registrars, on 0871 402 3341. They are not able to investigate such incidents themselves but will record the details and pass them on to us and liaise with the FSA.

Details of any sharedealing facilities that the Company endorses will be included in Company mailings.

More detailed information on this or similar activity can be found on the FSA website http://www.fsa.gov.uk/Pages/consumerinformation/.

# SHAREHOLDER INFORMATION CONTINUED

## FINANCIAL REPORTS
The Company's financial reports are available on the website. The Annual Report and Accounts are sent to those shareholders who have elected to receive paper copies. Alternatively, shareholders may elect to receive notification by email by registering on www.landgshareportal.com. If you receive more than one copy of our communications, it could be because you have more than one record on the share register. To avoid duplicate mailings, please contact the Registrar, who can arrange for your accounts to be amalgamated.

## REGISTRAR
You can contact our Registrar:

By post: Capita Registrars Limited, The Registry, 34 Beckenham Rd, Beckenham, Kent BR3 4TU. By telephone: 0871 402 3341*. If calling from outside the UK please dial + 44 800 1412959.

* Calls to this number cost 8p per minute plus network extras. Lines are open 8.30am to 5.30pm, Monday to Friday.

By email: landgshares@capitaregistrars.com

The Registrar also provides the following services:

## CORPORATE SPONSORED NOMINEE
The Corporate Sponsored Nominee allows you to hold shares in Legal & General without the need for a share certificate and enables you to benefit from shorter market settlement periods. Individual shareholders hold their Legal & General shares in a nominee holding registered in the name of Capita IRG Trustees (Nominees) Limited. To join or obtain further information contact the Registrar. They will send you a booklet, outlining the terms and conditions under which your shares will be held, together with the appropriate share transfer form. The booklet and the share transfer form are also available in the Investors section of the website.

## SHARE PORTAL
Share portal allows you to view your Legal & General shareholding on the internet. Registering is easy; simply log on to www.landgshareportal.com and follow the instructions. You will need your Shareholder Investor Code, which can be found on your share certificate, dividend statement or proxy form. If you have any queries, please call the Shareholder Helpline.

## SHARE DEALING SERVICE
A quick and easy share dealing service is provided by Capita Share Dealing Services to sell or buy shares in Legal & General and any other leading UK companies. Further information is available online at www.capitadeal.com.

## GENERAL INFORMATION
Capital gains tax: For the purpose of calculating UK capital gains tax, the market value on 31 March 1982 of each share was 7.996p, after adjusting for the 1986 capitalisation issue and the 1996 and 1999 sub-divisions, but not reflecting any rights taken up under the 2002 rights issue.

**Close company provisions:** The Company is not a close company within the terms of the Corporation Tax Act 2010.

**Registered office:** One Coleman Street, London EC2R 5AA. Registered in England and Wales, No. 01417162.

**Shareholder offer line:** For details of shareholder offers on Legal & General products call 0500 65 5555.

| Important Dates: | |
|---|---|
| 6 March 2013 | Final Results 2012 |
| 24 April 2013 | Ex-dividend date (Final Dividend) |
| 9 May 2013 | Last day for DRIP elections |
| 22 May 2013 | Annual General Meeting |
| 29 May 2013 | Payment of Final Dividend for 2012 (to members registered on 26 April 2013) |
| 6 August 2013 | Half Year Results 2013 |
| 28 August 2013 | Ex-dividend date (Interim Dividend) |
| 30 September 2013 | Payment of Interim Dividend for 2013 (to members registered on 30 August 2013) |

# GLOSSARY.

### ANNUAL PREMIUM EQUIVALENT (APE)
An industry measure of new business that is common in the UK. It is the total value of regular premiums, plus 10% of any new single premiums written for the year.

### BULK PURCHASE ANNUITY (BPA)
Bulk annuities are bought by firms that run final salary pension schemes to reduce their responsibilities by closing the schemes to new members and passing the assets and obligations to insurance providers.

### BULK PURCHASE ANNUITY DATA LOADING
Bulk Purchase Annuities (BPA) schemes are often sold on a set of quotation data which can differ to the final liabilities taken on. The reserves that are established for such schemes therefore contain an additional element of prudence to cover data risk. As and when final data is loaded this additional prudence is released.

### COMPANY
Legal & General Group Plc.

### DIVIDEND COVER
Dividend cover measures how many times over the profits could have paid the dividend. For example, if the dividend cover is 3, this means that the Company's post-tax profit attributable to shareholders was three times the amount of dividend paid out.

### EARNINGS PER SHARE (EPS)
EPS is a common financial metric which can be used to measure the profitability and strength of a company over time. It is the total earnings divided by the number of shares outstanding. Basic EPS uses a weighted average of shares outstanding during the year.

### EUROPEAN EMBEDDED VALUE (EEV)
The Embedded Value (EV) of a life insurance company is the value to equity shareholders of the net assets and expected future profits of the company on existing business. The European Embedded Value (EEV) is a variation of EV which allows for a more formalised method of choosing the parameters and doing the calculations to enable greater transparency and accountability.

### EUROPEAN EMBEDDED VALUE OPERATING PROFIT (EEV OPERATING PROFIT)
Legal & General provides supplementary financial statements prepared on the European Embedded Value (EEV) basis for long-term insurance contracts. The EEV basis provides an assessment of the value which has been generated by the business during a period. Operating profit on the EEV basis reports the change in embedded value in a period, but excludes fluctuations from assumed longer-term investment return.

### EUROPEAN EMBEDDED VALUE PER SHARE (EEV PER SHARE)
EEV per share is used to measure value creation over time. It is the total Group EEV including LGIM, divided by the closing number of shares in issue.
Purpose: EEV per share provides shareholders with an insight into the value of the existing book of business at the balance sheet date.

### FULL YEAR DIVIDEND
Full year dividend is the total dividends for the year (including interim dividends) divided by the number of outstanding ordinary shares in issue.
Purpose: Full year dividend per share demonstrates the level of distribution to shareholders.

### FUNDS UNDER MANAGEMENT (FUM)
The total amount of money investors have trusted to a fund manager to invest across all their investment products.

### GENERALLY ACCEPTED ACCOUNTING PRINCIPLES (GAAP)
These are a widely accepted collection of guidelines and principles, established by the International Accounting Standards Board, and used by the accounting community to report financial information.

### GROUP
The Company and its subsidiary undertakings.

### INSURANCE GROUP DIRECTIVE SURPLUS (IGD SURPLUS)
The IGD surplus is an FSA regulatory measure which calculates surplus capital within the Group. IGD surplus is defined as Group regulatory capital less the Group regulatory capital requirement. Surplus capital held within Society's Long Term Fund cannot be included in the IGD definition of capital employed. IGD surplus is after accrual of proposed dividend.
Purpose: IGD surplus is the Group level regulatory surplus capital measure.

### INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS)
These are accounting guidelines and rules that companies and organisations can follow when completing financial statements. They are designed to enable comparable reporting between companies, and they are the standards that all publicly listed groups in the European Union (EU) are required to use.

**Key performance indicators (KPIs) are denoted by the symbol throughout the glossary.**

# GLOSSARY CONTINUED

### INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS) OPERATING PROFIT
The Group's primary financial statements are prepared on an International Financial Reporting Standards (IFRS) basis. IFRS operating profit measures the pre-tax result using a smoothed longer-term investment return. Any variance between actual and smoothed investment return is reported below operating profit.
Purpose: IFRS operating profit gives an insight into the Group's ability to generate cash flows to support dividends during a period.

### KEY PERFORMANCE INDICATORS (KPIs)
These are measures by which the development, performance or position of the business can be measured effectively.

### LGIM
Legal & General Investment Management.

### LIABILITY DRIVEN INVESTMENT (LDI)
A form of investing in which the main goal is to gain sufficient assets to meet all liabilities, both current and future. This form of investing is most prominent in final salary pension plans, whose liabilities can often reach into billions of pounds for the largest of plans.

### NET CASH GENERATION *
Net cash generation is defined as operational cash generation less new business strain for the UK non-profit Protection and Annuities and Savings businesses.
Purpose: Net cash generation demonstrates the ability of the Company to pay returns to shareholders.

### NEW BUSINESS STRAIN
The impact of writing new business on the regulatory position, including the cost of acquiring new business and the setting up of regulatory reserves.

### OPERATIONAL CASH GENERATION*
Operational cash generation is the expected surplus from in-force business for the UK non-profit Protection and Annuities and Savings businesses, the shareholder's share of bonuses on With-profits business, the post-tax IFRS operating profit on other UK businesses, including an expected investment return on Group Capital and Financing invested assets, and dividends remitted from our international businesses from sustainable cash generation.

### PRESENT VALUE OF NEW BUSINESS PREMIUMS (PVNBP)
The industry measure used to determine the value of new business. It is calculated as 100% of single premiums plus the expected present value of new regular premiums.

### PURCHASED INTEREST IN LONG TERM BUSINESS (PILTB)
An estimate of the future profits that will emerge over the remaining term of life and pensions policies that have been acquired via a business combination.

### RETURN ON EQUITY (ROE)
ROE measures the return earned by shareholders on shareholder capital retained within the business. ROE is calculated as IFRS profit after tax divided by average IFRS shareholder's funds.
Purpose: RoE provides a link between performance and balance sheet management and ensures that an appropriate balance is maintained between the two.

### SELF-INVESTED PERSONAL PENSIONS (SIPP)
A self-invested personal pension which provides the policyholder with greater choice and flexibility as to the range of investments made, how these investments are managed, and the administration of those assets and how retirement benefits are taken.

### SOCIETY
Legal & General Assurance Society Limited.

### SOLVENCY II
A proposed EU-wide regulatory regime which intends to align solvency capital to an insurers risk profile. Not expected to be implemented before 2017.

### TOTAL SHAREHOLDER RETURN (TSR)
TSR is a measure used to compare the performance of different companies' stocks and shares over time. It combines the share price appreciation and dividends paid to show the total return to the shareholder.
Purpose: TSR measures total return to shareholders including dividends and share price movements.

### VALUE IN FORCE (VIF)
The value of in-force business is the present value of expected future shareholder profits less the present value cost of holding capital required to support the in-force business.

*** Non GAAP measures**

**Key performance indicators (KPIs) are denoted by the symbol throughout the glossary.**


Registered office:
One Coleman Street, London EC2R 5AA
T 020 3124 2000  F 020 3124 2500




legalandgeneralgroup.com


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