

Audit Committee report



Phillip Broadley
Chairman of the Audit Committee

The composition of the Committee
The Committee is composed entirely of independent non-executive directors. The table below sets out its membership during the year.

| Members |
|-------------------|
| Phillip Broadley |
| Henrietta Baldock |
| Lesley Knox |
| George Lewis |
| Toby Strauss |
| Julia Wilson |

Other regular attendees at Committee meetings include the following:

Group Chairman; Group Chief Executive; Group Chief Financial Officer; Group Chief Risk Officer; Director of Group Finance; Group Chief Internal Auditor; Legal & General Retirement Finance Director; LGIM Finance Director; Group Actuary; Chief Tax Officer; Representatives of the external auditor, KPMG LLP.

Letter from the Chairman Dear Shareholder

I am pleased to present the Audit Committee Report for the year ended 31 December 2019. The report explains the work of the Audit Committee during the year, and meets the disclosure requirements set out in the 2018 UK Corporate Governance Code (the 'Code').

The Code requires that the Audit Committee must operate effectively and efficiently and that its members have a balance of skills and experience to deliver its responsibilities. There were no changes to the membership of the Committee during the year. The members of the Audit Committee have a wide range of experience, including as executives in the financial services and other sectors, as non-executive directors, and as Board members responsible for financial reporting. The Board considers that I meet the requirements of the Code in having recent and relevant financial experience, as do other members of the Audit Committee.

It is worth highlighting that all members of the Audit Committee are also members of the Risk Committee, which ensures that there is appropriate identification and management of any issues that are relevant to both committees.

The Audit Committee meets regularly and privately with each of the external auditor and the Chief Internal Auditor. These meetings allow for regular and open dialogue of any issues relevant to the Audit Committee's work. Audit Committee members also meet regularly with management outside of formal committee meetings to discuss topical issues and maintain their understanding of the group's businesses.

Audit Committee focus for the 2019 year

The Audit Committee met five times in accordance with its annual plan and additional meetings were arranged as necessary. In line with its purpose, the Audit Committee's time over the course of the year was spent in consideration of:

- The integrity of the Company's financial statements and Solvency II disclosures, including consideration of the viability statement and going concern assessments
- Key accounting, financial reporting and actuarial areas of judgement
- The adequacy and effectiveness of our systems of internal control, including whistleblowing
- The effectiveness, performance and objectivity of both the internal and external audit functions

In addition to the above, the Committee has also begun focusing more on the Company's preparedness for IFRS 17. Our work in this regard has primarily been in respect of ensuring plans are in place to meet the new financial reporting requirements, but we expect the focus to increase significantly over the coming years, with a greater focus on the modelling, methodologies and assumptions used to calculate insurance liabilities and the impact of transition.

KPMG LLP ('KPMG') were appointed as the group's external auditors with effect from the financial year ended 31 December 2018, and their first externally facilitated internal audit effectiveness review was carried out during 2019 in conjunction with the broader review of the Board's effectiveness. The review focused on audit quality, the structure and independence of the audit team and KPMG's relationship with the Committee, Executive team and Group Internal Audit. The Committee commented on how the Committee perceived KPMG's understanding of the group's business environment and made suggestions on areas of future audit focus. I have shared the review's findings with the lead audit partner and discussed improvements which could be made to the way in which the Committee and KPMG interact.

The information on the following pages sets out in detail the activities of the Audit Committee during the year. I hope that you will find this report useful in understanding our work and I welcome any comments from shareholders on my report.

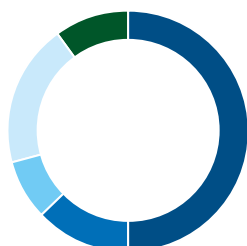
A handwritten signature in blue ink, appearing to read 'Phillip Broadley'.

Phillip Broadley
Chairman of the Audit Committee

How the Audit Committee spent its time in 2019

The Audit Committee is a Board Committee with governance responsibilities that include the oversight of financial disclosures and corporate reporting. The Board has delegated to the Audit Committee the following principal responsibilities to assist the Board in discharging its responsibilities with regards to monitoring the integrity of the group's financial statements, monitoring the effectiveness of the internal control (including financial internal control) framework and the independence and objectivity of the internal and external auditors. The Audit Committee is also responsible for advising the Board on whether the annual report and accounts, taken as a whole, are fair, balanced and understandable and for reviewing the basis on which the Board provides the viability statement and going concern assessment. These considerations have been factored into our year-end processes.

Percentage of time allocated to specific agenda items



- 50% Financial reporting, including areas of judgment, and reporting developments
- 13% External audit
- 8% Internal audit
- 19% Internal controls
- 10% Other (including governance)

The Audit Committee's terms of reference, which set out full details of its responsibilities, can be viewed on our website, <https://www.legalandgeneralgroup.com/about-us/corporate-governance/group-board-committees/>

The Audit Committee has an annual work plan aligned with the financial reporting cycle of the Company. The Audit Committee's activities fall into three principal areas:

- Accounting and Financial Reporting
- Internal Control
- Internal and external audit

Accounting and financial reporting

The Audit Committee reviews the appropriateness of the half year and annual financial statements, which it carries out with both management and the external auditors. This review includes ensuring that the annual report and accounts, taken as a whole, are fair, balanced and understandable, as well as covering compliance with disclosure requirements and the material areas in which significant judgements had been applied.

In collaboration with the Risk Committee, the Audit Committee also reviews the disclosures to be made in relation to internal control and risk management, as well as the principal risks and uncertainties.

The significant accounting issues considered in relation to the 2019 financial statements are detailed on page 78.

Robust year-end governance processes are in place to support the Audit Committee's considerations which include:

- ensuring that all of those involved in the preparation of the Company's annual report have been appropriately trained and fully briefed on the 'fair, balanced and understandable' requirements;
- internal legal verification of all factual statements, together with legal verification of descriptions used within the narrative;
- regular engagement with and feedback from senior management on proposed content and changes;
- feedback from external advisors (corporate reporting specialists, remuneration and strategic reporting advisors, external auditor) to enhance the quality of our reporting; and
- early opportunity for review and feedback on our annual report by Audit Committee members.

The Audit Committee, having completed its review, recommended to the Board that, when taken as a whole, the 2019 annual report is fair, balanced and understandable, and provides the information necessary for shareholders to assess the Company's position and performance, business model and strategy. The Audit Committee, together with the Risk Committee, reviewed the key assumptions and methodologies of the risk-based capital model as well as related Solvency II disclosures.

Audit Committee report continued

During the year, the Audit Committee has continued to keep abreast of significant and emerging accounting developments, and the Audit Committee regularly considers the progress of the projects to implement new

standards, and the key judgements relating to their implementation, including the expected impacts on results and the approach to transitional disclosures.

| Issue | Committee's response |
|---|---|
| <p>Valuation of non-participating insurance contract liabilities – retirement:</p> <p>The non-participating insurance liabilities for retirement products are significant in size and their estimation is inherently judgemental.</p> | <p>The Committee evaluated the significant judgements that have an impact on the valuation of non-participating insurance liabilities for retirement products. This included considering:</p> <p>Valuation interest rates – which are used to discount the liabilities. These are sensitive to judgements made, for example, on credit default of the backing assets, as well as the investment data used to calculate the internal rate of return. The Committee focused on management's proposed changes to reserving assumptions, other modelling changes, and the determination of the credit default assumption. This included analysis of internal historic data and external market experience, including consideration of Brexit outcomes.</p> <p>Longevity assumptions – which estimate how long policyholders receiving annuity payments will live. The challenge around the setting of longevity assumptions was a particularly significant area for review as the judgements could be expected to have a material impact on the group's results. The Committee considered the effectiveness of the controls over the accuracy and completeness of the data used in determining the longevity assumption and the validity of independent industry data supporting those assumptions. The Committee also reviewed available data illustrating recent trends in mortality experience in the UK population and the mortality experience on different blocks of our business.</p> <p>The Committee concluded that the retirement insurance contract liabilities are appropriate for including in the financial statements, reflecting the asset risks and the available data on policy holder longevity.</p> |
| <p>Valuation of complex investments:</p> <p>Mark to model investments can involve significant judgement and can produce valuation challenges for investments in new classes.</p> <p>Mark to model valuations inherently include assumptions that lead to the existence of a range of plausible valuations for financial instruments (known as valuation uncertainty). Certain assets are subject to a higher degree of valuation uncertainty, particularly where valuations are modelled using no market inputs or the valuations are affected by other factors such as the illiquidity of the asset.</p> | <p>The group has continued to increase its exposure to complex investments, in line with its strategy and risk appetite. The valuation of these investments, including property assets, lifetime mortgages, and private credit, requires the use of complex models and management judgement. The Committee seeks to ensure that the valuation process for these investments is robust.</p> <p>The Committee reviewed the processes and controls over investment valuations, in particular the valuation uncertainty policies and governance which included management's assessment of valuation uncertainty by asset type.</p> <p>The Committee concluded that there are appropriate controls surrounding the valuation of complex assets and that they are valued appropriately for inclusion in the financial statements.</p> |
| <p>Valuation of non-participating insurance liabilities – insurance:</p> <p>The non-participating insurance liabilities for protection contracts are an important driver of the profitability for this line of business and require judgements to be made regarding the assumed rates of mortality and persistency. The company makes extensive use of reinsurance to reduce mortality risk.</p> | <p>The Committee has reviewed the methodology for calculating reserves including the allowance made for payments to and from reinsurance counterparties. The assumptions for the rate of future mortality and morbidity (how many customers will die or become ill during the policy term) and persistency (how many customers will discontinue cover) are based on the company's internal experience and use judgement about how experience may vary in the future.</p> <p>The Committee reviewed the assumptions and the expected level of prudence taking into account market benchmarking, internal experience studies and the reinsurance structures. The Committee also considered the internal control environment in place to control the valuation models.</p> <p>The Committee concluded that the insurance liabilities of the Insurance division are appropriate for inclusion in the financial statements.</p> |

Internal control

The Board has delegated responsibility for reviewing the effectiveness of the group's systems of internal control to the Audit Committee.

The Audit Committee has the primary responsibility for the oversight of the group's system of internal controls including financial reporting control and the work of the internal audit function. The Audit Committee, in collaboration with the Risk Committee, seeks to ensure that the group operates within a framework of prudent and effective controls that allow risk to be identified, assessed and managed.

The Audit Committee has completed its review of the effectiveness of the group's system of internal control policies and procedures, during the year and up to the date this report was approved, in accordance with the requirements of the Guidance on Risk Management, Internal Control and related Financial and Business Reporting published by the FRC. During this review, the Audit Committee did not identify any weaknesses which were determined to be significant to the preparation of the financial statements. The Audit Committee also noted that there were no significant changes to the control environment noted in the current year, significant to the preparation of the financial statements. Where areas for improvement were

identified, processes are in place to ensure that the necessary actions are taken and progress is monitored by the Audit Committee.

The Audit Committee monitored and reviewed the scope, extent and effectiveness of the activity of the group internal audit function. In particular, the Audit Committee evaluates the alignment of the internal audit plan with the group's key risks and strategy.

Internal Audit

The Group Chief Internal Auditor has a standing agenda item at each Audit Committee meeting to update the Audit Committee on audit activities, progress of the audit plans, the results

of any unsatisfactory audits and the action plans to address these areas. In 2019, 117 audits were completed in line with the Internal Audit Plan approved by the Audit Committee. There was a particular focus on key themes including cyber/ data management and governance, financial control framework establishment, digital business and regulatory change, conduct risk, financial management and control, model risk, outsourcing/vendor management and economic and political volatility.

The external auditor

The Audit Committee has the primary responsibility for overseeing the relationship with, and performance of the external auditor. This includes making recommendations for their appointment, re-appointment, removal and remuneration.

Appointment

The Audit Committee is cognisant of the requirements governing the appointment of an external auditor, notably the requirements of the Competition and Markets Authority (CMA) in relation to the mandatory re-tendering of audit services every ten years, together with the European Union's requirements for mandatory audit firm rotation. The Company confirms that it has complied with the CMA requirements for the financial year under review.

KPMG were appointed as the group's external auditors with effect from the financial year ended 31 December 2018.

Performance

The Audit Committee assesses the effectiveness of the external auditor against some of the following criteria:

- Provision of timely and accurate industry specific and technical knowledge
- Maintaining a professional and open dialogue with the Audit Committee Chair and members at all times
- Delivery of an efficient audit and the ability to meet objectives within the agreed timeframes
- The quality of its audit findings, management's response and stakeholder feedback

The Audit Committee receives regular reports from the external auditor on audit findings and significant accounting issues. In 2019, the Audit Committee continued to focus on the external auditor's assurance work on the financial control environment, as well as their conclusions on the significant accounting issues noted above.

The Chair of the Audit Committee regularly meets the external auditor throughout the course of the year. The Audit Committee also meets the external auditor in private throughout the year.

The Audit Committee reviews and approves the terms of engagement of the external auditor and monitors its independence. This includes overseeing, and in certain circumstances approving, the engagement of the external auditors for non-audit work. The non-audit services policy prohibits the auditor from providing the following services:

- Tax advice and compliance
- Management or decision making
- Book-keeping and preparing accounting records or statements
- Design or implementation of internal controls
- Valuation
- Legal, internal audit or human resources
- Those linked to financing capital structure or allocation or investment strategy
- Promoting, dealing in or underwriting share issues
- Payroll services

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

| | 2019 | 2018 | 2017 |
|---------------------------------------|------|------|------|
| Audit | 7.1 | 6.0 | 6.1 |
| Audit-related required by legislation | 0.8 | 0.8 | 0.8 |
| Other audit-related | 1.1 | 0.6 | 1.0 |
| Other assurance | 0.3 | 0.2 | 0.4 |
| Non-assurance | 0.2 | 1.5 | 0.8 |
| Total | 9.5 | 9.1 | 9.1 |

Following the audit tender process, the policy was updated and approved by the Audit Committee to address the requirements as set out in the EU Audit regulation.

Our policy is to approach other firms for significant non-audit work. 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 one other alternate party in addition to the external auditor. If the external auditor is selected following the tender process, the Audit Committee is responsible for approving the external auditors' 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 are required to report regularly to the Audit Committee on the nature and fees relating to non-audit services provided under this authority.

Remuneration

In 2019, the group spent £1.6 million on non-audit services provided by KPMG. It spent a further £0.8 million on audit-related services required by legislation, which is excluded from any calculation of the ratio of non-audit to audit fees in accordance with the UK FRC Ethical Standard for Auditors (June 2016). Further details can be found in Note 34 to the consolidated financial statements. The non-audit fee represents 23% of the total audit fee for 2019. The audit fee in 2019 includes additional fees relating to the prior year audit of group subsidiaries.

The Audit Committee remains satisfied that KPMG continues to be independent. In addition, KPMG annually reports on whether and why it deems itself to be independent.