UK GAAP Accounting Policies

Royal London has opted to apply UK GAAP in its statutory financial reporting with effect from 1 January 2020. Set out below are the UK GAAP accounting policies that will be used for the Group and Company’s statutory financial statements from 2020.

1. Accounting policies
   (a) Basis of preparation
   The Royal London Mutual Insurance Society Limited (the ‘Parent Company’ or ‘RLMIS’) is a private company limited by guarantee, incorporated and registered in England and Wales with its registered office being 55 Gracechurch Street, London, EC3V 0RL.

   The financial statements of the Group and the Company (‘the financial statements’) are prepared in accordance with UK accounting standards, including Financial Reporting Standard (FRS) 102, ‘The Financial Reporting Standard applicable in the United Kingdom and the Republic of Ireland’ and FRS 103, ‘Insurance contracts’. The financial statements are also prepared in compliance with the Companies Act 2006 and under the provisions of the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 (‘the Regulations’) relating to insurance groups, except that a true and fair override has been applied to:
   * measure subsidiaries at fair value through profit or loss (‘FVTPL’) when they are excluded from the consolidation because they are held as part of an investment portfolio – see accounting policy (b); and
   * measure investments in associates that are part of an investment portfolio at FVTPL in the consolidated financial statements instead of using equity accounting – see accounting policy (b).

   The Group and Company are exempt from the requirements of Section 7 of FRS 102 to prepare a cash flow statement, as mutual life assurance companies are excluded from compliance with that section.

   The functional currency of the Group and Company is considered to be pounds sterling because that is the currency of the primary economic environment in which the Company operates. Foreign operations are included in accordance with the policies set out in accounting policy (d). Unless otherwise stated, all figures in the financial statements are presented rounded to the nearest million pounds.

   The Group and Company financial statements have been prepared under FRS 102 and FRS 103 for the first time. The previous financial statements for the year ended 31 December 2019 were prepared under International Financial Reporting Standards (IFRS) and the date of transition to FRS 102 was therefore 1 January 2019. The Group and Company have chosen to account for the classification and measurement of financial instruments under IFRS 9, with this accounting judgement detailed in accounting policy (f). As a consequence of adopting FRS 102 and FRS 103, a number of accounting policies have changed to comply with those standards resulting in adjustments to balances on transition. Further details on the transition adjustments will be disclosed in the Annual Report and Accounts for the year ended 31 December 2020.

   (b) Basis of consolidation
   The Group financial statements incorporate the assets, liabilities and results of the Company and its subsidiaries, except for those subsidiaries which are held as part of an investment portfolio. Subsidiaries that are held as part of an investment portfolio are excluded from the consolidation, and are included within the consolidated financial statements as an investment within ‘Other financial investments’, measured at FVTPL in accordance with Section 9 of FRS 102.

   The inclusion of these assets at FVTPL is a departure from the requirements of paragraph 30 of Schedule 3 to the Regulations, which has been applied so that the financial statements give a true and fair view.

   Investments in associates that are part of an investment portfolio are also included in the consolidated financial statements as an investment within ‘Other financial investments’, measured at FVTPL in accordance with Section 14 of FRS 102. The inclusion of these assets at FVTPL is a departure from the requirements of paragraph 21 of Schedule 6 to the Regulations, which has been applied so that the financial statements give a true and fair view.

   The Group applies the purchase method in accounting for business combinations. The cost of business combinations comprises the fair value of the consideration paid and of the liabilities incurred or assumed and any directly attributable expenses. The value of deferred consideration payable on acquisition or receivable on disposal of a subsidiary is determined using discounted cash flow techniques.

   The financial statements produced by subsidiaries for inclusion in the Group financial statements are prepared using accounting policies consistent with those adopted by the Group. Intra-group transactions, balances and unrealised gains and losses on intra-group transactions are eliminated.

   The accounting policies for Goodwill are detailed in accounting policy (p) and for investments in Group undertakings including subsidiaries, associates and other significant investments, in accounting policy (r).

   (c) Classification of contracts
   The Group classifies its products for accounting purposes as insurance, investment or investment with discretionary participation features. Insurance contracts are those contracts that transfer significant insurance risk. Contracts that do not transfer significant insurance risk are investment contracts.

   A discretionary participation feature is a contractual right held by a policyholder to receive additional payments as a supplement to guaranteed benefits:
   * that are likely to be a significant proportion of the total contractual payments; and
   * whose amount or timing is contractually at the discretion of the issuer and that is contractually based on:
     - the performance of a specified pool of contracts, or a specified type of contract, or
     - realised and/or unrealised investment returns on a specified pool of assets held by the issuer, or the profit or loss of the company that issues the contracts.

   Such contracts are more commonly known as ‘with-profits’ or as ‘participating’ contracts.

   Hybrid contracts are those where the policyholder can invest in and switch between both unit-linked (non-participating) and unitised with-profits (participating) investment mediums at the same time. Certain hybrid contracts that are classified as investment contracts are treated as if they were wholly non-participating investment contracts when accounting for premiums, claims and other revenue. Hybrid contracts that contain significant insurance risk are classified as the primary economic environment in which the Group and the Company operate is the United Kingdom.
1. Accounting policies (continued)

1.1. Classification of contracts continued

The Group seeks to reduce its exposure to potential losses by reinsuring certain levels of risk with reinsurer companies. Reinsurance contracts that meet the classification requirements for insurance contracts set out above are classified as reinsurance contracts held. Contracts that do not meet these classification requirements are classified as financial assets.

1.2. Foreign currency translation

The primary economic environment in which the Group and the Company operate is the United Kingdom. Hence the functional currency of the Group and the Company is pounds sterling. Revenue transactions and those relating to the acquisition and realisation of investments have been translated into sterling at the rates of exchange ruling at the time of the respective transactions. Assets and liabilities denominated in foreign currencies are expressed in sterling at the exchange rate ruling on the balance sheet date, exchange differences from the settlement of transactions and from the translation of assets and liabilities at period-end exchange rates are dealt with in the statement of comprehensive income under the same heading as the underlying transactions are reported.

The results of foreign operations are translated at average rates of exchange for the year. The assets and liabilities of foreign operations are translated at the closing rate at the balance sheet date. All resulting exchange differences are recognised in other comprehensive income.

1.3. Impairment of assets

The impairment charge in the statement of comprehensive income includes the change in expected credit losses for financial assets held at amortised cost. Expected credit losses are calculated by using an appropriate probability of default and applying this to the estimated exposure of the Group at the point of default after taking into account the value of any collateral held or other mitigants of loss.

At initial recognition, allowance is made for expected credit losses resulting from default events that are possible within the next 12 months (12-month expected credit losses). In the event of a significant increase in credit risk, allowance is made for expected credit losses resulting from all possible default events over the expected life of the financial instrument (lifetime expected credit losses). Financial assets where 12-month expected credit losses are recognised are considered to be Stage 1; financial assets which are considered to have experienced a significant increase in credit risk are in Stage 2; and financial assets which have defaulted or are otherwise considered to be credit impaired are allocated to Stage 3.

The loss allowance for lease receivables and trade receivables without a significant financing component is measured at an amount equal to lifetime expected credit losses, in accordance with the simplified approach in IFRS 9.

An assessment of whether credit risk has increased significantly since initial recognition considers the change in the risk of default occurring over the remaining expected life of the financial instrument. The assessment is unbiased, probability-weighted and uses forward-looking information consistent with that used in the measurement of expected credit losses.

Assets are transferred to Stage 3 when they have defaulted or are otherwise considered to be credit impaired. A loan or receivable is normally written off, either partially or in full, against the related allowance when the proceeds from realising any available security have been received or there is no realistic prospect of recovery and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off decrease the amount of impairment losses recorded in the statement of comprehensive income.

1.4. Judgments and key sources of uncertainty

The preparation of financial statements requires management to make judgements in the process of applying the Group’s accounting policies. In selecting accounting policies where FRS102 and FRS103 permit a choice of policy, the directors have applied the process of applying the Group’s accounting policies. In selecting accounting policies where FRS102 and FRS103 permit a choice of policy, the directors have applied judgment in determining the most appropriate policy as follows:

- recognition and measurement of financial instruments. FRS 102 allows a choice between applying Sections 11 and 12 of FRS 102, the measurement provisions of IAS 39, ‘Financial Instruments: Recognition and Measurement’ or the recognition and measurement provisions of IFRS 9, ‘Financial Instruments’. The group has chosen to apply IFRS 9 because this is considered to be the most appropriate basis for an insurance group such as Royal London;
- measurement model for financial instruments. The measurement basis for financial assets under IFRS 9 depends on an assessment of the Group’s business model for managing the financial assets and whether the cash flows represent solely payments of principal and interest. Further detail is given in accounting policy (s). For financial liabilities, other than derivative liabilities, the measurement basis is amortised cost unless the liability is designated at FVTPL. Further detail is given in accounting policy (dd);
- measurement model for non-participating investment contracts. These financial liabilities have been designated at FVTPL because the unit-linked liabilities are part of a group of financial assets and financial liabilities that are managed and whose performance is evaluated on a fair value;
- determining the fair value of assets and liabilities held at FVTPL. The Group categorises assets and liabilities measured at fair value using a three level hierarchy. Assets and liabilities categorised as Level 1 are valued using quoted market prices and therefore there is minimal judgment applied in determining fair value. However, the fair value of assets and liabilities categorised as Level 2 and, in particular, Level 3 is determined using valuation techniques. These valuation techniques involve management judgment and estimates, the extent of which depends on the complexity of the item and the availability of market observable information;
- the classification of contracts as insurance or investment on initial recognition, which requires an assessment of whether significant insurance risk has been transferred to the Group; and
- the determination of whether the Group has control over an entity. This decision requires the consideration of a number of factors, as set out in accounting policy (r).
1. Accounting policies (continued)

(f) Judgements and key sources of uncertainty continued

The preparation of financial statements also requires the use of estimates and assumptions that affect the amounts reported in the balance sheet and statement of comprehensive income 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 expectations of future events and actions, actual results may differ from those estimates, possibly significantly.

This is particularly relevant to the following:

• the valuation of the Group’s financial assets and liabilities held at FVTPL. The assumptions used in the valuation, particularly in respect of level 3 assets and liabilities are explained in the fair value measurement note;

• Other intangible assets are recognised and tested for impairment using the present value of future cash flows expected to arise from the asset. Significant estimates include forecast cash flows and discount rates;

• insurance and investment contracts. The key assumptions used in calculating the year end insurance and investment contract liabilities are described in the relevant notes;

• Provisions, contingent liabilities and contingent assets – the Group evaluates whether a provision or a contingent liability should be recognised by assessing the likelihood of a constructive or legal obligation to settle a past event and whether the amount can be reliably estimated. The amount of provision is determined based on the Group’s estimate of the expenditure required to settle the obligation. Further information is shown in notes 33 and 37. The Group assesses whether a contingent asset should be disclosed by considering the likelihood of an inflow of economic benefits; and

• pension schemes. The major assumptions used to calculate the pension scheme asset and the sensitivity of the schemes’ liabilities to changes in key assumptions are disclosed in the pension scheme note.

(g) Segmental information

The segmental disclosures are based on operating segments that reflect the level within the Group at which key strategic and resource allocation decisions are made and the way in which operating performance is reported internally to the chief operating decision-maker. The chief operating decision-maker, who is responsible for allocating resources and assessing performance of the operating segments, has been identified as the Company’s Board of Directors.

(h) Premiums

Gross premiums written and outward reinsurance premiums relate to insurance and non-hybrid participating investment contracts. They are accounted for when due for payment except for recurring single premiums and premiums in respect of unit-linked business, which are accounted for when the related liabilities are created.

For non-participating (unit-linked) investment and certain hybrid participating investment contracts the amounts received as premiums are not included in the statement of comprehensive income but are accounted for as deposits received and are added to the value of investment contract liabilities in the balance sheet.

(i) Investment return

Investment return comprises all investment income, including property rental income, realised investment gains and losses and movements in unrealised gains and losses, net of investment expenses and charges.

Investment income derived from assets held at FVTPL includes dividends and interest income. Dividends are recorded on the date on which the shares are declared ex-dividend. Dividends are recorded gross, with the related withholding tax included within the tax expense as foreign tax. Interest income is recognised on an accruals basis. Rental income from investment property, net of any lease incentives received or paid, is recognised on a straight-line basis over the term of the lease.

Realised gains and losses on investments held at FVTPL are calculated as the difference between net sales proceeds and purchase price. Movements in unrealised gains and losses on investments represent the difference between the valuation at the balance sheet date and the valuation at the last balance sheet date or for assets acquired during the period, their purchase price, together with the reversal of unrealised gains and losses recognised in earlier accounting periods in respect of investment disposals in the current period.

(j) Other income

Other income principally comprises fee income from managing investment funds and commission income where the Group acts as an introducer for certain third party insurers.

Management fees arising from investment and fund management contracts are recorded in the statement of comprehensive income in the period in which the services are provided. Initial fees relating to the provision of future services, are deferred and recognised in the statement of comprehensive income over the anticipated period in which the services will be provided. Such deferred fee income is shown as a liability in the balance sheet.

Commission income and profit commission received on the underwriting results of third party insurers is recognised in the statement of comprehensive income as the related services are provided.

The negative goodwill is recognised in profit or loss as set out in accounting policy (p).

(k) Claims

Gross claims paid and the reinsurers’ share of claims paid, relate to insurance and non-hybrid participating investment contracts. For non-participating policies, maturity claims and annuities are accounted for when due for payment. Surrenders are accounted for when paid or, if earlier, on the date when the policy ceases to be included within the calculation of the related contract liabilities. Death claims and all other non-linked claims are accounted for when accepted. For linked policies, claims are accounted for on cancellation of the associated units.

Claims payable include related claims handling costs. The reinsurers’ share of claims paid is accounted for in the same period as the related claim.

Amounts repaid as claims on non-participating (unit-linked) investment and certain hybrid participating investment contracts are not included in the statement of comprehensive income but are accounted for as a deposits repaid and are deducted from investment contract liabilities.

(l) Net operating expenses

Net operating expenses comprise costs relating to the operating activities of the Group. These costs are charged to the statement of comprehensive income as they are incurred.

(m) Investment expenses and charges

Investment expenses and charges comprise costs relating to the investing activities of the Group. These costs are charged to the statement of comprehensive income as they are incurred.
1. Accounting policies (continued)

(n) Other charges
Interest payable on borrowings is calculated using the effective interest method and includes the amortisation of any discount and attributable transaction costs.
Other project costs are charged to the statement of comprehensive income as they are incurred.

(o) Tax (credit)/charge
Tax expense comprises current and deferred tax and is recognised in profit or loss except to the extent that it relates to items recognised directly in other comprehensive income, in which case it is recognised directly in other comprehensive income. Both current and deferred tax are calculated using tax rates enacted or substantively enacted at the balance sheet date.

Current tax
Current tax is the expected tax payable on the taxable income for the year and any adjustment to tax payable in respect of previous years.

Deferred tax
Deferred tax is provided based on timing differences that arise from the inclusion of income and expenses in tax assessments in different periods from those in which they are recognised in the financial statements.
The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities.
The following temporary differences are not provided for:
- the initial recognition of goodwill not deductible for tax purposes; and
- temporary differences arising on investments in subsidiaries where the Group controls the timing of the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future.
A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised.

(p) Intangible Assets

Goodwill
Goodwill is the excess of the fair value of the consideration for a business combination plus directly attributable costs over the fair value of the identifiable net assets acquired. It is capitalised at cost and amortised through the statement of comprehensive income on a straight-line basis over its useful economic life (the period over which the benefits of the business combination are expected to be realised). The amortisation charge is recognised within ‘Net operating expenses’.
Negative goodwill is the excess of the fair value of identifiable net assets acquired in a business combination over the fair value of the consideration and directly attributable costs. It is capitalised at cost and shown as a negative asset. Subsequently the value of negative goodwill up to the fair value of non-monetary assets acquired is recognised in ‘Other income’ in the periods in which those non-monetary assets are realised. Any remaining value of negative goodwill in excess of the value of non-monetary assets acquired is recognised in ‘Other income’ in the periods expected to benefit.
The gain or loss on subsequent disposal of a subsidiary will include any attributable remaining balance of positive or negative goodwill.

Other intangibles
Other intangible assets include computer software. They are carried at cost less accumulated amortisation and impairment losses and are amortised on a straight line basis over their useful lives, which range from three to ten years. The useful lives are determined by considering relevant factors such as the remaining term of agreements, the normal lives of related products and the competitive position.

Impairment of intangibles assets
The carrying amounts of intangible assets, including positive goodwill, are reviewed at each balance sheet date for any indication of impairment or whenever events or circumstances indicate that their carrying amount may not be recoverable. These assets are tested for impairment whenever there is an indicator of impairment. An impairment loss is recognised whenever the carrying amount exceeds the recoverable amount. The recoverable amount is the higher of the asset's fair value less costs to sell and its value in use.
Impairment losses are recognised in the statement of comprehensive income. With the exception of goodwill, an impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that after the reversal, the asset’s carrying amount is no greater than the amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised. An impairment loss in respect of goodwill is never reversed.

(q) Land and buildings

Investment property
Investment property is property held for rental, capital growth or both, excluding that occupied by the Group or the Company.
Investment property includes freehold and leasehold land and buildings.
Investment property is initially measured at cost. For freehold investment property, cost comprises the fair value of the consideration paid plus the associated transaction costs.
Leasehold investment property is accounted for as a finance lease, even if the lease would otherwise be classified as an operating lease. The cost at the start of the lease is the lower of the fair value of the property and the present value of the minimum lease payments. An equal liability is established to represent the financing element of the lease contract. As lease payments are made, these are split between an interest element, calculated on an effective interest basis, which is charged to the statement of comprehensive income and a capital element, which reduces the finance lease liability.
All investment property is subsequently measured at fair value in the balance sheet. Fair value is determined annually by independent professional valuers based on market evidence. Any gain or loss arising from a change in fair value is recognised in the statement of comprehensive income.
When the Group or Company has given a lease incentive, the carrying value of the investment property is reduced by the value of the debtor arising from the lease incentive, which is shown separately within ‘Other debtors’.

Owner occupied land and buildings
Owner-occupied land and buildings are initially measured at cost, which comprises the fair value of the consideration paid plus the associated transaction costs. Costs incurred after initial recognition are included in an asset’s carrying value only to the extent that it is probable that there will be future economic benefits associated with the item and the cost of the item can be measured reliably. All other repairs and maintenance costs are charged to the statement of comprehensive income during the period in which they are incurred.
All owner-occupied land and buildings are subsequently carried at fair value in the balance sheet. Fair value is determined annually by independent professional valuers, who are members of the Royal Institution of Chartered Surveyors, and is based on market evidence.
1. Accounting policies (continued)

(a) Land and buildings continued
An increase in fair value is recognised in other comprehensive income, except to the extent that it is the reversal of a previous revaluation decrease which was recognised in profit or loss. A decrease in fair value is recognised immediately in profit or loss, except to the extent that it reverses a previous revaluation surplus recognised in other comprehensive income. Owner-occupied land and buildings are not depreciated.

Gains and losses on disposals are included in the statement of comprehensive income and are determined by comparing proceeds with carrying amounts.

(r) Investment in Group undertakings

Subsidiaries
The Company has elected to present investments in subsidiaries in the Company balance sheet measured at FVTPL, as permitted by FRS 102 Section 9.

Subsidiaries are those entities (including OEICs and other investment funds) over which the Group has control. The Group controls an entity when it has power to govern its financial and operating policies. The Group considers all relevant facts and circumstances when determining whether control exists and makes a re-assessment whenever those facts and circumstances change. Profits or losses of subsidiaries sold or acquired during the period are included in the consolidated results up to the date that control ceases or from the date of gaining control.

The Group invests in investment funds, which themselves invest mainly in equities, bonds, property and cash and cash equivalents. Some of these funds are managed by Group companies. For these funds, where the Group’s holding is greater than 50% it is presumed that it has the power to govern the fund’s financial and operating policies; in such cases the fund is classified as a subsidiary. Where the Group’s holding of internal investment funds is less than 50% it is classified as an associate, unless the Group’s interest is less than 20% in which case the Group is not considered to have significant influence over the fund and the fund is accounted for within ‘Other financial investments’ at fair value.

The Group also invests in certain private equity funds and property unit trusts, which are managed by external third-party administrators. The structure of each fund, the terms of the relevant agreements and the Group’s ownership percentage are all taken into consideration in determining whether the Group has control and therefore whether the unit trust/fund should be classified as a subsidiary.

In accordance with Section 9 of FRS 102, subsidiaries that are held as part of an investment portfolio are excluded from the consolidation and are held on the Group balance sheet as ‘Other financial investments’ measured at FVTPL. The inclusion of these entities at FVTPL is a departure from the requirements of paragraph 30 to Schedule 3 of the Regulations as set out in accounting policy (b).

Associates
Associates are entities over which the Group has significant influence but not control or joint control, generally accompanying an ownership interest of between 20% and 50%. The Group’s investments in associates are all investment funds held as part of an investment portfolio and are measured at FVTPL, in accordance with Section 14 of FRS 102. The inclusion of these assets at FVTPL is a departure from the requirements of paragraph 21 of Schedule 6 to the Regulations, as set out in accounting policy (b).

Joint ventures
Joint ventures are those entities over whose activities the Group has joint control, established by contractual agreement, and can take the form of jointly controlled operations, jointly controlled assets, or jointly controlled entities. The Group’s interests in joint ventures are all jointly controlled entities that are held as part of an investment portfolio, hence under FRS 102, Section 15, they are measured at FVTPL.

The fair value of investments in Group undertakings which are unit trusts, OEICs and other pooled funds is the bid price quoted on the last day of the accounting period on which investments in such funds could be redeemed. Fair value for those entities which are not unit trusts, OEICs and other pooled funds is determined by the Group Board of Directors using the same valuation techniques as are used for unquoted investments, as described in accounting policy (s).

(e) Financial Investments
All investment transactions are recognised at trade date i.e. the date the Group commits to purchase the asset from, or deliver the asset to, the counterparty.

Financial investments are classified on the basis of an assessment of the Group’s business model for managing the financial assets and whether the cash flows represent solely payments of principal and interest. Financial assets are classified at FVTPL where they are within a portfolio of financial assets that is managed and whose performance is evaluated on a fair value basis or they do not meet the criteria to be measured at amortised cost.

All of the financial assets of the Group’s non-linked funds, included on the balance sheet within ‘Other financial investments’, are part of a group of financial assets that are managed on a fair value basis and are classified upon initial recognition as held at FVTPL. All of the financial assets within the Group’s unit-linked funds, included on the balance sheet within ‘Assets held to cover linked liabilities’, are also a group of financial assets that are managed on a fair value basis and are classified upon initial recognition as held at FVTPL.

Financial assets classified as FVTPL are initially recognised at the fair value of the consideration paid. They are subsequently measured at fair value with any resultant gain or loss recognised in the statement of comprehensive income.

Fair value for quoted investments in an active market is the bid price, which management believe is representative of fair value. For investments in unit trusts, OEICs and other pooled funds (including those classified as investments in Group undertakings) it is the bid price quoted on the last day of the accounting period on which investments in such funds could be redeemed. If the market for a quoted financial investment is not active or the investment is unquoted, the fair value is determined by using valuation techniques. For these investments, the fair value is established by the Company Board of Directors using quotations from independent third parties, such as brokers or pricing services, or by using internally developed pricing models. Priority is given to publicly available prices from independent sources, when available, but overall, the source of pricing and/or valuation technique is chosen with the objective of arriving at a fair value measurement which reflects the price at which an orderly transaction would take place between market participants on the measurement date. Valuation techniques include the use of recent arm’s length transactions, reference to the current fair value of other instruments that are substantially the same, discounted cash flow
1. Accounting policies (continued)

(a) Financial Investments continued

Analysis and option pricing models making maximum use of market inputs from independent sources and relying as little as possible on entity specific input.

De-recognition and offset of financial assets and financial liabilities

A financial asset is de-recognised when the contractual rights to receive the cash flows from the asset have expired or where they have been transferred and the Group has also transferred substantially all of the risks and rewards of ownership.

A financial liability is de-recognised when the obligation specified in the contract is discharged or cancelled or expires.

All derivatives are accounted for on a contract-by-contract basis and are not offset in the balance sheet.

(t) Embedded derivatives

The Group does not separately measure embedded derivatives that meet the definition of an insurance contract or embedded options to surrender insurance contracts for a fixed amount (or a fixed amount and an interest rate). All other embedded derivatives are separated and carried at fair value if they are not closely related to the host contract and they meet the definition of a derivative.

(u) Debtors arising out of direct insurance operations and reinsurance operations

Debtors arising out of direct insurance operations and debtors arising out of reinsurance operations are measured at amortised cost as they are financial assets that are held to collect contractual cash flows where those cash flows represent solely payments of principal and interest. They are initially recognised at fair value and are subsequently measured at amortised cost using the effective interest method.

(v) Other debtors

Investment income receivable, amounts due from other Group entities and other receivables are measured at amortised cost as they are financial assets that are held to collect contractual cash flows where those cash flows represent solely payments of principal and interest. They are initially recognised at fair value and subsequently measured at amortised cost using the effective interest method.

Current tax assets are measured at the amount of tax expected to be recovered using tax rates substantively enacted at the balance sheet date.

(w) Tangible fixed assets

Tangible fixed assets are stated at cost less accumulated depreciation and impairment losses. Cost comprises expenditure directly attributable to the acquisition of the asset.

Depreciation on tangible fixed assets is charged to the statement of comprehensive income and is calculated so as to reduce the value of the assets to their estimated residual values on a straight-line basis over the estimated useful lives of the assets concerned, which range from three to eight years.

The carrying amounts of tangible fixed assets are reviewed at each balance sheet date for any indication of impairment or whenever events or circumstances indicate that their carrying amount may not be recoverable. An impairment loss is recognised whenever the carrying amount exceeds the recoverable amount. The recoverable amount is the higher of the asset’s fair value less costs to sell and its value in use. Impairment losses are recognised in the statement of comprehensive income.

Gains and losses on disposals are included in the statement of comprehensive income and are determined by comparing proceeds with carrying amounts.

(x) Deferred Acquisition Costs on investment contracts (DAC)

Incremental costs that are directly attributable to the acquisition of new non-participating investment and hybrid participating investment contracts are recognised as a DAC asset, provided those costs are considered to be recoverable. Incremental costs comprise both initial commission and an amount representing the present value of future commission payable to third parties. All other acquisition costs are expensed as incurred. The asset is amortised over the period in which we expect to receive the related investment management services fees.

All acquisition costs on insurance and non-hybrid participating investment contracts are recognised as an expense in the statement of comprehensive income when incurred.

(y) Pension scheme asset

The Group operates three defined benefit schemes and a number of defined contribution arrangements.

(i) Defined benefit schemes

The defined benefit schemes provide benefits based on pensionable pay. The assets of the schemes are held in separate Trustee administered funds. The position of each scheme is assessed annually by an independent qualified actuary using the projected unit credit method.

The pension scheme asset recognised in the balance sheet is the excess that is recoverable of the fair value of the plan assets in a scheme over the present value of that scheme’s liabilities. Deficits in the value of a scheme’s assets over its scheme liabilities are recognised in the balance sheet as a pension scheme liability. The ‘Administration costs’ and ‘Net interest (income)/cost’ are included within ‘Net operating expenses’ on an incurred basis. ‘Past service costs’ arising on a plan amendment or curtailment are included immediately within ‘Net operating expenses’. Remeasurements are recognised in other comprehensive income in the period in which they arise.

(ii) Defined contribution arrangements

The Group operates a number of defined contribution arrangements for employees. The Group pays contractual contributions in respect of these arrangements, which are recognised as an expense when they are due.

(z) Subordinated liabilities

Subordinated liabilities are recognised initially at the fair value of the proceeds received, net of any discount and less attributable transaction costs. Subsequent to initial recognition, they are stated at amortised cost. The transaction costs and discount are amortised over the period to the earliest possible redemption date on an effective interest rate basis.

The amortisation charge is included in the statement of comprehensive income within ‘Other charges’. An equivalent amount is added to the carrying value of the liability such that at the redemption date the value of the liability equals the redemption value.

(aa) Fund for future appropriations

Interest costs are expensed as they are incurred. The nature of benefits for participating contracts is such that the allocation of surpluses between participating policyholders is uncertain. The amount not allocated at the balance sheet date is classified within liabilities as the fund for future appropriations (FFA).
1. Accounting policies (continued)

(bb) Technical provisions

Insurance contracts and participating investment contracts

Under FRS 103, ‘Insurance Contracts’, insurance and participating investment contracts are valued using accounting policies consistent with those adopted prior to the application of FRS 103. A change to those accounting policies is permitted if it makes the financial statements more relevant and no less reliable, or more reliable and no less relevant.

The estimation techniques and assumptions used are periodically reviewed, with any changes in estimates reflected in the consolidated statement of comprehensive income as they occur.

Long-term business provision - participating insurance, non-participating insurance and participating investment contracts

Participating insurance, non-participating insurance (referred to as ‘non-profit’ contracts) and participating investment contracts are measured using the requirements of the current Solvency II (SII) regulatory regime, with the following adjustments:

- Remove the volatility adjustment (VA) from the discount rate so that a SII risk-free rate is used.
- Exclude the SII risk margin and instead include margins of prudence within demographic assumptions in a consistent way to the approach applied before the adoption of SII.
- Remove the SII transitional measure on technical provisions (TMTP).
- Include all excluded future premium payments restricted within the Solvency II balance sheet.
- Closed fund surpluses. For the closed funds, any excess of the UK GAAP value of assets over liabilities is included in the participating contract liabilities because it is not available for distribution to other policyholders or for other business purposes.

The participating contract liabilities include an assessment of the cost of any future options and guarantees granted to policyholders measured on a market consistent basis. The calculations also take into account with-profit bonus decisions which are consistent with the Company’s Principles and Practices of Financial Management.

The present value of future profits on non-participating investment contracts and With-profits fund transfers

The present value of future profits on non-participating investment contracts and the value of future transfers from the Group’s 90:10 with-profits funds are accounted for as part of the calculation of the participating contract liabilities. However these values cannot be allocated to particular participating liabilities and so, in accordance with FRS 103, they are shown as a separate asset on the face of the balance sheet, the ‘Non-participating value of in-force business’.

Non-profit insurance contracts

For non-linked, non-profit insurance contracts, the liability is calculated as the discounted value of all the cash flows expected to arise on those contracts, using the SII risk-free discount rate.

Technical provisions for linked liabilities

The technical provisions for linked liabilities include liabilities for unit-linked insurance contracts and unit-linked investment contracts.

Unit-linked insurance contracts

Unit-linked insurance contracts are measured using the requirements of the SII regulatory regime, adjusted for the items shown above for participating contracts, where applicable. The liability is calculated as the discounted value of all the cash flows expected to arise on those contracts, using the SII risk-free discount rate. The cash flows are determined on a best estimate basis plus an allowance for risk, which is made by including margins within the assumptions used, determined on a basis consistent with that applied prior to the adoption of SII.

Unit-linked investment contracts

The financial liabilities for unit-linked investment contracts are designated at inception as at FVTPL. This classification has been used because the unit-linked liabilities are part of a group of financial assets and financial liabilities that are managed and whose performance is evaluated on a fair value basis. The fair value is determined using the current unit values that reflect the fair values of the financial assets contained within the Group’s unitised investment funds linked to the financial liability, multiplied by the number of units attributed to the contract holder at the balance sheet date.

If the investment contract is subject to a surrender option, the fair value of the financial liability is never less than the amount payable on surrender, discounted for the required notice period, where applicable.

Liability adequacy test

A liability adequacy test is performed on insurance liabilities to ensure that the carrying amount of liabilities (less related intangible assets) is sufficient to cover current estimates of future cash flows. When performing the liability adequacy test, all contractual cash flows are discounted and compared against the carrying value of the liability. Any shortfall is charged immediately to the statement of comprehensive income.

Claims outstanding

The claims outstanding provision represents the estimated cost of settling claims reported by the balance sheet date.

Reinsurers’ share of technical provisions

The reinsurers’ share of technical provisions are dependent on the expected claims and benefits arising under the related reinsured insurance contracts. They are measured on a consistent basis to the underlying insurance contracts.

(cc) Other provisions

A provision is recognised in the balance sheet when there is a present legal or constructive obligation as a result of a past event, it is probable that an outflow of economic benefits will be required to settle the obligation and the amount can be reliably estimated. Provisions are not recognised for future losses. If the effect is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability.

A provision for onerous contracts is recognised when the expected benefits to be derived from a contract are less than the unavoidable costs of meeting the obligations under the contract.

(dd) Creditors

Creditors are measured at amortised cost with the exception of derivative liabilities, finance lease liabilities and a reinsurance liability designated at FVTPL.

The creditors measured at amortised cost are initially measured at fair value, being consideration received plus any directly attributable transaction costs. Subsequently they are measured at amortised cost using the effective interest method.
1. **Accounting policies (continued)**

**(dd) Creditors continued**

Derivative liabilities are classified at FVTPL as required by IFRS 9. Movements in the fair value of the liabilities are recognised within unrealised gains/losses on investments.

The Group has a financial liability in respect of a reinsurance arrangement and holds an unquoted debt security which has cash flows exactly matching those of the reinsurance liability. Consequently the reinsurance liability is designated at FVTPL in order to avoid a measurement or recognition inconsistency (sometimes referred to as ‘an accounting mismatch’). Movements in the fair value of the liability are recognised in the statement of comprehensive income within outwards reinsurance premiums. The matching movement in the fair value of the debt security is shown in the statement of comprehensive income within unrealised gains/losses on investments.

**(i) Finance lease obligations**

The Group’s finance lease obligations relate to leased investment property, which is accounted for as if it had been acquired under a finance lease. At the commencement of the lease a liability is established to represent the financing element of the lease contract. As lease payments are made, these are split between an interest element, calculated on an effective interest basis, which is charged to the statement of comprehensive income and a capital element, which reduces the finance lease liability.

**(ee) Contingent liabilities**

Contingent liabilities are disclosed if:

- there is a possible obligation as a result of a past event; or
- there is a present obligation as a result of a past event, but a liability is not recognised either because a payment is not probable or the amount cannot be reliably estimated.

Contingent assets are disclosed when an inflow of economic benefit is considered probable.

**(ff) Commitments**

**(f) Operating lease obligations**

Leases, where a significant portion of the risks and rewards of ownership is retained by the lessor, are classified as operating leases. Payments under operating leases, net of lease incentives received, are recognised as an expense in the statement of comprehensive income on a straight-line basis over the term of the lease.