Stock Exchange Release
14 March 2012

# LEGAL & GENERAL DELIVERS STRONG RESULTS, DIVIDEND UP 35%

- **FULL YEAR DIVIDEND UP 35% TO 6.40P PER SHARE (2010: 4.75P PER SHARE)**
- **OPERATIONAL CASH GENERATION UP 12% TO £940M (2010: £840M)**
  **NET CASH GENERATION UP 11% TO £846M (2010: £760M)**
- **WORLDWIDE SALES UP 7% TO £1.9BN APE (2010: £1.8BN APE)**
- **OPERATING PROFIT £1,056M (2010: £1,002M)**
  **IFRS PROFIT BEFORE TAX £956M (2010: £1,092M)**
- **EEV OPERATING PROFIT £1,469M (2010: £1,224M)**
  **EEV PER SHARE UP 11% TO 147P (2010: 132P)**
- **IGD SURPLUS UP TO £3.8BN AFTER DIVIDEND (2010: £3.7BN)**
- **IFRS RETURN ON EQUITY 14.5% (2010: 18.2%)**

Tim Breedon, Group Chief Executive, said:

"Legal & General had a strong 2011. All four of our operating business divisions - Risk, Savings, Investment management and International - delivered increased sales, cash generation and profits. Our balance sheet is strong, and our outlook for 2012 positive.

Following the combination of growth and strong cash generation the Board is recommending a full year dividend of 6.40p per share - a 35% increase. At this enhanced level, the dividend is 2.25 times covered by net cash generation.

Legal & General has significant scale: seven million customers and assets under management of over £370bn. Our broad product range, diversified distribution and ability to deliver will enable us to grow the business, further enhance shareholder value, and take advantage of the opportunities created in a fast-changing market."

## RETURNS - DIVIDEND INCREASED BY 35%

| Financials per share | 2011 | 2010 |
|---|---|---|
| Average number of shares (m) | 5,828 | 5,827 |
| Net cash generation per share (pence) | 14.52 | 13.04 |
| Operating profit earnings after tax per share (pence) (basic) | 13.50 | 12.89 |
| IFRS earnings per share (pence) (basic) | 12.46 | 14.07 |
| **Full year dividend per share (pence)** | **6.40** | **4.75** |

# FINANCIAL SUMMARY

## OPERATIONAL CASH GENERATION[1] UP 12% TO £940M, NET CASH GENERATION UP 11% TO £846M

| 2011<br>£m | Risk | Savings | Inv mgmt | International | Group capital & financing[2] | Investment projects | 2011 |
|---|---|---|---|---|---|---|---|
| Operational cash generation | 482 | 174 | 189 | 51 | 44 | - | **940** |
| New business strain | (31) | (63) | - | - | - | - | **(94)** |
| **Net cash generation** | **451** | **111** | **189** | **51** | **44** | - | **846** |
| | | | | | | | |
| **Operating profit** | **561** | **128** | **234** | **137** | **52** | **(56)** | **1,056** |

| 2010<br>£m | Risk | Savings | Inv mgmt | International | Group capital & financing | Investment projects | 2010 |
|---|---|---|---|---|---|---|---|
| Operational cash generation | 439 | 138 | 162 | 44 | 57 | - | **840** |
| New business strain | (10) | (70) | - | - | - | - | **(80)** |
| **Net cash generation** | **429** | **68** | **162** | **44** | **57** | - | **760** |
| | | | | | | | |
| **Operating profit** | **560** | **115** | **206** | **102** | **58** | **(39)** | **1,002** |

## ASSETS - £371BN IN LGIM, £65BN IN SAVINGS, £28BN IN ANNUITIES

| Assets<br>£bn | 2011 | 2010 |
|---|---|---|
| LGIM[3] | 371 | 354 |
| Savings | 65 | 64 |
| Annuities | 28 | 25 |

## EEV RESULTS - EMBEDDED VALUE PER SHARE UP 11% TO 147P

| EEV highlights<br>£m | 2011 | 2010 |
|---|---|---|
| Worldwide PVNBP | **8,516** | 7,876 |
| Worldwide new business margin (%) | **5.1** | 4.8 |
| EEV Operating profit | **1,469** | 1,224 |
| EEV Profit after tax | **1,234** | 1,264 |
| Shareholders' equity | **8,608** | 7,730 |
| Number of shares (m) | **5,872** | 5,867 |
| Equity per share (pence) | **147** | 132 |

1. Operational cash generation is defined as the post-tax operating profit on our Investment management, General insurance and Savings investments businesses together with the group capital and financing segment, the sustainable dividends remitted from our international businesses, the expected release from in-force business for the UK non profit Risk and Savings businesses, and the shareholders' share of bonuses on with-profits business. Net cash generation is defined as operational cash generation less new business strain for the UK non profit Risk and Savings businesses.

2. In Group capital and financing the rate used to calculate the smoothed return on cash and LIBOR benchmarked bonds has been reduced. The cash rate previously used of 4% has been replaced with a 1 year LIBOR of 1%. This ensures our operating profit and cash metric maintains relevance in current macro economic conditions. This change has reduced operating profit by £52m and operational cash generation by £38m, with no impact on IFRS profit before tax. It is our intention to continue with this prudent view in 2012.

3. LGIM assets include those assets managed on behalf of Risk and Savings divisions including £28bn for Annuities and £51bn for Savings.

# GROUP RESULTS

| Financial highlights £m | 2011 | 2010 |
|---|---|---|
| Operational cash generation | **940** | 840 |
| New business strain | **(94)** | (80) |
| **Net cash generation** | **846** | 760 |
| | | |
| **Analysis of operating profit** | | |
| Risk | **561** | 560 |
| Savings | **128** | 115 |
| Investment management | **234** | 206 |
| International | **137** | 102 |
| Group capital and financing | **52** | 58 |
| Investment projects | **(56)** | (39) |
| **Operating profit** | **1,056** | 1,002 |
| | | |
| Asset related investment variances | **(2)** | 185 |
| Other investment variances | **(95)** | (95) |
| Property losses attributable to non-controlling interests | **(3)** | - |
| **Profit before tax** | **956** | 1,092 |

## FINAL DIVIDEND INCREASED BY 39% TO 4.74 PENCE PER SHARE

*Strong cash generation delivering growth in dividend.*

Double digit growth in operational cash and net cash generation, coupled with the high visibility of future cash flows, has led the Board to recommended a 39% increase in the final dividend to 4.74p (2010: 3.42p), bringing the full year dividend to 6.40p (2010: 4.75p) an increase of 35%. The cost of the full year dividend is £376m (2010: £279m) with a net cash generation coverage ratio of 2.25 times (2010: 2.72 times).

## DOUBLE DIGIT GROWTH IN CASH GENERATION

*Sustainable and diversified operational cash.*

Operational cash generation was up 12% to £940m (2010: £840m) with all operating business divisions delivering higher operational cash than in 2010. Net cash generation was up 11% to £846m (2010: £760m) with the proportion backed by dividends to the Group of 83% (2010: 63%). Cash generation is diversified and has been achieved alongside a 7% growth in worldwide APE. We remain confident in our ability to deliver significant cash and profit to provide the basis for good growth in dividends in 2012 and beyond.

## OPERATING PROFIT OF £1.1BN

*Risk division demonstrating strong operating performance and market leadership.*

Risk delivered another strong performance with operating profit of £561m (2010: £560m) despite lower positive annuity strain (2011: £35m: 2010: £60m). Risk APE increased by 30% to £498m (2010: £382m) as we executed our first £1bn pension bulk annuity scheme, and our first ever longevity insurance transaction. Our Protection businesses continue to be the leading player in their chosen markets growing market share, premiums and profits. Group protection adverse variances in H1 have trended back towards assumptions and Individual protection favourable expense variances have improved profitability. Our General Insurance business had a successful year with profits improving by £50m to £42m (2010: £(8)m) helped by benign weather conditions.

*Savings business is well placed to take advantage of the regulatory change.*

Savings operating profit of £128m was up 11% (2010: £115m) and net cash generation was up 63% at £111m (2010: £68m), with continued focus on asset accumulation, sales of capital light products and improving operational efficiency. Sales APE and assets remain resilient at £1.3bn APE (2010: £1.3bn) and £65bn (2010: £64bn) respectively. Strain as a % of PVNBP has continued to reduce to 2.7% (2010: 2.8%).

*LGIM growing operating profit whilst executing growth plans.*

LGIM delivered a 14% growth in operating profit to £234m (2010: £206m) with net new business of £3.0bn (2010: £6.6bn) and assets under management of £371bn (2010: £354bn). LGIM continues to expand its global footprint in response to customer demand. Working together, LGIM and the Risk division, have demonstrated Legal & General's ability to provide pension de-risking solutions across LGIM's strong corporate client customer base with our passive products, our Liability Driven Investment ("LDI") offering, through to longevity swaps and buy-outs / buy-ins.

*Delivering top line growth and returning capital to the Group.*

International operating profit has increased by 34% to £137m in 2011 (2010: £102m) driven by strong underlying growth in the US business. Sales were up 5% to £154m APE (2010: £146m). International has continued with its capital restructuring programme releasing $100m of capital in the US, as well as increasing the level of ordinary and special dividends, totalling £80m (2010: £44m).

*GC&F growth driven by higher asset pool as business units generate cash.*

The growth in net cash generation from the operating business divisions, reinforced with dividends up from our subsidiaries, has seen Group Capital and Financing assets in the year up by £0.7bn to £4.3bn. With more prudent lower assumed return assumptions in 2011, the average assumed return on the larger average asset pool was 4.7% (2010: 5.8%). Contribution to Group operating profit was £52m (2010: £58m).

## BALANCE SHEET STRENGTH IGD SURPLUS £3.8BN (2010: £3.7BN)

*Resilient balance sheet with no defaults in 2010 and 2011.*

The Group's balance sheet, aided by strong risk controls and capital management policies remains robust with an IGD surplus of £3.8bn (2010: £3.7bn) and a coverage ratio of 220% (2010: 226%). The LGPL credit default provision of equivalent 61bps or £1.6bn (2010: £1.5bn) remains in place to fund against the risk of credit defaults, and in the year has experienced no defaults (2010: £nil).

## PRINCIPAL RISKS AND UNCERTAINTIES

A detailed list of the Group's Principal Risks and Uncertainties can be found on page 32.

*Risk management is a key focus for the Group.*

The economic, regulatory and political environment poses significant challenges for the life assurance and investment management industry. We have significantly upgraded our risk management and financial analysis capability and our governance framework in recent years to match the Board's risk appetite. We are proceeding to the submission of our internal model to the FSA. We believe our market position and our robust balance sheet will enable us not only to ride out the current volatility and uncertainty, but also to take advantage of opportunities as they arise.

*Managing prolonged low interest rate environment.*

Legal & General has limited appetite for unhedged interest rate guarantees, our liabilities are well matched and all businesses must adhere to strict limits on such risks.

*Solvency II and RDR regulatory uncertainty.*

Although the high level regulation for Solvency II has been defined, there is still debate about detailed rules and therefore implementation could be two years or more away. There is still uncertainty about the final approach to how required capital is determined and the transition from the current capital regime. Debate continues in Europe and Legal & General is heavily engaged to help secure recognition that countercyclical dampeners need to be a part of the final package.

In the Savings market, delivery of an integrated operating model for a post Retail Distribution Review ("RDR") environment is central to our strategy. We are investing to ensure that our business processes comply with the new regulatory requirements and that our business partners are able to distribute our products under the new regime.

## STRATEGY AND OUTLOOK

*Our strategy continues to deliver.*

The Board is confident that the strategy put in place over the last five years is being shown to be the right one and is being executed successfully. Our success in 2011 was driven by organic growth. We remain convinced that attractive and increasing returns are achievable in our core UK markets. The UK life assurance market is undergoing a period of considerable change. We are well positioned for these changes and believe significant profitable growth opportunities will result.

*Further opportunities in offering our pension de-risking solutions....*

In the UK and globally, the pension fund de-risking market will continue to grow as pension funds look to reduce their risks further. In 2011 we completed our largest ever pension bulk annuity scheme and announced our first ever longevity insurance transaction. These transactions leverage our expertise in both investment management and longevity risk pricing, and we remain confident of being at the forefront of this rapidly developing pensions market.

Legal & General can provide comprehensive de-risking solutions, including buy-out, buy-in, longevity insurance and liability driven solutions to pension schemes of all sizes.

*….and to expand our global footprint in response to customer demand*

In 2011 global companies are increasingly looking at their pension arrangements on a holistic basis rather than purely regionally. LGIM has expanded its marketing and distribution capability to promote our de-risking product capability internationally particularly to clients in North America, the Gulf and Asia.

*Delivery capability.*

A key differentiator in the coming years of complex regulatory change will be our ability to deliver change programmes to the highest standards. In 2011, alongside our two larger de-risking transactions, we also carried out a back book reassurance for £390m and over 80 smaller bulk purchase annuity transactions with a value of over £35m APE. We have completed distribution agreements with Nationwide Building Society and Yorkshire Building Society and been appointed by four workplace savings schemes for employers with more than 100,000 employees. We have established a leading position in the auto enrolment market and believe we have the delivery capability to succeed in this environment.

*Economic outlook.*

The size and frequency of global monetary policy intervention should ensure there is sufficient liquidity to allow financial markets to function and therefore avoid a repeat of the crisis that contributed to the 2008/09 recession. There is little prospect of a substantial rebound in real economic growth in 2012 across the UK, Europe and probably the US. Although there have been positive upside surprises in the macro data, these need to be set against the size and structural nature of fiscal deficits, bank de-leveraging, an increase in regulatory intervention, a lack of consumer expenditure growth and an unwillingness of corporates to invest for growth. We also expect global inflation to continue which will result in positive nominal economic growth.

*Aim to continue to grow profits, cash and dividends.*

We remain confident about the prospects for the Group. We have a strong platform to continue to deliver growth in cash generation, dividends and shareholder value.

# BUSINESS REVIEW – RISK

| Financial highlights £m | 2011 | 2010 |
|---|---|---|
| Operational cash generation | **482** | 439 |
| New business strain | **(31)** | (10) |
| **Net cash generation** | **451** | 429 |
| Experience variances, assumption changes, tax and other variances | **110** | 131 |
| **Operating profit** | **561** | 560 |
| Asset related investment variances | **172** | 102 |
| **IFRS profit before tax** | **733** | 662 |

*Market leadership.* With leading positions in its key markets, the Risk division has achieved strong APE sales performance of £498m up 30% (2010: £382m); as well as executing our first £1 billion pension bulk annuity scheme, and our first ever longevity insurance transaction. The Group is at the forefront of these markets and is able to offer buy-out, buy-in, longevity insurance and liability driven investment solutions to pension schemes across a wide range of pension scheme sizes.

*Cash generation growth.* Operational cash generation increased by 10% to £482m (2010: £439m), reflecting annual growth in both annuity assets, and protection and general insurance gross written premiums. Net cash generation increased by 5% to £451m (2010: £429m) with lower new business strain in protection on higher volumes, and lower new business surplus in annuities of £35m (2010: £60m). Operating variances are positive, although not as high as 2010, with positive expense variances of £26m, as efficiency improvements come on stream. The Group Protection adverse claims experience moved back towards expected levels from the exceptional experience observed in H1, with a total of £(35)m for the full year. IFRS profit before tax was £733m (2010: £662m).

## ANNUITIES

| Financial highlights £m | 2011 | 2010 |
|---|---|---|
| Operational cash generation | **227** | 229 |
| New business surplus | **35** | 60 |
| **Net cash generation** | **262** | 289 |
| | | |
| Individual annuity new business APE | **105** | 117 |
| Bulk annuity new business APE | **146** | 90 |
| **Total annuity new business APE** | **251** | 207 |
| | | |
| **Longevity insurance new business APE** | **70** | - |
| | | |
| **Annuities new business EEV margin (%)** | **10.0** | 11.9 |

*Operational cash generation of £227m in 2011. New business surplus of £35m.*

Operational cash generation was £227m (2010: £229m) with an earned interest margin on assets in line with our long term target for the portfolio. Net cash generation of £262m reflects reduced new business surplus of £35m (2010: £60m).

Annuities achieved another strong performance in 2011 with new business APE of £251m (2010: £207m). Sales volume and mix continue to be managed within risk appetite, helping annuity assets to grow to £28.4bn (2010: £25.4bn).

*Individual annuities continuing to benefit from distribution relationships.*

Individual annuity new business APE of £105m (2010: £117m) benefited from the flow of annuitants from our own pensions business as well as our distribution arrangements with Zurich Financial Services and SAGA. We continue to take a disciplined approach to writing new business, striving to provide the best possible retirement income to our customers whilst achieving our target return on economic capital.

*First bulk annuity scheme over £1bn.*

Bulk annuity sales were strong, writing 85 schemes worth £146m APE (2010: 115 schemes worth £90m). This includes the £1.1bn of premium relating to the bulk annuity scheme with the trustees of Turner & Newall ("T&N") pension scheme.

As in previous years we continue to offer prices on all schemes tendering in the market, irrespective of scheme size, with a strong focus on meeting return on economic capital thresholds. We have significant experience at the smaller end of the market where we have developed a market-leading position with trustees. We also bid for larger schemes where the liability characteristics and available returns on capital are attractive.

*Our first longevity insurance deal.*

We also closed our first longevity insurance deal with the Pilkington Superannuation Scheme, generating £70m APE, with c£1bn of associated liabilities, 90% of which were reinsured with our partner Hannover Re.

The business acted to manage its overall longevity exposure by completing a back book bulk longevity reinsurance transaction during the year to reinsure approximately 85% of £460m of existing liabilities. We are actively pursuing new opportunities within the longevity insurance market, including the promotion of our small scheme longevity insurance offering. This can be a more attractive product for those schemes where a less costly and less complex solution is required.

## HOUSING & PROTECTION

| Financial highlights £m | 2011 | 2010 |
|---|---|---|
| Operational cash generation | **255** | 210 |
| New business strain | **(66)** | (70) |
| **Net cash generation** | **189** | 140 |
| | | |
| Protection new business APE | **177** | 175 |
| Protection new business EEV margin (%) | **9.3** | 6.4 |
| | | |
| Protection gross premiums | **1,200** | 1,179 |
| General Insurance gross premiums | **304** | 281 |
| Total gross premiums | **1,504** | 1,460 |
| | | |
| General Insurance new business premiums | **110** | 80 |
| General Insurance combined operating ratio (%) | **88** | 106 |

*Net cash generation up 35% to £189m.*

Operational cash generation is up 21% to £255m (2010: £210m). New business strain has decreased to £66m (2010: £70m) which represents 37% of new business APE (2010: 40%). The business continues to grow with a 3% increase in gross premiums to £1,504m (2010: £1,460m).

*Continued diversification into growing and higher margin markets.*

Individual protection delivered an outstanding performance in 2011, building on the momentum of H2 2010. New business APE sales were up 11% to £131m (2010: £118m) providing cover for over 400,000 customers. Strong cost and reinsurance management has led to improved profitability. Gross premiums grew 3% to £914m (2010: £890m) and we maintain our market leading position.

This has been delivered against a backdrop of a continuing stagnation in the housing market, fragile consumer confidence and a competitive market. Our distribution has been assisted by the strength of our intermediated distribution with Legal & General Network which captured a 20% share of the intermediated mortgage market (2010: 16%), equivalent to £15.7bn of lending, supporting growing volumes of housing-related protection and general insurance sales. We continued to diversify into more specialist areas of the market with 13% growth in high net-worth protection and 48% growth in direct business.

Group Protection new business sales were down by 19% to £46m APE (2010: £57m) with increased focus on retaining existing schemes.

Total protection new business EEV margins increased to 9.3% (2010: 6.4%).

*General insurance grows by 8% and returns to profitability.*

In General Insurance, new business premium income grew by 38% to £110m (2010: £80m) as a result of building our presence in the direct market and continuing to develop key broker relationships. With a £50m improvement in operating performance, operating profit was £42m (2010: loss of £8m) and cash generation £31m (2010: loss of £6m). A combined operating ratio of 88% (2010: 106%) benefited from more benign weather conditions in the UK compared with the two severe weather events experienced in 2010.

# OUTLOOK

*Individual annuity market growth expected in the longer term.*

The demographics of growing numbers of customers in Defined Contribution pensions savings products creates an increasing opportunity for the individual annuity market, although we do see evidence that consumers are delaying their retirement in the current climate of economic uncertainty. Our distribution of annuities is well diversified and we believe the direct market will become more active after the implementation of RDR.

*Desire of bulk schemes to reduce risk creates an attractive market.*

Growth in newer types of bulk annuity deals (Buy-in and Longevity Insurance) will continue, driven by a greater appetite to reduce risk, with a potential market of over £1,000bn and a deal flow of on average £8bn per year in which the Group is a key player. In the short term, market size and pricing will remain uncertain until the detailed rules for Solvency II are finalised.

*Individual protection distribution well diversified.*

The individual protection business benefits from scale and spread of distribution with secure distribution through the L&G Network, a strong IFA market presence, direct capability (now 8% of our business) and sole supplier partnerships with a number of leading Banks and Building Societies. In 2011 Protection added advised family protection to the relationship with Barclays, re-contracted the sole supplier arrangement through Sainsbury's and secured new distribution partnerships with a number of other banks and direct affinity partners.

*Potential to increase protection market share.*

The overall Individual Protection UK market contracted slightly through 2011, with future growth projected to be modest. The Council of Mortgage Lenders has forecast that gross mortgage lending will fall from £140bn to around £133bn in 2012. Against this background we will continue to increase our family protection sales and use our strength in distribution to generate growth from the available market. We do anticipate some disruption to the market from regulatory change (gender neutral pricing, RDR, I-E tax changes), but we are taking steps to minimise the associated risks and maximise any potential advantages.

*Group protection market development.*

The Group Protection market continues to show signs of recovery. Auto enrolment will affect up to 10 million employees in the UK and research shows that the majority of employers would consider introducing group risk benefits alongside auto enrolment. Also, the government's Sickness Absence Review will heighten employers' awareness and in the longer term employers will also need more support in managing the health of their ageing workforce as the state pension age increases. Our investment in a new platform and digital capability means we are well positioned to grow with the development of the market.

*General Insurance opportunity.*

Gross written premiums increased by 8% in 2011 and we are targeting further growth, particularly in our Direct business proposition where 2012 new business is expected to build further on the 100% uplift we saw in the second half of last year. We will also be broadening our personal lines insurance offering, working more closely with selected affinity partners and building on our existing relationships with brokers and financial advisers.

# BUSINESS REVIEW – SAVINGS

| Financial highlights<br>£m | 2011 | 2010 |
|---|---|---|
| Operational cash | **174** | 138 |
| New business strain | **(63)** | (70) |
| **Net cash generation** | **111** | 68 |
| Experience variances, assumption changes, tax and other variances | **17** | 47 |
| **Operating profit** | **128** | 115 |
| Asset related and other investment variances | **(34)** | (54) |
| **IFRS profit before tax** | **94** | 61 |
| | | |
| Savings new business APE | **1,255** | 1,253 |
| Assets under administration (£bn) | **65** | 64 |
| Net inflows (£bn) | **1.2** | 3.1 |
| | | |
| New business strain % PVNBP[1] | **2.7** | 2.8 |
| In force costs to funds (bps) | **24** | 24 |

1. UK insured savings business.

*Net cash and operating profits up.*

Savings continues to grow on the back of asset accumulation, sales of capital light products and improving operational efficiency. Operational cash generation was up by 26% to £174m (2010: £138m) and net cash generation by 63% to £111m (2010: £68m). Operating profit grew by 11% to £128m (2010: £115m) with our mutual fund business contributing £34m, up 17% (2010: £29m). Strain as a % of PVNBP has continued to reduce to 2.7% (2010: 2.8%).

*Readiness for Retail Distribution Review and auto enrolment.*

Savings is successfully executing its strategy in readiness for the changes to the savings landscape taking place over the next few years. Increasing awareness of the need to save, the launch of auto enrolment into pensions in the workplace and the introduction of the RDR, provide our modern, fund based business with opportunities for further growth. In addition, our platform business has significantly grown in scale in 2011 with £6.8bn (2010: £3.8bn) of combined mutual fund and insured assets on our Investor Portfolio Service (IPS) platform. In 2011 we migrated £1.8bn of assets from legacy portfolios onto IPS. The platform is approaching the scale where we expect it to breakeven.

| Asset movements<br>£bn | Savings Investments | Insured Savings | With-profits | Total |
|---|---|---|---|---|
| **Assets under administration (at 1 January 2011)** | **23.3** | **18.7** | **22.1** | **64.1** |
| Gross inflows | 6.4 | 2.8 | 1.1 | 10.3 |
| Gross outflows | (3.9) | (2.4) | (2.8) | (9.1) |
| **Net flows** | **2.5** | **0.4** | **(1.7)** | **1.2** |
| Market movements | (0.5) | - | 0.1 | (0.4) |
| **Assets under administration (at 31 December 2011)** | **25.3** | **19.1** | **20.5** | **64.9** |

## SAVINGS INVESTMENTS

*Operating profits of £23m.*

Operating profit in our Savings investments businesses grew by 10% to £23m (2010: £21m), while net cash increased by 5% to £22m (2010: £21m). Despite market volatility in the second half of the year, results have been underpinned by a 9% growth in assets under administration to £25.3bn (2010: £23.3bn), including net flows of £2.5bn (2010: £4.1bn). Combined with our growing scale, we have continued to improve operational efficiency including further process automation.

*APE up 7% to £688m.*

Total Savings investments gross fund flows were £6.4bn (2010: £6.4bn), supported by new business APE growth of 7% to £688m (2010: £643m). Sales of mutual funds on our platform, IPS, continue to perform well, increasing by 58% to £204m (2010: £129m) and contributing a growing share of the total savings APE at 16% (2010: 10%). Unit Trusts and ISAs grew by 13% to £294m (2010: £261m), with both direct and intermediated customers attracted to our funds proposition. Uninsured SIPP new business grew by 26% during the year to £88m (2010: £70m) as we extend our proposition and distribution reach. Our Suffolk Life proposition is now available on eight third party platforms representing nearly 80% coverage of the SIPP market.

## INSURED SAVINGS

*Substantial increase in operating profit and cash contribution.*

Insured savings net cash generation increased in the year to £38m (2010: £1m) as a result of successfully executing the strategic shift towards fee based products such as workplace pensions and focus on cost management. Operating profit increased by 16% to £36m (2010: £31m). Operational cash generation grew by 42% to £101m (2010: £71m), while new business strain reduced to £63m (2010: £70m). We wrote business efficiently with new business strain as a percentage of PVNBP of 2.7% in 2011 (2010: 2.8%).

*Workplace savings as an engine for growth.*

We are seeing strong interest in our workplace proposition and innovative auto enrolment solutions, with a 30% year-on-year growth in schemes secured. In total, 133 new workplace pension schemes were secured during 2011 (2010: 102), generating the transfer of over 94,000 existing lives (2010: 24,000), plus additional opportunities from their auto enrolment populations, when all of these schemes come on stream. We are working with our customers to launch the majority of these schemes, totalling 85,000 of these existing lives, in 2012 and 2013 to align with employers' auto enrolment staging dates, when new business APE and asset transfers will be recognised. Against this backdrop, 2011 workplace pension non profit net flows grew by 50% to £0.9bn (2010: £0.6bn). As a result, non profit assets increased by 19% during the year to £3.8bn (2010: £3.2bn), with in-force non profit scheme lives numbering 211,000 (2010: 168,000). Total combined non profit and with-profits scheme lives now number 350,000 (2010: 335,000).

*International bonds new business up 27%.*

Despite market weakness in the second half of the year, Insured bonds APE grew by 14% in the year to £119m (2010: £104m), primarily driven by the success of our International Bonds proposition which experienced APE growth of 27%.

*Improving pensions EEV margin.*

Our shift towards capital light products and the growth in our workplace business continues to improve the non profit pensions new business margin which grew to 0.4% (2010: 0.1%). The non profit bonds margin was 1.3% (2010: 1.4%).

## WITH-PROFITS SAVINGS

*Growth in cash and operating profit.*

With-profits Savings operating profit, representing the shareholders' share of the with-profits bonus, was up 10% in 2011 at £69m (2010: £63m) with net cash generation of £51m (2010: £46m). New business APE has fallen by 8% to £122m (2010: £132m).

## OUTLOOK

*Challenging outlook for 2012.*

Market weakness in the second half of the year led to a slowing of growth in the latter part of 2011 and economic and market conditions in the UK are likely to present a challenging backdrop in 2012. However, as conditions improve, our strong brand, diversified distribution and effective operating model mean our Savings business is well placed to capitalise in the medium term on the macro developments in the UK savings market. As such we continue to invest in our Savings business in 2012 to exploit these opportunities.

*Strong growth opportunities in the UK savings market.*

The introduction of auto enrolment, which will commence in 2012, will see increased demand for defined contribution pensions saving, together with the need for employers to revisit their existing pension provision. RDR will drive fundamental change to the provision of financial advice for savings and investment products and will reward those firms with attractive, good value product propositions, fee-based structures, diversified routes to market and cost efficient operations. The strength of our diversified distribution, including our continuing partnerships with Nationwide Building Society and Yorkshire Building Society further enhances our position.

*Growing IPS platform with 420,000 customers.*

Platforms will benefit from the changes RDR will bring. Against a backdrop of late publication of the final rules, we are investing in the development of our platform model to reflect substantial changes to distribution processes and product fee and remuneration structures. We aim to ensure that post-RDR we have an efficient end-to-end business model. Our own platform, IPS, has significantly grown in scale in terms of both mutual and insured assets and customers, which increased in 2011 to 420,000 (2010: 152,000) and included a migration of 215,000 customers from legacy portfolios onto IPS. Our products are also offered on the Cofunds platform which has nearly £36bn of assets under administration and of which we have a 25% shareholding, together with other platforms that target our preferred market sectors.

*Auto enrolment, 133 schemes secured in 2011 and strong pipeline.*

Our workplace savings business is benefiting from the significant number of employers who are reviewing their employee pension arrangements in the light of auto enrolment. This, together with the trend towards holistic workplace savings solutions, will drive the growth of our workplace savings business. Membership of existing schemes is likely to increase. We have put in place a strong pipeline of business throughout 2011 which is set to continue. Our innovative auto enrolment solutions are attracting large employers, with their substantial existing memberships as well as their expected new populations of auto enrolees.

# BUSINESS REVIEW - INVESTMENT MANAGEMENT

| Financial highlights £m | 2011 | 2010 |
|---|---|---|
| **Operating profit** | **234** | 206 |
| Total revenue | **417** | 378 |
| Total costs | **(183)** | (172) |
| | | |
| **Net cash generation** | **189** | 162 |
| | | |
| Average ad valorem fee margin (bps) | **10.9** | 10.7 |
| Average expense margin (bps) | **5.3** | 5.5 |
| | | |
| Gross inflows (£bn) | **32.8** | 32.6 |
| Net inflows (£bn) | **3.0** | 6.6 |
| | | |
| Closing assets under management (£bn) | **371** | 354 |

*Operating profit up 14% to £234m.*

2011 was another successful year for LGIM. Despite the challenging market backdrop, LGIM delivered a 14% increase in operating profit to £234m (2010: £206m). Assets under management were up 5% to £371bn (2010: £354bn) with fee to asset margin of 10.9bps (2010: 10.7bps). Gross new business was £32.8bn in the year (2010: £32.6bn) with inflows particularly strong across the higher fee generating assets. Increased demand for LGIM's de-risking capabilities and additional services such as currency hedging, dynamic asset allocation and transition management helped drive strong revenues.

*Pension de-risking solutions leveraging on Group expertise.*

The de-risking of defined benefit pensions continues in both the UK and the US. LGIM's focus on delivering innovative LDI solutions to meet the evolving needs of clients resulted in healthy new asset flows of £5.8bn. LGIM's combined UK, European and US LDI assets grew 43% to £58.4bn (2010: £40.8bn). Through greater leveraging of Group wide expertise, LGIM has been able to offer a broad range of pension de-risking solutions. A particular highlight was the work done with our Annuities division to provide an innovative joint de-risking solution for the T&N pension scheme culminating in the buy-in of that scheme in October 2011.

*Global expansion continues to gain momentum.*

LGIM's geographic diversification is progressing well with an increasing number of new international clients. International AUM increased by 30% to £18.3bn (2010: £14.1bn) with gross new business of £6.5bn. LGIMA had strong asset performance and continues to be recommended by an increasing number of pension consultants in the US. LGIM will extend its geographic diversification with entry into the Asian market in 2012.

| Asset movements £bn | Index | Active | Total |
|---|---|---|---|
| **Assets under management (at 1 Jan 2011)** | **228.5** | **125.0** | **353.5** |
| Gross inflows | 22.2 | 10.6 | 32.8 |
| Gross outflows | (24.1) | (5.7) | (29.8) |
| **Net flows** | **(1.9)** | **4.9** | **3.0** |
| Market and other movements | (2.4) | 17.1 | 14.7 |
| **Assets under management (at 31 Dec 2011)** | **224.2** | **147.0** | **371.2** |

## INDEX ASSETS

*Continued focus on the provision of value for money solutions.*

The performance of the index business is predicated on strong index tracking performance, excellent customer service and good cost control. This results in sustained, strong gross new business flows, high persistency and good quality earnings. New business inflows of £22.2bn include increased Defined Contribution (DC) inflows of £3.5bn (up 39%) resulting in total DC assets of £21.3bn (2010: £19.2bn)

LGIM has a reputation for innovation in product development. The range of alternatively weighted passive equity assets was extended, covering additional fundamentally weighted indices and a carbon efficient index for UK equities. In the fixed income area, the available range of index assets now includes emerging markets sovereign debt funds.

*International growth of index assets.*

Initiatives to extend the index assets franchise into selected international markets built strong momentum in 2011, where LGIM expanded into a number of Gulf and European markets.

| Asset movements £bn | UK equities | Int'l equities | Fixed interest | Total – index |
|---|---|---|---|---|
| **Assets under management (at 1 Jan 2011)** | **72.0** | **86.0** | **70.5** | **228.5** |
| Gross inflows | 4.7 | 9.8 | 7.7 | 22.2 |
| Gross outflows | (7.2) | (9.0) | (7.9) | (24.1) |
| **Net flows** | **(2.5)** | **0.8** | **(0.2)** | **(1.9)** |
| Market and other movements | (6.2) | (4.6) | 8.4 | (2.4) |
| **Assets under management (at 31 Dec 2011)** | **63.3** | **82.2** | **78.7** | **224.2** |

## LDI AND ACTIVE ASSETS

*Liability driven investments a larger part of what we do.*

LGIM is experiencing high demand for LDI solutions with gross inflows of £5.8bn (2010: £4.9bn). We continue to work closely with pension schemes and their consultants to establish their optimal de-risking strategies. Clients are embracing a wide range of instruments to help address the impact of equity market volatility, interest rate and inflation risk.

As the nature of the pension market changes, we look to continue to provide innovative investment solutions to meet changing needs in both the Defined Benefit (DB) and DC sectors. In 2011 we have taken steps to expand our range of fund offerings in the DC area with the first of a stable of multi-asset funds available both directly to LGIM clients and via the Savings Division Workplace Pensions platform.

*Fixed Income.*

LGIM has been able to continue to deliver strong performance for its clients across the major credit asset classes despite volatile times. LGIM's focus has shifted towards developing products which embrace global diversification to respond to client demand and this has led to gross fixed income inflows of £4.6bn with total AUM up 9% to £72.4bn (2010: £66.6bn). Momentum continues to build in the US business which has seen significant growth.

| Asset movements £bn | Equities | Fixed interest | Property & other | LDI | Total – active |
|---|---|---|---|---|---|
| **Assets under management (at 1 Jan 2011)** | **9.1** | **66.6** | **8.5** | **40.8** | **125.0** |
| Gross inflows | - | 4.6 | 0.2 | 5.8 | 10.6 |
| Gross outflows | - | (3.0) | - | (2.7) | (5.7) |
| **Net flows** | **-** | **1.6** | **0.2** | **3.2** | **4.9** |
| Market and other movements | (1.9) | 4.2 | 0.3 | 14.5 | 17.1 |
| **Assets under management (at 31 Dec 2011)** | **7.2** | **72.4** | **9.0** | **58.4** | **147.0** |

## OUTLOOK

*Market conditions.*

Accounting and regulatory change in the UK continues to drive rapid change in the UK pension industry. We expect UK defined benefit schemes will remain focused on de-risking solutions and this is likely to lead to a decline in equity allocations. This in turn may have an impact on growth of AUM in the index business. Whilst we expect to see clients trim exposure to equities, we also expect to see increases in fixed income and LDI mandates. LGIM expects to benefit from this as existing clients move assets into higher revenue asset classes and new clients are attracted to LGIM's LDI and fixed income strategies.

*LGIM playing central role in de-risking solutions.*

Within the UK and US, demand for LDI solutions is expected to continue to grow. As a Group we are now able to provide trustees of defined benefit schemes with the complete range of de-risking solutions including LDI, longevity insurance contracts, buy-ins and buy-outs. Our product mix enables us to build tailored hedging solutions for a variety of schemes.

LGIM anticipates ongoing demand for more complex index mandates with clients taking advantage of our growing array of passively managed strategies and core competencies in transition management, currency hedging and dynamic asset allocation services.

*Build scale in the US and the Gulf. Implement plans to enter Asia.*

The geographic diversification of the business will continue into 2012, with a focus on North America, continental Europe and the Gulf and plans are in place to enter Asia. The North American market provides an enormous opportunity, being the largest pension fund market in the world. Almost half of the world's top 300 pension schemes are based in the region.

*Caution around volatility in the eurozone.*

The eurozone sovereign debt situation has not yet been resolved and will remain a major influence on the financial services industry. Although there is significant uncertainty as to the impact of eurozone failure, we have undertaken contingency planning at an operational level with the aim of limiting the negative impact of potential third party or counterparty downgrades and defaults.

The environment is likely to remain challenging due to expected low global growth and the eurozone crisis. However, in the longer term, these factors may represent an opportunity for LGIM as clients gain a greater understanding of the need to control risk and work with us to implement solutions to meet their long term objectives.

In 2012 we will continue to focus on creating high quality solutions for clients using our full range of passive, active and LDI capabilities.

# BUSINESS REVIEW - INTERNATIONAL

| Financial highlights £m | 2011 | 2010 |
|---|---|---|
| USA | **104** | 85 |
| Europe (Netherlands and France) | **41** | 26 |
| Egypt, the Gulf and India | **(8)** | (9) |
| **Operating profit** | **137** | 102 |
| | | |
| New Business APE | **154** | 146 |
| | | |
| **Net cash generation** | **51** | 44 |

*Improved operating performance.*

International operating profit has increased by 34% to £137m in 2011 (2010: £102m) with strong growth in Legal & General America ("LGA") new business contributing £17m. LGA and Legal & General France ("LGF") include investment gains realised in the period together with other operating variances in operating profit, and these account for £17m in 2011 (2010: £2m).

Operational Cash generation by International division was £51m (2010: £44m) representing a 16% growth in sustainable cash generation. These underlying dividend flows from LGA and Legal & General Netherlands ("LGN") are expected to continue and grow in future years.

*US growth and improved margins.*

International sales were up 5% at £154m APE driven by strong US sales growth, up 33% to £69m in 2011 (2010: £52m), and improved margins.

*Continue to deliver on capital program: LGA US$100m; and LGN €35m.*

International division has continued with its capital restructuring programme releasing $100m of capital in LGA, as well as the first phase of our European capital restructuring programme delivering a one off special dividend of €35m from the LGN. LGA has seen its rating raised by Standard & Poors to AA- from A+ reflecting its strong competitive position, conservative investment portfolio, core status and strong liquidity position.

## LEGAL & GENERAL AMERICA (LGA)

| Financial highlights $m | 2011 | 2010 |
|---|---|---|
| Operating profit | **167** | 132 |
| IFRS profit before tax | **165** | 175 |
| New business APE | **111** | 80 |
| Gross premium income | **836** | 778 |
| Net cash generation | **58** | 53 |
| New business margin (%) | **10.7** | 8.9 |
| Embedded value | **1,647** | 1,916 |

*LGA is now the No. 6 (2010: No. 10) provider of term life business.*

LGA focuses on writing mortality protection products in the term life and universal life markets. LGA competes in the protection market by being a low cost operator and delivering expert medical-based underwriting on higher sum assured policies, with in-force premiums of over US$830m.

*Strong sales for LGA.* LGA recorded its best ever year in terms of new business, with sales of US$111m (2010: $80m). This included 46% growth in the core term life product line. Margins further improved from 8.9% to 10.7% driven by expense and funding efficiencies. The capital restructuring plan has given LGA the capacity to price its products competitively and to finance the consequent volumes. At the same time, management has concentrated on building relationships with distributors, while refining underwriting and application handling processes.

*$220m DAC impact in 2012* From the 1 January 2012 we will be applying the new US accounting policy for Deferred Acquisition Costs (DAC) recognition issued by the FASB in October 2010. This specifies that only costs directly relating to successful acquisition of new contracts can be capitalised as DAC. Applying this retrospectively will reduce the opening 2012 shareholders' equity of the Group and LGA by an estimated $220m. There is no impact on IGD.

## LEGAL & GENERAL EUROPE (LGN & LGF)

| Financial highlights €m | 2011 | 2010 |
|---|---|---|
| Operating profit | **47** | 30 |
| Asset related investment variance | **(23)** | 7 |
| IFRS profit before tax | **24** | 37 |
| New business APE | **76** | 84 |
| Gross premium income | **674** | 709 |
| Net cash generation | **17** | 12 |
| New business margin (%) | **(0.6)** | 0.9 |
| Embedded value | **556** | 628 |

*Operating profit of €47m.* Our European businesses have delivered strong operating profit up 57% to €47m (2010: €30m). Given regulatory changes the Netherlands continues to be a difficult market, but the recent relaunch of the term assurance product increased sales of this product by 90% compared to H1 2011. The group protection business of LGF continues to grow with premiums up 6% year on year.

## EMERGING MARKETS

*Response to regulatory changes in India.* Despite the slowdown in the market with the changes imposed by local regulators in 2010, premium income rose 89% year on year. Single premiums were up from £7m in 2010 to £22m in 2011; however APE was down 50%.

## OUTLOOK

*Term product growth across all markets.* In the US we have the opportunity to further expand our product offering to continue to build scale and meet our customer requirements. We are experiencing growth in protection products across the US, Netherlands and France.

*Continue to focus on efficient capital allocation.* We continue to focus on the efficient use of capital. The US business continues to present us with a number of opportunities to free up excess capital held as a result of the XXX/AXXX reserving regime in the US.

# BUSINESS REVIEW – GROUP BUSINESS UNIT

## GROUP CAPITAL AND FINANCING

| Financial highlights £m | 2011 | 2010 |
|---|---|---|
| Investment return | **191** | 187 |
| Interest expense | **(123)** | (121) |
| Investment expenses and unallocated corporate expenses | **(16)** | (8) |
| **Group capital and financing operating profit** | **52** | 58 |
| | | |
| **Operational cash generation** | **44** | 57 |
| | | |
| *Closing group capital and financing assets* | ***4,344*** | *3,656* |
| *Closing outstanding debt balances* | ***2,732*** | *2,748* |

*Higher shareholder assets have lead to an increase to smoothed investment returns.*

The increase in the average Group Capital and Financing (GCF) assets has resulted in an increase in the smoothed investment return to £191m (2010: £187m). The smoothed return is calculated asset class by asset class and equates to an average smoothed investment return of 4.7% (2010: 5.8%) on the average balance of invested assets up £0.8bn to £4.0bn (2010: £3.2bn).

## GROUP TAX RATES

The effective tax rate on IFRS profit is 24.4% (2010: 24.9%) compared to the UK's standard rate of corporation tax applicable for the period of 26.5% (2010: 28%).

The effective tax rate is lower than the UK's standard rate of tax in both 2010 and 2011 due to the Group achieving favourable resolution of historic tax issues with HM Revenue & Customs. This has resulted in the release of tax provided in prior years. We continue to actively review our tax methodology, particularly in view of the changes to the tax regime for life assurance companies which come into effect from 2013.

### CHANGE IN UK CORPORATION TAX RATES – EEV IMPACT ON VIF (DISCOUNTED AND UNDISCOUNTED)

The Government have made clear their commitment to reduce corporation tax rates to 23% by 2014. As the reduction to 25% in 2012 has already been enacted, we are confident that the Government will deliver the proposed rate changes as announced.

As such, our best estimate of the applicable tax rates are those which were announced on Budget day and we have reflected the stepped rate change to 23% in our EEV as at 2011. This has given rise to a £155m benefit to discounted VIF and a £334m benefit to undiscounted VIF.

### DEFERRED TAX ASSET UTILISATION

The table below provides a breakdown of the key component parts of the IFRS UK net deferred tax asset of £493m (2010: £495m). The overall UK deferred tax asset has reduced slightly by £2m due to the utilisation of trading losses and excess and deferred expenses in the period, which is offset by an increase in the deferred tax asset recognised in respect of capital losses as a result of a fall in equity markets during 2011.

The utilisation of trading losses is reflected within net cash generation and has contributed £80m in 2011 (2010: £82m). It is expected that the deferred tax asset recognised for trading losses will continue to be utilised in 2012, 2013 and 2014.

The overseas deferred tax liability of £403m (2010: £356m) mainly relates to deferred acquisition costs in Legal & General America. The rate at which acquisition costs are capitalised for accounting purposes is far greater than that for tax purposes and as such gives rise to a timing difference between the two bases which is deferred tax effected.

| **Deferred Tax**<br>**£m** | **2011** | 2010 |
|---|---|---|
| Excess and deferred expenses (XSE) | **209** | 267 |
| Capital losses | **147** | 33 |
| Trading losses | **158** | 239 |
| Other | **(21)** | (44) |
| **UK net deferred tax asset** | **493** | 495 |
| | | |
| **Overseas deferred tax liability** | **(403)** | (356) |

# BUSINESS REVIEW – ASSET RELATED INVESTMENT VARIANCES

| **Investment variances**<br>**£m** | **2011** | 2010 |
|---|---|---|
| Risk | **172** | 102 |
| Savings | **13** | 4 |
| Investment management | **(7)** | (8) |
| International | **(21)** | 35 |
| Group capital and financing | **(159)** | 52 |
| **Asset related investment variances** | **(2)** | 185 |

*Risk investment variance.*

Risk investment variance increased to £172m (2010: £102m). The contributing factors are; improved asset diversity which increased the risk adjusted yield, e.g. sale and leaseback, no defaults in the portfolio, improved asset liability matching, more efficient cash management and small one-off benefits from tax and interest rates movements.

*GCF variance due to equity falls.*

Equity returns resulted in an adverse variance of £(139)m, out of a total variance of £(159)m.

*Reduction in short term LIBOR assumption.*

In GCF the rate used to calculate the smoothed return on cash and LIBOR benchmarked bonds has been reduced. The cash rate previously used of 4% has been replaced with a 1 year LIBOR of 1%. This ensures our operating profit and cash metric maintains relevance in current macro economic conditions. This change has reduced operating profit by £52m and operational cash generation by £38m with no impact on IFRS profit before tax. It is our intention to continue with this prudent view in 2012.

# BUSINESS REVIEW – CASH GENERATION

## CASH GENERATION UP TO GROUP

*Growing net cash generation leading to increased shareholder assets.*

The total shareholder assets which include Group Capital and Financing assets and other shareholder assets increased by £0.6bn to £5.9bn (2010: £5.3bn) demonstrating the strong link between our cash metric and shareholder assets in our balance sheet.

| Shareholder Assets<br>£m | |
|---|---|
| *Opening group capital and financing assets (including shareholder assets in LGAS and LGPL)* | *3,656* |
| *Opening shareholder assets in other subsidiaries* | *1,688* |
| **Opening shareholder assets** | **5,344** |
| | |
| Group operational cash generation | 940 |
| New business strain | (94) |
| **Net cash generation** | **846** |
| | |
| External dividend payments in the year | (298) |
| Other | 40 |
| | |
| *Closing group capital and financing assets (including shareholder assets in LGAS and LGPL)* | *4,344* |
| *Closing shareholder assets in other subsidiaries* | *1,588* |
| **Closing shareholder assets** | **5,932** |

*87% of net cash generated by divisions backed by dividends to Group.*

In 2011 we have also taken steps to demonstrate that cash can be extracted from the businesses for the benefit of shareholders. In the year LGAS has approved an annual dividend of £500m (2010: £300m) payable to Group which relates to the net cash generated from its Risk and Savings operating business units, and LGIM has approved an annual dividend of £150m (2010: £132m).

Together with the sustainable dividends, the Group capital and financing assets have received special dividends from LGN for €35m (2010: €nil).

| Dividends supporting cash generation | 2011 | | | 2010 | | |
|---|---|---|---|---|---|---|
| | Net cash £m | Dividend £m | Dividend % of cash | Net cash £m | Dividend £m | Dividend % of cash |
| Risk | 451 | 500 | **89** | 429 | 300 | **60** |
| Savings | 111 | | | 68 | | |
| Investment management | 189 | 150 | **79** | 162 | 132 | **81** |
| International | 51 | 51 | **100** | 44 | 44 | **100** |
| **Sub total** | 802 | 701 | **87** | 703 | 476 | **68** |
| Group capital and financing | 44 | | | 57 | | |
| **Total** | 846 | 701 | **83** | 760 | 476 | **63** |

# PREDICTABILITY OF CASH GENERATION

*Predictability over recent years.*

Sources of the Group's cash generation are transparent and we have used the format below to demonstrate the predictability of these cash flows since 2009.

*Diversified and growing net cash.*

The Group's net cash generation is well diversified. Operational cash generation in the year was up 12% to £940m (2010: £840m) with all business divisions delivering higher operational cash than in 2010. There has been a steady 13% per annum growth in the last 5 years.

Net cash generation was up 11% to £846m (2010: £760m) with 34% of the total generated by LGIM, Group and International. In 2009 these divisions accounted for only 24% of the Group's net cash generation. The Group is more balanced as a result.

| | 2009 | | | 2010 | | | 2011 | | |
|---|---|---|---|---|---|---|---|---|---|
| £m | Op cash | Strain | Net cash | Op cash | Strain | Net cash | Op cash | Strain | Net cash |
| Annuities | 235 | 129 | 364 | 229 | 60 | 289 | 227 | 35 | 262 |
| Protection | 203 | (79) | 124 | 216 | (70) | 146 | 232 | (66) | 166 |
| Insured savings | 58 | (77) | (19) | 77 | (70) | 7 | 101 | (63) | 38 |
| **In-force cash generation** | **496** | **(27)** | **469** | **522** | **(80)** | **442** | **560** | **(94)** | **466** |
| With-profits | 46 | | 46 | 46 | | 46 | 51 | | 51 |
| Savings Investments and Other Savings | 2 | | 2 | 15 | | 15 | 22 | | 22 |
| GI and Other risk | 16 | | 16 | (6) | | (6) | 23 | | 23 |
| LGIM | 125 | | 125 | 162 | | 162 | 189 | | 189 |
| International dividends | 8 | | 8 | 44 | | 44 | 51 | | 51 |
| GCF | 33 | | 33 | 57 | | 57 | 44 | | 44 |
| **Total** | **726** | **(27)** | **699** | **840** | **(80)** | **760** | **940** | **(94)** | **846** |
| Variances and other | | | 28 | | | (42) | | | (98) |
| International (excl. dividends) | | | 78 | | | 33 | | | 39 |
| Tax gross up | | | 304 | | | 251 | | | 269 |
| **Operating profit** | | | **1,109** | | | **1,002** | | | **1,056** |

*2012 in-force operational cash generation to grow.*

Operational cash generation from the in-force UK Risk and Savings businesses is forecast to grow to c£590m in 2012. In addition we expect with-profits operational cash generation to be c£50m and dividends from our International businesses to exceed £55m.

*£8.4bn of undiscounted VIF to monetise in the future.*

The monetisation of the Group's VIF will form the basis of the future profits and operational cash generation of the UK long-term Risk and Savings businesses. The £8.4bn (2010: £8.0bn) of undiscounted future profits within the VIF is expected to monetise into profits in the following years:

| Estimated monetisation of UK VIF (undiscounted)[1] £bn | 2012 - 2016 | 2017 - 2022 | 2023 - 2028 | Beyond 2029 |
|---|---|---|---|---|
| **UK VIF monetisation** | **33%** | **23%** | **15%** | **29%** |

1. Management estimates

*The VIF continues to be replaced.*

The table below demonstrates how the VIF is being replaced by the new covered business written in the period and illustrates the movements between the opening and closing UK long term Risk and Savings VIF. The contribution to VIF from new business written in 2011 and the unwind of the discount rate resulting as cash flows from new business written in previous periods are one year closer to the balance sheet date more than cover the expected releases from the non profit and with-profits businesses. Over the medium term experience variances and assumption changes have been positive.

| Reconciliation of UK long term Risk and Savings VIF £bn | Discounted | Undiscounted |
|---|---|---|
| **Opening VIF at 1 January 2011** | **3.89** | **8.0** |
| Contribution from new business | 0.38 | 0.8 |
| Unwind of discount rate | 0.30 | - |
| Expected release from non profit and with-profits businesses[1] | (0.61) | (0.6) |
| **Closing operational VIF at 31 December 2011** | **3.96** | **8.2** |
| Experience variances / assumption changes | 0.15 | 0.3 |
| Investment variance / economic assumption changes | 0.01 | (0.4) |
| Other | 0.13 | 0.3 |
| **Closing VIF at 31 December 2011** | **4.25** | **8.4** |

1. Comprises the expected release from non profit business of £560m and with-profits transfer of £51m.

# BUSINESS REVIEW – BALANCE SHEET

## CAPITAL RESOURCES

As at 31 December 2011 the Insurance Group's Directive (IGD) Pillar 1 surplus was £3.8bn up from £3.7bn at end 2010.

The Group's capital resources totalled £6.9bn, covering the capital resources requirement of £3.1bn by 2.20 times.

| Capital<br>£bn | 2011 | 2010 |
|---|---|---|
| Group capital resources | **6.9** | 6.7 |
| Group capital resources requirement | **3.1** | 3.0 |
| **IGD surplus[1]** | **3.8** | 3.7 |
| | | |
| **Coverage ratio %** | **220** | 226 |

*Robust Group capital resources.*

Under a Pillar 1 capital basis the Group has a surplus over the capital resources requirement of £3.8bn. This capital buffer is in addition to the £1.6bn of LGPL 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.

The table below demonstrates how the post tax operational delivery of the Group's IFRS performance flows through to the capital position under Pillar 1.

The IGD surplus has increased to £3.8bn as a result of the Group's cash generation.

For the With-profits business, the surplus is calculated on both a Peak 1 (regulatory) and Peak 2 (realistic) basis. The Peak 2 surplus is calculated based on the more onerous risk capital margin stress as defined by the FSA.

| IGD Surplus[1]<br>£m | |
|---|---|
| At 1 January 2010 | **3,148** |
| | |
| At 1 January 2011 | **3,745** |
| Operational cash | **940** |
| New business strain | **(94)** |
| Dividends | **(376)** |
| Experience variances, assumption changes and other variances | **29** |
| Group investment projects | **(41)** |
| Investment variance[2] | **(126)** |
| Increase in UK operational regulatory capital requirement | **(90)** |
| Release of capital from US capital management programme | **65** |
| Temporary capital usage (internal Triple X financing) | **(78)** |
| Differences between IFRS and International regulatory reporting | **(57)** |
| Other[3] | **(148)** |
| **At 31 December 2011** | **3,769** |

1. All IGD amounts are estimated, unaudited and after accrual of the final dividend of £279m (2010: £201m).
2. Includes £(97)m of investment variances and £(29)m arising from regulatory treatment on LGF held to maturity investment bonds.
3. Includes £(80)m resulting from the utilisation of trading losses included in net cash.

*International Capital restructuring programme.*

In 2010 we completed the first tranche of our US capital restructuring programme, and we completed a further tranche of the US capital restructuring programme in December 2011 releasing an additional US$100m of capital in LGA.

A first phase of European capital restructuring was also completed with LGN paying a special dividend of €35m, in addition to its underlying yearly dividend of €15m. It is anticipated that further phases of the international capital restructuring programme will be completed in 2012.

LGA has seen its rating raised by Standard & Poors to AA- from A+ reflecting its strong competitive position, conservative investment portfolio, core status and strong liquidity position coupled with the stable outlook of the parent.

## MOVEMENTS IN UK SOLVENCY CAPITAL

Solvency capital is analysed in two components:

1. **Changes to operational capital requirements.** This is the result of increases to required capital from new business written in the period less decreases in required capital from in-force business running off.

2. **Changes to technical capital requirements.** This is the result of the mechanical calculation of the capital required in the with-profits fund on the regulatory (Peak 1) and realistic (Peak 2) bases. The interaction between the two bases will give rise, under certain market conditions, to a technical capital requirement called the With-profits insurance capital requirement (WPICC).

| Pillar 1 capital requirement £bn | 2011 | 2010 |
|---|---|---|
| Risk | **1.7** | 1.5 |
| Savings | **0.1** | 0.1 |
| With-profits – operational | **0.6** | 0.7 |
| Other subsidiaries | **0.3** | 0.4 |
| **Operational group capital resources requirement** | **2.7** | 2.7 |
| With-profits insurance capital component (WPICC) | **0.4** | 0.3 |
| **Group capital resources requirement** | **3.1** | 3.0 |

The increase in the Risk capital requirement to £1.7bn (2010: £1.5bn) is primarily due to the increase in annuity reserves and the reinsurance of blocks of LGA business into LGAS.

# GROUP LIQUIDITY

*Prudent approach to liquidity management.*

Legal & General has a limited appetite for liquidity risk and seeks to maintain at Group level sufficient liquid assets and standby facilities to meet a prudent estimate of the Group's cash outflows over a period of two years. The predicted cash flows are identified through the annual planning processes and take into account the provision of facilities to operational businesses to accommodate their liquidity requirements in extreme stressed scenarios e.g. pandemic and adverse weather events.

The liquidity position across our operational business units is very strong. On average during 2011 daily overnight cash deposits of circa £500m were maintained as well as carrying significant holdings of liquid assets.

*Renewal of £1bn syndicated facility.*

We have also renewed our £1bn revolving credit facility with a larger syndicate that represent the Group's key relationship banks. The maximum individual commitment from these banks ranges from £40m to £51m. The renewal demonstrates our financial strength. The new facility will mature in 2016 with the option to extend through to 2018.

In addition the Group has had in place for over 20 years a Commercial Paper programme providing the Group with access to short term funds from the domestic sterling and euro capital markets as and when required.

*No bonds maturing before 2015.*

The Group has no outstanding bonds with maturity or call dates before 2015. There are no restrictive covenants and no credit rating or share price triggers in respect of group debt or liquidity positions.

# SUPPLEMENTARY EEV DISCLOSURE

| Analysis of EEV results - covered business £m | PVNBP | | Margin (%) | | Contribution | |
|---|---|---|---|---|---|---|
| | **2011** | 2010 | **2011** | 2010 | **2011** | 2010 |
| Risk | **3,446** | 2,925 | **9.8** | 10.3 | **345** | 300 |
| Savings | **3,896** | 3,934 | **0.8** | 0.8 | **31** | 33 |
| International | **1,174** | 1,017 | **5.5** | 4.3 | **65** | 44 |
| **Total** | **8,516** | 7,876 | **5.1** | 4.8 | | |
| Contribution from new business | | | | | **441** | 377 |
| Expected return from in-force business | | | | | **494** | 527 |
| *UK Persistency* | | | | | ***14*** | *(16)* |
| *UK Mortality / morbidity* | | | | | ***(32)*** | *(28)* |
| *UK Expenses* | | | | | ***55*** | - |
| *Other UK experience* | | | | | ***176*** | *174* |
| *International experience* | | | | | ***57*** | *(14)* |
| Experience variances and assumption changes | | | | | **270** | 116 |
| Development costs | | | | | **(10)** | (15) |
| Contribution from shareholder net worth | | | | | **178** | 160 |
| **Operating profit on covered business** | | | | | **1,373** | 1,165 |
| Business reported on an IFRS basis | | | | | **96** | 59 |
| **Operating profit** | | | | | **1,469** | 1,224 |

| Analysis of EEV results – worldwide business £m | 2011 | 2010 |
|---|---|---|
| Risk | **801** | 663 |
| Savings | **228** | 204 |
| Investment management | **210** | 179 |
| International | **242** | 163 |
| Group capital and financing | **44** | 54 |
| Investment Projects | **(56)** | (39) |
| **Operating profit** | **1,469** | 1,224 |
| Variation from longer term investment return | **(111)** | 161 |
| Effect of economic assumption changes | **(21)** | 292 |
| Property losses attributable to non-controlling interests | **(3)** | - |
| **Profit from ordinary activities before tax** | **1,334** | 1,677 |
| Tax and other | **(100)** | (413) |
| **Profit from ordinary activities after tax** | **1,234** | 1,264 |
| Earnings per share (p) | **21.17** | 21.71 |
| | | |
| **Shareholders' equity** | **8,608** | 7,730 |
| Number of shares (m) | **5,872** | 5,867 |
| **Shareholders' equity per share (p)** | **147** | 132 |

## OPERATING PROFIT

*EEV operating profits up 20%.*

The EEV operating profit increased by 20% to £1,469m in 2011 (2010: £1,224m).

New business contribution is up 17% to £441m (2010: £377m), with the strong sales performance and improvement in margins. Overall experience and assumption changes were again positive at £270m (2010: £116m).

The expected return from in-force business decreased to £494m (2010: £527m) due to the unwind of a lower opening discount rate (7.3% vs 8.0%) and a lower tax gross-up rate in the UK (23% vs 27%).

## NEW BUSINESS CONTRIBUTION

*New business contribution up 17% on higher margins.*

Contribution from worldwide new business increased 17% to £441m (2010: £377m).

Worldwide covered business APE grew 8% in the year to £1,219m (2010: £1,126m), which included a £70m contribution from the writing of the Longevity Insurance contract.

The overall margin improved to 5.1% (2010: 4.8%) benefiting from higher sales of higher margin risk and US term products, and margin improvements delivered by tight cost management of our risk and administration costs.

## NEW BUSINESS MARGINS

### RISK

| New business margin<br>% | **2011** | 2010 |
|---|---|---|
| Protection | **9.3** | 6.4 |
| Annuities | **10.0** | 11.9 |
| **Risk** | **9.8** | 10.3 |

*Stable risk new business margins continue.*

The increased competitive environment in the protection market in 2011 was offset by improved reinsurance terms, expense reductions and favourable new business mix. This led to an increase in the new business margin to 9.3% (2010: 6.4%). The IRR on protection new business was greater than 15% (2010: 15%) with an improved payback period of 4 years (2010: 5 years).

The annuities margin reduced to 10.0% (2010: 11.9%) reflecting shorter duration liabilities taken on in the year. Given positive strain on this business, annuities has an immediate IFRS payback and an infinite IRR in both 2011 and 2010.

## SAVINGS

| New business margin % | 2011 | 2010 |
|---|---|---|
| Unit linked bonds | **1.3** | **1.4** |
| Non profit pensions | **0.4** | **0.1** |
| With-profits | **1.8** | **2.6** |
| **Savings** | **0.8** | **0.8** |

*Savings margins positive.*

The focus on cost management and change in strategy from commission paying products to fee-based products has enabled a turnaround to positive margins for this business going forward.

Unit linked bonds have a margin of 1.3% in 2011 (2010: 1.4%). This translates into an IRR of 10% (2010: 11%) and a payback period of 7 years (2010: 7 years)

In non profit pensions, the delivery of further growth in scale and unit cost efficiencies has delivered an improved margin of 0.4% in 2011 (2010: 0.1%). This equates to an IRR and payback period of 8% and 12 years respectively (2010: IRR 8%, payback period 13 years).

The with-profits margin has reduced to 1.8% in 2011 from 2.6% in 2010, reflecting lower EEV investment return assumptions compared to last year.

## INTERNATIONAL

| New business margin % | 2011 | 2010 |
|---|---|---|
| USA | **10.7** | 8.9 |
| Netherlands | **(1.3)** | 1.4 |
| France | **(0.4)** | 0.6 |
| **International** | **5.5** | **4.3** |

LGA's strong results were driven by a 33% increase in APE and a 73% increase in new business value add. The consolidated International new business margin increased to 5.5% in 2011 (2010: 4.3%).

# EEV EXPERIENCE VARIANCES AND ASSUMPTION CHANGES

*UK experience and assumption changes.*

Overall experience and assumption changes are £213m, up £83m in the year (2010: £130m).

As the administration of our UK business is predominantly in house administration and not outsourced, we would expect positive expense benefits through our expense assumption changes. In the year £55m (2010: £1m) was released as cost efficiencies translate to lower unit costs.

The adverse mortality experience in the Group protection business which was impacted by a number of high value claims in the first half of 2011 is included in the overall mortality/ morbidity result of £(32)m (2010: £(28)m), but persistency has been a small positive compared to a small negative in 2010 showing an improvement of a further £30m.

Other UK experience: positive £176m (2010: positive £174m) experience in the UK included a reassessment of future BPA reserve release as data is loaded onto the BPA system (£42m), the unwind of the cost of capital in the UK (£54m), the impact of US capital restructuring (£15m) and one-off modelling improvements (£21m).

*US experience and assumption changes.*

Overall experience and assumption changes are £57m, up £71m in the year (2010: £(14)m).

The main variance relates to the impact of moving the domicile of the reinsurance arrangement for part of the US term business onshore from Bermuda to Vermont which has accelerated the emergence of distributable profit, and therefore increased the US value of in-force.

## INVESTMENT MANAGEMENT

The Investment management business is reported on an IFRS basis; operating profit of £210m (2010: £179m) excludes £24m (2010: £27m) 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 Risk and Savings covered businesses on an EEV basis.

## GROUP CAPITAL AND FINANCING

The Group capital and financing operating profit primarily reflects the smoothed investment return on the shareholder net worth and shareholders’ assets held at Group level less interest charges on Group debt. The profit from Group capital and financing reduced to £44m in 2011 (2010: £54m) as higher average invested assets throughout 2011 were offset by a lower assumed return on the assets.

## EEV PER SHARE

*EEV per share at 147 pence.*

The Group has delivered £1.23bn of EEV profit after tax in 2011 (2010: £1.26bn) which after external dividend payments of £298m in the year (2010: £238m) increases Shareholder’s equity to £8.6bn (2010: £7.7bn).

This equates to a shareholder’s equity per share of 147 pence (2010: 132 pence).

## ADDITIONAL VALUE OF LGIM

Within the calculation of Group embedded value, investment management profits on internally sourced business is included in Group embedded value on a look through basis at £0.2bn (2010: £0.2bn) equivalent to 4p per share.

The external assets element of the investment management business is included at the IFRS net asset value of £0.4bn (2010: £0.3bn), equivalent to 6p per share (2010: 6p per share).

Calculating the external assets element of LGIM on an embedded value basis, using assumptions detailed below, would increase the contribution of LGIM to Group Embedded value from £0.6bn (10p per share) to £1.8bn (31p per share). This excludes any value for LGIM's new business franchise.

| Estimated LGIM discounted cash flow valuation | 2011 (p per share) | 2011 £bn |
|---|---|---|
| Look through value of profits on covered business | 4 | 0.2 |
| Net asset value | 6 | 0.4 |
| **Current value of LGIM in Group embedded value** | **10** | **0.6** |
| LGIM VIF (assuming stable margins and 10% outflows per annum) | 21 | 1.2 |
| **Alternative discounted value of LGIM future cash flows** | **31** | **1.8** |

Including LGIM this scenario equates to an indicative valuation per share of 167 pence.

| Indicative valuation including LGIM | 2011 (p per share) | 2011 £bn |
|---|---|---|
| EEV as reported | 146.6 | 8.6 |
| LGIM VIF | 20.5 | 1.2 |
| **Total including LGIM** | **167.1** | **9.8** |

# PRINCIPAL RISKS AND UNCERTAINTIES

Legal & General runs a portfolio of risk taking businesses; we accept risk in the normal course of business and aim to deliver sustainable returns on risk based capital to our investors in excess of our cost of capital. We manage the portfolio of risk that we accept to build a sustainable franchise for the interests of all our stakeholders; we do not aim to eliminate that risk. We have an appetite for risks we are rewarded for and understand deeply, and which are consistent with delivery of our strategic objectives. Risk management is embedded within the business. The Group is exposed to a number of key risk categories.

## REGULATORY AND LEGISLATION

**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 retention of existing business 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 certain regulatory changes having a retrospective effect.

| PRINCIPAL UNCERTAINTIES | POTENTIAL IMPACT | MITIGATION |
|---|---|---|
| The Retail Distribution Review (RDR), the rules for which come into force on 31 December 2012, will change the regulations for the provision of sales advice for retail investment products and the relationship between advisers and manufacturers of these products. | RDR has required us to make significant changes to our products and distribution processes, particularly for our savings business. While the majority of required change has been executed, factors that could still hinder successful transition include late publication of the final rules, consumers failing to understand the change and financial advisers exiting the market, all of which may adversely impact the earnings of our savings business. | We continue to invest in ensuring that our business processes comply with the new regulatory requirements and that our business partners are positioned to distribute our products under the new regime. We remain committed to helping our customers and business partners transition to the new framework. |
| Solvency II (SII), the implementation of which has moved back 12 months to 1 January 2014, will lead to a fundamental change in the way that insurance companies are required to calculate prudential capital. While the high level regulation is defined, detailed rules governing the approaches to determining the quantum of capital and the transition from the current regime are still to be finalised. | Proposed rules have reduced the potential for firms writing long-term business, such as annuities, to hold a disproportionate amount of capital relative to the risk exposure. However, until detailed calibration rules for capital models are finalised, there remains a range of capital outcomes. The scope and duration of transitional arrangements remain undecided. | We continue to actively participate with Government and regulatory bodies in the UK and Europe to ensure capital requirements accurately reflect the risks implicit in insurance products. Our SII programme is on track to deliver required capabilities in advance of the SII implementation date. |
| The International Accounting Standards Board's (IASB's) project on accounting for insurance contracts, which seeks to improve and ensure consistency in accounting, is targeted to be either re-exposed or issued in near final form in late 2012, with possible implementation between 2014 and 2016. | We support the need for clear and consistent financial reporting; however, the proposals of the latest exposure draft may result in a significant change in the timing of profit recognition, inconsistencies with capital measurement under Solvency II and could result in increased complexity for users of accounts. | We are working with the IASB, the European Insurance CFO forum and the ABI to ensure that the IASB proposals are appropriate to the insurance sector and meet the needs of investors. |

| | | |
|---|---|---|
| The FSA's With-Profits Consultation (CP11/5) proposed changes to the rules and guidance over the operation of with-profits funds, which may have a significant impact on the future operation, governance and strategy for with-profits business. The FSA published a Policy Statement (PS12/4) on 7 March 2012 and we are currently reviewing the impact of the rule changes. | Effective governance of with-profits business and the fair treatment of policyholders is sound business practice. However, the differing interpretation and application of regulation over time may have a detrimental effect on our strategy and profitability. | We have worked with the FSA and industry bodies to ensure that proposed rule changes reflect the needs of all stakeholders in those with-profit funds that remain open to business. |
| During 2012 the FSA will begin to transition into the Prudential Regulatory Authority and Financial Conduct Authority, two distinct and separate regulatory bodies. Each body will establish its own regulatory framework from 2013. | We support a robust regulatory regime for the financial services sector. However, there is a risk that the new regimes will not reflect differences between insurance and banking business models, resulting in additional capital requirements or lead to duplication of activities and increased costs of regulation. | We are engaged with our regulators to understand the impact of the new regimes on our business. The establishment of a CRO team and a separate Regulatory Compliance team will enable us to deploy resource and manage regulatory relationships in line with the new regime. |
| Changes in the corporation tax regime for life insurance companies will come into effect on 1 January 2013. Reform is made necessary by Solvency II which will replace the existing reporting framework upon which life company taxation is currently based. | Whilst, draft rules were published for industry consultation in December 2011, final rules are not anticipated until the publication of the 2012 Finance Act. The financial and operational impact of the proposals therefore remains uncertain. | We are actively participating in the consultation process with HM Treasury and HM Customs & Revenue and have commissioned an internal project to ensure that our business processes will be fully compliant with the new rules in time for 1 January 2013. |

## FINANCIAL MARKET AND ECONOMIC CONDITIONS

**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 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. 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 retention of retail financial services products.

| PRINCIPAL UNCERTAINTIES | POTENTIAL IMPACT | MITIGATION |
|---|---|---|
| The outlook for the UK economy remains uncertain. Recent economic growth has been subdued with no sign of a sustained recovery. As well as impacting domestic economic conditions, ongoing concerns for the stability of the eurozone have resulted in volatile investment markets. | Continuing economic uncertainty may increase propensity for consumer saving benefiting our retail savings business. However, other product segments such as protection may experience reduced demand, impacting our new business volumes and our earnings. | 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. |
| Although European governments have taken action to stabilise the economies of weaker members of the eurozone, there is a risk that the euro will continue to be inherently unsustainable unless some countries default and leave the euro, or there is movement towards closer fiscal integration. | Market disruption from a major sovereign debt event may impact our ability to execute hedging strategies that ensure the profile of our assets and liability/cash flows are appropriately matched. An exit from the euro may result in the temporary closure of markets, uncertainty over the operation of financial instruments and imposition of capital controls, particularly impacting our investment management and European businesses.. | We are actively monitoring the impact of the eurozone crisis on our businesses and the adequacy of our contingency plans. The Group Risk Committee has given specific consideration to the risks and how they may be mitigated. |

## COUNTERPARTY AND THIRD PARTY RISKS

**In dealing with issuers of debt and other types of counterparty the Group is exposed to the risk of default**

As part of our strategies to match long term assets and liabilities, exposures arise to the issuers of corporate debt and other financial instruments. We also have exposures to banking, money market and reinsurance counterparties, and the providers of settlement, custody and IT services.

| PRINCIPAL UNCERTAINTIES | POTENTIAL IMPACT | MITIGATION |
|---|---|---|
| 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 contagion may result in default by strongly rated issuers of debt. | Market reaction to significant credit rating downgrades or a default event could result in the short-term diminution in the market value of corporate bond assets held in respect of our annuities business and in extreme circumstances may require an increase in default provisions for potential or actual defaults. A failure by a key service provider may result in short-term operational disruption of our business processes. | We actively manage our exposure to default risk, setting robust counterparty selection criteria and exposure limits. We continue to broaden asset classes backing our annuities business, including the use of property lending, and sale and leaseback assets. Our service providers are also subject to rigorous selection criteria. |

## UK FINANCIAL SERVICES SECTOR CONTAGION RISKS

**As a UK-based Group, our earnings are influenced by the performance and perception of the UK financial services sector as a whole**

Investment market performance, actions by regulators against organisations operating in the financial services sector and shock events can impact the confidence of customers in the sector as a whole. Such events may also result in changes to the regulatory and legislative environment in which we operate.

| PRINCIPAL UNCERTAINTIES | POTENTIAL IMPACT | MITIGATION |
|---|---|---|
| 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 action in the banking sector with regard to Payment Protection Insurance (PPI), may adversely impact consumers' perception of the value of Insurance products. | As a significant participant in the long-term savings markets, we are inherently exposed to downturns in new business volumes and persistency levels as a consequence of changes in consumer sentiment. | 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 management businesses. In addition we continue to focus on developing our international businesses. The Group Risk Committee has given specific consideration to how we manage reputation risk. |
| Regulatory and legislative responses to events in the banking sector continue. Within Europe, EIOPA has been established as an EU-wide policy setting body for the regulators of European insurers and, as outlined above, within the UK the FSA is to be split into separate Prudential and Conduct Regulators. Separately the US Foreign Account Tax Compliance Act will introduce new customer disclosure obligations on UK insurers from July 2013. | We support a robust regulatory regime for the financial services sector. However, there is a risk that regulatory responses to market events lead to excessively prudent regulation; capital inefficiencies as a result of regulation aimed at banks being read across to insurers without reference to the different business models; and a more aggressive supervision and enforcement regime; resulting in additional capital requirements and increased costs of regulation. | We seek to engage with regulators and legislators at a UK and European level to assist in the evaluation of change and influence the development of outcomes that meet the needs of all stakeholders. We encourage our executive and senior management to actively participate in a broad range of industry, regulatory and Intra-governmental forums including the ABI, FSA and EU bodies. |

## MORTALITY, CATASTROPHE AND OTHER ASSUMPTION UNCERTAINTIES

**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. Extreme events may require recalibration of these assumptions. Forced changes in reserves can also be required as a result of changes in regulation or legislation.

| PRINCIPAL UNCERTAINTIES | POTENTIAL IMPACT | MITIGATION |
|---|---|---|
| In writing annuity business, pricing requires assumptions to be made for factors such as improvements in the general health of the population and advances in medical science. For protection business assumptions are made for the expected level of mortality, taking account of factors such as pandemics. | 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. However, extreme events, such as a rapid advance in medical science leading to significantly enhanced annuitant longevity or an event causing widespread mortality/morbidity, coupled with a reinsurer default, may require assumptions to be recalibrated impacting profitability and capital. | We remain focused on developing a comprehensive understanding of annuitant mortality, including the development of 'cause of death' models using UK population data and engaging directly with the medical profession and scientific community. For our protection and general insurance businesses we continue to evolve and develop our underwriting capabilities. |
| There is an increasing trend for legislative intervention in the pricing of products irrespective of differing risk factors such as age or gender. There is a risk that European or national legislators interpret the application of legislation in a way that has unforeseen adverse consequences for insurance businesses and their customers or introduce a retrospection to requirements. | Our product pricing assumptions for annuities, protection and other insurance business reflect the risks we assess as being exposed to. A requirement to price products irrespective of differing risk factors, such as age or gender, will potentially increase the costs of insurance to certain consumers, reducing their propensity to purchase. Any retrospection of legislation would impact required reserves. | We continue to highlight to legislators the benefits to consumers of being able to price insurance products on the risks implicit in that business. We are supporting the UK legislator on the implementation approach for the 2011 ruling by the European Court of Justice (ECJ) that insurance product pricing must be gender neutral from 21 December 2012, without retrospective application to existing business. |

## INDUSTRY CHANGE

**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. This presents a range of challenges as well as opportunities to providers of sufficient scale such as Legal & General.

| PRINCIPAL UNCERTAINTIES | POTENTIAL IMPACT | MITIGATION |
|---|---|---|
| The UK Government is consulting on a broad range of changes to the provision of state benefits, with Increased focus on self provision. Such changes will affect the way consumers approach protecting their income and planning for retirement. Separately, the implementation of the RDR and Solvency II will change the competitive landscape in which we operate. | 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. | 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, and manage their evolution as market and consumer requirements change. We believe we have a strong record on responding to change. |

## BUSINESS PROCESSES

**A material failure in our business processes may result in unanticipated loss or reputation damage**

The financial services sector continues to go through a period of change. This presents a range of challenges as well as opportunities to providers of sufficient scale such as Legal & General.

| PRINCIPAL UNCERTAINTIES | POTENTIAL IMPACT | MITIGATION |
|---|---|---|
| Our product manufacturing, distribution and administration activities, together with the management of a substantial portfolio of investment assets, necessarily requires significant investment in IT systems, people and processes to ensure that we meet the expectations of our customers, as well as complying with regulatory, legal and financial reporting requirements. The complexity of activities can increase our exposure to operational and reputation risks. | We have constructed our framework of internal controls to minimise the risk of unanticipated loss or damage to our reputation. We seek to continually review and improve the framework. Our internal audit function also provides independent assurance on the adequacy and effectiveness of our controls. However, no system of internal control can completely eliminate the risk of error, financial loss, fraudulent actions or reputational damage. | In October 2011 we completed the relocation of our UK data centre to IBM. The migration will further mitigate the IT system risks to which we are exposed. We also continue to invest in new systems, including those to support our Annuities, Group Protection General and Investment Management businesses. |

## ENQUIRIES

**INVESTORS:**

| | | |
|---|---|---|
| Wadham Downing | Group Financial Controller | 020 3124 2120 |
| Andrew Jones | Head of Group Financial Reporting | 020 3124 2054 |
| Kate Vennell | Head of Investor Relations | 020 3124 2150 |

**MEDIA:**

| | | |
|---|---|---|
| John Godfrey | Group Communications Director | 020 3124 2090 |
| Richard King | Head of Media Relations | 020 3124 2095 |
| Andrew Grant | Tulchan Communications | 020 7353 4200 |

## NOTES

A copy of this announcement can be found in "Results", under the "Financial information" section of our shareholder website at http://www.legalandgeneralgroup.com/investors/results.cfm.

A presentation to analysts and fund managers will take place at 09.30 GMT today at One Coleman Street, London, EC2R 5AA. There will be a live webcast of the presentation which can be accessed at

http://investor.legalandgeneral.com/investors/results.cfm. A replay will be available on this website later today.

There will be a live listen only teleconference link to the presentation. Details below:

| Country You Are Dialling In From | Number You Should Dial |
|---|---|
| United Kingdom | 020 3059 5845 |
| All other locations | +44 20 3059 5845 |
| Conference Entry via QR Code | To gain access to the conference using the QR code, please ensure you have the appropriate software on your mobile device and scan the image. |

A replay will be available on this website later today.

| | |
|---|---|
| United Kingdom | **0121 2604 861** |
| All other locations | **+ 44 121 2604 861** |

PARTICIPANT PIN: 7632105 FOLLOWED BY #

| Financial Calendar 2012 | Date |
|---|---|
| Ex dividend date | 18 April 2012 |
| Record date | 20 April 2012 |
| Annual General Meeting | 16 May 2012 |
| Payment date of 2011 final dividend | 23 May 2012 |
| Half Year Results 2012 | 26 July 2012 |

The Preliminary Results for the year ended 31 December 2011 do not constitute statutory accounts as defined in section 434 of the Companies Act 2006. The Group's statutory accounts for 2010 and 2011 have been audited by PricewaterhouseCoopers LLP and their reports were unqualified and did not contain a statement under section 498(2) or (3) of the Companies Act 2006. The Group's 2010 statutory accounts have been filed with the Registrar of Companies.

## FORWARD LOOKING STATEMENTS

This document may contain certain forward-looking statements relating to Legal & General Group, its plans and its current goals and expectations relating to future financial condition, performance and results. By their nature forward-looking statements involve uncertainty because they relate to future events and circumstances which are beyond Legal & General's control, including, among others, UK domestic and global economic and business conditions, market related risks such as fluctuations in interest rates and exchange rates, the policies and actions of regulatory and Governmental authorities, the impact of competition, the timing impact of these events and other uncertainties of future acquisition or combinations within relevant industries. As a result, Legal & General Group's actual future condition, performance and results may differ materially from the plans, goals and expectations set out in these forward-looking statements and persons reading this announcement should not place reliance on forward-looking statements. These forward-looking statements are made only as at the date on which such statements are made and Legal & General Group Plc does not undertake to update forward-looking statements contained in this document or any other forward-looking statement it may make.

## DIRECTORS' RESPONSIBILITY STATEMENT (EXTRACTED FROM THE 2011 ANNUAL REPORT AND ACCOUNTS)

The directors are responsible for preparing the Directors' Report, the Directors' Remuneration Report and the 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 parent 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 and the company 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 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 parent company financial statements respectively;
- 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 and the group'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' Remuneration Report 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.

Each of the directors listed below confirms that to the best of their knowledge:

(a) the financial statements, prepared in accordance with the applicable set of accounting standards, give a true and fair view of the assets, liabilities, financial position and profit or loss of the Company and the Group as a whole; and

(b) the Directors' Report includes a fair review of the development and performance of the business and the position of the Company and Group as a whole, together with a description of the principal risks and uncertainties that they face.

| | | | |
|---|---|---|---|
| J. M. Stewart | Chairman | J.B. Pollock | Group Executive Director (Risk) |
| T.J. Breedon | Group Chief Executive | S.G. Popham | Non-Executive Director |
| M.E. Fairey | Non-Executive Director | N. Prettejohn | Non-Executive Director |
| Dame C.H.F. Furse | Non-Executive Director | H.E. Staunton | Non-Executive Director |
| M.J. Gregory | Group Executive Director (Savings) | N.D. Wilson | Group Chief Financial Officer |
| R.H.P. Markham | Non-Executive Director | J.S Wilson | Non-Executive Director |

# NOTES

# NOTES

# NOTES

# NOTES

## Supplementary operating profit information

For the year ended 31 December 2011

| | Notes | **2011 £m** | 2010 £m |
|---|---|---|---|
| **From continuing operations** | | | |
| Risk | 2.01(a) | **561** | 560 |
| Savings | 2.02(a) | **128** | 115 |
| Investment management | 2.03 | **234** | 206 |
| International | 2.04 | **137** | 102 |
| Group capital and financing | 2.05 | **52** | 58 |
| Investment projects[1] | | **(56)** | (39) |
| **Operating profit** | | **1,056** | 1,002 |
| Asset related investment variances | | **(2)** | 185 |
| Other investment variances | | **(95)** | (95) |
| **Variation from longer term investment return** | 2.06 | **(97)** | 90 |
| Property losses attributable to non-controlling interests | | **(3)** | - |
| **Profit before income tax attributable to equity holders of the Company** | | **956** | 1,092 |
| Tax expense attributable to equity holders of the Company | 2.07 | **(233)** | (272) |
| **Profit for the year** | | **723** | 820 |

| | | | |
|---|---|---|---|
| Attributable to: | | | |
| Non-controlling interests | | **(3)** | - |
| Equity holders of the Company | | **726** | 820 |

| | Notes | **p** | p |
|---|---|---|---|
| **Earnings per share** | 2.09 | | |
| Based on operating profit from continuing operations after tax attributable to equity holders of the Company | | **13.50** | 12.89 |
| Based on profit attributable to equity holders of the Company | | **12.46** | 14.07 |
| **Diluted earnings per share** | 2.09 | | |
| Based on operating profit from continuing operations after tax attributable to equity holders of the Company | | **13.28** | 12.72 |
| Based on profit attributable to equity holders of the Company | | **12.25** | 13.88 |

1. Investment projects predominantly relates to Solvency II and other strategic investments.

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.

Operating profit for the Risk 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). 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.

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 of 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.

Operating profit for the Investment management and International segments includes a longer term expected investment return on the shareholders' funds within the Investment management and LGN operations.

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.

## Supplementary operating profit information
## 2.01 Risk
## (a) Risk operating profit

| | Notes | 2011 £m | 2010 £m |
|---|---|---|---|
| **Annuities**[1] | | **287** | 364 |
| Protection[2] | | **242** | 207 |
| General insurance[3] | 2.01(f) | **42** | (8) |
| Other | | **(10)** | (3) |
| **Total Housing and Protection** | | **274** | 196 |
| **Total Risk operating profit** | 2.01(b) | **561** | 560 |

1. The prior year annuities result includes a one-off benefit of £72m resulting from inflation modelling enhancements (see Note 2.01(d)) and an additional £25m in positive new business strain.
2. The protection result includes a £23m positive expense assumption change (see Note 2.01(d)) reflecting lower unit costs due to efficiency improvements.
3. The current year result reflects the benign weather experienced during the year, with actual experience being below the long term expectations. The prior year general insurance result was impacted by two severe cold weather events, which resulted in approximately £30m of additional weather related claims (see Note 2.01(f)).

## (b) Analysis of Risk operating profit

| | Notes | Annuities 2011 £m | Housing and Protection 2011 £m | Total 2011 £m | Annuities 2010 £m | Housing and Protection 2010 £m | Total 2010 £m |
|---|---|---|---|---|---|---|---|
| Risk business segment operating profit comprises: | | | | | | | |
| Operational cash generation | | **227** | **255** | **482** | 229 | 210 | 439 |
| New business strain | | **35** | **(66)** | **(31)** | 60 | (70) | (10) |
| Net cash generation | | **262** | **189** | **451** | 289 | 140 | 429 |
| Experience variances | 2.01(c) | | | **22** | | | 67 |
| Changes to valuation assumptions | 2.01(d) | | | **24** | | | 30 |
| Movements in non-cash items | 2.01(e) | | | **(86)** | | | (122) |
| Other | | | | **-** | | | (1) |
| | | | | **411** | | | 403 |
| Tax gross up | | | | **150** | | | 157 |
| **Total Risk operating profit** | | | | **561** | | | 560 |

The annuities and protection (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 Risk 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 as required by the ABI SORP.

An analysis of the experience variances, valuation assumption changes and non-cash items, all net of tax, is provided below:

## Supplementary operating profit information
## 2.01 Risk (continued)
## (c) Experience variances

| | 2011 £m | 2010 £m |
|---|---|---|
| Persistency | **(4)** | (3) |
| Mortality/morbidity[1] | **(32)** | (8) |
| Expenses | **(2)** | (1) |
| Bulk purchase annuity data loading | **42** | 59 |
| Project and development costs | **(7)** | (9) |
| Tax[2] | **33** | 37 |
| Other | **(8)** | (8) |
| | **22** | 67 |

1. Mortality/morbidity in 2011 primarily relates to the group protection experience in H1 2011, driven by a number of high value claims. This has trended back to assumptions in H2 2011, and the total impact for the year was £35m.
2. This principally relates to the utilisation of brought forward tax losses.

## (d) Changes to valuation assumptions

| | 2011 £m | 2010 £m |
|---|---|---|
| Persistency | **(1)** | (5) |
| Mortality/morbidity | **(1)** | (19) |
| Expenses[1] | **28** | (9) |
| Other[2] | **(2)** | 63 |
| | **24** | 30 |

1. Expenses in 2011 relates to efficiency improvements in protection and annuities leading to lower unit costs. 2010 related to a change in the reserving basis for custodian fees.
2. Prior year Other reflects the £72m benefit from inflation modelling enhancement on the annuity business.

## (e) Movements in non-cash items

| | 2011 £m | 2010 £m |
|---|---|---|
| Deferred tax | **(77)** | (125) |
| Other | **(9)** | 3 |
| | **(86)** | (122) |

## (f) General insurance operating profit/(loss)

| | Net cash generation 2011 £m | Tax 2011 £m | Operating profit 2011 £m | Net cash generation 2010 £m | Tax 2010 £m | Operating profit 2010 £m |
|---|---|---|---|---|---|---|
| Household[1] | **27** | **10** | **37** | (10) | (4) | (14) |
| Other business | **4** | **1** | **5** | 4 | 2 | 6 |
| | **31** | **11** | **42** | (6) | (2) | (8) |

1. The current year result reflects the benign weather experienced during the year, with actual experience being below long term expectations. The prior year general insurance result was impacted by two severe cold weather events, which resulted in approximately £30m of additional weather related claims.

## Supplementary operating profit information
## 2.01 Risk (continued)
## (g) General insurance underwriting result

| | **2011** | 2010 |
|---|---|---|
| | **£m** | £m |
| Household[1] | **23** | (27) |
| Other business | **4** | 5 |
| | **27** | (22) |

1. The current year result reflects the benign weather experienced during the year, with actual experience being below long term expectations. The prior year general insurance result was impacted by two severe cold weather events, which resulted in approximately £30m of additional weather related claims.

## (h) General insurance combined operating ratio

| | **2011** | 2010 |
|---|---|---|
| | **%** | % |
| Household[1] | **90** | 109 |
| Other business | **75** | 77 |
| | **88** | 106 |

1. The current year result reflects the benign weather experienced during the year, with actual experience being below long term expectations. The prior year general insurance result was impacted by two severe cold weather events, which resulted in approximately £30m of additional weather related claims.

## Supplementary operating profit information
## 2.02 Savings
## (a) Savings operating profit

| | Note | 2011 £m | 2010 £m |
|---|---|---|---|
| Savings investments[1] | | **23** | 21 |
| Insured savings[2] | | **36** | 31 |
| With-profits[3] | | **69** | 63 |
| **Total Savings operating profit** | 2.02(b) | **128** | 115 |

1. Savings investments operating profit includes £34m (2010: £29m) from our mutual funds business and the results from our structured SIPPs and platform businesses.
2. Insured savings includes non profit investment bonds and pensions (including workplace savings and SIPPs), Nationwide Life Savings business and International (Ireland).
3. With-profits business operating profit is the shareholders' share of total with-profits bonuses.

## (b) Analysis of Savings operating profit

| | Notes | Insured savings 2011 £m | With-profits 2011 £m | Savings invest-ments 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[1] | | **38** | **51** | **22** | **111** |
| **Insured savings** | | | | | |
| Experience variances | 2.02(c) | | | | **(12)** |
| Changes to valuation assumptions | 2.02(d) | | | | **(5)** |
| Movements in non-cash items | 2.02(e) | | | | **6** |
| Other | | | | | **-** |
| **Savings investments** | | | | | |
| Movements in non-cash items and other | | | | | **(6)** |
| | | | | | **94** |
| Tax gross up | | | | | **34** |
| **Total Savings operating profit** | | | | | **128** |

1. Insured savings net cash generation of £38m (2010: £1m) reflects the benefit of higher fees on higher opening asset values coupled with continued expense savings and commission savings resulting in a lower new business strain.

## Supplementary operating profit information
## 2.02 Savings (continued)
## (b) Analysis of Savings operating profit (continued)

| | Notes | Insured savings 2010 £m | With-profits 2010 £m | Savings invest-ments 2010 £m | Total 2010 £m |
|---|---|---|---|---|---|
| **Savings business segment operating profit comprises:** | | | | | |
| Operational cash generation | | 71 | 46 | 21 | 138 |
| New business strain | | (70) | - | - | (70) |
| Net cash generation | | 1 | 46 | 21 | 68 |
| **Insured savings** | | | | | |
| Experience variances | 2.02(c) | | | | 10 |
| Changes to valuation assumptions | 2.02(d) | | | | 28 |
| Movements in non-cash items | 2.02(e) | | | | (21) |
| Other | | | | | 4 |
| **Savings investments** | | | | | |
| Movements in non-cash items and other | | | | | (9) |
| | | | | | 80 |
| Tax gross up | | | | | 35 |
| Total Savings operating profit | | | | | 115 |

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 as required by the ABI SORP.

An analysis of the experience variances, valuation assumption changes and non-cash items, all net of tax, is provided below:

## (c) Experience variances

| | **2011 £m** | 2010 £m |
|---|---|---|
| Persistency | **(1)** | (3) |
| Mortality/morbidity | **2** | 1 |
| Expenses | **1** | 3 |
| Project and development costs[1] | **(12)** | (4) |
| Tax | **(4)** | 14 |
| Other | **2** | (1) |
| | **(12)** | 10 |

1. The 2011 project and development costs related to auto-enrolment £7m, expenditure on distribution channel enhancements of £2m and other costs of £3m.

## Supplementary operating profit information
## 2.02 Savings (continued)
## (d) Changes to valuation assumptions

| | 2011 £m | 2010 £m |
|---|---|---|
| Persistency | **(2)** | - |
| Mortality/morbidity | **1** | 2 |
| Expenses | **(2)** | 3 |
| Other[1] | **(2)** | 23 |
| | **(5)** | 28 |

1. In 2010, Other assumption changes includes £12m from the recognition of the benefit of tax exempt UK dividend income.

## (e) Movements in non-cash items

| | Note | 2011 £m | 2010 £m |
|---|---|---|---|
| Deferred tax | | **(6)** | (39) |
| Deferred acquisition costs (DAC) | 2.02(f) | **(20)** | (16) |
| Deferred income liabilities (DIL) | | **27** | 33 |
| Other | | **5** | 1 |
| | | **6** | (21) |

## (f) Deferred acquisition cost movement, net of associated deferred tax

| | 2011 £m | 2010 £m |
|---|---|---|
| **As at 1 January** | **612** | 628 |
| Amortisation through income | **(74)** | (66) |
| Acquisition costs deferred | **54** | 50 |
| **As at 31 December** | **592** | 612 |

The Group's balance sheet deferred acquisition costs of £2.1bn (2010: £2.0bn) is presented gross of associated deferred tax. The main contributors to the balance are LGA £1.0bn (2010: £1.0bn), non profit savings of £0.7bn (2010: £0.7bn), retail investments £0.1bn (2010: £0.1bn), savings with-profit £0.1bn (2010: £0.1bn) and other business totalling £0.2bn (2010: £0.1bn).

**Expected amortisation profile:**

| | 2011 £m | 2010 £m |
|---|---|---|
| Expected to be amortised within one year | **65** | 69 |
| Expected to be amortised between one year and five years | **271** | 276 |
| Expected to be amortised in over five years | **256** | 267 |
| | **592** | 612 |

## Supplementary operating profit information
## 2.03 Investment management

| | 2011 £m | 2010 £m |
|---|---|---|
| Pension funds (managed and segregated) | **172** | 148 |
| Other non-pension[1] | **25** | 20 |
| Investment management services for internal funds | **37** | 38 |
| **Total Investment management operating profit** | **234** | 206 |

1. Other non-pension includes institutional segregated mandates, private equity and property (both in the UK and overseas). Interest income on shareholder funds of £9m (2010: £11m) on an average asset balance of £0.40 bn (2010: £0.37bn) has been included within other non-pension operating profit.

## 2.04 International

| | 2011 £m | 2010 £m |
|---|---|---|
| **USA (LGA)** | **104** | 85 |
| Netherlands (LGN) | **21** | 20 |
| France (LGF) | **20** | 6 |
| **Total Europe operating profit** | **41** | 26 |
| Other[1] | **(8)** | (9) |
| **Total International operating profit[2]** | **137** | 102 |

1. Other includes our joint venture operations in Egypt, the Gulf, India and divisional overhead costs of £5m (2010: £5m).

2. In the year, the International division paid £51m (2010: £44m) of sustainable dividends to the Group, which has been included in net cash generation. In addition, the LGN business paid a special dividend of £29m and the LGA business remitted a further £52m of capital representing the repatriation of profits in 2010 from the redemption of external debt during the first quarter of 2011. These amounts have been excluded from the Group's net cash generation.

Exchange rates are provided in Note 2.18.

## 2.05 Group capital and financing

| | 2011 £m | 2010 £m |
|---|---|---|
| Investment return[1] | **191** | 187 |
| Interest expense[2] | **(123)** | (121) |
| Investment expenses | **(5)** | (3) |
| Unallocated corporate expenses | **(11)** | (5) |
| **Total Group capital and financing operating profit** | **52** | 58 |

1. The increase in the average Group capital and financing assets has resulted in an increase in the smoothed investment return to £191m (2010: £187m). The smoothed investment return is calculated asset class by asset class and equates to an average smoothed investment return of 4.7% (2010: 5.8%) on the average balance of invested assets of £4.0bn (2010: £3.2bn). In GCF, the rate used to calculate the smoothed return on cash and LIBOR benchmarked bonds has been reduced. The cash rate previously used of 4% has been replaced with a 1 year LIBOR of 1%. This ensures our operating profit and cash metric maintains relevance in current macroeconomic conditions. This change has reduced operating profit by £52m, with an opposite impact on investment variance, and operational cash generation by £38m. It is our intention to continue with this prudent view in 2012.

2. Interest expense excludes interest on non recourse financing (see Note 2.14).

## Supplementary operating profit information
## 2.06 Variation from longer term investment return

| | 2011 £m | 2010 £m |
|---|---|---|
| Risk[1] | **172** | 102 |
| Savings[2] | **13** | 4 |
| Investment management | **(7)** | (8) |
| International[3] | **(21)** | 35 |
| GCF asset related[4] | **(159)** | 52 |
| **Asset related investment variances** | **(2)** | 185 |
| Savings other investment variance[5] | **(47)** | (58) |
| Treasury related[6] | **(68)** | (72) |
| Defined benefit pension scheme[7] | **20** | 35 |
| **Other investment variances** | **(95)** | (95) |
| **Total variation from longer term investment return** | **(97)** | 90 |

1. The positive investment variance has increased to £172m (2010: £102m). The contributing factors are: improved asset diversity which increased the risk adjusted yield, for example, sale and leaseback; no defaults in the portfolio; improved asset liability matching, for example, reinvestment into longer duration bonds; more efficient cash management and small one-off benefits from tax and interest rate movements.
2. The positive Savings asset related investment variance was driven by movements in the gilt portfolio backing non-linked reserves.
3. The International investment variance has arisen in LGN. The variance is caused by temporary timing differences in the valuation of the assets against the liabilities on the index linked margin business. The variance should be broadly neutral over the longer term.
4. The GCF asset related investment variance was primarily driven by a fall in equity markets which contributed £(139)m to the adverse investment variance. In GCF, the rate used to calculate the smoothed return on cash and LIBOR benchmarked bonds has been reduced. The cash rate previously used of 4% has been replaced with a 1 year LIBOR of 1%. This ensures our operating profit and cash metric maintains relevance in current macroeconomic conditions. This change has reduced operating profit by £52m, with an opposite impact on investment variance, and operational cash generation by £38m. It is our intention to continue with this prudent view in 2012.
5. Savings business other investment variance is primarily the difference between IFRS deferred policyholder tax and the amount included within the unit linked life funds.
6. Treasury related investment variance relates to derivative contracts which have not been designated within hedge accounting relationships resulting in short term income statement volatility which, in 2011, was caused by a decrease in the relevant long term interest rates.
7. The defined benefit pension scheme investment variance includes the actuarial gains and losses and valuation difference arising on annuity assets held by the defined benefit pension schemes that have been purchased from Legal & General Assurance Society Limited.

## 2.07 Analysis of tax

| | Profit/ (loss) before tax 2011 £m | Tax (exp-ense)/ credit 2011 £m | Profit/ (loss) before tax 2010 £m | Tax (exp-ense)/ credit 2010 £m |
|---|---|---|---|---|
| Risk | **561** | **(150)** | 560 | (157) |
| Savings | **128** | **(34)** | 115 | (35) |
| Investment management | **234** | **(45)** | 206 | (44) |
| International | **137** | **(47)** | 102 | (25) |
| Group capital and financing | **52** | **(8)** | 58 | (1) |
| Investment projects | **(56)** | **15** | (39) | 11 |
| **Operating profit/Tax expense** | **1,056** | **(269)** | 1,002 | (251) |
| Variation from longer term investment return | **(97)** | **42** | 90 | (16) |
| Impact of change in UK tax rates | **-** | **(6)** | - | (5) |
| Property losses attributable to non-controlling interests | **(3)** | **-** | - | - |
| **Profit for the period/Tax expense for the period** | **956** | **(233)** | 1,092 | (272) |

The equity holders' effective tax rate for the period is 24.4% (2010: 24.9%). This is mainly due to the release of tax provided in prior years in respect of disputed tax issues which are now resolved, which is partially offset by the impact of higher overseas tax rates on overseas profits.

## Consolidated Income Statement

For the year ended 31 December 2011

| | Notes | **2011 £m** | 2010 £m |
|---|---|---|---|
| **Revenue** | | | |
| Gross written premiums | 2.08 | **5,719** | 5,348 |
| Outward reinsurance premiums | | **(620)** | (590) |
| Net change in provision for unearned premiums | | **(18)** | (14) |
| **Net premiums earned** | | **5,081** | 4,744 |
| Fees from fund management and investment contracts | | **897** | 900 |
| Investment return | | **12,143** | 32,671 |
| Operational income | | **196** | 125 |
| **Total revenue** | | **18,317** | 38,440 |
| **Expenses** | | | |
| Claims and change in insurance liabilities | | **7,173** | 7,567 |
| Reinsurance recoveries | | **(493)** | (621) |
| Net claims and change in insurance liabilities | | **6,680** | 6,946 |
| Change in provisions for investment contract liabilities | | **9,306** | 28,154 |
| Acquisition costs | | **780** | 770 |
| Finance costs | | **165** | 168 |
| Other expenses | | **1,010** | 905 |
| Transfers (from)/to unallocated divisible surplus | | **(402)** | 190 |
| **Total expenses** | | **17,539** | 37,133 |
| **Profit before tax** | | **778** | 1,307 |
| Tax income/(expense) attributable to policyholder returns | | **178** | (215) |
| **Profit before tax attributable to equity holders of the Company** | | **956** | 1,092 |
| Total tax expense | | **(55)** | (487) |
| Tax (income)/expense attributable to policyholder returns | | **(178)** | 215 |
| Tax expense attributable to equity holders | 2.07 | **(233)** | (272) |
| **Profit for the year** | | **723** | 820 |
| Attributable to: | | | |
| Non-controlling interests | | **(3)** | - |
| Equity holders of the Company | | **726** | 820 |
| Dividend distributions to equity holders of the Company during the year | 2.10 | **298** | 238 |
| Dividend distributions to equity holders of the Company proposed after the year end | 2.10 | **279** | 201 |
| | | **p** | p |
| **Earnings per share** | | | |
| Based on profit attributable to equity holders of the Company | 2.09 | **12.46** | 14.07 |
| **Diluted earnings per share** | | | |
| Based on profit attributable to equity holders of the Company | 2.09 | **12.25** | 13.88 |

## Consolidated Statement of Comprehensive Income

For the year ended 31 December 2011

| | 2011 £m | 2010 £m |
|---|---|---|
| **Profit for the year** | **723** | 820 |
| **Other comprehensive income after tax** | | |
| Exchange differences on translation of overseas operations | **1** | 8 |
| Actuarial (losses) on defined benefit pension schemes | **(121)** | (9) |
| Actuarial losses on defined benefit pension schemes transferred to unallocated divisible surplus | **48** | 4 |
| Net change in financial investments designated as available-for-sale | **10** | 27 |
| **Total comprehensive income for the year** | **661** | 850 |
| | | |
| Total comprehensive income/(expense) attributable to: | | |
| Non-controlling interests | **(3)** | - |
| Equity holders of the Company | **664** | 850 |

## Consolidated Balance Sheet

As at 31 December 2011

| | Notes | 2011 £m | 2010 £m |
|---|---|---|---|
| **Assets** | | | |
| Purchased interest in long term businesses and other intangible assets | | **148** | 157 |
| Deferred acquisition costs | | **2,053** | 2,000 |
| Investment in associates | | **60** | 57 |
| Plant and equipment | | **78** | 64 |
| Investment property | | **4,894** | 4,571 |
| Financial investments | 2.11 | **300,604** | 299,570 |
| Reinsurers' share of contract liabilities | | **2,289** | 2,336 |
| Deferred tax asset | | **493** | 495 |
| Current tax recoverable | | **94** | - |
| Other assets | | **1,893** | 1,587 |
| Cash and cash equivalents | | **14,113** | 13,036 |
| **Total assets** | | **326,719** | 323,873 |
| **Equity** | | | |
| Share capital | 2.12 | **147** | 147 |
| Share premium | 2.12 | **941** | 938 |
| Employee scheme treasury shares | | **(48)** | (41) |
| Capital redemption and other reserves | | **101** | 79 |
| Retained earnings | | **4,059** | 3,704 |
| **Shareholders' equity** | | **5,200** | 4,827 |
| Non-controlling interests | | **66** | 47 |
| **Total equity** | | **5,266** | 4,874 |
| **Liabilities** | | | |
| Subordinated borrowings | 2.14 | **1,921** | 1,897 |
| Participating insurance contracts | 2.15 | **8,750** | 9,383 |
| Participating investment contracts | 2.16 | **7,276** | 7,323 |
| Unallocated divisible surplus | | **1,038** | 1,469 |
| Value of in-force non-participating contracts | | **(242)** | (377) |
| **Participating contract liabilities** | | **16,822** | 17,798 |
| Non-participating insurance contracts | 2.15 | **34,006** | 31,325 |
| Non-participating investment contracts | 2.16 | **251,345** | 253,426 |
| **Non-participating contract liabilities** | | **285,351** | 284,751 |
| Senior borrowings | 2.14 | **1,329** | 1,435 |
| Provisions | 2.19 | **891** | 761 |
| Deferred tax liabilities | | **403** | 356 |
| Current tax liabilities | | **1** | 111 |
| Payables and other financial liabilities | | **7,643** | 5,473 |
| Other liabilities | | **933** | 954 |
| Net asset value attributable to unit holders | | **6,159** | 5,463 |
| **Total liabilities** | | **321,453** | 318,999 |
| **Total equity and liabilities** | | **326,719** | 323,873 |

## Consolidated Statement of Changes in Equity

| For the year ended 31 December 2011 | 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) | 79 | 3,704 | 4,827 | 47 | 4,874 |
| Profit for the year | - | - | - | - | 726 | 726 | (3) | 723 |
| Exchange differences on translation of overseas operations | - | - | - | 1 | - | 1 | - | 1 |
| 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 | - | - | - | 10 | - | 10 | - | 10 |
| Total comprehensive income/(expense) for the year | - | - | - | 11 | 653 | 664 | (3) | 661 |
| 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 2011** | 147 | 941 | (48) | 101 | 4,059 | 5,200 | 66 | 5,266 |

## Consolidated Statement of Changes in Equity (continued)

| For the year ended 31 December 2010 | 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 | 936 | (38) | 41 | 3,110 | 4,196 | 2 | 4,198 |
| Profit for the year | - | - | - | - | 820 | 820 | - | 820 |
| Exchange differences on translation of overseas operations | - | - | - | 8 | - | 8 | - | 8 |
| Actuarial (losses) on defined benefit pension schemes | - | - | - | - | (9) | (9) | - | (9) |
| Actuarial losses on defined benefit pension schemes transferred to unallocated divisible surplus | - | - | - | - | 4 | 4 | - | 4 |
| Net change in financial investments designated as available-for-sale | - | - | - | 27 | - | 27 | - | 27 |
| Total comprehensive income for the year | - | - | - | 35 | 815 | 850 | - | 850 |
| Options exercised under share option schemes: | | | | | | | | |
| - Executive share option schemes | - | - | - | - | - | - | - | - |
| - Savings related share option scheme | - | 2 | - | - | - | 2 | - | 2 |
| Shares purchased | - | - | (11) | - | - | (11) | - | (11) |
| Shares vested | - | - | 8 | (18) | - | (10) | - | (10) |
| Employee scheme treasury shares: | | | | | | | | |
| - Value of employee services | - | - | - | 30 | - | 30 | - | 30 |
| Share scheme transfers to retained earnings | - | - | - | - | 8 | 8 | - | 8 |
| Dividends | - | - | - | - | (238) | (238) | - | (238) |
| Movement in third party interests | - | - | - | - | - | - | 45 | 45 |
| Currency translation differences | - | - | - | (9) | 9 | - | - | - |
| **As at 31 December 2010** | 147 | 938 | (41) | 79 | 3,704 | 4,827 | 47 | 4,874 |

## Consolidated Cash Flow Statement
For the year ended 31 December 2011

| | 2011 £m | 2010 £m |
|---|---|---|
| **Cash flows from operating activities** | | |
| **Profit for the year** | **723** | 820 |
| **Adjustments for non cash movements in net profit for the period** | | |
| Realised and unrealised gains on financial investments and investment properties | **(3,014)** | (23,673) |
| Investment income | **(8,971)** | (8,787) |
| Interest expense | **165** | 168 |
| Tax expense | **55** | 487 |
| Other adjustments | **65** | 59 |
| **Net decrease/(increase) in operational assets** | | |
| Investments held for trading or designated as fair value through profit or loss | **3,736** | (2,958) |
| Investments designated as available-for-sale | **(29)** | (39) |
| Other assets | **(1,678)** | (479) |
| **Net increase in operational liabilities** | | |
| Insurance contracts | **2,075** | 2,746 |
| Transfer (from)/to unallocated divisible surplus | **(431)** | 186 |
| Investment contracts | **(2,068)** | 20,702 |
| Value of in-force non-participating contracts | **135** | (10) |
| Other liabilities | **2,243** | 4,968 |
| **Cash used in operations** | **(6,994)** | (5,810) |
| Interest paid | **(164)** | (167) |
| Interest received | **5,021** | 5,030 |
| Tax paid[1] | **(193)** | (164) |
| Dividends received | **3,872** | 3,818 |
| **Net cash flows from operating activities** | **1,542** | 2,707 |
| **Cash flows from investing activities** | | |
| Net acquisition of plant and equipment | **(26)** | (17) |
| Acquisitions (net of cash acquired)[2] | **(11)** | (44) |
| Capital injection into overseas joint ventures | **(5)** | (8) |
| **Net cash flows from investing activities** | **(42)** | (69) |
| **Cash flows from financing activities** | | |
| Dividend distributions to ordinary equity holders of the Company during the year | **(298)** | (238) |
| Proceeds from issue of ordinary share capital | **3** | 2 |
| Purchase of employee scheme shares | **(15)** | (11) |
| Proceeds from borrowings | **1,327** | 750 |
| Repayment of borrowings | **(1,428)** | (758) |
| **Net cash flows from financing activities** | **(411)** | (255) |
| **Net increase in cash and cash equivalents** | **1,089** | 2,383 |
| Exchange (losses)/gains on cash and cash equivalents | **(12)** | 3 |
| Cash and cash equivalents at 1 January | **13,036** | 10,650 |
| **Cash and cash equivalents at 31 December** | **14,113** | 13,036 |

1. Tax comprises UK corporation tax paid of £80m (2010: £59m) and overseas withholding tax of £113m (2010: £105m).
2. Net cash flows from acquisitions include total net identifiable assets acquired of £15m (2010: £52m) less cash and cash equivalents acquired of £4m (2010: £8m).

The Group's consolidated cash flow statement includes all cash and cash equivalent flows, including those relating to the UK long term fund policyholders.

## Notes to the Financial Statements
## 2.08 Gross written premiums on insurance contracts

| | 2011 £m | 2010 £m |
|---|---|---|
| **From continuing operations** | | |
| **Risk** | | |
| Non-participating Risk business | **3,778** | 3,309 |
| General insurance | | |
| - Household | **283** | 259 |
| - Other business | **21** | 22 |
| **Total Risk** | **4,082** | 3,590 |
| **Savings** | | |
| Non-participating Savings business | **40** | 41 |
| Participating business | **488** | 609 |
| **Total Savings** | **528** | 650 |
| **International** | | |
| USA (LGA) | **522** | 502 |
| Netherlands (LGN) | **194** | 227 |
| France (LGF) | **393** | 379 |
| **Total International** | **1,109** | 1,108 |
| **Total gross written premiums** | **5,719** | 5,348 |

## 2.09 Earnings per share
## (a) Earnings per share

| | Profit before tax 2011 £m | Tax expense 2011 £m | Profit after tax 2011 £m | Earnings per share 2011 p | Profit before tax 2010 £m | Tax expense 2010 £m | Profit after tax 2010 £m | Earnings per share 2010 p |
|---|---|---|---|---|---|---|---|---|
| **Operating profit** | **1,056** | **(269)** | **787** | **13.50** | 1,002 | (251) | 751 | 12.89 |
| Variation from longer term investment return | **(97)** | **42** | **(55)** | **(0.94)** | 90 | (16) | 74 | 1.27 |
| Impact of change in UK tax rates | **-** | **(6)** | **(6)** | **(0.10)** | - | (5) | (5) | (0.09) |
| **Earnings per share based on profit attributable to equity holders** | **959** | **(233)** | **726** | **12.46** | 1,092 | (272) | 820 | 14.07 |

## (b) Diluted earnings per share
### (i) Based on operating profit after tax

| | Profit after tax 2011 £m | Number of shares[1] 2011 m | Earnings per share 2011 p | Profit after tax 2010 £m | Number of shares[1] 2010 m | Earnings per share 2010 p |
|---|---|---|---|---|---|---|
| **Operating profit after tax** | **787** | **5,828** | **13.50** | 751 | 5,827 | 12.89 |
| Net shares under options allocable for no further consideration | **-** | **97** | **(0.22)** | - | 79 | (0.17) |
| **Diluted earnings per share** | **787** | **5,925** | **13.28** | 751 | 5,906 | 12.72 |

## Notes to the Financial Statements
## 2.09 Earnings per share (continued)
## (b) Diluted earnings per share (continued)
#### (ii) Based on profit attributable to equity holders

| | **Profit after tax 2011 £m** | **Number of shares[1] 2011 m** | **Earnings per share 2011 p** | Profit after tax 2010 £m | Number of shares[1] 2010 m | Earnings per share 2010 p |
|---|---|---|---|---|---|---|
| **Profit attributable to equity holders of the Company** | **726** | **5,828** | **12.46** | 820 | 5,827 | 14.07 |
| Net shares under options allocable for no further consideration | **-** | **97** | **(0.21)** | - | 79 | (0.19) |
| **Diluted earnings per share** | **726** | **5,925** | **12.25** | 820 | 5,906 | 13.88 |

1. Weighted average number of shares.

The number of shares in issue at 31 December 2011 was 5,872,166,893 (31 December 2010: 5,866,669,323).

## 2.10 Dividends

| | **Per share 2011 p** | **Total 2011 £m** | Per share 2010 p | Total 2010 £m |
|---|---|---|---|---|
| Ordinary share dividends paid in the year | | | | |
| - Prior year final dividend | **3.42** | **201** | 2.73 | 160 |
| - Current year interim dividend | **1.66** | **97** | 1.33 | 78 |
| | **5.08** | **298** | 4.06 | 238 |
| Ordinary share dividend proposed[1] | **4.74** | **279** | 3.42 | 201 |

1. The dividend proposed has not been included as a liability in the balance sheet.

## 2.11 Financial investments

| | **2011 £m** | 2010 £m |
|---|---|---|
| Equities | **134,594** | 149,056 |
| Unit trusts | **7,487** | 7,550 |
| Debt securities[1] | **149,711** | 136,858 |
| Accrued interest | **1,705** | 1,682 |
| Derivative assets[2] | **6,756** | 4,014 |
| Loans and receivables | **351** | 410 |
| | **300,604** | 299,570 |

There have been no significant transfers between levels 1, 2 and 3 of the fair value hierarchy (as prescribed in IFRS 7 'Financial Instruments: Disclosures') for the year ended 31 December 2011. Further details are provided in Note 4.07.

1. Detailed analysis of debt securities which shareholders are directly exposed to are disclosed in Note 4.02.
2. Derivative exposures arise from efficient portfolio management, especially the use of interest rate swaps, inflation swaps, credit default swaps, foreign exchange forward contracts for asset and liability management and the matching of Guaranteed Equity Bonds within the Nationwide portfolio. Derivative assets are shown gross of derivative liabilities and include £3,174m (2010: £2,217m) held on behalf of unit linked policyholders.

## Notes to the Financial Statements
## 2.12 Share capital and share premium

| Authorised share capital | 2011 Number of shares | 2011 £m | 2010 Number of shares | 2010 £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 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** |

| Issued share capital, fully paid | Number of shares | Share capital £m | Share premium £m |
|---|---|---|---|
| **As at 1 January 2010** | 5,862,216,780 | 147 | 936 |
| Options exercised under share option schemes | | | |
| - Executive share option scheme | 295,065 | - | - |
| - Savings related share option scheme | 4,157,478 | - | 2 |
| **As at 31 December 2010** | 5,866,669,323 | 147 | 938 |

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.

## Notes to the Financial Statements
## 2.13 Segmental analysis of shareholders' equity

| | 2011 £m | 2010 £m |
|---|---|---|
| **Risk** | | |
| General insurance | **148** | 120 |
| Other | **6** | 3 |
| **Total Risk** | **154** | 123 |
| **Savings** | | |
| Savings investments | **136** | 121 |
| Other | **19** | 21 |
| **Total Savings** | **155** | 142 |
| **Investment management** | **351** | 324 |
| **International** | | |
| USA (LGA)[1] | **1,054** | 1,281 |
| Netherlands (LGN)[2] | **118** | 165 |
| France (LGF) | **196** | 181 |
| Emerging markets | **39** | 37 |
| **Total International** | **1,407** | 1,664 |
| **Group capital and financing** | **3,133** | 2,574 |
| **Shareholders' equity** | **5,200** | 4,827 |

1. The decrease in LGA reflects the repayment of £244m of capital provided by Group to complete the first phase of the LGA capital restructuring programme in 2010 and £51m from the repatriation of profits from the capital restructuring driven by the redemption of external debt.
2. The decrease in LGN has been largely driven by the €35m special dividend paid to Group during the year.

The Group has five reporting segments comprising Risk, Savings, Investment management, International, and Group capital and financing.

The Risk segment comprises individual and group protection, individual and bulk purchase annuities, and general insurance, together with estate agencies and the housing related business conducted through our regulated mortgage network.

The Savings segment comprises non profit investment bonds, non profit pensions (including SIPPs), ISAs, retail unit trusts, and all with-profits products. 'Other' principally comprises the Group's interest in Cofunds.

The Investment management segment comprises institutional fund management and institutional unit trust business.

Shareholders' equity supporting the non profit Risk 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, and do not constitute a separately reportable segment.

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 operating profit before tax. Segmental IFRS 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.

## Notes to the Financial Statements
## 2.14 Borrowings

| | 2011 £m | 2010 £m |
|---|---|---|
| **Subordinated borrowings** | | |
| 6.385% Sterling perpetual capital securities (Tier 1) | **721** | 690 |
| 5.875% Sterling undated subordinated notes (Tier 2) | **421** | 423 |
| 4.0% Euro subordinated notes 2025 (Tier 2) | **483** | 488 |
| 10% Sterling subordinated notes 2041 (Tier 2) | **309** | 308 |
| Client fund holdings of Group debt[1] | **(13)** | (12) |
| **Total subordinated borrowings** | **1,921** | 1,897 |
| | | |
| **Senior borrowings** | | |
| Sterling medium term notes 2031-2041 | **608** | 608 |
| Euro Commercial paper | **246** | 279 |
| Bank loans/other | **8** | 9 |
| Client fund holdings of Group debt[1] | **(51)** | (45) |
| **Total senior borrowings (excluding non recourse)** | **811** | 851 |
| **Total borrowings (excluding non recourse)** | **2,732** | 2,748 |
| | | |
| Non recourse | | |
| - US Dollar Triple X securitisation 2025 | **-** | 61 |
| - US Dollar Triple X securitisation 2037 | **286** | 283 |
| - Suffolk Life unit linked borrowings | **136** | 154 |
| - LGV 6/LGV 7 Private Equity Fund Limited Partnership | **96** | 86 |
| **Total senior borrowings (including non recourse)** | **1,329** | 1,435 |
| **Total borrowings** | **3,250** | 3,332 |

1. £64m (2010: £57m) of the Group's subordinated and senior debt is currently held by Legal & General customers through unit linked products. These borrowings are shown as a deduction from total borrowings in the tables above.

## Notes to the Financial Statements

## 2.14 Borrowings (continued)

**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.

**Non recourse financing**

*US Dollar Triple X securitisation 2025*
In 2004, a subsidiary of LGA issued US$550m of non recourse debt in the US capital markets to meet the Triple X reserve requirements of part of the US term insurance written up to 2005. It is secured on the cash flows related to that tranche of business. As at 31 December 2011, all of the outstanding debt had been redeemed and cancelled.

*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.

*Suffolk Life unit linked borrowings*
These borrowings relate solely to client investments.

*LGV6/LGV7 Private Equity Fund Limited Partnership*
These borrowings are non recourse bank borrowings.

**Syndicated credit facility**

As at 31 December 2011, 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 2016. This facility which was entered into in October 2011 replaces syndicated and bilateral facilities totalling £1.02bn which had been due to expire in December 2012. No drawings were made under any of these facilities during 2011.

**Holding company short term assets**

Short term assets available at the holding company level exceeded the amount of non-unit linked short term borrowings of £254m (2010: £288m). They comprise Euro Commercial Paper and Bank Loans.

## Notes to the Financial Statements
## 2.15 Insurance contract liabilities
## (a) Analysis of insurance contract liabilities

| | Notes | **Gross 2011 £m** | **Re-insurance 2011 £m** | Gross 2010 £m | Re-insurance 2010 £m |
|---|---|---|---|---|---|
| Participating insurance contracts | 2.15(b) | **8,750** | **(1)** | 9,383 | (1) |
| Non-participating insurance contracts[1] | 2.15(c) | **33,761** | **(2,110)** | 31,064 | (2,096) |
| General insurance contracts | 2.15(d) | **245** | **(6)** | 261 | (6) |
| **Insurance contract liabilities** | | **42,756** | **(2,117)** | 40,708 | (2,103) |

1. Excluding General insurance contracts.

During the year, the Group entered into prospective reinsurance arrangements which resulted in a profit of £173m (2010: £137m). This profit has been reflected in the consolidated income statement for the year.

## (b) Movement in participating insurance contract liabilities

| | **Gross 2011 £m** | **Re-insurance 2011 £m** | Gross 2010 £m | Re-insurance 2010 £m |
|---|---|---|---|---|
| **As at 1 January** | **9,383** | **(1)** | 9,404 | (1) |
| New liabilities in the year | **374** | **-** | 483 | - |
| Liabilities discharged in the year | **(1,435)** | **-** | (1,273) | - |
| Unwinding of discount rates | **85** | **-** | 69 | - |
| Effect of change in non-economic assumptions | **(26)** | **-** | 45 | - |
| Effect of change in economic assumptions | **357** | **-** | 658 | - |
| Other | **12** | **-** | (3) | - |
| **As at 31 December** | **8,750** | **(1)** | 9,383 | (1) |

## Notes to the Financial Statements
## 2.15 Insurance contract liabilities (continued)
## (c) Movement in non-participating insurance contract liabilities

| | **Gross 2011 £m** | **Re-insurance 2011 £m** | Gross 2010 £m | Re-insurance 2010 £m |
|---|---|---|---|---|
| **As at 1 January** | **31,064** | **(2,096)** | 28,353 | (1,902) |
| New liabilities in the year | **2,687** | **(309)** | 2,122 | (330) |
| Liabilities discharged in the year | **(2,018)** | **144** | (1,818) | 163 |
| Unwinding of discount rates | **1,321** | **(123)** | 1,299 | (125) |
| Effect of change in non-economic assumptions | **(403)** | **389** | (151) | 108 |
| Effect of change in economic assumptions[1] | **1,133** | **(111)** | 1,277 | (1) |
| Foreign exchange adjustments | **(23)** | **(4)** | (18) | (8) |
| Other | **-** | **-** | - | (1) |
| **As at 31 December** | **33,761** | **(2,110)** | 31,064 | (2,096) |

1. The economic assumptions changes in 2011 principally reflect the reduction in risk free yields over the course of 2011.

## (d) Analysis of General insurance contract liabilities

| | **Gross 2011 £m** | **Re-insurance 2011 £m** | Gross 2010 £m | Re-insurance 2010 £m |
|---|---|---|---|---|
| Outstanding claims | **76** | **(1)** | 99 | (1) |
| Claims incurred but not reported | **17** | **-** | 28 | - |
| Unearned premiums | **152** | **(5)** | 134 | (5) |
| **General insurance contract liabilities** | **245** | **(6)** | 261 | (6) |

## (e) Movement in General insurance claim liabilities

| | **Gross 2011 £m** | **Re-insurance 2011 £m** | Gross 2010 £m | Re-insurance 2010 £m |
|---|---|---|---|---|
| **As at 1 January** | **127** | **(1)** | 110 | (3) |
| Claims arising | **172** | **-** | 199 | (1) |
| Claims paid | **(179)** | **-** | (161) | 3 |
| Adjustments to prior year liabilities | **(27)** | **-** | (21) | - |
| **As at 31 December** | **93** | **(1)** | 127 | (1) |

## Notes to the Financial Statements
## 2.16 Investment contract liabilities
## (a) Analysis of investment contract liabilities

| | Gross 2011 £m | Re-insurance 2011 £m | Gross 2010 £m | Re-insurance 2010 £m |
|---|---|---|---|---|
| Participating investment contracts | **7,276** | **-** | 7,323 | - |
| Non-participating investment contracts | **251,345** | **(172)** | 253,426 | (233) |
| **Investment contract liabilities** | **258,621** | **(172)** | 260,749 | (233) |

## (b) Movement in investment contract liabilities

| | Gross 2011 £m | Re-insurance 2011 £m | Gross 2010 £m | Re-insurance 2010 £m |
|---|---|---|---|---|
| **As at 1 January** | **260,749** | **(233)** | 241,641 | (181) |
| Reserves in respect of new business | **28,500** | **(1,431)** | 30,088 | (1,474) |
| Amounts paid on surrenders and maturities during the year | **(39,419)** | **744** | (38,647) | 1,029 |
| Investment return and related benefits | **9,168** | **748** | 28,064 | 393 |
| Management charges | **(315)** | **-** | (322) | - |
| Foreign exchange adjustments | **(59)** | **-** | (75) | - |
| Other | **(3)** | **-** | - | - |
| **As at 31 December** | **258,621** | **(172)** | 260,749 | (233) |

Fair value movements of £(9,813)m (2010: £(27,604)m) are included within the income statement arising from movements in investment contract liabilities designated as FVTPL.

## 2.17 Sensitivity analysis

| **UK long term business** | **Impact on pre-tax profit net of re-insurance 2011 £m** | **Impact on equity net of re-insurance 2011 £m** | Impact on pre-tax profit net of re-insurance 2010 £m | Impact on equity net of re-insurance 2010 £m |
|---|---|---|---|---|
| **Sensitivity test** | | | | |
| 1% increase in interest rates | **49** | **36** | 35 | 25 |
| 1% decrease in interest rates | **(142)** | **(104)** | 1 | 1 |
| Credit spread widens by 100bps with no change in expected defaults | **(52)** | **(38)** | (76) | (55) |
| 1% increase in inflation | **37** | **28** | 17 | 12 |
| Default of largest reinsurer | **(694)** | **(510)** | (681) | (490) |
| 1% decrease in annuitant mortality | **(76)** | **(55)** | (66) | (47) |

The table above shows the impact on pre-tax profit and equity, net of reinsurance, under each sensitivity scenario for the non-participating business written in the non profit part of the UK LTF.

## Notes to the Financial Statements
## 2.17 Sensitivity analysis (continued)

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. In a scenario where the bases are not adjusted for regulatory restrictions i.e. changes to the reinvestment rate are ignored the sensitivity to a +/-1% interest rate movement would be +/-£7m.

* 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.

| General insurance | **Impact on pre-tax profit net of re-insurance 2011 £m** | **Impact on equity net of re-insurance 2011 £m** | Impact on pre-tax profit net of re-insurance 2010 £m | Impact on equity net of re-insurance 2010 £m |
|---|---|---|---|---|
| **Sensitivity test** | | | | |
| Single storm event with 1 in 200 year probability | **(90)** | **(66)** | (55) | (40) |
| Subsidence event – worst claims ratio in last 30 years | **(41)** | **(30)** | (39) | (28) |
| Economic downturn | **(43)** | **(32)** | (38) | (28) |
| 5% decrease in overall claims ratio | **9** | **7** | 9 | 6 |
| 5% surplus over claims liabilities | **5** | **3** | 6 | 4 |

## 2.18 Foreign exchange rates

Principal rates of exchange used for translation are:

| Year end exchange rates | **2011** | 2010 |
|---|---|---|
| United States Dollar | **1.55** | 1.57 |
| Euro | **1.20** | 1.17 |

| Average exchange rates | **01.01.11 - 31.12.11** | 01.01.10 - 31.12.10 |
|---|---|---|
| United States Dollar | **1.60** | 1.55 |
| Euro | **1.15** | 1.17 |

## Notes to the Financial Statements
## 2.19 Provisions
### (a) Analysis of provisions

| | Note | **2011 £m** | 2010 £m |
|---|---|---|---|
| Retirement benefit obligations | (b) | **871** | 748 |
| Other provisions | | **20** | 13 |
| | | **891** | 761 |

### (b) Retirement benefit obligations

| | **Fund and Scheme 2011 £m** | **Overseas 2011 £m** | Fund and Scheme 2010 £m | Overseas 2010 £m |
|---|---|---|---|---|
| Gross pension obligations included in provisions | **(870)** | **(1)** | (749) | 1 |
| Annuity obligations insured by Society | **583** | **-** | 514 | - |
| **Gross defined benefit pension deficit** | **(287)** | **(1)** | (235) | 1 |
| Deferred tax on defined benefit pension deficit | **72** | **-** | 66 | - |
| **Net defined benefit pension deficit** | **(215)** | **(1)** | (169) | 1 |

The Legal & General Group UK Pension and Assurance Fund and the Legal & General Group UK Senior Pension Scheme are defined benefit pension arrangements and account for all UK and the majority of worldwide assets of, and contributions to, such arrangements. At 31 December 2011, the combined after tax deficit arising from these arrangements (net of annuity obligations insured by Society) has been estimated at £215m (2010: £169m). These amounts have been recognised in the financial statements with £128m charged against shareholder equity (2010: £100m) and £87m against the unallocated divisible surplus (2010: £69m).

## 2.20 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.

## Notes to the Financial Statements
## 2.21 Basis of Preparation

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 International Financial Reporting Interpretations Committee (IFRIC) interpretations 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.

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.

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.

**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 and unquoted and illiquid financial investments; the estimation of deferred acquisition costs; tax balances; and the estimation of insurance and investment contract liabilities. The basis of accounting for these areas is outlined in the respective notes to the financial statements.

**Reportable segments**
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.

The Group has five reporting segments comprising Risk, Savings, Investment management, International, and Group capital and financing.

The Risk 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.

The Savings segment comprises non profit investment bonds, non profit pensions (including SIPPs), ISAs, retail unit trusts, retail platform businesses, and all with-profits products.

The Investment management segment comprises institutional fund management and LGIM America (LGIMA).

The International segment comprises Legal & General America (LGA), Legal & General France (LGF), Legal & General Netherlands (LGN) as well as our joint ventures in emerging markets.

Shareholders' equity supporting the non profit Risk 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.

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.

**Notes to the Financial Statements**

# Net Cash and Capital

## 3.01 Operational cash generation

As presented in our H1 2011 results, the operational cash definition for the Group capital and financing segment was amended to be equal to the post-tax operating profit. At 2010, the operational cash definition for the group capital and financing segment represented the post-tax operating profit excluding expected gains/losses on equities. The change in definition aligns the treatment between equities and fixed income securities. The prior year operational cash generation has been amended accordingly and resulted in an increase of £32m. As mentioned in Note 2.05 the rate used to calculate the smoothed return on cash and LIBOR benchmarked bonds has been reduced. The cash rate previously used of 4% has been replaced with a 1 year LIBOR of 1%. This ensures our operating profit and cash metric maintains relevance in current macro economic conditions. The combined change in the methodology and assumption change is broadly neutral on the 2011 operational cash generation.

The table below provides an analysis of the operational cash generated by each of the Group's business segments, together with a reconciliation to profit after tax.

| For the year ended 31 December 2011 | Opera-tional cash gene-ration £m | New busi-ness strain £m | Net cash £m | Exper-ience var-iances £m | Changes in valuation assump-tions £m | Non-cash items £m | Investment gains and losses, inter-national and other £m | IFRS profit/ (loss) after tax £m | Tax exp-ense/ (credit) £m | IFRS profit/ (loss) before tax £m |
|---|---|---|---|---|---|---|---|---|---|---|
| Total Risk operating profit | **482** | **(31)** | **451** | **22** | **24** | **(86)** | **-** | **411** | **150** | **561** |
| Total Savings | | | | | | | | | | |
| operating profit | **174** | **(63)** | **111** | **(12)** | **(5)** | **6** | **(6)** | **94** | **34** | **128** |
| Investment management | | | | | | | | | | |
| operating profit | **189** | **-** | **189** | **-** | **-** | **-** | **-** | **189** | **45** | **234** |
| International | **51** | **-** | **51** | **-** | **-** | **-** | **39** | **90** | **47** | **137** |
| Group capital and financing | **44** | **-** | **44** | **-** | **-** | **-** | **-** | **44** | **8** | **52** |
| Investment projects | **-** | **-** | **-** | **-** | **-** | **-** | **(41)** | **(41)** | **(15)** | **(56)** |
| **Operating profit** | **940** | **(94)** | **846** | **10** | **19** | **(80)** | **(8)** | **787** | **269** | **1,056** |
| Investment variance | **-** | **-** | **-** | **-** | **-** | **-** | **(55)** | **(55)** | **(42)** | **(97)** |
| Impact of change | | | | | | | | | | |
| in UK tax rates | **-** | **-** | **-** | **-** | **-** | **-** | **(6)** | **(6)** | **6** | **-** |
| Property losses attributable | | | | | | | | | | |
| to non-controlling interests | **-** | **-** | **-** | **-** | **-** | **-** | **(3)** | **(3)** | **-** | **(3)** |
| **Total** | **940** | **(94)** | **846** | **10** | **19** | **(80)** | **(72)** | **723** | **233** | **956** |

| For the year ended 31 December 2010 | Opera-tional cash gene-ration £m | New busi-ness strain £m | Net cash £m | Exper-ience var-iances £m | Changes in valuation assump-tions £m | Non-cash items £m | Investment gains and losses, inter-national and other £m | IFRS profit/ (loss) after tax £m | Tax exp-ense/ (credit) £m | IFRS profit/ (loss) before tax £m |
|---|---|---|---|---|---|---|---|---|---|---|
| Total Risk operating profit | 439 | (10) | 429 | 67 | 30 | (122) | (1) | 403 | 157 | 560 |
| Total Savings | | | | | | | | | | |
| operating profit | 138 | (70) | 68 | 10 | 28 | (21) | (5) | 80 | 35 | 115 |
| Investment management | | | | | | | | - | | |
| operating profit | 162 | - | 162 | - | - | - | - | 162 | 44 | 206 |
| International | 44 | - | 44 | - | - | - | 33 | 77 | 25 | 102 |
| Group capital and financing | 57 | - | 57 | - | - | - | - | 57 | 1 | 58 |
| Investment projects | - | - | - | - | - | - | (28) | (28) | (11) | (39) |
| **Operating profit** | 840 | (80) | 760 | 77 | 58 | (143) | (1) | 751 | 251 | 1,002 |
| Investment variance | - | - | - | - | - | - | 74 | 74 | 16 | 90 |
| Impact of change | | | | | | | | | | |
| in UK tax rates | - | - | - | - | - | - | (5) | (5) | 5 | - |
| Property losses attributable | | | | | | | | | | |
| to non-controlling interests | - | - | - | - | - | - | - | - | - | - |
| **Total** | 840 | (80) | 760 | 77 | 58 | (143) | 68 | 820 | 272 | 1,092 |

## 3.02 Regulatory capital resources

### (a) Insurance Group's Directive (IGD)

The Group is required to measure and monitor its capital resources on a regulatory basis and to comply with the minimum capital requirements of regulators in each territory in which it operates. At Group level, Legal & General must comply with the requirements of the IGD. The table below shows the estimated total Group capital resources, Group capital resources requirement and the surplus based on unaudited regulatory returns.

| | At 31.12.11 £bn | At 31.12.10 £bn |
|---|---|---|
| Core tier 1 | **6.0** | 5.9 |
| Innovative tier 1 | **0.6** | 0.6 |
| Upper tier 2 | **0.4** | 0.4 |
| Lower tier 2 | **0.8** | 0.8 |
| Deductions[1] | **(0.9)** | (1.0) |
| **Group capital resources** | **6.9** | 6.7 |
| **Group capital resources requirement[2]** | **3.1** | 3.0 |
| **IGD surplus** | **3.8** | 3.7 |
| **Coverage ratio (Group capital resources / Group capital resources requirement)[3]** | **2.20 times** | 2.26 times |

1. Deductions comprises inadmissible assets in LGA of £0.7bn (2010: £0.8bn), in Society of £0.1bn (2010: £0.1bn) and in other Group companies of £0.1bn (2010: £0.1bn).
2. The Group capital resources requirement includes a With-profits Insurance Capital Component (WPICC) of £0.4bn (2010: £0.3bn).
3. Coverage ratio is calculated on unrounded values.

A segmental analysis is given below.

| | At 31.12.11 £bn | At 31.12.10 £bn |
|---|---|---|
| Society long term fund[1] | **2.8** | 2.6 |
| Society shareholder capital | **2.4** | 2.5 |
| General insurance | **0.1** | 0.1 |
| France (LGF) | **0.2** | 0.2 |
| Netherlands (LGN) | **0.1** | 0.2 |
| Nationwide Life | **0.1** | 0.1 |
| USA (LGA) | **0.2** | 0.5 |
| Investment management | **0.3** | 0.3 |
| Other[2] | **1.5** | 1.1 |
| Innovative tier 1 | **0.6** | 0.6 |
| Tier 2 | **1.2** | 1.2 |
| Debt | **(2.6)** | (2.7) |
| **Group capital resources** | **6.9** | 6.7 |
| Society long term fund[1] | **2.8** | 2.6 |
| Other | **0.3** | 0.4 |
| **Group capital resources requirement** | **3.1** | 3.0 |

1. The Society LTF capital requirement of £2.8bn (2010: £2.6bn) is met by £2.8bn (2010: £2.9bn) of capital resources in the LTF and £nil (2010: £nil) of capital outside the LTF.
2. Other includes corporate assets held within the Group's treasury function.

### 3.02 Regulatory capital resources (continued)
### (a) Insurance Group's Directive (IGD) (continued)

A reconciliation of the Group capital resources on an IGD basis to the capital and reserves attributable to the equity holders of the Company on an IFRS basis is given below.

| | **At 31.12.11 £bn** | At 31.12.10 £bn |
|---|---|---|
| Capital and reserves attributable to equity holders on an IFRS basis | **5.2** | 4.8 |
| Innovative tier 1 | **0.6** | 0.6 |
| Tier 2 | **1.2** | 1.2 |
| Proposed dividends | **(0.3)** | (0.2) |
| Additional capital available from Society | **0.9** | 1.1 |
| Adjustment to reflect regulatory value of the LGA operation | **(0.7)** | (0.8) |
| Other regulatory adjustments | - | - |
| **Group capital resources** | **6.9** | 6.7 |

### (b) With-profits realistic balance sheet

The table below summarises the realistic position of the with-profits part of Society's LTF:

| | **At 31.12.11 £bn** | At 31.12.10 £bn |
|---|---|---|
| With-profits surplus | **0.7** | 0.9 |
| Risk capital margin | **0.1** | 0.2 |
| **Surplus** | **0.6** | 0.7 |

Society is required to maintain a surplus in the with-profits part of the fund on a realistic basis (Peak 2). The risk capital margin is calculated based on the most onerous capital requirement calculated after performing five stresses specified by the FSA. The surplus includes the present value of future shareholder transfers of £0.2bn (2010: £0.4bn) as a liability in the calculation.

### (c) Society capital surplus

Society is required to measure and monitor its capital resources on a regulatory basis.

| | **At 31.12.11 Long term business £bn** | **At 31.12.11 General insu-rance £bn** | At 31.12.10 Long term business £bn | At 31.12.10 General insu-rance £bn |
|---|---|---|---|---|
| **Available capital resources - Tier 1** | **5.6** | **0.1** | 5.6 | 0.1 |
| Insurance capital requirement | **2.4** | **0.1** | 2.3 | 0.1 |
| Capital requirements of regulated related undertakings | **0.2** | **-** | 0.2 | - |
| With-profits Insurance Capital Component | **0.4** | **-** | 0.3 | - |
| **Capital resources requirement** | **3.0** | **0.1** | 2.8 | 0.1 |
| **Regulatory capital surplus** | **2.6** | **-** | 2.8 | - |

## 3.02 Regulatory capital resources (continued)
## (c) Society capital surplus (continued)
**Movement in Society long term insurance capital requirement**

| Pillar 1 capital requirement | At 31.12.11 £bn | At 31.12.10 £bn |
|---|---|---|
| Protection | **0.7** | 0.6 |
| Annuities | **1.0** | 0.9 |
| Non profit pensions and unit linked bonds | **0.1** | 0.1 |
| Non profit | **1.8** | 1.6 |
| With-profits | **0.6** | 0.7 |
| **Long term insurance capital requirement** | **2.4** | 2.3 |

On a regulatory basis (Peak 1), Society long term business regulatory capital surplus of £2.6bn (2010: £2.8bn) comprises capital resources within the long term fund of £2.8bn (2010: £2.6bn) and capital resources outside the long term fund of £2.8bn (2010: £3.0bn) less the capital resources requirement of £3.0bn (2010: £2.8bn).

The With-profits Insurance Capital Component (WPICC) is an additional capital requirement calculated if the surplus in the with-profits fund on a Peak 2 basis is lower than on a Peak 1 basis and represents the difference in the surplus between the two bases. It is calculated based on the most onerous risk capital margin stress referred to in 3.02 (b). A further adjustment is made to the Peak 2 surplus to remove the present value of future shareholder transfers which is treated as a liability in Society's with-profits realistic surplus. At 31 December 2011, this adjustment amounted to £0.2bn (2010: £0.4bn).

# Asset Disclosures

## 4.01 Investment portfolio

| | **Market value 2011 £m** | Market value 2010 £m |
|---|---|---|
| Worldwide assets under management | **378,573** | 364,846 |
| Client and policyholder assets | **(320,228)** | (310,546) |
| Non-unit linked with-profits assets[1] | **(18,927)** | (19,927) |
| **Assets to which shareholders are directly exposed** | **39,418** | 34,373 |
| | | |
| Comprising: | | |
| Assets held to back the UK non-linked non profit business: | | |
| Legal & General Pensions Limited (LGPL)[2] | **30,029** | 25,107 |
| Other UK non profit insurance business | **285** | 642 |
| | **30,314** | 25,749 |
| Assets held to back other insurance businesses (including Triple-X reserves) | **3,172** | 3,280 |
| Group capital and financing assets[3] | **4,344** | 3,656 |
| Other shareholder assets[3] | **1,588** | 1,688 |
| | **39,418** | 34,373 |

1. Includes assets backing participating business in LGF of £2,277m (2010: £2,304m).
2. LGPL is the main operating subsidiary for the UK's annuity business.
3. The presentation of shareholder assets has been amended to align the presentation with the Group's reporting segments. 2010 comparatives have been restated accordingly.

**Analysed by asset class:**

| | Note | **LGPL 2011 £m** | **Other UK non profit insurance business 2011 £m** | **Other insurance business 2011 £m** | **Group capital and financing assets 2011 £m** | **Other share-holder assets 2011 £m** | **Total 2011 £m** | Total 2010 £m |
|---|---|---|---|---|---|---|---|---|
| Equities | | **-** | **-** | **-** | **905** | **8** | **913** | 975 |
| Bonds | 4.02 | **26,319** | **62** | **2,968** | **1,812** | **1,067** | **32,228** | 28,870 |
| Derivative assets[1] | | **2,939** | **168** | **9** | **299** | **-** | **3,415** | 1,713 |
| Property | | **486** | **-** | **-** | **107** | **13** | **606** | 275 |
| Cash (including cash equivalents) | | **285** | **55** | **195** | **1,221** | **500** | **2,256** | 2,540 |
| | | **30,029** | **285** | **3,172** | **4,344** | **1,588** | **39,418** | 34,373 |

1. Derivative assets are shown gross of derivative liabilities. Exposures arise from:
a. The use of derivatives for efficient portfolio management, especially the use of interest rate swaps, inflation swaps, credit default swaps and foreign exchange forward contracts for asset and liability management.
b. Derivatives matching guaranteed equity bonds within the Nationwide Life portfolio.

## 4.02 Bond portfolio summary
### (a) Analysed by sector

| | Notes | LGPL 2011 £m | LGPL 2011 % | **Total 2011 £m** | **Total 2011 %** |
|---|---|---|---|---|---|
| Sovereigns, Supras and Sub-Sovereigns | | 4,072 | 15 | **6,188** | **19** |
| Banks: | | | | | |
| - Tier 1[1] | 4.04 | 236 | 1 | **259** | **1** |
| - Tier 2 and other subordinated | 4.04 | 1,177 | 4 | **1,338** | **4** |
| - Senior | | 1,463 | 5 | **2,234** | **7** |
| Utilities | | 3,457 | 13 | **3,722** | **12** |
| Consumer Services and Goods | | 2,557 | 10 | **2,928** | **9** |
| Financial Services | | 941 | 4 | **1,179** | **4** |
| Technology and Telecoms | | 1,902 | 7 | **2,209** | **7** |
| Insurance | | 968 | 4 | **1,120** | **3** |
| Industrials | | 1,265 | 5 | **1,515** | **5** |
| Oil and Gas | | 1,614 | 6 | **1,837** | **6** |
| Health Care | | 748 | 3 | **786** | **2** |
| Property | | 577 | 2 | **640** | **2** |
| Traditional and secured asset backed securities | 4.03 | 4,344 | 17 | **5,275** | **16** |
| CDO | 4.02(d) | 998 | 4 | **998** | **3** |
| **Total** | | 26,319 | 100 | **32,228** | **100** |

| | Notes | LGPL 2010 £m | LGPL 2010 % | Total 2010 £m | Total 2010 % |
|---|---|---|---|---|---|
| Sovereigns, Supras and Sub-Sovereigns | | 3,042 | 13 | 5,034 | 17 |
| Banks: | | | | | |
| - Tier 1[1] | 4.04 | 480 | 2 | 513 | 2 |
| - Tier 2 and other subordinated | 4.04 | 1,619 | 7 | 1,811 | 6 |
| - Senior | | 1,448 | 6 | 2,168 | 8 |
| Utilities | | 2,831 | 12 | 3,033 | 11 |
| Consumer Services and Goods | | 2,160 | 9 | 2,503 | 9 |
| Financial Services | | 776 | 3 | 1,036 | 4 |
| Technology and Telecoms | | 1,538 | 7 | 1,768 | 6 |
| Insurance | | 978 | 5 | 1,103 | 4 |
| Industrials | | 1,124 | 5 | 1,299 | 4 |
| Oil and Gas | | 1,321 | 6 | 1,509 | 5 |
| Health Care | | 551 | 2 | 563 | 2 |
| Property | | 552 | 2 | 588 | 2 |
| Traditional and secured asset backed securities | 4.03 | 3,996 | 17 | 4,920 | 16 |
| CDO | 4.02(d) | 1,017 | 4 | 1,022 | 4 |
| **Total** | | 23,433 | 100 | 28,870 | 100 |

1. Tier 1 holdings include £49m (2010: £55m) of preference shares.

### 4.02 Bond portfolio summary
### (b) Analysed by domicile

| | Note | LGPL 2011 £m | **Total 2011 £m** | LGPL 2010 £m | Total 2010 £m |
|---|---|---|---|---|---|
| **Market value by region** | | | | | |
| United Kingdom | | 10,387 | **11,758** | 9,246 | 10,517 |
| USA | | 8,040 | **10,548** | 7,528 | 9,790 |
| Netherlands | | 1,226 | **1,830** | 935 | 1,578 |
| France | | 1,124 | **1,523** | 1,015 | 1,359 |
| Italy | | 543 | **652** | 398 | 505 |
| Germany | | 445 | **761** | 282 | 600 |
| Ireland[1] | | 213 | **225** | 239 | 300 |
| Spain | | 187 | **236** | 181 | 218 |
| Belgium | | 23 | **79** | - | - |
| Portugal | | 41 | **45** | 64 | 76 |
| Greece | | - | **-** | - | 15 |
| Europe - Other | | 994 | **1,324** | 1,197 | 1,483 |
| Rest of World | | 2,098 | **2,249** | 1,331 | 1,407 |
| CDO | 4.02(d) | 998 | **998** | 1,017 | 1,022 |
| **Total** | | 26,319 | **32,228** | 23,433 | 28,870 |

1. Within LGPL, out of the £213m of bonds domiciled in Ireland, £187m relate to financing vehicles where the underlying exposure lies outside Ireland.

The table above is based on the legal domicile of the security.

**Additional analysis of sovereign debt exposures**

| | **Sovereigns, Supras and Sub-Sovereigns** | | | |
|---|---|---|---|---|
| | LGPL 2011 £m | **Total 2011 £m** | LGPL 2010 £m | Total 2010 £m |
| **Market value by region** | | | | |
| United Kingdom[1] | 2,694 | **3,205** | 1,909 | 2,366 |
| USA | 380 | **782** | 276 | 524 |
| Netherlands | 15 | **468** | 28 | 553 |
| France | 119 | **317** | 117 | 251 |
| Italy | 201 | **281** | 77 | 189 |
| Germany | 143 | **386** | 131 | 359 |
| Ireland | - | **4** | 29 | 45 |
| Spain | - | **29** | - | 43 |
| Belgium | - | **40** | - | 31 |
| Portugal | - | **3** | - | 12 |
| Greece | - | **-** | - | 15 |
| Europe - Other | 448 | **602** | 413 | 543 |
| Rest of World | 72 | **71** | 62 | 103 |
| **Total** | 4,072 | **6,188** | 3,042 | 5,034 |

1. LGPL holds liquidity in the form of cash and cash equivalents of £285m (2010: £496m) and gilts of £2,694m (2010: £1,909m).

## 4.02 Bond portfolio summary (continued)
### (c) Analysed by credit rating

| | LGPL 2011 £m | LGPL 2011 % | **Total 2011 £m** | **Total 2011 %** |
|---|---|---|---|---|
| AAA | 4,685 | 18 | **7,328** | **23** |
| AA | 2,896 | 11 | **3,657** | **11** |
| A | 9,710 | 37 | **11,290** | **35** |
| BBB | 6,876 | 26 | **7,721** | **24** |
| BB or below | 417 | 2 | **481** | **1** |
| Unrated: Bespoke CDOs | 872 | 3 | **872** | **3** |
| Other[1] | 863 | 3 | **879** | **3** |
| | 26,319 | 100 | **32,228** | **100** |

| | LGPL 2010 £m | LGPL 2010 % | Total 2010 £m | Total 2010 % |
|---|---|---|---|---|
| AAA | 4,218 | 18 | 6,996 | 24 |
| AA | 2,444 | 10 | 3,092 | 11 |
| A | 8,949 | 39 | 10,125 | 35 |
| BBB | 5,718 | 24 | 6,424 | 22 |
| BB or below | 379 | 2 | 479 | 2 |
| Unrated: Bespoke CDOs | 912 | 4 | 912 | 3 |
| Other[1] | 813 | 3 | 842 | 3 |
| | 23,433 | 100 | 28,870 | 100 |

1. Other unrated bonds have been assessed and rated internally and are all assessed as investment grade.

## 4.02 Bond portfolio summary (continued)
## (d) CDOs

The Group holds collateralised debt obligations (CDOs) with a market value of £998m at 31 December 2011 (2010: £1,022m).

These holdings include £846m (2010: £875m) 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 no substitutions were made in 2010 and substitutions in 2011 were limited. A breakdown of the underlying CDO reference portfolio by sector is provided below:

**Sector**

| | **2011 %** | 2010 % |
|---|---|---|
| Banks | **14** | 14 |
| Utilities | **10** | 10 |
| Consumer Services & Goods | **25** | 26 |
| Financial Services | **6** | 6 |
| Technology & Telecoms | **9** | 9 |
| Insurance | **6** | 6 |
| Industrials | **20** | 20 |
| Oil & Gas | **6** | 6 |
| Health Care | **4** | 3 |
| | **100** | 100 |

The CDOs are termed as super senior since default losses on the reference portfolio have to exceed 27.5%, 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 27.5% 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 2010 or 2011.

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 2011 (2010: £nil). During the year, the Group received £nil (2010: £155m) 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.

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 £152m (2010: £147m) of CDO holdings includes a £26m (2010: £37m) exposure to an equity tranche of a bespoke CDO.

## 4.03 Traditional and secured asset backed securities summary
### (a) By security

| | LGPL 2011 £m | LGPL 2011 % | **Total 2011 £m** | **Total 2011 %** |
|---|---|---|---|---|
| **Traditional asset backed securities:** | | | | |
| Residential Mortgage-Backed Securities - Prime[1] | 416 | 10 | **680** | **13** |
| Residential Mortgage-Backed Securities - Sub-prime[2] | - | - | **20** | **-** |
| Commercial Mortgage-Backed Securities | 245 | 6 | **450** | **9** |
| Credit Card | 2 | - | **134** | **3** |
| Auto | 11 | - | **113** | **2** |
| Consumer Loans | 37 | 1 | **40** | **1** |
| Student Loans | 20 | - | **26** | **-** |
| | 731 | 17 | **1,463** | **28** |
| **Securitisations and debentures:** | | | | |
| Secured Bond | 1,935 | 45 | **1,975** | **37** |
| Commercial Property Backed Bonds | 236 | 5 | **236** | **5** |
| Infrastructure / Private Finance Initiative / Social housing | 1,104 | 25 | **1,168** | **22** |
| Whole Business Securitisation | 299 | 7 | **302** | **6** |
| Other secured holdings[3] | 39 | 1 | **131** | **2** |
| | 3,613 | 83 | **3,812** | **72** |
| **Total traditional and secured asset backed securities** | 4,344 | 100 | **5,275** | **100** |

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.

| | LGPL 2010 £m | LGPL 2010 % | Total 2010 £m | Total 2010 % |
|---|---|---|---|---|
| **Traditional asset backed securities:** | | | | |
| Residential Mortgage-Backed Securities - Prime[1] | 453 | 11 | 714 | 15 |
| Residential Mortgage-Backed Securities - Sub-prime[2] | - | - | 18 | - |
| Commercial Mortgage-Backed Securities | 242 | 6 | 439 | 9 |
| Credit Card | 12 | - | 242 | 5 |
| Auto | 12 | - | 128 | 3 |
| Consumer Loans | 41 | 1 | 47 | 1 |
| Student Loans | 20 | 1 | 39 | 1 |
| | 780 | 19 | 1,627 | 34 |
| **Securitisations and debentures:** | | | | |
| Secured Bond | 1,668 | 42 | 1,687 | 34 |
| Commercial Property Backed Bonds | 227 | 6 | 230 | 5 |
| Infrastructure / Private Finance Initiative / Social housing | 1,002 | 25 | 1,004 | 20 |
| Whole Business Securitisation | 267 | 7 | 269 | 5 |
| Other secured holdings[3] | 52 | 1 | 103 | 2 |
| | 3,216 | 81 | 3,293 | 66 |
| **Total traditional and secured asset backed securities** | 3,996 | 100 | 4,920 | 100 |

1. 56% (2010: 54%) of Prime RMBS holdings relate to UK mortgages.
2. 55% (2010: 52%) of Sub-prime RMBS holdings have a credit rating of AAA and 71% (2010: 54%) relate to the UK.
3. Other secured holdings in LGPL include covered bonds of £29m (2010: £17m).

## 4.03 Traditional and secured asset backed securities summary (continued)
### (b) By credit rating

| | LGPL 2011 £m | LGPL 2011 % | **Total 2011 £m** | **Total 2011 %** |
|---|---|---|---|---|
| AAA | 802 | 18 | **1,411** | **27** |
| AA | 1,077 | 25 | **1,202** | **23** |
| A | 1,604 | 37 | **1,661** | **31** |
| BBB | 634 | 15 | **739** | **14** |
| BB or below | 81 | 2 | **114** | **2** |
| Unrated | 146 | 3 | **148** | **3** |
| **Total** | 4,344 | 100 | **5,275** | **100** |

| | LGPL 2010 £m | LGPL 2010 % | Total 2010 £m | Total 2010 % |
|---|---|---|---|---|
| AAA | 1,223 | 31 | 1,939 | 39 |
| AA | 788 | 20 | 848 | 17 |
| A | 1,263 | 31 | 1,314 | 27 |
| BBB | 567 | 14 | 626 | 13 |
| BB or below | 23 | 1 | 61 | 1 |
| Unrated | 132 | 3 | 132 | 3 |
| **Total** | 3,996 | 100 | 4,920 | 100 |

Of the £733m (2010: £847m) of traditional ABS holdings held outside of LGPL, 65% are rated AAA (2010: 79%).

The credit ratings of monoline wrapped bonds are based on the rating of the underlying securities.

## 4.04 Group subordinated bank exposures

| | Total 2011 £m | Total 2011 % | Total 2010 £m | Total 2010 % |
|---|---|---|---|---|
| **Tier 1** | | | | |
| United Kingdom[1] | **139** | **9** | 244 | 10 |
| USA | **47** | **3** | 119 | 5 |
| Europe | **61** | **4** | 114 | 5 |
| Others | **12** | **1** | 36 | 2 |
| **Total tier 1** | **259** | **17** | 513 | 22 |
| **Lower tier 2** | | | | |
| United Kingdom | **586** | **36** | 806 | 35 |
| USA | **394** | **25** | 520 | 22 |
| Europe | **142** | **9** | 184 | 8 |
| Others | **68** | **4** | 79 | 3 |
| **Upper tier 2** | | | | |
| United Kingdom | **63** | **4** | 94 | 4 |
| USA | **1** | **-** | 19 | 1 |
| Europe | **39** | **2** | 55 | 3 |
| Others | **2** | **-** | 3 | - |
| **Other subordinated** | | | | |
| United Kingdom | **-** | **-** | - | - |
| USA | **43** | **3** | 51 | 2 |
| Europe | **-** | **-** | - | - |
| Others | **-** | **-** | - | - |
| **Total tier 2 and other subordinated** | **1,338** | **83** | 1,811 | 78 |
| **Total** | **1,597** | **100** | 2,324 | 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.

## 4.05 Value of policyholder assets held in Society and LGPL

| | 2011 £m | 2010 £m |
|---|---|---|
| With-profits business | **24,862** | 26,442 |
| Non profit business | **42,516** | 40,244 |
| | **67,378** | 66,686 |

## 4.06 With-profits non-linked business invested asset mix and investment return

| **As at 31 December 2011** | **Investment return %** | **UK with-profits asset share %** | **UK with-profits non par %** | **UK with-profits other %** |
|---|---|---|---|---|
| Equities | **(8)** | **38** | **3** | **(47)** |
| Bonds | **9** | **40** | **88** | **139** |
| Property | **5** | **15** | **-** | **-** |
| Cash | **1** | **7** | **9** | **8** |
| | | **100** | **100** | **100** |
| **Investment return (% pa)** | **4** | **2** | **8** | **19** |
| **Invested assets (£bn):** | | | | |
| **Net of derivative liabilities** | | **12.4** | **2.4** | **1.8** |
| **Gross of derivative liabilities** | | **12.5** | **2.4** | **1.8** |

| As at 31 December 2010 | | | | |
|---|---|---|---|---|
| Equities | 13 | 40 | 3 | (65) |
| Bonds | 9 | 39 | 86 | 153 |
| Property | 17 | 15 | - | (1) |
| Cash | 1 | 6 | 11 | 13 |
| | | 100 | 100 | 100 |
| Investment return (% pa) | 10 | 12 | 8 | 4 |
| Invested assets (£bn): | | | | |
| Net of derivative liabilities | | 13.8 | 2.4 | 1.5 |
| Gross of derivative liabilities | | 14.0 | 2.4 | 1.5 |

All investment return percentages reflect actual investment returns on average asset holdings for the period.

## 4.07 Analysis of fair value measurement bases

| As at 31 December 2011 | Fair value measurement at the end of the reporting period based on: Level 1 £m | Level 2 £m | Level 3 £m | Total £m |
|---|---|---|---|---|
| **Group capital and other insurance business** | | | | |
| Equities | **564** | **221** | **128** | **913** |
| Bonds[1] | **2,058** | **3,783** | **6** | **5,847** |
| Derivative assets | **13** | **295** | **-** | **308** |
| | **2,635** | **4,299** | **134** | **7,068** |
| **Non profit non-unit linked** | | | | |
| Bonds[1] | **3,440** | **22,941** | **-** | **26,381** |
| Derivative assets | **255** | **2,820** | **32** | **3,107** |
| | **3,695** | **25,761** | **32** | **29,488** |

| As at 31 December 2010 | Fair value measurement at the end of the reporting period based on: Level 1 £m | Level 2 £m | Level 3 £m | Total £m |
|---|---|---|---|---|
| Group capital and other insurance business | | | | |
| Equities | 730 | 115 | 130 | 975 |
| Bonds[1] | 2,093 | 3,134 | 9 | 5,236 |
| Derivative assets | 5 | 282 | - | 287 |
| | 2,828 | 3,531 | 139 | 6,498 |
| Non profit non-unit linked | | | | |
| Bonds[1] | 2,562 | 21,116 | - | 23,678 |
| Derivative assets | 78 | 1,348 | - | 1,426 |
| | 2,640 | 22,464 | - | 25,104 |

1. Consolidated CDO holdings have been presented on a net basis within level 2. The analysis excludes cash, loans and receivables and property investments of £2,862m (2010: £2,815m), as disclosed in Note 4.01.

## 4.07 Analysis of fair value measurement bases (continued)

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 reflects 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).

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). In normal market conditions, we would consider these market prices to be observable market prices. 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 prudently 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.

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.

**Significant transfers between levels**

There have been no significant transfers between levels 1, 2 and 3 for the year ended 31 December 2011 (2010: No significant transfers between levels 1, 2 and 3).

# Asset Disclosures

## Consolidated Income Statement
For the year ended 31 December 2011

| | Notes | **2011 £m** | 2010 £m |
|---|---|---|---|
| **From continuing operations** | | | |
| Risk | 5.01 | **801** | 663 |
| Savings | 5.01 | **228** | 204 |
| Investment management | 5.08 | **210** | 179 |
| International | 5.09 | **242** | 163 |
| Group capital and financing | 5.10 | **44** | 54 |
| Investment projects[1] | | **(56)** | (39) |
| **Operating profit** | | **1,469** | 1,224 |
| Variation from longer term investment return | 5.11 | **(111)** | 161 |
| Effect of economic assumption changes | 5.12 | **(21)** | 292 |
| Property losses attributable to non-controlling interests | | **(3)** | - |
| **Profit before tax** | | **1,334** | 1,677 |
| Tax expense attributable to equity holders of the Company | 5.14 | **(259)** | (446) |
| Effect of tax rate changes | 5.14 | **156** | 33 |
| **Profit for the year** | | **1,231** | 1,264 |
| **Loss attributable to non-controlling interests** | | **3** | - |
| **Profit attributable to equity holders of the Company** | | **1,234** | 1,264 |

| | | **p** | p |
|---|---|---|---|
| **Earnings per share** | 5.15 | | |
| Based on operating profit after tax attributable to equity holders of the Company | | **19.08** | 15.52 |
| Based on profit attributable to equity holders of the Company | | **21.17** | 21.71 |
| **Diluted earnings per share** | 5.15 | | |
| Based on operating profit after tax attributable to equity holders of the Company | | **18.77** | 15.31 |
| Based on profit attributable to equity holders of the Company | | **20.83** | 21.41 |

1. Investment projects predominately relates to Solvency II and other strategic investments.

# European Embedded Value

## Consolidated Statement of Comprehensive Income
For the year ended 31 December 2011

| | 2011 £m | 2010 £m |
|---|---|---|
| **Profit for the year** | **1,231** | 1,264 |
| **Other comprehensive income after tax** | | |
| Exchange differences on translation of overseas operations | **(1)** | (5) |
| Actuarial (losses) on defined benefit pension schemes | **(70)** | (5) |
| Actuarial losses on defined benefit pension schemes transferred to unallocated divisible surplus | **48** | 4 |
| **Total comprehensive income for the year** | **1,208** | 1,258 |
| Total comprehensive income/(expense) attributable to: | | |
| Non-controlling interests | **(3)** | - |
| Equity holders of the Company | **1,211** | 1,258 |

## Consolidated Balance Sheet
As at 31 December 2011

| | Notes | 2011 £m | 2010 £m |
|---|---|---|---|
| **Assets** | | | |
| Investments | | **319,671** | 317,234 |
| Long term in-force business asset | | **3,556** | 3,060 |
| Other assets | | **6,900** | 6,482 |
| **Total assets** | | **330,127** | 326,776 |
| **Equity** | | | |
| Shareholders' equity | 5.17/5.18 | **8,608** | 7,730 |
| Non-controlling interests | | **66** | 47 |
| **Total equity** | | **8,674** | 7,777 |
| **Liabilities** | | | |
| Subordinated borrowings | 2.14 | **1,921** | 1,897 |
| Unallocated divisible surplus | | **1,038** | 1,469 |
| Participating contract liabilities | | **15,784** | 16,329 |
| Non-participating contract liabilities | | **285,351** | 284,751 |
| Senior borrowings | 2.14 | **1,329** | 1,435 |
| Other liabilities and provisions | | **16,030** | 13,118 |
| **Total liabilities** | | **321,453** | 318,999 |
| **Total equity and liabilities** | | **330,127** | 326,776 |

## 5.01 Profit/(loss) for the year

| For the year ended 31 December 2011 | Notes | Risk and Savings £m | Invest-ment manage-ment £m | Inter-national £m | Group capital and financing £m | Total £m |
|---|---|---|---|---|---|---|
| **Business reported on an EEV basis:** | | | | | | |
| Contribution from new business after cost of capital | 5.03/5.05 | **376** | | **65** | | **441** |
| Contribution from in-force business: | | | | | | |
| - expected return[1] | | **387** | | **107** | | **494** |
| - experience variances | 5.07 | **112** | | **125** | | **237** |
| - operating assumption changes | 5.07 | **101** | | **(68)** | | **33** |
| Development costs | | **(10)** | | **-** | | **(10)** |
| Contribution from shareholder net worth | | | | **21** | **157** | **178** |
| **Operating profit on covered business** | | **966** | **-** | **250** | **157** | **1,373** |
| **Business reported on an IFRS basis:** | | | | | | |
| Risk non-covered business[2] | | **36** | | | | **36** |
| Savings non-covered business[3] | | **27** | | | | **27** |
| Investment management[4] | 5.08 | | **210** | | | **210** |
| Group capital and financing | 5.10 | | | | **(113)** | **(113)** |
| Investment projects[5] | | | | | **(56)** | **(56)** |
| International non-covered business[6] | | | | **(8)** | | **(8)** |
| **Total operating profit** | | **1,029** | **210** | **242** | **(12)** | **1,469** |
| Variation from longer term investment return | 5.11 | **124** | **(7)** | **(6)** | **(222)** | **(111)** |
| Effect of economic assumption changes | 5.12 | **43** | **-** | **(64)** | **-** | **(21)** |
| Property losses attributable to non-controlling interests | | **-** | **-** | **-** | **(3)** | **(3)** |
| **Profit/(loss) before tax** | | **1,196** | **203** | **172** | **(237)** | **1,334** |
| Tax (expense)/credit on profit from ordinary activities | | **(279)** | **(38)** | **(63)** | **121** | **(259)** |
| Effect of tax rate changes[7] | | **155** | **-** | **1** | **-** | **156** |
| **Profit/(loss) for the year** | | **1,072** | **165** | **110** | **(116)** | **1,231** |

| | | |
|---|---|---|
| Operating profit attributable to: | | |
| Risk | | **801** |
| Savings | | **228** |

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 Risk and Savings business was £3,886m in 2011 (2010: £3,679m). This is adjusted for the effects of opening model changes of £200m (2010: £39m) to give an adjusted opening base VIF of £4,086m (2010: £3,718m). 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% (2010: 27%) to give a return of £387m (2010: £407m).
2. Risk non-covered business primarily reflects GI operating profit of £42m (see Note 2.01(f)).
3. Savings non-covered business mainly comprises Savings investments on an IFRS basis, adjusted for Suffolk Life, International (Ireland) and Nationwide.
4. Investment management operating profit excludes £24m (2010: £27m) 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 Risk, Savings and Group capital and financing covered business on an EEV basis.
5. Investment projects predominately relates to Solvency II and other strategic investments.
6. International non-covered business includes our joint venture operations in Egypt, the Gulf, India and business unit costs of £5m (2010: £5m) allocated to the International segment.
7. Primarily reflects the implementation of the UK planned future reductions in corporation tax to 23% on 1 April 2014.

### 5.01 Profit/(loss) for the year (continued)

| For the year ended 31 December 2010 | Notes | Risk and Savings £m | Investment management £m | International £m | Group capital and financing £m | Total £m |
|---|---|---|---|---|---|---|
| **Business reported on an EEV basis:** | | | | | | |
| Contribution from new business after cost of capital | 5.03/5.05 | 333 | | 44 | | 377 |
| Contribution from in-force business: | | | | | | |
| - expected return[1] | | 407 | | 120 | | 527 |
| - experience variances | 5.07 | 188 | | 6 | | 194 |
| - operating assumption changes | 5.07 | (58) | | (20) | | (78) |
| Development costs | | (15) | | - | | (15) |
| Contribution from shareholder net worth | | | | 22 | 138 | 160 |
| **Operating profit on covered business** | | 855 | - | 172 | 138 | 1,165 |
| **Business reported on an IFRS basis:** | | | | | | |
| Risk non-covered business[2] | | (8) | | | | (8) |
| Savings non-covered business[3] | | 20 | | | | 20 |
| Investment management[4] | 5.08 | | 179 | | | 179 |
| Group capital and financing | 5.10 | | | | (84) | (84) |
| Investment projects[5] | | | | | (39) | (39) |
| International non-covered business[6] | | | | (9) | | (9) |
| **Total operating profit** | | 867 | 179 | 163 | 15 | 1,224 |
| Variation from longer term investment return | 5.11 | 115 | (8) | 43 | 11 | 161 |
| Effect of economic assumption changes | 5.12 | 252 | - | 40 | - | 292 |
| Property losses attributable to non-controlling interests | | - | - | - | - | - |
| **Profit/(loss) before tax** | | 1,234 | 171 | 246 | 26 | 1,677 |
| Tax (expense)/credit on profit from ordinary activities | | (332) | (34) | (84) | 4 | (446) |
| Effect of tax rate changes | | 33 | - | - | - | 33 |
| **Profit for the year** | | 935 | 137 | 162 | 30 | 1,264 |

| | | |
|---|---|---|
| Operating profit attributable to: | | |
| Risk | | 663 |
| Savings | | 204 |

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 Risk and Savings business was £3,679m in 2010. This is adjusted for the effects of opening model changes of £39m to give an adjusted opening base VIF of £3,718m. This is then multiplied by the opening risk discount rate of 8.0% and the result grossed up at the notional attributed tax rate of 27% to give a return of £407m.
2. Risk non-covered business primarily reflects GI operating profit of £(8)m (see note 2.01(f)).
3. Savings non-covered business mainly comprises Savings investments on an IFRS basis, adjusted for Suffolk Life, International (Ireland) and Nationwide.
4. Investment management operating profit excludes £27m 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 Risk, Savings and Group capital and financing covered business on an EEV basis.
5. Investment projects predominately relates to Solvency II and other strategic investments.
6. International non-covered business includes our joint venture operations in Egypt, the Gulf, India and business unit costs of £5m allocated to the International segment.

## 5.02 New business summary[1]

| | Notes | **APE[2] 2011 £m** | **PVNBP[3] 2011 £m** | **Margin[4] 2011 %** | APE 2010 £m | PVNBP 2010 £m | Margin 2010 % |
|---|---|---|---|---|---|---|---|
| Risk[5] | 5.03 | **498** | **3,446** | **9.8** | 382 | 2,925 | 10.3 |
| Savings | 5.03 | **590** | **3,896** | **0.8** | 628 | 3,934 | 0.8 |
| International | 5.05 | **131** | **1,174** | **5.5** | 116 | 1,017 | 4.3 |
| | | **1,219** | **8,516** | **5.1** | 1,126 | 7,876 | 4.8 |

1. Covered business only.
2. Annual Premium Equivalent (APE) comprises the new annual premiums together with 10% of single 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 new business margin is defined as the contribution from new business (including the cost of solvency capital) divided by the PVNBP.
5. Longevity insurance has been excluded from the Risk PVNBP and new business margin measures. See Note 5.22.

## 5.03 Risk and Savings[1] new business by product

| **For the year ended 31 December 2011** | **Annual premiums £m** | **Present value of annual premiums £m** | **Capital-isation factor[2]** | **Single premiums £m** | **PVNBP £m** | **Contri-bution from new business[3] £m** | **Margin %** |
|---|---|---|---|---|---|---|---|
| Protection | **177** | **931** | **5.3** | **-** | **931** | **86** | **9.3** |
| Annuities | **-** | **-** | **-** | **2,515** | **2,515** | **252** | **10.0** |
| Longevity insurance[4] | **70** | **n/a** | **n/a** | **-** | **n/a** | **7** | **n/a** |
| **Total Risk** | **247** | **931** | **5.3** | **2,515** | **3,446** | **345** | **9.8** |
| Unit linked bonds | **-** | **-** | **-** | **623** | **623** | **8** | **1.3** |
| Pensions, stakeholder and other non profit | **244** | **902** | **3.7** | **1,620** | **2,522** | **10** | **0.4** |
| With-profits savings | **69** | **226** | **3.3** | **525** | **751** | **13** | **1.8** |
| **Total Savings** | **313** | **1,128** | **3.6** | **2,768** | **3,896** | **31** | **0.8** |
| **Total Risk and Savings** | **560** | **2,059** | **4.2** | **5,283** | **7,342** | **376** | **5.0** |
| Cost of capital | | | | | | **49** | |
| **Contribution from new business before cost of capital** | | | | | | **425** | |

| **For the year ended 31 December 2010** | | | | | | | |
|---|---|---|---|---|---|---|---|
| Protection | 175 | 860 | 4.9 | - | 860 | 55 | 6.4 |
| Annuities | - | - | - | 2,065 | 2,065 | 245 | 11.9 |
| Longevity insurance[4] | - | n/a | n/a | - | n/a | - | n/a |
| **Total Risk** | 175 | 860 | 4.9 | 2,065 | 2,925 | 300 | 10.3 |
| Unit linked bonds | - | - | - | 586 | 586 | 8 | 1.4 |
| Pensions, stakeholder and other non profit | 300 | 1,135 | 3.8 | 1,373 | 2,508 | 3 | 0.1 |
| With-profits savings | 71 | 232 | 3.3 | 608 | 840 | 22 | 2.6 |
| **Total Savings** | 371 | 1,367 | 3.7 | 2,567 | 3,934 | 33 | 0.8 |
| **Total Risk and Savings** | 546 | 2,227 | 4.1 | 4,632 | 6,859 | 333 | 4.9 |
| Cost of capital | | | | | | 47 | |
| **Contribution from new business before cost of capital** | | | | | | 380 | |

1. Covered business only.
2. The capitalisation factor is the present value of annual premiums divided by the amount of annual premiums.
3. 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.
4. The PVNBP measure is not applicable. See Note 5.22.

### 5.04 Non profit internal rate of return (IRR) and payback period[1] by product

| | **IRR 2011 %** | **Payback period 2011 years** | IRR 2010 % | Payback period 2010 years |
|---|---|---|---|---|
| Protection | **>15** | **4** | 15 | 5 |
| Annuities[2] | **>30** | **<0** | >30 | <0 |
| Unit linked bonds | **10** | **7** | 11 | 7 |
| Pensions, stakeholder and other non profit | **8** | **12** | 8 | 13 |

1. The payback period is calculated on an undiscounted basis.
2. Includes longevity insurance. Given negative strain on annuity business and an immediate IFRS payback, the IRR calculation is infinite.

### 5.05 International[1] new business

| **For the year ended 31 December 2011** | **APE £m** | **PVNBP £m** | **Contri-bution from new business[2] £m** | **Cost of capital £m** | **Margin %** |
|---|---|---|---|---|---|
| USA (LGA) | **69** | **637** | **69** | **2** | **10.7** |
| Netherlands (LGN) | **15** | **130** | **(2)** | **2** | **(1.3)** |
| France (LGF) | **47** | **407** | **(2)** | **6** | **(0.4)** |
| **Total** | **131** | **1,174** | **65** | **10** | **5.5** |

| **For the year ended 31 December 2010** | APE £m | PVNBP £m | Contri-bution from new business[2] £m | Cost of capital £m | Margin % |
|---|---|---|---|---|---|
| USA (LGA) | 52 | 443 | 40 | 4 | 8.9 |
| Netherlands (LGN) | 18 | 166 | 2 | 2 | 1.4 |
| France (LGF) | 46 | 408 | 2 | 4 | 0.6 |
| **Total** | 116 | 1,017 | 44 | 10 | 4.3 |

1. Excludes core retail investments in LGF and new business from joint operations in Egypt, India and Gulf which are reported on an IFRS basis.
2. Contribution from new business is reported after the cost of capital.

### 5.06 International[1] new business in local currency

| For the year ended 31 December 2011 | Annual premiums m | Present value of annual premiums m | Capital-isation factor | Single premiums m | PVNBP m | Contri-bution from new business[2] m | Cost of capital m | Margin % |
|---|---|---|---|---|---|---|---|---|
| USA (LGA) | **$111** | **$1,028** | **9.3** | **-** | **$1,028** | **$110** | **$3** | **10.7** |
| Netherlands (LGN) | **€6** | **€40** | **6.7** | **€109** | **€149** | **(€2)** | **€2** | **(1.3)** |
| France (LGF) | **€27** | **€201** | **7.5** | **€267** | **€468** | **(€2)** | **€7** | **(0.4)** |

| For the year ended 31 December 2010 | Annual premiums m | Present value of annual premiums m | Capital-isation factor | Single premiums m | PVNBP m | Contri-bution from new business[2] m | Cost of capital m | Margin % |
|---|---|---|---|---|---|---|---|---|
| USA (LGA) | $80 | $690 | 8.6 | - | $690 | $62 | $7 | 8.9 |
| Netherlands (LGN) | €7 | €48 | 6.9 | €146 | €194 | €3 | €2 | 1.4 |
| France (LGF) | €27 | €203 | 7.5 | €277 | €480 | €3 | €5 | 0.6 |

1. Excludes core retail investments in LGF and new business from joint operations in Egypt, India and Gulf which are reported on an IFRS basis.
2. Contribution from new business is reported after the cost of capital.

## 5.07 Analysis of experience variances and operating assumption changes

| For the year ended 31 December 2011 | Risk and Savings Experience variances £m | Risk and Savings Operating assumption changes £m | Risk and Savings Total £m | International Experience variances £m | International Operating assumption changes £m | International Total £m |
|---|---|---|---|---|---|---|
| Persistency | **5** | **9** | **14** | **3** | **(24)** | **(21)** |
| Mortality/morbidity | **(25)** | **(7)** | **(32)** | **(27)** | **(55)** | **(82)** |
| Expenses | **-** | **55** | **55** | **(7)** | **1** | **(6)** |
| Other | | | | | | |
| - US capital restructure | **15** | | | **163** | | |
| - Bulk purchase annuity data loading | **42** | | | **-** | | |
| - UK cost of capital unwind | **54** | | | **-** | | |
| - Modelling changes and other experience variances | **21** | | | **(7)** | | |
| | **132** | **44** | **176** | **156** | **10** | **166** |
| | **112** | **101** | **213** | **125** | **(68)** | **57** |

2011 Risk and Savings mortality experience variances primarily relates to our group protection business which was impacted by a number of high value claims which predominately occurred during H1 11.

2011 Risk 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 International persistency and mortality operating assumptions changes mainly relate to LGA term assurances in the period after the end of the ordinary level premium period when policyholders may choose to continue their policies at reviewable rates.

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.

| For the year ended 31 December 2010 | Risk and Savings Experience variances £m | Risk and Savings Operating assumption changes £m | Risk and Savings Total £m | International Experience variances £m | International Operating assumption changes £m | International Total £m |
|---|---|---|---|---|---|---|
| Persistency | - | (16) | (16) | (1) | (14) | (15) |
| Mortality/morbidity | - | (28) | (28) | (12) | (13) | (25) |
| Expenses | (1) | 1 | - | (10) | (1) | (11) |
| Other | | | | | | |
| - US capital restructure | 30 | | | 16 | | |
| - Bulk purchase annuity data loading | 59 | | | - | | |
| - UK cost of capital unwind | 54 | | | - | | |
| - Modelling changes and other experience variances | 46 | | | 13 | | |
| | 189 | (15) | 174 | 29 | 8 | 37 |
| | 188 | (58) | 130 | 6 | (20) | (14) |

2010 Risk and Savings persistency assumption changes relate to the strengthening of lapse assumptions for individual protection and non profit pensions.

2010 Risk and Savings mortality assumption changes reflect the strengthening of the annuity business mortality assumptions partially offset by favourable individual protection mortality.

The 2010 US Capital restructuring programme involved replacing the Triple X financing solution with an internal reinsurance structure.

## 5.08 Investment management operating profit

| | 2011 £m | 2010 £m |
|---|---|---|
| Pension funds (managed and segregated)[1] | **172** | 148 |
| Other non-pension[2] | **25** | 20 |
| Investment management services for internal funds[3] | **13** | 11 |
| **Total Investment management operating profit** | **210** | 179 |

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 £9m (2010: £11m) has been included within other non-pension operating profit.
3. Investment management services for internal funds excludes £24m (2010: £27m) 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 Risk and Savings covered business on an EEV basis.

## 5.09 International operating profit

| | 2011 £m | 2010 £m |
|---|---|---|
| **USA (LGA)[1]** | **242** | 129 |
| Netherlands (LGN)[2] | **6** | 52 |
| France (LGF) | **2** | (9) |
| **Total Europe operating profit** | **8** | 43 |
| Other[3] | **(8)** | (9) |
| **Total International operating profit** | **242** | 163 |

1. The significant increase in LGA operating profit reflects the improved new business contribution and the impact of the captive reinsurance structure, which was moved from Bermuda to Vermont during 2011.
2. The reduction in LGN operating profit reflects one-off modelling assumption changes in 2010, not repeated in 2011.
3. Other includes our joint venture operations in Egypt, the Gulf, India and business unit costs of £5m (2010: £5m) allocated to the International segment.

## 5.10 Group capital and financing operating profit[1]

| | 2011 £m | 2010 £m |
|---|---|---|
| Investment return | **191** | 187 |
| Interest expense[2] | **(123)** | (121) |
| Investment expenses | **(5)** | (3) |
| Unallocated corporate expenses | **(11)** | (5) |
| Other | **(8)** | (4) |
| **Total Group capital and financing operating profit** | **44** | 54 |
| **Analysed as:** | | |
| On an EEV basis | **157** | 138 |
| On an IFRS basis | **(113)** | (84) |

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 2.14).

## 5.11 Variation from longer term investment return

| | 2011 £m | 2010 £m |
|---|---|---|
| **Business reported on an EEV basis:** | | |
| Risk and Savings[1] | **124** | 103 |
| International | **(6)** | 43 |
| Group capital and financing[2] | **(152)** | 82 |
| | **(34)** | 228 |
| **Business reported on an IFRS basis:** | | |
| Risk and Savings | **-** | 12 |
| Investment management | **(7)** | (8) |
| Group capital and financing[2] | **(70)** | (71) |
| | **(111)** | 161 |

1. The positive investment variance primarily reflects the annuity business. Contributing factors include: improved asset diversity which increased the risk adjusted yield, for example, sale and leaseback; no defaults in the portfolio; improved asset liability matching, for example, reinvestment into longer duration bonds; more efficient cash management and small one-off benefits from tax and interest rate movements.
2. Group capital and financing investment returns primarily consists of negative debt and equity related investment variance. (See Note 2.06).

## 5.12 Effect of economic assumption changes

| | 2011 £m | 2010 £m |
|---|---|---|
| **Business reported on an EEV basis:** | | |
| Risk and Savings[1] | **43** | 252 |
| International[2] | **(64)** | 40 |
| | **(21)** | 292 |

1. Primarily reflects the increased value of in-force from the reduction in the risk discount rate from 7.3% to 6.2% partially offset by the lower future expected investment returns.

2. Includes the impact of the increase in risk margin from 3.3% to 3.7%.

## 5.13 Time value of options and guarantees

| | 2011 £m | 2010 £m |
|---|---|---|
| Risk and Savings[1] | **21** | 15 |
| International | **10** | 13 |
| | **31** | 28 |

1. Includes £16m (2010: £10m) relating to UK with-profits business, and £5m (2010: £5m) relating to UK non profit business.

## 5.14 Tax

| | Profit/ (loss) before tax 2011 £m | Tax (expense)/ credit 2011 £m | Profit/ (loss) before tax 2010 £m | Tax (expense)/ credit 2010 £m |
|---|---|---|---|---|
| **From continuing operations** | | | | |
| Risk | **801** | **(187)** | 663 | (179) |
| Savings | **228** | **(54)** | 204 | (54) |
| Investment management | **210** | **(40)** | 179 | (36) |
| International | **242** | **(85)** | 163 | (54) |
| Group capital and financing | **44** | **(6)** | 54 | (8) |
| Investment projects | **(56)** | **15** | (39) | 11 |
| **Operating profit** | **1,469** | **(357)** | 1,224 | (320) |
| Variation from longer term investment return | **(111)** | **87** | 161 | (43) |
| Effect of economic assumption changes | **(21)** | **11** | 292 | (83) |
| Property losses attributable to non-controlling interests | **(3)** | **-** | - | - |
| Effect of tax rate changes | **-** | **156** | - | 33 |
| **Profit/(loss) before tax / Tax** | **1,334** | **(103)** | 1,677 | (413) |

The UK EEV calculations assume a tax basis which reflects the annualised current tax rate of 26.5% and the planned future reductions in corporation tax to 25% from 1 April 2012, 24% from 1 April 2013, and 23% from 1 April 2014 (previously a single tax rate was used: 2010: 27%). The tax rate used for grossing up in the income statement is based on a UK corporation tax rate of 23% (2010: 27%).

## 5.15 Earnings per share
## (a) Earnings per share

| | Profit before tax 2011 £m | Tax (expense)/ credit 2011 £m | Profit after tax 2011 £m | Per share 2011 p | Profit before tax 2010 £m | Tax (expense)/ credit 2010 £m | Profit after tax 2010 £m | Per share 2010 p |
|---|---|---|---|---|---|---|---|---|
| **Operating profit** | **1,469** | **(357)** | **1,112** | **19.08** | 1,224 | (320) | 904 | 15.52 |
| Variation from longer term investment return | **(111)** | **87** | **(24)** | **(0.41)** | 161 | (43) | 118 | 2.03 |
| Effect of economic assumption changes | **(21)** | **11** | **(10)** | **(0.17)** | 292 | (83) | 209 | 3.59 |
| Effect of tax rate changes | **-** | **156** | **156** | **2.67** | - | 33 | 33 | 0.57 |
| **Earnings per share based on profit attributable to equity holders** | **1,337** | **(103)** | **1,234** | **21.17** | 1,677 | (413) | 1,264 | 21.71 |

## (b) Diluted earnings per share
### (i) Based on operating profit after tax

| | Profit after tax 2011 £m | Number of shares[1] 2011 m | Per share 2011 p | Profit after tax 2010 £m | Number of shares[1] 2010 m | Per share 2010 p |
|---|---|---|---|---|---|---|
| **Operating profit after tax** | **1,112** | **5,828** | **19.08** | 904 | 5,827 | 15.52 |
| Net shares under options allocable for no further consideration | **-** | **97** | **(0.31)** | - | 79 | (0.21) |
| **Diluted earnings per share** | **1,112** | **5,925** | **18.77** | 904 | 5,906 | 15.31 |

### (ii) Based on profit attributable to equity holders of the Company

| | Profit after tax 2011 £m | Number of shares[1] 2011 m | Per share 2011 p | Profit after tax 2010 £m | Number of shares[1] 2010 m | Per share 2010 p |
|---|---|---|---|---|---|---|
| **Profit attributable to equity holders of the Company** | **1,234** | **5,828** | **21.17** | 1,264 | 5,827 | 21.71 |
| Net shares under options allocable for no further consideration | **-** | **97** | **(0.34)** | - | 79 | (0.30) |
| **Diluted earnings per share** | **1,234** | **5,925** | **20.83** | 1,264 | 5,906 | 21.41 |

1. Weighted average number of shares.

The number of shares in issue at 31 December 2011 was 5,872,166,893 (31 December 2010: 5,866,669,323).

### 5.16 Group embedded value reconciliation

| For the year ended 31 December 2011 | Covered business UK free surplus £m | UK required capital £m | UK value of in-force £m | Total UK £m | International £m | Non-covered business £m | Total £m |
|---|---|---|---|---|---|---|---|
| At 1 January | | | | | | | |
| Value of in-force business (VIF) | - | - | 3,886 | 3,886 | 1,015 | - | 4,901 |
| Shareholder net worth (SNW) | 1,395 | 1,640 | - | 3,035 | 748 | (954) | 2,829 |
| | 1,395 | 1,640 | 3,886 | 6,921 | 1,763 | (954) | 7,730 |
| Exchange rate movements | - | - | - | - | (4) | 3 | (1) |
| | 1,395 | 1,640 | 3,886 | 6,921 | 1,759 | (951) | 7,729 |
| Operating profit/(loss) for the year: | | | | | | | |
| - New business contribution[1] | (258) | 167 | 381 | 290 | | | |
| - Expected return on VIF | - | - | 298 | 298 | | | |
| - Expected transfer from Non profit VIF to SNW[2] | 745 | (185) | (560) | - | | | |
| - With-profits transfer | 51 | - | (51) | - | | | |
| - Expected return on SNW | 58 | 67 | - | 125 | | | |
| Generation of embedded value | 596 | 49 | 68 | 713 | | | |
| - Experience variances | (52) | 20 | 108 | 76 | | | |
| - Operating assumption changes | 34 | 3 | 41 | 78 | | | |
| - Development costs | (8) | - | - | (8) | | | |
| Variances | (26) | 23 | 149 | 146 | | | |
| Operating profit after tax for the year | 570 | 72 | 217 | 859 | 164 | 89 | 1,112 |
| Non-operating profit/(loss) for the year: | | | | | | | |
| - Investment variances | 81 | - | (47) | 34 | | | |
| - Economic assumption changes | (65) | 45 | 53 | 33 | | | |
| - Effect of UK Budget tax changes | - | - | 155 | 155 | | | |
| Non-operating profit/(loss) for the year: | 16 | 45 | 161 | 222 | (48) | (55) | 119 |
| Profit for the year | 586 | 117 | 378 | 1,081 | 116 | 34 | 1,231 |
| Capital movements[3] | - | - | - | - | (262) | 262 | - |
| Intra-group distributions[4] | (437) | - | - | (437) | (82) | 519 | - |
| Dividends to equity holders of the Company | - | - | - | - | - | (298) | (298) |
| Net movements in employee share schemes | - | - | - | - | - | 4 | 4 |
| Loss attributable to non-controlling interests | - | - | - | - | - | 3 | 3 |
| Transfer to non-covered business[5] | (19) | - | - | (19) | - | 19 | - |
| Other reserve movements including pension deficit | (64) | - | (17) | (81) | - | 20 | (61) |
| **Embedded value** | 1,461 | 1,757 | 4,247 | 7,465 | 1,531 | (388) | 8,608 |
| Represented by: | | | | | | | |
| - Non profit | | | 3,808 | | | | |
| - With-profits | | | 439 | | | | |
| Value of in-force business | - | - | 4,247 | 4,247 | 1,130 | - | 5,377 |
| Shareholder net worth | 1,461 | 1,757 | - | 3,218 | 401 | (388) | 3,231 |

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. The capital movement of £262m primarily reflects the capital repayment from LGA in respect of Potomac securities of £271m.
4. 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 $57m from LGA, €50m from LGN and €2m from LGF were also paid to the group.
5. 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.

### 5.16 Group embedded value reconciliation (continued)

| For the year ended 31 December 2010 | Covered business UK free surplus £m | Covered business UK required capital £m | Covered business UK value of in-force £m | Covered business Total UK £m | Covered business International £m | Non-covered business £m | Total £m |
|---|---|---|---|---|---|---|---|
| At 1 January | | | | | | | |
| Value of in-force business (VIF) | - | - | 3,679 | 3,679 | 928 | - | 4,607 |
| Shareholder net worth (SNW) | 1,067 | 1,521 | - | 2,588 | 518 | (1,018) | 2,088 |
| | 1,067 | 1,521 | 3,679 | 6,267 | 1,446 | (1,018) | 6,695 |
| Exchange rate movements | - | - | - | - | 7 | (12) | (5) |
| | 1,067 | 1,521 | 3,679 | 6,267 | 1,453 | (1,030) | 6,690 |
| Operating profit/(loss) for the year: | | | | | | | |
| - New business contribution[1] | (258) | 178 | 323 | 243 | | | |
| - Expected return on VIF | - | - | 297 | 297 | | | |
| - Expected transfer from Non profit VIF to SNW[2] | 688 | (166) | (522) | - | | | |
| - With-profits transfer | 46 | - | (46) | - | | | |
| - Expected return on SNW | 45 | 72 | - | 117 | | | |
| Generation of embedded value | 521 | 84 | 52 | 657 | | | |
| - Experience variances | 121 | 11 | (7) | 125 | | | |
| - Operating assumption changes | (14) | 1 | (28) | (41) | | | |
| - Development costs | (11) | - | - | (11) | | | |
| Variances | 96 | 12 | (35) | 73 | | | |
| Operating profit after tax for the year | 617 | 96 | 17 | 730 | 117 | 57 | 904 |
| Non-operating profit/(loss) for the year: | | | | | | | |
| - Investment variances | 95 | 49 | (6) | 138 | | | |
| - Economic assumption changes | - | - | 184 | 184 | | | |
| - Effect of UK Budget tax changes | - | - | 33 | 33 | | | |
| Non-operating profit/(loss) for the year: | 95 | 49 | 211 | 355 | 53 | (48) | 360 |
| Profit for the year | 712 | 145 | 228 | 1,085 | 170 | 9 | 1,264 |
| Capital movements[3] | - | - | - | - | 184 | (184) | - |
| Intra-group distributions[4] | (207) | - | - | (207) | (44) | 251 | - |
| Dividends to equity holders of the Company | - | - | - | - | - | (238) | (238) |
| Net movements in employee share schemes | - | - | - | - | - | 17 | 17 |
| Transfer to non-covered business[5] | (19) | - | - | (19) | - | 19 | - |
| Other reserve movements including pension deficit[6] | (158) | (26) | (21) | (205) | - | 202 | (3) |
| **Embedded value** | 1,395 | 1,640 | 3,886 | 6,921 | 1,763 | (954) | 7,730 |
| Represented by: | | | | | | | |
| - Non profit | | | 3,372 | | | | |
| - With-profits | | | 514 | | | | |
| Value of in-force business | - | - | 3,886 | 3,886 | 1,015 | - | 4,901 |
| Shareholder net worth | 1,395 | 1,640 | - | 3,035 | 748 | (954) | 2,829 |

1. The free surplus reduction of £258m to finance new business includes £80m IFRS new business strain and £178m additional required capital.
2. The increase in free surplus of £688m from the expected transfer from the in-force non profit business includes £522m of IFRS operational cash generation and a £166m reduction in required capital.
3. The capital movement of £184m reflects the capital contribution made to LGA to enable the repurchase of Potomac securities.
4. UK intra-group distributions reflect a £300m dividend paid from Society to Group and dividends of £93m paid to Society from subsidiaries (primarily Nationwide Life). Dividends of $53m from LGA, €10m from LGN and €2m from LGF were also paid to the group.
5. 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.
6. Other reserve movements primarily comprise the transfer from the covered business of Nationwide Life following the Part VII transfer of the majority of the Insurance business in 2009.

### 5.17 Analysis of shareholders' equity

| As at 31 December 2011 | Risk and Savings £m | Investment management £m | International £m | Group capital and financing £m | Total £m |
|---|---|---|---|---|---|
| Analysed as: | | | | | |
| IFRS basis shareholders' equity[1] | **309** | **351** | **1,407** | **3,133** | **5,200** |
| Additional retained profit/(loss) on an EEV basis | **4,247** | **-** | **163** | **(1,002)** | **3,408** |
| **Shareholders' equity on an EEV basis** | **4,556** | **351** | **1,570** | **2,131** | **8,608** |
| Comprising: | | | | | |
| Business reported on an IFRS basis | **309** | **351** | **39** | **(1,087)** | **(388)** |
| Business reported on an EEV basis: | | | | | |
| Shareholder net worth | | | | | |
| - Free surplus[2] | | | **148** | **1,461** | **1,609** |
| - Required capital to cover solvency margin | | | **253** | **1,757** | **2,010** |
| Value of in-force | | | | | |
| - Value of in-force business | **4,620** | | **1,211** | | **5,831** |
| - Cost of capital | **(373)** | | **(81)** | | **(454)** |

| As at 31 December 2010 | Risk and Savings £m | Investment management £m | International £m | Group capital and financing £m | Total £m |
|---|---|---|---|---|---|
| Analysed as: | | | | | |
| IFRS basis shareholders' equity[1] | 265 | 324 | 1,664 | 2,574 | 4,827 |
| Additional retained profit/(loss) on an EEV basis | 3,886 | - | 136 | (1,119) | 2,903 |
| **Shareholders' equity on an EEV basis** | 4,151 | 324 | 1,800 | 1,455 | 7,730 |
| Comprising: | | | | | |
| Business reported on an IFRS basis | 265 | 324 | 37 | (1,580) | (954) |
| Business reported on an EEV basis: | | | | | |
| Shareholder net worth | | | | | |
| - Free surplus[2] | | | 501 | 1,395 | 1,896 |
| - Required capital to cover solvency margin | | | 247 | 1,640 | 1,887 |
| Value of in-force | | | | | |
| - Value of in-force business | 4,220 | | 1,090 | | 5,310 |
| - Cost of capital | (334) | | (75) | | (409) |

1. Shareholders' equity supporting the non profit Risk 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 5.18.

## 5.18 Segmental analysis of shareholders' equity

| | Covered business EEV basis 2011 £m | Other business IFRS basis 2011 £m | Total 2011 £m | Covered business EEV basis 2010 £m | Other business IFRS basis 2010 £m | Total 2010 £m |
|---|---|---|---|---|---|---|
| **Risk** | | | | | | |
| - Risk reported on an EEV basis | **2,995** | **-** | **2,995** | 2,563 | - | 2,563 |
| - General insurance | **-** | **148** | **148** | - | 120 | 120 |
| - Other | **-** | **6** | **6** | - | 3 | 3 |
| **Total Risk** | **2,995** | **154** | **3,149** | 2,563 | 123 | 2,686 |
| **Savings** | | | | | | |
| - Savings reported on an EEV basis | **1,252** | **-** | **1,252** | 1,323 | - | 1,323 |
| - Savings investments | **-** | **136** | **136** | - | 121 | 121 |
| - Other | **-** | **19** | **19** | - | 21 | 21 |
| **Total Savings** | **1,252** | **155** | **1,407** | 1,323 | 142 | 1,465 |
| **Investment management** | **-** | **351** | **351** | - | 324 | 324 |
| **International** | | | | | | |
| - USA (LGA) | **1,062** | **-** | **1,062** | 1,220 | - | 1,220 |
| - Netherlands (LGN) | **271** | **-** | **271** | 335 | - | 335 |
| - France (LGF) | **198** | **-** | **198** | 208 | - | 208 |
| - Emerging markets | **-** | **39** | **39** | - | 37 | 37 |
| **Total International** | **1,531** | **39** | **1,570** | 1,763 | 37 | 1,800 |
| **Group capital and financing** | **3,218** | **(1,087)** | **2,131** | 3,035 | (1,580) | 1,455 |
| | **8,996** | **(388)** | **8,608** | 8,684 | (954) | 7,730 |

## 5.19 Reconciliation of shareholder net worth

| | UK covered business 2011 £m | Total 2011 £m | UK covered business 2010 £m | Total 2010 £m |
|---|---|---|---|---|
| SNW of long term operations (IFRS basis) | **4,209** | **5,588** | 4,154 | 5,781 |
| Other liabilities (IFRS basis) | **-** | **(388)** | - | (954) |
| **Shareholders' equity on the IFRS basis** | **4,209** | **5,200** | 4,154 | 4,827 |
| Purchased interest in long term business | **(76)** | **(77)** | (86) | (91) |
| Deferred acquisition costs/deferred income liabilities | **(252)** | **(1,291)** | (253) | (1,211) |
| Contingent loan[1] | **(210)** | **(210)** | (551) | (551) |
| Deferred tax[2] | **(235)** | **163** | (238) | 85 |
| Other[3] | **(218)** | **(554)** | 9 | (230) |
| **Shareholder net worth on the EEV basis** | **3,218** | **3,231** | 3,035 | 2,829 |

1. On an EEV basis the contingent loan (between Society and LGPL) is modelled within the VIF. On an IFRS basis the contingent loan asset is 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 UK 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.

## 5.20 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 2011**

| | 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 |
|---|---|---|---|---|---|---|
| UK | 7,465 | 515 | (444) | 204 | (202) | 121 |
| International | 1,531 | 147 | (119) | 37 | (39) | 5 |
| **Total covered business** | 8,996 | 662 | (563) | 241 | (241) | 126 |

| | 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 |
|---|---|---|---|---|---|---|
| UK | 7,465 | (233) | 83 | 87 | (220) | 50 |
| International | 1,531 | (8) | 21 | 10 | n/a | 150 |
| **Total covered business** | 8,996 | (241) | 104 | 97 | (220) | 200 |

**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 |
|---|---|---|---|---|---|---|
| UK | 376 | 54 | (46) | 21 | (13) | 11 |
| International | 65 | 15 | (12) | 3 | (3) | - |
| **Total covered business** | 441 | 69 | (58) | 24 | (16) | 11 |

| | 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 |
|---|---|---|---|---|---|---|
| UK | 376 | (2) | 11 | 9 | (11) | 4 |
| International | 65 | - | 2 | 1 | n/a | 18 |
| **Total covered business** | 441 | (2) | 13 | 10 | (11) | 22 |

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 £824m negative impact on embedded value and a £90m negative impact on new business contribution for the year.

## 5.21 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 are held at the reporting date in excess of, or below strategic investment guidelines, then it is assumed that these cash balances 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 2010) 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 2011 (29bps at 31 December 2010).

**Economic assumptions**

| **As at 31 December** | **2011 % p.a.** | 2010 % p.a. | 2009 % p.a. |
|---|---|---|---|
| Equity risk premium | **3.3** | 3.5 | 3.5 |
| Property risk premium | **2.0** | 2.0 | 2.0 |
| Investment return (excluding annuities in LGPL) | | | |
| - Gilts: | | | |
| - Fixed interest | **1.8 – 2.5** | 3.4 – 4.0 | 4.0 |
| - RPI linked | **2.6** | 4.1 | 4.5 |
| - Non gilts: | | | |
| - Fixed interest | **3.0 – 4.6** | 3.6 – 5.0 | 4.4 - 6.2 |
| - Equities | **5.8** | 7.5 | 8.0 |
| - Property | **4.5** | 6.0 | 6.5 |
| Long-term rate of return on non profit annuities in LGPL | **5.0** | 5.5 | 6.1 |
| Risk free rate[1] | **2.5** | 4.0 | 4.5 |
| Risk margin | **3.7** | 3.3 | 3.5 |
| Risk discount rate (net of tax) | **6.2** | 7.3 | 8.0 |
| Inflation | | | |
| - Expenses/earnings | **3.5** | 4.1 | 4.6 |
| - Indexation | **3.0** | 3.6 | 3.6 |

1. The risk free rate is the gross redemption yield on the 15 year gilt index (15 year gilt index for 31 December 2010; 20 year gilt index for 31 December 2009).

## 5.21 Assumptions (continued)

### 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. The proportion of profits derived from with-profits business allocated to shareholders has been assumed to be 10% throughout.

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 improvements in annuitant mortality based on experience and externally published data. Male annuitant mortality is assumed to improve in accordance with 100% of CMI2009 Working Paper 41, with a Long Term Rate of improvement of 1.5% for future experience, and 2.0% for statutory reserving. Female annuitant mortality is assumed to improve in accordance with 100% of CMI2009, with a Long Term Rate of improvement of 1.0% for future experience and 1.5% for statutory reserving. In each case, the annual improvement is assumed to reduce linearly after age 85 to zero at age 120.

On this basis, the best estimate of the expectation of life for a new 65 year old Male CPA annuitant is 24.2 years (31 December 2010: 24.3 years). The expectation of life on the regulatory reserving basis is 25.8 years (31 December 2010: 26.0 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.

### International

vi. Key assumptions:

| **As at 31 December** | **2011** | 2010 | 2009 |
|---|---|---|---|
| | **% p.a.** | % p.a. | % p.a. |
| LGA | | | |
| Reinvestment rate | **4.2** | 5.5 | 5.1 |
| Risk free rate[1] | **1.9** | 3.3 | 3.9 |
| Risk margin | **3.7** | 3.3 | 3.5 |
| Risk discount rate (net of tax) | **5.6** | 6.6 | 7.4 |
| | | | |
| Europe | | | |
| Risk free rate[1] | **2.6** | 3.2 | 3.6 |
| Risk margin | **3.7** | 3.3 | 3.5 |
| Risk discount rate (net of tax) | **6.3** | 6.5 | 7.1 |

1. The LGA risk free rate is the 10 year US Treasury effective yield (10 year US Treasury effective yield for 31 December 2010 and 2009). The Europe risk free rate is the 10 year ECB AAA-rated euro area central government bond par yield (10 year ECB AAA-rated euro area central government bond par yield for 31 December 2010 and 2009).

vii. Other actuarial assumptions have been set at levels commensurate with recent operating experience, including those for mortality, morbidity, persistency and maintenance expenses.

### Tax

viii. 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 26.5% and the subsequent planned future reductions in corporation tax to 25% from 1 April 2012, 24% from 1 April 2013, and 23% from 1 April 2014 (previously a single tax rate was used; 31 December 2010: 27%). The tax rate used for grossing up is the long term corporate tax rate in the territory concerned, which for the UK is 23% (31 December 2010: 27%) taking into account the expected further rate reductions to 23% 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.

## 5.21 Assumptions (continued)

**Stochastic calculations**

ix. 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.

Summary statistics:

The following table sets out means and standard deviations (StDev) of future returns as at 31 December 2011 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 | 2.2% | 3.1% | 3.3% | 3.3% |
| Corporate bonds | 4.5% | 3.6% | 5.1% | 3.8% |
| Property (excess returns) | 2.0% | 15.0% | 2.1% | 15.2% |
| Equities (excess returns) | 3.3% | 20.1% | 3.4% | 20.6% |
| **European Business (Euro)** | | | | |
| Long Government bonds[3] | 2.7% | 3.8% | 3.2% | 3.8% |
| Short Government bonds[4] | 2.7% | 3.2% | 3.2% | 5.8% |
| **US Business (US Dollar)** | | | | |
| Long Government bonds[3] | 2.0% | 4.3% | 3.1% | 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.

## 5.21 Assumptions (continued)

**Sensitivity calculations**

x. 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 5.8% to 6.8%).
- 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 an £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.

## 5.22 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.

**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).

**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 Risk 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 Risk 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.

## 5.22 Methodology (continued)

**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 and recurrent single premium contracts. Department of Work and Pensions rebates have not been treated as recurring and are included in single premium new business when received. Longevity insurance fixed leg payments have been treated as regular premiums.

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. 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. 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.

**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 LGA, 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.

**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. No account has been taken of the proposals for regime change for life insurance companies in 2013 which are still in draft form.

**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.

## 5.22 Methodology (continued)

**Required capital and free surplus**

Regulatory capital for the Risk 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 LGA, 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 212% 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.

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.

## 5.22 Methodology (continued)

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 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.

LGA 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.

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. 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.

## 5.22 Methodology (continued)

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 23%.

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.

# New Business

## 6.01 Investment management new business

| | 2011 £m | 2010 £m | Increase/ (decrease) % |
|---|---|---|---|
| **Managed pension funds[1]** | | | |
| Pooled funds | **22,094** | 19,898 | 11 |
| Segregated funds | **4,676** | 5,756 | (19) |
| **Total managed pension funds** | **26,770** | 25,654 | 4 |
| Other funds[2] | **6,711** | 8,440 | (20) |
| **Total new funds** | **33,481** | 34,094 | (2) |
| Attributable to: | | | |
| Legal & General Investment Management | **32,844** | 32,642 | 1 |
| Legal & General Retail Investments | **637** | 1,452 | (56) |
| **LGIM net flows** | **2,983** | 6,564 | (55) |

1. New monies from pension fund clients of Legal & General Assurance (Pension Management) exclude £4.1bn (2010: £5.9bn) held through the year on a temporary basis, generally as part of portfolio reconstructions.

2. Includes segregated property, property partnerships, private equity partnerships and institutional clients funds managed by Legal & General Investment Management and institutional investments in unit trust funds managed by Legal & General Retail Investments. Due to the expected volatility of gross new business inflows into the sterling/euro liquidity funds, these are now excluded from the gross new business figures. This resulted in a reduction of £492m in 2010.

## 6.02 Investment management new business quarterly progression

| | 3 months to 31.12.11 £m | 3 months to 30.09.11 £m | 3 months to 30.06.11 £m | 3 months to 31.03.11 £m | 3 months to 31.12.10 £m | 3 months to 30.09.10 £m | 3 months to 30.06.10 £m | 3 months to 31.03.10 £m |
|---|---|---|---|---|---|---|---|---|
| **Managed pension funds[1]** | | | | | | | | |
| Pooled funds | **4,084** | **5,219** | **6,712** | **6,079** | 3,569 | 4,009 | 4,936 | 7,384 |
| Segregated funds | **973** | **1,810** | **255** | **1,638** | 490 | 221 | 4,777 | 268 |
| **Total managed pension funds** | **5,057** | **7,029** | **6,967** | **7,717** | 4,059 | 4,230 | 9,713 | 7,652 |
| Other funds | **2,807** | **331** | **920** | **2,653** | 2,863 | 1,000 | 981 | 3,596 |
| **Total new funds** | **7,864** | **7,360** | **7,887** | **10,370** | 6,922 | 5,230 | 10,694 | 11,248 |
| Attributable to: | | | | | | | | |
| Legal & General Investment Management | **7,741** | **7,251** | **7,764** | **10,088** | 6,577 | 4,907 | 10,305 | 10,853 |
| Legal & General Retail Investments | **123** | **109** | **123** | **282** | 345 | 323 | 389 | 395 |
| **LGIM net flows** | **(607)** | **586** | **1,005** | **1,999** | (1,651) | (50) | 4,938 | 3,327 |

1. New monies from pension fund clients of Legal & General Assurance (Pension Management) exclude £4.1bn (2010: £5.9bn) held through the year on a temporary basis, generally as part of portfolio reconstructions.

## 6.03 Legal & General Investment Management new business by investment approach

| | 2011 % | 2010 % |
|---|---|---|
| Indexed equities | **44** | 47 |
| Indexed bonds (including index linked funds and cash) | **23** | 24 |
| Active bonds (including index linked funds and cash) | **14** | 12 |
| Liability driven investments | **18** | 15 |
| Property | **1** | 1 |
| Active equities | **-** | 1 |
| **Total** | **100** | 100 |

## 6.04 Assets under management

| | At 2011 £m | At 2010 £m |
|---|---|---|
| Legal & General Investment Management assets under management | **371,211** | 353,520 |
| Other assets under management[1] | **7,362** | 11,326 |
| **Worldwide assets under management** | **378,573** | 364,846 |

1. Other assets under management comprises retail investments and additional funds managed overseas.

Legal & General Investment Management's assets under management are analysed below:

| | | |
|---|---|---|
| *Represented by* | | |
| Index tracking funds: | | |
| - UK equities | **63,228** | 71,982 |
| - Overseas equities | **82,200** | 85,999 |
| - Fixed interest | **37,515** | 36,496 |
| - Index linked | **40,554** | 33,872 |
| - Cash/deposits | **671** | 188 |
| Total index tracking funds | **224,168** | 228,537 |
| Actively managed funds | **88,684** | 84,207 |
| Liability driven investments | **58,359** | 40,776 |
| | **371,211** | 353,520 |

| | | |
|---|---|---|
| *By investment approach* | | |
| Index equities | **145,428** | 157,981 |
| Index bonds (including index linked funds and cash) | **78,740** | 70,556 |
| Active bonds (including index linked funds and cash) | **72,355** | 66,564 |
| Liability driven investments | **58,359** | 40,776 |
| Active equities | **7,229** | 9,137 |
| Property | **8,757** | 8,136 |
| Private equity | **343** | 370 |
| | **371,211** | 353,520 |

| | | |
|---|---|---|
| *By source of business* | | |
| Institutional assets under management[1] : | | |
| - Managed pension funds pooled | **205,174** | 206,400 |
| - Liability driven investments | **58,367** | 40,776 |
| - Other | **16,920** | 16,772 |
| - Managed pension funds segregated | **5,136** | 3,508 |
| Total institutional assets under management | **285,597** | 267,456 |
| UK businesses (life and general insurance funds) | **70,630** | 70,024 |
| UK businesses (unit trusts - excluding life fund investment) | **14,984** | 16,040 |
| | **371,211** | 353,520 |

1. Excludes institutional investments in unit trust funds.

## 6.05 Savings net flows

| | **2011 £m** | 2010 £m |
|---|---|---|
| Investments | **2,490** | 4,149 |
| Insured | **424** | 476 |
| With-profits | **(1,736)** | (1,480) |
| **Total Savings net flows** | **1,178** | 3,145 |

## 6.06 Savings net flows quarterly progression

| | **3 months to 31.12.11 £m** | **3 months to 30.09.11 £m** | **3 months to 30.06.11 £m** | **3 months to 31.03.11 £m** | 3 months to 31.12.10 £m | 3 months to 30.09.10 £m | 3 months to 30.06.10 £m | 3 months to 31.03.10 £m |
|---|---|---|---|---|---|---|---|---|
| Investments | **165** | **622** | **804** | **899** | 985 | 1,106 | 1,123 | 935 |
| Insured | **200** | **4** | **107** | **113** | 211 | 163 | 74 | 28 |
| With-profits | **(381)** | **(568)** | **(387)** | **(400)** | (483) | (369) | (290) | (338) |
| **Total Savings net flows** | **(16)** | **58** | **524** | **612** | 713 | 900 | 907 | 625 |

New Business

## 6.07 Worldwide new business

| | Annual premiums 2011 £m | Single premiums 2011 £m | APE 2011 £m | Annual premiums 2010 £m | Single premiums 2010 £m | APE 2010 £m | Increase/ (decrease) % |
|---|---|---|---|---|---|---|---|
| Protection | | | | | | | |
| - Individual | **131** | **-** | **131** | 118 | - | 118 | 11 |
| - Group | **46** | **-** | **46** | 57 | - | 57 | (19) |
| | **177** | **-** | **177** | 175 | - | 175 | 1 |
| Annuities | | | | | | | |
| - Individual (non profit) | **-** | **1,030** | **103** | - | 1,142 | 114 | (10) |
| - Individual (with-profits) | **-** | **24** | **2** | - | 26 | 3 | (33) |
| - Bulk purchase | **-** | **1,461** | **146** | - | 897 | 90 | 62 |
| | **-** | **2,515** | **251** | **-** | 2,065 | 207 | 21 |
| Longevity insurance[1] | **70** | **-** | **70** | - | - | - | - |
| **Total Risk** | **247** | **2,515** | **498** | 175 | 2,065 | 382 | 30 |
| Investments[2] | **68** | **6,200** | **688** | 26 | 6,169 | 643 | 7 |
| Insured business | **244** | **2,015** | **445** | 299 | 1,795 | 478 | (7) |
| With-profits | **69** | **525** | **122** | 71 | 608 | 132 | (8) |
| **Total Savings** | **381** | **8,740** | **1,255** | 396 | 8,572 | 1,253 | - |
| - USA (LGA) | **69** | **-** | **69** | 52 | - | 52 | 33 |
| - Netherlands (LGN) | **5** | **95** | **15** | 6 | 124 | 18 | (17) |
| - France (LGF) | **24** | **232** | **47** | 22 | 237 | 46 | 2 |
| - India (26% share) | **5** | **22** | **7** | 13 | 7 | 14 | (50) |
| - Egypt (55% share) | **9** | **-** | **9** | 10 | - | 10 | (10) |
| - Gulf (50% share) | **2** | **5** | **2** | - | - | - | - |
| | **114** | **354** | **149** | 103 | 368 | 140 | 6 |
| France (LGF) retail investment business | **-** | **46** | **5** | - | 60 | 6 | (17) |
| **Total International** | **114** | **400** | **154** | 103 | 428 | 146 | 5 |
| **Total worldwide new business** | **742** | **11,655** | **1,907** | 674 | 11,065 | 1,781 | 7 |

1. As announced on 9 January 2012, the Group entered into its first longevity insurance transaction during December 2011.
2. Investments excludes institutional investments in unit trust funds which are disclosed as part of institutional fund management new business (see Note 6.01).

## 6.08 Worldwide new business APE quarterly progression

| | 3 months to 31.12.11 £m | 3 months to 30.09.11 £m | 3 months to 30.06.11 £m | 3 months to 31.03.11 £m | 3 months to 31.12.10 £m | 3 months to 30.09.10 £m | 3 months to 30.06.10 £m | 3 months to 31.03.10 £m |
|---|---|---|---|---|---|---|---|---|
| Protection | | | | | | | | |
| - Individual | **33** | **33** | **32** | **33** | 30 | 31 | 29 | 28 |
| - Group | **7** | **10** | **14** | **15** | 15 | 14 | 14 | 14 |
| | **40** | **43** | **46** | **48** | 45 | 45 | 43 | 42 |
| Annuities | | | | | | | | |
| - Individual (non profit) | **21** | **31** | **30** | **21** | 24 | 30 | 33 | 27 |
| - Individual (with-profits) | **-** | **1** | **-** | **1** | 2 | - | 1 | - |
| - Bulk purchase | **119** | **3** | **22** | **2** | 36 | 9 | 30 | 15 |
| | **140** | **35** | **52** | **24** | 62 | 39 | 64 | 42 |
| Longevity insurance | **70** | **-** | **-** | **-** | - | - | - | - |
| **Total Risk** | **250** | **78** | **98** | **72** | 107 | 84 | 107 | 84 |
| Investments[1] | **133** | **184** | **195** | **176** | 157 | 143 | 179 | 164 |
| Insured business | **128** | **97** | **112** | **108** | 106 | 182 | 124 | 66 |
| With-profits | **26** | **25** | **35** | **36** | 29 | 27 | 39 | 37 |
| **Total Savings** | **287** | **306** | **342** | **320** | 292 | 352 | 342 | 267 |
| - USA (LGA) | **19** | **18** | **16** | **16** | 16 | 14 | 13 | 9 |
| - Netherlands (LGN) | **4** | **3** | **3** | **5** | 5 | 3 | 4 | 6 |
| - France (LGF) | **5** | **6** | **21** | **15** | 8 | 6 | 19 | 13 |
| - India (26% share) | **1** | **2** | **1** | **3** | 3 | 3 | 2 | 6 |
| - Egypt (55% share) | **3** | **3** | **2** | **1** | 2 | 3 | 5 | - |
| - Gulf (50% share) | **-** | **1** | **1** | **-** | - | - | - | - |
| | **32** | **33** | **44** | **40** | 34 | 29 | 43 | 34 |
| France (LGF) retail investment business | **2** | **1** | **1** | **1** | 1 | 1 | 1 | 3 |
| **Total International** | **34** | **34** | **45** | **41** | 35 | 30 | 44 | 37 |
| **Total worldwide new business** | **571** | **418** | **485** | **433** | 434 | 466 | 493 | 388 |

1. Investments excludes institutional investments in unit trust funds which are disclosed as part of institutional fund management new business (see Note 6.01).

## 6.09 Worldwide new business annual premium quarterly progression

| | 3 months to 31.12.11 £m | 3 months to 30.09.11 £m | 3 months to 30.06.11 £m | 3 months to 31.03.11 £m | 3 months to 31.12.10 £m | 3 months to 30.09.10 £m | 3 months to 30.06.10 £m | 3 months to 31.03.10 £m |
|---|---|---|---|---|---|---|---|---|
| Protection | | | | | | | | |
| - Individual | **33** | **33** | **32** | **33** | 30 | 31 | 29 | 28 |
| - Group | **7** | **10** | **14** | **15** | 15 | 14 | 14 | 14 |
| | **40** | **43** | **46** | **48** | 45 | 45 | 43 | 42 |
| Annuities | | | | | | | | |
| - Individual (non profit) | **-** | **-** | **-** | **-** | - | - | - | - |
| - Individual (with-profits) | **-** | **-** | **-** | **-** | - | - | - | - |
| - Bulk purchase | **-** | **-** | **-** | **-** | - | - | - | - |
| | **-** | **-** | **-** | **-** | - | - | - | - |
| Longevity insurance | **70** | **-** | **-** | **-** | - | - | - | - |
| **Total Risk** | **110** | **43** | **46** | **48** | 45 | 45 | 43 | 42 |
| Investments[1] | **18** | **20** | **19** | **11** | 7 | 4 | 10 | 5 |
| Insured business | **72** | **51** | **62** | **59** | 47 | 138 | 81 | 33 |
| With-profits | **14** | **16** | **17** | **22** | 17 | 13 | 18 | 23 |
| **Total Savings** | **104** | **87** | **98** | **92** | 71 | 155 | 109 | 61 |
| - USA (LGA) | **19** | **18** | **16** | **16** | 16 | 14 | 13 | 9 |
| - Netherlands (LGN) | **1** | **2** | **1** | **1** | 1 | 2 | 1 | 2 |
| - France (LGF) | **-** | **-** | **15** | **9** | 2 | - | 12 | 8 |
| - India (26% share) | **1** | **1** | **1** | **2** | 2 | 3 | 2 | 6 |
| - Egypt (55% share) | **3** | **3** | **2** | **1** | 2 | 3 | 5 | - |
| - Gulf (50% share) | **1** | **-** | **1** | **-** | - | - | - | - |
| | **25** | **24** | **36** | **29** | 23 | 22 | 33 | 25 |
| France (LGF) retail investment business | **-** | **-** | **-** | **-** | - | - | - | - |
| **Total International** | **25** | **24** | **36** | **29** | 23 | 22 | 33 | 25 |
| **Total worldwide new business** | **239** | **154** | **180** | **169** | 139 | 222 | 185 | 128 |

1. Investments excludes institutional investments in unit trust funds which are disclosed as part of institutional fund management new business (see Note 6.01).

# New Business

## 6.10 Worldwide new business single premium quarterly progression

| | 3 months to 31.12.11 £m | 3 months to 30.09.11 £m | 3 months to 30.06.11 £m | 3 months to 31.03.11 £m | 3 months to 31.12.10 £m | 3 months to 30.09.10 £m | 3 months to 30.06.10 £m | 3 months to 31.03.10 £m |
|---|---|---|---|---|---|---|---|---|
| Protection | | | | | | | | |
| - Individual | - | - | - | - | - | - | - | - |
| - Group | - | - | - | - | - | - | - | - |
| | - | - | - | - | - | - | - | - |
| Annuities | | | | | | | | |
| - Individual (non profit) | 212 | 313 | 293 | 212 | 243 | 298 | 334 | 267 |
| - Individual (with-profits) | 7 | 6 | 5 | 6 | 11 | 5 | 6 | 4 |
| - Bulk purchase | 1,190 | 31 | 217 | 23 | 361 | 89 | 298 | 149 |
| | 1,409 | 350 | 515 | 241 | 615 | 392 | 638 | 420 |
| Longevity insurance | - | - | - | - | - | - | - | - |
| **Total Risk** | 1,409 | 350 | 515 | 241 | 615 | 392 | 638 | 420 |
| Investments[1] | 1,153 | 1,632 | 1,761 | 1,654 | 1,513 | 1,377 | 1,692 | 1,587 |
| Insured business | 568 | 456 | 502 | 489 | 591 | 441 | 434 | 329 |
| With-profits | 112 | 96 | 177 | 140 | 113 | 144 | 207 | 144 |
| **Total Savings** | 1,833 | 2,184 | 2,440 | 2,283 | 2,217 | 1,962 | 2,333 | 2,060 |
| - USA (LGA) | - | - | - | - | - | - | - | - |
| - Netherlands (LGN) | 20 | 17 | 19 | 39 | 42 | 16 | 23 | 43 |
| - France (LGF) | 51 | 56 | 69 | 56 | 61 | 53 | 78 | 45 |
| - India (26% share) | 5 | 4 | 2 | 11 | 2 | 3 | 1 | 1 |
| - Egypt (55% share) | - | - | - | - | - | - | - | - |
| - Gulf (50% share) | - | 5 | - | - | - | - | - | - |
| | 76 | 82 | 90 | 106 | 105 | 72 | 102 | 89 |
| France (LGF) retail investment business | 13 | 15 | 9 | 9 | 11 | 9 | 11 | 29 |
| **Total International** | 89 | 97 | 99 | 115 | 116 | 81 | 113 | 118 |
| **Total worldwide new business** | 3,331 | 2,631 | 3,054 | 2,639 | 2,948 | 2,435 | 3,084 | 2,598 |

1. Investments excludes institutional investments in unit trust funds which are disclosed as part of institutional fund management new business (see Note 6.01).

## 6.11 International new business in local currency

| | **Annual premiums 2011** | **Single premiums 2011** | **APE 2011** | Annual premiums 2010 | Single premiums 2010 | APE 2010 | Increase/ (decrease) % |
|---|---|---|---|---|---|---|---|
| USA (LGA) ($m) | **111** | **-** | **111** | 80 | - | 80 | 39 |
| Netherlands (LGN) (€m) | **6** | **109** | **17** | 7 | 146 | 22 | (23) |
| France (LGF) (€m): | | | | | | | |
| - Life and pensions | **27** | **267** | **54** | 27 | 277 | 55 | (2) |
| - Unit trusts | **-** | **53** | **5** | - | 70 | 7 | (29) |
| India (Rs m) - Group's 26% interest | **373** | **1,629** | **536** | 934 | 459 | 980 | (45) |
| Egypt (Pounds m) - Group's 55% interest | **87** | **-** | **87** | 87 | 3 | 87 | - |
| Gulf (US$m) - Group's 50% interest | **3** | **9** | **4** | - | - | - | - |

## 6.12 UK APE by channel quarterly progression

| | **3 months to 31.12.11 £m** | **3 months to 30.09.11 £m** | **3 months to 30.06.11 £m** | **3 months to 31.03.11 £m** | 3 months to 31.12.10 £m | 3 months to 30.09.10 £m | 3 months to 30.06.10 £m | 3 months to 31.03.10 £m |
|---|---|---|---|---|---|---|---|---|
| Retail IFA | **137** | **173** | **170** | **166** | 166 | 150 | 164 | 156 |
| Employee benefit consultants | **300** | **84** | **120** | **104** | 118 | 178 | 145 | 84 |
| Tied agents | **8** | **9** | **13** | **8** | 11 | 9 | 12 | 8 |
| Bancassurance | **86** | **107** | **123** | **100** | 97 | 93 | 115 | 94 |
| Direct | **6** | **11** | **14** | **14** | 7 | 6 | 13 | 9 |
| **Total** | **537** | **384** | **440** | **392** | 399 | 436 | 449 | 351 |

## 6.13 UK APE by channel

| **For the year ended 31 December 2011** | **Annual premiums £m** | **Single premiums £m** | **APE £m** | **% of total** |
|---|---|---|---|---|
| Retail IFA | **81** | **5,649** | **646** | **37** |
| Employee benefit consultants | **394** | **2,140** | **608** | **35** |
| Tied agents | **30** | **77** | **38** | **2** |
| Bancassurance | **97** | **3,195** | **416** | **23** |
| Direct | **26** | **194** | **45** | **3** |
| **Total** | **628** | **11,255** | **1,753** | **100** |

| **For the year ended 31 December 2010** | Annual premiums £m | Single premiums £m | APE £m | % of total |
|---|---|---|---|---|
| Retail IFA | 75 | 5,610 | 636 | 39 |
| Employee benefit consultants | 389 | 1,360 | 525 | 32 |
| Tied agents | 29 | 110 | 40 | 3 |
| Bancassurance | 57 | 3,420 | 399 | 24 |
| Direct | 21 | 137 | 35 | 2 |
| **Total** | 571 | 10,637 | 1,635 | 100 |