IFRS 17: Transition Document

Lloyds Banking Group plc

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CONTENTS

1. SUMMARY

Key messages

IFRS 17 is a new accounting standard for insurance contracts, which is effective from 1 January 2023. In advance of Lloyds Banking Group's 2023 first quarter results, which will be reported on an IFRS 17 basis, this transition document provides restated financials for 2022 on an IFRS 17 basis.

The detailed restatements provide comparatives for future reporting and are consistent with the detail and guidance provided in the Group's 2022 Results[1].

The financial information presented in the Transition Document is unaudited and represents the Group's current best estimate of IFRS 17 impacts. Analysis of results is subject to on-going review and potential change.

When reviewing the restated financials, it is important to recognise certain key points:

- **IFRS 17 does not impact the economic value of the Insurance business or the total profit recognised over the lifetime of any insurance contract.** The move to IFRS 17 is an accounting change impacting the phasing of profit recognition on insurance contracts
- **Under IFRS 17, insurance contract profit is recognised over the lifetime of the contract rather than substantially at inception**, as was the case under IFRS 4. Deferred income is recognised within the Contractual Service Margin (CSM) included on the balance sheet as insurance contract profit is no longer recognised substantially at inception
- **The CSM and risk adjustment combined of £5,108 million, net of reinsurance, as at 31 December 2022, represent a store of future earnings which will be released into the income statement over the life of the insurance contracts and as risks expire. This will provide a more stable, predictable earnings stream over time**
- **IFRS 17 will have no impact on the Group's financial results over the longer-term although near-term reported other income is expected to be lower.** There are no changes to Group guidance
- **There is a mid single digit pence per share reduction in tangible net asset value (TNAV). TNAV per share at 31 December 2022 is 46.5 pence per share under IFRS 17, 5.4 pence lower than under IFRS 4**. This arises from changes to the Group's equity from the move to IFRS 17, as outlined later in this document. **TNAV will benefit in future periods from the unwind of the deferred future value.** This is consistent with previous guidance
- **There is no impact on the Group and Insurance capital position and generation, nor Insurance dividends to Group.** Within the Insurance business, the Solvency II position is unchanged and all cash flows are unaffected

[1] The Group's 2022 Results News Release and the Annual Report and Accounts.

1. SUMMARY (continued)

High level financial impacts

The key impacts on the Group income statement and balance sheet are outlined below. The impact of transition to IFRS 17 is consistent with the detail and guidance provided in the Group's 2022 Results.

Impact on the 2022 income statement

- IFRS 17 will have no impact on the Group's financial results over the longer-term although near-term profits contribution from Insurance will be lower. Underlying profit has reduced from £7,448 million under IFRS 4 to £7,028 million under IFRS 17, due to a £583 million decrease of 2022 other income to £4,666 million (run rate impact of c.£300-£400 million, after elevated assumption benefits under IFRS 4 in 2022), partly offset by lower costs (as a result of IFRS 17 recognition changes). The Insurance income reduction, largely due to the deferral of new business profit and assumption changes, will increase the CSM and future earnings release going forward
- Exceptional adverse volatility given significant interest rate movements in the year. Volatility is £484 million higher than under IFRS 4. This impact is largely derived from market volatility from unit linked business that is now recognised through the CSM, except where the Group has applied the risk mitigation option, and the absence of policyholder interests volatility on the VIF. This was elevated during 2022 given rapid interest rate rises
- Exceptional below the line impact of £1,242 million arising from contract modifications, with an increase to CSM of £1,331 million, which will be released to the income statement over the contract service period. During 2022, the Group added a drawdown feature to its existing longstanding and workplace pension business as a significant customer enhancement. Under IFRS 17, this is a contract modification (given the increase in the expected contract service period) and requires that the contracts at the time of modification are derecognised and the modified contracts recognised as if they were new contracts. This is not expected to be a recurring event
- Group statutory profit before tax has reduced from £6,928 million under IFRS 4 to £4,782 million under IFRS 17, primarily driven by the one-off impact of contract modifications and exceptional adverse volatility, as outlined above. Group statutory profit after tax has reduced from £5,555 million to £3,923 million
- Restated return on tangible equity (RoTE) for 2022 of 9.8 per cent (IFRS 4: 13.5 per cent) given the reduction of statutory profit. We expect the implementation of IFRS 17 to result in a modest positive RoTE impact compared to IFRS 4

Impact on the 2022 balance sheet

- On transition, consistent with the disclosures in the Annual Report and Accounts (ARA)[1], the Group's total equity at 1 January 2022 has reduced by £1,935 million from £53,152 million under IFRS 4 to £51,217 million under IFRS 17. The reduction in equity is primarily driven by the derecognition of the value in-force (VIF) asset and the move to best estimate of contract liabilities, the creation of the new CSM liability (£1,927 million, net of reinsurance) and the establishment of the risk adjustment (£1,492 million, net of reinsurance)
- The release of CSM and risk adjustment in 2022 is £319 million (estimated release in 2022 of c.£300 million on the opening CSM and risk adjustment at 1 January 2022 is disclosed in the ARA[1])
- At 31 December 2022, total equity is further impacted by the restatement of the income statement for year ended 31 December 2022, resulting in a reduction of £1,632 million in retained profits for the year, arising from the impact of revised income recognition, changes in interest rates during 2022, including the impact of elevated volatility and the one-off impact of contract modifications. There is a further reduction in total equity of £43 million resulting from the IFRS 17 impact on foreign currency translation reserve. Total equity at 31 December 2022 has therefore reduced by £3,610 million, from £47,521 million under IFRS 4 to £43,911 million under IFRS 17. As noted above, these changes to Group equity do not affect the capital position of the Group or its Insurance business
- At 31 December 2022, the CSM position, net of reinsurance, is a liability of £3,999 million. This represents a store of future earnings that will unwind into the Group income statement over time, in line with the relevant insurance contracts' service period

[1] Disclosures in the ARA in the Financial Results section, page 65 and in Note 55, page 337.

2. SUMMARY OF BASIS OF ACCOUNTING CHANGE

IFRS 17 establishes principles for the recognition, measurement, presentation and disclosure of insurance contracts, participating investment contracts and reinsurance contracts issued (collectively referred to as 'insurance contracts issued' in this document, unless otherwise specified) and reinsurance contracts held.

What does not change

- There is no change in the total profit recognised over the life of the contracts but profit recognition is deferred under IFRS 17
- Actual cash flows and capital generation from the Insurance division remain unchanged in all respects

The key changes arising from the adoption of IFRS 17 are:

	IFRS 4	IFRS 17
New business	Expected profit is recognised on a discounted basis at the time the contract is initially recognised. Value of in-force business asset (VIF) is established.	**Profit is deferred and held as CSM** (part of the liabilities arising from insurance contracts and participating investment contracts). The CSM is recognised in the income statement over the contract service period. **VIF asset is written off** at transition.
Valuation of insurance contracts issued and reinsurance contracts held	Allows continuation of accounting practices applied prior to the adoption of IFRS 4. The reserving basis for insurance contract liabilities includes an element of prudence (or on a realistic basis for With-Profit contracts). The Group allows for VIF on a realistic basis.	Establishes standard measurement principles and introduces the balance sheet concepts of a CSM and a risk adjustment. The CSM is released over the contract service period and the risk adjustment is released as uncertainty within the calculation of the liabilities diminishes. More details on the CSM and the risk adjustment are provided in the 'Recognition and measurement section'. IFRS 17 does not allow for prudence but requires an explicit margin for non-financial risk through the risk adjustment.
Assumption changes	The impact of the majority of assumption changes is recognised immediately in the income statement.	**The impact of assumption changes relating to future service is deferred through CSM** and recognised in the income statement over the contract service period.
Market volatility	Underlying market volatility under IFRS 4 and IFRS 17 are similar, however volatility in the income statement under IFRS 17 differs due to the following:	
	Policyholder interests volatility on VIF is recognised. Volatility on unit-linked business is recognised in the income statement.	VIF as a concept does not exist under IFRS 17 so the related policyholder interests volatility on the VIF will also not exist. Market volatility on unit-linked business will be deferred to the CSM and released to the income statement in subsequent years except where the Group has applied the risk mitigation option.

A glossary of key IFRS 17 terms is included on page 38 of this document.

3. GROUP RESULTS

Income statement – underlying basis

Underlying profit has reduced from £7,448 million under IFRS 4 to £7,028 million under IFRS 17, with 2022 other income £583 million lower at £4,666 million (run rate impact of c.£300-£400 million, after elevated assumption benefits under IFRS 4 in 2022), partly offset by lower costs (see page 8). The income reduction, largely due to the deferral of new business profit and assumption changes, will increase the CSM and future earnings release into the income statement going forward.

The restatements detailed below are in line with the guidance provided in the Group's 2022 results.

The restated Group income statements on an underlying basis, for the half year ended 30 June 2022 and the year ended 31 December 2022, are presented below.

	Note	IFRS 4 Half year ended 30 Jun 2022 £m	IFRS 17 adjustments £m	IFRS 17 Half year ended 30 Jun 2022 £m
Underlying net interest income		6,135	—	6,135
Underlying other income	1	2,529	(162)	2,367
Operating lease depreciation		(213)	—	(213)
Net income		**8,451**	**(162)**	**8,289**
Operating costs	2	(4,249)	78	(4,171)
Remediation		(79)	—	(79)
Total costs		**(4,328)**	**78**	**(4,250)**
Underlying profit before impairment		**4,123**	**(84)**	**4,039**
Underlying impairment (charge) credit		(377)	—	(377)
Underlying profit		**3,746**	**(84)**	**3,662**
Restructuring		(47)	—	(47)
Volatility and other items	3	(38)	(428)	(466)
Statutory profit before tax		**3,661**	**(512)**	**3,149**
Tax (expense) credit		(835)	133	(702)
Statutory profit after tax		**2,826**	**(379)**	**2,447**

Notes

1. Underlying other income - adjustment primarily due to deferral of new business profit and the impacts from assumption changes to the CSM, release of which is recognised in income over the contract service period.
2. Operating costs - adjusted to exclude acquisition expenses deferred to the CSM.
3. Volatility and other items - updated to reflect IFRS 17 position: see further details in Insurance, Pensions and Investments division analysis. This includes the impact of contract modifications.

3. GROUP RESULTS (continued)

	Note	IFRS 4 Full year ended 31 Dec 2022 £m	IFRS 17 adjustments £m	IFRS 17 Full year ended 31 Dec 2022 £m
Underlying net interest income		13,172	—	13,172
Underlying other income	1	5,249	(583)	4,666
Operating lease depreciation		(373)	—	(373)
Net income		**18,048**	**(583)**	**17,465**
Operating costs	2	(8,835)	163	(8,672)
Remediation		(255)	—	(255)
Total costs		**(9,090)**	**163**	**(8,927)**
Underlying profit before impairment		**8,958**	**(420)**	**8,538**
Underlying impairment (charge) credit		(1,510)	—	(1,510)
Underlying profit		**7,448**	**(420)**	**7,028**
Restructuring		(80)	—	(80)
Volatility and other items	3	(440)	(1,726)	(2,166)
Statutory profit before tax		**6,928**	**(2,146)**	**4,782**
Tax (expense) credit		(1,373)	514	(859)
Statutory profit after tax		**5,555**	**(1,632)**	**3,923**

Notes

1. Underlying other income - adjustment primarily due to deferral of new business profit and the impacts from assumption changes to the CSM, release of which is recognised in income over the contract service period.
2. Operating costs - adjusted to exclude acquisition expenses deferred to the CSM.
3. Volatility and other items - updated to reflect IFRS 17 position: see further details in Insurance, Pensions and Investments division analysis. This includes the impact of contract modifications.

3. GROUP RESULTS (continued)

Income statement impacts – underlying basis

The high level impacts of implementing IFRS 17 on the Group's income statement, on an underlying basis, are outlined below.

	Note	Full year ended 31 Dec 2022 £m	Half year ended 31 Dec 2022 £m	Half year ended 30 Jun 2022 £m
Underlying profit as previously reported		**7,448**	**3,702**	**3,746**
IFRS 17 adjustments:				
Income impacts:				
Deferral of new business	1	(425)	(208)	(217)
Deferral of assumption changes relating to future service	2	(348)	(276)	(72)
Release of deferred profit	3	319	178	141
Deferral of investment return	4	(68)	(44)	(24)
Other	5	(61)	(71)	10
Total income impacts		(583)	(421)	(162)
Cost impacts:				
Deferral of acquisition expenses	6	163	85	78
Total impact of IFRS 17 on underlying profit		(420)	(336)	(84)
IFRS 17 restated underlying profit		**7,028**	**3,366**	**3,662**
Total impact of IFRS 17 on underlying profit		**(420)**	**(336)**	**(84)**
Impact of IFRS 17 adjustments on items included in statutory profit after tax, not included in underlying profit:				
Loss on contract modifications	7	(1,242)	(1,015)	(227)
Volatility	8	(484)	(283)	(201)
Tax (expense) credit		514	381	133
Total impact of IFRS 17 on statutory profit after tax		**(1,632)**	**(1,253)**	**(379)**

Notes

1. New business profit is deferred and spread over the contract service period under IFRS 17.
2. Impact of assumption changes relating to future service are generally deferred and spread over the contract service period under IFRS 17 (excluding impact of changes in financial assumptions for General Measurement Model business).
3. Deferred profit is represented by CSM and risk adjustment. CSM is released as insurance contract services are provided; risk adjustment is released as uncertainty within the calculation of the liabilities diminishes.
4. Investment return and economics - the uplift for additional investment return beyond risk-free rate, recognised in income under IFRS 4, is deferred to the CSM for certain businesses under IFRS 17.
5. Primarily relates to experience variances, notably persistency, which are generally deferred and spread over the contract service period under IFRS 17.
6. The cost of acquiring new business is deferred alongside the related income.
7. During 2022, the Group added a drawdown feature to its existing longstanding and workplace pension business as a significant customer enhancement. Under IFRS 17, this is a contract modification and requires that the contracts at the time of modification are derecognised and the modified contracts recognised as if they were new contracts. This is because the contract modification results in a substantial increase in the expected length of the contract services period for the modified contracts (refer to the 'Significant estimates and judgments' section for more information on contract modifications). The contract modifications result in a charge to the income statement of £1,242 million and an increase to CSM of £1,331 million, which is released to the income statement over the contract service period. The timing of recognition of contract modifications impacts occurred from May to December 2022, in line with communication of the addition of drawdown benefit to policyholders during the year.
8. Under IFRS 17, volatility relating to unit-linked business will be recognised within the CSM except where the Group has applied the risk mitigation option. In addition, policyholder interests volatility on the VIF will not exist under IFRS 17. The removal of these two components together increases reported adverse volatility by £484 million in the 2022 income statement restated for IFRS 17 versus IFRS 4.

3. GROUP RESULTS (continued)

Quarterly information – underlying basis

	IFRS 17				
	Quarter ended 31 Dec 2022 £m	Quarter ended 30 Sep 2022 £m	Quarter ended 30 Jun 2022 £m	Quarter ended 31 Mar 2022 £m	Full year ended 31 Dec 2022 £m
Underlying net interest income	3,643	3,394	3,190	2,945	13,172
Underlying other income	1,128	1,171	1,185	1,182	4,666
Operating lease depreciation	(78)	(82)	(119)	(94)	(373)
Net income	**4,693**	**4,483**	**4,256**	**4,033**	**17,465**
Operating costs	(2,356)	(2,145)	(2,112)	(2,059)	(8,672)
Remediation	(166)	(10)	(27)	(52)	(255)
Total costs	**(2,522)**	**(2,155)**	**(2,139)**	**(2,111)**	**(8,927)**
Underlying profit before impairment	**2,171**	**2,328**	**2,117**	**1,922**	**8,538**
Underlying impairment (charge) credit	(465)	(668)	(200)	(177)	(1,510)
Underlying profit	**1,706**	**1,660**	**1,917**	**1,745**	**7,028**
Restructuring	(11)	(22)	(23)	(24)	(80)
Volatility and other items	(638)	(1,062)	(289)	(177)	(2,166)
Statutory profit before tax	**1,057**	**576**	**1,605**	**1,544**	**4,782**
Tax (expense) credit	(75)	(82)	(303)	(399)	(859)
Statutory profit after tax	**982**	**494**	**1,302**	**1,145**	**3,923**
Cost:income ratio	53.7 %	48.1 %	50.3 %	52.3 %	51.1 %
Return on tangible equity	11.0 %	4.2 %	13.0 %	10.7 %	9.8 %
Tangible net assets per share	46.5p	44.5p	51.4p	53.7p	46.5p
Earnings per share	1.3p	0.5p	1.7p	1.4p	4.9p
Metrics not impacted by IFRS 17:					
Banking net interest margin	3.22 %	2.98 %	2.87 %	2.68 %	2.94 %
Average interest-earning banking assets	£453.8bn	£454.9bn	£451.2bn	£448.0bn	£452.0bn
Asset quality ratio	0.38 %	0.57 %	0.17 %	0.16 %	0.32 %
Loans and advances to customers	£454.9bn	£456.3bn	£456.1bn	£451.8bn	£454.9bn
Customer deposits	£475.3bn	£484.3bn	£478.2bn	£481.1bn	£475.3bn
Loan to deposit ratio	96 %	94 %	95 %	94 %	96 %
Risk-weighted assets	£210.9bn	£210.8bn	£209.6bn	£210.2bn	£210.9bn

3. GROUP RESULTS (continued)

Quarterly information – underlying basis (as previously published)

	IFRS 4				
	Quarter ended 31 Dec 2022 £m	Quarter ended 30 Sep 2022 £m	Quarter ended 30 Jun 2022 £m	Quarter ended 31 Mar 2022 £m	Full year ended 31 Dec 2022 £m
Underlying net interest income	3,643	3,394	3,190	2,945	13,172
Underlying other income	1,438	1,282	1,268	1,261	5,249
Operating lease depreciation	(78)	(82)	(119)	(94)	(373)
Net income	**5,003**	**4,594**	**4,339**	**4,112**	**18,048**
Operating costs	(2,399)	(2,187)	(2,151)	(2,098)	(8,835)
Remediation	(166)	(10)	(27)	(52)	(255)
Total costs	**(2,565)**	**(2,197)**	**(2,178)**	**(2,150)**	**(9,090)**
Underlying profit before impairment	**2,438**	**2,397**	**2,161**	**1,962**	**8,958**
Underlying impairment (charge) credit	(465)	(668)	(200)	(177)	(1,510)
Underlying profit	**1,973**	**1,729**	**1,961**	**1,785**	**7,448**
Restructuring	(11)	(22)	(23)	(24)	(80)
Volatility and other items	(203)	(199)	100	(138)	(440)
Statutory profit before tax	**1,759**	**1,508**	**2,038**	**1,623**	**6,928**
Tax (expense) credit	(239)	(299)	(416)	(419)	(1,373)
Statutory profit after tax	**1,520**	**1,209**	**1,622**	**1,204**	**5,555**
Cost:income ratio	51.3 %	47.8 %	50.2 %	52.3 %	50.4 %
Return on tangible equity	16.3 %	11.9 %	15.6 %	10.8 %	13.5 %
Tangible net assets per share	51.9p	49.0p	54.8p	56.5p	51.9p
Earnings per share	2.1p	1.5p	2.2p	1.5p	7.3p
Metrics not impacted by IFRS 17:					
Banking net interest margin	3.22 %	2.98 %	2.87 %	2.68 %	2.94 %
Average interest-earning banking assets	£453.8bn	£454.9bn	£451.2bn	£448.0bn	£452.0bn
Asset quality ratio	0.38 %	0.57 %	0.17 %	0.16 %	0.32 %
Loans and advances to customers	£454.9bn	£456.3bn	£456.1bn	£451.8bn	£454.9bn
Customer deposits	£475.3bn	£484.3bn	£478.2bn	£481.1bn	£475.3bn
Loan to deposit ratio	96 %	94 %	95 %	94 %	96 %
Risk-weighted assets	£210.9bn	£210.8bn	£209.6bn	£210.2bn	£210.9bn

3. GROUP RESULTS (continued)

Quarterly information – underlying basis: Impact of IFRS 17 (movement vs. published)

	Movement IFRS 17 v IFRS 4				
	Quarter ended 31 Dec 2022 £m	**Quarter ended 30 Sep 2022 £m**	**Quarter ended 30 Jun 2022 £m**	**Quarter ended 31 Mar 2022 £m**	**Full year ended 31 Dec 2022 £m**
Underlying net interest income	—	—	—	—	—
Underlying other income	(310)	(111)	(83)	(79)	(583)
Operating lease depreciation	—	—	—	—	—
Net income	**(310)**	**(111)**	**(83)**	**(79)**	**(583)**
Operating costs	43	42	39	39	163
Remediation	—	—	—	—	—
Total costs	**43**	**42**	**39**	**39**	**163**
Underlying profit before impairment	**(267)**	**(69)**	**(44)**	**(40)**	**(420)**
Underlying impairment (charge) credit	—	—	—	—	—
Underlying profit	**(267)**	**(69)**	**(44)**	**(40)**	**(420)**
Restructuring	—	—	—	—	—
Volatility and other items	(435)	(863)	(389)	(39)	(1,726)
Statutory profit before tax	**(702)**	**(932)**	**(433)**	**(79)**	**(2,146)**
Tax (expense) credit	164	217	113	20	514
Statutory profit after tax	**(538)**	**(715)**	**(320)**	**(59)**	**(1,632)**
Cost:income ratio	2.4 %	0.3 %	0.1 %	— %	0.7 %
Return on tangible equity	(5.3)%	(7.7)%	(2.6)%	(0.1)%	(3.7)%
Tangible net assets per share	(5.4)p	(4.5)p	(3.4)p	(2.8)p	(5.4)p
Earnings per share	(0.8)p	(1.0)p	(0.5)p	(0.1)p	(2.4)p

3. GROUP RESULTS (continued)

Income statement – statutory basis

The table below presents the summarised Group statutory income statement for the year ended 31 December 2022 on an IFRS 17 basis. The full Group statutory income statement is presented in the Appendix.

	IFRS 17		
	Full year ended 31 Dec 2022 £m	**Half year ended 31 Dec 2022 £m**	**Half year ended 30 Jun 2022 £m**
Net interest income	12,922	6,885	6,037
Other income	(18,268)	(238)	(18,030)
Total income	**(5,346)**	**6,647**	**(11,993)**
Net financial income in respect of insurance and participating investment contracts	20,887	946	19,941
Total income, net of insurance service results and income from investment contracts	**15,541**	**7,593**	**7,948**
Operating expenses	(9,237)	(4,819)	(4,418)
Impairment (charge) credit	(1,522)	(1,141)	(381)
Profit before tax	**4,782**	**1,633**	**3,149**
Tax expense	(859)	(157)	(702)
Profit for the period	**3,923**	**1,476**	**2,447**
Profit attributable to ordinary shareholders	3,389	1,199	2,190
Profit attributable to other equity holders	438	224	214
Profit attributable to equity holders	3,827	1,423	2,404
Profit attributable to non-controlling interests	96	53	43
Profit for the period	**3,923**	**1,476**	**2,447**

3. GROUP RESULTS (continued)

Income statement impacts – statutory basis

A summary of the impact of implementing IFRS 17 on the Group's statutory income statement for the year ended 31 December 2022 is outlined below. The full Group statutory income statement is presented in the Appendix.

	Note	Full year ended 31 Dec 2022 £m	Half year ended 31 Dec 2022 £m	Half year ended 30 Jun 2022 £m
Profit for the period as previously reported under IFRS 4		**5,555**	**2,729**	**2,826**
Remove and/or reclassify IFRS 4 income statement items:				
Remove insurance premium income	1	(9,059)	(4,408)	(4,651)
Reclassify insurance claims and changes in insurance and investment contract liabilities	2	(12,401)	2,642	(15,043)
Remove movement in VIF and other IFRS 4 related items	3	63	(227)	290
Reclassify net fee and commission income	4	217	114	103
Reclassify operating expenses	5	522	259	263
Add IFRS 17 income statement items[1]:				
Insurance revenue	6	2,461	1,260	1,201
Insurance service expenses	7	(3,863)	(2,416)	(1,447)
Net expense from reinsurance contracts held	8	62	68	(6)
Net insurance finance income	9	15,948	1,643	14,305
Net finance expense from reinsurance contracts held	10	(55)	(50)	(5)
Change in non-participating investment contracts	11	4,166	(612)	4,778
Impact of components previously accounted for under IFRS 9, now within the scope of IFRS 17	12	(207)	93	(300)
Adjust tax for differences between IFRS 4 and IFRS 17	13	514	381	133
Total impact of IFRS 17 on statutory profit after tax		**(1,632)**	**(1,253)**	**(379)**
Profit for the period restated for IFRS 17		**3,923**	**1,476**	**2,447**
Profit attributable to ordinary shareholders		3,389	1,199	2,190
Profit attributable to other equity holders		438	224	214
Profit attributable to equity holders		3,827	1,423	2,404
Profit attributable to non-controlling interests		96	53	43
Profit for the period		**3,923**	**1,476**	**2,447**

[1] These are new line items required to be presented on the income statement under IFRS 17.

Notes

Remove and/or reclassify IFRS 4 income statement items

1. Insurance premium income is removed as this is no longer presented in the income statement under IFRS 17; instead, amounts are included in the balance sheet to adjust the carrying value of liabilities arising from insurance contracts and participating investment contracts.
2. Insurance claims and changes in insurance and investment contract liabilities relating to IFRS 4 and IFRS 9 are removed. The IFRS 17 relevant amounts are reflected in insurance service expenses, net insurance finance income, net expense from reinsurance contracts held and net finance expense from reinsurance contracts held. The IFRS 9 relevant amounts are reflected in the change in non-participating investment contracts.
3. Movement in VIF on an IFRS 4 basis is removed.

3. GROUP RESULTS (continued)

4. Net fee and commission income is adjusted to reflect the reclassification of investment expenses (now included as part of insurance service expenses), commission expenses (now deferred as acquisition expenses) and certain annual management charge income (variable fees received that adjust CSM).
5. Operating expenses are adjusted to remove maintenance expenses from this line item (now included as part of insurance service expenses) and acquisition expenses are deferred to CSM.

Add IFRS 17 income statement items

6. Insurance revenue comprises:
   a. CSM released to the income statement during the period;
   b. Changes in risk adjustment related to current service;
   c. Expected claims excluding any investment components and other insurance service expenses expected;
   d. An allocation of premiums that relate to recovering insurance acquisition expenses; and
   e. Revenue for insurance contracts under the premium allocation approach.
7. Insurance service expenses comprises:
   a. Incurred claims, excluding any investment components;
   b. Attributable insurance service expenses;
   c. Amortisation of insurance acquisition expenses;
   d. Changes that relate to past service i.e. changes in fulfilment cash flows relating to liability for incurred claims;
   e. Changes that relate to future service i.e. losses and reversal of losses on onerous groups of contracts; and
   f. Losses as a result of contract modifications.
8. Net expenses from reinsurance contracts held comprises:
   a. CSM recognised for reinsurance services received;
   b. Change in risk adjustment for expired risks;
   c. Expected claim recoveries and other expenses recovery;
   d. Recoveries of incurred claims and other insurance service expenses;
   e. Recoveries of losses and reversals of losses on onerous underlying contracts; and
   f. Income and expenses (other than insurance finance income or expenses) for reinsurance contracts under the premium allocation approach.
9. Net insurance finance income represents the change in the carrying value of a group of insurance contracts comprising interest accreted to the CSM, effects of changes in interest rates and other financial assumptions, effects of the risk mitigation option and the effect of change in fair value of underlying items for direct participating contracts.
10. Net finance expense from reinsurance contracts held is the finance related change in the carrying value of a group of reinsurance contracts comprising interest accreted to the CSM and effects of changes in interest rates and other financial assumptions.

Other adjustments

11. Change in non-participating investment contracts is presented as a separate line item, reclassified from insurance claims and changes in insurance and investment contract liabilities.
12. The effect of reclassifying certain deposit components previously in scope of IFRS 9 is recognised. For certain hybrid Unit-Linked/ With-Profit contracts, applying IFRS 4 the deposit component was unbundled from the host contract and included within the scope of IFRS 9. Applying IFRS 17, the investment component has been assessed as non-distinct and so has not been separated and the entire contract is classified within insurance and participating investment contracts within scope of IFRS 17.
13. The tax impact of the IFRS 17 adjustments is recognised at the rate of tax it is expected to be realised at. For the year ended 31 December 2022, this includes the impact of the transitional tax provisions to allow spreading of life companies' profit or loss arising on transition to IFRS17 over 10 years. For the half year ended 30 June 2022, these provisions were not substantively enacted and so the rate of tax did not reflect them.

In addition to the adjustments set out above, movement in third party interests in consolidated funds is reclassified from interest expense to a separate line as part of the new IFRS 17 income statement presentation (see detailed Group statutory income statement in the Appendix). This reclassification does not impact the profit for the period.

3. GROUP RESULTS (continued)

Balance sheet impacts as at 1 January 2022 and 31 December 2022

On transition, consistent with the disclosures in the ARA, the Group's total equity at 1 January 2022 has reduced by £1,935 million from £53,152 million under IFRS 4 to £51,217 million under IFRS 17.

A summary of the impact of implementing IFRS 17 on the Group's total equity as of 1 January 2022 and 31 December 2022 is outlined below. The Group's full balance sheet is included in the Appendix.

	Note	Total equity as at 1 January 2022 £m	Profit for the year ended 31 Dec 2022 £m	Other equity movements during 2022[1] £m	Total equity as at 31 December 2022 £m
As previously reported under IFRS 4		**53,152**	**5,555**	**(11,186)**	**47,521**
IFRS 17 opening balance sheet adjustments					
Derecognition of VIF	1	(5,317)	—	—	(5,317)
Move to best estimate liabilities	2	5,915	—	—	5,915
Risk adjustment	3	(1,492)	—	—	(1,492)
CSM	4	(1,927)	—	—	(1,927)
Deferred tax	5	686	—	—	686
Other	6	200	—	—	200
IFRS 17 adjustments for the year ended 31 December 2022	7		(1,632)	(43)	(1,675)
IFRS 17 restated amounts		**51,217**	**3,923**	**(11,229)**	**43,911**

[1] Other equity movements are principally related to the impacts of cash flow hedging, defined benefit pension scheme remeasurements and the Group's dividends and share buyback.

Notes

1. VIF is derecognised as profits are deferred under IFRS 17 rather than recognised at the point at which the contract is initially recognised.
2. Liabilities for insurance contracts and participating investment contracts are valued on a best estimate basis under IFRS 17, instead of a prudent or realistic basis under IFRS 4.
3. A risk adjustment liability is recognised in respect of the impact of non-financial risk on insurance contract cash flows (adjustment shown net of reinsurance).
4. The CSM liability represents the unearned profit the Group will recognise as it provides insurance contract services over the life of the contracts (adjustment shown net of reinsurance). CSM recognised is after elimination of intra-Group fees and costs arising from insurance products sold through banking channels.
5. Deferred tax is adjusted for movements in retained earnings between IFRS 4 and IFRS 17. This includes the impact arising from the CSM relating to intra-Group fees.
6. Retained profit is adjusted for the consequential impacts of IFRS 17 on other accounting standards and for the impact of restatement of foreign currency translation relating to foreign operations.
7. Details of the IFRS 17 adjustments of £1,632 million relating the profit for the year ended 31 December 2022 are set out in the statutory income statement section. The adjustment of £43 million is in respect of restatement of the foreign currency translation reserve.

CSM and risk adjustment

The CSM represents a store of future earnings given it is the unearned profit the Group will recognise as it provides insurance contract services over the life of currently in-force insurance contracts. The risk adjustment also represents a store of future earnings to the extent that non-financial risks associated with insurance contracts expire as uncertainty within the valuation of the liabilities reduces. Under IFRS 17, income arising from insurance contracts will primarily be recognised through the release of the CSM and the risk adjustment (for non-financial risks such as mortality and persistency).

3. GROUP RESULTS (continued)

The opening CSM, net of reinsurance at 1 January 2022 was £1,927 million and the risk adjustment, net of reinsurance, was £1,492 million.

At 31 December 2022, the CSM, net of reinsurance, was £3,999 million and the risk adjustment, net of reinsurance, was £1,109 million. In total, £5,108 million of future earnings is expected be released to the income statement over the life of the insurance contracts and as risks expire.

The release of the CSM to the income statement takes place throughout the contract period over which the insurance contract services are provided. The number of years differs by product and will depend on the nature of benefits and the period over which they occur. For example, an annuity could be 15 to 20 years, pensions contracts could be between 18 to 20 years on average, while protection business will depend on the term of the policy, with shorter term assurance products typically being 8 to 10 years. The Group has a significant annuity and pensions business with relatively long contract lifetimes.

Future income levels within the Insurance business will be dependent on the unwind of the opening adjustment to retained earnings and the level of new business growth and economic conditions. **Based on the Group's current macroeconomic assumptions and business growth ambitions, it is possible that Insurance business other income could recover to the 2022 IFRS 4 levels within 5 years.**

4. INSURANCE, PENSIONS AND INVESTMENTS DIVISION ANALYSIS

Underlying performance summary

The financial information which follows provides more detail on the impact of IFRS 17 upon the results of the Group's Insurance, Pensions and Investment (IP&I) Division.

Income statement – underlying basis: half year ended 30 June 2022

	IFRS 4 Half year ended 30 Jun 2022 £m	IFRS 17 adjustments[1] £m	IFRS 17 Half year ended 30 Jun 2022 £m
Underlying net interest income	(43)	—	(43)
Underlying other income	712	(179)	533
Net income	**669**	**(179)**	**490**
Operating costs	(509)	78	(431)
Remediation	(21)	—	(21)
Total costs	**(530)**	**78**	**(452)**
Underlying profit (loss) before impairment	**139**	**(101)**	**38**
Underlying impairment charge	(3)	—	(3)
Underlying profit (loss)	**136**	**(101)**	**35**

[1] Includes impact of intra-group profit share arrangement, removed on consolidation.

Income statement – underlying basis: full year ended 31 December 2022

	IFRS 4 Full year ended 31 Dec 2022 £m	IFRS 17 adjustments[1] £m	IFRS 17 Full year ended 31 Dec 2022 £m
Underlying net interest income	(101)	—	(101)
Underlying other income	1,576	(616)	960
Net income	**1,475**	**(616)**	**859**
Operating costs	(1,042)	163	(879)
Remediation	(30)	—	(30)
Total costs	**(1,072)**	**163**	**(909)**
Underlying profit (loss) before impairment	**403**	**(453)**	**(50)**
Underlying impairment charge	(12)	—	(12)
Underlying profit (loss)	**391**	**(453)**	**(62)**

[1] Includes impact of intra-group profit share arrangement, removed on consolidation.

As previously reported, the IP&I Division's financial performance in 2022 was adversely impacted by unusually significant weather related claims, the impact on general insurance pricing following the FCA consumer review and an increase in operating costs, driven in significant part by a temporary increase in strategic investment and new Embark costs. These factors exacerbate the previously anticipated impact of IFRS 17 on other income, resulting in an underlying loss for 2022. Going forward, earnings will benefit from business momentum, the benefits of strategic investment and a higher phased release of the CSM and the risk adjustment. At 31 December 2021 the CSM and risk adjustment (net of reinsurance) totalled £3,419m and the release from these during 2022 was £319m. At 31 December 2022 the CSM and risk adjustment (net of reinsurance) totalled £5,108m and the release into the income statement during 2023 will subsequently be higher than 2022. The Group remains focused on building IFRS 17 profits for the Insurance business going forward and expects growth in future periods, reflecting expected increase in scale for key products.

4. INSURANCE, PENSIONS AND INVESTMENTS DIVISION ANALYSIS (continued)

Volatility

The Group's Insurance business has policyholder liabilities that are supported by substantial holdings of investments. When applying IFRS 4 and IFRS 9, the Group recognised the changes in both the value of the liabilities and investments in the statutory income statement. The value of the liabilities does not move exactly in line with changes in the value of the investments. As the investments are substantial, movements in their value can have a significant impact on the profitability of the Group. Management believes that it is appropriate to disclose the division's underlying results on the basis of an expected return. The impact of the actual return on these investments differing from the expected return is included within insurance volatility.

This approach continues under IFRS 17, with two notable adjustments:

- Market volatility on business accounted for under the Variable Fee Approach (largely unit-linked pensions business) is deferred to the CSM, other than where the risk mitigation option is applied
- Policyholder interests volatility on VIF under IFRS 4 does not exist under IFRS 17.

Volatility impacts - for the half year ended 30 June 2022

	Volatility as previously reported under IFRS 4 £m	Amount not recognised under IFRS 17 £m	Amount recognised under IFRS 17 £m	Amount deferred to the balance sheet £m	IFRS 17 restated volatility £m
Policyholder interests' volatility on VIF	231	(231)	—	—	—
Market volatility on unit-linked business	(73)	—	—	73	—
Other market volatility	(200)	—	(29)	—	(229)
Total volatility	**(42)**	**(231)**	**(29)**	**73**	**(229)**

Volatility impacts - for the full year ended 31 December 2022

	Volatility as previously reported under IFRS 4 £m	Amount not recognised under IFRS 17 £m	Amount recognised under IFRS 17 £m	Amount deferred to the balance sheet £m	IFRS 17 restated volatility £m
Policyholder interests' volatility on VIF	441	(441)	—	—	—
Market volatility on unit-linked business	(51)	—	—	51	—
Other market volatility	(538)	—	(138)	—	(676)
Total volatility	**(148)**	**(441)**	**(138)**	**51**	**(676)**

The level of negative market volatility seen in 2022 is driven by economic conditions during the year, notably interest rate increases. This is considered to be unusual and not expected to be a regular occurrence.

Under IFRS 4, the impact of this negative market volatility was significantly offset by favourable policyholder interests' volatility in VIF which is no longer recognised under IFRS 17.

The removal of this positive offset is the main driver behind volatility being £484 million higher than under IFRS 4 for the full year ended 31 December 2022.

4. INSURANCE, PENSIONS AND INVESTMENTS DIVISION ANALYSIS (continued)

Key performance indicators

IFRS 17 impacts the timing of profit recognition but not the underlying performance or actual cash flows associated with the Group's Insurance business.

The Insurance, Pensions and Investments (IP&I) division will continue to use key performance indicators to measure the performance of the business.

Financial performance

IFRS underlying profit – This is derived from IFRS statutory profit before tax adjusted for:

- Volatility caused by market movements;
- The unwind of acquisition-related fair value adjustments; and
- Restructuring costs relating to merger, acquisition and integration activities.

This measure allows for a comparable representation of performance by removing the impact of items such as volatility caused by market movements outside the control of management. IFRS underlying profit will be disclosed half-yearly.

Business growth

Assets under Administration (net flows) – This measures the growth of customer assets managed by the Insurance, Pensions and Investments division and is derived from the IFRS statutory balance sheet. This measure will continue to be disclosed quarterly.

Value creation

New business value – New business value is derived from the IFRS statutory balance sheet movement and represents the value added to the CSM and risk adjustment at the initial recognition of new contracts, net of acquisition expenses and any loss component on onerous contracts (which is recognised directly in the income statement) but does not include existing business increments. New business value will be disclosed half-yearly.

Solvency II excess equity movement – This represents the value created by Insurance, Pensions and Investments division during the year in respect of Solvency II excess equity, which drives the dividend capacity of the division. This measure will be disclosed annually.

Solvency II return on equity – This measure is derived from Equity Own Funds generated during the period as a proportion of total Equity Own Funds, excluding the impacts of market volatility. Solvency II return on equity will be disclosed annually.

In addition to these KPIs, **the Solvency II ratio (pre-dividend)** will continue to be utilised. This is the ratio of the Solvency II Eligible Own Funds to the Solvency Capital Requirement (SCR) for the Insurance, Pensions and Investments division. This ratio will be disclosed half-yearly.

The Solvency II measures are not impacted by IFRS 17.

5. RECOGNITION AND MEASUREMENT

IFRS 17 establishes principles for the recognition, measurement, presentation and disclosure of insurance contracts, participating investment contracts and reinsurance contracts issued (collectively referred to as 'insurance contracts issued' in this document, unless otherwise specified) and reinsurance contracts held.

Groups of contracts

IFRS 17 requires insurance contracts issued and reinsurance contracts held to be aggregated into groups of contracts, which defines the level at which the Group calculates and manages the CSM run-off.

Separating investment components

IFRS 17 also requires certain components of insurance contracts to be separated, including distinct investment components. Investments components are amounts that the Group is required to repay to the policyholder in all circumstances regardless of whether an insured event occurs. Distinct investment components, that are required to be separated, are investment components whose investment and insurance components are not highly interrelated and contracts with equivalent terms can be sold separately in the same market or the same jurisdiction. Non-distinct investment components are not separated and reflect amounts due to be repaid to policyholders, akin to deposits, so are not recognised in the income statement.

Initial measurement

IFRS 17 introduces a standard measurement model, the General Measurement Model (GMM), which requires groups of insurance contracts issued and reinsurance contracts held to be measured, on initial recognition, as the sum of:

- Fulfilment cash flows **–** which comprise:
  - an estimate of the present value of future cash flows that are expected to arise as the Group fulfils its service under the insurance contracts; and
  - an explicit risk adjustment for non-financial risk (i.e. the risk adjustment held on balance sheet)
- Contractual Service Margin (CSM) **–** this represents the unearned profit that the Group will recognise as it provides insurance contract services

The fulfilment cash flows comprise unbiased and probability-weighted estimates of future cash flows, discounted to present value to reflect both the time value of money and financial risks, plus a risk adjustment for non-financial risk. The discount rate applied reflects the time value of money, the characteristics of the cash flows, the liquidity characteristics of the insurance contracts and, where appropriate, is consistent with observable current market prices. For more information about discount rates see 'Significant judgements and estimates'.

The risk adjustment for non-financial risk for a group of insurance contracts is the compensation required for bearing the uncertainty in relation to the amount and timing of the cash flows that arises from non-financial risk. The risk adjustment is explicit and determined separately from other fulfilment cash flows. For further information on the risk adjustment, see 'Significant judgements and estimates'.

A CSM arises when, for a group of contracts, the sum of the discounted cash flows and the risk adjustment is a net inflow. If the sum of these items is a net outflow, then the group of contracts is onerous and a loss and an insurance contract liability equal to the net outflow will be recognised in the income statement and balance sheet respectively for that group of onerous contracts.

5. RECOGNITION AND MEASUREMENT (continued)

Subsequent measurement

At the end of each reporting period, IFRS 17 requires that insurance contracts are measured as the sum of:

- Liability for remaining coverage (LRC), comprising fulfilment cash flows related to future service and the CSM at the reporting date; and
- Liability for incurred claims (LIC), comprising fulfilment cash flows related to past service at the reporting date (claims and expenses not yet paid, including claims incurred but not yet reported)

The fulfilment cash flows of groups of insurance contracts are measured at the reporting date using current estimates of future cash flows, current discount rates and current estimates of the risk adjustment for non-financial risk. Changes in fulfilment cash flows are recognised as follows:

- Changes related to future service are adjusted against the CSM unless the group of contracts is onerous in which case such changes are recognised in the insurance service result in the income statement
- Changes related to past or current service are recognised in the insurance service result in the income statement
- The effects of the time value of money and financial risk are recognised as insurance finance income or expenses in the income statement

Changes in fulfilment cash flows related to future service that are adjusted against the CSM comprise:

- Experience adjustments arising from premiums received in the period that relate to future service and related cash flows such as insurance acquisition cash flows
- Changes in estimates of the present value of future cash flows in the LRC, arising from changes in non-financial assumptions
- Any differences between investment components expected to become payable in the period and the actual investment component that becomes payable in the period
- Changes in the risk adjustment for non-financial risk that relate to future service

Changes related to past or current service recognised in the income statement comprise:

- The effects of time value of money and the effects of financial risk
- Changes in estimates of fulfilment cash flows in the LIC
- Experience adjustments other than those adjusted against the CSM

For certain products, the GMM is modified to allow for variations specific to those products. The GMM is modified for reinsurance contracts held, contracts with direct participation features (contracts where returns are based on the performance of underlying assets) and general insurance contracts as follows:

5. RECOGNITION AND MEASUREMENT (continued)

	GMM (unmodified)	**GMM modified for reinsurance contracts held**	**GMM modified for contracts with direct participating features** **(Variable Fee Approach (VFA))**	**Premium Allocation Approach (PAA)**
Used for	Long-term insurance contracts without direct participating features	Reinsurance contracts held	Insurance and participating investment contracts with direct participating features	General Insurance (short-term contracts)
Type of business	Individual and Bulk annuities, Protection and With-Profit contracts with Guaranteed Annuity Options (GAO)	Reinsurance held on Individual and Bulk annuities, and Protection contracts	With-Profit contracts without GAO and Unit-Linked contracts	Predominantly home insurance
Key features/ modifications used by the Group	As described above	The estimates of the present value of future cash flows use assumptions consistent with those of the underlying insurance contracts. The estimates of the present value of future cash flows include the effect of any risk of non-performance by the reinsurer. The CSM represents the net cost or the net gain on purchasing the reinsurance (i.e. the CSM can either be positive or negative). The CSM can be adjusted, and income recognised, to offset a loss arising from an onerous group of underlying contracts.	On subsequent measurement: • The change in the obligation to pay a policyholder a share of the fair value of underlying assets is recognised in the income statement; • Most changes in the variable fee adjust the CSM. The Group has applied the risk mitigation option, which allows the Group to recognise the impact of financial risk in the income statement (as opposed to the CSM) where derivatives, non-derivative financial instruments held at fair value through profit or loss, or reinsurance contracts held is used to mitigate that financial risk. (See 'Significant judgements and estimates' for more information on the risk mitigation option).	This is an optional simplification mainly permitted for insurance contracts with a coverage period of one year or less. The LRC is measured as premiums less insurance acquisition cash flows. There is no CSM recognised.

Derecognition and contract modifications

The Group derecognises an insurance contract issued when the obligation specified in the contract expires, is discharged or is cancelled, or if its terms are modified significantly. When a contract is modified significantly, a new contract based on the modified terms is recognised. For more information on contract modifications, see 'Significant judgements and estimates' section.

6. SIGNIFICANT JUDGEMENTS AND ESTIMATES

The Group's management makes judgements and estimates that affect the reported amount of assets and liabilities. On adoption of IFRS 17, significant judgements and estimates have been made in the following areas:

- Transition approach
- Discount rates
- Risk adjustment
- Risk mitigation
- Contract modifications

Transition approach

At the date of transition, a CSM is calculated for all in-force business. IFRS 17 requires a full retrospective approach unless it is impracticable to do so. Under the full retrospective approach, transition impacts are calculated as if IFRS 17 had always applied and prohibits use of hindsight. This requires having full and granular data on assumptions and cash flows so that at the point of contract recognition, the IFRS 17 contract value and CSM can be calculated and revalued up to the point of transition.

If it is impracticable to apply IFRS 17 retrospectively, a choice is permitted between a modified retrospective approach, provided qualifying conditions are met, and a fair value approach. The approaches can be applied to different groups of insurance contracts.

The Group has applied judgement in the following areas:

- Impracticability assessment
- Use of accounting simplifications

The full retrospective approach was deemed impracticable for contracts initially recognised prior to 1 January 2016 as the models required to calculate the risk adjustment were not in use within the business prior to this date. The Group has decided to use the fair value approach for business initially recognised prior to 2016.

In applying the full retrospective approach, the Group uses reasonable and supportable information available which includes reasonable simplifications used to facilitate the large volumes of calculations the transition process requires.

The table below summarises the approach the Group has applied to groups of insurance contracts at the transition date and the resulting CSM at that date.

Year contracts initially recognised	Transition approach	CSM at transition date	
		£m	%
Contracts initially recognised prior to 1 January 2016	Fair value approach	1,419	74 %
Contracts initially recognised after 1 January 2016	Full retrospective approach	508	26 %
		1,927	

Discount rates

Discount rates are applied to measure fulfilment cash flows, to determine interest to accrete in the CSM valuation and to discount coverage units.

IFRS 17 requires that discount rates should be based on observable market inputs and shall include only relevant factors that arise from the time value of money, the characteristics of the cash flows and the liquidity characteristics of the insurance contracts.

6. SIGNIFICANT JUDGEMENTS AND ESTIMATES (continued)

IFRS 17 does not require a particular estimation technique for determining discount rates but provides two alternative approaches that may be used to derive discount rates. The determination of discount rates may be derived from a yield curve that reflects the current market rates of return of an actual or reference portfolio of assets, adjusted to eliminate any factors that are not relevant to the insurance contracts (top-down approach), or discount rates may be derived based on a liquid risk-free yield curve adjusted for an illiquidity premium (bottom-up approach).

The Group has applied judgment in the following areas:

- Determining which products to apply an illiquidity premium:
  - The products where the Group will be applying an illiquidity premium to the discount rate are annuity contracts, due to the illiquid nature of their cash flows, certain reinsurance contracts held where the underlying contracts are annuity contracts, due to the transfer of longevity risk to the reinsurer, and Whole of Life Protection contracts, due to the inherent policyholder value and zero surrender option
  - All other contracts use unadjusted risk-free yield curves
- How illiquidity premium is determined:
  - For protection contracts the ‘bottom-up approach’ is used, taking the spread on a covered bond index
  - For annuity products, and reinsurance contracts held where the underlying contracts are annuity contracts, for which the ‘top-down approach’ is used to derive discount rates, the approach taken is to use a strategic portfolio at initial recognition in order to calculate the CSM. At subsequent measurement, the illiquidity premium is calculated using the actual annuity asset mix, adjusted to take into account impacts of transition from initial recognition. The Group decided to maintain consistency with the existing Solvency II approach and use fundamental spread as the method for removing credit risk from the reference portfolio yield

Risk adjustment

Risk adjustment is a new concept under IFRS17. The risk adjustment for non-financial risk is the compensation that is required by the Group for bearing the uncertainty about the amount and timing of cash flows that arise from non-financial risk as the insurance contract is fulfilled.

IFRS17 provides limited prescriptive requirements as to the methodology to be used to calculate the risk adjustment and allows an entity to apply judgement in determining an appropriate estimation technique.

Risk adjustment (Life)

The Group has applied judgement in estimating the risk adjustment, in the following areas:

- Risks included within the risk adjustment calculation - the Group has considered the same risks as under the Solvency II risk margin, as they both use a definition of non-market risks, apart from specific differences referred to in IFRS17. The excluded categories are reinsurer default and uncrystallised operational risks. The Group also adds a premium escalation risk for IFRS17 due to the longer contract boundaries under this basis
- Method of calculation - the Group calculates a margin, above best estimate assumptions, for each non-financial risk to which the Group is exposed through issuing insurance contracts. The margins are set so that (in combination) they would cover potential losses from movements in non-financial risks within a specified confidence level. The total of these margins is the risk adjustment. The Group has applied judgement in setting the confidence level applied in the risk adjustment calculation, based on the Group’s appetite for accepting the risk inherent in writing insurance contracts and the compensation required for doing so

6. SIGNIFICANT JUDGEMENTS AND ESTIMATES (continued)

Risk adjustment (General Insurance business)

For General Insurance business for which PAA is applied, the risk adjustment forms a key component of the LIC. It is similar in concept to the previous uncertainty reserve under IFRS 4, so will be a component of the liability.

The risk adjustment for LRC forms a part of the loss component calculation which is used to determine the groupings of contracts that are expected to be onerous.

The key judgements applied are:

- The estimation approach to determine the risk adjustment for non-financial risk. For LIC the reserve risk distribution and for LRC a cost of capital approach
- The cost of capital to use for LRC. This is consistent with that used in pricing and the expected cost of capital at Scottish Widows Group Limited (SWG) level

Risk mitigation

The risk mitigation option allows entities to mitigate mismatch in the timing of recognition of profit impacts between asset and liability movements.

Under VFA, the CSM is adjusted for changes in the present value of future cash flows, including changes caused by financial risks. As a result, the impact of economic variances is deferred, rather than being recognised immediately.

Where derivatives are used to hedge economic exposure, and the risk mitigation option is used, a change in CSM due to financial risks is not recognised, to the extent that derivatives offset that risk.

As part of the Group's documented risk management objective and strategy on the use of equity and currency hedges to mitigate financial risk, the Group has taken the risk mitigation option for its VFA business (which comprises Unit-Linked and With-Profit contracts). The Group has chosen not to adjust the CSM for changes in the fulfilment cash flows and/or Group's share of the underlying items that reflect some or all of the changes in the effect of the time value of money and equity and currency risks.

Contract modifications

IFRS 17 requires that when a contract is modified:

- If that modification meets specific criteria, at the date of the modification, the contract is derecognised and the modified contract is recognised as a new contract; or
- If that modification does not meet specific criteria, the contract is not derecognised

If a contract modification does not result in derecognition, then the Group treats the changes in cash flows caused by the modification as changes in the estimates of fulfilment cash flows.

On derecognition of an insurance contract, the Group:

- Adjusts the fulfilment cash flows to eliminate the present value of future cash flows and risk adjustment for non-financial risk relating to the rights and obligations that have been derecognised from the group of contracts
- Adjusts the CSM of the group of contracts for the change in the fulfilment cash flows, except where such changes are allocated to a loss component; and
- Adjusts the number of coverage units for the expected remaining services, to reflect the number of coverage units derecognised from the group of contracts

If a contract is derecognised because its terms are modified, then the CSM of the group of contracts from which the modified contract is derecognised is also adjusted for the premium that would have been charged had the Group entered into a contract with the new contract's terms at the date of modification, less any additional premium charged for the modification. If the new contract recognised is an insurance contract, then it is measured assuming that, at the date of modification, the Group received the premium that it would have charged had the Group entered into a contract with the new contract's terms at the date of modification.

6. SIGNIFICANT JUDGEMENTS AND ESTIMATES (continued)

During 2022, the Group added a drawdown feature to its existing longstanding and workplace pension business as a significant customer enhancement. The key judgements applied were:

- Determining whether the modification met the specific criteria for the contracts to be derecognised, and the modified contracts recognised as new contracts. One of the specified criteria is that if the modified terms had been included at contract inception the modified contract would have had a substantially different contract boundary. The Group made a key judgement that the modification to add a drawdown option met this criterion. This required the existing contracts to be derecognised and the modified contracts to be recognised as new contracts
- The Group made a key judgement that the premium that would have been charged had the Group entered into a contract with the new contract's terms at the date of modification, less any additional premium charged for the modification, is equivalent to the unit value of the contract at the contract modification date

Contract modifications occurred throughout 2022, in line with the dates of policyholder communication of enhanced benefits. Existing CSM relating to contracts modified (£399 million net of reinsurance) was derecognised and a CSM relating to the new contracts post-modification (£1,730 million net of reinsurance) was recognised. CSM has increased by £1,331 million and will be released to the income statement in the future, in line with service provided.

There are two main drivers for the increase in CSM. Firstly, the new CSM is larger than the previously existing CSM as there were no acquisition costs incurred following modification and, secondly, the basis of calculation under IFRS 17 for the new CSM of the modified contacts leads to a higher value compared with the lower value of the existing CSM, reflecting the transition value on a fair value basis for a significant proportion of contracts in scope of modification. The new CSM also includes additional future profit of £89m expected to emerge from the addition of a drawdown feature, as a result of the increase in the expected length of the contract services period for this business, compared to previous contracts.

A charge to the income statement of £1,242 million arises given the requirements of IFRS 17. Economically, this charge is equivalent to the difference between the existing CSM derecognised and new CSM recognised (excluding the additional expected profit to emerge from the addition of the drawdown feature).

7. SIGNIFICANT ACCOUNTING POLICY CHOICES

The significant accounting policy choices applicable to the Group are in relation to:

- Disaggregation of insurance finance income or expenses
- Deferral of acquisition expenses
- Disaggregation of change in risk adjustment for non-financial risk

Disaggregation of insurance finance income or expenses

Insurance finance income or expenses comprise changes in the carrying amount of a group of insurance contracts arising from the effect of time value of money and the effects of financial risk.

IFRS 17 provides an accounting policy choice between:

- Including insurance finance income or expenses for the period in the income statement; or
- Disaggregating insurance finance income and expenses for the period to include in the income statement an amount determined by a systematic allocation, and the rest in other comprehensive income (OCI)

The Group has elected to recognise total insurance finance income or expenses in the income statement in the period in which they arise. This is consistent with the measurement basis of assets backing insurance contracts at fair value through profit or loss under IFRS 9.

Deferral of acquisition expenses

In applying the premium allocation approach, an insurer can elect to:

- Recognise insurance acquisition cash flows as an expense when incurred, provided that the coverage period of each contract in the group at initial recognition is no more than one year; or
- To defer insurance acquisition cash flows

The Group has chosen to defer insurance acquisition cash flows to be included in the measurement of the insurance contract groups to which those cash flows relate, including to future groups arising from anticipated contract renewals.

Disaggregation of change in risk adjustment for non-financial risk

Whilst IFRS 17 does not require disaggregation of the change in risk adjustment for non-financial risk between the insurance service result and insurance finance income and expenses, an insurer may elect to do so. The Group does not disaggregate the change in the risk adjustment for non-financial risk between the insurance service result and insurance finance income or expenses.

8. GOVERNANCE AND CONTROL

Implementation

As a result of the significant changes being introduced by IFRS 17, a programme was established to coordinate the implementation within the Insurance business. Based on the requirements of IFRS 17, an accounting policy framework was established. The Insurance business finance team used this framework to identify data and systems requirements and developed plans to meet these requirements. Progress was monitored by a steering committee, which included the Insurance business Chief Finance Officer and senior representatives of both IP&I and Group finance and risk functions. Issues of technical interpretation have been discussed through UK and European insurance industry bodies. Interpretations were supported by external professional advisors and approved by Insurance business technical design forum, with significant technical decisions approved by a Group Technical Panel. The Group's business and technology change platform was used to develop the models required to perform the revised calculations and these were subject to detailed review and approval through the Insurance business model governance procedures. Upon completion of the model development, a number of dry runs were conducted to embed the models and develop an understanding of the results.

During the course of the programme, there have been regular updates provided to the Insurance business Executive Committee and Insurance business Audit Committee. Key judgements and decisions have been the subject of review and approval by the Insurance business Audit Committee, with oversight from Group Audit Committee.

Ongoing

The Group's risk management framework is implemented through a 'Three Lines of Defence' model which defines clear responsibilities and accountabilities and ensures effective independent oversight and assurance activities take place covering key decisions. The business is the first line of defence and have responsibility for identifying, measuring, monitoring and controlling risks within their area of accountability. Risk division is the second line of defence, providing oversight and independent challenge to key risk decisions taken by the business, while Group Internal Audit is the third line of defence, providing assurance over the Group's processes and controls, in line with audit plans agreed with Group Audit Committee.

9. APPENDIX

Balance sheet as at 1 January 2022

The adjustments to the Group's balance sheet as at 1 January 2022 arising on the adoption of IFRS 17 are presented below.

	Note	IFRS 4 As at 31 Dec 2021 £m	Remove IFRS 4 £m	Add IFRS 17 £m	IFRS 17 Adjusted as at 1 Jan 2022 £m
Assets					
Cash and balances at central banks		76,420	—	—	76,420
Items in the course of collection from banks		147	—	—	147
Financial assets at fair value through profit or loss	1	206,771	—	200	206,971
Derivative financial instruments		22,051	—	—	22,051
Financial assets at amortised cost		517,156	—	—	517,156
Financial assets at fair value through other comprehensive income		28,137	—	—	28,137
Reinsurance assets	2	759	(759)	—	
Insurance contract assets	3		—	24	24
Reinsurance contract assets	2		—	331	331
Investments in joint ventures and associates		352	—	—	352
Goodwill		2,320	—	—	2,320
Value of in-force business	4	5,514	(5,514)	—	
Other intangible assets	5	4,196	197	—	4,393
Current tax recoverable		363	—	—	363
Deferred tax assets	6	3,118	(28,845)	29,500	3,773
Retirement benefit assets		4,531	—	—	4,531
Other assets	7	14,690	(402)	—	14,288
Total assets		**886,525**	**(35,323)**	**30,055**	**881,257**

9. APPENDIX (continued)

	Note	As at 31 Dec 2021 £m	Remove IFRS 4 £m	Add IFRS 17 £m	Adjusted as at 1 Jan 2022 £m
Liabilities					
Deposits from banks		7,647	—	—	7,647
Customer deposits		476,344	—	—	476,344
Repurchase agreements at amortised cost		31,125	—	—	31,125
Items in course of transmission to banks		316	—	—	316
Financial liabilities at fair value through profit or loss		23,123	—	—	23,123
Derivative financial instruments		18,060	—	—	18,060
Notes in circulation		1,321	—	—	1,321
Debt securities in issue		71,552	—	—	71,552
Liabilities arising from insurance contracts and participating investment contracts	8	123,423	(123,423)	125,179	125,179
Reinsurance contract liabilities	9		—	37	37
Liabilities arising from non-participating investment contracts	10	45,040	—	(4,150)	40,890
Other liabilities	11	19,947	(934)	1	19,014
Retirement benefit obligations		230	—	—	230
Current tax liabilities		6	—	—	6
Deferred tax liabilities	6	39	(31)	—	8
Other provisions		2,092	(12)	—	2,080
Subordinated liabilities		13,108	—	—	13,108
Total liabilities		**833,373**	**(124,400)**	**121,067**	**830,040**
Equity					
Share capital		7,102	—	—	7,102
Share premium account		18,479	—	—	18,479
Other reserves		11,189	—	186	11,375
Retained profits		10,241	89,077	(91,198)	8,120
Shareholders' equity		**47,011**	**89,077**	**(91,012)**	**45,076**
Other equity instruments		5,906	—	—	5,906
Non-controlling interests		235	—	—	235
Total equity		**53,152**	**89,077**	**(91,012)**	**51,217**
Total equity and liabilities		**886,525**	**(35,323)**	**30,055**	**881,257**

Notes

1. Own shares held through consolidated collective investment vehicles are classified as financial assets at fair value through profit or loss on transition to IFRS 17.
2. Reinsurance assets on an IFRS 4 basis are derecognised and reinsurance contract assets are recognised on an IFRS 17 basis.
3. Portfolios of insurance contracts which are in an asset position under IFRS 17 are recognised.
4. VIF is removed as this is no longer recognised for insurance and participating investment contracts under IFRS 17.
5. Acquired VIF in respect of non-participating investment contracts is reclassified from VIF to other intangible assets.
6. Deferred tax assets and liabilities are recalculated in respect of differences in retained earnings between IFRS 4 and IFRS 17.
7. Deferred acquisition costs and premium debtors on an IFRS 4 basis are derecognised as these are now recognised as part of liabilities arising from insurance contracts and participating investment contracts on an IFRS 17 basis.
8. The IFRS 4 value of liabilities arising from insurance contracts and participating investment contracts is removed. Liabilities arising from insurance contracts and participating investment contracts on an IFRS 17 basis are recognised.
9. Portfolios of reinsurance contracts which are in a liability position under IFRS 17 are recognised.
10. Liabilities arising from non-participating investment contracts that are now accounted for under IFRS 17 are re-classified. For certain hybrid Unit-Linked/With-Profit contracts, applying IFRS 4 the deposit component was unbundled from the host contract and included within the scope of IFRS 9. Applying IFRS 17, the investment component has been assessed as non-distinct and so has not been separated and the entire contract is classified within insurance and participating investment contracts within the scope of IFRS 17.

9. APPENDIX (continued)

11. Unallocated surplus relating to the With-Profit funds is no longer separately presented under IFRS 17 and is instead incorporated into the best estimate liabilities. Claims creditors on an IFRS 4 basis are derecognised as these are now recognised as part of liabilities arising from insurance contracts and participating investment contracts on an IFRS 17 basis.

9. APPENDIX (continued)

Balance sheet as at 31 December 2022

The adjustments to the Group's balance sheet as at 31 December 2022 arising on the adoption of IFRS 17 are presented below.

		IFRS 4			IFRS 17
	Note	As at 31 Dec 2022 £m	IFRS 17 adjustments as at 1 January 2022 £m	Adjust for IFRS 17 2022 movements £m	As at 31 Dec 2022 £m
Assets					
Cash and balances at central banks		91,388	—	—	91,388
Items in the course of collection from banks		242	—	—	242
Financial assets at fair value through profit or loss	1	180,609	200	(40)	180,769
Derivative financial instruments		24,753	—	—	24,753
Financial assets at amortised cost		520,322	—	—	520,322
Financial assets at fair value through other comprehensive income		23,154	—	—	23,154
Reinsurance assets	2	616	(759)	143	
Insurance contract assets	3		24	(24)	—
Reinsurance contract assets	2		331	41	372
Investments in joint ventures and associates		385	—	—	385
Goodwill		2,655	—	—	2,655
Value of in-force business	4	5,419	(5,514)	95	
Other intangible assets	5	4,786	197	(23)	4,960
Current tax recoverable		612	—	—	612
Deferred tax assets	6	5,228	655	539	6,422
Retirement benefit assets	7	3,823	—	—	3,823
Other assets		13,837	(402)	102	13,537
Total assets		**877,829**	**(5,268)**	**833**	**873,394**

9. APPENDIX (continued)

	Note	IFRS 4 As at 31 Dec 2022 £m	IFRS 17 adjustments as at 1 January 2022 £m	Adjust for IFRS 17 2022 movements £m	IFRS 17 As at 31 Dec 2022 £m
Liabilities					
Deposits from banks		7,266	—	—	7,266
Customer deposits		475,331	—	—	475,331
Repurchase agreements at amortised cost		48,596	—	—	48,596
Items in course of transmission to banks		372	—	—	372
Financial liabilities at fair value through profit or loss		17,755	—	—	17,755
Derivative financial instruments		24,042	—	—	24,042
Notes in circulation		1,280	—	—	1,280
Debt securities in issue		73,819	—	—	73,819
Liabilities arising from insurance contracts and participating investment contracts	8	106,893	1,756	1,629	110,278
Reinsurance contract liabilities	9		37	(18)	19
Liabilities arising from non-participating investment contracts	10	42,975	(4,150)	651	39,476
Other liabilities	11	19,090	(933)	216	18,373
Retirement benefit obligations		126	—	—	126
Current tax liabilities		8	—	—	8
Deferred tax liabilities	6	216	(31)	24	209
Other provisions		1,809	(12)	6	1,803
Subordinated liabilities		10,730	—	—	10,730
Total liabilities		**830,308**	**(3,333)**	**2,508**	**829,483**
Equity					
Share capital		6,729	—	—	6,729
Share premium account		18,504	—	—	18,504
Other reserves		6,602	186	(43)	6,745
Retained profits		10,145	(2,121)	(1,632)	6,392
Shareholders' equity		**41,980**	**(1,935)**	**(1,675)**	**38,370**
Other equity instruments		5,297	—	—	5,297
Non-controlling interests		244	—	—	244
Total equity		**47,521**	**(1,935)**	**(1,675)**	**43,911**
Total equity and liabilities		**877,829**	**(5,268)**	**833**	**873,394**

9. APPENDIX (continued)

Measurement components of insurance contracts and participating investment contracts balances

	Present value of future cash flows £m	Risk adjustment £m	Contractual service margin £m	Total £m
At 1 January 2022				
Insurance contract assets	149	(53)	(72)	24
Liabilities arising from insurance contracts and participating investment contracts	(121,620)	(1,617)	(1,942)	(125,179)
Net assets (liabilities)	(121,471)	(1,670)	(2,014)	(125,155)
At 31 December 2022				
Insurance contract assets	—	—	—	—
Liabilities arising from insurance contracts and participating investment contracts	(104,881)	(1,187)	(4,210)	(110,278)
Net assets (liabilities)	(104,881)	(1,187)	(4,210)	(110,278)

The net insurance contract liability in respect of the present value of future cash flows has reduced by £16,625 million, primarily driven by reductions in the value of underlying investments for VFA contracts (Unit-Linked and With-Profit) and changes in interest rates.

The net risk adjustment has reduced by £383 million over the period. The non-financial risk profile of the business has remained relatively stable over the period and so the uncertainty inherent within the insurance cash flows is largely unchanged. However, the increase in interest rates over the period has led to a significant reduction in the present value of those cash flows, leading to a significant reduction in the value of the risk adjustment.

The CSM, net of reinsurance, has increased by £2,072 million primarily driven by contract modifications and reductions in the present value of future cash flows and risk adjustment driven by changes in interest rates.

Measurement components of reinsurance contracts balances

	Present value of future cash flows £m	Risk adjustment £m	Contractual service margin £m	Total £m
At 1 January 2022				
Reinsurance contract assets	241	18	72	331
Reinsurance contract liabilities	(212)	160	15	(37)
Net assets (liabilities)	29	178	87	294
At 31 December 2022				
Reinsurance contract assets	203	51	118	372
Reinsurance contract liabilities	(139)	27	93	(19)
Net assets (liabilities)	64	78	211	353

9. APPENDIX (continued)

Income statement for the half year ended 30 June 2022 - statutory basis

The adjustments to the Group's statutory income statement for the half year ended 30 June 2022 arising on the adoption of IFRS 17 are presented below.

	Note	IFRS 4 Half year ended 30 Jun 2022 £m	IFRS 17 adjustments £m	IFRS 17 Half year ended 30 Jun 2022 £m
Interest income		7,429	—	7,429
Interest expense	1	(229)	(1,163)	(1,392)
Net interest income		**7,200**	**(1,163)**	**6,037**
Fee and commission income	2	1,408	(38)	1,370
Fee and commission expense	3	(662)	141	(521)
Net fee and commission income		746	103	849
Net trading income		(19,302)	—	(19,302)
Insurance premium income	4	4,651	(4,651)	
Insurance revenue	5		1,201	1,201
Insurance service expense	6		(1,447)	(1,447)
Net expense from reinsurance contracts held	7		(6)	(6)
Insurance service result			(252)	(252)
Other operating income	8	385	290	675
Other income		**(13,520)**	**(4,510)**	**(18,030)**
Total income		**(6,320)**	**(5,673)**	**(11,993)**
Insurance claims and changes in insurance and investment contract liabilities	9	15,043	(15,043)	
Net insurance finance income	10		14,305	14,305
Net finance expense from reinsurance contracts	11		(5)	(5)
Movement in third party interests in consolidated funds	1		1,163	1,163
Change in non-participating investment contracts	12		4,478	4,478
Total income, net of insurance service results and income from investment contracts		**8,723**	**(775)**	**7,948**
Operating expenses	13	(4,681)	263	(4,418)
Impairment (charge) credit		(381)	—	(381)
Profit before tax		**3,661**	**(512)**	**3,149**
Tax expense	14	(835)	133	(702)
Profit for the period		**2,826**	**(379)**	**2,447**
Profit attributable to ordinary shareholders		2,569	(379)	2,190
Profit attributable to other equity holders		214	—	214
Profit attributable to equity holders		2,783	(379)	2,404
Profit attributable to non-controlling interests		43	—	43
Profit for the period		**2,826**	**(379)**	**2,447**

9. APPENDIX (continued)

Notes

1. Movement in third party interests in consolidated funds is reclassified from interest expense to a separate line as part of the new IFRS 17 income statement presentation. This reclassification does not impact the profit for the period.
2. Reduction in fee and commission income is related to reclassification of certain annual management charge income (variable fees received that adjust CSM) under IFRS 17.
3. Reduction in fee and commission expense as investment expenses and other fees related to insurance contracts are reclassified to insurance service expense, and commission expenses and other fees directly attributable to the fulfilment of the insurance contract are also deferred to CSM.
4. Insurance premium income is removed as this is no longer presented in the income statement under IFRS 17, instead amounts are reclassified to the balance sheet to adjust the carrying value of liabilities arising from insurance contracts and participating investment contracts.
5. Insurance revenue is a new line item required under IFRS 17 which comprises:
   a. CSM released to the income statement during the period;
   b. Changes in risk adjustment related to current service;
   c. Expected claims excluding any investment components and other insurance service expenses expected;
   d. An allocation of premiums that relate to recovering insurance acquisition expenses; and
   e. Revenue for insurance contracts under the premium allocation approach.
6. Insurance service expenses is a new line item required under IFRS 17 which comprises:
   a. Incurred claims, excluding any investment components;
   b. Attributable insurance service expenses;
   c. Amortisation of insurance acquisition expenses;
   d. Changes that relate to past service i.e. changes in fulfilment cash flows relating to liability for incurred claims;
   e. Changes that relate to future service i.e. losses and reversal of losses on onerous groups of contracts; and
   f. Losses as a result of contract modifications.
7. Net expense from reinsurance contracts held, a new line item required under IFRS 17, covers all income statement movements in reinsurance service result.
8. Primarily driven by removal of movement in VIF.
9. Insurance claims and changes in insurance and investment contract liabilities is removed and replaced by new IFRS 17 presentation.
10. Net insurance finance income represents the finance related change in the carrying value of a group of insurance contracts comprising interest accreted to the CSM, effects of changes in interest rates and other financial assumptions, effects of the risk mitigation option and the effect of change in fair value of underlying items for direct participating contracts.
11. Net finance income from reinsurance contracts held is the finance related change in the carrying value of a group of reinsurance contracts comprising interest accreted to the CSM and effects of changes in interest rates and other financial assumptions.
12. Change in non-participating investment contracts is presented as a separate line item, reclassified from insurance claims and changes in insurance and investment contract liabilities. Movements in hybrid contracts, where all components of the contract now fall under IFRS 17, have been reclassified to net insurance finance expense.
13. Operating expenses are adjusted to remove maintenance expenses from this line item (now included as part of insurance service expenses) and acquisition expenses are deferred to CSM.
14. Tax expense is updated for changes in profit before tax due to IFRS 17. The tax impact of the IFRS 17 adjustments is recognised at the rate of tax it is expected to be realised at. For the year ended 31 December 2022, this includes the impact of the transitional tax provisions to allow spreading of life companies’ profit or loss arising on transition to IFRS17 over 10 years. For the half year ended 30 June 2022, these provisions were not substantively enacted and so the rate of tax did not reflect them.

9. APPENDIX (continued)

Income statement for the year ended 31 December 2022 - statutory basis

The adjustments to the Group's statutory income statement for the year ended 31 December 2022 arising on the adoption of IFRS 17 are presented below. The adjustments are as described in the previous section.

	Note	IFRS 4 Full year ended 31 Dec 2022 £m	IFRS 17 adjustments £m	IFRS 17 Full year ended 31 Dec 2022 £m
Interest income		17,645	—	17,645
Interest expense	1	(3,688)	(1,035)	(4,723)
Net interest income		**13,957**	**(1,035)**	**12,922**
Fee and commission income	2	2,835	(45)	2,790
Fee and commission expense	3	(1,332)	262	(1,070)
Net fee and commission income		1,503	217	1,720
Net trading income		(19,987)	—	(19,987)
Insurance premium income	4	9,059	(9,059)	—
Insurance revenue	5		2,461	2,461
Insurance service expense	6		(3,863)	(3,863)
Net expense from reinsurance contracts held	7		62	62
Insurance service result			(1,340)	(1,340)
Other operating income	8	1,276	63	1,339
Other income		**(8,149)**	**(10,119)**	**(18,268)**
Total income		**5,808**	**(11,154)**	**(5,346)**
Insurance claims and changes in insurance and investment contract liabilities	9	12,401	(12,401)	—
Net insurance finance income	10		15,948	15,948
Net finance expense from reinsurance contracts	11		(55)	(55)
Movement in third party interests in consolidated funds	1		1,035	1,035
Change in non-participating investment contracts	12		3,959	3,959
Total income, net of insurance service results and income from investment contracts		**18,209**	**(2,668)**	**15,541**
Operating expenses	13	(9,759)	522	(9,237)
Impairment (charge) credit		(1,522)	—	(1,522)
Profit before tax		**6,928**	**(2,146)**	**4,782**
Tax expense	14	(1,373)	514	(859)
Profit for the year		**5,555**	**(1,632)**	**3,923**
Profit attributable to ordinary shareholders		5,021	(1,632)	3,389
Profit attributable to other equity holders		438	—	438
Profit attributable to equity holders		5,459	(1,632)	3,827
Profit attributable to non-controlling interests		96	—	96
Profit for the year		5,555	(1,632)	3,923

GLOSSARY

This section sets out definitions of specific IFRS 17 terms used in this document. References in the Glossary to insurance contracts also apply to participating investment contracts, reinsurance contracts issued and reinsurance contracts held.

Term	**Definition**
Contractual service margin (CSM)	A component of the carrying amount of a group of insurance contract assets or liabilities representing the store of future earnings which the Group will recognise as it provides insurance contract services over the life of the insurance contracts in the group.
Contract service period (also known as the coverage period)	The period during which the Group provides insurance contract services. This period includes the insurance contract services that relate to all premiums within the boundary of the insurance contract.
Contract boundary	Cash flows are within the boundary of an insurance contract if they arise from substantive rights and obligations that exist during the reporting period in which the Group can compel the policyholder to pay premiums or in which the Group has a substantive obligation to provide the policyholder with insurance contract services.
Contracts with direct participation features	Contracts for which at inception, the contractual terms specify that the policyholder participates in a share of a clearly identified pool of underlying items, the Group expects to pay the policyholder an amount equal to a substantial share of the fair value returns of the underlying items and the Group expects a substantial portion of any change in the amounts to be paid to the policyholder to vary with the change in fair value of the underlying items. Examples include Unit-Linked products, and certain With-Profit products.
Fulfilment cash flows	An explicit, unbiased and probability-weighted estimate (i.e. expected value) of the present value of future cash flows that will arise as the Group fulfils insurance contracts, plus a risk adjustment for non-financial risk.
General measurement model (GMM)	The standard measurement model used to calculate the carrying amount of insurance contracts as prescribed under IFRS 17.
Insurance revenue	An amount that represents the change in the liability for remaining coverage in each reporting period that represents the provision of services for which the Group expects to receive consideration and an allocation of premiums that relate to recovering insurance acquisition cash flows.
Insurance service expenses	An amount that comprises incurred claims (excluding investment components) and other incurred insurance service expenses, amortisation of insurance acquisition expenses, changes in fulfilment cash flows relating to the liability for incurred claims, and losses on onerous groups of contracts and reversals of such losses.
Insurance service result	An amount that comprises insurance revenue, insurance service expenses and net income or expenses from reinsurance contracts held.
Insurance finance income or expenses	The change in the carrying value of a group of insurance contracts comprising interest accreted to the CSM, effects of changes in interest rates and other financial assumptions, effects of the risk mitigation option and the change in fair value of underlying items for contracts with direct participation features.
Investment component	The amounts that an insurance contract requires the Group to repay to a policyholder in all circumstances, regardless of whether an insured event occurs.

GLOSSARY (continued)

Term	Definition
Liability for incurred claims (LIC)	The Group's obligation to investigate and pay valid claims for insured events that have already occurred, including events that have occurred but have not been reported and other incurred insurance expenses, and pay any amounts relating to investment components that are not included in the liability for remaining coverage; effectively the fulfilment cash flows relating to past service at the reporting date.
Liability for remaining coverage (LRC)	The Group's obligation to investigate and pay valid claims under existing insurance contracts for insured events that have not yet occurred (i.e. the obligation relating to the unexpired portion of insurance coverage) and pay any amounts relating to investment components that have not been transferred to the liability for incurred claims; effectively the fulfilment cash flows relating to future service and the CSM at the reporting date.
Net finance income from reinsurance contracts	An amount that represents the change in the carrying value of a group of reinsurance contracts comprising interest accreted to the CSM and effects of changes in interest rates and other financial assumptions.
Non-participating investment contract	An investment contract that is not a participating investment contract. IFRS 9 is applied to these contracts.
Participating investment contract	A financial instrument that provides a particular investor with the contractual right to receive, as a supplement to an amount not subject to the discretion of the Group, additional amounts that are expected to be a significant portion of the total contractual benefits, the timing or amount of which are contractually at the discretion of the Group, and that are contractually based on returns on a specified pool of assets. Examples include With-Profit products without significant insurance risk. IFRS 17 is applied to these contracts. These contracts can also be referred to as investment contracts with discretionary participation features.
Premium allocation approach (PAA)	Simplification of the GMM permitted under IFRS 17 that can be applied when certain specified criteria is met, mainly for short duration contracts, for example Home Insurance products.
Risk adjustment	The compensation that the Group would require for bearing the uncertainty about the amount and timing of the cash flows that arises from non-financial risk as the Group fulfils insurance contracts.
Risk mitigation option	Under VFA, the CSM is adjusted for changes in the present value of future cash flows, including changes caused by financial risks. The risk mitigation option is a choice provided under IFRS 17 to not recognise some or all of these changes in CSM to the extent that the Group uses derivatives or reinsurance contracts held to mitigate the effect of changes in financial risk on the amount of the Group's share of underlying items, or to the extent that the Group uses derivatives, non-derivative financial instruments measured at fair value through profit or loss, or reinsurance contracts held to mitigate the effects of changes in financial risk not arising from underlying items.
Variable fee approach (VFA)	Modification of the GMM that is applied for measurement of contracts with direct participation features.

BASIS OF PREPARATION

At 31 December 2022, Lloyds Banking Group plc and its subsidiaries (the Group) prepared its financial statements in accordance with IFRS 4 ‘Insurance Contracts’.

IFRS 17 ‘Insurance Contracts’ replaces IFRS 4 ‘Insurance Contracts’ and is effective for annual periods beginning on or after 1 January 2023.

From 1 January 2023, the Group, in common with other listed entities within the United Kingdom (UK), implemented IFRS 17 ‘Insurance Contracts’. The transition date for the Group is 1 January 2022 and in accordance with the transition requirements of IFRS 17, comparative information as at 1 January 2022, and for the year ended 31 December 2022 is restated and transition adjustments recognised in retained earnings as at 1 January 2022, the transition date. The income statement for the year ended 31 December 2021 will continue to be presented under IFRS 4.

The purpose of this document is to set out the impact on the Group’s financial position of applying IFRS 17. Figures are presented on a statutory basis and on an underlying basis.

This document and the figures presented are not audited.

FORWARD LOOKING STATEMENTS

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