

# Scottish Widows Limited

## Annual Report and Accounts **2021**

Member of Lloyds Banking Group

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**COMPANY INFORMATION****Board of Directors**

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D L Davis

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## GROUP STRATEGIC REPORT

The Directors present their Strategic Report on Scottish Widows Limited ('the Company') and its subsidiary undertakings (together referred to as 'the Group') for the year ended 31 December 2021. The Company is limited by share capital.

Scottish Widows was founded in 1815, and since then we have been focused on helping customers protect themselves today whilst preparing for a secure financial future. Lloyds Banking Group plc (Lloyds Banking Group) continues to invest significantly in the development of the Insurance and Wealth Division which the Group is within, with the aim of becoming Britain's preferred financial partner for pensions and financial planning, helping to rebuild households' financial health and wellbeing, and meeting more of the Lloyds Banking Group customers' financial needs, increasingly with carbon neutral investments.

Our purpose remains to help Britain prosper, with an immediate focus on helping Britain recover, from both the economic and social impacts of the COVID-19 pandemic. The Group has a major role to play in this by:

- Supporting the financial health and wellbeing of our customers through propositions which provide immediate financial resilience such as Protection, and those such as Pensions and Investments which help prepare for the future
- Helping businesses to recover and thrive, including by de-risking their pensions liabilities
- Investing our policyholder and shareholder assets in ways which enable a green recovery, generate an appropriate return and help to build an inclusive society

Specifically, progress against strategic priorities for the Insurance and Wealth Division of Lloyds Banking Group included the following:

- The Group's parent, Scottish Widows Group (SWG), agreed the acquisition of Embark Group Limited (Embark) which was completed on 31 January 2022 and includes a platform which will support future growth of the pension and investment business within the Group, including the re-platforming of an existing proposition
- We have continued to help Britain recover and transition to a low carbon economy with the completion of c.£0.8 billion of loan investments within the Group, including the first Sustainability Linked Loan in the social housing sector
- We launched the 'Find Your Impact' feature into the Scottish Widows app; allowing pension scheme members to see the environmental, social and governance impact of their pension investments
- We have continued to collaborate across Lloyds Banking Group, with Commercial Banking relationships contributing to increased Workplace Pensions market share (estimated at 19 per cent)
- For the sixth consecutive year Scottish Widows has achieved 5 stars in the Financial Adviser Service Awards across Pension and Protection and Investments

### Principal activities

The principal activity of the Group is the undertaking of ordinary long-term insurance and savings business and associated investment activities in the United Kingdom. The Group offers a wide range of life insurance products such as annuities, pensions, whole life, term life and investment type products through independent financial advisors, the Lloyds Banking Group network and direct sales. The Group also reinsures business with insurance entities external to the Group and Lloyds Banking Group. The Group has freedom of services overseas through branches, which administer a relatively small amount of business, principally in Germany. This business is administered through a subsidiary, Scottish Widows Europe S.A. (SWE).

### Result for the Year

The result for the year ended 31 December 2021 is a Group loss after tax £(8) million (2020 loss after tax: £(164) million restated). This consists of a Group profit before tax of £132 million (2020: loss before tax of £(257) million) offset by a taxation charge of £(140) million (2020: taxation credit of £93 million). The result is reflective of interest rate movements and changes in demographic assumptions including a reduction of prudent margins during the year.

See note 41 for details of a restatement of insurance contract liabilities and the impact on retained earnings.

### Long term impact of the UK's exit from the EU

Uncertainties in respect of the medium to long-term implications of the UK's exit from the European Union (EU) on trade, regulation and employment continue to present risks. This includes impacts on supply chains, affordability of goods and services and UK demographics and prosperity.

Activity to respond to potential risks include the transfer of business to a European subsidiary in 2019 to ensure continuation of certain business activities, customer communications, market volatility scenario exercises, contingency planning and monitoring of emerging European Economic Area (EEA) regulatory requirements.

## GROUP STRATEGIC REPORT (continued)

### COVID-19

The outbreak of COVID-19 continues to significantly impact the principal risks faced by the Group. Note 36 provides further details of the impact on market risk (note 36 (a)), insurance underwriting risk (note 36 (b)), credit risk (note 36 (c)) and capital risk (note 36 (d)).

### Russian invasion of Ukraine

The Russian invasion of Ukraine, beginning in February 2022, has increased tensions between members of the North Atlantic Treaty Organisation (NATO) and Russia and caused sanctions to be imposed. This could have significant adverse economic effects on financial markets and on energy costs, and may also result in increased cyber attacks and an increase in costs associated with such cyber attacks, all of which could have a materially adverse effect on the Group's results of operations, financial condition or prospects. The Group will continue to monitor the situation and risks to the business; refer to note 36(c) for further detail on shareholder asset exposures.

### Climate Change

Lloyds Banking Group is committed to supporting the aims of the 2015 Paris Agreement, the UK Government's Net Zero target and Ten Point Plan for a Green Industrial Revolution, in transitioning to a more sustainable, low carbon economy and recognises the importance of embedding climate-related risks and opportunities into business operations and strategy.

Scottish Widows has published a climate plan that sets out a long-term strategy with actions to drive the investment portfolio towards net zero by 2050, formulated in a manner that prioritises customer goals within decision-making.

The Group is supportive of the Task Force on Climate-Related Financial Disclosures (TCFD) framework and related regulatory expectations, and aligned to best practice outlined by the Climate Financial Risk Forum (CFRF) has published a TCFD aligned report at the parent entity level (SWG).

The full Scottish Widows TCFD report is available on the Scottish Widows website.

#### *Governance*

Given the strategic importance in managing the impacts of climate change, the Group's governance structure provides clear oversight and ownership of the sustainability strategy and management of climate-related risk.

Governance for climate-related risk has been embedded into the existing governance structure and is complementary to the governance of Lloyds Banking Group's sustainability strategy. Two new committees have been formed during 2021: the Insurance Sustainability Committee (a committee of the Board of Directors) and the Responsible Business Executive Committee.

#### *Risk Management*

The Group has a well-established and robust risk management framework used to identify, measure, monitor, manage and report the risks faced by the business. Climate Risk is managed using this framework, consistent with all other risks.

Climate Risk has been integrated into the Group's existing risk management framework following consideration of how the effects of Climate Change may impact both the risk profile and business model, by:

- Embedding new, or developing existing processes and policies for the identification and management of climate-related risk
- Adding Climate Risk to both the Lloyds Banking Group and the Insurance Enterprise Risk Management (ERM) Frameworks as a Primary Risk
- Reflecting the impact of Climate Risk as a risk driver on all other risks within the ERM Framework
- Creating a Climate Risk Policy that provides an overarching framework, principles and requirements for the management of climate risks across the Group
- Adding Climate Risk to the Risk Appetite Framework with Board level Risk Appetite Statements

#### *Strategy*

The Group's position as a large investor presents an opportunity to participate in and influence the transition to a low carbon economy for the long-term benefit of customers and society. The Group has set goals to target a 50 per cent reduction in the carbon intensity (across the investment portfolio of customer and shareholder funds) by 2030 on a path to 'net zero' by 2050. The Group also backs climate solutions for real-world impact, and the use of engagement and shareholder voting power to drive companies to make the changes necessary. Further detail can be found in the Climate Action Plan published in February 2022.

Climate related scenario analysis is an evolving area that is important to the business and will be used to produce insightful outputs that aid the understanding of Climate Risk and support decision making.

## GROUP STRATEGIC REPORT (continued)

### Climate Change (continued)

#### *Metrics & Targets*

There has been a focus on expanding climate-related metrics during 2021, not just for disclosures but also for internal risk management. This includes the construction of value adding risk appetite statements for regular reporting to the Board and internal metrics for monitoring progress of the net zero transition.

The portfolio's "carbon footprint" is the principal metric for measuring financed emissions and monitoring progress toward the 2030 and 2050 net zero targets. The footprint is the total tonnes of carbon dioxide equivalents (CO<sub>2</sub>e) "owned" by the portfolio and scaled by £million invested. Measurement initially includes the Scope 1 and 2 (i.e. operational) emissions of investee companies.

### Key performance indicators

#### *Funds under management*

Funds under management relating to policyholder liabilities were £173.5 billion (2020: £160.0 billion). The movement reflects net flows from policyholders and investment returns for the period.

#### *Solvency II*

Our business model has exposure to a portfolio of risk types which delivers a significant capital benefit through risk diversification allowed under Solvency II. An Internal Model is used to calculate the Solvency Capital Requirement (SCR) taking account of the specific risks to which the Company is exposed. A Matching Adjustment is applied, resulting in a beneficial impact on the level of regulatory capital held in relation to annuities business.

During the year, the Group has delivered Solvency II reporting including full annual quantitative reporting as at 31 December 2021, as well as the narrative reporting required by Solvency II. The Company has a waiver from the Prudential Regulation Authority (PRA) exempting it from preparing a solo Solvency and Financial Condition Report (SFCR) for each Insurance entity. Instead, in April 2021, the Company reported publicly through a Group SFCR for SWG. The next SFCR will be published in April 2022.

The Directors believe that the Company currently has adequate capital resources and will continue to do so in the foreseeable future. On a Solvency II basis the regulatory surplus of the Company in excess of capital requirements is £2.6 billion, after a £300 million dividend was paid in first quarter of 2022 (2020: £2.2 billion, noting no dividend was paid in the first quarter of 2021).

The Solvency II ratio for SWG<sup>1</sup> of 192 per cent (pre dividend equivalent ratio for 2020: 152 per cent) represents the shareholder view of Solvency II surplus<sup>2</sup>. The equivalent ratio for the Company is 180 per cent while the Regulatory Solvency Ratio<sup>3</sup> included in the SFCR is 160 per cent (2020: 149 per cent and 142 percent respectively).

During 2021, benefits arose from positive market volatility primarily due to increases in long-term interest rates and capital generation on existing business, partially offset by capital invested in new business. The SWG ratio also includes a 17 per cent uplift as a result of the £560 million capital injection to SWG from Lloyds Banking Group to fund the acquisition of Embark, which completed in January 2022. The capital injection did not impact on the solvency ratio of the Company. Further information on the capital position of the Company is given in note 36.

As agreed with the PRA, the wider Insurance and Wealth Division submits a single Own Risk and Solvency Assessment (ORSA) each year which covers the Group headed by SWG. The assessment of own risks and solvency needs of the Company is therefore covered by that assessment.

<sup>1</sup> The Solvency II pre year-end dividend ratio is calculated as the ratio of eligible own funds divided by the SCR. The own funds in this ratio are before any year-end foreseeable dividend that may be payable following the year end.

<sup>2</sup> The shareholder view of Solvency II excludes the impact of eligible own funds and SCR within the with-profits funds.

<sup>3</sup> The Regulatory Solvency Ratio includes allowance for the impact of with-profits business and foreseeable dividends.

**GROUP STRATEGIC REPORT (continued)****Key performance indicators (continued)***Generation of capital surplus*

	Eligible Own Funds £m	SCR £m	Solvency Surplus £m
<b>As at 31 December 2020</b>	7,434	5,226	2,208
Regulatory and other model changes	62	(14)	76
Operating impacts:			
New business contribution	2	185	(183)
Expected in-force contribution	213	(269)	482
Assumption changes and experience variances	(182)	(106)	(76)
Debt costs	(64)	—	(64)
Market variances	199	(236)	435
Material miscellaneous items	(234)	(472)	238
Other non-operating charges	(300)	—	(300)
Capital management (payment of dividends and repayment of subordinated debt capital)	(200)	—	(200)
<b>As at 31 December 2021</b>	6,930	4,314	2,616

Expected earnings on in-force business generated significant surplus capital in 2021, through both generation of Own Funds and run-off of the SCR. This was used in part to fund investment in new business and to cover debt costs.

Market variances, primarily due to increases in long-term interest rates resulted in an increase in Solvency Surplus through both an increase in Eligible Own Funds and a reduction in the Solvency Capital Requirement.

The material miscellaneous items comprise a number of items including run-off and recalculation of the beneficial impact of the Solvency II Transitional Measures for Technical Provisions (which smooth the impact of moving from Solvency I to Solvency II) and the impact of the corporation tax rate increasing from April 2023.

A dividend of £200 million was paid in September 2021 from the Company to Scottish Widows Group. The Eligible Own Funds at 31 December 2021 anticipated a further dividend of £300 million would be paid in the first quarter of 2022 which is included in other non-operating charges in the table above. No dividend was paid in the first quarter of 2021.

**GROUP STRATEGIC REPORT (continued)****Key performance indicators (continued)**

*Comparison of Group total equity to Solvency II own funds*

Group Total Equity is as shown on the Balance Sheet on page 33.

	31 December 2021	31 December 2020
	£m	£m
<b>Group total equity per the Balance Sheet</b>	<b>2,235</b>	<b>2,452 *</b>
Adjustment for subsidiaries not included in Solvency II own funds	10	73
<b>Company total equity per the Balance Sheet</b>	<b>2,245</b>	<b>2,525 *</b>
<b>Valuation differences to Solvency II</b>		
Intangible assets not valued in Solvency II (see note a)	(1,476)	(1,676)
<i>Replace insurance and participating investment contract liabilities and non-participating investment contract liabilities with Solvency II best estimate liabilities (see note b):</i>	6,773	6,314 *
Revalue investment in subsidiaries for Solvency II (see note c)	(31)	(91)
Subordinated debt contributing to capital under Solvency II (see note d)	115	155
Deferred tax (see note e)	(721)	(483)
Other	(21)	(1)
<b>Solvency II excess of assets over liabilities</b>	<b>6,885</b>	<b>6,743</b>
Movements from assets over liabilities to own funds (see note f)	45	691
<b>Regulatory eligible own funds</b>	<b>6,930</b>	<b>7,434</b>

\* Restated. See note 41 for details regarding the restatement.

## Notes:

- Intangible assets including Deferred Income Reserve are not recognised under Solvency II
- The difference between Solvency II Best Estimate Liabilities and IFRS Liabilities (in respect of Insurance, participating investment and non-participating investment contracts). This amount has been amended from that reported in the prior year to reflect the restatement of insurance contract and participating investment contract liabilities. See note 41 for details of the restatement.
- The difference between Solvency II and IFRS valuation of subsidiaries. Under Solvency II, subsidiaries are recognised at their underlying balance sheet value, while under IFRS, some subsidiaries are recognised at cost
- The difference within the Solvency II and IFRS valuation of subordinated debt
- Deferred tax timing differences in relation to the valuation differences set out above
- Subordinated debt less ring-fenced assets which cannot be used to cover capital requirements. The reduction in this figure since prior year is driven by a £250 million increase in the With Profits restriction, a £300 million foreseeable dividend in 2021, and £97 million reduction in subordinated debt.

**GROUP STRATEGIC REPORT (continued)****Key performance indicators (continued)**

*The following table sets out the quality of eligible own funds of the Company*

No new Subordinated Debt (Tier 2) Capital has been issued by the Company during 2021, so the reduction in Own Funds during 2021 has been covered by Equity (Tier 1 unrestricted) Capital. The Company holds material investments in liquid assets, which could, if necessary, be realised within three months. The amount of liquid assets held is greater than the Own Funds in excess of capital requirements (£2.6 billion).

	31 December 2021	31 December 2020
<b>Regulatory Eligible Own Funds</b>	<b>£m</b>	<b>£m</b>
Tier 1 unrestricted	5,259	5,667
Tier 2	1,671	1,767
<b>Total</b>	<b>6,930</b>	<b>7,434</b>

*Liquidity*

The Company regularly monitors its liquidity position to ensure that, even under stressed conditions, the Company has sufficient liquidity to meet its obligations and remain within the approved risk appetite. As at 31 December 2021, the Company had liquidity coverage of 136 per cent (2020: 132 per cent). Liquidity coverage is defined as the comparison of available liquid assets, net of known cash flows, against 1-in-200 scenario stressed cash flows and 1-in-200 scenario liquidity risks. Liquidity methodology and reporting is compliant with Solvency II.

During 2021 there has been an improvement in the Company's excess liquidity position with an increase in the liquidity coverage since 31 December 2020.

This was driven by the restructuring of swap positions as part of the transition from IBOR to SONIA. Market movements have been volatile during the year, but due to the offsetting nature of these impacts has led to minimal net movements in the Company's excess liquidity position.

*Present value of new business premiums (PVNBP)*

Life and pensions sales (PVNBP) for the year were £17,289 million (2020: £14,529 million). PVNBP increased 19 per cent with year on year increases across all propositions with the exception of Bulk Annuities. Workplace pensions and Protection sales growth was particularly strong at 30 per cent and 42 per cent respectively.

*Non-financial KPIs*

The Directors consider non-financial KPIs in respect of the Group's strategic priorities. Where relevant, non-financial KPIs are presented below against the strategic priorities presented in this report.

	2021	2020
Customer satisfaction (Net Promoter Score - Life, Pensions and Investments business) (Strategic priority: Delivering a leading customer experience) <i>Note that the underlying surveys and weightings for this score have changed in 2021, therefore the prior year score has been rebaselined for comparative purposes.</i>	44	45
Customer complaints (FCA reportable complaints per 1,000 policies - scores align to latest Company biannual returns) (Strategic priority: Delivering a leading customer experience)	1.83	1.21
Colleague engagement index (% favourable - represents Insurance and Wealth Division index excluding Wealth index) (Strategic priority: Maximising the Group's capabilities)	65	75

The increase in customer complaints in 2021 is largely driven by a backlog of incoming cases carried over from 2020, and service delays and system migrations within the Company's outsourcers. Improvements were seen in the last quarter of 2021, and recovery plans with outsourcers are in place for completion in 2022.

*Other Sources where KPIs are presented*

The Group also forms part of Lloyds Banking Group's Insurance and Wealth Division. The development, performance and position of the Insurance and Wealth Division are presented within Lloyds Banking Group's Annual Report, which does not form part of this report.

The Directors consider that the above are the key performance indicators which are appropriate to the principal activity of the Group. These, together with other metrics which cover customer, operational measures and capital, are included in the balanced scorecard which is used to measure all aspects of the performance of the business. In addition, the Directors are of the opinion that the information contained in the Company's Solvency II reporting on capital resources and requirements and regular actuarial reports, in conjunction with the information presented in the financial statements as a whole, provide the management information necessary for the Directors to understand the development, performance and position of the business of the Company and the Group.

## GROUP STRATEGIC REPORT (continued)

### Review of the business

In addition to the progress made against the strategic initiatives summarised earlier there are other areas that are worthy of note and these are described below. Decisions taken in the areas described below and in pursuit of our strategy are brought to the Board for due consideration and approval.

#### *Migration of policy administration to outsourced partners*

The outsourcing contract with Diligenta was signed on 19 September 2017 with the purpose of providing improvements in customer experience for circa 4 million longstanding customers. During 2021, the continuing service improvement programme delivery included provision of an Integrated Drawdown capability for previously migrated pension customers, giving better options at retirement and making the process of taking tax free cash significantly simpler.

In October 2017, Zurich UK Life sold its Workplace Pensions and Savings business and an investment platform (which is administered by a third party, FNZ (UK) Limited) to Lloyds Banking Group. Subsequently, the investment platform was acquired by the Group in 2018, and existing business was migrated to the platform in 2021. Further migration events are planned for 2022.

### Outlook

The Directors consider that the Group's principal activities will continue to be unchanged in the foreseeable future.

### Principal risks and uncertainties

Risks and uncertainties to our strategic plan, both positive and negative, are considered by product through the planning process. The following table describes the principal risks faced by the Group. Further details on financial risks and how the Group mitigates them can be found in note 36, as shown by the note reference.

#### *Financial risks*

Principal Risk	Note reference	Description
Market risk	36(a)	Market risk is the risk that the Group's capital or earnings profile is affected by adverse market rates. Of particular importance to the Group are equity, credit default spreads, interest rates and inflation for assets backing insurance business. External rates are outwith the Group's control, so mitigation is via having sufficient financial reserves to cover reduced earnings, and using hedging strategies (see note 19).
Insurance underwriting risk	36(b)	Insurance underwriting risk is defined as the risk of adverse developments in the timing, frequency and severity of claims for insured/underwritten events and in customer behaviour, leading to reductions in earnings and/or value. Specific risks include mortality risk, morbidity risk and persistency risk. In order to mitigate insurance underwriting risk, the Group uses underwriting, reinsurance, pricing-to-risk, claims management, product design, policy wording, and demographics to accurately assess mortality risk.
Credit risk	36(c)	Credit risk is the risk that parties with whom we have contracted, fail to meet their financial obligations. The Group is subject to credit risk through a variety of counterparties through invested assets which are primarily used to back annuity business, cash in liquidity funds and bank accounts, derivatives and reinsurance. Credit risk is mitigated via the Credit Risk Policy framework, which ensures exposures are appropriately monitored and action taken where necessary.
Capital risk	36(d)	Capital risk is the risk that the Group has a sub-optimal quantity or quality of capital or that capital is inefficiently deployed across the Group. Capital, which includes regulatory capital for the Company and regulated subsidiaries, comprises all components of equity and subordinated debt. The business of the Group is regulated by the PRA. The PRA specifies the minimum amount of capital that must be held by the Company in addition to its liabilities. In addition to ensuring that the Company maintains sufficient regulatory capital to meet Solvency II capital requirements (based on a one in 200 year event), the Group's capital management strategy, as part of the integrated insurance business requires it to hold capital in line with the stated risk appetite for the business, which is to be able to withstand high-severity stress events without breaching the capital requirements. Capital risk is managed via the Capital Risk Policy, which includes tools and governance to monitor capital requirements and assign capital accordingly.
Liquidity risk	36(e)	Liquidity risk is the risk that the Group does not have sufficient financial resources to meet its commitments as they fall due, or can only secure them at excessive cost. The Group is exposed to liquidity risk from payments to policyholders and non-policyholder related activity, such as investment purchases and the payment of shareholder expenses). Liquidity risk is mitigated by applying the Liquidity Risk Policy, which includes controls to maintain liquidity at necessary levels.

**GROUP STRATEGIC REPORT (continued)****Principal risks and uncertainties (continued)***Non-financial risks*

<b>Principal Risk</b>	<b>Description</b>
Operational risk	Operational risk is the risk of loss from inadequate or failed internal processes, people and systems or from external events. This includes risks around cyber and information security, provision of external and internal services, financial crimes, financial reporting risk, fraud, IT systems, and security. Operational risk is managed through an operational risk framework, including a Risk and Control Self-Assessment (RCSA) process, and operational risk policies. The Group maintains a formal approach to operational risk event escalation, whereby material events are identified, captured and escalated. Root causes of events are determined, and action plans put in place to ensure an optimum level of control to keep customers and the business safe, reduce costs, and improve efficiency.
Data risk	Data risk is defined as the risk of failing to effectively govern, manage and control data (including data processed by third party suppliers), leading to unethical decisions, poor customer outcomes, loss of value and mistrust. It is present in all aspects of the business where data is processed, both within the company and by third parties. This risk is measured through a series of quantitative and qualitative indicators, covering data governance, data management, records management, data privacy and ethics. Data risks and controls are monitored and governed in line with an embedded risk management framework, which involves identification, measurement, management, monitoring and reporting.
Long term impact of the UK's exit from the EU	Risks arising from uncertainties in respect of the medium to long-term implications of the UK's exit from the EU on trade, regulation and employment. The Group continues to monitor the wider environment post EU exit, including for market volatility. Scenario planning exercises are performed as part of the business as usual, while contingency plans are regularly reviewed for potential strategic, operational and reputational impacts.
Climate risk	The Group is exposed to climate risk through transition and physical risks. The Group considers the impact of climate risk as a risk driver on other risks types, such as credit risk, market risk, and operational risk. Climate risk is mitigated via the application of the Climate Risk Policy, and actions taken to address other risk types.

In addition, as described in note 27, during the ordinary course of business the Group is subject to complaints and threatened or actual legal proceedings (including class or Group action claims) brought by or on behalf of current or former employees, customers, investors or other third parties, as well as legal and regulatory reviews, challenges, investigations and enforcement actions, both in the United Kingdom and overseas.

All such material matters are periodically reassessed, with the assistance of external professional advisors where appropriate, to determine the likelihood of the Group incurring a liability. In those instances where it is concluded that it is more likely than not that a payment will be made, a provision is established to management's best estimate of the amount required at the relevant balance sheet date. In some cases it will not be possible to form a view, for example because the facts are unclear or because further time is needed to properly assess the situation, and no provisions are held in relation to such matters. However the Group does not currently expect the final outcome of any such case to have a material adverse effect on its financial position, operations or cash flows.

**Section 172(1) Statement and Statement of Engagement with Other Stakeholders**

In accordance with the Companies Act 2006 (the 'Act') (as amended by the Companies (Miscellaneous Reporting) Regulations 2018), the Directors of the Board of the Company provide this Statement, which describes the ways in which they have had regard to the following matters set out in Section 172(1) of the Act when fulfilling their key duty to promote the success of the Company, under Section 172:

- The likely consequences of any decision in the long term;
- The need to foster business relationships with the Group's suppliers, customers and others
- The impact of the Group's operations on the community and the environment
- Maintaining a reputation for high standards of business conduct for the Group
- The need to act fairly as between the Group's shareholders

This Statement also provides examples of how the Directors have engaged with and had regard to the interests of key stakeholders in accordance with the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 (as amended by the Companies (Miscellaneous Reporting) Regulations 2018). The Group is a subsidiary of Lloyds Banking Group, and as such follows many of the processes and practices of Lloyds Banking Group, which are further referred to in this Statement where relevant.

## GROUP STRATEGIC REPORT (continued)

### Section 172(1) Statement and Statement of Engagement with Other Stakeholders (continued)

The Board is collectively responsible for the long-term success of the Group. Understanding the views and interests of our key stakeholders (this includes customers, shareholders, communities, the environment, regulators, and suppliers), is central to the Group's strategy, crucial to the Group's success, and informs key aspects of Board decision-making as set out in this Statement. Stakeholder engagement is embedded in all aspects of the Board's decision-making and can be seen in the range of activities across key stakeholder groups.

#### *How the Board has discharged its Section 172 duties*

The Directors, as part of their appointment and induction to the Board, are provided with a briefing on their statutory director duties and the standards required to be met by subsidiary boards within Lloyds Banking Group. The Board undertakes an annual review of its governance arrangements, in particular of the matters it has reserved for its own determination and those for which it has delegated authority to management. This arrangement is designed to enable the Board to provide effective, sound, and entrepreneurial leadership of the Group within Lloyds Banking Group's strategic aims and prudent and effective controls.

Stakeholder engagement is embedded in the Board's delegation to the Chief Executive Scottish Widows & Group Director Insurance (Chief Executive) for the delivery of the Group's strategy and overall management of the Group's business within its defined risk appetite. Examples of related actions taken during the year are included within this Report. The Chief Executive discharges his responsibility for the day-to-day management of the Group's business by delegating key areas of his authority to members of management and with the assistance of the Executive Committee (the Insurance & Wealth Executive Committee (IWECC)) which enables him to make informed decisions about the operations of the Group's business.

The Chief Executive and management both provide the Board with details of material stakeholder interaction and feedback, through a programme of business updates. Stakeholder interests are routinely identified by management in the wider proposals put to the Board. During 2021 (as in 2020) interaction with stakeholders evolved in response to the UK Governments' ongoing provisions on the COVID-19 global pandemic and the Group has made use of tools that enable virtual engagement.

Further details of how the Board considers each of the specific matters set out in Section 172, along with specific examples of how these considerations have influenced decisions taken by the Board, are set out in pages 11 to 16 which serves as the Group's Section 172(1) Statement.

#### *Customers*

The Board's understanding of customers' needs is vital in setting and achieving the Group's goals. Customer needs and a customer-centric approach are a key consideration in Board decision-making. The Group serves a wide variety of different customers and acts in a way designed to meet their diverse needs in a timely and efficient way through its range of products and the quality of customer service provided.

The Board reviews the performance of its customer propositions within a cycle of in-depth reviews and debates matters particular to each proposition. Such review in 2021 has covered product/investment performance, the quality of customer service and the effectiveness of product evolution to meet the changing needs of the Group's customer base. The Board, supported where appropriate by various committees (including the Independent Governance Committee and the With Profits Committee) challenges management from the perspective of the customer, such as in consideration of the design of written engagement materials (including investment reports) and the channels made available to customers to transact with and obtain support from the Group.

#### *Customer trust*

Customer trust is always a priority. The Board has established a governance framework that aims to treat all customers fairly, and makes it easy for customers to find, understand and access products that are right for them. The Board receives a regular customer dashboard update that measures brand performance on a number of metrics to identify areas of particular strength or where extra management focus is needed. This dashboard includes verbatim feedback from customers that helps to provide richer insight into performance across various dimensions to inform business planning and priorities. The Board's Risk Oversight Committee reviews more detailed customer-related risk matters and scrutinises risk performance (including Complaints and Conduct Risk Appetite Metrics) to identify areas where improvements could be made.

The Scottish Widows brand has strength derived by its consistency, heritage and specialism with a high level of brand engagement among both direct customers and intermediaries. The Board recognises the need for brand consistency and the need to ensure customer experience matches customer expectations of its brand.

## GROUP STRATEGIC REPORT (continued)

### Section 172(1) Statement and Statement of Engagement with Other Stakeholders (continued)

#### *COVID-19 response*

The COVID-19 pandemic impacted customers, colleagues and the operation of business of the Group in a number of ways including heightened telephony demand from customers who were themselves managing immediate pandemic impacts, alongside a transition to remote working for colleagues and third-party partners and the emergence of a sustained, heightened expectation among customers for digital engagement channels. Some areas of customer service continued to experience COVID-19 related impacts into 2021 and the management of complaints and resolution of queries remains a consistent Board and management focus, working closely with the customer service partners to enable the delivery of a consistently high standard of service as customers should expect.

The management of customer investments is a core matter managed by the Board, supported by some of its Committees. The Board has continued in 2021 to take a long-term view in its approach to investment management in partnership with the Group's selected active fund manager, Schroder Investment Management Limited (Schroders). Schroders are invited to present to certain meetings of the Board as a means of overseeing management's engagement with them and to engage with them in respect of key investment matters.

#### *Delivering value for customers*

The Board routinely reviews the performance of its customer propositions during its annual cycle of meetings, focusing on matters particular to each proposition within its standing annual cycle of discussions. The Board also considers in the widest sense the digital landscape and the effectiveness of its various channels open to customers to do business with the Group.

In 2021, alongside ongoing proposition developments, the Board of the Group's parent, SWG, gave time to consider an inorganic opportunity and on 31 January 2022 completed the acquisition of Embark. That acquisition is designed to improve the Group's capabilities in serving certain market segments and to enable the re-platforming of Scottish Widows' pensions and retirement proposition in due course to deliver a modern, mass market, direct-to-customer proposition.

#### *Fund performance*

The Group's business model of outsourcing fund management means asset managers who specialise in specific areas of the market are selected to deliver the investment style and performance expected by customers. This approach also enables the Group to keep the performance of its appointed asset manager under constant review. The management of most of the Group's active funds by Schroders provides access to leading investment management expertise and helps to drive improved potential for increased investment returns for customers. The Board of the Group invited representatives of Schroders to address one of its meetings in 2021 and discussed with them, in addition to overall fund performance, the Quant Equity Strategy and Net Zero initiative as part of the Board's wider focus on environmental, social and governance (ESG) considerations.

The Board of the Group recognises the importance of understanding its performance in supporting customers, including how the Group performs in this regard relative to its peers. Regular Board updates from management cover information from a range of relevant internal and external sources. Together these provide important insight that informs Board decision-making.

#### *Technology transformation*

The Board has taken steps to make sure the Group continues to build on its responses to customer demand for technology. Whilst digital transformation has remained a key focus in improving the customer experience, the Board acknowledges that many customers still value being able to get in touch with customer service staff over the phone, via letter or through email. The Board recognises the importance of the Group continuing to offer a range of engagement channels to suit customers and improve these services in parallel.

As part of the Group's drive towards continuously improving the service it provides to customers, the Group has contracted with Diligenta to enable an enhanced customer experience with new ways of managing investments online and accessing the information they need quickly and easily. As part of its rolling programme of engagement with management on technological matters, the Board considered during 2021 a programme of investments over the coming years that would move the Group closer to its ambition of being the UK's preferred, holistic financial partner for its personal and intermediated customers.

#### *Helping Britain Recover and Prosper*

The Board continues to participate appropriately in all Lloyds Banking Group related initiatives. The lasting social and economic effects on the UK as it emerges from the impacts of the COVID-19 pandemic have been a focus of Lloyds Banking Group and its Helping Britain Recover and Prosper Plan, building on its Helping Britain Prosper ambitions. The focus of Lloyds Banking Group's purpose will evolve in response to the current environment and changing customer needs and expectations. Helping rebuild UK households' financial health and wellbeing and accelerating the transition to a low-carbon economy are key commitments within the Helping Britain Recover and Prosper Plan.

Lloyds Banking Group continues to invest significantly in the development of its Insurance business, which the Group forms part of, with a focus on supporting customers' long-term financial resilience and ambitions to deliver good outcomes for customers in a sustainable way. Further information on Lloyds Banking Group's initiatives can be found in the Strategic Report within the Lloyds Banking Group Annual Report and Accounts for 2021, available on the Lloyds Banking Group website.

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## GROUP STRATEGIC REPORT (continued)

### Section 172(1) Statement and Statement of Engagement with Other Stakeholders (continued)

#### *Shareholders*

The Group is a wholly owned subsidiary of Lloyds Banking Group, forming part of its Insurance and Wealth Division. As a wholly owned subsidiary the Board ensures that the strategy, priorities, processes and practices of the Group are aligned where appropriate to those of Lloyds Banking Group, ensuring that its interests as the Group's shareholder are duly acknowledged. Further information in respect of the relationship of Lloyds Banking Group with its shareholders is included in the Strategic Report within the Lloyds Banking Group Annual Report and Accounts for 2021, available on the Lloyds Banking Group website.

The relationship between the Board of the Group and the Board of Lloyds Banking Group is supported by at least one senior leader from Lloyds Banking Group serving as a Non-executive Director on the Insurance Board throughout all of 2021. A number of Lloyds Banking Group Independent Non-executive Directors were also welcomed as observers at meetings of the Insurance Board during 2021. The Board of the Group also welcomed that the Lloyds Banking Group Chair and the Lloyds Banking Group Chief Executive Officer (who was appointed to that role in August 2021) both took part in some Board discussions during 2021 and debate included ways to optimise the relationship between the two Boards.

The Company paid a £200 million interim dividend in the year to the Company's parent, SWG. The constraint to determine dividend payments within the Company are the level of excess capital on a Solvency II basis, the availability of liquid assets within the Company to make the dividend payment and still meet other expected outflows, and having sufficient IFRS retained profits. During 2021 rises in long term interest rates have materially increased the amount of excess equity capital available which supports the interim and final dividend payments, and the IFRS retained profit position supports the ability to pay this dividend.

#### *Communities and the environment*

The Group is part of Lloyds Banking Group, one of the largest financial services providers in the UK and whose goals are to be a trusted, sustainable, and responsible business.

The Responsible Business Committee of the Board of Lloyds Banking Group is responsible for oversight of the Group's performance as a Responsible Business and has given much focus to overseeing the development of Lloyds Banking Group's Helping Britain Recover and Prosper Plan. This plan continues its strategy of Helping Britain Prosper while also playing a part in the UK's recovery from the COVID-19 pandemic. The views of stakeholders have informed the Responsible Business Committee's role in the development of Lloyds Banking Group's Society of the Future ambitions, which aim to fully integrate its societal objectives with its business objectives.

In September 2021, the Insurance Board established its own Insurance Sustainability Committee (ISCO), with membership drawn primarily from Independent Non-executive Directors in addition to the Chief Executive. The primary purpose of ISCO is to review the ESG Strategy of the Insurance business, and its alignment to Lloyds Banking Group's overarching purpose of Helping Britain Recover and Prosper in the future. Alongside ISCO, the Group's Insurance People Committee continues to consider, amongst other things, matters related to culture and in 2021 has debated and sponsored various Inclusion & Diversity matters and initiatives. The Chairs of the Insurance People Committee and ISCO work together to ensure that there is appropriate coverage of all social matters between them.

The Board as a whole is engaged on a regular basis on the Group's sustainability agenda, receiving regular briefings to build understanding and capability. Directors also attend relevant external briefings. In July 2021, the Board undertook climate risk training supported by the Cambridge Institute of Sustainability Leadership.

#### *Climate risk*

Approval of proposed external commitments in relation to climate risk that materially impact the Group or the Group's funds are matters reserved to the Board. ISCO on behalf of the Board considers the Group's management of climate risk and relevant public disclosures, providing oversight and challenge on those activities which impact on the Group's reputation as a responsible business.

#### *Responsible stewardship*

The Board monitors the Group's overall investment strategy and performance giving due consideration to wider Lloyds Banking Group and Scottish Widows' Responsible Investment and Stewardship Framework. This is a principles-based framework which guides the Group's decisions on the investments made, the fund managers selected, research into funds, and how the Group engages with companies it invests in. Research conducted by Scottish Widows to find out investor views on a wide range of sustainable investment themes, has informed this Framework which is available on the Scottish Widows website.

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## GROUP STRATEGIC REPORT (continued)

### Section 172(1) Statement and Statement of Engagement with Other Stakeholders (continued)

#### *Environmental ambitions*

The Board have supported some ambitious Lloyds Banking Group targets in relation to ESG and climate change. The Group's aim is to increase investment in companies adapting their businesses to be less carbon-intensive and to invest in climate awareness strategies (funds that have a materially lower carbon intensity than their benchmark) by 2025; achieve a 50 per cent reduction in the carbon emissions of the Group's overall funds under management by 2030; and get to net zero emissions by 2050. The Board believes that the ESG commitments that Lloyds Banking Group and Scottish Widows has made will not negatively impact investment returns for customers and is monitoring closely. The Board intends to provide more detail of how it is going to hit these targets in future years.

The Board is regularly updated on the work undertaken by the Scottish Widows' Responsible Investment Team with key stakeholders including the UK government, regulators, and the pensions industry to unlock opportunities to invest in the infrastructure required to successfully transition to a lower carbon economy.

Further detail on the Group's strategy in relation to Environmental Ambitions is covered in the Climate Change section commencing on page 5 of this report.

#### *Board diversity*

The Board considers its current size and composition to be appropriate to the Group's circumstances. The Board places great emphasis on ensuring its membership reflects the diversity of modern Britain and is inclusive for everyone. On gender diversity, the Board has a specific objective to maintain membership of at least 33 per cent female Board members. At 31 December 2021, the Board's membership consisted of 38 per cent female members. With effect from 18 March 2022 the Board has met the objectives of the Parker review for at least one Black, Asian and Minority Ethnic Board member. The Group also supports the Lloyds Banking Group high-level approach to diversity in senior management roles, which is governed in greater detail through Lloyds Banking Group policies.

#### *Regulators*

The Board maintains strong, open, and transparent relationships with regulators and relevant government authorities. Liaison with regulators and the Government, both directly and as part of Lloyds Banking Group, is an ongoing priority at all levels of the organisation, ensuring Lloyds Banking Group and the Group's strategic aims align with the requirement of these important stakeholders. In November 2020 and July 2021 respectively the Board invited representatives from the Financial Conduct Authority and Prudential Regulation Authority respectively to join one of its meetings to discuss key priorities. In addition, individual Directors have in the ordinary course of business continuing discussions with regulators on various matters within the regulatory agenda. Regulatory engagement provides a view of the key areas of regulatory focus to management and the Board with monitoring of regulatory actions in place.

#### *Suppliers*

As part of Lloyds Banking Group, the Group has entered into a number of strategic partnerships for important aspects of its operations and customer service provision. As well as external partners, the Group relies on supplier arrangements within Lloyds Banking Group for certain services. The Board recognises the importance of its role in overseeing these relationships, which are integral to the Group's future success.

Recognising the role of suppliers in the Group's day-to-day operations and its future ambitions, the Board undertakes regular reviews of its key suppliers, including its asset managers and its outsourced service providers. These reviews take into consideration supplier feedback on the Group's processes for potential improvement. During 2021, leaders from Diligenta and FNZ held detailed discussions with the Board of the Group.

An advantage of being part of a larger group means there are robust processes in place to monitor and review costs with third parties who provide services to the Group. The outsource business model allows the Company to negotiate competitive fees and commercial terms with its service suppliers to control costs for all the Group's customers.

#### *Supplier experience*

Importance is placed on having the right supplier framework to operate responsibly. Lloyds Banking Group's Sourcing & Supply Chain Management Policy applies to all its businesses, divisions and subsidiaries, including the Group, with the Directors assuming ultimate responsibility for the application of that policy in a way that is appropriate for the individual Company within the Group. As a result, the most significant supplier contracts must be approved by the Board, including those which are key in progressing strategic priorities. Recognising the role of suppliers in the Group's day-to-day operations and its future ambitions, the Board undertakes regular reviews of its key suppliers and takes into consideration supplier feedback where applicable on the Group's processes for potential improvement.

Suppliers are required to adhere to relevant Lloyds Banking Group policies and comply with its Code of Supplier Responsibility, which can be found on the Lloyds Banking Group website. This defines expectations for responsible business behaviour, underpinning the efforts of the Group and Lloyds Banking Group to share and extend good practice. All material contracts are subject to rigorous cost management governance with regular review of key supplier risks.

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**GROUP STRATEGIC REPORT (continued)****Section 172(1) Statement and Statement of Engagement with Other Stakeholders (continued)***Modern slavery*

The Responsible Business Committee of the Board of Lloyds Banking Group - as part of its oversight of its performance (including that of the Group, as a Responsible Business) - governs Lloyds Banking Group's approach to human rights. The Insurance People Committee, on behalf of the Group, considers matters at a Group level.


On a day-to-day basis, management of and engagement on modern slavery and human rights is guided by a cross-divisional working group led by the Responsible Business team, which meets regularly to assess the embedding of human rights within Lloyds Banking Group's operations.

Lloyds Banking Group, and the Group, have a zero-tolerance attitude towards modern slavery in its supply chains. Lloyds Banking Group's Modern Slavery and Human Trafficking Statement and Human Rights Policy Statement are published on its website and cover all its subsidiary companies, including the Group, which is required to publish an annual statement. This statement sets out the steps taken to prevent modern slavery in Lloyds Banking Group's business and supply chains. On an annual basis, the Insurance Sustainability Committee reviews these statements ahead of Board approval.

*Maintaining a reputation for high standards of business conduct*

The Board supports the Chief Executive to ensure a culture of customer focus (including treating customers fairly), risk awareness and ethical behaviours. As part of the Board's oversight of this, the Board where necessary will seek assurance that management corrective action has been taken to ensure that policy and behaviours are aligned to the purpose, value, and strategy of the wider Insurance business.

On behalf of the Board of Directors



J C S Hillman

Director

6 April 2022

## DIRECTORS' REPORT

The Directors present the audited consolidated financial statements of the Company and the Group. The Company is a private company limited by shares, domiciled and incorporated in England and Wales. The Group also has freedom of services overseas through branches, which administer a relatively small amount of business, principally in Germany. This business is administered through a subsidiary, SWE. Details of all the subsidiary undertakings are given in note 15.

### Results and dividend

The result for the year ended 31 December 2021 is a Group loss after tax of £(8) million (2020 loss: £(164) million restated, £32 million increase from previously reported). Further information on the results of the Group, and future prospects of the business, are provided in the Group Strategic Report. See note 41 for details of a restatement of insurance contract liabilities and the impact on retained earnings.

During the year, £200 million interim dividends (2020: £560 million) were paid. Details of dividends paid during the year are given in note 34.

### Post balance sheet events

An interim dividend of £300 million was declared on 3 February 2022 and paid to Scottish Widows Group on 9 February 2022.

Further information on post balance sheet events is set out in note 42.

### Directors

The names of the current Directors are listed on page 3. Changes in Directorships during the year and since the end of the year are as follows:

J Hylands	(resigned 31 March 2021)
J Bond	(resigned 14 May 2021)
K Cheetham	(resigned 9 September 2021)
N Prettejohn	(resigned 30 September 2021)
A J Reizenstein	(appointed 23 April 2021)
D L Davis	(appointed 18 March 2022)

Particulars of the Directors' emoluments are set out in note 37.

### Directors' indemnities

Lloyds Banking Group has granted deeds of indemnity by deed poll and by way of entering into individual deeds, which for the purposes of the Companies Act 2006 constitute 'qualifying third-party indemnity provisions' to the directors of its subsidiary companies, including those of the Company and its subsidiaries. Such deeds were in force during the whole of the financial year and at the date of approval of the financial statements or from the date of appointment in respect of the Directors who join the Board of the Company during the financial year. Directors no longer in office but who served on the Board of the Company at any time in the financial year had the benefit of this contract of indemnity during that period of service.

The deed for existing Directors is available for inspection at the registered office of Lloyds Banking Group plc. In addition, the Group has in place appropriate Directors and Officers Liability Insurance cover which was in place throughout the financial year.

### Disclosure of information to auditor

Each person who is a Director at the date of approval of this report confirms that, so far as the Director is aware, there is no relevant audit information of which the Company's auditors are unaware and each Director has taken all the steps that they ought to have taken as a Director in order to make themselves aware of any relevant audit information and to establish that the Company's auditors are aware of that information. This confirmation is given, and should be interpreted in accordance with, the provisions of the Companies Act 2006.

### Future developments

Future developments are detailed within the Group Strategic Report and also in note 40.

### Engagement with suppliers, customers, and others

Disclosures relating to engagement with suppliers, customers and others are included in the Strategic Report and are therefore incorporated into this report by reference.

### Research and Development

The accounting policy for software development costs is detailed in note 1i and further details of the development costs for 2021 are disclosed in note 12.

## DIRECTORS' REPORT (continued)

### Employees

Lloyds Banking Group is committed to providing employment practices and policies which recognise the diversity of the workforce and ensure equality for employees regardless of sex, race, disability, age, sexual orientation or religious belief. In the UK, Lloyds Banking Group belongs to the major employer groups campaigning for equality for all staff, including Employers' Forum on Disability, Employers' Forum on Age and Stonewall. Lloyds Banking Group is also represented on the Board of Race for Opportunity and the Equal Opportunities Commission. Involvement with these organisations enables Lloyds Banking Group to identify and implement best practice for staff.

Lloyds Banking Group encourages and gives full and fair consideration to job applications from people with a disability and are unbiased in the way it assesses, selects, appoints, trains and promotes people. Lloyds Banking Group encourages job applications from those with a disability and continues to run a work experience programme with Remploy to support people with disabilities wanting to enter the workplace.

Lloyds Banking Group is committed to continuing the employment of, and for arranging appropriate training for, its employees who have become disabled persons during the period when they were employed by the Company.

Employees are kept closely involved in major changes affecting them through such measures as team meetings, briefings, internal communications and opinion surveys. These meetings, briefings and internal communications also serve to achieve a common awareness of the financial and economic factors that affect the performance of the Company and the Group. There are well-established procedures, including regular meetings with recognised unions, to ensure that the views of employees are taken into account in reaching decisions. Schemes offering share options or the acquisition of shares are available for most staff, to encourage their financial involvement in Lloyds Banking Group.

The Group has no employees as colleagues are employed by other subsidiaries within Lloyds Banking Group.

### Corporate Governance Report

#### Approach to Corporate Governance

In accordance with the Large and Medium-sized Companies and Group (Accounts and Reports) Regulations 2008 (as amended by the Companies (Miscellaneous Reporting) Regulations 2018) (the 'Regulations'), for the year ended 31 December 2021, the Group has in its corporate governance arrangements applied the Wates Corporate Governance Principles for Large Private Companies (the 'Principles'). The following section explains the Group's approach to corporate governance, and its application of the Principles.

Fundamental to the Group's strategy are high standards of corporate governance. A Corporate Governance Framework is in place for the Group, which sets the approach and applicable standards in respect of the Group's corporate governance arrangements whilst addressing the matters set out in the Principles.

This includes the matters reserved to the Board, and the matters the Board has chosen to delegate to management, including decision-making on operational matters such as those relating to credit, liquidity and the day-to-day management of risk, and the governance requirements of the operation of the Group outside of Lloyds Banking Group's Ring-Fenced Bank. Governance arrangements, including the Corporate Governance Framework, are reviewed at least annually to ensure they remain fit for purpose. The Corporate Governance Framework of the Group further addresses the requirements of the Principles as follows.

#### *Principle One – Purpose and Leadership*

The Board is collectively responsible for the long-term success of the Group. It achieves this by agreeing the Company's strategy, within the wider strategy of Lloyds Banking Group, and overseeing delivery against it. The Board also assumes responsibilities for the management of the culture, values and wider standards of the Group, within the equivalent standards set by Lloyds Banking Group.

Consideration of the needs of all stakeholders is fundamental to the way the Group operates, as is maintaining the highest standards of business conduct, which along with ensuring delivery for customers, is a vital part of the corporate culture. The Group's approach is further influenced by the need to build a culture in which everyone feels included, empowered and inspired to do the right thing for customers. To this end, the Board (supported by one or more of its Committees) plays a lead role in establishing, promoting and monitoring the Group's corporate culture and values, with the Corporate Governance Framework ensuring such matters receive the appropriate level of prominence in Board and Executive decision-making. The Group's corporate culture and values align to those of Lloyds Banking Group, which are discussed in more detail in the Lloyds Banking Group annual report and accounts for 2021.

## DIRECTORS' REPORT (continued)

### Corporate Governance Report (continued)

#### *Principle Two – Board Composition*

The Group is led by a Board comprising a Chair, Independent Non-Executive Directors, other Non-Executive Directors and Executive Directors; further details of the Directors can be found on page 3. The Board reviews its composition regularly, and is committed to ensuring it has the right balance of skills and experience. The Board considers its current size and composition is appropriate to the Group's circumstances and places great emphasis on ensuring its membership reflects diversity in its broadest sense, for example three out of eight Directors in office at 31 December 2021 are women, increasing to four following the appointment of Deborah Davis on 18 March 2022, and meeting from that date the Parker Review requirement to have at least one Black, Asian and Minority Ethnic Board member. New appointments are made on merit, taking account of the specific skills and experience, independence and knowledge needed to ensure a rounded Board and the diversity benefits each candidate can bring overall. There are a range of initiatives to help provide mentoring and development opportunities for female and Black, Asian, and Minority Ethnic executives within Lloyds Banking Group, and to ensure unbiased career progression opportunities.

The Board is supported by its Committees, the operation of which is discussed below, which make decisions and recommendations to the Board according to the matters delegated to them, in particular in relation to internal controls, risk oversight, ESG strategy, culture and financial reporting. Each committee has written terms of reference setting out its delegated responsibilities. Each committee comprises individuals with appropriate skills and experiences and is chaired by a suitably skilled and experienced Chair. The committee Chairs report to the Board at each Board meeting.

The Board periodically undertakes self-reviews of its effectiveness, which provide an opportunity to consider ways of identifying greater efficiencies, ways to maximise strengths and highlight areas of further development. The effectiveness reviews are commissioned by the Chair of the Board, assisted by the Company Secretary. In addition to considering the effectiveness of the Board, the effectiveness of the Board committees is also considered. The Chair also ensures that the individual performance of individual Directors is reviewed.

#### *Principle Three – Director Responsibilities*

The Directors assume ultimate responsibility for all matters which concern the operation of the Group's business, and along with senior management, are committed to maintaining a robust control framework as the foundation for the delivery of good governance, including the effective management of delegation through the Corporate Governance Framework. Policies are also in place in relation to potential conflicts of interest which may arise.

The Board is supported by its Committees, which make recommendations on matters delegated to them under the Corporate Governance Framework. The management of all committees is in keeping with the basis on which meetings of the Board are managed, with open debate, and adequate time for members to consider proposals which are put forward. The Chair of the Board and each Board Committee assumes responsibility with support from the Company Secretary for the provision to each meeting of accurate and timely information.

#### *Principle Four – Opportunity and Risk*

The Board oversees the development and implementation of the Group's strategy, within the context of the wider strategy of Lloyds Banking Group, which includes consideration of all strategic opportunities.

The Board is also responsible for the long-term sustainable success of the Group, generating value for its shareholders and making a positive contribution to society. The Board agrees the Group's culture, purpose, values and strategy - within that of Lloyds Banking Group more widely - and agrees the related standards of the Group, again within the relevant standards of Lloyds Banking Group. Further specific aims and objectives of the Board are formalised within the Corporate Governance Framework.

Strong risk management is central to the strategy of the Group which, along with a robust risk control framework, serves as the foundation for the delivery of effective management of risk. The Board approves the Company's risk appetite, within the wider risk appetite of Lloyds Banking Group, and ensures the Company manages risk effectively, delegating related authorities to individuals through the Corporate Governance Framework and the further management hierarchy. Board level engagement - coupled with the direct involvement of senior management in risk issues - ensures that escalated issues are promptly addressed and remediation plans are initiated where required. The Company's risk appetite, principles, policies, procedures, controls and reporting are managed in conjunction with those of Lloyds Banking Group and, as such, are regularly reviewed to ensure they remain fully in line with regulations, law, corporate governance and industry best practice. The Company's principle risks are discussed further in note 36.

#### *Principle Five – Remuneration*

The Remuneration Committee of Lloyds Banking Group (the 'Remuneration Committee'), assumes responsibility for the Group's approach to remuneration. This includes reviewing and making recommendations on remuneration policy as relevant to the Group, ranging from the remuneration of Executive Directors to that of all other colleagues employed by the Group. This includes colleagues where the regulators require the Group to implement a specific approach to their remuneration, such as Senior Managers and other material risk takers.

**DIRECTORS' REPORT (continued)****Corporate Governance Report (continued)***Principle Six – Stakeholders*

The Group as part of Lloyds Banking Group operates under Lloyds Banking Group's wider Responsible Business approach, which acknowledges that the Group has a responsibility to help address the economic, social and environmental challenges which the UK faces and, as part of this, understand the needs of the Group's external stakeholders, including in the development and implementation of strategy. Central to this is Lloyds Banking Group's Helping Britain Recover and Prosper plan, in which the Group participates, which seeks to gather stakeholder views through a dedicated materiality study, as overseen by Lloyds Banking Group's Responsible Business Committee.

In 2021, the Responsible Business Committee determined that the Company and Lloyds Banking Group continued to demonstrate responsibility as a key priority, including keeping customers' data safe, supporting vulnerable customers, lending responsibly, supporting businesses and working with suppliers. The approach of the Board in respect of its non-colleague stakeholders is described in the separate s172 statement made in compliance with the Regulations, on page 11.

The Group established a Board Sustainability Committee during 2021 to focus on the ESG Strategy of the Insurance business, and its alignment to Lloyds Banking Group's overarching purpose of Helping Britain Recover and Prosper in the future.

**Going concern**

The going concern of the Company and the Group is dependent on successfully maintaining adequate levels of capital and liquidity. In order to satisfy themselves that the Company and the Group have adequate resources to continue to operate for the foreseeable future, the Directors have considered a number of key dependencies which are set out in note 36 under principal risks and uncertainties: funding and liquidity in note 36(e) and capital position in note 36(d) and additionally have considered projections (including stress testing) for the Group's capital and funding position. Having consulted on these, the Directors conclude that it is appropriate to continue to adopt the going concern basis in preparing the accounts.

**Hedging and financial risk management**

Disclosures relating to hedge accounting are included within note 1 and note 19 to the accounts; disclosures relating to financial risk management are included in note 36 to the accounts and are therefore incorporated into this report by reference.

**Information incorporated by reference**

The following additional information forms part of the Directors' Report, and is incorporated by reference.

Content	Section
Disclosures required under the Companies Act 2006 and the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008	Statement of other stakeholder engagement Group Strategic Report
Disclosures required by the Financial Conduct Authority's Disclosure and Transparency Rule 7.2.5R	Corporate Governance Statement - internal control and risk management systems Note 36 (Risk Management)

**Independent auditor**

Following the resignation of PricewaterhouseCoopers LLP on 13 May 2021, Deloitte LLP were appointed as auditors of the Company by resolution of the members dated 20 May 2021.

Pursuant to section 487 of the Companies Act 2006, auditors duly appointed by the members of the Company shall, subject to any resolution to the contrary, be deemed to be reappointed for the next financial year and Deloitte LLP will therefore continue in office.

The Financial Reporting Council's Audit Quality Review team reviewed PwC's audit of the Group's 2020 financial statements as part of its latest annual inspection of audit firms. The audit quality was assessed as Good, with no key findings arising from the review.

**DIRECTORS' REPORT (continued)****Statement of Directors' responsibilities**

The Directors are responsible for preparing the Annual Report and Accounts in accordance with applicable law and regulation.

Company law requires the Directors to prepare financial statements for each financial year. Under that law, the Directors have prepared the Group and Company financial statements in accordance with international accounting standards in conformity with the requirements of the Companies Act 2006. Additionally, the Financial Conduct Authority's Disclosure Guidance and Transparency Rules require the Directors to prepare the Group financial statements in accordance with international financial reporting standards adopted pursuant to Regulation (EC) No 1606/2002 as it applies in the European Union. Under Company law the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Group and Company and of the profit or loss of the Group and Company for that period. In preparing the financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently
- state whether for the Group and Company, UK-adopted international accounting standards in conformity with the requirements of the Companies Act 2006 have been followed, subject to any material departures disclosed and explained in the financial statements
- make judgements and accounting estimates that are reasonable and prudent
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Group and Company will continue in business

The Directors are also responsible for safeguarding the assets of the Group and Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Group and Company's transactions and disclose with reasonable accuracy at any time the financial position of the Group and Company and enable them to ensure that the financial statements comply with the Companies Act 2006 and, as regards the Group financial statements, Article 4 of the IAS Regulation.

The Directors are responsible for the maintenance and integrity of the Company's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions. A copy of the financial statements is placed on our website [www.scottishwidows.co.uk](http://www.scottishwidows.co.uk).

Each of the Directors whose names are listed on page 3 confirms that, to the best of their knowledge:

- The Group and Company financial statements which have been prepared in accordance with UK-adopted international accounting standards in conformity with the requirements of the Companies Act 2006, give a true and fair view of the assets, liabilities, financial position and financial performance of the Group and Company
- the Group Strategic Report on pages 4 to 16, and the Directors' Report on pages 17 to 23 include a fair review of the development and performance of the business and the position of the Group and Company, together with a description of the principal risks and uncertainties that it faces

The Directors have also separately reviewed and approved the Strategic Report.

On behalf of the Board of Directors



J C S Hillman

Director

6 April 2022

## INDEPENDENT AUDITOR'S REPORT TO THE MEMBER OF SCOTTISH WIDOWS LIMITED

### Report on the audit of the financial statements

#### 1. Opinion

In our opinion:

- the financial statements of Scottish Widows Limited (the 'Company') and its subsidiaries (the 'Group') give a true and fair view of the state of the Group's and of the Company's affairs as at 31 December 2021 and of the Group's loss for the year then ended
- the Group financial statements have been properly prepared in accordance with United Kingdom adopted international accounting standards
- the Company financial statements have been properly prepared in accordance with United Kingdom adopted international accounting standards and as applied in accordance with the provisions of the Companies Act 2006
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006.

We have audited the financial statements which comprise:

- the consolidated Group Statement of Comprehensive Income
- the consolidated Group and Company Balance Sheets
- the consolidated Group and Company Statement of Cash Flows
- the consolidated Group and Company Statements of Changes in Equity
- the related notes 1 to 42 (excluding the capital adequacy disclosures, calculated in accordance with the Solvency II regime which are disclosed as unaudited within note 36)

The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom adopted international accounting standards and, for the Company financial statements, as applied in accordance with the provisions of the Companies Act 2006.

#### 2. Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the auditor's responsibilities for the audit of the financial statements section of our report.

We are independent of the Group and the Company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the Financial Reporting Council's (the 'FRC's') Ethical Standard as applied to listed public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements. The non-audit services provided to the Group and Company for the year are disclosed in note 9 to the financial statements. We confirm that we have not provided any non-audit services prohibited by the FRC's Ethical Standard to the Group or the Company.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

#### 3. Summary of our audit approach

<b>Key audit matters</b>	<p>The key audit matters that we identified in the current year were:</p> <ul style="list-style-type: none"> <li>• Valuation of Insurance Contract and Participating Investment Contract Liabilities ('Insurance Contract Liabilities') – Base mortality and mortality improvements assumptions used for annuity business (Group and Company)</li> <li>• Valuation of Insurance Contract Liabilities – Maintenance expenses (Group and Company)</li> <li>• Valuation of Insurance Contract Liabilities – Credit Default Assumption used in valuation interest rate for annuities (Group and Company)</li> <li>• Valuation of Insurance Contract Liabilities – Long term assumptions and provisions related to workplace pensions persistency (Group and Company)</li> <li>• Valuation of certain Illiquid Financial Instruments (Group and Company)</li> </ul>
<b>Materiality</b>	<p>Overall materiality used for the Group consolidated financial statements was £67.2 million, which was determined on the basis of net assets.</p> <p>Overall materiality used for the Company financial statements was £63.8 million, which was determined on the basis net assets and capped at 95 per cent of Group materiality.</p>

**INDEPENDENT AUDITOR'S REPORT TO THE MEMBER OF SCOTTISH WIDOWS LIMITED (continued)**

<b>Scoping</b>	Our audit scope covers 98.5 per cent of Group revenue and 99.7 per cent of Group total assets.
<b>Significant changes in approach</b>	<p>In the prior year, the predecessor auditor identified the following additional key audit matters:</p> <ul style="list-style-type: none"> <li>• Impact of COVID-19 (Group and Company)</li> <li>• Valuation of material conduct provisions (Group and Company)</li> </ul> <p>We did not consider the impact of COVID-19 on going concern as a key audit matter as at the date of signing of this audit report, as the uncertainty due to COVID-19 has reduced.</p> <p>Valuation of material conduct provisions are removed from key audit matters as the estimation uncertainty around the provision was not identified as being significant in the current year.</p> <p>In the prior year, the predecessor auditor identified the following key audit matter:</p> <ul style="list-style-type: none"> <li>• Valuation of Insurance Contract Liabilities – Longevity Assumptions (Group and Company)</li> </ul> <p>We considered it appropriate to split this key audit matter into base mortality and longevity due to the differing judgements required for each assumption into the following key audit matters:</p> <ul style="list-style-type: none"> <li>• Valuation of Insurance Contract Liabilities – Base mortality and mortality improvements assumptions used for annuity business (Group and Company)</li> <li>• Valuation of Insurance Contract Liabilities – Long term assumptions and provisions related to workplace pensions persistency (Group and Company)</li> </ul>

**4. Conclusions relating to going concern**

In auditing the financial statements, we have concluded that the Directors' use of the going concern basis of accounting in the preparation of the financial statements is appropriate.

Our evaluation of the Directors' assessment of the Group's and Company's ability to continue to adopt the going concern basis of accounting included:

- Confirming our understanding of management's going concern assessment process and assessing controls related to the review of the Group and Company's going concern assessment
- Challenging the key assumptions used in management's four-year Operating Plan ('4YOP') and determined that the models are appropriate to enable management to make an assessment of the going concern basis of preparation of the Group and Company
- Evaluating the liquidity and solvency position of the Group and Company by reviewing base case liquidity and solvency projections
- Making enquiries of Group management about the assumptions, including climate risk considerations, used in their going concern models, and assessing the reasonableness of those assumptions and historical accuracy
- Inspecting the Group's Own Risk and Solvency Assessment (ORSA) to support our understanding of the key risks faced by the Group and its ability to continue as a going concern
- Obtaining and inspecting correspondence between the Group and Company and their regulators, the FCA and PRA, as well as reviewing the Risk Oversight Committee meeting minutes and attending its meetings regularly, to identify any items of interest which could potentially indicate either non-compliance with legislation or potential litigation or regulatory action held against the Group or Company

Based on the work we have performed, we have not identified any material uncertainties relating to events or conditions that, individually or collectively, may cast significant doubt on the Group's and Company's ability to continue as a going concern for a period of at least twelve months from when the financial statements are authorised for issue.

Our responsibilities and the responsibilities of the Directors with respect to going concern are described in the relevant sections of this report.

**INDEPENDENT AUDITOR'S REPORT TO THE MEMBER OF SCOTTISH WIDOWS LIMITED (continued)****5. Key audit matters**

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) that we identified. These matters included those which had the greatest effect on: the overall audit strategy, the allocation of resources in the audit; and directing the efforts of the engagement team.

These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

**5.1. Valuation of Insurance Contract Liabilities – Base mortality and mortality improvements assumptions used for annuity business**

<b>Key audit matter description</b>	<p><b>Refer to notes 1, 2, 24, 35, 36 and 41.</b></p> <p>The Group's insurance contracts and participating investment contract liabilities are £123,348 million (2020: £115,822 million).</p> <p>Annuitant mortality and longevity assumptions are set to estimate how long annuity payments are expected to be paid to annuity policyholders in the future. The balance sheet is sensitive to changes in these assumptions, which are highly judgemental, with additional judgement required this year-end in respect of the impact of COVID-19 on expected future mortality and longevity experience.</p>
<b>How the scope of our audit responded to the key audit matter</b>	<p>With the support of our life actuarial specialists, we have:</p> <ul style="list-style-type: none"> <li>• Tested underlying movement data used within the annual mortality experience investigations, through comparison with administration system records, on a sample basis</li> <li>• Tested underlying experience investigations calculations through independent replication of a sample of experience studies, and challenging expert judgement overlays</li> <li>• Challenged management's choice of parameters for use with latest available (2020) Continuous Mortality Investigation ('CMI') model by assessing the expert judgements applied, taking into account specific features in the Company's policies (including any adjustments for socio-economic group)</li> <li>• Challenged expert judgements made in respect of internal or external events, including the impact of COVID-19 on the Company's annuitant population, with reference to UK population (Office of National Statistics) mortality data</li> <li>• Assessed the appropriateness of the IFRS margin for prudence added to the best estimate assumptions, including consistency with prior period</li> <li>• Tested key controls over the business processes associated with the setting of these key assumptions</li> </ul>
<b>Key observations</b>	<p>The parameters adopted by the Company for use in the CMI 2020 model at 31 December 2021, including the use of a 0 per cent weighting on 2020 experience data, bring the longevity assumptions used closer in line with those adopted by peers. The assumptions used in the year-end 2021 valuation are reasonable.</p>

**5.2. Valuation of Insurance Contract Liabilities – Maintenance Expenses**

<b>Key audit matter description</b>	<p><b>Refer to notes 1, 2, 24, 35, 36 and 41.</b></p> <p>The Group's insurance contracts and participating investment contract liabilities are £123,348 million (2020: £115,822 million).</p> <p>The maintenance expense assumptions reflect the expected future expenses that will be required to service and maintain insurance contracts on the Company's balance sheet as at the valuation date until the contracts' expected cessation. Small changes to these assumptions can have a material impact on the valuation of the Group's and Company's Insurance Contract Liabilities.</p> <p>Judgement is required to identify all expenses which are attributable to the Group's and Company's life insurance business, adjust these expenses for known or expected future changes in the current expense base (e.g. for restructuring), identify the subset of total expenses that are required to maintain the in-force insurance contracts and to allocate these expenses between product types.</p>
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**INDEPENDENT AUDITOR'S REPORT TO THE MEMBER OF SCOTTISH WIDOWS LIMITED (continued)**

<b>How the scope of our audit responded to the key audit matter</b>	<p>With the support of our life actuarial specialists, we have:</p> <ul style="list-style-type: none"> <li>• Tested the application of the expense allocation methodology, through the testing of the cost allocation model output, and the subsequent derivation of per-policy expenses</li> <li>• Tested the expenses allocated to long-term business, including the treatment of the Company's allocation of Lloyds Banking Group plc and overhead costs, through reconciliation of expenses to the ledger on a sample basis</li> <li>• Challenged the expert judgements applied in the allocation process for appropriateness, including consistency with judgements made in other business processes</li> <li>• Tested the additional short and long-term provisions held, including the judgements applied in their derivation. This included testing the inputs to these provisions and inspecting calculation spreadsheets</li> <li>• Assessed the appropriateness of the IFRS margin for prudence added to the best estimate assumptions, including consistency with prior period</li> <li>• Tested key controls over the business processes associated with the setting of these key assumptions</li> </ul>
<b>Key observations</b>	The expense assumptions and related provisions set by management are in line with the agreed methodology and with standard actuarial practice, therefore we consider them reasonable.

**5.3. Valuation of Insurance Contract Liabilities – Credit default assumption used in valuation interest rate for annuities**

<b>Key audit matter description</b>	<p><b>Refer to notes 1, 2, 24, 35, 36 and 41.</b></p> <p>The Group's insurance contracts and participating investment contract liabilities are £123,348 million (2020: £115,822 million).</p> <p>The credit default assumptions are set with reference to historical credit default rates to reflect the expected credit default risk associated with the assets held to back the Immediate and Bulk Annuity liabilities.</p> <p>These assumptions are used to derive the Valuation Interest Rate (VIR) which is used in the valuation of the annuity contract liabilities. There is a significant level of judgement applied in the methodology used to set this assumption.</p> <p>Small changes to this assumption can have a material impact on the valuation of the Group's and Company's Insurance Contract Liabilities.</p>
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<b>How the scope of our audit responded to the key audit matter</b>	<p>With the support of our life actuarial specialists, we have:</p> <ul style="list-style-type: none"> <li>• Tested the appropriateness of management's calculation methodology and judgements made by management within that methodology, with reference to standard actuarial techniques</li> <li>• Tested a sample of data inputs into the calculation of the credit default assumptions and agreed the inputs to third party sources or to internally generated data, as applicable;</li> <li>• Challenged the proposed credit default and recovery rate assumptions based on our analysis of the underlying asset portfolio</li> <li>• Assessed the appropriateness of the allowance for prudence within the assumption setting methodology, including consistency with prior period</li> <li>• Tested key controls over the business processes associated with the setting of these key assumptions</li> </ul>
<b>Key observations</b>	The credit default assumptions used in the 2021 year-end valuation of Insurance Contract Liabilities are reasonable.

**INDEPENDENT AUDITOR'S REPORT TO THE MEMBER OF SCOTTISH WIDOWS LIMITED (continued)****5.4. Valuation of Insurance Contract Liabilities –Long-term assumptions and provisions related to workplace pensions persistency**

**Key audit matter description** Refer to notes 1, 2, 24, 35, 36 and 41.

The Group's insurance contracts and participating investment contract liabilities are £123,348 million (2020: £115,822 million).

The Workplace Pensions Persistency long-term assumptions are set to reflect the expected likelihood of policyholders cancelling their policies in the future. Given significant changes in the Workplace Pensions landscape and associated regulatory developments in the past 10 years, including the introduction of Auto-Enrolment, these assumptions are set with reference to recent experience data, overlaid with expert judgements to assess the relevance of that data to future policyholder behaviour.

Furthermore, recent experience over the COVID-19 pandemic and the UK Government Furlough period has increased the uncertainty over short-term policyholder behaviour, necessitating further judgements in the Workplace Pensions persistency assumption setting process for the 31 December 2021 valuation.

**How the scope of our audit responded to the key audit matter**

With the support of our life actuarial specialists, we have:

- Tested the underlying lapse experience investigations, including independent replication of a sample of relevant experience studies and testing of the completeness and accuracy of internally generated lapse data
- Challenged expert judgements made in considering the appropriateness, and therefore the use of historical data, with reference to recent regulatory developments and the current external environment
- Challenged management on judgements used in setting persistency related provisions and tested the rationale for and calculation of these provisions on a sample basis;
- Assessed the appropriateness of the IFRS margin for prudence added to the best estimate assumptions, including consistency with prior period
- Tested key controls over the business processes associated with the setting of these key assumptions

**Key observations** Persistency assumptions and provisions used in the 2021 year-end valuation of Insurance Contract Liabilities are reasonable.

**5.5. Valuation of certain Illiquid Financial Instruments**

**Key audit matter description** Refer to notes 1, 2, 21 and 36.

The Group's investments at fair value is £169,067 million (2020: £146,552 million).

The fair value of complex and illiquid financial instruments involves significant judgement. The extent of judgment applied by management in valuing the Group's and Company's illiquid financial investments varies with the nature of assets held, the markets in which they are traded, and the valuation methodology applied.

The Company holds a significant portfolio of illiquid financial instruments. The balance comprises loans in the commercial real estate, social housing, infrastructure and education sectors. We consider the key audit matter related to the valuation of these loans to be the significant judgement involved in setting the spread above risk free rates, this being the loan-to-bond premium and calibration spread.

**INDEPENDENT AUDITOR'S REPORT TO THE MEMBER OF SCOTTISH WIDOWS LIMITED (continued)**

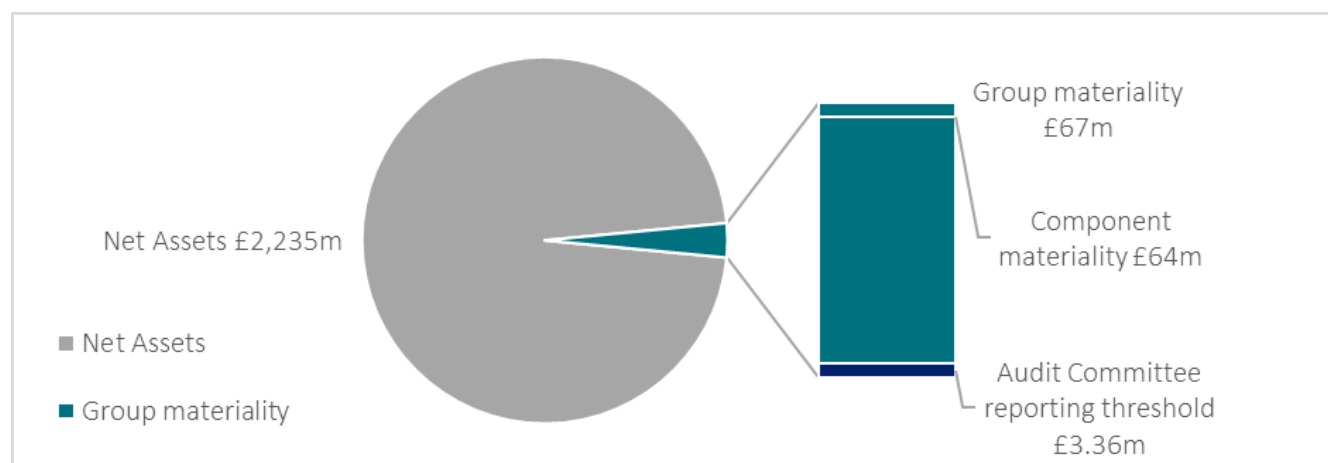
<b>How the scope of our audit responded to the key audit matter</b>	<p>With the support of our financial instruments valuation specialists, we have:</p> <ul style="list-style-type: none"> <li>• Challenged the appropriateness of loan valuation methodologies</li> <li>• Assessed and challenged key valuation inputs, including the illiquidity premium and supporting data</li> <li>• Assessed the appropriateness of management's internal credit ratings methodology and tested the appropriateness for a sample of credit files</li> <li>• Assessed consistency of inputs and assumptions through time, challenging both significant movements and non-movements where we would expect change</li> <li>• Independently calculated valuations for a sample of modelled illiquid financial instruments, comparing results to those of management and concluding on valuation differences, including sensitivity analysis</li> </ul> <p>In addition, we tested key controls over the business processes associated with the setting of these key assumptions.</p>
<b>Key observations</b>	We are satisfied that the valuation of these certain complex and illiquid financial instruments is reasonable and in accordance with IFRS 13.

**6. Our application of materiality****6.1. Materiality**

We define materiality as the magnitude of misstatement in the financial statements that makes it probable that the economic decisions of a reasonably knowledgeable person would be changed or influenced. We use materiality both in planning the scope of our audit work and in evaluating the results of our work.

Based on our professional judgement, we determined materiality for the financial statements as a whole as follows:

	<b>Group financial statements</b>	<b>Company financial statements</b>
<b>Materiality</b>	£67 million (2020: £45 million was used by the previous auditors)	£64 million (2020: £42 million was used by the previous auditors)
<b>Basis for determining materiality</b>	3 per cent of net assets	Company materiality was determined on a consistent basis to the Group materiality and equates to 2.8 per cent of net assets, having been capped at 95 per cent of Group materiality.
<b>Rationale for the benchmark applied</b>	<p>In determining our benchmark for materiality, we have considered the metrics used by the ultimate parent of the Group, Lloyds Banking Group plc, and other users of the financial statements. Given the importance of net assets to the users of the financial statements, including the focus of managing capital under Solvency II, meeting the PRA solvency regulations and ability to pay dividends to the ultimate parent company, we have determined net assets to be the benchmark most relevant to the users of the financial statements.</p> <p>Following the above consideration, and applying professional judgement, we consider a materiality of 3 per cent of net assets to be appropriate. The key reasons for determining that we should use 3 per cent included the relative size of the net assets in the context of the balance sheet, with net assets being just 1 per cent of total assets, and in the context of the Solvency II Own Funds, which are the binding constraint on dividends and solvency.</p>	

**INDEPENDENT AUDITOR'S REPORT TO THE MEMBER OF SCOTTISH WIDOWS LIMITED (continued)****6. Our application of materiality (continued)****6.2. Performance materiality**

We set performance materiality at a level lower than materiality to reduce the probability that, in aggregate, uncorrected and undetected misstatements exceed the materiality for the financial statements as a whole.

	<b>Group financial statements</b>	<b>Company financial statements</b>
<b>Performance materiality</b>	60 per cent (2020: 75 per cent was used by the predecessor auditors) of Group materiality, equating to £40 million (2020: £34 million).	63 per cent (2020: 75 per cent was used by the predecessor auditors) of Company materiality, equating to £40 million (2020: £32 million).
<b>Basis and rationale for determining performance materiality</b>	<p>In determining performance materiality, we have considered the following factors:</p> <ul style="list-style-type: none"> <li>• The current financial year being Deloitte LLP's first year auditing the Group and Company financial statements</li> <li>• The stability of senior management and oversight structures</li> <li>• The stable nature of the operations of the business</li> <li>• Our understanding from review of the predecessor auditor's files that, historically, there were few uncorrected misstatements, in particular given the scale and complexity of operations</li> <li>• The low number of control deficiencies identified by the predecessor auditor, and management's willingness to promptly address any identified weaknesses</li> <li>• IT control deficiencies which were identified in respect of privileged user access to IT infrastructure and in application user access management. The existence of these deficiencies in the year resulted in an increased risk in relation to data, reports and system functionality from the affected systems</li> </ul>	

**6.3. Error reporting threshold**

We agreed with the Audit Committee that we would report to the Committee all audit differences in excess of £3.36 million (2020: £2.23 million was used by the predecessor auditors), as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds. We also report to the Audit Committee on disclosure matters that we identified when assessing the overall presentation of the financial statements.

**7. An overview of the scope of our audit****7.1. Identification and scoping of components**

We have identified components based on the Group's operating segments and their geographical location. We identified one significant reporting component, Scottish Widows Limited, which we determined should be subjected to a full scope audit this year.

Specific audit procedures were completed in respect of three further components which, although not financially significant, did present some specific audit risks in relation to primary statement account balances which needed to be addressed.

The components within the scope of our audit procedures account for 98.5 per cent of the Group's revenue and 99.7 per cent of the Group's total assets.

All remaining components were subject to Group level analytical review procedures.

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**INDEPENDENT AUDITOR'S REPORT TO THE MEMBER OF SCOTTISH WIDOWS LIMITED (continued)****7. An overview of the scope of our audit (continued)****7.2. The impact of climate change on our audit**

In planning our audit, we considered the impact of climate change on the Group's operations and subsequent impact on its financial statements. The Group sets out its assessment of the potential impact on page 5 of the Group Strategic Report section of the annual report.

We held discussions with the Group to understand management's:

- process for identifying affected operations, including the governance and controls over this process, and the subsequent effect on the financial reporting for the Group
- long-term strategy to respond to climate change risks as they emerge including the effect on the Group's forecasts

Our audit work has involved:

- assessing the Group's qualitative analysis, which supports the Group's conclusion that there is no material financial statement impact of climate risk on expected credit losses
- assessing information included in the annual report and challenging the consistency between the financial statements and the remainder of the annual report

As part of our procedures, we are required to read the information and to consider whether they are materially inconsistent with the financial statements or our knowledge obtained during the course of our audit; we did not identify any material inconsistencies as a result of these procedures (see section 8 below).

**8. Other information**

The other information comprises the information included in the annual report, other than the financial statements and our auditor's report thereon. The Directors are responsible for the other information contained within the annual report.

Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in our report, we do not express any form of assurance conclusion thereon.

Our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the course of the audit, or otherwise appears to be materially misstated.

If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether this gives rise to a material misstatement in the financial statements themselves. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact.

We have nothing to report in this regard.

**9. Responsibilities of Directors**

As explained more fully in the Directors' responsibilities statement, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as the Directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the Directors are responsible for assessing the Group's and the Company's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless the Directors either intend to liquidate the Group or the Company or to cease operations, or have no realistic alternative but to do so.

**10. Auditor's responsibilities for the audit of the financial statements**

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

A further description of our responsibilities for the audit of the financial statements is located on the FRC's website at: [www.frc.org.uk/auditorsresponsibilities](http://www.frc.org.uk/auditorsresponsibilities). This description forms part of our auditor's report.

**11. Extent to which the audit was considered capable of detecting irregularities, including fraud**

Irregularities, including fraud, are instances of non-compliance with laws and regulations. We design procedures in line with our responsibilities, outlined above, to detect material misstatements in respect of irregularities, including fraud. The extent to which our procedures are capable of detecting irregularities, including fraud is detailed below.

**INDEPENDENT AUDITOR'S REPORT TO THE MEMBER OF SCOTTISH WIDOWS LIMITED (continued)****11. Extent to which the audit was considered capable of detecting irregularities, including fraud (continued)****11.1. Identifying and assessing potential risks related to irregularities**

In identifying and assessing risks of material misstatement in respect of irregularities, including fraud and non-compliance with laws and regulations, we considered the following:

- the nature of the industry and sector, control environment and business performance including the design of the Group's remuneration policies, key drivers for Directors' remuneration, bonus levels and performance targets
- results of our enquiries of management, non-executive Directors, internal audit, and the Audit Committee about their own identification and assessment of the risks of irregularities
- any matters we identified having obtained and reviewed the Group's documentation of their policies and procedures relating to:
  - identifying, evaluating and complying with laws and regulations and whether they were aware of any instances of non-compliance
  - detecting and responding to the risks of fraud and whether they have knowledge of any actual, suspected or alleged fraud
  - the internal controls established to mitigate risks of fraud or non-compliance with laws and regulations
- the matters discussed among the audit engagement team and relevant internal specialists, including tax, valuations, IT, and actuarial regarding how and where fraud might occur in the financial statements and any potential indicators of fraud

As a result of these procedures, we considered the opportunities and incentives that may exist within the organisation for fraud and identified the greatest potential for fraud in each of the key audit matters.

In common with all audits under ISAs (UK), we are also required to perform specific procedures to respond to the risk of management override.

We also obtained an understanding of the legal and regulatory frameworks that the Group operates in, focusing on provisions of those laws and regulations that had a direct effect on the determination of material amounts and disclosures in the financial statements. The key laws and regulations we considered in this context included the Companies Act and tax legislation.

In addition, we considered provisions of other laws and regulations that do not have a direct effect on the financial statements but compliance with which may be fundamental to the Group's ability to operate or to avoid a material penalty. These included the Group's regulatory and solvency requirements.

**11.2. Audit response to risks identified**

As a result of performing the above, we identified the Group's determination of "Valuation of Insurance Contract Liabilities - Base mortality and mortality improvements assumptions used for annuity business", "Valuation of Insurance Contract Liabilities - Maintenance expenses", "Valuation of Insurance Contract Liabilities - Credit Default Assumption used in valuation interest rate for annuities", "Valuation of Insurance Contract Liabilities - Long term assumptions and provisions related to workplace pensions persistency" and "Valuation of certain Illiquid Financial Instruments" as key audit matters related to the potential risk of fraud. The key audit matters section of our report explains the matter in more detail and also describes the specific procedures to in response to those key audit matters.

In addition to the above, our procedures to respond to risks identified included the following:

- reviewing the financial statement disclosures and testing to supporting documentation to assess compliance with provisions of relevant laws and regulations described as having a direct effect on the financial statements
- enquiring of management, the Audit Committee and in-house, and external legal counsel concerning actual and potential litigation and claims
- performing analytical procedures to identify any unusual or unexpected relationships that may indicate risks of material misstatement due to fraud
- reading minutes of meetings of those charged with governance, reviewing internal audit reports and reviewing correspondence with the PRA and the FCA
- in addressing the risk of fraud through management override of controls, testing the appropriateness of journal entries and other adjustments; assessing whether the judgements made in making accounting estimates are indicative of a potential bias; and evaluating the business rationale of any significant transactions that are unusual or outside the normal course of business

We also communicated relevant identified laws and regulations and potential fraud risks to all engagement team members including internal specialists and remained alert to any indications of fraud or non-compliance with laws and regulations throughout the audit.

**INDEPENDENT AUDITOR'S REPORT TO THE MEMBER OF SCOTTISH WIDOWS LIMITED (continued)****Report on other legal and regulatory requirements****12. Opinions on other matters prescribed by the Companies Act 2006**

In our opinion, based on the work undertaken in the course of the audit:

- the information given in the Strategic Report and the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements
- the Strategic Report and the Directors' Report have been prepared in accordance with applicable legal requirements

In the light of the knowledge and understanding of the Group and the Company and their environment obtained in the course of the audit, we have not identified any material misstatements in the Strategic Report or the Directors' Report.

**13. Matters on which we are required to report by exception****13.1. Adequacy of explanations received and accounting records**

Under the Companies Act 2006 we are required to report to you if, in our opinion:

- we have not received all the information and explanations we require for our audit; or
- adequate accounting records have not been kept by the Company, or returns adequate for our audit have not been received from branches not visited by us; or
- the Company financial statements are not in agreement with the accounting records and returns.

We have nothing to report in respect of these matters.

**13.2. Directors' remuneration**

Under the Companies Act 2006 we are also required to report if in our opinion certain disclosures of Directors' remuneration have not been made.

We have nothing to report in respect of this matter.

**14. Other matters which we are required to address****14.1. Auditor tenure**

Following the recommendation of the Audit Committee, we were appointed by shareholders at its general meeting on 20 May 2021 to audit the financial statements of Scottish Widows Limited for the year ending 2021 and subsequent financial periods. The period of total uninterrupted engagement including previous renewals and reappointments of the firm is one year.

**14.2. Consistency of the audit report with the additional report to the Audit Committee**

Our audit opinion is consistent with the additional report to the Audit Committee we are required to provide in accordance with ISAs (UK).

**15. Use of report**

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.



Paul Stephenson (Senior Statutory Auditor)

For and on behalf of Deloitte LLP

Statutory Auditor

London, United Kingdom

6 April 2022

# CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 2021

		2021	Restated*
		2020	
	Note	£m	£m
		Group	Group
<b>Revenue</b>			
Gross earned premiums	3	8,055	8,205
Premiums ceded to reinsurers		(376)	(333)
<b>Premiums net of reinsurance</b>		7,679	7,872
Fee and commission income	4	214	197
Investment income	5	3,047	3,094
Net gain on assets and liabilities at fair value through profit or loss	6	11,057	1,796
Other operating income	7	114	97
<b>Total revenue</b>		22,111	13,056
<b>Expenses</b>			
Gross claims and benefits paid		(9,071)	(7,546)
Claims recoveries from reinsurers		370	322
		(8,701)	(7,224)
Change in liabilities arising from insurance contracts and participating investment contracts	24, 41	(7,668)	(4,892)
Change in liabilities arising from non-participating investment contracts		(4,587)	(1,584)
Change in reinsurance assets	17a	(81)	90
Change in contracts with reinsurers at fair value through profit or loss	17b	2,090	1,333
Change in unallocated surplus	25	31	73
		(10,215)	(4,980)
Net (profit)/loss attributable to external interests in collective investment vehicles		(1,510)	177
Operating expenses	8	(1,313)	(1,044)
Expenses for asset management services received		(172)	(167)
Finance costs	10	(68)	(75)
		(3,063)	(1,109)
<b>Total expenses</b>		(21,979)	(13,313)
<b>Profit/(loss) before tax</b>		132	(257)
Taxation (charge)/credit	11, 41	(140)	93
<b>Loss after tax</b>		(8)	(164)
<b>Loss for the year</b>		(8)	(164)
<b>Other comprehensive (loss)/income</b>			
<b>Items that may subsequently be reclassified to profit or loss</b>			
Currency translation differences		(9)	8
		(9)	8
<b>Other comprehensive (loss)/income, net of tax</b>		(9)	8
<b>Total comprehensive loss for the year</b>		(17)	(156)
Total comprehensive loss		(17)	(156)
<b>Total comprehensive loss for the year</b>		(17)	(156)

\* See note 41 for details regarding the restatement.

The notes set out on pages 37 to 123 are an integral part of these financial statements.

## BALANCE SHEETS AS AT 31 DECEMBER 2021

		31 December 2021		31 December 2020		1 January 2020	
	Note	£m	£m	£m	£m	£m	£m
		Group	Company	Group	Company	Group	Company
<b>ASSETS</b>							
Intangible assets including insurance intangible	12	121	54	100	59	102	65
Deferred costs	13	1,437	1,433	1,635	1,628	1,635	1,625
Deferred tax assets	14	8	—	—	—	—	—
Current tax recoverable	14, 41	36	28	96	89	30	21
Investment in subsidiaries	15	—	443	—	463	—	624
Investment properties	16	3,588	118	3,324	120	3,523	132
Reinsurance assets	17a	729	736	810	819	720	726
Contracts with reinsurers at fair value through profit or loss	17b	12,371	12,371	19,549	19,549	22,837	22,837
Other assets	18	155	121	125	99	120	95
Derivative financial instruments	19	2,843	2,720	5,224	5,132	3,968	3,894
Loans and receivables at amortised cost	20	963	583	1,018	615	997	619
Investments at fair value through profit or loss	21	169,067	157,649	146,552	136,633	137,157	127,862
Cash and cash equivalents	22	228	96	218	95	276	98
<b>Total assets</b>		191,546	176,352	178,651	165,301	171,365	158,598
<b>EQUITY AND LIABILITIES</b>							
<b>Capital and reserves attributable to the Group's equity shareholder</b>							
Share capital	23	70	70	70	70	70	70
Share premium		1	1	1	1	1	1
Retained profits	41	2,164	2,174	2,381	2,454	3,097	3,169
<b>Total equity</b>		2,235	2,245	2,452	2,525	3,168	3,240
<b>Liabilities</b>							
Insurance contracts and participating investment contract liabilities	24, 41	123,348	122,842	115,822	115,344	110,815	110,495
Unallocated surplus	25	308	308	339	339	412	412
		123,656	123,150	116,161	115,683	111,227	110,907
Future profits on non-participating business in the With Profits Funds	26	(47)	(47)	(53)	(53)	(49)	(49)
Current tax liabilities	14	1	—	—	—	—	—
Deferred tax liabilities	14	199	198	147	155	266	265
Provisions for other liabilities and charges	27	106	47	120	50	141	80
Accruals and deferred income	28	29	22	31	21	35	24
Subordinated debt	29	1,753	1,786	1,892	1,923	1,795	1,820
Non-participating investment contract liabilities	30	45,035	45,016	38,448	38,433	37,456	37,455
Derivative financial instruments	19	2,508	2,429	4,609	4,590	3,445	3,434
Other financial liabilities	31	1,717	1,505	2,214	1,972	1,889	1,422
External interests in collective investment vehicles		14,348	—	12,620	—	11,966	—
Borrowings	32	1	1	2	2	3	—
Lease Liabilities	38	5	—	8	—	23	—
<b>Total liabilities</b>		189,311	174,107	176,199	162,776	168,197	155,358
<b>Total equity and liabilities</b>		191,546	176,352	178,651	165,301	171,365	158,598

Retained earnings for the Company includes loss for the year of £(80)m (2020: £(155)m restated).

\* See note 41 for details regarding the restatement.

The notes set out on pages 37 to 123 are an integral part of these financial statements.

The financial statements on pages 32 to 33 were approved by the Board on 31 March 2022, and signed on behalf of the Board:



J C S Hillman

Director

6 April 2022

## STATEMENTS OF CASH FLOWS FOR THE YEAR ENDED 31 DECEMBER 2021

		2021		Restated* 2020	
	Note	£m	£m	£m	£m
		<i>Group</i>	<i>Company</i>	<i>Group</i>	<i>Company</i>
<b>Cash flows from operating activities</b>					
Net Profit/(loss) before tax		132	(20)	(257)	(298)
Adjusted for:					
Amortisation of intangible assets	12	13	5	10	6
Finance costs	10	68	67	75	72
Impairment in investment in subsidiary	15	—	64	—	233
Dividends received		—	—	—	(194)
Net decrease in operating assets and liabilities	33	145	153	842	721
Currency translation differences		(9)	—	8	—
Taxation (paid)/received		(35)	44	(92)	(35)
<b>Net cash flows generated from operating activities</b>		<b>314</b>	<b>313</b>	<b>586</b>	<b>505</b>
<b>Cash flows from investing activities</b>					
Addition of intangible assets	12	(35)	—	(8)	—
Capital injections to subsidiaries		—	(44)	—	(72)
Dividends received		—	—	—	194
<b>Net cash flows (used in)/generated from investing</b>		<b>(35)</b>	<b>(44)</b>	<b>(8)</b>	<b>122</b>
<b>Cash flows from financing activities</b>					
Dividends paid	34	(200)	(200)	(560)	(560)
Finance costs paid	10	(68)	(67)	(75)	(72)
<b>Net cash flows used in financing activities</b>		<b>(268)</b>	<b>(267)</b>	<b>(635)</b>	<b>(632)</b>
<b>Net increase/(decrease) in cash and cash equivalents</b>		<b>11</b>	<b>2</b>	<b>(57)</b>	<b>(5)</b>
Cash and cash equivalents at the beginning of the year		216	93	273	98
<b>Net cash and cash equivalents at the end of the year</b>	22	<b>227</b>	<b>95</b>	<b>216</b>	<b>93</b>

The notes set out on pages 37 to 123 are an integral part of these financial statements.

\* See note 41 for details regarding the restatement.

## STATEMENTS OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 2021

*Group*

	Note	Share capital £m	Share premium £m	Retained profits £m	Other Reserves £m	Total equity £m
<b>Balance as at 1 January 2020 as previously reported</b>		70	1	3,018	(5)	3,084
Prior year adjustment	41			84		84
<b>Balance as at 1 January 2020 (restated*)</b>		70	1	3,102	(5)	3,168
Loss for the year (restated*)		—	—	(164)	—	(164)
Other comprehensive income						
Currency translation		—	—	—	8	8
Total comprehensive loss for the year		—	—	(164)	8	(156)
Dividend	34	—	—	(560)	—	(560)
<b>Balance as at 31 December 2020 (restated*)</b>		70	1	2,378	3	2,452
Loss for the year		—	—	(8)	—	(8)
Other comprehensive income						
Currency translation		—	—	—	(9)	(9)
Total comprehensive loss for the year		—	—	(8)	(9)	(17)
Dividend	34	—	—	(200)	—	(200)
<b>Balance as at 31 December 2021</b>		70	1	2,170	(6)	2,235

*Company*

	Note	Share capital £m	Share premium £m	Retained profits £m	Other Reserves £m	Total equity £m
<b>Balance as at 1 January 2020 as previously reported</b>		70	1	3,088	(3)	3,156
Prior year adjustment				84		84
<b>Balance as at 1 January 2020 (restated*)</b>		70	1	3,172	(3)	3,240
Loss for the year (restated*)		—	—	(155)	—	(155)
Other comprehensive loss						
Currency translation		—	—	—	—	—
Total comprehensive loss for the year		—	—	(155)	—	(155)
Dividend	34	—	—	(560)	—	(560)
<b>Balance as at 31 December 2020 (restated*)</b>		70	1	2,457	(3)	2,525
Loss for the year		—	—	(80)	—	(80)
Other comprehensive income						
Currency translation		—	—	—	—	—
Total comprehensive loss for the year		—	—	(80)	—	(80)
Dividend	34	—	—	(200)	—	(200)
<b>Balance as at 31 December 2021</b>		70	1	2,177	(3)	2,245

Not all of the above amounts can be distributed to the equity holder since the Company is required to meet regulatory capital requirements. Further details are given in note 36.

The notes set out on pages 37 to 123 are an integral part of these financial statements.

\* See note 41 for details regarding the restatement.

**NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2021 (continued)****1. Accounting policies**

The accounting policies adopted in the preparation of the financial statements, which have been consistently applied to all periods presented in these financial statements unless stated otherwise, are set out below.

**(a) Basis of preparation**

The financial statements of the Group and Company have been prepared:

- (1) in accordance with UK-adopted international accounting standards in conformity with the requirements of the Companies Act 2006.
- (2) in respect of the Group's and Company's With Profits Funds liabilities, which are measured using an assessment that uses the pre-Solvency II traditional regulatory assessment, grandfathered under IFRS 4 'Insurance Contracts'
- (3) under the historical cost convention, as modified by the revaluation of investment properties and certain financial assets and financial liabilities at fair value through profit or loss, as set out in the relevant accounting policies

The Directors are satisfied that the Group and Company have adequate resources to continue in business for the foreseeable future. Accordingly, the financial statements of the Group and Company have been prepared on a going concern basis.

In accordance with IAS 1 'Presentation of Financial Statements', assets and liabilities in the balance sheet are presented in accordance with management's estimated order of liquidity. Analysis of the assets and liabilities of the Group and Company into amounts expected to be received or settled within 12 months after the reporting date (current) and more than 12 months after the reporting date (non-current) is presented in the notes.

There has been a change made to the Group's presentation of assets arising from contracts with reinsurers, which has been separated on the face of the balance sheet into contracts that transfer significant insurance risk under IFRS 4, reinsurance contracts, and contracts that do not transfer significant insurance risk, contracts with reinsurers at fair value through profit or loss. The change in these balances have also been presented separately on the face of the statement of comprehensive income. Comparatives have been presented on a consistent basis. There has been no change to the basis of accounting for any of the underlying transactions.

The Group has taken advantage of the provisions of section 408 of the Companies Act 2006 and has not disclosed a statement of comprehensive income and related notes in respect of the Company.

*Standards and interpretations effective in 2021*

The Group has adopted the following amendments to IFRS as at 1 January 2021. Adoption has had no significant impact on the financial position of the Group.

- Amendments to IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16. Interest Rate Benchmark Reform – Phase 2 is the second phase of the IASB's IBOR Reform, and addresses issues that arise from the implementation of the reforms, including the replacement of one benchmark with an alternative one.

Details of standards and interpretations in issue but which have not been adopted early are set out at note 40.

**(b) Basis of consolidation**

The assets, liabilities and results of Group undertakings (including structured entities) are included on the basis of financial statements made up to the reporting date. Group undertakings include all entities controlled by the Group. The Group controls an entity when it has power over the entity, is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through the exercise of power. This generally accompanies a shareholding of more than one half of the voting rights. The existence and effect of substantive rights that are currently exercisable or convertible are considered when assessing whether the Group controls another entity and the Group reassesses whether or not it controls an entity if facts and circumstances indicate that there are changes to any of these elements.

Collective investment vehicles and limited partnerships ('investment vehicles') where the Group has control, in part through its long-term funds, are consolidated. Control arises where the Group has substantive rights to remove the external decision maker of the investment vehicle, and has a significant exposure to variable returns from the beneficial interest it holds in the investment vehicle.

**NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2021 (continued)****1. Accounting policies (continued)****(b) Basis of consolidation (continued)**

Where a subsidiary or related party of the Group acts as the decision maker of an investment vehicle the Group considers a number of factors in determining whether it acts as principal and therefore controls the investment vehicle including: an assessment of the scope of the Group's decision-making authority over the investment vehicle; the rights held by other parties including substantive removal rights without cause over the Group acting as decision maker; the remuneration to which the Group is entitled in its capacity as decision maker; and the Group's exposure to variable returns from the beneficial interest it holds in the investment vehicle.

Consolidation can be appropriate in circumstances where the Group has less than a majority beneficial interest. Where a collective investment vehicle is consolidated the interest of parties other than the Group are reported within liabilities as external interests in collective investment vehicles. Where a limited partnership is consolidated the non-controlling interest is reported in equity. Group undertakings are fully consolidated from the date on which the ability to exercise control is transferred to the Group and cease to be consolidated from the date on which the ability to exercise control ceases.

The treatment of transactions with non-controlling interests depends on whether, as a result of the transaction, the Group loses control of the subsidiary. Changes in the parent's ownership interest in a subsidiary that do not result in a loss of control are accounted for as equity transactions; any difference between the amount by which the non-controlling interests are adjusted and the fair value of the consideration paid or received is recognised directly in equity and attributed to the owners of the parent entity. Where the Group loses control of the subsidiary, at the date when control is lost the amount of any non-controlling interest in that former subsidiary is derecognised and any investment retained in the former subsidiary is remeasured to its fair value; the gain or loss that is recognised in profit or loss on the partial disposal of the subsidiary includes the gain or loss on the remeasurement of the retained interest.

Intragroup transactions, balances and gains and losses on transactions between Group companies have been eliminated.

All the financial statements included are uniformly prepared in conformity with IFRSs and the Group's accounting policies and have adopted consistent accounting policies as at 31 December 2021 and 31 December 2020.

**(c) Product classification**

The Group issues contracts that transfer insurance risk or financial risk or both.

*Insurance contracts*

Insurance contracts are those contracts which transfer significant insurance risk. Such contracts may also transfer financial risk. As a general guideline, the Group defines significant insurance risk as the possibility of having to pay benefits on the occurrence of an insured event which are significantly more than the benefits payable if the insured event were not to occur. Once a contract has been classified as an insurance contract, it remains an insurance contract for the remainder of its lifetime, even if the insurance risk reduces significantly over time.

*Investment contracts*

Any long-term contracts not considered to be insurance contracts under IFRSs because they do not transfer significant insurance risk are classified as investment contracts. Such contracts are further analysed between those with and without a discretionary participation feature (DPF). Contracts containing a DPF are referred to as participating investment contracts and those without a DPF as non-participating investment contracts.

A DPF is a contractual right that gives investors the right to receive, as a supplement to guaranteed benefits, additional discretionary benefits or bonuses that are likely to be a significant portion of the total contractual benefits, through participation in the surplus arising from the assets held in the fund. The Group has the discretion within the constraints of the terms and conditions of the contract to allocate part of this surplus to the policyholders and part to the Group's shareholder. Participating investment contracts are accounted for in the same manner as insurance contracts in accordance with the requirements of IFRS 4 'Insurance Contracts'.

Non-participating investment contracts are contracts that neither transfer significant insurance risk nor contain a DPF.

*Hybrid contracts*

For certain investment contracts, the contract can be partly invested in units which contain a DPF and partly in units without. Where switching levels for similar contracts are deemed to be significant, new investment contracts which contain an option to switch into investment contracts with DPF have been classified as participating investment contracts. Where the switching levels are not deemed to be significant, a new contract is split, with units containing a DPF being allocated as a participating investment contract and the units without a DPF as a non-participating investment contract. Investment contracts which were in force when IFRS was implemented in 2005 were classified according to the switching levels observed at the time and retain their original classification. For certain investment contracts, the contract can be partly invested in units which contain a DPF and partly without. Where the contract is split, part is allocated as a non-participating investment contract and part as a participating investment contract.

**NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2021 (continued)****1. Accounting policies (continued)****(c) Product classification (continued)***Financial assets and financial liabilities*

Management determines the classification of its financial assets and financial liabilities at initial recognition. Management's policies for the recognition of specific financial assets and financial liabilities, as identified on the balance sheet, are set out under the relevant accounting policies.

On initial recognition, financial assets are classified as measured at amortised cost or fair value through profit or loss, depending on the Group's business model for managing the financial assets and whether the cash flows represent solely payments of principal and interest. The Group assesses its business models at a portfolio level based on its objectives for the relevant portfolio, how the performance of the portfolio is managed and reported, and the frequency of asset sales. Financial assets with embedded derivatives are considered in their entirety when considering their cash flow characteristics. The Group reclassifies financial assets when and only when its business model for managing those assets changes. A reclassification will only take place when the change is significant to the Group's operations and will occur at a portfolio level and not for individual instruments; reclassifications are expected to be rare.

The Group initially recognises loans, debt securities and subordinated liabilities when the Group becomes a party to the contractual provisions of the instrument. Regular way purchases and sales of securities and other financial assets and trading liabilities are recognised on trade date, being the date that the Group is committed to purchase or sell an asset.

Financial assets are derecognised when the contractual right to receive cash flows from those assets has expired or when the Group has transferred its contractual right to receive the cash flows from the assets and either: substantially all of the risks and rewards of ownership have been transferred; or the Group has neither retained nor transferred substantially all of the risks and rewards, but has transferred control.

Financial liabilities are derecognised when the obligation is discharged, cancelled or expires.

Derivative assets (other than a derivative which is a designated and effective hedging instrument) are classified as held for trading. With the exception of derivative liabilities, no liabilities are classified as held for trading.

Transaction costs incidental to the acquisition of a financial asset classified as measured at fair value through profit or loss are expensed through the statement of comprehensive income, within net gains and losses on assets and liabilities at fair value through profit or loss.

Financial assets and financial liabilities are offset and the net amount reported in the balance sheet only when there is a legally enforceable right to offset the recognised amounts, both in the normal course of business and in the event of default, and there is an intention to settle on a net basis, or to realise the asset and settle the liability simultaneously.

**(d) Fair value methodology**

All assets and liabilities carried at fair value, or for which a fair value measurement is disclosed, are categorised into a 'fair value hierarchy' as follows:

**(i) Level 1**

Valued using quoted prices in active markets for identical assets and liabilities to those being valued. An active market is one in which similar arm's length transactions in the instrument occur with both sufficient frequency and volume to provide pricing information on an on-going basis. Examples include listed equities, listed debt securities, Open Ended Investment Companies (OEICs) and unit trusts traded in active markets, and exchange traded derivatives such as futures.

**NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2021 (continued)****1. Accounting policies (continued)****(d) Fair value methodology (continued)****(ii) Level 2**

Valued using inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (as prices) or indirectly (derived from prices). If the asset or liability has a specified (contractual) term, a Level 2 input must be observable for substantially the full term of the asset or liability. Level 2 inputs include the following:

- Quoted prices for similar (but not identical) instruments in active markets
- Quoted prices for identical or similar instruments in markets that are not active, where prices are not current, or price quotations vary substantially either over time or among market makers
- Inputs other than quoted prices that are observable for the instrument (for example, interest rates and yield curves observable at commonly quoted intervals and default rates)
- Inputs that are derived principally from, or corroborated by, observable market data by correlation or other means
- Examples of these are securities measured using discounted cash flow models based on market observable swap yields such as Over the Counter interest rate swaps, listed debt and restricted equity securities.

**(iii) Level 3**

Valuations are based on mathematical models, market prices/data (where available) and subjective assumptions, including unobservable inputs. Unobservable inputs may have been used to measure fair value where observable inputs are not available. This approach allows for situations in which there is little, if any, market activity for the asset or liability at the measurement date (or market information for the inputs to any valuation models). Unobservable inputs reflect the assumptions the Group considers that market participants would use in pricing the asset or liability, for example private equity investments held by the Group and Company. Where estimates are used, these are based on a combination of independent third-party evidence and internally developed models, calibrated to market observable data where possible.

Examples of Level 3 assets include portfolio of illiquid loans and advances to customers, investments in private debt funds, private equity shares and complex derivatives.

Further analysis of the Group's and Company's instruments held at fair value is set out at note 36. The Group's management, through a Fair Value Pricing Committee, review information on the fair value of the Group's financial assets and the sensitivities to these values on a regular basis.

Transfers between different levels of the fair value hierarchy are deemed to have occurred at the next reporting date after the change in circumstances that caused the transfer.

**(e) Revenue recognition***Premiums*

Premiums received in respect of life insurance contracts and participating investment contracts are recognised as revenue when they become payable by the policyholder and are shown before deduction of commission. Premiums ceded to reinsurers are recognised when the related gross premiums are recognised. Gross and ceded premiums are recorded through the relevant lines in the statement of comprehensive income.

*Fee and commission income*

The Group receives on-going investment management fees which are recognised as revenue as the investment management services are provided on a daily basis throughout the life of the investment. These fees are charged as a percentage of the fund being managed and are taken directly from the fund, or typically settled monthly.

The Group also receives initial investment management fees in the form of an adjustment, or charge, to the amount invested. These fees are in respect of services rendered in conjunction with the issue and management of investment contracts where the Group actively manages the consideration received from its customers to fund a return that is based on the investment profile that the customer selected on origination of the contract. These services comprise an indeterminate number of acts over the lives of the individual contracts and, therefore, the Group defers these fees and recognises them on a straight-line basis over the estimated lives of the contracts unless there is evidence to support an alternative recognition basis. Where an alternative recognition basis is applied, this is calculated by reference to experience information in respect of the period over which income from contracts is earned. The income is recognised through the statement of comprehensive income, within fee and commission income. The liability is recognised in the balance sheet within accruals and deferred income until recognition criteria are met.

**NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2021 (continued)****1. Accounting policies (continued)****(e) Revenue recognition (continued)***Investment income*

Interest income for all interest-bearing financial instruments is recognised in the statement of comprehensive income as it accrues, within investment income.

Dividends receivable in respect of listed shares and collective investment vehicles are recognised on the date that these are quoted ex-dividend; other dividend income is recognised when the right to receive the dividend is established. All dividends received are recognised through the statement of comprehensive income, within investment income.

Rental income in respect of investment properties is recognised on a straight line basis over the term of the lease. The costs of incentives are recognised as a reduction of total income over the term of the lease on a straight line basis.

*Net gains and losses on assets and liabilities at fair value through profit or loss*

Net gains and losses on assets and liabilities at fair value through profit or loss includes both realised and unrealised gains and losses. Movements are recognised in the statement of comprehensive income in the period in which they arise.

*Other operating income*

Within other operating income are rebates of annual management charges from external fund managers. Rebates are recognised when they are earned, as performance obligations are satisfied, being the Group's investment in the fund. The transaction price is calculated as a percentage of the fund value. Due to the ongoing investments in the fund, the Group recognises the revenue on a daily basis. Outstanding amounts are typically settled monthly.

**(f) Accruals and deferred income**

For non-participating investment contracts, the recognition of income is governed by IFRS 15. Income received for services to be provided in future periods is deferred and recognised in the statement of comprehensive income as the performance obligation is met. Estimation is required of the period that the business is expected to remain in force and an assessment of the duration of the Group's performance obligations are required for contracts which do not have a fixed maturity date. Further information on this liability is given in note 28.

**(g) Expense recognition***Claims*

Claims are recorded as an expense on the earlier of the maturity date or the date on which the claim is notified. Claims recoveries from reinsurers are recognised when the related claims are recognised. Claims and claims recoveries are recognised through the relevant lines in the statement of comprehensive income. Claims handling costs and interest on late claims are also included in claims.

*Operating expenses*

Commission paid in respect of the business written by the Group is recognised through the statement of comprehensive income, within operating expenses. Where certain criteria are met, commission and other acquisition costs may be deferred. The circumstances under which such costs are deferred are set out at policy (j).

Other operating expenses are recognised in the statement of comprehensive income as incurred, within operating expenses.

*Expenses for asset management services received*

Expenses for asset management services received are recognised in the statement of comprehensive income as they accrue, within expenses for asset management services received.

*Finance costs*

Interest expense for all interest-bearing financial instruments is recognised in the statement of comprehensive income as it accrues, within finance costs.

**NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2021 (continued)****1. Accounting policies (continued)****(h) Leases**

Assets leased to third parties, including properties leased to tenants, are classified as finance leases if the lease agreements transfer substantially all the risks and rewards of ownership to the lessee, otherwise they are classified as operating leases. Operating lease rental income and expenditure are recognised on a straight-line basis over the life of the leases through the statement of comprehensive income, within investment income and operating expenses respectively. Properties leased out to tenants under operating leases are included in investment properties in the balance sheet.

The Group has ground rent commitments on its investment properties, these commitments are accounted for as leases. The lease payments are discounted using the Group's incremental borrowing rate and the Group recognises the lease liabilities and a corresponding right-of-use asset in the balance sheet. The right-of-use asset is classified as investment property and is subsequently measured at fair value. Lease payments are allocated between the liability and finance cost. The finance cost is charged to profit or loss over the lease period so as to produce a constant periodic rate of interest on the remaining balance of the liability for each period.

**(i) Intangible assets including insurance intangible assets****(i) Acquired value of in-force business**

Insurance and investment contracts acquired in business combinations (other than business combinations of entities under common control) are initially measured at fair value at the time of acquisition. The initial fair value includes the recognition of an acquired value of in-force ('acquired VIF') asset which reflects the present value of future cash flows expected from the business acquired. The asset is shown gross of attributable tax and a corresponding deferred tax liability has been established.

The acquired VIF balance and related tax is amortised over the estimated life of the contracts. The amortisation is carried out on a best estimate basis over the estimated life of the contracts. The amortisation charge for the year is recognised through the statement of comprehensive income, within operating expenses. The carrying value of the acquired VIF balance is tested for impairment at each reporting date or when there is an earlier indication of impairment (further information on the Group's impairment policy is set out at policy (r)). Such an asset is not recognised in respect of future profits on contracts written in the normal course of business.

**(ii) Software development costs**

Costs that are directly associated with the acquisition of software licences and the production of identifiable and unique software products controlled by the Group, and that is expected to generate economic benefits exceeding costs beyond one year, are recognised as intangible assets, subject to de minimis limits.

Direct costs include the software development team's employee costs and an appropriate portion of relevant overheads. All other costs associated with developing or maintaining computer software programmes are recognised through the statement of comprehensive income as an expense as incurred, within operating expenses.

Computer software development costs recognised as assets are valued at cost and amortised using the straight-line method over their expected useful lives, not exceeding a period of seven years. Subsequent expenditure is only capitalised when it increases the expected future economic benefits of the specific asset to which it relates. The amortisation charge for the year in respect of software licences and software development costs is recognised through the statement of comprehensive income, within operating expenses. The carrying value of the assets is tested for impairment at each reporting date. Further information on the Group's impairment policy is set out at policy (r).

**(iii) Goodwill**

Goodwill arises on business combinations and represents the excess of the cost of an acquisition over the fair value of the Group's share of the identifiable assets, liabilities and contingent liabilities acquired.

Goodwill is recognised as an asset at cost and is tested at least annually for impairment. If an impairment is identified the carrying value of the goodwill is written down immediately through the statement of comprehensive income and is not subsequently reversed. Further information on the Group's impairment policy is set out at policy (r). At the date of disposal of a subsidiary, the carrying value of attributable goodwill is included in the calculation of the profit or loss on disposal.

**NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2021 (continued)****1. Accounting policies (continued)****(j) Deferred costs****(i) Deferred acquisition costs**

The costs of acquiring new insurance contracts and participating investment contracts (excluding those assessed on a realistic basis - see note 35(1)(a)), which are incurred during a financial year but which relate to subsequent financial years, are deferred to the extent that they are recoverable out of future revenue margins. The deferred acquisition cost asset is amortised over the lifetime of the related contracts on a straight line basis.

The amortisation charge for the year is recognised through the statement of comprehensive income, within operating expenses. The carrying value of the asset is tested for impairment at each reporting date. Deferred acquisition costs are reviewed by category of business at the end of each reporting period and are written-off where they are no longer considered to be recoverable.

**(ii) Deferred origination costs**

Costs which are directly attributable and incremental to securing new non-participating investment contracts are capitalised. This asset is subsequently amortised over the estimated contractual lifetime of each policy on a straight-line basis unless there is evidence to support an alternative recognition basis. Where an alternative recognition basis is applied, this is calculated by reference to experience information in respect of the period over which income from contracts is earned. The amortisation charge for the year is recognised through the statement of comprehensive income, within operating expenses. The carrying value of the asset is tested for impairment at each reporting date. Further information on the Group's impairment policy is set out at policy (r).

**(k) Investment in subsidiaries**

The Company owns a number of subsidiaries as set out in note 15. Certain subsidiaries do not form part of actively managed investment portfolios and the risks and rewards of owning those subsidiaries primarily rest with the shareholder of the Company, including such investments where ownership of the subsidiary is split between the Company's long-term fund and its shareholder fund. These subsidiaries are held initially at cost, being the fair value of the consideration given to acquire the holding, then subsequently at cost subject to impairment. Further information on the Group's impairment policy is set out at policy (r).

Certain subsidiaries, including holdings in collective investment vehicles, are held primarily as vehicles through which specific investments are held as part of the actively managed investment portfolios which are considered to be part of a business model that is managed and whose performance is evaluated on a fair value basis. Accordingly, such subsidiaries are carried at fair value and presented within investments at fair value through profit or loss in the Company as set out in policy (p). Changes in their fair value are reflected in the statement of comprehensive income, within net gains and losses on assets and liabilities at fair value through profit or loss.

**(l) Investment properties**

Investment properties comprise freehold and long leasehold land and buildings, which are held either to earn rental income or for capital appreciation, or both, are initially measured at cost, being the fair value of the consideration given, including directly attributable transaction costs. Subsequently, on a periodic basis and at each reporting date, such properties are carried at fair value, being the open market value, as assessed by qualified external appraisers who have recent experience in the relevant location and the category of properties being valued. If this information is not available, alternative valuation methods such as discounted cash flow analysis or recent prices are used. Investment property being redeveloped for continuing use as investment property, or for which the market has become less active, continues to be measured at fair value.

Gains or losses arising from changes in the fair values of investment properties are recognised in the statement of comprehensive income in the period in which they arise, within net gains and losses on assets and liabilities at fair value through profit or loss.

Service charge income and expense are disclosed separately within the investment income and operating expense notes.

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**NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2021 (continued)****1. Accounting policies (continued)****(m) Assets arising from reinsurance contracts held**

The Group cedes reinsurance in the normal course of business. Where the reinsurance contract transfers significant insurance risk to the reinsurer, the assets arising from reinsurance contracts held are classified as insurance contracts, under IFRS 4. Where the reinsurance contract does not transfer significant insurance risk to the reinsurer, the assets arising from reinsurance contracts held are classified as a financial asset designated as fair value through profit or loss, under IFRS 9.

*Reinsurance assets (classified as insurance contracts)*

Amounts recoverable from or due to reinsurers are measured consistently with the amounts associated with the underlying contracts and in accordance with the terms of each reinsurance contract. These balances are subject to an annual impairment review. Further information on the Group's impairment policy is set out at policy (r).

Changes in these assets are recognised on the face of the statement of comprehensive income, through change in reinsurance assets.

Premiums ceded and claims reimbursed are recognised when corresponding insurance premium assumed and claims incurred. These items are disclosed separately on the face of the statement of comprehensive income.

*Contracts with reinsurers at fair value through profit or loss*

Contracts with reinsurers that do not transfer significant insurance risk to the reinsurer are measured as fair value through profit or loss as they are within a portfolio of financial assets that is managed and whose performance is evaluated on a fair value basis. These contracts, whilst legally reinsurance contracts, do not meet the definition of a reinsurance contract under IFRSs. Where this is the case, the amounts recoverable have been recognised as a financial asset on the face of the balance sheet. Changes in these assets are recognised on the face of the statement of comprehensive income, through change in contracts with reinsurers at fair value through profit or loss.

**(n) Derivative financial instruments***Classification*

Derivative financial instruments, including embedded derivatives, are classified and measured at fair value through profit or loss. Certain derivatives are designated as effective hedging instruments, which are also held at fair value through profit or loss. Derivatives that are not designated as effective hedging instruments are used for the purposes of efficient portfolio management or to match contractual liabilities.

*Recognition*

Derivatives are initially recognised at fair value on the date on which a derivative contract is entered into and are subsequently re-measured at their fair value.

*Measurement*

Fair values are obtained from quoted market prices or, if these are not available, by using valuation techniques such as discounted cash flow models or other pricing models. Derivatives are presented as assets when the fair values are positive and as liabilities when the fair values are negative.

Changes in the fair value of derivatives are recognised in the statement of comprehensive income, through net gains and losses on assets and liabilities at fair value through profit or loss.

**NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2021 (continued)****1. Accounting policies (continued)****(n) Derivative financial instruments (continued)***Hedge accounting*

In limited circumstances, derivatives are designated as fair value hedges. Hedge accounting allows one instrument, generally a derivative such as a swap, to be designated as a hedge of another instrument such as a loan.

Derivatives may only be designated as hedging instruments provided certain strict criteria are met. At the inception of a hedge, its terms must be clearly documented and there must be an expectation that the derivative will be highly effective in offsetting changes in the fair value of the hedged risk. The hedge documentation must also specify the methodology that will be used to measure effectiveness. Changes in the fair value of derivatives that are designated as fair value hedges are recorded in the statement of comprehensive income, through net gains and losses on assets and liabilities at fair value through profit or loss, together with the changes in the fair value of the hedged asset or liability that are attributable to the hedged risk.

The effectiveness of the hedging relationship must be tested throughout its life. A hedge is regarded as highly effective if the change in fair value of the hedge instrument and the hedge item are negatively correlated within a range of 80 per cent to 125 per cent, either for the period since effectiveness was last tested or for the period since inception. Where the hedge is highly effective, the net impact on the statement of comprehensive income is minimised. If, at a reporting date, it is concluded that the hedge is no longer highly effective in achieving its objective, the hedge relationship is terminated. Should this happen, changes in the fair value of the hedged item are no longer recognised in the statement of comprehensive income and the adjustment that has been made to the carrying amount of the hedged item is amortised to the statement of comprehensive income over the period to maturity of the hedged item.

**(o) Loans and receivables at amortised cost**

Loans and receivables at amortised cost are financial assets, other than cash and cash equivalents that are held to collect contractual cash flows where those cash flows represent solely payments of principal and interest, a basic lending arrangement results in contractual cash flows that are solely payments of principal and interest on the principal amount outstanding. Where the contractual cash flows introduce exposure to risks or volatility unrelated to a basic lending arrangement such as changes in equity prices or commodity prices, the payments do not comprise solely principal and interest.

Loans and receivables at amortised cost are initially recognised at fair value less directly attributable transaction costs and subsequently measured at amortised cost, subject to impairment. Further information on the Group's impairment policy is set out at policy (r).

**(p) Investments at fair value through profit or loss**

Investments at fair value through profit or loss comprise debt, equity securities, loans and advances to banks and loans and advances to customers.

*Classification*

Financial assets are classified at fair value through profit or loss where they are within a portfolio of financial assets that is managed and whose performance is evaluated on a fair value basis or they do not otherwise meet the criteria to be measured at amortised cost. All derivatives and equity instruments are carried at fair value through profit or loss.

Financial liabilities are measured at fair value through profit or loss where they are designated at fair value through profit or loss in order to reduce an accounting mismatch or the liabilities are part of a group of liabilities (or assets and liabilities) which is managed, and its performance evaluated, on a fair value basis; or where the liabilities contain one or more embedded derivatives that significantly modify the cash flows arising under the contract and would otherwise need to be separately accounted for.

*Recognition*

Purchases and sales of financial assets are recognised on the trade date, i.e. the date the Group commits to purchase the asset from, or deliver the asset to, the counterparty. Investments are initially recognised at their fair value and are subsequently remeasured at fair value.

**NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2021 (continued)****1. Accounting policies (continued)****(p) Investments at fair value through profit or loss (continued)***Measurement*

The fair values of investments are based on current bid prices and therefore price in market expectations of the expected effects of potential changes to laws and regulations, risks associated with climate, credit and general market change and other factors. If the market for a financial asset is not active, and also for unlisted securities, the Group establishes fair value by using valuation techniques. These include the use of similar arm's length transactions and reference to other instruments that are substantially the same, making maximum use of market inputs and relying as little as possible on entity-specific inputs. Refer to note 1(d) Fair value methodology and note 36 Risk management for details of valuation techniques and significant inputs to valuation models.

In order to ensure that a fair value is recognised for unquoted or illiquid debt securities, the primary price source is an external broker valuation.

Deposits with cedants represents funds withheld under the terms of the reinsurance agreement between the Company and the subsidiary undertaking SWE. Under that agreement the amount payable as premiums includes the investment incomes and gains earned by SWE on the funds withheld assets. The amount is remeasured to reflect the fair value of the underlying funds withheld assets.

*Structured entities*

The Group invests in structured entities arising from investments in investment properties held through limited partnerships. The unconsolidated limited partnerships are initially recognised at cost, being the fair value of the consideration given. After initial recognition, such assets are accounted for and measured at fair value, which equates to the relevant proportion of the published net asset value of the Company. This valuation is based on open market valuations of the properties held by the limited partnership, as provided at the reporting date by independent valuers.

The Group holds investments in structured entities arising from investments in collective investment vehicles, carried at fair value. Some of these structured entities are consolidated, as set out at policy (b). Unconsolidated collective investment vehicles are carried at fair value.

**(q) Cash and cash equivalents**

Cash and cash equivalents includes cash at bank, short-term highly liquid investments with original maturities of three months or less (excluding such investments as otherwise meet this definition but which are held for investment purposes rather than for the purposes of meeting short-term cash commitments) and bank overdrafts where a legal right of set off exists.

Cash and cash equivalents that are held to collect contractual cash flows where those cash flows represent solely payments of principal and interest are measured at amortised cost. A basic lending arrangement results in contractual cash flows that are solely payments of principal and interest on the principal amount outstanding. Cash and cash equivalents that are within a portfolio of financial assets that is managed and whose performance is evaluated on a fair value basis or do not meet the criteria to be measured at amortised cost are classified and measured as investments at fair value through profit or loss, as set out in policy (p).

**(r) Impairment***Financial assets*

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

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

**NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2021 (continued)****1. Accounting policies (continued)****(r) Impairment (continued)****Financial assets (continued)**

An assessment of whether credit risk has increased significantly since initial recognition considers the change in the risk of default occurring over the remaining expected life of the financial instrument. The assessment is unbiased, probability-weighted and uses forward-looking information consistent with that used in the measurement of expected credit losses. In determining whether there has been a significant increase in credit risk, the Group uses quantitative tests based on relative and absolute probability of default (PD) movements linked to internal credit ratings and other indicators of historic delinquency. However, unless identified at an earlier stage, the credit risk of financial assets is deemed to have increased significantly when more than 30 days past due. Where the credit risk subsequently improves such that it no longer represents a significant increase in credit risk since initial recognition, the asset is transferred back to Stage 1.

For financial instruments that are considered to have low credit risk, the credit risk is assumed to not have increased significantly since initial recognition. Financial instruments are considered to have low credit risk when the borrower is considered to have a low risk of default from a market perspective. Typically financial instruments with an external credit rating of investment grade are considered to have low credit risk.

Assets are transferred to Stage 3 when they have defaulted or are otherwise considered to be credit impaired. IFRS 9 contains a rebuttable presumption that default occurs no later than when a payment is 90 days past due. The Group uses this 90 day backstop.

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

A loan or receivable is normally written off, either partially or in full, against the related allowance when the proceeds from realising any available security have been received or there is no realistic prospect of recovery and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off decrease the amount of impairment losses recorded in the statement of comprehensive income.

**Non-financial assets**

Assets that have an indefinite useful life, for example land, are not subject to depreciation or amortisation and are tested annually for impairment. Assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable.

An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its estimated recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and its value in use. For the purpose of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows.

If there is objective evidence that an impairment loss has occurred, the amount of the loss is charged to the relevant line in the statement of comprehensive income in the period in which it occurs. Non-financial assets that suffered an impairment are reviewed for possible reversal of the impairment at each reporting date.

**(s) Taxes**

Tax expense comprises current and deferred tax. Current and deferred tax are charged or credited in The Statement of Comprehensive Income except to the extent that the tax arises from a transaction or event which is recognised, in the same or a different period, outside The Statement of Comprehensive Income (either in other comprehensive income, directly in equity, or through a business combination), in which case the tax appears in the same statement as the transaction that gave rise to it.

**Current tax**

Current tax is the amount of corporate income taxes expected to be payable or recoverable based on the profit for the period as adjusted for items that are not taxable or not deductible, and is calculated using tax rates and laws that were enacted or substantively enacted at the balance sheet date.

Current tax includes amounts provided in respect of uncertain tax positions when management expects that, upon examination of the uncertainty by Her Majesty's Revenue and Customs (HMRC) or other relevant tax authority, it is more likely than not that an economic outflow will occur. Provisions reflect management's best estimate of the ultimate liability based on their interpretation of tax law, precedent and guidance, informed by external tax advice as necessary. Changes in facts and circumstances underlying these provisions are reassessed at each balance sheet date, and the provisions are re-measured as required to reflect current information.

**NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2021 (continued)****1. Accounting policies (continued)****(s) Taxes (continued)***Deferred tax*

Deferred tax is recognised on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the balance sheet. Deferred tax is calculated using tax rates and laws that have been enacted or substantively enacted at the balance sheet date, and which are expected to apply when the related deferred tax asset is realised or the deferred tax liability is settled.

Deferred tax liabilities are generally recognised for all taxable temporary differences but not recognised for taxable temporary differences arising on investments in subsidiaries where the reversal of the temporary difference can be controlled and it is probable that the difference will not reverse in the foreseeable future. Deferred tax liabilities are not recognised on temporary differences that arise from goodwill which is not deductible for tax purposes.

Deferred tax assets are recognised to the extent it is probable that taxable profits will be available against which the deductible temporary differences can be utilised, and are reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax assets and liabilities are not recognised in respect of temporary differences that arise on initial recognition of assets and liabilities acquired other than in a business combination. Deferred tax is not discounted.

*Allocation of tax charge between shareholder and policyholders*

The tax expense in the statement of comprehensive income is analysed between policyholder and shareholder tax. This allocation is based on the definition of policyholders' share and shareholders' share of taxable profit under current UK tax rules.

**(t) Share capital**

Shares are classified as equity when there is no obligation to transfer cash or other assets. Incremental costs directly attributable to the issue of equity instruments are shown in equity as a deduction from the proceeds, net of tax.

*Dividends payable*

Dividends payable on ordinary shares are recognised in equity in the period in which they are approved.

**(u) Insurance contracts and participating investment contracts**

The Group issues life insurance contracts to protect customers from the consequences of events (such as death, critical illness or disability) that would affect the ability of the customer or their dependants to maintain their current level of income and also issues pension and annuity contracts. Guaranteed claims paid on occurrence of the specified insured event are either fixed or linked to the extent of the economic loss suffered by the policyholder.

*Insurance contracts or participating investment contracts in the Group's With Profits Funds*

Liabilities of the Group's With Profits Funds, including guarantees and options embedded within products written by the funds, are accounted for under the realistic method in accordance with a pre-Solvency II traditional regulatory assessment, grandfathered under IFRS 4 'Insurance Contracts'. Projected transfers out of the funds into other funds of the Group are not treated as insurance liabilities, but are recorded in unallocated surplus. Changes in the value of these liabilities are recognised in the statement of comprehensive income, through change in liabilities in insurance contracts and participating investment contract liabilities.

Liabilities for non-participating insurance contracts in the Group's With Profits Funds are measured using an assessment that uses the pre Solvency II traditional regulatory assessment. In addition, the realistic value of future profits on those contracts is recognised as an offset to the corresponding liabilities in the balance sheet, as future profits on non-participating business in the With Profits Funds. The movement in this balance is recognised in the statement of comprehensive income, through change in liabilities arising from insurance contracts and participating investment contracts.

The Group writes With-Profits policies which guarantee a rate for vesting into an annuity contract. These contracts are accounted for as with-profits policies until they vest, and if vesting is taken up, they are derecognised as With-Profits and recognised as annuity contracts from that point.

*Insurance contracts which are neither unit-linked nor in the Group's With Profits Funds*

The liability is calculated by estimating the future cash flows over the duration of in-force policies and discounting them back to the valuation date, allowing for probabilities of occurrence. The liability will vary with movements in interest rates and with the cost of life assurance and annuity benefits where future mortality is uncertain. Assumptions are made in respect of all material factors affecting future cash flows, including future interest rates, mortality and costs. Changes in the value of these liabilities are recognised in the statement of comprehensive income, through change arising from insurance contracts and participating investment contract liabilities.

**NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2021 (continued)****1. Accounting policies (continued)****(u) Insurance contracts and participating investment contracts (continued)***Insurance contracts which are unit-linked*

Allocated premiums in respect of unit-linked contracts that are either insurance contracts or participating investment contracts are recognised as liabilities. These liabilities are increased or reduced by the change in the unit prices and are reduced by policy administration fees, mortality and surrender charges and any withdrawals. Non-unit reserves are also established for expected future expenses not covered by future margins, inadequacy of benefit charges to cover benefit claims, and inadequacy of guarantee charges to cover guarantees. Income consists of fees deducted for mortality, policy administration and surrender charges. Interest or changes in the unit prices credited to the account balances incurred in the period are charged as expenses in the statement of comprehensive income, through changes in liabilities arising from insurance contracts and participating investment contracts. Benefit claims in excess of the account balances incurred in the period are charged as expenses in the statement of comprehensive income, through gross claims and benefits paid.

*Unallocated surplus*

Any amounts in the With Profits Funds not yet determined as being due to policyholders or the equity holder and projected transfers out of the funds to other funds of the Group are recognised as an unallocated surplus which is shown separately from the other insurance liabilities.

*Inwards reinsurance*

Liabilities arising where the Group, acting as a reinsurer, accepts inward reinsurance are included within insurance and participating investment contract liabilities. These liabilities follow the same accounting treatment as direct insurance contract liabilities.

*Bonuses*

Bonuses in a given year comprise:

- Unit price increases and new reversionary bonuses declared in respect of that year which are provided within the calculation of liabilities arising from insurance and participating investment contracts
- Terminal and interim bonuses paid out to policyholders on maturity and included within gross claims and benefits paid

*Lifetime Mortgages*

The lifetime mortgages held within a special purpose vehicle provide a no-negative equity guarantee which meets the definition of an insurance contract. The guarantee is embedded in the mortgage and included within the mortgage valuation; it is accounted for in accordance with IFRS 4 'Insurance Contracts' and is not unbundled or disclosed separately. The lifetime mortgages are classified within a business model in line with policy (c) and held at fair value through profit or loss.

*Liability adequacy test*

At each reporting date, liability adequacy tests are performed to ensure the adequacy of the insurance contracts and participating investment contract liabilities net of related deferred costs and acquired VIF. In performing these tests, current best estimates of future contractual cash flows, claims handling and policy administration expenses, as well as investment income from assets backing such liabilities, are used. Any deficiency is immediately charged to the statement of comprehensive income, initially by writing off the relevant assets and subsequently by establishing a provision for losses arising from the liability adequacy tests.

**(v) Provisions for other liabilities and charges**

Provisions are recognised when the Group has a present legal or constructive obligation as a result of past events, when it is probable that the obligation will result in an outflow of resources to settle the obligation and when a reliable estimate of the amount of the obligation can be made. If the effect is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessment of the time value of money and, where appropriate, the risks specific to the liability.

The Group recognises a provision for onerous contracts when the expected benefits to be derived from contracts are less than the unavoidable costs of meeting the obligations under the contracts.

Contingent liabilities are possible obligations whose existence depends on the outcome of uncertain future events or those present obligations where the outflows of resources are uncertain or cannot be measured reliably. Contingent liabilities are not recognised in the financial statements but are disclosed unless the likelihood of possible obligations arising is remote.

**NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2021 (continued)****1. Accounting policies (continued)****(w) Subordinated debt**

Subordinated debt comprises dated and undated loan capital. They are recognised initially at fair value, being the issue proceeds net of transaction costs incurred. Subordinated debt is subsequently stated at amortised cost: any difference between the proceeds (net of transaction costs) and the redemption value is recognised in the statement of comprehensive income through finance costs over the period of the liabilities using the effective interest rate applicable to the instrument. Both dated and undated subordinated debt is adjusted for hedged interest rate risk. Changes in the resulting value of this subordinated debt is accounted for as set out at policy (p). Interest payable is recognised in the statement of comprehensive income, through finance costs.

The subordinated guaranteed bonds are classified as a liability on the basis of the existence of a capital disqualification event considered to be a genuine settlement provision in the context of current uncertainty surrounding the direction of future regulatory rule developments.

**(x) Non-participating investment contracts**

The Group's non-participating investment contracts are primarily unit-linked. These contracts are accounted for as financial liabilities whose value is contractually linked to the fair values of financial assets within the Group's unitised investment funds. The value of the unit-linked financial liabilities is determined using current unit prices multiplied by the number of units attributed to the contract holders at the reporting date. Their value is never less than the amount payable on surrender, discounted for the required notice period where applicable. Investment income allocated to non-participating investment contracts is presented within investment income, with corresponding movements being included in change in non-participating investment contract liabilities.

Deposits and withdrawals are not accounted for through the statement of comprehensive income but are accounted for directly in the balance sheet as adjustments to the liability arising from non-participating investment contracts.

Fee and commission income in relation to non-participating unit linked investment business is presented within the statement of comprehensive income within fee and commission income.

**(y) Other financial liabilities**

Other financial liabilities are initially recognised at fair value less directly attributable transaction costs and subsequently measured at amortised cost. In practice, the carrying value of these balances equates to the fair value due to the short-term nature of the amounts included within other financial liabilities.

**(z) External interests in collective investment vehicles**

External interests in collective investment vehicles which are accounted for by the Group as investments in subsidiaries as set out at policy (k) above are initially recognised, and subsequently measured at amortised cost. Due to the nature of these balances, the carrying value equates to the fair value. The fair value of holdings in these funds is determined at the valuation point applicable to the collective investment vehicles at the reporting date as set out under policy (p) above. Changes in the value of this balance are recognised in the statement of comprehensive income, through net profit attributable to external interests in collective investment vehicles.

**(aa) Borrowings**

Borrowings are recognised initially at fair value, being the issue proceeds net of transaction costs incurred. In practice, due to the nature of these balances, being bank overdrafts, the carrying value equates to the fair value of these liabilities as the borrowings are repayable on demand.

**(ab) Foreign currency translation**

Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates (the 'functional currency'). The consolidated financial statements are presented in pounds sterling, rounded to the nearest million, which is the Company's presentation and functional currency.

Monetary items denominated in foreign currencies are translated into sterling at the exchange rates ruling at the reporting date. Non-monetary items denominated in foreign currencies that are measured at fair value are translated at the exchange rates ruling at the date when the current fair value is determined. Non-monetary items denominated in foreign currencies that are measured at historical cost are translated at the exchange rates ruling at the date of the transaction. Revenue transactions and those relating to the acquisition and realisation of investments have been translated at rates of exchange ruling at the time of the respective transactions. Any exchange differences are dealt with in that part of the statement of comprehensive income in which the underlying transaction is reported.

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**NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2021 (continued)****1. Accounting policies (continued)****(ab) Foreign currency translation (continued)**

The results and financial position of the Group's foreign operations that have a functional currency different from the presentational currency are translated into sterling at foreign exchange rates ruling at the balance sheet date.

The income and expenses of foreign operations are translated into sterling at average exchange rates, unless these do not approximate to the foreign exchange rates ruling at the dates of the transactions in which case income and expenses are translated at the dates of the transactions. Foreign exchange differences arising on the translation of foreign operations are recognised in other comprehensive income.

**(ac) Collateral**

The Group receives or pledges collateral in the form of cash or securities in respect of derivative transactions it undertakes. The Group also receives collateral in the form of securities in respect of stock lending agreements, repurchase agreements, certain loans made to related parties and bulk annuity contracts. Cash collateral received is recognised as an asset on the balance sheet. Non-cash collateral is recognised as an asset on the balance sheet when the Group has the right to sell or repledge the collateral and when the transferor has defaulted. A corresponding liability for repayment of collateral is recognised in financial liabilities. Collateral received that is not recognised on the balance sheet is legally segregated from the assets of the Group. Cash collateral pledged is derecognised from the balance sheet and a corresponding asset is recognised. Non-cash collateral continues to be recognised on the balance sheet as the Group retains the risks and rewards of ownership.

**NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2021 (continued)****2. Critical accounting judgements and key sources of estimation uncertainty**

The Group's management makes estimates and judgements that affect the reported amount of assets and liabilities. Estimates and judgements are continually evaluated and based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Revisions to accounting estimates are recognised in the period in which the estimate is revised and in any future periods affected.

**a. Key sources of estimation uncertainty**

The key assumptions concerning the future and other key sources of estimation uncertainty at the reporting date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below.

**i. Insurance contracts and participating investment contract liabilities**

The estimation of the ultimate liability arising from insurance contracts and participating investment contracts which are not unit-linked is the Group's most critical accounting estimate.

The liabilities of the Group's With Profits Funds are calculated using stochastic simulation models which value liabilities on a basis consistent with tradable market option contracts (a 'market-consistent' basis). The liabilities are sensitive to both investment market conditions and changes to a number of non-economic assumptions, such as the level of take-up of options inherent in the contracts, mortality rates and lapses prior to dates at which a guarantee would apply.

For insurance contracts outside the With Profits Funds, the liabilities are calculated using a projection of future cash flows after making prudent assumptions about matters such as investment return, expenses, credit default and mortality. Discount rates used to value the liabilities for annuity business are set with reference to the risk-adjusted yields on the underlying assets and for non-annuity business with reference to cash yields. The most critical non-economic assumptions are mortality rates in respect of annuity business written and levels of future expenses.

Such assumptions are based on recent actual experience, supplemented by industry information where appropriate. No key sources of estimation uncertainty apply for participating investment contracts as the contract liabilities arising outside of the With Profits Funds are almost entirely current unit values.

At each reporting date, the estimates and assumptions referred to above are reassessed for adequacy and changes will be reflected in adjustments to the liability, through the statement of comprehensive income. Further information on these assumptions is given in note 35, including a sensitivity analysis on the effect of changing key assumptions in note 35(3) and 35(4).

**ii. Fair value of financial instruments**

In accordance with IFRS 13, the Group categorises financial instruments carried on the balance sheet at fair value using a three level hierarchy. Financial instruments categorised as Level 1 are valued using quoted market prices and therefore there is minimal judgement applied in determining fair value. However, the fair value of financial instruments categorised as Level 2 and, in particular, Level 3 is determined using valuation techniques. These valuation techniques involve management judgement and estimates, the extent of which depends on the complexity of the instrument and the availability of market observable information. Further details of these valuations are described in note 36.

**iii. Provisions for other liabilities and charges**

The Group continues to receive claims in Germany and Austria from customers relating to policies issued by the Company, under its former name of Clerical Medical Investment Group Limited but sold by independent intermediaries in Germany and Austria, principally during the late 1990s and early 2000s.

New complaint and litigation volumes have continued to reduce in 2021. The total provision made to 31 December 2021 is £696 million (2020: £674 million); utilisation has increased to £29 million in the year ended 31 December 2021 (2020: £28 million); the remaining unutilised provision as at 31 December 2021 is £84 million (2020: £91 million).

The validity of the claims facing the Group depends upon the facts and circumstances in respect of each claim. As a result the ultimate financial effect, which could be significantly different from the current provision, will only be known once all relevant claims have been resolved.

The Directors believe this provision represents an appropriate estimate of the financial impact based upon a series of assumptions, including the number of claims received from the respective populations of different classes of policies, the proportion upheld, and resulting legal and administration costs. Further information in relation to the provision is set out in note 27.

**NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2021 (continued)****2. Critical accounting judgements and key sources of estimation uncertainty (continued)****b. Critical judgements**

The Directors also use judgement in the process of applying the Group's accounting policies. The following judgements have the most significant effect on the amounts recognised in the consolidated financial statements.

**i. Assessment of significant insurance risk**

Insurance contracts are those contracts which transfer significant insurance risk. As a general guideline, the Group and the Company defines significant insurance risk as the possibility of having to pay benefits on the occurrence of an insured event which are significantly more than the benefits payable if the insured event were not to occur. Management judgement is required in assessing whether contracts transfer significant insurance risk to determine whether the contract is accounted for under IFRS 4. Further information about the Group's insurance contract liabilities is set out in notes 24 and 35.

**ii. Investment vehicles**

The Group consolidates investment vehicles when it has control and is therefore acting as a principal rather than an agent. Control typically arises where the Group has the power to determine investment activities of the fund and also has exposure to significant variable returns. Variable returns are assessed together with other relevant factors in accordance with the guidance in IFRS 10, such as the fund structure and remuneration of the decision maker. Control can arise when the Group has less than a majority beneficial interest. The Group's holdings in these investment funds can fluctuate over time. The Group has established a set of principles covering the percentage ownership of investment funds, approach to consolidation where ownership share varies and nature of the returns from the funds, which are considered together at each reporting date to allow judgement to be applied as to whether the Group is acting as a principal or agent.

**3. Segmental analysis**

In the opinion of the Directors, the Group operates in a single business segment, being the provision of long-term insurance and investment contracts, and therefore the following specific disclosure requirements under IFRS 8 'Operating Segments' are required. The table below provides a summary of the gross premiums written within the single business segment:

<i>Group</i>	<b>2021</b>	<b>2020</b>
	<b>£m</b>	<b>£m</b>
Regular premiums	5,191	5,127
Single premiums	2,864	3,078
<b>Total</b>	<b>8,055</b>	<b>8,205</b>

Further, a summary of the gross premiums written by the segment's main product types is shown below:

<i>Group</i>	<b>2021</b>	<b>2020</b>
	<b>£m</b>	<b>£m</b>
Bulk Annuities	78	929
Corporate pensions	5,408	4,859
Individual pensions	465	408
Retirement income	514	496
Protection	390	396
Investments	105	128
Retirement account	1,095	989
<b>Total</b>	<b>8,055</b>	<b>8,205</b>

Of the above gross written premiums, £83 million (2020: £90 million) relates to the European business with the remaining written in the UK.

**4. Fee and commission income**

<i>Group</i>	<b>2021</b>	<b>2020</b>
	<b>£m</b>	<b>£m</b>
Fund management and policy administration fees	209	191
Change in deferred income	4	5
Other	1	1
<b>Total</b>	<b>214</b>	<b>197</b>

**NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2021 (continued)****5. Investment income**

<i>Group</i>	<b>2021</b>	<b>Restated* 2020</b>
	<b>£m</b>	<b>£m</b>
Net income on investments at fair value through profit or loss	2,835	2,866
Interest income on Lloyds Banking Group loans	13	14
Rental income on investment properties	186	191
Service charge income	11	13
Other	2	10
<b>Total</b>	<b>3,047</b>	<b>3,094</b>

\*A representation of £136 million has been made between investment income and net gains on assets and liabilities at fair value through profit or loss in the 2020 comparative results, in order to more accurately present the substance of the transactions. This has decreased the net income on investments at fair value through profit or loss line above.

**6. Net gain on assets and liabilities at fair value through profit or loss**

<i>Group</i>	<b>2021</b>	<b>Restated* 2020</b>
	<b>£m</b>	<b>£m</b>
Derivative financial instruments at fair value through profit or loss	(239)	421
Investments at fair value through profit or loss	10,455	1,635
Investment properties at fair value through profit or loss	572	(188)
Fair value hedge adjustment in respect of swap	138	(102)
Foreign exchange	131	30
<b>Total</b>	<b>11,057</b>	<b>1,796</b>

\*As stated in note 5, a representation of £136 million has been made between investment income and net gain on assets and liabilities at fair value through profit or loss in the 2020 comparative results, in order to more accurately present the substance of the transactions. This has increased the investments at fair value through profit or loss line above.

**7. Other operating income**

<i>Group</i>	<b>2021</b>	<b>2020</b>
	<b>£m</b>	<b>£m</b>
External rebates	83	86
Other	31	11
<b>Total</b>	<b>114</b>	<b>97</b>

**8. Operating expenses**

<i>Group</i>	<b>2021</b>	<b>2020</b>
	<b>£m</b>	<b>£m</b>
Acquisition and origination costs in respect of insurance and investment contracts	119	113
Expenses for administration	832	837
	951	950
Fees and commissions payable	42	26
Change in deferred costs	198	—
Service charge expense	15	16
Amortisation of acquired VIF	6	6
Other	101	46
<b>Total</b>	<b>1,313</b>	<b>1,044</b>

**NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2021 (continued)****9. Auditor's remuneration**

<i>Group</i>	<b>2021</b>	<b>2020</b>
	<b>£000</b>	<b>£000</b>
Fees payable to the Group's auditors for the audit of the Company's annual financial statements and the consolidation	3,790	2,855
Fees payable to the Group's auditor and its associates for other services:		
Audit of subsidiaries	996	1,222
Audit-related assurance services	535	938
<b>Total fees payable</b>	<b>5,321</b>	<b>5,015</b>

The 2021 'Fees payable to the Group's auditors for the audit of the Company's annual financial statements and the consolidation' contains an amount of £404 thousand (2020: nil) for audit work carried out in respect of the IFRS 17 transition.

In the current year, the full audit fee for the Solvency II SFCR has been included within the SWG audit fee disclosure. This is a change from the prior year where the SFCR fee was split between all Solvency II regulated entities (including the Company), and reflected within 'Audit-related assurance services'.

**10. Finance costs**

<i>Group</i>	<b>2021</b>	<b>2020</b>
	<b>£m</b>	<b>£m</b>
Interest on swaps	(31)	(27)
Interest on subordinated debt	92	91
Other	7	11
<b>Total</b>	<b>68</b>	<b>75</b>

**11. Taxation charge/(credit)****(a) Current year tax charge/(credit)**

<i>Group</i>	<b>2021</b>	<b>Restated* 2020</b>
	<b>£m</b>	<b>£m</b>
<b>Current tax:</b>		
UK corporation tax	106	42 *
Overseas Tax	(1)	2
Adjustment in respect of prior years	(9)	(18)
<b>Total current tax</b>	<b>96</b>	<b>26 *</b>
<b>Deferred tax:</b>		
Reversal of temporary differences	17	(154)
Change in tax rate	27	26
Adjustment in respect of prior years	—	9
<b>Total deferred tax</b>	<b>44</b>	<b>(119)</b>
<b>Total income tax charge/(credit)</b>	<b>140</b>	<b>(93)*</b>

\* Amount restated. See note 41 for details of the restatement.

The policyholder tax expense or benefit is included in the income tax charge/(credit). Policyholder tax is a charge of £166 million (2020: credit of £(31) million).

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2021 (continued)

## 11. Taxation charge/(credit) (continued)

## (b) Reconciliation of tax charge/(credit)

<i>Group</i>	2021	Restated* 2020
	£m	£m
<b>Profit/(loss) before tax</b>	132	(257)*
<b>Tax at 19% (2020: 19%)</b>	25	(49)*
Effects of:		
Non-taxable income	(37)	(44)
Policyholder tax	135	(25)
Adjustment in respect of prior years	(9)	(9)
Disallowable expenses	(1)	4
Change in tax rate	27	26
Overseas tax	—	4
<b>Total</b>	140	(93)*

\* Amount restated. See note 41 for details of the restatement.

The Finance Act 2021, which was substantively enacted on 24 May 2021, increases the rate of corporation tax from 19 per cent to 25 per cent with effect from 1 April 2023. The impact of this rate change is an increase in the Company's net deferred tax liability as at 31 December 2021 of £27 million.

## 12. Intangible assets including insurance intangible assets

	2021		2020	
	£m	£m	£m	£m
	<i>Group</i>	<i>Company</i>	<i>Group</i>	<i>Company</i>
Acquired VIF	48	44	55	49
Goodwill	15	10	15	10
Software development costs	58	—	30	—
<b>Total</b>	121	54	100	59

The recoverable amount of the goodwill relating to the Workplace Savings business has been based on a value-in-use calculation. The calculation uses pre-tax projections of future cash flows based upon budgets and plans approved by management covering a three-year period, the related run-off of existing business in-force and a pre-tax weighted average cost of capital of 9 per cent (2020: 10 per cent). The budgets and plans are based upon past experience adjusted to take into account anticipated changes in sales volumes, product mix and margins having regard to expected market conditions and competitor activity. The discount rate is determined with reference to internal measures and available industry information. New business cash flows beyond the three-year period have been extrapolated using a steady 3.5 per cent (2020: 2 per cent) growth rate which does not exceed the long-term average growth rate for the life assurance market. Management believes that any reasonably possible change in the key assumptions above would not cause the recoverable amount of goodwill to fall below its balance sheet carrying value.

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2021 (continued)

## 12. Intangible assets including insurance intangible assets (continued)

<i>Group</i>	2021				2020			
	Acquired VIF	Goodwill	Software development costs	Total	Acquired VIF	Goodwill	Software development costs	Total
	£m	£m	£m	£m	£m	£m	£m	£m
<b>Cost</b>								
<b>At 1 January</b>	663	15	39	717	663	15	31	709
Additions	—	—	35	35	—	—	8	8
<b>At 31 December</b>	663	15	74	752	663	15	39	717
<b>Accumulated amortisation and impairment</b>								
<b>At 1 January</b>	(608)	—	(9)	(617)	(602)	—	(5)	(607)
Amortisation during the year	(6)	—	(7)	(13)	(6)	—	(4)	(10)
<b>At 31 December</b>	(614)	—	(16)	(630)	(608)	—	(9)	(617)
<b>Carrying amount</b>								
<b>At 31 December</b>	49	15	58	122	55	15	30	100

<i>Company</i>	2021			2020		
	Acquired VIF	Goodwill	Total	Acquired VIF	Goodwill	Total
	£m	£m	£m	£m	£m	£m
<b>Cost</b>						
<b>At 1 January</b>	657	10	667	657	10	667
Additions	—	—	—	—	—	—
<b>At 31 December</b>	657	10	667	657	10	667
<b>Accumulated amortisation and impairment</b>						
<b>At 1 January</b>	(608)	—	(608)	(602)	—	(602)
Amortisation during the year	(5)	—	(5)	(6)	—	(6)
<b>At 31 December</b>	(613)	—	(613)	(608)	—	(608)
<b>Carrying amount</b>						
<b>At 31 December</b>	44	10	54	49	10	59

The additions to software development costs in 2020 and 2021 arise from additional enhancements to the Corporate Saving Platform by Scottish Widows Administration Services Limited (SWAS) during the year.

Of the above total for acquired VIF, £39 million (2020: £44 million) is expected to be recovered more than one year after the reporting date. The remaining amortisation period is 6 years (2020: 7 years) for £34 million of the acquired VIF and 16 years (2020: 17 years) for £5 million of the acquired VIF.

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2021 (continued)

## 13. Deferred costs

		2021		2020	
		£m	£m	£m	£m
		<u>Group</u>	<u>Company</u>	<u>Group</u>	<u>Company</u>
Deferred acquisition costs	(a)	1,362	1,362	1,550	1,550
Deferred origination costs	(b)	75	71	85	78
<b>Total</b>		<b>1,437</b>	<b>1,433</b>	<b>1,635</b>	<b>1,628</b>

## (a) Deferred acquisition costs

		2021		2020	
		£m	£m	£m	£m
		<u>Group</u>	<u>Company</u>	<u>Group</u>	<u>Company</u>
<b>At 1 January</b>		1,550	1,550	1,531	1,531
Amounts incurred during the year		170	170	160	160
Amortisation during the year		(181)	(181)	(169)	(169)
Changes to impairment of deferred costs		(177)	(177)	28	28
<b>At 31 December</b>		<b>1,362</b>	<b>1,362</b>	<b>1,550</b>	<b>1,550</b>

Of the above total, £1,199 million for Group and Company (2020: £1,375 million for Group and Company) is expected to be recovered more than one year after the reporting date.

## (b) Deferred origination costs

		2021		2020	
		£m	£m	£m	£m
		<u>Group</u>	<u>Company</u>	<u>Group</u>	<u>Company</u>
<b>At 1 January</b>		85	78	104	94
Amounts incurred during the year		—	—	—	—
Amortisation during the year		(10)	(7)	(19)	(16)
<b>At 31 December</b>		<b>75</b>	<b>71</b>	<b>85</b>	<b>78</b>

Of the above total, £68 million for Group and £64 million for Company (2020: £74 million for Group and £69 million for Company) is expected to be recovered more than one year after the reporting date.

## 14. Tax assets and liabilities

		2021		Restated* 2020	
		£m	£m	£m	£m
		<u>Group</u>	<u>Company</u>	<u>Group</u>	<u>Company</u>
Current tax recoverable		36	28	96 *	89 *
Deferred tax assets		8	—	—	—
<b>Total tax assets</b>		<b>44</b>	<b>28</b>	<b>96 *</b>	<b>89 *</b>
Current tax liabilities		1	—	—	—
Deferred tax liabilities		199	198	147	155
<b>Total tax liabilities</b>		<b>200</b>	<b>198</b>	<b>147</b>	<b>155</b>

\* Amount restated. See note 41 for details of the restatement.

The Group has made claims to recover historic UK taxes paid on overseas dividends received. These claims may result in recovery of a material amount of taxes previously paid by the Company and the OEICs it consolidates, though the benefit of these claims remains uncertain pending ongoing litigation and other uncertainties.

HMRC issued a briefing note in January 2020 on their intended approach to settling some of these claims. The tax assets recognised in these accounts reflect the Group's view of the impact of this guidance.

**NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2021 (continued)****14. Tax assets and liabilities (continued)****a. Recognised deferred tax**

Deferred tax assets and liabilities have been offset in the balance sheet where there is a legally enforceable right of offset. The tables below split the individual deferred tax assets and liabilities by type, before such netting.

The amounts are as follows:

	2021		2020	
	£m	£m	£m	£m
	<u>Group</u>	<u>Company</u>	<u>Group</u>	<u>Company</u>
<b>Deferred tax assets comprise:</b>				
Trading losses	8	—	9	—
Expenses deductible in future periods	206	206	124	124
<b>Total deferred tax assets</b>	<b>214</b>	<b>206</b>	<b>133</b>	<b>124</b>
<b>Deferred tax liabilities comprise:</b>				
Unrealised gains on investment assets	228	228	58	58
Deferred acquisition costs	123	123	123	123
Transitional adjustments on introduction of new life tax regime	44	44	87	87
Deferred tax on acquired VIF	10	9	9	8
Other	—	—	3	3
<b>Total deferred tax liabilities</b>	<b>405</b>	<b>404</b>	<b>280</b>	<b>279</b>
<b>Net deferred tax liabilities</b>	<b>191</b>	<b>198</b>	<b>147</b>	<b>155</b>

Deferred tax assets for trading losses and expenses deductible in future periods are recognised on the basis of future profit projections, which show sufficient future taxable profits to utilise these assets.

Of the deferred tax liabilities included in the above table, £69 million for Group and Company (2020: £60 million for Group and Company) is expected to be settled within one year of the reporting date.

Of the deferred tax assets and liabilities balances shown in the above table, £nil for Group and Company (2020: £44 million for Group and Company), relating to 'transitional adjustments on introduction of new life tax regime' are expected to be settled more than one year after the reporting date.

The Finance Act 2021, which was substantively enacted on 24 May 2021, increases the rate of corporation tax from 19 per cent to 25 per cent with effect from 1 April 2023. The impact of this rate change is an increase in the the Company's net deferred tax liability as at 31 December 2021 of £27 million.

The tax charge/(credit) in the statement of comprehensive income relating to each item is as follows:

	2021	2020
	£m	£m
	<u>Group</u>	<u>Group</u>
Trading losses	1	(9)
Expenses deductible in future periods	(82)	(4)
Unrealised gains/ losses on investment assets	170	(84)
Deferred acquisition costs	1	(2)
Deferred tax on acquired VIF	1	—
Transitional adjustments on introduction of new life tax regime	(44)	(23)
Other liabilities	(3)	3
<b>Total deferred tax charge/(credit)</b>	<b>44</b>	<b>(119)</b>

**NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2021 (continued)****14. Tax assets and liabilities (continued)****b. Unrecognised deferred tax**

Deferred tax assets are recognised for tax loss carry forwards only to the extent that realisation of the related tax benefit is probable. The UK deferred tax assets not recognised are not subject to any expiry date and the Luxembourg trading losses are subject to a limit of 17 years.

Deferred tax assets have not been recognised in respect of excess expenses carried forward (£nil (2020: £115 million)) and in respect of £6 million of trading losses in Scottish Widows Europe (2020: £6 million), as there is insufficient certainty as to the availability of future profits.

**15. Investment in subsidiaries**

<i>Company</i>	<b>2021</b>	<b>2020</b>
	<b>£m</b>	<b>£m</b>
<b>At 1 January</b>	463	624
Impairment of investment in subsidiaries	(64)	(233)
Investment in subsidiary	44	72
<b>At 31 December</b>	<b>443</b>	<b>463</b>

A capital injection of £45 million was made to the entity's subsidiary, SWAS, during the year (2020: capital injections of £45 million and £27 million to SWAS and SWE respectively).

The carrying value of SWAS is £176 million, which is exceeded by the fair value of £228 million. The fair value is based on multiples of SWAS' pension and savings administration revenue. A 1 per cent reduction in revenue would lead to a £1.6 million reduction in headroom.

In the prior year, Scottish Widows Unit Trust Managers Limited (SWUTM) paid a dividend from the proceeds of the transfer of wealth related assets in 2019. Following this transfer, an impairment charge was made in order to reflect the long-term value of the subsidiary as at 31 December 2020 to its recoverable amount of £147 million.

In 2021, the basis for allocating and recharging costs between SWUTM and other Lloyds Banking Group entities changed, driving increased costs and a worsened profit forecast for SWUTM. Furthermore, a large dividend payment is forecast to be made next year. This has resulted in a reduction in the assessed value in use of the subsidiary, leading to impairment indicators and a further impairment charge being recognised in 2021. The remaining carrying value is equal to its value in use, calculated using a dividend discount model based on management dividend forecasts over a 4 year period, projected with a growth rate of 4.4 per cent and run off rate of 10.5 per cent as key assumptions (2020: equal to its fair value less costs of disposal, calculated considering the fair valuations from price-equity, earnings before interest, taxes, depreciation and amortisation, and price-assets under management models, and utilising a liquidity discount of 25 per cent and run off rate of 13 per cent as key assumptions).

**NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2021 (continued)****15. Investment in subsidiaries (continued)**

All entities detailed below are wholly-owned, directly or indirectly, and transact insurance or reinsurance business, investment management activities or services in connection therewith, unless otherwise stated. Following are particulars of the Company's subsidiaries:

Celsius European Lux 2 SARL	(3)	Scottish Widows Administration Services Limited	(13)
Clerical Medical Non Sterling Property Company SARL	(3)	Scottish Widows Administration Services (Nominees) Limited	(14)
CM Venture Investments Limited	(6)	Scottish Widows Auto Enrolment Services Limited	(13)
Dalkeith Corporation LLC	(7)	Scottish Widows Europe S.A.	(8)
France Industrial Premises Holding	(9)	Scottish Widows Fund and Life Assurance Society	(14)
General Reversionary and Investment Company (80%)	(2)	Scottish Widows Industrial Properties Europe BV	(10)
Halifax Life Limited	(11)	Scottish Widows Property Management Limited*	(1)
SARL HIRAM	(12)	Scottish Widows Trustees Limited	(14)
SAS Compagnie Fonciere de France	(12)	Scottish Widows Unit Trust Managers Limited	(13)
SCI Astoria Invest	(12)	St Andrew's Life Assurance plc	(2)
SCI de l'Horloge	(12)	Saint Michel Holding Company No 1	(9)
SCI Rambeateau CFF	(12)	Saint Michel Investment Property	(9)
		Saint Witz II Holding Company No 1	(9)
		Saint Witz II Investment Property	(9)
		SW No 1 Limited	(4)
		Thistle Investments (AMC) Limited	(5)
		Thistle Investments (ERM) Limited	(5)
		Waverley Fund II Investor LLC	(7)
		Waverley Fund III Investor LLC	(7)

\* In liquidation

The investments in subsidiaries included above are generally recoverable more than one year after the reporting date.

The ability of regulated entities to pay cash dividends to the Company or repay loans or advances is restricted by regulatory solvency requirements as well as Companies Act distributable reserves requirements. The ability of non-regulated entities to pay cash dividends to the Company or repay loans or advances is restricted by Companies Act distributable reserves requirements.

**NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2021 (continued)****15. Investment in subsidiaries (continued)****Registered office addresses**

- (1) Atria One, 144 Morrison Street, Edinburgh, EH3 8EX
- (2) 33 Old Broad Street, London, EC2N 1HZ
- (3) Citco REIF Services, 20 Rue de Poste, L-2346, Luxembourg
- (4) Port Hamilton, 69 Morrison Street, Edinburgh, EH3 8YF
- (5) 1 Bartholomew Lane, London, EC2N 2AX
- (6) RL360 House, Cooil Road, Douglas, Isle of Man, IM2 2SP
- (7) Corporation Service Company, 251 Little Falls Drive, Wilmington, DE 19805, United States
- (8) 1, Avenue du Bois, L-1251, Luxembourg
- (9) SAB Formalities, 23 Rue de Roule, Paris, 75001, France
- (10) Hoogoorddreef, 151101BA, Amsterdam, Netherlands
- (11) Trinity Road, Halifax, West Yorkshire, HX1 2RG
- (12) 8 Avenue Hoche, 75008, Paris, France
- (13) 25 Gresham Street, London, EC2V 7HN
- (14) 69 Morrison Street, Edinburgh, EH3 8BW

The table overleaf lists collective investment vehicles and limited partnerships ("investment vehicles") which are considered to be related undertakings due to the Group holding of 20 per cent or more. The basis to determine whether these investment vehicles are consolidated, in part through the Group's long-term funds, is set out in policy 1(b). The carrying value of the investment vehicles which are not consolidated is presented in investments at fair value through profit and loss (note 21).

**NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2021 (continued)****15. Investment in subsidiaries (continued)**

<b>Name Of Umbrella And Undertaking</b>	<b>% Held</b>	<b>Name Of Umbrella And Undertaking</b>	<b>% Held</b>
Aberdeen Liquidity Fund (i)		HBOS International Investment Funds ICVC (xi)	
Aberdeen Liquidity Fund (Lux) – Ultra Short Duration Sterling Fund	27.18%	North American Fund	95.16%
Aberdeen Standard OEIC I (ii)		Far Eastern Fund	80.44%
Aberdeen European Property Share Fund	35.86%	European Fund	93.83%
Aberdeen Sterling Bond Fund	71.08%	International Growth Fund	55.32%
Aberdeen Standard OEIC IV (ii)		Japanese Fund	93.75%
Aberdeen Global Corporate Bond Tracker Fund	96.30%	HBOS Property Investment Funds ICVC (xi)	
ASI UK Equity Index Managed Fund	84.49%	UK Property Fund	51.33%
Aberdeen Standard OEIC VI (ii)		HBOS Specialised Investment Funds ICVC (xi)	
Aberdeen Global Emerging Markets Quantitative Equity Fund	67.24%	Cautious Managed Fund	50.27%
ACS Pooled Property (iii)		Ethical Fund	82.22%
Scottish Widows Pooled Property ACS Fund	99.83%	Fund Of Investment Trusts	39.93%
Scottish Widows Pooled Property ACS Fund 2	99.71%	Smaller Companies Fund	63.89%
AgFe UK Real Estate Senior Debt Fund LP (iv)	78.00%	Special Situations Fund	49.92%
Artemis Institutional Funds (v)		HBOS UK Investment Funds ICVC (xi)	
Artemis Institutional Global Capital Fund	24.20%	UK Equity Income Fund	58.99%
BlackRock Authorised Contractual Scheme I (vii)		UK Growth Fund	61.35%
ACS World Multifactor Equity Tracker Fund	47.84%	UK FTSE All-Share Index Tracking Fund	60.18%
Blackrock ACS 60:40 Global Equity Tracker Fund	32.91%	HLE Active Managed Portfolio Ausgewogen (xii)	59.46%
BlackRock ACS Climate Transition World Equity Fund	97.02%	HLE Active Managed Portfolio Dynamisch (xii)	44.89%
BlackRock ACS Japan Equity Tracker Fund	68.16%	HLE Active Managed Portfolio Konservativ (xii)	46.08%
BlackRock ACS UK Equity Tracker Fund	62.17%	Investment Portfolio ICVC (xiii)	
BlackRock ACS US Equity Tracker Fund	79.80%	IPS Income Portfolio	35.81%
Blackrock ACS World ex UK Equity Tracker Fund	23.59%	IPS Growth Portfolio	39.57%
BlackRock Collective Investment Funds (vii)		Lazard Developing Markets Fund (xiv)	96.70%
iShares Corporate Bond Index Fund (UK)	20.33%	Legg Mason Western Asset Multi-Asset Credit Fund (xv)	28.67%
iShares Global Property Securities Equity Index Fund	45.86%	MGI Funds plc (xvi)	
BlackRock Fixed Income Dublin Funds (viii)		Mercer Diversified Retirement Fund	71.81%
iShares Emerging Markets Local Government Bond Index Fund (IE)	62.38%	Mercer Multi Asset Defensive Fund	40.36%
iShares Emerging Markets Government Bond Index Fund (IE)	80.86%	Mercer Multi Asset Growth Fund	65.67%
BNY Mellon Investment Funds (ix)		Mercer Multi Asset High Growth Fund	77.68%
BNY Mellon Global Balanced Fund	20.94%	Mercer Multi Asset Moderate Growth Fund	73.51%
BNY Mellon Global Equity Fund	26.03%	Mercer Passive Sustainable Global Equity Feeder Fund	84.70%
BNY Mellon US Opportunities Fund	45.35%	Multi-Manager ICVC (xiii)	
Insight Global Absolute Return Fund	78.92%	Multi Manager UK Equity Income Fund	39.01%
Insight Global Multi-Strategy Fund	42.94%	Nordea 1 – GBP Diversified Return Fund (xvii)	23.33%
Newton Multi-Asset Growth Fund	25.15%	Pan European Urban Retail Fund (xviii)	22.00%
Newton UK Income Fund	27.46%	Pemberton European Mid-Market Debt Fund II (xix)	100.00%
Newton UK Opportunities Fund	58.74%	Retail Authorised Unit Trusts (vii)	
Fidelity Investment Funds 2 (x)		Blackrock Balanced Growth Portfolio Fund	38.02%
Fidelity UK Opportunities Fund	22.13%		

**NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2021 (continued)****15. Investment in subsidiaries (continued)**

<b>Name Of Umbrella And Undertaking</b>	<b>% Held</b>	<b>Name Of Umbrella And Undertaking</b>	<b>% Held</b>
Schroder Funds ICAV (xx)		American Growth Fund	80.45%
Schroder Sterling Liquidity Fund	66.61%	Pacific Growth Fund	69.01%
Schroder Sterling Short Duration Bond Fund	63.43%	Japan Growth Fund	92.48%
Schroder International Selection Fund (xxi)		Scottish Widows Tracker And Specialist Investment Funds ICVC (iii)	
Multi Asset Total Return	28.85%	UK All Share Tracker Fund	90.60%
Emerging Market Bond Fund	71.54%	UK Tracker Fund	45.47%
Sustainable Emerging Markets Synergy	100.00%	UK Fixed Interest Tracker Fund	95.69%
Schroder Matching Plus Bespoke Investment Fund 10 (xxi)	100.00%	Emerging Markets Fund	82.09%
Scottish Widows Income And Growth Funds ICVC (iii)		UK Index-Linked Tracker Fund	66.39%
Balanced Growth Fund	30.46%	Scottish Widows UK And Income Investment Funds ICVC (iii)	
Progressive Growth Fund	46.22%	UK Growth Fund	59.63%
UK Index Linked Gilt Fund	100.00%	UK Equity Income Fund	23.63%
Corporate Bond PPF Fund	100.00%	Environmental Investor Fund	78.84%
SW Corporate Bond Tracker	100.00%	Ethical Fund	83.07%
Scottish Widows GTAA 1	84.01%	State Street Global Advisors (xxii)	
Corporate Bond 1 Fund	88.79%	State Street AUT Europe Ex UK Screened (ex Controversies and CW) Index Equity Fund	96.48%
Adventurous Growth Fund	44.23%	State Street AUT Asia Pacific Ex-Japan Screened(ex Controversies and CW) Index Equity Fund	96.72%
Scottish Widows Investment Solutions Funds ICVC (iii)		State Street AUT Emerging Market Screened (ex Controversies and CW) Index Equity Fund	100.00%
European (Ex UK) Equity Fund	95.17%	The TM Levitas Funds (xxiii)	
Asia Pacific (Ex Japan) Equity Fund	98.61%	TM Levitas A Fund	59.91%
Japan Equities Fund	93.70%	TM Levitas B Fund	50.51%
US Equities Fund	89.30%	UBS Global Optimal Fund (xxiv)	36.50%
Fundamental Index UK Equity Fund	89.38%	Universe, The CMI Global Network (vi)	
Fundamental Index Global Equity Fund	94.51%		
Fundamental Index Emerging Markets Equity Fund	90.94%		
Fundamental Low Volatility Index Global Equity Fund	97.45%	CMIG GA 70 Flexible	100.00%
Fundamental Low Volatility Index Emerging Markets Equity Fund	93.16%	CMIG GA 80 Flexible	100.00%
Fundamental Low Volatility Index UK Equity Fund	86.07%	CMIG GA 90 Flexible	100.00%
Scottish Widows High Income Bond Fund	49.91%	European Enhanced Equity	100.00%
Scottish Widows International Bond Fund	69.50%	CMIG Access 80%	100.00%
Scottish Widows Corporate Bond Fund	69.72%	Continental Euro Equity	97.30%
Scottish Widows Gilt Fund	97.48%	UK Equity	83.60%
Scottish Widows Strategic Income Fund	64.11%	US Enhanced Equity	86.07%
Scottish Widows Managed Investment Funds ICVC (iii)		Japan Enhanced Equity	92.70%
International Equity Tracker Fund	63.96%	Pacific Enhanced Basin	77.23%
Balanced Growth Portfolio	23.68%	Euro Bond	61.64%
Strategic Growth Portfolio	44.26%	US Bond	94.64%
Cash Fund	99.50%	US Currency Reserve	64.49%
Scottish Widows Overseas Growth Investment Funds ICVC (iii)		Euro Currency Reserve	98.86%
Global Growth Fund	57.89%	US Tracker	36.60%
European Growth Fund	86.60%	CMIG Focus Euro Bond	99.91%
Global Select Growth Fund	44.80%	Euro Cautious	88.44%

**NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2021 (continued)****15. Investment in subsidiaries (continued)****Principal Place of Business:**

- (i) 35a, Avenue John F. Kennedy, L-1855, Luxembourg
- (ii) 1 Bread Street, Bow Bells House, London, EC4M 9HH
- (iii) 69 Morrison Street, Edinburgh, EH3 8BW
- (iv) 3rd Floor South, 55 Baker Street, London, W1U 8EW
- (v) 57 St James's Street, London, SW1A 1LD
- (vi) 106, Route D'arlon, L-8210 Mamer, Luxembourg
- (vii) 12 Throgmorton Avenue, London, EC2N 2DL
- (viii) 79 Sir John Rogerson's Quay, Dublin 2, Ireland
- (ix) 160 Queen Victoria Street, London, EC4V 4LA
- (x) Beech Gate, Millfield Lane, Lower Kingswood, Tadworth, Surrey, KT20 6RP
- (xi) Trinity Road, Halifax, West Yorkshire, HX1 2RG
- (xii) 2, Boulevard Konrad Adenauer, L-1115, Luxembourg
- (xiii) 25 Gresham Street, London, EC2V 7HN
- (xiv) 50 Stratton Street, London, W1J 8LL
- (xv) Arthur Cox, Earlsfort Centre, Earlsfort Terrace, Dublin 2, Ireland
- (xvi) 70 Sir John Rogerson's Quay, Dublin 2, Ireland
- (xvii) Nordea 1, SICAV, 562, Rue de Neudorf, L-2220, Luxembourg
- (xviii) Jackson House, 18 Saville Row, London, W1S 3PW
- (xix) 2 - 4, Rue Eugène Ruppert L-2453, Luxembourg
- (xx) Georges Court, 54-62 Townsend Street, Dublin 2, D02 R156
- (xxi) 5, Rue Höhenhof, L-1736, Senningerberg, Luxembourg
- (xxii) 20 Churchill Place, Canary Wharf, London, E14 5HJ
- (xxiii) Exchange Building, St. John's Street, Chichester, West Sussex, PO19 1UP
- (xxiv) 21 Lombard Street, London, EC3V 9AH

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2021 (continued)

## 16. Investment properties

	2021		2020	
	£m	£m	£m	£m
	<i>Group</i>	<i>Company</i>	<i>Group</i>	<i>Company</i>
<b>At 1 January</b>	3,324	120	3,523	132
Additions – new properties	1	1	52	—
Additions – subsequent expenditure on existing properties	31	—	17	—
Disposals	(340)	(17)	(80)	—
Net gain/(loss) from change in fair values	572	14	(188)	(12)
<b>At 31 December</b>	<b>3,588</b>	<b>118</b>	<b>3,324</b>	<b>120</b>

Rental income arising from investment properties during the year, included in investment income, amounted to: Group £186 million (2020: £191 million) and Company £8 million (2020: £9 million). The total future minimum rental payments receivable under non-cancellable leases, including subleases, are as follows:

	2021		2020	
	£m	£m	£m	£m
	<i>Group</i>	<i>Company</i>	<i>Group</i>	<i>Company</i>
Within one year	150	8	167	8
Between one and two years	139	8	151	8
Between two and three years	129	8	137	8
Between three and four years	114	8	127	8
Between four and five years	104	8	112	8
Beyond five years	781	102	946	146
<b>Total</b>	<b>1,417</b>	<b>142</b>	<b>1,640</b>	<b>186</b>

Direct operating expenses (included within operating expenses) arising in respect of such investment properties during the year amounted to: Group £24 million (2020: £34 million) and Company £1 million (2020: £1 million).

Expenditure on investment properties which did not generate rental income was: Group nil (2020: £1 million) and Company nil (2020: nil). The carrying value of land held for development in Group is £45 million (2020: £40 million) and Company is nil (2020: nil). The carrying value of investment property under development in Group is £97 million (2020: £27 million) and Company is nil (2020: nil).

Due to the nature of the above assets, there is no fixed term associated with these investments. The investment properties are independently valued by Savills or Knight Frank, on at least a quarterly basis for the purpose of determining the open market value of the properties. Commercial investment property is measured at fair value by independent property valuers having appropriate recognised professional qualifications and recent experiences in the location and category of the property being valued.

**NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2021 (continued)****17. Assets arising from reinsurance contracts held**

Assets arising from reinsurance contracts held can be analysed between those classified as insurance contracts under IFRS 4, reinsurance assets, and those classified as financial assets at fair value through profit or loss under IFRS 9, contracts with reinsurers at fair value through profit or loss, as follows:

**(a) Reinsurance assets**

	<b>2021</b>		<b>2020</b>	
	<b>Group £m</b>	<b>Company £m</b>	<b>Group £m</b>	<b>Company £m</b>
<b>At 1 January</b>	810	819	720	726
Movement recognised through the statement of comprehensive income	(81)	(83)	90	93
<b>At 31 December</b>	729	736	810	819
Amounts in respect of liabilities arising from insurance and participating investment contracts	729	736	810	819
<b>Total</b>	729	736	810	819

**(b) Contracts with reinsurers at fair value**

	<b>2021</b>		<b>2020</b>	
	<b>Group £m</b>	<b>Company £m</b>	<b>Group £m</b>	<b>Company £m</b>
<b>At 1 January</b>	19,549	19,549	22,837	22,837
Movement recognised through the statement of comprehensive income	2,090	2,090	1,333	1,333
Other movements recognised directly through the balance sheet	(9,268)	(9,268)	(4,621)	(4,621)
<b>At 31 December</b>	12,371	12,371	19,549	19,549
Amounts in respect of liabilities arising from insurance and participating investment contracts	4,566	4,566	5,279	5,279
Amounts in respect of liabilities arising from non-participating investment contracts	7,805	7,805	14,270	14,270
<b>Total</b>	12,371	12,371	19,549	19,549

Reinsurance assets include £681 million for Group and Company (2020: £767 million for Group and Company) that is expected to be settled more than one year after the reporting date. Contracts with reinsurers at fair value include £11,400 million for Group and Company (2020: £17,960 million for Group and Company) that is expected to be settled more than one-year after the reporting date.

The large decrease in other movements recognised directly through the balance sheet, within contracts with reinsurers at fair value, in 2021 is driven by a transfer of assets out of reinsured funds, reducing the reinsurance exposure.

In order to improve presentation in the current and prior year, assets arising from contracts with reinsurers has been separated on the face of the balance sheet into contracts that transfer significant insurance risk under IFRS 4, reinsurance contracts, and contracts that do not transfer significant insurance risk, contracts with reinsurers at fair value through profit or loss. The change in these balances have also been presented separately on the face of the statement of comprehensive income for the current and the prior year.

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2021 (continued)

## 18. Other assets

	2021		2020	
	£m	£m	£m	£m
	<u>Group</u>	<u>Company</u>	<u>Group</u>	<u>Company</u>
Prepayments	31	31	56	30
Other receivables	124	90	69	69
<b>Total</b>	<b>155</b>	<b>121</b>	<b>125</b>	<b>99</b>

## 19. Derivative financial instruments

In the normal course of business, the Group and Company enter into swap contracts, option contracts, index futures contracts and forward foreign exchange contracts. All such contracts are undertaken either for efficient portfolio management purposes or for the purpose of matching contractual liabilities. In addition, the Company has entered into a swap for the specific purpose of hedging movements in the fair value of certain subordinated debt, as described in note 29.

Swap contracts include currency, interest and inflation rate swaps. Currency swaps generally involve the exchange of interest payment obligations denominated in different currencies; the exchange of principal can be notional or actual. An interest or inflation rate swap is an agreement between two parties to exchange fixed and variable rate interest payments, based upon interest or inflation rates defined in the contract, without the exchange of the underlying principal amount.

Option contracts include index and single equity options. Such options represent a contract sold by one party to another party offering the right, but not the obligation, to buy or sell a financial asset at an agreed price on a specified future date or within a specified period of time.

Index futures contracts are used to hedge the investment portfolio against adverse movements in underlying markets or effecting policy switches between markets without the need to trade the underlying securities. Futures may also be used for the purposes of efficient portfolio management provided that their substance would otherwise be permitted as a series of direct transactions. Forward foreign exchange contracts are an agreement to buy or sell a specified amount of foreign currency on a specified future date at an agreed rate.

Details regarding derivative financial instruments are given in the following tables:

<u>Group</u>	2021			2020		
	Contract Amount £m	Fair value assets £m	Fair value liabilities £m	Contract Amount £m	Fair value assets £m	Fair value liabilities £m
Derivative financial instruments held for trading:						
Swap contracts	32,760	2,071	(2,186)	38,331	4,119	(4,208)
Option contracts	2,174	372	(213)	2,273	553	(311)
Index futures contracts	8,760	44	(62)	6,882	55	(46)
Forward foreign exchange contracts	20,522	76	(47)	9,361	79	(44)
Derivative financial instruments designated as fair value hedges	1,500	280	—	1,500	418	—
<b>Total</b>	<b>65,716</b>	<b>2,843</b>	<b>(2,508)</b>	<b>58,347</b>	<b>5,224</b>	<b>(4,609)</b>

<u>Company</u>	2021			2020		
	Contract Amount £m	Fair value assets £m	Fair value liabilities £m	Contract Amount £m	Fair value assets £m	Fair value liabilities £m
Derivative financial instruments held for trading:						
Swap contracts	30,669	1,993	(2,142)	36,794	4,073	(4,208)
Option contracts	2,174	372	(213)	2,192	552	(310)
Index futures contracts	4,972	17	(54)	4,468	38	(40)
Forward foreign exchange contracts	16,747	58	(20)	6,878	51	(32)
Derivative financial instruments designated as fair value hedges	1,500	280	—	1,500	418	—
<b>Total</b>	<b>56,062</b>	<b>2,720</b>	<b>(2,429)</b>	<b>51,832</b>	<b>5,132</b>	<b>(4,590)</b>

**NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2021 (continued)****19. Derivative financial instruments (continued)**

Derivative financial instrument fair value assets include £2,656 million for Group and £2,578 million for Company (2020: £5,027 million for Group and £4,979 million for Company) that is expected to be recovered more than one year after the reporting date.

Derivative financial instrument fair value liabilities include £2,373 million for Group and £2,329 million for Company (2020: £4,480 million for Group and £4,480 million for Company) that is expected to be settled more than one year after the reporting date.

The fair value hedges included in the above tables represent interest rate swaps in respect of the interest payments relating to subordinated debt issued by the Group. These instruments form part of hedge relationships with the subordinated debt issued.

Details of collateral accepted and pledged in respect of derivative financial instruments are given in note 36.

The following tables provide information about the designated fair value hedge, which hedges against interest rate risk, for the Group and Company. The hedged item is presented in the statement of financial position in subordinated debt. The hedging instrument is presented in the statement of financial position in derivative financial instruments.

<i>Group</i>	2021		2020	
	Hedged item	Hedging instrument	Hedged item	Hedging instrument
	£m	£m	£m	£m
Notional amount of hedging instrument	—	1,500	—	1,500
Carrying amount:				
Assets	—	280	—	418
Liabilities	—	—	—	—
Change in fair value used for calculating hedge ineffectiveness	138	(137)	(102)	101
Accumulated amount of fair value hedge adjustments on the hedged item included in the carrying amount of the hedged item:				
Assets	—	—	—	—
Liabilities	(246)	—	(384)	—

<i>Company</i>	2021		2020	
	Hedged item	Hedging instrument	Hedged item	Hedging instrument
	£m	£m	£m	£m
Notional amount of hedging instrument	—	1,500	—	1,500
Carrying amount:				
Assets	—	280	—	418
Liabilities	—	—	—	—
Change in fair value used for calculating hedge ineffectiveness	138	(137)	(102)	101
Accumulated amount of fair value hedge adjustments on the hedged item included in the carrying amount of the hedged item:				
Assets	—	—	—	—
Liabilities	(246)	—	(384)	—

**NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2021 (continued)****20. Loans and receivables at amortised cost**

	2021		2020	
	£m	£m	£m	£m
	<i>Group</i>	<i>Company</i>	<i>Group</i>	<i>Company</i>
Accrued income, dividend and rent	253	10	225	4
Loans to related parties	368	352	353	353
Other amounts due from related parties	35	9	22	11
Amounts receivable from direct insurance business	113	108	108	105
Other	194	104	310	142
<b>Total</b>	<b>963</b>	<b>583</b>	<b>1,018</b>	<b>615</b>

Of the above total, £347 million for Group and Company (2020: £348 million for Group and Company) is expected to be recovered more than one year after the reporting date. The carrying amount of loans to related parties is a reasonable approximation of fair value.

Within loans and receivables at amortised cost, the largest credit concentration is with SWG of £347 million (2020: SWG of £348 million). Further information in respect of credit risk, including credit concentration risk and collateral held against loans to related parties, is given in note 36.

**21. Investments at fair value through profit or loss**

	2021		2020	
	£m	£m	£m	£m
	<i>Group</i>	<i>Company</i>	<i>Group</i>	<i>Company</i>
Shares and other variable yield securities	116,596	130,842	94,957	107,884
Debt and other fixed/variable income securities	38,992	15,176	37,256	16,677
Loans and advances to customers	9,395	8,910	9,646	9,095
Loans and advances to banks	4,084	1,274	4,693	1,468
Deposits with cedants	—	1,447	—	1,509
<b>Total investments at fair value</b>	<b>169,067</b>	<b>157,649</b>	<b>146,552</b>	<b>136,633</b>

Debt securities of £31,455 million for Group and £14,402 million for Company (2020: £30,268 million for Group and £16,035 million for Company) is expected to be recovered more than one year after the reporting date. Loans and Advances to Customers of £8,713 million for Group and £8,227 million for Company (2020: £9,435 million for Group and £8,884 million for Company) is expected to be recovered more than one year after the reporting date. Loans and Advances to Banks are short-term in nature. Due to the nature of shares and other variable yield securities there is no fixed term associated with these securities. Included within the Company's shares and other variable yield securities are shares in subsidiary undertakings of £56,015 million (2020: £53,635 million), which are held at fair value through profit or loss.

During 2021, the Group acquired illiquid credit assets from, or issued by, parties within Lloyds Banking Group totalling £168 million (2020: £15 million). The Group also originated loans during the year totalling £288 million (2020: £357 million) and committed to lend a further £269 million (2020: £220 million). These credit assets are secured on Social Housing, Infrastructure, Lifetime Mortgages and Commercial Real Estate portfolios. Further details on the credit risk and fair value measurement of these assets can be found in note 36.

All assets acquired from Lloyds Banking Group were acquired at their fair value and further details on the credit risk and fair value measurement of these assets can be found in note 36.

Deposits with cedants represents funds withheld for reinsurance premiums due to the Company under the reinsurance agreement with SWE.

Of the total Loans and advances to customers above, £5,882 million for Group (2020: £5,944 million) and £5,396 million for Company (2020: £5,393 million) is secured on real estate. Of the Loans and advances to customers above, £6,238 million (2020: £6,725 million) for Group and £5,752 million (2020: £6,174 million) for Company was acquired from a related party. All transactions were completed at arm's length.

Within shares and other variable yield securities are cash funds of £464 million for Group and £390 million for Company (2020: £785 million for Group and £769 million for Company) representing collateral received and reinvested in relation to derivatives contracts and stocklending programmes, further details are given in note 36.

**NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2021 (continued)****21. Investments at fair value through profit or loss (continued)****Interests in unconsolidated structured entities**

Included within investments at fair value through profit or loss are investments in unconsolidated structured entities for Group of £74,916 million (2020: £54,819 million) arising from investments in collective investment vehicles and limited partnerships. Refer to note 15 for the list of these collective investment vehicles and limited partnerships.

The collective investment vehicles and limited partnerships are primarily financed by investments from investors in the vehicles. The investments are carried at fair value and the Group's maximum exposure to loss is equal to the carrying value of the investment.

However, investments in collective investment vehicles and limited partnerships are primarily held to match policyholder liabilities and the majority of the risk from a change in the value of the Group's investment is matched by a change in policyholder liabilities. At 31 December 2021, the total net assets of unconsolidated collective investment vehicles and limited partnerships in which the Group held a beneficial interest were £2,597 billion (2020: £2,470 billion). During the year the Group has not provided any non-contractual financial or other support to these unconsolidated collective investment vehicles and limited partnerships (2020: none).

The Group sponsors a range of collective investment vehicles and limited partnerships where it acts as the decision maker over the investment activities and markets the funds under one of Lloyds Banking Group's brands. The Group earns fees from managing the investments of these funds. The investment management fees that the Group earned from these sponsored unconsolidated collective investment vehicles and limited partnerships, including those in which the Group held no interest at 31 December 2021 was £35 million (2020: £49 million).

**Interests in consolidated structured entities**

The Group consolidates a number of structured entities, in accordance with the consolidation policy set out in note 1(b).

In 2015 the Company fully assumed a guarantee granted by SW Funding plc. The guarantee concerns a contractual arrangement with State Street Trustees Limited (SSTL), which acts as the Depositary of a consolidated structured entity, the Scottish Widows Property Authorised Contractual Scheme (SWACS). Under the terms of the contractual arrangement, the Company has indemnified SSTL against all losses suffered or incurred by SSTL arising out of or in relation to the scheme property of the SWACS, which consists of real property and for which SSTL is the legal owner. During the year, no losses have arisen and the Company has made no payment under this contractual arrangement (2020: none).

During the year, the Group has not provided any non-contractual financial support to consolidated structured entities and has no current intention of providing such support (2020: none).

**22. Cash and cash equivalents**

Cash and cash equivalents for the purposes of the statement of cash flows include the following:

	2021		2020	
	£m	£m	£m	£m
	<u>Group</u>	<u>Company</u>	<u>Group</u>	<u>Company</u>
Cash at bank	228	96	217	95
Short-term deposits	—	—	1	—
Cash at bank	228	96	218	95
Less: bank overdrafts note 32	(1)	(1)	(2)	(2)
<b>Total</b>	<b>227</b>	<b>95</b>	<b>216</b>	<b>93</b>

**23. Share capital**

	2021		2020	
	£m	£m	£m	£m
	<u>Group</u>	<u>Company</u>	<u>Group</u>	<u>Company</u>
<b>Authorised, issued and fully paid share capital:</b>				
70,000,000 (2020: 70,000,000) ordinary shares of £1 each	70	70	70	70
<b>Total</b>	<b>70</b>	<b>70</b>	<b>70</b>	<b>70</b>

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2021 (continued)

## 24. Insurance contracts and participating investment contract liabilities

An analysis of the change in liabilities arising from insurance contracts and participating investment contracts and reinsurers' share of insurance and participating investment contract liabilities is as follows:

<i>Group</i>	2021			Restated* 2020		
	£m	£m	£m	£m	£m	£m
	<i>Gross</i>	<i>Reinsurance</i>	<i>Net</i>	<i>Gross</i>	<i>Reinsurance</i>	<i>Net</i>
<b>At 1 January</b>	115,822	(6,089)	109,733	110,815 *	(8,809)	102,006 *
New business	3,467	(110)	3,357	3,803 *	(99)	3,704 *
Changes in existing business	5,489	766	6,255	(859)*	2,856	1,997 *
Assumption changes	(1,430)	138	(1,292)	2,063 *	(37)	2,026 *
<b>At 31 December</b>	123,348	(5,295)	118,053	115,822 *	(6,089)	109,733 *

<i>Company</i>	2021			Restated* 2020		
	£m	£m	£m	£m	£m	£m
	<i>Gross</i>	<i>Reinsurance</i>	<i>Net</i>	<i>Gross</i>	<i>Reinsurance</i>	<i>Net</i>
<b>At 1 January</b>	115,344	(6,098)	109,246	110,495 *	(8,815)	101,679 *
New business	3,467	(110)	3,357	3,807 *	(99)	3,708 *
Changes in existing business	5,476	767	6,243	(981)*	2,855	1,875 *
Assumption changes	(1,445)	139	(1,306)	2,023 *	(39)	1,983 *
<b>At 31 December</b>	122,842	(5,302)	117,540	115,344 *	(6,098)	109,245 *

\* Amount restated. See note 41 for details of the restatement.

An analysis of the expected maturities of liabilities arising from insurance contracts and participating investment contracts is given in note 36. The portfolio is subject to a number of risks as set out in note 36.

Changes in existing business represents the effects of in year experience e.g. mortality and surrender experience plus market movements on unit linked funds. Assumption changes represent changes to assumptions of future experience such as expense, mortality, investment returns and inflation.

In the prior year, the Company entered into a longevity pass-through transaction, which passes longevity risk from a subset of Lloyds Banking Group defined benefit pension schemes through the Company and onto an external reinsurer. The Company has an agency role and accounts for the transaction under IFRS 15, with the agency fee income recognised in note 4. However, the legal structure of the transaction is an insurance contract with Lloyds Banking Group pension schemes and a reinsurance contract with an external reinsurer. During 2021, the Group and Company has passed through £373 million of associated premiums and £371 million of associated claims.

## 25. Unallocated surplus

An analysis of the change in unallocated surplus is as follows:

	2021		2020	
	£m	£m	£m	£m
	<i>Group</i>	<i>Company</i>	<i>Group</i>	<i>Company</i>
<b>At 1 January</b>	339	339	412	412
Change recognised through the statement of comprehensive income	(31)	(31)	(73)	(73)
<b>At 31 December</b>	308	308	339	339

Of the above total, £268 million for Group and Company (2020: £297 million for Group and Company) is expected to be settled more than one year after the reporting date.

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2021 (continued)

## 26. Future profits on non-participating business in the With Profits Funds

An analysis of the change in future profits on non-participating business in the Scottish Widows With Profits Fund is as follows:

	2021		2020	
	£m	£m	£m	£m
	<i>Group</i>	<i>Company</i>	<i>Group</i>	<i>Company</i>
<b>At 1 January</b>	53	53	49	49
Change recognised through the statement of comprehensive income	(6)	(6)	4	4
<b>At 31 December</b>	47	47	53	53

£47 million for Group and Company (2020: £53 million for Group and Company) is expected to be recovered more than one year after the reporting date.

## 27. Provisions for other liabilities and charges

<i>Group</i>	2021			2020		
	German insurance business litigation	Other	Total	German insurance business litigation	Other	Total
	£m	£m	£m	£m	£m	£m
<b>At 1 January</b>	91	29	120	101	40	141
Increase in the year	22	21	43	18	25	43
Amount utilised in the period	(29)	(28)	(57)	(28)	(36)	(64)
<b>At 31 December</b>	84	22	106	91	29	120

<i>Company</i>	2021			2020		
	German insurance business litigation	Other	Total	German insurance business litigation	Other	Total
	£m	£m	£m	£m	£m	£m
<b>At 1 January</b>	21	29	50	40	40	80
(Release)/increase in the year	13	21	34	(11)	25	14
Amount utilised in the period	(10)	(27)	(37)	(8)	(36)	(44)
<b>At 31 December</b>	24	23	47	21	29	50

Of the above total, provisions for other liabilities and charges include £64 million for Group and £19 million for Company (2020: £64 million for Group and £15 million for Company) expected to be settled more than one year after the reporting date.

**Customer claims in relation to insurance business in Germany and Austria**

The Group continues to receive claims in Germany and Austria from customers relating to policies issued by the Company, under its former name of Clerical Medical Investment Group Limited. The total provision made to 31 December 2021 is £696 million (2020: £674 million). Utilisation has increased to £29 million in the year ended 31 December 2021 (2020: £28 million); the remaining unutilised provision as at 31 December 2021 is £84 million (2020: £91 million).

The validity of the claims facing the Group depends upon the facts and circumstances in respect of each claim. As a result the ultimate financial effect, which could be significantly different from the current provision, will only be known once all relevant claims have been resolved. Claims received to date represent 13 per cent of the relevant total policy population. Key metrics and sensitivities are highlighted in the table below:

Sensitivities	Actuals to date	Anticipated Future	Sensitivity
Number of claims	18,800	3,100	1,000 = £9m
Average uphold rate per claim	61 %	39 %	10% = £7m
Average redress per upheld claim	£41,000	£18,000	£1,000 = £1m
Administrative expenses	£183m	£23m	1 case = £2,500

**NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2021 (continued)****27. Provisions for other liabilities and charges (continued)**

The actuals to date include claims that have been received and provided for but not yet resolved. For future claims the anticipated average uphold rate, redress per upheld claim and administrative and legal expenses are consistent with the actual experience seen over the 12-24 months prior to the reporting date. This recent experience is more favourable compared with previous years due to time barring of more onerous types of claim and because most claims are now settled without recourse to litigation. The experience in Austria might worsen in future due to a change in legislation in 2022 which will remove the time barring of claims.

The Company has provided a 90 percent indemnity to SWE in respect of costs arising on these matters in relation to business transferred to SWE in March 2019.

**Other provisions**

Other provisions include amounts for customer remediation costs, restructuring and third-party contractual compensation.

**Contingent liabilities***Tax authorities*

Lloyds Banking Group has an open matter in relation to a claim for group relief of losses incurred in its former Irish banking subsidiary, which ceased trading on 31 December 2010. In 2013 HMRC informed Lloyds Banking Group that its interpretation of the UK rules means that the group relief is not available. In 2020, HMRC concluded their enquiry into the matter and issued a closure notice. Lloyds Banking Group's interpretation of the UK rules has not changed and hence it has appealed to the First Tier Tax Tribunal, with a hearing expected in 2022. If the final determination of the matter by the judicial process is that HMRC's position is correct, management estimate that this would result in an increase in current tax liabilities for the Group of approximately £21.3 million (including interest). Lloyds Banking Group, having taken appropriate advice, does not consider that this is a case where additional tax will ultimately fall due.

*Outsourcing of long-standing customer administration platform*

The outsourcing contract signed with Diligenta on 19 September 2017 provides for certain future payments which are contingent on contractual milestones being achieved. At 31 December 2021, no conditions exist for such payments to be made, and as such these payments continue to be regarded as contingent in nature in continuation of the approach from 2017. A proportion of these costs (£7 million) have been recognised already in insurance contract liabilities. The remainder relating the share of these future payments by investment business, will be expensed as incurred in future periods.

*Final Salary Pension Schemes*

Historically the Group has provided services to Final Salary Pension schemes and trustees including investment, actuarial, documentation and member administration. A number of claims have been brought against the Company after the expiry of the statutory limitation periods. Given the significant delays that have been experienced in the notification in these claims following the statutory limitation period, the potential number of incidents, the number of schemes they cover, and uncertainties associated with establishing liability, the ultimate cost cannot be determined with certainty. However, on the basis of the current information the Directors consider that any additional costs arising are not likely to have a material impact on the financial position of the Company and the Group.

*Other legal actions and regulatory matters*

During the ordinary course of business the Group is subject to complaints and threatened or actual legal proceedings (including class or Group action claims) brought by or on behalf of current or former employees, customers, investors or other third parties, as well as legal and regulatory reviews, challenges, investigations and enforcement actions, both in the United Kingdom and overseas. All such material matters are periodically reassessed, with the assistance of external professional advisors where appropriate, to determine the likelihood of the Group incurring a liability. In those instances where it is concluded that it is more likely than not that a payment will be made, a provision is established to management's best estimate of the amount required at the relevant balance sheet date. In some cases it will not be possible to form a view, for example because the facts are unclear or because further time is needed to properly assess the situation, and no provisions are held in relation to such matters. However, the Group does not currently expect the final outcome of any such case to have a material adverse effect on its financial position, operations or cash flows.

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2021 (continued)

## 28. Accruals and deferred income

	2021		2020	
	£m	£m	£m	£m
	<u>Group</u>	<u>Company</u>	<u>Group</u>	<u>Company</u>
Accrued expenses	14	11	11	7
Deferred income	13	10	17	12
Other	2	1	3	2
<b>Total</b>	<b>29</b>	<b>22</b>	<b>31</b>	<b>21</b>

Of the above total, £12 million for Group and £9 million for Company (2020: £13 million for Group and £10 million for Company) is expected to be settled more than one year after the reporting date.

## 29. Subordinated debt

The carrying value shown in the balance sheet is as follows:

	2021		2020	
	£m	£m	£m	£m
	<u>Group</u>	<u>Company</u>	<u>Group</u>	<u>Company</u>
Subordinated debt	1,467	1,500	1,469	1,500
Issue costs	(10)	(10)	(11)	(11)
	1,457	1,490	1,458	1,489
Accrued interest on subordinated debt	50	50	50	50
Fair value hedge adjustment	246	246	384	384
<b>Total</b>	<b>1,753</b>	<b>1,786</b>	<b>1,892</b>	<b>1,923</b>

Movements in the carrying value are as follows:

	£m	£m
	<u>Group</u>	<u>Company</u>
At 1 January 2021	1,892	1,923
Changes in fair value	(138)	(138)
Other non-cash movements	90	93
Interest settlement	(91)	(92)
<b>At 31 December 2021</b>	<b>1,753</b>	<b>1,786</b>

£1,500 million of fixed rate subordinated notes were issued by the Company in April 2013, at a discount of £13 million. Redemption is due in 2023 for £850 million of the notes, and in 2043 for the remaining £650 million. Interest is payable on an annual basis at a rate of 5.5 per cent on the former and 7 per cent on the latter. Repayment of the notes is subordinate to the claims of the Company's senior creditors, including all policyholders. The interest rate risk of the notes is managed using a derivative which is accounted for using hedge accounting, as set out in note 1(o).

The fair values of the subordinated debt of the Group and Company are as follows:

<u>Group</u>	2021		2020	
	£m	£m	£m	£m
	<u>Carrying value</u>	<u>Fair value</u>	<u>Carrying value</u>	<u>Fair value</u>
Dated subordinated debt	1,753	1,904	1,892	1,945
<b>Total</b>	<b>1,753</b>	<b>1,904</b>	<b>1,892</b>	<b>1,945</b>

<u>Company</u>	2021		2020	
	£m	£m	£m	£m
	<u>Carrying value</u>	<u>Fair value</u>	<u>Carrying value</u>	<u>Fair value</u>
Dated subordinated debt	1,786	1,937	1,923	1,976
<b>Total</b>	<b>1,786</b>	<b>1,937</b>	<b>1,923</b>	<b>1,976</b>

The fair value of dated subordinated debt has been assessed by management with reference to published prices. The prior year comparative of the fair value has been updated to more better reflect the nature of the balance.

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2021 (continued)

## 30. Non-participating investment contract liabilities

An analysis of the change in net liabilities arising from non-participating investment contracts is as follows:

Group

	Gross	2021 Contracts with reinsurers	Net	Gross	2020 Contracts with reinsurers	Net
	£m	£m	£m	£m	£m	£m
<b>At 1 January</b>	38,448	(14,270)	24,178	37,456	(14,748)	22,708
New business	4,187	—	4,187	2,114	—	2,114
Changes in existing business	2,400	6,465	8,865	(1,122)	478	(644)
<b>At 31 December</b>	45,035	(7,805)	37,230	38,448	(14,270)	24,178

Company

	Gross	2021 Contracts with reinsurers	Net	Gross	2020 Contracts with reinsurers	Net
	£m	£m	£m	£m	£m	£m
<b>At 1 January</b>	38,433	(14,270)	24,163	37,455	(14,748)	22,707
New business	4,187	—	4,187	2,113	—	2,113
Changes in existing business	2,396	6,465	8,861	(1,135)	478	(657)
<b>At 31 December</b>	45,016	(7,805)	37,211	38,433	(14,270)	24,163

An analysis of the contractual and expected maturities of liabilities arising from non-participating investment contracts is given in note 36.

## 31. Other financial liabilities

	2021		2020	
	£m	£m	£m	£m
	<u>Group</u>	<u>Company</u>	<u>Group</u>	<u>Company</u>
Amounts payable in respect of direct insurance business	692	670	567	545
Amounts payable on reinsurance contracts	11	11	14	14
Due to related parties	125	148	103	207
Due to brokers	93	81	255	153
Collateral liability	463	390	868	821
Other	333	205	407	232
<b>Total</b>	1,717	1,505	2,214	1,972

Of the above total, £nil for Group and £nil for Company (2020: £nil for Group and £nil for Company) is expected to be settled more than one year after the reporting date.

The Group and Company has recognised assets and liabilities in relation to cash collateral received and reinvested in relation to derivatives contracts and stock lending programme. The liability is recognised as Collateral Liability within Other financial liabilities and the reinvestment assets as Reverse Repurchase Assets, within Loans and Receivables at Amortised Cost and liquidity funds within Investments at fair value through profit or loss.

## 32. Borrowings

	2021		2020	
	£m	£m	£m	£m
	<u>Group</u>	<u>Company</u>	<u>Group</u>	<u>Company</u>
Bank overdrafts	1	1	2	2
<b>Total</b>	1	1	2	2

The fair value of the balances set out above is not materially different to the carrying value due to the short-term nature of these balances.

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2021 (continued)

## 33. Net (increase)/decrease in operating assets and liabilities

	2021		Restated* 2020	
	£m	£m	£m	£m
	<u>Group</u>	<u>Company</u>	<u>Group</u>	<u>Company</u>
<b>Net (increase)/decrease in operating assets</b>				
Deferred costs	198	195	—	(3)
Investment properties	(264)	2	199	12
Reinsurance assets	81	83	(90)	(93)
Other Assets	(30)	(22)	(5)	(4)
Financial assets:				
Contracts with reinsurers at fair value through profit or loss	7,178	7,178	3,288	3,288
Derivative financial instruments	2,381	2,412	(1,256)	(1,238)
Loans and receivables at amortised cost	55	32	(21)	4
Investments at fair value through profit or loss	(22,515)	(21,016)	(9,395)	(8,771)
<b>Net increase in operating assets</b>	<b>(12,916)</b>	<b>(11,136)</b>	<b>(7,280)</b>	<b>(6,805)</b>
<b>Net increase/(decrease) in operating liabilities</b>				
Insurance contracts and participating investment contract liabilities	7,526	7,498	5,007 *	4,849 *
Future profits on non-participating business in the With Profits Funds	6	6	(4)	(4)
Unallocated surplus	(31)	(31)	(73)	(73)
Provisions for other liabilities and charges	(14)	(3)	(21)	(30)
Accruals and deferred income	(2)	1	(4)	(3)
Financial liabilities:				
Subordinated debt	(139)	(137)	97	103
Non-participating investment contract liabilities	6,587	6,583	992	978
Derivative financial instruments	(2,101)	(2,161)	1,164	1,156
Other financial liabilities	(497)	(467)	325	550
External interest in collective investment vehicles	1,729	—	654	—
Lease liabilities	(3)	—	(15)	—
<b>Net increase in operating liabilities</b>	<b>13,061</b>	<b>11,289</b>	<b>8,122</b>	<b>7,526</b>
<b>Net decrease in operating assets and liabilities</b>	<b>145</b>	<b>153</b>	<b>842</b>	<b>721</b>

\* Amount restated. See note 41 for details of the restatement.

## 34. Dividends paid

	2021	2020
	£m	£m
Total dividends paid on equity shares	200	560

The Company paid dividends of £200 million in September 2021 (2020: £560 million in February 2020). The dividend paid in the year amounted to £2.86 per share (2020: £8.00 per share).

**NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2021 (continued)****35. Liabilities arising from insurance contracts and investment contracts – assumptions, change in assumptions and sensitivities**

Policyholder liabilities can be analysed into With Profits Fund liabilities and non-participating fund liabilities. In accordance with IFRS 4, which allows grandfathering of the pre-Solvency II traditional regulatory assessment, the liabilities of the With Profits Funds are accounted for using the realistic capital regime of the PRA (realistic liabilities). All non-participating liabilities are accounted for using a traditional prospective actuarial discounted cash flow methodology. In calculating the value of policyholder liabilities for the current year, the increased level of uncertainty from impacts of COVID-19 has been considered, in particular in relation to persistency and mortality assumptions.

**(1) Processes used to determine key assumptions in respect of insurance and investment contracts****(a) Liabilities of the With Profits Funds calculated on a realistic basis**

The Group and Company has With Profits Funds containing both insurance and participating investment contracts. The main components of the realistic liabilities are: with profits benefit reserves (i.e. the total asset shares for with profits policies); the costs of options and guarantees; and deductions levied against asset shares and the impact of smoothing policy.

The realistic assessment is carried out using a stochastic simulation model which values liabilities on a market consistent basis. The calculation of realistic liabilities uses best estimate assumptions of e.g. mortality, persistency and expenses.

The processes for determining the key assumptions are set out below, and unless otherwise stated, remain unchanged from the prior year:

*Investment returns and discount rates*

A stochastic economic scenario generator, which uses recognised asset models, provides future asset value and yield scenarios; these determine investment returns for each scenario. The economic scenario generator is calibrated to observable yield curves and option prices where possible. Nominal interest rates are modelled using a standard interest rate model, calibrated to risk-free yields. The risk-free yield is defined as the spot yield derived from the UK swap yield curve less a deduction for credit risk. The liabilities are valued by discounting projected future cash flows using the risk free yield.

*Investment volatility*

The volatility of future equity returns in excess of nominal interest rates has been calibrated to at-the-money forward options of up to 10 years term on appropriate indices. The indices used are the FTSE-100, the EuroStoxx-50, and the S&P 500. For property, no observable prices exist and so volatility has been derived from analysis of historic data.

*Mortality and morbidity*

The mortality and morbidity assumptions, including allowances for improvements in longevity for annuitants, are based on recent actual experience, industry tables and projection models, internal research and reinsurance terms.

*Persistency*

Persistency is a function of both the rate of policy termination and the rate at which policyholders stop paying regular premiums. The assumed levels of these rates are based on a combination of historical experience and management's views on future experience taking into consideration potential changes that may result from guarantees and options becoming more valuable under adverse market conditions.

*Maintenance expenses*

Allowance is made for the charges applied to the With Profits Funds and these are, for conventional with profits business, governed by the relevant Schemes of Transfer.

*Guaranteed annuity option take-up rates*

The guaranteed annuity option take-up rates are set with regard to the Company's recent actual experience, increased to reflect future uncertainties where the exercise of options by policyholders might increase liabilities.

**NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2021 (continued)****35. Liabilities arising from insurance contracts and investment contracts – assumptions, change in assumptions and sensitivities (continued)****(1) Processes used to determine key assumptions in respect of insurance and investment contracts (continued)****(b) Liabilities of the non-participating funds****(i) Insurance contracts and participating investment contracts**

The liabilities of the Group and Company are determined on the basis of recognised actuarial methods. The methods used involve estimating future policy cash flows over the duration of the in-force book of policies, and discounting these cash flows back to the valuation date allowing for probabilities of occurrence.

The liabilities will vary with movements in interest rates (this applies in particular to the cost of guaranteed benefits payable in the future) and with movements in the cost of life assurance and annuity benefits for which future mortality is uncertain.

Assumptions are made in respect of all material factors affecting future cash flows, including future interest rates, mortality, costs and credit default. Generally, assumptions used to value the liabilities contain a margin for adverse deviation. This margin for adverse deviation is based on management's judgement and reflects management's views on the inherent level of uncertainty. The assumptions to which the liabilities are most sensitive are the interest rates used to discount the cash flows and the mortality assumptions, particularly those for annuitants.

The key assumptions used in the measurement of the non-participating fund liabilities are:

*Interest rates*

Discount rates used to value the liabilities for annuity business are set with reference to the risk-adjusted yields on the underlying assets and for non-annuity business with reference to cash yields.

*Mortality and morbidity*

The mortality and morbidity assumptions, including allowances for improvements in longevity for annuitants, are set with regard to the Group's actual experience where this provides a reliable basis, and relevant industry data otherwise, and includes a margin for adverse deviation.

Despite an unprecedented spike in annuitant mortality rates over 2020 and 2021, it is expected that current annuitant mortality rates will revert to broadly the previous level. The longer-term impacts of COVID-19 on future annuitant mortality improvements remain unclear, however it is becoming clear that they are likely to be a net negative so smaller increases in life expectancy in the near future are now expected. Improvements in annuitant mortality are assumed to follow the CMI\_2020 mortality projection model from the Actuarial profession's Continuous Mortality Investigation, with a long-term rate of improvement of 2.8 per cent per annum for female and 3.0 per cent for males. The initial rates of improvement assumed are higher than from using the core approach but lower than in previous years to reflect our views on COVID-19. A higher than core smoothing parameter is also used.

Non-annuitant mortality and morbidity rates are expected to be broadly unchanged in the longer term. The longer term impacts of COVID-19 on future non-annuitant mortality and morbidity rates remain unclear, with limited data available to date to support any change to our assumptions.

*Maintenance expenses*

Allowance is explicitly made for future policy costs. Expense loadings are determined by reference to an internal analysis of current and expected future expense levels, plus a margin for adverse deviations. Explicit allowance is made for future expense inflation from the valuation date. There are some allowances made for expected reductions in expense levels, e.g. future operating model changes, that have not occurred at the valuation date.

For business covered by the Diligenta outsourcing contract the impact from this on maintenance costs is allowed for along with a prudent estimate of the associated costs required to deliver the guaranteed financial benefits from the contract. There is no allowance for prudence on contractual costs.

From 1 May 2018, to comply with Ring-Fenced Bank regulations, a mark-up of 4.5 per cent on certain cost recharges from Lloyds banking Group has been included.

**NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2021 (continued)****35. Liabilities arising from insurance contracts and investment contracts – assumptions, change in assumptions and sensitivities (continued)****(1) Processes used to determine key assumptions in respect of insurance and investment contracts (continued)****(b) Liabilities of the non-participating funds (continued)****(i) Insurance contracts and participating investment contracts (continued)***Persistency rates*

Prudent lapse rate assumptions have been used for term assurance business and other business categories. For term assurance business if the projected liability is negative at any point in the projection of a policy a high lapse rate is assumed, otherwise a low lapse rate is assumed. On other business lines the prudent lapse rates are set at a product level by testing whether an increase or a decrease in lapse rates, relative to our central view, leads to higher reserves.

**(ii) Non-participating investment contracts**

These contracts are unit-linked, and the liability is determined as the value of the units allocated to the contracts.

**(2) Key assumptions****(a) With Profits Funds**

Assumptions are set for the realistic valuation of the Company's With Profits Funds. In addition, liabilities in respect of non-participating policies in the Scottish Widows With Profits Fund are also accounted for on the regulatory assessment.

**(i) Investment returns and discount rates**

In the realistic valuation of liabilities in calibrating the economic scenario generator, the risk-free yield curve is defined as the UK swap yield curve less a deduction for credit risk.

The following interest rates are assumed in the regulatory valuation of non-participating policies in the Scottish Widows With Profits Fund:

Class of business	Interest rate (net)	
	2021	2020
	%	%
Annuities in Payment	1.00	0.40
Deferred Annuities	0.60	0.20

**(ii) Investment volatility (realistic liabilities only)**

The calibration of the stochastic simulation model uses implied volatilities of derivatives where possible, or historical observed volatility where it is not possible to observe meaningful prices. For example, as at 31 December 2021, the 10 year equity-implied at-the-money assumption was 19.4 per cent (19.0 per cent as at 31 December 2020). The assumption for property volatility at 31 December 2021 was 12.5 per cent (31 December 2020: 12.5 per cent). The volatility of interest rates has been calibrated to the absolute implied volatility of Swaptions. This is broadly 0.63 per cent as at 31 December 2021 (0.54 per cent at 31 December 2020), based on an average of the at-the-money surface.

**(iii) Mortality assumptions**

The mortality assumptions for the main classes of business are set with regard to recent Group experience and general industry trends, all of which are adjusted for smoker status and age / sex specific factors. The mortality tables used in the valuation are summarised below.

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2021 (continued)

## 35. Liabilities arising from insurance contracts and investment contracts – assumptions, change in assumptions and sensitivities (continued)

## (2) Key assumptions (continued)

## (a) With Profits Funds (continued)

## (iii) Mortality assumptions (continued)

## With Profits Fund

Proposition	Product Type	Heritage	Category	2021 Assumption	2020 Assumption
Annuities					
Purchased Annuities	Purchased (whole life)	Scottish Widows	Males	Bespoke tables CMI2020_M_(7.25) 2%_0.3A_2013	Bespoke tables CMI2019_M_(7.25) 2%_0.5A_2013
			Females	Bespoke tables CMI2020_F_(7.25) 1.8%_0.4A_2013	Bespoke tables CMI2019_F_(7.25) 1.8%_0.5A_2013
Pension Annuities	Self-employed / personal pensions	Scottish Widows and Clerical Medical	Males	Bespoke tables CMI2020_M_(7.25) 2%_0.3A_2013	Bespoke tables CMI2019_M_(7.25) 2%_0.5A_2013
			Females	Bespoke tables CMI2020_F_(7.25) 1.8%_0.4A_2013	Bespoke tables CMI2019_F_(7.25) 1.8%_0.5A_2013
Other Annuities	Deferred Annuities	Scottish Widows and Clerical Medical	Males	Bespoke tables CMI2020_M_(7.25) 2%_0.3A_2013	Bespoke tables CMI2019_M_(7.25) 2%_0.5A_2013
			Females	Bespoke tables CMI2020_F_(7.25) 1.8%_0.4A_2013	Bespoke tables CMI2019_F_(7.25) 1.8%_0.5A_2013
	Other Annuities in payment	Scottish Widows	Males	87% TMCL08 Ultimate CMI2020_M_(7.25) 2%_0.3A_2013	87% TMCL08 Ultimate CMI2019_M_(7.25) 2%_0.5A_2013
			Females	85% TFCL08 Ultimate CMI2020_F_(7.25) 1.8%_0.4A_2013	85% TFCL08 Ultimate CMI2019_F_(7.25) 1.8%_0.5A_2013
Assurances					
Assurances	Conventional With Profits	Scottish Widows	Males		
			Smoker	85% TMSL08 Ultimate	85% TMSL08 Ultimate
			Non smoker/ Unknown	77% TMNL08 Ultimate	77% TMNL08 Ultimate
			Females	77% TMCL08 Ultimate	77% TMCL08 Ultimate
			Smoker	85% TFSL08 Ultimate	85% TFSL08 Ultimate
			Non smoker	82% TFNL08 Ultimate	82% TFNL08 Ultimate
			Unknown	84% TFCL08 Ultimate	84% TFCL08 Ultimate
	Unitised Assurances	Clerical Medical	Males	35% AMC00 Ultimate	35% AMC00 Ultimate
			Females	50% AFC00 Ultimate	50% AFC00 Ultimate
		Scottish Widows	Males	42% TMCL08 Ultimate	42% TMCL08 Ultimate
			Females	66% TFCL08 Ultimate	66% TFCL08 Ultimate
Clerical Medical		Males	79% AMC00 Ultimate	79% AMC00 Ultimate	
		Females	83% AFC00 Ultimate	83% AFC00 Ultimate	

With regard to the above and subsequent tables:

The initial rate of improvement and smoothing parameter used are both higher than the core values in CMI\_2020. Additionally, for with-profit annuities business, the long term rate of mortality improvements in the CMI mortality projections model begins to taper linearly to zero from a lower age than the core value in CMI\_2020.

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2021 (continued)

## 35. Liabilities arising from insurance contracts and investment contracts – assumptions, change in assumptions and sensitivities (continued)

## (2) Key assumptions (continued)

## (a) With Profits Funds (continued)

## (iv) Other assumptions

Deferred annuity contracts with a guaranteed-rate annuity option have been valued based upon an assumed rate of take-up of the guaranteed annuity option of 65 per cent for business which is formerly Scottish Widows plc and 85 per cent for business which is formerly Clerical Medical Investment Group Limited, for the realistic assessment (65 per cent for business which is formerly Scottish Widows plc and 85 per cent for business which is formerly Clerical Medical Investment Group Limited at 31 December 2020).

## (b) Non-participating funds

The principal assumptions underlying the calculation of each of the business transferred in from Group companies in respect of non-participating fund liabilities are given below.

## (i) Investment returns and discount rates

Class of business	Interest rate (net)	
	2021	2020
	%	%
Annuities in payment	1.61	0.96
Conventional life business and non-unit reserves on linked pre-2013 life business	0.58	(0.07)
Conventional life business and non-unit reserves on linked post-2013 life business and conventional pensions business and non-unit reserves on other linked pensions business	0.73	(0.09)

## (ii) Mortality assumptions

The initial rate of improvement and smoothing parameter used are both higher than the core values in CMI 2020.

The mortality assumptions for the main classes of business are as follows:

Proposition	Product Type	Heritage	Category	2021 Assumption	2020 Assumption
<b>Annuities</b>					
<b>Purchased Annuities</b>	<b>Purchased (whole life)</b>	Scottish Widows and Clerical Medical	Males	94% Bespoke tables CMI2020_M_(7.25) 3%_0.3A_2013	94% Bespoke tables CMI2019_M_(7.25) 3%_0.5A_2013
			Females	94% Bespoke tables CMI2020_F_(7.25) 2.8%_0.4A_2013	94% Bespoke tables CMI2019_F_(7.25) 2.8%_0.5A_2013
<b>Pension Annuities</b>	<b>Self-employed / personal pensions</b>	Scottish Widows and Clerical Medical	Males	94% Bespoke tables CMI2020_M_(7.25) 3%_0.3A_2013	94% Bespoke tables CMI2019_M_(7.25) 3%_0.5A_2013
			Females	94% Bespoke tables CMI2020_F_(7.25) 2.8%_0.4A_2013	94% Bespoke tables CMI2019_F_(7.25) 2.8%_0.5A_2013
	<b>Executive Pensions and Pension Annuities</b>	Scottish Widows Clerical Medical and Halifax Life	Males	94% Bespoke tables CMI2020_M_(7.25) 3%_0.3A_2013	94% Bespoke tables CMI2019_M_(7.25) 3%_0.5A_2013
			Females	94% Bespoke tables CMI2020_F_(7.25) 2.8%_0.4A_2013	94% Bespoke tables CMI2019_F_(7.25) 2.8%_0.5A_2013

Under the mortality assumptions adopted for personal/ self-employed business a male aged 65 will live on average for 24 years.

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2021 (continued)

## 35. Liabilities arising from insurance contracts and investment contracts – assumptions, change in assumptions and sensitivities (continued)

## (2) Key assumptions (continued)

## (b) Non-participating funds (continued)

## (ii) Mortality assumptions (continued)

Proposition	Product Type	Heritage	Category	2021 Assumption	2020 Assumption
<b>Annuities</b>					
<b>Other Annuities</b>	<b>Group Scheme Annuities/ Transferred from LTSB</b>	Scottish Widows	Males	94% Bespoke tables CMI2020_M_(7.25) 3%_0.3A_2013	94% Bespoke tables CMI2019_M_(7.25) 3%_0.5A_2013
			Females	94% Bespoke tables CMI2020_F_(7.25) 2.8%_0.4A_2013	94% Bespoke tables CMI2019_F_(7.25) 2.8%_0.5A_2013
		Scottish Widows	Males	82% TMCL08 Ultimate CMI2020_M_(7.25) 3%_0.3A_2013	82% TMCL08 Ultimate CMI2019_M_(7.25) 3%_0.5A_2013
			Females	80% TFCL08 Ultimate CMI2020_F_(7.25) 2.8%_0.4A_2013	80% TFCL08 Ultimate CMI2019_F_(7.25) 2.8%_0.5A_2013
	<b>Deferred</b>	Clerical Medical and Halifax Life	Males	94% Bespoke tables CMI2020_M_(7.25) 3%_0.3A_2013	94% Bespoke tables CMI2019_M_(7.25) 3%_0.5A_2013
			Females	94% Bespoke tables CMI2020_F_(7.25) 2.8%_0.4A_2013	94% Bespoke tables CMI2019_F_(7.25) 2.8%_0.5A_2013
		Scottish Widows and Clerical Medical	Males	94% Bespoke tables CMI2020_M_(7.25) 3%_0.3A_2013	94% Bespoke tables CMI2019_M_(7.25) 3%_0.5A_2013
			Females	94% Bespoke tables CMI2020_F_(7.25) 2.8%_0.4A_2013	94% Bespoke tables CMI2019_F_(7.25) 2.8%_0.5A_2013
			Males	94% Bespoke tables CMI2020_M_(7.25) 3%_0.3A_2013	94% Bespoke tables CMI2019_M_(7.25) 3%_0.5A_2013
			Females	94% Bespoke tables CMI2020_F_(7.25) 2.8%_0.4A_2013	94% Bespoke tables CMI2019_F_(7.25) 2.8%_0.5A_2013

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2021 (continued)

## 35. Liabilities arising from insurance contracts and investment contracts – assumptions, change in assumptions and sensitivities (continued)

## (2) Key assumptions (continued)

## (b) Non-participating funds (continued)

## (ii) Mortality assumptions (continued)

Proposition	Product Type	Heritage	Category	2021 Assumption	2020 Assumption
Protection					
Whole of Life	Protection for Life	Scottish Widows	Males		
			Smoker	80% Bespoke table	80% Bespoke table
			Non smoker	77% Bespoke table	77% Bespoke table
			Females		
			Smoker	87% Bespoke table	87% Bespoke table
			Non smoker	83% Bespoke table	83% Bespoke table
Term Assurance	Protection for Life	Scottish Widows	Males		
			Smoker	100% TMSL08 Select	100% TMSL08 Select
			Non smoker	99% TMNL08 Select	99% TMNL08 Select
			Females		
			Smoker	111% TFSL08 Select	111% TFSL08 Select
			Non smoker	88% TFNL08 Select	88% TFNL08 Select
	Assurances	Scottish Widows	Males		
			Smoker	110% TMSL08 Ultimate	110% TMSL08 Ultimate
			Non smoker/unknown	95% TMNL08 Ultimate	95% TMNL08 Ultimate
			Females		
			Smoker	99% TFSL08 Ultimate	99% TFSL08 Ultimate
			Non smoker/unknown	86% TFNL08 Ultimate	86% TFNL08 Ultimate
		Clerical Medical	Males	29% TMC00 Ultimate	29% TMC00 Ultimate
			Females	40% TFC00 Ultimate	40% TFC00 Ultimate
		St Andrews Life	Males	139% TMSL08 Ultimate	139% TMSL08 Ultimate
			Smoker	144% TMNL08 Ultimate	144% TMNL08 Ultimate
			Non smoker/unknown		
			Females		
			Smoker	108% TFSL08 Ultimate	108% TFSL08 Ultimate
			Non smoker/unknown	112% TFNL08 Ultimate	121% TFNL08 Ultimate

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2021 (continued)

## 35. Liabilities arising from insurance contracts and investment contracts – assumptions, change in assumptions and sensitivities (continued)

## (2) Key assumptions (continued)

## (b) Non-participating funds (continued)

## (ii) Mortality assumptions (continued)

Proposition	Product Type	Heritage	Category	2021 Assumption	2020 Assumption
Pensions					
Pensions	Unitised Pensions (Solutions, Stakeholder)	Scottish Widows	Males	77% TMCL08 Ultimate	77% TMCL08 Ultimate
			Females	68% TFCL08 Ultimate	68% TFCL08 Ultimate
	Retirement Account	Scottish Widows	Males	68% TMCL08 Ultimate	68% TMCL08 Ultimate
			Females	64% TFCL08 Ultimate	64% TFCL08 Ultimate
	UL Individual Pensions Regular Premium	Halifax Life	Males	50% AMC00 Ultimate	50% AMC00 Ultimate
			Females	53% AFC00 Ultimate	53% AFC00 Ultimate
	UL Individual Pensions Single Premium	Halifax Life	Male	77% AMC00 Ultimate	77% AMC00 Ultimate
			Female	65% AFC00 Ultimate	65% AFC00 Ultimate
	UL Group Pension	Halifax Life	Males	77% AMC00 Ultimate	77% AMC00 Ultimate
			Females	65% AFC00 Ultimate	65% AFC00 Ultimate
	Black Horse Life Pensions	Scottish Widows	Male		
			Smoker	64% TMSL08 Ultimate	64% TMSL08 Ultimate
			Non smoker	101% TMNL08 Ultimate	101% TMNL08 Ultimate
			Unknown	101% TMNL08 Ultimate	101% TMNL08 Ultimate
			Female		
			Smoker	77% TFSL08 Ultimate	77% TFSL08 Ultimate
			Non smoker	98% TFNL08 Ultimate	98% TFNL08 Ultimate
			Unknown	98% TFNL08 Ultimate	98% TFNL08 Ultimate
Savings and Investments					
Savings and Investments	UL SP Investment Bonds	St. Andrews Life	Males	55% AMC00 Ultimate	55% AMC00 Ultimate
			Females	80% AFC00 Ultimate	80% AFC00 Ultimate

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2021 (continued)

## 35. Liabilities arising from insurance contracts and investment contracts – assumptions, change in assumptions and sensitivities (continued)

## (3) The effect of changes in key assumptions

## (a) With Profits Funds

There is no net impact on profit before tax of the changes in key assumptions within the With Profits Funds as any change in policyholder liabilities is offset by an equal and opposite movement in the unallocated surplus of the long-term business.

## (b) Non-participating funds

Changes in certain key assumptions were made during the year with the following impacts on profit after tax:

Variable	Impact on profit after tax			
	2021		2020	
	£m	£m	£m	£m
	<u>Group</u>	<u>Company</u>	<u>Group</u>	<u>Company</u>
Mortality	168	168	83	83
Expenses	(21)	(20)	(146)	(123)
Lapses	(1)	(1)	(4)	(4)
Valuation interest rate	216	181	(146)	(134)
Inflation (1)	(452)	(410)	95	86

(1) This figure purely shows the impact on liabilities and does not include the offsetting hedge assets which would reduce the overall profit impact. Inflation risk is hedged, largely on a best estimate basis. A delta hedging strategy is used to manage the inflation risk from the upper and lower limits associated with the inflation-linked liabilities. See also note 19 for further information on derivative financial instruments.

## (4) Sensitivity analysis (in respect of insurance and participating investment contracts only)

## (a) With Profits Funds

There is no net impact on profit before tax of the changes in key assumptions within the With Profits Funds as any change in policyholder liabilities is offset by an equal and opposite movement in the unallocated surplus of the long-term business.

## (b) Non-participating funds

The following table demonstrates the effect of changes in key assumptions on profit after tax assuming that the other assumptions remain unchanged. In practice this is unlikely to occur, and changes in some assumptions may be correlated. The impact is shown in one direction but can be assumed to be reasonably symmetrical.

Variable	Change in variable	Impact on profit after tax			
		2021		Restated* 2020	
		£m	£m	£m	£m
		<u>Group</u>	<u>Company</u>	<u>Group</u>	<u>Company</u>
Annuitant Mortality	5% reduction	(269)	(269)	(301)*	(301)*
Non-annuitant Mortality	5% reduction	10	10	8	8
Lapses	10% reduction	(34)	(34)	(41)	(41)
Future maintenance expenses and investment expenses	10% reduction	133	102	147	112
Interest rate – change in redemption yield(1)	0.25% reduction	(9)	(9)	(48)*	(49)*
Interest rate – change in valuation margin(2)	0.25% reduction	(555)	(542)	(643)*	(630)*

\* Amount restated. See note 41 for details of the restatement.

(1) This interest rate sensitivity shows the impact of a 0.25 per cent movement in gilt yields and all of the consequential impacts on key economic assumptions including the investment returns, the valuation rates of interest and values of assets backing the business in question.

(2) This interest rate sensitivity shows the impact of a change to the valuation rate of interest without a corresponding change to asset yields; this would increase the margin available to cover default and other risks. This sensitivity has been updated since that reported in the prior year to include the impact from all propositions, whereas previously only the impact for annuity business was disclosed.

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**NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2021 (continued)****35. Liabilities arising from insurance contracts and investment contracts – assumptions, change in assumptions and sensitivities (continued)****(5) Options and guarantees outside the With-Profit Funds**

A number of typical guarantees are provided outside the With-Profit Funds such as guaranteed payments on death (for example term assurance) or guaranteed income for life (e.g. annuities). Caps and floors on inflation linked increases to benefits and premiums across the Annuities and Protection business form additional guarantees in the Group. Key assumptions affecting the time value of these guarantees are inflation, inflation volatility and interest rates. Additional reserves of £102 million (2020: £170 million) are held to cover the time value of these guarantees. In addition, certain personal pension policyholders, for whom reinstatement to their occupational pension scheme was not an option, have been given a guarantee that their pension and other benefits will correspond in value to the benefits of the relevant occupational pension scheme. The key assumptions affecting the ultimate value of the guarantee are future salary growth, gilt yields at retirement, annuitant mortality at retirement, marital status at retirement and future investment returns. There is currently a provision, calculated on a deterministic basis, of £61 million (2020: £65 million) in respect of those guarantees.

**NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2021 (continued)****36. Risk management**

The Group is a part of Lloyds Banking Group. The principal activity is the undertaking of ordinary long-term insurance and savings business and associated activities in the United Kingdom. The Group offers a wide range of life insurance products such as annuities, pensions, whole life, term life and investment type products through independent financial advisors, the Lloyds Banking Group network and direct sales. The Company also reinsures business with insurance entities external to the Group.

This note summarises the financial risks and the way in which they are managed.

The Group writes a variety of insurance and investment contracts which are subject to a variety of financial risks, as set out below. Contracts can be either single or regular premium and conventional (non-profit), With Profits or unit-linked in nature.

The Group is exposed to a range of financial risks through its financial assets, financial liabilities, assets arising from reinsurance contracts and liabilities arising from insurance and investment contracts. In particular, the key financial risk is that long-term investment proceeds are not sufficient to fund the obligations arising from its insurance and investment contracts. The most important components of financial risk are market, insurance underwriting, credit, capital and liquidity risk.

The Group manages these risks in a number of ways, including risk appetite assessment and monitoring of capital resource requirements. In addition, the Principles and Practices of Financial Management (PPFMs) set out the way in which the With Profits business is managed. The Group also uses financial instruments (including derivatives) as part of its business activities and to reduce its own exposure to market risk and credit risk.

For With Profits business, subject to minimum guarantees, policyholders' benefits are influenced by the smoothed investment returns on assets held in the With Profits Funds. The smoothing cushions policyholders from daily fluctuations in investment markets. This process is managed in accordance with the published PPFMs.

The financial risks arising from providing minimum guaranteed benefits are borne in the With Profits Funds, but the Group bears financial risk in relation to the possibility that in extreme market conditions the With Profits Funds might be unable to bear the full costs of the guarantees. The amount of the guaranteed benefits increases as additional benefits are declared and allocated to policies.

For unit-linked business, policyholders' benefits are closely linked to the investment returns on the underlying funds. In the short-term, profit and equity are therefore largely unaffected by investment returns on assets in internal unit-linked funds as any gains or losses will be largely offset by changes in the corresponding insurance and investment contract liabilities, provided that there is appropriate matching of assets and liabilities within these funds. However, any change in the market value of these funds will have an indirect impact on the Group and Company through the collection of annual management and other fund related charges. As markets rise or fall, the value of these charges rises or falls correspondingly.

For non-participating business, the principal market risk is interest rate risk, which arises because assets and liabilities may exhibit differing changes in market value as a result of changes in interest rates. Asset and liability matching is used to mitigate the impact of changes in interest rates where the difference is material.

Financial assets and financial liabilities are measured on an on-going basis either at fair value or at amortised cost. The summary of significant accounting policies (note 1) describes how the classes of financial instruments are measured and how income and expenses, including fair value gains and losses, are recognised.

The timing of the unwind of the deferred tax assets and liabilities is dependent on the timing of the unwind of the temporary timing differences, arising between the tax bases of the assets and liabilities and their carrying amounts for financial reporting purposes, to which these balances relate.

The sensitivity analyses given throughout this note are based on a change in an assumption while holding all other assumptions constant. In practice, this is unlikely to occur as changes in some of the assumptions may be correlated, for example changes in interest rates and changes in market values. The sensitivity analysis presented also represents management's assessment of a reasonably possible alternative in respect of each sensitivity, rather than worst case scenario positions.

**NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2021 (continued)****36. Risk management (continued)****(a) Market risk**

Market risk is defined as the risk that our capital or earnings profile is affected by adverse market rates, in particular equity, credit default spreads, interest rates and inflation in Insurance business.

Investment holdings within the Group are diversified across markets and, within markets, across sectors. Holdings of individual assets are diversified to minimise specific risk and large individual exposures are monitored closely. For assets held with unit-linked funds, investments are only permitted in countries and markets which are sufficiently regulated and liquid.

Market risk policy is dependent on the nature of the funds in question, and can be broadly summarised as follows:

- Assets held in shareholder funds are invested in money-market funds, gilts, loans and investment grade bonds to match regulatory capital requirements. The balance of the shareholder fund assets is managed in line with the policies of Lloyds Banking Group to optimise shareholder risk and return. This includes suitable use of derivatives to minimise shareholder risk
- Unit-linked assets are invested in accordance with the nature of the fund mandates. "Unit matching" is adopted on a significant proportion of unit-linked business, under which sufficient units are created to cover Solvency II technical provisions. An equity hedging programme has also been established in respect of the unit-linked business that is not subject to unit matching. This is an economic hedge designed to mitigate the effects of the equity market on profit
- Conventional non-profit liabilities are 'close matched' as far as possible in relation to currency, nature and duration
- With Profits Funds are managed in line with the published PPFMs. Benchmarks and minimum and maximum holdings in asset classes are specified to allow limited investment management discretion whilst ensuring adequate diversification. Swaps and swaptions provide significant protection to the With Profits Funds from the effects of interest rate falls in respect of the cost of guaranteed annuity rates (as annuity rates are determined by interest rates)

Below is an analysis of the carrying values of assets and liabilities at fair value through profit or loss and assets and liabilities for which a fair value is required to be disclosed, according to their fair value hierarchy (as defined in note 1 (d)).

**Group As at 31 December 2021**

	<b>Fair value hierarchy</b>			
	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total</b>
	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>
Investment properties	—	—	3,588	3,588
Contracts with reinsurers at fair value through profit or loss	—	12,371	—	12,371
Shares and other variable yield securities	116,066	4	526	116,596
Debt and other fixed/variable income securities	11,129	27,639	224	38,992
Loans and advances to customers	—	—	9,395	9,395
Loans and advances to banks	—	4,084	—	4,084
Derivative financial assets	43	2,543	257	2,843
<b>Total assets</b>	<b>127,238</b>	<b>46,641</b>	<b>13,990</b>	<b>187,869</b>
Derivative financial liabilities	63	2,445	—	2,508
Liabilities arising from non-participating investment contracts	—	45,035	—	45,035
Subordinated debt	—	1,753	—	1,753
<b>Total liabilities</b>	<b>63</b>	<b>49,233</b>	<b>—</b>	<b>49,296</b>

For all financial assets held at amortised cost by the Group and Company, carrying value is a reasonable approximation of fair value. The fair value of subordinated debt is presented in note 29.

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2021 (continued)

## 36. Risk management (continued)

## (a) Market risk (continued)

## Company As at 31 December 2021

	Fair value hierarchy			
	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Investment properties	—	—	118	118
Contracts with reinsurers at fair value through profit or loss	—	12,371	—	12,371
Shares and other variable yield securities	130,261	—	581	130,842
Debt and other fixed/variable income securities	7,334	7,033	809	15,176
Loans and advances to customers	—	—	8,910	8,910
Loans and advances to banks	—	1,274	—	1,274
Deposits with cedants	—	1,447	—	1,447
Derivative financial assets	17	2,446	257	2,720
<b>Total assets</b>	<b>137,612</b>	<b>24,571</b>	<b>10,675</b>	<b>172,858</b>
Derivative financial liabilities	54	2,375	—	2,429
Liabilities arising from non-participating investment contracts	—	45,016	—	45,016
Subordinated debt	—	1,786	—	1,786
<b>Total liabilities</b>	<b>54</b>	<b>49,177</b>	<b>—</b>	<b>49,231</b>

For all financial instruments held at amortised cost by the Group and Company, carrying value is a reasonable approximation of fair value.

## Group As at 31 December 2020

	Fair value hierarchy			
	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Investment properties	—	—	3,324	3,324
Contracts with reinsurers at fair value through profit or loss	—	19,549	—	19,549
Shares and other variable yield securities	94,188	164	605	94,957
Debt and other fixed/variable income securities	12,802	24,267	187	37,256
Loans and advances to customers	—	—	9,646	9,646
Loans and advances to banks	—	4,693	—	4,693
Derivative financial assets	56	5,040	128	5,224
<b>Total assets</b>	<b>107,046</b>	<b>53,713</b>	<b>13,890</b>	<b>174,649</b>
Derivative financial liabilities	47	4,562	—	4,609
Liabilities arising from non-participating investment contracts	—	38,448	—	38,448
Subordinated debt	—	1,892	—	1,892
<b>Total liabilities</b>	<b>47</b>	<b>44,902</b>	<b>—</b>	<b>44,949</b>

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2021 (continued)

## 36. Risk management (continued)

## (a) Market risk (continued)

## Company As at 31 December 2020

	Fair value hierarchy			
	Level 1	Level 2	Level 3	Total
	£m	£m	£m	£m
Investment properties	—	—	120	120
Contracts with reinsurers at fair value through profit or loss	—	19,549	—	19,549
Shares and other variable yield securities	107,067	152	665	107,884
Debt and other fixed/variable income securities	8,106	7,729	842	16,677
Loans and advances to customers	—	—	9,095	9,095
Loans and advances to banks	—	1,468	—	1,468
Deposits with cedants	—	1,509	—	1,509
Derivative financial assets	39	4,965	128	5,132
<b>Total assets</b>	<b>115,212</b>	<b>35,372</b>	<b>10,850</b>	<b>161,434</b>
Derivative financial liabilities	40	4,550	—	4,590
Liabilities arising from non-participating investment contracts	—	38,433	—	38,433
Subordinated debt	—	1,923	—	1,923
<b>Total liabilities</b>	<b>40</b>	<b>44,906</b>	<b>—</b>	<b>44,946</b>

Contracts with reinsurers held at fair value through profit and loss are valued using the published price for the funds invested in. Fair values have not been disclosed for participating investment contracts. There is currently no agreed definition of fair valuation for these types of contracts applied under IFRS and therefore the range of possible fair values of these contracts cannot be measured reliably.

The derivative securities classified as Level 2 above have been valued using a tri-party pricing model as determined by the Pricing Source Agreement between Investment Manager(s) and the Third-Party Administrator (State Street). Further detail on valuation is given in note 1(n).

Assets classified as Level 3 include portfolios of illiquid loans and advances to customers, investments in private debt funds and private equity assets, investment properties, investments in asset-backed securities, derivatives and corporate debt instruments. Private equity investments are valued using the financial statements of the underlying companies prepared by the general partners, adjusted for known cash flows since valuation and subject to a fair value review to take account of other relevant information. Investment property is independently valued as described in the Property section of this note below.

## COVID-19

Markets in 2021 have been less volatile than in 2020 although pandemic related sector uncertainties remain as well as new inflationary pressures. Equity markets have risen over the last six months increasing the value of collective investments and driving the rise in value in the linked portfolio assets. The shape of the risk-free interest rate curve has changed significantly during the second half of 2021, with rising interest rates at the short end of the curve but rate falls at the long end creating a more negatively sloped GBP curve. Inflationary pressures have seen the short end of the Retail Price Index (RPI) curves also rise sharply and become more negatively sloped. The majority of the debt security and illiquid credit asset positions have seen value declines as a result of rising rates. Credit spread moves have been more subdued, but with some steepening amongst investment grade ratings.

The following valuation methods and sensitivity of valuation assumptions are applied to both the Group and the Company.

**NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2021 (continued)****36. Risk management (continued)****(a) Market risk (continued)***Loan assets*

Loans classified as Level 3 within debt securities are valued using a discounted cash flow model. The discount rate comprises market observable interest rates, a risk margin that reflect loan credit ratings and calibrated to weighted average life on borrower level using sector bond spread curves for each rating, and an incremental illiquidity premium that is estimated by reference to historical spreads at origination on similar loans where available and established measures of market liquidity. Libor tenor and base rate options are valued by comparing the current tenor with the lowest tenor option (basis swap approach). Prepayment options are valued using a monthly time step binomial lattice approach.

The base valuation of loans is £8.8 billion (2020: £9.1 billion). The unobservable inputs in the valuation model include the credit spread and specifically the illiquidity premium of loans compared to bonds and the spread adjustments due to the specific credit characteristics of the borrower. The impact of current economic conditions on the valuation of the loan portfolio has been taken into account in the year end valuation. The impact of applying reasonably possible alternative assumptions to the value of these loans would be to decrease the fair value by £402 million (2020: £575 million) or increase it by £442 million (2020: £454 million). The impact of alternative assumptions, mainly related to credit spread and illiquidity premium sensitivities would be -4.6 per cent (2020: -6.3 per cent) to base in adverse scenario and +5.1 per cent (2020: +5.0 per cent) to base in the favourable scenario. The skew observed in 2021 is less pronounced than 2020 due to refinements in the interplay between rating and sector spread uncertainty and changes in the dispersion of base market data.

*Agricultural Loans – Agriculture SPV*

A portfolio of agricultural loans is securitised through a Special Purpose Vehicle into a Senior Note (A Note) and a Junior Note (E Note). These notes are classified as Level 3 within debt securities. The underlying agricultural loans are valued using a discounted cash flow approach. The discount rate comprises market observable interest rates, a risk margin that reflect underlying loan credit ratings, a spread to represent the risks associated with the Agricultural sector and an incremental illiquidity premium including additional spread for prepayment uncertainty.

The unobservable input in the valuation model is principally the credit spread including the illiquidity premium of loans compared to mortgages, the spread adjustments relevant to the Agricultural sector and the credit profile of the borrowers and the notes issued from the securitisation.

The base valuation of Agricultural loans is £327 million (2020: £379 million). The impact of applying reasonably possible alternative assumptions to the valuation of the loans and senior note would be to decrease the fair value of the SPV by £20 million (2020: £21 million) or increase it by £17 million (2020: £13 million). Impact of alternative assumptions on credit spread, illiquidity premium and prepayment assumptions is -6.1 per cent (2020: -5.5 per cent) to base in the adverse scenario and +5.2 per cent (2020: +3.5 per cent) to base in the favourable scenario.

*Securitised Lifetime Mortgages*

A portfolio of historical Lifetime Mortgages is securitised through a Special Purpose Vehicle into a Senior Note (A Note) and a Junior Note (B Note). The value of the B Note is determined using a discounted cashflow approach. The spread is derived using expert judgement, supported by spreads in comparable LTM Mortgages against changes in the expected performance of the underlying mortgage portfolio. The value of the A Note is derived as a balancing item from the value of the underlying portfolio less the value of the B Note and expenses. These notes are classified as Level 3 within debt securities due to the unobservable parameters required in the valuation of the Senior Note, Junior Note and in the valuation of the portfolio of mortgages.

These lifetime mortgages are valued using a discounted cash flow approach. Decrements (mortality, voluntary early repayment, entry into long-term care) are used to determine the incidence of cash flows. The discount rate is based on a risk-free rate plus a spread assessed by reference to the current comparable lifetime mortgages market, after adjusting for the relative risks associated with this portfolio of mortgages and those of a notional portfolio of new mortgages. In the assessment of the value of the risks, the No Negative Equity Guarantee (NNEG) for Lifetime Mortgages is valued using a time-dependent Black-Scholes model. The value of NNEG is £9 million (2020: £14 million).

Inputs in the valuation model include the gross interest rate applicable to a notional portfolio of comparable Lifetime Mortgages, risk free rates, residential property volatilities, property valuation haircuts and settlement lags as well as decrement assumptions on mortality, voluntary early repayment and entry into long-term care.

The base valuation of Securitised Lifetime Mortgages is £162 million (2020: 176 million). December 2021 Valuation Uncertainty calculations reflects uncertainty in the market rates for comparable notional portfolios as well as decrement assumptions and their impacts on the value of the A Note and B Note. The range of the notional portfolio rate assumption was 3.95 per cent to 4.30 per cent (2020: 3.50 per cent to 4.27 per cent).

**NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2021 (continued)****36. Risk management (continued)****(a) Market risk (continued)***Securitised Lifetime Mortgages (continued)*

The effect of applying the aforementioned reasonably possible alternative assumptions in line with the ranges disclosed above on the A & B Notes would be to decrease the fair value by £5 million (2020: £5 million) or increase it by £5 million (2020: £9 million). The impact of alternative assumptions on credit spread and illiquidity premium is -2.5 per cent (2020: -2.9 per cent) to base in the adverse scenario and +3 per cent (2020: +5 per cent) to base in the favourable scenario.

*Originated Lifetime Mortgages*

New Lifetime Mortgage Loans have been originated by Lloyds Banking Group Retail since April 2020 on behalf of the Company. The loans are being warehoused with the intention to securitise in 2022.

The valuation methodology uses the same principles as that for the securitised historical mortgages. The mortgages are valued using a discounted cash flow approach. Decrements (mortality, voluntary early repayment, entry into long-term care) are used to determine the incidence of cash flows. The discount rate includes an illiquidity spread by reference to the market for new Lifetime Mortgages, after adjusting for the relative risks associated with this portfolio of mortgages and those of a notional portfolio of new mortgages. The model for originated mortgages utilises a Jarrow-Yildirim model, which is a variant of the Black-Scholes mechanism, and an Economic Scenario generator in determining the No Negative Equity Guarantee. The model also includes additional features and factors that are pertinent to recently originated mortgages as compared those that are more mature.

The base valuation of Originated Lifetime Mortgage is £123 million (2020: £16 million). December 2021 Valuation Uncertainty calculations principally reflect uncertainty in the market rates and acquisition costs of comparable notional portfolios and their corresponding impact on the loan portfolio values. The effect of applying the aforementioned reasonably possible alternative assumptions in line with the ranges disclosed above on the loans would be to decrease the fair value by £3 million (2020: £0.7 million) or increase it by £5 million (2020: £0.3 million). The increase in this range year-on-year is due to the significant increase of new loan origination throughout 2021. The range of Notional Interest Rates as of December 2021 for the Favourable scenario was 2.76 per cent to 3.41 per cent (2020: 2.48 per cent to 3.66 per cent) and for the Adverse Scenario was 2.99 per cent to 3.79 per cent (2020: 2.68 per cent to 4.18 per cent) compared to Base case range of 2.93 per cent to 3.41 per cent (2020: 2.54 per cent to 3.66 per cent).

*ERM Public Securitisation*

On 2 November 2021 the Company purchased a new public securitisation of UK Lifetime Mortgages sponsored by RGA Americas Reinsurance Company Ltd (RGA). The origination of the underlying Lifetime Mortgages is by More2Life (M2L). The assets purchased are £25 million of the Class A1 notes and £8 million of the Class A2 notes.

The assets are classified as Level 3 and are included within Asset Backed Securities. The valuation for the Class A1 notes as of Dec 2021 was £26 million and the Class A2 notes valuation is £8 million. The valuation of these assets is provided by the lead manager on a monthly basis.

*Private Credit Funds*

The Company holds investments in two private credit funds that hold portfolios to European medium sized enterprises. The assets are classified as level 3 and are included within equity securities. The underlying loan values, on which the investment values are based, are assessed by the fund manager on a discounted cash flows approach using spreads determined from the credit quality and illiquidity of the loans as compared to other credit assets. Our valuation uncertainty on these investments is assessed based on the valuation uncertainty characteristics of the underlying illiquid loans.

The fair value of Private Credit Funds is £456 million (2020: £544 million) as valued by the fund manager. The effect of applying reasonably possible alternative assumptions to the value of these assets would be to decrease the fair value by £11 million (2020: £19 million) or increase it by £10 million (2020: £3 million). For Pemberton European Mid-Market Debt Fund II (E) (Pemberton), the impact of alternative assumptions on credit spread and illiquidity premium is -2.5 per cent (2020: -2.0 per cent) to base in the adverse scenario and 2.1 per cent (2020: 0 per cent) to base in the favourable. The stable credit spread environment has meant there is now a favourable scenario related to these positions as compared to the fund managers pricing model.

For AgFe UK Real Estate Senior Debt Fund LP (AgFe), the fair valuations are provided by the fund manager. For the assessment of valuation uncertainty alternative assumptions on debt margin for the underlying loans are applied, resulting in a -1.9 per cent (2020: -5.9 per cent) to base in the adverse scenario and +1.9 per cent (2020: +1.9 per cent) to base in favourable scenario.

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**NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2021 (continued)****36. Risk management (continued)****(a) Market risk (continued)***Derivatives with Unobservable inputs*

Derivatives are used to hedge interest rate and inflation risks. Where complex risks arise in other assets or liabilities, these hedging derivatives can be complex and have unobservable inputs such as volatilities, correlations and basis differences to vanilla derivatives. In these cases, the complex derivatives are assessed as level 3.

Favourable and adverse scenarios are determined by stressing unobservable inputs into the valuation models, with reference to the valuations of the instruments they hedge where appropriate, in order to generate a plausible range of fair values that different market participants might apply.

The base valuation of Derivatives is £359 million (2020: £567 million). The effect of applying reasonably possible alternative assumptions to the value of these assets would be to decrease the fair value by £84 million (2020: £62 million) or increase it by £23 million (2020: £20 million). The impact of alternative assumptions is -23.3 per cent (2020: -10.9 per cent) to base in the adverse scenario and +6.4 per cent (2020: +3.5 per cent) to base in the favourable scenario.

*Property*

Investment properties are valued by external Chartered Surveyors using industry standard techniques based on guidance from the Royal Institute of Chartered Surveyors. The valuation methodology includes an assessment of general market conditions and sector level transactions and takes account of expectations of occupancy rates, rental income and growth. Properties undergo individual scrutiny using cash flow analysis to factor in the timing of rental reviews, capital expenditure, lease incentives, dilapidation and operating expenses; these reviews utilise both observable and unobservable inputs.

The effect of applying reasonably possible alternative assumptions to the value of these assets would be to decrease the fair value by £14 million (2020: £21 million) or increase it by £22 million (2020: £17 million).

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2021 (continued)

## 36. Risk management (continued)

## (a) Market risk (continued)

The table below shows movements in the assets and liabilities measured at fair value based on valuation techniques for which any significant input is not based on observable market data (Level 3 only).

Group

	2021		2020	
	£m	£m	£m	£m
	<u>Assets</u>	<u>Liabilities</u>	<u>Assets</u>	<u>Liabilities</u>
Balance at 1 January	13,897	—	13,541	—
Transfers in	167	—	179	—
Transfers out	(132)	—	(356)	—
Purchases	842	—	756	—
Disposals	(1,031)	—	(534)	—
Net gains recognised within net gains on assets and liabilities at fair value through profit or loss in the statement of comprehensive income	247	—	311	—
<b>Balance at 31 December</b>	<b>13,990</b>	<b>—</b>	<b>13,897</b>	<b>—</b>

Total unrealised gains for the period included in the statement of comprehensive income for assets and liabilities held at 31 December

215 — 692 —

Company

	2021		2020	
	£m	£m	£m	£m
	<u>Assets</u>	<u>Liabilities</u>	<u>Assets</u>	<u>Liabilities</u>
Balance at 1 January	10,850	—	10,303	—
Transfers in	104	—	154	—
Transfers out	(77)	—	(340)	—
Purchases	810	—	676	—
Disposals	(706)	—	(407)	—
Net gains recognised within net gains on assets and liabilities at fair value through profit or loss in the statement of comprehensive income	(306)	—	464	—
<b>Balance at 31 December</b>	<b>10,675</b>	<b>—</b>	<b>10,850</b>	<b>—</b>

Total unrealised gains for the period included in the statement of comprehensive income for assets and liabilities held at 31 December

(316) — 498 —

Total gains or losses for the period included in the statement of comprehensive income, as well as total gains or losses relating to assets and liabilities held at the reporting date, are presented in the statement of comprehensive income, through net gains/losses on assets and liabilities at fair value through profit or loss.

**NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2021 (continued)****36. Risk management (continued)****(a) Market risk (continued)****(i) Equity and property risk**

The exposure of the Group's insurance and investment contract business to equity risk relates to financial assets and financial liabilities whose values will fluctuate as a result of changes in market prices other than from interest and foreign exchange fluctuations. This is due to factors specific to individual instruments, their issuers or factors affecting all instruments traded in the market. Accordingly, the Group monitors exposure limits both to any one counterparty and any one market.

From 2018, exposure to market risk has been managed by the implementation of unit matching and equity hedging to reduce the sensitivity of future dividend payments to market movements. Unit matching involves more effectively matching unit linked liabilities on a best-estimate view (as defined by Solvency regulations). This best-estimate view incorporates an allowance for expected future income and expenses, which are not fully allowed for under IFRS. As a result, this leads to a mismatch between IFRS statutory assets and liabilities in respect of market movements. For example, in the event of rising markets, a loss would now be recognised in the accounts as a result of this mismatch, which would be offset in the future due to higher income as fees are received.

The effect on the Group of changes in the value of investment property held in respect of investment contract liabilities due to fluctuations in property prices is negligible as any changes will be offset by movements in the corresponding liability.

The sensitivity analysis below illustrates how the fair value of future cash flows in respect of equities and properties, net of offsetting movements in insurance and investment contract liabilities, will fluctuate because of changes in market prices at the reporting date. The equity sensitivity includes the impact of unit matching and equity hedging which leads to a statutory profit or loss, mainly due to the hedging result under falling and rising markets respectively.

	<b>Profit/(loss) after tax and equity impact for the year</b>	
	<b>2021</b>	<b>2020</b>
	<b>£m</b>	<b>£m</b>
10% (2020: 10%) decrease in equity prices	237	180
10% (2020: 10%) decrease in property prices	(5)	(5)
10% (2020: 10%) increase in equity prices	(221)	(157)
10% (2020: 10%) increase in property prices	4	3

**(ii) Interest rate risk**

Interest rate risk is the risk that the value of future cash flows of a financial instrument will fluctuate because of changes in interest rates and the shape of the yield curve. Interest rate risk in respect of the Group's insurance and investment contracts arises when there is a mismatch in duration or yield between liabilities and the assets backing those liabilities.

The Group's interest rate risk policy requires that the maturity profile of interest-bearing financial assets is appropriately matched to the guaranteed elements of the financial liabilities.

A fall in market interest rates will result in a lower yield on the assets supporting guaranteed investment returns payable to policyholders. This investment return guarantee risk is managed by matching assets to liabilities as closely as possible. An increase in market interest rates will result in a reduction in the value of assets subject to fixed rates of interest which may result in losses, as a result of an increase in the level of surrenders, the corresponding fixed income securities have to be sold.

The effect of changes in interest rates in respect of financial assets which back insurance contract liabilities is given in note 35. The effect on the Group of changes in the value of investments held in respect of investment contract liabilities due to fluctuations in market interest rates is negligible as any changes will be offset by movements in the corresponding liability.

The sensitivity analysis below illustrates how the fair value of future cash flows in respect of interest-bearing financial assets, net of offsetting movements in insurance and investment contract liabilities, will fluctuate because of changes in market interest rates at the reporting date.

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2021 (continued)

## 36. Risk management (continued)

## (a) Market risk (continued)

## (ii) Interest rate risk (continued)

	Impact on profit after tax and equity for the year	
	2021 £m	Restated* 2020 £m
25 basis points (2020: 25 basis points) increase in yield curves	5	40 *
25 basis points (2020: 25 basis points) decrease in yield curves	(9)	(48)*
50 basis points (2020: 50 basis points) increase in yield curves	8	72 *
50 basis points (2020: 50 basis points) decrease in yield curves	(24)	(104)*

\* Amount restated. See note 41 for details of the restatement.

**Interest Rate Benchmark Reform**

During 2021, the Group has continued to manage its process to transition to alternative benchmark rates under its Lloyds Banking Group-wide IBOR Transition Programme and has delivered the core changes required to its technology and business processes. Through this programme, the Group has ensured that the most appropriate benchmark rate is used for financial instruments impacted by the IBOR reform and has managed the impacts and risks relating to systems, processes, accounting and reporting. Most affected financial instruments were transitioned to new benchmark rates prior to 31 December 2021, with activity continuing to transition or otherwise remove the exposure to LIBOR for the remainder. The Group does not expect material changes to its risk management approach and strategy as a result of interest rate benchmark reform.

The material risks identified include the following:

*Conduct and litigation risk*

The Group may be exposed to conduct and litigation charges as a direct result of inappropriate or negligent actions taken during IBOR transition resulting in detriment to the customer. The Group is working closely with its counterparties to avoid this outcome.

*Market risk*

IBOR transition is expected to lead to changes in the Group's market risk profile which will continue to be monitored and managed within the appropriate risk appetites. The key change is expected to be on the management of basis risk profile during the period when alternative benchmark rates are referenced in contracts up to the cessation of the in-scope IBOR index.

*Credit risk*

Clients may wish to renegotiate the terms of existing transactions as a consequence of IBOR reform. This could lead to a change in the credit risk exposure of the client depending on the outcome of the negotiations. The Group will continue to monitor and manage changes within the appropriate risk appetites.

*Accounting risk*

If IBOR transition is finalised in a manner that does not permit the application of the reliefs introduced in the IFRS Phase 2 amendments, the financial instrument may be required to be derecognised and a new instrument recognised.

*Operational risk*

Additional operational risks may arise due to the IBOR transition programme impacting all businesses and functions within the Group and leading to the implementation of changes to technology, operations, client communication and the valuation of in-scope financial instruments.

At 31 December 2021, the Group had the following significant exposures impacted by interest rate benchmark reform which have yet to transition to the replacement benchmark: Sterling LIBOR non-derivative financial instruments at fair value through profit or loss of £1,432 million, and sterling LIBOR interest rate derivatives with contract/notional amount of £3,226 million. As at December 2021, these Sterling LIBOR balances relate to contracts that have not converted to a risk-free rate, for example where a contract matures in 2022 and it is not in both parties' interests to transition, or where both parties have not agreed to include fallback provisions that would have effect when LIBOR ceases. In both cases, these contracts will have both cash flows and valuations determined on a 'synthetic' LIBOR basis for reporting periods during 2022, unless they are transitioned to alternative benchmark rates.

**NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2021 (continued)****36. Risk management (continued)****(a) Market risk (continued)****(ii) Interest rate risk (continued)*****Interest Rate Benchmark Reform (continued)***

In respect of the Group's hedge accounting relationships, for the purposes of determining whether:

- a. a forecast transaction is highly probable
- b. a hedge is expected to be highly effective in achieving offsetting changes in fair value or cash flows attributable to the hedged risk
- c. an accounting hedging relationship should be discontinued because of a failure of the retrospective effectiveness test

The Group assumes that the interest rate benchmark on which the hedged risk or the cash flows of the hedged item or hedging instrument are based is not altered by uncertainties resulting from interest rate benchmark reform. In addition, for a fair value hedge of a non-contractually specified benchmark portion of interest rate risk, the Group assesses only at inception of the hedge relationship and not on an ongoing basis that the risk is separately identifiable and hedge effectiveness can be measured.

The interest benchmark reform affects the Sterling LIBOR interest rate benchmarks in respect of a fair value hedge. The value of assets designated in fair value hedges had a notional of nil (2020: nil) at 31 December 2021. The value of liabilities designated in fair value hedges had a notional of £1.5 billion (2020: £1.5 billion) at 31 December 2021.

At 31 December 2021, the notional amount of the hedging instruments in hedging relationships to which these amendments apply was £1.5 billion (2020: £1.5 billion).

**(iii) Inflation risk**

The Company's exposure to inflation risk on its liabilities arises primarily from annuity contracts, where the benefit payments are linked to an inflation index, and from the element of all policyholder liabilities relating to the future expenses of administering the in-force policies which are expected to increase with higher inflation. This exposure is hedged through holding appropriate assets, generally RPI linked swaps, such that the change in value of the assets is broadly offsetting to the change in value of the liabilities.

Within the Group, Scottish Widows Europe also hedges its exposure to inflation from the liability to future expenses.

Residual risk remains after the hedges. For example due to caps and floors to payments on some of the annuity liabilities and differences in inflation measures between assets and liabilities (e.g. RPI, CPI and salary growth).

The sensitivity below shows the expected impact of a 0.5 per cent increase to inflation in all future years. This is a multiple of the impact of one year's inflation increasing.

	<b>Impact on profit after tax and equity for the year</b>	
	<b>2021 £m</b>	<b>2020 £m</b>
50 basis points increase in RPI	82	44

**NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2021 (continued)****36. Risk management (continued)****(a) Market risk (continued)****(iii) Foreign exchange risk**

Foreign exchange risk relates to the effects of movements in exchange markets including changes in exchange rates.

The Group's foreign currency exposure is driven by holding financial instruments to hedge changes in future investment management fees resulting from exchange rate movements. These investment management fees are based on charges to policyholder funds invested in overseas equities. The hedges are placed by the Company to reduce foreign exchange exposure in the SII capital position.

Sensitivity analysis for the impact of a 10 per cent depreciation of sterling against foreign currency shows a £(175) million impact for 2021 on profit after tax and equity (2020: £(117) million).

With the exception of these holdings, the overall risk to the Group is minimal due to the following:

- The Group's principal transactions are carried out in pounds sterling
- The Group's financial assets are primarily denominated in the same currencies as its insurance and investment contract liabilities
- Other than shareholder funds, all non-linked investments of the non-profit funds are in sterling or are currency matched. The effect on the Group of changes in the value of investments held in respect of investment contract liabilities due to fluctuations in foreign exchange rates is negligible as any changes will be offset by movements in the corresponding liability

**(b) Insurance underwriting risk**

Insurance underwriting risk is defined as the risk of adverse developments in the timing, frequency and severity of claims for insured/underwritten events and in customer behaviour, leading to reductions in earnings and/or value.

The principal risk the Group faces under insurance contracts is that the actual claims and benefit payments exceed the amounts expected at the time of determining the insurance liabilities.

The nature of the Group's business involves the accepting of insurance underwriting risks which primarily relate to mortality, longevity, morbidity, persistency and expenses. When transacting new business, the Group underwrites policies to ensure an appropriate premium is charged for the risk or that the risk is declined.

The Group principally writes the following types of life insurance contracts:

- Life assurance – where the life of the policyholder is insured against death or permanent disability, usually for pre-determined amounts
- Annuity products – where typically the policyholder is entitled to payments which cease upon death
- Morbidity products – where the policyholder is insured against the risk of contracting a defined illness

For contracts where death is the insured risk, the most significant factors that could increase the overall level of claims are epidemics or widespread changes in lifestyle, such as eating, smoking and exercise habits, resulting in earlier or more claims than expected. The occurrence of a pandemic, such as the one arising from COVID-19 in 2020, is regarded as a potentially significant mortality risk. For contracts where survival is the insured risk, the most significant factor is continued improvement in medical science and social conditions that would increase longevity.

Despite an unprecedented spike in annuitant mortality rates during 2020 and 2021, it is expected that current annuitant mortality rates will revert to broadly the previous level in the short term. The longer-term impacts of COVID-19 on future annuitant mortality improvements remain unclear, however it is becoming clear that the pandemic is likely to have a net negative impact so smaller increases in life expectancy in the near future are now reflected in assumptions. Mortality assumptions continue to be updated annually, reflecting both historic experience and future expectations so as further information becomes available it will be incorporated in future assumptions. No additional provisions are held in respect of annuitant mortality.

A provision is held in respect of morbidity products as the reduced availability of medical screening has reduced critical illness claims made in 2021. It is expected that this reduction will be offset in 2022 as delayed claims arise.

For contracts with fixed and guaranteed benefits and fixed future premiums, there are no mitigating terms and conditions that significantly reduce the insurance underwriting risk accepted. For participating investment contracts, the participating nature of these contracts results in a significant portion of the insurance underwriting risk being shared with the policyholder.

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**NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2021 (continued)****36. Risk management (continued)****(b) Insurance underwriting risk (continued)**

Insurance underwriting risk is also affected by the policyholders' right to pay reduced or no future premiums, to terminate the contract completely, to exercise a guaranteed annuity option or, for bulk annuity business, for pensioners to exercise options following retirement. As a result, the amount of insurance underwriting risk is also subject to policyholder behaviour. On the assumption that policyholders will make decisions that are in their best interests, overall insurance underwriting risk will generally be aggravated by policyholder behaviour. For example, it is likely that policyholders whose health has deteriorated significantly will be less inclined to terminate contracts insuring death benefits than those policyholders who remain in good health.

The Group has taken account of the expected impact of policyholder behaviour in setting the assumptions used to measure insurance and investment contract liabilities.

The principal methods available to the Group to control or mitigate longevity, mortality and morbidity risk are through the following processes:

- Underwriting (the process to ensure that new insurance proposals are properly assessed)
- Pricing-to-risk (new insurance proposals would usually be priced in accordance with the underwriting assessment)
- Demographics to accurately assess mortality risk
- Claims management
- Product design
- Policy wording
- The use of reinsurance and other risk mitigation techniques

Rates of mortality and morbidity are investigated annually based on the Group's recent experience. Future mortality improvement assumptions are set using the latest population data available. In addition, bulk annuity business pricing and valuation assumptions also consider underlying experience of the scheme where available. Where they exist, the reinsurance arrangements of each company in the Group are reviewed at least annually.

Persistency risk is the risk associated with the ability to retain long-term business. The Group aims to reduce its exposure to persistency risk by undertaking various initiatives to promote customer loyalty. These initiatives are aimed both at the point of sale and through direct contact with existing policyholders, for example through annual statement information packs.

COVID-19 and changes to the labour market have created uncertainty over employment levels and, as a result, Workplace pension contributions. This could negatively impact the value of Workplace pensions. There is a provision held in relation to this risk.

Further information on assumptions, changes in assumptions and sensitivities in respect of insurance and participating investment contracts is given in note 35.

**NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2021 (continued)****36. Risk management (continued)****(c) Credit risk**

The risk that parties with whom we have contracted, fail to meet their financial obligations (both on and off balance sheet).

The Group accepts credit risk with a variety of counterparties through invested assets which are primarily used to back annuity business, cash in liquidity funds and bank accounts, derivatives and reinsurance. These are managed through a credit control framework which uses a tiered approach to set credit limits:

- Tier 1: Credit limits are set by the Insurance Board as part of the overall Insurance Risk Appetite
- Tier 2: Insurance Asset and Liability Committee (IWALCO) assists the Chief Investment Officer to set additional controls, sub limits and guidelines. These operate within the boundaries of the Board's Tier 1 Risk Appetite statements and are designed to assist the business with more efficient utilisation of higher level Board Risk Appetite statements in delivery of Insurance's investment strategy
- Tier 3: Insurance Credit approvers have individual personal delegated authorities from the Insurance Board to approve exposures to individual counterparties. Amounts above these delegated authorities require approval by the Insurance Board

Group exposure limits are set for the maximum single name concentration, industry sector, country of risk and portfolio quality. In addition, each individual counterparty exposure requires a counterparty limit or is within the criteria of an approved sanction matrix.

Group exposures are reported on a monthly basis to the Insurance Shareholder Investment Management Committee (ISIM) and semi-annually to IWALCO, and other senior committees. Any exceptions to limits must be approved in advance by the relevant authority that owns that limit, and any unapproved excesses notified to that authority as a breach.

A core part of the invested asset portfolio which backs the annuity business is invested in loan assets. These have predominately been purchased from Lloyds Banking Group although the Group has also started originating new business. All loan assets are assessed and monitored using established robust processes and controls.

Reinsurance is primarily used to reduce insurance risk. However, it is also sought for other reasons such as improving profitability, reducing capital requirements and obtaining technical support. In addition, reinsurance is also used to offer policyholders access to third-party funds via Investment Fund Links which we are unable to provide through other means. The Group's reinsurance strategy is to reduce the volatility of profits through the use of reinsurance whilst managing the insurance and credit risk within the constraints of the risk appetite limits.

The Group has reinsurance on all significant lines of business where mortality, morbidity or property risks exceed set retention limits. This does not, however, discharge the Group's liability as primary insurer. If a reinsurer fails to pay a claim for any reason, the Group remains liable for the payment to the policyholder. All new material reinsurance treaties are subject to Board approval and reinsurance arrangements are reviewed annually to ensure that the reinsurance strategy is being achieved. Reinsurance for Investment Fund Links is not assessed as a counterparty exposure for the Group since with invested assets matching liabilities, any loss to the Group would only be the result of operational failures of internal controls and as such it is outside of the credit control framework described above.

Shareholder funds are managed in line with the Insurance Credit Risk Policy and the wider Lloyds Banking Group Credit Risk Policy which set out the principles of the credit control framework outlined above.

Credit risk in respect of unit-linked funds and With Profits Funds is largely borne by the policyholders. Consequently, the Group has no significant exposure to credit risk for those funds.

The tables below analyse financial assets and reinsurance assets subject to credit risk exposure using S&P Global Ratings' rating or equivalent. For certain classes of assets, internally generated ratings have been used where external ratings are not available. This includes credit assets held in both shareholder and policyholder funds. No account is taken of any collateral held to mitigate the risk.

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2021 (continued)

## 36. Risk management (continued)

## (c) Credit risk (continued)

Group As at 31 December 2021

	Total £m	AAA £m	AA £m	A £m	BBB or lower £m	Not rated £m
<b>Stage 1 assets</b>						
Cash and cash equivalents	228	1	—	203	24	—
Loans and receivables at amortised cost	732	—	—	384	—	348
Loss allowance	—	—	—	—	—	—
<b>Exposure to credit risk</b>	<b>960</b>	<b>1</b>	<b>—</b>	<b>587</b>	<b>24</b>	<b>348</b>
<b>Simplified approach assets</b>						
Loans and receivables at amortised cost	234	—	—	31	—	203
Loss allowance	(3)	—	—	(2)	—	(1)
<b>Exposure to credit risk</b>	<b>231</b>	<b>—</b>	<b>—</b>	<b>29</b>	<b>—</b>	<b>202</b>
<b>Assets at FVTPL</b>						
Contracts with reinsurers at fair value through profit or loss	12,371	—	12,328	—	43	—
Debt and other fixed/variable income securities	38,992	2,320	15,020	9,901	11,725	26
Derivative financial instruments	2,843	—	273	2,499	—	71
Loans and advances to customers	9,395	67	295	5,799	2,583	651
Loans and advances to banks	4,084	—	246	3,397	377	64
<b>Other</b>						
Reinsurance contracts	729	—	616	113	—	—
<b>Total</b>	<b>69,605</b>	<b>2,388</b>	<b>28,778</b>	<b>22,325</b>	<b>14,752</b>	<b>1,362</b>

Cash at bank, included with Stage 1 assets, is considered to have low credit risk.

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2021 (continued)

## 36. Risk management (continued)

## (c) Credit risk (continued)

Group As at 31 December 2020

	Total £m	AAA £m	AA £m	A £m	BBB or lower £m	Not rated £m
<b>Stage 1 assets</b>						
Cash and cash equivalents	218	1	0	191	26	0
Loans and receivables at amortised cost	775	—	—	341	—	434
Loss allowance	—	—	—	—	—	—
<b>Exposure to credit risk</b>	<b>993</b>	<b>1</b>	<b>0</b>	<b>532</b>	<b>26</b>	<b>434</b>
<b>Simplified approach assets</b>						
Loans and receivables at amortised cost	250	—	—	54	—	196
Loss allowance	(7)	—	—	(3)	—	(4)
<b>Exposure to credit risk</b>	<b>243</b>	<b>—</b>	<b>—</b>	<b>51</b>	<b>—</b>	<b>192</b>
<b>Assets at FVTPL</b>						
Contracts with reinsurers at fair value through profit or loss	19,549	—	19,230	0	314	5
Debt and other fixed/variable income securities	37,256	2,036	16,831	8,602	9,756	31
Derivative financial instruments	5,224	—	636	4,426	90	72
Loans and advances to customers	9,646	76	266	6,131	2,570	603
Loans and advances to banks	4,693	—	213	4,440	3	37
<b>Other</b>						
Reinsurance contracts	810	—	810	—	—	—
<b>Total</b>	<b>78,414</b>	<b>2,113</b>	<b>37,986</b>	<b>24,182</b>	<b>12,759</b>	<b>1,374</b>

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2021 (continued)

## 36. Risk management (continued)

## (c) Credit risk (continued)

## Company As at 31 December 2021

	Total £m	AAA £m	AA £m	A £m	BBB or lower £m	Not rated £m
<b>Stage 1 assets</b>						
Cash and cash equivalents	96	—	—	73	24	(1)
Loans and receivables at amortised cost	359	—	—	357	—	2
Loss allowance	—	—	—	—	—	—
<b>Exposure to credit risk</b>	<b>455</b>	<b>—</b>	<b>—</b>	<b>430</b>	<b>24</b>	<b>1</b>
<b>Simplified approach assets</b>						
Loans and receivables at amortised cost	224	—	—	29	—	195
Loss allowance	—	—	—	—	—	—
<b>Exposure to credit risk</b>	<b>224</b>	<b>—</b>	<b>—</b>	<b>29</b>	<b>—</b>	<b>195</b>
<b>Assets at FVTPL</b>						
Contracts with reinsurers at fair value through profit or loss	12,371	—	12,328	—	43	—
Debt and other fixed/variable income securities	15,176	443	8,788	2,247	3,592	106
Derivative financial instruments	2,720	—	264	2,437	—	19
Loans and advances to customers	8,910	67	296	5,799	2,583	165
Loans and advances to banks	1,274	—	—	855	361	58
Deposits with cedants	1,447	—	—	—	—	1,447
<b>Other</b>						
Reinsurance contracts	736	—	623	113	—	—
<b>Total</b>	<b>43,313</b>	<b>510</b>	<b>22,299</b>	<b>11,910</b>	<b>6,603</b>	<b>1,991</b>

Cash at bank, included with Stage 1 assets, is considered to have low credit risk.

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2021 (continued)

## 36. Risk management (continued)

## (c) Credit risk (continued)

## Company As at 31 December 2020

	Total £m	AAA £m	AA £m	A £m	BBB or lower £m	Not rated £m
<b>Stage 1 assets</b>						
Cash and cash equivalents	95	—	—	69	26	—
Loans and receivables at amortised cost	383	—	—	382	—	1
Loss allowance	—	—	—	—	—	—
<b>Exposure to credit risk</b>	<b>478</b>	<b>—</b>	<b>—</b>	<b>451</b>	<b>26</b>	<b>1</b>
<b>Simplified approach assets</b>						
Loans and receivables at amortised cost	236	—	—	54	—	182
Loss allowance	(4)	—	—	(3)	—	(1)
<b>Exposure to credit risk</b>	<b>232</b>	<b>—</b>	<b>—</b>	<b>51</b>	<b>—</b>	<b>181</b>
<b>Assets at FVTPL</b>						
Contracts with reinsurers at fair value through profit or loss	19,549	—	19,230	—	314	5
Debt and other fixed/variable income securities	16,677	514	9,741	2,714	3,561	147
Derivative financial instruments	5,132	—	606	4,385	90	51
Loans and advances to customers	9,095	76	266	6,131	2,570	52
Loans and advances to banks	1,468	—	—	1,437	—	31
Deposits with cedants	1,509	—	—	—	—	1,509
<b>Other</b>						
Reinsurance contracts	819	—	819	—	—	—
<b>Total</b>	<b>54,959</b>	<b>590</b>	<b>30,662</b>	<b>15,169</b>	<b>6,561</b>	<b>1,977</b>

Amounts classified as 'not rated' within contracts with reinsurers at fair value through profit or loss principally relate to an amount due from SWE which is not rated by Standard & Poor's or an equivalent rating agency.

Expected credit losses are calculated using three key input parameters: the probability of default (PD) (except for lifetime expected credit losses), the expected loss given default (LGD) and the exposure at default (EAD). The probability of default and expected loss given default are determined using internally generated credit ratings. For lease receivables, the past due information is used to determine the expected loss given default.

Expected credit losses are measured on a collective basis for certain Groups of financial assets, such as control accounts, trade receivables and intercompany receivables, which are considered to be homogenous in terms of their risk of default.

**Maximum credit exposure**

The maximum credit risk exposure of the Group in the event of other parties failing to perform their obligations is detailed below. No account is taken of any collateral held and the maximum exposure to loss, which includes amounts held to cover unit-linked and With Profits Funds liabilities, is considered to be the balance sheet carrying amount.

Net credit exposure represents the exposure net of offsetting, as defined in section 36(c)(iii).

**NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2021 (continued)****36. Risk management (continued)****(c) Credit risk (continued)**

<u>Group</u>	<b>2021</b>		<b>2020</b>	
	<b>Maximum exposure £m</b>	<b>Net exposure £m</b>	<b>Maximum exposure £m</b>	<b>Net exposure £m</b>
Loans and receivables at amortised cost	963	963	1,018	1,107
Investments at fair value through profit or loss:				
Contracts with reinsurers at fair value through profit or loss	12,371	12,371	19,549	19,549
Debt securities	38,992	38,992	37,256	37,256
Derivative Financial Instruments	2,843	2,843	5,224	5,224
Loans and advances to customers	9,395	9,395	9,646	9,646
Loans and advances to banks	4,084	4,084	4,693	4,693
Reinsurance contracts	729	729	810	810
Cash and cash equivalents	228	228	218	218
<b>At 31 December</b>	<b>69,605</b>	<b>69,605</b>	<b>78,414</b>	<b>78,503</b>

<u>Company</u>	<b>2021</b>		<b>2020</b>	
	<b>Maximum exposure £m</b>	<b>Net exposure £m</b>	<b>Maximum exposure £m</b>	<b>Net exposure £m</b>
Loans and receivables at amortised cost	583	583	615	615
Investments at fair value through profit or loss:				
Contracts with reinsurers at fair value through profit or loss	12,371	12,371	19,549	19,549
Debt securities	15,176	15,176	16,677	16,677
Derivative Financial Instruments	2,720	2,720	5,132	5,132
Loans and advances to customers	8,910	8,910	9,095	9,095
Loans and advances to banks	1,274	1,274	1,468	1,468
Deposits with cedants	1,447	1,447	1,509	1,509
Reinsurance contracts	736	736	819	819
Cash and cash equivalents	96	96	95	95
<b>At 31 December</b>	<b>43,313</b>	<b>43,313</b>	<b>54,959</b>	<b>54,959</b>

**Shareholder asset credit experience**

The Group invests in a non-cyclical and high quality portfolio of assets, and regarding shareholder assets, the majority of these are used to match against long term annuity liabilities. The bonds, loans and gilts in which the Group invests have an average rating of A and are well diversified. In 2021 the net downgrades to sub-investment grade totalled £7 million, this was a result of £63 million of downgrades offset by total upgrades to investment grade of £56 million. A total of 0.5 per cent of shareholder assets are currently rated sub-investment grade.

The Group continues to have no direct exposure to Russia or Ukraine in its shareholder asset portfolios. There is limited indirect exposure in the corporate bond portfolio, but no material impact is expected. There has been no immediate impact on credit quality in the shareholder portfolio, however should a conflict and/or sanctions persist, there will be increased risk of credit deterioration due to macroeconomic pressures such as inflation or increasing energy prices.

**NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2021 (continued)****36. Risk management (continued)****(c) Credit risk (continued)****(i) Concentration risk***Credit concentration risk*

Credit concentration risk relates to the inadequate diversification of credit risk.

Credit risk is managed through the setting and regular review of counterparty credit and concentration limits on asset types which are considered more likely to lead to a concentration of credit risk. For other asset types, such as UK government securities or investments in funds falling under the Undertakings for Collective Investment in Transferable Securities (UCITS) Directive, no limits are prescribed as the risk of credit concentration is deemed to be immaterial. This policy supports the approach mandated by the PRA for regulatory reporting.

At 31 December 2021 and 31 December 2020, the Group did not have any significant concentration of credit risk with a single counterparty or Group of counterparties where limits applied. Regarding shareholder assets, the largest aggregated counterparty exposure is 0.2 per cent (2020: 0.2 per cent) of the Group's total assets.

The following table shows where the Group and Company has concentrations of credit risk with counterparties sharing similar features, specifically type of counterparty:

	2021		2020	
	£m	£m	£m	£m
	<u>Group</u>	<u>Company</u>	<u>Group</u>	<u>Company</u>
Trade and other receivables:				
Amounts due from brokers	43	33	57	32
Amounts due from Group undertakings	403	361	375	364
Other receivables	517	189	586	219
Cash and cash equivalents with financial institutions	228	96	218	95
<b>Total</b>	<b>1,191</b>	<b>679</b>	<b>1,236</b>	<b>710</b>

For other receivables, the largest single counterparty balance is with policyholders, which totals £132 million for Group (2020: £83 million) and £76 million for Company (2020: £83 million).

*Liquidity concentration risk*

Liquidity concentration risk arises where the Group is unable to meet its obligations as they fall due or do so only at an excessive cost, due to over-concentration of investments in particular financial assets or classes of financial asset.

As most of the Group's invested assets are diversified across a range of marketable equity and debt securities in line with the investment options offered to policyholders it is unlikely that a material concentration of liquidity concentration could arise.

This is supplemented by active liquidity management in the Group, to ensure that even under stress conditions the Group has sufficient liquidity as required to meet its obligations. This is delegated by the Board to and monitored through the Insurance and Wealth Asset and Liability Committee (IWALCO), IWRC, ISIM and Banking and Liquidity Operating Committee (BLOC).

**(ii) Collateral management***Collateral in respect of derivatives*

The requirement for collateralisation of OTC derivatives, including the levels at which collateral is required and the types of asset that are deemed to be acceptable collateral, are set out in a Credit Support Annex (CSA), which forms part of the International Swaps and Derivatives Association (ISDA) agreement between the Company and the counterparty.

The CSA will require collateralisation where any net exposure to a counterparty exceeds the OTC counterparty limit, which must be established in accordance with the Derivatives Risk Policy (DRP). The aggregate uncollateralised exposure to any one counterparty must not exceed limits specified in the DRP. Where derivative counterparties are related, the aggregate net exposure is considered for the purposes of applying these limits.

Acceptable collateral is defined in each instance and must take into account the quality and appropriateness of the proposed collateral as well as being acceptable to the entity receiving the collateral. Collateral may include cash, corporate bonds, supranational debt and government debt.

**NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2021 (continued)****36. Risk management (continued)****(c) Credit risk (continued)****(ii) Collateral management (continued)***Collateral in respect of derivatives (continued)*

Assets with the following carrying amounts have been pledged in accordance with the terms of the relevant CSAs entered into in respect of various OTC and other derivative contracts:

	2021		2020	
	£m	£m	£m	£m
	<i>Group</i>	<i>Company</i>	<i>Group</i>	<i>Company</i>
Financial assets:				
Investments at fair value through profit or loss	1,326	1,326	1,483	1,483
Cash and cash equivalents	281	183	445	425
<b>Total</b>	<b>1,607</b>	<b>1,509</b>	<b>1,928</b>	<b>1,908</b>

Collateral pledged in form of financial assets, is continued to be recognised in the balance sheet as the Group and Company retains all risks and rewards of the transferred assets. The Group and the Company has the right to recall any collateral pledged provided that this is replaced with alternative acceptable assets. The counterparty has right to repledge or sell the collateral in the absence of default by the Group and Company.

Cash collateral pledged where the counterparty retains the risks and rewards is derecognised from the balance sheet and a corresponding receivable is recognised for its return.

Where the Group and Company receives collateral in form of financial instruments for which the counterparty retains all risks and rewards, it is not recognised in the balance sheet. The fair value of financial assets accepted as collateral for OTC derivatives but not recognised in the balance sheet amounts to £1,162 million (2020: £1,440 million) by the Group and £1,162 million (2020: £1,440 million) by the Company, all of which is permitted to be sold or repledged in the absence of default. However the policy of the Group and Company is not to repledge assets, and hence no collateral was sold or repledged by the Group or Company during the year or in the prior year. Non-cash collateral received during the year was made up of high quality government Bonds such as UK Gilts and Treasury Bills, with the exception of one asset which was a Corporate bond.

Where the Group and Company receives collateral in form of cash, it is recognised in the balance sheet along with a corresponding liability to repay the amount of collateral received within other financial liabilities. The amount of cash collateral received by the Group and Company amounts to £463 million (2020: £868 million) and £390 million (2020: £821 million) respectively.

*Collateral in respect of Stock Lending*

Stock lending activity has been suspended. Until the prior year, the Group and Company lent financial assets held in its portfolio to other institutions. The IISC and its sub-committee Investment Management Operational Review Committee (IMOR) were responsible for setting the parameters of stock lending. Stock lending is permitted in accordance with the Insurance Stock Lending Policy. All stock lending took place on an open/call basis, enabling the loan to be recalled at any time within the standard settlement terms of the market concerned.

The financial assets lent do not qualify for derecognition as the Group and Company retains all risks and rewards of the transferred assets except for the voting rights. The aggregate carrying value of securities on loan by the Group is £1 million (2020: £1 million) and by the Company is nil (2020: nil).

It is the Group's and Company's practice to obtain collateral in stock lending transactions. The accepted collateral can include cash, equities, certain bonds and money-market instruments. On a daily basis, the fair value of collateral is compared to the fair value of stock on loan. The value of collateral must always exceed the value of stock on loan.

Where the Group and Company receives collateral in form of financial instruments for which counterparty retains all risks and rewards, it is not recognised in the balance sheet. The fair value of financial assets accepted as collateral but not recognised in the balance sheet amounts to £1 million (2020: £1 million) by the Group and nil (2020: nil) by the Company. The Group and the Company is not permitted to sell or repledge the collateral in the absence of default.

Where the Group and Company receives collateral in form of cash, it is recognised in the balance sheet along with a corresponding liability to repay the amount of collateral received within other financial liabilities. The amount of cash collateral received by the Group and Company amounts to nil (2020: nil) and nil (2020: nil) respectively.

There were no defaults in respect of stock lending during the year ended 31 December 2021 (2020: none) which required a call to be made on collateral.

**NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2021 (continued)****36. Risk management (continued)****(c) Credit risk (continued)****(ii) Collateral management (continued)***Collateral in respect of Bulk Annuity Business*

Acceptable collateral is defined in each instance and must take into account the quality and appropriateness of the proposed collateral as well as being acceptable to the entity receiving the collateral. Collateral may include cash, corporate bonds, supranational debt and government debt.

During 2021, the Company purchased Bulk Annuity contracts which provide buy in and buy-out solutions to defined benefit pension schemes. To enter into the transaction some trustees may seek collateral to cover the counterparty default scenario. Collateral pledged cumulatively in respect of Bulk Annuity business was £1,314 million (2020: £1,436 million) for Group and Company.

**(iii) Offsetting**

The Group and Company are not offsetting under master netting arrangements. Financial assets and liabilities are offset in the statement of financial position when the Group and/or Company has a legally enforceable right to offset and has the intention to settle the asset and liability on a net basis, or to realise the asset and settle the liability simultaneously.

**a) Derivatives**

The derivative assets and liabilities in the tables below consist of OTC and exchange traded (ET) derivatives. The value of gross/net amounts for derivatives in the table below comprises those that are subject to master netting arrangements. The right to set off balances under these master netting agreements or to set off cash and securities collateral only arises in the event of non payment or default and, as a result, these arrangements do not qualify for offsetting under IAS 32. As a result no amount has been set off in the balance sheet (2020: nil). Total derivatives presented in the balance sheet are shown in note 19.

The 'financial instruments' amounts in the tables below show the values that can be set off against the relevant derivatives asset and liabilities in the event of default under master netting agreements. In addition, the Group and the Company holds and provides cash and securities collateral in respect of derivative transactions to mitigate credit risks.

In the tables below, the amounts of derivative assets or liabilities presented are offset first by financial instruments that have the right of offset under master netting with any remaining amount reduced by the amount collateral.

**b) Repurchase and Reverse Repurchase Arrangements**

The Group and the Company participates in repurchase (repo) and reverse repurchase arrangements (reverse repo). The gross/net amount in the table shows the relevant assets that the Group and the Company has transferred to counterparties under these arrangements. Cash and non cash collateral is received by the Group and the Company for securities transferred. Cash collateral may be reinvested by the Group and Company through reverse repo against non cash collateral.

In the tables below, the amounts that are subject to repo and reverse repo are set off against the amount of collateral received according to the relevant legal agreements, showing the potential net amounts.

The actual fair value of collateral may be greater than amounts presented in the tables below in the case of over collateralisation.

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2021 (continued)

## 36. Risk management (continued)

## (c) Credit risk (continued)

## (iii) Offsetting (continued)

## b) Repurchase and Reverse Repurchase Arrangements (continued)

Group as at 31 December 2021

				Related amounts where set off not permitted in the balance sheet (sub note 2)		
	Gross amounts of assets / liabilities	Amounts set off in the balance sheet	Net amounts presented in the balance sheet (sub note 1)	Financial instruments	Collateral	Potential net amounts if offset of related amounts permitted
	£m	£m	£m	£m	£m	£m
<b>Financial assets</b>						
OTC Derivatives	2,800	—	2,800	(963)	(1,550)	287
ET Derivatives	43	—	43	(12)	(33)	(2)
<b>Financial liabilities</b>						
OTC Derivatives	(2,446)	—	(2,446)	962	1,458	(26)
ET Derivatives	(62)	—	(62)	12	50	—

Group as at 31 December 2020

				Related amounts where set off not permitted in the balance sheet (sub note 2)		
	Gross amounts of assets / liabilities	Amounts set off in the balance sheet	Net amounts presented in the balance sheet (sub note 1)	Financial instruments	Collateral	Potential net amounts if offset of related amounts permitted
	£m	£m	£m	£m	£m	£m
<b>Financial assets</b>						
OTC Derivatives	5,169	—	5,169	(3,233)	(2,225)	(289)
ET Derivatives	55	—	55	(29)	(26)	—
<b>Financial liabilities</b>						
OTC Derivatives	(4,562)	—	(4,562)	3,233	1,695	366
ET Derivatives	(46)	—	(46)	29	17	—

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2021 (continued)

## 36. Risk management (continued)

## (c) Credit risk (continued)

## (iii) Offsetting (continued)

## b) Repurchase and Reverse Repurchase Arrangements (continued)

Company as at 31 December 2021

				Related amounts where set off not permitted in the balance sheet (sub note 2)		
	Gross amounts of assets / liabilities	Amounts set off in the balance sheet	Net amounts presented in the balance sheet (sub note 1)	Financial instruments	Collateral	Potential net amounts if offset of related amounts permitted
	£m	£m	£m	£m	£m	£m
<b>Financial assets</b>						
OTC Derivatives	2,703	—	2,703	(942)	(1,490)	271
ET Derivatives	17	—	17	(5)	(13)	(1)
<b>Financial liabilities</b>						
OTC Derivatives	(2,376)	—	(2,376)	942	1,437	3
ET Derivatives	(53)	—	(53)	5	48	—

Company as at 31 December 2020

				Related amounts where set off not permitted in the balance sheet (sub note 2)		
	Gross amounts of assets / liabilities	Amounts set off in the balance sheet	Net amounts presented in the balance sheet (sub note 1)	Financial instruments	Collateral	Potential net amounts if offset of related amounts permitted
	£m	£m	£m	£m	£m	£m
<b>Financial assets</b>						
OTC Derivatives	5,093	—	5,093	(3,233)	(2,185)	(325)
ET Derivatives	39	—	39	(26)	(13)	—
Reverse Repo	—	—	—	—	—	—
<b>Financial liabilities</b>						
OTC Derivatives	(4,550)	—	(4,550)	3,233	1,689	372
ET Derivatives	(40)	—	(40)	26	14	—

The following sub notes are relevant to the tables on this and the preceding page:

1. The value of net amounts presented in the balance sheet for derivatives comprises those derivatives held by the Group and the Company that are subject to master netting arrangements. Total derivatives presented in the balance sheet are shown in note 19.
2. The Group and the Company enters into derivative transactions with various counterparties which are governed by industry standard master netting agreements. The Group and the Company holds and provides cash and securities collateral in respective of derivative transactions covered by these agreements. The right to set off balances under these master netting agreements or to set off cash and securities collateral only arises in the event of non-payment or default and, as a result, these arrangements do not qualify for offsetting under IAS 32.

**NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2021 (continued)****36. Risk management (continued)****(d) Capital Risk**

Capital risk is defined as the risk that the Group has a sub-optimal quantity or quality of capital or that capital is inefficiently deployed across the Group. The risk that:

- the Group, or one of its separately regulated subsidiaries, has insufficient capital to meet its regulatory capital requirements
- the Group has insufficient capital to provide a stable resource to absorb all losses up to a confidence level defined in the risk appetite
- the Group loses reputational status by having capital that is regarded as inappropriate, either in quantity, type or distribution

The business of several of the companies within the Group is regulated by the PRA and the FCA. The PRA rules, which incorporate all Solvency II requirements, specify the minimum amount of capital that must be held by the regulated companies within the Group in addition to their insurance liabilities. Under the Solvency II rules, each insurance Company within the Group must hold assets in excess of this minimum amount, which is derived from an economic capital assessment undertaken by each regulated Company and the quality of capital held must also satisfy Solvency II tiering rules.

The Solvency II minimum required capital must be maintained at all times throughout the year. These capital requirements and the capital available to meet them are regularly estimated in order to ensure that capital maintenance requirements are being met.

The Group's objectives when managing capital are:

- to have sufficient capital to safeguard the Group's ability to continue as a going concern so that it can continue to provide returns for the shareholder and benefits for other stakeholders
- to comply with the insurance capital requirements set out by the PRA in the UK
- when capital is needed, to require an adequate return to the shareholder by pricing insurance and investment contracts according to the level of risk associated with the business written
- to meet the requirements of the Schemes of Transfer

The capital management strategy is such that the integrated insurance business (comprising SWG and its subsidiaries, including the Group) will hold capital in line with the stated risk appetite for the business, which is to be able to withstand high-severity stress events without breaching the capital requirements. At SWG level it is intended that all surplus capital above that required to absorb a one in ten year stress event will be distributed to Lloyds Banking Group.

Capital support arrangements are in place for SWUTM and SWAS, which are provided by the Company. These irrevocable guarantees will come into effect on the occurrence of a material operational risk event impacting their respective capital positions. In addition for SWAS only, these arrangements will also come into effect on the occurrence of a material reinsured fund default event impacting its capital position. The Company has made these arrangements to provide sufficient capital to meet the regulatory capital adequacy and internal capital surplus requirements of these subsidiaries if such events occur.

The Company's capital comprises all components of equity, movements in which are set out in the statement of changes in equity and includes subordinated debt (note 29).

**NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2021 (continued)****36. Risk management (continued)****(d) Capital Risk (continued)**

The table below sets out the regulatory capital held (specifically, eligible own funds, allowing for any year-end foreseeable dividend, available to cover the solvency capital requirement) at 31 December in each year for the Company on a Solvency II basis.

*Company*

	2021 £m	2020 £m
Regulatory Capital held	6,930	7,434
SCR (unaudited)	4,314	5,226
Solvency II Ratio (unaudited)	180 %	149 %

The solvency position increased over 2021 due to recovery in the markets and is expected to remain above risk appetite at 31 December 2021. Exposure of the solvency position to market volatility continues to be actively monitored, in particular relating to interest rates and credit assets. The credit portfolio is average 'A' rated, well diversified and non-cyclical, with less than 1 per cent invested in sub investment grade or unrated assets.

All minimum regulatory requirements were met during the year.

**(e) Liquidity risk**

Liquidity risk is defined as the risk that the Group does not have sufficient financial resources to meet its commitments as they fall due, or can only secure them at excessive cost.

Liquidity risk may result from either the inability to sell financial assets quickly at their fair values; or from an insurance liability falling due for payment earlier than expected; or from the inability to generate cash inflows as anticipated.

Liquidity risk has been analysed as arising from payments to policyholders (including those where payment is at the discretion of the policyholder) and non policyholder related activity (such as investment purchases and the payment of shareholder expenses).

In order to measure liquidity risk exposure the Group's liquidity is assessed in a stress scenario. Liquidity risk is actively managed and monitored to ensure that, even under stress conditions, the Company and Group has sufficient liquidity to meet its obligations and remains within approved risk appetite. Liquidity risk appetite considers two time periods; three month stressed outflows are required to be covered by primary liquid assets; and one-year stressed outflows are required to be covered by primary and secondary liquid assets. Primary liquid assets are gilts or cash, and secondary liquid assets are corporate bonds. The stressed outflows also make allowance for the increased collateral that needs to be posted under derivative contracts in stressed conditions. Liquidity risk is actively managed and monitored to ensure that, even under stress conditions, the Group has sufficient liquidity to meet its obligations and remains within approved risk appetite.

Liquidity risk is managed in line with the Insurance Liquidity Risk Policy and the wider Lloyds Banking Group Funding and Liquidity Policy. Liquidity risk in respect of each of the major product areas is primarily mitigated as follows:

*Annuity contracts*

Assets are held which are specifically chosen to correspond to the expectation of timing of annuity payments. Gilts, corporate bonds, loans and, where required, derivatives are selected to reflect the expected annuity payments as closely as possible and are regularly rebalanced to ensure that this remains the case in future.

*With Profits contracts*

For With Profits business, a portfolio of assets is held in line with investment mandates which will reflect policyholders' reasonable expectations.

Liquidity is maintained within the portfolio via the holding of cash balances and a substantial number of highly liquid assets, principally gilts, bonds and listed equities.

**NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2021 (continued)****36. Risk management (continued)****(e) Liquidity risk (continued)***Non-participating contracts*

For unit-linked products, portfolios are managed through mandates which ensure that they are run within defined tolerances, maintaining sufficient liquidity to carry out operations of the portfolio without material disruption. Deferral clauses are included in policyholder contracts to give time, when necessary, to realise linked assets without being a forced seller. Redemptions (other than on death, maturity or retirement) of units in certain property-linked funds were deferred during 2020 due to material uncertainty in the valuation of the underlying assets and were unrestricted in 2021. As at 31 December 2021, there are no funds subject to deferral (2020: one).

For non-linked products other than annuity contracts, backing investments are mostly held in gilts with minimal liquidity risk. Investments are arranged to minimise the possibility of being a distressed seller whilst at the same time investing to meet policyholder obligations. This is achieved by anticipating policyholder behaviour and sales of underlying assets within funds.

*Shareholder funds*

For shareholder funds, liquidity is maintained within the portfolio via the holding of cash balances and a substantial number of highly liquid assets, principally gilts and bonds.

The following tables indicate the timing of the contractual cash flows arising from the Group and Company's financial liabilities, as required by IFRS 7. The table is based on the undiscounted cash flows of financial liabilities based on the earliest date on which the Group and Company are obliged to pay. The table includes both interest and principal cash flows.

Liquidity risk in respect of liabilities arising from insurance contracts and participating investment contracts has been analysed based on the expected pattern of maturities as permitted by IFRS 4 rather than by contractual maturity. A maturity analysis of liabilities arising from non-participating investment contracts based on expected contract maturities is also given as it is considered that this analysis provides additional useful information in respect of the liquidity risk relating to contracts written by the Group and Company.

**Group As at 31 December 2021****Contractual cash flows**

Liabilities	Carrying amount £m	No stated maturity £m	Less than 1 month £m	1-3 months £m	3-12 months £m	1-5 years £m	More than 5 years £m
Liabilities arising from non-participating investment contracts	45,035	—	45,036	—	—	—	—
External interests in collective investment vehicles	14,348	14,347	—	—	—	—	—
Derivatives held for trading	2,508	—	42	73	40	223	2,547
Subordinated debt	1,753	—	—	—	93	1,094	1,420
Borrowings	1	—	1	—	—	—	—
Lease liabilities	5	—	—	—	—	1	71
Other financial liabilities	1,717	298	1,408	4	9	—	—
<b>Total</b>	<b>65,367</b>	<b>14,645</b>	<b>46,487</b>	<b>77</b>	<b>142</b>	<b>1,318</b>	<b>4,038</b>

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2021 (continued)

## 36. Risk management (continued)

## (e) Liquidity risk (continued)

## Group As at 31 December 2020

Liabilities	Carrying amount £m	Contractual cash flows					
		No stated maturity £m	Less than 1 month £m	1-3 months £m	3-12 months £m	1-5 years £m	More than 5 years £m
Liabilities arising from non-participating investment contracts	38,448	—	38,448	—	—	—	—
External interests in collective investment vehicles	12,620	12,620	—	—	—	—	—
Derivatives held for trading	4,609	—	49	81	139	837	3,673
Subordinated debt	1,892	—	—	—	113	1,074	1,420
Borrowings	2	—	2	—	—	—	—
Lease liabilities	8	—	—	—	1	2	77
Other financial liabilities	2,214	229	1,961	15	9	—	—
<b>Total</b>	<b>59,793</b>	<b>12,849</b>	<b>40,460</b>	<b>96</b>	<b>262</b>	<b>1,913</b>	<b>5,170</b>

The contractual cash flow analysis set out above has been based on the earliest possible contractual date, regardless of the surrender penalties that might apply and has not been adjusted to take account of such penalties.

An analysis of the contractual cash flows in respect of insurance and investment contract liabilities by expected contract maturity, on a discounted basis, is shown below:

## Group As at 31 December 2021

	Total	Less than 1 month	1-3 months	3-12 months	1-5 years	More than 5 years
<b>Maturity Analysis for liabilities arising from insurance and investment contracts</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>
Insurance and participating investment contracts	123,348	1,007	1,467	5,854	26,948	88,072
Non-participating investment contracts	45,035	527	616	2,686	14,398	26,808

Group As at 31 December 2020  
(Restated\*)

	Total	Less than 1 month	1-3 Months	3-12 months	1-5 years	More than 5 years
<b>Maturity Analysis for liabilities arising from insurance and investment contracts</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>
Insurance and participating investment contracts	115,822 *	853 *	1,232 *	5,355 *	25,199 *	83,183 *
Non-participating investment contracts	38,448	469	537	2,363	11,510	23,569

\* restated. See note 41 for details of restatement.

The 2020 Group figures for Insurance and participating investment contracts have been adjusted to enhance the consistency between the Group and Company maturity analysis.

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2021 (continued)

## 36. Risk management (continued)

## (e) Liquidity risk (continued)

## Company As at 31 December 2021

Liabilities	Contractual cash flows						
	Carrying amount £m	No stated maturity £m	Less than 1 month £m	1-3 months £m	3-12 months £m	1-5 years £m	More than 5 years £m
Borrowings	1	—	1	—	—	—	—
Liabilities arising from non-participating investment contracts	45,016	—	45,016	—	—	—	—
Derivative financial instruments	2,429	—	18	64	41	203	2,515
Subordinated debt	1,786	—	—	—	92	1,100	1,444
Other financial liabilities	1,505	272	1,235	—	—	—	—
<b>Total</b>	<b>50,737</b>	<b>272</b>	<b>46,270</b>	<b>64</b>	<b>133</b>	<b>1,303</b>	<b>3,959</b>

## Company As at 31 December 2020

Liabilities	Contractual cash flows						
	Carrying amount £m	No stated maturity £m	Less than 1 month £m	1-3 months £m	3-12 months £m	1-5 years £m	More than 5 years £m
Borrowings	2	—	2	—	—	—	—
Liabilities arising from non-participating investment contracts	38,433	—	38,433	—	—	—	—
Derivative financial instruments	4,590	—	40	71	138	837	3,673
Subordinated debt	1,923	—	—	—	92	1,100	1,444
Other financial liabilities	1,972	229	1,743	—	—	—	—
<b>Total</b>	<b>46,920</b>	<b>229</b>	<b>40,218</b>	<b>71</b>	<b>230</b>	<b>1,937</b>	<b>5,117</b>

The contractual cash flow analysis set out above has been based on the earliest possible contractual date, regardless of the surrender penalties that might apply and has not been adjusted to take account of such penalties.

An analysis of liabilities arising from insurance and investment contracts by expected contract maturity, on a discounted basis, is shown below:

## Company As at 31 December 2021

	Total	Less than 1 month	1-3 months	3-12 months	1-5 years	More than 5 years
<b>Maturity Analysis for liabilities arising from insurance contracts and investment contracts</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>
Insurance and participating investment contracts	122,842	1,004	1,461	5,825	26,816	87,736
Non-participating investment contracts	45,016	527	615	2,684	14,390	26,800

Company As at 31 December 2020  
(Restated\*)

	Total	Less than 1 month	1-3 months	3-12 months	1-5 years	More than 5 years
<b>Maturity Analysis for liabilities arising from insurance and investment contracts</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>
Insurance and participating investment contracts	115,344 *	850 *	1,226 *	5,322 *	25,076 *	82,870 *
Non-participating investment contracts	38,433 *	469 *	536 *	2,361 *	11,504 *	23,563 *

\* restated. See note 41 for details of restatement.

**NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2021 (continued)****37. Related party transactions****(a) Ultimate parent and shareholding**

The Group's immediate parent undertaking is SWG, a Company registered in the United Kingdom. SWG has taken advantage of the provisions of the Companies Act 2006 and has not produced consolidated financial statements.

The ultimate parent undertaking and controlling party is Lloyds Banking Group which is the parent undertaking of the only group to consolidate these financial statements. Copies of the consolidated Annual Report and Accounts of Lloyds Banking Group may be obtained from Lloyds Banking Group's head office at 25 Gresham Street, London EC2V 7HN or downloaded via [www.lloydsbankinggroup.com](http://www.lloydsbankinggroup.com).

**(b) Transactions with other Lloyds Banking Group companies**

In accordance with IAS 24 'Related Party Disclosures', transactions and balances between Group companies have been eliminated on consolidation and have not been reported as part of the consolidated financial statements.

The Group has entered into transactions with related parties in the normal course of business during the year.

**Group as at 31 December 2021**

Relationship	2021			
	Income during period	Expenses during period	Payable at period end	Receivable at period end
	£m	£m	£m	£m
Parent	13	(200)	—	352
Other related parties	1,034	(1,634)	(1,280)	2,150

**Group as at 31 December 2020**

Relationship	2020			
	Income during period	Expenses during period	Payable at period end	Receivable at period end
	£m	£m	£m	£m
Parent	14	(560)	—	348
Other related parties	403	(848)	(1,671)	2,762

The Company has entered into transactions with related parties in the normal course of business during the year. Holdings by the Group, including consolidated OEIC investments, give rise to £197 million (2020: £219 million) of shares in the ultimate parent undertaking on the balance sheet, with associated transactions of £(82) million (2020: £(90) million) during the year.

**NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2021 (continued)****37. Related party transactions (continued)****(b) Transactions with other Lloyds Banking Group companies (continued)****Company as at 31 December 2021**

	<b>2021</b>			
	<b>Income during period</b>	<b>Expenses during period</b>	<b>Payable at period end</b>	<b>Receivable at period end</b>
	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>
<b>Relationship</b>				
Parent	13	(200)	—	352
Subsidiary	222	(243)	(1,623)	652
Other related parties	993	(1,495)	(1,250)	1,989

**Company as at 31 December 2020**

	<b>2020</b>			
	<b>Income during period</b>	<b>Expenses during period</b>	<b>Payable at period end</b>	<b>Receivable at period end</b>
	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>
<b>Relationship</b>				
Parent	14	(560)	—	348
Subsidiary	352	(233)	(1,679)	675
Other related parties	386	(713)	(1,651)	2,650

Further, amounts relating to other related parties of £2,513 million due from OEICs investments were outstanding at 31 December 2021 (2020: £2,234 million). The above balances are unsecured in nature and are expected to be settled in cash.

Included within the consolidated statement of comprehensive income were net (expense)/income amounts related to other parties of £216 million (2020: £(9) million) from OEIC investments.

Parent undertaking transactions relate to all reported transactions and balances with SWG, the Group's immediate parent. Such transactions with the parent Company are primarily financing (through capital and subordinated debt), provision of loans and payment of dividends.

Transactions with other related parties (which includes Subsidiary and Other categories above) are primarily in relation to operating and employee expenses.

There are no loss allowances on intercompany balances as the risk of default is minimal.

**(c) Transactions between the Group and entity employing key management**

Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the Company which, for the Company, are all Directors and Insurance and Wealth Executive Committee (IWECE) members. Key management personnel, as defined by IAS 24, are employed by a management entity, transactions with this entity are as follows:

**Key management compensation:**

	<b>2021</b>	<b>2021</b>	<b>2020</b>	<b>2020</b>
	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>
	<i>Group</i>	<i>Company</i>	<i>Group</i>	<i>Company</i>
Short-term employee benefits	5	5	5	5
Share-based payments	1	1	1	1
<b>Total</b>	<b>6</b>	<b>6</b>	<b>6</b>	<b>6</b>

Included in short-term employee benefits is the aggregate amount of emoluments paid to or receivable by Directors in respect of qualifying services of £2 million (2020: £2 million).

There were no retirement benefits accruing to Directors (2020: nil) under defined benefit pension schemes. Two Directors (2020: two Directors) are paying into a defined contribution scheme. There were no contributions paid to a pension scheme for qualifying services (2020: nil) for Group and Company.

Certain members of key management in the Group, including the highest paid Director, provide services to other companies within Lloyds Banking Group. In such cases, for the purposes of this note, figures have been included based on an apportionment to the Group of the total compensation earned.

**NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2021 (continued)****37. Related party transactions (continued)****(c) Transactions between the Group and entity employing key management (continued)**

The aggregate amount of money receivable and the net value of assets received/receivable under Lloyds Banking Group share-based incentive schemes in respect of Directors qualifying services was £1 million (2020: £1 million). During the year, one Director exercised share options (2020: two Directors) and one Director received qualifying service shares under long-term incentive schemes (2020: two Directors). Movements in share options are as follows:

	2021 million Options	2020 million Options
<b>Outstanding at 1 January</b>	16	15
Granted	3	11
Exercised	(2)	(4)
Forfeited	(3)	(6)
<b>Outstanding at 31 December</b>	14	16

Detail regarding the highest paid Director is as follows:

	2021 £m	2021 £m	2020 £m	2020 £m
	<i>Group</i>	<i>Company</i>	<i>Group</i>	<i>Company</i>
Apportioned aggregate emoluments	1	1	1	1
Apportioned share-based payments	1	1	—	—

The highest paid Director did exercise share options during the year. (2020: The highest paid Director did exercise share options during the year).

**38. Lease liabilities**

The Group has lease liabilities arising from ground rent commitments on its investment properties. The lease liabilities and related right-of-use assets are included in the balance sheet as follows:

	2021 £m	2021 £m	2020 £m	2020 £m
	<i>Group</i>	<i>Company</i>	<i>Group</i>	<i>Company</i>
Lease liabilities:				
Current	—	—	1	—
Non-current	5	—	7	—
<b>Total</b>	5	—	8	—

A maturity analysis of lease liabilities is provided in note 36 (e) Liquidity Risk.

Operating lease receipts and payments represent rental receivable and payable by the Group for certain of its properties. Generally the Group's operating leases are for terms of 15 years or more.

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**NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2021 (continued)****39. Capital commitments**

The Group and Company has given an undertaking to provide up to £1,101 million (2020: £1,109 million) of capital to Private Credit Funds and at 31 December 2021, £1,073 million had been drawn down (2020: £1,057 million). The Group has also agreed £269 million of undrawn loan commitments in 2021 (2020: £220 million). £225 million of this undrawn balance is to be drawn within one year (2020: £155 million) and the remaining £44 million will be drawn within seven years (2020: £65 million).

The Group has total undrawn lending commitments of £354 million (2020: £311 million). £300 million of this undrawn balance is to be drawn within one year (2020: £227 million) and the remaining £54 million will be drawn within seven years (2020: £84 million). The commitments are irrevocable if the borrowers meet the terms of the agreements.

The Group has contracted for, but not paid for, £49 million (2020: £38 million) of development expenses for investment property. Of this amount, the Company has contracted for, but not paid for, £nil (2020: £nil).

**NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2021 (continued)****40. Future accounting developments**

The following pronouncements may have a significant effect on the Group's financial statements but are not applicable for the year ending 31 December 2021 and have not been applied in preparing these financial statements. Except as disclosed below, the full impact of these accounting changes is being assessed by the Group.

<b>Pronouncement</b>	<b>Nature of change</b>	<b>IASB effective date</b>
IFRS 17 'Insurance Contracts' <sup>1</sup>	<p>IFRS 17 replaces IFRS 4 Insurance Contracts and is effective for annual periods beginning on or after 1 January 2023.</p> <p>IFRS 17 requires insurance contracts and participating investment contracts to be measured on the balance sheet as the total of the fulfilment cash flows and the contractual service margin. The fulfilment cash flows consist of the present value of future cash flows, together with an explicit risk adjustment, and are required to be remeasured at each reporting date. The contractual service margin is equal and opposite to any day one gain in the fulfilment cash flows of a group of contracts and represents the unearned profit of the insurance contracts. Changes to estimates of future cash flows from one reporting date to another are recognised either as an amount in profit or loss or as an adjustment to the expected profit for providing insurance coverage, depending on the type of change and the reason for it. The effects of some changes in discount rates can either be recognised in profit or loss or in other comprehensive income as an accounting policy choice. The risk adjustment is released to profit and loss as an insurer's risk reduces. Profits which are currently recognised under IFRS 4 will no longer be recognised at inception of an insurance contract. Instead, the expected profit for providing insurance coverage is recognised in the contractual service margin and released to profit or loss over time as the insurance coverage is provided.</p> <p>The standard will have a significant impact on the accounting for the insurance and participating investment contracts issued by the Group as, whilst the profits which emerge under IFRS 17 would not be different over the lifetime of an insurance contract compared to current accounting, the timing of profit recognition may differ from IFRS 4.</p> <p>The standard is not expected to be effective until 1 January 2023, with a transition date of 1 January 2022 (reflecting the starting point for comparative results), and management is currently unable to quantify with reasonable assurance the estimated impact on transition to IFRS 17. This is because, the impact on transition will need to incorporate economic conditions and risks at the time of the transition date, and calculation of the transition impacts is planned to be undertaken across the first half of 2022.</p> <p>The Group's IFRS 17 project is progressing to plan. Work has focused on interpreting the requirements of the standard, developing methodologies, disclosures and accounting policies, and implementing the changes required to reporting and other systems. The development of the Group's data warehousing and actuarial liability calculation processes required for IFRS 17 reporting continues to progress, with testing underway and business readiness activity due to take place in 2022, ahead of full implementation from 1 January 2023.</p>	Annual periods beginning on or after 1 January 2023
Minor amendments to other accounting standards	The IASB has issued a number of minor amendments to IFRSs effective 1 January 2022 and in later years (including IFRS 9 Financial Instruments and IAS 37 Provisions, Contingent Liabilities and Contingent Assets). These amendments are not expected to have a significant impact on the Group.	Annual periods beginning on or after 1 January 2022 and later years

<sup>1</sup> At the date of this report, these pronouncements are awaiting endorsement for use in the United Kingdom.

There are no other standards or interpretations that are not yet effective and that would be expected to have a material impact on the Group or Company.

**NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2021 (continued)****41. Restatement of comparatives - Adjustment to accounting for insurance contract liabilities**

During the year, management identified a matter relating to a historical data error on annuity business spousal benefit, which has developed incrementally since 1999. The impact across the periods previously reported resulted in insurance contracts and participating investment contract liabilities being overstated by £104 million at 1 January 2020 and £143 million at 31 December 2020 for both Group and Company positions.

Retained profits for the Group and Company at 1 January 2020 and 31 December 2020 have been restated to reflect the change in insurance contract and participating investment contract liabilities, which had not been recognised in the statement of comprehensive income.

The impact of this on the Group and Company balance sheets at 1 January 2020 and 31 December 2020, and on the Group statement of comprehensive income for the year ended 31 December 2020, has been shown in the tables below.

Sensitivity analyses impacted by this adjustment have been restated, as shown in notes 35 and 36.

**Group**

	<b>Restated £m</b>	<b>Adjustment £m</b>	<b>Previously reported £m</b>
<b>Statement of Comprehensive Income for the year ended 31 December 2020</b>			
Change in liabilities arising from insurance contracts and participating investment contracts	(4,892)	39	(4,931)
Taxation credit	93	(7)	100
<b>Balance sheet as at 1 January 2020</b>			
<b>Assets</b>			
Current tax recoverable	30	(20)	50
<b>Equity</b>			
Retained profits	3,097	84	3,013
<b>Liabilities</b>			
Insurance contracts and participating investment contract liabilities	110,815	(104)	110,919
<b>Balance sheet as at 31 December 2020</b>			
<b>Assets</b>			
Current tax recoverable	96	(27)	123
<b>Equity</b>			
Retained profits	2,381	116	2,265
<b>Liabilities</b>			
Insurance contracts and participating investment contract liabilities	115,822	(143)	115,965

**NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2021 (continued)****41. Restatement of comparatives - Adjustment to accounting for insurance contract liabilities (continued)**  
**Company**

	<b>Restated £m</b>	<b>Adjustment £m</b>	<b>Previously reported £m</b>
<b>Balance sheet as at 1 January 2020</b>			
<b>Assets</b>			
Current tax recoverable	21	(20)	41
<b>Equity</b>			
Retained profits	3,169	84	3,085
<b>Liabilities</b>			
Insurance contracts and participating investment contract liabilities	110,495	(104)	110,599
<b>Balance sheet as at 31 December 2020</b>			
<b>Assets</b>			
Current tax recoverable	89	(27)	116
<b>Equity</b>			
Retained profits	2,454	116	2,338
<b>Liabilities</b>			
Insurance contracts and participating investment contract liabilities	115,344	(143)	115,487

**42. Post balance sheet events****Acquisition of Embark**

On 31 January 2022, Scottish Widows Group acquired 100 per cent of the ordinary share capital of Embark Group Limited, which together with its subsidiaries operates an investment and retirement platform business. The acquisition will enable the Company to re-platform its individual pensions and retirement proposition, delivering a platform for intermediaries and significantly strengthening its pensions and investments offering.

**Dividend**

An interim dividend of £300 million was declared on 3 February 2022 and paid to Scottish Widows Group on 9 February 2022.

**Lloyds Banking Group longevity reinsurance pass-through**

On 28 January 2022, the Company entered into a further longevity pass-through transaction, which passes longevity risk from a subset of Lloyds Banking Group defined benefit pension schemes through the Company and onto an external reinsurer. For further details of the accounting of this transaction, see note 24 which describes the accounting treatment of a longevity pass-through transaction of the same nature, but with a different subset of Lloyds Banking Group defined benefit pension schemes. The Group and Company expect to pass through £0.2 billion of associated premiums and £0.2 billion of associated claims each year.

**Director appointment**

Deborah Davis was appointed to the Board as a Director on 18 March 2022.

**Russian invasion of Ukraine**

The Russian invasion of Ukraine, beginning in February 2022, has increased tensions between members of the North Atlantic Treaty Organisation (NATO) and Russia and caused sanctions to be imposed. This could have significant adverse economic effects on financial markets and on energy costs, and may also result in increased cyber attacks and an increase in costs associated with such cyber attacks, all of which could have a materially adverse effect on the Group's results of operations, financial condition or prospects. The Group will continue to monitor the situation and risks to the business; refer to note 36(c) for further detail on shareholder asset exposures.