



Chesnara

—
Annual Report and Accounts
2012



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FORWARD-LOOKING STATEMENTS

This document may contain forward-looking statements with respect to certain of the plans and current expectations relating to the future financial condition, business performance and results of Chesnara plc. By their nature, all forward-looking statements involve risk and uncertainty because they relate to future events and circumstances that are beyond the control of Chesnara plc including, amongst other things, UK domestic, Swedish domestic and global economic and business conditions, market-related risks such as fluctuations in interest rates, currency exchange rates, inflation, deflation, the impact of competition, changes in customer preferences, delays in implementing proposals, the timing, impact and other uncertainties of future acquisitions or other combinations within relevant industries, the policies and actions of regulatory authorities, the impact of tax or other legislation and other regulations in the jurisdictions in which Chesnara plc and its subsidiaries operate. As a result, Chesnara plc's actual future condition, business performance and results may differ materially from the plans, goals and expectations expressed or implied in these forward-looking statements.

NOTE ON TERMINOLOGY

As explained in Note 8 to the IFRS financial statements, the principal reporting segments of the Group are:

-
- CA** which comprises the business of Countrywide Assured plc, the Group's original UK operating subsidiary, and of City of Westminster Assurance Company Limited, which was acquired by the Group in 2005 and the long-term business of which was transferred to Countrywide Assured plc during 2006;
-
- S&P** which was acquired on 20 December 2010 and is the balance of the Group's UK business. This business was transferred from Save & Prosper Insurance Limited and Save & Prosper Pensions Limited to Countrywide Assured plc on 31 December 2011 under the provisions of Part VII of the Financial Services and Markets Act 2000 (referred to in this document as 'the Part VII Transfer'); and
-
- Movestic** which comprises the Group's Swedish business, Movestic Livförsäkring AB and its subsidiary and associated companies.

In this Report and Accounts:

- i.** The CA and S&P segments may also be collectively referred to as the 'UK Business';
- ii.** The Movestic segment may also be referred to as the 'Swedish Business';
- iii.** 'CA' may also refer to Countrywide Assured plc, as the context implies;
- iv.** 'CWA' refers to City of Westminster Assurance Company Limited or to its long-term business funds transferred to Countrywide Assured plc;
- v.** 'S&P' may also refer collectively to Save & Prosper Insurance Limited and Save & Prosper Pensions Limited, as the context implies. Where it is necessary to distinguish reference to Save & Prosper Insurance Limited and Save & Prosper Pensions Limited, or to the businesses subsisting in those companies prior to the transfer referred to above, they are designated 'SPI' and 'SPP' respectively; and
- vi.** 'Movestic' may also refer to Movestic Livförsäkring AB, as the context implies.

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OVERVIEW & STRATEGY

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2012 HIGHLIGHTS

Notes

- i. Throughout the Chairman's Statement, Chief Executive's Review and Financial Review sections following, all results quoted at business segment level exclude the impact of consolidation adjustments relating to the amortisation of acquired value in force (VIF) and other adjustments, arising on the acquisition of Movestic. These consolidation adjustments are analysed by business segment on page 28.
2. Net cash generation in the year is defined as the net amount of the following items:
 - i. The change in the excess of actual regulatory capital resource over target capital resource in respect of the CA and S&P operating segments to the extent that distribution of the excess to shareholder funds is not restricted;
 - ii. Capital contributions made by the Group to the Movestic operating segment; and
 - iii. Cash utilised by Parent Company operations.

Details of target capital resource are set out in Note 31 to the IFRS financial statements.

Throughout the Report and Accounts the following symbols are used to help distinguish between the various financial and non financial measures reported:

-  IFRS
-  Cash generation
-  EEV
-  EEV earnings
-  Solvency
-  Dividend
-  Part VII
-  Operational performance
-  Compliance
-  New business market share

FINANCIAL



9% INCREASE IN IFRS PRE-TAX PROFIT

Increase in IFRS pre-tax profit to £24.5m excluding exceptional item (2011: £22.4m).
Financial Review Page 28



CASH GENERATION £41.0M Note 2

Net cash generated during 2012 of £41.0m (2011: £31.4m).
Cash Generation Page 32



EEV INCREASE OF £16.6M

Increase in EEV from £294.5m to £311.1m after recognising the impact of £19.5m dividend distributions.
Financial Review Page 35



EEV OPERATING PROFIT £19.0M

Pre-tax EEV operating profit increased to £19.0m from £15.3m.
Financial Review Page 33



GROUP SOLVENCY 244%

Strong Insurance Group Directive solvency cover of 244% (2011: 198%).
Financial Management Page 40



FINAL DIVIDEND INCREASED BY 3%

Proposed final dividend increased by 3% to 11.25p per share.

OPERATIONAL



PART VII TRANSFER

Final stages of the S&P Part VII Transfer programme completed releasing £7m of capital.



S&P INTEGRATION

S&P fully integrated into the UK business.



STRONG OUTSOURCER PERFORMANCE

All administration and asset management partners have out-performed their respective targets and benchmarks.



MOVESTIC SERVICE IMPROVEMENTS

Process re-engineering programme successfully mitigated the servicing problems experienced in 2011 and into 2012.



GOOD COMPLIANCE RECORD

Good regulatory compliance record continues.



NEW BUSINESS MARKET SHARE

Recovery in new business market share in the core Movestic unit-linked pensions target market during the second half of 2012.

CHAIRMAN'S STATEMENT



Continued strong operational performance in the UK, together with encouraging signs that Movestic is through the worst of its recent operating difficulties, when combined with the generally favourable investment market conditions during the year, means we end 2012 in good financial shape and well positioned to continue to deliver value to our stakeholders.

Peter Mason
Chairman

CHAIRMAN'S STATEMENT (CONTINUED)

Chesnara has delivered a strong set of financial results, benefiting in part from generally favourable investment market conditions during the year.

Whilst we have benefited from investment markets performance during 2012, the Board remains mindful that the financial strength, and hence dividend paying capacity of the Group, remains sensitive to economic conditions outside of its direct control and, as such, the management of market risk remains a key priority.

The Chesnara Group has a relatively low risk and transparent investment model as a direct result of our long-established values which put responsible risk management at the heart of all decisions we make. During 2012 we have continued to enhance our management of market risk, in particular through improvements in the management of our asset and liability matching position and through the continuing development of long-term projection models.

Whilst the 2012 results illustrate the significant levels of cash generation available in favourable economic conditions, we remain vigilant to the fact that continued market recovery, growth and stability cannot be taken for granted. The ongoing improvements in our management of market risk gives me significant comfort regarding the ability of the Group to weather any future adverse investment market conditions that may arise.

Risk management and Solvency II

We have continued to progress the Solvency II programme such that I remain confident that we will be in a position to adhere to statutory requirements and timeframes ultimately agreed by both European and UK Regulators.



That said, whilst the Solvency II implementation will create a beneficial and consistent regulatory framework, it is my belief that Chesnara already embraces the core principles and purpose of Solvency II. Responsible, risk-based decision making has and continues to be at the heart of our business culture.

Regardless of the Solvency II regulatory requirements, we continue to develop our internal risk-based management model:

- The Board has approved the development of a risk-based business planning model, to be fully implemented by 2014.
- The first phase of risk-based projection modelling has been developed, with outputs used by the Board during 2012. Further enhancements are under development.
- Asset and liability matching is actively monitored and assessed throughout the year with investment changes implemented to ensure the most appropriate level of market risk for all stakeholders.

- During the year we have undertaken a full independent review of our UK Internal Audit function and will implement the relevant recommendations.
- Within Movestic we have begun the roll-out of the most appropriate elements of the well-established and effective UK risk management framework.

Financial results

IFRS

On the IFRS basis, we have achieved a pre-tax profit of £24.5m, excluding an exceptional item, for the year ended 31 December 2012. This compares with a pre-tax profit of £22.4m for the year ended 31 December 2011. Pre-tax profit of £33.1m (2011: £33.2m) from the UK closed books which are in run-off, have remained resilient to policy attrition. The pre-tax contribution from CA at £18.5m has declined from the £25.7m contribution posted in 2011, although the core product-based surpluses which underpin long-term profit emergence have held up well. Conversely pre-tax contribution of £14.6m from the more volatile S&P business has improved significantly compared with the 2011 contribution of £7.5m, primarily reflecting more beneficial investment market conditions. Further, there is a £1.0m improvement in Movestic pre-tax profit which has increased from £0.4m to £1.4m. The IFRS results are analysed in more detail within the "Financial Review" section on page 28.

EEV

On the EEV basis of reporting, excluding the effect of modelling adjustments, we have posted a profit after tax of £31.2m compared with a loss after tax of £(29.8)m for the year ended 31 December 2011. Investment market factors directly account for a year-on-year improvement of £70.9m. During 2012 economic related profits were £21.5m (2011: £(49.4)m loss). The underlying operating result has improved by £3.7m to £19m in 2012 (2011: £15.3m). The EEV results are analysed in more detail within the "Financial Review" section on page 33.

Cash generation and solvency

The capacity of the Group to pursue its dividend policy relies on the continuing generation of cash in the UK businesses. During 2012 net cash generation within the Group was £41m. This healthy outcome reflects a proposed dividend of £40m from CA to Chesnara and is reinforced by a strong CA post-dividend solvency ratio of 199% as at 31 December 2012. The associated Group Solvency ratio was also strong at 244%.

Dividend



The proposed full year dividend of £19.9m, which is more than covered by the level of cash generated during the year, represents the continuation of our attractive dividend policy.

(See cash generation analysis on page 32).

Existing business development

S&P

During the year we have completed the final stages of the integration of S&P. The S&P regulated entities have been de-authorised, thereby releasing £7m of capital and giving rise to a corresponding cash generation. We have also finalised the transfer of operational and governance responsibilities into the core Chesnara head office structure, thereby ensuring consistent practice and generating cost synergies.

Movestic

Without question Movestic has been through a difficult period, partly due to market conditions but also due to internal systems and administration process deficiencies. The difficulties clearly had an adverse impact on the business during 2011 and through much of 2012. The servicing proposition failings resulted in a loss of IFA support with a direct impact on the main business performance indicators, namely new business growth and in-force book retention.

Against this backdrop I am encouraged by signs of recovery in the Movestic business as evidenced by the recent improvements in several measures, including investment performance, improved lapse rates and improvements in new business volumes in the last quarter of 2012.



Although the recent difficulties have had an adverse impact on the Movestic results, the impact has been mitigated in part by positive Swedish equity market performance. This, together with an improved level of management direction and focus, a recovery in levels of staff motivation and the early indication of a recovery in IFA confidence, means I am increasingly confident that Movestic is in a good position to generate the profitable growth required to add significant value to the Chesnara Group.

Corporate governance and Board effectiveness

We note the continuing dialogue relating to the corporate governance of publicly-listed companies and I provide further comment in my overview on page 48.

We continually assess and challenge the effectiveness of the Board and of the Senior Management team. It is a long established view that the expertise of the Board and Senior Management team is a core strength of the Chesnara business model but that said, we always look to strengthen the team where possible. I am pleased to, therefore, report the appointment of three new Non-executive Directors who will add to the general effectiveness and diversity of the Board.

The appointments of Veronica France, David Brand and Mike Evans are consequent upon the planned departure of Mike Gordon, our current Senior Independent Director, and Terry Marris, who will have both served full nine-year terms and, therefore, in accordance with accepted corporate governance guidelines, are standing down. I would like to record the Group's, and my own personal, thanks to each of them for the notable contribution they have made to the development and success of Chesnara and, indeed, to their significant service to Countrywide Assured plc before it was demerged into Chesnara in 2004. I also wish to express sincere thanks to Ken Romney who steps down as Finance Director of Chesnara at the forthcoming Annual General Meeting. Not only has Ken been Finance Director of Chesnara since its inception in 2004, he has also been a loyal servant of Countrywide Assured since 1989 having been appointed as Finance Director to the Board of CA in 1997. Ken has been integral in the development of Chesnara and contributed significantly to its success.

Further assessment of Board effectiveness is included in section C on page 50.

People and business partners

The fact that we end the year in good shape and well positioned for the future is largely due to the skill and dedication of our people and those within our outsource partners. All UK administration and asset management partners have out-performed their respective targets and benchmarks which is testament to their expertise and continued commitment. The Swedish business has been through a challenging year and that we are now in a significantly stronger position than 12 months ago is largely due to the drive, dedication and positive outlook of our Swedish colleagues. As always the Chesnara Head Office governance team continues to ensure the Group maintains and develops governance procedures that deliver a sound level of regulatory control across the business.

Outlook

Investment markets recovered during 2012 and this has continued into the early months of 2013. However, we do not take market recovery or stability for granted and our financial and capital management procedures will continue to recognise the risk of continued poor, or indeed worsening, economic conditions. The modelling of our business indicates continued healthy cash generation and a solvency capital surplus in both base and realistic adverse scenarios in the short to medium term.

Peter Mason
Chairman
27 March 2013

OUR VISION & STRATEGY

MISSION

Our mission is to deliver value for shareholders, while maximising returns to policyholders. Underpinning everything we do is a desire to maintain regulatory and legal compliance. Meeting these aims is achieved through attracting and retaining highly talented people who not only bring expertise and quality thinking into our business and industry, but also have a passion for improving outcomes for our customers and shareholders. All members of the Chesnara team share a common value in recognising their responsibility to shareholders and policyholders.

VISION

To be recognised as a responsible and profitable company engaged in the management of life and pensions books in the UK and Western Europe through:

- Commitment to the core business of closed UK life and pensions book management.
- Further acquisitions where they meet stringent assessment criteria.
- Realisation of increasing economies of scale.
- Continued delivery of competitive returns to shareholders and policyholders.

While we focus on delivering value to shareholders primarily through dividend streams arising from strong cash generation as the UK life and pensions books run off, we also consider the acquisition of open businesses where there is clear value enhancement and where the scale is such that our core proposition of being principally a closed book consolidator and manager does not become unbalanced.

STRATEGIC OBJECTIVES

At Chesnara the strategic objectives, which support the fulfilment of our mission and the realisation of our vision are embedded in day-to-day business operations and underpin management decisions. At the core of the business is the recognition by the Board and Management Team of their responsibility to policyholders and shareholders, so that the values and principles of management wholly align with strategic objectives. This value of responsibility is at the heart of the Chesnara business model. Our core strategic objectives are explained and evidenced on the following pages.

STRATEGIC OBJECTIVES

MAXIMISE VALUE FROM THE IN-FORCE BOOK

Why is this of strategic importance?

Chesnara is primarily a “closed book” operation and as such generating surplus and cash from the existing in-force books is at the heart of its investment proposition.

How do we deliver this strategic objective?

We proactively manage continuing financial exposures:

- Significant financial exposures in life and pensions portfolios typically arise in the areas of onerous policy options and guarantees and of compensation claims for past misselling of products. The Group’s portfolios have, historically had very little exposure to the impact of investment market performance on options and guarantees. However, just over 29% of the policies managed by S&P, which was acquired in December 2010, contain guarantees to policyholders and therefore the Group’s exposure has increased. Furthermore, the Group continues to have exposure to market falls by way of the impact on policyholders’ linked funds, from which surplus is generated. We seek to minimise this exposure by regular review of investment asset holdings and by adjusting investment manager guidelines where appropriate and within the boundaries of our obligations to policyholders.

We operate in a manner that ensures policy attrition is as low as possible, as this is a key determinant of our future profitability and of the level and longevity of the emergence of surplus, which underpins our dividend-paying capacity.

We will continue to invest in a service proposition that ensures a high level of customer satisfaction.

We continue to maintain a focus on the retention of policies where it is in the interest of customers to continue with their arrangements.

We continue to manage investment performance so as to provide a competitive level of return to our policyholders. The CA funds are primarily managed by Schroder Investment Management Limited while the CWA funds continue to be managed by Irish Life Investment Managers Limited. The S&P funds are managed by JPMorgan Asset Management (UK) Ltd in order to maintain continuity for policyholders. We meet formally with fund managers on a quarterly basis to assess past performance and future strategy.

The Movestic funds are managed by a carefully selected range of fund managers who have strong performance records in the relevant sector. Performance is monitored very closely and regular meetings are held with fund managers. Should under performance continue then an alternative manager is sourced and appointed to manage the relevant assets. Where a new market niche or specific opportunity is identified new funds may also be added.

We adopt a business operating model which ensures unit expenses remain appropriate for the scale of the in-force book.

- UK operations are predominantly outsourced, with contract charging structures that ensure a significant element of the cost base is variable with run off of the business.

- Acquisitions are integrated into the Chesnara Group in a manner to ensure optimum operational and financial synergies.

Risks associated with this strategic objective

- Sustained adverse investment market conditions undermine our ability to manage financial risks inherent in the in-force portfolio.
- Despite the effective cost management model, in the absence of further acquisitions or management action, there remains a risk that unit costs will increase in the long-term.
- A number of factors including economic recession, adverse investment performance and a deterioration in customer servicing standards could lead to an increase in policy attrition.

ACQUIRE LIFE AND PENSIONS BUSINESSES

Why is this of strategic importance?

- As with any business, it is important that we use our capital efficiently to provide optimum return to shareholders.
- As a primarily “closed book” operation, further acquisitions can maintain and increase the Group’s cash flow and operational economies of scale.

How do we deliver this strategic objective?

Ultimately we rely on acquisition opportunities being available in the market. To maximise our opportunities we have extended our target market beyond the UK, to include Western Europe.

We actively engage with various investment bank advisers (including Canaccord Genuity Limited on a retained basis) to ensure we are aware of acquisition opportunities. We extend our network to cover opportunities in the UK and Western Europe.

We will leverage our proven track record in the consolidation market. Past experience suggests we maintain a high degree of credibility with regulators, policyholders, lenders and shareholders. All prior acquisitions have been delivered with no adverse impact in terms of treating customers fairly, regulatory standing or our reputation in the life and pensions consolidation market.

We will not pursue opportunities which do not meet very stringent assessment criteria.

Risks associated with this strategic objective

- If Chesnara makes no further acquisitions there will be a potential strain on the per policy unit costs of the existing business.
- Any departure from the current, stringent acquisition assessment criteria and due diligence procedures could result in an acquisition that, under certain stress scenarios, adversely impacts the financial strength of the Group.

ENHANCED VALUE THROUGH NEW BUSINESS IN SELECTED MARKETS

Why is this of strategic importance?

- The Chesnara business model primarily focuses on "closed book" consolidation. However, where acquisitions offer the potential to write new business at an adequate return on capital we will continue to invest in the new business operations so as to maximise value for the Group.
- Maintaining a flexible position regarding the willingness to remain open to new business will potentially increase the number of acquisition targets and indeed our attractiveness to such targets.

How do we deliver this strategic objective?

Currently the only part of the Chesnara Group writing material levels of new business is Movestic, our Swedish business. Movestic has a new business operation that delivers a positive new business contribution. There are detailed business plans in place that aim to increase new business profits through a combination of new product launches and improvements to operational effectiveness. Local and group management receive management information to enable a continuous assessment of the performance to ensure being open to new business continues to enhance value.

Risks associated with this strategic objective

- New business volumes fall below levels required to ensure sufficient return on the acquisition cost base.
- Product margins fall to unsustainable levels due to factors including; market price pressures, reduced investment growth, increased policy lapse rates and increasing maintenance unit costs.

MAINTAIN A STRONG SOLVENCY POSITION

Why is this of strategic importance?

Adequate solvency capital:

- Protects against volatility particularly due to external economic conditions outside management control.
- Ensures compliance with regulatory requirements.
- Supports potential acquisition opportunities.
- Supports ongoing dividend capability.

How do we deliver this strategic objective?

We ensure the Board is furnished with high quality information regarding the solvency position. This includes information regarding the actual solvency position together with the projection of solvency under stress scenarios. The management team tracks the performance of the key factors known to impact the solvency position. Trigger points are set and documented such that management action will be instigated should any of the key trigger points be reached. The setting and review of trigger points is an integral component of the Group's risk appetite model.

Potential acquisitions are assessed by taking a prudent view on not only the short-term impact on the Group's Solvency position but also on the potential risk to long-term solvency.

Risks associated with this strategic objective

- Sustained adverse economic conditions outside of risk appetite tolerances will erode the solvency surplus.
- Changes in legal or regulatory requirements e.g. Solvency II.

ADOPT GOOD REGULATORY PRACTICE AT ALL TIMES

Why is this of strategic importance?

Chesnara management fully recognises the benefits to both shareholders and policyholders of adherence to good regulatory practice. We comply not because the regulations insist but because the rules clearly reflect good, responsible business management and governance.

How do we deliver this strategic objective?

We maintain a strong internal risk management culture and regime throughout the Group and we maintain systems and controls which satisfy regulatory requirements at all levels.

The UK and Swedish life assurance and pensions industries are both highly regulated, in terms of the conduct of business operations and of financial reporting. We place particular emphasis on managing our regulatory compliance through a proactive and prudent approach and on maintaining a positive relationship with our principal regulators, the Financial Services Authority ('FSA') and the Finansinspektionen ('FI').

Accordingly, significant effort is directed towards ensuring that the operations are effectively managed in terms of conduct of business regulations and of prudential solvency requirements and towards the significant change that is required in the business to implement Solvency II and to ensure continuing compliance with its requirements.

We have developed a strong Governance core at the heart of the Chesnara operating model, which exists within a robust and effective Corporate Governance framework.

- All governance roles, with direct impact on regulatory compliance, are carried out by people with significant industry experience.
- The level of investment in the Governance team is fully reflective of the Board's recognition and understanding of the implications and challenges of effective adherence to all regulatory best practice.
- The Chesnara culture ensures other objectives do not conflict with the objective of adopting good regulatory practice at all times.

Risks associated with this strategic objective

The key risk relating to regulatory compliance is that rules and regulations are poorly understood or implemented.

Deliver value to stakeholders on a responsible and balanced basis

Underlying the fulfilment of strategic objectives is the core value shared by the Board and Management Team of recognising responsibilities to all stakeholders on a balanced basis.

Often decisions are required that may have conflicting impacts on the different stakeholders. Maintaining a balanced view across the stakeholder groups is critical to ensuring management continue to make decisions that will benefit all stakeholders in the longer term.

The general governance framework ensures controls and procedures are in place to protect all stakeholders.

THE CHESNARA BUSINESS



The history of the development of the Chesnara business, together with a description of the characteristics of our operating businesses, illustrates how we have endeavoured to achieve our strategic objectives and how we have created the platform for their ongoing realisation.

The higher proportion of pensions policies in the successive acquisitions made by Chesnara has progressively increased the overall longevity of its run-off portfolio, while diversifying the long-term policy base. At 31 December 2012, the Group had 258,000 pension policies and 119,000 life policies in force.



Chesnara continues to seek to participate in the consolidation of life assurance and pensions businesses in the UK and Western Europe.

We primarily target acquisitions with a value of between £50m and £200m, although other opportunities are considered. All opportunities are assessed against a number of key criteria including size, risk (including actual or potential product and financial liabilities), discount to embedded value, capital requirements and the pattern and quality of predicted profit emergence. Our strategic approach, however, remains that such potential acquisitions should not detract significantly from, and should contribute to the primary aim of delivering an attractive dividend yield, although opportunities which present a significant value uplift or growth opportunity will also be evaluated.

History (2004 – 2012)

'04

Chesnara listed on the London Stock Exchange, following its acquisition of CA on the latter's demerger from Countrywide plc, a large estate agency group. CA is a substantially closed UK Life and Pensions business whose portfolio predominantly comprises unit-linked endowment and protection policies.

'05

Chesnara acquired CWA from Irish Life and Permanent plc for a consideration of £47.8m, funded principally by a mixture of debt and new equity capital. CWA is also a substantially closed UK Life and Pensions business. Its portfolio, which is also predominantly unit-linked, comprises endowments, protection and pensions policies.

'06

The long-term business of CWA was transferred to CA under the provisions of Part VII of the Financial Services and Markets Act 2000 ('FSMA'), thereby realising significant financial and operational synergies.

'09

Chesnara acquired Movestic Liv, an open predominantly unit-linked Swedish Life and Pensions business, for £20m at a significant discount to its embedded value. Subsequently a new subsidiary, Movestic Kapitalförvaltning was established to separate out fund selection and management activities from Movestic Liv and to develop these services in the wider marketplace.

'10

Movestic acquired the in-force business, personnel, expertise and systems of Aspis Försäkrings Liv AB, a small Swedish life and health insurer, thereby complementing Movestic's existing focus on pensions and savings contracts. Chesnara acquired SPI and its subsidiary, SPP, from JPMorgan Asset Management Limited for a consideration of £63.5m, funded by a mixture of debt and new equity capital. SPI and SPP are also closed UK Life and Pensions businesses whose portfolios predominantly comprise pensions policies (both unit-linked and with-profits), endowments (some with-profits) and protection policies.

'11

The long-term business funds and part of the shareholder funds of SPI and SPP were transferred to CA under the provisions of Part VII of FSMA, thereby realising significant financial and operational synergies.

'12

SPI and SPP were de-authorised from conducting activities regulated under the provisions of the Financial Services and Markets Act 2000, thereby releasing £7m of solvency capital.

BUSINESS MODEL

Business model

The following sets out the key operating characteristics of the Chesnara business:

Chesnara plc and the UK business activities are based in Preston, Lancashire, while Movestic is based in Stockholm in Sweden. Chesnara has 20 full-time equivalent employees in its corporate governance team in the UK. In Sweden, the headcount is 127.

UK

- The primary focus of the UK business is the efficient run-off of their existing life and pensions portfolios. This gives rise to the emergence of surplus which supports our primary aim of delivering an attractive long-term dividend yield to our shareholders. By the very nature of the life business assets, the surplus arising will deplete over time as the policies mature, expire or are the subject of a claim.
- In the UK we maintain a small professional corporate governance team who are responsible for both the regulatory and operational requirements of the listed entity Chesnara and those of the UK business. Our team in the UK is intentionally small and focused in the interests of keeping the overall expense base tight. It has the capability to manage the UK business and to assess acquisition opportunities, but it is supplemented from time to time by temporary resource if justified by operational or strategic demands.
- The operating model of our UK business is directed towards maintaining shareholder value by outsourcing all support activities to professional specialists. This typically embraces policy administration, systems, accounting and investment management and reduces the impact of potential fixed and semi-fixed cost issues which would otherwise occur as the income streams arising from a declining in-force portfolio diminish. By securing long-term contracts to support these activities we aim to enhance the variability of the expense base with the size of the in-force policy portfolio. This also leads to the avoidance of the full weight of systems development costs, as these will, where possible, be shared with other users of the outsourcers' platforms.
- Oversight of the outsourced functions is a significant part of the responsibility of the central governance team. The maintenance of service and performance standards, and thereby the core interests of shareholders and policyholders, is maintained through a strict regime of service level agreements and through continuous monitoring of performance. This is reinforced by adherence to the principles and practice of treating customers fairly.

Sweden

- The primary focus of the Swedish business is to grow market share in the company-paid and individual pensions market, whilst developing further profitable business in other areas, in particular in the risk and health market. Writing new business requires funding to support the initial costs incurred: this is provided by way of external financial reinsurance or cash contributions from Chesnara. As the in-force business portfolio grows in scale the income generated by it eventually allows the business to self-fund and become a net generator of cash. Movestic is targeted to reach this pivotal point over the next two years.
- In Sweden, as the Movestic book is open and in a growth phase, we retain a broader-based management and operational team. Rather than outsource core functions, we believe that it is important that the drive and team ethic of Movestic is preserved as they seek to grow profitable market share in our target markets. Whilst Movestic manages the selection of appropriate investment funds, investment decisions are made solely by the fund managers.

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CHIEF EXECUTIVE'S REVIEW

HIGHLIGHTS

- Growth in IFRS pre-tax profit, excluding exceptional item, to £24.5m (2011: £22.4m).
- Despite operational performance issues, Movestic has delivered growth in IFRS pre-tax profit to £1.4m (2011: £0.4m).
- Cash generation and Group solvency remain strong.
- Significant progress made to resolve Movestic servicing issues with a gradual recovery in IFA support.
- Increase in Group EEV by £16.6m after recognition of dividend payments of £19.5m.
- 3.6% increase in total group funds under management.
- Strong investment performance in both the UK and Sweden.



Group IFRS pre-tax profit
£24.5m*

2011: £22.4m

*Excluding exceptional item



Group EEV net of tax result*
£31.3m

2011: £(29.8)m loss

*Excluding modelling adjustments



Insurance Group Directive Solvency 244%

2011: 198%

Business review

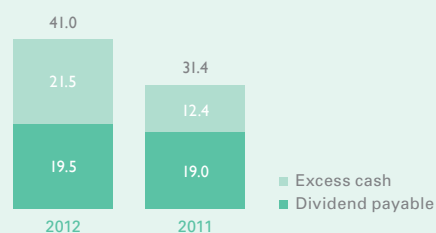
Financial

First and foremost I am extremely pleased with the levels of earnings on both the IFRS and EEV bases. The UK IFRS result underpins cash generation and cash transfers to the Chesnara parent company.



As was the case in 2011, the level of cash generation in the UK is more than sufficient to support the continuation of our attractive dividend strategy.

In addition, Movestic has required no further capital support during the year following a capital injection of £5.3m in 2011. The total cumulative cash generated at Chesnara Group level for 2011 and 2012 of £72.4m is equivalent to 188% of total dividends during the same period.



Net cash generation (£m)

The surplus cash generation will have a positive effect in terms of ensuring we are able to sustain our dividend strategy through any potential short-term reductions in IFRS earnings.

UK



Operational performance levels for the UK business remain strong with all administration and asset management partners out-performing their respective targets and benchmarks. This positive performance has contributed towards a modest increase in total UK funds under management during the year.

The revised outsource contract with HCL, who provide administration, finance and actuarial services for the S&P and CA books remains unsigned. Whilst this creates a degree of uncertainty which is not ideal, it is important to recognise that the level of inherent risk to the business model is considered to be relatively low. In the short-term, HCL retain contractual responsibility for servicing the CA book for a further 2 years and the existing S&P arrangement is on a rolling 2 years basis. In addition, in the medium to long-term, several realistic alternatives exist, all of which are not considered to have any detrimental impact on either operational effectiveness or the cost base.

Sweden

The performance issues in Movestic, namely the deterioration in service levels which resulted in a loss of IFA support, have been well documented in previous reports.



In light of the challenges faced, I have given significant attention to the Movestic business during the year. I am encouraged by the immediate positive impact the new Movestic Chief Executive, Lars Norstrand, has had on both the operational effectiveness and on the recovery of support from the IFA community.

Lars has overseen a process re-engineering programme that has successfully mitigated the service level deficiencies experienced during 2011 and into 2012. The positive impact of this will be further embedded through improvements to the operating structure, whereby certain processes critical to IFAs are being centralised into Stockholm, where they will benefit from the positive management environment. Despite the significant recent improvements, Movestic has more to do to fully recover and consolidate its market position. The business foundations are significantly stronger than last year and from this improved base I am confident that Movestic can begin to deliver longer-term financial benefits to the Chesnara Group.

Outlook

The Group continues to investigate further acquisition opportunities and we will progress these where we see value and a clear strategic fit. We remain open-minded as to location in the UK and Western Europe and, as ever, we will continue to apply our strict financial and risk criteria when we assess them. Whilst growth through acquisition remains a key strategic objective, projections do indicate that the Group remains able to deliver its core objectives, in the medium term, without any further acquisitions.

CHIEF EXECUTIVE'S REVIEW
UK BUSINESS REVIEW

Key performance indicators

IFRS profit before tax, excluding exceptional item

 **£33.1m**

2011: £33.2m

Cash transfer to Chesnara Parent Company

 **£40m**^{Note 1}

2011: £44m^{Note 2}

Note 1 – includes £7m arising on the de-authorisation of the S&P regulated entities.

Note 2 – includes the effect of distributions from surplus funds arising on the acquisition of S&P in 2010.

EEV result net of tax^{Note 3}

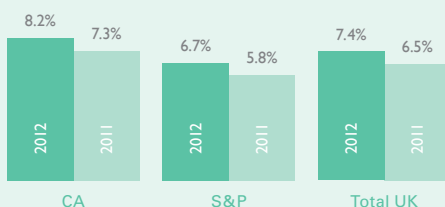
 **£22.8m profit**

2011: £(10.9)m loss

Note 3 – excluding impact of modelling adjustments.

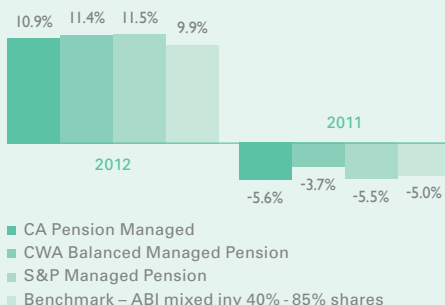
Annual policy attrition rate

There is no suggestion of a sustained worsening trend and the 2012 attrition rates align closely with the 2010 figures. The rate of run-off is influenced by maturities which can vary from year to year based on the original policy inception year. The increase in attrition rate corresponds to an absolute increase in policy exits of c4,000 policies.



Fund performance

Relative outperformance in the unit-linked funds helps promote policy retention and, when positive, increases the embedded value of the Group as future management charges received will be of a higher magnitude.



Good operational performance together with a positive investment market impact, result in strong financial results in terms of IFRS and EEV earnings, cash transfers to Chesnara and CA solvency.

HIGHLIGHTS

- Pre-tax IFRS profit of £33.1m (2011: £33.2m) excluding exceptional item.
- £35.4m increase in EEV, excluding impact of dividend payments.
- £41.6m cash generation (2011: £38.8m).
- Increase in CA solvency ratio to 199% (2011: 183%).
- Core product-based deductions remain resilient to book run-off.
- Successful de-authorisation of the S&P regulated entities, thereby releasing £7.0m of capital.
- Full operational integration of S&P into the Chesnara Group has enabled the closure of the S&P London office with significant operational cost savings.
- Good regulatory compliance record continues.

Review of the year

This year has been focused on four areas – management of investment assets, regulatory compliance, finalising the integration of S&P into the UK business and ensuring we continue to provide a high quality service to policyholders in terms of administration service levels and investment return.

Management of assets

The acquisition of S&P, as signalled at the time of the acquisition, results in an increased level of earnings volatility for the UK business. S&P has a sizeable proportion of its product base that provides guaranteed returns. The probability of guarantees being of value to policyholders increases when the value of assets held to match the policy liabilities falls. To mitigate this risk, assets held by shareholders to provide security for these guarantees are invested in cash and long bonds. Consequently, our results are vulnerable to (a) falls in equity and property values, which impact assets backing policyholder liabilities; and (b) falls in bond yields, which impact the cost of providing guarantees.

Integration of S&P

As a final stage of the integration of S&P, the two S&P companies were de-authorised resulting in an additional cash generation of £7m. The full operational integration of the S&P processes and procedures has been completed during the year which has enabled the closure of the S&P London office. This has resulted in annualised cost savings of c£0.4m.

Policyholder service and investment return

Our administration and asset management outsource partners have all performed well in the year and exceeded service level arrangements and relevant benchmarks. Two initiatives with our outsourcing partners are worthy of mention. Firstly, in the first quarter of 2012 we completed, with HCL, the final phase of the offshoring project. To date, the quality of service and speed of turnaround have exceeded expectations. Secondly, building on our experience with HCL we initiated, with Capita, a retention program, whereby we offer information to customers intending to discontinue their policies, which has provided a significant return on our investment whilst providing policyholders with an improved service.

Regulation and legal

As ever in this highly regulated industry there have been a number of new and ongoing initiatives that have led to various levels of attention and challenge. We are pleased to report that none of these has given rise to significant issues and below I set out a list of the key activities and a little background.

Solvency II

- A significant and increasing amount of work means that our progress remained in line with our plans. We were able to ascertain that, based on QIS 5 calculations together with further Pillar I analysis, no increase in solvency capital is likely to be required. It has become increasingly clear that the original implementation date of 1 January 2014 has been postponed. However, in the expectation that interim measures will be introduced, we are continuing to develop the key aspects of the prospective regulations as they stand. Further information on our Solvency II project is provided on page 45.

FSA

- We received the formal feedback from the FSA's ARROW visit, which took place in the final quarter of 2011, in April of 2012. The Risk Mitigation Plan contained a handful of issues which have been attended to. In addition we maintain our commitment to maintaining a compliant operating model and a good relationship with our regulator.

ABI retirement code

- The ABI issued a code which changes the way in which policyholders who are vesting their pensions are advised of their options with particular regard given to the notification of the availability of better-value annuities from other providers. We have successfully introduced all the measures the code requires.

Treating Customers Fairly (TCF)

- We have continued to monitor performance against, and to continue the development of, our TCF measures. The results are discussed, where relevant, with our outsourcing partners and are reviewed by senior management and reported to the CA Board. No issues of significance have arisen.

Gender neutral rates

- We considered in some detail whether we should implement gender neutral rates or limit policyholder flexibility such that gender neutral rates would not be required. In the event we decided on the latter route in the knowledge that we would remove some of the discretionary policy changes we had previously allowed. This decision has led to the closure of the small in-house sales and retention team which will lead to annual savings of c£0.2m. The retention capability of the former sales team work has been transferred to our outsourcing partner.

Complaints

- On the underlying business, complaints have remained at reasonable levels with no discernible change in the number of complaints referred to the Financial Ombudsman or the percentage of such referred complaints being successful. However, the absolute number of complaints has risen primarily due to Complaints Management companies submitting complaints to us alleging that we missold Payment Protection Insurance (PPI). Although we have never sold PPI policies and, therefore, cannot have any possible liability, we are still required to open a complaint file and formally respond.

New life tax regime

- A new regime pertaining to the taxation of Life Assurance companies came into effect at the end of the year. We have thoroughly planned for its implementation and developed appropriate models to calculate current and future liabilities. These show no significant changes to current levels of taxation. There is, however, a significant benefit on the IFRS basis of £6.1m relating to the recognition of brought forward pension losses.

Retail Distribution Review (RDR)

- Although significant in the wider market this regulation, which essentially moves IFA's to a fee-charging model by banning commission by providers, has little effect on our closed books of business. Some minor system and correspondence changes were necessary which were completed within required timescales.

Policyholder investment funds

- Through the auspices of the CA Investment Committee we have continued our oversight of policyholder funds through regular meetings with the investment managers. There have been a number of reviews and developments during the year in order to ensure the underlying investment mix is the most appropriate for policyholders. Measures undertaken include reviewing the investment mandates for the ex-S&P With-profit Funds, higher indexation for the ex-CVA Managed Funds and agreeing a programme to move the ex-S&P Pension Property Fund from direct investment to collective funds over an eighteen-month period to avoid any potential liquidity issues that could arise due to the natural decline in the size of the fund.

CHIEF EXECUTIVE'S REVIEW
UK BUSINESS REVIEW (CONTINUED)

Cash generation

Cash generation remains strong. This is due in the main to core product-based surpluses remaining resilient.



The S&P book has made a significant contribution of £26.6m to cash generation in 2012. This is consistent with the fact that the S&P surplus is sensitive to investment market performance which was generally favourable during 2012.

2012 cash generation includes a £7m exceptional item relating to the de-authorisation of S&P residual companies. Whilst this level of S&P cash generation is welcomed, it is recognised that cash releases from S&P may be volatile. We do not see this as a particular issue, as S&P was acquired as a medium to long-term underpin to the stronger, shorter-term cash generation from CA and CWA.

Unit-linked funds under management

The continuing level of unit-linked funds under management is an indicator of the ongoing level of profitability of the UK businesses as fund-related charges are an important component of profit.

The movement in the value of unit-linked funds under management is driven by:

- i) performance of the funds across UK equities, international equities, property and fixed interest securities;
- ii) received and invested premiums; and
- iii) policies closed, due to surrender, transfer or claim.



The combined impact of these three drivers has resulted in an increase in Unit-linked Funds under Management from £2,190m at the end of 2011 to £2,221m at the end of 2012.

Unit costs

A key area of focus for the UK business is the management of expenses incurred in servicing the in-force life and pensions policy base. In particular we seek, through outsourcing arrangements, to maximise the proportion of costs which vary with policy volume. Renewal costs, excluding the impact of the expected revisions to the HCL contract, have reduced by £1.2m (6%) compared with 2011. The impact of higher expected HCL charges in accordance with the proposed new arrangements has, however, resulted in a £1.5m increase in the cost base. The net cost increase, together with a 7% reduction in total policy count, results in an increase in unit cost to £47.40 per policy compared with £39.41 per policy in 2011. Management remain mindful of the risk of increasing unit costs in a closed-book business and continuing actions will be taken to manage the issue as effectively as possible. Recent examples include the closure of our internal sales team and the closure of our London office towards the end of 2012. The positive impact of these actions will be reflected in the 2013 results.

CHIEF EXECUTIVE'S REVIEW

SWEDISH BUSINESS REVIEW

Key performance indicators

IFRS pre-tax profit*


£1.4m

2011: £0.4m

*Excluding amortisation of intangibles

EEV result net of tax*


£12.7m profit

2011: £17m loss

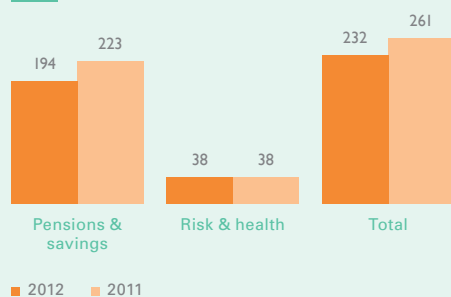
*Excluding modelling adjustments

Funds under management


£1,361m

2011: £1,220m

The value of funds under management is a key reference point for establishing the ongoing profit-earning capacity of the business, as fees are received based on those values. Funds under management increased despite the operational difficulties and their impact on new business volumes and policy attrition.


Premiums (£m)


Premium income, in the form of new business and continuing premiums into existing contracts, is key to the success of Movestic. Policy attrition combined with a reduction in new business volumes during the year has resulted in the reduction in total premiums earned.

KPIs continue on page 25.



During the year the recent servicing problems have been addressed and there are encouraging signs of a return of IFA support.

HIGHLIGHTS

- Increase in IFRS pre-tax profit to £1.4m (2011: £0.4m) before amortisation of intangibles.
- Funds under management and solvency ratio resilient to operational difficulties.
- Positive EEV development, despite a strengthening of lapse assumptions.
- Process re-engineering programme has successfully mitigated the servicing problems experienced in 2011 and into 2012.
- Appointment of new Chief Executive with previous knowledge of the Movestic business and strong reputation within the IFA community.
- Lapse rates and new business levels show demonstrable signs of recovery during the final quarter of 2012 following a relatively poor performance earlier in the year.
- Gradual recovery in new business market share throughout the year.

Review of the year

Financial results

While the Swedish business has been through a difficult period it is encouraging to see that the core financial dynamics of the business have proved resilient. In particular, given that the revenue model is largely dependent on the level of unit-linked funds under management it is pleasing to report that these have increased by 12% during 2012. Further, the solvency position is strong and cash generation is positive, resulting in Movestic requiring no additional capital support from Chesnara during the year (2011: £5.3m).

Earnings on both an IFRS and EEV basis have improved compared with 2011. Having moved into profit for the first time in 2011, the IFRS result has improved further in 2012 with £1.4m pre-tax profit for the year (2011: £0.4m). 2012 EEV net-of-tax earnings of £12.7m compare favourably with a predominantly investment market driven loss of £17m in 2011.

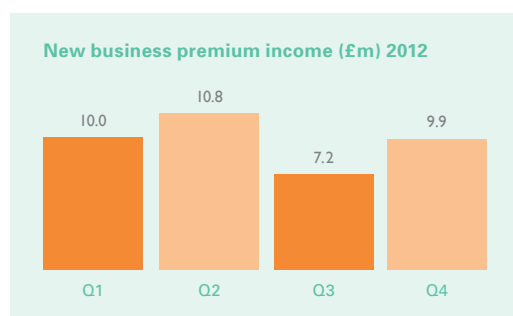
Business review

The priority during 2012 has been to address the servicing problems that emerged during 2011 as a result of a system migration. Significant progress has been made, and our current assessment is that the servicing proposition is now “fit for purpose”. Work continues to ensure we continue to improve the service offering such that, again, it becomes a positive differentiator alongside our investment proposition.

CHIEF EXECUTIVE'S REVIEW
SWEDISH BUSINESS REVIEW (CONTINUED)

New business

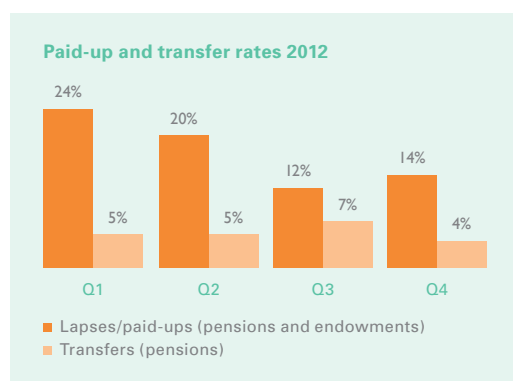
New business volumes have fallen by 20% compared with 2011. From our contact with the IFA community we fully understand the reasons for this decline. The current sentiment is that IFAs recognise that Movestic has addressed its servicing problems and there has been a recovery in levels of support and confidence. This is evident in the recovery of new business volumes during the final quarter of 2012.



The improvement during the final quarter partly reflects the seasonality of the business (Q3 is traditionally a low sales period) but the level of shortfall of 10% against the final quarter of 2011 is significantly less marked than for the first three quarters. Clearly, we require new business volumes to recover to levels at least comparable with those experienced prior to the operational issues, but even at the reduced new business levels during 2012, Movestic has generated a modest EEV new business profit of £2.6m (including the value of increments to existing policies).

Policy attrition

Policy attrition has been higher than expected during the year. Again, as with the New Business results, the reasons are well understood and positive management action has been taken. Quarterly analysis illustrates the positive impact of this on the most significant attrition measures:



The pension transfer rates during the final quarter of 2012 represent the lowest levels since Q1 2010.

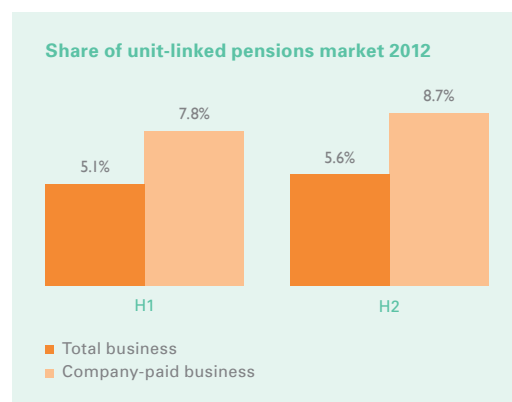
Fund performance

The relative fund performance measure adopted within the KPI's on the following page focuses on the number of funds under or over performing their relevant indices. An alternative and well established fund performance measure, produced by a respected industry magazine, compares the value of savers' average fund holdings. This measure best reflects the investment performance from a policyholder perspective. Movestic's fund range had the best performance over the period 2005 to 2010 and the second best performance for the period 2006 to 2011. The results for periods ended 31 December 2012 are not published until later in 2013.

Outlook

We believe that the Swedish business has substantially overcome its operating difficulties and has proved relatively resilient. The management team has remained focused and positive throughout and organisational changes initiated by the new Chief Executive further promote a positive outlook.

Movestic has seen a gradual recovery in its market share of the company-paid pension market during the second half of 2012, which supports the observation of a gradual recovery in IFA confidence, as a result of service level improvements and the focus of the senior management team.



With a motivated workforce and significantly improved servicing processes, we are confident that these initial signs of a recovery in IFA support will continue throughout 2013.

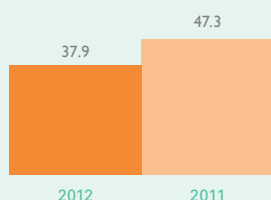
Economic conditions in Sweden have remained sound and it has proved to be relatively immune to economic pressures experienced across the rest of Europe. However, there remains a general sense of uncertainty that has resulted in consumer preference for more traditional investment products than for equity-based unit-linked investments. Movestic remains committed to the unit-linked market and believes that, in time, as equity market confidence recovers and that as the traditional investment offerings become less sustainable for providers, there will be a general shift back towards unit-linked investments.

Movestic KPIs (continued)

New business premium income

New business markets have remained difficult. In particular, the unit-linked market has been less strong than the market for more traditional investment products which have a lower risk profile and continue to offer guarantees, which we believe to be unsustainable. This external factor, when combined with the reduction in average market share, is reflected in the reduction in total new business premium income in 2012.

New business premium income (£m)



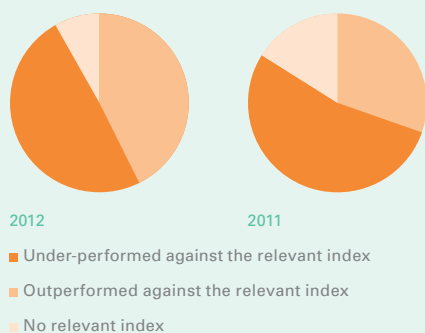
Fund performance

The increase in the number of funds out-performing their indices is a testament to our investment and fund selection strategy.

One of Movestic's key differentiators is its approach to selecting the funds available to investors. Rather than adopt mainstream funds, which, in Sweden, are those predominantly managed by subsidiaries of banks which also have life assurance subsidiaries, we select a limited number of funds from a wide range of independent fund managers.

The funds selected are, in general, actively managed funds with a value approach. The performance of all funds is closely monitored and regular contact is made with managers to ensure that the underlying reason for fund performance, whether positive or negative, is fully understood. Funds that do not perform favourably compared to the relevant index are wholly replaced if there are no acceptable strategies for improvement. During the year further funds were added to fill perceived gaps in the range.

Relative fund performance

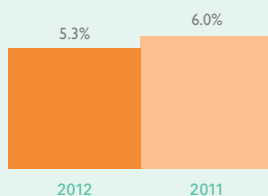


New business market share

Movestic's primary target market is unit-linked pensions business and, within that, company-paid contribution business. The servicing issues during 2011 which continued into 2012 have resulted in a loss of average market share compared with 2011.

This performance should be seen in the context of some of the traditional product providers having undertaken campaigns to move customers to 'new' unit-linked policies to address the challenges inherent in traditional guaranteed return products.

Total unit-linked pension business market share (excluding 'tick the box' market)

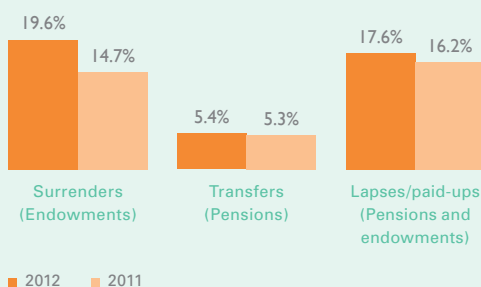


Annual policy attrition rate

The longer that insurance and investment contracts remain in force, the more profit accrues to the business. Different policy product types will be subject to surrender, transfer or lapse to varying extents.

We have continued with relatively high rates of attrition throughout much of 2012, although quarterly analysis does show a marked improvement in the most dominant category (pension transfers) during the second half of the year. Although the endowment surrender rate is relatively high this only affects a small proportion of the in-force book.

Annual policy attrition rate. Twelve months ended 31 December



The percentages for surrenders and transfers are based on the capital amount surrendered or transferred, divided by the amount of capital potentially transferable. For lapses, they are the annual premium of lapsed policies, divided by the total annual premium in force at the start of the year.

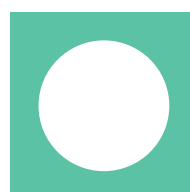
FINANCIAL REVIEW

The Group's key financial performance indicators as at 31 December 2012 and for the year ended on that date demonstrate the financial performance and strength of the Group as a whole. A summary of these is shown below and further analysis is provided in the following sections:



IFRS pre-tax profit, excluding exceptional item £24.5m

2011: £22.4m



Cash generation £41m

2011: £31.4m

The presentation of the results in accordance with International Finance Reporting Standards (IFRS) aims to smooth the recognition of profit arising from written business over the life of insurance and investment contracts. For businesses in run-off the reported profit is closely aligned with, and a strong indicator of, the emergence of surpluses arising within the long-term insurance funds of those businesses.

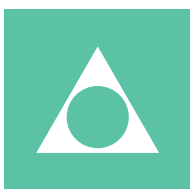
Highlights

- IFRS pre-tax profit of £24.5m, shows a 9.4% improvement from the prior year of £22.4m, excluding exceptional item.
- Pre-tax profit from the core CA closed book remain significant albeit at a reduced level compared with 2011 (2012: £18.5m; 2011: £25.7m). The reduction is predominately due to some specific investment market movements, with the core underlying product-based surplus remaining resilient to book run off.
- The 2012 result includes a £14.6m pre-tax profit arising in the S&P business. This compares favourably with the 2011 pre-tax profit of £7.5m which benefited from the Part VII Transfer, including the recognition of a £12.4m profit, arising from the alignment of actuarial assumptions.
- There was a £1.0m improvement in the Movestic pre-tax result.

Cash generation is a key measure, because it is the net cash flows to the Chesnara parent company from its Life and Pensions businesses which support Chesnara's dividend capacity. The dominating aspect of cash generation is the change in amounts freely transferable from the operating businesses, taking into account target statutory solvency requirements which are determined by the boards of the respective businesses. It follows that cash generation is not only influenced by the level of surplus arising but also by the level of target solvency capital.

Highlights

- At £15m, cash generation in CA continues to be strong (2011: £23.0m).
- S&P has generated £19.6m cash in 2012 from the underlying business compared with £3.4m in 2011.
- In addition, there is an exceptional cash release of £7m arising from the de-authorisation of the S&P regulated entities. This adds to the favourable synergistic effects of £12.4m arising from the Part VII Transfer during 2011.
- Movestic has required no capital support during 2012 (2011: £5.3m).



EEV earnings, net of tax* £31.2m profit

2011: £(29.8)m loss
*Excluding modelling adjustments of £3.6m
in 2012 (2011: £(10.3)m)



EEV £311.1m

2011: £294.5m

In recognition of the longer-term nature of the Group's insurance and investment contracts, supplementary information is presented in accordance with European Embedded Value 'EEV' principles. By recognising the net present value of expected future cash flows arising from the contracts (in-force value), a different perspective is provided in the performance of the Group and on the valuation of the business.

The principal underlying components of the EEV result are:

- i) The expected return from existing business (being the effect of the unwind of the rates used to discount the value in force);
- ii) Value added by the writing of new business;
- iii) Variations in actual experience from that assumed in the opening valuation; and
- iv) The impact of restating assumptions underlying the determination of expected cash flows.

Highlights

- Significant economic profit of £21.5m (2011: £(49.4)m loss).
- Increase in operating profit to £19.1m (2011: £15.3m).
- Movestic has generated a £12.7m EEV profit despite a significant strengthening of lapse assumptions.
- Notwithstanding a reduction in new business volumes, the Movestic new business operation continues to make a positive contribution to earnings.

As it takes into account expected future earnings streams on a discounted basis, EEV is an important reference point by which to assess Chesnara's market capitalisation. A life and pensions group may typically be characterised as trading at a discount or premium to its embedded value. Analysis of EEV, distinguishing value in force by segment and by product type, provides additional insight into the development of the business over time.

Highlights

- £36.1m increase in EEV before recognition of dividend payments.
- Modelling adjustments generate a £3.6m increase in EEV (2011: £(10.3)m reduction).
- Good balance of EEV across the operating segments.
- Good product diversification within the value in-force.



FINANCIAL REVIEW

IFRS pre-tax profit, excluding exceptional item

£24.5m

2011: £22.4m

Executive summary

The IFRS results by business segment reflect the natural dynamics of each line of business. In summary the current financial model has three major components which can be characterised as: the “stable core”, the “variable element”, and the “growth operation”. The results and financial dynamics of each segment are analysed further as follows:

Stable core

At the heart of surplus, and hence cash generation, is the CA non-profit business which is in run off. The requirement of this book is to provide a predictable and stable platform for the financial model and dividend strategy. As a closed book, the key is to sustain this income source as effectively as possible. The IFRS results during 2012 support this objective, with product-based deductions of £26.3m continuing to emerge in a predictable fashion and at a level that compares favourably against the prior-year equivalent of £25.8m. This level of product-based deductions has underpinned CA’s ability to generate a significant level of IFRS pre-tax profit at £18.5m.

Variable element

S&P has introduced an element of IFRS earnings volatility to the Group, as illustrated by the cost of policy guarantees, which are sensitive to movements in investment markets and lapse rates. Investment market conditions during 2012 have had a net favourable impact of £2.5m: this has, however, been offset by the £3.3m adverse impact of lower lapse experience, as a greater number of policies are estimated to rank for guarantee payments. Investment returns of £6.3m on shareholder assets within the with-profits funds compensated for this increased cost, giving rise to an overall net favourable with-profits result of £3.6m. This compares with a loss of £3.3m in 2011, excluding the effect of a change in the valuation interest rate.

Growth operation

Although, at its current scale, Movestic has posted a small and increased IFRS profit, the long-term financial model is based on growth. Levels of new business are targeted to more than offset the impact of policy attrition, leading to a general increase in assets under management and, hence management fee income. Despite the difficult operating conditions referred to in the Swedish Business Review section, the 2012 results show a 12% increase in funds under management.

Year ended 31 December	2012 £m	2011 £m	Note
CA	18.5	25.7	
S&P	14.6	7.5	
Movestic	1.4	0.4	
Chesnara	(5.8)	(5.5)	
Consolidation adjustments	(4.2)	(5.7)	
Total profit before tax and exceptional item	24.5	22.4	
Exceptional item	(4.8)	–	1
Total profit before tax	19.7	22.4	
Tax	8.2	3.3	1 & 2
Total profit after tax	27.9	25.7	

Note 1 – As explained in Note 7 to the IFRS financial statements, an exceptional item of £4.8m relating to the reclassification of policyholder tax liabilities within the S&P segment has been charged to IFRS profits. There is a corresponding deferred tax release to income tax of £4.8m included in the tax item above. The net of tax impact of these adjustments, which were made to align the treatment within the S&P segment with that within the CA segment, is accordingly £nil.

Note 2 – As explained in Note 18 to the IFRS financial statements the changes in the Life and Pensions tax regime has resulted in a deferred tax credit during 2012 of £6.1m.

The adjustments arising on consolidation are analysed below:

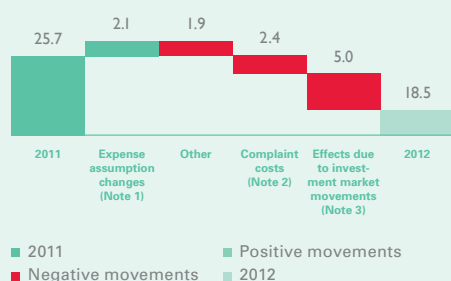
Year ended 31 December	2012 £m	2011 £m
CA – Amortisation of AVIF	(2.8)	(3.6)
S&P – Amortisation of AVIF	(0.8)	(1.0)
Movestic		
Amortisation of AVIF	(4.0)	(4.4)
Write back of DAC	3.4	3.3
Total	(0.6)	(1.1)
Total	(4.2)	(5.7)

The IFRS results by business segment are analysed in more detail as follows:

CA

Despite a slight increase in product-based deductions, the core source of IFRS earnings, the overall CA IFRS result has declined compared with 2011. There are a number of complex aspects to the IFRS result but the primary drivers of the decline in profit from 2011 to 2012 are illustrated as follows:

Profit before tax movement Year ended 31 December 2011 to 2012 (£m)



Note 1 – During 2011 we agreed, in principle, commercial terms for extending the outsourcing contract with HCL with the new terms resulting in an increase in expense assumptions recognised in 2011. This adjustment does not replicate in 2012.

Note 2 – The level of complaints costs incurred has remained relatively constant year on year at c£0.8m. During 2011 there was a general reduction in complaints reserves over and above the impact of claims paid. During 2012 further review of potential future Mortgage Endowment mis-selling costs was undertaken, due to higher complaints volumes arising from an increase in claims management company activity, which resulted in a small £1.3m increase in the reserves.

Note 3 – The impact of investment market conditions is relatively muted for the CA book. However, during 2012, the cumulative impact of a number of different investment-related items was adverse as compared with 2011 when the impact, dominated by mismatch profits, was positive.

The key components of the 2012 IFRS result are summarised as follows:

Pre-tax IFRS profit	2012 £m	2011 £m	Note
Product-based deductions	26.3	25.8	1
Gains and interest on retained surplus	5.4	6.2	1
Administration expenses	(9.1)	(8.6)	1
Other effects due to investment market movements	(1.7)	3.3	2
Expense assumption changes (HCL)	–	(2.1)	
Complaint costs	(2.3)	0.1	3
Other	(0.1)	1.0	
Total	18.5	25.7	

Note 1 – Product-based deductions and returns on retained surplus remain significantly in excess of recurring administration expenses. The total level of product-based deductions has increased despite the run-off of the book, reflecting an increase in mortality surplus and the positive impact of investment capital growth on funds under management, on which fees are based.

Note 2 – The impact of investment market conditions is generally relatively muted for the CA book compared with the value of the other key components. However, during 2012, the cumulative impact of a number of different investment-related items was slightly adverse compared with 2011 when the impact, dominated by mismatch profits, was positive. As a general observation, the investment market-driven result, although less significant, tends to hedge against investment market impacts in S&P.

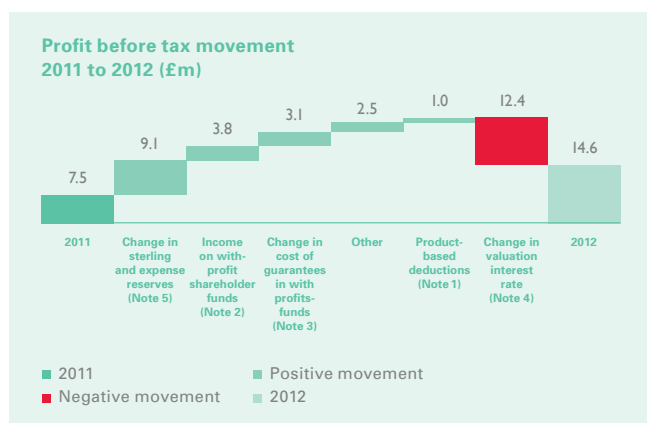
Note 3 – 2012 complaints costs include the impact of strengthening the mortgage endowment mis-selling complaints reserve and, as such, is not expected to recur at this level.

FINANCIAL REVIEW

IFRS PRE-TAX EARNINGS,
EXCLUDING EXCEPTIONAL ITEM (CONTINUED)

S&P

The S&P pre-tax profit has increased significantly compared with 2011:



S&P posted a pre-tax IFRS profit of £14.6m for 2012, the key components of the result being:

Pre-tax IFRS profit	2012		2011		Note
	£m	£m	£m	£m	
Product-based deductions		16.9	15.9		1
Administration expenses		(11.0)	(11.7)		1
Income on with-profits shareholder funds		6.3	2.5		2
Change in cost of guarantees in with-profit funds					3
Investment market movements	9.0		5.1		
Change in yield curve	(6.5)		(10.3)		
Lapse experience	(3.3)		-		
Change in valuation interest rate	-		12.4		4
Other	(1.9)		(0.6)		
Total		(2.7)	6.6		
Change in sterling and expense reserves	3.9		(5.2)		5
Other	1.2		(0.6)		
Total profit before exceptional item and tax		14.6	7.5		

Note 1 – Product deductions have held up well as the book runs off, aided to some extent by the impact of capital growth on funds under management. Product deductions exceed administration expenses by £5.9m and £4.2m in 2012 and 2011 respectively.

Note 2 – The income on with-profits shareholder funds is driven by investment market performance which has been significantly more favourable in 2012.

Note 3 – During 2012 there was a £2.7m increase in the cost of guarantees compared with a £5.8m increase in 2011, excluding the impact of £12.4m relating to an alignment in actuarial assumptions (see Note 4 below). The 2012 movement includes a £5.2m increase due to non-investment market items, principally reflecting a change in lapse assumptions. The investment market-related component during 2012 gave rise to a net reduction in cost of guarantees, of £2.5m. The corresponding investment market component in 2011 gave rise to an increase in the cost of guarantees of £5.2m, thereby illustrating the underlying sensitivity to investment markets.

Note 4 – A change in actuarial assumptions, to align them with those adopted for CA fund, as a result of the Part VII Transfer, resulted in the recognition of profit of £12.4m in 2011. The pre-existing S&P methodology was to reduce valuation interest rates to a level which eliminated the need for a resilience capital reserve.

Note 5 – Sterling and expense reserves are sensitive to both the expense base and to investment market movements. As investment markets improve, the level of sterling reserves (which provide against situations where future policy-based revenue does not cover future administration costs) reduces. The profit of £3.9m in 2012 is predominantly driven by investment market movements, whereas the loss of £5.2m in 2011 principally reflects the impact of a change in expense assumptions, resulting from the agreement in principle, of higher expense levels, following the prospective extension of the outsourcing contract with HCL.

Movestic

Pre-tax IFRS profit	2012 £m	2011 £m	Note
Pensions and savings	(0.3)	(1.5)	1
Risk and health	0.9	2.3	2
Other	0.8	(0.4)	3
Total profit before tax	1.4	0.4	

Note 1 – The Pensions and Savings business model is directly dependent upon fees and rebates earned on funds under management (FUM). Total FUM average has increased slightly during the year resulting in a £1.8m (9%) increase in fee and rebate income. This is partly offset by a £0.6m (6%) increase in internal costs.

Note 2 – The Risk and Health business, although not the core target growth operation, is significant to the Movestic financial and operating model. Unlike the longer-term Pension and Savings business the Risk and Health business tends to be cash generative in the short-term, thereby providing a source of internal funding. Further, the Risk and Health business is operationally significant due to the size of the book, there being 404,000 short-term policies in force as at 31 December 2012, which generated £36m of gross annual premiums. The reduction in pre-tax profit compared with 2011 is principally due to a 15% (£0.8m) increase in claims net of reinsurance and an 11% (£0.6m) increase in brokerage costs.

Note 3 – The “Other” component includes the results of the associate, Modernac, Movestic investment income and the impact of fair value adjustments to the Financial Reinsurance liability. The Modernac and Movestic investment income results have improved by £1.3m and £0.4m respectively year on year, while the financial reinsurance fair value adjustment has reduced by £0.4m. All of these movements are predominately a consequence of investment market conditions.

FINANCIAL REVIEW



Cash generation

£41.0m 2011: £31.4m



The Group's cash flows are generated principally from the interest earned on capital, the release of excess capital as the life funds run down, policyholder charges and management fees earned on funds under management.

Net cash generation within the Group continues to be robust. Key aspects underpinning the outcome are:

HIGHLIGHTS

- Net cash generation in the UK run-off businesses, supporting a £40m dividend to the parent company, has increased by some £8m year on year, driven by more favourable investment markets.
- A further significant benefit of £7m has arisen from the Part VII Transfer, following the de-authorisation of the S&P companies.
- There has been a pause in the Movestic funding requirements, although these are anticipated to resume at a modest level in 2013.

The Group's closed life funds provide predictable fund maturity and liability profiles, creating stable long-term cash flows for distribution to shareholders and for repayment of outstanding debt. Cash flow generation will naturally decline over time as the UK business run off.

Although investment returns are less predictable, a significant portion of the investment risk is borne by policyholders. However, the acquisition of S&P, while extending the longevity of cash generation within the Group, has introduced an element of volatility over shorter periods. This arises from the impact of investment market movements on the cost to shareholders of guarantees within the S&P with profits-funds. Although the short-term measure of this cost follows the fortunes of investment markets, we proactively manage the risk taking a longer-term perspective.

The following identifies the source of internal net cash generation within the Group, representing the net change in funds available to service debt (interest and loan principal repayment) and equity (dividends):

Year ended 31 December	2012	2011
Cash generated from/(utilised by):	£m	£m
CA		
Surplus and profits arising in the year	13.3	21.8
Change in target capital requirement	1.7	1.2
S&P		
Surplus and profits arising in the year	14.5	14.5
Change in target capital requirement	5.4	(11.8)
(Decrease)/increase in policyholder funds cover for target capital requirement	(0.3)	0.7
Synergistic effects of Part VII transfer	7.0	12.4
Movestic		
Additional capital contributions	-	(5.3)
Chesnara		
Cash utilised by operations	(0.6)	(2.1)
Net cash generation	41.0	31.4

FINANCIAL REVIEW



EEV earnings, excluding exceptional item

£31.2m profit 2011: £(29.8)m loss

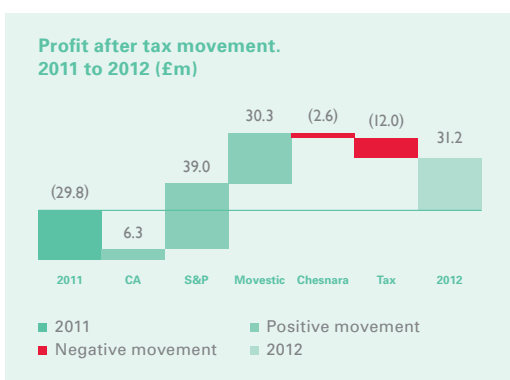
EEV result

Summary

The headline EEV result for the year has improved significantly over 2011. The majority of the improvement relates directly to investment market conditions. In 2011 investment markets generally performed worse than assumed, resulting in a significant EEV loss, whereas in 2012, a recovery in equity markets and a modest reduction in bond yields have resulted in a significant corresponding profit.

The operating result, upon which management has the most direct and immediate influence, represents a significant proportion of the total earnings during 2012. Total operating profit has improved by £3.8m from £15.3m in 2011 to £19.1m. A significant proportion of this is the return on shareholder net worth, which at £7.9m has also benefited from favourable investment market conditions.

The following tables analyse the Group EEV earnings after-tax by source and by business segment:



Analysis of the EEV result in the year by business segment

	2012 £m	2011 £m
CA	13.1	6.8
S&P	15.7	(23.3)
Movestic	13.0	(17.3)
Chesnara	(5.7)	(3.1)
Total pre-tax profit/(loss)	36.1	(36.9)
Tax	(4.9)	7.1
Profit/(loss) after tax	31.2	(29.8)

Analysis of the EEV result in the year by earnings source

	2012 £m	2011 £m
New business contribution	2.9	4.4
Return from in-force business		
Expected return	5.8	10.2
Experience variances	0.4	(0.8)
Operating assumption changes	2.0	(2.6)
Return on shareholder net worth	7.9	4.1
Operating profit of covered business	19.0	15.3
Variation from longer term		
investment return	28.0	(16.9)
Effect of economic assumption changes	(6.5)	(32.5)
Profit/(loss) on covered business before tax	40.6	(34.1)
Tax	(6.0)	5.6
Profit/(loss) on covered business after tax	34.5	(28.5)
Uncovered business and other		
Group activities	(4.4)	(2.8)
Tax on uncovered business	1.1	1.5
Profit/(loss) after tax	31.2	(29.8)

Economic conditions

As indicated above, the EEV result is sensitive to economic conditions. Economic experience and assumption changes contributed a profit of £21.5m in 2012 compared with a loss of £49.4m in 2011. During 2011 there was a general decline in equity markets and bond yields and the result is sensitive to both these factors (further sensitivity analysis is provided in Note 7 of EEV Supplementary Information). Although bond yields continued to decline during 2012, the level of reduction was significantly less than in 2011 and this was more than offset by a relatively strong recovery in equity markets. The impact of these effects on each operating segment is illustrated below:

	2012 £m	2011 £m
Economic expense and assumption changes		
CA	4.7	(5.7)
S&P	8.3	(25.5)
Movestic	8.5	(18.2)
Total	21.5	(49.4)

The S&P profit in 2012 includes an experience profit of £11m offset in part by a £2.7m assumption loss. The experience profit largely arises from equity and bond capital growth of £7.2m and £3.3m respectively. The assumption loss is primarily due to the £3.3m impact of a reduction in our assumed level of the risk-free rate of return.

FINANCIAL REVIEW
EEV EARNINGS (CONTINUED)

The Movestic business is sensitive to movements in equity markets (predominantly Swedish) due to its core income stream being dependent upon management charges levied on funds under management, which are primarily equity-based. The S&P result is sensitive to equity and bond market movements, principally through the impact on the cost of guarantees. Whereas in 2011 there was a significant decline in both equity values and fixed-interest investment returns, there has been a modest equity market recovery in 2012, offset by a continuing downward drift in bond yields. The CA result is relatively less sensitive to investment market movements.

New business contribution

The new business contribution relates primarily to the Movestic Pensions and Savings business. Movestic also writes Risk and Health policies but due to its more short-term nature the Risk and Health business is reported as uncovered business and hence does not contribute to the new business result. The Movestic contribution is £2.6m, of which £2.4m relates to the value of premium increments received on existing policies. Profits on "new contract" business of £0.2m, has declined significantly compared with the 2011 equivalent of £3.1m. The reduction is due to a 20% reduction in new business volumes following from the servicing issues arising during a 2011 systems migration (see Swedish Business Review on page 23).

Experience variances	2012 £m	2011 £m
CA	5.2	5.2
S&P	3.1	(0.2)
Movestic	(7.9)	(5.8)
Total	0.4	(0.8)

The CA favourable variances relate to policy persistency and mortality experience being better than assumed. The S&P favourable variances in 2012 relate principally to policyholder tax deductions of £1.9m and better than assumed expense and lapse experience of £1m and £1.1m respectively.

The Movestic loss of £7.9m is primarily due to adverse lapse experience during the year, as was the case in 2011. In recognition of the level of continuing level of adverse experience, lapse assumptions have been strengthened, the impact of which is included in the operating assumption changes in the analysis below:

Operating assumption changes	2012 £m	2011 £m
CA	(0.3)	1.7
S&P	(2.9)	(0.9)
Movestic	5.2	(3.4)
Total	2.0	(2.6)

The S&P result reflects a loss of £3.7m following a change in lapse assumptions. Policies are expected to run-off at a slower rate than previously assumed and for a book carrying guarantees this has a negative impact as more policies are anticipated to rank for guarantee payments. This is partially offset by a profit resulting from a reduction in future expenses assumptions.

Adverse Movestic lapse experience has continued through 2012 and the long-term assumptions have been strengthened accordingly, with a total adverse impact of £7.9m. This is more than offset by positive assumption changes relating to broker and fund manager rebates totalling some £13m. In 2011 no corresponding lapse assumption changes were considered appropriate at that time due to the introduction of new retention initiatives.

Tax

During 2012 the EEV tax model has been updated to fully reflect proposed changes in the UK Life and Pension tax regime.

The 2011 tax credit of £7.1m includes the positive impact of tax synergies arising on the Part VII transfer of S&P into CA.

Uncovered business and other group activities.

Uncovered business and other group activities	2012 £m	2011 £m
Chesnara	(5.7)	(3.1)
Movestic	1.3	0.3
Total	(4.4)	(2.8)

The result includes Chesnara parent company costs relating to corporate governance and business development, not attributable to the covered business. The year-on-year increase is primarily due to a £2.5m increase in a provision to cover future contractual property costs associated with the Group Head Office.

The Movestic result is impacted by:

- i) Risk and Health results; This business is less long-term in nature and hence is not modelled as covered business. Profit has reduced by £1.3m compared with 2011, primarily due to a 15% (£0.8m) increase in claims net of reinsurance and a 11% (£0.6m) increase in brokerage costs.
- ii) Profit from the Modernac associate, which has increased by £1.4m compared with 2011.
- iii) Valuation adjustments for the Movestic financial reinsurance arrangements. The 2012 adjustment is £0.3m compared with a negative adjustment of £1.9m in 2011, largely reflecting investment market movements.

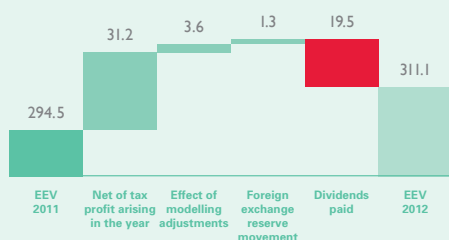


FINANCIAL REVIEW

European Embedded Value (EEV)

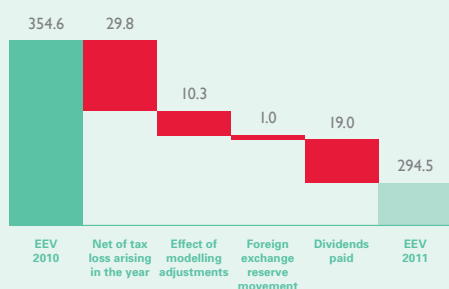
£311.1m 2011: £294.5m

EEV movement 2011 to 2012 (£m)



■ EEV 2011 ■ Positive movement
■ Negative movement ■ EEV 2012

EEV movement 2010 to 2011 (£m)



■ EEV 2010 ■ Positive movement
■ Negative movement ■ EEV 2011

Net of tax profit

The EEV profit arising during the year is analysed in more detail within the preceding section.

Effect of modelling adjustments

Modelling adjustments during the year ended 31 December 2012 give rise to a net increase in EEV of £3.6m, comprising:

Movestic

During 2012, there has been a continued focus on ensuring that the Movestic EEV model is robust. The process, which has included independent review, has identified the following:

- i) levels of commission claw-back within the future cash flow projections were overstated by £7.9m; and
- ii) several enhancements to policy fee cash flow estimates and data input routines have been identified with a total net adverse impact of £1.1m.

UK

The CA and CWA EEV models previously assumed a single average rate of investment return for all durations as opposed to the use of a full yield curve. This approximation was reported in the EEV assumptions section 4(a) of the Supplementary Information within the 2011 Report and Accounts. As at 31 December 2012 the models have been enhanced to recognise differing rates of return across the different durations of the yield curve resulting in a net of tax increase of £12.6m.

Modelling adjustment during the year ended 31 December 2011 gave rise to a reduction of EEV of £(10.3)m comprising:

Movestic

- i) an improvement was introduced into the Movestic modelling system in respect of projected fee income from investment contracts where the fee is premium based, such contracts hitherto not being differentiated and this resulted in an increase in embedded value of £2.7m; and
- ii) modelling errors were detected relating to certain parameters and discounting periods specified at inception of a new model and the correction of these gave rise to a reduction in embedded value of £12.4m.

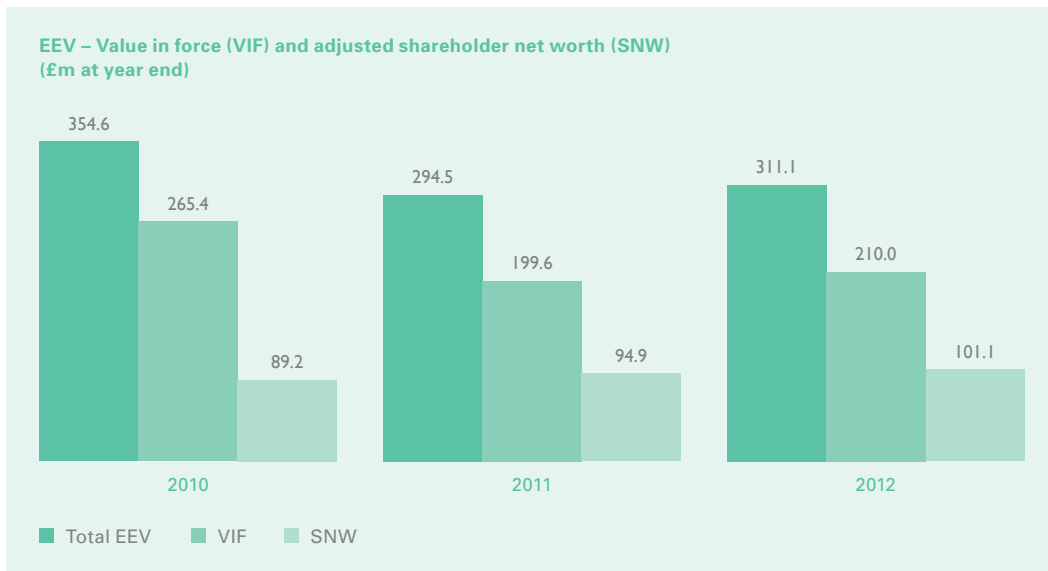
UK

S&P model enhancements gave rise to a further £0.6m reduction in EEV.

Foreign exchange reserve movements

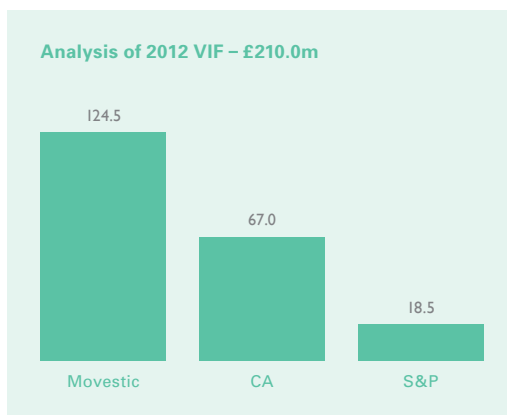
The £1.3m foreign exchange reserve movement in 2012 is the impact of a 1% strengthening of the Swedish Krona against Sterling during the year, following its depreciation of 1% during 2011.

EUROPEAN EMBEDDED VALUE (CONTINUED)



HIGHLIGHTS

- There is a good balance in EEV across the core business segments although the UK businesses represent the majority (59%) of the total EEV. Conversely the value in-force component is dominated by the Swedish business which represents 59% of the total Group VIF.
- There is a significant level of product diversification within the VIF. When adjusted to recognise the impact of the S&P cost of guarantees which are predominantly pension contract related, 60% of the total product level value in-force relates to pension contracts, 19% to protection business and 17% to endowments.



The tables below set out the value of in-force business by major product line at each period end. Analysis of the composition of the VIF by business and major product category provides a useful insight into the commercial dynamics underpinning the value of Chesnara.

Number of policies	31 December 2012				31 December 2011			
	CA 000's	S&P 000's	Movestic 000's	Total 000's	CA 000's	S&P 000's	Movestic 000's	Total 000's
Endowment	39	5	12	56	44	6	14	64
Protection	43	5	–	48	48	6	–	54
Annuities	6	–	–	6	6	–	–	6
Pensions	46	128	78	252	49	136	77	262
Other	3	12	–	15	4	14	–	18
Total	137	150	90	377	151	162	91	404

Value of in-force business	31 December 2012				31 December 2011			
	CA £m	S&P £m	Movestic £m	Total £m	CA £m	S&P £m	Movestic £m	Total £m
Endowment	27.7	3.8	8.1	39.6	29.7	4.3	9.7	43.7
Protection	49.2	3.7	–	52.9	46.2	3.9	–	50.1
Annuities	7.8	0.9	–	8.7	(0.8)	1.0	–	0.2
Pensions	33.6	55.0	124.2	212.8	30.7	52.4	118.2	201.3
Other	3.2	3.3	–	6.5	2.2	4.1	–	6.3
Total at product level	121.5	66.7	132.3	320.5	108.0	65.7	127.9	301.6
Holding company expenses	(7.0)	(3.9)	(7.7)	(18.6)	(5.4)	(3.3)	(6.4)	(15.1)
Other	(28.6)	(41.8)	–	(70.4)	(27.8)	(41.7)	–	(69.5)
Cost of capital/frictional costs	(1.1)	(2.4)	(0.1)	(3.6)	(1.2)	(3.2)	(0.1)	(4.5)
Value in-force pre-tax	84.8	18.6	124.5	227.9	73.6	17.5	121.4	212.5
Taxation	(17.8)	–	–	(17.8)	(12.9)	–	–	(12.9)
Value in force post-tax	67.0	18.6	124.5	210.1	60.7	17.5	121.4	199.6

The value-in-force represents the discounted value of the future surpluses arising from the insurance and investment contracts in force at each respective period end. The future surpluses are calculated by using realistic assumptions for each component of the cash flows.

Holding company expenses are apportioned across the segments pro-rata to the total product-based VIF. The total holding company expense adjustment was, prior to 2012, allocated to the CA segment. The 2011 comparatives have been re-presented in accordance with the new allocation methodology. The total increase in the value of holding company expenses reflects an enhancement to the profile assumed for how the costs run-off into the future.

'Other' valuation adjustments in CA principally comprise expenses for managing policies which are not attributed at product level. In S&P they represent the estimated cost of guarantees to with-profits policyholders.

From 31 December 2011, following the Part VII Transfer, taxation in the value in force is modelled on a combined CA and S&P basis and, in the analysis above, is attributed wholly to the CA segment.

FINANCIAL MANAGEMENT

OBJECTIVES



The Group's financial management framework is designed to provide security for all stakeholders, while meeting the expectations of policyholders and shareholders. Accordingly it:

- i) safeguards policyholders' interests by meeting regulatory requirements established by the regulators of the insurance markets in which the Group's regulated companies operate, while not retaining unnecessary excess capital;
- ii) seeks to meet the dividend expectations of shareholders and to optimise the gearing ratio to ensure an efficient capital base;
- iii) ensures there is sufficient liquidity to meet obligations to policyholders, debt financiers and creditors as they fall due; and
- iv) maintains the Group as a going concern so that it continues to provide returns and to meet obligations to shareholders.

CAPITAL STRUCTURE AND CASH FLOWS

The Group's UK operations are ordinarily financed through retained earnings and through the current emergence of surplus in the UK life businesses.

Movestic is financed by a combination of external financial reinsurance arrangements and capital contributions from Chesnara.

With respect to acquisitions the Group seeks to finance these through a suitable mix of debt and equity, within the constraints imposed by the operation of regulatory rules over the level of debt finance which may be borne by Insurance Groups without breaching solvency requirements.

The acquisition of S&P in December 2010 for £63.5m was accomplished by way of debt: equity financing broadly in a ratio of 2:1. This introduced a modest level of gearing to the structure of Group financing.

Other factors which may place a demand on capital resources in the future include the costs of unavoidable large scale systems developments such as those which may be involved with changing regulatory requirements. To the extent that ongoing administration of the UK life businesses is performed within the terms of its third-party outsourcing agreements, the Group is sheltered, to a degree, from these development costs as they are likely to be on a shared basis.

The Group's longer-term cash flow cycle continues to be characterised by the strong inflow to shareholders' funds of transfers from the long-term insurance funds of CA, which is supported by the emergence of surplus within those funds.

These flows are used:

- i) to repay our debt obligations as set out in Note 35 of the IFRS of these financial statements;
- ii) to support dividend distributions to shareholders; and
- iii) to support the medium-term requirements of Movestic to meet regulatory solvency capital requirements as it expands.

METHODS

In order to meet our obligations we employ and undertake a number of methods. These are centred on:

- i) regulatory solvency capital resource and capital requirements analysis, where the relevant Boards set minimum targets for solvency capital resources;
- ii) longer-term projections of key financial variables, including the regulatory solvency calculations set out in (i); and
- iii) the setting of policies and investment manager guidelines for the investment of policyholder and shareholder funds.

Regulatory solvency capital resources and requirements

The operation of the UK, Swedish and EU regulatory regimes with respect to solvency capital requirements at the individual regulated company and Group level together with details of minimum target solvency ratios are set out in Note 31 of the IFRS financial statements ('Capital Management'). Targets are established at a level which aims to balance policyholder and shareholder interests. A higher target affords a greater degree of protection to policyholders, but constrains the level of cash generated and transferable by the UK businesses, which are in run-off, and absorbed by Movestic which is in a development phase. In respect of the UK businesses statutory regulations require:

- i) a Pillar 1 calculation, which compares regulatory capital resource requirements, based on the characteristics of the in-force life business, with an associated measure of capital as prescribed by regulation; and
- ii) a Pillar 2 calculation which compares a risk-based assessment of solvency capital with an associated measure of capital based on a realistic assessment of insurance liabilities; and
- iii) the amount of required regulatory solvency capital is then determined by the method which gives rise to the lower excess of regulatory capital over requirements.

These calculations are monitored continuously.

Longer-term projections

On a six monthly basis, longer-term projections are prepared on a Group basis embracing:

- i) Segmental earnings and surplus arising in the long-term insurance funds;
- ii) Chesnara company cash flows;
- iii) Regulatory solvency and capital resources and requirements on a regulated individual entity basis and on a consolidated Group basis; and
- iv) European embedded value.

The projections are prepared for a base case and for various sensitivities; the base case follows the latest assumptions approved by the respective boards, regarding:

- i) the calculation of actuarial liabilities for longer-term insurance contracts; and
- ii) cash flows within the embedded value calculation.

The sensitivities which are prepared include the impact of movements in:

- i) equity, property and bond markets;
- ii) variations in anticipated new business volumes in the Swedish business; and
- iii) adverse movements in the Sterling: Swedish Krona exchange rate.

In addition:

- Financial condition reports are prepared on an annual basis which include assessments of the ability of the business to withstand key adverse events, including increased rates of policy lapse, expense overruns and unfavourable market conditions.
- Reverse stress testing techniques are employed which assess events and circumstances which would cause the combined CA and S&P business to become unviable. In this context, unviable is defined as the point at which the market loses confidence in the firm being able to carry out its normal business activities.

Investment management

An element of meeting policyholders' expectations and thereby, promoting customer retention is the pursuit of good relative investment performance in the policyholder funds.

The CA funds are primarily managed by Schroder Investment Management Limited while the CWA funds continue to be managed by Irish Life Investment Managers Limited and the S&P funds continue to be managed by JPMorgan Asset Management (UK) Ltd.

We meet formally with fund managers on a quarterly basis to assess past performance and future strategy. Investment guidelines for investment fund managers are established for each fund having regard to the nature of the fund and to contractual obligations to policyholders. For the with-profits funds these are also in accordance with the published Principles and Practices of Financial Management.

Movestic funds are managed by a carefully selected range of fund managers who have strong performance records in the relevant sector. Performance is monitored very closely and regular meetings are held with fund managers. Should under performance continue then an alternative manager is sourced and appointed to manage the relevant assets. Where a new market niche or specific opportunity is identified new funds may also be added.

The CA Board continues to have a conservative approach to the investment of shareholders' funds in the UK life businesses, which underpins our strong solvency position. For the UK businesses, where the greater part of shareholders' funds subsist, this approach targets the investment of 100% of available funds in cash and fixed interest securities. In the light of recent volatility in financial markets, particular attention is given to the mix and spread of these investments to ensure that we are not unduly exposed to particular sectors and that our counterparty limits are strictly adhered to.

FINANCIAL MANAGEMENT (CONTINUED)

OUTCOMES

Key outcomes from our financial management process, in terms of meeting our objectives are set out below:

Solvency and regulatory capital

For the whole of the periods presented below the Pillar 1 calculation for the UK business, as described above, gave rise to the lower measure of excess capital. The statutory solvency position of the individual businesses may accordingly be summarised as:

	31 December 2012		31 December 2011	
	Solvency ratio %	Excess capital £m	Solvency ratio %	Excess capital £m
CA				
Pre proposed dividend to Chesnara	279	64.6	259	67.0
Post proposed dividend to Chesnara	199	24.6	183	23.0
S&P	n/a	n/a	115	0.9
Movestic	280	15.1	245	11.4
Group (Consolidated EU Insurance Groups Directive basis post proposed dividend)	244	90.4	198	75.4

- i) The positions as at 31 December 2011 and 31 December 2012 reflect the impact of the Part VII Transfer, as a result of which CA includes the transfer of all the long-term business funds and certain of the shareholder funds of S&P.
- ii) The amounts reported as S&P as at 31 December 2011 accordingly represent residual S&P shareholder funds which were retained to cover the minimum EU regulatory capital resource requirements for regulated entities. The S&P companies were de-authorised during 2012 thereby removing the need for them to maintain regulatory capital resources.
- iii) Excess capital is determined by the minimum regulatory capital resource targets set by the respective boards, except for the Group solvency ratio for which no target is set above the regulatory minimum of 100%. Reliance is placed instead on the efficacy of targets set at the subsidiary level.
- iv) The Movestic Board has set a minimum target of 150% of the regulatory capital requirement. Swedish solvency regulation requires that a certain proportion of assets, to be fully admissible, is to be held in the form of cash. The operation of this requirement may, from time to time, act as the operative constraint in determining the level of additional funding requirements, thereby causing Movestic's solvency ratio to rise above what it would otherwise have been, had the form of assets matching capital resources not been a constraint.

The information provided in respect of CA and the Group illustrates:

- robust protection for policyholders; and
- a favourable position from which Chesnara, which relies on dividend distributions from CA, continues to service its loan commitments and to pursue and attractive dividend policy.

The information in respect of Movestic also illustrates robust policyholder protection and provides the context in which Chesnara makes further capital contributions as the business expands.

Returns to shareholders



The Board's primary aim is to continue to provide an attractive dividend flow to shareholders within the context of the emergence of surplus in the UK businesses.

Returns to shareholders are underpinned by the emergence of surpluses in, and transfer of surpluses from, long-term insurance funds to shareholder funds and by the return on shareholder net assets representing shareholder net equity.

These realisations are utilised in the first instance for the repayment and servicing of debt. The surpluses arise from the realisation of in-force value of UK businesses, which are in run-off. The return on shareholder net assets is determined by the Group's investment policy. Shareholder funds bear central corporate governance costs which cannot be fairly attributed to the long-term insurance funds and which arise largely in connection with Chesnara's obligations as a listed company.

Following the announcement of the acquisition of S&P on 20 December 2010 up to mid-March 2011, the share price steadily strengthened so that it was consistently trading within a range of 240p to 260p per share. Based on total proposed dividends for 2010 of 16.4p per share, this implied a yield of between 6.3% and 6.8%, with the shares trading at a discount of between 13% to 19% to the latest published embedded value of £354.6m at 31 December 2010.

Over the period from mid-March 2011 to mid-November 2011 the share price declined steadily from a high in the range of 255p to 260p per share to a low in the range of 160p to 165p per share. This fall was largely driven by the decline in global investment markets and followed the fortunes of the life insurance sector as a whole. However, the share price from mid-November 2011 to mid-March 2012, fluctuated within a range of 165p to 186p and did not reflect the upturn in the sector as a whole. Based on total proposed dividends for 2011 of 16.85p per share this implied a yield of between 9.1% and 10.2% with the shares trading at a discount of between 29% and 36% to EEV as at 31 December 2011.

Over the period from mid-March to mid-July 2012 the share price showed no consistent sustained movement although it did dip to a two year low of 155p in April. From mid-July 2012 to late-March 2013 the share price has steadily strengthened reaching a high of 233p. From mid-February through to late-March 2013 the price has stabilised within a range of 217p to 233p per share. Based on the total proposed dividends for 2012 of 17.35p per share this implies a yield of between 8.0% and 7.5% with the shares trading at a discount of between 19.8% and 13.9% to EEV as at 31 December 2012.

Returns to policyholders

Key aspects of policyholder fund performance in respect of the UK Business are set out on page 20 and in respect of the Swedish Business on page 23.

Liquidity

The current profile and mix of investment asset holdings between fixed-interest securities and cash deposits is such that realisations to meet obligations to third parties and to support dividend distributions can be made in an orderly and efficient way.

Going concern

The Group's cash flow position described on page 32, together with the return on financial assets in the parent company, supports the ability to trade in the short-term. Accordingly, the underlying solvency position of the UK life business and their ongoing ability to generate surpluses which support cash transfers to shareholders' funds is critical to the ongoing ability of the Group to continue trading and to meet its obligations as they fall due.

The information set out in 'Solvency and Regulatory Capital' above indicates a strong solvency position as at 31 December 2012 as measured at both the individual regulated life company levels in both the UK and Sweden and at the Group level. In addition, in respect of the UK business, the financial condition report and reverse stress testing assessments indicate that it is able to withstand the impact of adverse scenarios, including the effect of significant investment market falls, while the business's outsourcing arrangements protect it from significant expense overruns.

Notwithstanding that the Group is well capitalised, the current financial and economic environment continues to present specific threats to its short-term cash flow position and it is appropriate to assess other relevant factors. In the first instance, the Group does not rely on the renewal or extension of bank facilities to continue trading – indeed, as indicated, its normal operations are cash generative. The Group does, however, rely on cash flow from the maturity or sale of fixed interest securities which match certain obligations to policyholders: in the current economic environment there remains a continuing risk of bond default, particularly in respect of financial institutions. In order to manage this risk we ensure that our bond portfolio is actively monitored and well diversified. Other significant counterparty default risk relates to our principal reinsurers. We monitor their financial position and are satisfied that any associated credit default risk is low. It is noteworthy that we have negligible exposure to Euro-denominated sovereign debt.

Our expectation is that, notwithstanding the risks set out above, the Group will continue to generate surplus in its UK long-term businesses sufficient to meet its debt obligations as they fall due, to continue to pursue an attractive dividend policy and to meet the short-term financing requirements of Movestic.

RISK MANAGEMENT

Risk management processes

Overlaying all the day-to-day and development activity we undertake is a focused risk management culture and regime.

In both the UK and Swedish businesses we maintain processes for identifying, evaluating and managing the significant risks faced by the Group, which are regularly reviewed by the Group Audit & Risk Committee. Our risk processes have regard to the significance of risks, the likelihood of their occurrence and take account of existing controls and the cost of mitigating them. The processes are designed to manage rather than eliminate risk and, as such, provide reasonable, but not absolute, assurance against loss.

At the subsidiary level in the UK businesses we maintain, in accordance with the regulatory requirements of the FSA, a risk and responsibility regime. Accordingly, the identification, assessment and control of risk are firmly embedded within the organisation and the procedures for the monitoring and updating of risk are robust. As part of this we established a Risk Committee in CA, which comprises solely of Non-executive Directors. This committee receives quarterly updates of the key risk registers, as maintained by the senior management, for review and challenge. The committee reports directly to the CA Board which also reviews reports from the compliance and internal audit functions. CA risks are summarised and reviewed by the Chesnara Audit & Risk Committee on a quarterly basis. The key risk registers have been designed to complement the production of Individual Capital Assessments, which we are required to submit to the FSA on request and maintain on an ongoing basis. We categorise all risks against the following relevant categories – insurance, market, credit, liquidity, operational and group – and identify potential exposures and the necessary capital requirements accordingly.

In the Swedish business, at the subsidiary Movestic level, there is full compliance with the regulatory requirement in that its Board and Managing Director have responsibility for ensuring that the management of the organisation is characterised by sound internal control, which is responsive to internal and external risks and changes in them. The Board has responsibility for ensuring that there is an internal control risk function, which is charged with (i) ensuring that there is information which provides a comprehensive and objective representation of the risks within the organisation and (ii) proposing changes in processes and documentation regarding risk management. These obligations are evidenced by regular compliance, internal audit, general risk and financial risk reports to the Movestic Board. The latter is supplemented by quarterly returns to the Swedish regulator, Finansinspektionen, which set out estimated capital requirements in respect of insurance, market, credit, liquidity, currency and operational risks.

Risk management processes are enhanced by stress and scenario testing, which evaluates the impact on the Group of certain adverse events occurring separately or in combination. There is a strong correlation between these adverse events and the risks identified in 'principal risks and uncertainties' below. The outcome of this testing provides context against which the Group can assess whether any changes to its risk management processes are required.

Group and subsidiary auditors regularly report to management on identified control weaknesses together with suggested improvements.

In accordance with the need to comply with the requirements of Solvency II on an EU-wide basis, we are currently reviewing and upgrading our risk management processes, so that Group-wide they will be enhanced in a uniform and consistent manner, embracing:

- articulation of risk appetite statements, following from documented strategic objectives;
- formulation and monitoring of associated risk metrics;
- risk identification and assessment;
- calculation of risk-based capital; and
- the embedding of risk management processes so that they are at the forefront of, and underpin, strategic and operating decisions.

These developments continued through 2012 and are planned to be completed during 2014.

Principal risks and uncertainties

Risk and uncertainties are assessed by reference to the extent to which they threaten, or potentially threaten, the ability of the Group to meet its core strategic objectives. These currently centre on the intention of the Group to maintain an attractive dividend policy.

The specific principal risks and uncertainties subsisting within the Group are determined by the fact that:

- i) the Group's core operations centre on the run-off of closed life and pensions businesses in the UK;
- ii) notwithstanding this, the Group has a material segment, which comprises an open life and pensions business operating in a foreign jurisdiction; and
- iii) these businesses are subject to local regulation, which significantly influences the amount of capital which they are required to retain and which may otherwise constrain the conduct of business.

The following identifies the principal risks and uncertainties, together with a description of their actual or potential impact and of the way in which the Group seeks to control the specific insurance and financial risks which are set out in Notes 5 and 6 to the IFRS financial statements. The analysis below includes a re-presentation of the more significant risks identified therein.

PRINCIPAL RISKS AND UNCERTAINTIES

Risk	Impact	Control
Adverse mortality/morbidity/longevity experience	To the extent that actual mortality or morbidity rates vary from the assumptions underlying product pricing, so more or less profit will accrue to the Group.	<ul style="list-style-type: none"> – Effective underwriting techniques and reinsurance programmes. – Option on certain contracts to vary premium rates in the light of actual experience. – Partial risk diversification in that the Group has a portfolio of annuity contracts where the benefits cease on death.
Adverse persistency experience	Persistency rates significantly lower than those assumed will lead to reduced Group profitability in the medium to long-term.	<ul style="list-style-type: none"> – In closed life and pensions books, persistency rates tend to improve over time due to policyholder/investor inertia. – Active investment management to ensure competitive policyholder investment funds. – Outsourcer service levels ensure strong customer service standards. – Proactive customer retention processes.
Expense overruns and unsustainable unit cost growth	For the closed UK life and pensions businesses, the Group is exposed to the impact of fixed and semi-fixed expenses, in conjunction with a diminishing policy base, on profitability. For the Swedish open life and pensions business, the Group is exposed to the impact of expense levels varying adversely from those assumed in product pricing.	<ul style="list-style-type: none"> – For the UK businesses, the Group pursues a strategy of outsourcing functions with charging structures such that the cost is sensitive to book run off to the fullest extent possible. – The Swedish operations assume growth through new business such that the general unit cost trend is positive. – For both the UK and Swedish businesses, the Group maintains a strict regime of budgetary control.
Significant and prolonged equity and property market falls	A significant part of the Group's income and, therefore, overall profitability derives from fees received in respect of the management of policyholder and investor funds. Fee levels are generally related to the value of funds under management and, as the managed investment funds overall comprise a significant equity and property content, the Group is particularly exposed to the impact of significant and prolonged equity market falls, which may lead to policyholders switching to lower-margin, fixed-interest funds.	<ul style="list-style-type: none"> – Individual fund mandates may give rise to a degree of diversification of risk and within those funds, hedging techniques are used where appropriate. – Investment management costs fall in line with market falls and hence cost savings partially hedge the impact on income. – There is a wide range of investment funds and managers so that there is no significant concentration of risk.

Risk	Impact	Control
Adverse movements in yields on fixed interest securities	The Group maintains portfolios of fixed interest securities (i) in order to match its insurance contract liabilities, in terms of yield and cash flow characteristics, and (ii) as an integral part of the investment funds it manages on behalf of policyholders and investors. It is exposed to mismatch losses arising from a failure to match its insurance contract liabilities or from the fact that sharp and discrete fixed interest yield movements may not be associated fully and immediately with corresponding changes in actuarial valuation interest rates.	<ul style="list-style-type: none"> - The Group maintains rigorous matching programmes to ensure that exposure to mismatching is minimised. - Active investment management such that, where appropriate, asset mixes will be changed to mitigate the potential adverse impact on declines in bond yields.
Adverse Sterling: Swedish Krona exchange rate movements	Exposure to adverse Sterling/Swedish Krona exchange rate movements arises from actual planned cash flows between the Swedish subsidiary and its UK parent company and from the impact on reported IFRS and EEV results which are expressed in sterling.	<ul style="list-style-type: none"> - The Group monitors exchange rate movements and the cost of hedging the currency risk on cash flows when appropriate.
Counterparty failure	The Group carries significant inherent risk of counterparty failure in respect of: <ul style="list-style-type: none"> - its fixed interest security portfolio; - cash deposits; and - amounts due from reinsurers. 	<ul style="list-style-type: none"> - Operation of guidelines which limit the level of exposure to any one counterparty and which impose limits on exposure to credit ratings. - In respect of exposure to one major reinsurer, Guardian Assurance Limited ('Guardian'), the Group has a floating charge over the reinsurer's related investment assets, which ranks the Group equally with Guardian's policyholders.
Failure of outsourced service providers to fulfill contractual obligations	The Group's UK life and pensions businesses are heavily dependent on outsourced service providers to fulfill a significant number of their core functions. In the event of failure by either or both service providers to fulfill their contractual obligations, in whole or in part, to the requisite standards specified in the contracts, the Group may suffer loss as its functions degrade.	<ul style="list-style-type: none"> - Rigorous service level measures and management information flows under its contractual arrangements. - Continuing and close oversight of the performance of both service providers. - The supplier relationship management approach is conducive to ensuring the outsource arrangements deliver obligations. - Under the terms of the contractual arrangements the Group may impose penalties and/or exercise step-in rights in the event of specified adverse circumstances.
Key man dependency	The nature of the Group is such that, for both its Group-level functions and for its UK life and pensions operations, it relies on a small, professional team. There is, therefore, inevitably a concentration of experience and know how within particular key individuals and the Group is, accordingly, exposed to the sudden loss of the services of these individuals.	<ul style="list-style-type: none"> - The Group promotes the sharing of know how and expertise to the fullest extent possible. - It periodically reviews and assesses staffing levels, and, where the circumstances of the Group justify and permit, will enhance resource to ensure that know how and expertise is more widely embedded. - The Group maintains succession plans and remuneration structures which comprise a retention element. - The Group complements its internal expertise with established relationships with external specialist partners.
Adverse regulatory and legal changes	The Group operates in jurisdictions which are currently subject to significant change arising from regulatory and legal requirements. These may either be of a local nature, or of a wider nature, following from EU-based regulation and law. Significant issues which have arisen and where there is currently uncertainty as to their full impact on the Group include: <ul style="list-style-type: none"> i) the implementation of Solvency II requirements; and ii) potential change in the regulatory environment in Sweden. 	<p>The current opinion is that the implementation of Solvency II will strengthen the long-term risk management environment of Chesnara (as is its intention).</p> <p>The Solvency II programme is covered in more detail on the following page. The key risks are mitigated as follows:</p> <ul style="list-style-type: none"> - Proposed appointment of external specialist Quality Assurance partner; - Dedicated internal resource; and - Robust programme governance framework. <p>Management continually reviews the potential impact of any prospective regulatory changes.</p>

FOCUS ON SOLVENCY II



Solvency II is a fundamental review of the capital adequacy regime for the European insurance industry. It aims to establish a revised set of EU-wide capital requirements and risk management standards that will replace the current solvency requirements.

Solvency II's primary objective is to strengthen policyholder protection by aligning capital requirements more closely with the risk profile of the company. The regime has a three pillar structure, with each pillar governing a different aspect of the Solvency II requirements and approach. As well as requiring firms to disclose their capital and risk frameworks, the Directive also asks firms to demonstrate how and where the requirements are embedded in their wider activities. The planned implementation date of 1 January 2014 is now widely accepted as not being achievable, with 1 January 2016 anticipated to be the likely new date, though this has yet to be formalised. However, it is expected that, during 2013, guidelines for interim measures will be issued, which will require firms to develop and implement various aspects of Solvency II in the lead up to the revised implementation date.

Chesnara's approach

Pillar one

Pillar 1 considers the quantitative requirements of the system, including the calculation of technical provisions and the rules relating to the calculation of the Minimum Capital Requirement (MCR) and the Solvency Capital Requirement (SCR). Under Solvency II there are two prescribed methods for assessing an insurer's SCR; either a Standard Formula set by the regulator or an Internal Model specific to that insurer and which is subject to regulatory approval. Chesnara has opted for the Standard Formula approach for both CA and Movestic on the grounds that it is a good fit and appropriate for its businesses at the current time. However, we will continue to monitor our position on the choice of approach as our businesses evolve.

Progress update

The majority of the Pillar 1 development is now complete and the work to produce the Pillar 1 results for the CA and Movestic businesses will be undertaken during Q1 2013 and reported to the respective boards in Q1 and Q2 2013. We also expect to produce consolidated Pillar 1 results for the Group during Q2 2013. A decision will be taken in Q2 2013 as to whether any further Pillar 1 development is required.

Pillar two

Pillar 2 deals with two main areas: firstly, that our businesses have in place effective strategies and controls to assess and manage the risks it is exposed to and to assess and maintain its solvency capital based on its own risk profile and, secondly, that its strategies, controls and assessment of its solvency capital are subject to supervisory review. This pillar requires us to produce either, an Own Risk and Solvency Assessment (ORSA) for each subsidiary and one for the Group or a single Group-wide ORSA. We will be producing an ORSA for each subsidiary and the Group ORSA. Each ORSA is subject to review and scrutiny by the relevant regulator who will have the power to impose a higher capital requirement should it find any inadequacies in the approach to calculating the SCR or in the risk and governance controls in operation.

Progress update

Work is ongoing to enhance our Solvency II-compliant approach to risk management, business planning, projections, stress testing and solvency assessment. Work has also continued on drafting the various policies required under Solvency II and these are at various stages of development. We await clarity on the revised timetable and interim requirements before firming up on future plans.

Pillar three

Pillar 3 seeks to enhance market discipline on regulated firms by requiring them to disclose publicly key information that is relevant to market participants. As such, in choosing which information should be selected for disclosure under Pillar 3, supervisors will be guided by the actual needs of market participants rather than by their own information needs. The key reporting requirements are a Solvency & Financial Condition Report (SFCR) and a Regular Supervisory Report (RSR). The SFCR is for public disclosure and will follow a prescribed format. The RSR is not public and is only communicated to the relevant supervisor and, again, will largely follow a prescriptive format.

Progress update

To date, the main focus of Pillar 3 development has been on the analysis of the Quantitative Reporting Templates (QRTs). This work will identify the source of the data required for populating the QRTs and estimate the development work required to deliver the completed QRTs. The analysis is due to be completed at the end of Q1 2013. We await clarity on the revised timetable and interim requirements before firming up on future plans.

SECTION C

GOVERNANCE

IN THIS SECTION

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GOVERNANCE OVERVIEW FROM THE CHAIRMAN



This section of the Annual Report and Accounts provides me with the opportunity to comment on aspects of the management of the Company through 2012, with particular focus on how we are developing, or propose to develop, our Corporate Governance framework.

Pages 6 to 13 provide an overview of the Company's strategic objectives and of the risks to fulfilment of those objectives. Our Business Model is outlined on page 14. We employ various techniques in promoting fulfilment of our strategic objectives and in providing a suitable context for operational decision-making, including longer-term profit, cash flow and solvency projections for base case assumptions and for various stress scenarios. These lie at the heart of our management of the Company and are underpinned by sound Corporate Governance practices.

We judge the effectiveness of our Corporate Governance practices and procedures, and assess the need for specific enhancement, according to the extent to which they provide assurance as to our ability to meet our strategic objectives and to manage operational challenges. The Board makes decisions on whether changes to current practice are required based on guidance, best practice in the industry and the particular circumstances of the Company. In forming our judgements we consider the intention behind recommended practices. Although Chesnara is not a FTSE 350 Company, we also explicitly consider the requirements for FTSE 350 Companies, such as annual re-election of directors.

We noted the publication of the revised UK Corporate Governance Code by the FRC in September 2012 and reviewed the revisions against our existing practices, noting where changes would be required for the 2013 reporting year.

The specific areas of development of our Corporate Governance practices and procedures during 2012 were:

Board diversity

- As planned, a formal policy has been developed with regard to Board diversity. Consideration of this policy formed part of the selection process for the new Non-executive Directors.

Board effectiveness

- A questionnaire approach was followed in 2012. Given the planned and agreed changes to Board composition we have decided to review the effectiveness of our current methodology and the value of its findings with that which may be provided by external evaluation.

Annual re-election of Directors

- This is not a formal requirement for the Company in view of its size. As mentioned previously, consideration was given to providing for the annual re-election of Non-executive Directors with effect from 2013. However, the significant changes to the Board membership have resulted in the majority of Non-executive Directors being subject to election in 2013 so we plan to introduce annual re-election of Non-executive Directors with effect from 2014. We do not plan to extend this requirement to Executive Directors.

UK stewardship code

- We believe that this code issued by the Financial Reporting Council, together with subsequent clarifying changes are an important aspect of governance and we regularly discuss, with our fund managers, their approach to active management with the companies in which our portfolios are invested.

The following sections set out in more detail our Corporate Governance arrangements and the extent of our compliance with the provisions of the UK Corporate Governance Code. An overview of the activities of the Remuneration Committee is set out on page 56 and of the Audit & Risk Committee on page 61.

Peter Mason
Chairman
27 March 2013

BOARD OF DIRECTORS

Peter Mason was appointed as Chairman of Chesnara plc and Chairman of the Nomination Committee on 1 January 2009. He was re-appointed as a member of the Remuneration and Audit & Risk Committees with effect from 22 December 2009 and was appointed as Chairman of Movestic Livförsäkring AB with effect from 23 July 2009. He is currently the Investment Director and Actuary of Neville James Group, an investment management company. He was admitted as a Fellow of the Institute of Actuaries in 1979.

Graham Kettleborough is the Chief Executive of Chesnara plc. He joined Countrywide Assured plc in July 2000 with responsibility for marketing and business development and was appointed as Managing Director and to the Board in July 2002. He was appointed as a Non-executive Director of Movestic Livförsäkring AB and as Chairman of Movestic Kapitalförvaltning AB with effect from 23 July 2009. Prior to joining Countrywide Assured plc, he was Head of Servicing and a Director of the Pension Trustee Company at Scottish Provident. He has lifetime experience in the financial services industry, primarily in customer service, marketing, product and business development, gained with Scottish Provident, Prolific Life, City of Westminster Assurance and Target Life.

Ken Romney is the Finance Director of Chesnara plc. He joined Countrywide Assured plc in 1989 and became a member of the Board in 1997. He has worked in the life assurance industry for the last 28 years. He was Chief Accountant at Laurentian Life (formerly Imperial Trident) up to 1987 and was Financial Controller at Sentinel Life between 1987 and 1989. He worked for Price Waterhouse in their audit division until 1983 in both the UK and South Africa. He is a Fellow of the Institute of Chartered Accountants in England and Wales.

Frank Hughes is the Business Services Director of Chesnara plc. He joined Countrywide Assured plc in November 1992 as an IT Project Manager and was appointed to the Board as IT Director in May 2002. He has 26 years' experience in the life assurance industry gained with Royal Life, Norwich Union and CMG.

Mike Gordon is an Independent Non-executive Director of Chesnara plc and is Chairman of the Remuneration Committee. He was appointed as Senior Independent Non-executive Director of Chesnara plc on 1 January 2009. He also serves on the Audit & Risk Committee and the Nomination Committee and was appointed as a Non-executive Director of Movestic Livförsäkring AB with effect from 23 July 2009. He spent 12 years as Group Sales Director of Skandia Life Assurance Holdings.

Terry Marris is an Independent Non-executive Director of Chesnara plc and serves on the Audit & Risk Committee, the Remuneration Committee and the Nomination Committee. He joined Countrywide Assured Group plc in 1992 and was Managing Director of Countrywide Assured plc until July 2002. Previous roles included senior management positions at Lloyds Bank and General Accident.

Peter Wright is an Independent Non-executive Director who was appointed to the Chesnara plc Board on 1 January 2009. At the same date he was appointed as Chairman of the Audit & Risk Committee and as a member of the Remuneration Committee. He was appointed as a member of the Nomination

Committee with effect from 9 July 2009. He retired as a Principal of Towers Perrin on 1 January 2008 and is a former Vice President of the Institute of Actuaries, having been admitted as a Fellow in 1979. He is Chairman of the Risk Committee and of the With-profits Committee of Countrywide Assured plc.

Veronica France is an Independent Non-executive Director who was appointed to the Chesnara plc Board on 16 January 2013. She serves on the Nomination, Remuneration and Audit & Risk Committees and will chair the Remuneration Committee when Mike Gordon steps down on 17 May 2013. She also serves on the Countrywide Assured Risk Committee and With-profits Committee. She is currently a Non-executive Director of Family Assurance where she sits on their Risk and Audit and Nominations Committees and chairs their Remuneration Committee. Since 1992 Veronica has run her own financial services consultancy business advising on strategy, business development, product development and related activities. Veronica was Chairman of the trade body, the Investment and Life Assurance Group in 2002/3 and served on its Management Committee for over ten years before stepping down in 2010.

David Brand is an Independent Non-executive Director who was appointed to the Chesnara plc Board and the Board of Movestic Livförsäkring AB with effect from 16 January 2013. He serves on the Nomination, Remuneration Committee and Audit & Risk Committees. He is a qualified actuary who, prior to his retirement in June 2012, had worked for the Hannover Re Group in the UK, acting as the Managing Director of the UK life reinsurance subsidiary since 2003. David had been with the company since 1988, and a Director since 1990. During his career David has also held various roles with the Institute of Actuaries, including being a member of Council and he also served on the ABI Health Committee from 2006 to 2012.

Mike Evans is an Independent Non-executive Director who was appointed to the Chesnara plc Board on 4 March 2013. He serves on the Audit & Risk, Nomination and Remuneration Committees. Mike will become Senior Independent Director on the retirement of Mike Gordon on 17 May 2013. He is currently Non-executive Chairman of Hargreaves Lansdown plc, a FTSE 100 listed company, a position he has held since 2009. He originally joined the Hargreaves Lansdown Board as a Non-executive Director in 2006 and has served on their Nominations, Remuneration and Audit Committees. Mike is also a Non-executive Director of CBRE Global Investors Group (UK) and a member of the advisory board of Spectrum Corporate Finance. Mike is a qualified actuary and served in a number of director-level positions within Skandia UK between 1991 and 2006.

David Rimmington is to replace Ken Romney as Group Finance Director with effect from 17 May 2013, subject to approval at the AGM. He trained as a chartered accountant with KPMG, has more than 17 years' experience in financial management within the life assurance and banking sectors and has had a significant role in a number of major acquisitions and business integrations. Prior to joining Chesnara plc in 2011 as Associate Finance Director David held a number of financial management positions within the Royal London Group including 6 years as Head of Group Management Reporting.

BOARD PROFILE



In its assessment of the effectiveness of the Board Chesnara includes consideration of the core competencies required to govern the Group and deliver strategic objectives.

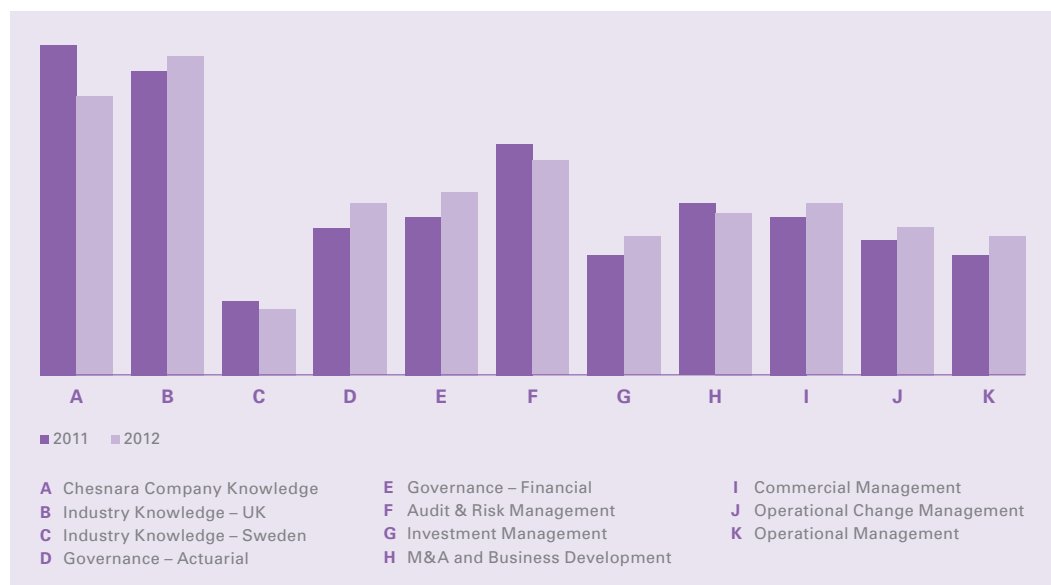
This part of the assessment focuses on ensuring the appropriate breadth and depth of competencies and experience.

A competency matrix is defined for the Board which is aligned to the strategic objectives set out on pages 10 to 13. Each Board member is assessed and scored against the core competencies and cumulative scores provide a competency profile for the Board as a whole, as set out below.

The profile is used to ensure that the Board as a whole possesses an appropriate skills and experience base for effective governance of the Group. The chart below compares the position as at 31 December 2011 with the expected Board composition following the changes in Non-executive Directors and the change in Group Finance Director which are subject to approval at the AGM on 17 May 2013.

Highlights of the current profile and including changes compared with 2011 are:

- In general the proposed Board changes tend to have a positive impact on the lower-ranking competency measures at the expense of a slight adverse impact on the very high ranking measures, thereby creating a general improvement in the balance of the overall Board competency profile.
- In particular, the fact that members with a long established involvement with Chesnara plc are to be replaced, will have an inevitable temporary adverse impact on the Chesnara Company knowledge measure. This is more than compensated for by the general improvement in the level of Investment Management, Operational Management and other competencies.
- The changes result in a short-term reduction in the overall level of knowledge of the Swedish business. Induction programmes and ongoing familiarisation are expected to have a positive impact such that any deterioration will be of a transitional nature. Notwithstanding this, the level of knowledge of the Swedish Insurance market is adequate to enable effective Board oversight of the Swedish business for which the deeper specialist knowledge is devolved to the local Board and executive management team.



CORPORATE GOVERNANCE REPORT



The Directors are committed to achieving a high standard of corporate governance including compliance with the principles and practices of the UK Corporate Governance Code (the 'Code'), as published by the Financial Reporting Council in June 2010 and updated in September 2012.

The following statement, together with the Directors' Remuneration Report on pages 56 to 60 and the Audit & Risk Committee Report on pages 61 to 62 describes how the principles set out in the Code have been applied by the Company and details the Company's compliance with the Code's provisions for the year ended 31 December 2012.

During the year under review the UK life and pensions businesses of the Group subsisted in one UK subsidiary company being Countrywide Assured plc.

Compliance with the Code

The Company has complied throughout the year with all of the relevant provisions of the Code.

The Board

For the year ended 31 December 2012, the Board comprised a Non-executive Chairman, three other Non-executive Directors and three Executive Directors, each of whom served throughout the period under review.

Since the end of the year, there have been changes to the Board membership with more changes planned with effect from the Annual General Meeting on 17 May 2013.

Two new Non-executive Directors, Veronica France and David Brand, were appointed to the Board with effect from 16 January 2013. A further Non-executive Director, Mike Evans was appointed to the Board on 4 March 2013. Two of the existing Non-executive Directors, Mike Gordon and Terry Marris have announced their intention to step down from the Board with effect from 17 May 2013, the date of the Annual General Meeting. Mike Gordon is currently chairman of the Remuneration Committee and that role will be assumed by Veronica France from 17 May 2013. Mike Evans will assume the role of Senior Independent Director when Mike Gordon steps down on 17 May 2013.

In addition, it has been announced that Ken Romney will step down from the Board and will leave the Company on 17 May 2013, with David Rimmington to be appointed to the Board as Finance Director from that date.

Biographical details of all current and proposed Directors are given on page 49 and a Board Profile, which assesses the core competencies required to meet strategic objectives, is provided on page 50. The Board, which plans to meet eight times during the year, has a schedule, which it reviews annually, of matters reserved for its consideration and approval. These matters include:

- setting corporate strategy;
- approving the annual budget and medium-term projections;
- reviewing operational and financial performance;
- approving acquisitions, investments and capital expenditure;
- reviewing the Group's system of financial and business controls and risk management and setting risk appetite parameters;
- approving appointments to the Board and to its Committees;
- appointment of the Company Secretary; and
- approval of policies relating to Directors' remuneration.

In addition:

- i) the Directors of the Company are also the Directors of Countrywide Assured plc ('CA'), in which the UK-based life and pensions business of the Group subsists. Under FSA Prudential Regulation the Directors of CA have responsibility for maintenance and projections of solvency and for assessment of capital requirements, based on risk assessments, and for establishing the level of long-term business provisions, including the adoption of appropriate assumptions;
- ii) three Directors of the Company, being Messrs Mason, Kettleborough and Brand, are also Directors of Movestic Livförsäkring AB ('Movestic'), the principal subsidiary company in which the Swedish-based life and pensions business of the Group subsists. Under regulation by Finansinspektionen, the Directors of Movestic have responsibility for ensuring that Movestic complies with regulatory solvency requirements. Mike Gordon will step down from the Movestic Board when he leaves the Chesnara Board on 17 May 2013.

The responsibilities that the Board has delegated to the respective Executive Management teams, of the UK and Swedish businesses include: the implementation of the strategies and policies of the Group as determined by the Board; monitoring of operational and financial results against plans and budget; prioritising the allocation of capital, technical and human resources and developing and managing risk management systems.

The roles of the Chairman and Chief Executive

The division of responsibilities between the Chairman of the Board, Peter Mason, and the Chief Executive, Graham Kettleborough, is clearly defined and has been approved by the Board. The Chairman leads the Board in the determination of its strategy and in the achievement of its objectives and is responsible for organising the business of the Board, ensuring its effectiveness and setting its agenda. The Chairman has no day-to-day involvement in the management of the Group. The Chief Executive has direct charge of the Group on a day-to-day basis and is accountable to the Board for the financial and operational performance of the Group.

CORPORATE GOVERNANCE REPORT (CONTINUED)

Senior Independent Director

The Board has designated Mike Gordon as Senior Independent Director. He is available to meet shareholders on request and to ensure that the Board is aware of shareholder concerns not resolved through the existing mechanisms for shareholder communication. Mike will be stepping down from the Board on 17 May 2013 and, with effect from that date, Mike Evans will assume the role of Senior Independent Director.

Directors and Directors' independence

The Board considers that Peter Mason was independent on his appointment as Chairman on 1 January 2009. In making this determination, the Board has carefully considered the fact that he is also a Non-executive Director of Countrywide Assured plc, a position which he has held since 1 October 1990, and a Non-executive Director of Countrywide Assured Life Holdings Limited ('CALHL'), the parent company of Countrywide Assured plc, a position he has held since 18 November 1991.

The Board considers that all Non-executive Directors are independent. In making this determination, the Board has carefully considered the following specific matters:

- i) Terry Marris had, within five years of his appointment, been an employee of a subsidiary company within the Group, which was acquired by the Company on 24 May 2004. He also held the position of Managing Director of Countrywide Assured plc, the principal operating life assurance subsidiary of the group prior to the acquisition of CA by the Company. He resigned these positions in July 2002; and
- ii) Peter Wright had, within the last three years prior to his appointment, held regulatory actuarial roles at Countrywide Assured plc and had otherwise provided actuarially-based consultancy advice, all such services being provided under an agreement with his employer at the time, Tillinghast Towers Perrin.

There were no comparable matters to consider in respect of Mike Gordon, Veronica France, David Brand or Mike Evans.

With regard to Peter Mason and Terry Marris, the Board considers that the characteristics, aims and mode of operation of the relevant activities of the Company are sufficiently different from those prevailing when they held the relevant positions, that the judgement and independence of mind exercised on behalf of the Company are not adversely affected or circumscribed. The Board is of the view that their considerable specific experience and knowledge in the business of the Group outweighs any residual risk in the historical relationships described above. With regard to Peter Wright, the nature of the services he provided, being subject either to FSA regulation or to professional standards and guidance prescribed or issued variously by the Institute of Actuaries or by the Financial Reporting Council Board of Actuarial Standards, was such that he was required to maintain a vigorous independence of mind and to prepare recommendations in accordance with the highest professional standards.

The Board is satisfied that the overall balance of the Board continues to provide significant independence of mind and judgement and further considers that, taking the Board

as a whole, the Independent Directors are of sufficient calibre and number that their views carry significant weight in the Company's decision making. The changes in Board membership are seen as a further enhancement of the Board's skills, diversity and experience and formal induction and training have been provided to new Non-executive Directors to ensure the Board continues to operate effectively.

The Directors are given access to independent professional advice, at the Company's expense, when the Directors deem it necessary, in order for them to carry out their responsibilities.

Details of the Chairman's professional commitments are included in his biography on page 49. The Board is satisfied that these are not such as to interfere with his performance, which is based around a commitment of between fifty and sixty hours in any three-month period.

Professional development

The Directors were advised, on their appointment, of their legal and other duties and obligations as Directors of a listed Company. This has been supplemented by the adoption and circulation to each Director of a written Code of Conduct, covering all aspects of the specific operation of Corporate Governance standards and of policies and procedures within the Group. Throughout their period in office, the Directors have, through the conduct of business at scheduled Board meetings, been continually updated on the Group's business and on the competitive and regulatory environment in which it operates. Through their membership of the CA Board all of the Directors who served during the period under review have considerable knowledge and experience of the UK-based businesses of the Chesnara plc Group. Similarly, Messrs Mason, Kettleborough, Brand and Gordon, through their membership of the Movestic Board, have considerable knowledge and experience of the Swedish-based business of the Group.

Information

Regular reports and information are circulated to the Directors in a timely manner in preparation for Board and Committee meetings.

As stated above, the Company's Directors are also variously members of the Boards of CA and Movestic. These Boards hold scheduled quarterly meetings, which are serviced by detailed regular reports and information, which cover all of the key areas relevant to the direction and operation of that subsidiary including:

For CA:

- Earnings report;
- Report from the Actuarial Function Holder and With-profits Actuary;
- Compliance report;
- Investment report; and
- Outsourcing reports.

CA monitors risk management procedures, including the identification, measurement and control of risk through the offices of a Risk Committee. This committee is accountable to and reports to its Board on a quarterly basis.

In addition, annual reports are produced which cover an assessment of the capital requirements of the life assurance subsidiary, its financial condition and a review of risk management and internal control systems.

For Movestic:

- Earnings report;
- Operating reports, including sales and fund performance;
- Financial risk report;
- General risk report, including an estimate of risk-based capital, in accordance with Swedish regulatory requirements;
- Compliance report; and
- Report on subsidiaries and the associated company.

In addition, Movestic is required to submit to the Chesnara Audit & Risk Committee a quarterly risk report, an annual report on risk management and internal control systems and all internal audit reports.

On a monthly basis, the Directors receive summary high level information, relating to total Group operations, prepared by the Group Chief Executive, which enables them to maintain continuing oversight of the Group's and management's performance against objectives.

In addition to these structured processes, the papers are supplemented by information which the Directors require from time to time in connection with major events and developments, where critical views and judgements are required of Board members outside the normal reporting cycle.

Performance evaluation

During the period under review the Chairman undertook a formal performance evaluation of the Board, of individual Directors and of the Audit & Risk, Remuneration and Nomination Committees. To that end he devised a series of questionnaires to provide a framework for the evaluation process and to provide a means of making year-on-year

comparisons. Individual Director assessments were supplemented by discussions between the Chairman and each Director on a one-to-one basis.

In addition, and using similar methods to those described above, the Non-executive Directors, led by the Senior Independent Director, met to conduct a performance evaluation of the Chairman.

The Company Secretariat facilitated the process to ensure that the performance evaluations were conducted in a timely and objective manner while the Head of Internal Audit, reporting to the Chairman of the Group Audit & Risk Committee, monitors the assessment and follow through of the issues arising in the evaluation process. As stated previously the Board will be reviewing its approach to the evaluation of Board effectiveness during 2013.

Company Secretary

The Company Secretary is responsible for advising the Board, through the Chairman, on all governance matters. For the period under review, Mary Fishwick held the position of Company Secretary. The Directors have access to the advice and services of the Company Secretary.

Board committees

The Board has established the committees set out below to assist in the execution of its duties. Each of these committees operates according to written terms of reference and the Chairman of each committee reports to the Board. The constitution and terms of reference of each committee are reviewed at least annually to ensure that the committees are operating effectively and that any changes considered necessary are recommended to the Board for approval. During the year the terms of reference of all the committees were reviewed and changes made, where required, to reflect updated guidance on corporate governance. The terms of reference of each committee are available on the Company's website at www.chesnara.co.uk or, upon request, from the Company Secretary.

The attendance record of each of the Directors at scheduled Board and Committee meetings for the period under review is:

	Scheduled Board	Nomination Committee	Remuneration Committee	Audit & Risk Committee
Peter Mason – Non-executive Chairman	8 (8)	2 (2)	2 (2)	6 (6)
Terry Marris – Non-executive Director	8 (8)	2 (2)	2 (2)	6 (6)
Mike Gordon – Non-executive Director	6 (8)	2 (2)	2 (2)	5 (6)
Peter Wright – Non-executive Director	8 (8)	2 (2)	2 (2)	6 (6)
Graham Kettleborough – Executive Director	8 (8)	n/a	n/a	n/a
Ken Romney – Executive Director	8 (8)	n/a	n/a	n/a
Frank Hughes – Executive Director	8 (8)	n/a	n/a	n/a
Veronica France – Non-executive Director (appointed 16/1/13)	1 (1)	0 (0)	0 (0)	1 (1)
David Brand – Non-executive Director (appointed 16/1/13)	1 (1)	0 (0)	0 (0)	1 (1)

The figures in brackets indicate the maximum number of meetings in the period during which the individual was a Board or Committee member. The information above relates to the period from 1 February 2012 to 31 January 2013 and, therefore, excludes Mike Evans who was appointed on 4 March 2013.

CORPORATE GOVERNANCE REPORT (CONTINUED)

Nomination Committee

During the whole of the period under review, the Nomination Committee comprised Peter Mason who also served as Chairman of the Committee, Terry Marris, Mike Gordon and Peter Wright. David Brand and Veronica France joined the Committee on 16 January 2013 and Mike Evans joined the Committee on 4 March 2013.



The Committee considers the mix of skills and experience that the Board requires and seeks the appointment of Directors to ensure that the Board is effective in discharging its responsibilities.

During the period, the Committee met four times. The two scheduled meetings considered the continuing mix of skills and experience of the Directors, whilst the two extra meetings considered proposed changes to the Directorate.

Remuneration Committee

Full details of the composition and work of the Remuneration Committee are provided in the Directors' Remuneration Report on pages 56 to 60.

Audit & Risk Committee

Full details of the composition and work of the Audit & Risk Committee are provided in the Audit & Risk Committee Report on pages 61 to 62.

Auditor independence and objectivity

The external Auditor, Deloitte LLP and its associates, provide some non-audit services primarily in the provision of taxation and regulatory advice and in relation to corporate transactions that may arise from time to time. In order to ensure that auditor objectivity and independence are safeguarded, the following procedures have been put in place:

Audit-related services

These relate to formalities such as shareholder and other circulars, regulatory reports and work on acquisitions. This is work that the external Auditor performs in its capacity as Auditor, where the nature of the work is closely allied to that on the audit of the annual financial statements. Accordingly, this work will be undertaken by the external Auditor unless unusual circumstances apply.

Tax advice

The external Auditor will be used when particularly relevant and all other significant tax advice will be put out to tender.

General advice

The external Auditor will be invited to tender, provided that both parties are satisfied that the nature of the contract will not present a threat to the independence of the Auditor.

These safeguards have been approved by the Audit & Risk Committee and it is intended that they will be reviewed when required in the light of internal developments or of changes in the external circumstances of the Company. The Auditor reports to both the Directors and the Audit & Risk Committee with regard to compliance with professional and regulatory requirements and best practice.

Details of the fees paid to the external Auditor, and its associates, for both audit and non-audit services during the year are provided in Note 15 to the financial statements.

Relations with shareholders

The Chief Executive, Graham Kettleborough, and the Finance Director, Ken Romney, meet with institutional shareholders on a regular basis and are available for additional meetings when required. Should they consider it appropriate, institutional shareholders are able to meet with the Chairman, the Senior Independent Director and any other Director. The Chairman is responsible for ensuring that appropriate channels of communication are established between the Chief Executive and the Finance Director on the one part and the shareholders on the other and is responsible for ensuring that the views of shareholders are known to the Board. This includes twice yearly feedback prepared by the Group's brokers on meetings the Executive Directors have held with institutional shareholders.

Annual and interim reports are distributed to other parties who may have an interest in the Group's performance and those reports, together with a wide range of information of interest to existing and potential shareholders, are made available on the Company's website, www.chesnara.co.uk



Regular meetings are also held with industry analysts and commentators so that they are better informed in formulating opinions and making judgements on the Group's performance.

Private investors are encouraged to attend the Annual General Meeting ('AGM') at which the opportunity is provided to ask questions on each proposed resolution. The Chairmen of the Board Committees will be available to answer such questions as appropriate. Details of the resolutions to be proposed at the AGM on 17 May 2013 can be found in the notice of the meeting on pages 174 to 177.

Internal control

The Board is ultimately responsible for the Group's system of internal control and for reviewing its effectiveness. In establishing the system of internal control, the Directors have regard to the significance of relevant risks, the likelihood of risks occurring and the costs of mitigating risks. It is, therefore, designed to manage rather than eliminate the risks which might prevent the Company meeting its objectives and, accordingly, only provides reasonable, but not absolute, assurance against the risk of material misstatement or loss.

In accordance with 'Internal Control: Guidance for Directors on the Combined Code' (The 'Turnbull Guidance') the Board confirms that there is an ongoing process for identifying, evaluating and managing the significant risks faced by the Group, that this process has been in place for the year under review and up to the date of approval of the Annual Report and Accounts, and that the process is regularly reviewed by the Board and accords with the guidance.

In accordance with the regulatory requirements of the FSA, CA has established and maintained a risk and responsibility regime. This ensures that the identification, assessment and control of risk are firmly embedded within the organisation and that there are procedures for monitoring and update of the same. The CA Risk Management function reviews and reports quarterly on this regime to the CA Board. The Group also maintains a Key Risk Register which ensures that there is identification, assessment and control of the significant risks subsisting within the Company, CA and Movestic. The maintenance of the key risk registers is the responsibility of executive management, who respectively report on them quarterly to the CA Risk Committee and to each Chesnara Audit & Risk Committee meeting. In accordance with the requirements of the Swedish regulator, the Finansinspektionen, Movestic has also established and maintained a risk and responsibility regime, which requires inter alia that:

- the Movestic Board and Chief Executive have responsibility for ensuring that the organisation and management of the operation are characterised by sound internal control, which is responsive to internal and external risks and to changes in them;
- the Movestic Board has responsibility for the satisfactory management and control of risks through the specification of internal procedures; and
- there is an explicit risk control function, which is supported by compliance and internal control functions.

As an integral part of this regime Movestic also maintains a detailed risk register, which identifies, monitors and assesses risk by appropriate classification of risk.

As stated above, all of the Chesnara Directors are also members of the CA Board and the Company thereby has effective oversight of the maintenance and effectiveness of controls subsisting within CA. Regarding Movestic, such oversight is exercised by way of the membership of at least three of the Chesnara Directors of the Movestic Board, together with quarterly reporting by Movestic to the Chesnara Audit & Risk Committee.

In addition, the Chesnara Board confirms that it has undertaken a formal annual review of the effectiveness of the system of internal control for the year ended 31 December 2012, and that it has taken account of material developments between that date and the date of approval of the Annual Report and Accounts. The Board confirms that these reviews took account of reports by the internal audit functions on the operation of controls, internal financial controls, and management assurance on the maintenance of controls and reports from the external Auditor on matters identified in the course of statutory audit work.

The Board also confirms the continuing appropriateness of the maintenance of a Group Internal Audit Function, which reports to the Chairman of the Audit & Risk Committee.

Going concern

The Directors' Statement on Going Concern is included in the Directors' Report on page 65.

Directors

The present Directors of the Company and their biographical details are set out on page 49.

The Directors benefited from qualifying third party indemnity provisions in place during the years ended 31 December 2011 and 31 December 2012 and the period to 27 March 2013.

DIRECTORS' REMUNERATION REPORT

The Remuneration Committee

The Remuneration Committee (the 'Committee') determines the overall pay policy and the remuneration packages and service contracts of the Executive Directors of the Company, including the operation of bonus schemes. It also monitors the remuneration of other senior employees within the Chesnara Group.

During the period under review the Committee comprised of the Non-executive Directors: Mike Gordon (who also acted as Chairman), Peter Wright, Terry Marris and Peter Mason, who is Chairman of the Group. The Company Secretary, Mary Fishwick, acts as Secretary to the Committee, and provides advice on legal and regulatory issues relating to remuneration policy. At the request of the Committee, Graham Kettleborough, the Chief Executive, also attends and makes recommendations to the Committee regarding changes to the remuneration packages of individual Directors (excluding himself) or to policy generally. Such recommendations are discussed

by the Committee and adopted or amended as it sees fit. No Executive Director is present at any part of the Committee meeting at which his own remuneration or contractual terms are being discussed. The membership and terms of reference of the Committee are reviewed at least annually and the terms of reference are available on the Company's website at www.chesnara.co.uk or, upon request, from the Company Secretary. Details of the number of meetings held and the attendance can be found in the Corporate Governance Report on page 53.

Veronica France and David Brand joined the Committee on their appointment as Directors of the Group on 16 January 2013. Mike Evans joined the Committee on his appointment as a Director of the Group on 4 March 2013. Mike Gordon and Terry Marris will be leaving the Group, and the Committee, on 17 May 2013 at which time Veronica France will become Chairman of the Remuneration Committee.

Remuneration policy

The Committee aims to set remuneration at an appropriate level to attract, retain and motivate executives of the necessary calibre.

The Committee also receives updates on pay and employment conditions applying to other Group employees: these are taken into consideration when setting Executive Directors' remuneration, consistent with the Group's general aim of seeking to reward all employees fairly according to the nature of their role, their performance and market forces.



An annual review of remuneration is undertaken to ensure reward levels are appropriate to the duties and responsibilities of the roles with a suitable balance between the fixed and variable elements of overall reward. In determining salary levels due regard is given to external market data relating to both financial services sector companies and listed companies of similar size.

During the period under review the Committee benchmarked the Chief Executive's benefits package against industry peers and listed companies with a similar market capitalisation with the assistance of New Bridge Street, a leading benefits consultancy. The review led, from 1 January 2013, to an increase of £30,000 per annum to the Chief Executive's salary and, in order to retain relativity, an increase in the Business Services Director's salary of £20,000 per annum. Pension contributions and other associated benefits increased in line with the adjustment to basic salary. The Committee is satisfied that these revised levels of benefit are deserved and suitably rewarding whilst noting that they remain below the average when compared to both industry and market peers.

The Company has in place the Annual Bonus Scheme and the 2012 Long-Term Incentive Plan, which are designed to incentivise and retain the Executive Directors. These bonus schemes, which are cash-based, reward the achievement of corporate targets and are therefore aligned with the delivery of value to shareholders. Neither the benefits under the Annual Bonus Scheme nor those under the 2012 Long-Term Incentive Plan are pensionable. The Committee may award other discretionary bonuses to the Executive Directors where it considers extraordinary value has been created or significant achievement has occurred.

In addition, the Company has established frameworks for approved and unapproved discretionary Share Option Plans, neither of which have been utilised to date. A Sharesave Plan was launched to all UK employees of the Group, including Executive Directors, in October 2011.

The Committee has made no changes to the terms of the Annual Bonus Scheme or the Long-Term Incentive Plan. Details of these are provided on the following pages.

Bonus Schemes

Annual Bonus Scheme

The Annual Bonus Scheme is designed to incentivise the Executive Directors. The overall maximum award is limited to 100% of basic salary in the year to which the reward relates. Furthermore there is an overall cap which applies to reward under this scheme and benefit derived from the Long-Term Incentive Plan where, together, the total reward is subject to the same cap of 100% of basic salary.

The Annual Bonus Scheme is based on Group performance and was designed to ensure that Executive Directors' awards were closely aligned to shareholders' interests on this element of the scheme. It was, therefore, based upon the level of achievement of budgeted IFRS pre-tax profit.

These arrangements can be summarised as follows:

Element	Award
Group performance IFRS pre-tax profit:	
Less than 75% of budget	Nil (increasing on a straight-line basis up to 100%)
At 100% of budget	15.79% of basic salary
At or greater than 100% of budget	Increases on a straight-line basis

The table below sets out the details of the awards made to the Executive Directors under the scheme in 2012.

Annual Bonus Scheme – awards made in respect of year ended 31 December 2012

The target for awards is based on IFRS pre-tax profit with certain adjustments. The target profit on this basis was set out at £16.407m. The result, on an equivalent adjusted basis, was £29.532m. This represents an achievement of 178.89% of the target. Consequently the awards are:

	£'s
Graham Kettleborough	190,419
Ken Romney	129,683
Frank Hughes	116,716
Total	436,818

2012 Long-Term Incentive Plan

The 2012 Long-Term Incentive Plan was designed as a long-term cash-based incentive for Executive Directors.

As the business is predominantly a run-off proposition the Remuneration Committee remains of the opinion that a cash-based scheme is the most appropriate form of reward.

The 2012 Long-Term Incentive Plan for Executive Directors was designed to align Executive Director reward with shareholder value and dividend experience. The scheme:

- i) is based on achievement of Group Embedded Value target at the end of 2014;
- ii) reflects the share price performance, as related to the Group Embedded Value, during the three year period after allowing for dividend payments;
- iii) rewards on a sliding scale from 0% of basic annual salary on achievement of 75% of target to 21.05% of basic annual salary on achievement of target, continuing on a straight-line basis if target is exceeded; and
- iv) together with the annual bonus, generated in respect of 2012, would normally be capped, on award, at 100% of 2012 basic salary.

The table below summarises potential long-term incentive plan awards made to Executive Directors for each of the relevant plans covered by this report.

	Potential award under the 2012 Scheme
Graham Kettleborough	£71,292
Ken Romney	£nil
Frank Hughes	£43,698

The 2011 LTIP scheme resulted in no awards.

DIRECTORS' REMUNERATION REPORT (CONTINUED)

The 2013 Long-Term Incentive Plan
The 2013 Long-Term Incentive Plan for Executive Directors follows the format of the 2012 Plan and is designed to align Executive Director reward with shareholder value and dividend experience.

It will:

- i) be based on achievement of Group Embedded Value target at the end of 2015;
- ii) reflect the share price performance, as related to the Group Embedded Value, during the three year period after allowing for dividend payments;
- iii) reward on a sliding scale from 0% of basic annual salary on achievement of 75% of target to 21.05% of basic annual salary on achievement of target, continuing on a straight-line basis if target is exceeded; and
- iv) together with the annual bonus, generated in respect of 2013, be normally capped, on award, at 100% of 2013 basic salary.

Discretionary bonus

The exceptional profit arising from the purchase of Movestic in 2009 was excluded from the calculation of bonus under both the Annual Bonus Scheme and the Long-term Incentive Plan in that year. The Remuneration Committee decided that extraordinary value had been created as a result of the transaction and awarded discretionary bonuses to the Executive Directors. Half of the award was paid at the end of 2009 and the remaining half, which was accrued for, became payable on 31 December 2012 subject to the Embedded Value of Movestic being higher on 31 December 2012 than on 31 December 2009 after allowing for capital contributions made by the Group to Movestic. This condition has been satisfied and therefore the following bonuses become payable:

	£'s
Graham Kettleborough	75,000
Ken Romney	50,000
Frank Hughes	25,000

The bonuses are non-pensionable.

Movestic

A scheme based on the increase in Movestic's Embedded Value (excluding any capital contributions from the Group) was implemented for a limited number of senior managers within Movestic. Forty per cent of the award is paid at the end of the year in which it is earned with the remaining 60% being deferred for three years.

Awards made under this scheme in 2012 were:

	SEK
Lars Nordstrand	712,000
Anna Schöld	356,000
Per Friman	178,000

No awards were made under this scheme in respect of 2011.

Share options

The Board has established frameworks for approved and unapproved discretionary Share Option Plans which may, at the discretion of the Committee, be utilised for granting options to Executive Directors and other employees. During 2012 no such options were granted. The Group made an offering under a Sharesave Plan to all UK employees of the Group in October 2011 following approval of the scheme by shareholders at the 2011 Annual General Meeting.

Service contracts

The Executive Directors, who were all appointed on 1 March 2004, have service contracts with a rolling twelve-month notice period. On appointment to the Finance Director role and the Board, David Rimmington will have a service contract with a rolling 12 month notice period. Compensation on termination of service contracts will be decided on a case-by-case basis having regard to the particular circumstances.

Pension policy

The Executive Directors benefit from employer contributions to either the Chesnara plc Stakeholder Scheme or their personal SIPP arrangements at rates agreed by the Remuneration Committee. Employer contributions to the respective schemes are detailed on page 60.

Other benefits

Executive Directors' remuneration also includes non-pensionable benefits in kind by way of a fully-expensed company car, life assurance and private medical insurance.

Non-executive Directors

The remuneration of the Non-executive Directors is determined by the Board as a whole in accordance with the Articles of Association. Non-executive Directors do not have service contracts with the Company, neither are they eligible for bonuses, pensions or participation in Company share option schemes. The dates of expiry of their terms of appointment are:

Date of expiry of term of appointment	
Peter Mason	31 October 2014
Mike Gordon	30 April 2014
Terry Marris	1 March 2016
Peter Wright	31 December 2014
Veronica France	15 January 2016
David Brand	15 January 2016
Mike Evans	3 March 2016

Mike Gordon and Terry Marris are retiring as Non-executive Directors on 17 May 2013. Resolutions proposing the election of Veronica France, David Brand and Mike Evans will be tabled at the forthcoming AGM.

Executive Directors

Ken Romney is retiring as Finance Director and from the Board, on 17 May 2013. A resolution proposing the election of David Rimmington to the Board will be tabled at the AGM. On appointment David will become the Finance Director.

Frank Hughes, an Executive Director, retires by rotation at the end of the forthcoming AGM, at which a resolution proposing his re-election will be tabled.

Directorate

The Directors who served during the year were:

Chairman

Peter Mason

Non-executive Directors

Terry Marris

Mike Gordon

Peter Wright

Executive Directors

Graham Kettleborough

Ken Romney

Frank Hughes

After the AGM the proposed Directorate will be:

Chairman

Peter Mason

Non-executive Directors

Mike Evans

Peter Wright

Veronica France

David Brand

Executive Directors

Graham Kettleborough

David Rimmington

Frank Hughes

Directors' interests in shares

Directors' interests in the ordinary shares of Chesnara plc were as set out below (number of shares):

	31 December 2012		31 December 2011	
	Beneficial	Non-beneficial	Beneficial	Non-beneficial
Peter Mason	19,768	–	19,768	–
Terry Marris	57,615	–	57,708	–
Mike Gordon	–	–	–	–
Peter Wright	70,000	–	70,000	–
Graham Kettleborough	68,100	–	58,100	–
Ken Romney	79,476	–	70,476	–
Frank Hughes	5,832	–	5,832	–

The newly appointed Non-executive Directors namely Veronica France, David Brand and Mike Evans have no beneficial holdings in the ordinary shares of Chesnara plc as at 27 March 2013.

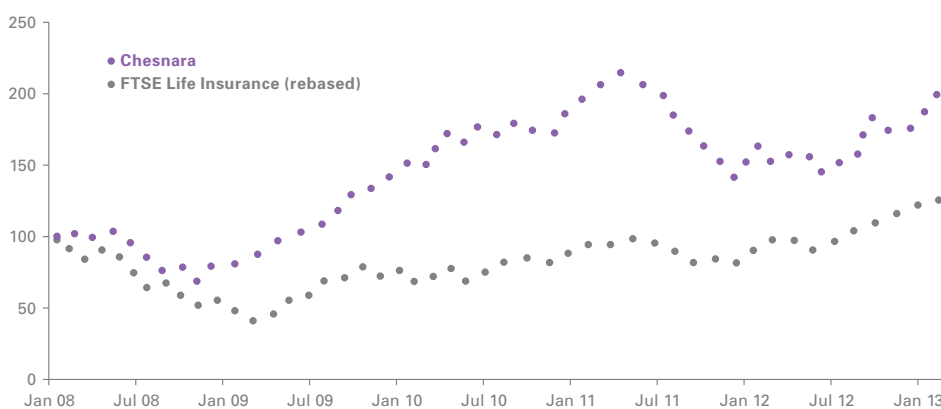
There were no changes in the Directors' shareholdings in Chesnara plc between 31 December 2012 and 27 March 2013.

Directors' Remuneration

The Auditors are required to report on this and the remaining sections of the Remuneration Report.

Total Directors' remuneration for the year ended 31 December 2012 is shown below with comparative figures for the year ended 31 December 2011.

Year ended 31 December	2012 £000	2011 £000
Aggregate emoluments:		
Fees to Non-executive Directors	225	225
Emoluments to Executive Directors	1,132	745
Company contributions to pension schemes	136	132
Total	1,493	1,102

Performance graph

The above graph shows a comparison of the Company's total shareholder return ('TSR') performance against the FTSE Life Insurance sector index. The Company considers this to be the most appropriate index, given that its activities are centred on life insurance. The graph has been prepared in accordance with section 421(2) of the Companies Act 2006.

DIRECTORS' REMUNERATION REPORT (CONTINUED)

The following table, which has been prepared in accordance with regulatory requirements, sets out the constituents of Directors' emoluments for the year ended 31 December 2012:

Executive Directors	Salaries and fees £000	Bonuses £000	Deferred bonuses £000	Benefits £000	Total 2012 £000	Total 2011 £000
Graham Kettleborough	272	190	24	18	504	329
Ken Romney	190	130	–	12	332	229
Frank Hughes	150	117	15	14	296	187
Total Executive Directors	612	437	39	44	1,132	745

Non-executive Directors	Salaries and fees £000	Bonuses £000	Deferred bonuses £000	Benefits £000	Total 2012 £000	Total 2011 £000
Peter Mason	90	–	–	–	90	90
Terry Marris	40	–	–	–	40	40
Mike Gordon	45	–	–	–	45	45
Peter Wright	50	–	–	–	50	50
Total Non-executive Directors	225	–	–	–	225	225
Total	837	437	39	44	1,357	970

The following table sets out each Executive Director's pension benefits for the years ended 31 December 2012 and 31 December 2011.

Company contributions to Directors' pensions arrangements	2012 £000	2011 £000
Graham Kettleborough	49	47
Ken Romney	42	41
Frank Hughes	45	44
Total	136	132

A Salary Sacrifice scheme, which allows salary to be foregone in place of benefits, was introduced in July 2007. As a result, contributions formerly made by Executive Directors are now made by the Group and deducted from Directors' salaries.

The pension arrangements for the Executive Directors are set out on page 58.

No pension contributions were made by companies within the Chesnara plc Group from 1 January 2011 to 31 December 2012 in respect of any of the Non-executive Directors.

Compensation

Ken Romney will cease to be a director on 17 May 2013.

Subject to the terms of a Compromise Agreement made on 21 November 2012, on cessation of his employment he will receive the sum of £125,233 representing pay in lieu of notice (salary and contractual benefits). In addition, the Remuneration Committee has agreed a further £75,000 as compensation for the early termination of his employment.

The Remuneration Committee has exercised its discretion to permit Ken Romney to receive performance-vested Long Term Incentive Plan and acquisition-related payments of £155,110 as he will have served for the majority of the deferral period, which expires at the end of 2013.

Ken Romney was eligible for the annual bonus for 2012 on the same terms as the other Executive Directors, but no LTIP award was made to him in 2012. He will not be eligible to participate in the Company's Annual Bonus Scheme for 2013, the Company's LTIP for 2013 or any other bonus, LTIP, share or other incentive scheme for the remainder of his employment. A discretionary award of £41,601 has, however, been agreed in lieu of a 2012 LTIP award.

Payment of the sums stated in the previous two paragraphs is subject to certain transitional personal performance obligations being achieved to the satisfaction of the Board.

Directors' share options

No options were granted in respect of any Chesnara plc Share Option Scheme between 1 January 2013 and 27 March 2013, nor were there any options outstanding as at 31 December 2011, 31 December 2012 or 27 March 2013.

Approved by the Board of Directors on 27 March 2013 and signed on its behalf by:

Peter Mason Graham Kettleborough

AUDIT & RISK COMMITTEE REPORT

The Audit & Risk Committee continues to bring to bear its knowledge and expertise in fulfilling its obligations and in exercising judgement in critical areas.

Role and composition

During the year ended 31 December 2012 the Audit & Risk Committee comprised Peter Wright (Chairman), Mike Gordon and Terry Marris, as independent Non-executive Directors and Peter Mason (Group Chairman). Veronica France and David Brand were appointed as independent Non-executive Directors to the Committee on 16 January 2013. Similarly Mike Evans was appointed to the Committee on 4 March 2013. On invitation, the Chief Executive, the Finance Director, the Business Services Director (whose role includes risk reporting), the Head of UK Internal Audit, the consulting firm which provides internal audit services to Movestic and the external Auditor attends meetings to assist the Committee in the fulfilment of its duties. The Committee met six times during the year ended 31 December 2012.

The role of the Audit & Risk Committee includes assisting the Board in discharging its duties and responsibilities for financial reporting, corporate governance and internal control. The scope of its responsibilities also includes focus on risk and risk management: accordingly it also assists the Board in fulfilling its obligations in this regard. The Committee is also responsible for making recommendations to the Board in relation to the appointment, re-appointment and removal of the external Auditor. The Committee's duties include keeping under review the scope and results of the audit work, its cost effectiveness and the independence and objectivity of the external Auditor.

Activity

During the period under review, the Audit & Risk Committee discharged its responsibilities by:

- reviewing the Group's draft Financial Statements prior to Board approval and reviewing the external Auditor's detailed reports thereon, in respect of the half year ended 30 June 2012 and the year ended 31 December 2012;
- reviewing the appropriateness of the Group's accounting policies;
- reviewing the provision of supplementary reporting of financial information in accordance with European Embedded Value principles, including the methodology undertaken and the assumptions adopted;
- reviewing and approving the audit fee estimates and reviewing and approving the audit and non-audit fees, in conjunction with an assessment of external Auditor performance;

- reviewing the external Auditor plan for the audit of the Group's financial statements which included an assessment of key risks and confirmation of Auditor independence;
- reviewing and approving internal audit plans for the internal audit of the Group's internal controls, embracing operating, financial and business controls;
- reviewing an annual report on the Group's systems of risk management and internal control and their effectiveness and reporting to the Board on the results of the review;
- reviewing regular reports from the internal audit functions;
- assessing internal audit effectiveness, by way of a review performed by independent consultants and by consideration of suggestions for improvement contained therein;
- reviewing the internal audit arrangements for, and approving the change in external consultants providing internal audit services to Movestic;
- meeting the Head of UK Internal Audit without an Executive Director or a member of the Company's senior management being present;
- reviewing quarterly reports by Executive Management on the identification, evaluation and management of key risks, embracing the Company, CA and Movestic;
- meeting the external Auditor without an Executive Director or a member of the Company's senior management being present;
- reviewing the nature and volume of non-audit services provided by the external Auditor to ensure that a balance is maintained between objectivity and value added; and
- reviewing the Group's policies and procedures relating to fraud, whistle-blowing and employment of ex-employees of the external Auditor.

In addition to the above, Committee members have detailed knowledge of CA's risk management processes by virtue of their common membership of the CA Risk Committee, which reports to the CA Board, CA being subject to the FSA Risk and Responsibility regime.

Key issues

During the period under review the following issues have arisen, which have required careful consideration and exercise of judgement by the Committee:

The allowance for persistency in the EEV results

This should be the expected long-term mean level over the run-off of the existing portfolios and have regard to current experience. In respect of the UK businesses, current experience may be unduly favourable as a long-term average, because some deterioration may arise from the impact on retention of gender-neutral pricing introduced on 21 December 2012 and because of the possible impact of lower rates of investment return, to be adopted in 2014, in connection with illustrative projections sent to policyholders. In respect of the Swedish business, lapse and transfer rates continued, over 2012, to exceed the long-term assumptions set at the end of 2011. The monitoring of the experience was refined over 2012 and, in addition to making assumptions more responsive to duration-in-force, they have generally been strengthened. Nevertheless, in some cases the new assumptions remain below recent experience, as the view is taken that changes in product design and management focus on persistency, together with an improvement in IFA sentiment towards Movestic, will bring lapse and transfer rates down.

The determination of long-term projections of expenses

In respect of the UK businesses, some of the outsourcing agreements have been subject to renegotiation and the prospective impact of this has been anticipated when setting the EEV assumptions. There is also an impact on the determination of insurance contract provisions reported under IFRS and on the determination of actuarial reserving for statutory solvency purposes, although both to a lesser degree. In respect of the Swedish business, new business is currently at a level below that supported by the business infrastructure and this has resulted in judgements having to be made regarding the allocation of expenses between those related to acquisition and those related to ongoing maintenance for EEV reporting purposes.

Cost of S&P with-profits guarantees for IFRS reporting purposes

The method used to provide for the cost of guarantees to S&P with-profits policyholders for IFRS reporting purposes has the aim of establishing the liability on a less prudent basis than the unrealistic method required for statutory solvency assessment, while still being more prudent than the market-consistent basis applied to EEV reporting. During 2012 it was recognised that the method hitherto selected to achieve this, while producing, since the date of acquisition of S&P on 20 December 2010, a result between the upper and lower limits set out above, may not always do so. As a consequence, it was decided to adopt a method of establishing the liability for IFRS reporting purposes at 110% of the cost of guarantees determined for EEV reporting, which closely replicated the positions established in previous reporting periods using the former method. Subsequently, the former method, had it still been used, would have resulted in an IFRS liability lower than that recognised for EEV reporting. Further information in respect of this item can be found in Note 32 to the IFRS financial statements, 'Insurance contract provisions'.

Classification of policyholder surplus in the S&P with-profits funds for IFRS reporting purposes

As permitted under IFRS4, the Group classified the excess of policyholder assets over policyholder liabilities with the S&P funds as unallocated divisible surplus in the IFRS Consolidated Balance Sheet. However, the Committee, in recognition of the fact that such surplus is not capable of allocation to shareholders funds at any time, has determined that such excess is more properly classified within insurance contract provisions. Accordingly, as described in Note 2(d) the Group has changed its accounting policy with regard to the classification of policyholder surplus in the S&P with-profit funds.

Classification of S&P policyholders liabilities to taxation

Following the transfer, on 31 December 2011, of the whole of the business of the S&P operating segment to Countrywide Assured plc under the provisions of the Financial Services and Markets Act 2000, S&P policyholder liabilities to taxation have, with effect from 1 January 2012, been re-classified within the IFRS Consolidated Balance Sheet from deferred tax liabilities to insurance contract provisions. It was decided that it was appropriate to make this change to more appropriately reflect the tax-paying position of the combined businesses. Further information on this re-classification is presented in Note 7 to the IFRS financial statements, 'Exceptional item'.

Determination of reportable segments

The segments which are reportable in accordance with IFRS 8 'Operating Segments' were reviewed during the year and it was concluded that it was appropriate to continue, for the time being, to present, in the IFRS financial statements, two reportable segments for the UK Business, being CA and S&P and that the EEV Supplementary Information should also continue to present similar segmentation. This decision was heavily influenced by the existence of a material volume of with-profits business within the S&P segment, the performance of which is closely monitored by the Board.

Determination of onerous contract provision

The Company has a lease arrangement until mid-2019 in respect of its Head Office at Harbour House, Preston, of which it now occupies only a small proportion. A provision of £1.5m was established as at 31 December 2011 in respect of the potential net cost of vacant space over the remaining term of the lease, based on the excess of the estimated future stream of future contractual costs over anticipated sub-lease income. Two tenants have now served notice of discontinuance of sub-lease arrangements, so that from early 2013 a significantly smaller proportion of the building is sub-let. The company has received advice from a local firm of property consultants and, based on careful consideration of this, has significantly increased the related provision to £3.8m as at 31 December 2012, further details of which are provided in Note 36 to the IFRS financial statements, 'Onerous contract provisions'.

Going concern assumptions

The Committee continues to review the periodic reports relating to the continuing appropriateness of preparing Group financial statements on a going concern basis, and gives particular attention to the integrity of the underlying assumptions and to the appropriateness of the different stress scenarios which test the assumptions.

CORPORATE AND SOCIAL RESPONSIBILITY STATEMENT



Chesnara takes its responsibilities for social and environmental issues seriously and recognises the importance of developing and maintaining high standards.

We do not, however, consider that these aspects are critical to the achievement of our strategic aims or that they should form any significant element of remuneration or reward.

Equal opportunities

Chesnara is committed to a policy of equal opportunity in employment and it will continue to select, recruit, train and promote the best candidates based on suitability for the role and treat all employees and applicants fairly regardless of race, age, gender, marital status, ethnic origin, religious beliefs, sexual orientation or disability. Chesnara will ensure that no employee suffers harassment or intimidation.

Disabled employees

Chesnara will provide employment for disabled persons wherever the requirements of the business allow and if applications for employment are received from suitable applicants. If existing employees become disabled, every reasonable effort will be made to achieve continuity of employment.

Health, safety and welfare at work

Chesnara places great importance on the health, safety and welfare of its employees. Relevant policies, standards and procedures are reviewed on a regular basis to ensure that any hazards or material risks are removed or reduced to minimise or, where possible, exclude the possibility of accident or injury to employees or visitors.

The policies, standards and procedures are communicated to employees through contracts of employment, the staff handbook and employee briefings and all employees have a duty to exercise responsibility and do everything possible to prevent injury to themselves and others.

Social, environmental and ethical issues

Chesnara aims to be sensitive to the cultural, social and economic needs of our local community and endeavours to protect and preserve the environment where it operates. To support this we allow each of our UK employees two days release on full pay each year where they can support a local charity project of their choice.

We seek to be honest and fair in our relationships with our customers and provide the standards of products and services that have been agreed.

Being primarily office-based financial services companies, the Directors believe that the Group's activities do not materially contribute to pollution or cause material damage to the environment. However, the Group takes all practicable steps to minimise its effects on the environment and encourages its employees to conserve energy, minimise waste and recycle work materials.

DIRECTORS' REPORT

Chesnara plc — Company No. 4947166

The Directors present their report and the audited consolidated accounts of Chesnara plc ('Chesnara') for the year ended 31 December 2012. The Corporate Governance Report on pages 51 to 55 forms part of the Directors' Report.

Business review

The information which fulfills the Companies Act requirements for a Business Review can be found in the following sections:

Requirements/reference

Strategic aims and how we achieve our strategic aims

The Our Vision and Strategy section on pages 10 to 13.

Principal risks and uncertainties

The Risk Management section on pages 42 to 44.

Performance and development during the year and position at the end of the year

Likely future developments

Financial and non-financial KPIs

The Chief Executive's Review on pages 18 to 25, the Financial Review on pages 26 to 37 and the Financial Management section on pages 38 to 41.

Environmental, employee and social community matters

The Corporate and Social Responsibility Statement on page 63.

Results and dividends

The Group consolidated statement of comprehensive income for the year ended 31 December 2012, prepared in accordance with International Financial Reporting Standards and set out on page 58, shows:

	2012 £000	2011 £000
Profit for year attributable to shareholders	27,941	25,665

An interim dividend of 6.10p per ordinary share was paid by Chesnara on 15 October 2012. The Board recommends payment of a final dividend of 11.25p per ordinary share on 22 May 2013 to shareholders on the register at the close of business on 12 April 2013.

Directors

The present Directors of the Company and their biographical details are set out on page 49. Peter Mason, Mike Gordon, Terry Marris, Peter Wright, Graham Kettleborough, Ken Romney and Frank Hughes all served for the period from 1 January 2012 to 31 December 2012. Since the end of the year, there have been changes to the Board membership with further changes planned with effect from the Annual General Meeting on 17 May 2013.

Two new Non-executive Directors, Veronica France and David Brand, were appointed to the Board with effect from 16 January 2013. A further Non-executive Director, Mike Evans was appointed to the Board on 4 March 2013. Two of the existing Non-executive Directors, Mike Gordon and Terry Marris have announced their intention to step down from the Board with effect from 17 May 2013, the date of the Annual General Meeting. Mike Gordon is currently Chairman of the Remuneration Committee and Senior Independent Director. From 17 May 2013, the role of Chairman of the Remuneration Committee will be assumed by Veronica France and the role of Senior Independent Director will be assumed by Mike Evans.

Furthermore, Ken Romney, currently Finance Director, will also stand down at the Annual General Meeting and David Rimmington will be appointed to the Board and will assume the role from that date.

The Non-executive Directors who served in 2012 and will serve in 2013 as Chairmen and members of the Nominations and Audit & Risk Committees of the Board are set out in the Corporate Governance Report and Audit & Risk Committee reports respectively on pages 51 to 55 and 61 to 62. Information in respect of the Chairman and members of the Remuneration Committee and in respect of Directors' service contracts is included in the Remuneration Report on pages 56 to 60, which also includes details of Directors' interests in shares and share options.

Pursuant to the Articles of Association, Frank Hughes will retire by rotation at the Annual General Meeting and, being eligible, offers himself for re-election. His service contract with the Company is of no more than one year's duration. In addition, no Director had any material interest in any significant contract with the Company or with any of the subsidiary companies during the year.

The Directors benefited from qualifying third party indemnity provisions in place during the years ended 31 December 2011 and 31 December 2012 and the period to 27 March 2013.

Substantial shareholdings

The following substantial interests in the Company's ordinary share capital at 31 December 2012 have been notified to the Company:

Name of substantial shareholder	Total number of ordinary shares held	Percentage of the issued share capital as at 31 December 2012
Artemis Investment Management LLP	12,845,608	11.18
Amerprise Financial, Inc. (Threadneedle Asset Management)	12,741,529	11.09
Henderson Global Investors Limited	5,730,537	4.98
Standard Life Investments Limited	4,172,345	3.63
Legal and General Group	4,130,698	3.60
Norges Bank	3,434,374	2.99
Hermes Equity Ownership Services	3,401,096	2.96

There have been changes to the position since 31 December 2012 and the revised holding is shown below. No other person holds a notifiable interest in the issued share capital of the Company.

Name of substantial shareholder	Total number of ordinary shares held	Percentage of the issued share capital as at 27 March 2013
Henderson Global Investors Limited	5,798,306	5.04

There were no significant contracts with substantial shareholders during the year.

Charitable donations and political contributions

Charitable donations made by Group companies during the year ended 31 December 2012 were £nil (2011: £nil). No political contributions were made during the year ended 31 December 2012 (2011: £nil).

Employees

The average number of employees during the year was 148 (2011: 156).

Creditors payment policy

It is Chesnara's policy to pay creditors in accordance with the CBI Better Practice Payment Code (available at www.payontime.co.uk) on supplier payments. The number of creditor days outstanding at 31 December 2012, based on the consolidated financial statements, was 11 for the Group (31 December 2011: 6) and for the Company 31 (31 December 2011: 28).

Going concern statement

After making appropriate enquiries, the Directors confirm that they are satisfied that the Company and the Group have adequate resources to continue in business for the foreseeable future. Accordingly, they continue to adopt the going concern basis in the preparation of the financial statements as stated in Note 2(c) to the financial statements. Detailed analysis of relevant risks and other factors is included within the Risk Management section on pages 42 to 44, within the Financial Management Section on pages 38 to 41 and within Notes 5 and 6 to the IFRS financial statements.

Disclosure of information to Auditor

The Directors who held office at the date of approval of this Directors' Report confirm that, so far as they are each aware, there is no relevant audit information of which the Company's Auditor is unaware; and each Director has taken all the steps that he ought to have taken as a director to make themselves aware of any relevant audit information and to establish that the Company's Auditor is aware of that information. This information is given and should be interpreted in accordance with the provisions of section 418 of the Companies Act 2006.

Auditor

A resolution for the re-appointment of Deloitte LLP as Auditor of the Company is to be proposed at the forthcoming Annual General Meeting.

Approved by the Board on 27 March 2013 and signed on its behalf by:

Ken Romney
Director

SECTION D

IFRS FINANCIAL STATEMENTS

IN THIS SECTION

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DIRECTORS' RESPONSIBILITIES STATEMENT

Directors' responsibilities statement in respect of the Financial Statements

The directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors are required to prepare the group financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union and Article 4 of the IAS Regulation and have also chosen to prepare the parent company financial statements under IFRSs as adopted by the EU. Under company law the directors must not approve the accounts unless they are satisfied that they give a true and fair view of the state of affairs of the company and of the profit or loss of the company for that period. In preparing these financial statements, International Accounting Standard 1 requires that directors:

- properly select and apply accounting policies;
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- provide additional disclosures when compliance with the specific requirements in IFRSs are insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance; and
- make an assessment of the company's ability to continue as a going concern.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the company's transactions and disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The directors are responsible for the maintenance and integrity of the corporate and financial information included on the company's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Responsibility statement

We confirm that to the best of our knowledge:

- the financial statements, prepared in accordance with International Financial Reporting Standards, give a true and fair view of the assets, liabilities, financial position and profit or loss of the company and the undertakings included in the consolidation taken as a whole; and
- the management report, which is incorporated into the directors' report, includes a fair review of the development and performance of the business and the position of the company and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that they face.

By order of the Board

Chairman
Peter Mason
27 March 2013

Chief Executive Officer
Graham Kettleborough
27 March 2013

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF CHESNARA PLC

We have audited the financial statements of Chesnara plc for the year ended 31 December 2012 which comprise the Consolidated Statement of Comprehensive Income, the Consolidated and Company Balance Sheets, the Consolidated and Company Statements of Cash Flows, the Consolidated and Company Statements of Changes in Equity and the related Notes 1 to 53. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union and as regards the parent company financial statements, as applied in accordance with the provisions of the Companies Act 2006.

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.

Respective responsibilities of directors and auditor

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. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the group's and the parent company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the annual report to identify material inconsistencies with the audited financial statements. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Opinion on financial statements

In our opinion:

- the financial statements give a true and fair view of the state of the group's and of the parent company's affairs as at 31 December 2012 and of the group's profit for the year then ended;
- the group financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union;
- the parent company financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union and as applied in accordance with the provisions of the Companies Act 2006; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the group financial statements, Article 4 of the IAS Regulation.

Opinion on other matters prescribed by the Companies Act 2006

In our opinion:

- the part of the Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006; and
- the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF CHESNARA PLC (CONTINUED)

Matters on which we are required to report by exception

We have nothing to report in respect of the following:

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

- adequate accounting records have not been kept by the parent company, or returns adequate for our audit have not been received from branches not visited by us; or
- the parent company financial statements and the part of the Directors' Remuneration Report to be audited are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

Under the Listing Rules we are required to review:

- the directors' statement, contained within the Directors' Report, in relation to going concern;
- the part of the Corporate Governance Statement relating to the company's compliance with the nine provisions of the UK Corporate Governance Code specified for our review; and
- certain elements of the report to shareholders by the Board on directors' remuneration.

David Heaton (Senior Statutory Auditor)

for and on behalf of Deloitte LLP
Chartered Accountants and Statutory Auditor
Manchester
United Kingdom
27 March 2013

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

Consolidated Statement of Comprehensive Income for the year ended 31 December 2012

Year ended 31 December	Note	2012 £000	2011 £000
Insurance premium revenue		115,520	121,976
Insurance premium ceded to reinsurers		(35,336)	(34,970)
Net insurance premium revenue		80,184	87,006
Fee and commission income	9	66,658	67,863
Net investment return	10	332,053	(192,402)
Total revenue net of reinsurance payable		478,895	(37,533)
Other operating income	11	19,645	21,782
Total income net of investment return		498,540	(15,751)
Insurance contract claims and benefits incurred			
Claims and benefits paid to insurance contract holders	12	(272,479)	(267,691)
Net (increase)/decrease in insurance contract provisions	12	(20,732)	204,864
Reinsurers' share of claims and benefits	12	47,865	17,401
Net insurance contract claims and benefits		(245,346)	(45,426)
Change in investment contract liabilities	13	(156,663)	164,166
Reinsurers' share of investment contract liabilities	13	2,810	(1,500)
Net change in investment contract liabilities		(153,853)	162,666
Fees, commission and other acquisition costs	14	(17,967)	(17,276)
Administrative expenses	15	(37,029)	(38,798)
Other operating expenses			
Charge for amortisation of acquired value of in-force business	16	(7,863)	(9,032)
Charge for amortisation of acquired value of customer relationships	16	(391)	(758)
Other	16	(9,205)	(9,664)
Total expenses net of change in insurance contract provisions and investment contract liabilities		(471,654)	41,712
Total income less expenses		26,886	25,961
Share of profit/(loss) of associate	24	1,244	(152)
Exceptional item	7	(4,778)	–
Operating profit		23,352	25,809
Financing costs	17	(3,670)	(3,388)
Profit before income taxes		19,682	22,421
Income tax credit			
Before exceptional item	18	3,481	3,244
Exceptional item	7	4,778	–
After exceptional item		8,259	3,244
Profit for the year attributable to the equity holders of the parent company	8	27,941	25,665
Foreign exchange translation differences arising on the revaluation of foreign operations		741	(738)
Total comprehensive income for the year		28,682	24,927
Basic earnings per share from continuing operations (based on profit for the year)	48	24.33p	22.35p
Diluted earnings per share from continuing operations (based on profit for the year)	48	24.33p	22.35p

The notes and information on pages 78 to 149 form part of these financial statements.

CONSOLIDATED BALANCE SHEET

Consolidated Balance Sheet at 31 December 2012

31 December		2012	2011
	Note	£000	(*restated) £000
Assets			
Intangible assets			
Deferred acquisition costs	19	22,555	19,720
Acquired value of in-force business	20	76,118	83,346
Acquired value of customer relationships	21	1,884	2,255
Software assets	22	5,712	6,744
Property and equipment	23	369	385
Investment in associates	24	2,902	1,613
Investment properties	25	100,167	132,128
Deferred tax assets	37	2,295	–
Reinsurers' share of insurance contract provisions	32	278,692	263,792
Amounts deposited with reinsurers	33	30,245	28,031
Financial assets			
Equity securities at fair value through income	26	427,303	404,431
Holdings in collective investment schemes at fair value through income	26	3,009,799	2,917,935
Debt securities at fair value through income	26	363,377	330,610
Policyholders' funds held by the Group	26	61,171	49,080
Insurance and other receivables	26/27	24,313	30,799
Prepayments	26/27	3,160	3,234
Derivative financial instruments	26/28	3,095	10,308
Total financial assets		3,892,218	3,746,397
Reinsurers' share of accrued policyholder claims	39	4,489	4,667
Income taxes	29	4,299	6,956
Cash and cash equivalents	30	228,676	195,920
Total assets		4,650,621	4,491,954
Liabilities			
Insurance contract provisions	32	2,207,078	2,190,939
Other provisions	36	5,161	2,811
Financial liabilities			
Investment contracts at fair value through income	33	2,022,314	1,876,463
Liabilities relating to policyholders' funds held by the Group	34	61,171	49,080
Borrowings	35	48,324	54,753
Derivative financial instruments	28	286	144
Total financial liabilities		2,132,095	1,980,440
Deferred tax liabilities	37	5,894	15,390
Reinsurance payables	38	16,610	16,336
Payables related to direct insurance and investment contracts	39	38,894	40,651
Deferred income	40	8,884	10,000
Income taxes	41	–	947
Other payables	42	17,057	24,417
Bank overdrafts	30	602	834
Total liabilities		4,432,275	4,282,765
Net assets	8	218,346	209,189
Shareholders' equity			
Share capital	43	42,024	42,024
Share premium	43	42,523	42,523
Treasury shares	44	(217)	(217)
Other reserves	45	7,719	6,978
Retained earnings	46	126,297	117,881
Total shareholders' equity		218,346	209,189

The notes and information on pages 78 to 149 form part of these financial statements.

*See Note 2(d) for an explanation of the restatement of the Consolidated Balance Sheet as at 31 December 2011.

Approved by the Board of Directors on 27 March 2013 and signed on its behalf by:

Peter Mason

Graham Kettleborough

COMPANY BALANCE SHEET

Company Balance Sheet at 31 December 2012

31 December	Note	2012 £000	2011 £000
Assets			
Non-current assets			
Financial assets			
Investment in subsidiaries	26	146,699	146,699
Current assets			
Receivables and prepayments	27	585	296
Income taxes	29	1,394	1,197
Cash and cash equivalents	30	32,412	15,637
Total current assets		34,391	17,130
Total assets		181,090	163,829
Current liabilities			
Borrowings	35	7,844	5,819
Other provisions	36	399	176
Other payables	42	2,725	2,087
Total current liabilities		10,968	8,082
Non-current liabilities			
Borrowings	35	21,818	29,667
Other provisions	36	3,405	1,324
Total non-current liabilities		25,223	30,991
Total liabilities		36,191	39,073
Net assets		144,899	124,756
Shareholders' equity			
Share capital	43	5,752	5,752
Share premium	43	42,523	42,523
Treasury shares	44	(217)	(217)
Other reserves	45	50	50
Retained earnings	46	96,791	76,648
Total shareholders' equity		144,899	124,756

The notes and information on pages 78 to 149 form part of these financial statements.

The financial statements of Chesnara plc (registered number 4947166) were approved by the Board of Directors on 27 March 2013 and signed on its behalf by:

Peter Mason

Graham Kettleborough

CONSOLIDATED STATEMENT OF CASH FLOWS

Consolidated Statement of Cash Flows for the year ended 31 December 2012

Year ended 31 December	2012 £000	2011 £000
Profit for the year	27,941	25,665
Adjustments for:		
Depreciation of property and equipment	128	219
Amortisation of deferred acquisition costs	7,657	7,339
Amortisation of acquired value of in-force business	7,864	9,032
Amortisation of acquired value of customer relationships	391	758
Amortisation of software assets	2,188	1,968
Tax recovery	(8,259)	(3,244)
Interest receivable	(25,961)	(28,632)
Dividends receivable	(46,774)	(40,261)
Interest expense	3,670	3,388
Change in fair value of investment properties	5,650	(4,233)
Fair value (gains)/losses on financial assets	(254,457)	272,517
Gain on sale of property and equipment	(2)	–
Share of (profit)/loss of associate net of impairment	(1,244)	152
Interest received	26,357	27,874
Dividends received	46,738	40,350
Increase in intangible assets related to insurance and investment contracts	(10,255)	(12,642)
Changes in operating assets and liabilities		
Decrease in financial assets	145,971	44,697
(Increase)/decrease in reinsurers share of insurance contract provisions	(14,138)	15,442
(Increase)/decrease in amounts deposited with reinsurers	(2,214)	2,233
Decrease in insurance and other receivables	402	2,967
Decrease in prepayments	96	659
Decrease in assets held for sale	–	380
Decrease in liabilities held for sale	–	(380)
Increase/(decrease) in insurance contract provisions	15,271	(212,424)
Increase/(decrease) in investment contract liabilities	140,360	(115,100)
Increase in provisions	2,336	989
Increase/(decrease) in reinsurance payables	88	(5,859)
(Decrease)/increase in payables related to direct insurance and investment contracts	(1,795)	4,981
(Decrease)/increase in other payables	(3,251)	5,719
Cash generated from operations	64,758	44,554
Income tax paid	(1,152)	(9,119)
Net cash generated from operating activities	63,606	35,435
Cash flows from investing activities		
Development of software	(1,094)	(1,968)
(Purchases)/disposals of property and equipment	(109)	63
Net cash utilised by investing activities	(1,203)	(1,905)
Cash flows from financing activities		
Repayment of borrowings	(6,406)	(7,510)
Dividends paid	(19,525)	(19,007)
Interest paid	(3,949)	(3,625)
Net cash utilised by financing activities	(29,880)	(30,142)
Net increase in cash and cash equivalents	32,523	3,388
Cash and cash equivalents at beginning of period	195,086	191,980
Effect of exchange rate changes on cash and cash equivalents	465	(282)
Cash and cash equivalents at end of the year	228,074	195,086

The notes and information on pages 78 to 149 form part of these financial statements.

COMPANY STATEMENT OF CASH FLOWS

Company Statement of Cash Flows for the year ended 31 December 2012

Year ended 31 December	2012 £000	2011 £000
Profit for the year	39,668	21,634
Adjustments for:		
Tax recovery	(1,420)	(1,197)
Interest expense	1,218	1,419
Dividends received from subsidiary company	(44,000)	(26,002)
Changes in operating assets and liabilities		
Increase in loans and receivables	(310)	(41)
Decrease/(increase) in prepayments	21	(12)
Increase in provisions	2,304	1,500
Increase in other payables	669	87
Tax received	1,223	543
Cash utilised by operations	(627)	(2,069)
Cash flows from investing activities		
Capital contributions paid to subsidiary	–	(5,265)
Dividends received from subsidiary company	44,000	26,002
Net cash generated from investing activities	44,000	20,737
Cash flows from financing activities		
Repayment of borrowings	(6,000)	(4,000)
Dividends paid	(19,524)	(19,007)
Interest paid	(1,074)	(1,222)
Net cash utilised by financing activities	(26,598)	(24,229)
Net increase/(decrease) in cash and cash equivalents	16,775	(5,561)
Cash and cash equivalents at beginning of period	15,637	21,198
Cash and cash equivalents at end of period	32,412	15,637

The notes and information on pages 78 to 149 form part of these financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

Consolidated Statement of Changes in Equity for the year ended 31 December 2012

Year ended 31 December 2012						
	Share capital £000	Share premium £000	Other reserves £000	Treasury shares £000	Retained earnings £000	Total £000
Equity shareholders' funds at 1 January 2012	42,024	42,523	6,978	(217)	117,881	209,189
Profit for the period	–	–	–	–	27,941	27,941
Dividends paid (Note 46)	–	–	–	–	(19,525)	(19,525)
Foreign exchange translation differences	–	–	741	–	–	741
Equity shareholders' funds at 31 December 2012	42,024	42,523	7,719	(217)	126,297	218,346

Year ended 31 December 2011						
	Share capital £000	Share premium £000	Other reserves £000	Treasury shares £000	Retained earnings £000	Total £000
Equity shareholders' funds at 1 January 2011	42,024	42,523	7,716	(217)	111,223	203,269
Profit for the period	–	–	–	–	25,665	25,665
Dividends paid (Note 46)	–	–	–	–	(19,007)	(19,007)
Foreign exchange translation differences	–	–	(738)	–	–	(738)
Equity shareholders' funds at 31 December 2011	42,024	42,523	6,978	(217)	117,881	209,189

The notes and information on pages 78 to 149 form part of these financial statements.

COMPANY STATEMENT OF CHANGES IN EQUITY

Company Statement of Changes in Equity for the year ended 31 December 2012

Year ended 31 December 2012						
	Share capital £000	Share premium £000	Other reserves £000	Treasury shares £000	Retained earnings £000	Total £000
Equity shareholders' funds at 1 January 2012	5,752	42,523	50	(217)	76,648	124,756
Profit for the year representing total recognised income and expenses	–	–	–	–	39,668	39,668
Dividends paid	–	–	–	–	(19,525)	(19,525)
Equity shareholders' funds at 31 December 2012	5,752	42,523	50	(217)	96,791	144,899

Year ended 31 December 2011						
	Share capital £000	Share premium £000	Other reserves £000	Treasury shares £000	Retained earnings £000	Total £000
Equity shareholders' funds at 1 January 2011	5,752	42,523	50	(217)	74,021	122,129
Profit for the year representing total recognised income and expenses	–	–	–	–	21,634	21,634
Dividends paid	–	–	–	–	(19,007)	(19,007)
Equity shareholders' funds at 31 December 2011	5,752	42,523	50	(217)	76,648	124,756

The notes and information on pages 78 to 149 form part of these financial statements.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

1 General information

Chesnara plc (Registered Number 4947166) (the Company) is a limited liability company incorporated and domiciled in England and Wales and has a primary listing on the London Stock Exchange. The address of the registered office is Harbour House, Portway, Preston, PR2 2PR, UK.

The Company and its subsidiaries, together forming the Group, comprise UK and Swedish life and pensions businesses.

The UK businesses, which comprise the CA and S&P segments described in Note 8, the activities of which are performed entirely in the UK, underwrite life risks such as those associated with death, disability and health and provide a portfolio of investment contracts for the savings and retirement needs of customers through asset management. They are substantially closed to new business, such that new insurance contracts are only issued to existing customers, dependent on their changing needs. New investment contracts relate to the sale of Guaranteed Growth and Guaranteed Income Bonds by CA.

The Swedish business, which comprises the Movestic segment, described in Note 8, the activities of which are performed predominantly in Sweden, underwrites life, accident and health risks and provides a portfolio of investment contracts. It is open to new business, securing distribution of its products principally through independent financial advisers.

These financial statements are presented in pounds sterling, which is the functional currency of the Parent Company. Foreign operations are included in accordance with the policies set out in Note 2. The financial statements were authorised for issue by the Directors on 27 March 2013.

2 Significant accounting policies

In the information which follows distinction is made, where necessary, in respect of the applicability of certain policies, or as to their clarification:

- (i) as between the UK businesses and the Swedish business, which comprises the Movestic segment; and
- (ii) as between the CA and S&P segments of the UK businesses.

(a) Statement of compliance

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ('IFRSs') as adopted by the European Union ('Adopted IFRSs') and therefore comply with Article 4 of the EU IAS Regulation. Both the Parent Company financial statements and the Group financial statements have been prepared and approved by the Directors in accordance with Adopted IFRSs.

The Group has applied, for the first time, IAS24 (revised) Related Party Disclosures, effective for accounting periods beginning on or after January 1 2011. Its application has not led to any changes in Group accounting policies.

At the date of authorisation of these financial statements the following Standards and Interpretations, which are applicable to the Group and which have not been applied in these financial statements, were in issue but not yet effective (and in some cases have not been adopted by the EU):

Title	Subject
Annual Improvements to IFRSs	2009-2011 Cycle
IFRS 7 (amended December 2011)	Disclosures – Offsetting Financial Assets and Financial Liabilities
IFRS 9	Financial Instruments
IFRS 10	Consolidated Financial Statements
IFRS 10, IFRS 12 and IAS 27 (amended October 2012)	Investment Entities
IFRS 11	Joint Arrangements
IFRS 12	Disclosure of Interests in Other Entities
IFRS 13	Fair Value Measurement
IAS 1 (amended June 2011)	Presentation of Items of Other Comprehensive Income
IAS 12 (amended December 2010)	Deferred Tax: Recovery of Underlying Assets
IAS 19 (revised June 2011)	Employee Benefits
IAS 27 (revised May 2011)	Separate Financial Statements
IAS 28 (revised May 2011)	Investments in Associates and Joint Ventures
IAS 32 (amended December 2011)	Offsetting Financial Assets and Financial Liabilities

The Directors do not expect that the adoption of the standards listed above will have a material impact on the financial statements of the Group in future periods, except as follows:

- IFRS 7 (amended) will increase the disclosure requirements where netting arrangements are in place for financial assets and financial liabilities;
- IFRS 9 will impact both the measurement and disclosures of Financial Instruments;
- IFRS 12 will impact the disclosures of interests Chesnara plc has in other entities; and
- IFRS 13 will impact the measurement of fair value for certain assets and liabilities as well as the associated disclosures.

Beyond the information above, it is not practicable to provide a reasonable estimate of the effect of these standards until a detailed review has been completed.

In publishing the Parent Company financial statements together with the Group financial statements the Company has taken advantage of the exemption in s408 of the Companies Act 2006 not to present its individual income statement and related notes that form a part of these approved financial statements. The Parent Company profit for the year has been disclosed in Note 46.

(b) Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Company and of entities controlled by the Company (its subsidiaries), made up to 31 December each year. Control is achieved where the Company has the power to govern the financial and operating policies of an investee entity so as to obtain benefits from its activities. The Parent Company financial statements present information about the Company as a separate entity and not about its group.

Non-controlling interests in the net assets of consolidated subsidiaries are identified separately from the Group's equity therein. Non-controlling interests consist of the amount of those interests at the date of the original business combination and the non-controlling interest's share of changes in equity since the date of the combination.

Profit or loss and each component of other comprehensive income are attributed to the Company and to the non-controlling interests. Total comprehensive income is attributed to the Company shareholders and to the non-controlling interests even if this results in the non-controlling interests having a deficit balance.

The results of subsidiaries acquired or disposed of during the year are included in the consolidated statement of comprehensive income from the effective date of acquisition or up to the effective date of disposal. Where necessary, adjustments are made to the financial statements of subsidiaries to bring the accounting policies used into line with those used by the Group.

All intra-group transactions, balances, income and expenses are eliminated on consolidation.

(c) Basis of preparation

The Consolidated and Parent Company financial statements have been prepared on a going concern basis. The Directors believe that they have a reasonable expectation that the Group has adequate resources to continue in operational existence for the foreseeable future. In making this assessment, the Directors have taken into consideration the points as set out in the Financial Management section under the heading 'Going Concern'.

The financial statements are presented in pounds sterling, rounded to the nearest thousand and are prepared on the historical cost basis except that the following assets and liabilities are stated at their fair value: derivative financial instruments, financial instruments at fair value through income, assets and liabilities held for sale, investment property and investment contract liabilities at fair value through income.

Assets and liabilities are presented on a current and non-current basis in the notes to the financial statements. If assets are expected to be recovered and liabilities expected to be settled within a year, they are classified as current. If they are expected to be recovered or settled in more than one year, they are classified as non-current.

The preparation of financial statements in conformity with IFRSs requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgements about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the year in which the estimate is revised if the revision affects only that year, or in the year of the revision and future years if the revision affects both current and future years. Judgements made by management in the process of applying the Group's accounting policies that have a significant effect on the financial statements and estimates with a significant risk of material adjustment in the next year are set out in Note 3.

The accounting policies set out below, unless otherwise stated, have been applied consistently to all years presented in these consolidated financial statements.

These financial statements have also been prepared in accordance with the disclosure provisions of FRS 27 'Life Assurance', which was issued by the UK's Accounting Standards Board (ASB) in December 2004. FRS 27 adds to the requirements of IFRS but does not vary them in any way.

(d) Change in accounting policy

As at 31 December 2012 the Group has changed its accounting policy with respect to the treatment of any excess of policyholder assets over policyholder liabilities within the S&P with-profits funds. Up to that date it had opted, as permitted under IFRS 4, to record such unallocated surplus as a liability within a separate unallocated divisible surplus account. However, in recognition of the fact that such surplus has been determined not to be capable of allocation to shareholders at any time, the Group has, with effect from that date, opted to classify such surplus as an insurance contract provision. Accordingly, the Consolidated Balance Sheet as at 31 December 2011 has been re-stated to reflect the re-classification of the previously-reported unallocated divisible surplus of £6,254,000 within insurance contract provisions. The corresponding re-classification being £83,000 as at 31 December 2010 is not material, and therefore further comparatives are not presented. No associated re-classifications or adjustments are required in the Consolidated Statement of Comprehensive Income, the consolidated statement of cash flows or the consolidated statement of changes in equity.

The following table highlights the impact of this change in accounting policy on the 2011 comparative information:

31 December 2011	As previously presented £000	Adjustment £000	As restated £000
Insurance contract provisions	(2,184,685)	(6,254)	(2,190,939)
Unallocated divisible surplus	(6,254)	6,254	–
Total liabilities	(4,282,765)	–	(4,282,765)
Net assets	209,189	–	209,189

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(e) Business combinations

The Group uses the purchase method of accounting to account for the acquisition of subsidiaries. The cost of an acquisition is measured as the fair value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange. Expenses directly attributable to the acquisition are expensed as incurred. The acquiree's identifiable assets, liabilities, and contingent liabilities, which meet the conditions for recognition under IFRS 3, are measured initially at their fair values at the acquisition date. Gains arising on a bargain purchase, where the net fair value of the identifiable assets, liabilities and contingent liabilities of the acquiree exceeds the cost of acquisition, is recognised in profit or loss at the acquisition date.

The non-controlling interest in the acquiree is initially measured at the non-controlling interest's proportion of the net fair value of the assets, liabilities and contingent liabilities recognised.

(f) Investments in associates

An associate is an entity over which the Group is in a position to exercise significant influence, but not control or joint control, through participation in the financial and operating policy decisions of the investee. Significant influence is the power to participate in the financial and operating policy decisions of the investee, but is not control or joint control over those policies.

The results and assets and liabilities of associates are incorporated in these financial statements using the equity method of accounting. Investments in associates are carried in the balance sheet at cost as adjusted by post-acquisition changes in the Group's share of the net assets of the associate, less any impairment in the value of individual investments.

Where a Group company transacts with an associate of the Group, profits and losses are eliminated to the extent of the Group's interest in the associate. Losses may provide evidence of an impairment of assets transferred, in which case appropriate provision is made for impairment.

(g) Foreign currencies

The individual financial statements of each Group company are presented in the currency of the primary economic environment in which it operates, being its functional currency. For the purpose of these consolidated financial statements, the results and financial position of each Group company are expressed in pounds sterling, which is the functional currency of the Parent Company and the presentation currency of the consolidated financial statements.

In preparing the financial statements of the individual companies, transactions in currencies other than the entity's functional currency, being foreign currencies, are recorded at the rates of exchange prevailing on the dates of the transactions. At each balance sheet date, monetary assets and liabilities which are denominated in foreign currencies are retranslated at the rates prevailing on the balance sheet date. Non-monetary items carried at fair value, which are denominated in foreign currencies, are translated at the rates prevailing when the fair value was determined. Exchange differences are recognised in profit or loss in the period in which they arise, except when they relate to items for which gains and losses are recognised in equity.

For the purpose of presenting consolidated financial statements, the assets and liabilities of the Group's foreign operations are translated at exchange rates prevailing on the balance sheet date. Income and expense items are translated at the average exchange rates for the period, unless exchange rates fluctuate significantly during the period, in which case the exchange rates at the dates of transactions are used. Exchange differences arising are classified as equity and are recognised in the Group's foreign currency translation reserve. Such translation differences are recognised as income or as expense in the period in which the operation is disposed of.

Transactions relating to business combinations denominated in foreign currencies are translated into sterling at the exchange rates prevailing on the transaction date.

(h) Product classification

The Group's products are classified at inception as either insurance or investment contracts for accounting purposes. Insurance contracts are contracts which transfer significant insurance risk and remain as insurance contracts until all rights and obligations are extinguished or expire. They may also transfer financial risk. Investment contracts are contracts which carry financial risk, with no significant insurance risk. Where contracts contain both insurance and investment components and the investment components can be measured reliably, the contracts are unbundled and the components are separately accounted for as insurance contracts and investment contracts respectively.

In some insurance contracts and investment contracts the financial risk is borne by the policyholders. Such contracts are usually unit-linked contracts.

With-profits contracts, which subsist only within the UK businesses, all contain a discretionary participation feature ("DPF") which entitles the holder to receive, as a supplement to guaranteed benefits, additional benefits or bonuses, which may be a significant portion of the total contractual benefits.

In respect of S&P the amount and timing of such contractual benefits are at the discretion of the Group and are contractually based on realised and/or unrealised investment returns on a specified pool of assets held by the Group. The terms and conditions of these contracts, together with UK regulations, set out the bases for the determination of the amounts on which the additional discretionary benefits are based and within which the Group may exercise its discretion as to the quantum and timing of their payment to contract holders.

In respect of CA all such contracts are wholly reinsured with Guardian Assurance Limited ('Guardian'), and the amount or timing of the additional payments are contractually at the discretion of the reinsurer and are contractually based on:

- (i) the performance of a specified pool of contracts or a specified type of contract;
- (ii) realised and/or unrealised investment returns on a specified pool of assets held by the reinsurer; or
- (iii) the profit or loss of the reinsurer.

All contracts with discretionary participation features are classified as insurance contracts.

(i) Insurance contracts

There are fundamental differences between the nature of the insurance contracts subsisting in the UK and Swedish businesses, including inter alia contract longevity: the related product characteristics are set out for the separate UK and Swedish businesses in Note 5. As a consequence, the alignment of income and expense recognition with the underlying assumption of risk leads to the adoption of separate accounting policies appropriate to each business, as follows:

UK businesses**(i) Premiums**

Premiums are accounted for when due, or in the case of unit-linked insurance contracts, when the liability is recognised, and exclude any taxes or duties based on premiums. Outward reinsurance premiums are accounted for when due.

(ii) Claims and benefits

Claims are accounted for in the accounting period in which they are due or notified. Surrenders are accounted for in the accounting period in which they are paid. Claims include policyholder bonuses allocated in anticipation of a bonus declaration. Reinsurance recoveries are accounted for in the same period as the related claim.

(iii) Acquisition costs

Acquisition costs comprise all direct and indirect costs arising from the conclusion of insurance contracts. They are initial fees amortised at a rate based on the pattern of anticipated margins in respect of the related policies. An explicit deferred acquisition cost asset is established in the balance sheet to the extent that acquisition costs exceed initial fees deducted. At 31 December each year, such costs that are deferred to future years are reviewed to ensure they do not exceed available future margins.

Renewal commission and other direct and indirect acquisition costs arising on enhancements to existing contracts are expensed as incurred.

(iv) Measurement of insurance contract provisions

Insurance contract provisions are measured using accounting policies having regard to the principles laid down in Council Directive 2002/83/EC.

Insurance contract provisions are determined following an annual actuarial investigation of the long-term funds and are calculated initially on a statutory solvency basis in order to comply with the reporting requirements of the Prudential Sourcebook for Insurers. This valuation is then adjusted to remove certain contingency reserves and to remove excess prudence from other reserves. In accordance with this, the provisions are calculated on the basis of current information, using the specific valuation methods set out below.

Unit-linked provisions are measured by reference to the value of the underlying net asset value of the Group's unitised investment funds, determined on a bid value basis, at the balance sheet date.

For immediate annuities in payment the provision is calculated as the discounted value of the expected future annuity payments under the policies, allowing for mortality, including projected improvements in future mortality, interest rates and expenses. For certain temporary annuities in payment no allowance for mortality has been made.

In respect of S&P, for those classes of non-linked business with a discretionary participation feature, a gross premium method has been used to value the liability, whereby expected income and costs have been projected, allowing for mortality, interest rates and expenses.

For the other classes of non-linked business the provision is calculated on a net premium basis, being the level of premium consistent with a premium stream, the discounted value of which, at the outset of the policy, would be sufficient to cover exactly the discounted value of the original guaranteed benefits at maturity, or at death if earlier, on the valuation basis. The provision is then calculated by subtracting the present value of future net premiums from the present value of the benefits guaranteed at maturity, or death if earlier, as a result of events up to the balance sheet date. Negative provisions do not arise under the net premium method, which makes no allowances for voluntary discontinuances by policyholders, and which only implicitly allows for future policy maintenance costs.

In respect of CA for those classes of non-linked and unit-linked business where policyholders participate in profits the liability is wholly reassured to Guardian. The liability is calculated on a net premium basis, but is then increased to the realistic liability as a result of the liability adequacy test.

Insurance contract provisions are tested for adequacy by discounting current estimates of all contractual cash flows and comparing this amount to the carrying value of the provision and any related assets: this is known as the liability adequacy test. Where a shortfall is identified, an additional provision is made and the Group recognises the deficiency in income for the year.

Insurance contract provisions can never be definitive as to their timing or the amount of claims and are therefore subject to subsequent reassessment on a regular basis.

Swedish business – life**(i) Premiums**

Premiums are accounted for when received, and exclude any taxes or duties based on premiums. Outward reinsurance premiums are accounted for when due.

(ii) Claims and benefits

Claims are accounted for in the accounting period in which they are due or notified. Reinsurance recoveries are accounted for in the same period as the related claim.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(iii) Acquisition costs

Acquisition costs comprise expenditure incurred arising from the completion of insurance contracts. They are initial fees amortised at a rate based on the pattern of anticipated margins in respect of the related policies. An explicit deferred acquisition cost asset is established in the balance sheet to the extent that acquisition costs exceed initial fees deducted. At the end of each year, such costs that are deferred to future years are reviewed to ensure they do not exceed available future margins.

Renewal commission and other direct and indirect acquisition costs arising on enhancements to existing contracts are expensed as incurred.

(iv) Measurement of insurance contract provisions

Provision is made at the year-end for the estimated cost of claims incurred but not settled at the balance sheet date, including the cost of claims incurred but not yet reported. The estimated cost of claims includes expenses to be incurred in settling claims. Outstanding claim provisions are not discounted other than for income protection and waiver of premium benefits, where payments may be made for a considerable period of time.

All reasonable steps are taken to ensure that there is appropriate information regarding claims exposures. However, given the uncertainty in establishing claims provisions, it is likely that the final outcome will prove to be different from the original liability established.

Insurance contract provisions are tested for adequacy by discounting current estimates of all contractual cash flows and comparing this amount to the carrying value of the provision and any related assets: this is known as the liability adequacy test. Where a shortfall is identified, an additional provision is made and the deficiency in income for the year is recognised.

Swedish business – non-life

(i) Premiums

Written premiums for non-life (general) insurance business comprise the premiums on contracts incepting in the financial year. Written premiums are stated gross of commission payable to intermediaries and exclusive of taxes and duties paid on premiums.

Unearned premiums are those proportions of the premium which relate to periods of risk after the balance sheet date. Unearned premiums are calculated on a straight-line basis according to the duration of the policy underwritten.

(ii) Acquisition costs

Acquisition costs, which represent commission payable, incurred in writing written premiums, are deferred and amortised over the period in which the related premiums are earned.

(iii) Claims

Claims incurred

Claims incurred comprise claims and related expenses paid in the year and changes in provisions for outstanding claims, including provisions for claims incurred but not yet reported and related expenses, together with any adjustments to claims from previous years.

Outstanding claims provisions

Provision is made at the year-end for the estimated cost of claims incurred but not settled at the balance sheet date, including the cost of claims incurred but not yet reported. The estimated cost of claims includes expenses to be incurred in settling claims. Outstanding claims provisions are not discounted. Provisions are calculated gross of any reinsurance recoveries.

All reasonable steps are taken to ensure that there is appropriate information regarding claims exposures. However, given the uncertainty in establishing claims provisions, it is likely that the final outcome will prove to be different from the original liability established.

The estimation of outstanding claims provisions is described in Note 32.

(j) Investment contracts

(i) Amounts collected

Amounts collected on investment contracts, which primarily involve the transfer of financial risk such as long-term savings contracts, are accounted for using deposit accounting, under which the amounts collected, less any initial fees deducted, are credited directly to the balance sheet as an adjustment to the liability to the investor.

(ii) Amounts deposited with reinsurers

Amounts deposited with reinsurers under reinsurance arrangements, which primarily involve the transfer of financial risk, are entered directly to the balance sheet as amounts deposited with reinsurers. These assets are designated on initial recognition as at fair value through income.

(iii) Benefits

For investment contracts, benefits paid are not included in the income statement but are instead deducted from investment contract liabilities in the accounting period in which they are paid.

(iv) Acquisition costs

Acquisition costs relating to investment contracts comprise directly attributable incremental acquisition costs, which vary with, and are related to, securing new contracts, and are recognised as an asset to the extent that they represent the contractual right to benefit from the provision of investment management services. The asset is presented as a deferred acquisition cost asset and is amortised over the expected term of the contract, as the fees relating to the provision of the services are recognised. All other costs are recognised as expenses when incurred.

(v) Liabilities

All investment contract liabilities are designated on initial recognition as held at fair value through income. The Group has designated investment contract liabilities at fair value through income as this more closely reflects the basis on which the businesses are managed.

The financial liability in respect of unit-linked contracts is measured by reference to the value of the underlying net asset value of the unitised investment funds, determined on a bid value, at the balance sheet date.

For the UK businesses, deferred tax on unrealised capital gains and for the Swedish business a yield tax in respect of an estimate of the investment return on the underlying investments in the unitised funds are also reflected in the measurement of the respective unit-linked liabilities.

In respect of the UK businesses guaranteed income and guaranteed growth bond liabilities and other investment contract liabilities are managed together with related investment assets on a fair value basis as part of the documented risk management strategy.

The fair value of other investment contracts is measured by discounting current estimates of all contractual cash flows that are expected to arise under contracts.

(k) Reinsurance

The Group cedes reinsurance in the normal course of business for the purpose of avoiding the retention of undue concentration of risk on any one life, policyholder or loss event (for example multiple losses under a Group Life contract). Assets, liabilities and income and expense arising from ceded reinsurance contracts are presented separately from the related assets, liabilities, income and expenses from the related insurance contracts because the reinsurance arrangements do not relieve the Group from its direct obligations to its policyholders.

Only rights under contracts that give rise to a significant transfer of insurance risk are accounted for as reinsurance assets, which comprise amounts due from insurance companies for paid and unpaid losses and ceded life policy benefits. Rights under contracts that do not transfer significant insurance risk are accounted for as financial instruments and are presented as amounts deposited with reinsurers.

The net premiums payable to a reinsurer may be more or less than the reinsurance assets recognised by the Group in respect of the reinsurance cover purchased. Any gain or loss is recognised in the income statement in the period in which the reinsurance premiums are payable.

Rights under reinsurance contracts comprising the reinsurers' share of insurance contract provisions and accrued policyholder claims are estimated in a manner that is consistent with the measurement of the provisions held in respect of the related insurance contracts and in accordance with the terms of the reinsurance contract. Such assets are deemed impaired if there is objective evidence, as a result of an event that occurred after its initial recognition, that the Group may not recover all amounts due and the event has a reliably measurable impact on the amounts that the Group will receive from the reinsurer. Impairment losses reduce the carrying value of the related reinsurance assets to their recoverable amount and are recognised as an expense in the income statement.

The Group enters into certain financing arrangements, which are established in the form of a reinsurance contract, but which are substantively in the form of a financial instrument. Such arrangements are classified and presented as borrowings within financial liabilities.

(l) Fee and commission income

Fees charged for investment management services provided in connection with investment contracts are recognised as revenue as the services are provided. Initial fees which exceed the level of recurring fees and relate to the future provision of services are deferred and amortised over the anticipated period in which services will be provided.

Initial fees charged for investment management services provided in connection with insurance contracts are recognised as revenue when earned.

For both insurance and investment contracts, initial fees, annual management charges and contract administration charges are recognised as revenue on an accruals basis. Surrender charges are recognised as a reduction to policyholder claims and benefits incurred when the surrender benefits are paid.

Benefit-based fees comprising charges made to unit-linked insurance and investment funds for mortality and morbidity benefits are recognised as revenue on an accruals basis.

For insurance and investment contracts, commissions received or receivable which do not require the Group to render further services are recognised as revenue by the Group on the effective commencement or renewal dates of the related contract. However, when it is probable that the Group will be required to render further services during the life of the contract, the commission, or part thereof, is deferred and recognised as revenue over the period in which services are rendered.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(m) Investment income

Investment income comprises income from financial assets and rental income from investment properties.

Income from financial assets comprises dividend and interest income, net fair value gains and losses (both unrealised and realised) in respect of financial assets classified as fair value through income, and realised gains on financial assets classified as loans and receivables.

Dividends are accrued on an ex-dividend basis. Interest received and receivable in respect of interest-bearing financial assets classified as at fair value through income is included in net fair value gains and losses. For loans and receivables and cash and cash equivalents interest income is calculated using the effective interest method.

Rental income from investment properties under operating leases is recognised in the income statement on a straight-line basis over the term of each lease. Lease incentives are recognised in the income statement as an integral part of the total lease income.

(n) Expenses

(i) Operating lease payments

Leases where a significant proportion of the risks and rewards of ownership is retained by the lessor are classified as operating leases. Payments made under operating leases are recognised in the income statement on a straight-line basis over the term of the lease. Lease incentives received are recognised in the income statement as an integral part of the total lease expense.

(ii) Financing costs

Financing costs comprise interest payable on borrowings and on reinsurance claims deposits included within reinsurance payables, calculated using the effective interest rate method.

(o) Income taxes

Income tax on the profit or loss for the year comprises current and deferred tax and is recognised in the income statement. Tax that relates directly to transactions reflected within equity is also presented within equity.

(i) Current tax

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years.

(ii) Deferred tax

Deferred tax is provided using the balance sheet liability method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantively enacted at the balance sheet date.

A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised. Deferred tax assets are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

(iii) Policyholders' fund yield tax

Certain of the Group's policyholders within the Swedish business are subject to a Swedish yield tax which is calculated based on an estimate of the investment return on underlying investments within their unitised funds. The Group is under an obligation to deduct the yield tax from the policyholders' unitised funds and to remit these deductions to the tax authorities. The remittance of this tax payment is included in other operating expenses as it does not comprise a tax charge on Group profits.

(p) Acquired value of in-force business

Acquired in-force insurance and investment contracts arising from business combinations are measured at fair value at the time of acquisition.

The difference between the fair value of insurance contracts and the liability measured in accordance with the Group's accounting policies for the contracts is recorded as acquired present value of in-force business. Present value of in-force business is carried gross of tax and is amortised against income on a time profile which, it is intended, will broadly match the profile of the underlying emergence of surplus as anticipated at the time of acquisition. The present value of in-force insurance contracts is tested for recoverability/impairment as part of the liability adequacy test.

The present value of in-force investment contracts is stated at cost less accumulated amortisation and impairment losses. The initial cost is deemed to be the fair value of the contractual customer relationships acquired. The acquired present value of the in-force investment contracts is carried gross of tax and is amortised against income on a time profile which, it is intended, will broadly match the profile of the underlying emergence of profit from the contracts. The recoverable amount is estimated at each balance sheet date. If the recoverable amount is less than the carrying amount, an impairment loss is recognised in the income statement and the carrying amount is reduced to its recoverable amount.

(q) Acquired value of customer relationships

The acquired value of customer relationships arising from business combinations is measured at fair value at the time of acquisition. This comprises the discounted cash flows relating to new insurance and investment contracts which are expected to arise from existing customer relationships. These are carried gross of tax, are amortised in accordance with the expected emergence of profit from the new contracts and are tested periodically for recoverability.

(r) Software assets

An intangible asset in respect of internal development software costs is only recognised if all of the following conditions are met:

- (i) an asset is created that can be identified;
- (ii) it is probable that the asset created will generate future economic benefits; and
- (iii) the development costs of the asset can be measured reliably.

Where no internally-generated intangible asset can be recognised, development expenditure is recognised as an expense in the period in which it is incurred. Software assets, including internally developed software, are amortised on a straight-line basis over their estimated useful life, which typically varies between 3 and 5 years.

(s) Property and equipment

Items of property and equipment are stated at cost less accumulated depreciation and impairment losses.

Depreciation is charged to the income statement on a straight-line basis over the estimated useful economic lives of the property and equipment on the following basis:

Computers and similar equipment 3 years

Fixtures and other equipment 5 years

Assets held under finance leases are depreciated over their useful economic lives on the same basis as owned assets, or where shorter, over the term of the relevant lease.

(t) Investment property

Investment properties are properties which are held either to earn rental income or for capital appreciation or for both. On initial recognition investment properties are measured at cost including attributable transaction costs, and are subsequently measured at fair value. Independent external valuers, having an appropriate recognised professional qualification and recent experience in the location and category of property being valued, value the portfolio every twelve months.

The fair values reflect market values at the balance sheet date, being the estimated amount for which a property could be exchanged on the date of valuation between a willing buyer and a willing seller in an arm's length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently and without compulsion.

Any gain or loss arising from a change in fair value is recognised in the income statement. Rental income from investment property is accounted for as described in accounting policy (m).

(u) Financial assets

Investments in subsidiaries are carried in the Company balance sheet at cost less impairment.

Financial assets are classified into different categories depending on the type of asset and the purpose for which it is acquired. Currently two different categories of financial assets are used: 'financial assets at fair value through income' and 'loans and receivables'. Financial assets classified as at fair value through income comprise financial assets designated as such on initial recognition and derivative financial instruments.

All financial assets held for investment purposes other than derivative financial instruments are designated as at fair value through income on initial recognition since they are managed, and their performance is evaluated, on a fair value basis in accordance with documented investment and risk management strategies. This designation is also applied to the Group's investment contracts, since the investment contract liabilities are managed together with the investment assets on a fair value basis as part of the documented risk management strategy.

Purchases and sales of 'regular way' financial assets are recognised on the trade date, which is when the Group commits to purchase, or sell, the assets.

All financial assets are initially measured at fair value plus, in the case of financial assets not classified as at fair value through income, transaction costs that are directly attributable to their acquisition.

Subsequent to initial recognition, financial assets classified as at fair value through income are measured at their fair value without any deduction for transaction costs that may be incurred on their disposal.

The fair values of financial assets quoted in an active market are their bid prices at the balance sheet date.

Financial assets classified as loans and receivables are stated at amortised cost less impairment losses. A provision for the impairment of loans and receivables is established when there is objective evidence that the Group will not be able to collect all the amounts due according to the original contract terms after the date of the initial recognition of the asset and when the impact on the estimated cash flows of the financial asset can be reliably measured.

Financial assets classified as prepayments are held at cost and are amortised over the relevant time period.

Financial assets not recognised at fair value through income are regularly reviewed for objective evidence of impairment. In determining whether objective evidence exists, the Group considers, among other factors, the financial stability of the counterparty, current market conditions and fair value volatility.

Financial assets are derecognised when contractual rights to receive cash flows from the financial assets expire, or where the financial assets have been transferred together with substantially all the risks and rewards of ownership.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(v) Derivative financial instruments

Derivative financial instruments are recognised at fair value. The gain or loss on re-measurement to fair value is recognised immediately in profit or loss. Hedge accounting has not been applied.

The fair value of interest rate swaps is the estimated amount that the Group would receive or pay to terminate the swap at the balance sheet date, taking into account current interest rates and the current creditworthiness of the swap counterparties. The fair value of forward exchange contracts is their quoted market price at the balance sheet date, being the present value of the quoted forward price.

The fair value of forward exchange contracts is their quoted market price at the balance sheet date, being the present value of the quoted forward price.

Embedded derivatives which are not closely related to their host contracts and which meet the definition of a derivative are separated and fair valued through income.

(w) Policyholders' funds held by the group and liabilities relating to policyholders' funds held by the group

Policyholders' funds held by the Group and liabilities relating to policyholders' funds held by the Group are recognised at fair value.

(i) Policyholders' funds held by the Group

The policyholders' funds held by the Group represent the assets associated with an Investment product in the Swedish business, where the assets are held on behalf of the policyholder and where all the risks and rewards associated with the assets are the policyholders' not the Group's.

The policyholders' funds held by the Group are held for investment purposes on behalf of the policyholders and are designated as at fair value through income. The fair values of the policyholders' funds held by the Group are the accumulation of the bid prices of the underlying assets at the balance sheet date. Transactions in these financial assets are recognised on the trade date, which is when the Group commits (on behalf of the policyholder) to purchase, or sell the assets.

(ii) Liabilities relating to policyholders' funds held by the Group

The liability relating to policyholders' funds held by the Group represents the liability that matches the asset policyholders' funds held by the Group. As stated previously, the risk and rewards associated with the investment product (and its underlying assets and matching liability) lie with the policyholders, not the Group.

(x) Cash and cash equivalents

Cash and cash equivalents include cash in hand, deposits held at call with banks and other short-term highly liquid investments. Highly liquid is defined as having a short maturity of three months or less at their acquisition.

(y) Assets held for sale and liabilities held for sale

Assets and liabilities are classified as held for sale if their carrying amount is to be recovered principally through a sale transaction that is highly likely to complete within one year from the date of classification, rather than through continuing use. Such assets are measured at the lower of carrying amount and fair value and are classified separately from other assets in the balance sheet. Assets and liabilities are not netted. In the period where a non-current asset or disposal group is recognised for the first time, the balance sheet for the comparative prior period is not restated.

(z) Impairment

The carrying amounts of the Group's assets other than reinsurance assets (refer to (k) above) and assets which are carried at fair value are reviewed at each balance sheet date to determine whether there is any indication of impairment. If any such indication exists, the assets' recoverable amount is estimated in order to determine the extent of the impairment loss, if any. An impairment loss is recognised whenever the carrying amount of an asset exceeds its recoverable amount and impairment losses are recognised in the income statement. The recoverable amount is the higher of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money.

Impairment losses are reversed through the income statement if there is a change in the estimates used to determine the recoverable amount. Such losses are reversed only to the extent that the assets' carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation where applicable, if no impairment loss had been recognised.

(aa) Provisions

Provisions are recognised when the Group has a present, legal or constructive obligation as a result of past events such that it is probable that an outflow of economic benefits will be required to settle the obligation and a reliable estimate of the amount of the obligation can be made. Where the effect of the time value of money is material, the amount of the provision is the present value of the expenditures expected to be required to settle the obligation. The Group recognises provisions for onerous contracts when the expected benefits to be derived from a contract are less than the unavoidable costs of meeting the obligations under the contract.

(bb) Borrowings

Borrowings are recognised initially at fair value, less transaction costs, and are subsequently measured at amortised cost using the effective interest method, with interest expense recognised in the income statement on an effective yield basis. The effective interest method is a method of calculating the amortised cost of a financial liability and of allocating interest expense over the relevant period. The effective interest rate is the rate that exactly discounts future cash payments through the expected life of the financial liability.

(cc) Employee benefits**(i) Pension obligations***UK businesses*

Group companies operate defined contribution pension schemes, which are funded through payments to insurance companies, to which Group companies pay fixed contributions. There are no legal or constructive obligations on Group companies to pay further contributions if the fund does not hold sufficient assets to pay employee benefits relating to service in current and prior periods. Accordingly, Group companies have no further payment obligations once the contributions have been paid. Contributions to defined contribution pension schemes are recognised in the income statement when due.

Swedish business

The Group participates in a combined defined benefit and defined contribution scheme for the benefit of its employees. However, the scheme is a multi-employer scheme, with the associated assets and liabilities maintained on a pooled basis. There is limited information available to the Group to allow it to account for the scheme as a defined benefit scheme and, in accordance with IAS19 Employee Benefits, it is, therefore, accounted for as a defined contribution scheme. Contributions paid to the scheme are recognised in the income statement when due.

(ii) Bonus plans

The Group recognises a liability and an expense for bonuses based on a formula that takes into consideration the profit attributable to the Company's shareholders after certain adjustments. The expense is recognised in the income statement on an accruals basis.

(dd) Share capital and shares held in treasury**(i) 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. Incremental costs directly attributable to the issue of equity instruments, as consideration for the acquisition of a business, are included in the cost of acquisition.

(ii) Shares held in treasury

Where the Company purchases its own equity share capital, the consideration paid, including directly attributable costs, is deducted from total shareholders' equity and shown separately as 'treasury shares' until they are cancelled. Where such shares are subsequently sold, any consideration received is credited to the share premium account.

(ee) Dividends

Dividend distributions to the Company's shareholders are recognised in the period in which the dividends are paid, and, for the final dividend, when approved by the Company's shareholders at the annual general meeting.

(ff) Other payables and payables related to direct insurance and investment contracts

Insurance and investment contract payables and other payables are recognised when due and are measured on initial recognition at the fair value of the consideration paid. Subsequent to initial recognition, payables are measured at amortised cost using the effective interest rate method.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

3 Critical accounting judgements and key sources of estimation and certainty.

The Group makes estimates and assumptions that affect the reported amounts of assets and liabilities and also makes critical accounting judgements in applying the Group's accounting policies. Such estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable. The more critical areas, where accounting estimates and judgements are made, are set out below. Each item identifies the business segments, as described in Note 8, to which it is relevant.

(a) Classification of long-term contracts (CA, S&P and Movestic)

The Group has exercised judgement in its classification of long-term business as between insurance and investment contracts, which fall to be accounted for differently in accordance with the policies set out in Note 2 Significant Accounting Policies. Insurance contracts are those where significant risk is transferred to the Group under the contract and judgement is applied in assessing whether the risk so transferred is significant, especially with regard to pensions contracts, which are predominantly, but not exclusively, created for investment purposes.

(b) Acquired value of in-force business (CA, S&P and Movestic)

The Group applies accounting estimates and judgements in determining the fair value, amortisation and recoverability of acquired in-force business relating to insurance and investment contracts. In the initial determination of the acquired value of in-force business, the Group uses actuarial models to determine the expected net cash flows (on a discounted basis) of the policies acquired. The key assumptions applied in the models are driven by the expected behaviour of policyholders on termination rates, expenses of management and age of individual contract holders as well as global estimates of investment growth, based on recent experience at the date of acquisition. The assumptions applied within the models are considered against historical experience of each of the relevant factors. No amendments are made for any changes that may arise as a result of changes in operational procedures or customer interaction as a result of ownership by Chesnara.

The acquired value of in-force business has been amortised on a basis that reflects the expected profit stream arising from the business acquired at the date of acquisition. Acquired value of in-force business is tested for recoverability by reference to expected future income and expense levels. Such impairment testing requires a degree of estimation and judgement. In particular the value is sensitive to the rate at which future cashflows are discounted and to the rates of return on invested assets. Analysis shows that no impairment adjustments are required for a realistic range of discount rates ranging from those used in the EEV models to a higher and more onerous estimate based on the Weighted Average Cost of Capital (WACC) for Chesnara. The rates used for the purpose of the impairment testing were 8%, 10% and 12%.

As at 31 December 2012, the carrying value of acquired in-force business, net of amortisation, was £14.6m in respect of CA (as at 31 December 2011: £17.5m), £7.2m in respect of S&P (as at 31 December 2011: £8.1m) and £54.3m in respect of Movestic (as at 31 December 2011: £57.8m).

(c) Deferred acquisition costs and deferred income – investment contracts (CA and Movestic)

The Group applies judgement in deciding the amount of direct costs that are incurred in acquiring the rights to provide investment management services in connection with the issue of investment contracts. Judgement is also applied in establishing the amortisation of the assets representing these contractual rights and the recognition of initial fees received in respect of these contracts. The assets are amortised over the expected lifetime of the investment management service contracts and deferred income, where applicable, is amortised over the expected period over which it is earned. Estimates are applied in determining the lifetime of the investment management service contracts and in determining the recoverability of the contractual rights assets by reference to expected future income and expense levels. This test for recoverability is performed using best estimates of future cash flows, using a market consistent estimate of future investment returns.

As at 31 December 2012, the carrying values of deferred acquisition costs, net of amortisation, and of deferred income, in respect of CA, were £5.1m and £8.9m respectively (as at 31 December 2011: £5.7m and £10.0m respectively). The impact on the above numbers of a one year movement in the estimated lifetime of the management services contract or amortisation period is not material.

As at 31 December 2012, the carrying values of deferred acquisition costs, net of amortisation, in respect of Movestic, was £17.5m (as at 31 December 2011: £14.0m). An increase in the length of the amortisation period by one year would have increased profit before tax for the year ended 31 December 2012 by £0.5m and shareholders' equity as at 31 December 2012 by £0.5m.

(d) Fair value of financial assets and unit-linked investments (CA, S&P and Movestic)

Fair value measurement has been adopted to reduce volatility in reported earnings in the income statement as the liabilities so determined are measured in a way which is consistent with the fair value of the underlying invested financial assets.

Fair value is the amount for which an asset could be exchanged, or a liability settled, between willing, knowledgeable parties in an arm's length transaction.

Fair values are determined by reference to observable market prices where available and reliable.

(e) Estimates of future benefits payments arising from long-term insurance contracts (CA and S&P)

The Group makes estimates of the expected number of deaths for each of the years that it is exposed to risk. These estimates are based on either standard mortality tables or reinsurers' rate tables as appropriate, adjusted to reflect the Group's own experience. For contracts without fixed terms the Group has assumed that it will be able to increase charges to policyholders in future years, in line with emerging mortality experience.

The Group has offered guaranteed annuity options within certain contracts. Estimates have been made of the number of contract holders who will exercise these options, in order to measure their value. Changes in investment conditions could result in significantly more contract holders exercising their options than the Group has assumed in determining the liabilities arising from these contracts.

The Group makes estimates of future deaths, voluntary contract terminations, investment returns and administration expenses at the inception of long-term insurance contracts with fixed and guaranteed terms. These estimates, which are reconsidered annually, form the assumptions used to calculate the liabilities arising from these contracts.

When assessing assumptions relating to future investment returns the Group makes estimates of the impact of defaults on the related financial assets. The estimates are reassessed annually.

The assumptions used to establish insurance contract liabilities and appropriate sensitivities relating to variations in critical assumptions are disclosed in Note 32.

(f) Contracts which contain discretionary participation features (S&P)

All S&P with-profits contracts contain a discretionary participation feature ('DPF') which entitles the holder to receive, as a supplement to guaranteed benefits, additional benefits or bonuses:

- that may be a significant portion of the total contractual benefits;
- whose amount or timing is contractually at the discretion of the Group; and
- that are contractually based on realised and/or unrealised investment returns on a specified pool of assets held by the Group.

The terms and conditions of these contracts, together with UK regulations, set out the bases for the determination of the amounts on which the additional discretionary benefits are based and within which the Group may exercise its discretion as to the quantum and timing of their payment to contract holders.

As at 31 December 2012, the carrying value of insurance contract liabilities which contain S&P discretionary participation features was £346.7m (31 December 2011: £347.2m re-stated).

As stated in Note 32 'Insurance contract provisions', the cost to shareholders of guarantees in respect of S&P contracts with discretionary participation features is estimated, based on a constant margin of 10% above a market-consistent evaluation of such costs. An increase in the margin to 20% would reduce profit before tax for the year ended 31 December 2012, by £4.2m and shareholder equity as at 31 December 2012 by £3.2m.

(g) Insurance claim reserves (Movestic)

Provisions are determined by management based on experience of claims settled and on statistical models which require certain assumptions to be made regarding the timing, incidence and amount of claims. In order to calculate the total provision required, the historical development of claims is analysed using statistical methodology to extrapolate, within acceptable parameters, the value of outstanding claims.

For more recent underwriting years the provisions will make more use of techniques that incorporate expected loss ratios. As underwriting years mature, the reserves are increasingly driven by methods based on actual claims experience. The data used for statistical modelling is internally generated. Actual claims experience may differ from the historical pattern on which the estimate is based and the cost of individual claims may exceed that assumed.

Liabilities carried in respect of waiver of premium and income protection policies are sensitive to the Group's assessment of the length of period in which benefits will be paid to policyholders (which can be significant). Estimates are made based on the sex, age and occupation of the claimant as well as the length of time the claimant has been claiming on the policy.

As at 31 December 2012, the carrying value of the insurance claim reserves, gross of reinsurance, was £68.6m (as at 31 December 2011: £63.8m). The key sensitivities in respect of insurance claim reserves are considered in Note 32.

(h) Insurance claim reserves – reinsurance recoverable (Movestic)

A significant proportion of the insurance claims arising within Movestic are ceded to reinsurers. In preparing the financial statements the Directors have made an assessment as to whether claims ceded to reinsurers are recoverable. As at 31 December 2012, such claims ceded to reinsurers and reflected on the balance sheet were £46.2m (31 December 2011: £43.1m). The application of a 10 per cent bad debt provision on the reinsurance balance would reduce 2012 profit before tax by £4.6m and shareholders' equity by £3.4m.

(i) Accounting for pension plans (Movestic)

The Group participates in a defined benefit pension scheme on behalf of its Swedish employees. The scheme is a multi-employer plan to which a number of third party employers also contribute. The underlying assets and liabilities of the scheme are pooled and are not allocated between the contributing employers. As a result, information is not available to account for the scheme as a defined benefit scheme and the Group has accounted for the scheme as a defined contribution scheme.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

4 Exchange rates

The Group's principal overseas operations during the year were located within Sweden.

The results and cash flows of these operations have been translated into sterling at an average rate for the year of £1 = SEK 10.7326.

Assets and liabilities have been translated at the year end rate of £1 = SEK10.5247.

Total foreign currency exchange rate movements for the year-ended 31 December 2012 resulted in a gain recognised in the Consolidated Statement of Comprehensive Income of £741,000 (year ended 31 December 2011: £738,000 loss).

5 Management of insurance risk

The Group's management of insurance risk is a critical aspect of its business. The primary insurance activity carried out by the Group comprises the assumption of the risk of loss from persons that are directly subject to the risk. Such risks in general relate to life, accident, health and financial perils that may arise from an insurable event. As such, the Group is exposed to the uncertainty surrounding the timing and severity of claims under the related contracts. The principal risk is that the frequency and severity of claims is adverse to that expected. The theory of probability is applied to the pricing and provisioning for a portfolio of insurance contracts. Insured events are, by their nature, random, and the actual number and size of events during any one year may vary from those estimated using established statistical techniques. The risk under assurance policies is partly naturally hedged by risks under annuity policies where the exposure is to the risk of longevity.

The Group manages its insurance risk through adoption of underwriting strategies, the aim of which is to avoid the assumption of undue concentration of risk, approval procedures for new products, pricing guidelines and adoption of reinsurance strategies, the aim of which is to reinforce the underwriting strategy by avoiding the retention of undue concentration of risk on any one life.

Notwithstanding that the Group pursues common overarching objectives and employs similar techniques in managing these risks, the disparate characteristics of the products and of the market and regulatory environments of the UK and Swedish businesses are such that insurance risk is managed separately for the separate businesses. Accordingly, the information which follows differentiates these businesses. The UK businesses, which are substantially closed to new business, comprise the CA and S&P segments and these are further differentiated in the information provided below, where necessary. The Swedish business, which is open to new business, comprises the Movestic segment.

UK businesses

Terms and conditions of insurance contracts

The terms and conditions of insurance contracts that have a material effect on the amount, timing and uncertainty of future cash flows arising from insurance contracts are set out in the product analyses below, which give an assessment of the main products of the UK businesses and of the ways in which the associated risks are managed.

Sums assured/benefits per annum – gross and net of reinsurance 31 December	2012		2011	
	Gross £000	Net £000	Gross £000	Net £000
Long-term unit-linked without DPF (sums assured)	3,847,002	2,942,430	4,237,926	3,220,375
Long-term non-linked without DPF (sums assured)	133,566	119,713	154,062	137,227
Immediate annuities – CA (benefits per annum)	6,224	6,120	6,007	5,856
Deferred annuities with DPF – S&P (benefits per annum)	2,599	2,599	2,893	2,893
Long-term with DPF – CA (sums assured)	56,441	120	59,855	120
Long-term with DPF – S&P (sums assured)	434,750	416,760	462,186	439,175

Long-term unit-linked and non-linked insurance contracts – without discretionary participation features*Product features*

The UK businesses have written both unit-linked and non-linked contracts, which include death and morbidity benefits on a whole life, endowment and term assurance basis. In addition there are immediate annuities primarily written from vesting pensions.

For contracts where death is the insured risk, the most significant factors that could increase risk are epidemics (such as AIDS, SARS or a flu pandemic) or widespread changes in lifestyle, such as eating, smoking and exercise habits, resulting in earlier or more claims than expected.

Management of risks

Unit-linked insurance contracts are contracts where charges are made for insurance risk and administration charges and the primary purpose of which is to provide an investment return to policyholders. In addition, the policyholder is insured against death and serious injury. Unit-linked contracts operate by investing the policyholders' premiums into pooled investment funds of the UK businesses, the policyholders' share of the fund being represented by units. The benefit is payable on death, or maturity if earlier, the amount payable on death being subject to a guaranteed minimum amount. For these contracts, all of the investment risk is borne by the policyholder as investment performance directly affects the value of the unit fund and hence the benefits payable. Therefore, there is exposure to insurance risk only insofar as the value of the unit-linked fund is lower than the guaranteed minimum death benefit. For a material portion of the business, the charges taken for mortality and morbidity costs are reviewable, which allows the company to mitigate some of its insurance risk.

Non-linked business contains three distinct groups of products:

- (i) A number of products representing approximately 2% of sums assured, provide fixed and guaranteed benefits and have fixed future premiums. For these there are no mitigating terms and conditions that reduce the insurance risk accepted.
- (ii) Immediate annuities provide regular income payments generally during the outstanding life of the policyholder, and in some cases that of a surviving spouse or partner. In certain cases payments may be guaranteed for a minimum period. These expose the business to longevity risk, though to some extent this provides a hedge to the mortality risk taken on other products.
- (iii) For the remainder of the business, which is operated on a quasi-linked basis, charges are made for mortality risk on a monthly basis and these charges may be altered based on mortality experience, thereby minimising the exposure to mortality risk. In the light of charges made for insurance risk and administration services and of the investment performance of the assets notionally backing these contracts, the premium payable may be altered at regular intervals. A number of these contracts also include Permanent Health Insurance (PHI) benefits which have reviewable charges, which may be altered based on morbidity experience, thereby minimising the exposure to morbidity risk. Delays in implementing increases in charges and market or regulatory restraints over the extent of the increases may reduce this mitigating effect.

Reinsurance is used extensively on the business described above to mitigate concentrations of insurance risk. The insurance risk is further managed through pricing, product design and, for non-linked and quasi-linked contracts, appropriate investment strategy.

Concentration of insurance risk

Through the use of reinsurance exposures to material insurance risks on individual cases are avoided, with 97% of the business having retained sums assured of less than £250,000.

Long-term insurance contracts – with discretionary participation features – CA*Product features*

CA historically wrote with-profits business in the UK, where the policyholder benefits comprise a guaranteed sum assured payable on death or at maturity, to which may be added a discretionary annual bonus and a discretionary terminal bonus.

Management of risks

This business is wholly reassured to Guardian and hence the only risk retained by CA for this business is the risk of default by the reinsurer. This risk is detailed in the Credit Risk Management section of Note 6.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

Long-term insurance contracts – with discretionary participation features – S&P

Product features

At retirement the with-profits deferred annuity contracts provide for guaranteed minimum pensions and the with-profits endowments provide for guaranteed minimum lump sums. With-profits whole of life policies guarantee a minimum amount payable on death. The guaranteed annuities or lump sums represent investment returns on contributions mainly at 5% p.a. A terminal bonus may be paid at maturity or retirement, and on death, depending on the investment performance of the with-profits policyholder assets when the policyholder receives the higher of the asset share and the minimum guaranteed amount. The asset share is based on the contributions invested plus an allocation of investment return less costs and expenses. In accordance with the Principles and Practices of Financial Management for its with-profits business S&P may make a deduction of up to 1.5% per annum from the asset shares of with-profits policyholders to meet the future cost of guarantees. The amount deducted remains part of the assets in the with-profits policyholder funds. The size of the deduction is reassessed at least annually. In the event of a policyholder choosing to transfer out, the amount payable is not guaranteed and is based on the asset share.

Management of risks

For life endowment and whole of life policies mortality risk is material. This risk is mitigated to some extent by the use of reinsurance. The risk is to increases in mortality rates, which are most likely to be from epidemics (such as AIDS, SARS or a flu pandemic) or widespread changes in lifestyle, such as eating, smoking and exercise habits, resulting in earlier or more claims than expected.

For deferred annuity contracts, the risk is to improving mortality. The risk is managed through the initial pricing, and technical provisions are assessed allowing for future mortality improvements based on industry available information on mortality experience.

Concentration of insurance risk

Through the use of reinsurance exposures to material insurance risks on individual cases are avoided, with 99.0% of the business having retained sums of less than £250,000.

Other risks on insurance contracts

Apart from financial risks relating to the financial assets, which support life assurance contracts, as set out in Note 6, there are other significant types of risk pertaining to life insurance contracts written by the UK businesses, as follows:

Expense risk

The strategy of the UK businesses is to outsource all operational activities to third party administrators in order to reduce the significant expense inefficiencies that would arise with fixed and semi-fixed costs on a diminishing policy base. There are, however, risks associated with the use of outsourcing. In particular, there will be a need in future to renegotiate the terms of the outsourcing arrangements as the existing agreements expire. There is also a risk that, at some point in the future, third party administrators could default on their obligations. The UK businesses monitor the financial soundness of third party administrators and have retained step-in rights on the more significant of these agreements. There are also contractual arrangements in place which provide for financial penalties in the event of default by the administration service provider.

Mortgage endowment misselling complaints

The UK businesses have experienced a significant level of complaints from mortgage endowment policyholders since their first regulatory mailing programme in 2000. In response to this, the UK businesses hold mortgage endowment complaints redress provisions. The UK businesses continue to monitor closely, among other factors, the volume of complaints and the value of compensation paid to policyholders in order to assess the continuing adequacy of the provisions.

There remains however a residual risk that at some point in future the levels of complaints received may prove to be higher than those anticipated within the provision.

Persistency risk

Persistency risk is the risk that the investor cancels the contract or discontinues paying new premiums into the contract, thereby exposing the UK businesses to a loss resulting from an adverse movement in the actual experience compared to that expected in the product pricing. Although changes in the levels of persistency would not adversely affect the result in the short-term they would reduce future profits available from the contract.

Assumptions and sensitivities

The assumptions and sensitivities relating to insurance contract provisions for the UK businesses are set out in Note 32 Insurance Contract Provisions.

Swedish business

The terms and conditions of insurance contracts which have a material effect on the amount, timing and uncertainty of future cash flows arising from insurance contracts are set out in the product analyses below, which give an assessment of the main products of Movestic and of the ways in which the associated risks are managed. The breakdown of the insurance products of Movestic, by gross and net premiums written and by claims outstanding, which reflects the scale of business written, is as follows:

Premiums Year ended 31 December	Before reinsurance		After reinsurance	
	2012	2011	2012	2011
	£000	£000	£000	£000
Group				
Sweden	20,369	17,947	7,704	6,845
Norway	2,378	2,252	282	251
Individual				
Death	3,127	3,463	1,512	1,363
Waiver of premium	3,096	3,166	906	902
Income protection	10,266	11,557	6,009	7,645
	39,236	38,385	16,413	17,006

Claims outstanding As at 31 December	Before reinsurance		After reinsurance	
	2012	2011	2012	2011
	£000	£000	£000	£000
Group				
Sweden	24,214	21,360	5,445	5,194
Norway	4,474	4,760	679	743
Individual				
Death	1,604	1,350	678	820
Waiver of premium	6,007	4,965	1,739	1,304
Income protection	32,282	31,347	13,869	12,656
	68,581	63,782	22,410	20,717

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

Terms and conditions

Product features – Group Contracts

Group Contracts insure policyholders in respect of death with the option to include additional accident and disability benefits. Policyholders may also include their spouse and children (up to the age of 25) on the policy.

Policies are sold in both Sweden and Norway and all sales are intermediated. Group Contracts sold in Sweden allow the policyholder to choose the sum assured level. Contracts sold in Norway have sum assured levels that are normally determined by the policyholders' employer and apply to all members of that company scheme.

The Swedish product provides a maximum coverage of insured benefits up to 40 times a base amount (as at 31 December 2012 SEK 44,000 being approximately £4,181) although most policies are between 6 to 15 times the base amount.

The Norwegian product provides a maximum coverage of insured benefits up to 80 times a base amount (as at 31 December 2012 NOK 82,122, being approximately £9,102) although most policies are between 5 to 10 times the base amount.

All contracts are for an annual period and premium payments are made usually on either an annual or quarterly basis.

Product features – Individual Contracts

In relation to Individual Contracts, Movestic writes contracts, which include death and morbidity benefits on term assurance with disability, waiver of premium and income protection options. Policies are sold in Sweden and all sales are intermediated.

In relation to the income protection and the waiver of premium benefits within the Individual Contracts, the monthly benefits upon a claim may be payable to the policyholders over a long period up to their retirement.

The contracts have been unbundled as between insurance and investment contracts. Risk in respect of investment contracts is described in Note 6. All insurance contracts are for an annual period and payments are made on a monthly basis.

Management of risk

The main risk associated with the Group and Individual Contracts is the frequency of claims (for either death or accident or sickness). Claims experience can be variable, with the main factors being the age, sex and occupation of the policyholder.

In addition, for the Group Contracts, Movestic is exposed to a single loss event that covers a number of employees of an organisation.

The key risks are managed through appropriate product design and pricing of the policies to ensure that the potential cost to Movestic of these events (and associated expenses of underwriting and administration) are reflected in the price charged to the policyholder. Key controls implemented include a defined pricing structure based on the characteristics of the policyholder and the regular review of management information on the type and frequency of accidents.

Group Contracts are issued on an annual basis which means that Movestic's exposure runs for a period of 12 months, after which Movestic has the option to decline to renew or can increase the price on renewal.

Individual Contracts are long-term contracts but Movestic has the option to review the premiums on an annual basis.

For both the Group and Individual Contracts, between 30% to 90% of the premiums and claims relating to this product are ceded to a reinsurer which reduces the overall insurance risk exposure to Movestic. The policies and products from the Aspis acquisition are reinsured for approximately 80% of the claims amount.

In addition, for the majority of the Group Contracts, the loss arising from a single event to multiple employees is reinsured. The reinsurance provides indemnity for a single loss between SEK 5m (approximately £0.5m) and SEK 140m (approximately £13.3m).

Concentration of insurance risk

Concentration of insurance risk is determined by reference to benefits assured for Individual Contracts and by estimated maximum loss for Group Contracts.

Regarding benefits assured for individual contracts, the combined effect of reinsurance and the fact that the vast majority of the total benefit assured relates to numerous small value contracts, limit the level of concentration risk.

Through the use of reinsurance exposures to material insurance risks on individual cases are avoided, with 99.8% of the business having retained sums assured of less than £250,000.

In respect of Group Contracts, the business is exposed to multiple employees of the same organisation being involved in a single loss event. Movestic estimates that its largest such exposures arise in Norway, where the Group Contracts sold tend to cover all employees within that organisation (whereas in Sweden employees may opt in to the Group Contract). Movestic forecasts that its maximum loss would be approximately SEK 44m (approximately £4.2m) gross of reinsurance and SEK 5m (approximately £0.5m) after reinsurance.

Assumptions and sensitivities for Group Contract and Individual Contract insurance contract provisions

Information relating to insurance contract provisions assumptions and sensitivities for the Swedish business is set out in Note 32 Insurance Contract Provisions.

6 Management of financial risk

The Group is exposed to a range of financial risks, principally through its insurance contracts, financial assets, including assets representing shareholder assets, financial liabilities, including investment contracts and borrowings, and its reinsurance assets. In particular, the key financial risk is that, in the long-term, proceeds from financial assets are not sufficient to fund the obligations arising from its insurance and investment contracts and borrowings. The most important components of this financial risk are market risk (interest rate risk, equity and property price risk, foreign currency exchange risk and liquidity risk), and credit risk, including the risk of reinsurer default. Further, the Group has significant foreign currency exchange rate risk in relation to movements between the Swedish Krona and Sterling arising from its ownership of Movestic.

The terms and conditions of insurance contracts that have a material effect on the amount, timing and uncertainty of future cash flows arising from insurance contracts are set out in Note 5. The terms and conditions of investment contracts that have a material effect on the amount, timing and uncertainty of future cash flows arising from investment contracts are as follows:

The Group provides three types of investment contract: unit-linked savings, unit-linked pensions predominantly written in the UK and Sweden and guaranteed income and growth bonds predominantly written in the UK.

- (i) Unit-linked savings are single or regular premium contracts, with the premiums invested in a pooled investment fund, where the policyholder's investment is represented by units or trust accounts where the policyholder decides where to invest. On certain contracts there is a small additional benefit payable on death which is deemed not to transfer significant insurance risk to the business for these contracts. The benefits payable at maturity or surrender of the contracts are the underlying value of the investment in the unit-linked funds or trust accounts, less surrender penalties where applicable.
- (ii) Unit-linked pensions are single or regular premium contracts with features similar to unit-linked savings contracts. Benefits are payable on transfer, retirement or death.
- (iii) Guaranteed income bonds are mainly single premium contracts for a fixed term offering fixed-income payments plus a return of capital at maturity. A guaranteed growth bond offers no income, but a higher guaranteed payment at maturity date.

Market risk management

(i) General

The Group businesses manage their market risks within asset liability matching (ALM) frameworks that have been developed to achieve long-term investment returns at least equal to their obligations under insurance and investment contracts, with minimal risk. Within the ALM frameworks the businesses periodically produce reports at legal entity and asset and liability class level, which are circulated to the businesses' key management. The principal technique of the ALM frameworks is to match assets to the liabilities arising from insurance and investment contracts by reference to the type of benefits payable to policyholders, with separate portfolios of assets being maintained for each distinct class of liability.

For unit-linked contracts the Group's objective is to match the liabilities, both insurance and investment contract liabilities, with units in the assets of the funds to which the value of the liabilities is linked, such that the policyholder bears the market risk. This minimises the impact of market risks on these contracts, such that the remaining primary exposure to market risk is the risk of volatility in asset-related fees due to the impact of interest rate, equity price and foreign currency movements on the fair value of the unit-linked assets, on which asset-related fees are based.

For non unit-linked business, the Group's objective is to match the timing of cash flows from insurance and investment contract liabilities with the timing of cash flows from assets subject to identical or similar risks. By matching the cash flows of liabilities with those of suitable assets, market risk is managed effectively, whilst liquidity risk is minimised. These processes to manage the risks, which the Group has not changed from previous periods, ensure that the Group is able to meet its obligations under its contractual liabilities as they fall due.

With respect to S&P there is significant additional risk insofar as investment returns on policyholder with-profits assets supporting the with-profits business may result in insufficient policyholder assets to meet contractual obligations to with-profits policyholders, because of the impact of contract guarantees, as explained further below.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

The notes below explain how market risks are managed using the categories utilised in the businesses' ALM (Asset Liability Matching) frameworks. In particular, the ALM frameworks require the management of interest risk, equity price risk, and liquidity risk at the portfolio level, so that the appropriate risks for each portfolio may be managed in an effective way. The following tables reconcile the classes and portfolios used in the businesses' ALM frameworks to relevant items in the consolidated balance sheet and are followed by a portfolio-by-portfolio description of the nature of the related market risk and how that risk is managed.

31 December 2012						
	Unit-linked contracts £000	Insurance* contracts with DPF £000	Annuities in payment £000	Guaranteed bonds £000	Other non-linked contracts and other shareholder funds £000	Total £000
Assets						
Investment in associates	–	–	–	–	2,902	2,902
Property and equipment	–	–	–	–	369	369
Reinsurers' share of insurance contract provisions	131,266	102,237	–	–	45,189	278,692
Amounts deposited with reinsurers	30,245	–	–	–	–	30,245
Investment properties	77,338	22,349	–	–	480	100,167
Deferred tax asset	2,186	–	–	–	109	2,295
Financial assets						
Equity securities at fair value through income	427,294	2	–	–	7	427,303
Holdings in collective investment schemes at fair value through income	2,619,000	313,497	–	–	77,302	3,009,799
Debt securities at fair value through income	151,201	61,652	112,943	1,512	36,069	363,377
Insurance and other receivables	12,758	855	–	89	10,611	24,313
Prepayments	137	–	–	–	3,023	3,160
Derivative financial instruments	310	206	–	–	2,579	3,095
Total financial assets	3,210,700	376,212	112,943	1,601	129,591	3,831,047
Reinsurers' share of accrued policyholder claims	3,806	–	–	–	683	4,489
Income taxes	–	–	–	–	4,299	4,299
Cash and cash equivalents	99,253	4,039	164	337	124,883	228,676
Total assets	3,554,794	504,837	113,107	1,938	308,505	4,483,181
Liabilities						
Insurance contract provisions	1,506,770	453,421	113,107	–	133,780	2,207,078
Financial liabilities						
Investment contracts	2,012,983	–	–	1,790	7,541	2,022,314
Borrowings	–	–	–	–	48,324	48,324
Derivative financial instruments	278	8	–	–	–	286
Total financial liabilities	2,013,261	8	–	1,790	55,865	2,070,924
Provisions	4	–	–	–	5,157	5,161
Deferred tax liabilities	–	–	–	–	5,894	5,894
Reinsurance payables	1,422	–	–	–	15,188	16,610
Payables related to direct insurance and investment contracts	23,405	4,204	–	148	11,137	38,894
Other payables	3,874	565	–	–	12,618	17,057
Bank overdraft	10	–	–	–	592	602
Total liabilities	3,548,746	458,198	113,107	1,938	240,231	4,362,220

*Insurance contract with DPF include shareholder funds within the S&P with-profits funds.

31 December 2011

	Unit-linked contracts £000	Insurance* contracts with DPF £000	Annuities in payment £000	Guaranteed bonds £000	Other non-linked contracts and other shareholder funds £000	Total £000
Assets						
Investment in associates	–	–	–	–	1,613	1,613
Property and equipment	–	–	–	–	385	385
Reinsurers' share of insurance contract provisions	123,750	92,780	–	–	47,262	263,792
Amounts deposited with reinsurers	28,031	–	–	–	–	28,031
Investment properties	102,459	29,219	–	–	450	132,128
Financial assets						
Equity securities at fair value through income	404,423	2	–	–	6	404,431
Holdings in collective investment schemes at fair value through income	2,522,243	292,802	–	–	102,890	2,917,935
Debt securities at fair value through income	113,243	70,481	105,516	2,758	38,612	330,610
Insurance and other receivables	9,092	1,318	–	141	20,248	30,799
Prepayments	39	–	–	–	3,195	3,234
Derivative financial instruments	6,845	47	–	–	3,416	10,308
Total financial assets	3,055,885	364,650	105,516	2,899	168,367	3,697,317
Reinsurers' share of accrued policyholder claims	–	–	–	–	4,667	4,667
Income taxes	–	–	–	–	6,956	6,956
Cash and cash equivalents	73,498	1,235	587	664	119,936	195,920
Total assets	3,383,623	487,884	106,103	3,563	349,636	4,330,809
Liabilities						
Insurance contract provisions	1,510,734	444,146	106,103	–	129,956	2,190,939
Financial liabilities						
Investment contracts	1,865,860	–	–	3,020	7,583	1,876,463
Borrowings	–	–	–	–	54,753	54,753
Derivative financial instruments	92	52	–	–	–	144
Total financial liabilities	1,865,952	52	–	3,020	62,336	1,931,360
Provisions	–	–	–	–	2,811	2,811
Deferred tax liabilities	(686)	(1,358)	–	(1)	14,729	15,390
Reinsurance payables	–	–	–	–	16,336	16,336
Payables related to direct insurance and investment contracts	4,394	290	–	554	35,413	40,651
Income taxes	–	–	–	–	947	947
Other payables	3,114	1,048	–	–	20,255	24,417
Bank overdraft	115	–	–	–	719	834
Total liabilities	3,383,623	446,894	106,103	3,563	283,502	4,223,685

*Insurance contract with DPF include shareholder funds within the S&P with-profits funds.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

Unit-linked contracts

For unit-linked contracts, which may be insurance or investment contracts, the Group matches the financial liabilities, with units in the financial assets of the funds to which the value of the liabilities is linked, such that the policyholders bear the principal market risk (being interest rate, equity price and foreign currency risks) and credit risk. Accordingly, this approach results in the Group having no significant direct market or credit risk on these contracts. Its primary exposure to market risk is the risk of volatility in asset-related fees due to the impact of interest rate, equity price and foreign exchange rate movements on the fair value of the assets held in the linked funds, on which asset-related fees are based.

There is residual exposure to market risk on certain unit-linked contracts where the Group provides to policyholders guarantees as to fund performance or additional benefits which are not dependent on fund performance. This exposure is mitigated to the extent that the Group matches the obligations with suitable financial assets external to the unit-linked funds, such that the residual exposure is not considered to be material.

Insurance contracts with discretionary participation features

Insurance contracts with discretionary participation features subsist entirely within the UK businesses in the form of with-profits policies.

For the CA business, where the policyholder benefits comprise a discretionary annual bonus and a discretionary terminal bonus, the with-profits business is wholly reinsured to Guardian and hence there is no market risk for this class of business. Policyholders have the option, for a small element of the with-profits business, to invest a portion of their investment in unit-linked funds as an alternative to the with-profits fund. In this case, a portion of the business is retained, with the management of financial risks of this portion being the same as described under 'Unit-linked Contracts' above.

For the S&P business the primary investment objective of the with-profits policyholder funds is that the guaranteed minimum benefits of the with-profits policyholders should be met entirely from the policyholder funds. The secondary investment objective is, where possible, to provide a surplus in excess of the guaranteed minimum benefits. The entire surplus in the policyholder fund accrues to the with-profits policyholders. Any deficit in the policyholder fund is ultimately borne by shareholders. Therefore the Group has a significant exposure to market risk in relation to with-profits business should the with-profits policyholder assets be unable to fully meet the cost of guarantees. To achieve the investment objectives, the funds may invest in a range of asset classes including property, equities, fixed interest securities, convertibles, cash and derivatives, both in UK and overseas investments. Such exposure may be achieved by investment in collective investment schemes (including such schemes with total or absolute return objectives or which include investments in commodities). Investment guidelines restrict the level of exposure for certain asset categories. In respect of derivatives, these may only be used for the purposes of reduction of investment risks and efficient portfolio management.

Annuities in payment

These are contracts which pay guaranteed financial benefits, generally monthly, for the lifetime of the policyholder, and in some cases of their spouse. The financial component of these contracts is a guaranteed fixed interest rate: accordingly the Group's primary financial risk on these contracts is the risk that interest income and capital redemptions from the fixed interest debt securities backing the liabilities are insufficient to fund the benefits payable. The Group manages the interest rate risk by matching closely new contracts written with fixed interest debt securities of a suitable duration and quality. Regular monitoring of the interest rate risk is carried out by analysis of expected cash flows from the financial assets held with those for the liabilities, which are determined by means of projecting expected cash flows from the contracts using prudent estimates of mortality.

Guaranteed bonds

These contracts are for a fixed term with financial benefits that are fixed and guaranteed at the inception of the contract. The Group manages its market risk on these products, by closely matching contracts written with fixed interest debt securities of a suitable duration and quality. Accordingly, the Group's primary financial risk is the risk that interest income and capital redemptions from the financial assets backing the liabilities are insufficient to fund the guaranteed benefits payable. Regular monitoring of the interest rate risk is carried out by analysis of expected cash flows from the financial assets held with those for the liabilities, which are determined assuming all contracts continue until their expected maturity date. This analysis also enables the Group to control its liquidity risk for this portfolio.

Other non-linked contracts and shareholder funds

These categories, in which market risk is borne by shareholders, consist of non-linked insurance contracts without DPF and of net shareholder assets representing shareholders' equity. The Group manages market risks by setting investment guidelines which restrict market exposures.

Non-linked contracts without DPF include contracts which pay guaranteed benefits on death or other insured events, the terms being fixed at the inception of the contract. Exposure to market price risk is minimised by generally investing in fixed-interest debt securities, while interest rate risk is generally managed by closely matching contracts written with financial assets of suitable yield and duration. To the extent that the Group is unable to fully match its interest rate risk, it makes provision in respect of assumed shortfalls on guaranteed returns to policyholders.

Shareholder funds at both Group parent company and operating subsidiary level, in accordance with corporate objectives and, in some instances, in accordance with local statutory solvency requirements, are invested in order to protect capital and to minimise market and credit risk. Accordingly they are generally invested in assets of a shorter-term liquid nature, which gives rise to the risk of lower returns on these investments due to changes in short-term interest rates.

(ii) Liquidity risk

Liquidity risk is the risk that adequate liquid funds are not available to settle liabilities as they fall due and is managed by forecasting cash requirements and by adjusting investment management strategies to meet those requirements. Liquidity risk is generally mitigated by holding sufficient investments which are readily marketable in sufficiently short timeframes to allow the settlement of liabilities as they fall due. Where liabilities are backed by less marketable assets, for example investment properties, there are provisions in contractual terms which allow deferral of redemptions in times of adverse market conditions. The Group's substantial holdings of money market assets also serves to reduce liquidity risk.

The tables below present a maturity analysis of the Group's liabilities, showing balance sheet carrying value and distinguishing between investment contracts and insurance contracts and other liabilities.

31 December 2012							
Carrying values and cash flows arising from:	Carrying value £000	Contractual cash flows (undiscounted)					Total £000
		0-5 years £000	5-10 years £000	10-15 years £000	15-20 years £000	>20 years £000	
Insurance contract liabilities							
Unit-linked	1,506,770	1,506,770	–	–	–	–	1,506,770
CA	106,715	106,715	–	–	–	–	106,715
S&P	346,706	104,576	75,335	88,223	71,820	40,650	380,604
Annuities in payment	113,107	26,883	24,031	20,837	17,353	28,818	117,922
Other non-linked	133,780	57,916	9,182	4,988	3,187	1,873	77,146
Investment contract liabilities							
Unit-linked	2,012,983	2,012,983	–	–	–	–	2,012,983
Guaranteed bonds	1,790	1,790	–	–	–	–	1,790
Other	7,541	7,541	–	–	–	–	7,541
Other liabilities	132,828	132,828	–	–	–	–	132,828
	4,362,220	3,958,002	108,548	114,048	92,360	71,341	4,344,299

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

31 December 2011							
Carrying values and cash flows arising from:	Carrying value £000	0-5 years £000	Contractual cash flows (undiscounted)				Total £000
			5-10 years £000	10-15 years £000	15-20 years £000	>20 years £000	
Insurance contract liabilities							
Unit-linked	1,510,734	1,510,734	–	–	–	–	1,510,734
With DPF							
CA	96,977	96,977	–	–	–	–	96,977
S&P	347,169	114,762	75,125	84,821	76,667	47,291	398,666
Annuities in payment	106,103	27,394	25,082	22,375	19,316	55,371	149,538
Other non-linked	129,956	48,683	41,309	6,842	6,232	13,899	116,965
Investment contract liabilities							
Unit-linked	1,865,860	1,865,860	–	–	–	–	1,865,860
Guaranteed bonds	3,020	3,020	–	–	–	–	3,020
Other	7,583	7,583	–	–	–	–	7,583
Other liabilities	156,283	152,875	3,409	–	–	–	156,284
	4,223,685	3,827,888	144,925	114,038	102,215	116,561	4,305,627

The maturity analysis for unit-linked insurance and investment contracts presents all the liabilities as due in the earliest period in the table because they are repayable or transferable on demand.

Insurance contracts with DPF (with-profits business) can be surrendered before maturity for a cash amount specified in contractual terms and conditions. Accordingly, a maturity analysis based on the earliest contractual repayment date would present all the liabilities as due in the earliest period of the table because this option can be exercised immediately by all policyholders. As stated above, CA insurance contracts with DPF are wholly reinsured to Guardian and hence, in practice, there is no liquidity risk, the only risk retained for this business being the risk of default by the reinsurer, which is detailed under 'Credit Risk Management' below. The maturity analysis in respect of the S&P segment of the business, however, is presented on an estimated basis, in accordance with the anticipated maturity profile and on estimates of mortality.

(iii) Currency risk

Currency risk is the risk that the fair value or future cash flows of an asset or liability will change as a result of movements in foreign exchange rates. The Group's exposure to currency risk is minimised to the extent that the risk on investments denominated in foreign currencies which back unit-linked investment and insurance contracts is borne by policyholders. It is, however, exposed to currency risk through:

- (i) its investment in Movestic, the assets and liabilities of which are principally denominated in Swedish Krona;
- (ii) the trading operations of Movestic, which include the underwriting of insurance contracts in Norway giving rise to some exposure to the Norwegian Krone: as the Swedish business reinsures 90 per cent of the risk and has some assets denominated in the same currencies as the foreign insurance liabilities, most of the foreign currency exchange rate risk on these operations is eliminated; and
- (iii) Movestic's part ownership of Modernac SA, an associated company, the assets and liabilities of which are denominated in Euros.

The Group's currency risk through its ownership of Movestic is reflected in:

- (i) foreign exchange translation differences arising on the translation into sterling and consolidation of Movestic's financial statements; and
- (ii) the impact of adverse exchange rate movements on cash flows between Chesnara plc and Movestic: in the short-term these relate to capital contributions made to Movestic to support its regulatory solvency capital resource requirements as it develops, while, in the medium-term there is the prospect of cash flows from Movestic to Chesnara by way of dividend payments. The risk on cash flows is managed by closely monitoring exchange rate movements and buying forward foreign exchange contracts, where deemed appropriate.

The following tables set out the Group's exposure to assets and liabilities denominated in foreign currencies, expressed in sterling, at the respective balance sheet date:

31 December		2012	2011
		£000	£000
Swedish Krona			
Assets		1,515,969	1,376,552
Liabilities		1,475,561	1,337,831
Net assets		40,408	38,721
Norwegian Krone			
Assets		4,164	4,690
Liabilities		4,526	4,762
Net liabilities		(362)	(72)
Euro			
Assets		1,275	896
Liabilities		33	–
Net assets		1,242	896

(iv) **Sensitivities**

The table below shows the impact of movements in market risk variables identified above on profit before tax for the year under review and on shareholder equity as at the balance sheet date.

The variables are:

- (i) a 10% increase and decrease in the value of assets backing unit-linked insurance and investment contract liabilities
- (ii) a 10% increase and decrease in equity and property values
- (iii) a 100 basis point increase and decrease in per annum market rates of interest
- (iv) a 10% favourable and adverse movement in foreign currency exchange rates

As explained above, market risks relating to assets backing unit-linked insurance and investment contract liabilities are borne by policyholders, while there is shareholder exposure to volatility in asset-related fees due to the impact of interest rate, equity price and foreign exchange rate movements on the fair value of the assets held in the linked funds, on which asset-related fees are based. Accordingly, the sensitivities to these risks are presented as generic sensitivities to unit-linked asset movements.

Variation in/ arising from	2012		2011	
	Profit before tax	Shareholders' equity	Profit before tax	Shareholders' equity
	£m	£m	£m	£m
100 bp increase in market rates of interest	18.6	14.1	4.4	3.8
100 bp decrease in market rates of interest	(23.7)	(18.0)	(7.8)	(6.2)
10% increase in equity and property prices	10.6	8.1	15.9	12.1
10% decrease in equity and property prices	(10.6)	(8.1)	(15.9)	(12.1)
10% favourable movement in SEK: sterling exchange rate	0.2	4.5	–*	4.3
10% adverse movement in SEK: sterling exchange rate	(0.1)	(3.7)	–*	(3.5)

*Not material

As explained in Note 32(c) on page 130 the method of estimating the cost of guarantees to policyholders in respect of the S&P with-profits funds has been changed. An effect of this change has been to make the results and financial position of the Group more sensitive to variations in market rates of interest.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

Credit risk management

The Group has exposure to credit risk, which is the risk that a counterparty will be unable to pay amounts in full when due. Key areas where the Group is exposed to credit risk are:

- Counterparty risk with respect to debt securities and cash deposits;
- Reinsurers' share of insurance liabilities;
- Amounts deposited with reinsurers in relation to investment contracts;
- Amounts due from reinsurers in respect of claims already paid; and
- Insurance and other receivables.

In addition there will be some exposures to individual policyholders, on amounts due on insurance contracts. These are tightly controlled, with contracts being terminated or benefits amended if amounts owed are outstanding for more than a specified period of time, so that there is no significant risk to the results of the businesses.

The Group businesses structure the levels of credit risk they accept by placing limits on their exposure to a single counterparty, or group of counterparties. Such risks are subject to at least an annual review, while watch lists are maintained for exposures requiring additional review.

Although the businesses hold a significant proportion of their financial assets in debt securities and cash deposits the risk of default on these is mitigated to the extent that any losses arising in respect of unit-linked assets backing the insurance and investment contracts which the businesses issue, would effectively be passed on to policyholders and investors through the unit-linked funds backing the insurance and investment contracts.

Reinsurance is used to manage insurance risk in the businesses. This does not, however, discharge the businesses' liability as primary insurers. If a reinsurer fails to pay a claim for any reason, the businesses remain liable for the payment to the policyholder. In respect of Movestic, the current guidelines state that re-insurance should only be effected with counterparties with a credit rating from Standard & Poor's of A or higher, except for the reinsurer which is an associate of Movestic: this credit risk is managed by Movestic being represented on the Board of the reinsurer and, therefore, being able to influence its strategy and operational decisions.

The creditworthiness of major reinsurers is considered on an annual basis by reviewing their financial strength.

The following table presents the assets of the Group which are subject to credit risk and a reconciliation to the balance sheet carrying value of each item:

31 December	2012			2011		
	Amount not subject to credit risk £000	Amount subject to credit risk £000	Balance sheet carrying value £000	Amount not subject to credit risk £000	Amount subject to credit risk £000	Balance sheet carrying value £000
Holdings in collective investment schemes	3,008,808	991	3,009,799	2,792,748	125,187	2,917,935
Debt securities	139,513	223,864	363,377	110,342	220,268	330,610
Cash and cash equivalents	86,446	142,230	228,676	83,572	112,348	195,920
Derivative financial instruments	2,889	206	3,095	10,261	47	10,308
Reinsurers' share of insurance contract liabilities	–	278,692	278,692	–	263,792	263,792
Amounts deposited with reinsurers	–	30,245	30,245	–	28,031	28,031
Insurance and other receivables	20,620	3,693	24,313	15,121	15,678	30,799
Reinsurers' share of accrued policyholder claims	–	4,489	4,489	–	4,667	4,667
Income taxes	–	4,299	4,299	–	6,956	6,956
Total	3,258,276	688,709	3,946,985	3,012,044	776,974	3,789,018

Holdings in collective investment schemes are, in principle, not subject to credit risk, as, given the nature of the financial instruments, they do not directly expose the Group to credit risk. However, classified within holdings in collective investment schemes is an amount of £990,000 (31 December 2011: £97,738,000), as presented above, invested under an investment contract arrangement with JPMorgan Life Limited (JPML). This counterparty exposure to JPML is off-set by a counterparty exposure that JPML has to S&P of £3m (31 December 2011: £13m) under an investment contract arrangement held by JPML with S&P. The exposure has reduced materially following agreement with JPML to substantially recapture the business, so as to reduce credit risk.

Under these investment contract arrangements the respective amounts are onward invested in the collective investment schemes maintained by the respective counterparty.

The remaining amounts presented above as not being subject to credit risk represent unit-linked assets where the risk is borne by the holders of unit-linked insurance and investment contracts, except for (i) reinsurers' share of insurers' contract provisions and (ii) amounts deposited with reinsurers in respect of investment contracts, where the risk of default is borne by shareholders.

Assets held to cover Insurance contracts with DPF, held within a segregated with-profits fund, are included as being subject to credit risk, as such risk will be borne by shareholders where default would result in there being insufficient with-profits policyholder assets to fund minimum guaranteed obligations. However, in normal circumstances (where the asset share is in excess of the minimum guaranteed amount) substantially all the credit risk remains with policyholders.

The Group's exposure to credit risk is summarised as:

Credit rating	AAA	AA	A	Below A	Unrated	Total
As at 31 December 2012	£000	£000	£000	£000	£000	£000
Reinsurers share of insurance contract liabilities	–	38,084	(3,496)	–	244,104	278,692
Holdings in collective investment schemes	–	–	991	–	–	991
Amounts deposited with reinsurers	–	–	–	–	30,245	30,245
Debt securities at fair value through income	218,002	2,006	2,611	–	1,245	223,864
Insurance and other receivables	1,536	–	–	–	2,157	3,693
Reinsurers share of accrued policyholder claims	–	632	203	–	3,654	4,489
Derivative financial instruments	–	–	206	–	–	206
Income taxes	–	–	–	–	4,299	4,299
Cash and cash equivalents	21,024	47,362	73,838	–	6	142,230
Total	240,562	88,084	74,353	–	285,710	688,709
As at 31 December 2011						
Reinsurers share of insurance contract liabilities	–	36,213	(3,762)	–	231,341	263,792
Holdings in collective investment schemes	–	–	97,738	–	27,449	125,187
Amounts deposited with reinsurers	–	–	–	–	28,031	28,031
Debt securities at fair value through income	216,878	1,044	1,129	–	1,217	220,268
Insurance and other receivables	–	–	–	–	15,678	15,678
Reinsurers share of accrued policyholder claims	–	1,482	496	–	2,689	4,667
Derivative financial instruments	–	–	47	–	–	47
Income taxes	–	–	–	–	6,956	6,956
Cash and cash equivalents	–	33,071	73,117	5,618	542	112,348
Total	216,878	71,810	168,765	5,618	313,903	776,974

Included within unrated reinsurers' share of insurance contract provisions and unrated amounts deposited with reinsurers, in respect of investment contracts is a total significant exposure of £251.4m as at 31 December 2012 (31 December 2011: £237.4m) to Guardian, which does not have a published credit rating. Of this amount £207m (31 December 2011: £202.9m) is in respect of currently guaranteed benefits. This counterparty exposure was mitigated during 2006 when Guardian granted to CA a floating charge over related investment assets, which ranks that company equally with Guardian policyholders. In order to monitor the ongoing creditworthiness of Guardian, CA reviews the financial statements and regulatory returns submitted by Guardian to the FSA on an annual basis.

No credit limits were exceeded during the year ended 31 December 2012.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

Financial assets that are past due or impaired

In 2008, a cash deposit with Kaupthing Singer & Friedlander ('KSF') was written down by its full amount of £1,091,000 as a result of KSF entering administration. During 2012, further interim distributions totalling £141,331 (2011: £108,716) were made from the administrators in respect of the deposit.

There are no other Group financial assets that are impaired, would otherwise be past due, or impaired, whose terms have been negotiated or past due but not impaired.

The Group has no significant exposure to Euro-denominated sovereign debt as at 31 December 2012.

7 Exceptional item

Following the transfer, on 31 December 2011, of the whole of the business of the S&P operating segment to Countrywide Assured plc under the provisions of Part VII of the Financial Services and Markets Act 2000, S&P policyholder liabilities to taxation have, with effect from 1 January 2012, been re-classified within the Consolidated Balance Sheet from deferred tax liabilities to insurance contract provisions. The purpose of this is to align the classification with that adopted by the CA operating segment. As a consequence there is:

- (i) as at 1 January 2012 a reduction of £4.8m in deferred tax liabilities and an equal and opposite increase of £4.8m in insurance contract provisions; and
- (ii) in the Condensed Consolidated Statement of Comprehensive Income a pre-tax charge of £4.8m and a deferred tax release to income tax of £4.8m, both of these amounts being presented as exceptional items, by virtue of their size and incidence. The net-of-tax result in the Condensed Consolidated Statement of Comprehensive Income attributable to these exceptional items is, accordingly, £nil.

8 Operating segments

The Group considers that it has no product or distribution-based business segments. It reports segmental information on the same basis as reported internally to the Chief Operating Decision Maker, which is the Board of Directors of Chesnara plc.

The segments of the Group as at 31 December 2012 comprise:

CA

This segment is part of the Group's UK life insurance and pensions run-off portfolio and comprises the original business of Countrywide Assured plc, the Group's principal UK operating subsidiary, and of City of Westminster Assurance Company Limited which was acquired in 2005 and the long-term business of which was transferred to Countrywide Assured plc during 2006. It is responsible for conducting unit-linked and non-linked business.

S&P

This segment, which was acquired on 20 December 2010, is the balance of the Group's UK life insurance and pensions run-off portfolio and comprises the business of Save & Prosper Insurance Limited and its subsidiary Save & Prosper Pensions Limited. It is responsible for conducting both unit-linked and non-linked business, including a with-profits portfolio, which carries significant additional market risk, as described in Note 6 'Management of financial risk'. On 31 December 2011 the whole of the business of this segment was transferred to Countrywide Assured plc under the provisions of Part VII of the Financial Services and Markets Act 2000.

Movestic

This segment comprises the Group's Swedish life and pensions business, Movestic Livförsäkring AB ('Movestic') and its subsidiary and associated companies, which are open to new business and which are responsible for conducting both unit-linked and non-linked business.

Other Group Activities

The functions performed by the parent company, Chesnara plc, are defined under the operating segment analysis as Other Group Activities. Also included therein are consolidation and elimination adjustments.

There were no changes to the basis of segmentation during the year ended 31 December 2012.

The accounting policies of the segments are the same as those for the Group as a whole. Any transactions between the business segments are on normal commercial terms in normal market conditions. The Group evaluates performance of operating segments on the basis of the profit before tax attributable to shareholders and on the total assets and liabilities of the reporting segments and the Group. There were no changes to the measurement basis for segment profit during the year ended 31 December 2012.

(i) Segmental income statement for the year ended 31 December 2012

Year ended 31 December						
	CA £000	S&P £000	UK Total £000	Movestic £000	Other Group Activities £000	Total £000
Net Insurance premium revenue	54,785	8,987	63,772	16,412	–	80,184
Fee and commission income	35,191	2,776	37,967	28,691	–	66,658
Net investment return	128,009	105,936	233,945	97,846	262	332,053
Total revenue (net of reinsurance payable)	217,985	117,699	335,684	142,949	262	478,895
Other operating income	3,484	11,114	14,598	5,047	–	19,645
Segmental income	221,469	128,813	350,282	147,996	262	498,540
Net insurance contract claims and benefits incurred	(140,502)	(97,787)	(238,289)	(7,057)	–	(245,346)
Net change in investment contract liabilities	(52,679)	(4,134)	(56,813)	(97,040)	–	(153,853)
Fees, commission and other acquisition costs	(947)	(62)	(1,009)	(16,958)	–	(17,967)
Administrative expenses						
Amortisation charge on software assets	–	–	–	(2,188)	–	(2,188)
Depreciation charge on property and equipment	(22)	–	(22)	(187)	–	(209)
Other	(8,105)	(11,000)	(19,105)	(13,053)	(2,474)	(34,632)
Other operating expenses						
Charge for amortisation of acquired value of in-force business	(2,892)	(852)	(3,744)	(4,119)	–	(7,863)
Charge for amortisation of acquired value of customer relationships	–	–	–	(391)	–	(391)
Other	(625)	(1,212)	(1,837)	(5,046)	(2,322)	(9,205)
Segmental expenses	(205,772)	(115,047)	(320,819)	(146,039)	(4,796)	(471,654)
Segmental income less expenses	15,697	13,766	29,463	1,957	(4,534)	26,886
Share of profit of associate	–	–	–	1,244	–	1,244
Exceptional item	–	(4,778)	(4,778)	–	–	(4,778)
Segmental operating profit/(loss)	15,697	8,988	24,685	3,201	(4,534)	23,352
Financing costs	–	(1)	(1)	(2,451)	(1,218)	(3,670)
Profit/(loss) before income taxes	15,697	8,987	24,684	750	(5,752)	19,682
Income tax credit/(expense)						
Income tax credit/(expense) – before exceptional item			2,384	(323)	1,420	3,481
Exceptional item			4,778	–	–	4,778
After exceptional item			7,162	(323)	1,420	8,259
Profit/(loss) for the year attributable to the equity holders of the parent company			31,846	427	(4,332)	27,941

(ii) Segmental balance sheet as at 31 December 2012

31 December						
	CA £000	S&P £000	Movestic £000	Other Group Activities £000	Total £000	
Total assets	1,815,021	1,266,946	1,534,263	34,391	4,650,621	
Total liabilities	1,728,523	1,191,376	1,476,185	36,191	4,432,275	
Net assets/(liabilities)	86,498	75,570	58,078	(1,800)	218,346	
Investments in associates	–	–	2,902	–	2,902	
Additions to segment non-current assets	230	–	11,353	–	11,583	

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(iii) Segmental income statement for the year ended 31 December 2011

Year ended 31 December	CA £000	S&P £000	UK Total £000	Movestic £000	Other Group Activities £000	Total £000
Net insurance premium revenue	59,561	10,440	70,001	17,005	–	87,006
Fee and commission income	37,675	2,768	40,443	27,420	–	67,863
Net investment return	(19,009)	(21,685)	(40,694)	(151,938)	230	(192,402)
Total revenue (net of reinsurance payable)	78,227	(8,477)	69,750	(107,513)	230	(37,533)
Other operating income	3,584	11,702	15,286	6,446	50	21,782
Segmental income	81,811	3,225	85,036	(101,067)	280	(15,751)
Net insurance contract claims and benefits incurred	(56,981)	18,063	(38,918)	(6,508)	–	(45,426)
Net change in investment contract liabilities	11,731	(963)	10,768	151,898	–	162,666
Fees, commission and other acquisition costs	(1,293)	(63)	(1,356)	(15,920)	–	(17,276)
Administrative expenses						
Amortisation charge on software assets	–	–	–	(1,979)	–	(1,979)
Depreciation on property and equipment	(18)	–	(18)	(278)	–	(296)
Other	(8,716)	(11,687)	(20,403)	(13,085)	(3,035)	(36,523)
Other operating expenses						
Charge for amortisation of acquired value of in-force business	(3,640)	(964)	(4,604)	(4,428)	–	(9,032)
Charge for amortisation of acquired value of customer relationships	–	–	–	(758)	–	(758)
Other	(729)	(1,087)	(1,816)	(6,457)	(1,391)	(9,664)
Segmental expenses	(59,646)	3,299	(56,347)	102,485	(4,426)	41,712
Segmental income less expenses	22,165	6,524	28,689	1,418	(4,146)	25,961
Share of loss of associate	–	–	–	(152)	–	(152)
Segmental operating profit/(loss)	22,165	6,524	28,689	1,266	(4,146)	25,809
Financing costs	–	(12)	(12)	(1,957)	(1,419)	(3,388)
Profit/(loss) before income taxes	22,165	6,512	28,677	(691)	(5,565)	22,421
Income tax credit	–	–	1,772	275	1,197	3,244
Profit/(loss) for the year attributable to the equity holders of the parent company			30,449	(416)	(4,368)	25,665

(iv) Segmental balance sheet as at 31 December 2011

31 December	CA £000	S&P £000	Movestic £000	Other Group Activities £000	Total £000
Total assets	1,774,864	1,304,209	1,395,751	17,130	4,491,954
Total liabilities	1,689,378	1,215,473	1,338,841	39,073	4,282,765
Net assets/(liabilities)	85,486	88,736	56,910	(21,943)	209,189
Investments in associates	–	–	1,613	–	1,613
Additions to segment non-current assets	6	–	14,653	–	14,659

9 Fees and commission income

Year ended 31 December		
	2012	2011
Fee income	£000	£000
Policy-based fees	14,143	12,776
Fund management-based fees	25,324	26,258
Benefit-based fees	21,614	22,626
Change in deferred income – gross	1,116	1,647
Change in deferred income – reinsurer's share	(45)	(47)
Total fee income	62,152	63,260
Commission income	4,506	4,603
Total fee and commission income	66,658	67,863

10 Net investment return

Year ended 31 December		
	2012	2011
	£000	£000
Dividend income	46,774	40,261
Interest income	25,961	28,632
Rental income from investment properties	7,612	8,108
Net fair value gains and losses		
Equity securities designated as at fair value through income on initial recognition	224,848	(326,014)
Debt securities designated as at fair value through income on initial recognition	29,609	53,332
Derivative financial instruments	2,899	(954)
Investment properties	(5,650)	4,233
Net investment return	332,053	(192,402)

Net fair value gains and losses in respect of holdings in collective investment schemes are included in the line that is most appropriate taking into account the nature of the underlying investments.

No amounts included in net fair value gains and losses of financial instruments were estimated using a valuation technique (year ended 31 December 2011: £nil).

11 Other operating income

Year ended 31 December		
	2012	2011
	£000	£000
Release of unused provisions	629	390
Recharge of shared property services to tenants	–	457
Administration fees charged to reinsurers	95	103
Professional indemnity insurance recoveries	52	173
Investment management fee rebate	13,483	14,120
HMRC interest on tax refund	–	9
Charges to policyholder funds for yield tax	5,046	6,428
Other	340	102
Total other operating income	19,645	21,782

All of the income streams set out in Notes 9, 10 and 11 equate to revenue as defined by IAS 18.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

12 Insurance contract claims and benefits

Year ended 31 December	2012 £000	2011 £000
Claims and benefits paid to insurance contract holders	272,479	267,691
Net increase/(decrease) in insurance contract provisions	20,732	(204,864)
Total insurance contract claims and benefits	293,211	62,827
Recoveries from reinsurers	(47,865)	(17,401)
Net insurance contract claims and benefits incurred	245,346	45,426

13 Change in investment contract liabilities

Year ended 31 December	2012 £000	2011 £000
Net changes in the fair value of investment contracts designated on initial recognition as fair value through income	114,468	(169,281)
Net changes in the fair value of policyholders' funds held by the Group designated on initial recognition as fair value through income	42,195	5,115
Reinsurers' share	(2,810)	1,500
Net increase/(decrease) in investment contract liabilities	153,853	(162,666)

Investment contract benefits comprise benefits accruing to holders of investment contracts issued by the Group.

14 Fees, commission and other acquisition costs

Year ended 31 December	2012 £000	2011 £000
Directly expensed costs		
Insurance contracts		
Commission	5,806	6,037
New business and renewal costs	4,357	2,654
Investment contracts		
Commission	7,579	10,457
New business and renewal costs	2,851	3,444
Additions to deferred acquisition costs		
Insurance contracts	(5,654)	(5,881)
Investment contracts – gross	(4,604)	(6,747)
Amortisation of deferred acquisition costs		
Insurance contracts	5,991	5,665
Investment contracts-gross	1,667	1,674
Investment contracts-reinsurance	(26)	(27)
Total	17,967	17,276

15 Administrative expenses

Year ended 31 December	2012 £000	2011 £000
Personnel-related costs (Note 47)	12,910	12,772
Investment management fees	9,848	11,859
Amortisation charge on software assets	2,188	1,979
Depreciation charge on property and equipment	209	296
Costs paid to third-party administrators	8,201	8,436
Other goods and services	3,673	3,456
Total	37,029	38,798

Included in Other Goods and Services above are the following amounts payable to the Auditor and its associates, exclusive of VAT.

Year ended 31 December	2012 £000	2011 £000
Fees payable to the Company's Auditor for the audit of the company's annual accounts	94	78
Fees payable to the Company's Auditor and its associates for other services to the group:		
The audit of the Company's subsidiaries pursuant to legislation	386	360
Audit-related assurance services*	192	183
Taxation compliance services	27	44
All other services	18	16
Total	717	681

*Includes the audit regulatory returns submitted to the UK regulator.

16 Other operating expenses

Year ended 31 December	2012 £000	2011 £000
Charge for amortisation of acquired value of in-force business	7,863	9,032
Charge for amortisation of acquired value of customer relationships (AVCR)	391	758
Other		
Increase in other provisions	2,546	1,531
Direct operating expenses of investment properties		
Revenue-generating properties	1,212	1,162
Non revenue-generating properties	233	154
Recovery of cash deposit	(141)	(109)
Payment of yield tax relating to policyholder funds	5,046	6,428
Akademiker impairment charge	–	29
Other	309	469
Total	9,205	9,664

The recovery of cash deposit represents interim distributions received from the administrators of Kaupthing Singer & Friedlander relating to a cash deposit, previously written down and charged to operating expenses.

17 Financing costs

Year ended 31 December	2012 £000	2011 £000
Interest expense on bank borrowings	1,219	1,426
Interest expense on financial reinsurance	2,313	1,957
Other interest	138	5
Total financing costs	3,670	3,388

Interest expense on bank borrowings is calculated using the effective interest method and is the total interest expense for financial liabilities that are not designated at fair value through income.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

18 Income tax credit before exceptional item

Total income tax credit before exceptional item comprises:		
Year ended 31 December	2012	2011
	£000	£000
CA, S&P and Other Group Activities – net credit	3,804	2,969
Movestic – net (expense)/credit	(323)	275
Total net credit	3,481	3,244

CA, S&P and Other Group Activities		
Year ended 31 December	2012	2011
	£000	£000
Current tax expense		
Current year	(2,939)	(2,160)
Overseas tax	(582)	(587)
Adjustment to prior years	(29)	592
Net expense	(3,550)	(2,155)
Deferred tax credit		
Origination and reversal of temporary differences excluding exceptional item	7,354	5,124
Total income tax credit	3,804	2,969

Reconciliation of effective tax rate on profit before tax		
Year ended 31 December	2012	2011
	£000	£000
Profit before tax and exceptional item	23,710	23,112
Income tax using the domestic corporation tax rate of 24.5% (2011: 26.5%)	(5,809)	(6,125)
Permanent difference arising on Part VII Transfer	–	4,146
Other permanent differences	(70)	(270)
Effect of UK tax bases on insurance profits		
Offset of franked investment income	3,525	2,667
Variation in rate of tax on amortisation of acquired in-force value	389	619
Impact of new life tax regime	6,129	–
Other	(331)	1,340
(Over)/under provided in previous years	(29)	592
Total income tax credit	3,804	2,969

The permanent difference arising on the Part VII Transfer relates to a duty of fairness reserve allowed for tax purposes in the transferred S&P business, not now expected to reverse.

A new regime for the taxation of life assurance companies in the UK was introduced with effect from 1 January 2013. The new regime bases the taxable trading profit on IFRS profits rather than on FSA return surplus generated as under the previous rules and also treats pension business separately from life assurance business. Whilst this change does not impact the 2012 current tax charge, it has created a significant recovery in the deferred tax charge as the pension losses in the UK life company will be of value going forward whereas no value was ascribed to them under the previous regime. In addition, as part of the transition to the new regime, accumulated historical profits as at 31 December 2012 are compared between the two bases and any taxable difference is brought into charge over the next ten years. This transitional adjustment has created a deferred tax charge as at 31 December 2012, partially offsetting the pension related recovery noted here.

Movestic		
Year ended 31 December		
	2012	2011
	£000	£000
Current tax credit		
Current year expense	–	(15)
Adjustment to prior years	–	289
Net credits	–	274
Deferred tax (expense)/credit		
Origination and reversal of temporary differences	(323)	1
Total income tax (expense)/credit	(323)	275

Reconciliation of effective tax rate on profit before tax		
Year ended 31 December		
	2012	2011
	£000	£000
Profit/(loss) before tax	750	(691)
Income tax using the domestic corporation tax rate of 26.3%	(197)	182
Non-taxable income in relation to unit-linked business	655	195
Non-taxable fair value adjustment	(215)	(293)
Impact of different tax rate for subsidiaries	(41)	5
Permanent differences	(179)	(8)
Unrecognised tax recoverable	(309)	–
Non-deductible expenses	(37)	(95)
Overprovided in prior years	–	289
Total income tax (expense)/credit	(323)	275

19 Deferred acquisition costs

Year ended 31 December					
	CA	S&P	Movestic	2012	2011
	£000	£000	£000	Total	Total
				£000	£000
Balance at 1 January	5,725	–	13,995	19,720	14,659
Additions arising from new business	–	–	10,255	10,255	12,642
Amortisation charged to income	(667)	–	(6,991)	(7,658)	(7,339)
Foreign exchange translation difference	–	–	238	238	(242)
Balance at 31 December	5,058	–	17,497	22,555	19,720
Current	578	–	1,574	2,152	1,911
Non-current	4,480	–	15,923	20,403	17,809
Total	5,058	–	17,497	22,555	19,720

The amortisation charged to income is recognised in Fees, Commission and Other Acquisition Costs (see Note 14).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

20 Acquired value of in-force business (AVIF)

Cost 31 December	2012 £000	2011 £000
Balance at 1 January	127,907	128,777
Foreign exchange translation difference	872	(870)
Balance at 31 December	128,779	127,907
Amortisation and impairment losses		
Balance at 1 January	44,561	35,731
Amortisation for the year	7,863	9,032
Foreign exchange translation difference	237	(202)
Balance at 31 December	52,661	44,561
Carrying amounts		
At 1 January	83,346	93,046
At 31 December	76,118	83,346
Current	7,228	8,620
Non-current	68,890	74,726
Total	76,118	83,346

The amortisation is charged to income and is recognised in Other Operating Expenses (see Note 16).

21 Acquired value of customer relationships (AVCR)

Cost 31 December	2012 £000	2011 £000
Balance at 1 January	4,113	4,164
Foreign exchange translation difference	51	(51)
Balance at 31 December	4,164	4,113
Amortisation and impairment losses		
Balance at 1 January	1,858	1,132
Amortisation for the year	391	758
Foreign exchange translation difference	31	(32)
Balance at 31 December	2,280	1,858
Carrying amounts		
At 1 January	2,255	3,032
At 31 December	1,884	2,255
Current	291	139
Non-current	1,593	2,116
Total	1,884	2,255

The amortisation period of AVCR is based on the underlying returns on the policies expected to be written as a result of customer relationships.

The amortisation is charged to income and is recognised in Other Operating Expenses (see Note 16).

22 Software assets

Cost		
31 December	2012	2011
	£000	£000
Balance at 1 January	11,229	9,421
Additions	1,094	1,968
Disposals	–	(1)
Foreign exchange translation difference	160	(159)
Balance at 31 December	12,483	11,229
Amortisation and impairment losses		
Balance at 1 January	4,485	2,592
Amortisation charge for the year	2,188	1,979
Disposals	–	(11)
Foreign exchange translation difference	98	(75)
Balance at 31 December	6,771	4,485
Carrying amounts at 31 December	5,712	6,744
Current	2,349	1,922
Non-current	3,363	4,822
Total	5,712	6,744

23 Property and equipment

Cost		
31 December	2012	2011
	£000	£000
Balance at 1 January	1,249	1,327
Additions	235	49
Disposals	(123)	(113)
Foreign exchange translation difference	12	(14)
Balance at 31 December	1,373	1,249
Amortisation and impairment losses		
Balance at 1 January	864	656
Depreciation charge for the year	209	296
Disposals	(82)	(77)
Foreign exchange translation difference	13	(11)
Balance at 31 December	1,004	864
Carrying amounts at 31 December	369	385
Current	138	209
Non-current	231	176
Total	369	385

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

24 Investment in associate

Cost				
31 December			2012	2011
			£000	£000
Balance at 1 January			1,613	1,783
Share of profit/(loss)			1,244	(152)
Foreign exchange translation difference			45	(18)
Balance at 31 December			2,902	1,613
Associates at 100%	Assets	Liabilities	Revenues	Profit
	£000	£000	£000	£000
Modernac S.A.	26,313	20,391	10,002	2,539
Total 31 December 2012	26,313	20,391	10,002	2,539
Associates at 49%			Equity	Equity
			at 100%	at 49%
			£000	£000
Modernac S.A.		5,922	2,902	1,244
Total 31 December 2012		5,922	2,902	1,244

25 Investment properties

31 December		2012	2011
		£000	£000
Balance at 1 January		132,128	120,820
Additions			
Properties acquired		5,927	9,310
Disposals		(32,238)	(2,235)
Fair value adjustments		(5,650)	4,233
Balance at 31 December		100,167	132,128
Current		–	2,750
Non-current		100,167	129,378
Total		100,167	132,128

Investment properties were bought for investment purposes in line with the investment strategy of the Group. The properties are independently valued in accordance with International Valuation Standards on the basis of determining the open market value of the investment properties on an annual basis. The latest valuations were conducted as at 31 December 2012.

Income arises from investment properties in two streams:

- (i) Fair value gains arising as a result of market appreciation in the value of the properties; and
- (ii) Rental income arising from leases granted on the properties.

Both of these amounts are disclosed in Net Investment Return (see Note 10). Expenses incurred in the operation and maintenance of investment properties are disclosed in Other Operating Expenses (see Note 16).

26 Financial assets**Group****Financial assets by measurement category
31 December**

	2012 £000	2011 £000
Fair value through income		
Designated at fair-value through income on initial recognition	3,861,650	3,702,056
Derivative financial instruments	3,095	10,308
Insurance and other receivables	24,313	30,799
Prepayments	3,160	3,234
Total	3,892,218	3,746,397

Fair value is the amount for which an asset could be exchanged between willing parties in an arm's length transaction. The tables below show the determination of fair value according to a three-level valuation hierarchy. Fair values are generally determined at prices quoted in active markets (Level 1). However, where such information is not available, the Group applies valuation techniques to measure such instruments. These valuation techniques make use of market-observable data for all significant inputs where possible (Level 2), but, in some cases it may be necessary to estimate other than market-observable data within a valuation model for significant inputs (Level 3).

Financial assets at fair value through income**Fair value measurement at 31 December 2012 using**

	Level 1 £000	Level 2 £000	Level 3 £000	Total £000
Equities				
Listed	427,303	–	–	427,303
Debt securities – fixed rate				
Government Bonds	306,623	–	–	306,623
Listed	46,677	–	–	46,677
Debt securities – floating rate				
Listed	10,077	–	–	10,077
Total debt securities	363,377	–	–	363,377
Holdings in collective investment schemes	3,008,808	991	–	3,009,799
Policyholders' funds held by the group	61,171	–	–	61,171
Derivative financial instruments	310	2,785	–	3,095
Total	3,860,969	3,776	–	3,864,745
Current				1,466,685
Non-current				2,396,060
Total				3,864,745

Fair value measurement at 31 December 2011 using

	Level 1 £000	Level 2 £000	Level 3 £000	Total £000
Equities				
Listed	404,431	–	–	404,431
Debt securities – fixed rate				
Government Bonds	293,903	–	–	293,903
Listed	29,163	–	–	29,163
Debt securities – floating rate				
Listed	7,544	–	–	7,544
Total debt securities	330,610	–	–	330,610
Holdings in collective investment schemes	2,820,197	97,738	–	2,917,935
Policyholders' funds held by the group	49,080	–	–	49,080
Derivative financial instruments	6,845	3,463	–	10,308
Total	3,611,163	101,201	–	3,712,364
Current				1,337,188
Non-current				2,375,176
Total				3,712,364

There were no transfers between levels 1, 2 and 3 during the year.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

Company

Year ended 31 December	2012 £000	2011 £000
Balance at 1 January	146,699	141,434
Equity contributions paid to Movestic Livförsäkring AB	–	5,265
Balance at 31 December	146,699	146,699
Current	–	–
Non-current	146,699	146,699
Total	146,699	146,699

A list of investments in subsidiaries held by the Group is disclosed in Note 53.

27 Insurance and other receivables and prepayments

Group

Insurance and other receivables 31 December	2012 £000	2011 £000
Receivables arising from insurance contracts		
Brokers	694	653
Policyholders	3,667	3,926
Receivables arising from investment contracts		
Policyholders	7	1,737
Reinsurance receivables	231	201
Commission receivables	267	417
Debtor for professional indemnity insurance	92	40
Other receivables		
Loan to associated companies	642	536
Accrued interest income	4,775	4,631
Accrued rent	720	630
Receivables from fund management companies	3,943	7,865
Initial margin payments on derivatives	6,663	4,997
Other	2,612	5,166
Total	24,313	30,799
Current	22,548	30,263
Non-current	1,765	536
Total	24,313	30,799

The carrying amount is a reasonable approximation of fair value.

31 December	2012 £000	2011 £000
Prepayments	3,160	3,234
Current	3,160	2,084
Non-current	–	1,150
Total	3,160	3,234

The carrying amount is a reasonable approximation of fair value.

Company

Receivables and prepayments			
31 December			
		2012	2011
		£000	£000
Amounts due from subsidiary companies		510	188
Other receivables		25	37
Prepayments		50	71
Total		585	296
Current		585	296
Non-current		–	–
Total		585	296

The carrying amount is a reasonable approximation of fair value.

28 Derivative financial instruments

The Group does not hold derivatives outside the unit-linked and with-profits funds, except for an option to repay a financial reinsurance contract early, which comprises an embedded derivative.

31 December				
	2012		2011	
	Asset	Liability	Asset	Liability
	£000	£000	£000	£000
Exchange-traded futures	516	(286)	6,893	(144)
Financial reinsurance embedded derivative	2,579	–	3,415	–
Total	3,095	(286)	10,308	(144)
Current	1,118	(286)	8,163	(144)
Non-current	1,977	–	2,145	–
Total	3,095	(286)	10,308	(144)

Derivatives within unit-linked funds

As part of its Investment management strategy, the Group purchases derivative financial instruments comprising part of its investment portfolio for unit-linked investment funds, which match the liabilities arising on its unit-linked insurance and investment business.

A variety of equity futures are part of the portfolio matching the unit-linked investment and insurance liabilities. Derivatives are used to facilitate more efficient portfolio management allowing changes in Investment strategy to be reflected by futures transactions rather than a high volume of transactions in the underlying assets.

All the contracts are exchange-traded futures, with their fair value being the bid price at the balance sheet date: They are, accordingly, determined at Level 1 in the three-level fair value determination hierarchy set out in Note 26.

Exchange-traded futures (by geographical investment market)				
31 December				
	2012		2011	
	Asset	Liability	Asset	Liability
	£000	£000	£000	£000
Australia	23	–	183	(28)
Europe	–	(26)	878	–
UK	140	(260)	3,613	(72)
Hong Kong	8	–	137	(4)
Japan	227	–	183	(12)
South Korea	16	–	325	(25)
Singapore	1	–	30	(3)
USA	101	–	1,544	–
Total	516	(286)	6,893	(144)

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

Financial reinsurance embedded derivative

In respect of Movestic, the Group has entered into a reinsurance contract with a third party that has a section that is deemed to transfer significant insurance risk and a section that is deemed not to transfer significant insurance risk. This assessment has been determined by management based on the contractual terms of the reinsurance agreement. The element of the contract that does not transfer significant insurance risk has two components and has been accounted for as a financial liability at amortised cost and an embedded derivative asset at fair value.

The embedded derivative represents an option to repay the amounts due under the contract early at a discount to the amortised cost, with its fair value being determined by reference to market interest rates at the balance sheet date. It is, accordingly, determined at Level 2 in the three-level fair value determination hierarchy set out in Note 26.

Derivatives within the S&P with-profits funds

As part of its investment management strategy, S&P enters into a limited range of derivative instruments to manage its exposure to various risks.

S&P uses equity index futures in order to economically hedge equity market risk in the with-profit funds' investments.

The change in fair value of the futures contracts is intended to offset the change in fair value of the underlying equities being hedged. S&P settles the market value of the futures contracts on a daily basis by paying or receiving a variation margin. The futures contracts are not discounted as this daily settlement is equal to the change in fair value of the futures. As a result, there is no additional fair value to recognise in relation to these derivatives on the balance sheet at the period end.

S&P also purchases exchange rate futures to mitigate exchange rate risk within its with-profits funds.

These contracts are exchange-traded contracts in active markets with their fair value being the bid price at the balance sheet date. They are, accordingly, determined at Level 1 in the three-level fair value determination hierarchy set out in Note 26.

29 Income tax assets

Income tax assets, which are all current, comprise:		
31 December	2012	2011
	£000	£000
Group		
Corporation tax recoverable	4,299	6,956
Company		
Corporation tax recoverable	1,394	1,197

The carrying amount is a reasonable approximation of fair value.

30 Cash and cash equivalents

Group	2012	2011
31 December	£000	£000
Bank and cash balances	76,115	57,601
Call deposits due within 1 month	58,552	73,361
Call deposits due after 1 month	94,009	64,958
Total cash and cash equivalents	228,676	195,920
Bank overdrafts	(602)	(834)
Cash and cash equivalents in the statement of cash flows	228,074	195,086

The effective interest rate on short-term bank deposits was 0.74% (2011: 0.94%), with an average maturity of 37 days. All deposits included in cash and cash equivalents were due to mature within 3 months of their acquisition.

Included in cash and cash equivalents held by the Group are balances totalling £99,253,000 (2011: £78,907,000) held in unit-linked policyholders' funds.

Company 31 December	2012 £000	2011 £000
Bank and cash balances	389	267
Call deposits due within 1 month	29,015	15,370
Short-term deposits due within 1 year	3,008	–
Total	32,412	15,637

31 Capital management

(a) Objective

The Group's capital management framework is designed to provide security for all shareholders, while meeting the expectations of policyholders and shareholders. Accordingly it:

- 1) safeguards policyholders interests by meeting regulatory requirements established by the regulators of the insurance markets in which the Group's regulated companies operate, while not retaining unnecessary excess capital;
- 2) seeks to meet the dividend expectations of shareholders and to optimise the gearing ratio to ensure an efficient capital base;
- 3) ensures there is sufficient liquidity to meet obligations to policyholders, debt financiers and creditors as they fall due; and
- 4) maintains the Group as a going concern so that it continues to provide returns and to meet obligations to all stakeholders.

The Group's subsidiary and associate companies are subject to minimum regulatory capital requirements according to the jurisdictions in which they operate. In addition CA is required to prepare and submit a Group-level solvency capital statement in accordance with the EU Insurance Groups Directive (IGD).

The rules are designed to ensure that companies have sufficient assets to meet their liabilities in specified adverse circumstances. As such, there is, in the UK, a restriction on the full transfer of surpluses from the long-term business funds to shareholder funds in CA, and on the full distribution of retained earnings from CA to Chesnara and, in Sweden, on distributions from Movestic shareholder funds.

On 31 December 2011 the long-term business funds and the shareholder funds of SPI and SPP were transferred to CA under the provisions of Part VII of the Financial Services and Markets Act 2000 ('the Part VII Transfer'), subject to leaving sufficient capital within SPI and SPP to meet regulatory requirements for the limited period until these companies were de-authorised as they subsequently have been during 2012. Accordingly all of the long-term business of the UK businesses subsists within one regulated entity, CA, with effect from that date.

The overall capital dynamics of the Group are such that the UK businesses, being substantially in run-off, are net contributors of capital, which is reflected in the medium-term by way of dividend distributions to the parent company, while, in the medium-term, the Swedish business, as it expands, and before it achieves economies of scale, is a net consumer of capital, which is reflected by way of additional capital contributions from the parent company.

(b) Operation of the UK, Swedish and EU regulatory regimes

UK businesses

The operation of regulation with respect to the UK Businesses is such as to specify the minimum amount of capital that must be held in addition to the insurance liabilities as determined for regulatory purposes. This is established by reference to two calculations, being:

- (i) the Pillar 1 calculation, which compares regulatory capital based on the characteristics of the in-force life assurance business with an associated measure of capital as prescribed by regulation; and
- (ii) the Pillar 2 calculation, which compares a risk-based assessment of economic capital with an associated measure of capital based on a realistic assessment of insurance liabilities.

For CA, SPI and SPP, for the whole of the period covered by these financial statements, the minimum regulatory capital requirement was determined by the first calculation, as this gave rise to the lesser measure of surplus capital. This calculation is set out below in Section (c) Regulatory Capital Resources and Requirements, together with the CA Board's policy in targeting regulatory capital resource cover for total regulatory capital resource requirements.

The long-term insurance business subsisting within CA prior to the Part VII Transfer fell outside the scope of the FSA's 'realistic capital' regime and comprises mainly non-profit business, both unit-linked and non-linked business. The with-profits liabilities of the long-term insurance business, subsisting within CA prior to the Part VII Transfer, are wholly reassured to Guardian.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

Therefore, in respect of this with-profits business, there is no separate with-profits fund. The long-term insurance business transferred to CA from SPI and SPP, which also fell outside the scope of the FSA's 'realistic capital' regime, comprises with-profits business, for which two separate subfunds continue to be maintained, and unit-linked and non-linked non-profit business. CA continues to fall outside the scope of the FSA's 'realistic capital' regime following the Part VII Transfer. Within these IFRS financial statements excess of policyholder assets and liabilities relating to these funds is classified within insurance contract provisions.

Swedish business

Movestic is subject to the Swedish regulatory regime and has to maintain a minimum level of regulatory capital, being the prescribed minimum solvency margin requirements.

The solvency surplus under the Swedish regulatory regime is the excess of the regulatory capital resources over the capital resource requirements which are based on the insurance business. This calculation is set out below in Section (c) Regulatory Capital Resources and Requirements together with the Movestic Board's policy in targeting regulatory capital resource cover for total regulatory capital resource requirements. The Swedish business also includes a 49% interest in an associated company, Modernac S.A. ('Modernac'), a Luxembourg-based reinsurer, which is subject to EU regulatory solvency requirements: its scale of operations are such that its capital resource requirement is the EU regulatory minimum.

Group

In addition to the solvency requirements for the UK and Swedish Businesses, as set out above, the Group is subject to the requirements of the EU Insurance Group Directive, in accordance with which the Group calculates the excess of the aggregate of regulatory capital resources determined on a group-wide basis over the aggregate minimum regulatory capital requirement imposed by local regulators. The requirement is that available Group capital resources, as set out in Section (d) Group Capital Position Statement below, should be at least 100% of capital requirements.

(c) Regulatory capital resources and requirements

UK businesses

The following summarises the capital resources and requirements of CA, SPI and SPP, as determined for UK regulatory purposes (Pillar 1):

31 December	2012		2011	
	£m	£m	£m	£m
	CA	S&P	CA	S&P
Available capital resources (CR)	99.3	–	104.8	7.0
Long-term insurance capital requirement (LTICR)	39.5	–	39.1	–
Resilience capital requirement (RCR)	10.5	–	18.3	–
European minimum solvency capital requirement	–	–	–	6.1
Total capital resource requirements (CRR)	50.0	–	57.4	6.1
Excess of CR over CRR (solvency surplus)	49.3	–	47.4	0.9
Ratio of available CR to CRR	199%	–	183%	115%
Target capital requirement cover	74.7	–	81.8	6.1
Excess of CR over target requirement	24.6	–	23.0	0.9

The information presented in respect of CA as at 31 December 2011 reflects the position following the Part VII Transfer referred to above.

Available capital resources for CA as at 31 December 2012 are stated after provision for a dividend of £40.0m which was approved by the CA Board subsequent to 31 December 2012 (as at 31 December 2011: £44.0m subsequent to 31 December 2011).

CA's Board, as a matter of policy, continues to target CR cover for total CRR at a minimum level of 162.5% of the LTICR plus 100% of the RCR.

As at 31 December 2011 shareholder funds of £7.0m were retained in S&P, in order to cover the EU regulatory minimum for regulated insurance companies. SPI and SPP were de-authorised during 2012, following which those residual shareholder funds were transferred to CA shareholder funds.

Individual Capital Assessment (Pillar 2)

The FSA Prudential Sourcebooks require UK insurance companies to make their own assessment of their capital needs to a required standard (a 99.5% probability of being able to meet liabilities to policyholders after one year). In the light of scrutiny of this assessment, the FSA may impose its own additional individual capital guidance. The Individual Capital Assessment (ICA) is based on a realistic liability assessment, rather than on the statutory mathematical reserves, and involves stress testing the resultant realistic balance sheet for the impact of adverse events, including such market effects as significant falls in equity values, interest rate increases and decreases, bond defaults and further widening of bond spreads.

CA completed a full annual assessment during 2012 as a result of which it was concluded that the effective current and medium-term capital requirement constraints on distributions to Chesnara will continue to be on the basis set out under 'Regulatory capital resources and requirements' above. This assessment is subject to quarterly high-level updates until the next full annual assessment.

Swedish business

The following summarises the Capital Resources and the Capital Resources Requirements of Movestic as determined for Swedish regulatory purposes and Movestic's 49% proportionate share in the Capital Resources and Capital Resources Requirements of Modernac:

31 December 2012	Movestic £m	Modernac £m
Available Capital Resources (CR)	32.5	3.5
Capital Resource Requirements (CRR)	11.6	1.3
Excess of CR over CRR (solvency surplus)	20.9	2.2
Ratio of available CR to CRR	280%	269%
Target capital requirement cover	17.4	n/a
Excess of CR over target requirement	15.1	n/a

31 December 2011	Movestic £m	Modernac £m
Available Capital Resources (CR)	29.6	2.3
Capital Resource Requirements (CRR)	12.1	1.5
Excess of CR over CRR (solvency surplus)	17.5	0.8
Ratio of available CR to CRR	245%	153%
Target capital requirement cover	18.2	n/a
Excess of CR over target requirement	11.4	n/a

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

The Movestic Board has set a minimum target of 150% of the regulatory capital requirement. Swedish solvency regulation requires that a certain proportion of assets, to be fully admissible, is to be held in the form of cash. The operation of this requirement may, from time to time, act as the operative constraint in determining the level of additional funding requirements, thereby causing the solvency ratio to rise above what it would otherwise have been, had the form of assets matching capital resources not been a constraint. Movestic's solvency ratio declines as the increasing scale of its business requires a higher level of regulatory capital: as the ratio approaches 150%, further planned capital contributions will be made by the Group.

Movestic, in accordance with local regulatory requirements, continues to make quarterly assessments of the risk-based capital requirements of its business: these indicate that capital resources currently provide a comfortable margin over capital resource requirements.

(d) Group capital position statement

The following summarises the regulatory capital resources arising in both life and non-life entities, together with a statement of capital resources on a consolidated basis and with a reconciliation to shareholders' net equity established on the IFRS basis:

As at 31 December 2012						
	UK life businesses with-profits £000	UK life businesses non- participating £000	UK life businesses shareholder £000	UK life businesses total £000	Swedish life and non-life business total £000	Group life insurance businesses total £000
Shareholder funds outside long-term insurance funds – retained earnings	–	–	49,110	49,110	38,759	87,869
Shareholder funds in long-term insurance funds	44,456	4,917	–	49,373	–	49,373
Total shareholder funds	44,456	4,917	49,110	98,483	38,759	137,242
Adjustment onto regulatory basis						
Policyholder funds	15,351	–	–	15,351	–	15,351
Adjustments to net assets	(7,312)	(839)	(6,330)	(14,481)	(6,277)	(20,758)
Total available capital resources	52,495	4,078	42,780	99,353	32,482	131,835

	Group life insurance businesses total £000	Other activities UK business £000	Other activities Swedish business £000	Consolidation adjustments £000	Group total £000	Adjustment for dividend £000	Group total IFRS basis £000
Shareholder funds outside long-term insurance funds – retained earnings	87,869	178,839	1,649	(112,304)	156,053	12,920	168,973
Shareholder funds in long-term insurance funds	49,373	–	–	–	49,373	–	49,373
Total shareholder funds	137,242	178,839	1,649	(112,304)	205,426	12,920	218,346
Adjustment onto regulatory basis							
Policyholder funds	15,351	–	–	–	15,351	–	15,351
Adjustments to net assets	(20,758)	(62,960)	3	16,217	(67,498)	–	(67,498)
Total available capital resources	131,835	125,879	1,652	(96,087)	153,279	–	153,279

As at 31 December 2011						
	UK life businesses with-profits £000	UK life businesses non- participating £000	UK life businesses shareholder £000	UK life businesses total £000	Swedish life and non-life business total £000	Group life insurance businesses total £000
Shareholder funds outside long-term insurance funds – retained earnings	–	–	61,164	61,164	37,059	98,223
Shareholder funds in long-term insurance funds	40,990	7,623	1,078	49,691	–	49,691
Total shareholder funds	40,990	7,623	62,242	110,855	37,059	147,914
Adjustment onto regulatory basis						
Policyholder funds	15,643	–	–	15,643	–	15,643
Adjustments to net assets	(7,709)	(1,090)	(5,872)	(14,671)	(7,454)	(22,125)
Total available capital resources	48,924	6,533	56,370	111,827	29,605	141,432

	Group life insurance businesses total £000	Other activities UK business £000	Other activities Swedish business £000	Consolidation adjustments £000	Group total £000	Adjustment for dividend £000	Group total IFRS basis £000
Shareholder funds outside long-term insurance funds – retained earnings	98,223	156,529	1,662	(109,435)	146,979	12,519	159,498
Shareholder funds in long-term insurance funds	49,691	–	–	–	49,691	–	49,691
Total shareholder funds	147,914	156,529	1,662	(109,435)	196,670	12,519	209,189
Adjustment onto regulatory basis							
Policyholder funds	15,643	–	–	–	15,643		
Adjustments to net assets	(22,125)	(52,271)	16	14,537	(59,843)		
Total available capital resources	141,432	104,258	1,678	(94,898)	152,470		

The tables presented above illustrate Group total available capital resources as measured for the purposes of inclusion in the related regulatory returns. As at 31 December 2012 they are stated after provision of a dividend of £12.9m and, as at 31 December 2011, after provision of a dividend of £12.5m, which were approved by the Chesnara plc Board subsequent to the respective year ends. Provision is not made for such dividends on the IFRS basis: accordingly, it is necessary to make adjustment to shareholder funds outside long-term insurance funds as at 31 December 2012, as reflected above, in order to illustrate the relationship with the total shareholder equity included in the consolidated balance sheet prepared on the IFRS basis.

The following tables set out the principal forms of capital, which comprise (i) total available capital resources for the total UK Life Businesses, the total Swedish Life and Non-life Business and the total Group for regulatory purposes and (ii) total shareholder funds for the Group on the IFRS basis.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

Available Capital Resources for Regulatory Purposes Year ended 31 December 2012	CA £000	S&P £000	Movestic £000	Group £000
Share capital	40,000	–	1,235	42,024
Share premium	–	–	–	42,523
Treasury shares	–	–	–	(217)
Other equity contributions	–	–	40,460	–
Capital redemption reserve	–	–	–	50
Foreign exchange translation reserve	–	–	–	7,669
Surplus in long-term business fund	4,078	–	–	–
Surplus in with-profits funds	52,495	–	–	52,495
Retained earnings/(accumulated deficit)	2,780	–	(9,213)	8,735
Total	99,353	–	32,482	153,279

The following tables summarise the movement in the available capital resources of the constituent funds of the life businesses, as determined under the respective regulatory regimes for the year ended 31 December 2012:

UK businesses

Year ended 31 December 2012	Life business non- participating CA £000	Life business non- participating S&P £000	With profits CA £000	With profits S&P £000	Life business shareholder CA £000	Life business shareholder S&P £000	Total life business £000
At beginning of period	6,533	–	48,924	–	49,370	7,000	111,827
Surplus arising in the year	22,545	–	4,593	–	–	–	27,138
Net profit arising in shareholder fund	–	–	–	–	388	–	388
Intrafund transfers	–	–	(1,022)	–	8,022	(7,000)	–
Transfer from long-term business fund to shareholder fund	(25,000)	–	–	–	25,000	–	–
Proposed dividend	–	–	–	–	(40,000)	–	(40,000)
At end of period	4,078	–	52,495	–	42,780	–	99,353

Year ended 31 December 2011	Life business non- participating CA £000	Life business non- participating S&P £000	With profits CA £000	With profits S&P £000	Life business shareholder CA £000	Life business shareholder S&P £000	Total life business £000
At beginning of period	3,248	924	–	36,651	40,816	32,172	113,811
Surplus arising on alignment of actuarial reserving methodology	3,215	–	10,153	–	–	–	13,368
Surplus arising in the year, net of the effect of the item shown above	21,148	(1,502)	–	3,198	–	–	22,844
Net profit arising in shareholder fund	–	–	–	–	636	168	804
Intrafund transfers	–	1,500	(1,078)	–	1,078	(1,500)	–
Transfer from long-term business fund to shareholder fund	(22,000)	–	–	–	22,000	–	–
Part VII Transfer	922	(922)	39,849	(39,849)	28,840	(23,840)	5,000
Proposed dividend	–	–	–	–	(44,000)	–	(44,000)
At end of period	6,533	–	48,924	–	49,370	7,000	111,827

There were no changes in available capital resources for the year ended 31 December 2012 due to changes in management policy, regulatory changes or external factors. The effect of new business written in the period on available capital resources is not considered to be significant.

Swedish business

Year ended 31 December 2012		Total £000
At beginning of period		29,605
Profit arising in the period		8,787
Equity contributions		–
Change in intangible assets: software assets		(6,274)
Change in deferred tax		(3)
Change in foreign exchange reserve		367
At end of period		32,482

Year ended 31 December 2011		Total £000
At beginning of period		23,321
Profit arising in the period		8,758
Equity contributions		5,265
Change in intangible assets: software assets		(7,438)
Change in deferred tax		(16)
Change in foreign exchange reserve		(285)
At end of period		29,605

There were no changes in available capital resources for the period ended 31 December 2012 due to changes in management policy, regulatory changes or external factors.

The capital position of the Swedish business is sensitive to changes in market conditions affecting the asset values and changes in the assumptions for calculating the insurance contract liabilities, as described in Note 32.

Group Capital Adequacy

In accordance with the EU Insurance Groups Directive, the Group calculates the excess of the aggregate of regulatory capital employed over the aggregate minimum solvency requirement imposed by local regulators for all of the constituent members of the Group, all of which are based in Europe. The following sets out these calculations after the recognition of final dividends for the respective financial year, but approved by the Board and paid to Group shareholders after the respective dates:

31 December		
	2012 £m	2011 £m
Total available capital resources (CR)	153.3	152.5
Capital resources requirement		
CA	50.0	57.4
S&P	–	6.1
Movestic Liv	11.6	12.1
Modernac SA	1.3	1.5
Total (CRR)	62.9	77.1
Group solvency surplus (CR less CRR)	90.4	75.4
Group solvency ratio	244%	198%

The Group and its individually regulated life assurance businesses have complied with all externally and internally imposed capital requirements during the year.

There has been no material change in the Group's management of capital during the period, except that, notwithstanding that there are no formal intragroup funding arrangements in place, the parent company continues to commit to provide any additional capital contributions to support the target capital requirement of Movestic as set out in Section (c) above.

Subject to the regulatory constraints and capital management policy of the Group as set out above, capital resources are available for use elsewhere in the Group.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(e) **Technical provisions net of reinsurance – UK businesses**

(i) The technical provisions established to determine the regulatory capital resources as set out above are:

31 December	CA		SPI/SPP	
	2012 £000	2011 £000	2012 £000	2011 £000
Unit-linked				
Insurance contracts	662,316	670,117	704,833	709,813
Investment contracts	592,777	563,576	92,170	105,547
Non-unit (sterling)				
Insurance contracts	20,128	17,541	19,403	17,502
Investment contracts	9,627	9,232	191	273
Non-participating				
Insurance contracts	149,265	139,984	9,900	11,056
Investment contracts	9,485	11,037	–	–
With DPF	–	–	340,848	340,915
Total	1,443,599	1,411,487	1,167,345	1,185,106

(ii) Process used to determine assumptions underlying the calculation of technical provisions.

The process used to determine the assumptions underlying the calculation of technical provisions, which are checked to ensure that they are consistent with observed market prices or other published information, is intended to result in conservative estimates of the most likely, or expected, outcome. The assumptions which are considered include the expected number and timing of deaths, other claims and investment returns over the period of risk exposure. A reasonable allowance is made for the level of uncertainty within the contracts.

(iii) The basis for establishing technical provisions is:

The technical provision for S&P with-profits contracts is based on the guaranteed minimum benefits and is calculated on a gross premium basis, by subtracting the present value of future premiums from the present value of future benefits payable under the policy, until it ceases at maturity, or death if earlier. The gross premium method makes explicit allowance for future policy maintenance costs. If the net present value of the future discounted cash flows is positive, no asset is recognised. Provision is not made for future bonuses as all bonuses are terminal bonuses.

For those classes of CA non-linked and unit-linked business where policyholders participate in profits, the liability is wholly reinsured to Guardian. When performing the gross liability adequacy test allowance is made for expected future bonuses paid by Guardian. This is based on the realistic liabilities of the underlying policies reinsured, as provided to CA by Guardian.

For all other classes of unit linked and quasi-linked business, the technical provision consists of a provision equal to the value of the matching unit-linked assets plus an additional reserve calculated on a gross premium basis, by subtracting the present value of future premiums from the present value of future benefits payable under the policy, until it ceases at maturity, or death if earlier. The gross premium method makes explicit allowance for future policy maintenance costs. If the net present value of the future discounted cash flows is positive, no asset is recognised.

For immediate annuities in payment the technical provision is calculated as the discounted value of the expected future annuity payments under the policies, allowing for mortality, interest rates and expenses.

For all other classes of non-linked business the technical provision is calculated on a net premium basis, being the level of premium consistent with a premium stream, the discounted value of which, at the outset of the policy, would be sufficient to cover exactly the discounted value of the original guaranteed benefits at maturity, or at death if earlier, on the valuation basis. The provision is then calculated by subtracting the present value of future net premiums from the present value of the benefits guaranteed at maturity, or death if earlier, as a result of events up to the balance sheet date. Negative provisions do not arise under the net premium method, which makes no allowances for voluntary discontinuances by policyholders, and which only implicitly allows for future policy maintenance costs.

(iv) The principal assumptions underlying the calculation of the technical provisions are:

Mortality

A base mortality table is selected which is most appropriate for each type of contract taking into account rates charged to CA by reinsurers. The mortality rates reflected in these tables are periodically adjusted, allowing for emerging experience and changes in reinsurer rates.

Morbidity

Morbidity tables are derived based on reinsurer tables. These are periodically adjusted to take into account emerging experience where appropriate.

Persistence

In general, no allowance is made for lapses or surrenders within the valuation of insurance contract liabilities, which is a prudent assumption.

For S&P unit-linked business, when assessing additional reserves for expenses and mortality risk, allowance has been made for lapses at a prudent level of 75% of the expected level as indicated by recent experience, the rates used being:

Rate of lapse 31 December	2012		2011	
	SPI*	SPP*	SPI	SPP
Assurances:				
Regular premium plans	3.0%	2.625%	3.75%	3.00%
Single premium contracts	3.375%	3.375%	3.75%	3.75%
Linked TIC*	–	7.50%	–	7.50%

* Trustee Investment Contract, a unit-linked contract ('TIC').

Discount rates

CA uses appropriate rates of interest, for different product types, in discounting projected liabilities. As at 31 December 2012 for the material product types, these lay between 1.4% and 2.75% (31 December 2011: between 1.25% and 3.2%).

The rates of interest shown above have been set after consideration of the risk of default on non-government bonds by applying the following adjustments to the earned yield:

- (i) Risk reduction of 0.1% for supranational issuers such as the European Investment Bank;
- (ii) For other issuers, a portion of the excess yield above that available on government backed bonds, where the portion varies by credit rating; and
- (iii) An overall maximum margin over the equivalent term government fixed interest security of 2.0%.

Credit rating	AAA	AA	A	BBB	BB	B	C+
Reduction	25%	30%	35%	40%	50%	65%	80%

For many of the life insurance products the interest rate risk is managed through asset/liability management strategies that seek to match the interest rate sensitivity of the assets to that of the underlying liabilities. The overall objective of these strategies is to limit the net change in value of assets and liabilities arising from interest rate movements.

Technical provisions for with-profits contracts are particularly sensitive to the interest rate used when discounting due to the existence of investment guarantees.

Renewal expenses and inflation

The renewal expenses assumed are based on the charges made to CA by its two third party insurance administration services providers, with appropriate margins. These are assumed to inflate at a mix of current inflation rates in the UK, being the Retail Price Index and the National Average Earnings Index. Explicit allowance is also made for those Governance expenses which are charged to the long-term funds.

Taxation

It has been assumed that current tax legislation and tax rates will not change.

The sensitivities of technical provisions and of components of capital to changes in assumptions are materially the same as those detailed in Note 32.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(f) Valuation of options and guarantees – UK businesses

(i) Stochastically-valued options and guarantees

CA has a small number of guaranteed annuity options which are valued stochastically.

(ii) Deterministically-valued options and guarantees

Timed Investment Funds

Certain investment funds, the 'Timed Investment Funds', carry a guarantee that the price at maturity date or death will not be less than the highest price attained between commencement and contract cessation. The cost of the guarantee can be managed by changing the investment policy adopted by each fund.

In respect of this guarantee:

- (i) a monthly charge of 1/48% of the fund value is made; and
- (ii) investment conditions were such as to require the establishment of a reserve of £327,000 as at 31 December 2012 (31 December 2011: £279,605).

The reserve for a given fund is derived as the discounted exposure at fund maturity date, the exposure being the difference between the guaranteed Timed Investment Fund value and the projected fund maturity value, with the latter projected value being derived assuming an immediate fall in value of equities within the fund of 26% and allowing for future investment returns, including presumed future equity investment return of 2.57% per annum.

Guaranteed Growth Fund

The Guaranteed Growth Fund (GGF) is a deposit-based contract which provides a return to policyholders that is linked to the average residential mortgage rate. However, the assets backing the contract are largely held as cash on deposit. There is, therefore, likely to be a shortfall between the return given to policyholders and the return earned on assets, and the value of this shortfall is reserved for.

Reserves for this product comprise a 'unit' reserve of the current value of the benefits held and a non-unit reserve for expenses.

The underlying fund at 31 December 2012 was £2.0m (31 December 2011: £6.47m). 196 policies invested in the fund (31 December 2011: 717), of which 75 (31 December 2011: 76) were paying premiums (for a total of approximately £2,000 per annum (31 December 2011: £25,500).

For the valuation of contract liabilities the following are projected for each future year:

- the benefit outgo from the fund;
- the investment return from the assets backing the fund; and
- the difference between these items.

These differences are then discounted and summed to establish the GGF loss reserve.

The following assumptions are used for calculating the loss reserve:

Rate of growth of liability:	4.18% pa
Rate of return on cash:	0.4% pa
Discount rate:	0.5% pa
Retirement age:	90% of business with policyholders retiring at age 65 10% of business with policyholders retiring at age 70
Terminations before retirement:	3% pa

The reserve for the guarantee as at 31 December 2012 was £0.5m (31 December 2011: £1.0m).

Deferral of retirement ages

Policyholders with a Personal Retirement Account and Guaranteed Plus Retirement Plan may defer their retirement age on terms that may be beneficial to the policyholder. The cost of policyholders exercising this benefit is assessed using a prudent assumption as to the level of take-up of the option and deferral to age 75. The reserve for this option as at 31 December 2012 was £7.1m (31 December 2011: £7.3m).

Increase of premiums on Personal Retirement Account

Policyholders with a Personal Retirement Account may increase their regular premium contribution on terms that can be beneficial to the policyholder. The cost of policyholders exercising this benefit is assessed using a prudent assumption as to the level of take-up of the option. The reserve for this option as at 31 December 2012 was £0.2m (31 December 2011: £0.2m).

Insurability options

Policyholders with certain contracts have the right to increase their sum assured without underwriting, in certain circumstances. The reserve for this option as at 31 December 2012 was £0.3m (31 December 2011: £0.3m).

(g) Management of risk

The Group's approach to the management of risk which may have an impact on the measurement of capital resources and requirements, as measured on a regulatory basis, is set out in Notes 5 and 6 to these financial statements.

32 Insurance contract provisions**(a) Analysis of insurance contract provisions by operating segment**

31 December	2012			2011 (restated)		
	Gross £000	Reinsurance £000	Net £000	Gross £000	Reinsurance £000	Net £000
CA	1,058,070	226,649	831,421	1,042,030	214,719	827,311
S&P	1,080,427	5,873	1,074,554	1,085,127	6,008	1,079,119
Movestic	68,581	46,170	22,411	63,782	43,065	20,717
Total insurance contract provisions	2,207,078	278,692	1,928,386	2,190,939	263,792	1,927,147
Current	408,702	18,551	390,151	185,261	16,719	168,542
Non-current	1,798,376	260,141	1,538,235	2,005,678	247,073	1,758,605
Total	2,207,078	278,692	1,928,386	2,190,939	263,792	1,927,147

See Note 2(d) for an explanation of the re-statement as at 31 December 2011.

(b) Analysis of movement in insurance contract provisions

Year ended 31 December	2012			2011 (restated)		
	Gross £000	Reinsurance £000	Net £000	Gross £000	Reinsurance £000	Net £000
Balance at 1 January	2,190,939	263,792	1,927,147	2,404,162	280,743	2,123,419
Premiums received	75,575	10,845	64,730	82,668	11,748	70,920
Fees deducted	(27,467)	(3,140)	(24,327)	(27,815)	(3,446)	(24,369)
Reserves released in respect of benefits paid	(233,017)	(18,356)	(214,661)	(226,419)	(20,718)	(205,701)
Movements in provisions for contracts sold – Movestic						
– in current year	25,363	14,992	10,371	25,477	14,172	11,305
– in prior years	(14,972)	(7,611)	(7,361)	(16,212)	(9,134)	(7,078)
Investment return	159,877	7,983	–	(27,888)	(7,908)	(19,980)
Other movements	30,780	10,187	20,593	(23,034)	(1,665)	(21,369)
Balance at 31 December	2,207,078	278,692	1,928,386	2,190,939	263,792	1,927,147

See Note 2(d) for an explanation of the re-statement for the year ended 31 December 2011.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(c) Process, basis and assumptions for establishing insurance contract provisions

The process, basis and assumptions for establishing insurance contract provisions for the UK businesses are materially the same as those stated in Note 31(e) (ii), (iii) and (iv) for establishing technical provisions, except as set out in the following.

Provisions for S&P contracts with discretionary participation features ('DPF') provide for the present value of projected payments to policyholders based on guaranteed minimum investment returns, mainly at 5 per cent per annum. When the insurance contract provisions established on this basis are greater than the associated policyholder asset shares, a shareholder charge for the cost of guarantees arises.

The actual cost to shareholders depends principally on the future investment performance of the associated policyholders' assets and on the rate of discontinuance of policies prior to maturity. Up to 31 December 2011 the estimated cost of these guarantees to shareholders was based on a simplification of the method used for statutory solvency purposes, which sought to remove some of the unrealistic level of prudence associated with that method. However, this basis is recognised as potentially giving rise to costs below the market-consistent level, which is considered to be the lowest acceptable reported cost. As a consequence, the estimated cost to shareholders, subsequent to that date, has been refined and is determined by reference to the market consistent evaluation of the cost, the methodology of which is set out on page 158 in the EEV Supplementary Information following and is taken as a constant margin of 10% above the amount so determined, in order to allow for an appropriate level of prudence (the 'market-consistent' method).

The following sets out the cumulative charge to shareholders for the cost of guarantees on these bases:

Year ended 31 December	2012 £000s	2011 £000s
At beginning of the period	44,011	50,596
Effect of change to market-consistent method: charge to income	1,899	–
Charge/(credit) to income	400	(6,585)
At the end of period	46,310	44,011

Had the market consistent embedded value (MCEV) method been used during 2011, the cumulative cost of guarantees would have been £4,700,000 lower at the beginning of the period and £1,899,000 higher at the end of the period, with no resultant charge or credit to income.

Swedish business (Movestic)

Group Contracts are sold on an annual basis and the Individual Contracts include an option for Movestic to increase the premium on an ongoing basis. Therefore, for both Group and Individual Contracts, Movestic adopts a reserving approach that is similar to that of a non-life insurance business, with claim reserves projected using an estimated loss ratio with reference to previous loss development for earlier years.

The insurance contract provisions comprise unearned premium provisions, outstanding claims and associated reinsurance recoveries. Except for the income protection and the waiver of premium benefits within the Individual Contracts, provisions for the insurance contracts are not discounted because of the short-term nature of the liabilities, which are generally paid by the fourth year of development for a single accident year. Income protection and waiver of premium contracts are discounted at a rate equivalent to a high quality (i.e. AA rated) corporate bond.

(d) Assumptions used in establishing insurance contract provisions

The assumptions used in establishing insurance contract provisions for the UK businesses are materially the same as those set out in Note 31 (e) (iv) for establishing technical provisions.

Swedish business (Movestic)

Unearned premiums

Unearned premiums represent a proportion of the premium relating to policies that expire after the balance sheet date. Unearned premiums are calculated automatically by the underwriting system on a straight-line basis over the period of the policy.

Outstanding claims

Outstanding claims include notified claims, claims incurred as at the balance sheet date but not reported and an estimate of the cost of handling the claims.

The key risk in respect of notified claims is that they are paid or handled inappropriately (for example invalid or fraudulent claims are paid). Management information is reviewed on a regular basis to identify unusual trends in the payment of claims.

The estimation of claims incurred but not reported ('IBNR') is generally subject to a greater degree of uncertainty than the estimation of costs of settling claims already notified to Movestic, where more information about the claim event is generally available. In calculating the estimated cost of claims which have not been notified, Movestic uses a variety of estimation techniques, generally based upon statistical analyses of historical experience, which assumes that the development pattern of the current claims will be consistent with past experience.

The most common methods that are used are the chain ladder method and the Bornhuetter-Ferguson method. Chain ladder methods involve the analysis of historical claims development factors and the selection of estimated development factors based on this historical pattern. The selected factors are applied to cumulative claims data for each accident year that is not fully developed to provide an estimated ultimate claims cost. The Bornhuetter-Ferguson method uses a combination of an initial estimate of the expected loss ratio and an estimate based on observed claims experience. The two estimates are combined using a formula that gives more weight to the experience-based estimate as time passes.

The use of different approaches assists in giving greater understanding of the trends inherent in the data being projected and also assists in setting the range of possible outcomes. The most appropriate estimation technique is selected taking into account the characteristics of the policies sold. Where deemed appropriate, an allowance is made for changes or uncertainties which may create distortions in the underlying statistics or which might cause the cost of unsettled claims to increase or reduce when compared with the cost of previously settled claims. Although claim reserves are considered reasonable, on the basis of information available to Movestic, the ultimate liabilities will vary as a result of subsequent information and events.

Income protection and waiver of premium benefits within Individual Contracts

For reported claims, the liabilities are reviewed on a case by case basis. A discounted cash flow model is used to determine the liabilities and the key factors used are:

- the probability of 'recovery' (i.e. return to work). The recovery rates depend on age, sex and length of time the claimant has been claiming the benefits;
- the mortality rate; and
- the discount rate.

For unreported claims, the claims development table is used. The development of insurance liabilities provides a measure of Movestic's ability to estimate the ultimate value of claims. The top half of the table below illustrates how Movestic's estimate of total claims outstanding for each accident year has changed at successive year-ends. The bottom half of the table reconciles the cumulative claims to the amount appearing in the balance sheet. An accident-year basis is considered to be the most appropriate for the business written by Movestic. The information is presented on both a gross and net of reinsurance basis.

Analysis of claims development – gross

	2007 £000	2008 £000	2009 £000	2010 £000	2011 £000	2012 £000
Estimate of ultimates						
End of accident year	17,421	19,619	20,269	50,916	31,981	33,163
One year later	13,204	15,435	13,879	37,851	18,397	–
Two years later	11,322	14,078	13,841	36,566	–	–
Three years later	10,134	11,825	13,797	–	–	–
Four years later	9,651	11,410	–	–	–	–
Five years later	9,547	–	–	–	–	–
Current estimate of ultimate claims	9,547	11,410	13,797	36,566	18,397	33,163
Cumulative payments	(7,601)	(9,711)	(8,920)	(14,185)	(8,753)	(7,299)
In balance sheet	1,946	1,699	4,877	22,381	9,644	25,864
Provision for prior years						2,171
Liability in balance sheet						68,581

Analysis of claims development – net

	2007 £000	2008 £000	2009 £000	2010 £000	2011 £000	2012 £000
Estimate of ultimates						
End of accident year	2,711	2,704	3,464	17,287	13,028	12,790
One year later	1,717	2,349	2,111	10,356	6,113	–
Two years later	1,642	2,137	2,442	9,902	–	–
Three years later	1,485	1,715	2,446	–	–	–
Four years later	1,408	1,708	–	–	–	–
Five years later	1,443	–	–	–	–	–
Current estimate of ultimate claims	1,443	1,708	2,446	9,902	6,113	12,790
Cumulative payments	(1,068)	(1,406)	(1,549)	(3,532)	(2,569)	(2,214)
In balance sheet	375	302	897	6,370	3,544	10,576
Provision for prior years						347
Liability in balance sheet						22,411

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

e) Sensitivity to changes in assumptions

UK businesses (CA and S&P)

Assumptions are adjusted for changes in mortality, investment return, policy maintenance expenses and expense inflation to reflect anticipated changes in market conditions and market experience and price inflation.

CA and S&P re-run their valuation models on various bases. An analysis of sensitivity around various scenarios provides an indication of the sensitivity of the estimates to changes in assumptions in respect of its life assurance contracts. The table presented below demonstrates the sensitivity of assets and insured liability estimates to particular movements in assumptions used in the estimation process. Certain variables can be expected to impact on life assurance liabilities more than others, and consequently a greater degree of sensitivity to these variables may be expected.

Impact on reported net of tax profits and equity to changes in key variables:

	Change in variable %	Change in net of tax profits and equity 2012 £m	Change in net of tax profits and equity 2011 £m
CA business			
Investment return	+1	(3.0)	(1.6)
Investment return	-1	(1.0)	2.6
Mortality/morbidity	+10	2.4	1.8
Mortality alone	+10	3.5	2.9
Morbidity alone	+10	(1.1)	(1.1)
Policy maintenance expenses	+10	(1.7)	(1.8)
S&P business			
Investment return	+1	16.1	4.6
Investment return	-1	(17.6)	(4.3)
Mortality	+10	0.4	0.7
Policy maintenance expenses	+10	(1.8)	(2.5)

The above sensitivities are calculated as an expected impact on IFRS-based profits, net of reinsurance and tax and the analysis has been prepared for a change in the stated variable, with all other assumptions remaining constant.

The sensitivities to the changes in investment returns are calculated taking into account the consequential changes to valuation assumptions.

The sensitivities to mortality and morbidity (critical illness) rates shown above are calculated on the assumption that there would be no consequential change in rates to policyholders. In practice, Group policy is to pass costs on to policyholders where it is contractually permitted and where it considers that the impact of the change is significant.

As explained in Note 32(c) on page 130 the method of estimating the cost of guarantees to policyholders in respect of the S&P with-profits funds has been changed. An effect of this change has been to make the results and financial position of the Group more sensitive to variations in market rates of interest.

The main expense risk is that of unforeseen changes to third party administration expenses: the impact shown above quantifies a 10% increase in those expenses.

Swedish business (Movestic)

The key sensitivities in the measurement of the Group and Individual Contracts insurance claim reserves within Movestic are a movement in the loss ratio applied to earned premium and the foreign exchange risk arising on business written in Norway. In addition, for the income protection and the waiver of premium benefits within the Individual Contracts, the claims reserves are impacted by the discount rate used. The impact of these sensitivities is shown below:

	Pre-tax profit		Shareholders' equity	
	2012 £000	2011 £000	2012 £000	2011 £000
5% increase in loss ratio				
Gross before reinsurance	(1,962)	(1,875)	(1,474)	(1,382)
Net after reinsurance	(1,320)	(681)	(992)	(502)
5% decrease in loss ratio				
Gross before reinsurance	1,962	1,875	1,474	1,382
Net after reinsurance	1,320	681	992	502
10% increase in the Norwegian Krone				
Gross before reinsurance	(238)	(476)	(179)	(351)
Net after reinsurance	(31)	74	(23)	(55)
10% decrease in the Norwegian Krone				
Gross before reinsurance	238	476	179	351
Net after reinsurance	31	74	23	55
1% increase in discount rate				
Gross before reinsurance	1,979	1,772	1,487	1,547
Net after reinsurance	782	577	588	425
1% decrease in discount rate				
Gross before reinsurance	(2,363)	(2,014)	(1,776)	(1,484)
Net after reinsurance	(917)	(656)	(689)	(484)

33 Investment contracts at fair value through income and amounts deposited with reinsurer

Analysis by operating segment

31 December						
	Investment contract liability £000	2012 Amount deposited with reinsurer £000	Net £000	Investment contract liability £000	2011 Amount deposited with reinsurer £000	Net £000
CA	629,882	30,245	599,637	599,495	28,031	571,464
S&P	92,170	–	92,170	105,547	–	105,547
Movestic	1,300,262	–	1,300,262	1,171,421	–	1,171,421
Total	2,022,314	30,245	1,992,069	1,876,463	28,031	1,848,432
Current	568,222	523	567,699	138,114	488	137,626
Non-current	1,454,092	29,722	1,424,370	1,738,349	27,543	1,710,806
Total	2,022,314	30,245	1,992,069	1,876,463	28,031	1,848,432

The fair values of the Groups' investment contract liabilities are determined according to a three-level valuation hierarchy which is explained in Note 26, as follows:

	Level 1 £000	Level 2 £000	Level 3 £000	Total £000
Investment contract liabilities	2,010,545	11,509	260	2,022,314

The liabilities in Level 1 of the valuation hierarchy represent the fair value of unit-linked liabilities based on the aggregation of prices quoted in active markets of their associated assets.

The liabilities in Level 2 of the valuation hierarchy represent the fair value of non-linked and guaranteed income and growth bond liabilities valued using established actuarial techniques utilising market observable data for all significant inputs, such as investment yields.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

34 Liabilities relating to policyholders' funds held by the Group

Unit-linked 31 December	2012 £000	2011 £000
Balance at 1 January	49,080	52,337
Deposits received	17,869	4,877
Fees deducted from account balances	(277)	(526)
Investment yield	3,314	(5,115)
Foreign exchange translation difference	833	(578)
Other movements	(9,648)	(1,915)
Balance at 31 December	61,171	49,080
Current	21,356	4,304
Non-current	39,815	44,776
Total	61,171	49,080

The fair values of the 'Liabilities relating to Policyholders' funds held by the Group' are determined according to a three-level valuation hierarchy, which is explained in Note 26.

The fair value of these liabilities is based on the aggregation of prices quoted in active markets of their associated assets (Level 1), as disclosed in Note 26.

35 Borrowings

Group 31 December	2012 £000	2011 £000
Bank loan	29,662	35,486
Amount due in relation to financial reinsurance	18,662	19,267
Total	48,324	54,753
Current	12,218	12,472
Non-current	36,106	42,281
Total	48,324	54,753

Company 31 December	2012 £000	2011 £000
Bank loan	29,662	35,486
Current	7,844	5,819
Non-current	21,818	29,667
Total	29,662	35,486

The bank loan subsisting at 31 December 2012, which was drawn down on 20 December 2010 under a facility made available on 17 November 2010, is unsecured and is repayable in five increasing annual instalments on the anniversary of the draw down date. The outstanding principal on the loan bears interest at a rate of 2.25 percentage points above the London Inter-Bank Offer Rate and is repayable over a period which varies between one and six months at the option of the borrower.

The fair value of the bank loan at 31 December 2012 was £30,000,000 (31 December 2011: £36,000,000).

The fair value of amounts due in relation to financial reinsurance was £20,197,549 (31 December 2011: £20,672,526).

The fair value of other borrowings is not materially different from their carrying value.

36 Other provisions

Group	MECR £000	Other complaints redress £000	Onerous contracts £000	Unit pricing redress £000	Total £000
Balance at 1 January 2011	61	221	1,000	540	1,822
Provisions made during the year	25	6	1,500	–	1,531
Provisions used during the year	(17)	(15)	(119)	(1)	(152)
Provisions reversed during the year	–	(10)	(291)	(89)	(390)
Balance at 31 December 2011	69	202	2,090	450	2,811
Provisions made during the year	40	2	2,504	–	3,258
Provisions used during the year	(28)	(1)	(263)	(1)	(279)
Provisions reversed during the year	–	–	(184)	(445)	(629)
Balance at 31 December 2012	81	203	4,147	4	5,161
31 December 2011					
Current	69	202	315	450	1,036
Non-current	–	–	1,775	–	1,775
Total	69	202	2,090	450	2,811
31 December 2012					
Current	81	203	496	4	1,510
Non-current	–	–	3,651	–	3,651
Total	81	203	4,147	4	5,161

The reversal of provisions during the year was credited to Other Operating Income as disclosed in Note 11.

Company	Onerous contracts £000
Balance at 1 January 2011	–
Provisions made during the year	1,500
Balance at 31 December 2011	1,500
Provisions made during the year	2,463
Provisions used during the year	(159)
Company balance at 31 December 2012	3,804
31 December 2011	
Current	176
Non-current	1,324
Total	1,500
31 December 2012	
Current	399
Non-current	3,405
Total	3,804

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(a) Mortgage Endowment Complaints Redress (MECR)

Insurance contract provisions include a mortgage endowment complaints reserve of £2.44m, in respect of the estimate of future redress for future claims by customers in respect of past misselling of mortgage endowment policies.

As part of the redress process if the complaint is upheld an offer of redress is made to the customer where a loss has occurred. These offers are classified as payables for the first 6 months after they are made, subsequent to which they are reclassified as provisions, as the customer loses the right of redress at the level offered, but continues to have a right to enforce a claim, which the Group has the right to reassess. The provision is established at the original offer level.

(b) Other complaints redress

Offers of redress on complaints other than mortgage endowment related are classified in a manner similar to that detailed for MECR above.

(c) Onerous contracts

The Group and Company have a number of onerous operating lease contracts that have been entered into historically, whose activity and current status is described in Note 49 Operating leases. Given the terms of the contracts the Group and company have created onerous contract provisions for anticipated future net costs. Over the terms of the contracts these provisions take account of the contract terms, future payments and future mitigating income from sublets, contract by contract, to create a view as to the Group's and Company's exposure.

These provisions comprise three components: provision for vacant properties, provision for properties due to become empty at the end of their subleases, and provision for future under-recoveries of costs on subleases entered into.

The provision made during 2011 of £1.5m relates to the potential cost of vacant space within the Harbour House Head Office in Preston. The Company has a lease arrangement until mid-2019 for the entire building although it only occupies a small proportion. The majority of the building is available for sub-let. The additional provision represents the future contractual costs not expected to be covered by sub-let income when existing tenants vacate the building. During 2012 Chesnara plc has received notice from tenants of their intention to vacate Harbour House. In recognition of this, and in light of the excess commercial property capacity in the market, the estimated level of future sub let income has been reduced and the provision as at 31 December 2012 has been increased accordingly. The critical factor to which the value is sensitive is the assumed level of re-letting income. The closing provision includes a significantly reduced level of re-let income such that the maximum exposure based on no re-letting income is £0.7m.

(d) Unit pricing redress

A data error in the indexation of the costs of underlying financial assets in certain of the unit-linked funds was identified during 2007. As a result, the amount of capital gains chargeable to tax had been overestimated for unit pricing purposes and greater deductions were made from these funds than would otherwise have been the case. A provision of £2,994,000 was established at 31 December 2007 to cover the estimated cost of redress and the administration costs of performing the review. Associated recoveries from third parties were established at £494,000 as at the same date and these were included in 'Insurance and other receivables' as at 31 December 2007.

The provision established at 31 December 2007 was estimated insofar as it was not based on specific individual calculations for each policyholder, but was established on the basis of generic data relating to the amount of payments to policyholders who exited from the funds in specific periods, of the unit prices ruling in those periods and of an estimate of the extent of the pricing error pertaining to those periods. Subsequently, a revised estimate was established at £2,794,000 based on specific policy-by-policy data, which by 31 December 2011 had reduced to £450,000 as compensation was paid to policyholders. During 2012 the majority of outstanding amounts owed to policyholders, for which the respective policyholders could not be traced, were re-invested into unit-linked funds for the benefit of all remaining policyholders, and only a small balancing residual provision of £4,000 as at 31 December 2012 continues to be held until all of the associated administration procedures are completed.

(e) Sharesave Plan

A Sharesave Plan was launched during October 2011. The level of contributions combined with the closing share price, result in an immaterial level of company liability and hence no provision has been raised.

37 Deferred tax assets and liabilities

Deferred tax assets and liabilities comprise:

31 December	2012 £000	2011 £000
Net deferred tax assets		
CA, S&P and Other Group Activities	2,295	–
Movestic	–	–
Total	2,295	–
Current	–	–
Non-current	2,295	–
Total	2,295	–

31 December	2012 £000	2011 £000
Net deferred tax liabilities		
CA, S&P and Other Group Activities	(4,786)	(14,623)
Movestic	(1,108)	(767)
Total	(5,894)	(15,390)
Current	(1,048)	(1,279)
Non-current	(4,846)	(14,111)
Total	(5,894)	(15,390)

CA, S&P and Other Group Activities

(a) Recognised deferred tax assets and liabilities

31 December	2011 Assets/ (liabilities) £000	(Charge)/ credit in year £000	2012 Assets/ (liabilities) £000
Profit arising on transition to new tax regime	–	(2,636)	(2,636)
Deferred acquisition costs	(1,319)	254	(1,065)
Deferred income	2,322	(433)	1,889
Acquired value in force	(6,159)	1,302	(4,857)
Property, plant and equipment	(79)	40	(39)
Tax losses on pensions business	–	4,178	4,178
Unrealised and deferred investment gains	(4,682)	27	(4,655)
Excess expenses of management	–	4,655	4,655
Insurance contract provisions	(4,706)	4,706	–
Other	–	39	39
Total	(14,623)	12,132	(2,491)
Comprising:-			
Net deferred tax assets	–	2,295	2,295
Net deferred tax liabilities	(14,623)	9,837	(4,786)
Total	(14,623)	12,132	(2,491)

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

31 December	2010 Assets/ (liabilities) £000	(Charge)/ credit in year £000	2011 Assets/ (liabilities) £000
Deferred acquisition costs	(1,692)	373	(1,319)
Contingency reserves	(220)	220	–
Deferred income	2,939	(617)	2,322
Acquired value in force	(8,007)	1,848	(6,159)
Property, plant and equipment	(73)	(6)	(79)
Unrealised and deferred investment gains	(6,776)	2,094	(4,682)
Insurance contract provisions	(5,918)	1,212	(4,706)
Total	(19,747)	5,124	(14,623)
Comprising:-			
Net deferred tax assets	–	–	–
Net deferred tax liabilities	(19,747)	5,124	(14,623)
Total	(19,747)	5,124	(14,623)

Note (i) The deferred tax credit to the income statement for the year is classified as follows:

Year ended 31 December	2012 £000	2011 £000
Income tax credit before exceptional item	7,354	5,124
Exceptional item (see Note 7 on page 104)	4,778	–
Total	12,132	5,124

A new regime for the taxation of life assurance companies in the UK was introduced with effect from 1 January 2013. The new regime bases the taxable trading profit on IFRS profits rather than on FSA return surplus generated as under the previous rules and also treats pension business separately from life assurance business. Whilst this change does not impact the 2012 current tax charge, it has created a significant recovery in the deferred tax charge as the pension losses in the UK life company will be of value going forward whereas no value was ascribed to them under the previous regime. In addition, as part of the transition to the new regime, accumulated historical profits as at 31 December 2012 are compared between the two bases and any taxable difference is brought into charge over the next ten years. This transitional adjustment has created a deferred tax charge as at 31 December 2012, partially offsetting the pension related-recovery noted here.

(b) Items for which no deferred tax asset is recognised

31 December	2012 £000	2011 £000
Tax losses on pensions business	–	34,180
Transitional losses on non-pensions business	4,837	–
Unrelieved expenses	58,685	90,695
Realised and unrealised investment losses	4,235	2,166
Total	67,757	127,041

A deferred tax asset has not been recognised in respect of unrelieved expenses, because it is not probable that there will be a sufficient level of taxable income arising from income and gains on financial assets, so that the Group can utilise the benefits therefrom.

Movestic

(a) Recognised deferred tax assets and liabilities

31 December				
	2011 Assets/ (liabilities) £000	(Charge)/ credit in year £000	Foreign exchange translation difference £000	2012 Assets/ (liabilities) £000
Intangible assets				
Fair value adjustment on acquisition	(561)	(31)	(9)	(601)
Corporation tax recoverable	–	90	1	91
Equity accounting for associate	(222)	(368)	(11)	(601)
Property, plant and equipment	16	(14)	1	3
Total	(767)	(323)	(18)	(1,108)
Comprising:-				
Net deferred tax assets	16	76	2	94
Net deferred tax liabilities	(783)	(399)	(20)	(1,202)
Total	(767)	(323)	(18)	(1,108)

31 December				
	2010 Assets/ (liabilities) £000	(Charge)/ credit in year £000	Foreign exchange translation difference £000	2011 Assets/ (liabilities) £000
Intangible assets				
Fair value adjustments on acquisition	(564)	(5)	8	(561)
Corporation tax recoverable	50	(50)	–	–
Equity accounting for associate	(270)	45	3	(222)
Property, Plant and Equipment	5	11	–	16
Total	(779)	1	11	(767)
Comprising:-				
Net deferred tax assets	55	(39)	–	16
Net deferred tax liabilities	(834)	40	11	(783)
Total	(779)	1	11	(767)

(b) Unrecognised deferred tax (liabilities)/assets (gross)

31 December		
	2012 £000	2011 £000
Corporation tax recoverable – not recognised	(822)	734
Total	(822)	734

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

38 Reinsurance payables

Payable to reinsurers		
31 December	2012	2011
	£000	£000
Payables in respect of insurance contracts	15,914	15,060
Payables in respect of investment contracts	22	105
Reinsurer's share of deferred acquisition costs and claims deposits	674	1,171
Total	16,610	16,336
Current	15,154	16,336
Non-current	1,456	–
Total	16,610	16,336

The carrying value of payables to reinsurers is a reasonable approximation of fair value.

39 Payables related to direct insurance and investment contracts

31 December						
	Gross	Reinsurance	Net	Gross	Reinsurance	Net
	£000	£000	£000	£000	£000	£000
Accrued claims	32,490	4,489	28,001	30,784	4,667	26,117
Intermediaries' liabilities	1,447	–	1,447	2,378	–	2,378
Policyholder premium liabilities	2,289	–	2,289	5,610	–	5,610
Other	2,668	–	2,668	1,879	–	1,879
Total	38,894	4,489	34,405	40,651	4,667	35,984
Current	38,894	4,489	34,405	40,651	4,667	35,984
Non-current	–	–	–	–	–	–
Total	38,894	4,489	34,405	40,651	4,667	35,984

The carrying value of payables related to the direct insurance and investment contracts is a reasonable approximation of fair value.

40 Deferred income

31 December		
	2012	2011
	£000	£000
Balance at 1 January	10,000	11,647
Release to income	(1,116)	(1,647)
Balance at 31 December	8,884	10,000
Current	1,018	1,147
Non-current	7,866	8,853
Total	8,884	10,000

The release to income is included in Fees and Commission Income (see Note 9).

41 Income tax liabilities

31 December	2012	2011
	£000	£000
Income tax liabilities, which are all current, comprise:		
Corporation tax – CA, S&P and Other Group Activities	–	947
Corporation tax – Movestic	–	–
	–	947

The carrying value of income tax liabilities is a reasonable approximation of fair value.

42 Other payables

Group 31 December	2012	2011
	£000	£000
Accrued expenses	4,222	6,524
VAT	474	360
Employee tax	538	421
Policyholder property fund creditors	1,773	–
Other	10,050	17,112
Total	17,057	24,417
Current	17,057	24,417
Non-current	–	–
Total	17,057	24,417

Company 31 December	2012	2011
	£000	£000
Accrued expenses	2,544	1,481
Amounts due to Group companies	–	266
Other	181	340
Total	2,725	2,087
Current	2,725	2,087
Non-current	–	–
Total	2,725	2,087

The carrying value of other payables is a reasonable approximation of fair value.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

43 Share capital and share premium

Group 31 December	2012		2011	
	Number of shares	Share capital £000	Number of shares	Share capital £000
Share capital	115,047,662	42,024	115,047,662	42,024
		Share premium £000		Share premium £000
		42,523		42,523

The number of shares in issue at the balance sheet date included 199,011 shares held in treasury (31 December 2011: 199,011).

Share capital for the group includes the impact of "reserve acquisition accounting" associated with Chesnara plc's acquisition of Countrywide Assured Life Holdings Ltd (CALH) from Countrywide plc (Countrywide) on 24 May 2004. As a result of this, included within share capital of the Group is £41,501,00, which represents the amount of issued share capital of Countrywide Assured Life Holding (the legal subsidiary) immediately before the acquisition. As a result of this accounting treatment the Group share capital differs from the Chesnara plc company position. Which is set out below.

There were no changes in Group share capital or share premium during the years ended 31st December 2012 and 31st December 2011.

Company 31 December	2012		2011	
	Number of shares	Share capital £000	Number of shares	Share capital £000
Authorised				
Ordinary shares of 5p each	201,000,000	10,050,000	201,000,000	10,050,000
Issued				
Ordinary shares of 5p each	115,047,662	5,752,383	115,047,662	5,752,383
		Share premium £000		Share premium £000
		42,523		42,523

The number of shares in issue at the balance sheet date included 199,011 shares held in treasury (31 December 2011: 199,011).

44 Treasury shares

Group and Company 31 December	2012 £000	2011 £000
Balance at 1 January and 31 December	217	217

45 Other reserves

Group 31 December	2012 £000	2011 £000
Capital redemption reserve	50	50
Foreign exchange translation reserve	7,669	6,928
Balance at 31 December	7,719	6,978

Company 31 December	2012 £000	2011 £000
Capital redemption reserve	50	50

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

46 Retained earnings

Group Year ended 31 December	2012 £000	2011 £000
Retained earnings attributable to equity holders of the parent company comprise:		
Balance at 1 January	117,881	111,223
Profit for the year	27,941	25,665
Dividends		
Final approved and paid for 2010	–	(12,174)
Interim approved and paid for 2011	–	(6,833)
Final approved and paid for 2011	(12,519)	–
Interim approved and paid for 2012	(7,006)	–
Balance at 31 December	126,297	117,881

The interim dividend in respect of 2011, approved and paid in 2011 was paid at the rate of 5.95p per share. The final dividend in respect of 2011, approved and paid in 2012, was paid at the rate of 10.90p per share so that the total dividend paid to the equity shareholders of the Parent Company in respect of the year ended 31 December 2011 was made at the rate of 16.85p per share.

The interim dividend in respect of 2012, approved and paid in 2012, was paid at the rate of 6.10p per share to equity shareholders of the Parent Company registered at the close of business on 14 September 2012, the dividend record date.

A final dividend of 11.25p per share in respect of the year ended 31 December 2012 payable on 22 May 2013 to equity shareholders of the Parent Company registered at the close of business on 12 April 2013, the dividend record date, was approved by the Directors after the balance sheet date. The resulting total final dividend of £12.9m has not been provided for in these financial statements and there are no income tax consequences.

The following summarises dividends per share in respect of the year ended 31 December 2012 and 31 December 2011:

Year ended 31 December	2012 p	2011 p
Interim – approved and paid	6.10	5.95
Final – proposed/paid	11.25	10.90
Total	17.35	16.85

Company Year ended 31 December	2012 £000	2011 £000
Balance at 1 January	76,648	74,021
Profit for the year	39,668	21,634
Dividends paid		
Final approved and paid for 2010	–	(12,174)
Interim approved and paid for 2011	–	(6,833)
Final approved and paid for 2011	(12,519)	–
Interim approved and paid for 2012	(7,006)	–
Balance at 31 December	96,791	76,648

Details of dividends, approved and paid, are set out in the 'Group' section above.

47 Employee benefit expense, including Directors

Year ended 31 December						
	CA	S&P	Movestic	Other Group	2012	2011
	£000	£000	£000	Activities	£000	£000
				£000		
Wages and salaries	1,126	840	6,124	991	9,081	8,930
Social security costs	152	113	1,924	143	2,332	2,381
Pension costs-defined contribution plans	131	117	1,132	117	1,497	1,461
Total	1,409	1,070	9,180	1,251	12,910	12,772
Average number of employees						
Company					23	22
Subsidiaries					125	134
Total					148	156

Directors

Note 52 provides detail of compensation to Directors of the Company.

UK-based employees

UK-based employees are all employed by Chesnara plc.

At the end of May 2005 the Group allowed eligible employees to enter a pension scheme known as the Chesnara plc Stakeholder Scheme, on a basis where employer contributions are made to the scheme at the same rate as would be payable had their membership of their predecessor scheme continued, provided that employee contributions also continued to be made at the same rate. The employee may opt to request the Company to pay employer contributions into a personal pension plan, in which instance, employer contributions will be made on the same terms as for the Chesnara plc Stakeholder Scheme.

Employees who joined the Group as a result of the acquisition of CWA Life Holdings plc continue to be members of the pre-existing defined contribution Group Personal Pension scheme, to which employer and employee contributions are made.

The Group has, for the period covered by these financial statements, only made contributions to defined contribution plans to provide pension benefits for employees upon retirement and, otherwise, has no residual obligation or commitments in respect of any defined benefit scheme.

The Group has established frameworks for approved and unapproved discretionary share option plans which may, at the discretion of the Remuneration Committee, be utilised for granting options to Executive Directors and to other Group employees. No options have been granted in relation to these plans. A Sharesave Plan was launched to all UK employees of the Group in October 2011.

Swedish-based employees

The Swedish Business participates in a combined defined benefit and defined contribution scheme operated by Försäkringsbranschen Pensionskassa (the 'Scheme'). The Scheme is a multi-employer scheme with participants including other Swedish insurance companies not related to the Group. The Scheme provides, for those born in 1978 or earlier, benefits to employees which are linked to their final salary and to the amount of time working for companies which are members of the Scheme. For those employees born in 1979 or later, the scheme operates on a defined contribution basis.

Assets and liabilities are held on a pooled basis and are not allocated by the Trustee to any individual company. Consequently, reliable information is not available to account for the Scheme as a defined benefit scheme and therefore, in accordance with IAS 19 Employee Benefits, the Scheme is accounted for as a defined contribution scheme.

Contributions to the Scheme are based on the funding recommendations of the independent qualified actuary: the contributions paid to the Scheme subsequent to the acquisition of the Swedish Business on 23 July 2009 and up to 31 December 2011, totalled SEK6,967,053 (£633,642). During 2012 further contributions of SEK 4,211,042 (£392,360) were made.

The employers within the Scheme are responsible collectively for the funding of the Scheme as a whole and therefore in the event that other employers exit from the Scheme, remaining employers would be responsible for the ongoing funding. The collective nature of the Scheme results in all participating entities sharing the actuarial risk associated with the Scheme.

Försäkringsbranschens Pensionskassa ("FPK") issues an audited annual report (under Swedish law-limited IFRS) each year. The last available published report was as at 31 December 2011.

The annual report states that the Scheme's surplus is SEK 179m (£16.8m) as at 31 December 2011 (SEK 1,525m (£146.5m) as at 31 December 2010). As at 31 December 2011, the fund had assets under management of SEK 10.4bn (£976m), 141 employer insurance companies participating in the Scheme and 25,900 insured individuals.

From the available information, it cannot be determined with certainty as to whether there would be a change in the required employer funding rate, although there is currently no deficit in the Scheme.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

48 Earnings per share

Earnings per share are based on the following:

Year ended 31 December	2012	2011
	£000	£000
Profit for the year attributable to shareholders (£000)	27,941	25,665
Weighted average number of ordinary shares	114,848,651	114,848,651
Basic earnings per share	24.33p	22.35p
Diluted earnings per share	24.33p	22.35p

The weighted average number of ordinary shares in respect of the years ended 31 December 2012 and 31 December 2011 is based upon 115,047,662 shares in issue less 199,011 own shares held in treasury.

There were no share options outstanding during the year ended 31 December 2011 or during the year ended 31 December 2012. Accordingly, there is no dilution of the average number of ordinary shares in issue in respect of these periods.

49 Operating leases

Leases as lessee

Non-cancellable operating lease rentals are payable as follows:

Operating lease rentals Year ended 31 December	2012			2011		
	Non- investment properties £000	Motor vehicles £000	Total £000	Non- investment properties £000	Motor vehicles £000	Total £000
Less than one year	1,437	31	1,468	1,306	74	1,380
Between one and two years	1,169	19	1,188	1,363	64	1,427
Between two and five years	2,411	3	2,414	2,887	37	2,924
More than five years	746	–	746	1,226	–	1,226
Expenses recognised in the year in respect of operating leases	1,347	46	1,393	1,312	65	1,377

The Group leases a property under an operating lease which it part occupies in the course of its day-to-day business. The lease expires on 22 July 2019, with an option to renew the lease after that date. Lease payments are reviewed every five years to reflect market rentals. The lease does not include any contingent rentals. The Group also leases a number of office premises which are no longer used for Group purposes. The leases typically run for approximately a further 4 years after the balance sheet date. Lease payments are reviewed every five years to reflect market rentals. None of the leases includes contingent rentals. These leased properties are sublet by the Group. Sublease payments as detailed below are expected to be received during the following years. The Group has recognised a provision of £4,147,000 at 31 December 2012 (31 December 2011: £2,090,000) in respect of these leases (see Note 36).

Leases as lessor

The Group subleases out both investment properties from its investment portfolio and the office premises which are no longer used for Group purposes. The future minimum lease payments under non-cancellable leases are as follows:

Sub lease rentals Year ended 31 December	2012			2011		
	Investment properties £000	Non- investment properties £000	Total £000	Investment properties £000	Non- investment properties £000	Total £000
Less than one year	6,011	244	6,255	7,692	382	8,074
Between one and two years	5,426	25	5,451	7,577	372	7,949
Between two and five years	13,577	45	13,622	18,696	911	19,607
More than five years	20,313	30	20,343	24,771	767	25,538
Rental income recognised in the year	7,612	220	7,832	8,108	465	8,573
Repairs and maintenance costs recognised in the year	1,212	74	1,286	1,162	154	1,316

50 Contingencies**Past sales**

The Group has made provision for the estimated cost of settling complaints in respect of past sales of endowment mortgages. Although the provisions are regularly reviewed, the final outcome could be different from the provisions established as these costs cannot be calculated with certainty and are influenced by external factors beyond the control of management, including future regulatory actions.

51 Capital commitments

There were no capital commitments as at 31 December 2012 or as at 31 December 2011.

52 Related party transactions**(a) Identity of related parties**

The shares of the Company were widely held and no single shareholder exercised significant influence or control over the Company.

The Company has related party relationships with:

- (i) key management personnel who comprise only the Directors of the Company;
- (ii) its subsidiary companies;
- (iii) its associated company; and
- (iv) other companies over which the Directors have significant influence.

(b) Related party transactions

- (i) Transactions with key management personnel.

Key management personnel comprise of the Directors of the Company. There are no executive officers other than certain of the Directors. Key management compensation is as follows:

Year ended 31 December	2012 £000	2011 £000
Short-term employee benefits	1,440	970
Post-employment benefits	136	132
Long-term employment benefits	39	–
Total	1,615	1,102

In addition to their salaries the Company also provides non-cash benefits to Directors, and contributes to a post employment defined contribution pension plan on their behalf.

The following amounts were payable to Directors in respect of bonuses and incentives:

Year ended 31 December	2012 £000	2011 £000
Annual bonus scheme (included in the short-term employee benefits above)	442	112
Long-term incentive plan	453	415
Discretionary bonus	238	238
Compensation for loss of office	117	–
Total	1,250	765

These amounts have been included in Accrued Expenses as disclosed in Note 42.

The amounts payable under the annual bonus scheme were payable within one year.

As at 31 December 2012, £415,715 is payable within one year in respect of the long-term incentive plan (as at 31 December 2011: £nil).

As at 31 December 2012, £237,500 in respect of discretionary bonuses was payable within one year (as at 31 December 2011: £nil).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(ii) *Transactions with subsidiaries*

The Company undertakes centralised administration functions, the costs of which it charges back to its operating subsidiaries. The following amounts which effectively comprised a recovery of expenses at no mark up were credited to the income statement of the Company for the respective periods:

Year ended 31 December	2012 £000	2011 £000
Recovery of expenses	2,834	2,775

In addition, the Company has made equity contributions to its subsidiary, Movestic Livförsäkring AB as follows:

Year ended 31 December	2012 £000	2011 £000
Equity contribution – Movestic Livförsäkring AB	–	5,265

(iii) *Transactions with associate*

Movestic Livförsäkring AB and its associate Modernac SA

Year ended 31 December	2012 £000	2011 £000
Reinsurance premiums paid	(9,442)	(8,863)
Reinsurance recoveries received	4,109	4,167
Reinsurance commission received	899	878
	(4,434)	(3,818)
Amounts outstanding as at balance sheet date	(6,731)	(1,450)

Movestic Livförsäkring AB had the following amounts outstanding at the balance sheet date:

31 December 2012	Amounts owed by associate £000	Amounts owed to associate £000
Modernac S.A.	130	6,861

31 December 2011	Amounts owed by associate £000	Amounts owed to associate £000
Modernac S.A.	658	2,108

These amounts have been included in other payables as disclosed in Note 42 and other receivables as disclosed in Note 27.

53 Group entities**Control of the Group**

The issued share capital of Chesnara plc the Group parent company is widely held, with no single party able to control 20% or more of such capital or of the rights which such ownership confers.

Group Subsidiary Companies

Name	Country of Incorporation or Registration	Ownership interest 31 December 2012	Ownership interest 31 December 2011	Functional Currency
Countrywide Assured plc	England & Wales	100% of all share capital (1)	100% of all share share capital (1)	Sterling
Countrywide Assured Life Holdings Limited	England & Wales	100% of all share capital (1)	100% of all share share capital (1)	Sterling
Countrywide Assured Services Limited	England & Wales	100% of all share capital (1)	100% of all share share capital (1)	Sterling
Countrywide Assured Trustee Company Limited	England & Wales	100% of all share capital (1)	100% of all share share capital (1)	Sterling
CWA Trustee Company Limited	England & Wales	Dissolved 20 March 2012	100% of all share share capital (2)	Sterling
CWA Life Holdings plc	England & Wales	Dissolved 10 April 2012	100% of all share share capital	Sterling
Movestic Livförsäkring AB	Sweden	100% of all share capital	100% of all share capital	Swedish Krona
Modernac S.A.	Luxembourg	49% of all share share capital (3)	49% of all share share capital (3)	Swedish Krona
AkademikerRådgivning i Sverige AB	Sweden	Dissolved 31 January 2012	100% of all share capital (3)	Swedish Krona
Movestic Kapitalförvaltning AB	Sweden	100% of all share capital (3)	100% of all share capital (3)	Swedish Krona
Save & Prosper Insurance Limited	England & Wales	100% of all share share capital (5)	100% of all share share capital	Sterling
Save & Prosper Pensions Limited	England & Wales	100% of all share share capital (4)/(5)	100% of all share share capital (4)	Sterling

(1) Held indirectly through Countrywide Assured Life Holdings Limited

(2) Held indirectly through CWA Life Holdings plc – dissolved on 20 March 2012

(3) Held indirectly through Movestic Livförsäkring AB

(4) Held indirectly through Save & Prosper Insurance Limited

(5) Dissolved 22 January 2013

SECTION E

EEV SUPPLEMENTARY INFORMATION

IN THIS SECTION

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155	Summarised EEV Consolidated Balance Sheet
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DIRECTORS' RESPONSIBILITY STATEMENT

Directors' Responsibility Statement in respect of the EEV Basis Supplementary Information

The Directors have chosen to prepare supplementary information in accordance with the EEV Principles issued in May 2004 by the CFO Forum of European Insurance Companies and expanded by the Additional Guidance on European Embedded Value Disclosures issued in October 2005.

When compliance with the EEV Principles is stated, those principles require the Directors to prepare supplementary information in accordance with the Embedded Value Methodology ('EVM') contained in the EEV Principles and to disclose and explain any non-compliance with the EEV guidance included in the EEV Principles.

In preparing the EEV supplementary information, the Directors have:

- Prepared the supplementary information in accordance with the EEV Principles;
- Identified and described the business covered by the EVM;
- Applied the EVM consistently to the covered business;
- Determined assumptions on a realistic basis, having regard to past, current and expected future experience and to any relevant external data, and then applied them consistently;
- Made estimates that are reasonable and consistent; and
- Described the basis on which business that is not covered business has been included in the supplementary information, including any material departures from the accounting framework applicable to the Group's financial statements.

By order of the Board

Chairman
Peter Mason
27 March 2013

Chief Executive Officer
Graham Kettleborough
27 March 2013

INDEPENDENT AUDITOR'S REPORT

Independent Auditor's Report to the Directors of Chesnara plc on the European Embedded Value (EEV) Basis Supplementary Information

We have audited the EEV Basis Supplementary Information of Chesnara plc for the year ended 31 December 2012 which comprises the summarised EEV consolidated income statement, the summarised EEV consolidated balance sheet and the related notes 1 to 10. The financial reporting framework that has been applied in their preparation is the EEV Principles issued in May 2004 by the CFO Forum of European Insurance Companies and expanded by the Additional Guidance on European Embedded Value Disclosures issued in October 2005 ("the EEV Principles").

We have reported separately on the statutory group financial statements of Chesnara plc for the year ended 31 December 2012. The EEV Basis Supplementary Information should be read in conjunction with the financial statements prepared on an IFRS basis.

This report is made solely to the company's directors in accordance with our engagement letter and solely for the purpose of expressing an opinion on whether the EEV Basis Supplementary Information has been properly prepared in accordance with the EEV principles. Our audit work has been undertaken so that we might state to the company's directors those matters we are required to state to them in an independent auditors' report and for no other purpose. To the fullest extent permitted by law, we will not accept or assume responsibility to anyone other than the company, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditor

As explained more fully in the Directors' Responsibility Statement in respect of the EEV Basis Supplementary Information, the directors are responsible for the preparation of the EEV Basis Supplementary Information. Our responsibility is to audit and express an opinion on the EEV Basis Supplementary Information in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

Scope of the audit of the EEV Basis Supplementary Information

An audit involves obtaining evidence about the amounts and disclosures in the Supplementary Information sufficient to give reasonable assurance that the Supplementary Information is free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the Supplementary Information. In addition, we read all the financial and non-financial information in the annual report to identify material inconsistencies with the audited financial statements. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Opinion

In our opinion, the EEV Basis Supplementary Information for the year ended 31 December 2012 has been properly prepared in accordance with the EEV principles using the methodology and assumptions set out on pages 156 to 169.

Deloitte LLP
Chartered Accountants
Manchester
United Kingdom
27 March 2013

SUMMARISED EEV CONSOLIDATED INCOME STATEMENT

Summarised EEV consolidated income statement for the year ended 31 December 2012

Year ended 31 December	Note	2012 £000	2011 £000
Operating profit of covered business	6	19,032	15,314
Other operational result	6	(4,446)	(2,811)
Operating profit		14,586	12,503
Variation from longer-term investment return	6	28,035	(16,929)
Effect of economic assumption changes	6	(6,504)	(32,479)
Profit/(loss) before tax and before exceptional item		36,117	(36,905)
Exceptional item			
Effect of modelling adjustments	6	3,574	(10,328)
Profit/(loss) before tax		39,691	(47,233)
Tax	6	(4,862)	7,123
Profit/(loss) for the year attributable to the equity holders of the parent company		34,829	(40,110)
Earnings per share			
Based on profit/(loss) for the period	9	30.33p	(34.92)p
Diluted earnings per share			
Based on profit/(loss) for the period	9	30.33p	(34.92)p

The notes and information on pages 156 to 169 form part of this supplementary information.

SUMMARISED EEV CONSOLIDATED BALANCE SHEET

Summarised EEV consolidated balance sheet as at 31 December 2012

31 December		2012	2011
Assets	Note	£000	£000
Value of in-force business	5, 8	210,080	199,560
Deferred acquisition costs arising on unmodelled business		497	834
Acquired value of customer relationships		562	694
Property and equipment		369	385
Investment in associate		2,902	1,613
Deferred tax asset		1,280	–
Reinsurers' share of insurance contract provisions		235,782	230,891
Amounts deposited with reinsurers		28,941	26,637
Investment properties		100,167	132,128
Financial assets			
Equity securities at fair value through income		427,303	404,431
Holdings in collective investment schemes at fair value through income		3,009,799	2,917,935
Debt securities at fair value through income		363,377	330,610
Insurance and other receivables		24,313	30,799
Prepayments		3,160	3,234
Policyholders' funds held by the Group		61,171	49,080
Derivative financial instruments		3,095	10,308
Total financial assets		3,892,218	3,746,397
Reinsurers' share of accrued policy claims		4,489	4,667
Income taxes		8,649	6,932
Cash and cash equivalents		228,676	195,920
Total assets		4,714,612	4,546,658
Liabilities			
Insurance contract provisions		2,171,259	2,165,320
Other provisions		5,161	2,811
Deferred tax liabilities		–	3,080
Financial liabilities			
Investment contracts at fair value through income		2,033,131	1,887,261
Borrowings		55,373	61,765
Derivative financial instruments		286	144
Liabilities relating to policyholders' funds held by the Group		61,171	49,080
Total financial liabilities		2,149,961	1,998,250
Reinsurance payables		16,183	15,883
Payables related to direct insurance and investment contracts		38,894	40,651
Income taxes		4,350	923
Other payables		17,057	24,417
Bank overdraft		602	834
Total liabilities		4,403,467	4,252,169
Net assets		311,145	294,489
Equity			
Share capital		42,024	42,024
Share premium		42,523	42,523
Treasury shares		(217)	(217)
Foreign exchange reserve		15,378	14,026
Other reserves		50	50
Retained earnings		211,387	196,083
Total shareholders' equity	5, 8	311,145	294,489

The notes and information on pages 156 to 169 form part of this supplementary information. Approved by the Board of Directors on 27 March 2013 and signed on its behalf by:

Ken Romney

Graham Kettleborough

NOTES TO THE EEV SUPPLEMENTARY INFORMATION

1 Basis of preparation

This section sets out the detailed methodology followed for producing these Group financial statements which are supplementary to the Group's primary financial statements which have been prepared in accordance with International Financial Reporting Standards ('IFRS'). These financial statements have been prepared in accordance with the European Embedded Value ('EEV') principles issued in May 2004 by the European CFO Forum and supplemented by Additional Guidance on EEV Disclosures issued by the same body in October 2005. The principles provide a framework intended to improve comparability and transparency in embedded value reporting across Europe.

In order to improve understanding of the Group's financial position and performance, certain of the information presented in these financial statements is presented on a segmental basis: the business segments are the same as those described in Note 8 to the primary financial statements prepared on the IFRS basis.

2 Covered business

The Group uses EEV methodology to value the bulk of its long-term business (the 'covered business'), which is written primarily in the UK and Sweden, as follows:

- (i) for the UK businesses (comprising the CA and S&P segments), the covered business comprises the business's long-term business being those individual life insurance, pensions and annuity contracts falling under the definition of long-term insurance business for UK regulatory purposes.
- (ii) for the Swedish business (comprising the Movestic segment), the covered business comprises the business's long-term pensions and savings unit-linked business. Group life and sickness business, including waiver of premium and non-linked individual life assurance policies are not included in the covered business: the result relating to this business is established in accordance with IFRS principles and is included within 'other operational result' within the consolidated summarised income statement.
- (iii) The operating expenses of the holding company, Chesnara plc, are allocated across the segments.

On 31 December 2011, under the provisions of Part VII of the Financial Services and Markets Act 2000 ('The Part VII Transfer'), the long-term business funds and certain of the shareholder funds of the companies comprising the S&P business segment, being Save & Prosper Insurance Limited and Save & Prosper Pensions Limited, were transferred to Countrywide Assured plc ('CA'), the principal operating subsidiary company of the UK Business. As a result, the whole of the covered business of the UK Business subsists within CA with effect from that date. The transfer gives rise to benefits which have been recognised within the covered business, including:

- (i) Determination of the capital requirements of the covered business on a combined basis; and
- (ii) Other financial synergies. The impact of these benefits has been recognised in the cash flow projections relating to the value of business in force as at 31 December 2011 and in the income statement for the year then ended.

Under EEV principles no distinction is made between insurance and investment contracts, as there is under IFRS, which accords these classes of contracts different accounting treatments.

3 Methodology

(a) Embedded value

Overview

Shareholders' equity comprises the embedded value of the covered business, together with the net equity of other Group companies, including that of the holding company which is stated after writing down fully the carrying value of the covered business.

The embedded value of the covered business is the aggregate of the shareholder net worth ('SNW') and the present value of future shareholder cash flows from in-force covered business (value of in-force business) less any deduction for (i) the cost of guarantees within S&P, and (ii) the cost of required capital. It is stated after allowance has been made for aggregate risks in the business. SNW comprises those amounts in the long-term business, which are either regarded as required capital or which represent surplus assets within that business.

*New business***CA and S&P**

Much of the covered business is in run-off and is, accordingly, substantially closed to new business. Up to 31 December 2012 the UK businesses did still sell a small amount of new business but, overall, the contribution from new business to the results established using EEV methodology is not material. Accordingly, not all of those items related to new business values, which are recommended by the EEV guidelines, are reported in this supplementary financial information.

Movestic

New business, in relation to the pensions and savings covered business is taken as all business where contracts are signed and new premiums paid during the reporting period, for both new policies and premium increases on existing business, but excluding standard renewals. New business premium volumes as disclosed in the Swedish Business Review on page 25 are not consistent with this definition, as they include non-covered business. New business premium volume for the period which is consistent with the analysis of profit in Note 6 is as follows:

Pensions and savings covered business 31 December	2012	2011
New business premium income*	£18.8m	£26.3m

*Basis: annualised premium plus 1/10 single premium translated into sterling at the 2012 average rate of SEK 10.7326 = £1 (2011: SEK10.4102 = £1).

The new business contribution has been assessed as at the end of the period, using opening assumptions.

Value of in-force business

The cash flows attributable to shareholders arising from in-force business are projected using best estimate assumptions for each component of cash flow.

The present value of the projected cash flows is established by using a discount rate which reflects the time value of money and the risks associated with the cash flows which are not otherwise allowed for. There is a deduction for the cost of holding the required capital, as set out below.

In respect of Movestic there are certain non-linear exposures of shareholder profit to asset returns arising from variable administrative fees and variable investment fund rebates which are modelled deterministically rather than stochastically.

Participating business

For participating business within the S&P business the Group maintains the assets and liabilities in separate with-profits funds. In accordance with the Principles and Practices of Financial Management, in the first instance all benefits, which in some cases include guaranteed minimum investment returns, are paid from policyholder assets within the fund. The participating business effectively operates as a smoothed unit linked contract subject to minimum benefit guarantees. The with-profits funds contain assets which are attributable to shareholders as well as those attributable to policyholders. Assets attributable to shareholders can only be released from the fund subject to meeting prudent liabilities in respect of minimum benefits and the frictional cost of this restriction has been allowed for in determining the value of the in-force business.

Fundamentally, the value of the with-profits in-force business is driven by the fund management charges levied on the policyholder assets, subject to the effect of minimum benefit guarantees.

Taxation

The present value of the projected cash flows arising from in-force business takes into account all tax which is expected to be paid under current legislation, including tax which would arise if surplus assets within the covered business were eventually to be distributed. For the UK businesses, allowance has been made for planned reductions in corporation tax, as announced by the Chancellor in his budget speech on 21 March 2012, and allowance has been made for changes to insurance taxation taking effect from 1 January 2013. The value as at 31 December 2011 was not restated to allow for these changes. No allowance has been made for the changes announced by the Chancellor in his budget speech on 20 March 2013.

The value of the in-force business has been calculated on an after-tax basis and is grossed up to the pre-tax level for presentation in the income statement. The amount used for the grossing up is the amount of shareholder tax, excluding those payments made on behalf of policyholders, being policyholder tax in the UK businesses and yield tax in Movestic.

NOTES TO THE EEV SUPPLEMENTARY INFORMATION (CONTINUED)

Cost of capital

The valuation approach used requires consideration of 'frictional' costs of holding shareholder capital: in particular, the cost of tax on investment returns and the impact of investment management fees can reduce the face value of shareholder funds. For CA, the expenses relating to corporate governance functions eliminate any taxable investment return in shareholder funds, while investment management fees are not material. The cost of holding the required capital to support the covered business (see 3(b) below) is reflected as a deduction from the value of in-force business.

Financial options and guarantees

CA

The principal financial options and guarantees in CA are (i) guaranteed annuity rates offered on some unit-linked pension contracts and (ii) a guarantee offered under Timed Investment Funds that the unit price available at the selected maturity date (or at death, if earlier) will be the highest price attained over the policy's life. The cost of these options and guarantees has been assessed, in principle, on a market-consistent basis, but, in practice, this has been carried out on approximate bases, which are appropriate to the level of materiality of the results.

S&P

The principal financial options and guarantees in S&P are (i) minimum benefits payable on maturity or retirement for participating business; (ii) the option to extend the term under the Personal Retirement Account contract on terms potentially beneficial to the policyholder; (iii) the option to increase premiums under the Personal Retirement Account contract on terms potentially beneficial to the policyholder; and (iv) certain insurability options offered.

The cost of guaranteeing a minimum investment return on participating contracts, being the only material guarantee, has been assessed on a market consistent basis. This has involved the use of a stochastic asset model, which is designed to establish a cost of guarantees which is consistent with prices in the market at the valuation date, for example the prices of derivative instruments. For the remaining options and guarantees the cost has been assessed on an approximate basis, appropriate to the level of materiality of the results.

Movestic

In respect of Movestic, some contracts provide policyholders with an investment guarantee, whereby a minimum rate of return is guaranteed for the first 5 years of the policy, at a rate of 3% per annum. The value of the guarantee is ignored as it is not material to the results.

Allowance for risk

Allowance for risk within the covered business is made by:

- (i) setting required capital levels by reference to the assessment of capital needs made by the directors of the regulated entities within the respective businesses;
- (ii) setting the risk discount rate, which is applied to the projected cash flows arising on the in-force business, at a level which includes an appropriate risk margin (see 3(c) below); and
- (iii) explicit allowance for the cost of financial options and guarantees and, where appropriate, for reinsurer default.

Internal group company

EEV Guidance requires that actual and expected profit or loss incurred by an internal group company on services provided to the covered business should be included in allowances for expenses. The covered business in Movestic is partially managed by an internal group fund management company. Not all relevant future income and expenses of that company have been included in the calculation of embedded value. However, the effect is not considered to be material.

Consolidation adjustments

Consolidation adjustments have been made to:

- (i) eliminate the investment in subsidiaries;
- (ii) allocate group debt finance against the segment to which it relates; and
- (iii) allocate corporate expenses as explained in Note 4(d) below.

(b) Level of required capital

The level of required capital of the covered business reflects the amount of capital that the Directors consider necessary and appropriate to manage the respective businesses. In forming their policy the Directors have regard to the minimum statutory requirements and an internal assessment of the market, insurance and operational risks inherent in the underlying products and business operations. The capital requirement resulting from this assessment represents:

- (i) for the UK business, 162.5% of the long-term insurance capital requirement ('LTICR') together with 100% of the resilience capital requirement ('RCR'), as determined by the regulations of the Financial Services Authority in the UK; and
- (ii) or Movestic, 150% of the regulatory solvency requirement as determined by Finansinspektionen in Sweden.

The required level of regulatory capital is provided as follows:

- (i) for the UK businesses, by the retained surplus within the long-term business fund and by share capital and retained earnings within the shareholder funds of the regulated entities; and
- (ii) for Movestic, by share capital and additional equity contributions from the parent company, net of the accumulated deficit in the regulated entity, these components together comprising shareholder's equity.

Movestic is reliant, in the short to medium term, on further equity contributions from the parent company, Chesnara plc.

(c) Discount rates

The discount rates are a combination of the reference rate and a risk margin. The reference rate reflects the time value of money and the risk margin reflects any residual risks inherent in the covered business and makes allowance for the risk that future experience will differ from that assumed. In order to reduce the subjectivity when setting the discount rates, the Group has decided to adopt a 'bottom up' market-consistent approach to allow explicitly for market risk.

Using the market-consistent approach, each cash flow is valued at a discount rate consistent with that used in the capital markets: in accordance with this, equity-based cash flows are discounted at an equity discount rate and bond-based cash flows at a bond discount rate. In practice a short-cut method known as the 'certainty equivalent' approach has been adopted. This method assumes that all cash flows earn the reference rate of return and are discounted at the reference rate.

In general, and consistent with the market's approach to valuing financial instruments for hedging purposes, the reference rate is based on swap yields. These have been taken as mid swap yields available in the market at the end of the reporting period.

Allowance also needs to be made for non-market risks. For some of these risks, such as mortality and expense risk, it is assumed that the shareholder can diversify away any uncertainty where the impact of variations in experience on future cash flows is symmetrical. For those risks that are assumed to be diversifiable, no adjustment has been made. For any remaining risks that are considered to be non-diversifiable risks, there is no risk premium observable in the market and, therefore, a constant margin has been added to the risk margin. The margin added reflects the assumed risks within the businesses and is 50 basis points for CA and S&P (2011: 50 basis points), and 70 basis points for Movestic (2011: 70 basis points). This margin is applied to the basic value of in-force business prior to the deductions for financial options and guarantees and the cost of required capital.

(d) Analysis of profit

The contribution to operating profit, which is identified at a level which reflects an assumed longer-term level of investment return, arises from three sources:

- (i) new business;
- (ii) return from in-force business; and
- (iii) return from shareholder net worth.

Additional contributions to profit arise from:

- (i) variances between the actual investment return in the period and the assumed long-term investment return; and
- (ii) the effect of economic assumption changes.

The contribution from new business represents the value recognised at the end of each period in respect of new business written in that period, after allowing for the cost of acquiring the business, the cost of establishing the required technical provisions and after making allowance for the cost of capital, calculated on opening assumptions.

NOTES TO THE EEV SUPPLEMENTARY INFORMATION (CONTINUED)

The return from in-force business is calculated using closing assumptions and comprises:

- (i) the expected return, being the unwind of the discount rates over the period applied to establish the value of in-force business at the beginning of the period;
- (ii) variances between the actual experience over the period and the assumptions made to establish the value of business in force at the beginning of the period; and
- (iii) the net effect of changes in future assumptions, made prospectively at the end of the period, from those used in establishing the value of business in force at the beginning of the period, other than changes in economic assumptions.

The contribution from shareholder net worth comprises the actual investment return on residual assets in excess of the required capital.

(e) Assumption setting

There is a requirement under EEV methodology to use best estimate demographic assumptions and to review these at least annually with the economic assumptions being reviewed at each reporting date. The current practice is detailed below.

Each year the demographic assumptions are reviewed as part of year-end processes and hence were reviewed in December 2012.

The detailed projection assumptions, including mortality, morbidity, persistency and expenses reflect recent operating experience. Allowance is made for future improvement in annuitant mortality based on experience and externally published data. Favourable changes in operating experience, particularly in relation to expenses and persistency, are not anticipated until the improvement in experience has been observed. Holding company expenses (for the Chesnara Group such expenses relate largely to listed company functions) are allocated across the segments in proportion to the value before tax of the in-force business. Hence the expense assumptions used for the cash flow projections include the full cost of servicing this business.

The economic assumptions are reviewed and updated at each reporting date based on underlying investment conditions at the reporting date. The assumed discount rates and inflation rates are consistent with the investment return assumptions.

In addition, the demographic assumptions used at 31 December 2012 are considered to be best estimate and, consequently, no further adjustments are required. In respect of the CA Business, the assumptions required in the calculation of the value of the annuity rate guarantee on pension business have been set equal to best-estimate assumptions.

(f) Pension schemes

In Movestic, where the Group participates in a combined defined benefit and defined contribution scheme, future contributions to the scheme are reflected in the value of in-force business.

(g) Financial reinsurance

In respect of Movestic the Group uses financial reinsurance to manage the impact of its new business strain. Whilst this liability is valued at fair value within the IFRS statements, allowing for an option which provides the Group with the right to settle the liability early on beneficial terms, when valuing the shareholder net worth within the EEV it is considered more appropriate to assess this liability at a higher cost, reflecting the likelihood of the option not being utilised.

4 Assumptions

(a) Investment returns

Investment returns are assumed to be equal to the reference rate, as covered in Note 3(c) above. For linked business, the aggregate return has been determined by the reference rate less an appropriate allowance for tax. For the valuation at 31 December 2012 the models for the CA business have been enhanced to allow for the use of a full yield curve. Refer to Note 6(a) below for the impact of this change which is classified as a modelling adjustment. For 2011, whilst for S&P and Movestic, a full swap curve was used, for the CA business, a single rate was applied for all durations.

The rates presented below are indicative spot rates:

31 December	CA		S&P		Movestic	
	2012	2011	2012	2011	2012	2011
Investment Return		1.9%				
5 year	1.03%		1.03%	1.58%	1.52%	2.04%
10 year	1.93%		1.93%	2.36%	2.04%	2.37%
15 year	2.58%		2.58%	2.79%	2.28%	2.42%
20 year	2.94%		2.94%	3.00%	2.33%	2.39%
25 year	3.15%		3.15%	3.14%	2.33%	2.39%
30 year	3.23%		3.23%	3.20%	2.33%	2.39%
Inflation – RPI	2.3%	2.4%	2.3%	2.4%	1.71%	2.3%

(b) Actuarial assumptions

The demographic assumptions used to determine the value of the in-force business have been set at levels commensurate with the underlying operating experience identified in the periodic actuarial investigations.

Certain products contain provisions that provide for the charges in respect of morality risk to be reviewable. In these cases assumptions for future experience and charges are assumed to be in linked and assumptions are only updated when decisions have been made regarding product charges, so as not to capitalise any benefits that may not accrue to shareholders.

(c) Taxation

Projected tax has been determined assuming current tax legislation and rates continue unaltered, except where future tax rates or practices have been announced. The tax rates for CA and S&P allow for changes in Corporation Tax as announced by the Chancellor in his budget speech of 21 March 2012, so reflect a reduction from the current rate of 24% to 23% from April 2013, and 21% from April 2014. They do not allow for the further change, announced by the Chancellor in his budget speech on 20 March 2013, for a reduction in the UK Corporation Tax rate to 20% from April 2015.

(d) Expenses

The expense levels are based on internal expense analysis investigations and are appropriately allocated to the new business and policy maintenance functions. For CA and S&P, these have been determined by reference to:

- (i) the outsourcing agreements in place with our third-party business process administrators;
- (ii) anticipated revisions to the terms of such agreements as they fall due for renewal; and
- (iii) corporate governance costs relating to the covered business.

For Movestic, these have been determined by reference to:

- (i) an expense analysis in which all expenses were allocated to covered and uncovered business, with expenses for the covered business being allocated to acquisition and maintenance activities; and
- (ii) expense drivers, being, in relation to acquisition costs, the number of policies sold during the period and, in relation to maintenance expenses, the average number of policies in force during the period.

Holding company expenses (for the Chesnara Group such expenses relate largely to listed company functions) are allocated across the segments in proportion to the value before tax of the in-force business. For periods up to and including 31 December 2011 such expenses were previously reported as wholly allocable to the CA segment. All segmental information in the following Notes to the Supplementary Information has, as applicable, been restated to reflect the change in allocation methodology.

EEV Guidance requires that no allowance is made for future productivity improvements in expense assumptions. For the UK business, for expenses relating to policy administration this requirement is met. As the UK company is essentially closed to new business, those governance expenses which are not immediately variable can reasonably be expected to reduce through management control in the future, though the timing and scale of such reductions is not fixed. A prudent estimate of the reductions has been allowed for within the expense assumptions.

NOTES TO THE EEV SUPPLEMENTARY INFORMATION (CONTINUED)

(e) Discount rate

An explicit constant margin is added to the reference rate shown in (a) above to cover any remaining risks that are considered to be non-market, non-diversifiable risks, as there is no risk premium observable in the market. This margin, which is 50 basis points for CA and S&P (as at 31 December 2011: 50 basis points) and 70 basis points for Movestic (as at 31 December 2011: 70 basis points), gives due recognition to the relative sensitivity of the value of in-force business to the discount rate for the different businesses, and to the fact that:

a) For CA:

- (i) the covered business is substantially closed to new business;
- (ii) there is no significant exposure in the with profit business, which is wholly reinsured;
- (iii) expense risk is limited as a result of the outsourcing of substantially all policy administration and related functions to third-party business process administrators; and
- (iv) for much of the life business the Group has the ability to vary risk charges made to policyholders.

b) For S&P:

- (i) the covered business is substantially closed to new business; and
- (ii) expense risk is limited as a result of the outsourcing of substantially all policy administration and related functions to third-party business process administrators.

c) For Movestic:

- (i) the covered business remains open;
- (ii) the in-force business is relatively small;
- (iii) reinsurance is used to significantly reduce insurance risks; and
- (iv) a number of the risks provide diversification benefits within the Chesnara Group, in relation to reinsurance counterparties, market exposures and policyholder populations.

5 Analysis of shareholders' equity

31 December 2012					
	CA £000	S&P £000	Movestic £000	Other group activities £000	Total £000
Regulated entities					
Capital required	26,967	47,731	17,355	–	92,053
Restricted capital	–	–	–	–	–
Free surplus	37,142	27,513	15,127	–	79,782
Regulatory capital resource of regulated entities	64,109	75,244	32,482	–	171,835
Adjustments to shareholder net worth:					
Deferred acquisition costs	–	–	(54,314)	–	(54,314)
Financial reinsurance liability	–	–	(5,213)	–	(5,213)
Software asset adjustment	–	–	(5,712)	–	(5,712)
Adjustment to provisions on insurance contracts	–	3,052	–	–	3,052
Policyholder funds	–	(15,351)	–	–	(15,351)
Other asset/liability adjustments	388	–	6,340	–	6,728
Adjusted shareholder net worth	64,497	62,945	(26,417)	–	101,025
In-force value of covered business	67,040	18,537	124,503	–	210,080
Embedded value of regulated entities	131,537	81,482	98,086	–	311,105
Less: amount financed by borrowings	–	(29,662)	–	–	(29,662)
Embedded value of regulated entities attributable to shareholders	131,537	51,820	98,086	–	281,443
Net equity of other Group companies	–	–	1,587	28,115	29,702
Total shareholders' equity	131,537	51,820	99,673	28,115	311,145

31 December 2011 (restated)					
	CA £000	S&P £000	Movestic £000	Other Group Activities £000	Total £000
Regulated entities					
Capital required	28,701	59,237	18,131	–	106,069
Restricted capital	–	888	–	–	888
Free surplus	37,147	29,854	11,474	–	78,475
Regulatory capital resource of regulated entities	65,848	89,979	29,605	–	185,432
Adjustments to shareholder net worth:					
Deferred acquisition costs	–	–	(53,293)	–	(53,293)
Financial reinsurance liability	–	–	(5,499)	–	(5,499)
Software asset adjustment	–	–	(6,744)	–	(6,744)
Adjustment to provisions on insurance contracts	–	2,913	–	–	2,913
Policyholder funds	–	(15,643)	–	–	(15,643)
Other asset/liability adjustments	308	–	7,784	–	8,092
Adjusted shareholder net worth	66,156	77,249	(28,147)	–	115,258
In-force value of covered business	60,655	17,519	121,386	–	199,560
Embedded value of regulated entities	126,811	94,768	93,239	–	314,818
Less: amount financed by borrowings	–	(35,486)	–	–	(35,486)
Embedded value of regulated entities attributable to shareholders	126,811	59,282	93,239	–	279,332
Net equity of other Group companies	–	–	1,332	13,825	15,157
Total shareholders' equity	126,811	59,282	94,571	13,825	294,489

The analysis of shareholder equity at 31 December 2011 has been restated to:

- (i) reflect the change in methodology for the allocation of holding company expenses to the segments, as explained in Note 4(d) above; and to
- (ii) reflect a change in the determination of S&P restricted capital and free surplus within the analysis of the S&P regulated capital resources, there being a £5,366,000 reduction in the determination of restricted capital, and a consequential increase of the same amount in free surplus.

NOTES TO THE EEV SUPPLEMENTARY INFORMATION (CONTINUED)

EEV free surplus, as shown above, represents the balance of the shareholder's net worth above the capital required. The movement in free surplus is analysed as follows:

Year ended 31 December 2012	CA £000	S&P £000	Movestic £000	Total £000
Free surplus at beginning of the year	37,147	29,854	11,474	78,475
Dividend paid to parent	(22,000)	(22,000)	–	(44,000)
Contribution from parent	–	–	–	–
Synergies and adjustments arising from the Part VII transfer, including adjustments to required capital	7,000	–	–	7,000
Surplus arising in the year	13,261	14,557	2,877	30,695
Adjustments to required capital	1,734	5,394	776	7,904
Decrease in policyholder funds cover for capital requirement	–	(292)	–	(292)
Free surplus at end of the year	37,142	27,513	15,127	79,782

Year ended 31 December 2011 (restated)	CA £000	S&P £000	Movestic £000	Total £000
Free surplus at beginning of the year	30,064	24,149	4,736	58,949
Dividend paid to parent	(26,000)	–	–	(26,000)
Contribution from parent	–	–	5,265	5,265
Synergies and adjustments arising from the Part VII transfer, including adjustments to required capital	10,144	2,243	–	12,387
Surplus arising in the year	21,784	14,518	1,019	37,321
Adjustments to required capital	1,155	(11,770)	454	(10,161)
Increase in policyholder funds cover for capital requirement	–	714	–	714
Free surplus at end of the year	37,147	29,854	11,474	78,475

The movement in the in-force value of covered business comprises:

Year ended 31 December 2012	CA £000	S&P £000	Movestic £000	Total £000
Value at beginning of period	60,655	17,519	121,386	199,560
Amount charged to foreign exchange reserve	–	–	1,640	1,640
Amount charged to operating profit	6,385	1,018	1,477	8,880
Value at end of period	67,040	18,537	124,503	210,080

Year ended 31 December 2011 (restated)	CA £000	S&P £000	Movestic £000	Total £000
Value at beginning of period	85,035	39,269	141,111	265,415
Amount charged to foreign exchange reserve	–	–	(1,409)	(1,409)
Amount charged to operating profit	(24,380)	(21,750)	(18,316)	(64,446)
Value at end of period	60,655	17,519	121,386	199,560

The movement in the in-force value for the year ended 31 December 2011 has been restated to reflect the change in methodology for the allocation of holding company expenses to the segments, as explained in Note 4(d).

S&P

On 20 December 2010, the Group drew down £40m on a bank loan facility, in order to part fund the acquisition of Save & Prosper Insurance Limited and its subsidiary, Save & Prosper Pensions Limited (together 'S&P'). This effectively represented a purchase of part of the underlying value in force of S&P by way of debt finance and it follows that the embedded value of the UK regulated entity is not attributable to equity shareholders of the Group to the extent of the outstanding balance on the loan account at each balance sheet date. In accordance with this a further £6.0m of the loan was repaid on 20 December 2012, leaving principal outstanding at that date of £30m.

Movestic

The adjusted shareholder net worth of Movestic is that of the regulated entity, which includes also the net worth attributable to the non-covered business within the regulated entity. Accordingly, for Movestic, the embedded value of regulated entities comprises the embedded value of covered business and the value of the non-covered business of the regulated entity, the latter component being valued on an IFRS basis.

6 Summarised statement of changes in equity and analysis of profit/(loss)**(a) Changes in equity may be summarised as:**

Statement of changes in equity Year ended 31 December	2012 £000	2012 £000	2011 £000	2011 £000
Shareholders' equity at beginning of the year		294,489		354,636
Profit/(loss) for the period attributable to shareholders before modelling adjustments	31,255		(29,782)	
Effect of modelling adjustments	3,574		(10,328)	
Profit/(loss) for the year		34,829		(40,110)
Foreign exchange reserve movement		1,352		(1,030)
Dividends paid		(19,525)		(19,007)
Shareholders' equity at end of the year		311,145		294,489

Effect of modelling adjustments

Modelling adjustments during the year ended 31 December 2012 give rise to a net increase in EEV of £3.6m, comprising:

Movestic

During 2012, there has been a continued focus on ensuring that the Movestic EEV model is robust. The process, which has included independent review, has identified the following:

- (i) Levels of commission claw-back within the future cash flow projections were overstated by £7.9m; and
- (ii) Several enhancements to policy fee cash flow estimates and data input routines have been identified with a total net adverse impact of £1.1m.

UK

The CA and CWA EEV models previously assumed a single average rate of investment return for all durations as opposed the use of a full yield curve. This approximation was reported in the EEV assumptions section 4(a) of the Supplementary Information within the 2011 Report and Accounts. As at 31 December 2012 the models have been enhanced to recognise differing rates of return across the different durations of the yield curve resulting in a net of tax increase of £12.6m.

Modelling adjustments during the year ended 31 December 2011 gave rise to a net reduction in EEV of £(10.3)m comprising:

Movestic

- (i) An improvement was introduced into the Movestic modelling system in respect of projected fee income from investment contracts where the fee is premium based, such contracts hitherto not being differentiated and this resulted in an increase in embedded value of £2.7m; and
- (ii) Modelling errors were detected relating to certain parameters and discounting periods specified at inception of the new model and the correction of these has given rise to a reduction in embedded value of £12.4m. The European Embedded Value principles issued by the European CFO Forum in May 2004, together with supplementary guidance, do not provide specific guidance on how these errors should be treated and presented.

UK

S&P model enhancements giving rise to a further £0.6m reduction in EEV, account for the balance of the total modelling adjustments of £(10.3)m for the year ended 31 December 2011, as presented above.

The effect of modelling adjustments is classified as an exceptional item in the consolidated income statement and is presented after operating profit.

NOTES TO THE EEV SUPPLEMENTARY INFORMATION (CONTINUED)

(b) The profit/(loss) for the year before modelling adjustments is analysed as:

Year ended 31 December 2012						
	CA £000	S&P £000	UK Total £000	Movestic £000	Other Group Activities £000	Total £000
Covered business						
New business contribution	339	(33)	306	2,596	–	2,902
Return from in-force business						
Expected return	2,308	274	2,582	3,290	–	5,872
Experience variances	5,194	3,029	8,223	(7,855)	–	368
Operating assumption changes	(335)	(2,858)	(3,193)	5,176	–	1,983
Return on shareholder net worth	859	7,048	7,907	–	–	7,907
Operating profit of covered business	8,365	7,460	15,825	3,207	–	19,032
Variation from longer-term investment return	8,864	10,967	19,831	8,204	–	28,035
Effect of economic assumption changes	(4,106)	(2,713)	(6,819)	315	–	(6,504)
Profit of covered business before tax	13,123	15,714	28,837	11,726	–	40,563
Tax thereon			(5,990)	–	–	(5,990)
Profit of covered business after tax			22,847	11,726	–	34,573
Results of non-covered business and of other group companies						
Profit/(loss) before tax			–	1,299	(5,745)	(4,446)
Tax			–	(295)	1,423	1,128
Profit/(loss) after tax			22,847	12,730	(4,322)	31,255

The results of the non-covered business and of other group companies before tax and before exceptional item are presented as 'other operational result' in the consolidated income statement.

Year ended 31 December 2011 (restated)						
	CA £000	S&P £000	UK Total £000	Movestic £000	Other Group Activities £000	Total £000
Covered business						
New business contribution	398	42	440	3,074	–	3,514
Return from in-force business						
Expected return	4,072	257	4,329	5,902	–	10,231
Experience variances	5,203	(157)	5,046	(4,922)	–	124
Operating assumption changes	1,641	(887)	754	(3,371)	–	(2,617)
Return on shareholder net worth	1,126	2,936	4,062	–	–	4,062
Operating profit of covered business	12,440	2,191	14,631	683	–	15,314
Variation from longer-term investment return	3,066	(1,762)	1,304	(18,233)	–	(16,929)
Effect of economic assumption changes	(8,754)	(23,706)	(32,460)	(19)	–	(32,479)
Profit/(loss) of covered business before tax	6,752	(23,277)	(16,525)	(17,569)	–	(34,094)
Tax thereon			5,651	–	–	5,651
Loss of covered business after tax			(10,874)	(17,569)	–	(28,443)
Results of non-covered business and of other group companies						
Profit/(loss) before tax			–	308	(3,119)	(2,811)
Tax			–	280	1,192	1,472
Loss after tax			(10,874)	(16,981)	(1,927)	(29,782)

The analysis of profit/(loss) of covered business before tax for the year ended 31 December 2011 has been restated to reflect the change in methodology for the allocation of holding company expenses to the segments as explained in Note 4(d) above.

7 Sensitivities to alternative assumptions

The following tables show the sensitivity of the embedded value as reported at 31 December 2012, and of the new business contribution of Movestic, to variations in the assumptions adopted in the calculation of the embedded value. Sensitivity analysis is not provided in respect of the new business contribution of CA and S&P for the year ended 31 December 2012 as the reported level of new business contribution is not considered to be material (see Note 3(a)).

	Embedded value					New business contribution
	UK business				Swedish business	
	CA Pre-tax £m	S&P Pre-tax £m	Tax £m	Total UK Post-tax £m	Post-tax £m	Swedish business £m
Published value as at 31 December 2012	149.3	81.5	(17.8)	213.0	98.1	2.6
Changes in embedded value/new business contribution arising from:						
Economic sensitivities						
100 basis point increase in yield curve	(2.5)	18.0	(1.7)	13.8	(0.6)	(0.1)
100 basis point reduction in yield curve	3.1	(17.8)	(1.3)	(16.0)	0.6	0.1
10% decrease in equity and property values	(2.2)	(10.9)	1.5	(11.6)	(10.2)	–
Operating sensitivities						
10% decrease in maintenance expenses	3.1	4.5	(0.2)	7.4	6.1	0.4
10% decrease in lapse rates	2.7	(1.9)	0.2	1.0	8.9	0.8
5% decrease in mortality/morbidity rates						
Assurances	1.0	0.9	–	1.9	0.2	–
Annuities	(1.8)	(0.7)	0.2	(2.3)	n/a	n/a
Reduction in the required capital to statutory minimum	0.4	0.8	–	1.2	–	–

The key assumption changes represented by each of these sensitivities are as follows:

Economic sensitivities

- (i) 100 basis point increase in the yield curve: The reference rate is increased by 1% and the rate of future inflation has also been increased by 1% so that real yields remain constant;
- (ii) 100 basis point reduction in the yield curve: The reference rate is reduced by 1% (with a minimum of zero to avoid negative yields where relevant) and the rate of future inflation has also been reduced by 1% so that real yields remain constant; and
- (iii) 10% decrease in the equity and property values. This gives rise to a situation where, for example, a Managed Fund unit liability with a 60% equity holding would reduce by 6% in value.

Operating sensitivities

- (i) 10% decrease in maintenance expenses, giving rise to, for example, a base assumption of £20 per policy pa reducing to £18 per policy pa;
- (ii) 10% decrease in persistency rates giving rise to, for example, a base assumption of 10% of policy base lapsing pa reducing to 9% pa;
- (iii) 5% decrease in mortality/morbidity rates giving rise to, for example, a base assumption of 95% of the parameters in a selected mortality/morbidity table reducing to 90.25% of the parameters in the same table, assuming no changes are made to policyholder charges or any other management actions; and
- (iv) the sensitivity to the reduction in the required capital to the statutory minimum shows the effect of reducing the required capital from that defined in Note 3(b) above to the minimum requirement prescribed by regulation.

In each sensitivity calculation all other assumptions remain unchanged except where they are directly affected by the revised economic conditions: for example, as stated, changes in interest rates will directly affect the reference rate.

NOTES TO THE EEV SUPPLEMENTARY INFORMATION (CONTINUED)

8 Reconciliation of shareholders' equity on the IFRS basis to shareholders' equity on the EEV basis

31 December 2012	CA £000	S&P £000	Movestic £000	Other Group Activities £000	Total £000
Shareholders' equity on the IFRS basis	86,498	75,570	58,078	(1,800)	218,346
Reclassifications					
Debt finance	–	(29,662)	–	29,662	–
Other	(253)	–	–	253	–
Adjustments					
Deferred acquisition costs	(4,631)	–	(17,000)	–	(21,631)
Deferred income	8,214	–	–	–	8,214
Adjustment to provisions on investment contracts, net of amounts deposited with reinsurers	(11,451)	–	–	–	(11,451)
Adjustments to provisions on insurance contracts, net of reinsurers' share	(40)	(7,051)	–	–	(7,091)
Acquired in-force value	(11,403)	(5,574)	(54,286)	–	(71,263)
Acquired value of customer relationships	–	–	(1,322)	–	(1,322)
Software assets	–	–	(5,712)	–	(5,712)
Adjustment to borrowings	–	–	(7,049)	–	(7,049)
Deferred tax	(2,437)	–	2,461	–	24
Shareholder net worth	64,497	33,283	(24,830)	28,115	101,065
Value of in-force business	67,040	18,537	124,503	–	210,080
Shareholders' equity on the EEV basis	131,537	51,820	99,673	28,115	311,145
Shareholder net worth comprises:					
Shareholder net worth in regulated entities	64,497	62,945	(26,417)	–	101,025
Shareholders' net equity in other Group companies	–	–	1,587	28,115	29,702
Debt finance	–	(29,662)	–	–	(29,662)
Total	64,647	33,283	(24,830)	28,115	101,065

31 December 2011 (restated)					
	CA	S&P	Movestic	Other Group	Total
	£000	£000	£000	Activities	£000
				£000	
Shareholders' equity on the IFRS basis	85,486	88,736	56,910	(21,943)	209,189
Reclassifications					
Debt finance	–	(35,486)	–	35,486	–
Other	(282)	–	–	282	–
Adjustments					
Deferred acquisition costs	(5,272)	–	(13,161)	–	(18,433)
Deferred income	9,285	–	–	–	9,285
Adjustment to provisions on investment contracts, net of amounts deposited with reinsurers	(11,477)	–	–	–	(11,477)
Adjustments to provisions on insurance contracts, net of reinsurers' share	(119)	(7,163)	–	–	(7,282)
Acquired in-force value	(13,350)	(6,068)	(57,770)	–	(77,188)
Acquired value of customer relationships	–	–	(1,561)	–	(1,561)
Software assets	–	–	(6,744)	–	(6,744)
Adjustment to borrowings	–	–	(7,012)	–	(7,012)
Deferred tax	1,885	1,744	2,523	–	6,152
Shareholder net worth	66,156	41,763	(26,815)	13,825	94,929
Value of in-force business	60,655	17,519	121,386	–	199,560
Shareholders' equity on the EEV basis	126,811	59,282	94,571	13,825	294,489
Shareholder net worth comprises:					
Shareholder net worth in regulated entities	66,156	77,249	(28,147)	–	115,258
Shareholders' net equity in other Group companies	–	–	1,332	13,825	15,157
Debt finance	–	(35,486)	–	–	(35,486)
Total	66,156	41,763	(26,815)	13,825	94,929

The reconciliation for the year ended 31 December 2011 has been restated to reflect the change in methodology for the allocation of holding company expenses to the segments as explained in Note 4(d) above.

9 Earnings per share

Year ended 31 December	2012	2011
	p	p
Basic earnings per share		
Based on profit/(loss) for the period	30.33	(34.92)
Based on profit/(loss) for the period before exceptional item	27.21	(25.93)
Diluted earnings per share		
Based on profit/(loss) for the period	30.33	(34.92)
Based on profit/(loss) for the period before exceptional item	27.21	(25.93)

10 Foreign exchange translation reserve

A foreign exchange translation reserve arises on the translation of the financial statements of Movestic, the functional currency of which is the Swedish Krona, into pounds sterling, which is the presentational currency of the Group financial statements. Items in the consolidated income statement are translated at the average exchange rate of SEK10.7326 = £1 ruling in the reported period (year ended 31 December 2011: SEK10.4104 = £1), while all items in the balance sheet are stated at the closing rates ruling at the reported balance sheet date, being SEK10.5247 = £1 at 31 December 2012 (SEK10.6553 = £1 at 31 December 2011). The differences arising on translation using this methodology are recognised directly in shareholders' equity within the foreign exchange translation reserve.

The reported embedded value is sensitive to movements in the SEK: £ exchange rate. Had the exchange rate as at 31 December 2012 been 10% higher at SEK11.5772 = £1, then the reported embedded value of £311.1m as at 31 December 2012 would have been reported as £301.7m.

SECTION F

ADDITIONAL INFORMATION

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FINANCIAL CALENDAR

28 March 2013

Results for the year ended 31 December 2012 announced

10 April 2013

Ex dividend date

11 April 2013

Published Financial Statements issued to shareholders

12 April 2013

Dividend record date

17 May 2013

Annual General Meeting

17 May 2013

Interim Management Statement for the quarter ending 31 March 2013

22 May 2013

Dividend payment date

August 2013

Interim results for the 6 months ending 30 June 2013 announced

November 2013

Interim Management Statement for the quarter ending 30 September 2013 announced

KEY CONTACTS

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Fax: +44 (0)1772 840010
www.chesnara.co.uk

Legal Advisors

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Broadwalk House
5 Appold Street
London
EC2A 2HA

Addleshaw Goddard LLP
100 Barbirolli Square
Manchester
M2 3AB

Auditor

Deloitte LLP
Chartered Accountants and Statutory Auditors
2 Hardman Street
Manchester
M60 2AT
United Kingdom

Registrars

Capita
The Registry
34 Beckenham Road
Beckenham
Kent
BR3 4TU

Stockbrokers

Panmure Gordon
One New Change
London
EC4M 3UR

Canaccord Genuity Limited
88 Wood Street
London
EC2V 7QR

Bankers

National Westminster Bank plc
135 Bishopsgate
London
EC2M 3UR

The Royal Bank of Scotland
8th Floor, 135 Bishopsgate
London
EC2M 3UR

Lloyds TSB Bank plc
3rd Floor, Black Horse House
Medway Wharf Road
Tonbridge
Kent
TN9 1QS

Public Relations Consultants

Cubitt Consulting
30 Coleman Street
London
EC2R 5AL

Corporate Advisors

Canaccord Genuity Limited
41 Lothbury
London
EC2R 7AE

NOTICE OF ANNUAL GENERAL MEETING

This document is important and requires your immediate attention

If you are in any doubt as to the action you should take, you should immediately consult your stockbroker, bank manager, solicitor, accountant or other independent professional adviser authorised under the Financial Services and Markets Act 2000 if you are resident in the United Kingdom or, if you reside elsewhere, another appropriately authorised financial adviser.

If you have sold or otherwise transferred all of your shares in Chesnara plc please pass this document together with the accompanying proxy form as soon as possible to the purchaser or transferee, or to the person who arranged the sale or transfer so they can pass these documents to the person who now holds the shares.

Company No. 4947166

Chesnara plc

Notice is given that the 2013 Annual General Meeting of Chesnara plc will be held at the offices of Panmure Gordon (UK) Limited, One New Change, London EC4M 9AF on 17 May 2013 at 11a.m. for the business set out below. Resolutions 1 to 12 inclusive will be proposed as ordinary resolutions and resolutions 13 to 15 inclusive will be proposed as special resolutions.

1. To receive and adopt the audited accounts for the financial year ended 31 December 2012, together with the reports of the directors and auditor thereon.
2. To declare a final dividend of 11.25 pence per share for the financial year ended 31 December 2012.
3. To approve the directors' remuneration report set out in the Annual Report and Accounts for the financial year ended 31 December 2012.
4. To re-elect Frank Hughes as a director who retires by rotation in accordance with the Company's Articles of Association.
5. To elect Veronica France as a director.
6. To elect David Brand as a director.
7. To elect Mike Evans as a director.
8. To elect David Rimmington as a director.
9. To reappoint Deloitte LLP as auditor of the Company to hold office until the conclusion of the next general meeting of the Company at which accounts are laid before shareholders.
10. To authorise the directors to fix the auditor's remuneration.
11. That, from the passing of this resolution until the earlier of 16 November 2014 and the conclusion of the Company's next Annual General Meeting, the Company and all companies which are its subsidiaries at any time during such period are authorised:
 - (a) to make donations to political parties or independent election candidates;
 - (b) to make donations to political organisations other than political parties; and
 - (c) to incur political expenditure,
up to an aggregate total amount of £100,000, with the individual amount authorised for each of heads (a) to (c) above being limited to £100,000. Any such amounts may comprise sums paid or incurred in one or more currencies. Any sum paid or incurred in a currency other than sterling shall be converted into sterling at such rate as the board may decide is appropriate. Terms used in this resolution have, where applicable, the meanings that they have in Part 14 of the Companies Act 2006 on "Control of political donations and expenditure."
12. That the directors be and they are hereby generally and unconditionally authorised in accordance with section 551 of the Companies Act 2006 to exercise all powers of the Company to allot shares in the Company and to grant rights to subscribe for or to convert any security into such shares ("Allotment Rights"), but so that:
 - (a) the maximum amount of shares that may be allotted or made the subject of Allotment Rights under this authority are shares with an aggregate nominal value of £3,790,019, of which:
 - (i) half may be allotted or made the subject of Allotment Rights in any circumstances; and
 - (ii) the other half may be allotted or made the subject of Allotment Rights pursuant to any rights issue (as referred to in the Financial Services Authority's listing rules) or pursuant to any arrangements made for the placing or underwriting or other allocation of any shares or other securities included in, but not taken up under, such rights issue;
 - (b) this authority shall expire 18 months after the passing of this resolution or, if earlier, on the date of the Company's next Annual General Meeting;
 - (c) the Company may make any offer or agreement before such expiry which would or might require shares to be allotted or Allotment Rights to be granted after such expiry; and
 - (d) all authorities vested in the directors on the date of the notice of this meeting to allot shares or to grant Allotment Rights that remain unexercised at the commencement of this meeting are revoked.

13. That, subject to the passing of the resolution numbered 12 in the notice convening this meeting, the directors be and they are hereby empowered, pursuant to section 570 of the Companies Act 2006, to allot equity securities (as defined in section 560 of that Act) pursuant to the authority conferred on them by the foregoing resolution numbered 12 in the notice of this meeting or by way of a sale of treasury shares as if section 561 of that Act did not apply to such allotment, provided that this power shall be limited to:

(a) the allotment of equity securities in connection with any rights issue or open offer (each as referred to in the Financial Services Authority's listing rules) or any other pre-emptive offer that is open for acceptance for a period determined by the directors to the holders of ordinary shares on the register on any fixed record date in proportion to their holdings of ordinary shares (and, if applicable, to the holders of any other class of equity security in accordance with the rights attached to such class), subject, in each case, to such exclusions or other arrangements as the directors may deem necessary or appropriate in relation to fractions of such securities, the use of more than one currency for making payments in respect of such offer, any such shares or other securities being represented by depositary receipts, treasury shares, any legal or practical problems in relation to any territory or the requirements of any regulatory body or any stock exchange; and

(b) the allotment of equity securities for cash (otherwise than as mentioned in sub-paragraph (a) above), provided that the maximum aggregate nominal value of equity securities allotted does not exceed £287,619,

and shall expire 18 months after the passing of this resolution or, if earlier, on the date of the Company's next Annual General Meeting save that, before the expiry of this power, the Company may make any offer or agreement which would or might require equity securities to be allotted after such expiry.

14. That the Company be and is hereby generally and unconditionally authorised for the purposes of section 701 of the Companies Act 2006 to make one or more market purchases (as defined in section 693 of that Act) of ordinary shares of 5p each in the capital of the Company, provided that:

(a) the maximum aggregate number of ordinary shares hereby authorised to be purchased is 11,484,908;

(b) the minimum price (exclusive of expenses) which may be paid for such ordinary shares is 5p per share;

(c) the maximum price (exclusive of expenses) which may be paid for such ordinary shares is the maximum price permitted under the Financial Services Authority's listing rules or, in the case of a tender offer (as referred to in those rules), 5% above the average of the middle market quotations for the ordinary shares (as derived from the Daily Official List of London Stock Exchange plc) for the five business days immediately preceding the date on which the terms of the tender offer are announced;

(d) the authority hereby conferred shall expire 18 months after the passing of this resolution or, if earlier, on the date of the Company's next Annual General Meeting; and

(e) the Company may make a contract or contracts to purchase ordinary shares under the authority hereby conferred prior to the expiry of such authority which will or may be completed wholly or partly after the expiry of such authority, and may make a purchase of ordinary shares in pursuance of any such contract or contracts.

15. That a general meeting of the Company (other than an Annual General Meeting) may be called on not less than 14 clear days' notice.

By order of the Board

Mary Fishwick
Company Secretary

Registered office:
Harbour House
Portway
Preston
Lancashire
PR2 2PR
Registered in England No. 4947166

Dated 27 March 2013

NOTES

1. Any member who is entitled to attend and vote at this Annual General Meeting is entitled to appoint another person, or two or more persons in respect of different shares held by him, as his proxy to exercise all or any of his rights to attend and to speak and to vote at the Annual General Meeting.
2. A member wishing to attend and vote at the Annual General Meeting in person should arrive prior to the time fixed for its commencement. A member that is a corporation can only attend and vote at the Annual General Meeting in person through one or more representatives appointed in accordance with section 323 of the Companies Act 2006. Any such representative should bring to the Annual General Meeting written evidence of his appointment such as a certified copy of a board resolution of, or a letter from, the corporation concerned confirming the appointment. Any member wishing to vote at the Annual General Meeting without attending in person or (in the case of a corporation) through its duly appointed representative must appoint a proxy to do so. A proxy need not be a member of the Company. A form of proxy for this Annual General Meeting is enclosed and, in order to be valid, must be completed in accordance with the instructions that accompany it and then be delivered (together with any power of attorney or other authority under which it is signed, or a certified copy of such item), to the Company's Registrars, Capita Registrars at PXS, 34 Beckenham Road, Beckenham, Kent, BR3 4TU or by post to Business Reply Licence No RSBH-UXKS-LRBC, PXS, 34 Beckenham Road, Beckenham, Kent, BR3 4TU by 11 a.m. on Wednesday 15 May 2013. Alternatively, members may appoint a proxy online by following the instructions for the electronic appointment of a proxy at www.capitashareportal.com, by entering the company name "Chesnara plc" and following the on screen instructions. To be a valid proxy appointment, the member's electronic message confirming the details of the appointment completed in accordance with those instructions must be transmitted so as to be received by the same time. Members who hold their shares in uncertificated form may also use the "CREST" voting service to appoint a proxy electronically, as explained below. The appointment of a proxy will not preclude a member from attending and voting at the Annual General Meeting.
3. CREST members who wish to appoint one or more proxies through the CREST system may do so by using the procedures described in "the CREST voting service" section of the CREST Manual. CREST personal members or other CREST sponsored members, and those CREST members who have appointed one or more voting service providers, should refer to their CREST sponsor or voting service provider(s), who will be able to take the appropriate action on their behalf. In order for a proxy appointment or a proxy instruction made using the CREST voting service to be valid, the appropriate CREST message (a "CREST proxy appointment instruction") must be properly authenticated in accordance with the specifications of CREST's operator, Euroclear UK & Ireland Limited ("Euroclear"), and must contain all the relevant information required by the CREST Manual. To be valid, the message (regardless of whether it constitutes the appointment of a proxy or is an amendment to the instruction given to a previously appointed proxy) must be transmitted so as to be received by Capita Registrars (ID RA10), by 11 a.m. on Wednesday 15 May 2013, which is acting as the Company's "issuer's agent". After this time, any change of instruction to a proxy appointed through the CREST system should be communicated to the appointee through other means. The time of the message's receipt will be taken to be when (as determined by the timestamp applied by the CREST Applications Host) the issuer's agent is first able to retrieve it by enquiry through the CREST system in the prescribed manner. Euroclear does not make available special procedures in the CREST system for transmitting any particular message. Normal system timings and limitations apply in relation to the input of CREST proxy appointment instructions. It is the responsibility of the CREST member concerned to take (or, if the CREST member is a CREST personal member or a CREST sponsored member or has appointed any voting service provider(s), to procure that his CREST sponsor or voting service provider(s) take(s)) such action as is necessary to ensure that a message is transmitted by means of the CREST system by any particular time. CREST members and, where applicable, their CREST sponsors or voting service providers should take into account the provisions of the CREST Manual concerning timings as well as its section on "Practical limitations of the system". In certain circumstances, the Company may, in accordance with the Uncertificated Securities Regulations 2001 or the CREST Manual, treat a CREST proxy appointment instruction as invalid.
4. Copies of directors' service contracts and letters of appointment will be available for inspection at the registered office of the Company during normal business hours each business day and at the place of the Annual General Meeting for at least 15 minutes prior to and during the Annual General Meeting.

5. The time by which a person must be entered on the register of members in order to have the right to attend and vote at the Annual General Meeting (and for the purpose of the determination by the Company of the votes they may cast) is 6.00p.m. on Wednesday 15 May 2013. Changes to entries on the register of members after that time will be disregarded in determining the right of any person to attend or vote at the Annual General Meeting.
6. The right to appoint proxies does not apply to persons nominated to receive information rights under section 146 of the Companies Act 2006, as such rights can only be exercised by the member concerned. Any person nominated to enjoy information rights under section 146 of the Companies Act 2006 who has been sent a copy of this notice of Annual General Meeting is hereby informed, in accordance with section 149(2) of the Companies Act 2006, that they may have a right under an agreement with the registered member by whom they were nominated to be appointed, or to have someone else appointed, as a proxy for this Annual General Meeting. If they have no such right, or do not wish to exercise it, they may have a right under such an agreement to give instructions to the member as to the exercise of voting rights. Nominated persons should contact the registered member by whom they were nominated in respect of these arrangements.
7. As at 27 March 2013 (being the last practicable date prior to the publication of this document), the Company's issued share capital consisted of 115,047,662 ordinary shares, carrying one vote each. The total voting rights in the Company as at 27 March 2013 (being the last practicable date prior to the publication of this document) were 114,849,083.
8. Information regarding this Annual General Meeting, including information required by section 311A of the Companies Act 2006, is available at www.chesnara.co.uk. Any electronic address provided either in this notice or any related documents (including the proxy appointment form) may not be used to communicate with the Company for any purposes other than those expressly stated.
9. In accordance with section 319A of the Companies Act 2006, any member attending the Annual General Meeting has the right to ask questions. The Company must cause to be answered any such question relating to the business being dealt with at the Annual General Meeting, but no such answer need be given if (a) to do so would interfere unduly with the preparations for the Annual General Meeting or involve the disclosure of confidential information, (b) the answer has already been given on a website in the form of an answer to a question or (c) it is undesirable in the interests of the Company or the good order of the Annual General Meeting that the question be answered.
10. Under section 527 of the Companies Act 2006, members meeting the threshold requirements set out in that section have the right to require the Company to publish on a website a statement in accordance with section 528 of the Companies Act 2006 setting out any matter relating to (i) the audit of the Company's accounts (including the auditor's report and the conduct of the audit) that are to be laid before the Annual General Meeting or (ii) any circumstances connected with an auditor of the Company ceasing to hold office since the previous meeting at which annual accounts and reports were laid in accordance with section 437 of the Companies Act 2006. The Company may not require the members requesting any such website publication to pay its expenses in complying with sections 527 or 528 of the Companies Act 2006. Where the Company is required to place a statement on a website under section 527 of the Companies Act 2006, it must forward the statement to the Company's auditor not later than the time when it makes the statement available on the website. The business which may be dealt with at the Annual General Meeting includes any statement that the Company has been required under section 527 of the Companies Act 2006 to publish on a website.

EXPLANATORY NOTES TO THE NOTICE OF ANNUAL GENERAL MEETING

The notes on the following pages give an explanation of the proposed resolutions:

Resolution 1:

Report and accounts

For each financial year, the directors are required to present the directors' report, the audited accounts and the auditor's reports to shareholders at a general meeting.

Resolution 2:

Final dividend

The payment of the final dividend requires the approval of shareholders in general meeting. If the Annual General Meeting approves resolution 2, the final dividend of 11.25 pence per share will be paid on 22 May 2013 to ordinary shareholders who are on the register of members at the close of business on 12 April 2013 in respect of each ordinary share.

Resolution 3:

Approval of the directors' remuneration report

The Company is required by law to seek the approval of shareholders of its annual report on remuneration policy and practice. This does not affect the directors' entitlement to remuneration and the result of this resolution is advisory only.

The remuneration report for the year ended 31 December 2012 is set out in full on pages 56 to 60 of this document.

Your directors are satisfied that the Company's policy and practice in relation to directors' remuneration are reasonable and that they deserve shareholder support.

Resolutions 4 – 8 inclusive:

Re-election/Election of directors

Under the Company's Articles of Association, directors are obliged to retire by rotation at Annual General Meetings and may not serve beyond three years without being re-elected by shareholders. The director who now falls due for retirement and re-election at the Annual General Meeting is Frank Hughes. In addition, Veronica France, David Brand and Mike Evans have been appointed to the board since the last Annual General Meeting and it is proposed that David Rimmington be elected to the board at the Meeting and they are therefore put forward for election to the board. Brief biographical details of Veronica France, David Brand, Mike Evans and David Rimmington can be found on page 49 of this document. The Chairman confirms that, following formal performance evaluation of Frank Hughes by the board, he continues to be effective and demonstrate commitment to the role. The Chairman further confirms that, following a rigorous selection process by the board, each of Veronica France, David Brand, Mike Evans and David Rimmington, is expected to be effective and committed to her or his role. The remaining directors therefore unanimously recommend that each of these directors be re-elected or elected (as applicable) as a director of the Company.

Resolutions 9 and 10:

Re-appointment and remuneration of auditors

The Company is required to appoint an auditor, at each general meeting before which accounts are laid, to hold office until the end of the next such meeting. Deloitte LLP has indicated that it is willing to act as the Company's auditor. You are asked to re-appoint Deloitte LLP and, following normal practice, to authorise the directors to determine its remuneration. The directors recommend its appointment.

Resolution 11:

Political donations

It has always been the Company's policy that it does not make political donations. This remains the Company's policy.

Part 14 of the Companies Act 2006 imposes restrictions on companies making political donations to any political party or other political organisation or to any independent election candidate unless they have been authorised to make donations at a general meeting of the Company. Whilst the Company has no intention of making such political donations, the Act includes broad and ambiguous definitions of the terms "political donation" and "political expenditure" which may apply to some normal business activities which would not generally be considered to be political in nature.

The directors therefore consider that, as a purely precautionary measure, it would be prudent to obtain the approval of the shareholders to make donations to political parties, political organisations and independent election candidates and to incur political expenditure up to the specified limit. The directors intend to seek renewal of this approval at future Annual General Meetings, but wish to emphasise that the proposed resolution is a precautionary measure for the above reason and that they have no intention of making any political donations or entering into party political activities.

Resolution 12

Power to allot shares

The directors are currently authorised to allot shares and to grant rights to subscribe for or to convert any security into shares of the Company, but their authorisation ends on the date of this year's Annual General Meeting. This resolution seeks to renew the directors' authority to allot shares.

The Association of British Insurers ("ABI") published guidance on 31 December 2008 (as amended on 30 November 2009) to the effect that ABI members will regard as routine a request for authorisation to allot new shares in an amount of up to one third of the existing issued share capital and additionally that they will regard as routine requests to authorise the allotment of a further one third, provided that such additional authority is applied to fully pre-emptive rights issues only and the authorisation is valid for one year only. This authority was conferred on the directors at last year's Annual General Meeting and the directors recommend that the Company

should have this additional headroom this year. This authority is limited to a maximum nominal amount of £3,790,019 (representing 75,800,380 ordinary shares), which represents approximately two thirds in aggregate of the total ordinary share capital in issue (excluding treasury shares) as at 27 March 2013 (being the latest practicable date prior to the publication of this document). Of this amount, 37,900,190 ordinary shares (representing approximately one third in aggregate of the total ordinary share capital in issue, excluding treasury shares) can only be allotted pursuant to a rights issue.

As at 27 March 2013 (being latest practicable date prior to the publication of this document), the Company held 198,579 treasury shares, being approximately 0.17% of the total ordinary share capital in issue (calculated exclusive of treasury shares).

The renewed authority will expire 18 months after the passing of this resolution or, if earlier, on the date of the next Annual General Meeting.

The directors have no present intention of exercising this authority. The purpose of giving the directors this authority is to maintain the Company's flexibility to take advantage of any appropriate opportunities that may arise.

Resolution 13

Disapplication of pre-emption rights

This resolution, which will be proposed as a special resolution, seeks to renew the authority conferred on the directors at last year's Annual General Meeting to issue equity securities of the Company for cash without first offering them to existing shareholders in proportion to their existing shareholdings. Other than in connection with a rights or other similar issue or scrip dividend (where difficulties arise in offering shares to certain overseas shareholders and in relation to fractional entitlements), the authority contained in this resolution will be limited to an aggregate nominal value of £287,619 (representing 5,752,380 ordinary shares), which represents approximately 5% of the Company's issued equity share capital as at 27 March 2013 (being the latest practicable date prior to the publication of this document). The renewed authority will expire 18 months after the passing of this resolution or, if earlier, on the date of the of the next Annual General Meeting. This is a standard resolution for most UK listed companies each year.

In accordance with the Statement of Principles on disapplying pre-emption rights issued in July 2008 by the Pre-Emption Group (which is supported by the Association of British Insurers, the National Association of Pension Funds Limited and the Investment Managers Association), the board confirms its intention that no more than 7.5% of the issued share capital will be issued for cash on a non pre-emptive basis during any rolling three year period. The directors have no present intention of exercising this authority.

Resolution 14:

Authority to purchase own shares

This resolution, which will be proposed as a special resolution, is to renew the authority granted to the directors at last year's Annual General Meeting, which expires on the date of this year's Annual General Meeting, and to give the Company authority to buy back its own ordinary shares in the market as permitted by the Companies Act 2006. The authority limits the number of shares that can be purchased to a maximum of 11,484,908 (representing 10% of the issued ordinary share capital of the Company (excluding treasury shares) as at 27 March 2013 (being the latest practicable date prior to the publication of this document) and sets the minimum and maximum prices. This authority will expire no later than 18 months after the date of the Annual General Meeting.

Your directors believe that the Company should continue to have the authority to purchase its own shares. The authority will be exercised only if the directors believe that to do so would result in an increase in earnings per share and would promote the success of the Company for the benefit of its shareholders generally. To the extent that any shares so purchased are held in treasury (see below), earnings per share will be enhanced until such time, if any, as such shares are resold or transferred out of treasury.

Any purchases of ordinary shares would be by means of market purchases through the London Stock Exchange.

Sections 724 – 732 inclusive of the Companies Act 2006 provide that shares held in treasury can be cancelled, sold for cash or, in appropriate circumstances, used to meet obligations under employee share schemes. Any shares held in treasury would not be eligible to vote nor would any dividend be paid on any such shares. If any ordinary shares purchased pursuant to this authority are not held by the Company as treasury shares, then such shares would be immediately cancelled, in which event the number of ordinary shares in issue would be reduced.

The directors believe that it continues to be desirable for the Company to have this choice. Holding the repurchased shares as treasury shares gives the Company the ability to re-issue them quickly and cost effectively and provides the Company with additional flexibility in the management of its capital base. No dividends will be paid on, and no voting rights will be exercised in respect of, treasury shares. In 2012, no shares were purchased into treasury, none were sold and none were cancelled. Between 1 January 2013 and 27 March 2013 432 shares were transferred out of treasury to meet a sharesave plan option.

EXPLANATORY NOTES TO THE NOTICE OF ANNUAL GENERAL MEETING (CONTINUED)

Resolution 15:

Notice of general meetings

The Companies Act 2006 requires the notice period for general meetings of the Company to be at least 21 days, but, as a result of a resolution which was passed by the Company's shareholders at last year's Annual General Meeting, the Company is currently able to call general meetings (other than an Annual General Meeting) on not less than 14 clear days' notice. In order to preserve this ability, shareholders must approve the calling of meetings on not less than 14 days' notice. Resolution 14 seeks such approval. The approval will be effective until the Company's next Annual General Meeting, when it is intended that a similar resolution will be proposed. The Company will also need to meet the requirements for electronic voting under the Companies (Shareholders' Rights) Regulations 2009 before it can call a general meeting on less than 21 days' notice.

The shorter notice period would not be used as a matter of routine for general meetings, but only where the flexibility is merited by the business of the meeting and is thought to be to the advantage of shareholders as a whole.

The directors recommend all shareholders to vote in favour of all the resolutions, as the directors intend to do in respect of their own shares, and consider that they are in the best interests of the Company and its shareholders as a whole.



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